

Press Release

Future Enterprises Limited (FEL)

April 20, 2017

Rating Reaffirmed

Total Facilities Rated*	Rs.300.00 Cr
Long Term Rating	SMERA AA provisional (SO)/Stable # (Reaffirmed)

*Refer Annexure for details

Credit enhancement on account of structured payment mechanism in the form of Debt Service Reserve Account (DSRA).

The assigned provisional rating will be converted to final rating after the required conditions are met

Rating Rationale

SMERA has reaffirmed the rating of '**SMERA provisional AA (SO)**' (**read as SMERA provisional double A Structured Obligation**) on the Rs.300.00 crore non-convertible, secured, redeemable, taxable debenture issue of Future Enterprises Limited (FEL). The outlook is '**Stable**'. FEL has completed NCD issue of Rs.180.00 cr in January 2017 in eight tranches (out of Rs. 300.00 cr) and entered into a debenture trust deed (DTD). FEL is in the process of executing the supplementary DTD to include timelines for funding trust and retention account (TRA). In the interim, SMERA has continued the provisional rating on the Rs. 180.00 cr NCD issue.

The rating is provisional and the final rating is subject to the execution of a trust deed (with a SEBI registered trustee) that will clearly lay down the legal payment mechanism as also the rights and obligations of various parties involved in the issuance document structure for the issue and proposed issue. This will remain in force for the tenure of NCDs, notwithstanding the demerger, merger or restructuring in FEL.

Future Enterprises Limited (FEL) houses the physical assets (store formats of erstwhile Future Retail Limited (FRL) and Bharti Retail Limited including all infrastructure at stores) apart from strategic investments in various companies. The company is also engaged in the manufacturing of denim garments for men, women and kids. FRL, the retail arm of the Future group utilises the physical infrastructure (i.e. stores and other allied infrastructure) owned by FEL and pays rentals to FEL.

Analytical Approach: SMERA has consolidated the financial and business risk profiles of FEL and Future Retail Limited (FRL) hereinafter referred to as 'the Combined Entity' on account of their strong operational and financial linkages. Further, SMERA has considered credit enhancement on account of structured payment mechanism in the form of Debt Service Reserve Account (DSRA).

List of key rating drivers and their detailed description

Strengths:

Structured payment mechanism for interest servicing on NCDs along with Debt Service Reserve Account (DSRA): FEL maintains DSRA, equivalent to one year interest obligation initially in the form of fixed deposits/AAA rated bonds with an option to replace part/whole of such fixed deposits/AAA rated bonds by bank guarantee during the tenure of NCDs. The rating factors in the adherence to a specific legal payment mechanism (credit enhancement in the form of DSRA) to be administered by the trustees of the NCD. The trust and retention account (TRA) is to be funded one working day in advance (T-1) in case of fixed deposits and two working days in advance (T-2) in case of bank guarantee. In case of 'AAA' rated liquid bonds, the same will be three working days in advance (T-3) for servicing debenture holders on the forthcoming due date T, and ensuring that the trustee is intimated about the clear funds. If FEL fails to do so, the payment will be made good through liquidation of fixed deposits by due date, bank guarantee (invocation by T-1) or 'AAA' rated liquid bonds (invocation by T-2).

Long track record and established position in organised retail: FEL (the combined entity) benefits from the established track record and extensive experience of the promoters in retail. The promoters are supported by a strong management team with significant experience in retail. FRL enjoys a leading position in organised retail with pan India presence across multiple formats. FRL's Big Bazaar was ranked among the top four most trusted brands in 2016 by Brand Equity survey. As on December 2016, FRL, along with the recently acquired Bharti Retail has 794 stores in 25 states and 238 cities.

FEL posted net sales of Rs. 2801.17 cr with profit after tax (PAT) of Rs.239.41 cr while FRL posted net sales of Rs. 12591.25 cr with PAT of Rs. 245.23 cr for 9MFY2017. SMERA believes that with the acquisition of retail, agriculture, and bakery businesses of Heritage Foods (including the chain of 124 Heritage Fresh stores of 2,000-8,000 square ft in Hyderabad, Bengaluru, and Chennai) and organic and inorganic growth expected, the Combined entity is expected to maintain its market position.

Strong resource mobilisation ability and management focus on divestments of non-core businesses: The Combined entity has strong resource mobilisation ability and has diversified funding mix with funds being raised from banks, institutions and capital markets.

FEL effectively holds (through direct and indirect ownership) 27.40 per cent and 49.87 per cent stake in Future Generali India Life Insurance Company Limited (life insurance business) and Future Generali India Insurance Company Limited (general insurance business) respectively. FEL plans to divest its holdings in these companies over the next three to four years. FEL has already divested 12.75 per cent stake in Future Supply Chains Solutions Limited (FSC) for a total consideration of ~Rs.185 cr in April 2016. Further, the company has divested its entire stake in Future Lifestyle Fashions Limited (FLFL) at a book value of Rs.334 cr for a total consideration of Rs.375 cr in Q2FY2017.

SMERA believes that, the management's continuous focus on monetisation of non-core investments and reduction of debt levels is expected to improve the credit profile of the Combined entity over the near to medium term.

Weaknesses:

Moderate capital structure and debt coverage indicators: The gearing (debt to equity ratio) of FEL (combined) stood at 1.22 times as on March 31, 2016, with interest coverage ratio (ICR) of 2.24 times in FY2016. The gearing stood at 0.95 times as on March 31, 2015 with ICR of 2.04 times in FY2015. The gearing levels registered deterioration in FY2016 mainly due to the debt raised for funding capex/renovation of FRL's formats and also for the recently acquired Easyday stores of Bharti Retail. Further, on account of addition of Bharti Retail's Easyday stores, the Combined entity is in the process of introducing many of its own private label brands and fashion category in the Easyday store network. Accordingly, the Combined entity has invested in the working capital requirements for its private label brands and FMCG products being sold out of Easyday stores leading to high working capital levels.

Working capital intensity: The Combined entity has high working capital requirements as the debtors days stood low at ~15 days due to the retail format (cash and carry) and high inventory storage of ~100 days in FY2016 leading to higher working capital requirements. The gross current assets stood high at 187 days in FY2016. However, the working capital limit utilisation remained moderate at ~50 to 60 per cent in the last six months ended February 2017 due to extended credit period received from suppliers. SMERA believes that the working capital requirements will remain high in the medium term due to organic and inorganic growth of the combined entity.

Highly competitive landscape of the retail segment: Organised retailers face immense competition from unorganised or Kirana stores that constitute over 94 per cent of the total retail market. These stores largely cater to customers in and around the locality. Additionally, within organised retail too there exists stiff competition from established players like Avenue Supermart, Shoppers Stop, Reliance Retail etc. Moreover, the offline as well as online players have added significantly to price wars and discounts. Further, the government has permitted 100 per cent foreign direct investments (FDI) in multi- brand retail and 100 per cent FDI in single-brand retail resulting in the competition getting even more tougher.

Analytical approach: as mentioned above

Applicable Criteria

- Securitised Transactions - <https://www.smera.in/criteria-securitization.htm>
- Trade Entities - <https://www.smera.in/criteria-trading.htm>
- Application of Financial Ratios and Adjustments: <https://www.smera.in/criteria-fin-ratios.htm>
- Default Recognition: <https://www.smera.in/criteria-default.htm>

Outlook: Stable

SMERA believes that FEL will maintain a stable outlook over the medium term owing to the promoter's extensive experience. The outlook may be revised to 'Positive' in case of significantly higher than expected growth in revenues/profitability margins coupled with sizeable reduction in debt levels. Conversely, the outlook may be revised to 'Negative' in case of significant movement in gearing or debt servicing metrics vis a vis SMERA's expectations due to large debt funded capex/acquisitions, lower cash flows from operations or challenges in monetising its non-core investments.

About the Combined Entity

The erstwhile Future Retail Limited (E-FRL), the flagship company of the Future Group (one of India's largest retailers), is engaged mainly in home and electronics and value retailing. Till FY2014-15, E-FRL was engaged in retail operations as well as owned the infrastructure assets associated with retail operations. During FY2015-16, pursuant to a business restructuring exercise, E-FRL's retail and infrastructure operations were split into two separate entities namely Future Retail Limited (FRL) and Future Enterprises Limited (FEL) respectively. As per the arrangement, FRL would be carrying out the retail trade whereas all the infrastructure assets would be owned by FEL.

On October 31, 2015 (appointed date), E-FRL acquired Bharti Retail Limited (BRL) in an all- stock deal. The retail operations of E-FRL and that of Bharti Retail Limited (BRL) were merged and subsequently the name was changed to Future Retail Limited (FRL). The infrastructure operations of BRL merged with E-FRL's infrastructure and investment operations and subsequently the name of the entity was changed to Future Enterprises Limited (FEL).

Presently FEL owns the physical assets (store formats of E-FRL and BRL including all the infrastructure assets situated in the stores) apart from strategic investments in various companies. FRL operates all retail formats. Mr. Kishore Biyani continues to be associated as a promoter of both, FEL and FRL. As on December 31, 2016, FRL operates 794 stores with 13.03 mn. sq.ft. spread across 238 cities. It includes stores such as Big Bazaar (231), Easyday (379), E-Zone (87), FBB (54), Home Town (37) and rest of the other formats.

About the Rated Entity – Key Financials

On a standalone basis, for FY2015-16, FEL (excluding subsidiaries, joint ventures and associates) and FRL together reported net profit after tax (PAT) of Rs.26.38 cr on operating income of Rs.14,613.00 cr. The tangible net worth stood at Rs.4,930.00 cr as on March 31,2016.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for the last three years:

Name of Instrument/ Facilities	FY2018			FY2017		FY2016		FY2015	
	Scale	Amount (Rs. Crore)	Rating with Outlook	Date	Rating with Outlook	Date	Rating with Outlook	Date	Rating with Outlook
Non Convertible Debentures (Proposed)	LT	120.00	SMERA provisional AA (SO)/Stable	Sep 06, 2016	SMERA provisional AA (SO)/Stable	-	-	-	-
Non - Convertible Debentures (Series XV- A)	LT	25.00	SMERA provisional AA (SO)/Stable	-	-	-	-	-	-
Non - Convertible Debentures (Series XV-B)	LT	25.00	SMERA provisional AA (SO)/Stable	-	-	-	-	-	-
Non - Convertible Debentures (Series XV-C)	LT	20.00	SMERA provisional AA (SO)/Stable	-	-	-	-	-	-
Non - Convertible Debentures (Series XV-D)	LT	30.00	SMERA provisional AA (SO)/Stable						
Non - Convertible Debentures (Series XV-E)	LT	6.00	SMERA provisional AA (SO)/Stable						
Non - Convertible Debentures (Series XV-F)	LT	29.00	SMERA provisional AA (SO)/Stable						
Non - Convertible Debentures (Series XV-G)	LT	27.00	SMERA provisional AA (SO)/Stable						
Non - Convertible Debentures (Series XV-H)	LT	18.00	SMERA provisional AA (SO)/Stable						

***Annexure - Details of instruments rated:**

Name of the Facilities	Date of Issuance	Coupon Rate (Per cent)	Maturity Date	Size of the Issue (Rs. Cr)	Ratings/Outlook
Non Convertible Debentures (Proposed)	NA	NA	NA	120.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV- A)	Oct 13, 2016	9.75	Oct 13, 2021	25.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-B)	Oct 13, 2016	9.80	Oct 13, 2023	25.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-C)	Oct 26, 2016	9.75	Oct 26, 2021	20.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-D)	Oct 26, 2016	9.80	Oct 26, 2023	30.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-E)	Dec 05, 2016	9.75	Dec 05, 2021	6.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-F)	Dec 05, 2016	9.80	Dec 05, 2023	29.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-G)	December 21, 2016	9.50	December 21, 2021	27.00	SMERA provisional AA (SO)/Stable
Non – Convertible Debentures (Series XV-H)	December 21, 2016	9.55	December 21, 2023	18.00	SMERA provisional AA (SO)/Stable

Note on complexity levels of the rated instrument: <https://www.smera.in/criteria-complexity-levels.htm>

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ABOUT SMERA

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