April 06, 2023

Farida Shoes Private Limited: [ICRA]A3 assigned for enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	8.08	8.08	[ICRA]BBB- (Stable); outstanding
Fund Based Facilities	121.92	130.00	[ICRA]A3; outstanding / assigned
Non Fund-Based Facilities	5.00	5.00	[ICRA]A3; outstanding
Total	**135.00**	**143.08**	

**Instrument details are provided in Annexure-I*

Rationale

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

The ratings reaffirmation of the Group factors in the lower-than-expected operating profits, largely affected by substantial increase in raw material costs, which could not be fully passed on to its customers as the Group continued to offer competitive prices in order to maintain its top line amid subdued demand of leather shoes in the European and other Western markets (which contributed more than 90% to the overall revenue). While the company has been able to report a top line growth in FY2023 so far, input cost pressure has constrained the operating margin, which stood at ~3.7% in 9M FY2023, which is lower than the historical level of 4.0-4.5%. This, along with higher working capital intensity, is expected to lead to subdued leverage and coverage indicators going forward, which translates into an overall weaker financial profile. Due to dip in profit margins and dependence on sizeable external capital to support its operations, the Group's Total debt/ OPBITDA slipped to 6.1 times and interest coverage to 2.4 times in FY2022. While there has been some improvement in the current fiscal, the Group's Total debt/ OPBITDA is expected to remain at an elevated level of 5.0-5.5 times in FY2023/ FY2024. Additionally, the TOL/TNW[1] remained at an adverse level of 2.0-2.5 times in FY2021/ FY2022, and the same is unlikely to meaningfully improve in FY2023/ FY2024. That said, ICRA notes that the undrawn buffer lines on working capital borrowings have improved marginally (average working capital utilisation stood at 88% in 9M FY2023 vis-à-vis 97% in FY2022) following the enhancements in the post shipment credit limits to tide over the liquidity squeeze. However, the ability of the Group to maintain a comfortable liquidity headroom over a longer period through efficient management of working capital and increase its operating profit margins to the pre-Covid levels would remain a key monitorable from the credit perspective. 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 generate commensurate earnings in this segment so far, the same 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 shoes segment could strengthen its business profile. The ratings also continue to be impacted by the intense competition in the leather footwear industry and vulnerability of profits to regulatory risks as well as any adverse movement in raw material prices.

The ratings, however, favourably factor in the Group's established presence in the leather footwear segment, as one of the largest exporters of leather shoes from 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 across five decades in the leather exports business, which has helped in acquiring new customers and grow the business over the years.

[1] Total Outside Liabilities / Net Worth

The Stable outlook reflects ICRA's expectations that FSPL's financial profile and credit indicators will remain at modest levels, benefitting from established operational track record of the Group with a reputed client base, and the recent initiatives to tighten its working capital cycle.

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. 522.3 crore in FY2022 and Rs. 457.1 crore in 9M FY2023 (against Rs. 402.8 crore in FY2021). On a consolidated level, the Group achieved revenue of Rs. 835.2 crore in FY2022 and Rs. 769.0 crore in 9M FY2023 (against Rs. 605.4 crore in FY2021). The Group's established relationships with large multinational brands aided in securing repeat orders and helping mitigate competition from suppliers in other countries. FSPL has a capacity to manufacture ~45 lakh pairs of full shoes per annum.

Established track record of the Group in the leather business – The Farida Group has been in the business for more than five decades and has expanded to eleven companies, out of which six are involved in shoe manufacturing activities, while the rest are involved in manufacturing shoe components. The Group's demonstrated industry experience has helped in acquiring new customers and growing the business over the years.

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 relationships with these customers, as reflected in repeat orders from them over the years. The customer concentration risk of FSPL remains moderate as revenues from the top ten customers stood at 90% in FY2022 and 92% in 10M FY2023. Nevertheless, established relationships with these customers mitigate the risk of lower revenues/ earnings due to loss of a large customer.

Credit challenges

Input cost pressure leading to operating margins being lower than historical levels – While the company has been able to report a top line growth in FY2023 so far, input cost pressure has constrained the operating margin, which stood at ~3.7% in 9M FY2023 (3.8% in FY2022), lower than the historical level of 4.0-4.5%. The company posted lower-than-expected operating profits owing to a substantial increase in raw material costs, which were not fully passed on to its customers as the Group continued to offer competitive prices in order to maintain its top line amid subdued demand of leather shoes in the European and other Western markets (which contributed more than 90% to the overall revenue). ICRA expects that the input cost will continue to exert pressure on the operating profit margin in the near term as many Western economies face the possibility of a slowdown in the economic activity.

Lower than expected operating profits and higher working capital intensity to lead to subdued leverage and coverage indicators in FY2023 – The Group's working capital intensity is high and NWC/OI[2] stood in the range of 25-32% in FY2021/FY2022. This has been due to the elongated receivables cycle and higher inventory holding on account of financial challenges faced by the customers during the pandemic and longer lead time for leather imports due to logistical bottlenecks. Therefore, along with suppressed margins, leverage and coverage indicators remained subdued. Due to dip in profit margins and dependence on sizeable external capital to support its operations, the Group's Total debt/ OPBITDA slipped to 6.1 times and interest coverage to 2.4 times in FY2022. While there has been some improvement in the current fiscal, the Group's Total debt/ OPBITDA is expected to remain at an elevated level of 5.0-5.5 times in FY2023/ FY2024.

Sizeable dependence on external capital has led to the TOL/TNW remaining at adverse level – Sizeable dependence on external capital in the form of short-term borrowings emanated from higher working capital intensity and suppressed margins.

[2] Net Working Capital / Operating Income

As a result, the Group's capitalisation remained weak with TOL/TNW remaining at 2.4 times in FY2022, and the same is unlikely to meaningfully improve in FY2023/ FY2024.

Suboptimal 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 generate commensurate earnings in this segment so far, which in turn has had an adverse impact on the Group's business return indicators. However, ICRA believes that the Group's ability to diversify in the high-growth sports shoes segment could strengthen its business profile.

Vulnerability to regulatory risks and price fluctuation risks – As an exporter, the Group enjoys export incentives and interest subvention under 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 fluctuations in raw material prices and exchange rates.

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. This apart, association with reputed brand restricts its bargaining power, resulting in lower margins.

Liquidity position: Stretched

The liquidity position of the company is stretched due to negative free cash flows in FY2021 and FY2022 owing to a marked increase in the working capital intensity, decline in profitability, and fresh investments in growth capex to add new factory buildings. The funding gap was met through an increase in working capital borrowings, leading to limited headroom availability. The company's stretched liquidity can also be gauged from its low current ratio of 1.0-1.1 times seen across the years, which reflects the company's over-dependence on short-term funds to meet its growth objectives, exposing to the company to the risks of an asset-liability mismatch. That said, ICRA notes that the undrawn buffer lines on working capital borrowings have improved marginally (average working capital utilisation stood at 88% in 9M FY2023 vis-à-vis 97% in FY2022) following enhancements in the post-shipment credit limits to tide over the liquidity squeeze. While the improvement in the working capital cycle is visible only in H2 FY2023, the ability of the Group to maintain a comfortable liquidity headroom over a longer period through efficient management of working capital and shore up its operating profit margins would remain a key monitorable from the liquidity perspective.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings of the Group if there is an improvement in profit margin and working capital intensity, resulting in a significant improvement in liquidity profile and debt coverage indicators. Specific credit metric that might trigger for an upgrade includes interest coverage over 3.2 times on a sustained basis.

Negative factors – ICRA could downgrade the Group's ratings if the stretch in liquidity position continues, leading to working capital utilisation remains above 90% on a sustained basis. The ratings can also come under pressure if there is a deterioration in profit margins and coverage indicators. Specific credit metric that might trigger for a downgrade includes interest coverage being below 2.5 times.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Consolidation and Rating Approach Rating Methodology - Footwear
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 operations 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 eleven entities, with six of them involved in shoe manufacturing activities, and the rest in manufacturing shoe components. FSPL was incorporated in 1976 to manufacture full shoes. The company operates out of its manufacturing units in Ambur, Vellore district, Tamil Nadu, and has a capacity to manufacture ~ 4.5 million pairs per year. M/s Farida Holdings Private Limited is promoted by the Group Chairman, Mr. Rafeeque 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 1.26 million pairs per year. M/s Farida Holdings Private Limited is the single largest stakeholder in FSPL.

Key financial indicators (Consolidated)*

FSPL + ISEPL	FY2021 (Audited)	FY2022 (Audited)	9M FY2023 (Provisional)
Operating income	605.4	835.2	769.0
PAT	4.7	9.4	11.0
OPBDIT/OI	4.3%	3.8%	3.7%
PAT/OI	0.8%	1.1%	1.4%
Total outside liabilities/Tangible net worth (times)	2.2	2.4	2.2
Total debt/OPBDIT (times)	6.9	6.1	4.8
Interest coverage (times)	2.9	2.4	3.2

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; *consolidation made by ICRA based on adjustment of intergroup transactions based on available disclosures, to the extent possible*

Key financial indicators (Standalone)

FSPL	FY2021 (Audited)	FY2022 (Audited)	9M FY2023 (Provisional)
Operating income	402.7	522.3	457.1
PAT	2.5	6.2	8.6
OPBDIT/OI	5.3%	5.2%	4.8%
PAT/OI	0.6%	1.2%	1.9%
Total outside liabilities/Tangible net worth (times)	2.2	2.3	1.9
Total debt/OPBDIT (times)	5.9	5.1	4.0
Interest coverage (times)	3.3	3.0	3.3

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Jan 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021
					Apr 06, 2023	Mar 31, 2023	Dec 09, 2021	Nov 30, 2021	Aug 31, 2020
1	**Term Loans**	Long Term	8.08	8.08	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)	-	-
2	**Fund Based Facilities**	Short Term	130.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+
3	**Non Fund-Based Facilities**	Short Term	5.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3+	[ICRA]A3+	[ICRA]A3+
4	**Unallocated Facility**	Long Term	-	-	-	-	-	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)

Source: Company data

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loans	Simple
Fund Based Facilities	Simple
Non Fund-Based Facilities	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 are available on ICRA’s website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term Loans**	FY2021	NA	FY2026	8.08	[ICRA]BBB-(Stable)
NA	**Fund Based Facilities**	NA	NA	NA	130.00	[ICRA]A3
NA	**Non Fund-Based Facilities**	NA	NA	NA	5.00	[ICRA]A3

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

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

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