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INDIAN FASHION RETAIL INDUSTRY

Industry out of the woods; outlook revised to Stable as business conditions improve

JULY 2022

Summary – Industry Trends

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Fashion retail sales have reverted to pre-pandemic levels in Q1 FY2023, on the back of improving vaccination coverage, increased footfalls and uptick in discretionary spends

- Fashion retail sector was more resilient during the second and third waves compared to impact during the first wave; entities in ICRA's sample set registered healthy growth of around 46% YoY in FY2022, albeit on a lower base.
- Increased footfalls on the back of strong pent-up demand, improving vaccination coverage and healthy offtake towards marriages have been the key drivers behind the consumption growth in recent months.
- Level of discounting remained lower in FY2021 and FY2022 (vis-à-vis FY2020), with no extended end-of-season sales. Organised players were also able to successfully pass on the impact of increased cotton yarn prices to end consumers in H1 CY2022
- Retail entities have reverted to pre-pandemic level of sales in Q1 FY2023 and are expected to witness healthy growth in FY2023, driven by improved footfalls.
- Store additions which had remained curtailed in FY2021, had picked up since H2 FY2022. Entities are expected to focus on accelerated store expansions in FY2023.
- **Given the recent improvement in performance and expected steady revenues and earnings, ICRA's outlook on the sector is revised to Stable from Negative.**

Summary – Financial Performance and Credit Profiles

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Financial performance and debt protection metrics of fashion retailers to remain comfortable in FY2023, in line with the preceding fiscal. Credit metrics and liquidity position are expected to be supported by the improved scale driving earnings, despite the expected moderation in margins and part debt-funded store expansions being undertaken.

- **ICRA expects its sample of 10 major organised retailers to record healthy YoY revenue growth of around 12-13% in FY2023 . This translates to an 5-6% growth over the pre-pandemic year of FY2020**
- Gross margins are likely to contract in FY2023 led by YoY increase in discounted sales, which was largely curtailed during the previous two years. Nevertheless, led by improved revenues and high operating leverage, operating profit margins are expected to improve to 8.2% in FY2023 from 6.7% in FY2022
- With retail demand recovering to pre-pandemic levels, organised retailers have re-initiated their expansion plans. **Total capex outlay towards new store additions for ICRA sample set is expected to increase by 48% YoY in FY2023**
- Share of omni-channel retailing had increased to ~8% of revenues in FY2022, up from 3% in FY2020. Penetration of online sales is further expected to increase to 12-14% of the total sales over the medium term.
- Debt protection metrics are likely to remain comfortable despite new capex, supported by steady earnings from operations and deleveraging as well as improved liquidity aided by equity raisings in FY2021
- Led by the healthy improvement in performance and favourable outlook, credit ratio for fashion retail sector has witnessed an uptick in YTD FY2023.

Sector Outlook movement – Value and lifestyle fashion retailers

FY2021 and FY2022

- Shutdown of malls and closure of non-essential stores across most states in the country in FY2021 and sporadic lockdowns in FY2022
- Subdued consumer sentiments and reduced discretionary spends till H1 FY2022, though recovery since the second wave has been healthy

Outlook for FY2023

- Segment recovered to pre-Covid level of sales in Q1 FY2023
- Given the YoY improvement in footfalls, ICRA estimates fashion retailers to report ~12-13% YoY increase in revenues in FY2023, translating into 5-6% revenue growth (vis-à-vis FY2020); OPM[1] expected to improve on YoY basis by 150 bps to 8.2% in FY2023

Outlook - Negative

Outlook - Stable

Segment expected to witness healthy sales growth in FY2023, led by improved footfalls and uptick in discretionary spends

1-As per I-GAAP

Sector Outlook | Current Outlook and Benchmarks

Presented below is ICRA's current outlook on the Indian retail industry. Also presented are the broad indicative thresholds that would be considered for revising the outlook.

Current Outlook	Indicative Thresholds for Revision in Outlook		
	Positive	Stable	Negative
Stable	Revenue growth >15% (vis-à-vis the pre-covid period)	Revenue growth: -5% to 15% ((vis-à-vis the pre-covid period)	Revenue de-growth <-5% (vis-à-vis the pre-covid period)

**For details regarding sector outlook designation and thresholds, click here.*

Outlook: Stable

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FY2023 Outlook

Demand Driver

Improving consumer sentiments, increasing footfalls amid the waning impact of the pandemic to drive demand for fashion retail in the coming quarters

Revenue Growth

Entities in ICRA's sample set expected to witness 12-13% YoY revenue growth in FY2023. This translates into 5-6% YoY growth over FY2020

Operating Margins

OPMs[2] expected to improve by upto 150 bps to 8.2% in FY2023, led by economies of scale

Liquidity

Liquidity position and coverage metrics of large listed players remain comfortable, aided by large equity raisings in FY2021 and healthy cash flows in H2 FY2022 as well as that expected in FY2023

Capex

Post a brief lull induced by the pandemic, most organised players have recommenced expansion (especially into Tier 2 and 3 cities) to drive growth

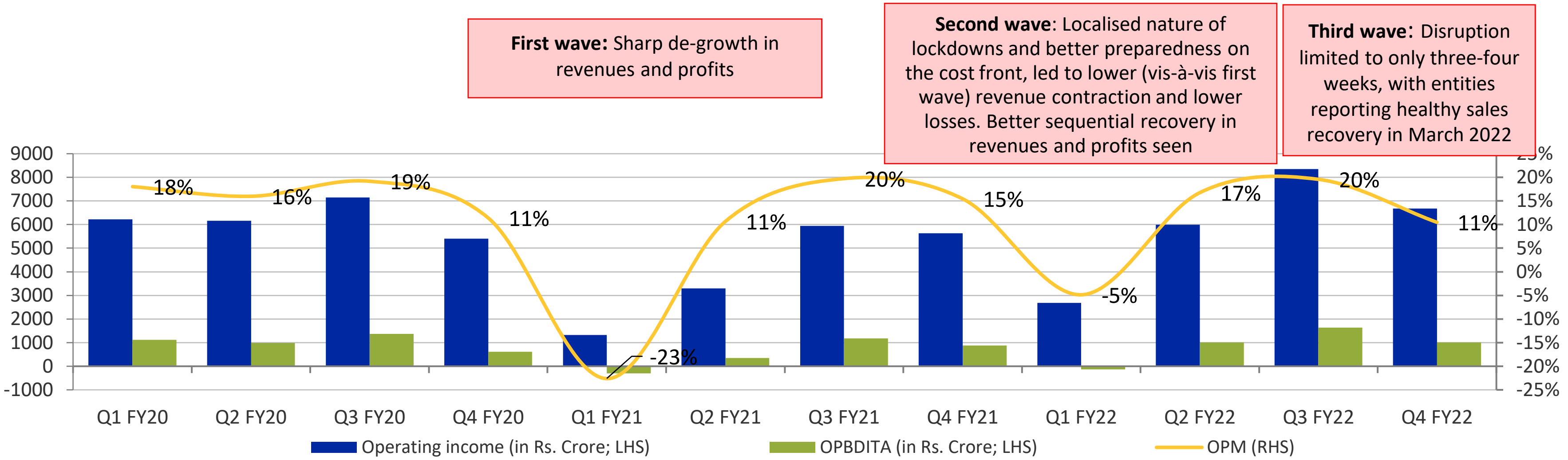
2-As per I-GAAP

Recent Trends

- *Strong recovery across all retail segments, with revenues reaching the pre-pandemic levels*
- *Accelerated store expansions on the anvil*

Building resilience through the Covid waves

Exhibit: QoQ recovery in revenues of fashion retailers



- Retail entities witnessed a healthy 17% revenue growth in H2 FY2022 vis-à-vis H2 FY2020, led by pent-up demand, improving vaccination coverage and pick-up in economic activity. Fashion retailers in ICRA's sample set recovered up to 90% of the pre-Covid revenues in FY2022, higher than ICRA's estimates of up to 72% recovery. This was led by a sharp uptick in discretionary spends post the second wave and limited impact of the third wave.
- Fashion retailers are estimated to have reached the pre-Covid level of revenues in Q1 FY2023. Recovery is broad-based, being witnessed across Metros/Tier-I as well as Tier II/III cities.

Source: ICRA Research; aggregate of 10 listed fashion retailers, OPBDITA and OPM given above are as per Ind AS

Fighting the pandemic: Key themes that emerged during the last two years

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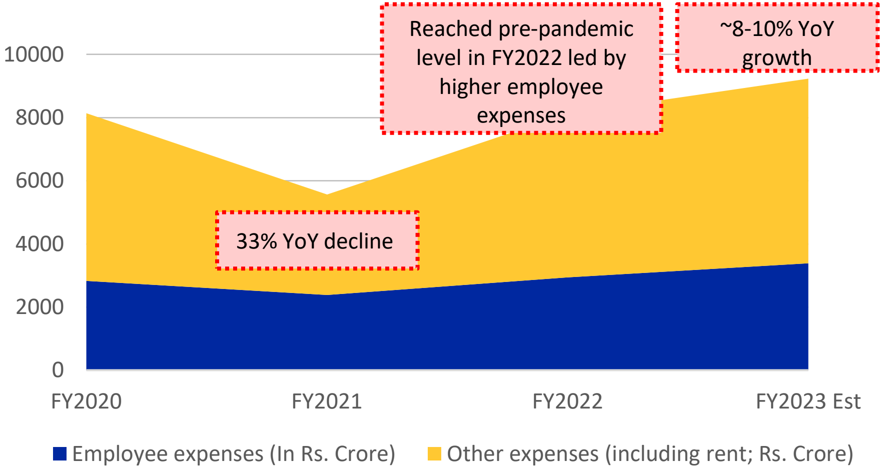
Key themes

- Stringent cost rationalisation including rental negotiations
- Lower discounting and no extended end-of-season sales
- Stronger preference for athleisure and casual wear segments. Kidswear and home segments also performed well
- Equity raising for loss funding and deleveraging
- Increasing thrust on omni-channel presence and private label brands

Temporary — Long-Term

Surviving the earnings decline: Cost rationalisation

Exhibit: YoY reduction in expenses



Source: ICRA Research, based on aggregate of 10 listed value and lifestyle fashion retailers

Exhibit: Rental concessions in FY2021 and FY2022

	Received In FY2021	Savings	Received In FY2022	Savings
	Rs. crore	As a % of rent expense in FY2020	Rs. crore	As a % of rent expense in FY2020
Aditya Birla Fashion and Retail Limited	343.9	28%	224.5	18%
Trent Limited	88.8	19%	64.7	14%
Shopper's Stop Limited	238.1	59%	108.7	27%
V-Mart Limited	27.8	30%	15.8	17%
V2 Retail Limited	11.4	23%	8.7	18%
Bata India Limited	102.0	26%	37.1	9%

Source: ICRA Research

- Fashion retailers invoked force majeure clauses in rental agreements negotiated and converted fixed rental charges into variable for FY2021 and FY2022. The extent of rental concession received were, however, lower by an average ~40% in FY2022
- Salary cuts were rolled back in FY2022 to retain talent; advertising and other overhead expenses remained marginally lower by ~5% vis-à-vis pre-pandemic levels
- With recovery in sales, ICRA expects 8-10% YoY growth in these expenses in FY2023

Emerging stronger: Strengthening the balance sheet

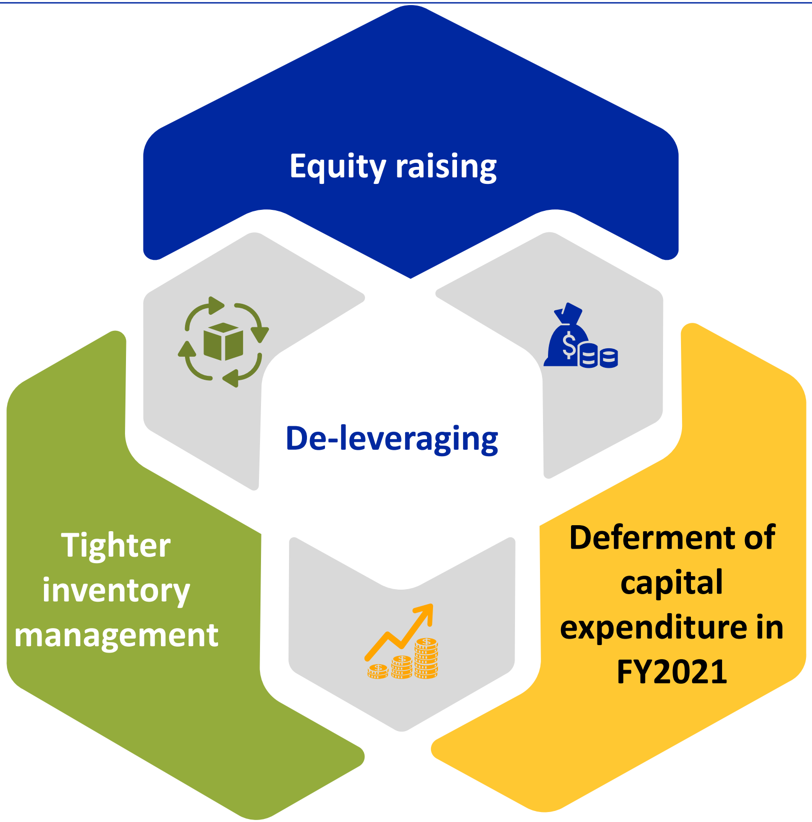


Exhibit: Large fund raisings in FY2021 and FY2022

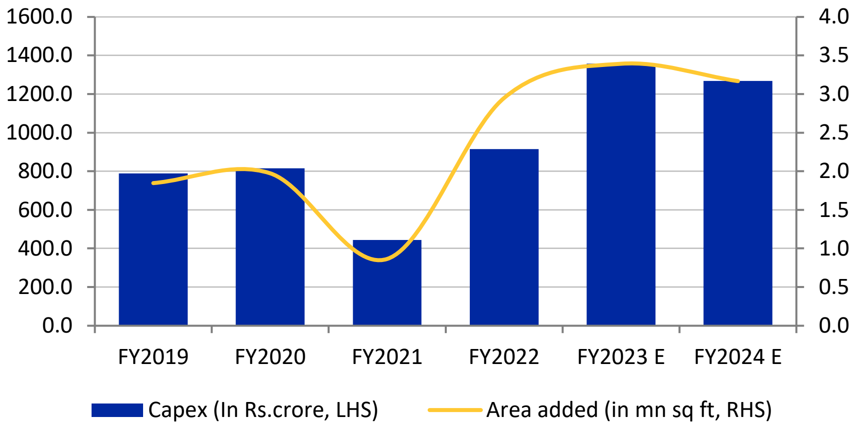
Company	Amount raised in FY2021 and FY2022
Reliance Retail Limited	Rs. 473 billion
Aditya Birla Fashion and Retail Limited	Rs. 25 billion; additional Rs 21.75 billion planned over FY2023 -FY2025
Trent Limited	NA, but had raised Rs. 9.5 billion in Q2 FY2020
Shopper's Stop Limited	Rs. 3 billion
V-Mart Limited	Rs. 3.75 billion

Source: ICRA Research

- Equity raisings primarily used for loss-funding and debt repayments in FY2021 and FY2022
- Retailers maintained strict control on discounting and operated on low inventory levels during FY2021 and FY2022
- Retailers undertook calibrated store expansions during FY2021-H1 FY2022 to curtail capex outflows

FY2023: Store additions to pick up

Exhibit: Trend in capex



Source: ICRA Research

Exhibit: Store additions

Company	Actual (Net) Additions in FY2021	Actual (Net) Additions in FY2022	Likely Additions in FY2023
ABFRL	4 stores (Pantaloons)	~60 stores	~70 -75 stores
Shopper's Stop	Closed 5 stores	8 stores	~22 stores
Trent	9 Westside stores, 53 Zudio stores	26 Westside stores and 100 Zudio stores	>20 Westside stores; accelerated expansion in Zudio segment
V-Mart Retail	13 stores	110 stores (including ~77 acquired 'Unlimited' stores)	~60 new stores
V2 Retail	~19 stores	~6 stores	25-30 stores

- After having curtailed the expansion plans in FY2021, fashion retailers in ICRA's sample set doubled their capex spending FY2022 (vis-à-vis FY2021). This was partly supported by equity raisings that had happened in FY2021.
- Driven by buoyant demand outlook and recovery in footfalls, capex outlay on store additions is expected to increase YoY by 48% in FY2023.

Omnichannel presence: Going the phy-gital way!

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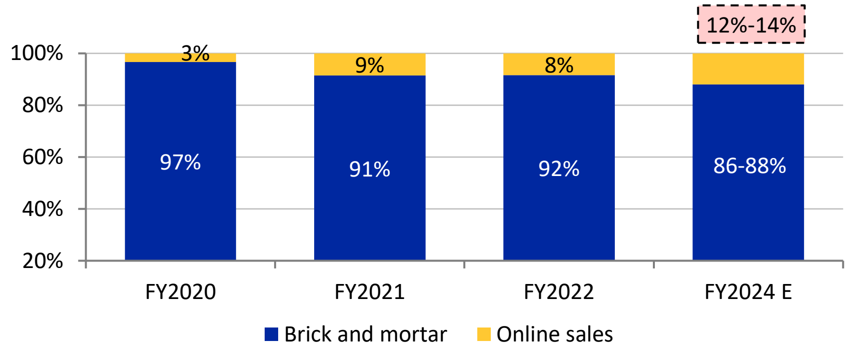
Exhibit: Trend in online sales



Source: ICRA Research; companies press release/annual reports

- The pandemic accelerated the adoption of e-commerce in brick-and-mortar retail. Online sales for entities in ICRA's sample set increased by 1.4 times in FY2022 (vis-à-vis FY2020)
- Penetration of online sales further expected to increase to 12-14% over the medium term
- While entities will continue to focus on increasing their online presence, this will remain supplemental to brick and mortar store additions

Exhibit: Key trends in online sales in FY2022

Company	Online presence	Key trends in online sales witnessed in FY2022
ABFRL	▪ Separate online portals for all its lifestyle brands. ▪ Various e-commerce websites	▪ E-commerce sales grew YoY by 52% in FY2022, accounting for 12% of revenues ▪ Currently 50% stores are omni-enabled
Trent	▪ Westiside.com and Tatacliq and Tata Neu	▪ ~7% of Westside revenues generated through e-commerce sales in FY2022
Shopper's Stop	▪ Has its own website. Has also tied up with Amazon	▪ Digital sales grew by 60% in FY2022 ▪ Proportion of online sales increased from 1% (pre-covid) to 9% in FY2022
Bata	▪ Bata.in and other online marketplaces. Hyperlocal digital channels-Bata ChatShop and Bata Store-on-Wheels in FY2021	▪ Sales through digitally enabled services doubled from pre-covid levels ▪ Digital channels contributed to ~10-12% of revenues in FY2022
V-Mart Retail	▪ Own portal	▪ Following a cautious approach Currently derives 1-2% of revenues from online channel
V2 Retail	▪ Own online platform v2kart.com	▪ Derives very small proportion of revenues from e-commerce Medium term target is to have e-commerce sales anywhere between 5% to 10%

Fashion retailers: Healthy recovery expected

Exhibit: Movement in operating income and profits

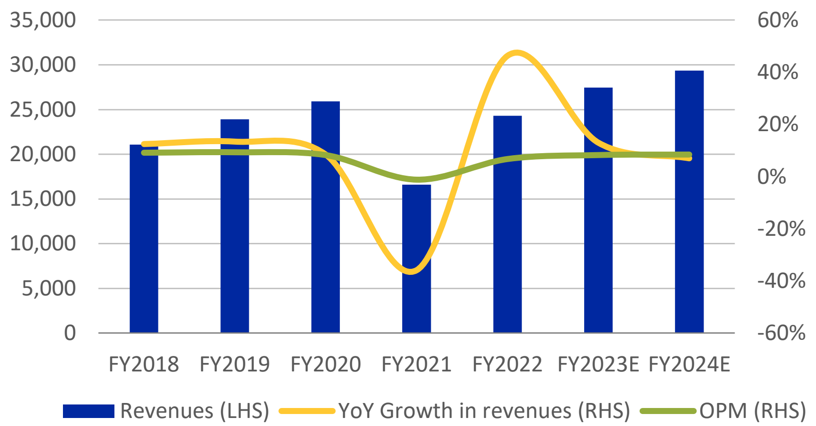
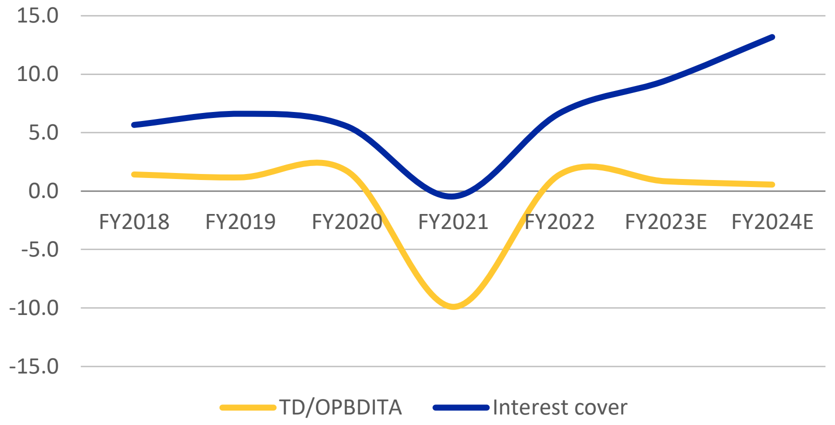


Exhibit: Movement in coverage indicators



Source: ICRA Research, Numbers excluding the impact of Ind AS 116; aggregate of 10 listed platers in fashion industry

- ICRA expects the fashion retailers to report ~12-13% YoY increase in revenues in FY2023 aided by improved footfalls. The operating profit margin is expected to improve by upto 150 bps to~8.2%, led by benefits of operating leverage. ICRA expects the large listed retailers to continue to successfully pass on increased input costs, as witnessed in H1 CY2022.
- Despite lower-than-pre-pandemic revenues, credit profile of entities in ICRA's samples set improved aided by deleveraging of balance sheet due to equity raising in FY2021 and YoY improvement in cash flows in FY2022.
- Consequently, despite the higher capex, increased revenues and profits would result in an improvement in the credit metrics of retail entities in FY2023 and FY2024.

Margin expansion aided by benefits of operating leverage

FY2022	Cost structure comparison As % of OI	FY2023 (Est)
~47.7%	Gross margins	~46.5%
~12%	Employee expenses	~11.5%
~8.2%	Rental expenses	~10.2%
~20.7%	Selling & Admin expenses	~17.1%
~6.7%	Operating margin	~8.2%
~4.1%	Interest + depreciation	~3.9%

Despite expected contraction in gross margins due to higher discounting, improved revenues resulting from better scale economics is expected to support improvement in margins of retailers.

Rating Actions

Rating actions in the recent past in retail sector

Exhibit: Rating distribution of ICRA rated universe of 16 companies*

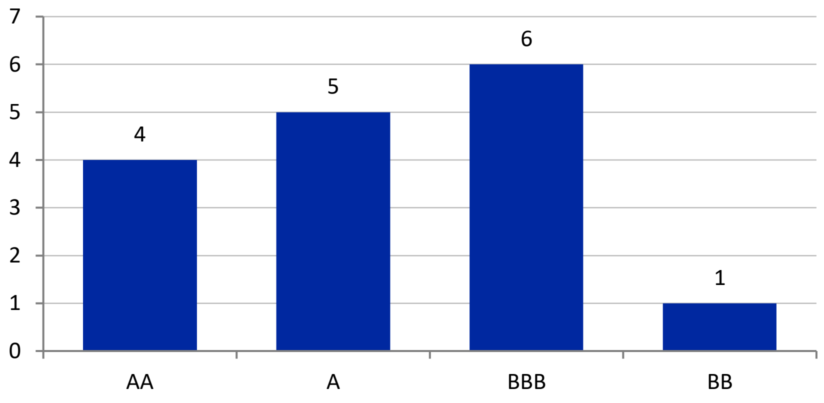
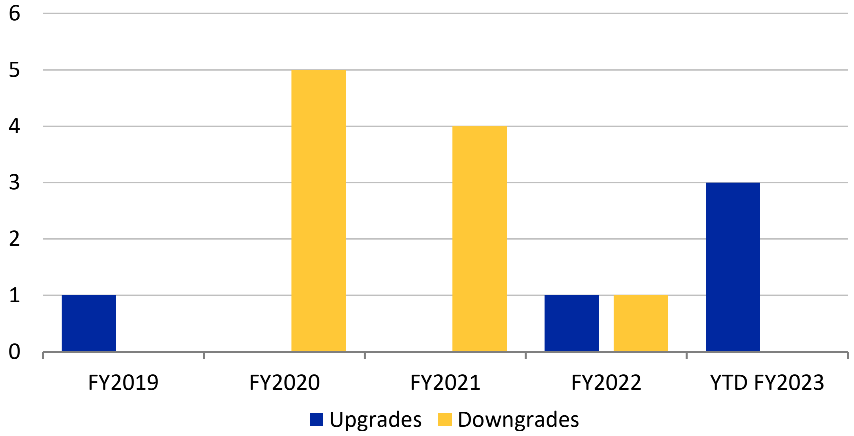


Exhibit: Count of upgrades and downgrades (ICRA rated universe)



*Source: ICRA Research, * Downgrades exclude rating downgrades due to issuer non-cooperation*

- The rating downgrades during FY2020-FY2022 were largely for those retail entities which did not raise adequate funding. This, coupled with pressure on profit due to reduction in discretionary spends amid the pandemic, adversely impacted their credit metrics.
- The credit profile of the entities have improved in YTD FY2023 with recovery in sales. Besides the rating upgrades in YTD FY2023, ICRA has also revised the outlook for three of the entities to Positive from Stable, while that for one entity was revised to Stable from Negative. Currently none of the ratings are on Negative outlook.

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Thank You!