

Future Lifestyle Fashions Limited (Revised)

August 13, 2020

Ratings

Bank Facilities	Amount (Rs. crore)	Rating	Rating Action
Long-term - Proposed Term Loan	175.00	CARE BBB (Triple B) (Credit watch with developing implications)	Revised from CARE A+; Negative (Single A Plus; Outlook: Negative) Placed on credit watch with developing implications
Long-term Bank Facilities – Term Loan	339.39		
Long-term fund based bank facilities – CC	550.00		
Short-term Bank Facilities – LC/BG	475.00	CARE A3 (A Three) (Credit watch with developing implications)	Revised from CARE A1 (A One) Placed on credit watch with developing implications
Total	1,539.39 (Rs. One thousand five hundred thirty nine crore and thirty nine lakh only)		
Non-convertible Debenture Issue	350.00	CARE BBB (Triple B) (Credit watch with developing implications)	Revised from CARE A+; Negative (Single A Plus; Outlook: Negative) Placed on credit watch with developing implications
Proposed Non-convertible Debenture Issue	150.00		

*carved out of working capital limits

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The revision in ratings assigned to the bank facilities and instruments of Future Lifestyle Fashions Ltd. (FLFL) factors in the elevated liquidity pressure on the company on account of weakened business and financial profile due to subsequent extensions of lockdown in the wake of COVID19 outbreak. On account of extended lockdown the cash flows of the company would be inadequate to service debt repayments of Rs. ~280 crore (excluding NCD of Rs.350 crore with Put/Call option in Nov. 2020) in FY21 and the same would require to be serviced through refinance/monetisation of brands/equity infusion. The ability of the company to raise funds could be curtailed on account of stretched credit profile of Future group.

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 expectation of 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 has sought moratorium from banks as per RBI package. 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. 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.

The ratings are placed on credit watch with developing implications on account of the company's plans to improve its liquidity through monetisation of brands and infusion of equity through strategic divestment. The disruption in operations due to COVID19, has impacted the business risk profile resulting in lower operating cash flow, increase in working capital requirement impacting the liquidity position. To improve liquidity FLFL has 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, raise additional working limits and plans to divest one of its investee brands to augment its cash flows in the near to medium term. The company is also in discussion with strategic investors for equity infusion. CARE will continue to monitor the situation and will resolve the watch once the exact implication of the situation on credit profile of FLFL is clear.

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 Managing Director 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 Mar 31, 2020, FLFL distribution network includes 348 stores having a retail space of 7.7 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. During FY20 the company had bought back investment by PE player in 'Future Speciality Retail Limited' at ~Rs.350 crore.

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

Improvement in FY19 Operational Performance but ROCE remains moderate; further expected to contract 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 led to inventory days declining to 126 days in FY19 as against 135 days in FY18. However, on account of temporary closure of stores during last week of FY20, inventories couldn't be liquidated leading to rise in inventory days to 154 in FY20.

Deterioration of debt coverage metrics on the back of COVID19: FLFL's financial risk profile has weakened on account of disruption in operations caused by temporary shutdown of operations on the back of COVID19 pandemic. As on March 31, 2020, the capital structure has deteriorated to 1.68x as against 0.64x as on March 31, 2019 on account of net losses, increase in debt and adoption of IndAS 116. Similarly debt coverage metrics such as interest coverage ratio and total debt to GCA have also deteriorated to 3.45x and 11.65 respectively.

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.

Significant shares pledged/encumbered by the promoter: The total shares pledged/encumbered by promoters as on June 30, 2020 continues to remain high at 99.78%.

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. 119.40 as on Aug 5, 2020 as against closing of Rs.397.80 on Dec 18, 2019. Market capitalisation has declined from Rs.8,012 crore to Rs.2,409 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. 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. However, on account of continued losses reported by Koovs, FLFL in Q4FY20 had impaired its investment to the tune of Rs. 84 crore (which is reported as exceptional item).

FLFL in Q2FY20, launched its digital business through the website 'brandfactoryonline.com'. For FY20, it reported a turnover of Rs. 19 crore and operating losses of Rs. 25 crore. The fall was primarily on account of platform building cost, trial run cost and one time set up cost.

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

Deterioration in credit profile of Future Group

The share price of various Future Group entities have witnessed a steep decline. The weakening of market capitalization has impacted the financial flexibility of the group.

Due to the coronavirus pandemic, the retail sector has been one of the most adversely affected following the lockdown imposed by the Government and its subsequent extensions. Flagship entity of Future group viz .Future Retail Limited (CARE BB+; under credit watch with developing implication/CARE A4+; under credit watch with developing implication) has been facing adverse liquidity issues and has missed interest payment on USD bonds of 500 million due on July 22, 2020 and is required to make the payment within a 30-day grace period, before it can be constituted as an 'Event of Default.' According to the management, FRL shall be releasing the payment within the grace period, which is contingent upon release of enhanced limits from bankers.

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: Stretched

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 lenders have approved the moratorium on payments as per the RBI package. FLFL has also applied to the lenders for additional limits which is under process. The liquidity profile of the company is stretched on account of reduced cash flows and short term financial liabilities and term loan repayments of Rs. ~280 crore (scheduled repayments prior to availing moratorium) 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/monetisation remains critically imperative 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](#)

[Liquidity Analysis of Non-Financial Sector Entities](#)

[Criteria for Short Term Instruments](#)

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 March 31, 2020 operate 348 stores having a retail space of 7.7 million sq. ft.

Brief Financials (Rs. crore)	FY18 (A)	FY19 (A)	FY20 (Abg.)
Total operating income	4520	5755	6362
PBILDT	453	620	1055
PAT	126	189	-53
Overall gearing (times)	0.70	0.71	1.68
Interest coverage (times)	4.39	3.98	3.45

A: Audited; Abg: Abridged

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 BBB (Under Credit watch with Developing Implications)
Fund-based - LT-Term Loan – Proposed	-	-	-	175.00	CARE BBB (Under Credit watch with Developing Implications)
Fund-based - LT-Cash Credit	-	-	-	550.00	CARE BBB (Under Credit watch with Developing Implications)
Non-fund-based - ST-Working Capital Limits	-	-	-	475.00	CARE A3 (Under Credit watch with Developing Implications)
Non-Convertible Debentures INE452007047	November 10, 2017	8.75	November 9, 2022	350.00	CARE BBB (Under Credit watch with Developing Implications)
Proposed Non-Convertible Debentures	-	-	-	150.00	CARE BBB (Under Credit watch with Developing 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 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 BBB (Under Credit watch with Developing Implications)	1)CARE A+; Negative (12-May-20) 2)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 BBB (Under Credit watch with Developing Implications)	1)CARE A+; Negative (12-May-20) 2)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 A3 (Under Credit watch with Developing Implications)	1)CARE A1 (12-May-20) 2)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	-	-	1)Withdrawn (06-Aug-20) 2)CARE A1 (12-May-20) 3)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 BBB (Under Credit watch with Developing Implications)	1)CARE A+; Negative (12-May-20) 2)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	-	-	1)Withdrawn (06-Aug-20) 2)CARE A2+ (12-May-20) 3)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	-	-	1)Withdrawn (06-Aug-20) 2)CARE A2+ (12-May-20) 3)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%

Annexure 4: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Commercial Paper	Simple
2.	Commercial Paper-Commercial Paper (Carved out)	Simple
3.	Debentures-Non Convertible Debentures	Simple
4.	Fund-based - LT-Cash Credit	Simple
5.	Fund-based - LT-Term Loan	Simple
6.	Non-fund-based - ST-Working Capital Limits	Simple

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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Disclaimer

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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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