December 13, 2019

Mirza International Limited: Rating reaffirmed at [ICRA]A-/[ICRA]A2+; outlook revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Term Loan	19.50	27.45	[ICRA]A-; rating reaffirmed and outlook revised to Negative from Stable
Fund Based – Working Capital Facilities	410.0	436.10	[ICRA]A-; rating reaffirmed and outlook revised to Negative from Stable
Non-fund Based – Working Capital Facilities	50.5	16.45	[ICRA]A2+; rating reaffirmed
Total	**480.0**	**480.0**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in outlook to Negative from Stable for the long-term rating of Mirza International Limited (MIL) takes into account the YoY deterioration in debt protection indicators – interest cover decreased to 3.3x in H1 FY2020 from 5.2x in H1 FY2019 and 4.2x in FY2019, and DSCR reduced to 2.2x in H1 FY2020 from 2.9x in H1 FY2019 and 2.5x in FY2019. The credit metrics declined because of a decrease in profitability (from 17.9% in FY2018 to 12.5% in FY2019 and 12.8% in H1FY2020) owing to discounts offered for expanding the customer base in the domestic as well as export market and due to the increase in leverage in FY2019 and H1 FY2020 because of the debt-funded expansion in the domestic market.

The ratings continue to be constrained by high working capital intensity owing to significant investments in inventory and receivables in the domestic business as well as exports. The ratings also continue to be impacted by the intense competition in the leather footwear industry, geographic concentration in exports, and vulnerability of profits to adverse movements in raw material prices, exchange rates, and changes in duty drawback rates, especially given that the company currently imports most of the non-leather footwear and garments it sells in the domestic market.

The rating reaffirmation, however, factors in the healthy top-line growth of 10% to Rs. 613.8 crore in H1 FY2020 from Rs. 557.6 crore in H1 FY2019. The ratings continue to draw comfort from the company's established market position as one of the leading leather footwear exporters in India, its backward-integrated manufacturing operations that increase its cost competitiveness, and its experienced promoters and management team. Moreover, the rating derives comfort from the established position of the company's Red Tape brand in the domestic market, along with launch of brands like Red Tape Athleisure, Bond Street, and Mode, which have enabled the higher share of domestic sales at 57% in FY2019 compared to 46% in FY2018 and 30% in FY2017. Launch of more brands, along with addition in the product offerings to include sports shoes, casual shoes and apparel, has facilitated in the expansion and diversification of the clientele and product offerings. The company has also strengthened its domestic retail network and the share of sales from exclusive brand outlets (EBOs) has increased to 45% in FY2019 from 35% in FY2018, given the increase in store count to 206 as of March 2019 vis-à-vis 159 as of March 2018. The ratings are further strengthened by the large and diversified customer base in the export market, with repeat orders from reputed clients like Steve Madden and Marks & Spencer, etc., reflecting positively on the company's track record. Further, MIL has a policy of 100% hedging of export receivables since FY2011, which insulates it from adverse movements in foreign exchange. This is, however, partially offset as 50% of the company's imports remains unhedged.

ICRA has noted that MIL plans to construct a corporate office-cum-showroom. The quantum of the debt availed for the same would remain a monitorable.

Key rating drivers and their description

Credit strengths

Experienced management; MIL's long track record in domestic and global footwear market - MIL was incorporated in 1979 as a private limited company. Currently, the manufacturing capacity is spread across its five manufacturing units in Kanpur and Noida (Uttar Pradesh). Since FY2018, the company has started expansion 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 200 clients, including reputed clients like Etablissements 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 under the Red Tape brand through its own chain of stores across India, and through various retail stores like Shoppers Stop, Metro Shoes, Lifestyle, Reliance Retail, Regal Shoe, Big Bazaar, etc, and through ecommerce 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.

Healthy growth in turnover and improvement in market share - MIL's top line increased by 10% to Rs. 613.8 crore in H1 FY2020 from Rs. 557.6 crore in H1 FY2019, and by 18% to Rs. 1,151.7 crore in FY2019 from Rs. 972.1 crore in FY2018. The rise in revenues was driven by the company's decision to offer substantial discounts to expand the customer base in the domestic market in FY2019 and H1 FY2020 as well as exports market in H1 FY2020. The increase in revenues from the domestic market have been aided by an increase in the number of retail stores to 214 as of September 2019 from 206 as of March 2019 and 159 as of March 2018, coupled with an increase in the number of large format online shops (~4,500-5,000 sq ft).

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 capture the value addition across the supply chain, along with enabling the company to fulfil orders in a timebound manner while maintaining the quality of the products.

Credit challenges

Significant decline in profitability in FY2019 and H1 FY2020 - The operating margin for MIL declined to 12.8% in H1 FY2020 and 12.5% in FY2019 from 17.9% in FY2018. Also, the net profit margins declined to 4.2% in FY2019 and 3.1% in H1 FY2020 from 8.1% in FY2018. The decrease is attributable to substantial discounts offered for clearing the inventory and for expanding the customer base in the domestic as well as export market, given the tepid demand sentiment in the domestic as well as export consumer market. Adjusting for the impact of IndAS, the operating profitability would be

10.7% and net profitability would stand at 3.7%. Further, the leather segment has continued to report losses, given the moderate capacity utilisation and decline in realisations from the segment. Further, MIL has offered steep discounts to make inroads in leather upholstery segment, which has also impacted realisations from the leather segment.

Moderation in debt protection indicators - Expansion in the domestic market (which has higher working cycle) and investments to set up online shops and retail stores in FY2018, FY2019, and H1 FY2020 led to an increase in total debt to Rs. 486.8 crore as of September 30, 2019 from Rs. 444.3 crore as of March 31, 2019. Further, the bills discounted have risen because of an increase in exports in H1 FY2020, which contributed to the rise in debt during this period. Increase in debt coupled with the drop in accruals led to deterioration in debt protection indicators. MIL's interest cover decreased to 3.3x in H1 FY2020 from 4.2x in FY2019 and 7x in FY2018, and DSCR reduced to 2.2x in H1 FY2020 from 2.5x in FY2019 and 3.5x in FY2018.

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, the company witnessed elevated working capital intensity with net working capital/operating income at 55% in H1 FY2020 compared with 58% in FY2019.

Vulnerability of profits to adverse movements in exchange rate, raw material prices and export incentives - MIL is a manufacturer of leather and leather products and its operations are dependent on procuring quality animal skins at competitive prices. Also, as an exporter, MIL enjoys export incentives and interest subvention under various schemes run by the Government of India (GoI). Any adverse change in raw material availability/prices, exchange rates, or in the GoI's regulations may adversely impact the company's profitability.

Liquidity position: Adequate

The liquidity position is **adequate** as reflected by the unutilised portion of the working capital limits, which averaged 83% of the sanctioned limits and 80% of the drawing power over the last 12-month period that ended in September 2019. Further, cash and equivalents of Rs. 38.0 crore as of September 2019 provide liquidity buffer.

Rating sensitivities

Positive triggers - The outlook on long-term rating may be changed if interest coverage ratio improves to 5x or more on a sustained basis. Further, improvement in accruals and working capital intensity while maintaining the current leverage will be credit positive.

Negative triggers – The rating may be downgraded in case the interest coverage ratio falls below 3x on prolonged basis. Additionally, higher-than-expected debt-funded expansion, additional stress in the profitability and working capital cycle of the company will be credit negatives.

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	Standalone

About the company

Mirza International Limited (MIL) was incorporated in 1979 as a private limited company promoted by Mr. Irshad Mirza and his son Mr. Rashid Mirza. Initially, the operations of the company 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. Currently, 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. The promoters together hold a 70.19% stake in the company. It has expanded presence in the domestic market since FY2019, which contributed 57% of the top line in FY2019. The various brands of MIL include Red Tape, Red Tape Athleisure, Bond Street, MODE, and Oaktrak.

In FY2019, the company reported a net profit of Rs. 48.8 crore on an operating income (OI) of Rs. 1151.7 crore compared with a net profit of Rs. 78.4 crore on an OI of Rs. 972.1 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019	H1FY2020 (Limited review)
Operating Income (Rs. crore)	972.1	1,151.7	613.8
PAT (Rs. crore)	78.4	48.8	19.1
OPBDIT/OI (%)	17.9%	12.5%	12.8%
RoCE (%)	15.7%	10.8%	9.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.0	1.0	1.3
Total Debt/OPBDIT (times)	2.3	3.1	3.1
Interest Coverage (times)	7.0	4.2	3.3
DSCR	3.5	2.5	2.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating	FY2019			FY2018	FY2017
					13-Dec-2019	5-Mar-2019	25-Feb-2019	8-Oct-2018	30-Aug-2017	05-Aug-2016
1	Fund Based – Term Loan	Long Term	27.45	27.45	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
2	Fund Based – Working Capital Facilities	Long Term	436.10	-	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)
3	Non-fund Based – Working Capital Facilities	Short Term	16.45	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	-		

Amount in Rs. crore

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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	FY2018-FY2019	-	FY2021-FY2024	27.45	[ICRA]A- (Negative)
NA	Fund Based – Working Capital Facilities	-	-	-	436.10	[ICRA]A- (Negative)
NA	Non-fund Based – Working Capital Facilities	-	-	-	16.45	[ICRA]A2+

Source: Mirza International Limited

Annexure-2: List of entities considered for consolidated analysis – Not Applicable

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