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INDIAN RETAIL INDUSTRY

Fashion retail witnesses early trends of recovery, post reopening; sector likely to recover to pre-Covid level of sales in FY2023

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BUSINESS OUTLOOK – NEGATIVE FOR FASHION RETAILERS

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Fashion retail segment is witnessing the encouraging early trends of recovery post re-opening and is expected to revert to pre-Covid level of sales by Q2 FY2023. A severe third wave may, however, delay the recovery further

The fashion retail segment is witnessing strong recovery in sales post reopening after Covid 2.0. ICRA's channel checks suggest that during the months of July and August 2021, the segment witnessed a healthy recovery upto 70-85% of pre-covid level of sales. While the average ticket size has moderated from FY2021 levels (though remained higher than the pre-Covid levels), the footfalls have increased, suggesting that this time around consumers are more comfortable in making repeat visits. This current recovery is in contrast to a relatively muted recovery (upto 48-50% of pre-Covid sales) reported during Q2 FY2021 following the reopening after the first wave. ICRA expects the segment to witness a 15-17% YoY growth during July 2021-March 2022, translating into an annual revenue growth of 23-25% in FY2022

A severe third wave of infections, if any, peaking in the months of October/November 2021, however, poses significant downside risks to this base case. As per estimates, this could potentially shave upto 40% of the segment's revenues from ICRA's base case during Q3 FY2022, translating into a modest 7-8% Y-o-Y revenue growth only in FY2022. This, in turn, would further delay the fashion retail segment's recovery to normalcy.

Performance adversely impacted in Q1 FY2022 following Covid 2.0; sector witnessing green shoots of recovery: The coronavirus pandemic had adversely impacted the credit profile of the Indian fashion retail industry in FY2021. While these retailers were on the path to recovery, having reported up to 94% of pre-Covid sales by Q4 FY2021, a sharp spike in the number of Covid cases during March-April 2021 derailed the recovery. Ensuing lockdowns and restrictions on store operating hours acutely impacted the financial performance in Q1 FY2021, with fashion retailers in ICRA's sample set witnessing a sharp 62% revenue decline in Q1 FY2022 (vis-a-vis Q1 FY2020). Following the lifting of restrictions, the store operating hours improved in Q2 FY2022 accompanied by a pickup in economic activity. The segment is, however, witnessing encouraging early signs of recovery, with months of July and August 2021 having reported a healthy recovery of upto 70-85% of pre-covid level of sales.

Outlook remains negative on fashion retail industry with the sector expected to recover to pre-Covid level of sales by Q2 FY2023: ICRA has maintained its negative outlook on the fashion retail segment and expects the segment to revert to its pre-covid level of sales by Q2 FY2023. Revenues in FY2022 are expected to remain lower by upto 20% vis-a-vis pre-covid level of sales. Likewise, OPMs though improved on YoY basis, shall remain lower by around 450 bps from FY2020 levels (as per Ind AS 116).

Liquidity remains strong for large retailers; renewed focus on store additions: Most of the large retailers raised equity during FY2021 to strengthen their balance sheets, given the high operating leverage of the business. Consequently, despite the sharp revenue declines during the year, liquidity positions of most of the retailers remain strong. These entities, after having deferred their store expansion plans in FY2021, have now announced increased capital expenditure towards store additions. Fashion retail entities in our sample set are expected to increase their capital spending by over 45% in FY2022, entailing a total capital outlay of approximately Rs. 14 billion. Against this, the extent of equity infusion (for these entitites) during FY2021 stood at ~Rs. 32 billion.

Increasing focus on omni-channel presence: The pandemic spurred the adoption of online retailing in India, with most retailers reporting more than 50% jump on a YoY basis, albeit on a low base, in online sales in FY2021. Omnichannel retailing, however, has its fair share of challenges requiring large investments towards technology upgradation. Consequent to this, contribution from omnichannel sales, though increased over FY2020, is expected to remain low at low-mid double digit levels of the overall sales mix over the medium term. While the retailers will remain focused on increasing their omnichannel presence, the same is expected to remain only supplemental to, and not replace, the offline model of store expansion, given the overall low penetration of organised retail in India

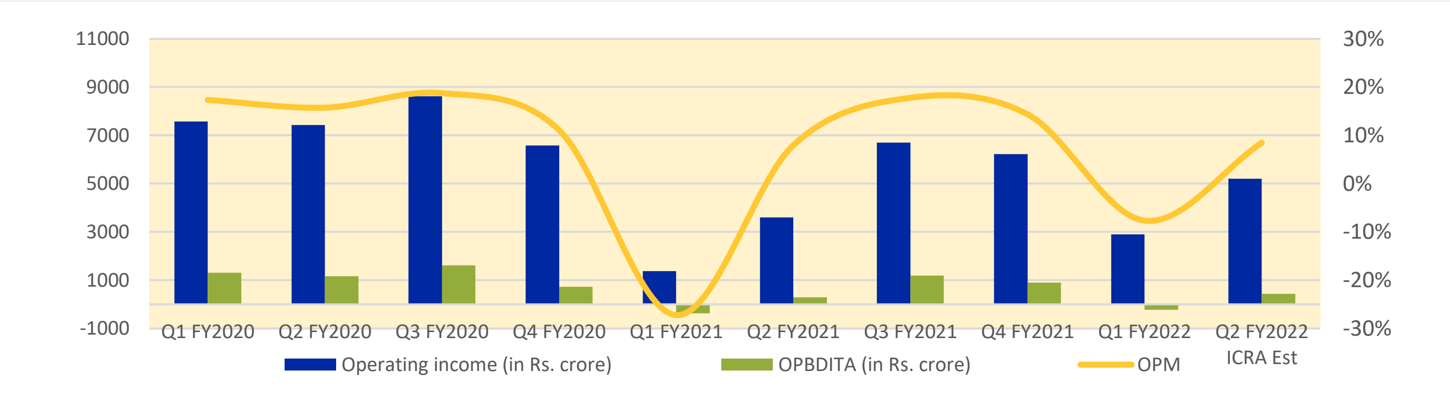
Entities in ICRA's sample set reported a sharp revenue decline of 62% in Q1 FY2022 (vis-a-vis Q1 FY2020), adversely impacted by the lockdowns and restrictions amid the second wave. The revenues however, doubled on YoY basis, led by increased online sales and localised nature of restrictions

SECOND WAVE OF PANDEMIC DERAILED RECOVERY TO PRE-COVID LEVEL OF SALES AND PROFITABILITY

Fashion retailers in ICRA's sample set reported a 47% YoY decline in revenues in FY2021, adversely impacted by the lockdown during Q1 FY2021 and sporadic local restrictions in Q2 FY2021. The segment recovered well in H2 FY2021, aided by pent-up demand, festive season buying as well as declining rate of infections, with entities in ICRA's sample recovering upto ~94% of their pre-covid level of sales by Q4 FY2021. Region wise, outlets located in non-metros and smaller cities performed better than those located in metros in FY2021, as was the case with standalone stores vis-a-vis stores located in malls.

With the onset of the second wave and the ensuing regional lockdowns as well as the restrictions on store operating hours, footfalls during Q1 FY2022 were sharply impacted. Given the non-essential nature of fashion retail, most of these stores were closed during Q1 FY2022. Entities in ICRA's sample set operated with only~13-15% of their total stores during the months of April and May 2021. With gradual easing of lockdown restrictions, the operational store network improved in June 2021, though remained marred by restricted store timings. Consequently, fashion retailers in ICRA's sample set witnessed a sharp 62% revenue decline in Q1 FY2022 (vis-a-vis Q1 FY2020), though were higher by 111% on YoY basis. Besides better preparedness to handle another wave of pandemic, localised nature of restrictions and greater contribution of online channels to sales, helped partly mitigate the impact.

EXHIBIT 1: QoQ trend in revenues and profits of fashion retailers



Source: *ICRA research, Sample set includes nine listed entities mainly engaged in retailing of apparel and footwear; figures as per Ind AS 116*

Rental concessions received during the second wave were markedly lower than that received during the first wave of pandemic. While salary cuts have been rolled-back in FY2022, rationalisation of other overheads is expected to continue

Rental, employee cost and selling/promotional expenses are the three key cost components of retail entities, accounting for ~29-30% of their total costs (after raw material cost/ purchase of traded goods, which account for ~59-60% of the total costs). Given the high operating leverage of the retail business and in the backdrop of sharp revenue decline, fixed cost rationalisation becomes imperative. FY2021 saw retailers invoking force majeure clauses in their rental agreements to save on the rental costs during the period of lockdown. These entities also negotiated their rental agreements to convert their fixed rental charges into variable rates upon commencement of operations for FY2021. In value terms, retailers were able to achieve unconditional rental concessions for as high as 59% of their rental outgo in FY2020.

While the rental negotiations were earlier entered into till March 2021, following the second wave of Covid-19 and lockdowns, fashion retailers again invoked the force majeure clause in the rental agreements and renegotiated rents for the current fiscal. The extent of rental concessions in Q1 FY2022 were, however, markedly lower by upto 55% than those seen in Q1 FY2021.

Besides rental renegotiations, employee cost rationalisation by way of salary cuts and reduced fresh hiring as well as curtailed discretionary spends towards advertising, selling and promotion and other overheads were also undertaken in FY2021. Employee expenses witnessed a steep 19% YoY decline in FY2021. Most of the retailers have at present not indicated any curtailment of employee expenses in FY2022, though the same cannot be ruled out in case of slower than anticipated recovery in demand. Nonetheless, ICRA expects the retailers to tread cautiously with respect to other overheads, including selling and advertisement expenses, till there is recovery in discretionary demand.

EXHIBIT 2: Trend in key expenses for retailers

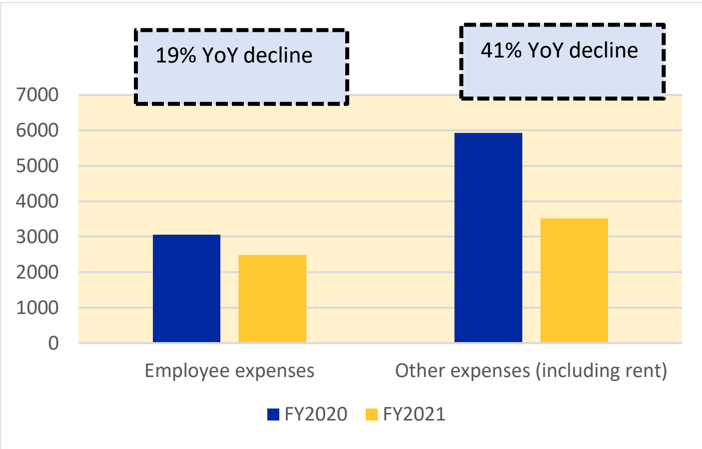


EXHIBIT 2: Rent concessions received during FY2021 and Q1 FY2022

	Received In FY2021	Savings	Received in Q1 FY2022	Variance
	Rs. crore	As a % of total rent expense in FY2020	Rs. crore	vis-a-vis Q1 FY2021
Aditya Birla Fashion and Retail Limited	343.9	28%	74.8	-53%
Trent Limited	88.8	19%	35.0	-3%
Shopper's Stop Limited	238.1	59%	61.3	-40%
V2 Retail Limited	11.4	23%	6.0	-55%
Bata India Limited	102.0	26%	23.1	-54%

***Source:** ICRA research, Sample set includes nine listed entities mainly engaged in retailing of apparel and footwear; figures as per Ind AS 116*

ENCOURAGING EARLY TRENDS, THE SECTOR EXPECTED TO RECOVER TO PRE-COVID LEVEL OF SALES IN FY2023; THE THIRD WAVE, HOWEVER, POSES SEVERE DOWNSIDE RISK

Stronger recovery of upto 85% of pre-Covid sales post reopening after the second wave, with improvement in footfalls and transaction size. Notwithstanding this, the revenue growth during FY2022 is expected to remain lower by upto 20% vis-a-vis pre-Covid level of sales.

With further lifting of restrictions and pickup in economic activity, the store operating hours improved in Q2 FY2022. By August 2021, more than 85% of the retail network of entities in ICRA's sample was operational, with the balance 15% being accounted for by regions like Maharashtra (including malls) and Kerala. Despite the full retail network not being operational, ICRA's channel check suggests that in contrast to reopening post the first wave, a stronger recovery is being witnessed following Covid 2.0. Months of July and August 2021 witnessed a robust recovery ranging between 70-85% of pre-Covid level of sales (vis-a-vis July 2019). On the lower end of this range are large-sized departmental stores located primarily in malls, where footfalls still remain constrained.

The average ticket size or the transaction value has somewhat moderated from FY2021 levels for most of the formats (though remained higher than the pre-Covid levels), suggesting that this time around consumers are more comfortable in making repeat visits. The extent of recovery remains stronger in non-metro regions, despite the increased incidence of infections to hinterlands during Covid 2.0. Category wise, kids wear, casual wear and home textiles categories continue to witness healthy traction of sales vis-a-vis formal wear, given the continued work from home arrangement. The level of discounting also remained restricted in Q1 FY2022, with strict control on inventory management.

While part of the recovery could be attributed to the pent-up demand, with improvement in the vaccination coverage, ICRA expects the segment to witness a 15-17% YoY growth during July-March 2022, translating into an annual revenue growth of 23-25% in FY2022 (given the low base of FY2021) . This shall, however, remain lower by upto 20% vis-a-vis pre-Covid level of sales. ICRA expects the segment to revert to its pre-covid level of sales by Q2 FY2023. Aided by improved revenues, the OPMs are expected to improve in FY2022, though these will remain lower by around 450 bps from FY2020 levels (as per Ind AS 116).

A severe third wave, however, poses downside risks to this base case, as it may hurt the segment during its most profitable festive season quarter. As per ICRA's estimates, a severe third wave peaking in the months of October/November 2021 could potentially shave upto 40% of the segment's revenues from ICRA's base case during Q3 FY2022, translating into a modest 7-8% YoY revenue growth in FY2022. This, in turn, would further shift the fashion retail segment's recovery to normalcy. Large brands with relatively better presence in e-commerce channels shall fare better vis-a-vis the small brands as they would be better placed to cater to customer's requirements during restrictions on mobility.

LIQUIDITY SHORED UP; STORE ADDITIONS TO PICK-UP IN FY2022

Entities in ICRA's sample set are expected to increase their capital spending by over 45% in FY2022, entailing a total capital outlay of approximately Rs. 14 billion.

Most of the large retailers raised equity during FY2021 in a bid to de-leverage and improve liquidity, given the high operating leverage of the business. Reliance Retail Limited (RRL) saw the largest equity raising ~Rs. 473 billion in FY2021, followed by Aditya Birla Fashion and Retail Limited's capital raise of Rs. 25 billion, V-Mart's qualified institutional placement (QIP) of Rs. 3.75 billion and Shopper's Stop's rights issue of Rs. 3 billion. The proceeds of the above were primarily used to reduce debt and improve liquidity position, amid the pandemic. Consequently, despite the sharp revenue decline, most retailers closed FY2021 with a stronger balance-sheet and have therefore, increased their capital outlay towards store additions in FY2022. This is also bolstered by the healthy medium-term demand outlook for the industry, supported by favourable demographics and rising disposable incomes.

Fashion retail entities in ICRA's sample set, after having curtailed store expansion plans in FY2021, are expected to increase their capital spending by over 45% in FY2022, entailing a total capital outlay of approximately Rs. 14 billion.

Exhibit 4: Expected store additions (fashion retail) by large players

Company	Expected store addition in FY2021 (pre-covid)	Actual (Net) Additions in FY2021	Likely store additions in FY2022
Reliance Retail Limited	1000+ stores addition across core fashion and lifestyle formats	600+ new stores	Multifold expansion
Aditya Birla Fashion Retail Limited (ABFRL)	70 stores in Pantaloons segment	4 stores	~60 stores
Shopper's Stop Limited	10+ stores (department stores)	Closed down 5 stores (net)	20+ stores
Trent Limited	30+ stores in Westside format and 100+ stores addition in Zudio store format	9 Westside store, 53 Zudio stores	35 Westside stores and 75 Zudio stores
V-Mart Retail Limited	50+ stores	13 stores	Acquired 77 stores from brand-Unlimited; 40-50 additional new stores
V2 Retail Limited	5-15 stores	~19 stores	~15 stores

Source: Company data, ICRA research

VIRUS BOON FOR OMNI-CHANNEL RETAILING

Accelerated shift towards omni-channel retailing during the pandemic. The same is expected to remain only supplemental to, and not replace, the offline model of store expansion, given the overall low penetration of organised fashion retail in India

The pandemic spurred the adoption of online retailing in India, with most of the retailers reporting more than 50% jump on a YoY basis, albeit on a low base, in online sales in FY2021. This was particularly witnessed for categories like fashion, grocery as well as personal care. While some of the spurt in online sales is temporary and is likely to subside once vaccination coverage improves, the momentum towards digital adoption is likely to continue. This would be led by changes in consumer behavior with growing preference for online shopping as well as increasing internet penetration. In this backdrop, omni-channel presence or offline and online integration is expected to be the apt model for retailers over the medium-term. With increased focus on profitability by the pure-play e-commerce players and the restrictive nature of the foreign direct investment (FDI) policy for them, and the changing consumer preferences and inherent convenience associated with online platforms both the online and brick and mortar players will look at ways to partner and grow together.

Among the various retailers, Reliance Retail Limited leads the pack in terms of online-offline integration, through its online portal, ajio.com, reliancedigital.in (online portal for consumer electronics) and JioMart (F&G online portal). The omni-channel presence of other large brick and mortar retailers like ABFRL, Trent Limited, Shoppers Stop, Bata India Limited, also grew in FY2021.

Omni-channel retail, has its fair share of challenges, consequent to which its adoption, though growing, remains low in India. Major investments towards technology upgradation are needed by brick and mortar stores to provide real-time information on product visibility and inventory availability (to avoid a situation of stock-outs), personalise consumer experience as well as enable stores to handle return and pack and ship capabilities. Consequent to this, contribution from omnichannel sales is expected to remain low at low-mid double digit levels of the overall sales mix over the medium term. While the retailers will remain focused on increasing omnichannel presence, the same is expected to remain only supplemental to, and not replace, the offline model of store expansion, given the overall low penetration of organised fashion retail in India, with concentration primarily in Metros and Tier-I cities. This is also evinced in retailers' renewed focus on store additions, especially in Tier-II/III and IV cities, where penetration of organised retail remains low.

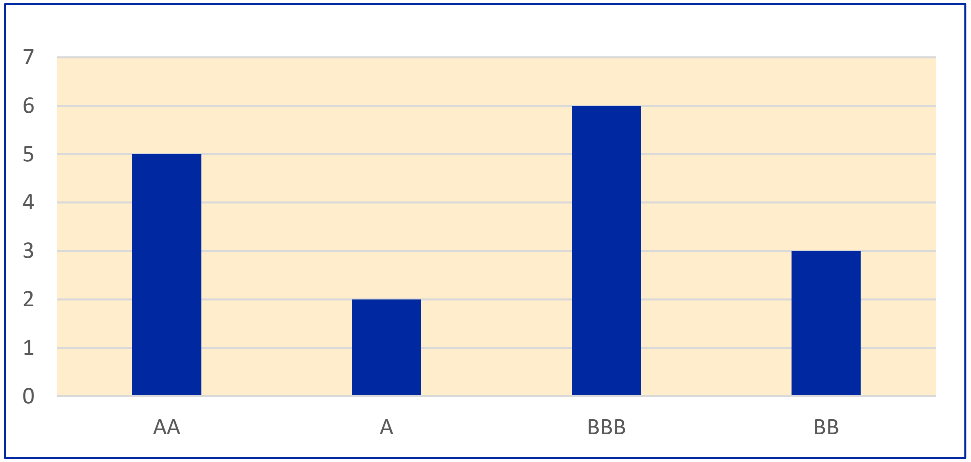
Exhibit 5: Online presence of fashion retailers

Company	Online presence	Key trends in online sales witnessed in FY2021
Reliance Retail Limited	• Online channels for consumer electronics (reliancedigital.in), fashion business (ajio.com) and Jio Mart--online grocery shopping portal • Physical stores also equipped with kiosks so that consumers can browse and shop products which may not be readily available at stores. Stores are equipped to handle delivery, return, replacement and refunds • Acquired minority stake in Zivame (innerwear) and 96% stake in Urban ladder (furniture). These acquisitions are expected to sharpen omni-channel capabilities and bring in operational efficiencies	• Digital commerce and merchant partnerships business contributed nearly 10% to revenues (includes fashion and lifestyle, grocery, consumer electronics, pharma retail, connectivity) • Within fashion retailing, Ajio's run rate was up 4x over FY2020 along with improvement across customer and operating metrics • Ajio contributed ~25% to apparel revenues. • Augmented omnichannel capabilities to 500+ cities under Trends umbrella.
Aditya Birla Fashion Retail Limited	• Separate online portals for all its lifestyle brands. Products also available on various other e-commerce websites	• Ecommerce sales grew by 2-3x in FY2021 • Currently 35% of Madura and 60% of Pantaloons network omni-enabled • Medium-term target 8-10% of sales from online channels vis-a-vis 1% pre-covid
Shopper's Stop Limited	• Has its own website. Has also tied up with Amazon	• Upgraded technology to enhance the overall user experience as well as to analyse customer shopping behaviour and real-time visibility of business operations • Net online sales grew by 92% in FY2021 • Proportion of online sales increased from 1% (in previous quarters) to 6% in FY2021
Bata India Limited	• Own platform-Bata.in as well as other online marketplaces- like Amazon, Myntra, Flipkart, Paytm, Tata Cliq and Ajio, amongst others • Launched hyperlocal digital channels-Bata ChatShop and Bata Store-on-Wheels in FY2021	• Witnessed a YoY growth of 22% in FY2021 • Digital channels contributed to 15% of revenues in FY2021 • More than 75% of stores omni-enabled, up from ~57% in FY2020
V-Mart Retail	• Own portal	• Following a cautious approach • Currently derives 1% of revenues from online channel
V2 Retail	• Own online platform v2kart.com	• Increasing focus on online channels, but currently derives very small proportion of revenues from e-commerce • Medium term target is to have e-commerce sales anywhere between 5% to 10%

Source: Company data, ICRA research

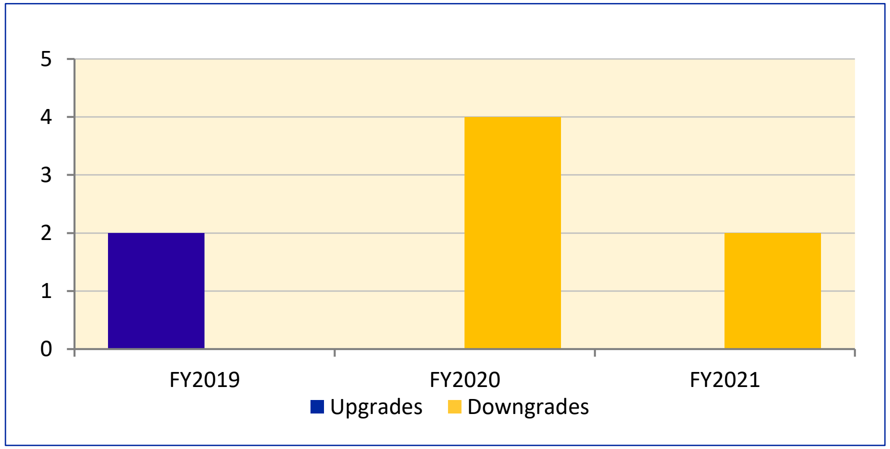
ICRA-RATED FASHION RETAIL COMPANIES

Exhibit 6: Rating distribution of ICRA rated universe of fashion retail companies (September 17, 2021)



Source: *ICRA research*

Exhibit 7: Count of upgrades and downgrades (ICRA rated universe of fashion retail companies)



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