Arvind Fashions Limited

August 02, 2018

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Proposed Long term/Short term bank facilities	200.00	CARE A+; Stable/ CARE A1+ (Single A Plus; Outlook: Stable)/ (A One Plus)	Assigned
Total	**200.00 (Rupees Two hundred crore only)**		

Details of instruments in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the proposed bank facilities of Arvind Fashions Limited (AFL) derive strength from AFL being part of the Ahmedabad based 'Arvind' group along with track record of the group in apparel brands and retail business over last one decade, strong brand portfolio of various owned and licensed international brands, its pan-India retail presence across multiple sales channel and diversified revenue mix though concentrated in men's wear. The ratings also derive comfort from its strong financial flexibility marked by augmented net worth base along with planned listing of equity shares of AFL post its demerger from Arvind Ltd (rated CARE AA; Stable/ CARE A1+) and steady growth in scale of operations of the brands and retail business. The rating further factors strong performance of its 'power brand' with healthy profitability which is driving the overall financial performance of AFL.

The ratings of AFL are, however, constrained on account of the operating losses in growth brands, specialty retail and 'Unlimited' segment resulting in its moderate profitability. The ratings are further constrained by increased working capital intensity of its operations as reflected in elongation of its debtors level during FY18, moderate debt coverage indicators and its presence in a highly competitive fashion retail industry, susceptibility of its operations to downturn in the economic cycle and requirement of cash outlay for expanding its retail presence. Furthermore, its moderate profitability and increasing working capital intensity has resulted in relatively moderate operating ROCE as compared to many of its established peers. Nevertheless, CARE ratings take cognizance of various management initiatives for further increasing market penetration of power brands, adding retail space of Unlimited at strategic locations while closing down of loss making stores and rationalize working capital levels. As articulated by AFL's management, all its brand categories are expected to report positive PBILDT in the near term aided by turnaround of operations of specialty retail and 'Unlimited' segments and stabilization of operations post exceptional transitory impact of GST. Going forward, fructification of management's various initiatives leading to improvement in its profitability margins (PBILDT), debt coverage indicators and operating ROCE shall be the key rating sensitivities. Ability of AFL to achieve envisaged growth in scale of operations within envisaged capital outlay and ensure sustained profitable operations of its various brand categories shall be a key rating monitorable.

Detailed description of the key rating drivers

Key Rating Strengths

Part of Ahmedabad based Arvind Group

AFL is a part of the Ahmedabad based Arvind group which was founded by Late Mr. Kasturbhai Lalbhai in 1931. The group is a diversified conglomerate having presence in textile, apparel retailing, engineering, assembling and installation of water treatment plants and real estate business. Arvind Ltd, 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. Currently, AFL is a 90% subsidiary of Arvind Ltd and there is active involvement of Mr. Sanjay Lalbhai – Chairman and Managing Director (CMD) of Arvind Ltd and Mr. Kulin Lalbhai (Executive Director of Arvind Ltd) in its operations. Balance 10% stake in AFL is held by Multiples Private Equity Fund. Mr. Suresh Jayraman (Managing Director and Chief Executive Officer (CEO)) and Mr. Jayesh Shah (Executive Director and Group Chief Financial Officer) are also involved in the strategic decision making of the company. Further, AFL's board comprises of eminent industry experts such as Ms.Renuka Ramnath and Ms.Nithya Easwaran. The management team of AFL is ably supported by experienced professionals having vast experience in the retail industry.

Strong brand portfolio of own and international brands

AFL has a strong portfolio of own and licensed international apparel brands. The licenses are for an average period of ten years. The brand portfolio of AFL is broadly categorized as below:

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

Category	Brands/Description
Power Brands	Arrow, Flying Machine, Tommy Hilfiger, U.S. Polo
Growth Brands	Aeropostale, Calvin Klein, Ed-Hardy, Elle, Gant, Hanes, Nautica, The Children's Place
Speciality Retail	GAP, Sephora
Unlimited	Value retailing (largely sells Arvind's own brands apart from 'Flying Machine' and various other international brands like Cherokee, Geoffrey Beene, Mossimo, etc

AFL's brand portfolio is positioned across various price points and fashion styles although dominated towards casual wear. It also covers various segments like men's wear, women's wear, kids wear, inner wear, beauty and accessories; albeit it is skewed towards men's wear (~70% of its overall sales in FY18). Going forward, AFL's management plans to increase its sales in beauty brand, inner wear and kids wear segment in the medium term so as to improve its demographic presence.

Strong retail footprint across India and presence across multiple sales channels
AFL has a strong distribution network with 1,297 exclusive brand outlets (EBOs) and 1,660 multi brand outlets (MBOs) having total retail space of 21.49 lakh square feet (LSF) as on March 31, 2018. AFL's apparel brands are sold through multiple sales channels such as its retail store network, through wholesale to MBOs and large departmental stores and through various online retailers. Sales through retail channel constituted ~54% of AFL' total sales during FY18.

Strong performance of 'power' brands partly offset by operating losses of 'growth brands', 'speciality retail' and 'Unlimited'
AFL's power brands are mature brands in its portfolio and continue to be the major driver of its revenue and profitability. During FY18, power brands registered y-o-y sales growth of 14% and contributed 60% of total operating income (TOI). Higher growth momentum of power brands has led to healthy PBILDT margin thus driving the overall profitability of AFL. During FY18, net sales from power brand stood at Rs.2,278 crore (FY17: Rs.1,991 crore) with PBILDT margin of Rs.12.50% (FY17: 11.20%).
Growth brands are the emerging brand in AFL's portfolio; albeit it incurred losses on account of higher raw material prices due to change in the import duty structure during FY18. Speciality retail also continued to incur losses; albeit with curtailment of the losses at PBILDT level during FY18, on account of increase in sale of 'Sephora'. Further, recent re-branding exercise of value retailing store from erstwhile 'Megamart' to 'Unlimited' and closure of certain loss making stores has resulted in 'Unlimited' registering a healthy y-o-y growth of 16% during FY18 coupled with curtailment of its losses. These three segments together contributed ~40% of TOI of AFL during FY18 with net sales of Rs.1,508 crore (FY17: Rs.1,321 crore) and PBILDT margin of -1.60% (FY17: -4.00%). Going forward, sustained turnaround of Growth brands, Speciality retail and Unlimited within stipulated time frame will be crucial for improving overall profitability.

Steady growth in the scale of operations; albeit with moderate profitability
Total operating income (TOI) of brands and retail business has increased steadily registering healthy CAGR of 22% over the past five years ended March 31, 2018 on account of sustained growth momentum in power brands and addition of new brands in growth brands and specialty retail.
In line with the increase in scale of operations, the PBILDT margin of AFL improved to 6.54% during FY18. Despite increase the PBILDT margin remained moderate on account of the relative under-performance of its other segments except power brands. Further, PBILDT margins were also impacted during FY18 on account of the one-time impact of Rs.21.00 crore due to GST implementation. Adjusting for the one-time impact of GST, the PBILDT margin of the company stood at 7.10% during FY18. Going forward, the ability of AFL to ensure sustained improvement in its profitability through envisaged turnaround of its other brand segments while continuing the good performance of its power brand shall remain the key rating sensitivity.

Strong financial flexibility marked by healthy net worth and large brand portfolio
During FY17, AFL raised Rs.740 crore of equity through dilution of 10% of its equity stake at an enterprise value of Rs.8,000 crore to Multiples - Private Equity firm. Further, during the year ended March 31, 2018 promoters have infused additional equity which has resulted in a net worth base of Rs.984.17 crore as on March 31, 2018. The overall gearing continued to remain moderate at 1.01 times as on March 31, 2018. Financial flexibility of the company is envisaged to strengthen further post listing of equity shares of AFL. AFL also has flexibility to raise funds through monetization of its right in own brands/licensed brands in light of strong portfolio of brands.

Key Rating Weaknesses
Moderate debt coverage indicators and relatively low operating ROCE
Debt coverage indicators of the company remained moderate with interest coverage of 2.59 times and total debt to cash accruals of 8.00 times for the year ended March 31, 2018 on account of moderate profitability and increase in working

capital intensity. Increased working capital intensity due to inventory holding requirement and elongation in debtors had led to moderate operating efficiency marked by relatively low operating ROCE of 5.68% during FY18.

Working capital intensive nature of operations

Operations of AFL are working capital intensive due to requirement of large inventory holding in its retail business. Moreover, working capital borrowing of AFL increased during FY18 on account of elongation in its receivables. Credit cycle was also affected due to GST implementation, increase in online sales during Q4FY18 and lagging effect of demonetization. Incremental working capital requirement was funded through increase in bank borrowing, equity infusion and increase in creditors. AFL's ability to improve collection efficiency within stipulated time frame will be a key rating sensitivity.

Requirement of cash outlay for expanding its retail presence

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, management has adopted a cautious approach towards opening/closing of stores which has been reflected from moderate level of capex incurred during past five years. Going forward, generation of envisaged benefits for completed capex along with lower gestation period of newly opened stores will also be crucial for the overall performance of the company.

Highly competitive branded apparel retail industry partly offset by good growth prospects of branded apparel business

Increasing urbanization and disposable income augur well for the branded apparel segment's growth prospects in India. In any market globally there co-exists top three fast fashion brands. The rationale of customers choosing these brands includes: Uniqlo for better quality, Zara for better designs and H&M for better prices. This is expected to benefit players like AFL which has license of more than 15 global brands particularly Gap, Gant, Nautica, US Polo, Tommy Hilfiger, etc. However, apparel retail sector in India is highly competitive with presence of many domestic and international brands as well as with foray of large corporates like TATA group, Reliance group and Aditya Birla group into apparel retail segment. Further, AFL also faces tough competition from the established and seasoned players like Shoppers Stop Limited (rated CARE AA-; Stable/CARE A1+), Lifestyle International Private Limited, Aditya Birla Fashion and Retail Limited, Future Lifestyle Fashions Limited (rated CARE AA-; Stable/ CARE A1+), etc. Moreover, large expansion by retailers lead to pressure on their PBILDT margin as earnings from existing stores do not adequately offset gestation losses from high proportion of new stores added. Furthermore, business remains susceptible to economic slowdown owing to discretionary nature of its products.

Analytical approach

CARE has outstanding ratings of CARE AA (SO); Stable/CARE A1+ (SO) for the outstanding bank facilities/debt instruments of AFL based on the corporate guarantee extended by Arvind Ltd. However, the proposed new facilities rated, does not have any credit enhancement. Hence, CARE Ratings has analyzed the brands and retail business on a standalone basis (i.e. by considering consolidated view of AFL).

Applicable Criteria

Criteria on assigning Outlook to Credit Rating
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology- Organized Retail Companies
Factoring Linkages in Ratings
Financial Ratios-Non Financial Sectors

About the company

AFL was incorporated in January 2016 as Arvind J&M Limited and its name was changed to AFL in October 2016. It is a part of Ahmedabad based Lalbhai group and is currently a 90% subsidiary of Arvind Ltd with the balance stake being held by Multiples Private Equity Fund.

Post business structuring undertaken within Arvind group, all the investments in brands and retail businesses which were previously held by Arvind Brands and Retails Limited (wholly owned subsidiary of Arvind Ltd) have been consolidated under AFL during FY17. Further, during November 2017, Arvind Ltd announced a scheme of de-merger of its branded business undertaking, where by it has proposed to de-merge AFL into a separately listed company on the stock exchange. Shareholders of Arvind Ltd shall become shareholders of AFL post demerger.

Brief on business activities of AFL and its subsidiaries/joint venture is tabulated below:

Company Name	Business activities
Arvind Fashions Limited (AFL)	Wholesale of licensed brands - (i.e. Arrow and Izod), and own brand (i.e. Flying Machine)
Arvind Lifestyle Brands Limited (ALBL)- 100% subsidiary of AFL	Wholesale and retailing of various international licensed brands Retailing of Arrow, Izod and Flying Machine Value retail format stores - 'Unlimited'
Arvind Beauty Brands Retail Private Limited (ABBRPL)-100% subsidiary of AFL	Retailing of beauty products under 'Sephora'
Tommy Hilfiger Arvind Fashion Private Limited* (THAFPL; rated CARE A+; Stable) - 50% JV between AFL and PVH Corp, USA	Wholesale and retailing of 'Tommy Hilfiger' branded apparels, accessories
Calvin Klein Arvind Fashion Private Limited (CKAFPL)* - 50% JV between AFL and PVH Corp, USA	Wholesale and retailing of 'Calvin Klein' branded apparels, accessories

**With the amendment in the terms of the JV agreement, both these companies are now consolidated under AFL starting FY18.*

Brief Financials (Rs. Crore)	FY18 (12m, A)
Total operating income (TOI)	3,804
PBILDT	249
PAT	13
Overall Gearing-including acceptances (times)	1.01
Interest coverage (times)	2.59

A: Audited;

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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In case of partnership/proprietary concerns, the rating /outlook assigned by CARE is based on the capital deployed by the partners/proprietor and the financial strength of the firm at present. The rating/outlook may undergo change in case of withdrawal of capital or the unsecured loans brought in by the partners/proprietor in addition to the financial performance and other relevant factors.

Annexure-I: Details of Facilities/Instruments

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Proposed Fund-based-LT/ST	-	-	-	200.00	CARE A+; Stable / CARE A1+

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
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) (16-Nov-17) 2)CARE AA (SO); Stable / CARE A1+ (SO) (04-Oct-17)	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 (16-Nov-17) 2)Provisional CARE AA (SO); Stable (04-Oct-17)	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) (16-Nov-17) 2)Provisional CARE A1+ (SO) (04-Oct-17)	1)Provisional CARE A1+ (SO) (20-Mar-17)	-
4.	Commercial Paper	ST	150.00	Provisional CARE A1+ (SO)	-	1)Provisional CARE A1+ (SO) (16-Nov-17) 2)Provisional CARE A1+ (SO) (04-Oct-17) 3)Provisional CARE A1+ (SO) (01-Aug-17)	-	-
5.	Proposed Fund-based-LT/ST	LT/ST	200.00	CARE A+; Stable / CARE A1+	-	-	-	-

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CIN - L67190MH1993PLC071691