PVH Arvind Fashion Private Limited
(Erstwhile Calvin Klein Arvind Fashion Private Limited)

November 11, 2020

Ratings

Facilities	Amount (Rs. Crore)	Rating[1]	Rating Action
Long term Bank Facilities	80.00 **(Rupees Eighty Crore Only)**	**CARE A; Negative (Single A; Outlook: Negative)**	**Assigned**

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of PVH Arvind Fashion Private Limited (PAFPL) derives strength from its parentage of USA-based PVH Corporation Limited (PVH) and India-based Arvind Group through Arvind Fashions Limited (AFL; rated CARE A-; Negative/ CARE A2+), its strong brand identity with the global presence of 'Tommy Hilfiger' (TH) and 'Calvin Klein' (CK) brands and its established operations in India with widespread distribution network along with favorable long-term growth prospects for the Indian apparel retail industry. The rating is further underpinned by its growing total operating income (TOI) supported by its well-known brands, its hitherto moderate capital structure and debt coverage indicators; albeit moderation expected in overall financial performance in FY21 (FY; refers to the period April 01 to March 31) due to outbreak of COVID-19 pandemic. CARE also takes cognizance of the various cost management initiatives being undertaken by the company such as rationalization of its lease rentals, headcount and manpower cost so as to counter the loss of sale and challenging operating environment arising from the spread of corona virus. CARE further takes cognizance of AFL's [one of the Joint Venture (JV) partners of PAFPL] successful rights issue of Rs.400 crore and strategic sale of significant minority stake in its step down subsidiary Arvind Youth Brands Private Limited (AYB; which houses the 'Flying Machine' brand) to Flipkart Group (FG) for a value of Rs.260 crore in July 2020 towards strengthening of its weakened consolidated Balance Sheet, funding of losses and supporting its liquidity. Moreover, CARE takes note of PAFPL's decision to not avail the moratorium granted by its lenders as a COVID-19 relief measure (as permitted by the Reserve Bank of India) towards the interest payment on its working capital limits.

The rating of PAFPL, however, remains constrained on account of inherent working capital intensive operations of the apparel retail industry, elongated operating cycle of the company owing to high receivables and inventory holding, it's moderate ROCE, along with susceptibility of its profitability to foreign exchange rate fluctuations and changes in import duty structure. The rating is further constrained by its presence in the highly competitive premium branded apparel industry which is vulnerable to changes in fashion trends/consumer preferences and economic cycles which is likely to be further exacerbated by the expectation of lower demand for discretionary products in the medium-term due to outbreak of COVID-19 pandemic along with intense competition from the various local and global brands in the sector.

Outlook: Negative

The 'Negative' outlook on the rating of PAFPL reflects CARE's expectation of likely adverse impact on the credit profile of the company in the medium-term despite staggered easing of the lockdown from June 2020 with gradual reopening of its retail stores as the recovery in consumer demand is likely to be delayed and gradual given the discretionary nature of the apparel products in the backdrop of people avoiding visiting crowded places like malls/retail outlets and the overall lower income levels due to higher unemployment as a result of the expected economic downturn due to impact of COVID-19. CARE expects the consumers to curtail their discretionary spending with reduced income as well as tendency to preserve cash due to uncertain environment. In the light of lower revenue, profitability and cash flows, the debt coverage indicators of PAFPL are expected to be affected in the medium term. The outlook may be revised to 'Stable' on sustained improvement in demand along with improvement in its profitability and cash accruals leading to better liquidity and debt coverage indicators than presently envisaged for FY21.

Rating Sensitivities

Positive Factors

- Revival of consumer demand to normalcy levels leading to improvement in its operational performance along with significant growth in its sales and improvement in its profitability margins as well as debt coverage indicators on a sustained basis
- Earning ROCE of more than 18% on a sustained basis
- Curtailment of gross working capital cycle to around 120 days on a sustained basis
- Significant improvement in the credit profile of its JV partners i.e. AFL and PVH

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

Negative Factors

- Significant adverse impact on the liquidity, working capital cycle and debt coverage indicators of the company beyond envisaged level arising from longer than expected panning out of the challenging operating environment for premium apparel sector
- Significant deterioration in the credit profile of its JV partners

Detailed description of the key rating drivers

Key Rating Strengths

Experienced and resourceful JV partners

AFL, the 50% JV partner in PAFPL is a part of the Arvind Group promoted by the Sanjay Lalbhai family of Ahmedabad. Arvind group is a diversified conglomerate having presence in textile, apparel retailing, engineering, water treatment and real estate businesses amongst others. AFL was previously a subsidiary of Arvind Limited (Arvind; rated CARE AA-; Negative/ CARE A1+) which is the flagship company of Arvind group. Post business restructuring undertaken within Arvind group, AFL got demerged and was separately listed on the stock exchange on March 08, 2019. AFL, through its subsidiaries and JVs, is engaged in the wholesale and retailing of several owned and licensed branded apparels in India. Post significant moderation in the consolidated credit profile of AFL during FY20 due to huge losses incurred by it, AFL has received investment of Rs.260 crore by selling significant minority stake in its recently formed subsidiary, AYB (which owns the 'Flying Machine' brand) to the Flipkart Group (FG). Further, AFL raised equity of Rs.400 crore by way of rights issue. On an aggregate level, AFL received cash inflow of Rs.660 crore in FY21 through the above-mentioned transactions which has been utilized towards reduction of its debt and stretched creditors at a consolidated level and balance for funding of its losses. The above non-debt cash inflow shall augment the consolidated net worth base of AFL which was previously significantly eroded in FY20 and Q1FY21 and provide financial flexibility to it apart from shoring up its liquidity cushion at a consolidated level.

PVH, the other JV partner of PAFPL, is a leading American clothing company and owner of brands like Tommy Hilfiger, Calvin Klein, Van Heusen, IZOD, ARROW, Warner's and Olga, and has licensed brands such as Speedo, Geoffrey Beene, Kenneth Cole New York, Kenneth Cole Reaction, Michael Kors, Sean John, Chaps, Donald J. Trump Signature Collection, JOE Joseph Abboud, DKNY, Ike Behar and John Varvatos. The key focus of the PVH group is to acquire brands and grow them globally through wholesale, retail, e-commerce and licensing channels. PVH, through its subsidiaries, also focuses on designing and marketing high quality menswear, women wear, children's apparels and denim collections. On a consolidated basis, PVH Corp reported total revenue of USD 9,909 million and PBIT of USD 558.70 million for the year ended February 02, 2020 and for the half year ended August 02, 2020, PVH earned revenue of USD 2,924 million with loss of USD 1,220 million at PBIT level on account of disruption caused by COVID-19 pandemic.

The decision of amalgamating Tommy Hilfiger Arvind Fashion Private Limited (THAFPL) into Calvin Klein Arvind Fashion Private Limited (CKAFPL; and now known as PAFPL) follows PVH's global strategy of synergizing the operational benefits for both the brands as both of them are owned by PVH and jointly managed by PVH and AFL in India.

Established brands with global identity

TH is one of the world's leading designer lifestyle brands and is internationally well-recognized. TH has built a strong global brand awareness and recognition due to its quality apparel, accessories and lifestyle products at accessible price points. The TH brand portfolio primarily includes Tommy Hilfiger, Hilfiger Collection, Tommy Hilfiger Tailored, Tommy Jeans and Tommy Sport. CK is another global lifestyle brand built on iconic essentials and powered by bold, progressive ideals. CK has preserved brand's prestige and a distinct marketing identity and position with its strategy to provide a focused, consistent approach to global brand growth and development. The CK brand portfolio primarily includes CK Calvin Klein, Calvin Klein, Calvin Klein Jeans, Calvin Klein Underwear and Calvin Klein Performance.

Global retail sales for products sold under TH and CK brands were approximately USD 9.2 billion and USD 9.4 billion respectively during CY20 (CY; refers to the period from February 04, 2019 to February 02, 2020) (the figure represents sales from franchisees, licensees and other stores to end customers). PVH Corp earned revenues of USD 4.7 billion and USD 3.7 billion for the year ended February 02, 2020 from TH and CK brand business respectively. Thus, it can be seen that the performance of PVH Corp is significantly driven by TH and CK brand portfolio. Further, for the half year ended August 02, 2020, PVH earned revenue of USD 1.45 billion (P.Y. USD 2.16 billion) and USD 1.07 billion (P.Y. USD 1.76 billion) from TH and CK brands respectively.

Established operations of PAFPL with widespread distribution network

PAFPL sells apparels, accessories and other products under the 'Tommy Hilfiger' and 'Calvin Klein' trademarks in India. These products are sold through exclusive stores which are either EBOs i.e. exclusive brand outlets through company operated stores and franchisee stores, SIS i.e. stores in stores, exclusive counters/ sections for TH and CK products in stores like Shoppers Stop, Lifestyle, Central mall, Pantaloons, etc. and Outlet stores (discount stores for TH and CK products).

As on September 30, 2020, PAFPL had a total of 515 stores (310 for TH and 205 for CK) spread across India which includes 163 EBOs, 345 SIS and 7 outlet stores having an aggregate retail space of 3.04 Lakh Square Feet (LSF). Further, despite

adverse impact of COVID-19 on its operations during March 2020, TH witnessed like to like sales growth of 6% during FY20 (excl. impact of COVID-19 in March'20; like-to-like growth remained even better at 9%) whereas CK witnessed like to like sales growth of 16% during FY20 as CK is relatively new brand as compared to TH. PAFPL has also sub-licensed the 'Tommy Hilfiger' trade mark to various companies for different products (like watches to Titan Company Ltd, eyewear to Sterling Metaplast India Pvt. Ltd, and travel bags to Brand Concepts Pvt. Ltd) for which PAFPL receives trade mark sub-licensing fees every year.

Moderate capital structure and debt coverage indicators

Subsequent to adoption of IND-AS 116 and amalgamation of THAFPL into PAFPL, the company has recognized lease repayment obligation of Rs.92.92 crore (including short term and long term lease liability) along with recognition of corresponding right of use (RoU) assets of Rs.76.69 crore as on March 31, 2020. The difference between RoU and the lease liability is adjusted against the general reserve thereby impacting its net worth to that extent. Considering the impact of IND-AS 116, the overall gearing ratio (including lease liability as debt) remained at 1.73 times as on March 31, 2020. Further, the debt coverage indicators remained moderate marked by total debt to GCA of 13.74 years and PBILDT interest coverage of 2.46 times during FY20 although the debt coverage indicators are expected to weaken in FY21 on the back of expectation of moderation in profitability and expectation of cash losses during the year. Further, total debt/ PBILDT remained moderate at 3.83 times during FY20. The debt profile of the company includes working capital borrowings and lease liability whereas the company does not have any long-term debt repayment obligation.

Favorable long-term growth prospects of branded apparel business post effective control of COVID-19 pandemic

The trend of increasing urbanization and expectation of better disposable income post the economic slowdown induced by measures to control the outbreak of the corona virus is likely to augur well for the branded apparel segment's long-term growth prospects in India. In the long-term, the organized apparel retail market is likely to exhibit good growth due to expectation of increased consumer spending driven by changing demographic profile, high brand consciousness, rising income and purchasing power, increasing number of dual income-nuclear families, changing lifestyle and consumer behaviour.

Growing revenue with moderate profitability; albeit expectation of decline in sales and profitability in FY21 due to outbreak of COVID-19

Sales of both the brands have been increasing continuously during the last four years ended FY20 backed by sustained growth momentum in both the brands due to their acceptance and liking among the end-customers. Moreover, growth in wholesale business of TH, increasing online sales for TH and CK coupled with increase in the distribution network of both the brands have contributed to the growing revenue. However, growth in sales was restricted for both the brands in FY20 due to reduced footfalls in Q4FY20 amidst COVID-19 pandemic as people tried to avoid crowded spaces. Of the total revenue of Rs.679 crore of PAFPL (post amalgamation) in FY20, majority of the revenue was contributed by TH which accounted for 64% of total revenue whereas the balance 36% was contributed by CK. Further, as articulated by PAFPL's management, the company lost sales worth around Rs.50-55 crore in light of COVID-19 induced lockdown and reduced footfalls in Q4FY20 and consequently, its hitherto moderate profitability was also impacted due to contribution loss of around Rs.25 crore associated with the loss of sales.

Moreover, with almost negligible operations for most part of Q1FY21 and gradual improvement from September 2020 onwards, the TOI and profitability of PAFPL for FY21 is likely to remain significantly lower as compared to FY20. The company expects de-growth of around 30% in its TOI during FY21 over FY20 which is likely to result in loss at PBT level of around Rs.18-19 crore despite various cost rationalization measures planned by the company. Significant adverse deviation in PAFPL's performance beyond envisaged level would be a key rating sensitivity.

Key Rating Weaknesses

Inherent working capital intensive operations which further increased due to the COVID-19 crisis

The operating cycle of the company remains elongated on account of higher inventory holding and receivable days. Due to high lead time involved in procurement of the imported apparels and seasonality associated with the apparel retailing business coupled with a wide range of products and designs for its various stores, PAFPL has a high inventory holding requirement which results into a longer inventory holding period. Moreover, nationwide lockdown towards the end of March 2020 restricted the inter-state movement of non-essential goods to combat the spread of COVID-19 impacting the business operations of the company which also resulted in its increased inventory holding. Furthermore, it is required to provide high credit to its customers (franchisees as well as departmental stores and online players) resulting into working capital intensive operations of PAFPL. The same was negated to an extent by extension in the credit period offered by the vendors of PVH Corp during FY20. PAFPL largely funds its working capital requirement through bank borrowings. The operating cycle may further elongate due to likely slowdown in consumption demand for non-essential goods in the light of economic downturn brought about by COVID-19. The ability of PAFPL to efficiently manage its inventory requirements and exercise good control over its debtors in this backdrop shall remain crucial from the credit perspective. PAFPL's management expects meaningful correction in its inventory only during Q4FY21.

Intense competition and susceptibility to volatile raw material prices

PAFPL continues to face intense competition from other premium brands like Louis Phillipe, U.S. Polo, Gucci, Guess, DKNY, Raymond, Park Avenue, Color Plus, Zodiac, Indian Terrain, etc. and it is also inherently vulnerable to changes in fashion trends, consumer spending habits as well as economic cycles. Further, 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. Notwithstanding, PAFPL continues to remain a key player in the premium semi-casual wear segment in the country due to its established brands. Furthermore, the volatility in input prices (primarily cotton) may impact the performance of PAFPL going forward given its large inventory holding.

Susceptibility to foreign exchange rate fluctuation and changes in import duty structure

PAFPL imports around 60-70% of its total requirement of readymade garments and accessories. As articulated by the company management, it hedges almost 90% of its foreign currency exposure through forward contract booking; however, it remains susceptible to foreign currency fluctuation risk on its balance un-hedged exposure. Further, due to competitive pricing environment, it is difficult for PAFPL to pass on any increase in import duty to its customers which may also impact the profitability. The company's management has also articulated to gradually increase domestic sourcing from PVH Corp's approved vendors to mitigate the forex risk.

Short to medium-term consumption slow-down in the economy accentuated by the outbreak of COVID-19 crisis

India's GDP contracted by 23.9% in Q1FY21 which is the worst decline in decades. Private consumption which is a driver of the economy (accounting for around 60% of the GDP) witnessed a notable decline of 27% in Q1FY21 compared with Q1FY20. Moreover, the nationwide lockdown imposed by the government from end-March 2020 till May 31, 2020 for controlling the outbreak of COVID-19 had an adverse impact on the retail industry as the non-essential establishments remained closed which almost stopped the business operation of the retail industry. Fashion and lifestyle segment of the retail industry is likely to suffer to a greater extent due to the shutdown and consumer spending on such items taking a backseat during such times. Further, the restrictive measures for containment of the virus, the overall lower income levels due to higher unemployment and the sharp global economic slowdown is expected to constrain consumption demand. The cash inflow of the retail industry came to a standstill during the lockdown period, and despite significant one-time actions to manage the negative impact on profitability and cash-flows, significant losses were incurred during this period. Even after the staggered opening of malls and stores from June 2020; while sales have shown signs of improvement from September 2020 as the festive season arrives, demand is not expected to reach pre-COVID levels during FY21 as people are likely to curtail their discretionary spending with reduced income as well as tendency to preserve cash. Also, retailers may have to extend heavy discounts or extend the sale period to clear the piled-up inventory, thereby impacting their profitability. Furthermore, there is a likely shift in consumer preference towards online channels in order to avoid crowded spaces. In such times, apparel retailers with omni-channel presence and those with access to support from strong parents or groups will be better placed to counter the challenging business environment. PAFPL having presence across offline and online channels with strong parentage of AFL and PVH Corp is expected to fare relatively better which would aid faster recovery once the COVID-19 pandemic subsides.

Negative impact of COVID-19 pandemic; albeit mitigating steps planned by PAFPL's management towards cost rationalization

In view of envisaged lowering of 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 for at least the next two or three quarters, will be more pronounced in case of players with presence in non-essential items and luxury segments. However, rental waivers from the mall-owners could help the retailers to bring down their fixed costs which will reduce the impact on their credit profile to an extent. On the other hand, a faster reversal to normalcy may contain the extent of likely deterioration.

The widespread disruption brought about by the outbreak of COVID-19 pandemic across the globe is also likely to adversely impact the performance of PAFPL. However, PAFPL's management has articulated various proactive steps taken by the company to reduce its cost and augment liquidity. Lease is a major fixed cost for the company, and it has successfully negotiated the lease rentals with mall owners and land owners to reduce the minimum lease rent to up to 50% along with waiver of lease rentals for the lockdown period which has resulted into material reduction in its fixed costs during Q1FY21 as per management's articulation. The company is also conserving cash by reducing workforce, salary cuts, and other establishment costs, apart from cutting marketing and deferring capital expenditure (capex) outlay. PAFPL's management has articulated various steps to reduce cost during FY21 compared with FY20; majority of which has already been achieved in H1FY21.

Liquidity: Adequate

PAFPL funds its working capital requirements through bank borrowings and trade credit from approved vendors of PVH Corp. The average utilization of its fund based working capital limits remained around 85-90% for the trailing 12 months ended September 2020. Despite high working capital intensity, the liquidity of the company was adequately supported by

cash accruals of ~Rs.22 crore during FY20 and moderate current ratio of 1.21 times as on March 31, 2020. Furthermore, expectation of need-based support from JV partners and absence of fixed term debt repayment obligation continues to provide cushion to its liquidity. Consequently, PAFPL had not availed moratorium granted by its lenders as a Covid relief measure (as permitted by the Reserve Bank of India) for a period of six months towards the interest payment on its working capital limits. Also, PAFPL's management has articulated that the approved vendors of PVH Corp (JV partner) had extended credit period for its purchases during H1FY21 so as to provide cushion to its liquidity. Moreover, proceeds from the rights issue of AFL and stake sale in Flying Machine brand to Flipkart group are likely to augment its liquidity cushion, if the need arises.

Analytical Approach: Standalone while factoring strengths of its JV partners (i.e. AFL and PVH Corp)

Applicable Criteria:
Criteria on assigning 'outlook' and 'credit watch' to Credit Ratings
CARE's Policy on Default Recognition
Rating Methodology - Factoring Linkages - Parent Sub JV Group
Financial ratios – Non-Financial Sector
Rating Methodology - Organized Retail Companies
Liquidity Analysis of Non-Financial Sector Entities

About the company
PVH Arvind Fashion Private Limited (PAFPL) was incorporated on March 31, 2011 in the name 'Premium Garments Retail Private Limited'. Later on, its name was changed to 'Calvin Klein Arvind Fashion Private Limited (CKAFPL) from May 19, 2016. The name of the company was rechristened to its present form i.e. PAFPL on September 09, 2020 post amalgamation of 'Tommy Hilfiger Arvind Fashion Private Limited *(THAFPL; rated: CARE A; Negative and withdrawn in October 2020)* into CKAFPL vide National Company Law Tribunal (NCLT) order dated July 14, 2020 which was later filed with Ministry of Corporate Affairs (MCA) on September 14, 2020 (i.e. since the scheme legally became applicable). The scheme has become effective with an appointed date of April 01, 2019.
PAFPL is a 50:50 joint venture between PVH Corp, USA [through its wholly-owned subsidiary PVH B.V.] and AFL. The company is engaged in wholesale trading and marketing of licensed products under the brand 'Tommy Hilfiger' and 'Calvin Klein' including retail trading for TH brand in India.

(Rs. Crore)

Brief Financials	FY19 (A) CK	FY19 (UA) @ (TH+CK)	FY20 (UA)* (TH+CK)
Total Operating Income	228.25	650.31	678.79
PBILDT	14.20	52.82	78.94
PAT	1.06	9.74	5.23
Overall Gearing (times) including lease liability	-	-	1.73
Overall Gearing (times) excluding lease liability	*1.67*	*1.02*	*1.10*
PBILDT Interest Coverage (times)	2.12	3.00	2.46

A: Audited; UA: Un-audited
**Financial results of PAFPL post implementation of IND-AS 116 and amalgamation of THAFPL in to it*
@ For the purpose of analysis and comparison, CARE has combined financials of THAFPL (which ceased to exist post amalgamation into PAFPL) and CKAFPL (now known as PAFPL) for FY19

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

Complexity level of various instruments rated for this company: Annexure-3

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-Cash Credit	-	-	-	80.00	CARE A; Negative

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-Cash Credit	LT	80.00	CARE A; Negative	-	-	-	-

Annexure-3: Complexity level of the rated instruments

Sr. No.	Name of the Instrument/Bank Facilities	Complexity Level
1.	Fund-based - LT-Cash Credit	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. 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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