October 07, 2022

Mirza International Limited: Ratings continue to be on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	24.68	17	[ICRA]A- &; continues on watch with developing implications
Fund Based – Working Capital Facilities	420.0	410	[ICRA]A- &; continues on watch with developing implications
Non-fund Based – Working Capital Facilities	35.05	25	[ICRA]A2+ &; continues on watch with developing implications
Long term-unallocated	0.27	28	[ICRA]A- &; continues on watch with developing implications
Total	**480**	**480**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings of Mirza International Limited (MIL) continues to remain on Watch with Developing Implications, owing to the ongoing restructuring wherein there is a proposal of the amalgamation of RTS Fashions Private Limited, the ultimate holding company of Mirza U.K. Limited, with Mirza International Limited and a demerger of the domestic business of Mirza International Limited into a separate company, on a mirror shareholding basis. ICRA will continue to monitor the development of the same and the timelines involved and will take appropriate action as may be required.

The ratings take comfort from the healthy improvement in performance of the company in FY2022, with the improvement in revenues by ~60% to Rs. 1,678 crore from Rs. 1,048 crore in FY2021. Moreover, there was recovery of operating margins to the pre-pandemic levels of around 13-14%. This resulted in improvement in cash accruals to Rs 174 crore in FY2022 from Rs 71 crore in FY2021. Better profitability resulted in healthy debt coverage indicators, with interest coverage improving to 8.7 times in FY2022 from 2.9 times in FY2021. Further, the liquidity profile of the company remains heathy with a cushion of more than 70% in fund-based limits. The ratings continue to factor in the company's established market position as one of the leading leather footwear companies in India, its backward-integrated manufacturing operations that increase its cost competitiveness, along with its experienced promoter and management team.

The ratings also favourably factor in the established position of the company's 'Red Tape' brand in the domestic market, along with diversified brand portfolio including brands such as 'Red Tape Athleisure', 'Bond Street', 'Mode', and 'Oaktrak'. With rapid expansion in the domestic market, the share of domestic sales has risen to 69% in FY2022 compared with 58% in FY2020. The launch of more brands, along with diversification in the product offerings, which includes sports shoes, casual shoes and apparel, has facilitated in the expansion and diversification of the clientele and product offerings. ICRA notes that MIL has gradually reduced the share of the wholesale/multi-brand outlet (MBO) segment owing to the high working capital-intensive nature of the segment. The same, coupled with rise in focus on online and exclusive business outlets (EBOs), led to rise in the cumulative sales contribution of these two segments over the last three years. The company has also strengthened its domestic retail network via own stores as well as franchisee stores, with 348 EBOs, increased from 222 as of March 2020. The ratings are further strengthened by the large and diversified customer base in the export market, with repeat orders from reputed clients such as Steve Madden and Marks & Spencer, etc, reflecting positively on its track record. Further, MIL has a policy of 100% hedging of export receivables since FY2011, which insulates it from any adverse movements in foreign exchange. Since

FY2021, the company has started 100% hedging of imports as well, vis-à-vis 50% earlier, which reduces the forex exposure for the client.

The ratings remain constrained by the tepid demand scenario in the export market as majority of revenues are driven by the United Kingdom (UK). The ratings also factor in the low capacity utilisation despite some improvement in FY2022. The ratings continue to be constrained by high working capital intensity (32% in FY2022), owing to significantly high inventory and receivables position. The ratings also continue to be impacted by the intense competition in the leather footwear industry, and vulnerability of profits to any adverse movements in raw material prices and changes in rates of export incentives/duty remission rates, especially given that the company currently imports most of the non-leather footwear and garments, which are sold in the domestic market. ICRA has also noted the export incentives have also gradually reduced in the past few years and profits remain vulnerable to any adverse fluctuations in the same.

ICRA will continue to monitor the development of the merger/demerger process as well as the timelines involved and will take appropriate rating action as may be required.

Key rating drivers and their description

Credit strengths

Improvement in performance in FY2022 and Q1 FY2023 -The company's performance has improved in FY2022, as reflected in 60% growth in revenues and recovery of margins to the pre-pandemic level**.** This resulted in improvement in cash accruals to Rs. 174 crore in FY2022 from Rs 71 crore in FY2021. Moreover, the coverage indicators saw a significant improvement with interest coverage improving to 8.7 times in FY2022 from 2.9 times in FY2021. Further, the revenues witnessed a 92% growth in Q1 FY2023 compared with Q1 FY2022, and margins saw a further improvement to 15.7%.

Experienced management – MIL, incorporated in 1979 as a private limited company, has a long track record in the domestic and global footwear markets. At present, the manufacturing capacity is spread across its five manufacturing units in Kanpur and Noida (Uttar Pradesh). Since FY2018, the company has been aggressively expanding in the domestic market with ramp-up of its exclusive business outlets (EBOs), along with launch of brands for sale of shoes and garments. MIL has a customer base of more than 150 clients, including reputed clients such as Establishments Cleon, Steve Madden, Marks & Spencer, etc.

Established position of MIL's 'Red Tape' brand in domestic market – MIL's domestic sales include selling finished leather to its vendors. It also sells footwear and garments under the 'Red Tape' brand through its own chain of stores across India, and through various retail stores such as Shoppers Stop, Metro Shoes, Lifestyle, Reliance Retail, Regal Shoe, Big Bazaar, etc (albeit the company is exiting this line of business), and through e-commerce sites like Amazon, Flipkart, etc. Additionally, MIL has launched brands like 'Red Tape Athleisure', 'Bond Street', and 'Mode' in FY2018 and FY2019. Further, it has made additions in the product offerings to include sports shoes, casual shoes, and garments, thereby expanding its customer base.

Reduction in debt and healthy liquidity buffer available with MIL – The company has witnessed reduction in leverage to 0.4 times in March 2022 from 0.6 times as on March 31, 2021, due to the improved cash flow arising from release of working capital. This, coupled with unutilised working capital lines, has led to healthy liquidity buffer available with the company.

Backward-integrated nature of operations with leather tanneries and complete footwear manufacturing facilities – MIL has backward-integrated operations with the presence of leather tanneries and complete footwear manufacturing facilities, most of which are concentrated near Kanpur. This ensures quality control and helps to capture the value addition across the supply chain, along with enabling the company to fulfil orders in a timely manner, while maintaining the quality of the products.

Credit challenges

Elevated working capital intensity – MIL's working capital intensity remained elevated owing to significant investments in inventory and receivables. Additionally, owing to the elongated working capital cycle in the domestic market and rise in the proportion of sales from the same, it witnessed elevated working capital intensity with net working capital/operating income at 32% in FY2022.

Vulnerability of profits to adverse movements in raw material prices and export incentives – MIL is a manufacturer of leather and leather products. Its operations are dependent on procuring quality animal skins at competitive prices. As an exporter, MIL enjoys export incentives and interest subvention under various schemes run by the Government of India (GoI). The export incentives have seen a gruelling reduction in the past few years. Additionally, any adverse changes in raw material availability or prices, or in the GoI's regulations, may adversely affect the company's profitability.

Environmental and Social Risks

The exposure of MIL's credit profile to environmental risks emanates from the tightening regulatory requirements relating to waste treatment and the additional costs that the entity is required to incur for treating and managing its effluents. Lapses in adhering to the statutory pollution limits could invite fines and penalties which could impact profitability. Thus, MIL's ability to remain compliant with the necessary regulatory stipulations will remain a key sensitivity. Footwear manufacturing also involves a high volume of water consumption and any disruption in operations because of the lack of availability of water would have a bearing on the credit profile.

MIL faces social risks arising from the health and safety hazards that its operations could create for the community that might result in a backlash. However, MIL's track record of carrying out its operations responsibly over the years provides comfort.

Liquidity position: Adequate

The liquidity position is **adequate,** reflected by the unutilised portion of the working capital limits. MIL reported an average utilisation of 20-25% of the sanctioned working capital limits of Rs. 260 crore for the past year ended August 2022. The company has limited long-term debt. Further, it has buffer from unencumbered cash and equivalents of Rs. 20 crore as of March 2022.

Rating sensitivities

Positive factors – Sustained growth in scale of operations, while maintaining healthy profitability, strong return indicators, comfortable debt protection metrics and healthy liquidity position could lead to an upgrade.

Negative factors – The ratings may be downgraded, in case of sustained decline in revenues and profitability resulting in weakening of debt protection metrics. Moreover, pressure on liquidity driven by any major debt-funded capex or stress in working capital cycle could also be a negative trigger. Any adverse impact of proposed restructuring on the credit profile of the company shall be a key monitorable. A specific credit metric for a downgrade is if interest coverage is below 4 times, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in Footwear Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	Consolidated

About the company

Mirza International Limited (MIL) was incorporated in 1979 as a private limited company and promoted by Mr. Irshad Mirza and his son Mr. Rashid Mirza. Initially, its operations were limited to manufacture and sale of processed leather through its own tannery unit in Kanpur. However, in 1990, MIL established an integrated shoe factory at Unnao, Kanpur. At present, the manufacturing capacity is spread across its five manufacturing units in Kanpur and Noida. Besides the above manufacturing

capacities, the company outsources the production of footwear to other vendors. It has expanded presence in the domestic market since FY2019. The various brands of MIL include 'Red Tape', 'Red Tape Athleisure', 'Bond Street', 'MODE', and 'Oaktrak'.

Key financial indicators

Consolidated	FY2021(A)	FY2022(A)
Operating Income (Rs. crore)	1,048.9	1,678.7
PAT (Rs. crore)	8.4	113.0
OPBDIT/OI (%)	11.3%	14.0%
PAT/OI (%)	0.8%	6.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	1.0
Total Debt/OPBDIT (times)	3.0	1.3
Interest Coverage (times)	2.9	8.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; A-Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31,2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					October 07,2022	Nov 24,2021	Mar 22,2021	Dec 13,2019
1	Fund Based – Term Loan	Long-term	17	18.56	[ICRA]A- &	[ICRA]A-&	[ICRA]A-(Negative)	[ICRA]A-(Negative)
2	Fund Based – Working Capital Facilities	Long-term	410	--	[ICRA]A- &	[ICRA]A-&	[ICRA]A-(Negative)	[ICRA]A-(Negative)
3	Non-fund Based – Working Capital Facilities	Short term	25	--	[ICRA]A2+ &	[ICRA]A2+&	[ICRA]A2+	[ICRA]A2+
4	Long term-unallocated	Long-term	28	--	[ICRA]A- &	[ICRA]A-&	[ICRA]A-(Negative)	-

&-on watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund Based – Term Loan	Simple
Fund Based – Working Capital Facilities	Simple
Non-fund Based – Working Capital Facilities	Very Simple
Long term-unallocated	Not Applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, are available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based – Term Loan	FY 2018-19	NA	FY 25-26	17	**[ICRA]A-&**
NA	Fund Based – Working Capital Facilities	-	NA	-	410.0	**[ICRA]A-&**
NA	Non-fund Based – Working Capital Facilities	-	NA	-	25	**[ICRA]A2+&**
NA	Long term-unallocated	-	NA	-	28	**[ICRA]A-&**

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	MIL Ownership	Consolidation Approach
Mirza (H.K) Limited	100%	Full Consolidation
Mirza Bangla Limited	99.9%	Full Consolidation
SEN EN MIRZA INDUSTRIAL SUPPLY CHAIN LLP	52%	Full Consolidation
Redtape Limited	100%	Full Consolidation

ANALYST CONTACTS

Jayanta Roy
91-33-71501100
jayanta@icraindia.com

Priyesh Ruparelia
91-22- 61693328
priyesh.ruparelia@icraindia.com

Sumit Jhunjhunwala
91-33- 7150 1111
sumit.jhunjhunwala@icraindia.com

Gaurav Singla
91-124- 4545366
gaurav.singla@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches

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