Mirza International Limited

October 08, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based -Term Loan	20.0	19.50	[ICRA]A; Reaffirmed, Outlook revised from Stable to Negative
Fund based - Working Capital Facilities	350.0	350.5	[ICRA]A; Reaffirmed, Outlook revised from Stable to Negative
Total	**370.0**	**370.0**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]A (pronounced ICRA A) to the Rs. 370.0-crore long-term facilities of Mirza International Limited (MIL) [1]. The outlook on the long-term rating has been revised from Stable to Negative.

Rationale

The change in outlook for MIL's long-term rating takes into account the increase in its leverage, deterioration in its liquidity position in FY2018 as evidenced by almost full utilisation of cash credit limits, substantial rise in the working capital intensity of its operations (from 53% in FY2017 to 62% in FY2018) due to significant investment in receivables and inventory for growing domestic sales, and marked drop in its gross cash flows in FY2018. The reaffirmation of MIL's rating takes into account its established market position as one of the leading leather footwear exporters in India, its integrated manufacturing operations which increase its cost competitiveness, and its experienced promoters and management team. The rating also derives comfort from the healthy growth in MIL's domestic turnover over the last two years, mainly due to the increase in sales of products under the in-house Red Tape brand, along with launch of brands like Red Tape Athleisure, Bond Street, and Mode. Launch of more brands, along with addition in the product offerings to include sports shoes, casual shoes, and apparel as well as leather shoes, has led to expansion of the customer base, diversified the clientele and product offerings. It has also supported investments for expansion in both online and offline channels led to 58% growth in domestic sales in FY2018. Furthermore, MIL's interest coverage ratio and Total Debt/OPBDITA were healthy at 7.0 times and 2.3 times respectively, in FY2018.

The rating, however, is constrained by the increase in total debt from Rs. 334.1 crore in FY2017 to Rs. 402.5 crore in FY2018, drop in cash flow from operations and decline in cash DSCR from 3 times in FY2017 to 0.7 times in FY2018 on account of significant investments for stepping up online and offline presence in domestic market FY2018 and increase in working capital intensity from 53% in FY2017 to 62% in FY2018 owing to the investments necessitated by the longer working capital cycle in the domestic business vis-à-vis exports. The ratings also factor in the consequent high utilisation of working capital limits of the company which reduces the cushion available with it in case of exigencies. The debt availed for construction of a new warehouse and corporate office-cum-showroom would further increase leverage in FY2019. The rating is further constrained by a decline in MIL's export revenues for the third consecutive year in FY2018 on account of weak demand from its customers in the European region. The ratings continue to be constrained by high geographic concentration in MIL's export revenues as ~73% of these revenues are from the UK and around ~15% from

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

the US. Intense competition in the leather footwear industry, and vulnerability of its profits to adverse movements in exchange rates, raw material prices and changes in duty drawback rates also limit the ratings.

Outlook: Negative

The outlook has been revised to Negative from Stable due to the increase in leverage, deterioration in liquidity position in FY2018 as evidenced by almost full utilisation of cash credit limits, substantial rise in the working capital intensity of operations (from 53% in FY2017 to 62% in FY2018) due to significant investment in receivables and inventory for growing domestic sales, and significant drop in gross cash flows and cash DSCR in FY2018. The ratings may be downgraded in case of further increase in leverage or additional stress in the working capital cycle and liquidity position. The outlook may be revised to Stable if the working capital intensity and leverage improves and utilisation of working capital limits eases.

Key rating drivers

Credit strengths

Experienced promoters with long track record in leather footwear business - MIL was incorporated in 1979 as a private limited company. Initially, its operations were limited to manufacture and sale of processed leather through its own tannery unit in Kanpur (Uttar Pradesh). 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 (Uttar Pradesh).

Established position in export footwear market with diversified and large customer base - MIL has a customer base of more than 200 clients, including reputed clients like Establishments Cleon, Debenhams Retail, Bugatti Shoes, Steve Madden, Marks And Spencer etc. MIL has been doing business over the past many years and has bagged repeated orders from the same, which reflects positively on its track record.

Established position in domestic market under Red Tape brand - MIL's domestic sales include sale of finished leather to its vendors and sale of 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. or shoes. Additionally, MIL has launched brands like Red Tape Athleisure, Bond Street, and Mode in FY2018 and YTD FY2019 along with addition in the product offerings to include sports shoes, casual shoes, and garments, which has led to expansion in the customer base. Domestic sales witnessed a healthy growth of 58% in FY2018.

Complete hedging of export receivables since FY2011 - Post FY2011, MIL changed its policy related to foreign exchange receivables and it now hedges most export receivables and does not indulge into speculative transactions. At the time of order booking, MIL receives the delivery schedule of the order and depending on the credit terms with various parties, it books the forward contracts. It has been following this practice since more than three years and the same is reflected in the minimal profit/loss reported by the company on account of foreign currency fluctuations.

Credit challenges

Debt-funded expansion in domestic market - Expansion in the domestic market (which has higher working cycle), along with the investments for setting up online shops and retail stores in FY2018, has led to an increase in total debt from Rs. 334.1 crore in FY2017 to Rs. 402.5 crore in FY2018. Further, the company has plans to ramp up the presence in the domestic market, along with debt-funded construction of a warehouse and corporate office-cum-showroom, which would further elevate debt level in FY2019.

High working capital intensity of operations - MIL's working capital intensity increased in FY2018 to 62% from 53% in FY2017, owing to significant investments made in inventory and receivables. Further, a high inventory holding period exposes the company to the risk of inventory losses. Further, the gross cash flows declined significantly in FY2018 owing to incremental working capital requirements.

Decline in available liquidity because of high utilisation of limits - Owing to the increased working capital intensity of operations, the company's working capital limits were highly utilised in the 12 months ending June 2018, constraining the liquidity cushion available with the company in case of exigencies.

De-growth of 18% in export sales in FY2018 - Following persistently tepid demand from the customers in MIL's largest export market (the UK) as well as increased focus on expansion in the domestic market, the company's exports have declined for the third consecutive year. More than 70% of the exports sales of MIL come from the European continent, leading to high regional concentration with respect to exports. Further, there is intense competition in the leather footwear industry which limits the pricing power of all players in the industry.

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 the 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 or in the GoI's regulations may impact the company's profitability. However, MIL is currently hedging 100% of its export receivables, which mitigates the currency fluctuation risk, though imports are not hedged.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Corporate Credit Rating Methodology

Rating Methodology for Entities in the Footwear Industry

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 company has a manufacturing capacity of 54 lakh pairs per annum, which 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, which exclusively cater to manufacturing footwear for Mirza International. The promoters together hold a 70.43% stake in the company.

In FY2018, the company reported a net profit of Rs. 78.42 crore on an operating income (OI) of Rs. 972.09 crore compared with a net profit of Rs. 71.74 crore on an OI of Rs. 935.68 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	935.7	972.1
PAT (Rs. crore)	71.7	78.4
OPBDITA/ OI (%)	17.2%	17.9%
RoCE (%)	15.7%	15.7%
Total Debt/TNW (times)	0.7	0.7
Total Debt/OPBDITA (times)	2.1	2.3
Interest coverage (times)	6.2	7.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

		Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
					Date &Rating	Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
	Instrument	**Type**	**Amount Rated (Rs. crore)**	**Amount Outstanding (Rs. crore)**	**Oct 2018**	**Aug , 2017**	**Aug , 2016**	**Jul , 2015**
1	Fund Based Term Loan	Long Term	19.5	**19.5**	**[ICRA]A (Negative)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**
2	Fund based- Working Capital Facilities	Long Term	350.5	**-**	**[ICRA]A (Negative)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A (Stable)**

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Feb 2018	NA	FY2022	19.5	[ICRA]A (Negative)
NA	Fund based- Working Capital Facilities	NA	NA	-	350.5	[ICRA]A (Negative)

Source: Mirza International Limited

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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