Future Retail Limited

March 26, 2020

Ratings

Bank Facilities	Amount (Rs. crore)	Rating	Rating Action
Long-term - Term Loan	528.00 (reduced from 540.00)	**CARE A+ (Single A Plus) (Credit watch with negative implications)**	**Revised from AA-; Negative (Double A Minus; Outlook: Negative) Placed on credit watch with negative implications**
Long-term fund based bank facilities – CC	3250.00		
Short-term non-fund based bank facilities – LC/BG	2500.00	**CARE A1 (A One) (Credit watch with negative implications)**	**Revised from A1+ (A One Plus) Placed on credit watch with negative implications**
Total	**6,278 (Rs. Six thousand two hundred seventy eight crore only)**		
Non-Convertible Debenture Issue	199.00	**CARE A+ (Single A Plus) (Credit watch with negative implications)**	**Revised from AA-; Negative (Double A Minus; Outlook: Negative) Placed on credit watch with negative implications**
Proposed Non-Convertible Debenture Issue	100.00		
Commercial Paper Issue	750.00	**CARE A1 (A One) (Credit watch with negative implications)**	**Revised from A1+ (A One Plus) Placed on credit watch with negative implications**
Commercial Paper Issue*	650.00		
Fixed Deposit Programme	700.00	**CARE A+ (FD) (Single A Plus) (Credit watch with negative implications)**	**Revised from AA- (FD); Negative (Double A Minus; Outlook: Negative) Placed on credit watch with negative implications**

**carved out of working capital limits*
Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision of ratings assigned to the long-term bank facilities and instruments of Future Retail Limited (FRL) takes into account significant decline in market capitalisation which along with high promoter pledge is expected to significantly impact financial flexibility. The ratings, however, continues to factor significant experience of promoters in retail industry. The ratings also derive strength from FRL's proven track record with a leading position in the organized retail business in India, pan-India presence across multiple formats and stable operational performance.

The rating strengths are tempered due to increase in debt levels, high working capital cycle and the intense competition in retail industry.

The ratings have been placed on watch negative on account of disruption in operations due to Covid-19 which could impact the business risk profile resulting in lower operating cash flow. Disruption could also lead to increase working capital requirement which may impact the liquidity position; though the company is in discussion with the banks for enhancement in working capital lines. CARE will continue to monitor the situation and will resolve the watch once the exact implication of the situation on credit profile of FRL is clear.

Key Rating Sensitivities

Positive Factors

- Improvement in capital structure through divestment/equity infusion and reduction in debt resulting in overall gearing below 0.50x
- Stronger-than-anticipated business performance due to faster ramp-up of stores and/or due to savings in lease outflow while improving profitability between 8-10% and debt to EBITDA of 1.50x on a sustained basis
- Significant reduction in promoter pledge
- Reduction in inventory holding

Negative Factors

- Deterioration in ROCE falling below 15%.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced Promoters & Management

The promoters of FRL have been closely involved in the management of business and in defining & monitoring the business strategy for the company. Mr. Kishore Biyani, the founder and Group CEO of the Future group, is widely recognised as a pioneer of modern retail in India. Furthermore the promoters are supported by a strong management team having significant experience in retail industry.

Established pan-India presence of various operationally profitable formats

Future group has presence in retail (value, home and electronics retail), insurance (life and non-life through JV with the Generali Group) and retail support services (through various subsidiaries).

FRL is one of the leading retailers in India and occupies total retail space of 16.05msf as on Dec 31, 2019. Aggregately, the Future group has pan India presence in value retailing (Big Bazaar, Food Bazaar, KB's Fairprice, Easyday, Nilgiris), lifestyle (Central, Brand Factory, Planet Sports) & home retailing (HomeTown, eZone) and across various price points. The large scale of operations of Future group provides greater bargaining power with various suppliers & real estate developers.

Stable Operational Performance

The footfalls increased to 350 million in FY19 as compared to 340 million in FY18. Also, the conversion ratio increased to 66% in FY19 from 53% in FY18.

During FY19, FRL registered PBILDT and PAT of Rs. 1142 crore and Rs. 733 crore respectively on total operating income of Rs. 20183 crore as against PBILDT and PAT of Rs. 919 crore and Rs. 11 crore respectively on total operating income of Rs. 18492 crore. PBILDT margin improved to 5.66% as against 4.97% in FY18. The improvement in operating profits was on account of better same store sales growth, turnaround of convenience store (Easy Day), demerger of low margin hometown segment and rationalisation of E-Zone stores.

Divestment of stake in Future Coupons Limited (FCL)

A promoter company, FCL, has entered into a share subscription agreement and shareholders' agreement with Amazon.com NV Investment Holdings LLC. Pursuant to these agreements, Amazon has made an equity investment in FCL for acquiring a 49% stake (Rs. ~1,500 crore) comprising both voting and non-voting shares. The funds raised through divestment has been infused in FRL and the same has been used for working capital requirements.

Acquisition of assets from FEL to be margin accretive; albeit leading to higher debt

Subsequent, to the equity infusion from Amazon, FRL raised USD 500mn (Rs. 3,560 crore) through debt which has been utilised towards acquisition of retail infrastructure assets up to Rs. 4,000 crore of FEL in one or more tranches and deleverage FEL's balance sheet.

During FY19, the total lease outflow to FEL was Rs. 694.23 crore as against Rs. 759.40 crore in FY18. Post the completion of the transaction, FRL is expected to save Rs. 550-650 crore on lease rentals annually which will result in reduction of operating costs.

Raising fresh debt to fund the transaction has led to deterioration of capital structure. However, the ability of the company to achieve the envisaged margin accretion while maintaining the growth and profitability as envisaged remains the key rating monitorable.

Robust supply chain infrastructure in place

The company's inventory management module operates on state of art ERP system that is SAP R3. The sophisticated inventory management tools in the SAP allows the company to monitor, manage and control the inventory levels. This helps the company to manage the flow of inventory efficiently. The sales trends are also regularly monitored to optimise inventory levels.

The company's warehousing and logistic requirements are managed by Future Supply Chain Solutions Limited, which is a part of the Future Group. FRL has mother warehouses at various locations in each zone which feeds the regional warehouse which in turn provides services to the stores across all the locations.

Increase in reliance on group companies for purchase of goods & services; support to group company in terms of corporate guarantee

FRL's reliance on its group companies has shown an increasing trend from sourcing 8% of its total requirements in FY17 to 32% in FY19.

FRL is reliant on Future Enterprises Limited as it rents its retail assets from the latter (FY19: Lease rental Rs. 694 crore) and for purchasing goods (FY19: Rs. 3,142 crore). The company's warehousing and logistic requirements are managed by Future Supply Chain Solutions Limited (FY19: Rs. 557.88 crore).

Furthermore, FEL and FRL have also provided cross guarantees on behalf of each other for various borrowings to the tune of Rs. 5750 crore and Rs. 3583 crore respectively as on March 31, 2019.

Going ahead, with the proposed acquisition of retail assets from FEL, FRL's reliance on FEL is expected to come down and cross corporate guarantees between both the companies will also eventually be withdrawn.

Deterioration of debt coverage ratios

The overall gearing deteriorated to 1.30x as on March 31, 2019 from 1.19x as on March 31, 2018 on account of significant increase in working capital borrowings. Total debt to PBILDT and Interest coverage ratio remained broadly stable to 3.73x and 3.77x as against 3.32x and 3.68x respectively. Further, on account of launch of various private brands (in fashion and food category) and store addition of Easyday and Heritage, the company has invested in the base working capital requirement leading to high working capital levels.

Capital structure further deteriorated on account of higher debt raised to acquire lease assets from FEL, opening of new stores and increase in working capital requirements. Debt as on Feb 29, 2020 stood at Rs. 7,241 crore (excl. acceptances on LC) as against Rs. 2,657 crore as on Mar 31, 2019.

Average working capital utilisation including CP remained high at 83.64% for the past 12 months ending Dec 2019.

FRL does not have any significant repayments to be made over the next few years. Total scheduled repayments over the next 2 years aggregate to Rs. 298.30 crore as against aggregate GCA of Rs. 1,838 crore for both years.

Deterioration in financial flexibility; considerable promoters' stake pledged

The promoters of FRL as of Sep 2018 had pledged 10.76 crore shares (46.03% of promoter stake) towards debt raised at promoter level. During the past year, the company's market capitalisation has declined significantly from Rs. 25,380 crore to Rs. 5,933 crore as on March 20, 2020. Falling market capitalisation coupled with rising debt has led to significant deterioration of debt to market-capitalisation from 0.11x as on March 31, 2018 to 0.19x as on March 31, 2019 to current level of ~1.47x.

However, in lieu of significant fall in share price, the promoters had to pledge additional shares taking the total to 52.28% of promoters' stake (as on Jan 6, 2020). As per the management, post the current steep fall in share prices, promoters' pledged stake as increased to ~90%.

Considerable reduction in market capitalisation and significant proportion of promoter's stake pledged hampers the company's flexibility to raise funds.

High Working Capital Cycle

FRL has low collection period which is inherent in the industry, however the inventory days are higher on account of bought out stock arrangement for its inventory which leads to higher working capital requirement. Inventory days have increased from 79 in FY17 to 85 in FY18 and 91 in FY19. Increase in inventory days and growth in operations has led to an increase in company's fund based average working capital utilisation (including CP) for the past 12 months ending Oct 2019 to 76% as against 55% during the same period last year. The company's cash flow from operations was negative in FY19 and H1FY20.

Intensifying competition

Heightened competition from both brick and mortar and online players could impact overall SSSG of FRL. Competition from e-commerce players, remains a key threat. Also, change in FDI norms can lead to further competition. Currently, the government has allowed FDI in food processing sector. Apart from this, the government is also contemplating liberalising rules relating to multi-brand retail. This will open up foreign investments which may pose a threat to existing retail players like FRL, etc.

Liquidity Position: Adequate

As on Feb 29, 2020, FRL has adequate liquidity in the form of cash and cash equivalents to the tune of Rs. 348.25 crore, high utilised working capital limits (average utilisation incl. CP for trailing 12 months Feb-20 stands at 84%) and expected cash accrual of Rs. 593 crore in FY20 as against scheduled debt repayment aggregating to Rs. 103.06 crore.

Analytical approach: Earlier, the combined Financials of FEL and FRL were considered for analysis; given the strong operational synergies. Further, FEL and FRL also provided cross corporate guarantee for all the sanctioned debt in both the companies as of May 01, 2016. However, FRL has purchased the store assets from FEL which will lead to reduction in operational linkages and the debt guaranteed by FRL to FEL will also reduce to a significant extent. Further as per the revised criteria, a listed entity cannot be combined with other listed/non-listed entities to arrive at the ratings for a group of entities/entity on a combined approach & hence they have to be viewed/analysed as a separate entity and not combined with other entities of the group.Hence the analytical approach is changed to Standalone, factoring the debt of FEL guaranteed by FRL.

Applicable Criteria
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology: Factoring Linkages in Ratings
Rating Methodology-Manufacturing Companies
Rating Methodology: Organised Retail Companies
Financial ratios – Non-Financial Sector

About the Company
Erstwhile Future Retail Limited is the flagship company of the Future Group (one of India's leading retailers) and is engaged mainly in home & electronics retailing and value retailing.
Post the merger with Bharti Retail Limited (BRL), erstwhile FRL had split its operations into retail and infrastructure (with effect from October 31, 2015) and had formed two separate entities in the following manner:

a) **Infrastructure, Investment and distribution operations:** Erstwhile Future Retail Ltd. was renamed as Future Enterprises Ltd. It houses the physical assets (store formats of erstwhile FRL and BRL including all the infrastructure assets situated in the stores) apart from strategic investments in various companies. Also, the company is engaged in manufacturing and trading of garments.

b) **Retail operations:** Erstwhile Future Retail Ltd.'s retail operations was consolidated with Bharti Group's Retail operations and was renamed as Future Retail Limited (FRL).

FRL as on Dec 31, 2019 operates 1,338 stores across 414 cities with retail space of 16.05msf. The company has signed a master franchise agreement with 7-Eleven, the world's largest convenience store chain, that will open and manage the brand stores in India. Future Retail's subsidiary SHME Food Brands will open newer stores as well as convert existing locations to the 7-Eleven brand. The project is currently under pilot stage.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	18492	20183
PBILDT	919	1142
PAT	11	733
Overall gearing (times)	1.19	1.30
Interest coverage (times)	3.66	3.78

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

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
Non-fund-based - ST-BG/LC	-	-	-	2500.00	CARE A1 (Under Credit watch with Negative Implications)
Fund-based - LT-Working Capital Limits	-	-	-	3250.00	CARE A+ (Under Credit watch with Negative Implications)
Fund-based - LT-Term Loan	-	-	Aug 2024	528.00	CARE A+ (Under Credit watch with Negative Implications)
Debentures-Non Convertible Debentures	June 3, 2019	10.65%	June 3, 2023	199.00	CARE A+ (Under Credit watch with Negative Implications)
Proposed Debentures-Non Convertible Debentures	-	-	-	100.00	CARE A+ (Under Credit watch with Negative Implications)
Fixed Deposit	-	-	-	700.00	CARE A+ (FD) (Under Credit watch with Negative Implications)
Commercial Paper	-	-	7 days to 364 days	650.00	CARE A1 (Under Credit watch with Negative Implications)
Commercial Paper	-	-	7 days to 364 days	200.00	CARE A1 (Under Credit watch with Negative Implications)
Commercial Paper	-	-	7 days to 364 days	250.00	CARE A1 (Under Credit watch with Negative Implications)
Commercial Paper	-	-	7 days to 364 days	300.00	CARE A1 (Under Credit watch with Negative Implications)

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-Working Capital Limits	LT	3250.00	CARE A+ (Under Credit watch with Negative Implications)	1)CARE AA-; Negative (23-Oct-19) 2)CARE AA-; Negative (23-Jul-19)	1)CARE AA-; Stable (03-Oct-18)	1)CARE AA-; Stable (12-Oct-17) 2)CARE AA-; Stable (17-Aug-17) 3)CARE AA-; Stable (05-May-17)	1)CARE AA-; Stable (21-Feb-17) 2)CARE AA- (23-Aug-16)
2.	Commercial Paper	ST	650.00	CARE A1 (Under Credit watch with Negative Implications)	1)CARE A1+ (23-Oct-19) 2)CARE A1+ (23-Jul-19)	1)CARE A1+ (18-Jan-19) 2)CARE A1+ (03-Oct-18)	1)CARE A1+ (12-Oct-17) 2)CARE A1+ (20-Sep-17) 3)CARE A1+ (17-Aug-17) 4)CARE A1+	1)CARE A1+ (21-Feb-17) 2)CARE A1+ (23-Aug-16)

							(05-May-17)	
3.	Non-fund-based - ST-BG/LC	ST	2500.00	CARE A1 (Under Credit watch with Negative Implications)	1)CARE A1+ (23-Oct-19) 2)CARE A1+ (23-Jul-19)	1)CARE A1+ (03-Oct-18)	1)CARE A1+ (12-Oct-17) 2)CARE A1+ (17-Aug-17) 3)CARE A1+ (05-May-17)	1)CARE A1+ (21-Feb-17) 2)CARE A1+ (23-Aug-16)
4.	Commercial Paper	ST	200.00	CARE A1 (Under Credit watch with Negative Implications)	1)CARE A1+ (23-Oct-19) 2)CARE A1+ (23-Jul-19)	1)CARE A1+ (18-Jan-19) 2)CARE A1+ (03-Oct-18)	1)CARE A1+ (20-Nov-17) 2)CARE A1+ (12-Oct-17) 3)CARE A1+ (20-Sep-17) 4)CARE A1+ (17-Aug-17) 5)CARE A1+ (05-May-17)	1)CARE A1+ (21-Feb-17) 2)CARE A1+ (03-Oct-16)
5.	Commercial Paper	ST	250.00	CARE A1 (Under Credit watch with Negative Implications)	1)CARE A1+ (23-Oct-19) 2)CARE A1+ (23-Jul-19)	1)CARE A1+ (18-Jan-19) 2)CARE A1+ (03-Oct-18)	1)CARE A1+ (20-Nov-17) 2)CARE A1+ (12-Oct-17) 3)CARE A1+ (20-Sep-17) 4)CARE A1+ (17-Aug-17) 5)CARE A1+ (05-May-17) 6)CARE A1+ (20-Apr-17)	-
6.	Commercial Paper	ST	300.00	CARE A1 (Under Credit watch with Negative Implications)	1)CARE A1+ (23-Oct-19) 2)CARE A1+ (23-Jul-19)	1)CARE A1+ (18-Jan-19) 2)CARE A1+ (03-Oct-18)	1)CARE A1+ (20-Nov-17)	-
7.	Fund-based - LT-Term Loan	LT	528.00	CARE A+ (Under Credit watch with Negative Implications)	1)CARE AA-; Negative (23-Oct-19) 2)CARE AA-; Negative (23-Jul-19)	1)CARE AA-; Stable (14-Mar-19) 2)CARE AA-; Stable (03-Oct-18)	1)CARE AA-; Stable (20-Nov-17)	-
8.	Fixed Deposit	LT	700.00	CARE A+ (FD) (Under Credit watch with Negative Implications)	1)CARE AA- (FD); Negative (23-Oct-19) 2)CARE AA- (FD); Negative (23-Jul-19)	1)CARE AA- (FD); Stable (14-Nov-18)	-	-
9.	Debentures-Non Convertible Debentures	LT	200.00	CARE A+ (Under Credit watch with Negative	1)CARE AA-; Negative (23-Oct-19)	1)CARE AA-; Stable (14-Mar-19)	-	-

				Implications)	2)CARE AA-; Negative (23-Jul-19)			
10.	Debentures-Non Convertible Debentures	LT	100.00	CARE A+ (Under Credit watch with Negative Implications)	1)CARE AA-; Negative (23-Oct-19) 2)CARE AA-; Negative (23-Jul-19)	1)CARE AA-; Stable (14-Mar-19)	-	-

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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