

November 30, 2021

## Farida Shoes Private Limited: Ratings reaffirmed

### Summary of rating action

| Instrument*                          | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action                  |
|--------------------------------------|-----------------------------------|----------------------------------|--------------------------------|
| Long term – Unallocated facility     | 3.50                              | 3.50                             | [ICRA]BBB (Stable); reaffirmed |
| Short term – Fund based facility     | 100.00                            | 100.00                           | [ICRA]A3+; reaffirmed          |
| Short term – Non-fund based facility | 5.00                              | 5.00                             | [ICRA]A3+; reaffirmed          |
| <b>Total</b>                         | <b>108.50</b>                     | <b>108.50</b>                    |                                |

\*Instrument details are provided in Annexure-1

### Rationale

ICRA has taken a consolidated view on Farida Shoes Private Limited (FSPL) and India Shoes Exports Private Limited (ISEPL) (called as Group), while arriving at the credit ratings, given the common management and the same line of business of exporting leather shoes.

The reaffirmation of the ratings factor in the Group's established presence in the leather footwear segment, being one of the largest exporters of leather shoes in India, and the continued association with reputed international footwear brands such as Rockport, Clarks, Marks & Spencer and Bally Shoes through repeat orders. The ratings also favourably factor in the extensive experience of the Group's promoters spanning five decades in the leather export business.

The ratings, however, are constrained by the stretched liquidity position of the company emanating from an increase in working capital intensity in the last two fiscals following the disruption in the operations of its customers post the pandemic outbreak. ICRA notes that the Group has availed enhancements in post-shipment credit limits to tide over this interim period of liquidity squeeze. However, the ability of the Group to maintain a comfortable liquidity headroom through a combination of timely limit enhancements and efficient management of working capital would remain a key monitorable from the credit perspective.

The ratings are also constrained by the adverse impact of the Covid-19 pandemic exacerbated by the lockdowns in the export market, which has led to a significant decline in revenues and accruals in FY2020 and FY2021. Nonetheless, the Group's revenue recovered in 6M FY2022 with the revival in export demand for leather shoes. The ratings also reflect a deterioration in the financial risk profile of the Group characterised by an increase in the debt level and a deterioration in the coverage indicators owing to lower absolute earnings in FY2021.

The Group has made sizeable investments in new growth areas like sports shoes in the last few years. Given that the company has not yet been able to attract large customers in this segment so far, the assets have not started generating commensurate earnings, which in turn has had an adverse impact on the Group's business return indicators. ICRA believes that the Group's ability to diversify in the high-growth sports shoe segment could strengthen its business profile. The ratings also continue to be impacted by the intense competition in the leather footwear industry and the vulnerability of profits to the adverse movements in raw material prices.

The Stable outlook reflects ICRA's expectations that FSPL will continue to benefit from the established operational track record of the Group with a reputed client base.

## Key rating drivers and their description

### Credit strengths

**One of the largest export players in organised leather footwear sector** – FSPL is one of the largest export players in the leather footwear segment with an operating income (OI) of Rs. 402.8 crore in FY2021 (against Rs. 607.8 crore in FY2020 and Rs. 690.1 crore in FY2019). On a consolidated level, the Group achieved a revenue of Rs. 604.3 crore in FY2021 (against Rs. 850.5 crore in FY2020 and Rs. 943.9 crore in FY2019). The Group's established relationships with large multinational brands helped it secure repeat orders and mitigated competition from other countries. FSPL has a capacity to manufacture ~60 lakh pairs of full shoes per annum.

**Established track record of Group in leather business** – The Farida Group has been in the business for more than five decades and has expanded to 11 companies, of which six are involved in shoe manufacturing, while the rest manufacture shoe components.

**Reputed client base** – The Group's customers are large multinational footwear companies, including Rockport, C&J Clarks, Marks & Spencer, Bally Shoes, Asco General etc. The Group has long-standing relationships with these customers, as reflected in the repeat orders from them over the years. The customer concentration risk of FSPL remains moderate as revenues from the top six customers stood at 72% in FY2021. Nevertheless, established relationships with these customers mitigate the risk of lower revenues/earnings due to the loss of a large customer.

### Credit challenges

**Contraction in revenues and earnings amid the pandemic** – The Group witnessed a decline in its order book from Q4 FY2020 onwards and the Covid-induced lockdowns across the globe led to a steep fall in demand for leather shoes as people started adapting to a work-from-home mode of living. Therefore, the revenue of the Group declined by 29% year-on-year (YoY) to Rs. 604.33 crore in FY2021 from Rs. 850.52 crore in FY2020 owing to the closure of operations during Q1 FY2021. An increase in the operating leverage due to a lower turnover caused the FY2021 operating margins to decline to 4.1% in FY2021 from 4.3% in FY2020 and 4.7% in FY2019. Nonetheless, the Group booked an export revenue of Rs. 327.08 crore in H1 FY2022, thereby witnessing a recovery in export demand following the opening up of the global economy.

**Increase in working capital intensity spiked debt levels** – The Group's working capital intensity is high with NWC/OI<sup>1</sup> increasing to 32.7% in FY2021 from 19.0% in FY2020. This has been due to the elongated receivables cycle and higher inventory holding on account of the financial challenges faced by customers during the pandemic. As a result, the short-term borrowings increased in the last two fiscals, weakening the capital structure and coverage indicators. The Group's gearing stood at 1.1 times as on March 31, 2021 while the interest coverage, TOL/TNW<sup>2</sup> and NCA/TD<sup>3</sup> stood at 2.8 times, 2.2 times and 10.8%, respectively, in FY2021. Given a reputed customer base, the working capital intensity is likely to gradually improve with better collections from them. However, inability to reduce the working capital intensity and/or secure adequate working capital facilities to maintain a comfortable liquidity position could exert downward rating pressure.

**Subdued business return indicators due to suboptimal returns from new investments** - The Group has made sizeable investments in new growth areas like sports shoes in the last few years. Given that the company has not yet been able to attract large customers in this segment so far, the assets have not started generating commensurate earnings, which in turn has had an adverse impact on the Group's business return indicators. ICRA believes that the Group's ability to diversify in the high-growth sports shoe segment could strengthen its business profile.

<sup>1</sup> Net working capital / operating income

<sup>2</sup> Total outside liability / Tangible net worth

<sup>3</sup> Net cash accrual / Total debt

**Vulnerability to regulatory and price fluctuation risks** – As an exporter, the Group enjoys export incentives and interest subvention under the various schemes run by the Government of India (GoI). Any adverse change in the benefits received might impact the Group’s profitability. Further, the Group’s margins remain exposed to the fluctuations in raw material prices and exchange rates. Nevertheless, the Group, apart from having a natural hedge in the form of imports, hedged most of the foreign exchange receivables by using forward contracts, which protect the profitability margins from the adverse currency fluctuations to some extent.

**Fragmented and intensely competitive nature of the industry** – The Group faces intense competition from multiple branded footwear manufacturers and exporters as well as unorganised players, which limit its pricing flexibility and consequently, its ability to expand its operating margins. Moreover, the association with reputed brands restricts its bargaining power, resulting in lower margins.

## Liquidity position: Stretched

The liquidity position of the Group is stretched with fully utilised working capital limits, modest net cash accruals and low free cash balance of Rs. 1.57 crore as on March 31, 2021. The free cashflow of the Group was negative in the last two years (FY2020 and FY2021) owing to a stretch in the working capital intensity, decline in profitability and investments in growth capex to add new factory buildings. The funding gap was met through an increase in working capital borrowings, leading to an asset-liability mismatch. Going forward, the Group has witnessed an uptick in demand in FY2022 so far, which is expected to lead to a sequential improvement in profitability. This, along with a reduction in the working capital intensity, would remain crucial to pull back the company’s free cashflows in the positive territory in the current fiscal, in turn supporting a reduction in overall borrowings. The Group has modest repayment obligations in the next three years, which support its liquidity.

## Rating sensitivities

**Positive factors** – ICRA could upgrade the ratings of the Group if there is an improvement in the profitability metrics and working capital intensity, resulting in a significant improvement in the liquidity profile and debt coverage indicators. A specific credit metric that might trigger an upgrade includes interest coverage over 4.0 times on a sustained basis.

**Negative factors** – ICRA could downgrade the Group’s ratings if the stretch in the liquidity position continues. The ratings can also come under pressure if there is a deterioration in the profitability and coverage indicators. A specific credit metric that might trigger a downgrade includes an interest coverage below 2.8 times and a TOL/TNW over 1.8 times on a sustained basis.

## Analytical approach

| Analytical Approach             | Comments   |
|---------------------------------|--|
| Applicable Rating Methodologies | <a href="#">Corporate Credit Rating Methodology</a><br><a href="#">Consolidation and Rating Approach</a><br><a href="#">Rating Methodology - Footwear</a>  |
| Parent/Group Support            | Not Applicable   |
| Consolidation/Standalone        | For arriving at the ratings, ICRA has consolidated the financials of FSPL and ISEPL given the common ownership, close managerial linkages, and the entities operating in the same line of business |

## About the company

FSPL is the flagship of the Farida Group of companies – one of India’s largest exporters of leather and leather goods. The Group comprises 11 entities, with six of them involved in shoe manufacturing activities, while the rest are involved in the manufacturing of shoe components. FSPL was incorporated in 1976 to manufacture full shoes. The company operates out of its manufacturing units at Ambur, Vellore district, Tamil Nadu, and has a capacity to manufacture ~ 6.0 million pairs per year. M/s Farida Holdings Private Limited is promoted by Group chairman, Mr. Rafeeqe Ahmed and family.

ISEPL is a part of the Farida Group of companies – one of India’s largest exporters of leather and leather goods. The company operates out of its manufacturing units located in Chennai and Ambur, Vellore district, Tamil Nadu, and has a capacity to manufacture 1.5 million pairs per year. M/s Farida Holdings Private Limited is the single largest stakeholder in FSPL.

### Key financial indicators (consolidated)\*

| FSPL + ISEPL (ICRA’s Estimate)                       | FY2020 (Audited) | FY2021 (Audited) |
|--|------------------|------------------|
| Operating Income (Rs. crore)                         | 850.5            | 604.3            |
| PAT (Rs. crore)                                      | 14.3             | 4.7              |
| OPBDIT/OI (%)  | 4.3%             | 4.1%             |
| PAT/OI (%)   | 1.7%             | 0.8%             |
| Total Outside Liabilities/Tangible Net Worth (times) | 1.9              | 2.0              |
| Total Debt/OPBDIT (times)                            | 2.5              | 4.3              |
| Interest Coverage (times)                            | 3.7              | 3.6              |

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

\*Based on ICRA’s estimate

### Key financial indicators (Standalone)

| FSPL (Reported)                                      | FY2020 (Audited) | FY2021 (Audited) |
|--|------------------|------------------|
| Operating Income (Rs. crore)                         | 607.8            | 402.8            |
| PAT (Rs. crore)                                      | 10.7             | 2.6              |
| OPBDIT/OI (%)  | 5.3%             | 5.3%             |
| PAT/OI (%)   | 1.8%             | 0.6%             |
| Total Outside Liabilities/Tangible Net Worth (times) | 2.1              | 2.2              |
| Total Debt/OPBDIT (times)                            | 3.5              | 5.9              |
| Interest Coverage (times)                            | 4.5              | 3.3              |

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

**Status of non-cooperation with previous CRA:** Not Applicable

**Any other information:** None

### Rating history for past three years

|   | Instrument              | Current Rating (FY2021) |                          |   |                    | Chronology of Rating History for the past 3 years |                         |                         |                      |
|---|-------------------------|-------------------------|--------------------------|---|--------------------|---|-------------------------|-------------------------|----------------------|
|   |                         | Type                    | Amount Rated (Rs. crore) | Amount Outstanding as on Mar 31, 2021 (Rs. crore) | Date & Rating on   | Date & Rating in FY2021                           | Date & Rating in FY2020 | Date & Rating in FY2019 |                      |
|   |                         |                         |                          |   |                    |   |                         | 25-Mar 2019             | 21-Feb 2019          |
|   |                         |                         |                          |   | 30-Nov-2021        | 31-Aug 2020                                       |                         |                         |                      |
| 1 | Unallocated facility    | Long term               | 3.50                     | -   | [ICRA]BBB (Stable) | [ICRA]BBB (Stable)                                |                         | [ICRA]BBB (Positive)    | [ICRA]BBB (Positive) |
| 2 | Fund based facility     | Short term              | 100.00                   | -   | [ICRA]A3+          | [ICRA]A3+   |                         | [ICRA]A3+               | [ICRA]A3+            |
| 3 | Non-fund based facility | Short term              | 5.00                     | -   | [ICRA]A3+          | [ICRA]A3+   |                         | [ICRA]A3+               | [ICRA]A3+            |

### Complexity level of the rated instrument

| Instrument                  | Complexity Indicator |
|-----------------------------|----------------------|
| Long Term – Unallocated     | Not Applicable       |
| Short Term – Fund based     | Simple               |
| Short Term – Non fund based | Very Simple          |

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, is available on ICRA's website: [www.icra.ins](http://www.icra.ins)

### Annexure-1: Instrument details

| ISIN No | Instrument Name      | Date of Issuance / Sanction | Coupon Rate* | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---------|----------------------|-----------------------------|--------------|---------------|--------------------------|----------------------------|
| NA      | Unallocated facility | -                           | -            | -             | 3.50                     | [ICRA]BBB (Stable)         |
| NA      | Export credit        | -                           | -            | -             | 100.00                   | [ICRA]A3+                  |
| NA      | Letter of credit     | -                           | -            | -             | 5.00                     | [ICRA]A3+                  |

*Source: Company,*

### Annexure-2: List of entities considered for consolidated analysis

| Company Name                        | Consolidation Approach |
|-------------------------------------|------------------------|
| Farida Shoes Private Limited        | Full Consolidation     |
| India Shoes Exports Private Limited | Full Consolidation     |

## ANALYST CONTACTS

**Jayanta Roy**

+91 33-71501100

[jayanta@icraindia.com](mailto:jayanta@icraindia.com)

**\_Priyesh Ruparelia**

+91 22-61693328

[priyesh.ruparelia@icraindia.com](mailto:priyesh.ruparelia@icraindia.com)

**Ritabrata Ghosh**

+91 33-61143438

[ritabrata.ghosh@icraindia.com](mailto:ritabrata.ghosh@icraindia.com)

**Ayush Kumar Mohta**

+91 80-4922 5517

[ayush.mohta@icraindia.com](mailto:ayush.mohta@icraindia.com)

## RELATIONSHIP CONTACT

**Jayanta Chatterjee**

+91 80 4332 6401

[jayantac@icraindia.com](mailto:jayantac@icraindia.com)

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**

Tel: +91 124 4545 860

[communications@icraindia.com](mailto:communications@icraindia.com)

## Helpline for business queries

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

[info@icraindia.com](mailto:info@icraindia.com)

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## ICRA Limited



### Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



### Branches



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