

Future Lifestyle Fashions Limited

December 24, 2019

Ratings

Bank Facilities	Amount (Rs. crore)	Rating	Rating Action
Long-term – Proposed Term Loan	175.00	CARE AA-; Positive (Double A Minus; Outlook: Positive)	Assigned
Long-term Bank Facilities – Term Loan	339.39 (reduced from 475.00)		Reaffirmed
Long-term fund based bank facilities – CC	550.00		
Long-term/Short-term Bank Facilities – LC/BG	475.00	CARE AA-; Positive/CARE A1+ (Double A Minus; Outlook: Positive/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 (Rs. Three hundred and fifty crore only)	CARE AA-; Positive (Double A Minus; Outlook: Positive)	Reaffirmed
Proposed Non-Convertible Debenture Issue	150.00 (Rs. One hundred and fifty crore only)		
Commercial Paper Issue*	140.00 (Rs. One hundred and forty crore only)	CARE A1+ (A One Plus)	
Commercial Paper Issue^	112.50 (Rs. One hundred twelve crore and fifty lakh only)		
Commercial Paper Issue	37.50 (Rs. Thirty seven crore and fifty lakh only)		

*Carved out of working capital limits

^As per undertaking submitted by FLFL to CARE, the outstanding CP including working capital borrowings will not exceed lower of the sanctioned working capital limits or drawing power at any point of time. (As per revised criteria CARE will not consider the undertaking and the CP will now be considered as standalone)

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The reaffirmation of ratings of Future Lifestyle Fashions Ltd. (FLFL) derive strength from the vast experience of the promoters (Future Group) in the retail industry, established pan-India presence of various operationally profitable formats, healthy same store sales growth and established portfolio of own and licensed brands.

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

Outlook Positive

The positive outlook factors in expected improvement in credit profile of FLFL on back of strong sales growth and increased contribution from private labels. The outlook may be revised to stable in case of lower than expected cash accruals, increase in working capital intensity or weakening of debt credit metrics.

Rating Sensitivity Factors

Positive factors

- Improvement in credit profile of FLFL on back of strong sales growth and increased contribution from private brands leading to overall gearing (post adoption of IndAS116) below 1.00x.

Negative factors

- Higher than envisaged investments towards the digital business
- 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.

Detailed description of the key rating drivers**Key Rating Strengths**

Experienced promoters: 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.

Established pan-India presence of various operationally profitable formats: As on Sep 30, 2019, FLFL distribution network includes 349 stores having a retail space of 7.3 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: 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 H1FY20, overall SSSG stood at 6.9%.

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'.

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 Sep 30, 2019 increased to 97.42% as against 26.38% as on Jun 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.

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.

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

The Indian retail industry has emerged as one of the most dynamic and fast-paced industries due to the entry of several new players. Total consumption expenditure is expected to reach nearly USD 3,600bn by 2020 from USD 1,824bn in 2017. It accounts for over 10% of the country's Gross Domestic Product (GDP) and around 8% of the employment. India is the world's fifth-largest global destination in the retail space.

The Government of India has also supported and taken various initiatives to improve the retail industry in India. In 2018, India's retail sector investments doubled to reach Rs. 1,300 crore.

Going ahead, e-commerce is expected to drive the growth rate which makes brands/retailers access customers in tier 2 and tier 3 cities easier. It is projected that by 2021 traditional retail will hold a major share of 75 per cent, organised retail share will reach 18 per cent and e-commerce retail share will reach 7 per cent of the total retail market.

Barring the current downturn in the economy and reduction in consumer spending in the medium term, the long-term outlook for the industry seems positive which is supported by rising incomes, favourable demographics, entry of foreign players, and increasing urbanisation.

Liquidity: Adequate

As on Sep 30, 2019, FLFL has adequate liquidity in the form of cash and cash equivalents to the tune of Rs. 102.19 crore, of which Rs. 8.83 crore is kept as margin towards non-fund based limits, moderate utilised working capital limits (average utilisation for trailing 12 months Oct-19 stands at 70%) and expected cash accrual of Rs. 449.90 crore in FY20 as against scheduled debt repayment aggregating to Rs. 93.96 crore. NCD of Rs ~350 crore is redeemable at the end of 60 Months from the deemed date of allotment falling due on November 09, 2022. The instrument carries Put/Call Option at the end of 3rd and 4th year from the deemed date of allotment. The company needs to refinance the NCD if the Put Option is exercised. The company has capex of around Rs.380 crore which is expected to be funded through internal accruals and debt.

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 Sep 30 2019 has 349 stores (Central-48; Brand Factory-100; 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 AA-; Positive
Fund-based - LT-Term Loan – Proposed	-	-	FY26	175.00	
Fund-based - LT-Cash Credit	-	-	-	550.00	CARE AA-; Positive
Non-fund-based - ST-Working Capital Limits	-	-	-	475.00	CARE A1+
Debentures-Non Convertible Debentures	10-Nov-2017	8.75	9-Nov-2022	500.00	CARE AA-; Positive
Commercial Paper	-	-	7 days to 364 days	37.50	CARE A1+
Commercial Paper	-	-	7 days to 364 days	112.50	CARE A1+
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 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-Term Loan	LT	514.39	CARE AA-; Positive	-	1)CARE AA-; Positive (12-Dec-18)	1)CARE AA-; Stable (11-Jul-17)	1)CARE A+ (11-Nov-16)
2.	Fund-based - LT-Cash Credit	LT	550.00	CARE AA-; Positive	-	1)CARE AA-; Positive (12-Dec-18)	1)CARE AA-; Stable (11-Jul-17)	1)CARE A+ (11-Nov-16)
3.	Non-fund-based - ST-Working Capital Limits	ST	475.00	CARE A1+	-	1)CARE A1+ (12-Dec-18)	1)CARE A1+ (11-Jul-17)	1)CARE A1+ (11-Nov-16)
4.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (11-Jul-17)	1)CARE A+ (11-Nov-16)
5.	Commercial Paper-Commercial Paper (Carved out)	ST	140.00	CARE A1+	-	1)CARE A1+ (12-Dec-18)	1)CARE A1+ (11-Jul-17)	1)CARE A1+ (11-Nov-16)
6.	Debentures-Non Convertible Debentures	LT	-	-	-	-	1)Withdrawn (11-Jul-17)	1)CARE A+ (11-Nov-16)
7.	Debentures-Non Convertible Debentures	LT	500.00	CARE AA-; Positive	-	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 A1+	1)CARE A1+ (23-Aug-19)	1)CARE A1+ (12-Dec-18)	-	-
10.	Commercial Paper	ST	112.50	CARE A1+	1)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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