Arvind Fashions Limited

January 05, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	30.26 (Reduced from 46.10)	CARE A; Stable	Revised from CARE A-; Positive
Long-term/ Short-term bank facilities	145.00 (Enhanced from 130.00)	CARE A; Stable/ CARE A1	Revised from CARE A-; Positive/ CARE A2+
Short-term bank facilities	17.50	CARE A1	Revised from CARE A2+

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

The revision in the ratings assigned to the bank facilities of Arvind Fashions Limited (AFL) takes into account improvement in its operating performance during the trailing 12 months ended September 2023, wherein profit before interest, lease rentals, depreciation and taxation (PBILDT) improved on y-o-y basis leading to improvement in net profit and cash accruals during the period. With improvement in profitability coupled with tight working capital management and release of capital employed in loss incurring operations, AFL achieved return on capital employed (ROCE) of nearly 15% in FY23 (refers to period April 01 to Mach 31). The revision in the ratings also take cognisance of significant reduction in consolidated debt level during November 2023 from the proceeds of sale of its 'Sephora' business and expectation of improvement in profitability in H2FY24. With expected improvement in the operating performance coupled with reduction in debt level, total debt to PBIDLT is expected to remain below 2.5x in FY24, while ROCE is expected to remain at around 18% in FY24.

The ratings of 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 above rating strengths are, however, tempered by its modest profitability as some of the brands of AFL operate at sub-optimal scale and its presence in a highly competitive fashion retail industry which is vulnerable to changes in fashion trends, consumer preferences and economic cycles.

Rating sensitivities: Factors likely to lead to rating actions

Positive factors

- Sustained double digit growth in its total operating income (TOI) along with improvement in its PBILDT margin to more than 16% and ROCE of more than 20% on a sustained basis.
- Sustained improvement in its total debt to PBILDT below 2x.
- Maintaining gross working capital cycle at around 180 days on sustained basis along with company maintaining adequate liquidity cushion.

Negative factors

- Decline in its PBILDT margin below 10% on a sustained basis leading to moderation in its total debt to PBILDT above 3.5x and ROCE below 12%.
- Significantly lower than envisaged cash flow from operations.

Outlook: Stable

Stable outlook reflects that AFL is likely to maintain its market position supported by its strong brand portfolio. The financial risk profile of AFL is also likely to sustain over the medium term with expectations of improved scale of operations and profitability with no major debt funded capex plan.

Analytical approach: Consolidated

CARE Ratings Limited (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-6.**

Detailed description of the key rating drivers:

Key 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

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

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 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 Girdhar Chitlangia (Chief Financial Officer). Furthermore, the board of AFL comprises eminent industry experts, including Nilesh Shah and Nithya Easwaran.

Strong brand portfolio of own and licensed international apparel brands
AFL discontinued many of its loss-incurring brands over the past few years. The company completed closure of most of its loss-incurring brands and has decided to focus on its five key brands (Tommy Hilfiger, U.S. Polo, Arrow, Flying Machine and Calvin Klein) with an aim to improve its profitability. The licenses of these existing international apparel brands are long term/perpetual in nature. Furthermore, 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 and accessories; albeit it is skewed towards men's wear (over 70% of its overall sales in FY23). The company has a dedicated team for its adjacent categories (footwear, inner wear, kids wear, women wear and accessories) which has supported revenue of around ₹500 crore from adjacent categories in FY23. Adjacent categories account for 20-25% of the revenue for some of the brands. Going forward, the management plans to increase its sales in adjacent categories within its existing brands to improve its demographic presence. During Q2FY24, AFL launched women wear line under U.S. Polo through online channels.

Wide distribution network with presence across multiple sales channels
AFL has a strong distribution network with 1,077 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, 2023. 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. 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, 2023, around 900 stores of AFL were omni-channel enabled which supported AFL to achieve sales of around ₹1,000 crore from online channel in FY23 contributing 22% (FY22: 33%) of its consolidated sales. The sales mix changed during FY23 with decline in share of online sales as consumer shift back towards offline shopping as impact of COVID-19 subside.

Profitable track record of past eight quarters with expectation of further improvement in profitability
AFL reported an aggregate net profit of ₹159 crore in last eight quarters ended Q2FY24 after reporting net losses for the immediately trailing 10 quarters ended Q2FY22. With gradual recovery in sales, AFL witnessed an improvement in revenue and profitability on year-on-year basis. 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 FY23 and H1FY24, consolidated sales and profitability of AFL was impacted by slowdown in demand mainly for value segment due to inflationary pressures along with consumer shift towards offline shopping. Additionally, sales and profitability during H1FY24 was impacted by higher advertising spend and festive shift towards Q3FY24. Despite challenging demand environment, AFL could increase its revenue and profitability in H1FY24 on y-o-y along with improvement in profitability supported by increase in share of full price sales across brands and lower discounting.
The revenue of AFL is expected to grow by 10-12% over near to medium term supported by strong market position of its apparel brands, increase in sales from adjacent categories, addition of new stores, improvement in performance of 'Arrow' and 'flying Machine' brands 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 12-15% (post-Ind AS 116 basis) in the near to medium term. With improvement in profitability coupled with improvement in operating cycle and release of capital employed in loss incurring operations, AFL achieved ROCE of nearly 15% in FY23 and it is expected to reach around 18% by FY24 and 25% by FY26.

Improvement in capital structure and debt coverage indicators

The capital structure of the company marked by overall gearing ratio (including lease liability) and total outside liabilities (TOL)/ tangible net worth (TNW) remained largely stable at 1.55x (PY: 1.30x) and 2.74x (PY: 2.60x), respectively, as on March 31, 2023. During November 2023, AFL sold its entire stake in Arvind Beauty Brands Retail Private Limited (ABBRPL; retailing of Sephora brand) to Reliance Beauty and Personal Care Limited at enterprise value of ₹216 crore. As on March 31, 2023, AFL had also extended loans of ₹74 crore to ABBRPL. Subsequently, AFL reduced its consolidated debt level (excluding lease liability and acceptances) by more than ₹150 crore during November 30, 2023.

With improvement in operating performance coupled with reduction in debt level, CARE Ratings expects the debt coverage and leverage indicators of AFL to improve during FY24. The overall gearing (including lease liability) is expected to improve to around 1.2x by March 2024 and fall below unity by March 2025. Moreover, the debt coverage marked by total debt to PBIDLT which improved in FY23 to 3.09x (PY: 5.04x), is further expected to improve and remain below 2.5x in FY24.

Liquidity: Strong

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 gross operating cycle which elongated to nearly 400 days in FY21 mainly due to COVID-19-induced pandemic, improved to 174 days in FY23 supported by various steps taken by management to improve collection period, inventory turnover and store efficiency.

AFL has strong liquidity at a consolidated level marked by significant reduction in working capital borrowings and positive cashflow from operations. During FY23, cash flow from operations stood at ₹149 crore (FY22: ₹63 crore) supported by reduction in gross operating cycle. On a standalone level, AFL's average utilisation of fund-based working capital limits stood at around 62% during the trailing 12 months ended September 2023 while the average utilisation of fund-based limits of Arvind Lifestyle Brands Limited (ALBL; its major subsidiary) stood at 86% for the same period. During November 2023, AFL reduced consolidated debt level by more than ₹150 crore from the proceeds of sale of its Sephora business. Subsequently, as on November 30, 2023, on consolidated level, AFL had unutilised working capital limits of around ₹400 crore apart from cash and bank balance of over ₹200 crore thereby providing liquidity cushion. Furthermore, CARE Ratings expects cash accruals of over ₹200 crore as against relatively low term debt repayment obligation of around ₹40 crore due in FY24.

Key weaknesses

Operating performance exposed to economic down-cycles

The retail clothing and apparel industry has heavy dependence on the disposable income of its customer segment and is susceptible to economic cycles because of the discretionary nature of purchases. The retail clothing and apparel industry is facing demand slowdown mainly in value segment due to inflationary pressures and demand improvement is expected from H2FY24 with the onset of the festive season.

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. Some of the brands of AFL are still at nascent stage and operate at sub-optimal scale which results in moderate profitability. 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 16% in FY23. 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 ₹100-120 crore per annum during FY24-FY26, which is expected to be funded through internal accruals.

Environment, social, and governance (ESG) risks

Parameter	Compliance and action by the company
Environment	• AFL has shifted 80% of its electricity consumption in the corporate office to renewable sources and has plan to shift 50% of its energy consumption in warehouse operations to renewable sources by 2025. • AFL has introduced certain SKUs which has a blend of sustainable cotton and manufactured using non-hazardous chemicals in the washing process.
Social	• AFL has introduced the 'responsible sourcing guidelines' for its finished goods vendors which contain the minimum sustainability and compliance standards that its vendors are expected to meet and good

Parameter	Compliance and action by the company
	practices that may be adopted.
Governance	• AFL's board of directors consists of 50% independent directors (6 out of 12). • There are separate Codes of Conduct for Board Members and senior management personnel. • Various policies, including whistle blower policy, is in place in line with the requirement.

Applicable criteria

Policy on default recognition
Consolidation
Financial Ratios – Non financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Retail
Wholesale Trading

About the company and industry

Industry classification

Macro-economic Indicator	Sector	Industry	Basic Industry
Services	Services	Commercial services & supplies	Trading & distributors

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. The 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 U.S. Polo 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
ABBRPL - 100% subsidiary of AFL @	Retailing of beauty products under 'Sephora' till stake sale in business during November 2023
Value Fashion Retail Limited – wholly-owned by ALBL	Non-operational

@ During November 2023, AFL sold its entire stake in ABBRPL to Reliance Beauty and Personal Care Limited.

Brief Consolidated Financials (₹ crore)	FY22 (A)	FY23 (A)	H1FY24 (UA)
Total operating income	3,094	4,421	2,240
PBILDT	225	472	268
PAT from continuing operations	(104)	88	33
PAT from continuing operations and discontinued operations	(237)	87	33
Overall gearing (times) @	1.30	1.55	NA
Interest coverage (times)	1.74	3.05	3.37

A: Audited UA: Unaudited; NA: Not available; Note: 'the above results are latest financial results available'

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: Detailed explanation of covenants of the rated instruments/facilities is given in Annexure-3

Complexity level of various instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned along with Rating Outlook
Fund-based - LT-Term loan	-	-	-	March 2026	30.26	CARE A; Stable
Fund-based-LT/ST	-	-	-	-	145.00	CARE A; Stable/ CARE A1
Non-fund-based - ST-Working capital limits	-	-	-	-	17.50	CARE A1

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 2023-2024	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
1	Fund-based-LT/ST	LT/ ST*	145.00	CARE A; Stable/ CARE A1	-	1)CARE A-; Positive/ CARE A2+ (06-Dec-22)	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)
2	Fund-based - LT-Term loan	LT	30.26	CARE A; Stable	-	1)CARE A-; Positive (06-Dec-22)	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)
3	Non-fund-based - ST-Working capital limits	ST	17.50	CARE A1	-	1)CARE A2+ (06-Dec-22)	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)

*Long term/Short term.

Annexure-3: Detailed explanation of covenants of the rated instruments/facilities: Not applicable

Annexure-4: Complexity level of the various instruments rated

Sr. No.	Name of the 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

Annexure-5: Lender details

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

Annexure-6: List of subsidiaries/JVs of AFL

Name of the Company	% share-holding of AFL as on March 31, 2023	Consolidation
Arvind Lifestyle Brands Limited	100%	Fully consolidated
Arvind Beauty Brands Retail Private Limited @	100%	Fully consolidated
PVH Arvind Fashion Private Limited (JV)	50%	Fully consolidated
Arvind Youth Brands Private Limited*	100%	Fully consolidated
Value Fashion Retail Limited*	100%	Fully consolidated

@ During November 2023, AFL entered into a share purchase agreement with Reliance Beauty and Personal Care Limited to sell and transfer the entire equity stake held in ABBRPL post which ABBRPL ceased to be the subsidiary of AFL.
*Held by Arvind Lifestyle Brands Limited

Note on the complexity levels of the rated instruments: 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.

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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