Arvind Fashions Limited

December 06, 2022

Ratings

Facilities	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	46.10 (Reduced from 52.08)	**CARE A-; Positive (Single A Minus; Outlook: Positive)**	**Reaffirmed; Outlook revised from Stable**
Long-term/ Short-term bank facilities	130.00 (Reduced from 145.00)	**CARE A-; Positive/ CARE A2+ (Single A Minus; Outlook: Positive/ A Two Plus)**	**Reaffirmed; Outlook revised from Stable**
Short-term bank facilities	17.50	**CARE A2+ (A Two Plus)**	**Reaffirmed**
Total bank facilities	**193.60 (₹ One hundred ninety-three crore and sixty lakh only)**		

Details of facilities in Annexure-1

Detailed rationale and key rating drivers

The ratings assigned to the bank facilities of Arvind Fashions Limited (AFL) continue to derive strength from AFL being part of the Ahmedabad-based Lalbhai group which has a track record of over a decade in the apparel brands and retail business, AFL's strong brand portfolio of owned and licensed international brands, its pan-India retail presence across multiple sales channel and diversified revenue mix; albeit concentrated towards men's wear. The ratings also favourably factor the improvement in its operating performance during the trailing 12 months ended September 2022 wherein AFL registered an aggregate net profit of ₹76 crore after reporting net losses for trailing ten quarters ended Q2FY22. The ratings also take cognisance of equity/non-debt fund infusion in the past two years ended FY22 (refers to the period April 01 to March 31), the proceeds from which have been utilised for funding of its losses as well as towards reduction of its consolidated debt and creditors; and shoring up its liquidity.

The ratings are, however, constrained on account of sizeable cash losses incurred by AFL during the last three years ended FY22 due to losses from discontinued operations and adverse impact of pandemic on its continuing operations. AFL's modest profitability and return ratios compared to its peers and its presence in a highly competitive fashion retail industry which is vulnerable to changes in fashion trends, consumer preferences and economic cycles further constrain its ratings.

Outlook: Positive

The revision in the outlook on the long-term rating of AFL from 'Stable' to 'Positive' reflects the expectations of continued improvement in operating and financial performance over the medium term aided by growth in revenue and improvement in performance of its Arrow brand, thus leading to sustained improvement in its profitability, debt coverage indicators and ROCE.

Rating sensitivities

Positive factors – Factors that could lead to positive rating action/upgrade:

- Significant improvement in its PBILDT margins to more than 14% and ROCE of more than 18% on a sustained basis
- Sustained improvement in its total debt to PBILDT below 4x
- Gross working capital cycle improving to around 180 days on sustained basis along with company maintaining adequate liquidity cushion

Negative factors – Factors that could lead to negative rating action/downgrade:

- Major deterioration in profitability margins, debt coverage indicators and ROCE
- Inability to improve its cash flow from operations

Detailed description of the key rating drivers

Key rating strengths

Part of the Ahmedabad-based Lalbhai Group with experienced and qualified management: AFL is a part of the Ahmedabad-based Lalbhai group which was founded by Late Kasturbhai Lalbhai in 1931. The group is a diversified conglomerate having presence in textile, apparel retailing, engineering, waste water treatment and real estate business. Arvind Limited (Arvind; rated *CARE AA-; Stable/ CARE A1+*), the flagship company of the group, is one of India's leading vertically-integrated textile companies having presence of more than eight decades in the industry. Post its demerger from Arvind; AFL got separately listed on the stock exchanges on March 08, 2019. The Lalbhai family of Arvind is the largest shareholder in AFL

[1]Complete definition of the ratings assigned are available at www.careedge.in and other CARE publications

while Multiples Private Equity fund managed by Renuka Ramnath; ex-MD and CEO of ICICI Ventures Ltd., holds nearly 9% equity stake in the company.
Sanjay Lalbhai is the Chairman of AFL while his sons, Punit Lalbhai and Kulin Lalbhai, are non-Executive Directors on the Board of AFL. The management team of AFL includes Shailesh Chaturvedi (Managing Director and Chief Executive Officer (CEO)) and Piyush Gupta (Chief Financial Officer). Furthermore, the board of AFL comprises of eminent industry experts such as Nilesh Shah, Vallabh Bhansali and Nithya Easwaran.

Strong brand portfolio of own and licensed international apparel brands: AFL discontinued many of its loss-incurring brands over the past three years ended FY22. The company completed closure of most of its loss-incurring brands and has decided to focus on its six key brands (Tommy Hilfiger, U.S. Polo, Arrow, Flying Machine, Calvin Klein and Sephora) with an aim to improve its profitability. The licenses of these existing international apparel brands are long term/perpetual in nature. Furthermore, the focus on the existing brands have been major revenue driver for the company over past few years and it is expected to continue in medium to long term. Historically, higher growth momentum of some of these brands has led to healthy PBILDT margin thus driving the overall profitability of AFL.
AFL's brand portfolio is positioned across various price points and fashion styles although more focused towards casual wear. It also encompasses various segments like men's wear, women's wear, kids wear, inner wear, footwear, beauty and accessories; albeit it is skewed towards men's wear (around 78% of its overall sales in FY22). Going forward, the management of AFL plans to increase its sales in beauty brand and adjacent categories (footwear, inner wear, kids wear, women wear and accessories) within its existing brands to improve its demographic presence. Moreover, the company has a dedicated team for its adjacent categories with focus to increase revenue from adjacent categories.

Wide distribution network with presence across multiple sales channels: AFL has a strong distribution network with 1,072 exclusive brand outlets (EBOs) and around 3,500 key counters having total retail space of 10.45 lakh square feet (LSF) as on March 31, 2022. AFL's brands are sold through multiple sales channels such as its retail store network, through wholesale to Multi Brand Outlets (MBO) and large departmental stores as well as through online retailers like Flipkart, Myntra and Amazon in addition to its own website NNNOW.com. With a shift in the consumer behaviour towards online sales due to the outbreak of COVID-19 pandemic, the online channel has become a key growth driver for the company thereby increasing the reach of the brand portfolio of AFL. AFL has integrated its offline stores and warehouse inventory to NNNOW.com and third-party online platforms to create 'one-view of inventory' which refers to access to the inventory of all the stores apart from the online inventory. As on March 31, 2022, more than 800 stores of AFL were omni-channel enabled which supported AFL to achieve sales of around ₹1,000 crore from online channel in FY22 contributing 33% of its consolidated sales.

Profitable track record of four quarters with expectation of further improvement in profitability: AFL reported an aggregate net profit of ₹76 crore in last four quarters ended Q2FY23 after reporting net losses for the immediately trailing ten quarters ended Q2FY22. With gradual recovery in sales witnessed from July 2021 onwards whereby sales improved on year-on-year basis backed by growing online sales and gradual opening of stores along with improving footfalls supported by festive demand, AFL witnessed an improvement in revenue and profitability on year-on-year basis (growth of 31%, 33%, 171% and 45% in revenue during Q3FY22, Q4FY22, Q1FY23 and Q2FY23 respectively). AFL also witnessed gradual increase in share of full price sales across brands and lower discounting which coupled with improvement in performance of 'Arrow' brand, discontinuation of loss-making brands and benefits of operating leverage aided improvement in profitability.
During H1FY23, debt coverage indicators marked by PBILDT interest coverage improved to 3.83x (FY22: 1.74x) supported by improved profitability. With improvement in profitability coupled with reduction in operating cycle, AFL achieved annualised ROCE of nearly 15% in Q2FY23.
Revenue of AFL is expected to grow by 12-15% over the medium term supported by strong market position of its apparel brands, increase in sales from adjacent categories, addition of new stores, turnaround of 'Arrow' brand, strengthening omni-channel presence and increase in store efficiency. Operating profitability is mainly a function of sales volume, being very high gross margin (around 45%) business. Growth in sales supported by steps taken by management to rationalise its brand portfolio and stores network is expected to improve overall profitability to 12-14% (post-Ind AS 116 basis) in near to medium term.

Improvement in capital structure and debt coverage indicators: The company raised equity funding of ₹1,260 crore apart from proceeds of ₹167 crore from sale of its value retail 'Unlimited' business during the period of one and half years-ended September 30, 2021, the proceeds from which have been utilised for funding of its significant losses incurred on a continuous basis during FY20, FY21 and H1FY22 as well as towards reduction of its consolidated debt and creditors and shoring up its liquidity. Such timely fund infusion has enabled AFL to successfully counter the challenging external operating environment due to COVID-19 pandemic. The gross debt level (excluding lease liability; including acceptances) reduced sizably from ₹1,099 crore as on March 31, 2021 to ₹680 crore as on March 31, 2022. With improving trend in operating performance

coupled with reduction in debt level, the debt coverage and leverage indicators of AFL also improved during FY22; albeit continued to remain moderate.
With expectation of further reduction in debt level, the overall gearing (including lease liability) is expected to gradually fall below unity by FY24. Moreover, with improvement in profitability, the debt coverage marked by total debt to PBIDLT is expected to remain below 2x while ROCE is expected at over 20% by March 2024.

Liquidity: Adequate

The operations of AFL have been highly working capital intensive due to requirement of large inventory holding in its retail business and extension of credit to its wholesale/online channels. However, AFL has taken various steps to improve inventory turnover and collection period. The operating cycle which elongated from 117 days in FY20 to 185 days in FY21 mainly due to COVID-19-induced pandemic, improved to 95 days in FY22. The operating cycle is further expected to improve in FY23 with various steps taken by management to improve inventory turnover and store efficiency.
The liquidity of the company at a consolidated level has remained adequate marked by moderate utilisation of working capital limits and positive cashflow from operations. During FY22, cash flow from operations stood at ₹63 crore. On a standalone level, AFL's average utilisation of fund-based working capital limits stood at around 44% during the trailing 12 months ended September 2022 while the average utilisation of fund-based limits of Arvind Lifestyle Brands Limited (ALBL; its major subsidiary) stood at 73% for the same period. As on September 30, 2022, on an aggregate level, AFL and ALBL had unutilised fund-based working capital limits of around ₹130 crore apart from cash and bank balance of around ₹180 crore at consolidated level thereby providing adequate liquidity cushion. Furthermore, CARE Ratings Limited (CARE Ratings) expects cash accruals of around ₹200 crore as against relatively low term debt repayment obligation of around ₹40 crore due in FY23. CARE Ratings also factors in the promoters' strong commitment to provide need-based support to the company in case of any exigency.

Key rating weaknesses

Modest profitability margins and return ratios compared to its peers: Performance of AFL was significantly impacted in FY20, FY21 and H1FY22 due to loss of sales and provisions arising out of COVID-19 disruption, curtailing its sales in the wholesale channel coupled with loss on discontinued brands. AFL reported aggregate net loss and cash loss of around ₹1,230 crore and around ₹920 crore respectively in FY20, FY21 and FY22.
Even after improvement as witnessed during H2FY22 and H1FY23, the profitability and ROCE of the company remains moderate compared to its peers due to sub-optimal performance of some of its brands. Some of the brands of AFL are still at nascent stage and operate at sub-optimal scale which results in moderate profitability. Going forward, realisation of the envisaged benefits from store expansion will be crucial for the overall performance of the company and improvement in its profitability and return indicators.

Highly competitive branded apparel retail industry which exerts pressure on profitability margins: The apparel retail sector in India is highly competitive with presence of many domestic and international brands as well as foray of large corporates like the TATA group, the Reliance group and the Aditya Birla group into apparel retail segment. AFL faces tough competition from the private label brands of its established distributors. Furthermore, large expansion by retailers lead to pressure on their PBILDT margin as earnings from the existing stores do not adequately offset gestation losses from high proportion of new stores added. However, a strong brand portfolio could help AFL in managing the increasing competition in a better manner.
Being in the retail business, AFL has to continuously invest in order to revamp its existing stores as well as for opening of new stores. However, AFL has gradually increased its focus on franchisee stores from FY20 onwards whereby share of the company-operated stores in total stores decreased from 47% in FY19 to 27% in FY22. Also, most of the store expansion going forward is planned to be done through franchisee route, thereby limiting the capex requirements. AFL has planned capex of ₹70-100 crore per annum during FY23-FY25 which is expected to be funded through internal accruals.

Analytical approach: Consolidated

CARE Ratings has considered the consolidated financials of AFL for its analytical purpose, which includes the financials of its subsidiaries/JVs. The list of subsidiaries/JVs consolidated in AFL is placed in **Annexure-3.**

Applicable criteria

Criteria on assigning 'outlook' and 'credit watch' to credit ratings
CARE's policy on default recognition
Policy on Withdrawal of Ratings
Financial ratios – non-financial sector
Criteria for short-term instruments
Rating Methodology: Consolidation

Rating Methodology - Organized Retail Companies
Rating Methodology - Wholesale Trading
Liquidity analysis of non-financial sector entities

About the company

AFL was originally incorporated in January 2016 as Arvind J&M Limited and its name was changed to its current form in October 2016. It is a part of the Ahmedabad-based Lalbhai group and earlier used to be a 90% subsidiary of Arvind with the balance stake being held by Multiples Private Equity Fund. Post business restructuring undertaken within the Arvind group, AFL got demerged and was separately listed on the stock exchange on March 08, 2019. Shareholders of Arvind became shareholders of AFL post demerger. AFL, through its two wholly owned subsidiaries, one joint venture (JV) and two step-down subsidiaries, is engaged in the wholesale and retailing of owned and licensed branded apparels in India. However, its wholly-owned subsidiary, ALBL, has major contribution to AFL's consolidated revenue, profitability and debt profile.

Brief details of various businesses conducted by AFL and its subsidiaries/JV:

Company Name	Business activities
AFL	Wholesale of licensed brand 'Arrow'
ALBL - 100% subsidiary of AFL	Wholesale and retailing of various international licensed brands and retailing of Arrow
Arvind Youth Brands Private Limited (AYBPL) – nearly 40% equity stake held directly by AFL and balance equity stake held by AFL through its 100% subsidiary ALBL	Wholesale and retailing of own brand 'Flying Machine'
PVH Arvind Fashion Private Limited (PAFPL) - 50% JV between AFL and PVH Corp, USA	Wholesale trading of 'Tommy Hilfiger' (TH) and 'Calvin Klein' branded apparels, accessories and retail trading for TH brand
Arvind Beauty Brands Retail Private Limited (ABBRPL) - 100% subsidiary of AFL	Retailing of beauty products under 'Sephora'
Value Fashion Retail Limited – wholly-owned by ALBL	Non-operational

Brief Consolidated Financials of AFL (₹ crore)	FY21 (A)	FY22 (A)	H1FY23 (UA)
Total operating income	1,992	3,094	2,124
PBILDT	80	225	230
PAT	(596)	(104)	36
Overall gearing (times) @	3.24	1.30	NA
PBILDT Interest coverage (times)	0.44	1.74	3.83

A: Audited; UA: Un Audited; NA: Not available @ including lease liability in debt; Financials have been classified as per CARE Ratings' standards

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating history for last three years: Please refer Annexure-2

Covenants of rated instrument / facility: Not Applicable

Complexity level of various instruments rated for this company: Please refer Annexure-4

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term loan		-	-	March 2026	46.10	CARE A-; Positive
Fund-based-LT/ST		-	-	-	130.00	CARE A-; Positive/ CARE A2+
Non-fund-based - ST-Working capital limits		-	-	-	17.50	CARE A2+

Annexure-2: Rating history for the last three years

Sr. No.	Name of the Instrument/ Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022	Date(s) and Rating(s) assigned in 2020-2021	Date(s) and Rating(s) assigned in 2019-2020
1	Fund-based-LT/ST	LT/ ST	130.00	CARE A-; Positive/ CARE A2+	-	1)CARE A-; Stable/ CARE A2+ (14-Mar-22) 2)CARE A-; Negative/ CARE A2+ (14-Dec-21) 3)CARE A-; Negative/ CARE A2+ (06-Aug-21)	1)CARE A-; Negative / CARE A2+ (29-Sep-20) 2)CARE A-; Negative / CARE A2+ (30-Apr-20)	1)CARE A-; Stable/ CARE A2+ (20-Feb-20) 2)CARE A; Negative/ CARE A1 (15-Oct-19 3)CARE A; Negative/ CARE A1 (20-Sep-19)
2	Fund-based - LT-Term loan	LT	46.10	CARE A-; Positive	-	1)CARE A-; Stable (14-Mar-22) 2)CARE A-; Negative (14-Dec-21) 3)CARE A-; Negative (06-Aug-21)	1)CARE A-; Negative (29-Sep-20) 2)CARE A-; Negative (30-Apr-20)	1)CARE A-; Stable (20-Feb-20) 2)CARE A; Negative (15-Oct-19)
3	Non-fund-based - ST-Working capital limits	ST	17.50	CARE A2+	-	1)CARE A2+ (14-Mar-22) 2)CARE A2+ (14-Dec-21) 3)CARE A2+ (06-Aug-21)	1)CARE A2+ (29-Sep-20) 2)CARE A2+ (30-Apr-20)	1)CARE A2+ (20-Feb-20) 2)CARE A1 (15-Oct-19)
4	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ ST	-	-	-	-	-	1)CARE AA- (CE); Stable/ CARE A1+ (CE) (20-Sep-19) 2)Withdrawn (20-Sep-19)
5	Fund-based - LT-Working capital limits	LT	-	-	-	-	-	1)Withdrawn (20-Sep-19)
6	Non-fund-based - ST-Letter of credit	ST	-	-	-	-	-	1)Withdrawn (20-Sep-19)
7	Commercial paper	ST	-	-	-	-	-	1)Withdrawn (21-Aug-19)

Annexure 3: List of subsidiaries/JVs of AFL

Name of the Company	% share-holding of AFL as on March 31, 2022	Consolidation
Arvind Lifestyle Brands Limited	100%	Fully Consolidated
Arvind Beauty Brands Retail Private Limited	100%	Fully Consolidated
PVH Arvind Fashion Private Limited (erstwhile Calvin Klein Arvind Fashion Private Limited) (JV)	50%	Fully Consolidated
Arvind Youth Brands Private Limited*	100%	Fully Consolidated
Value Fashion Retail Limited*	100%	Fully Consolidated

*Held by Arvind Lifestyle Brands Limited

Annexure-4: Complexity level of various instruments rated for this company

Sr. No.	Name of Instrument	Complexity Level
1.	Fund-based - LT-Term loan	Simple
2.	Fund-based-LT/ST	Simple
3.	Non-fund-based - ST-Working capital limits	Simple

Note on complexity levels of the rated instrument: CARE Ratings has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for any clarifications.

Annexure-5: Bank lender details for this company

To view the lender-wise details of bank facilities please click here

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About us:
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