

Future Lifestyle Fashions Limited

May 12, 2020

Ratings

Bank Facilities	Amount (Rs. crore)	Rating	Rating Action
Long-term - Proposed Term Loan	175.00	CARE A+; Negative (Single A Plus; Outlook: Negative)	Revised from CARE AA-; Negative (Double A Minus; Outlook: Negative)
Long-term Bank Facilities – Term Loan	339.39		
Long-term fund based bank facilities – CC	550.00		
Long-term/Short-term Bank Facilities – LC/BG	475.00	CARE A+; Negative/CARE A1 (Single A Plus; Outlook: Negative/A One)	Revised from CARE AA-; Negative/CARE A1+ (Double A Minus; Outlook: Negative/A One Plus)
Total	1,539.39 (Rs. One thousand five hundred thirty nine crore and thirty nine lakh only)		
Non-convertible Debenture Issue	350.00	CARE A+; Negative (Single A Plus; Outlook: Negative)	Revised from CARE AA-; Negative (Double A Minus; Outlook: Negative)
Proposed Non-convertible Debenture Issue	150.00		
Commercial Paper Issue	150.00	CARE A2+ (A Two Plus)	Revised from CARE A1+ (A One Plus)
Commercial Paper Issue*	140.00	CARE A1 (A One)	

*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 bank facilities and instruments of Future Lifestyle Fashions Ltd. (FLFL) factors in weakening in business and financial risk profile on account of extended lockdown due to Covid-19. CARE expects the recovery to be slow and gradual on account of extension of lockdown and given the discretionary spend by the customers towards apparels.

The consumers are likely to curtail their discretionary spending with reduced income as well as tendency to preserve cash. Also, more preference is likely towards online channels in order to avoid crowded spaces. In such times, the retailers with omni-channel strategy with presence in both offline and online channels are expected to have a quicker recovery. FLFL with its 'Brand factory' format has presence across offline and online channels which is expected to benefit FLFL it faster recovery.

The ratings continue to derive strength from the vast experience of the promoters (Future Group) in the retail industry, established pan-India presence of various operationally profitable formats, established portfolio of own and licensed brands and need based support from PE investors.

The aforesaid rating strengths are however tempered by moderate return on capital employed, refinancing risk, high operating cycle coupled with susceptibility to economic cycles and increasing competition in the fashion retail industry.

FLFL is seeking a moratorium on payments from its lenders as part of the COVID-19 - Regulatory Package announced by the RBI on March 27, 2020. As informed to CARE, in the anticipation of the said approval following the regulatory package by RBI some of the scheduled repayments were deferred by the company as at March 31, 2020. CARE has not recognized this instance as a Default as of now, as the same is permitted by the RBI as part of the relief measures announced recently. This is based on CARE's expectation that a formal approval for rescheduling the loan would be received soon by the group. Non-recognition of default in this case is as per the guidance provided by the SEBI circular SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53 dated March 30, 2020.

Outlook Negative

The outlook continues to be Negative on account of adverse impact on credit profile due to extension of store closures on the back of COVID-19 outbreak. Sharp decline in the share prices of the Future group companies including FLFL has impacted the overall financial flexibility of the group and restricted the ability to raise further capital.

As per the discussion with the management, FLFL has availed moratorium on payments as allowed by RBI, sought additional working capital limits, undertaken initiatives to rationalise costs, including but not limiting to closure of non-profitable stores,

migrate from fixed rental model to a revenue sharing one and plans to divest one of its investee brands to augment its cash flows in the near to medium term. The outlook may be revised to stable on sustained improvement in sales and PBILDT margins post resumption of operations.

Rating Sensitivity Factors

Positive factors

- Improvement in credit profile of FLFL post end of pandemic on back of strong sales growth and increased contribution from private brands.
- Improvement in capital structure through equity infusion/monetisation of brands leading to overall gearing (post adoption of IndAS116) below 1.00x

Negative factors

- Weakening in liquidity position resulting from extended closure/and or delay in need based support from PE players and enhancement in working capital limits
- Increase in working capital intensity or weakening of debt credit metrics on account of larger than anticipated debt funded capex leading to overall gearing (post adoption of IndAS116) above 2.00x.
- The NCDs have an accelerated redemption clause along with accrued interest of happening of any of the following events
 - Credit Rating revision / assignment to "A" or lower; or
 - Withdrawal / Suspension of long term credit rating of Instrument.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters and expected support from PE Investors: FLFL is part of the Future Group, which is one of the largest retailers in India. Mr Kishore Biyani, founder of Future group is Vice Chairman (non-executive) of FLFL. The promoters of FLFL are involved in the management of the business, defining and monitoring the business strategy for the company, and have been successful in building and scaling up in both value retail and fashion retail. Furthermore, the promoters are supported by a strong management team, having significant experience in the retail industry. FLFL is backed by PE investors such as Blackstone, LCatterton, PremjiInvest and Aion Capital. As per discussion with few PE Investors CARE understands that they have long term investment horizon and believe in the business formats of Central and Brand Factory. Based on the discussion CARE expects the investors to extend need based funding support to FLFL.

Established pan-India presence of various operationally profitable formats: As on Dec 31, 2019, FLFL distribution network includes 354 stores having a retail space of 7.5 million sq. ft. FLFL's fashion retail business is led by two major retail chains – Central and Brand Factory. These outlets contribute nearly 88% of the total retail sales for FY19. FLFL sells the premium apparel segment through Central while the low priced apparels are sold through Brand Factory. Central alone contributes 50% of the total sales in FY19. The company further operates EBOs and is also into distribution business wherein it is selling its brands from other MBOs (Multi Brand Outlets) falling outside Future Group Retail network. The key formats 'Central' and 'Brand Factory' are the major contributors to the EBDITA of the company.

Established and diversified lifestyle fashion brand portfolio: FLFL is associated with various brands in apparel, footwear, accessories, home fashion and luggage via three formats: (i) Own/Private Brands, (ii) Licensed Brands held directly by FLFL and (iii) Investments in various companies holding Brand licenses. FLFL brands contributed 39% of total sales in FY19 whereas the balance was by third party brands. These brands are sold through Central and Brand Factory as well as through EBOs and MBOs.

FLFL's investments in nurturing such brands offer it opportunities to unlock value over a period of time. During FY17, FLFL had transferred its investments in various companies holding brand licenses to "FLFL Lifestyle Brands Ltd. (FLBL)" and divested 51% stake to raise Rs.450 crore.

The company is expected to benefit from the focus on brands along with increase in retail space in the medium term.

Improvement in Operational Performance but ROCE remains moderate; further expected to moderate due to Covid19 lockdown: Footfalls in the stores of FLFL have increased by 19% in FY19 with an improvement in conversion rate as well. However, the average transaction size and average selling price declined by 5% and 2% respectively over FY18 on account of increase in contribution from the discount format store (Brand Factory).

During FY19, same store sales growth (SSSG) for Central was 5.7% and for Brand Factory was 13.9%, whereas overall SSSG stood at 8.7%. During 9MFY20, overall SSSG stood at 2.0%.

On back of increase in footfalls, improvement in conversion rate, increase in share of own brands led to increase in net sales by 27.59% to Rs. 5,624 crore and improvement in operating margins by 75bps.

The company maintains large inventory and with increasing contribution from 'Brand Factory' the company's profit margins have remain modest. ROCE has improved over the years, however, the same is expected to moderate on account of addition of new stores and increasing contribution from 'Brand Factory'.

Post lifting of lockdown CARE expects recovery to be slow and gradual which is likely to result in moderation in debt coverage indicators and ROCE.

Robust supply chain infrastructure in place: FLFL has a robust supply chain infrastructure in place which helps in achieving better operational efficiencies. The inventory management system enables it to offer and display correct merchandise assortments in the right mix, style, colour and fashion at various price points on the shelves as per the regional taste and preference. 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. FLFL 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. Better inventory management has led to inventory days declining to 126 days in FY19 as against 135 days in FY18.

Comfortable debt coverage metrics; however, cash flow management and debt service indicators sensitive to future capex plans: FLFL has a strong financial risk profile characterised by growth in total income, low leverage, sufficient liquidity & comfortable debt service indicators.

As on March 31, 2019, the capital structure and debt coverage metrics continue to improve to 0.64x as on March 31, 2019 on account of better operational performance and accretion of profits.

Apart from the financial flexibility due to comfortable capital structure, the company as on September 30, 2019 also has adequate liquidity available in the form of cash & cash equivalents amounting to Rs. 102.19 crore, of which Rs. 8.83 crore is kept as margin towards non-fund based limits and moderate working capital utilisation. Furthermore, the company also has comfortable debt service indicators with total debt to GCA of 2.82x as on March 31, 2019.

FLFL's investments in nurturing brands offer it opportunities to unlock value over a period of time and provide it with the financial flexibility to raise funds whenever needed. The company also has demonstrated track record of raising funds from marquee investors like Blackstone, L-Catterton and Aion Capital which has invested funds in FLFL or promoter level entity.

However, cash flow management in light of future capex plans remains a rating sensitivity.

Significant shares pledged/encumbered by the promoter: The total shares pledged/encumbered by promoters as on March 31, 2020 increased to 99.78% as against 97.42% as on Sep 30, 2019.

Blackstone has invested a total of Rs. 1,750 crore or USD 250mn in holding company of FLFL, Ryka Commercial Ventures Private Limited (Ryka). As a part of the deal, 6% of equity shares of FLFL held by Ryka have been acquired by Blackstone for an amount of Rs. 545 crore. The balance amount (Rs. 1,205 crore) is issued as NCD by Ryka and subscribed by Blackstone entity. The structure is backed by the security by way of encumbrance (Non-Disposal Undertaking) sale of shares of Ryka and FLFL (held by Ryka) and pledge will be created only upon the occurrence of the event of defaults.

As per the management, there is no recourse to the cash flows of FLFL and the NCD is a zero coupon instrument with payment at the end of five years.

The share price has also witnessed a significant decline. Share price has fallen by 73.39% to Rs.105.25 as on April 13, 2020 as against closing of Rs.397.80 on Dec 18, 2019. Market capitalisation has declined from Rs.8,012 crore to Rs.2,136 crore.

High Working Capital Cycle: FLFL has low receivables period like other retailers, however the inventory days are higher on account of bought out stock arrangement for its private brands which leads to higher working capital requirement. Also, the retailing of private brands coupled with the distribution business leads to an extended inventory requirement. The company has a relatively high working capital cycle.

Inventory carrying risk is partially mitigated through the 'Sale or Return' (SOR) model adopted by the company. This provides FLFL the right to return unsold stock to the vendor at determined frequency. The same minimises the inventory carrying risk for the company and help it with better working capital management. The company procures 50%-60% of inventory on SOR basis.

Acquisition of Koovs and investment towards digital business: The Board of FLFL in FY19 approved the investment in equity shares of Koovs plc. for GBP 15.3 million (approx. Rs.140.00 crore) for 30% stake. FLFL currently holds 16.25% stake in the company and intend to reach upto 29.9%. Koovs plc (company incorporated in England) is a supplier of branded fashion garments and accessories for sale by a third party through Koovs.com website principally in India.

The company has till June 2019 invested Rs. 85 crore in Koovs and holds 25.8% of ordinary share capital.

Koovs is currently incurring losses on account of lower scalability and penetration which is resulting in the unabsorbed operating and fixed costs and subdued margins. The losses are currently met out of debt & equity. As per the management,

FLFL at this juncture is not envisaging further investments other than already made and thus shall not have any further impact on its cash flows on account of this investment.

FLFL in Q2FY20, launched its digital business through the website 'brandfactoryonline.com'. During the quarter, it reported a turnover of Rs. 9 crore and operating losses of Rs. 16 crore. The fall was primarily on account of platform building cost, trial run cost and one time set up cost. As per the management, they plan to invest Rs. 15-20 crore towards the business every year.

The ability of the company to ramp up businesses and generate envisaged returns through stipulated investments remains key rating monitorable.

Coronavirus crisis and its resultant impact on the overall Future Group

The share price of various Future Group entities have witnessed a steep decline, which is in line with the concerns relating to global economic slowdown due to coronavirus outbreak. The weakening of market capitalization has impacted the financial flexibility of the group.

Intensifying competition: FLFL faces intense competition from other brick and mortar retailers like Lifestyle International, Shoppers Stop Limited, Aditya Birla Fashion, Trent Limited etc. The company also faces competition from online retailers like Amazon, Flipkart, Myntra. Heightened competition from both brick and mortar and online players could impact overall SSSG of FLFL. However, with its diverse offering with presence in premium and discount formats would support FLFL over the medium term.

Industry Outlook

In view of the COVID19 outbreak and lowering of the discretionary spending by the consumers in these times of economic downturn, the outlook for the Indian players in retail sector is 'Negative' in the short to medium term. The impact on demand, which is expected to remain muted at least for the next three or four quarters, will be more in case of players with presence in non-essential items and luxury segments. However, the expected support from the government in terms of financial stimulus packages and wage support subsidy as well as rental waivers from the mall-owners which would help the retailers to bring down their fixed costs, will reduce the impact on their credit profile to an extent. The retailers with presence in essential commodities continue to have some cash flows to support their fixed costs.

After the control of the spread of the coronavirus and post the lock-down period, the spending as well as shopping patterns of the consumers are expected to change significantly. The consumers are likely to curtail their discretionary spending with reduced income in their hands as well as tendency to preserve cash. Also, more preference is likely towards online channels in order to avoid crowded spaces. In such times, the retailers with presence across the retail segments (grocery, apparel, appliances, accessories) as well as who have an omni-channel strategy with presence in both offline and online channels are expected to have a quicker recovery.

Liquidity: Adequate

Temporary closure of operations as directed by the governing authorities on the back of COVID19 outbreak has hampered the company's ability to generate cash flows. The company however has adequate liquidity in the near term. The company has applied to lenders for moratorium on payments as per the relief package announced by RBI on March 27, 2020 and as per the lenders the approval is under process. FLFL is also looking to enhance its working capital limits to augment its liquidity position. The company is negotiating with its operational creditors to restructure the payment terms. The company has short term financial liabilities and term loan repayments of Rs. 120 crore (scheduled term loan repayments prior to availing moratorium) of due in FY21. In addition, NCD of Rs 350 crore falling due on November 09, 2022 carries Put/Call Option in FY21 and FY22. The company plans to refinance this NCD. Timely and adequate fund infusion from investors/promoters remains critical from company's credit profile. CARE expects need based financial support from PE investors.

Analytical approach: Consolidated financials of FLFL along with its subsidiaries and joint ventures are considered for analysis due to strong operational linkages.

The list of entities consolidated is provided in Annexure – III.

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: Organised Retail Companies](#)

[Financial ratios – Non-Financial Sector](#)

About the Company

Future Lifestyle Fashions Limited (FLFL) is a part of the Future Group (one of India's largest retailers). FLFL is in the business of managing the lifestyle fashion segment of the Future Group. It has a portfolio of fashion brands that cover a range of fashion categories including formal menswear, casual wear, active or sportswear, women's ethnic wear, women's denim wear, women's casual wear, footwear and accessories and are present across various price points. The company as on Dec 31, 2019 has 354 stores (Central-49; Brand Factory-104; EBOs-201) covering an area of 7.3msf.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)
Total operating income	4520	5755
PBILDT	453	620
PAT	126	189
Overall gearing (times)	0.70	0.71
Interest coverage (times)	4.39	3.98

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
Fund-based - LT-Term Loan	-	-	Jan 2025	339.39	CARE A+; Negative
Fund-based - LT-Term Loan – Proposed	-	-	FY26	175.00	CARE A+; Negative
Fund-based - LT-Cash Credit	-	-	-	550.00	CARE A+; Negative
Non-fund-based - ST-Working Capital Limits	-	-	-	475.00	CARE A1
Non-Convertible Debentures INE452O07047	November 10, 2017	8.75	November 9, 2022	500.00	CARE A+; Negative
Commercial Paper	-	-	7 days to 364 days	150.00	CARE A2+
Commercial Paper (Carved out)	-	-	7 days to 364 days	140.00	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Term Loan	LT	514.39	CARE A+; Negative	1)CARE AA-; Negative (17-Apr-20)	1)CARE AA-; Positive (24-Dec-19)	1)CARE AA-; Positive (12-Dec-18)	1)CARE AA-; Stable (11-Jul-17)
2.	Fund-based - LT-Cash Credit	LT	550.00	CARE A+; Negative	1)CARE AA-; Negative (17-Apr-20)	1)CARE AA-; Positive (24-Dec-19)	1)CARE AA-; Positive (12-Dec-18)	1)CARE AA-; Stable (11-Jul-17)
3.	Non-fund-based - ST-Working Capital Limits	ST	475.00	CARE A1	1)CARE A1+ (17-Apr-20)	1)CARE A1+ (24-Dec-19)	1)CARE A1+ (12-Dec-18)	1)CARE A1+ (11-Jul-17)

4.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (11-Jul-17)
5.	Commercial Paper-Commercial Paper (Carved out)	ST	140.00	CARE A1	1)CARE A1+ (17-Apr-20)	1)CARE A1+ (24-Dec-19)	1)CARE A1+ (12-Dec-18)	1)CARE A1+ (11-Jul-17)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	-	-	1)Withdrawn (11-Jul-17)
7.	Debentures-Non Convertible Debentures	LT	500.00	CARE A+; Negative	1)CARE AA-; Negative (17-Apr-20)	1)CARE AA-; Positive (24-Dec-19)	1)CARE AA-; Positive (12-Dec-18)	1)CARE AA-; Stable (11-Jul-17)
8.	Fund-based - ST-Term loan	ST	-	-	-	-	1)Withdrawn (12-Dec-18)	1)CARE A1+ (11-Jul-17)
9.	Commercial Paper	ST	37.50	CARE A2+	1)CARE A1+ (17-Apr-20)	1)CARE A1+ (24-Dec-19) 2)CARE A1+ (23-Aug-19)	1)CARE A1+ (12-Dec-18)	-
10.	Commercial Paper	ST	112.50	CARE A2+	1)CARE A1+ (17-Apr-20)	1)CARE A1+ (24-Dec-19) 2)CARE A1+ (23-Aug-19)	-	-

Annexure-3: Name of the companies consolidated with FLFL

Name of the Company	Relationship	Ownership as on March 31, 2019
Future Trendz Limited	Subsidiary	100.00%
Future Speciality Retail Limited	Subsidiary	99.96%
FLFL Business Services Limited	Subsidiary	100.00%
FLFL Travel Retail Bhubaneswar Private Limited	Joint Venture	51.00%
FLFL Travel Retail Guwahati Private Limited	Joint Venture	51.00%
FLFL Travel Retail West Private Limited	Joint Venture	51.00%
FLFL Travel Retail Lucknow Private Limited	Joint Venture	51.00%
FLFL Lifestyle Brands Limited	Joint Venture	49.02%
Clarks Future Footwear Private Limited	Joint Venture	1.00%
Holii Accessories Private Limited	Joint Venture	1.00%

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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Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

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