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# FOOTWEAR INDUSTRY

## Demand and margin recovery pushed back to Q2 FY2023 due to third wave and cost pressures

**FEBRUARY 2022**

# Highlights

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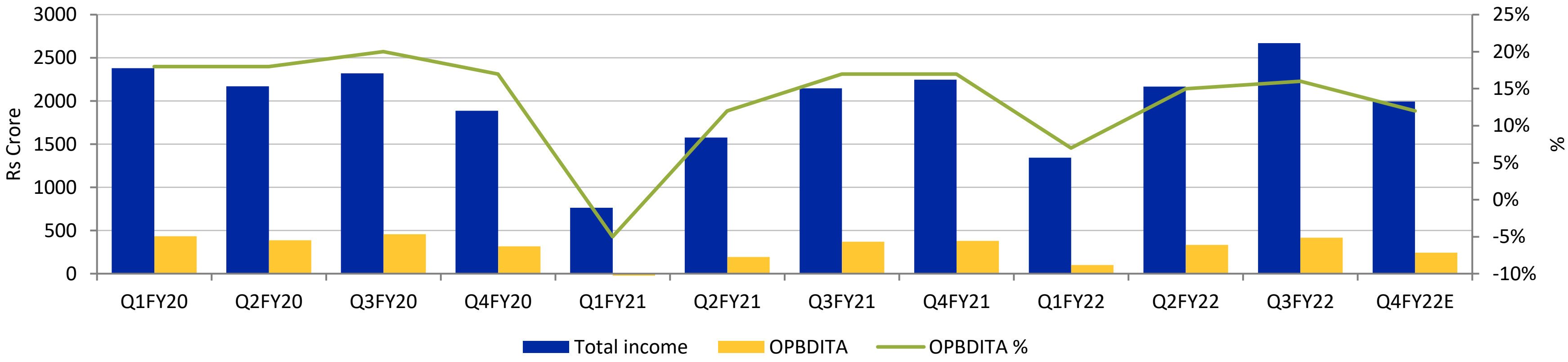
*While the industry reported strong rebound in Q2 FY2022 and Q3 FY2022, the adverse impact of the Omicron variant is likely to derail recovery of the domestic players; amidst cost pressures and delayed demand recovery, ICRA expects operating margin to return to pre-Covid levels only in Q2 FY2023; however, balance sheet of key players remains strong with healthy liquidity and low financial leverage thus supporting debt protection metrics.*

- Domestic footwear players are likely to witness muted performance in FY2022 with reversion to pre-Covid levels expected by Q2 FY2023. While the recovery had been sharp in Q2 FY2022 and Q3 FY2022, the spread of Omicron variant poses downside risks and could potentially shave upto 10% of the revenue in Q4 FY2022 compared to last fiscal, translating into an annual revenue growth of 20-25% in FY2022, which still remains almost 7-10% lower compared to pre-covid levels.ICRA expects the revenue growth of footwear players to remain in the range of 8-10% in FY2023 thereby mirroring pre-pandemic levels.
- While the operating margins (OPM) of ICRA sample of six entities are estimated at 13.8% in 9M FY2022 (against 11.7% in 9M FY2021), the same is expected to remain under pressure In Q4 FY2022 primarily owing to localised lockdown/restrictions thereby impacting operating hours and footfalls. The impact would be more visible for companies having high retail presence. While cost rationalisation efforts including rental concessions would support margins to an extent, it is to be noted that the extent of concessions was markedly lower in 9M FY2022 compared to the previous fiscal, indicating limited headroom for further reduction in the fixed cost. Consequently, the OPM in FY2022 would remain marginally higher compared to FY2021 but still lower by ~400-500 bps against FY2020 levels. ICRA expects operating margin to return to pre-Covid levels only in Q2 FY2023.
- The financial position of footwear players is expected to remain strong with healthy on-balance sheet liquidity and low financial leverage. The companies are aggressively expanding in Tier 3 towns and rural areas through the franchisee route thus limiting own capex requirements. The credit metrics are expected to remain strong with interest coverage and Total Debt/OPBDITA of 6.5x and 1.7x respectively in FY2022 compared to 4.2x and 2.4x respectively in FY2021 and would improve further in FY2023.
- The e-commerce presence of industry players has increased in recent years, with major players reporting significant jump in online sales. However, the share of e-commerce is expected to remain in low to mid double digit levels of the overall sales in the medium term.

# Omicron to push back recovery to Q2 FY2023

**Exhibit: QOQ trend in revenues and operating margins of ICRA Sample set**




- The footwear entities in ICRA's sample set reported a 25% YoY decline in revenues in FY2021, adversely impacted by the lockdown during Q1 FY2021 and restrictions in Q2 FY2021. While the performance gradually improved during H2 FY2021, aided by pent-up demand and festive season sales, the onset of the second wave and ensuing regional lockdown/restrictions adversely impacted revenue in Q1 FY2022.
- While the recovery has been sharp in Q2 FY2022 and Q3 FY2022, the spread of the new variant would trim revenues by ~10% in Q4 FY2022 compared to the corresponding previous year. Consequently, the revenues would remain lower than pre-Covid levels and reversion to historic levels is expected in Q2 FY2023.
- While OPM was adversely impacted in Q1FY 22,the same improved in Q2 FY2022 and Q3 FY2022 driven by better operating leverage. However, muted revenues following the spread of Omicron variant would negatively impact margins in Q4 FY2022. Consequently, the margin is expected to remain at ~15% in FY2022, which though better than FY2021, is still lower than pre-Covid levels of ~19%.

*Source: ICRA Research, data based on 6 footwear entities(Bata India Limited,Relaxo Footwears Limited,Mirza International Limited,Superhouse Limited,Khadim Limited,Liberty Shoes Limited*

# Limited headroom in cost savings on account of lower rent concessions in FY2022

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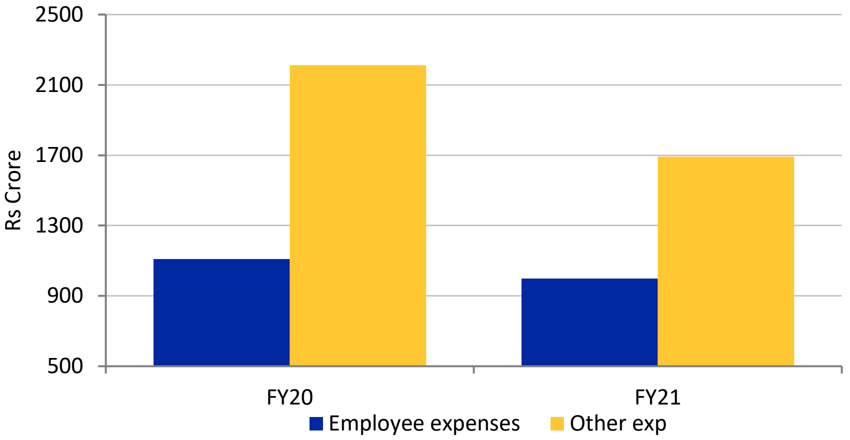
### Exhibit: Movement of expenses




*Source: ICRA Research ;Other exp include selling, general and admin expenses*

### Exhibit: Rent concessions received

| | Received in FY 2021 | Savings | Received in H1 FY2022 | Variance |
|---|---|---|---|---|
| | Rs. crore | As a % of total rent expense in FY2020 | Rs. crore | vis-a-vis H1 FY2021 |
| Bata India Limited | 101.02 | 27% | 49.42 | -36% |
| Relaxo Footwears Limited | 11.82 | 27% | 5.83 | -19% |
| Khadim India Limited | 7.32 | 22% | 3.25 | -31% |
| Liberty Shoes Limited | 9.02 | 40% | 2.75 | -46% |

*Source: ICRA Research*

- Apart from raw material costs, rental, employee and selling/promotional expenses are the three key cost components of footwear entities, accounting for ~30-40% of their total costs .
- Although companies were able to improve margins through savings on employee and rental expenses in FY2021 ,the rental concessions for most of the companies reduced significantly in current fiscal. Moreover, there has been an appx 14% growth in employee expenses in H1 FY2022 vis a vis H1 FY2021 thereby reflecting the limited scope for further reducing the fixed expenses.

# Raw material prices sequentially increased in FY2022 impacting margins

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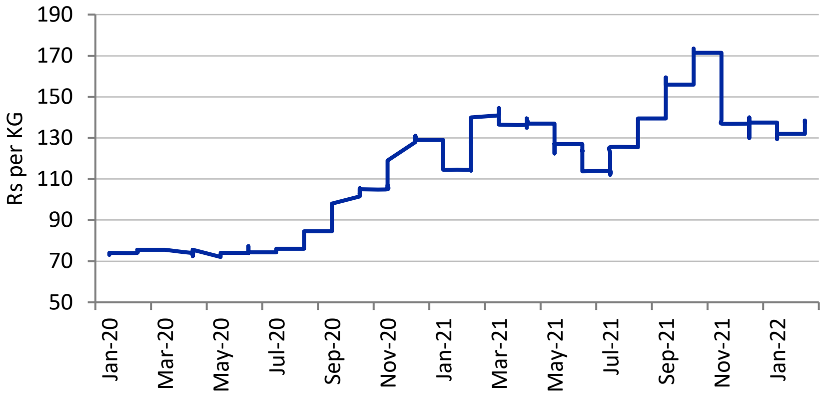
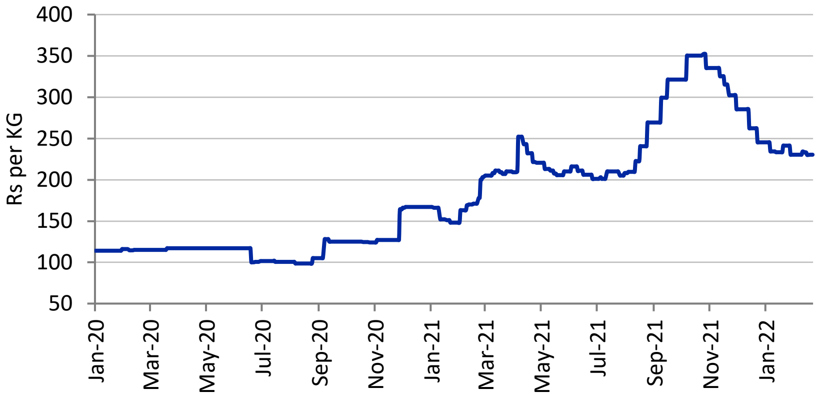
**Exhibit: Price Trend of Polyvinyl Chloride(PVC)**




*Source: ICRA Research*

**Exhibit: Ethylene vinyl acetate (EVA)price trend**

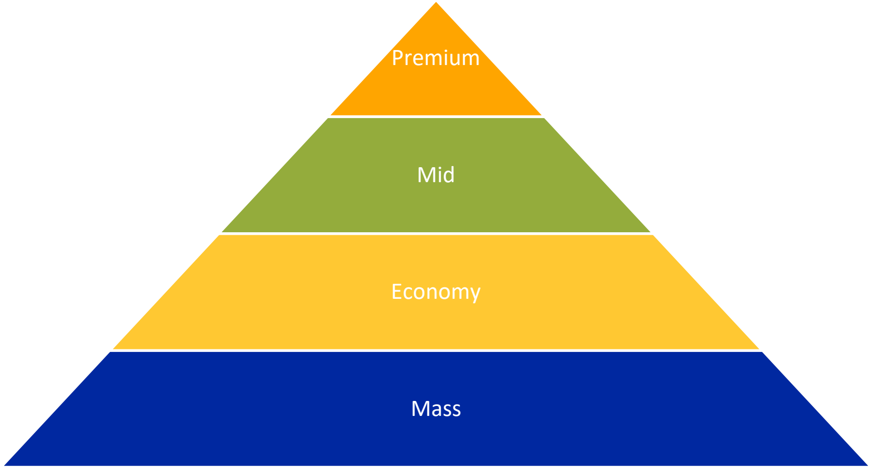



*Source: ICRA Research*

- The prices of major raw materials viz. Polyvinyl Chloride(PVC) and Ethylene vinyl acetate (EVA) have increased substantially in the last one year the impact of which was offset through price hikes to an extent.
- However the raw material prices, notwithstanding slight moderation in recent months, continue to remain high which if sustained would negatively impact profitability of footwear players in FY 2023.

# GST hike may impact profitability on existing inventory

### Exhibit: Categorization of price segments




*Source: ICRA Research*

### Exhibit: Proportion of <1000 MRP for major players

| Company | % of portfolio under Rs 1000 MRP |
|---|---|
| **Bata India Limited** | ~50% |
| **Relaxo Footwears Limited** | 90% |
| **Mirza International Limited** | 20-30% |
| **Khadim India Limited** | 84% |

*Source: ICRA Research*

- Around 80% of overall footwear sales are in less than Rs 1000 MRP bracket. The same varies for some of major players from 30% to as high as 90%.
- Depending on the portfolio mix, unless passed on to the customers, the GST hike could have a negative impact on existing inventory and hence on operating margins in Q4 of the current fiscal.

# Casual and Athleisure segments dominate SKU mix; e-commerce to support revenue growth

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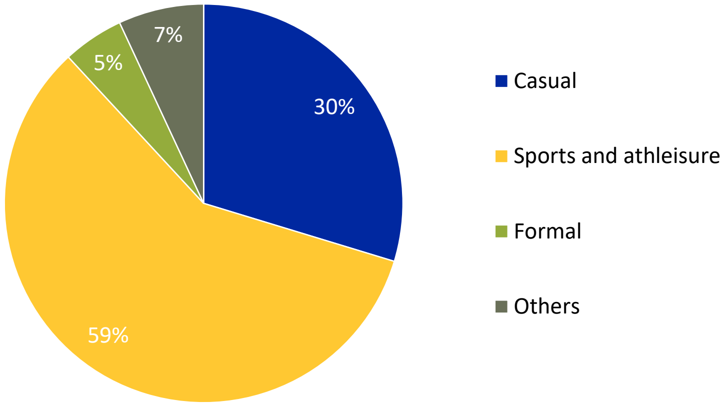
**Exhibit: % of SKUs across categories**




*Source: ICRA Research; ,% of overall SKUs of industry as on Sep 2021;others include outdoor,school uniform etc*

**Exhibit: Proportion of e commerce sales**

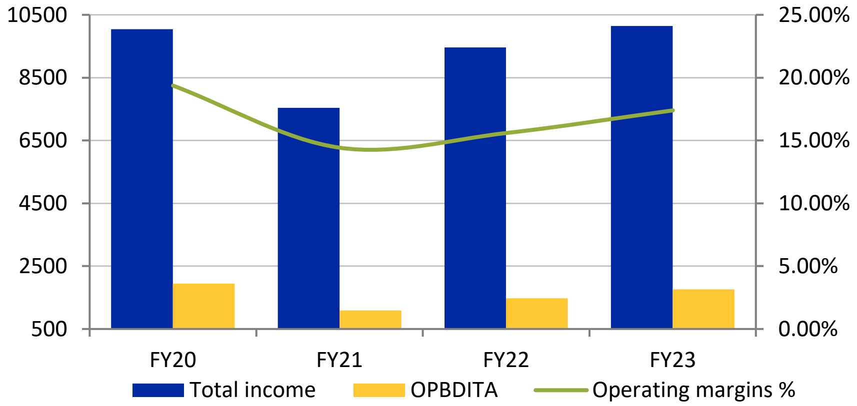
| Company | FY20 | FY21 | Next 1-2 years |
|---|---|---|---|
| **Bata India Limited** | 5% | 8.70% | 15% |
| **Relaxo Footwears Limited** | <10% | <10% | 12-15% |
| **Mirza International Limited** | 17% | 20% | 20-25% |
| **Metro Brands Limited** | 3% | 7.25% | |

*Source: ICRA Research*

- Post pandemic, the portfolio is shifting towards casual and athleisure segments which stand at appx 85-90% of overall SKUs at present. However, with office resumption and re opening of schools, the other segments are also expected to grow.
- The e-commerce segment, on account of its wide reach has also seen a good growth and is expected to further grow to low to mid double digit in the next 1-2 years.

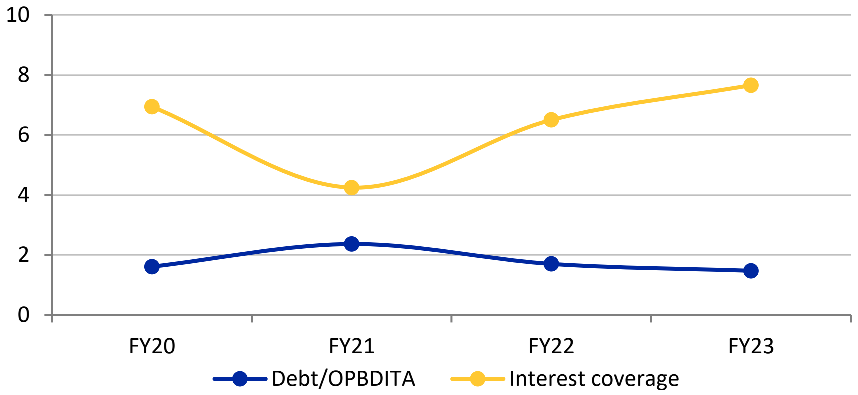
# Revenues expected to reach pre covid levels in FY 2023

**Exhibit: Trend in future revenues and margins**




*Source: ICRA Research*

**Exhibit: Trend in debt coverage indicators**




*Source: ICRA Research; ; Debt includes lease liabilities as well*

- With adverse impact of Covid in Q1FY 2022(second wave) and Q4FY 2022(third wave),the revenue in FY2022 to remain almost ~7-10% lower than pre covid levels. The operating margins would improve in FY2022 compared to FY2021 but would remain lower than pre-Covid levels.
- In FY2023, the steady improvement in demand along with improvement in operating margins is expected to support the credit profile of footwear companies.

- With low leverage and healthy liquidity, the credit metrics to remain comfortable with interest coverage of 7.7 times and Debt/OPBDITA of 1.5 times in FY2023 as against 6.5 times and 1.7 times in FY2022 respectively.

# Capex plans

**Exhibit: Expected store additions for major players**

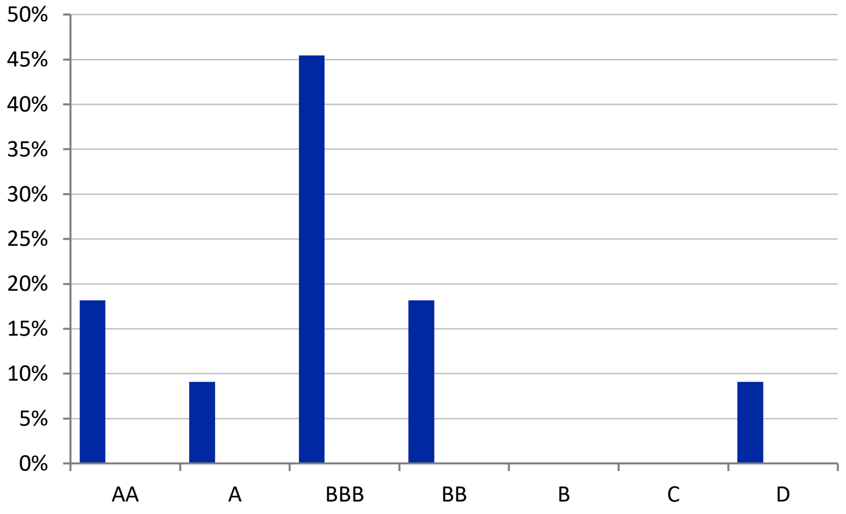
| Company | Latest store count | Store addition plan | Route of addition |
|---|---|---|---|
| **Bata India Limited** | 1500+ stores and 284 franchsiee stores as on December 2021 | Grow franchise store to 500+ in next 2-3 years, Total store count would be 1700+ accordingly | More addition through franchisee route although company would keep looking for opportunities in company operated mode also |
| **Relaxo Footwears Limited** | 402 stores as on December 2021 | Not major addition expected and retail contribution expected to be maintained. | MBO Route |
| **Mirza International Limited** | 276 stores as on Mar end out of which 151 are franchisee operated | Total stores expected to be around 500+ in next 2-3 years | Franchisee route |
| **Khadim India Limited** | 757 outlets as on Mar 2021;762 as on Sep 2021 out of which 555 are franchisee operated | ▪ Expanding retail footprint in markets across South India, West India and in Uttar Pradesh in North India<br>▪ Focus on entering into new markets through own stores and further augment presence in such markets through franchisees | Both own and franchisee |
| **Metro Brands Limited** | 629 stores as on Dec 2021 out of which 175 are EBOs. | Open 200+ new stores in next 2-3 years | Both EBO and MBO |

*Source: ICRA Research;EB0-Exlcuisve brand outlets,MBO-Multi brand outlets*

- Most of the companies involved in retailing of footwear are expected to improve their reach in Tier 1 and 2 cities through owned stores whereas expansion in Tier 3 to 5 towns is expected to happen through the franchisee route. The franchisee route also becomes effective in terms of working capital requirements.

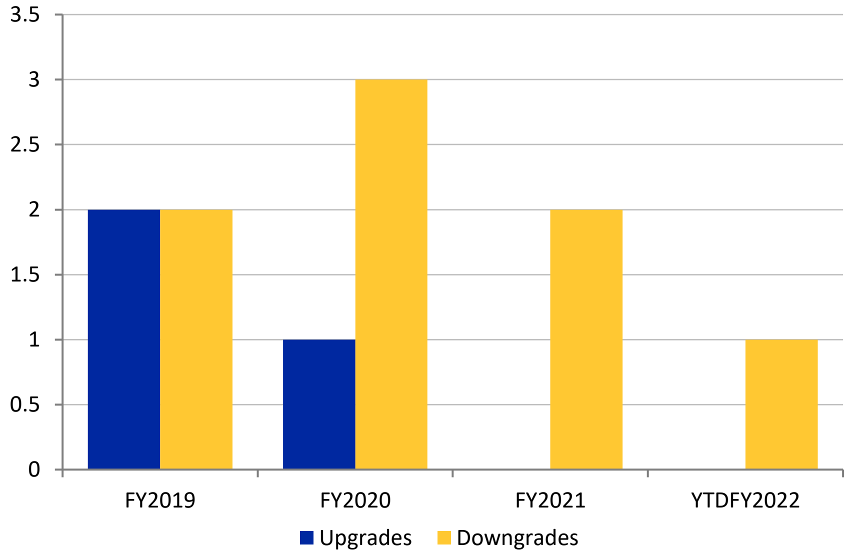
# ANNEXURE:ICRA-rated footwear companies

**Exhibit: Distribution of ICRA rated footwear companies**




*Source: ICRA Research*

**Exhibit: Count of Upgrades and downgrades**




*Source: ICRA Research,YTD denotes period from April 2021 to January 2022*

- More than 70% of ICRA's portfolio is in investment grade. There have been higher number of downgrades than upgrades in past two years on account of pandemic-led reduction in export demand as well as weak consumer spending.

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# Thank You!