July 23, 2020

Khadim India Limited: Ratings downgraded to [ICRA]BBB (Negative)/ [ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash Credit	125.00	125.00	[ICRA]BBB (Negative); Rating downgraded from [ICRA]BBB+ (Negative)
Non-Fund based – Letter of Credit/ Bank Guarantee/ Derivative	41.50	41.50	[ICRA]A3+; Rating downgraded from [ICRA]A2
Non-Fund based – Letter of Credit/ Bank Guarantee[1]	(17.00)	(17.00)	[ICRA]A3+; Rating downgraded from [ICRA]A2
Fund based – Purchase Bill Discounting/ Short Term Loans	37.50	37.50	[ICRA]A3+; Rating downgraded from [ICRA]A2
Total	**204.00**	**204.00**	

**Instrument details are provided in Annexure-1*
[1]Sublimit of Cash Credit

Rationale

The downward revision in the ratings primarily takes into consideration Khadim India Limited's (KIL) net loss of Rs. 31.22 crore against a net profit of Rs. 21.17 crore in FY2019 because of losses suffered in the last two quarters of FY2020, primarily because of a decline in the proportion of high-margin retail sales to total sales, and a sharp increase in the promotional and advertisement expenses. The ratings downgrade also considers the likelihood of a steep decline in the top line of the company in FY2021 compared to the previous fiscal owing to a sharp drop in sales volume because of the Covid-19 pandemic. Although around 75% of the showrooms are currently operational, most of the showrooms were closed for the major part of Q1 FY2020. ICRA expects the company's operating as well as financial performance to remain under pressure because of the weak macro-economic environment translating into lower spending and a potential change in the consumer behaviour due to the ongoing pandemic in the near term, at least. The demand recovery is likely to be very small and gradual. ICRA notes that the company is likely to incur losses at the net level in FY2021 as well despite several cost-saving measures adopted.

Meanwhile, the ratings derive comfort from the long experience of the promoters and its established track record in the footwear industry for around four decades. ICRA also notes the company's strong market presence, and a pan-India network of 911 retail stores and 576 distributors (as on September 30, 2019) that supply Khadim's products. However, KIL continues to remain exposed to the high geographical concentration risk with ~65% of its revenues contributed by East India. The ratings also derive comfort from the diversified product portfolio of the company across multiple price points, catering to a wide customer base and various segments. The ratings also consider the conservative capital structure of the company despite an increase in the short-term borrowings over the past two fiscals and an erosion of net worth in FY2020.

The ratings, however, continued to be constrained by the high working capital intensity of business, primarily due to the accumulation of GST receivables and high inventory level of the company, exerting pressure on its liquidity. The ratings also factor in the highly fragmented industry structure, characterised by low value-additive nature of business and intense competition from several players, which impact margin. Besides, the overall profitability remains vulnerable to fluctuations in raw material prices.

The Negative outlook on the [ICRA]BBB rating reflects ICRA's opinion that low profits as well as cash accruals and high working capital intensity of business will continue to stretch the liquidity position of the company in the near term at least.

Key rating drivers and their description

Credit strengths

Established position of KIL in domestic market – KIL has been in the business of manufacturing footwear and accessories for around four decades and has an established track record in the footwear industry. The company has a pan-India network of 911 retail stores and 576 distributors (as on September 30, 2019), supplying Khadim's products. East India accounts for around 65% of its revenues, which exposes the company to high geographical concentration risk. However, its established presence in the market mitigates such risk to an extent. The company is also expanding to northern and western states and has also started selling its products online to reach a wider customer base.

Diversified product portfolio across multiple price points – KIL has a large product portfolio with various sub-brands at multiple price points, catering to the needs of a wide customer base. The company also caters to various segments – retail, distribution and institutional. The growth in the retail segment has remained subdued, however, the distribution and institutional sales have witnessed a steady increase over the past few years.

Conservative capital structure – The capital structure of the company remained conservative, as depicted by a gearing of 0.50 times (0.26 times as on March 31, 2018) as on March 31, 2020, on the back of a healthy net worth of KIL. However, ICRA notes that an increase in the working capital requirements along with a decline in the cash accruals from the business resulted in an increase in short-term borrowings to Rs. 116.05 crore as on March 31, 2020 from Rs. 68.66 crore as on March 31, 2018. Further, the net loss registered by the company in FY2020 led to an erosion in net worth, which stood at Rs. 233.50 crore as on March 31, 2020 against 287.67 crore as on March 31, 2019.

Credit challenges

Net loss incurred in FY2020 – The company reported a net loss of Rs. 31.27 crore against a net profit of Rs. 21.17 crore in FY2019 because of losses suffered in the last two quarters of FY2020, primarily on account of a decline in the proportion of high-margin retail sales to total sales, and a sharp increase in the promotional and advertisement expenses. Given the weak macro-economic scenario, ICRA expects that the top line of the company is likely to decline, and the company would continue to incur losses at the net level in FY2021, despite several cost-saving measures adopted.

Adverse impact of Covid-19 expected on operational and financial profiles – An unprecedented nationwide lockdown announced by the Government of India (GoI) from March 25, 2020, following the Covid-19 pandemic, led to a closure of most of the company's showrooms for the major part of Q1 FY2021, which is likely to result in low sales volume. Accordingly, the operating income of the company is estimated to decline sharply in Q1 FY2021, which is likely to result in significant cash losses during the quarter. At present, ~75% of the company's showrooms are operational. ICRA expects the company's operating and financial performance to remain under pressure because of the weak macro-economic environment, translating into lower spending and a potential change in the consumer behaviour due to the ongoing pandemic in the near term, at least. The demand recovery is likely to be very small and gradual.

High working capital intensity of business – The working capital intensity of operations stood high at 25% in FY2020 (27% in FY2019) primarily due to an accumulation of the GST receivables and high inventory level of the company. This leads to high working capital requirements for the company, exerting pressure on its liquidity position.

Fragmented and intensely competitive nature of the industry – The company faces intense competition from multiple branded footwear manufacturers as well as unorganised players, which limit its pricing flexibility and consequently, its ability to expand its operating margins.

Profitability remains susceptible to volatility in raw material prices – As footwear manufacturing is raw material intensive operation, the profit margins remain susceptible to adverse fluctuations in the costs of raw materials. The company's ability to pass on the increased cost to the customers will remain a key determinant of the company's profitability, going forward.

Liquidity position: Stretched

ICRA expects that the liquidity position of the company is likely to remain stretched on account of a consistent decline in the cash accruals over the past few years, and high working capital intensity of operations, which in turn will restrict its financial flexibility to a large extent. However, the absence of long-term debt service obligations would provide some cushion to the company's cash flows. The company had availed moratorium for interest payment on the major portion of its bank loans in April and May 2020, as per the RBI guidelines. However, KIL have not opted for the extended moratorium from July 2020 and all the interest payments due for the period of the moratorium have been paid. As the company's business is expected to decline in the near term, efficient management of working capital requirement would remain crucial, going forward.

Rating Sensitivities

Positive triggers – ICRA may revise KIL's long-term rating outlook if the company demonstrates a meaningful recovery in the margins, resulting in an improvement in cash accruals and liquidity position.

Negative triggers – Pressure on KIL's ratings may arise if there is any further weakness in profitability and/ or an increase in working capital intensity of operations.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Footwear Industry
Parent/Group Support	Not Applicable
Consolidation / Standalone	Ratings are based on the standalone financial statements of the company

About the company

Khadim's was founded in 1965, when Late S.P. Roy Burman acquired a single shoe store in Chitpur, Kolkata. Subsequently in 1981, the company was incorporated in the name of S. N. Footwear Industries Pvt. Ltd. Since then, it has grown from a single-shop entity to a company, having 911 retail outlets and 576 distributors for the sale of footwear and accessories. In June 2005, the company's status was changed from a private limited company to a public limited company under the name, Khadim Chain Stores Limited. Further, in August 2005, the company's name was changed to Khadim India Limited (KIL). In November 2017, private equity investor, Reliance Alternative Investments Fund, sold its stake through an IPO and the company got listed on the stock exchange.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	799.18	771.87
PAT (Rs. crore)	21.17	-31.22
OPBDIT/ OI (%)	7.40%	3.95%
PAT/ OI (%)	2.65%	-4.04%
Total Outside Liabilities/Tangible Net Worth (times)	0.91	1.95
Total Debt/OPBDIT (times)	1.85	3.80
Interest Coverage (times)	4.28	1.04

Status of non-cooperation with previous CRA: Not Applicable

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
					23-Jul-2020	21-Feb-2020	28-Jan-2019	6-Aug-2018	-
1	Cash Credit	Long Term	125.00	-	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	-
2	Letter of Credit/ Bank Guarantee/ Derivative	Short Term	41.50	-	[ICRA]A3+	[ICRA]A2	-	-	-
3	Letter of Credit/ Bank Guarantee[1]	Short Term	(17.00)	-	[ICRA]A3+	[ICRA]A2	-	-	-
4	Purchase Bill Discounting/ Short Term Loans	Short Term	37.50	-	[ICRA]A3+	[ICRA]A2	[ICRA]A1	[ICRA]A1	-
5	Letter of Credit/ Bank Guarantee	Long Term	-	-	-	-	[ICRA]A (Stable)	[ICRA]A (Stable)	-
6	Term Loan	Long Term	-	-	-	-	-	[ICRA]A- (Stable) withdrawn	-

Amount in Rs. crore

[1]*Sublimit of the cash credit*

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	Cash Credit	-	-	-	125.00	[ICRA]BBB (Negative)
NA	Letter of Credit/ Bank Guarantee/ Derivative	-	-	-	41.50	[ICRA]A3+
NA	Letter of Credit/ Bank Guarantee[1]	-	-	-	(17.00)	[ICRA]A3+
NA	Purchase Bill Discounting/ Short Term Loans	-	-	-	37.50	[ICRA]A3+

Source: Khadim India Limited

[1]Sublimit of Cash Credit

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

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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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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