

August 28, 2020

Relaxo Footwears Limited: Ratings reaffirmed at [ICRA]AA(Stable)/[ICRA]A1+; rating for commercial paper withdrawn

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	6.2	-	-
Cash Credit	140.0	140.0	[ICRA]AA (Stable); Rating reaffirmed
Non-fund Based Working Capital Limits	120.0	120.0	[ICRA]A1+; Rating reaffirmed
Commercial Paper	50.0	-	[ICRA]A1+; Rating reaffirmed and withdrawn
Total	316.2	260.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation takes into account Relaxo Footwears Limited's (RFL) strong financial risk profile, characterised by its robust internal accruals, limited debt, and healthy debt protection indicators. Despite the impact of Covid-19 in Q1 FY2021, the interest cover stood at 14.0x in (24.2x as of March 31, 2020), NCA/TD¹ stood at 22,187% (1367% as of March 31, 2020), and TD/OPBDITA² at 0.004x in Q1FY2021 (0.05x as of March 31, 2020). Further, the company's liquidity position remains strong with cash and equivalents of Rs. 99.7 crore as of June 30, 2020 and undrawn working capital limits of Rs. 139.1 crore, out of the sanctioned amount of Rs 140.0 crore. ICRA notes that the liquidity position could moderate from the current levels in the near term, once the company replenishes its inventory levels and re-stocks the distribution and retails channels, which have been impacted due to restrictions on manufacturing and the implementation of social distancing measures at its plants. Nevertheless, the liquidity profile will remain strong. Further, the assessed drawing power of the company is significantly higher than the sanctioned working capital limits, which provides financial flexibility.

The ratings continue to draw comfort from RFL's strong operational risk profile, as reflected in its long and established track record as one of the largest players in the Indian footwear industry, its pan-India presence, its diversified product portfolio, and the improvement in its market position over the years on account of successful product launches as well as multiple advertising, branding and celebrity endorsement initiatives. RFL started with a single product (Hawai slippers) and has over the years been successful in diversifying into higher value slippers as well as casual and sports shoes. The portfolio premiumisation, along with improvement in scale, has also led to an improvement in margins over the years.

The ratings, however, are constrained by the adverse impact of the lockdown measures implemented at the end of March 2020 to contain the spread of the Covid-19 pandemic, which resulted in a 44% fall in operating income (OI)

¹NCA/TD – Net Cash Accruals / Total Debt

²TD/OPBDITA – Total Debt/ Operating Profit before Depreciation, Interest, Tax, and Amortisation

to Rs. 363.6 crore in Q1 FY2021 from Rs. 648.3 crore in Q1 FY2020, and a 46% decline in OPBITDA³ to Rs. 57.0 crore in Q1 FY2021 from Rs. 106.4 crore in Q1 FY2020 due to drop in both volumes as well as average selling price (ASP). Furthermore, due to the impact of Covid-19 and lockdown measures, the revenues dropped by 15% in Q4 FY2020, leading to a dip in revenue growth to 5% in FY2020 against 18% in FY2019.

Post the announcement of lockdown measures, the company's sales have been driven primarily by the demand for lower value open footwear, while the demand for shoes and higher value footwear has remained muted. ICRA notes that the sales and accruals in FY2021 are likely to decline, particularly due to impact on the shoes segment and on higher value products, on account of restricted movements of people, weak consumer sentiments and fall in disposable incomes. Nonetheless, the credit risk profile of RFL is likely to remain strong.

The ratings continue to be constrained by significant outflows (~Rs. 90–100 crore) towards capex every year, which has reduced the company's free cash flows, though the capex is largely funded by internal accruals. The ratings are also impacted by the intense competition due to the fragmented nature of the Indian footwear industry, strong presence of the unorganised sector, and vulnerability of RFL's profitability to fluctuation in raw material prices and exchange rates. ICRA also takes into account the loss in RFL's retail segment in FY2020 owing to the impact on retail sales due to Covid-19. Even though most sales are through distributors, the company operates a network of 390 retail and franchise stores in the country. Despite improved scale, reach and investments in expanding the network of retail stores across territories, the profitability of this division has remained muted over the years.

During the pandemic, sales have been driven primarily by the lower value open footwear. However, the same has been offset by the muted demand for its shoes and higher value products. ICRA notes that the sales and accruals are likely to decline in FY2021, though the credit risk profile of RFL is likely to remain strong. Further, the Stable outlook reflects the company's long and established track record as one of the largest footwear manufacturers in the country, having a large pan-India distribution network and a diversified product portfolio, with products at multiple price points and catering to varied needs.

Key rating drivers and their description

Credit strengths

Robust internal accruals and low debt result in healthy debt protection indicators: RFL has a strong financial risk profile, characterised by robust internal accruals, limited debt, and healthy debt protection indicators. Despite the impact of Covid-19 in Q1 FY2021, the interest cover stood at 14.0x in (24.2x as of March 31, 2020), NCA/TD stood at 22,187% (1367% as of March 31, 2020), and TD/OPBDITA at 0.004x in Q1FY2021 (0.05x as of March 31, 2020). The portfolio premiumisation, along with improvement in scale, has led to improvement in margins over the years.

³ Operating Profit before Depreciation, Interest, Tax, and Amortisation

Strong liquidity position: The company's liquidity position remains comfortable with cash and equivalents of Rs. 99.7 crore as of June 30, 2020 and the undrawn working capital limits of Rs. 139.1 crore, out of the sanctioned amount of Rs. 140.0 crore. The liquidity position could moderate from the current levels in the near term, once the company replenishes its inventory levels and re-stocks the distribution channel, which had been impacted by restrictions on manufacturing and implementation of social distancing measures at its plants. Nevertheless, the liquidity profile will remain strong. Further, the assessed drawing power of the company is much higher than the sanctioned working capital limits, which provides financial flexibility.

Long and successful track record in Indian footwear industry: RFL was incorporated in 1984 and its promoters have been involved in the footwear business for over three decades. Over this period, the company has successfully expanded in new product categories, geographies and customer segments; it is now one of the largest footwear manufacturers in the country. It has nine plants spread across three cities with aggregate manufacturing capacity of more than 20 crore pairs per annum.

Pan-India presence: The company has a pan-India network of distributors and retail stores supplying Relaxo products through more than 50,000 point of sales (POS), resulting in high geographical and customer diversification. RFL also sells its products through e-commerce websites such as Amazon and Flipkart to reach a wider customer base.

Diversified product portfolio and good brand recall: RFL started as a manufacturer of rubber-based Hawaii slippers, but has expanded the product portfolio over the years to include ethylene vinyl acetate (EVA) slippers, polyurethane (PU) slippers, casual shoes, sports shoes and sandals. The market position of the company's products has also improved over the years on account of significant advertising, branding initiatives and celebrity endorsements.

Credit challenges

Impact of Covid-19 pandemic: RFL has been impacted by the lockdown measures implemented at the end of March 2020 to contain the spread of Covid-19, which resulted in a 44% fall in OI to Rs. 363.6 crore in Q1 FY2021 from Rs. 648.3 crore in Q1 FY2020, and a 46% decline in OPBITDA to Rs. 57.0 crore in Q1 FY2021 from Rs. 106.4 crore in Q1 FY2020 due to a drop in volumes as well as ASP. Furthermore, due to the impact of Covid-19 and lockdown measures, the revenues dropped by 15% in Q4 FY2020, leading to a decrease in revenue growth to 5% in FY2020 against 18% in FY2019.

Significant outflows towards capex likely to continue: The company is in capex mode with annual capex outflow (adjusted for IndAS 116) of ~Rs. 100 crore over the last few years. Significant capex-related outflows are expected to continue going forward as well, reducing the free cash flows of the entity. Nonetheless, ICRA expects the internal cash flows to be adequate for meeting capex requirements without any reliance on external debt.

Exposure to volatility in commodity prices and fluctuations in exchange rate: RFL's profitability is exposed to fluctuations in commodity prices and exchange rates. In addition to the price of commodities, the changes in exchange rate impact the cost of material as the company imports most of its EVA and PU requirements.

Highly competitive industry: The footwear industry is inherently competitive as it is characterised by the strong presence of the unorganised sector. The industry does not have a capital-intensive manufacturing process and hence, the barriers to entry of new players are low. Also, the presence of a large number of small-to-medium-sized

players constrains the pricing power.

Liquidity position: Strong

RFL’s liquidity position is **strong**, with cash and equivalents of Rs. 99.7 crore as of June 30, 2020, nil term debt, and utilisation of Rs. 0.9 crore in the fund-based working capital limits, which represents 0.6% of the sanctioned limits of Rs. 140.0 crore, reflecting a significant buffer in working capital limits. ICRA notes that the liquidity position could moderate from the current levels in near term, once the company replenishes its inventory levels and restocks the distribution and retail channels, where the inventory levels had been impacted by restrictions on manufacturing and the implementation of social distancing measures at its plants. Nevertheless, the liquidity profile will remain strong. Further, the assessed drawing power of the company is much higher than the sanctioned working capital limits, which provides financial flexibility. Further, ICRA estimates that the company will generate surplus free cash flows in FY2021, after accounting for working capital as well as capex requirements.

Rating sensitivities

Positive trigger – Significant ramp up in scale of operations as well as free cash flows, while maintaining current leverage and strong liquidity position could lead to an upgrade.

Negative trigger – A steeper drop in sales in FY2021 due to the impact of Covid-19, increased reliance on leverage for expansion, deterioration in liquidity position or debt protection indicators could lead to a downward revision in ratings.

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

Relaxo Footwears Ltd. (RFL) was founded by Mr. Mool Chand Dua. The company was incorporated in September 1984 as Relaxo Footwears Private Limited and was subsequently converted into a public limited company in March 1993. RFL started off as a marketing company for the Relaxo Group and subsequently ventured into manufacturing of Hawaii slippers in 1995. Currently, the company manufactures Hawaii rubber slippers, EVA and PU-based slippers and sports shoes and sandals. It is one of the largest players in non-leather footwear market in India with a pan-India distribution network and sells its footwear under the Relaxo, Bahamas, Flite and Sparx brands. The company has capacity to manufacture more than 20 crore pairs per annum.

Key financial indicators (audited)

	FY2019	FY2020	Q1FY2021 (Limited review)
Operating Income (Rs. crore)	2,292.1	2,410.5	363.6
PAT (Rs. crore)	175.4	226.3	24.2
OPBDIT/OI (%)	14.1%	17.0%	15.7%
PAT/OI (%)	7.7%	9.4%	6.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.4	0.4
Total Debt/OPBDIT (times)	0.3	0.0	0.0
Interest Coverage (times)	47.0	24.2	14.0

Status of non-cooperation with previous CRA: CARE A/CARE A1, ratings assigned have been suspended as of March 25, 2015.

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018	
					28-Aug-2020	5-Aug-2019	16-Jan-2019	6-Jul-2018	28-Dec-2017-	20-Jun-2017
1	Term Loans	Long Term	-	-	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
2	Cash credit	Long Term	140.0	-	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA- (Positive)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
3	Non fund based working capital limits	Short Term	120.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
4	Commercial Paper	Short Term	50.0	-	[ICRA]A1+ ; Rating withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

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	Cash credit	-	-	-	140.0	[ICRA]AA (Stable); Rating reaffirmed
NA	Non fund based working capital limits	-	-	-	120.0	[ICRA]A1+; Rating reaffirmed
NA	Commercial Paper	-	-	-	50.0	[ICRA]A1+ ; Rating withdrawn

Source: PCPL

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

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