Arvind Fashions Limited

September 20, 2019

Ratings

Facilities*	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long term/ Short term Bank Facilities (Proposed)	200.00	**CARE A; Negative/ CARE A1 (Single A; Outlook: Negative/ A One)**	Revised from CARE A+; Stable/ CARE A1+ (Single A Plus; Outlook: Stable/ A One Plus)
Total	**200.00 (Rupees Two Hundred Crore Only)**		

**Details of facilities in Annexure-1*

Detailed Rationale & Key Rating Drivers

The revision in the ratings assigned to the proposed bank facilities of Arvind Fashions Limited (AFL) take into account its weakened financial risk profile during Q1FY20 (UA; refers to the period April 1 to June 30) arising from de-growth in its total operating income (TOI) and significant fall in its operating profitability resulting into net loss of Rs.95 crore. Due to ongoing consumption slowdown and weak consumer sentiment along with the need to reduce exposure to long credit period customers, the company decided to curtail its primary sales resulting into decline in TOI and profitability. Moreover, the company had also implemented its plan to exit few of its non-profitable apparel brands in the growth/emerging brand portfolio during Q1FY20 resulting in a high one-time loss on discontinued brands which coupled with continued under-performance of its 'Unlimited' value-retail segment has adversely impacted AFL's overall profitability. These developments have been contrary to management's earlier articulation around a year ago of making all its brand categories earn positive PBILDT and turning around the operations of its 'Unlimited' segment.

The ratings continue to derive strength from AFL being part of the Ahmedabad based 'Arvind' group which has a track record of over a decade in the apparel brands and retail business, AFL's strong brand portfolio of various 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 factor expected improvement in AFL's cash flow position post discontinuation of some of the loss incurring growth/emerging brands and steps taken by the management to curtail the hitherto high receivables in its wholesale/online channels; a part of which is already achieved during Q1FY20. The ratings further derive comfort from AFL's strong net worth base arising from significant equity infusion in the past few years and takes cognizance of the promoters' commitment to support the operations of AFL.

The ratings are, however, constrained on account of the continued losses in its growth/emerging brands and 'Unlimited' segments, increased working capital intensity as reflected by elongation of debtors during FY19 which was largely funded through bank borrowings, AFL's presence in a highly competitive fashion retail industry and susceptibility of its operations to downturn in the economic cycle. Furthermore, weakened profitability and increased debt levels have resulted in moderation in its debt coverage indicators and low ROCE as compared to many of its established peers. Nevertheless, CARE takes cognizance of its strong brand portfolio and various management initiatives for improving its profitability through steps such as cost management, adding retail space for growing brands like GAP and Sephora at strategic locations while closing down of loss making stores and liquidating the aged inventories.

Going forward, fructification of management's various initiatives including turnaround of operations of 'Unlimited' leading to sustained improvement in its profitability and curtailment of its working capital cycle thereby resulting in positive cash flow from operations, improvement in its debt coverage indicators and ROCE shall be the key rating sensitivities. The ability of AFL to achieve envisaged growth in scale of operations within envisaged capital outlay shall also remain critical.

Outlook: Negative

The 'negative' outlook reflects CARE's expectation that AFL's growth and profitability are likely to remain subdued due to continued sluggish consumer demand scenario in a competitive environment which may result in weaker than previously envisaged debt coverage indicators. The outlook may be revised to 'stable' in case of meaningful and sustained improvement in its profitability and/or significant support from promoters thereby leading to better liquidity cushion.

Detailed description of the key rating drivers

Key Rating Strengths

Part of Ahmedabad based Arvind Group with experienced and qualified management

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, the flagship company of the group, is one of India's leading

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

vertically integrated textile companies having presence of more than eight decades in the industry. Post its demerger from Arvind Limited (*Arvind; rated CARE AA-; Stable/ CARE A1+*); AFL got separately listed on the stock exchanges on March 08, 2019. The Lalbhai family of Arvind is the largest shareholder in AFL. The funds managed by Ms. Renuka Ramnath; ex-MD & CEO of ICICI Ventures Ltd., also holds close to 10% equity stake in the company.
Mr. Sanjay Lalbhai is the Chairman of AFL while his sons, Mr. Pulin Lalbhai and Mr. Kulin Lalbhai, are non-Executive Directors on the Board of AFL. Mr. Jayesh Shah (Director and CFO of Arvind) is also a non-Executive Director on the Board of AFL. The management team of AFL includes Mr. Suresh Jayraman (Managing Director and Chief Executive Officer (CEO)) and Mr. Pramod Gupta (Chief Financial Officer). Mr. Pramod Gupta is a seasoned business leader with 30 years of Finance & Supply Chain experience across diverse industries. Further, the board of AFL comprises of eminent industry experts such as Mr. Nilesh Shah, Mr. Vallabh Bhanshali and Ms. Nithya Easwaran.

Strong brand portfolio of own and licensed international apparel brands
AFL has a strong portfolio of own and licensed international apparel brands. The licenses are long term/perpetual in nature. The brand portfolio of AFL is broadly categorized as below:

Brand Category	Apparel Brands/Description
Power Brands	Arrow, Flying Machine, Tommy Hilfiger, U.S. Polo
Growth/Emerging Brands*	Aeropostale, Calvin Klein, Ed-Hardy, Hanes, The Children's Place (TCP)
Specialty Retail	GAP, Sephora
Unlimited	Value retailing (largely sells Arvind's own brands apart from 'Flying Machine' and other international brands like Cherokee)

** Previously it also included brands like Elle, Izod, Gant and Nautica; however, these have been discontinued during FY20*

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 (~69% of its overall sales in FY19). During Q1FY20, the company decided to discontinue some of its loss making growth brands i.e. Gant, Nautica, Elle and Izod. Going forward, the management of AFL 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. This is envisaged to sharpen its brand portfolio with focus on improving profitability.

Wide distribution network with presence across multiple sales channels
AFL has a strong distribution network with 1,354 exclusive brand outlets (EBOs) and 3,460 Shop-in Shops (SIS) having total retail space of 22.60 lakh square feet (LSF) as on June 30, 2019. Revenue per square feet per day has remained steady during FY17-FY19 in the range of Rs.53-55/ per sq. ft. per day. 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, Jabong and Amazon. Sales through online channel registered y-o-y growth of 47% during FY19 thus increasing the reach of the brand portfolio of AFL and increasing its contribution to its total sales. Sales mix through wholesale and retail was relatively evenly distributed during FY19.

Performance of 'power' brands offsets the operating losses of 'growth brands', 'specialty retail' and 'Unlimited'
Power brands are the mature brands in the portfolio of AFL and continue to be the major revenue driver for the company. Further, higher growth momentum of some of the power brands especially U.S. Polo and Tommy Hilfiger has led to healthy PBILDT margin from these brands thus driving the overall profitability of AFL. However, during FY19, power brands registered marginal y-o-y sales growth of 9% and contributed 60% of TOI. Like-to-like store sales growth of power brand was -2.60% during FY19 on account of low consumption demand and growth of online channel.
Growth brands are the emerging brands in the portfolio of AFL with growth rate of 5-10%; albeit incurring losses at PBILDT level.
Specialty retail too continued to incur losses; albeit with curtailment of losses at PBILDT level during FY19, on account of the growth in sale of 'GAP' and 'Sephora' which was however offset by the higher than envisaged losses from 'Unlimited'. These three segments together contributed ~40% of TOI of AFL during FY19 with net sales of Rs.1,847 crore (FY18: Rs.1,646 crore).
Going forward, sustained turnaround of Growth brands, Specialty retail and Unlimited within stipulated time frame will be crucial for improving overall profitability of AFL.

Growing scale; albeit moderate profitability
TOI of AFL has increased steadily registering healthy CAGR of 22% over the past five years ended FY19 on account of sustained growth momentum in power brands and addition of new brands in growth brand portfolio and specialty retail. During FY19, TOI of AFL grew by 10% to Rs.4,646 crore, largely driven by the increase in sales through online channel of brands like U.S. Polo, Tommy Hilfiger, Gap and Sephora. In line with the growth in scale of operations, the PBILDT margin of the company marginally improved by 42 bps to 6.37% during FY19 from 5.95% during FY18. However, the PBILDT

margin continued to remain moderate on account of the relative under-performance of its other segments except power brands and the same was lower than previously envisaged.

Healthy net worth base, expected improvement in cash flow post discontinuation of few loss-incurring brands and promoters' commitment to support the operations of the company

Financial flexibility of AFL has improved post listing of its equity shares on March 08, 2019. The tangible net worth base of AFL stood at Rs.1,157 crore as on March 31, 2019 as against Rs.984 crore as on March 31, 2018 backed by accretion of share/security premium followed by issue of additional shares at premium. The overall gearing continued to remain moderate at 0.81 times as on March 31, 2019. Moreover, AFL also has flexibility for fund raising through monetization of its right in own brands/licensed brands in light of strong portfolio of brands.

However, net loss incurred by the company during Q1FY20 and one time impact of adoption of IND-AS 116 for accounting of operating lease has resulted in some reduction in its net worth as on June 30, 2019. As per the requirement of IND-AS 116, the company has recognized large size lease repayment obligation to the extent of Rs.1,087 crore along with recognition of corresponding assets of Rs.853 crore with effect from April 1, 2019. The difference between right to use asset and the lease liability of Rs.234 crore is adjusted against the reserves thereby eroding its net worth to that extent. However, despite expectation of weak profitability during FY20, management expects the cash flow from operations to remain healthy due to its plans to reduce its costs and capex, liquidate inventories and realize elongated debtors. The expected positive cash flow from operations is likely to take care of AFL's debt repayment obligations. Further, the promoters have articulated their strong commitment to support the operations of AFL – the market value of unpledged shares held by Mr. Sanjay Lalbhai and his family members stood at Rs.1,617 crore (includes AFL, Arivnd Limited, and The Anup Engineering Limited) as on September 10, 2019.

Key Rating Weaknesses

Significant deterioration in the financial performance during Q1FY20

TOI of AFL declined by 11% (5% at Rs.912 crore from Rs.958 crore considering only continuing brands) and stood at Rs.902 crore during Q1FY20 as compared to Rs.1,007 crore during Q1FY19 with net loss of Rs.95 crore on account of poor operating performance amidst broader consumption slow-down in the economy with weak consumer sentiment leading to lower sales. Lower sales were largely pertaining to de-growth in its power brands through wholesale trade channel. Apart from the above reasons, reversal effect of sales of Rs.11 crore from the discontinued brands also led to de-growth in its TOI during Q1FY20.

Profitability during Q1FY20 was impacted largely on account of one-time loss of Rs.68 crore provided for the discontinued 'growth' brands (which includes inventory write-downs, loss arising from store closure and royalty settlements with principals). Moreover, PBILDT of its hitherto highly profitable 'power' brands also registered significant reduction on account of conscious plan of the management to reduce exposure to long credit period customers in its wholesale channel wherein the company sells through its multi-brand outlets. Also, its 'Unlimited' segment continued to incur high losses impacting the overall profitability of the company.

Modest debt coverage indicators and relatively low operating ROCE

Debt coverage indicators of the company remained modest with interest coverage of 2.25 times, debt to PBILDT of 2.91 times and total debt to cash accruals of 6 times during FY19 on account of moderate profitability and increase in working capital intensity. Increased working capital intensity due to inventory holding requirement and elongation in debtors in its wholesale/online channels had led to moderate operating efficiency marked by relatively low operating ROCE of 7.89% during FY19. These parameters further deteriorated during Q1FY20 due to losses incurred by the company.

Continuous 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. Also, most of the store expansion going forward is planned to be done through franchisee stores, further reducing capex requirements. Going forward, realization of envisaged benefits from 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 which puts pressure on profitability margins, albeit strong brand portfolio of AFL alleviates competition to a certain extent

Apparel retail sector in India is highly competitive with presence of many domestic and international brands as well as foray of large corporates like TATA group, Reliance group and Aditya Birla group into apparel retail segment. AFL faces tough competition from the established and seasoned retail players like Shoppers Stop Limited, Lifestyle International Private Limited, Aditya Birla Fashion and Retail Limited, Future Lifestyle Fashions Limited, etc. However, 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. A strong brand portfolio, coupled with growing online sales could help AFL in dealing with the increasing competition.

Medium-term consumption slow-down in the economy being partly offset by good long-term growth prospects of branded apparel business

Increasing urbanization and disposable income augur well for the branded apparel segment's long-term growth prospects in India. In any market globally, there co-exist 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, US Polo, Tommy Hilfiger, etc. However, according to the data released by Central Statistical Organization (CSO), growth rate in Q1FY20 dropped to a six-year low of 5% and private consumption expenditure decelerated to an 18-quarter low of 3.1% in the June quarter. These are likely to result in medium-term headwinds for retailers. Furthermore, business remains vulnerable to fashion trends, consumer spending habits, and economic slowdown owing to discretionary nature of demand.

Liquidity Analysis

Operations of AFL are highly working capital intensive due to requirement of large inventory holdings in its retail business and significant build-up of receivables in its wholesale/online channels. The working capital borrowing of AFL increased during FY19 mainly on account of increase in its receivables from Rs.785 crore as on March 31, 2018 to Rs.879 crore as on March 31, 2019. Credit cycle increased due to increase in online sales and increased receivables from the wholesale players on account of lower off-take from the retail market as a result of consumption slow-down and liquidity crunch in the wholesale channel due to GST and demonetization. The liquidity of the company remains moderate marked by low cash accruals and high average utilization of fund based working capital limits around 85-90% for the past 12 months ended July 2019. Moreover, AFL had unencumbered cash and bank balance of Rs.7.73 crore as on March 31, 2019 which provides some cushion to its liquidity which is expected to derive further support from promoters' strong commitment to support AFL's operations.

Analytical Approach: CARE 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 to Credit Rating
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
CARE's Methodology for Organized Retail Companies
Financial ratios – Non-Financial Sector
CARE's Methodology for Factoring Linkages in Ratings

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 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 Arvind group, AFL got demerged and was separately listed company on the stock exchange on March 08, 2019. Shareholders of Arvind became shareholders of AFL post demerger.

AFL, through its two wholly owned subsidiaries and two joint ventures (JV), is engaged in the wholesaling and retailing of several owned and licensed branded apparels in India.

Brief details of business conducted by AFL and its subsidiaries/JVs:

Company Name	Business activities
AFL	Wholesale of licensed brands - (i.e. Arrow), and own brand (i.e. Flying Machine)
Arvind Lifestyle Brands Limited - 100% subsidiary of AFL	Wholesale and retailing of various international licensed brands. Retailing of Arrow and Flying Machine and 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 & PVH Corp, USA	Wholesale and retailing of 'Calvin Klein' branded apparels, accessories

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

(Rs. Crore)

Brief Financials of AFL (Consolidated)	FY18 (A) @	FY19 (A)
Total Operating Income	4,229	4,646
PBILDT	252	296
PAT	13	21
Overall Gearing (times)	0.78	0.81
TOL/TNW (times)	2.04	2.17
Interest Coverage (times)	2.62	2.25

A: Audited; @ Restated wherever necessary

Latest Quarterly Results (AFL):

Particulars		Q1FY19	Q1FY20	Q1FY20
		Excluding IND AS 116 impact		Including IND AS 116 impact
Continuing Brands	Revenue	958	912	-
	PBILDT	47	7	
Brands to be Discontinued	Revenue	49	-11	
	PBILDT	-7	-68	
Total	**Revenue**	**1007**	**901**	**901**
	PBILDT	**40**	**-61 @**	**21**

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

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
Fund-based-LT/ST	-	-	-	200.00	CARE A; Negative / 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 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based-LT/ST	LT/ST	200.00	CARE A; Negative / CARE A1	-	1)CARE A+; Stable / CARE A1+ (02-Aug-18)	-	-
2.	LT/ST Fund-based/Non-fund-based-EPC / PCFC / FBP / FBD / WCDL / OD / BG / SBLC	LT/ST	-	Withdrawn	CARE AA- (CE); Stable / CARE A1+ (CE) (20-Sep-19)	1)CARE AA (SO); Stable / CARE A1+ (SO) (03-Dec-18)	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)
3.	Fund-based - LT-Working Capital Limits	LT	-	Withdrawn	-	1)Provisional CARE AA (SO); Stable (03-Dec-18)	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)
4.	Non-fund-based - ST-Letter of credit	ST	-	Withdrawn	-	1)Provisional CARE A1+ (SO)	1)Provisional CARE A1+ (SO)	1)Provisional CARE A1+ (SO)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
						(03-Dec-18)	(16-Nov-17) 2)Provisional CARE A1+ (SO) (04-Oct-17)	(20-Mar-17)
5.	Commercial Paper	ST	-	-	1)Withdrawn (21-Aug-19)	1)Provisional CARE A1+ (SO) (03-Dec-18)	1)Provisional CARE A1+ (SO) (16-Nov-17) 2)Provisional CARE A1+ (SO) (04-Oct-17) 3)Provisional CARE A1+ (SO) (01-Aug-17)	-

Annexure-3: List of Subsidiaries/JVs of AFL

Name of the Company	% holding of AFL as on March 31, 2019	Consolidation
Arvind Lifestyle Brands Limited	100%	Fully Consolidated
Arvind Beauty Brands Retail Private Limited	100%	Fully Consolidated
Tommy Hilfiger Arvind Fashion Private Limited	50%	Fully Consolidated
Calvin Klein Arvind Fashion Private Limited	50%	Fully Consolidated

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.*

Contact Us

Media Contact
Mr. Mradul Mishra
Contact No.: +91-22-6837 4424
Email ID – mradul.mishra@careratings.com

Analyst Contact
Mr. Krunal Modi
Contact No.: 079-40265614/+91-8511190084
Email ID – krunal.modi@careratings.com

Relationship Contact
Mr. Deepak Prajapati
Contact No.: +91-79-4026 5656
Email ID – deepak.prajapati@careratings.com

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