Arvind Fashions Limited

August 1, 2017

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Proposed CP issue (carved out of working capital limits)@	100.00 (Rs. One Hundred Crore Only)	**Provisional 'CARE A1+ (SO)' [A One Plus (Structured Obligation)]**	**Assigned**
Proposed CP issue (standalone)@	50.00 (Rs. Fifty Crore Only)	**Provisional 'CARE A1+ (SO)' [A One Plus (Structured Obligation)]**	**Assigned**

@proposed to be backed by unconditional, irrevocable and continuing corporate guarantee to be extended by Arvind Limited (Arvind, rated CARE AA; Stable/CARE A1+).
Both the above ratings shall be 'confirmed' upon receipt of the deed of guarantee and other documents to the satisfaction of CARE Ratings Ltd
Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers
The rating for the proposed commercial paper (CP) issues of Arvind Fashions Limited (AFL) are based on the credit enhancement in the form of unconditional, irrevocable and continuing corporate guarantee of Arvind.
The ratings of Arvind derives strength from the vast experience of its promoters, long-standing operational track record of Arvind as an integrated textile manufacturer having presence across the textile value chain and the strong growth potential associated with its wide brand portfolio spread across all customer and product segments supported by widespread retail distribution network. The rating further continues to factor sustained growth in its scale of operations with stable profitability despite volatile cotton prices and forex rates, gradual diversification in revenue mix and shift in its business profile as indicated by the increasing contribution of non-denim textiles and brands & retail sales to its revenue stream thereby reducing its dependence on the cyclical denim business. The rating also takes into account the significant rationalization of debt-level as on March 31, 2017 consequent to the extraordinary cash flow of nearly Rs.1,000 crore generated during FY17 (refers to the period April 1 to March 31) through 10% equity stake dilution in its brands and apparel business subsidiary and liquidation of quoted investment in shares resulting into substantial savings on interest charges and improvement in leverage and debt-coverage indicators.
The rating is, however, constrained on account of Arvind's working capital intensive nature of operations, susceptibility of its profitability to volatile cotton prices and forex rate fluctuation, losses in e-commerce segment considering its initial stage, moderate profitability of its brands and retail business albeit improving year on year and its presence in the cyclical and competitive textile and apparel industry.
The ability of Arvind to maintain the growth momentum in scale of operations while efficiently managing raw material price fluctuation and working capital requirement, to improve the profitability of its brands and retail business and maintain improved capital structure and debt coverage indicators would be the key rating sensitivities. Extent of impact on profitability subsequent to implementation of Goods and Service Tax (GST) in light of unsold inventory especially for garmenting and branded retail segment is also a key rating monitorable.

Detailed description of the key rating drivers of the guarantor (Arvind)
Key Rating Strengths
Improvement in leverage and debt coverage indicators due to rationalization of debt levels through extraordinary cash flow during FY17
During Q2FY17 and Q3FY17, Arvind generated extraordinary cash flow of nearly Rs.972 crore by way of 10% equity dilution in apparel and brands business subsidiary Arvind Fashions Ltd (AFL) leading to receipt of proceeds of Rs.740 crore and liquidation of investment in quoted shares of Atul Ltd with sales proceeds of Rs. 232 crore. These funds were utilized mainly for pre-payment of long-term loans. Consequently, consolidated total debt of the Arvind has reduced from Rs.4,477 crore as on March 31, 2016 to Rs.3,239 crore as on March 31, 2017. Augmentation of net-worth base and rationalization of debt levels led to improvement in consolidated overall gearing as on March 31, 2017. Consolidated interest cost also reduced from Rs.359 crore during FY16 to Rs.288 crore which led to improvement in the debt coverage indicators.
Sustained growth in the scale of operations
The total operating income (TOI) of Arvind registered a compounded annual growth rate (CAGR) of nearly 10.46% during the past three years ended FY17 largely led by strong operational performance by the company in textile as well as

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

brands & retail divisions. Arvind's total operating income (TOI) grew around 15% in FY17 as compared to FY16, due to growth in its garment division, woven fabrics and apparel & brands business. The textile division revenue grew at healthy rate of 9.66% during FY17 as compared to 3% growth of FY16 with further reduction in dependence on denim segment. It was on account of volume growth in woven and garment segment. Voiles segment also grew steadily by 12% during FY17. Arvind also earns revenue from export market which comprised nearly 24%-28% of its consolidated revenue over the past three years ended FY17.

Diversified revenue stream and product portfolio along with complete vertical integration

Arvind has significantly diversified its revenue base in different segments over the past. Further, Arvind's textile business operations are vertically integrated across the complete value chain from fabric to garments to branded apparel to retail. This integrated setup gives Arvind operational flexibility and ability to rationalize costs by managing dependence on outsourced vendors. During FY17, textiles division contributed 62% of Arvind's TOI whereas brands & retail division contributed 31%.

Strong and diversified brand portfolio providing healthy growth opportunity in the fast growing apparel market

Over the years, Arvind has continuously increased its focus on brands and retail business in order to reduce its revenue dependence on the highly cyclical and commoditized textiles business. The income from Arvind's brands & retail division has grown from Rs.732 crore in FY10 to Rs.2,898 crore in FY17. The brands portfolio of Arvind includes some of the key national and international brands categorized in to power brands like Arrow, US Polo and Flying Machine, growth brands like Nautica, Gant, Izod, Ed Hardy, Elle and Hanes and Specialty retails like GAP, TCP, Sephora (in beauty and cosmetics segment) and Aeropostale. While the older/mature brands like Arrow, US Polo, Flying Machine and Tommy Hilfiger are growing at a healthy rate and generating profits, Arvind's ability to generate envisaged revenue growth and cash accruals from other brands is crucial from the credit perspective.

Widespread distribution network

Arvind has one of the largest retail networks in the textile apparel space in the country. Over the years, Arvind has widened its retail distribution footprints. As on March 31, 2017, Arvind had 1,014 stores which include brands outlet and Megamart with retail space aggregating 16.28 lakh square feet (lsf) apart from 1,495 key account counters in multi brand outlets.

Wide experience of the promoters in textile industry along with competent management

Arvind, the flagship company of the Ahmedabad based Lalbhai group, is currently led by next generation entrepreneurs of the Lalbhai family under the leadership of Mr Sanjay Lalbhai. Mr Sanjay Lalbhai, aged 67 years, is the Chairman and Managing Director of Arvind and looks after the overall operations of the company and has a total work experience of nearly 35 years. Further, the next generation of the Lalbhai family, Mr Punit Sanjay Lalbhai and Mr Kulin Sanjay Lalbhai, have also been inducted on the board as Executive Directors. Mr Jayesh Shah, Whole-time-Director and CFO, is a Chartered Accountant and looks after finance activities with total work experience of over two decades. The management team of Arvind also consists of experienced professionals who have guided the company successfully through various economic cycles.

Favorable prospects of Indian apparel industry and garmenting segment

Indian Apparel (Garment) is the largest segment of the Indian Textile and Clothing Industry (IT&C); accounts 60-65% of the total Industry. Further, it is one of the largest sources of foreign exchange flow into the country. Moreover, the share of India is nearly 3%-4% in the total apparel exports to the world as against 41% share of China. With increasing labour cost in China, the demand is expected to shift to Bangladesh, India, Vietnam, etc. Arvind is currently setting up garment manufacturing unit at Ethiopia in light of tax benefits on exports to USA. Further, GST rates are largely neutral for the industry with 5% rate on apparel costing less than Rs. 1000 and 12% above Rs.1,000. However, impact on the profitability due to closing stock in transition phase is a key rating monitorable.

Key Rating Weaknesses

Vulnerability of profitability to volatility in cotton prices and foreign exchange fluctuation along with initial stage of operations of e-commerce segment

Cotton and cotton yarn are the key raw materials for Arvind. Being agriculture based input; the operations of Arvind are vulnerable to its inherent risks associated with agri-based inputs prices.

Arvind also earns revenue from the international market as during FY17 Arvind earned 25% of consolidated TOI from exports sale; whereas import on the other side is negligible. Hence, Arvind is a net exporter and is exposed to adverse fluctuation in foreign currency exchange rates. PBILDT margins declined from 12.77% during FY16 to 10.96% during FY17 on account of losses in the internet business in light of its initial stage of operations. In the near term, Arvind's ability to maintain profitability is crucial in light of increase in cotton prices, appreciation of INR against USD, intense competition in brand & retail segment mainly through rival e-commerce portals and short-term impact of implementation of GST on unsold inventory.

Highly competitive and cyclical retail apparel and textile industry

Textile industry is highly competitive and cyclical in nature having few large players and several unorganized regional players. Though Indian apparel industry provides strong opportunity to grow, it is highly competitive marked by presence of some of the large corporate groups. Further, extent of competition has increased due to deep discounting offered by online rivals like Flipkart, Amazon etc. and entry of large global apparel chain in domestic market through joint venture with domestic companies Moreover, growth of the Indian apparel sector is closely linked to the growth of the economy and hence any downturn in economic environment may also slow down the demand for branded apparel in light of discretionary nature of spending on these products.

Moderate profitability of its brands and retail business

Arvind has been consistently adding new brands to its portfolio over the last 4-5 years, the cost incurred on developing and expanding a newly acquired brand has been pulling down the profits generated by older brands which have already achieved break-even. As a result, while Arvind's brands & retail division sales have been growing at a healthy rate over the last three years, its contribution to profits has remained limited as reflected by PBILDT margins of 5% from brands and retail business during FY17.

Working capital intensive operations

Operations of Arvind are working capital intensive marked by operating cycle of around 90 days during FY16. Operating cycle reduced to 66 days during FY17 mainly on account of reduction in collection period. However, reduction of collection period was mainly one time in FY17 as it was due to IND AS impact on account of reversal of sales made on 'sales or return' basis to its dealers. Arvind continued to require inventory holding of 95-99 days due to its wide product portfolio and increased focus on branded retail segment. Nevertheless, prepayment of term loans during FY17 has resulted in lower repayment obligations in the medium term which has strengthened liquidity of Arvind. Average utilization of the fund based working capital limits was 87% for the trailing twelve months ended May 2017.

Analytical approach: Credit enhancement derived from corporate guarantee to be extended by Arvind

Applicable Criteria

Rating Methodology - Wholesale Trading
Financial ratios – Non-Financial Sector
CARE's Policy on Default Recognition
Rating Methodology: Factoring Linkages in Ratings
Criteria for Short Term Instruments

About the company (AFL)

Incorporated in January 2016 as Arvind J&M Limited, the name of the company was changed to AFL in October 2016. Arvind, through its wholly owned subsidiary, Arvind Lifestyle Brands Limited [ALBL; rated: 'CARE AA (SO); Stable/CARE A1+ (SO)'], engaged in marketing and distribution of various local and global apparel brands in India. ALBL is a licensee for some of the reputed global brands like US Polo, Gant, Nautica, Elle, Cherokee, Ed Hardy, Hanes and Geoffrey Beene, etc. ALBL was also holding the licenses of other apparel brands like 'Arrow', 'IZOD' and 'Flying Machine'; however, under the business restructuring within the Arvind group, ALBL transferred the wholesale business of these three (i.e. 'Arrow', 'IZOD' and 'Flying Machine') brands to AFL since November 01, 2016. Now, AFL procures apparels of these brands from both overseas and domestic markets and sells them in domestic market on wholesale basis while ALBL continues to operate stores of these brands and sells them in the retail segment in India. Apart from holding 100% share in ALBL, AFL also holds 50% stake in Tommy Hilfiger Arvind Fashion Private Limited (rated 'CARE A+'), Calvin Klein Arvind Fashion Private Limited and Arvind Beauty Brands Retail Private Limited.

About Arvind (The Guarantor)

Arvind, the flagship company of the Ahmedabad-based Lalbhai group which was founded by the Late Mr Kasturbhai Lalbhai in 1931, is a diversified conglomerate having presence in textiles, apparel retailing, engineering and real estate

businesses amongst others. Currently, the group is led by next generation of the Lalbhai family under the leadership of Mr Sanjay Lalbhai, Chairman & Managing Director, Arvind and Mr Sunil Lalbhai, MD of Atul Limited (rated 'CARE AA+/CARE A1+').
Arvind is one of the India's leading vertically integrated textile companies with the presence of more than eight decades in the industry. Arvind is among the largest denim and woven fabric manufacturers with an installed capacity of 108 million meters per annum (MMPA) and 132 MMPA respectively as on March 31, 2017. Apart from the denim and woven, Arvind also manufactures a range of cotton shirting, knits and bottom weights (Khakis) fabrics. Recently Arvind also has made foray in to technical textiles on its own and in joint venture with leading global players.
Further, Arvind, through its step-down subsidiary ALBL, is also engaged in brands and retail business. Arvind is a licensee for marketing various global brands in India.
Arvind has 13 manufacturing facilities located at Ahmedabad (5), Bangalore (7) and Kolhapur (1).

Brief Financials of Arvind (Rs. Crore)	FY16 (A)*	FY17 (A)*
Total operating income	8,093	9,314
PBILDT	1,033	1,021
PAT	316	320
Overall Gearing (times)	1.66	0.87
Interest coverage (times)	2.88	3.55

A: Audited, * as per brief published results on Stock Exchange based on IND AS

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Proposed Commercial Paper (carved out of working capital limits)	-	-	7 – 364 days	100.00	Provisional CARE A1+ (SO)
Proposed Commercial Paper (standalone)			7 – 364 days	50.00	Provisional CARE A1+ (SO)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	50.00	CARE AA (SO); Stable / CARE A1+ (SO)	-	1)CARE AA (SO); Stable / CARE A1+ (SO) (20-Mar-17)	-	-
2.	Fund-based - LT-Working Capital Limits	LT	175.00	Provisional CARE AA (SO); Stable	-	1)Provisional CARE AA (SO); Stable (20-Mar-17)	-	-
3.	Non-fund-based - ST-Letter of credit	ST	75.00	Provisional CARE A1+ (SO)	-	1)Provisional CARE A1+ (SO) (20-Mar-17)	-	-
4.	Proposed Commercial Paper (carved out of working capital limits)	ST	100.00	Provisional CARE A1+ (SO)	-	-	-	-
5	Proposed Commercial Paper (standalone)	ST	50.00	Provisional CARE A1+ (SO)	-	-	-	-

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