December 18, 2020

V2 Retail Limited: [ICRA]A- (Stable) assigned

Summary of rating action

Instrument	Current Rated Amount (Rs. crore)	Rating Action
Fund based- Working Capital Facilities (Cash Credit)	50.00	[ICRA]A- (Stable); Assigned
Total	**50.00**	

Rationale

The assigned rating takes into consideration the established position of V2 Retail Limited (V2 Retail) in the value retailing segment, extensive experience of its promoter family and its healthy financial risk profile characterised by low leverage and adequate liquidity supported by sizeable cash and liquid investments.

V2 Retail is a medium-size retail company whose business model is focused on value retailing with most of its store located in Tier II and III cities in India. The company generates most of its turnover from the sale of fashion apparel. Its business profile is characterised by a healthy share of private label sales backed by backward integration and an overall competitive cost structure. The company is promoted by Mr. Ram Chandra Agarwal, one of the pioneers of value retailing in India with a long entrepreneurial track record of more than 25 years in the retail industry. The rating favourably factors in V2 Retail's wide geographic presence (76 operational stores across 17 states/Union Territories as on March 31, 2020). V2 Retail enjoys an established relationship with a wide and diversified vendor base that optimises its cost structure. This enables the company to maintain its gross margins in the range of 28-32%, which are expected to further improve with increasing private label share and recent initiatives of backward integration into apparel manufacturing. The rating also takes cognizance of V2 Retail's store rationalisation measures and cluster-based expansion approach to achieve economies of scale. The rating continues to factor in V2 Retail's strong financial profile, as is evident from its healthy cash accruals, comfortable capital structure and strong debt coverage indicators.

The above mentioned strengths are, however, partially mitigated by the company's relatively weak operating performance over the past 3-4 years as reflected by steadily declining same store sales and accordingly lower sales per square feet metric. The company's same store sales declined by 5% and 8.5% in FY2019 and FY2020, respectively. This was primarily because of increasing competition from new entrants in the value retailing segment, relatively subdued consumer demand sentiments, especially in the previous fiscal, and the company's strategy of focusing on higher priced product categories, which adversely impacted demand. ICRA also notes that the company's operations are characterised by high working capital intensity and the risks of aged inventory buildup, as is inherent in the apparel retail business.

Further, during the current fiscal, the company's operations were adversely impacted by the disruption caused by the pandemic. As a result, its revenues declined by 82% in Q1 FY2021 on a YoY basis, before improving sequentially in Q2 FY2021 as lockdown related restrictions eased. Nonetheless, the company reported a decline of 65% in revenues in H1 FY2021 and a loss of Rs. 22.5 crore at PBT level. While footfalls have been gradually improving, ICRA expects the company's performance to remain muted during FY2021.

The Stable outlook reflects ICRA's expectation that V2 Retail will stabilise its operational metrics and report an improvement in performance from H2 FY2021 onwards, which would help it maintain a healthy financial risk profile. The company's ability to scale up its operations in the face of competition, improve operational indicators, efficiently manage its working capital cycle, and maintain a healthy financial profile will remain monitorable.

Key rating drivers and their description

Credit strengths

Established value retail player in India with presence in Tier II and III cities; extensive track record of promoters in retail industry - V2 Retail is an established player in the value retailing segment in India with its stores located primarily in Tier II and III cities in India that offer healthy potential for growth. The company is promoted by Mr. Ram Chandra Agarwal who established 'Vishal Megamart' in 2001. The promoter's vast experience in understanding India's retail footprint, especially in the value segment of small town India, remains a credit positive. Over the past five years, the company has expanded its retail footprint to 76 stores across 71 cities, primarily in Uttar Pradesh, Bihar and Odisha. During this period, the company's revenues have grown at a CAGR of 21%. Over the next three years, the company aims to expand its store network by penetrating further into its core markets of Uttar Pradesh, Bihar, Odisha.

Business profile characterised by healthy share of private label sales, backward integration and competitive cost structure – When the company started selling some of its own private labels, this resulted in the revenue share of its private labels increasing from 2% in FY2016 to 30% of its total revenue in FY2020. To further support the private label growth, the company incorporated a wholly-owned subsidiary, V2 Smart Manufacturing Private Limited, in 2019 with an initial production capacity of 7 lakh pieces per month. The subsidiary is focused on manufacturing the company's private label apparel to provide better cost control and quality. The company has been able to secure gross margins of 28-32% consistently for the past four years, which are likely to improve further with the backward integration initiative.

Further, the company has undertaken a store rationalisation exercise to identify and close more than 18 loss-making stores to improve profitability and store space utilisation metrics over the past 40 months. It has also been successful in managing rental costs by entering into long-term leases as the rentals per square feet have been stable for the past 4-5 years. With inventory management remaining key, the management has been focused on technology investments in supply chain management; aided by the same, it has brought down the inventory days to 133 days in FY2020 from 164 days in FY2019.

Geographically diversified store presence; scaling through cluster-based approach and omni channel strategy - With approximately 76 stores spread across 71 Indian cities, V2 Retail benefits from healthy geographic diversity. In FY2020, the company generated ~51% of its revenue from the East zone, ~29% from the North and ~20% from the South. The company's total retail footprint is also adequately spread across the three regions; however, with major concentration in Uttar Pradesh, Odisha and Bihar where ~42% of its total stores are located due to a higher number of Tier II and III towns. As the company has already gained significant physical footprint, it embarked on the next phase of penetrating deeper into existing clusters to extend the focus on generating superior economies of scale. With a changing industry landscape, the company has also tied up with prominent e-commerce players, such as Amazon and Myntra, along with the launch of its own e-commerce portal—V2kart—to diversify its sales channel.

Healthy financial risk profile, characterised by a conservative capital structure - Over the years, the company has funded its expansion largely through promoter funds and internal cash accruals resulting in a low leverage. As of FY2020, the total borrowings on the company's balance sheet primarily comprised working capital loans of Rs. 28 crore. This resulted in low leverage and comfortable coverage indicators. While the company's credit metrics after adjusting for AS 116 (TD/TNW of 0.1 time and TD/OPBDIT at 1.2 times) have remained comfortable, the same are likely to weaken in the current fiscal owing to pressure on earnings from pandemic induced disruption. Nevertheless, ICRA draws comfort from the company's stated strategy of funding its capital expenditure plans through internal cash flows, which would limit its reliance on external borrowings.

Credit challenges

Weak operating performance; lockdowns on account of ongoing pandemic significantly impacted operations - The company's sales per square feet have been declining consistently from Rs. 942 in FY2018 to Rs. 672 in FY2020 per square feet per month owing to increased competition from new entrants in the value retailing segment, subdued consumption demand and its strategy of focusing on higher realisations vis-à-vis volume growth. This translated into lower operating profitability with adjusted OPBITDA margin[1] declining by around 430 bps YoY in FY2020 to 2.1% from 6.4% in FY2019. The company's financial performance further weakened during H1 FY2021 because of the Covid-19 induced lockdown, which curtailed operations during the initial months followed by limited footfalls owing to high risk. In H1 FY2021, the company's sales dropped by 65% on a YoY basis resulting in PBT loss of Rs. 22.5 crore. ICRA expects the company to witness sales recovery in H2 FY2021 to close the fiscal year at a degrowth of 35-40%.

Exposure to intense competition and cyclicity in retail sector - The company faces stiff competition from numerous players in the unorganised segment along with competition from various organised players in the offline as well as online segments. Additionally, the demand for V2 Retail's products is dependent upon on the prospects of the rural economy as well as small cities and towns with the agri economy and the monsoons playing a critical role in its sales.

High working capital intensity of retail business – V2 Retail's operations are characterised by high working capital intensity primarily because of its need to maintain adequate inventory at stores as well as warehouses. While the company managed to reduce its NWC/OI from 21% in FY2019 to 18% in FY2020, but the same continues to remain higher vis-à-vis its industry peers. Considering the slowdown in discretionary spending due to the pandemic, there is an increased risk of higher inventory levels in FY2021. ICRA, however, takes comfort from the management' focus on reducing inventory holding through monthly inventory monitoring at its stores and distribution centres.

Liquidity position: Adequate

V2 Retail maintains an adequate liquidity profile characterised by free cash balances of Rs. 66 crore and unutilised working capital facilities of Rs. 43 crore as on September 2020. The company does not have significant debt payment obligations and primarily utilises its cash flows from operations to fund its expansion. ICRA expects the company to open ~8-12 stores annually over the next two years at a capex of Rs. 35-40 crore, which is expected to be funded through existing cash reserves and adequate internal accruals, thereby reducing its reliance on external borrowings.

Rating sensitivities

Positive Triggers – The rating could be upgraded if the company demonstrates a track record of improving same store revenue coupled with scale-up in operations aided by healthy store expansion. Further, reduction in the working capital intensity, leading to an improvement in the company's return indicators would also be considered favourably for a rating upgrade.

Negative triggers – Negative pressure on the rating could arise if there is a prolonged impact of Covid-19 on revenue growth and cash accruals. Elongation in working capital intensity leading to a deterioration in liquidity, or debt-funded

[1] *Adjusted for the impact of IND AS 116*

capex leading to deterioration in the credit profile and interest coverage falling below 4.0 times (without the impact of IND AS 116) on a sustained basis could also be negative triggers.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Retail Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on the consolidated financial profile of the company. As of March 31, 2020, the company has only 1 subsidiary, the details of which can be found in Annexure 2.

About the company

V2 Retail Limited, earlier known as Vishal Mega Mart Limited, was incorporated in 2001 by Mr. Ram Chandra Agrawal. The company was a pioneer in creating a value retail chain in India. Vishal Mega Mart offered both apparel and FMCG products from its stores in India's Tier II and III cities and towns. The company expanded across the country at a swift pace and went public in FY2007. However, the company faced headwinds and turned loss-making due to multiple reasons. These included an aggressive debt-funded expansion strategy and weak store locations with poor economics, coupled with lack of IT-backed supply chain management, which led to piling of stocks. To overcome financial constraints, the promoters sold their 'Vishal' brand in 2011. Mr. Agarwal restructured the business and introduced the 'V2 Retail Limited' brand when it opened its first store at Jamshedpur (Jharkhand) in 2011.

V2 Retail currently operates 76 retail stores, which mostly sell fashion apparel for men, women and children along with lifestyle products from its stores located primarily in India's Tier II and III cities. The company's presence is concentrated in the northern and eastern states of Uttar Pradesh, Bihar, Odisha, Jharkhand and Assam, etc. The company is primarily focused on the value retailing segment in India, catering to mass market consumers. In line with evolving trends in the retail industry, the company is also present on e-commerce platforms; however, revenues from its online sales account for less than 5% of its turnover at present.

Key financial indicators (audited):

	FY2019	FY2020*
Operating Income (Rs. crore)	748.4	701.2
PAT (Rs. crore)	20.5	8.6
OPBDIT/OI (%)	6.4%	10.7%
PAT/OI (%)	2.7%	1.2%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	1.6
Total Debt/OPBDIT (times)	0.2	4.4
Interest Coverage (times)	26.3	2.5

**Owing to change in accounting policies (Adoption of Ind AS 116), the overall debt from FY2020 onwards is expected to include lease liabilities henceforth, which would impact the reported leveraging and coverage indicators*

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding as on Sep 30, 2020	Rating	FY2020	FY2019	FY2018
					18-Dec-2020			
1	Fund based-Working Capital Facilities (Cash Credit)	Long Term	50.0	6.8	[ICRA]A- (Stable)			

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund based- Working Capital Facilities (Cash Credit)	28-Jun-2019	NA	NA	50.00	[ICRA]A-(Stable)

Source: V2 Retail Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
V2 Smart Manufacturing Private Limited	100.00%	Full Consolidation

Source: V2 Retail Limited

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Dishant Mahajan
+91 9971013432
dishant.mahajan@icraindia.com

Shamsher Dewan
+91 1244545328
shamsherd@icraindia.com

Rohan Kanwar Gupta
+91 1244545808
rohan.kanwar@icraindia.com

Relationship Contact

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999