December 11, 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 rating assigned takes into consideration 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 as characterized by low leverage and adequate liquidity profile supported by sizeable cash & liquid investments.

V2 Retail is a medium-size retail company with its business model focused on value retailing segment with most its store located in Tier II & III cities in India. The company generates majority its turnover from the sale of fashion apparel. Its business profile is characterized by healthy share of private label sales backed by backward integration and overall competitive cost structure. The company is promoted by Mr. Ram Chandra Agarwal, who is regarded as the pioneer of value retailing in India and has a long entrepreneurial track record of more than 25 years in the retail industry. The ratings favorably factor in V2 Retail's wide geographic presence (76 operational stores in 17 states/Union Territories as on March 31, 2020) with most of its stores in tier-II and tier-III cities. V2 Retail has an established relationship with a wide and diversified vendor base that optimizes 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 backward integration initiative into apparel manufacturing. The rating also takes cognizance of V2 Retail's store rationalization measures and cluster-based expansion approach to achieve economies of scale. The ratings continue 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 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 FY 2019 and FY 2020, respectively. This has primarily been because of increasing competition from new entrants in the value retailing segment, relatively subdued consumer demand sentiments, especially in the previous fiscal and company's strategy of focusing on higher priced product categories, which adversely impacted demand. ICRA also notes that the company's operations are characterized 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 because of the disruption caused by the pandemic. As a result, its revenues declined by 82% in Q1 FY2021 on 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 company's performance to remain muted during FY2021.

The Stable outlook reflects ICRA's expectation that V2 Retail will stabilize 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 player in the value retailing segment in India with presence in Tier II & III cities; Established 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 & III cities in India that offer healthy potential for growth. The company is promoted by Mr. Ram Chandra Agarwal who is the pioneer of value retailing segment in India having established 'Vishal Megamart' in the early 2001. The promoter's vast experience in understanding India's retail footprint, especially in value segment in smaller towns remains a credit positive. Over the past five years, the company has expanded its retail footprint to 76 stores located across 71 cities primarily in the states of UP, Bihar and Odisha. During this period, the company's revenues have grown at a CAGR of 21%. Over the next 3 years, the company aims to further expand its store network by further penetrating in its core markets of UP, Bihar, Odisha.

Business profile characterised by healthy share of private label sales, backward integration, and competitive cost structure

The Company started selling a portion of its merchandise under its own Private labels resulting in 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 wholly owned subsidiary named V2 Smart Manufacturing Private limited in 2019 with an initial capacity of producing 7 lakh pieces monthly. The subsidiary is focused on the manufacturing of private labelled 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 considering the backward integration initiative.

Further, the company has undertaken store rationalization exercise to identify and close more than 18 loss-making stores to improve profitability and store space utilization 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, the company has been able to bring down the inventory days to 133 days in FY 2020 from 164 days in FY 2019.

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 region, ~29% from North and ~20% from South. The company's total retail footprint is also adequately spread across the three regions, however with major concentration in the states U.P, Odisha and Bihar where ~42% of its total stores are located due to higher number of Tier II and Tier II locations. 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 changing industry landscape, the company has also tied up with prominent e-commerce players such as Amazon, Myntra etc 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 FY 2020, the total borrowings on company's balance sheet comprised primarily of working capital loans of Rs. 28 crore. This resulted in low leverage and comfortable coverage indicators. While company's credit metrics post adjustment for AS 116 (TD/TNW of 0.1 times 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 because of pandemic induced disruption. Nevertheless, ICRA draws comfort from company's stated strategy of funding its capital expenditure plans through internal cash flows, which would limit reliance on external borrowings.

Credit challenges

Weak operating performance; lockdowns on account of the ongoing pandemic significantly impacted operations -
The company's sales per square feet have been declining consistently from Rs. 942 in FY 2018 to Rs. 672 in FY 2020 per square feet per month years owing to increased competition from new entrants in the value retailing segment, subdued consumption demand and company's strategy of focusing on higher realisations vis-à-vis volume growth. This translated in 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 Covid-19 induced lockdown which curtailed operations during initial few months followed by limited footfalls owing to high risk. In H1 FY2021, the company's sales dropped by 65% on YoY basis resulting in PBT loss of Rs. 22.5 crore. ICRA expects the company to witness sales recovery in H2 FY 2021 to close the fiscal year at de-growth of 35-40%.

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

High working capital intensity of the retail business – V2 Retail's operations are characterized by high working capital intensity primarily because of need to maintain adequate inventory at stores as well as warehouses. While the company managed to reduce its NWC/OI from 21% in FY 2019 to 18% in FY 2020 but the same continues to remain higher vis-a-vis industry peers. Considering the slowdown in discretionary spending due to pandemic, there is an increased risk of higher inventory levels in FY 2021; ICRA however takes comfort from management' focus on reducing inventory holding through monthly inventory monitoring at stores and distribution centers.

Liquidity position: Adequate

V2 Retail maintains adequate liquidity profile as 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 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 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 rating upgrade

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

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

to deterioration in the credit profile and Interest coverage falling below 4 times (without the impact of IND AS 116) on a sustained basis

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
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 Ramchandra Agrawal. The company was a pioneer in bringing the concept of Value retail chain in India. Vishal Mega mart offered both apparel and FMCG products with its stores located in Tier II & III cities in India. 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: aggressive debt-funded expansion strategy, weak store locations with poor economics, coupled with lack of IT backed Supply chain management, which lead to piling of stocks etc. To overcome financial constraints, the promoters sold their brand 'Vishal' in 2011. Mr. Agarwal restructured the business and introduced brand 'V2 Retail Limited' when it opened its first store in Jamshedpur in 2011.

Under V2 Retail, the company currently operates 76 retail stores which mostly sell fashion apparel for men, women, and kids along with lifestyle products with its stores located primarily in Tier II and Tier-III cities. The company presence is concentrated in the Northern and Eastern states such as U.P., Bihar, Odisha, Jharkhand, Assam etc. The company is primarily focused on value retailing segment in India and caters to mass market consumers. In line with evolving trends in the retail industry, the company also has presence through e-commerce platforms; however, revenues from online sales account for less than 5% of 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, 2020)	Rating	FY2020	FY2019	FY2018
					11-Dec-2020			
1	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 click here

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	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

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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.

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