

**SCARNOSE INTERNATIONAL LIMITED**

**A REVIEW REPORT ON SCARNOSE INTERNATIONAL LIMITED IPO**

**IPO Details**

<b>Opening Date</b>	June 14, 2022
<b>Closing Date</b>	June 17, 2022
<b>Stock Exchange</b>	BSE SME
<b>Status</b>	Active
<b>Lot Size</b>	2000 Shares
<b>Issue Price</b>	₹ 55 per share
<b>Issue Size</b>	12,00,000 Equity shares of FV of ₹ 10 (aggregating up to ₹ 660 Lakh)
<b>Application Amount</b>	₹ 1,10,000

**Company Background**

- Incorporated in the year 2011, it mainly deals in trading of Agro Commodities, Cotton Bales and Manufacturing of Ladies Kurtis and Dress Materials.
- It had no major business activities until March 2019.
- From FY 2019-20, the revenues started generating on a higher scale.
- Company started manufacturing of Ladies Kurtis and Dress Materials in FY 2021-22 through outsourcing model.
- Although outsourced, the Kurtis are sold under company's brand name "Scarnose"

**IPO Objective**

- To meet working capital requirements
- To make repayment of unsecured loans
- To meet issue expenses
- General Corporate Purposes

**Pre-Issue Shareholding**

Category	No. of Shares	% of Total Shares
Promoter & Promoter Group	19,50,000	99.992 %
Public	150	0.008 %

**Promoter of the Company**

1. Mr. Shah Vimalkumar Mishrilal
2. Mr. Hitesh Loonia

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## Company Overview

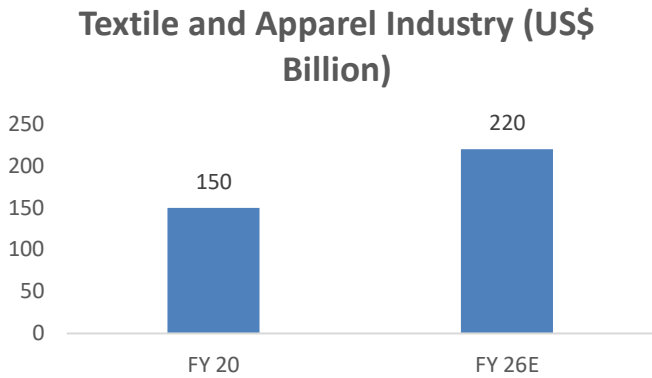
Scarnose International Limited is involved in the trading of Agro Commodities, Raw Cotton, Cotton Bales and Yarn and also manufactures Ladies Kurtis and Dress Materials. The company procures cotton from various ginneries whereby the ginneries provide the company cotton in the form of bales. In the financial year 2021, the company started in manufacturing activities where it manufactures Ladies Kurtis and Dress Materials through outsourcing model. The company sells these Kurtis and Dress Materials in its own brand name “**Scarnose**”. Scarnose endeavours to introduce new styles, fits finishes and offers extensive range of designs, colours, styles and patterns of Kurtis.

### Analysis

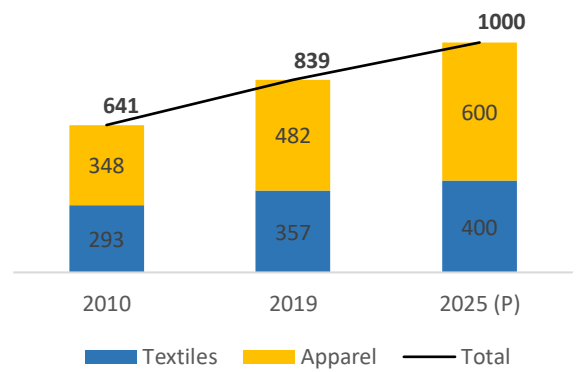
Established in 2011, although the company has more than a decade of existence, the major operations of the company began only after 2018-19. The company earned a revenue of around Rs. 1,204.56 lakhs in 2019-20 (95% from agro commodities), Rs. 3,255.73 lakhs in 2020-21 (99.97% from trading of cotton bales) and Rs. 9,593.02 lakhs in 2021-22 (98.93% trading of cotton bales). The revenue contribution of the company suddenly shifted from trading of agro commodities to trading of cotton bales in the year 2020-21. Also the company has started manufacturing of Ladies Kurtis and Dress Segments from the last financial year. So it can be assumed that the company has totally shifted its focus from agro commodities to trading of cotton bales and manufacturing of Ladies Kurtis. But it is not very well established in this segment. If we look at the data and details provided, company has been involved in its main product segment only since 2 years and the growth in the segment can be attributed to the growth in demand for the overall textile sector. In the coming times, such a revenue growth might not be possible to see and even if we see such growth, the margins would be much lower due to increasing transportation and shipping cost and low power to pass on the prices to consumers due to higher competition. To conclude it can be said that the company is still in the embryonic stage and has to sustain its margins in order to survive in the highly competitive market.

## Industry Charts

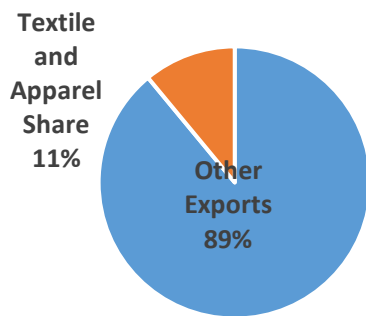
**Exhibit 1: Textile and Apparel Industry to grow at a CAGR of 6.59% from FY 20 to FY 26**



**Exhibit 2: Global Textile and Apparel Trade (US\$ Billion)**



**Exhibit 3: India's Textile and Apparel Export Share in Total Trade**



**Exhibit 4: Key Facts as of FY 20**



(Source: ibef.org, Wazir advisors)

## Investment Overview

### **Textile and Apparel Industry**

India's textiles sector is one of the oldest industries in the Indian economy, dating back to several centuries. The industry is extremely varied, with hand-spun and hand-woven textiles sectors at one end of the spectrum, with the capital-intensive sophisticated mills sector on the other end. India's Textile and Apparel Industry to grow at a CAGR of 6.59% from FY 20 to FY 26 from US \$150 billion to US \$ 220 billion. The domestic textiles and apparel market stood at an estimated US\$ 100 billion in FY19. The production of raw cotton in India is estimated to have reached 35.4 million bales in FY20<sup>^</sup>. During FY19, production of fibre in India stood at 1.44 million tonnes (MT) and reached 2.40 MT in FY21 (till January 2021), while that for yarn, the production stood at 4,762 million kgs during same period. Exports of textiles (RMG of all textiles, cotton yarn/fabrics/made-ups/handloom products, man-made yarn/fabrics/made-ups, handicrafts excl. handmade carpets, carpets and jute mfg. including floor coverings) stood at US\$ 2.99 billion, as of June 2021. In July 2021, exports of cotton yarn/fabrics/made-ups, handloom products, etc., from India increased by 50.86% in June 2021 over June 2019.

(Source: ibef.org)

### **Addressable Market for Scarnose International Limited**

Company is currently supplying to various domestic client. The company believes that their growth in the local market can fetch them new business expansions and opportunities. In the upcoming times, the company can also target the export market, but as of now it seems the company is mainly focusing to cater only to the domestic market.

### **Competition**

The industry, also mentioned by company in their prospectus, is very competitive. The company faces competition from a large number of organized and unorganized companies in its segment providing wider range of products to its clients. It operates in a highly unorganized and fragmented market. There are no high barriers to entry which makes the threat of new entrant very high. Also because of high competition, the bargaining power of

the supplier is very low and everything depends upon the quality of goods or services one provides. It is very difficult for any company to survive in such a highly competitive market and Scarnose being relatively new in this segment need to be highly efficient in making strategic decisions

### **Peer Analysis**

As mentioned in the prospectus, the peers of the company are Pioneer Embroideries Limited, Hisar Spinning Mills Limited, Dhanalaxmi Roto Spinner Limited and Vippy Spinpro Limited.

The key measures of these companies have been highlighted in the table below –

<b>Company</b>	<b>Scarnose International Limited</b>	<b>Pioneer Embroideries Limited</b>	<b>Hisar Spinning Mills Limited</b>	<b>Dhanalaxmi Roto Spinner Limited</b>	<b>Vippy Spinpro Limited</b>
Net Profit (INR in Cr.)	0.33	11.3	4.13	7.33	16.33
EBITDA (INR in Cr.)	0.57	26.5	6.19	11.68	17.93
Return on Capital Employed	16.04%	16.82%	22.80%	34.96%	28.62%
Return on Equity	9.73%	9.34%	19.90%	24.35%	27.05%
EPS (INR)	0.94	4.10	11.05	18.8	20.73
P/E* (Times)	58.33	9.84	3.76	4.46	5.02

\*P/E has been calculated as on 14/06/2022

The Industry has done quite well in recent times, however Scarnose seems to lag behind its peer companies in all aspects.

## Promoters' Profile

### Mr. Shah Vimalkumar Mishrilal



- **Shah Vimalkumar Mishrilal** is the Promoter and Managing Director of the Company.
- He has Professional Degree of Chartered Accountants and Cost Management Accountant.
- He has over a decade of professional experience.
- He is responsible for the purchase division of the Company, administrative affairs, expansion activities, heads the marketing and sales team and takes overall care of the functional attributes of the Company

### Mr. Hitesh Loonia



- **Hitesh Loonia** is the promoter of the company and has been associated with the company since 2020.
- He has professional degree of Chartered Accountants, Company Secretaries and Cost Management Accountant and has an experience of more than a decade.
- He has been instrumental in developing the business activities of the Company, growth and future prospectus of the Company.

## **Analysis on the Company's Promoter and Board of Directors**

The Managing Director, **Mr. Shah Vimalkumar Mishrilal**, has over 10 years of professional experience. He holds a directorship in the company since 2018. He is the only managing director of the company and the other directors are Non-Executive and Independent Directors. The other promoter of the company **Mr. Hitesh Loonia** does not hold any directorship position in the company. Both of the Promoters do not have experience in the relevant field of business. Although both of them are highly educated and can be a good driving force for the company, not being highly experienced in the industry might be quite worrysome for the business. The strategic decision that the company might need in the coming times will require someone who has worked for a good number of years in the area of the business in which the company is operating but current management structure does not seem to have so. Also since there is only one Managing Director, the whole and sole of the company depends up on his capabilities and experience. Furthermore, the Independent Directors of the company, though having professional degrees, seems to lack the knowledge of the business operations

Looking at the management, it looks like the company needs to change its management structure and hire personnel who are well versed and educated in the main business of the operations. The analysis of the management of the company is very negative with these observations.



## Financial Snapshot

(Amount in Lacs)

Particulars	As at 31st March, 2020	As at 31st March, 2021	As at 31st March, 2022
<b>Profit and Loss</b>			
Revenue from operation	1,204.57	3,254.90	9,564.58
Other income	-	0.83	28.45
Total Revenue	1,204.57	3,255.73	9,593.03
Expenses	1,200.82	3,225.64	9,536.13
Depreciation and Amortisation Cost	-	-	2.07
Finance Cost	-	-	10.15
Total Expenses	1,200.82	3,225.64	9,548.35
PBT	3.75	30.09	44.68
EBITDA	3.75	30.09	56.90
EBITDA Margin	0.31%	0.92%	0.59%
Net Profit	2.81	22.51	33.42
Net Profit Margin	0.23%	0.69%	0.35%
<b>Balance Sheet</b>			
Total Borrowings	0.26	1.00	290.79
Net Worth	4.05	190.55	339.00
Fixed Assets	-	-	73.92
Net Working Capital	4.04	152.78	217.54
<b>Financial Measures</b>			
Inventory Turnover Ratio	0.03	-	-
Receivables Turnover Ratio	1.00	2.70	7.94
Payables Turnover Ratio	1.00	16.23	16.51
Fixed Assets Turnover Ratio	-	-	129.39
Return on Capital Employed	92.82%	15.79%	16.04%
Return on Equity	69.38%	11.81%	9.86%
Debt-Equity Ratio	0.06	0.01	0.86

(The data has been taken and calculated from the financials given in the prospectus)

## **Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)**

The EBITDA of the company has grown from Rs. 3.75 lacs in 2020 to 56.90 lacs in 2022 growing at a CAGR of 290%, which seems to be highly unsustainable looking at the highly competitive market and the size of the company. The EBITDA margin in 2022 was 0.59% which is very low. Also the margin has decreased from 0.92% in 2021 to 0.59% in 2022.

## **Net Profit**

The net profit of the company has grown from Rs. 2.81 lacs in 2020 to Rs. 33.42 lacs in 2022 growing at CAGR of 245%. Although the PAT has grown multi-folds the PAT margin is just 0.35% which is considered to be very low.

## **Finance Cost.**

The finance cost of the company is majorly towards short-term borrowings taken from Directors/Shareholders and inter-corporate deposits.

## **Financial Measures/Ratios**

The RoCE has come down drastically from 92.82% in FY 2020 to 16.04% in FY 2022. The reason is due to equity shares issued in the FY 2021 as well as FY 2022 increasing the capital employed in the business. The ratio looks good at 16.04% but still lags behind its peers.

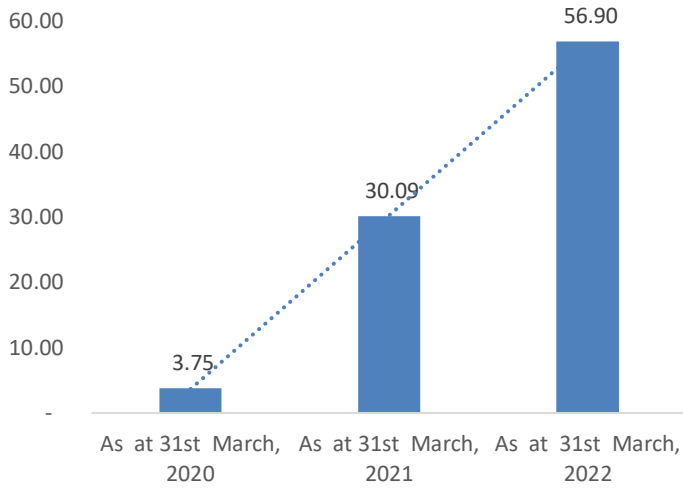
The ROE of the company also has come down from 69.38% in FY 2020 to 9.86% in FY 2022. The reason can also be stated as new equity shares issued. ROE also looks good at 9.86% but again is behind the industry standards.

The Receivables turnover ratio of the company in FY 2020 was 1 which means the company was not able to collect anything from their customers, however it has been increasing and in the FY 2022 the ratio was 7.94 showing that the company has increased its effectiveness in managing its receivables.

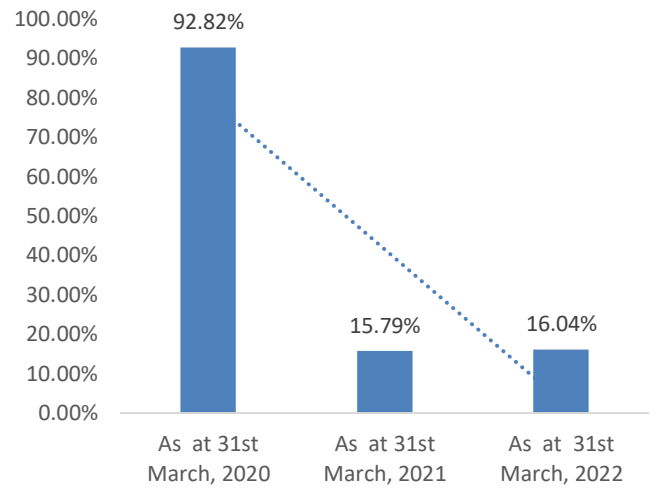
The Payables turnover ratio of the company in FY 2020 was 1 which means the company was not able to pay anything to its suppliers. Also it has been increased to almost 16 times which is also not good as it reflects that the company is not getting enough credit days or is not able to utilize its credit period properly.

## Financial Graph

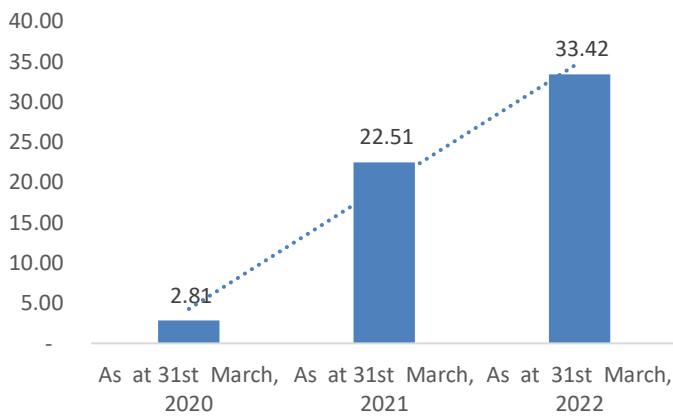
**EBITDA (In Lacs)**



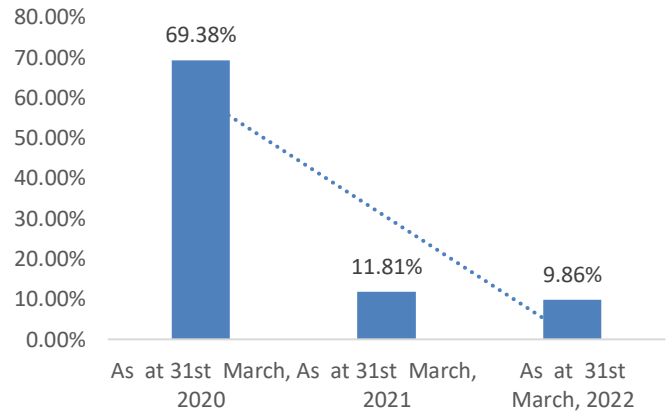
**Return on Capital Employed**



**Net Profit (In Lacs)**



**Return on Equity**



## Key Risk Factors

1. Company has a record of having more than 95% of its revenue generated from a single segment of its product base. Although the company has tried to diversify its revenue by manufacturing of Ladies Kurtis and Dress Materials, it has an experience of only 1 year in this segment.
2. The company only had 1 client in FY 19-20 and in FY 20-21 and FY 21-22 100% of its revenue is generated from 7-8 major customers. So the company is highly dependent on its major customers.
3. Similar to its customers, the company is also highly dependent on few suppliers. More than 70% of its purchases are contributed by its top 10 suppliers.
4. The company is outsourcing the manufacturing of Kurtis and Dress Materials and would continue to do so in future, so the company cannot strictly monitor the quality and timelines and any adverse outcome resulting in loss of client will have an adverse impact on its brand and financial position
5. Company has availed certain unsecured loan which is repayable on demand. Any demand from the lender for repayment of such unsecured loan may affect its cash flow and financial condition
6. The company has only one Managing Director. Dependency on the managerial decision of only one Managing Director could prove to be troublesome for the business.

## Track Record of Merchant Banker/Lead manager

The lead manager to the issue is Finshore Management Services Limited and the previous issue details have been taken from the Prospectus. A table has been set below highlighting the details of the IPO of some of the companies handled by the Lead Manager in recent times –

Sr. No	Company Name	Issue Size in Cr.	Issue Price/Share (In INR)	Listing date	CMP#
1.	ICL Organic Dairy Products Ltd.	4.08	20/-	17/02/2020	18.30
2.	DJ Mediaprint & Logistics Ltd.	2.40	20/-	13/04/2020	59.25
3.	Promax Power Ltd.	1.60	10/-	12/10/2021	21.00
4.	Dynamic Services & Security Ltd.	24.13	51/-	13/10/2021	15.75
5.	Destiny Logistics & Infra Limited	5.39	20/-	13/10/2021	14.20
6.	Timescan Logistics (India) Limited	4.81	51/-	12/01/2022	20.10
7.	Safa Systems & Technologies Ltd.	4.00	10/-	09/02/2022	8.20
8.	Shigan Quantum Technologies Limited	22.70	50/-	11/03/2022	88.50
9.	Swaraj Suiting Limited	10.68	56/-	28/03/2022	50.00
10.	Fone4 Communications (India) Limited	6.80	10/-	06/05/2022	5.88

**#CMP (In INR) is taken as on 14<sup>th</sup> June 2022**

In 2022, lead manager has made 5 IPOs out of which 3 had positive listing and 2 had negative listing. In 2021, lead manager had made 3 IPOs out of which 2 had positive listing and 1 had negative listing. The track record of the lead manager is good and also has managed listings of more than 10 crores.

## Recommendation

Based on the Business track record, Products/Services, Competitive Scenario, Management Background and Experience, Financial Measures, Peer Analysis and Industry Outlook, we would like to state that one **should avoid** applying in the IPO. The business is not very well established in the market, and the revenue of the company although increasing does not compete with the industry leaders. The company started earning revenue only after 2019 and has more than 90% of the revenue only from one product segment.

The company is utilizing the funds to repay its unsecured loan and utilizing only Rs. 2.51 crores for its working capital. Also, looking at the size of the company, the company should have opted for Working capital loan from bank and minimize its weighted average cost of capital. But it seems the company does not find itself to have the capability to incur finance cost which gives a negative perspective towards the company from shareholders' point of view. Reducing finance cost will help it increasing operating and net profit and the margins in the coming years might look good but only high margins won't be enough to say that the company has managed its operations efficiently.

Also the company is not able to generate enough cash from its operating activities in its last three financial years.

The management of the company is dependent on one person and lacks team of highly experienced in the field of its business operations giving a negative outlook of the company.

To conclude, one should **avoid** applying in the IPO.

## Disclaimer

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