ViewCube

August 2023

The reach ramp-up imperative

CRISIL Ratings view on the organised retail sector

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CRISIL ViewCube on the organised retail sector

ViewCube is a compilation of sector views expressed during CRISIL's webinars. These include CRISIL's own views, those of stakeholders, and those emanating from a poll done during the webinar.

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Key messages

The organised retail sector* poised for 15-16% growth this fiscal, led by higher volume and increasing penetration

- Revenue of brick & mortal (B&M) retailers seen growing 13-14%, driven by continued expansion across segments
- Growth of the e-retail segment will normalise at 20-22%, with consumers striking a balance between online and in-store shopping
- Growth to be mainly volume-driven, with easing inflation limiting material price hikes

Operating margin to remain rangebound this fiscal; benefit of moderation in raw material prices offset by increased competition

- Margins of food & grocery (F&G) retailers to fall 40-50 basis points (bps) due to increasing competition from e-retailers
- Apparel retailers to see flat operating margins as benefit of lower cotton prices will be offset by higher discounting to support demand
- Profitability of consumer durable retailers to increase 100 bps due to better operating leverage

Capex intensity to be largely in line with last fiscal; B&M retailers to continue capex to gain share

- Pace of area addition in the F&G segment to moderate with focus on expansion in Tier 2/3 cities through smaller stores
- New area addition to normalise in apparel
- Expansion in consumer durables to continue at current pace

Credit outlook for retailers to remain ‘Stable’

- F&G retailers will continue to have low leverage and resilient profitability
- Apparel retailers to benefit from prudent debt-funded expansion and timely equity raise
- Strong sponsor backing for consumer durable and apparel retailers to support their credit risk profiles

Key monitorables:

- Sustainability of demand, commodity trends and inflation, impact of unseasonal rains on purchasing power

** 75-80% of sector covered, comprising F&G, apparel and consumer durables*

Section 1

Our view

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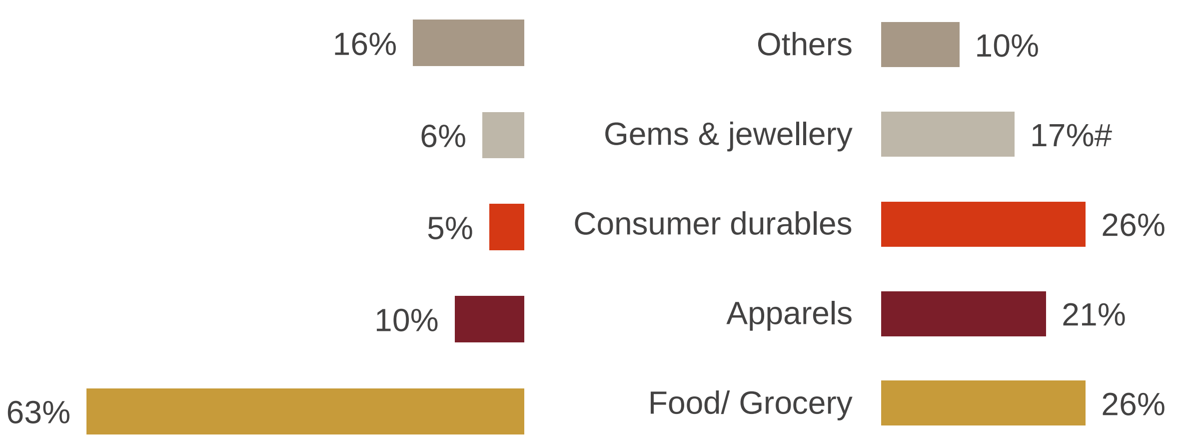
Organised penetration to rise after recovering from pandemic lows

F&G, apparel and consumer durables constitute 75-80%

Total retail industry: Rs 84 lakh crore* Organised retail: ~Rs 9 lakh crore*

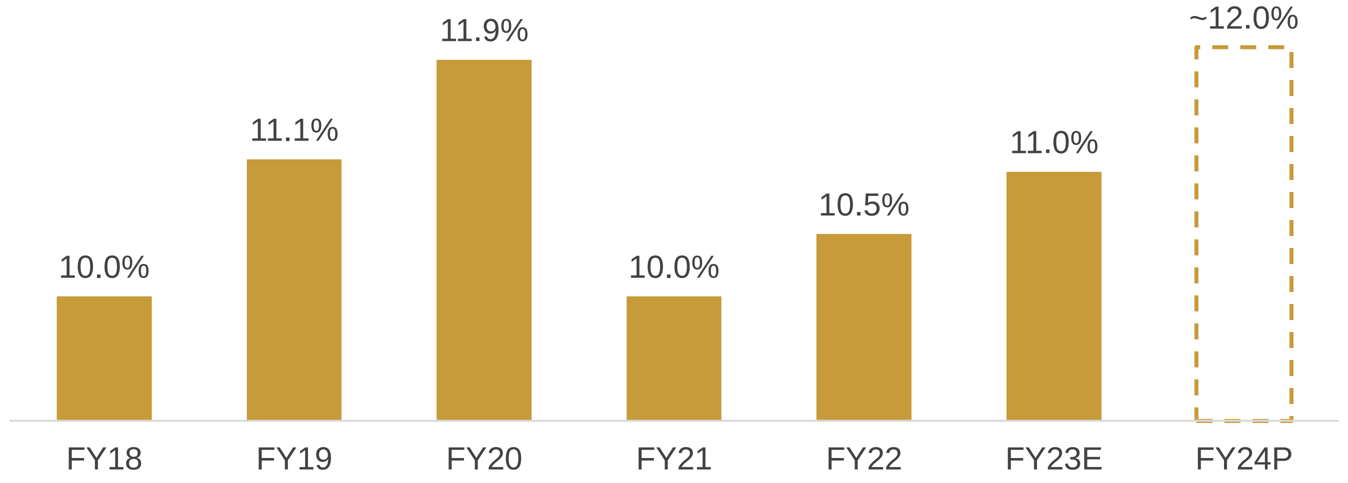


**Market size in fiscal 2023*
Others include footwear, cosmetics, books, music; #Gems & jewellery includes multi-store formats

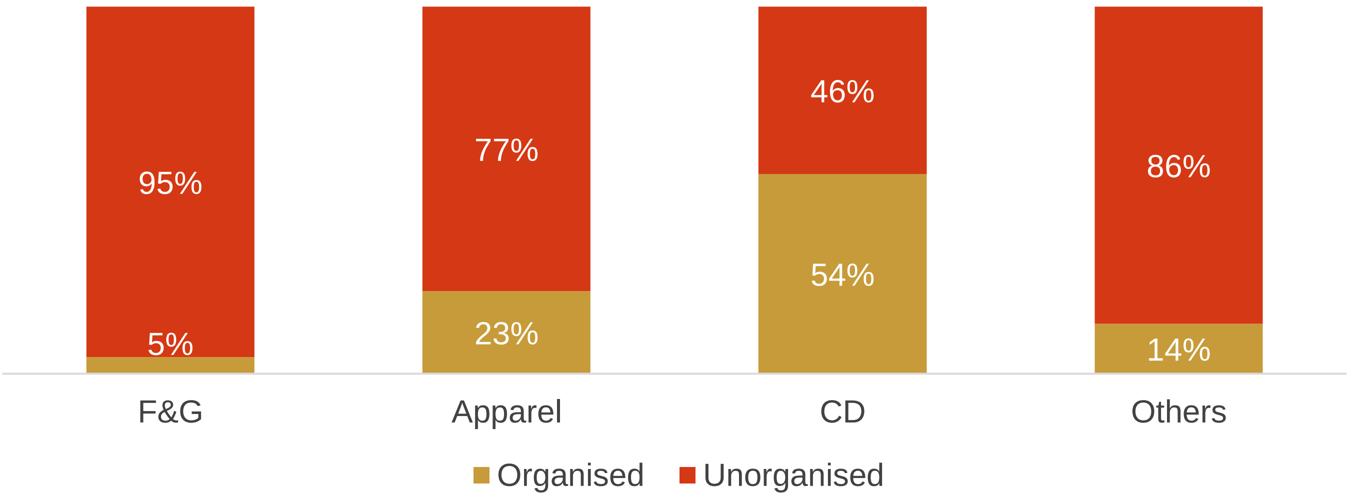
- Organised retail accounts for ~11% of the total retail sector, thus offering sustained growth opportunity
- Organised penetration continues to grow from the pandemic-induced lows of fiscal 2021; set to reach pre-pandemic levels this fiscal
- F&G has the largest share in the retail segment, at over 60%; however, it remains the most underpenetrated, indicating significant untapped growth potential
- Consumer durables remain the most penetrated segment

Source: CRISIL Research, CRISIL Ratings

Overall organised share to reach pre-pandemic levels this fiscal



Ample scope for expansion in F&G



Note: Figures for fiscal 2023

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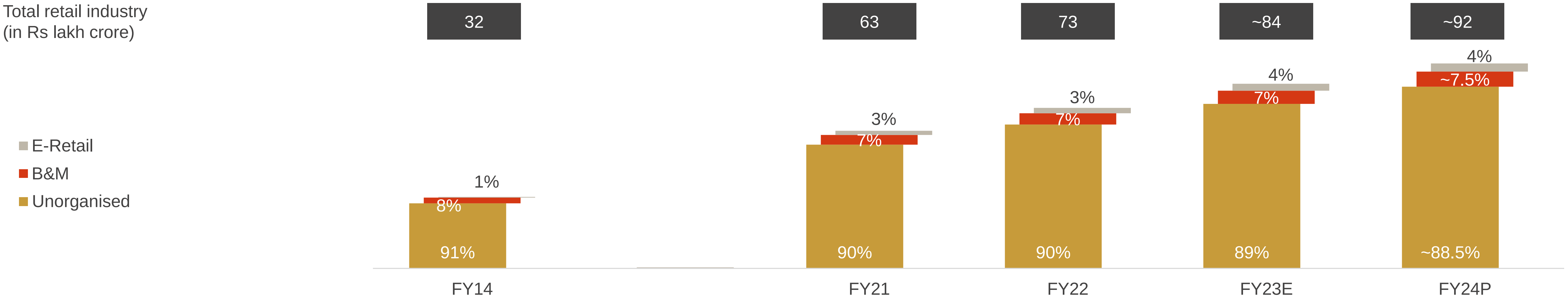
Organised retail to maintain steady double-digit growth

To normalise after successive years of strong growth as pent-up demand wanes



Segment growth	FY14-20	FY21	FY22	FY23E	FY24P
Unorganised	**12%**	**0%**	**16%**	**14%**	**10-12%**
Organised	***19%***	***-18%***	***21%***	***20%***	***15-16%***
B&M	15%	-26%	19%	16%	13-14%
E-retail	44%	12%	26%	29%	20-22%

Source: CRISIL Research & CRISIL Ratings

- Organised retail bounced back strongly in fiscals 2022 and 2023 with healthy double-digit growth, backed by easing of pandemic-induced lockdown restrictions and pent-up demand
- E-retail experienced faster growth during the pandemic; other segments faced challenges due to lockdowns, closures of malls and shopping centres
- E-retail growth to moderate, but remain healthy, this fiscal, with consumers finding balance between online and in-store shopping; focus on profitability by e-retailers

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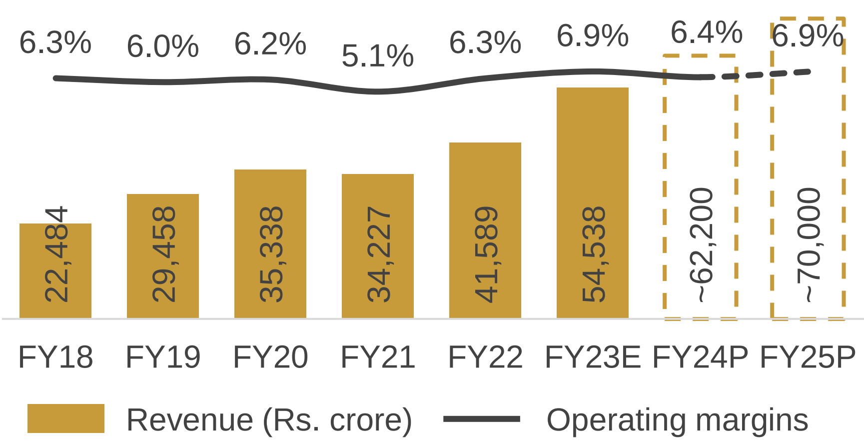
F&G growth to be stable, aggressive expansion in consumer durables

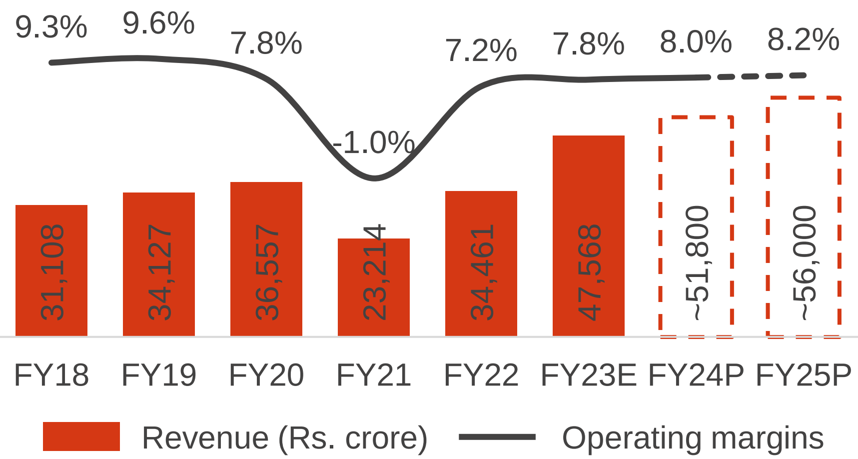
F&G ~Rs 2.4 lakh crore*	Apparel ~Rs 1.9 lakh crore*	Consumer durables ~Rs 2.4 lakh crore*

Revenue CAGR (FY18-25) ~18%



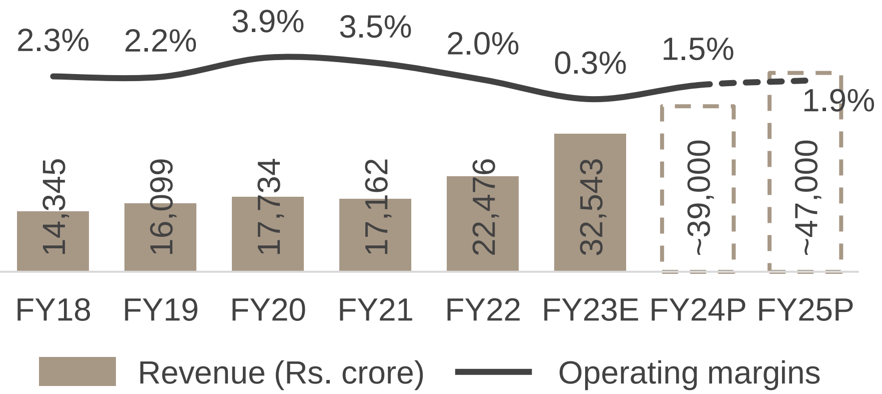
Source: CRISIL Ratings, analysis of 6 players covering 23% of the organised market
**Organised market size for fiscal 2023*

Revenue CAGR (FY18-25) ~9%



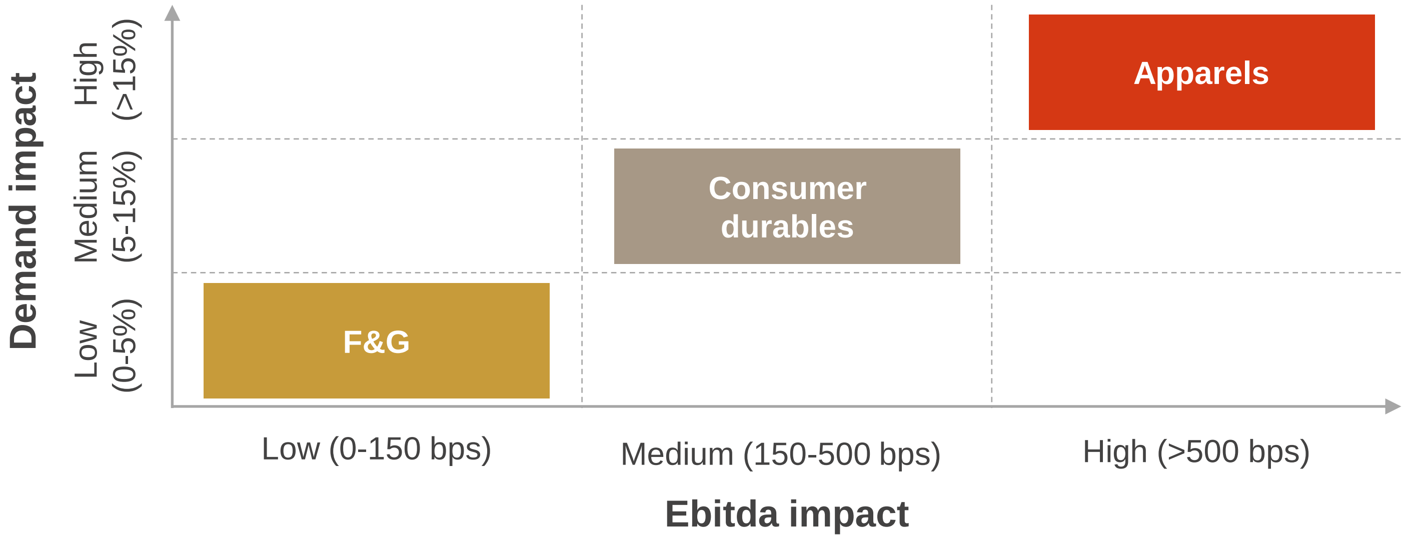
Source: CRISIL Ratings, analysis of 39 players covering 25% of the organised market

Revenue CAGR (FY18-25) ~18%



Source: CRISIL Ratings, analysis of 16 players covering 14% of the organised market

Apparel segment was the most impacted during the pandemic



- F&G is the most resilient sector owing to its non-discretionary nature, which provides stability even during challenging economic times
- Apparel sector was the most affected during the pandemic due to its discretionary nature
- Consumer durables, though partly discretionary, is seeing aggressive expansion by large retailers; however, this segment has the lowest operating margin due to intense competition

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B&M: F&G retail

Increasing penetration into new geographies driving growth

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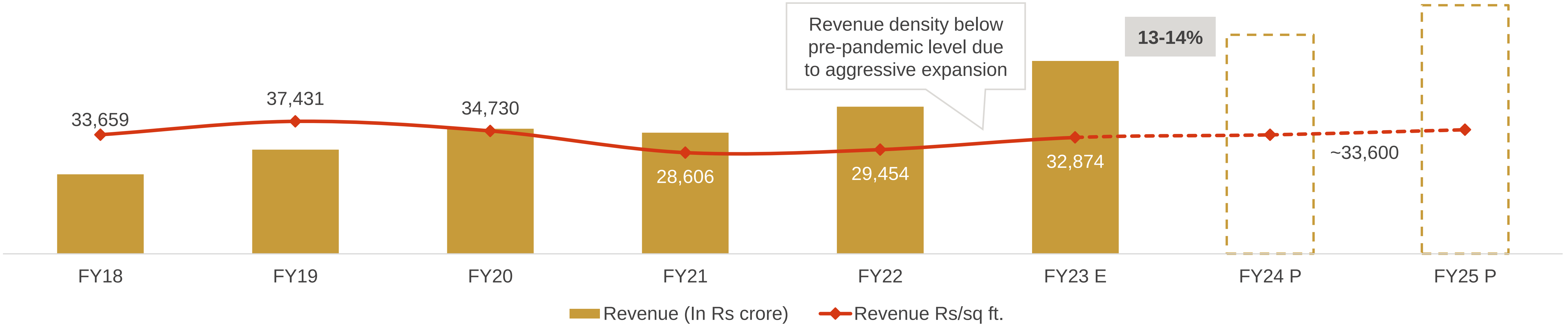
Growth to be volume-driven this fiscal

Pace of store addition to normalise; focus on increasing penetration in Tier 2, 3 markets

	FY18	FY19	FY20	FY21	FY22	FY23 E	FY24 P	FY25 P
Revenue (Rs crore)	~22,500	*CAGR 25%*	~35,000		*CAGR 15%*	~54,500	*CAGR 13-14%*	~70,000
Area (mn sq ft)	6.68	9.06	11.3	12.6	15.6	17.5	19.2	20.8



Source: CRISIL Ratings, analysis of 6 players covering 23% of the organised market

- **Growth driven by volume this fiscal:** Limited price hikes expected; growth to be driven by higher volume
- **Increasing penetration into newer geographies**: Store additions in Tier II and III cities to help increase organised penetration
- **Improving store productivity; marginally below pre-pandemic levels**: Revenue per square feet to be marginally below the pre-pandemic levels owing to aggressive expansion over the past two fiscals; likely to surpass the fiscal 2020 level by fiscal 2025

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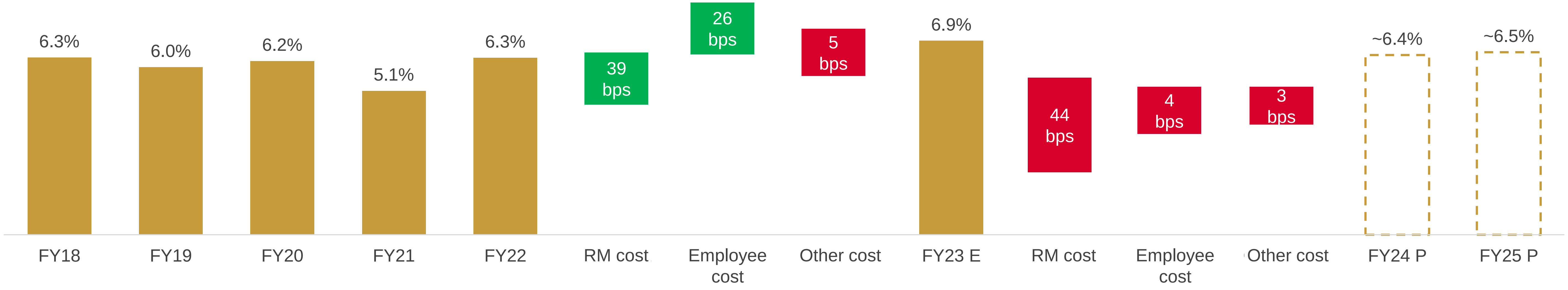
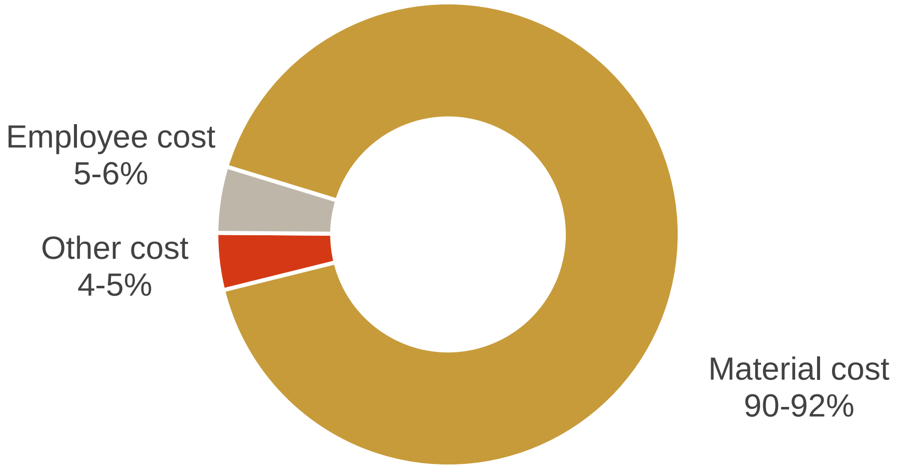
Stable profitability across cycles due to non-discretionary nature

Despite moderation in raw material costs, operating margin to remain flattish due to increasing competition

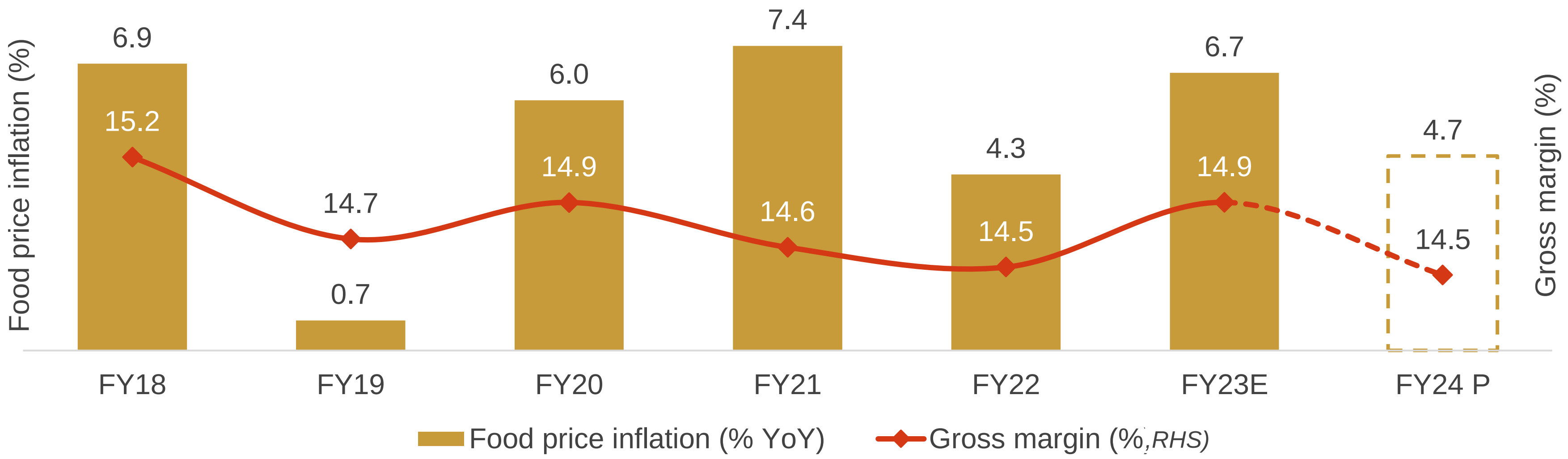


Low fixed-cost structure; expenses largely variable in nature



Source: CRISIL Ratings, analysis of 6 players covering 23% of the organised market

Nominal impact of food price inflation on gross margin



Source: CRISIL Ratings, CRISIL Research

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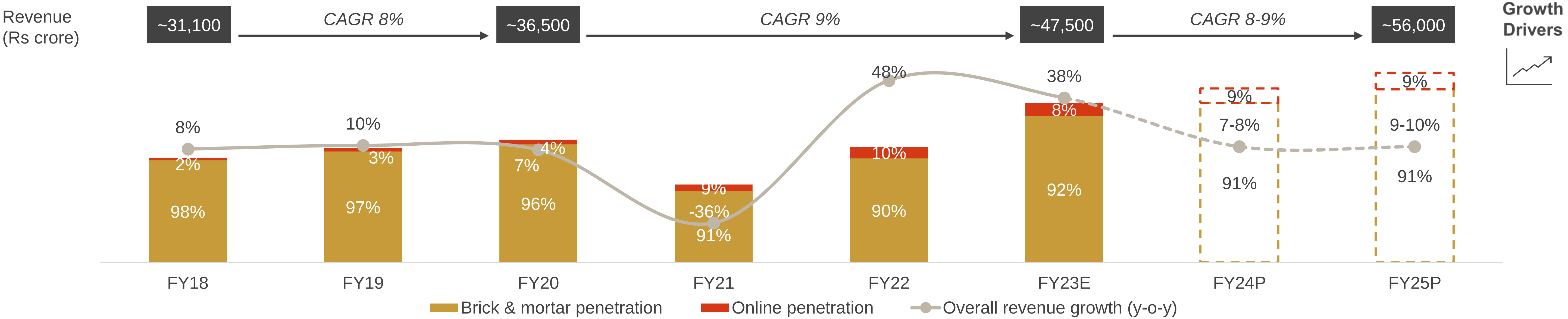
B&M apparel retail

Growth to normalise with dwindling pent-up demand

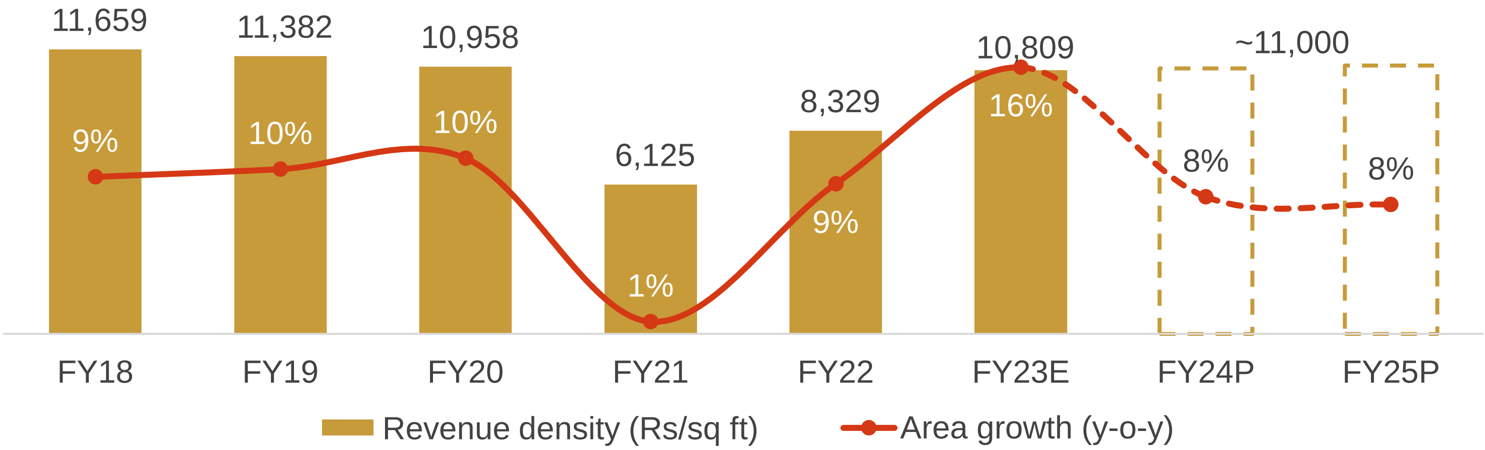
Growth seen normalising this fiscal, will be driven by volume

Growth to normalise with pace of B&M area additions reverting to pre-pandemic levels; share of online to remain stable



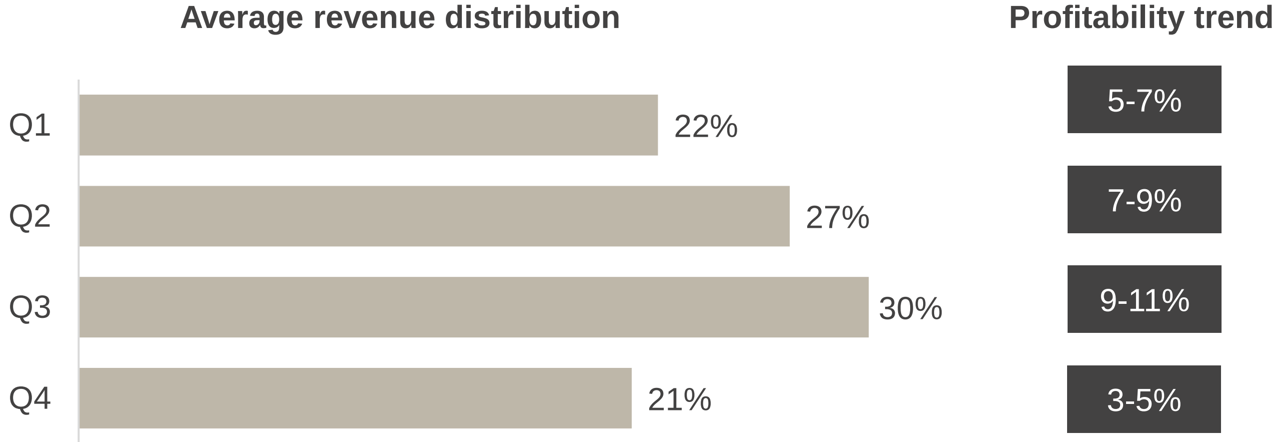
Source: CRISIL Ratings, analysis of 39 players covering 25% of the organised market

Revenue density to improve, but remain below the pre-pandemic level



Source: CRISIL Ratings, analysis of 7 players covering 70% of the sample space rated by CRISIL Ratings

Festive season in Q2, Q3 to drive up revenue and profit



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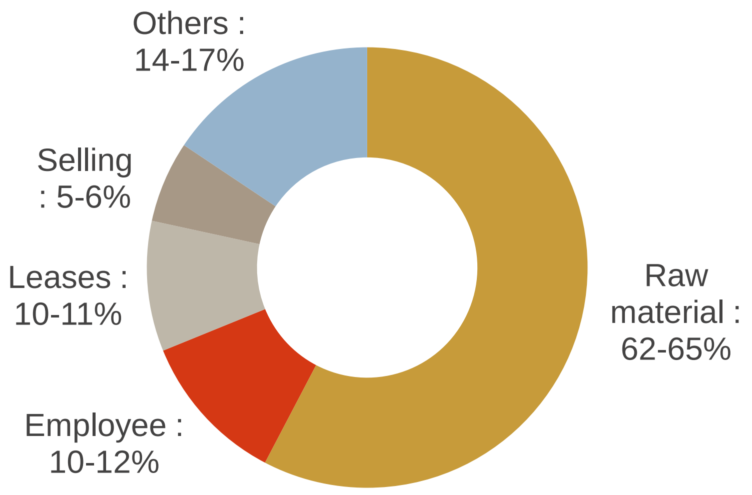
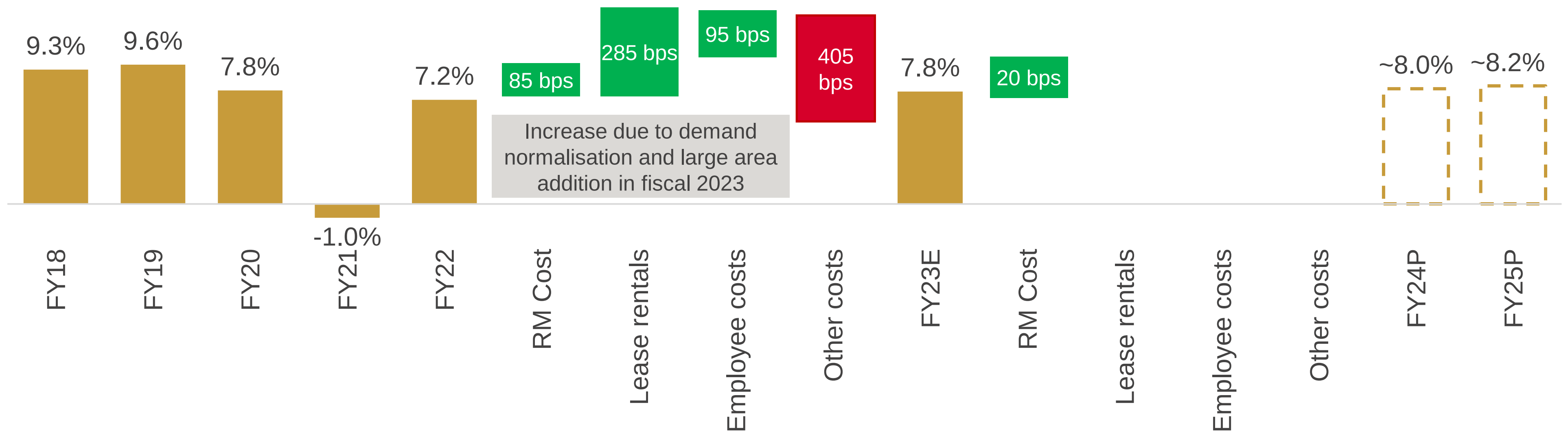
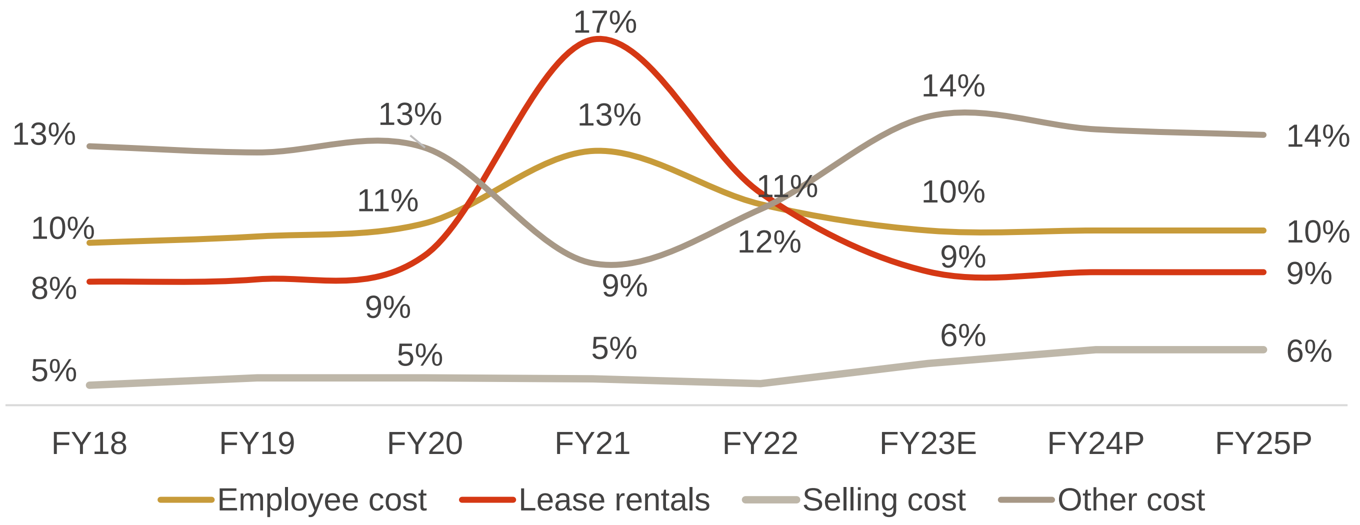
Operating margin to remain rangebound amid moderating demand

Private labels drive gross margin; overall operating profitability to remain below pre-pandemic level



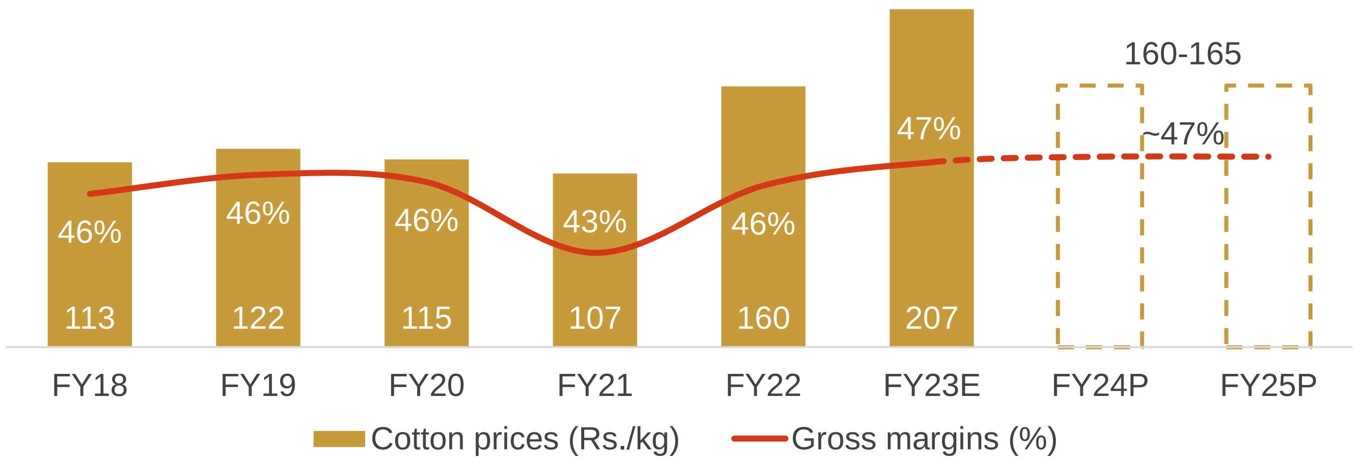


Operating leverage benefit offset by increased marketing spends



Source: CRISIL Ratings, analysis of 39 players covering 25% of the organised market

Higher discounting to limit benefits of softening raw material prices



Source: CRISIL Ratings, CRISIL Research

B&M consumer durable retail

Aggressive expansion in Tier II and III cities to drive growth

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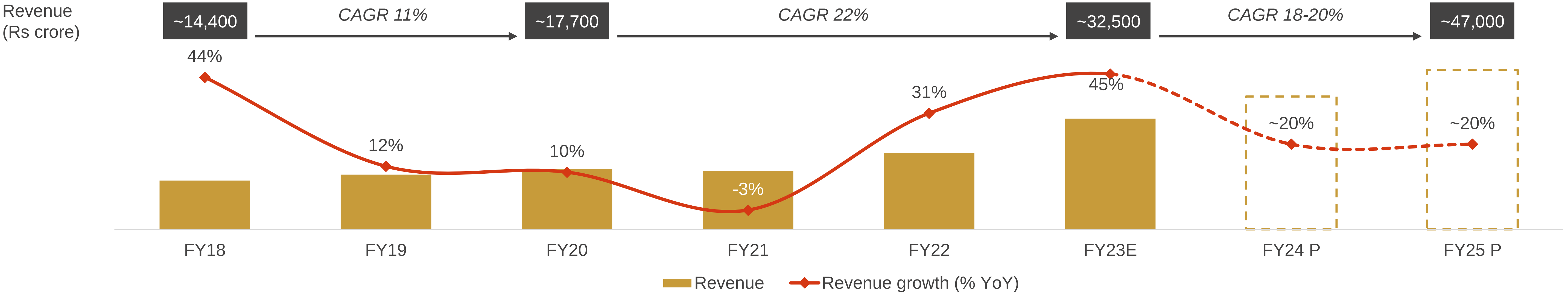
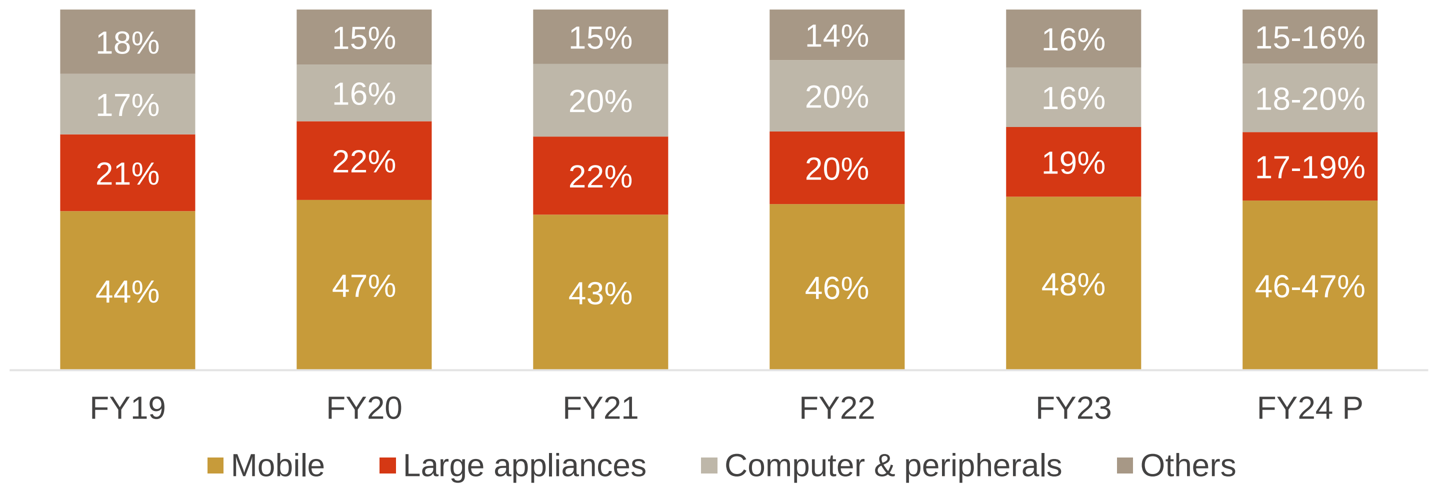
Strong revenue growth to continue with aggressive expansions

Growth to be driven by penetration into newer geographies, especially Tier 2 and 3 cities



Mobiles and laptops comprise nearly two-thirds of the overall market

% denotes share in overall organised CD market

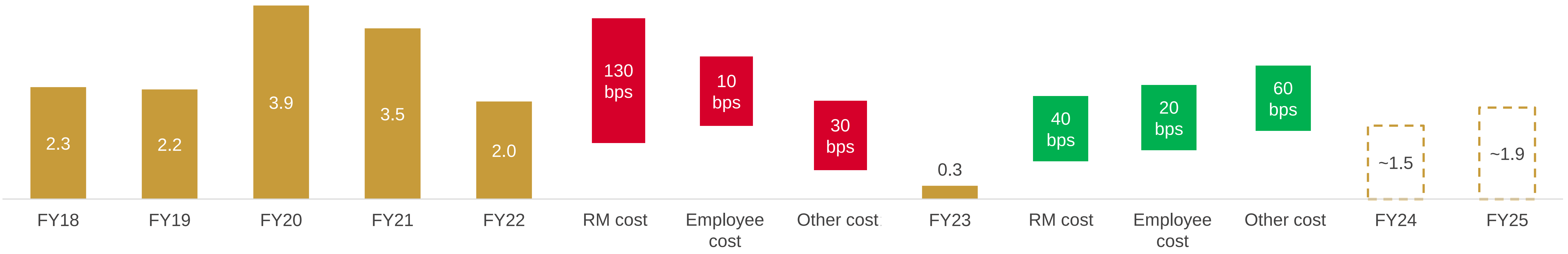


- The organised sector will continue to post strong double-digit growth backed by aggressive expansion into new geographies
- Mobile sales were subdued in the first quarter of this fiscal due to destocking of large inventory built up over the previous quarters amid sluggish demand. Consumer preference for refurbished phones, supply issues with key Chinese operators and ongoing migration to 5G ready phones had also affected sales.
- Growth to moderate this fiscal owing to lower sales of ACs and refrigerators during the first quarter following uneven rains, which impacted purchasing power in rural/semi-urban regions
- Mobiles and laptops will continue to dominate the segment.

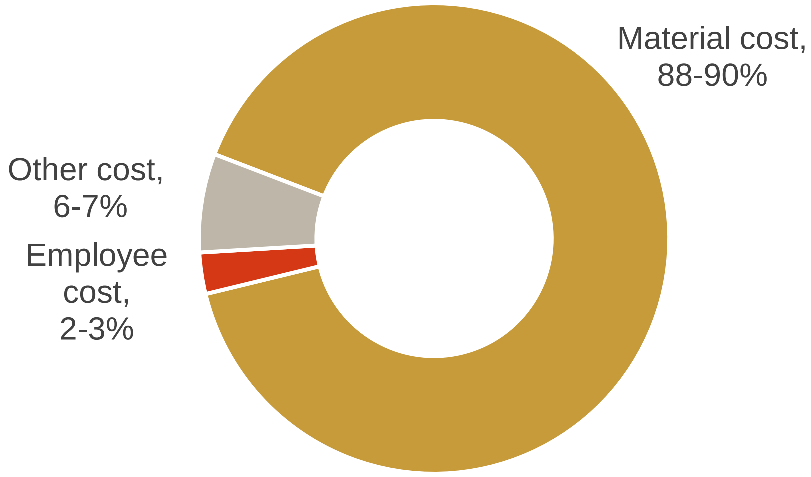
Source: CRISIL Ratings, analysis of 16 players covering 14% of the organised market

Subdued margins owing to heightened competitive intensity

Improving operating leverage to benefit profitability this fiscal

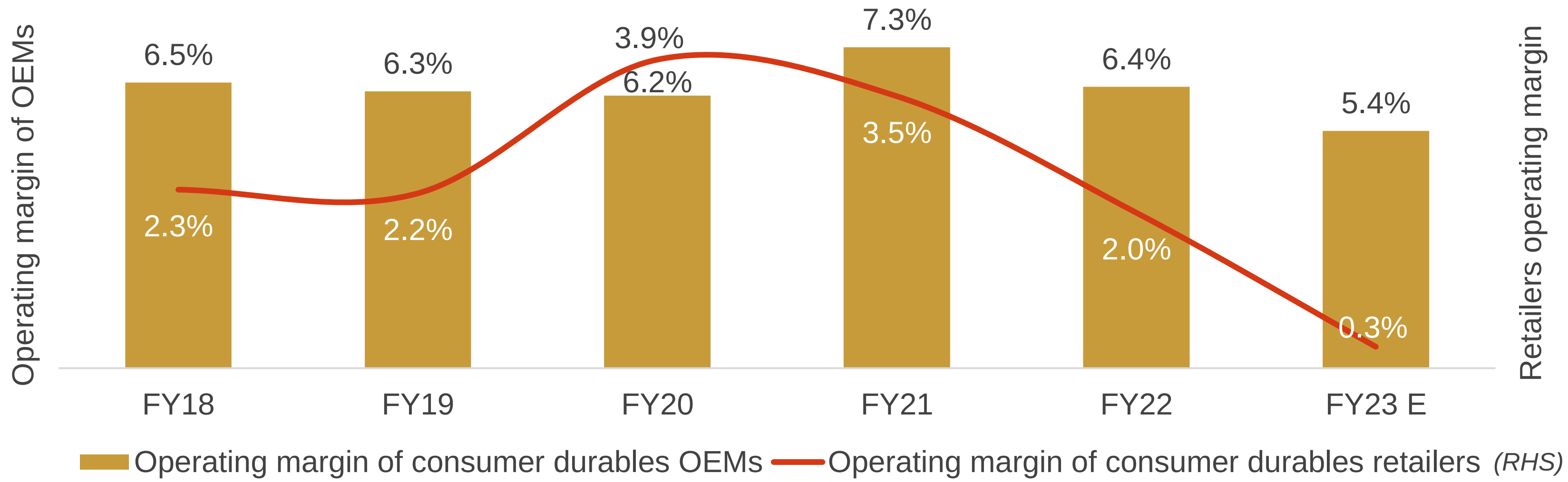


High variable cost structure; scale critical for returns



Source: CRISIL Ratings, analysis of 16 players covering 14% of the organised market

Low bargaining power with original equipment manufacturers



Source: CRISIL Ratings analysis of 14 consumer durable OEM players with revenue of ~Rs 90,000 crore

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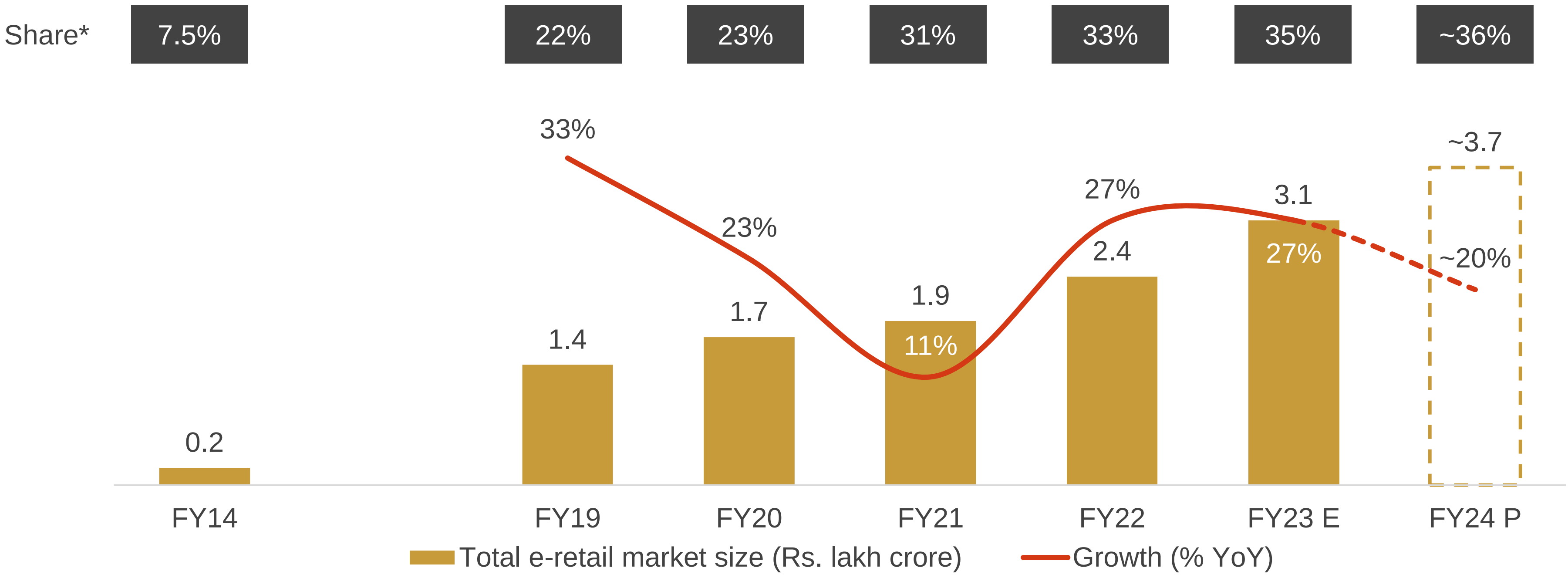
E-retail

Growth momentum to normalise on higher base of the past few years

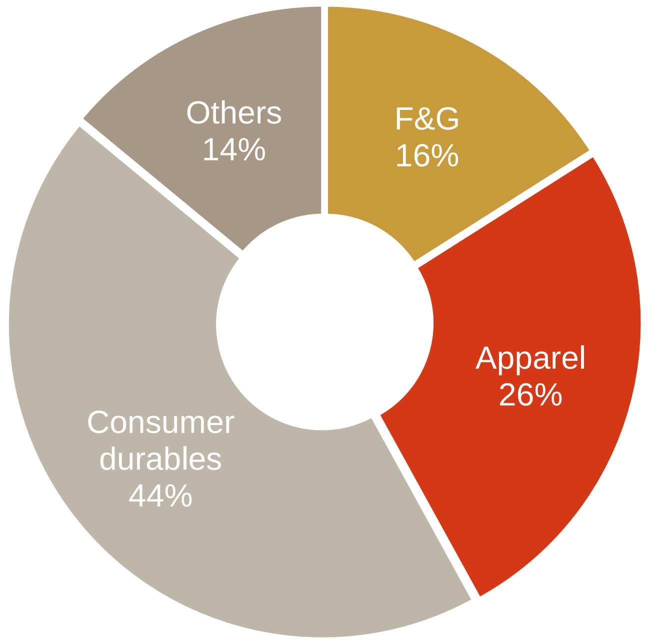
E-retail to stabilise after stellar growth in the past two fiscals

E-retail share in organised retail increased 5 times over the past decade



**Share of e-retail in organised retail*

Consumer durables continue to dominate e-retail



- E-retail has witnessed phenomenal growth, supported by rising internet penetration
- There is significant scope for growth, given the 4% share in total retail in India vis-à-vis ~20% in developed countries such as the US and China
- Key monitorables:
  – Ability to scale up amid slowing funding environment
  – Roadmap to profitability
  – Regulatory intervention to safeguard small indigenous players

Segment	Growth % (FY23-28)	Comments
F&G	33-35%	Growth to be led by increased investor interest and untapped potential
Apparel	20-22%	Growth to be driven by low ticket size vide product range and festive discounts
Consumer durables	16-20%	Growth to remain subdued due to consumer preference for high-value products from B&M stores

Source: CRISIL Research, CRISIL Ratings

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Credit outlook trends for retailers rated by CRISIL Ratings

Wide coverage of organised B&M retailers by CRISIL Ratings

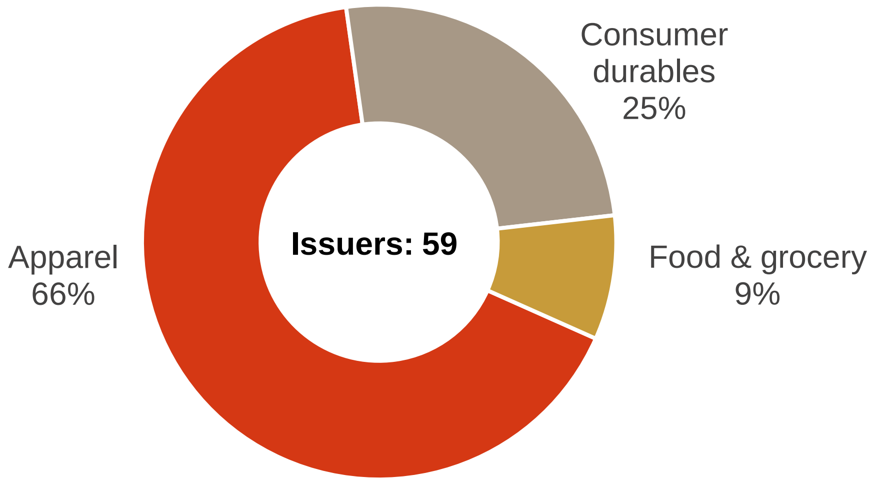
Well-represented across segments, formats

- **Coverage encompasses 59 issuers** comprising
  - F&G, apparel, consumer durables across different formats such as departmental stores, hypermarkets, supermarkets and speciality stores
-

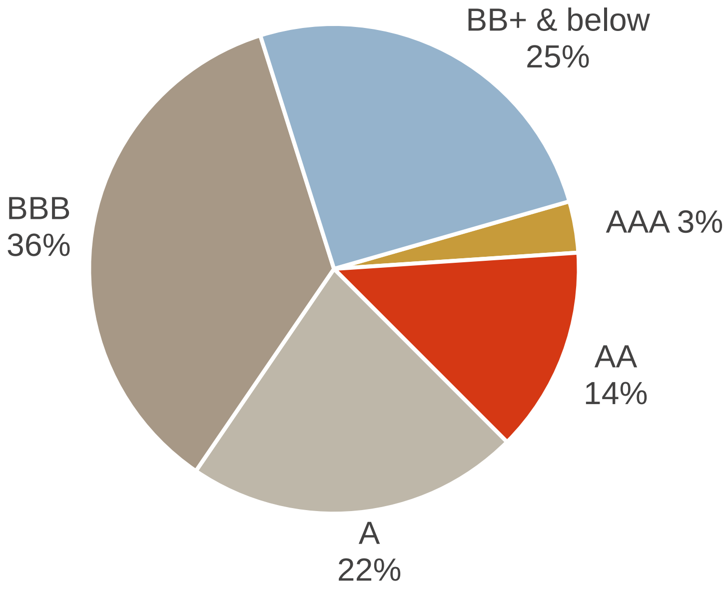
Top rated players

Company name	Segment	Long-term rating	Short-term rating	Outlook
Reliance Retail Ventures Limited	Diversified	CRISIL AAA	CRISIL A1+	Stable
Reliance Retail Limited	Diversified	CRISIL AAA	CRISIL A1+	Stable
Lifestyle International Private Limited	Apparel	CRISIL AA+	CRISIL A1+	Stable
Avenue Supermarts Limited	F&G	CRISIL AA+	-	Positive
Aditya Birla Fashion and Retail Limited	Apparel	CRISIL AA+	CRISIL A1+	Stable
Vedant Fashions Limited	Apparel	CRISIL AA	CRISIL A1+	Stable
Monte Carlo Fashions Limited	Apparel	CRISIL AA-	CRISIL A1+	Stable
Kewal Kiran Clothing Limited	Apparel	CRISIL AA-		Stable
Infiniti Retail Limited	CD	CRISIL AA-	CRISIL A1+	Stable
Fabindia Limited	Apparel	CRISIL AA-		Negative
Shoppers Stop Limited	Apparel	-	CRISIL A1+	-

Rated universe led by apparel, with two-third share



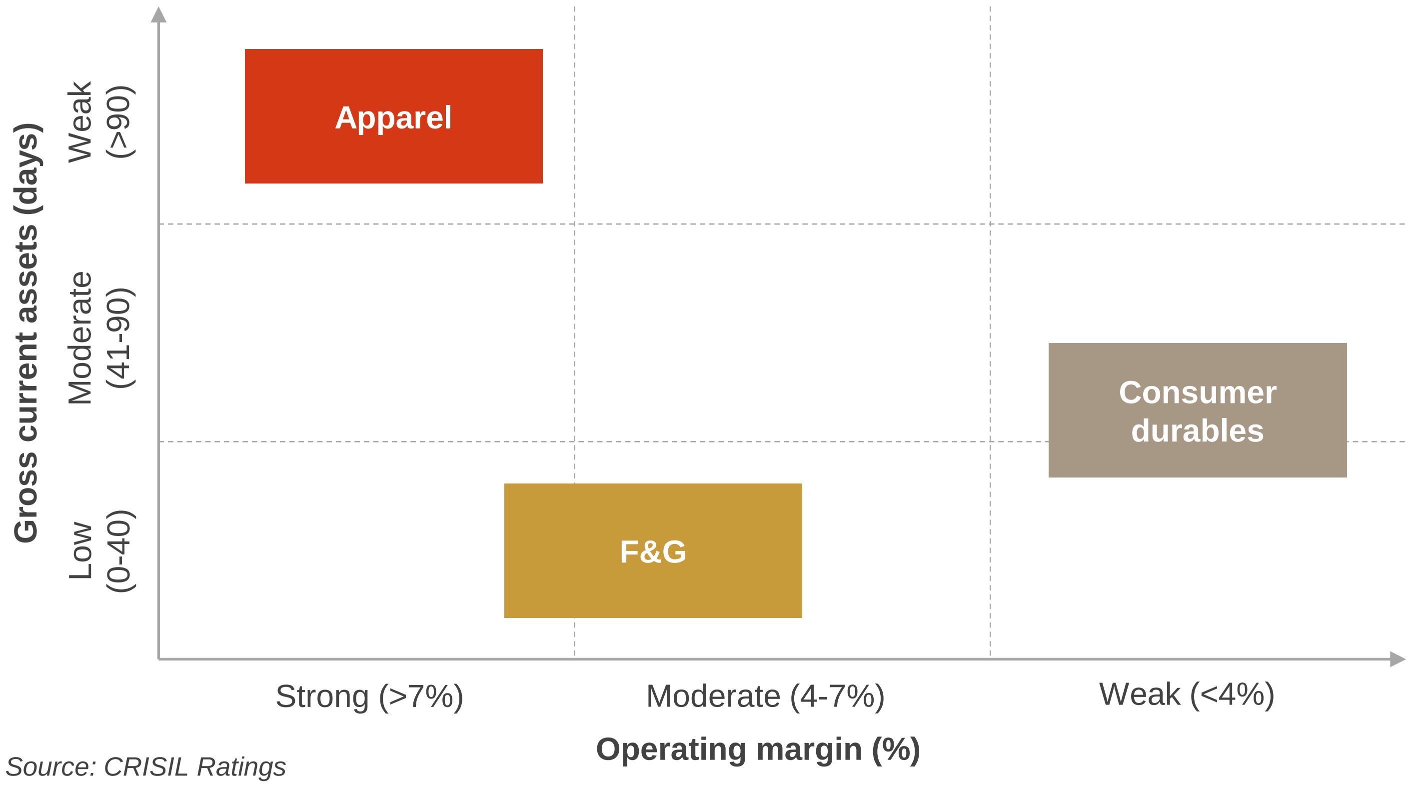
About 75% rating above investment grade



Source: CRISIL Ratings

F&G segment has the strongest operating efficiency

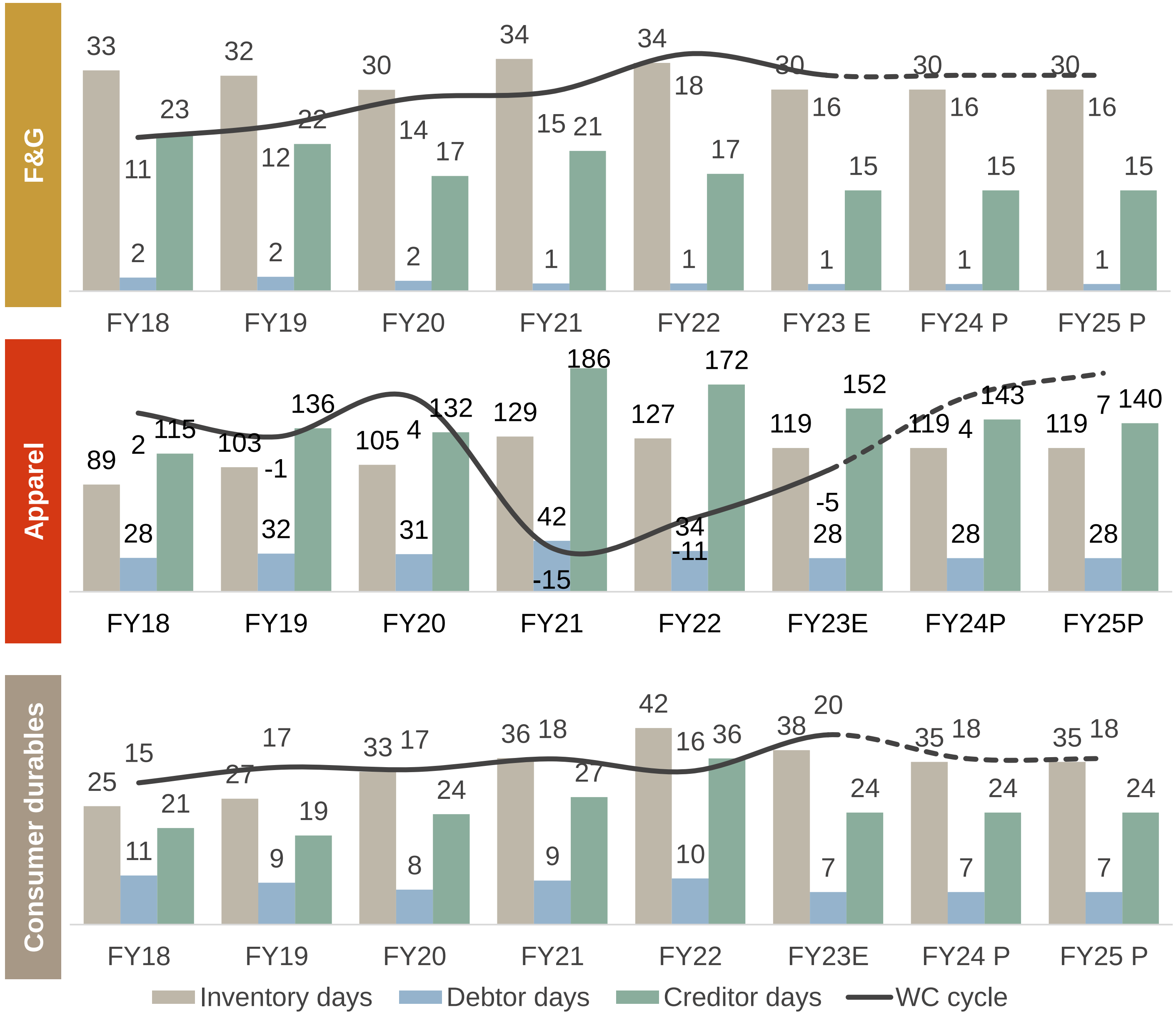
Apparel has the highest GCAs due to large inventory



Source: CRISIL Ratings

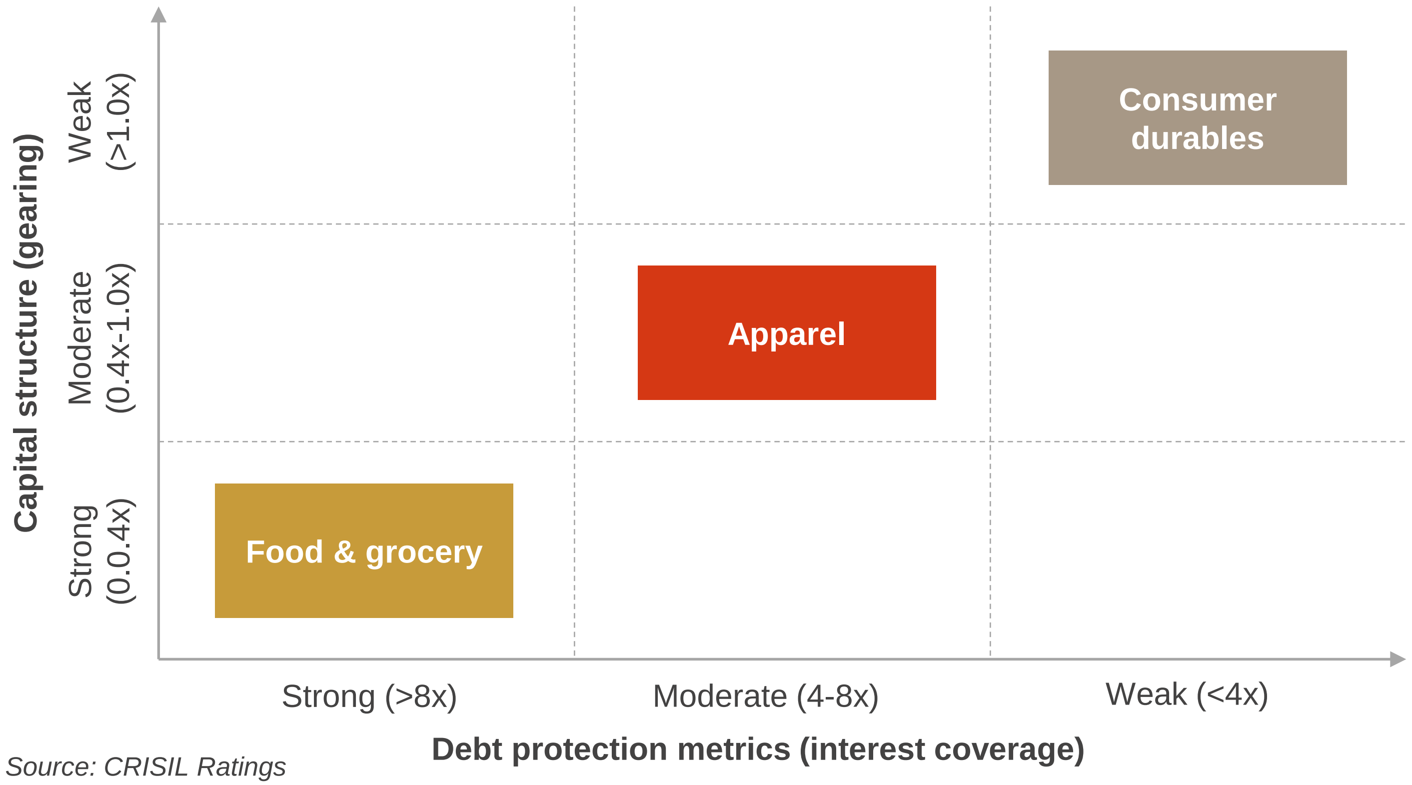
- Stable margins of F&G retailers and sound working capital management support strong operating efficiency
- The apparel retail segment is the most working capital intensive; retailers balance requirement by stretching payables
- Consumer durable retailers have modest operating margin; have focused on effective working capital management over the years

Net working capital cycle efficient across entire organised retail



F&G segment leads with the strongest financial risk profile

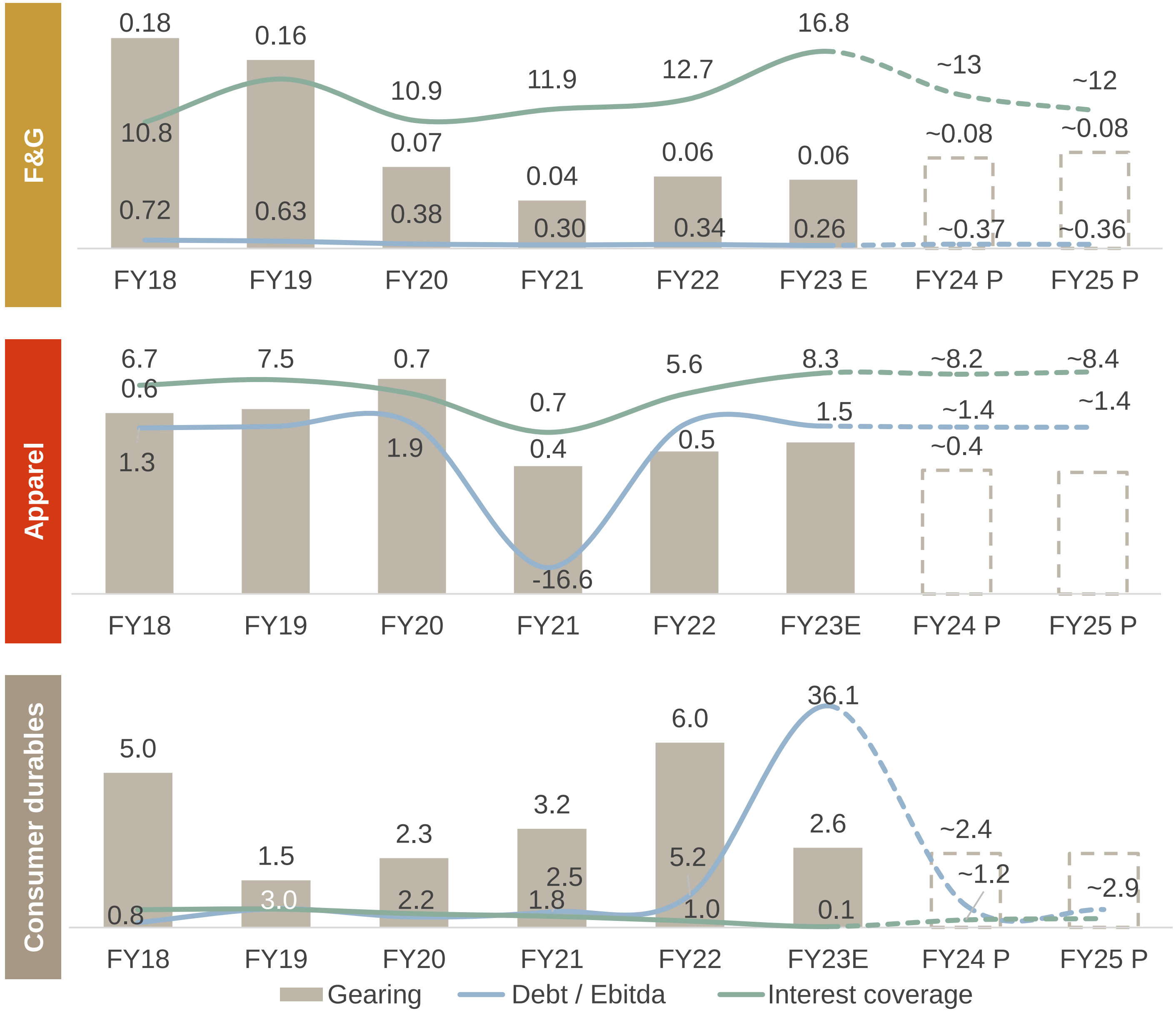
Strong profile of F&G retailers led by robust accrual



Source: CRISIL Ratings

- F&G retailers have strong balance sheets and debt metrics, and high cash-generating ability
- Debt protection metrics of apparel retailers moderated during the pandemic; strong revenue growth and equity raises supported post-pandemic recovery
- Financial risk profiles of consumer durable retailers remain subdued due to aggressive expansion and muted profitability because of intense competition

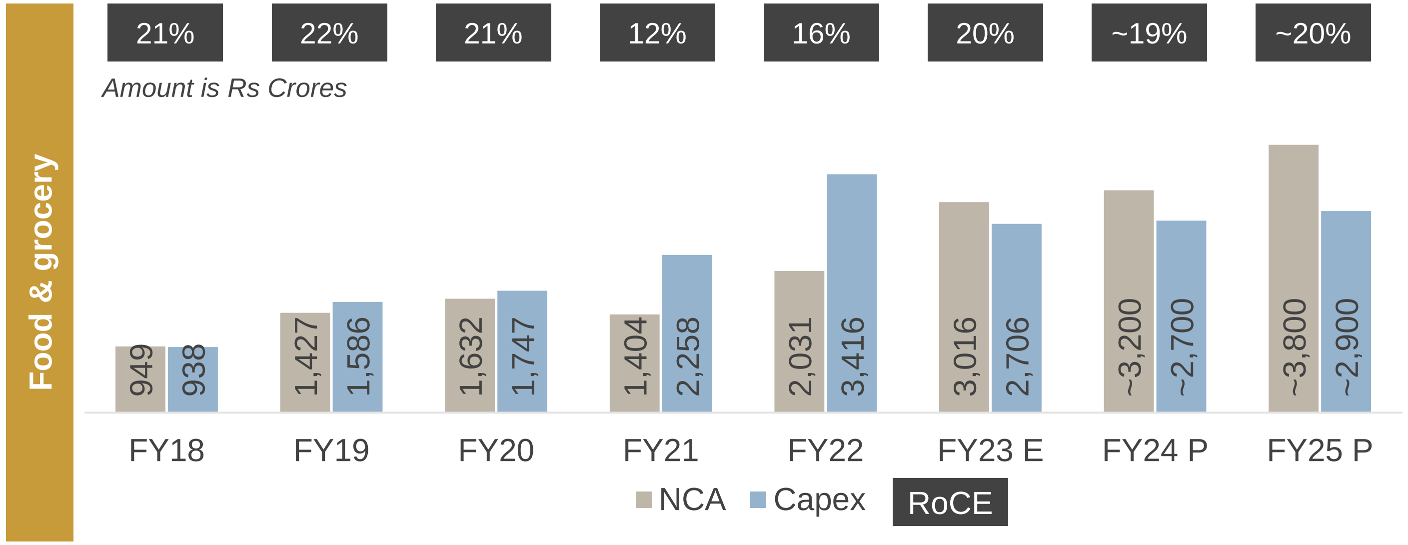
Financial risk profiles of consumer durables retailers subdued due to aggressive growth plans



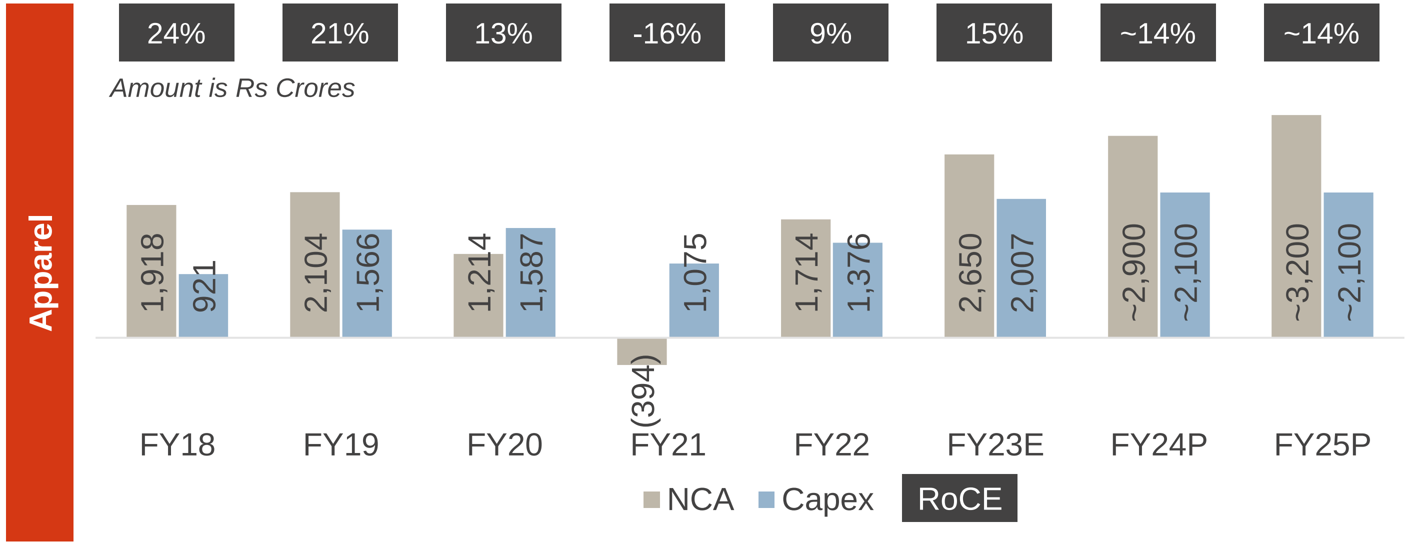
Gearing, debt/Ebitda and interest coverage in times

Return on capital employed highest for the F&G segment

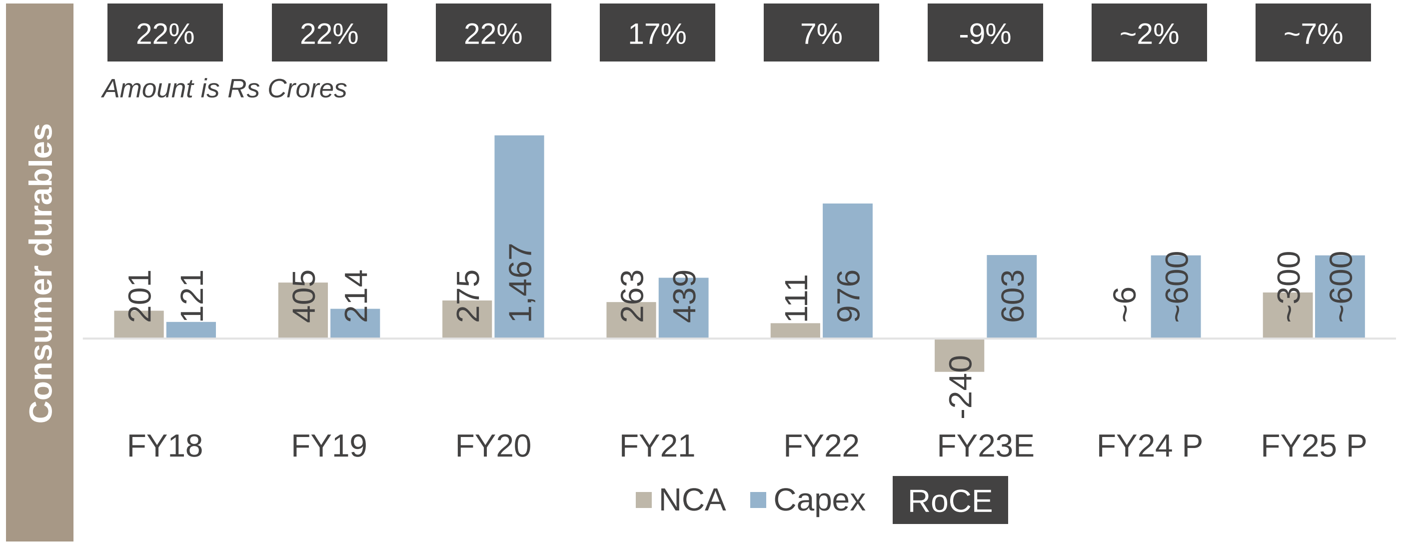
Healthy cash accrual to largely help meet capex requirement



Capex to be funded through accruals and limited debt



Capex funding supported by equity infusion



- Aggressive expansion in the past by F&G retailers was funded through equity with limited reliance on borrowings; strong annual cash accrual to meet large part of future capex
- Focus on working capital management and improving cash accrual to lower external debt requirement for capex for apparel retailers. Timely fund raising has helped fund capex (as seen in fiscal 2021) and is likely to continue
- Due to modest accrual, consumer durable retailers have relied heavily on borrowings/equity raises to fund expansion

Source: CRISIL Ratings analysis of 39 players it has rated, NCA: Net cash accrual; RoCE: Return on capital employed

To summarise

- Growth of the organised retail segment to normalise at 15-16% this fiscal (from 20%+ in the previous two fiscals) as pent-up demand after the pandemic wanes
  - Growth to be driven by higher volume and increasing penetration
- Operating margin to remain rangebound as benefits of softening raw material prices get offset by increased competition
- Capex to be similar to last fiscal – balanced focus on increasing geographic penetration and online presence
- Debt metrics to remain adequate despite continued capex, lending stability to credit risk profiles
- Risk monitorables
  - Ability to sustain demand while maintaining operating margin and expanding stores
  - Commodity trends and inflation
  - Uneven rainfall impacting purchasing power, especially in rural and semi-rural areas

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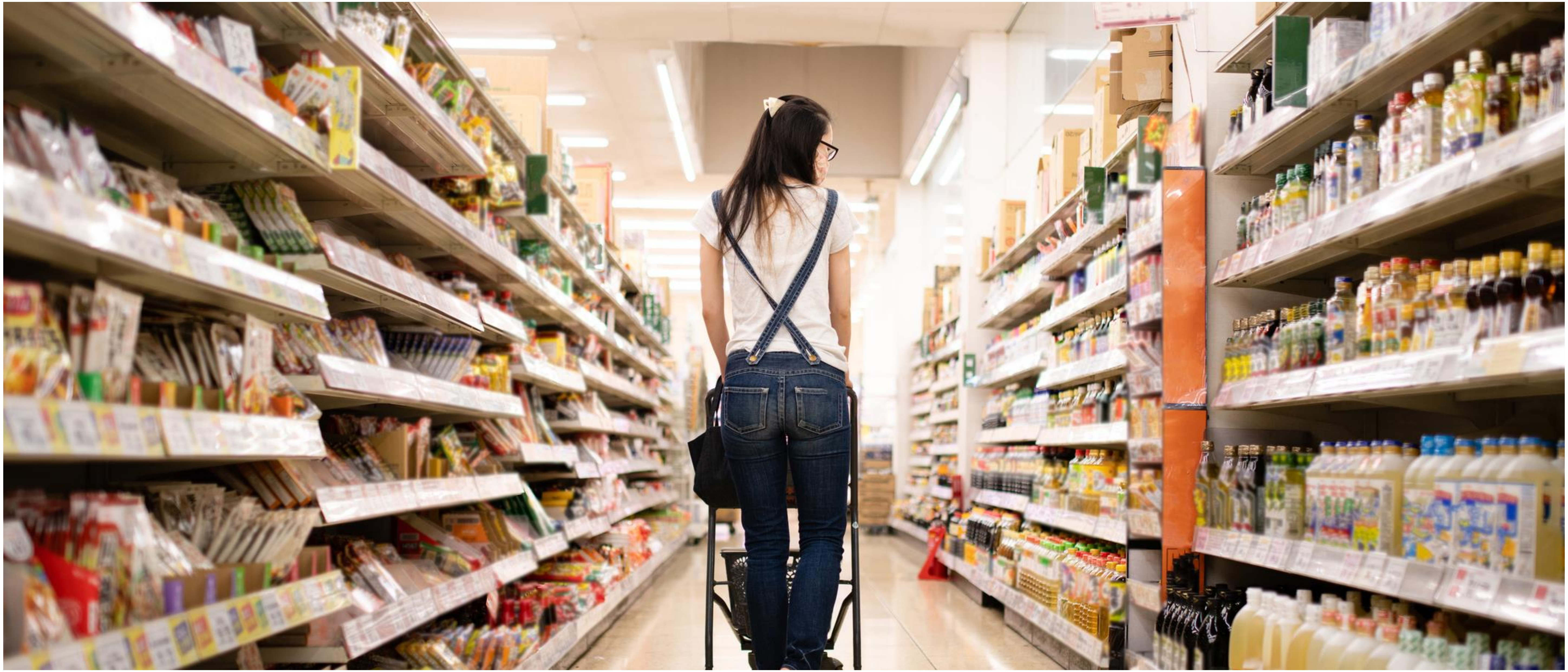
Section 2

Their view



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Views excerpted from a panel discussion during the webinar (1/5)

Eminent panelists

Ashwin Khasgiwala
Chief of Operations
Reliance Retail Ltd

Lars Nielsen
Chief Financial Officer
Benetton India Pvt Ltd

Bharat Adnani
Chief Financial Officer
Kewal Kiran Clothing Ltd

F&G retailers to maintain focus on expansion, specially in Tier 2, 3 cities

- The disruptive impact of an erratic monsoon were restricted to specific regions. Overall demand remained strong and is expected to remain so.
- Although store productivity and revenue density have rebounded sharply post the Covid-led disruptions, they have not yet returned to the pre-pandemic levels and will reach those levels gradually.
- Retailers are focusing on expanding their reach into previously untapped regions. The F&G sector has the most untapped potential.
- India's expansive geographical landscape offers ample opportunities for such expansion. Careful planning could ensure that new stores become profitable rapidly.
- Also, smaller store sizes in small towns tend to result in higher productivity.

Views excerpted from a panel discussion during the webinar (2/5)

Organised apparel retail sector to rebound during the second half of the year

- The Indian economy remains robust and is in a much better position compared to many other nations.
- Demand has moderated slightly over the past couple of quarters.
- Strong pent-up demand following the Covid-19 pandemic drove super normal growth last fiscal. The growth trajectory is now normalising to the pre-pandemic level.
- Growth is anticipated to pick up during the second half of the year buoyed by festive demand. The apparel industry continues to benefit from growth in e-commerce channels, which received a major fillip during the pandemic.
- Sustaining growth hereon will require presence across multiple channels. Hence, retailers are increasingly focusing on omni-channel expansion and growth.

Apparel growth to be driven by increased sales volume as realisations are expected to remain flattish

- Fiscal 2023 was the first year of fully normalised operations after the pandemic, and benefitted from substantial pent-up demand.
- This fiscal, pent-up demand has subsided and growth is seen reverting to the pre-pandemic level.
- With the addition of stores in new geographies, the organised sector is gaining market share at the expense of unorganised players.
- Although cotton prices have declined somewhat, they remain elevated compared to the pre-pandemic levels.
- However, with increase in scale over the medium term, benefits accruing from better operating leverage will support profitability.

Views excerpted from a panel discussion during the webinar (3/5)

Apparel retailers to continue intensified advertisement and promotional spends amid normalising growth prospects

- Retailers increased their spending on advertising and promotions last fiscal to capitalise on the pent-up demand, and will maintain the spend this fiscal to propel demand, especially during the festive season. Hence, advertising expense as a percentage of revenue will remain flat.
- Emerging marketing trends, such as collaborations with social media influencers, are gaining prominence — the focus is on higher returns on similar marketing spends.
- It is essential to consider the return on investment for advertising, encompassing online strategies (sales generated through e-commerce portals) and above-the-line (ATL) efforts (the percentage of sales a company achieves through advertising).
- With marketing spends remaining stable, players will focus on controlling other overheads.

Focus to remain on enhancing share of private labels to improve profitability

- While private labels enhance the potential for higher margins, it is a common practice for retailers to begin with basic items before progressing to more intricate products.
- The key is to deliver quality products at competitive prices while maintaining better margins than national brands.
- Developing a strategy centered around a scalable and sustainable product can be instrumental in enhancing margins.

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Views excerpted from a panel discussion during the webinar (4/5)

Continued relevance of expansion through franchisee route and revenue-sharing leasing model

- During the pandemic, retailers leaned towards a rental model tied to their revenue. As the situation stabilises, a return to a more conventional fixed rental model is expected. That said, some level of caution will persist, given the learnings from the pandemic.
- While rental costs are on the rise in many cities, excessively high rents are not foreseen. A combination of both fixed and revenue-linked rentals may become prevalent.
- Opting for the franchisee route, which is typically less capital-intensive, entails sharing a portion of the profits.
- Many companies initially use a company-owned, company-operated (CoCo) approach to establish a foothold in new regions.
- As they aim for expansion, some companies may transition to the franchisee model.
- Although this approach may yield lower margins, businesses are willing to share profits due to reduced risk and the disproportionate benefits of an expanded brand presence.

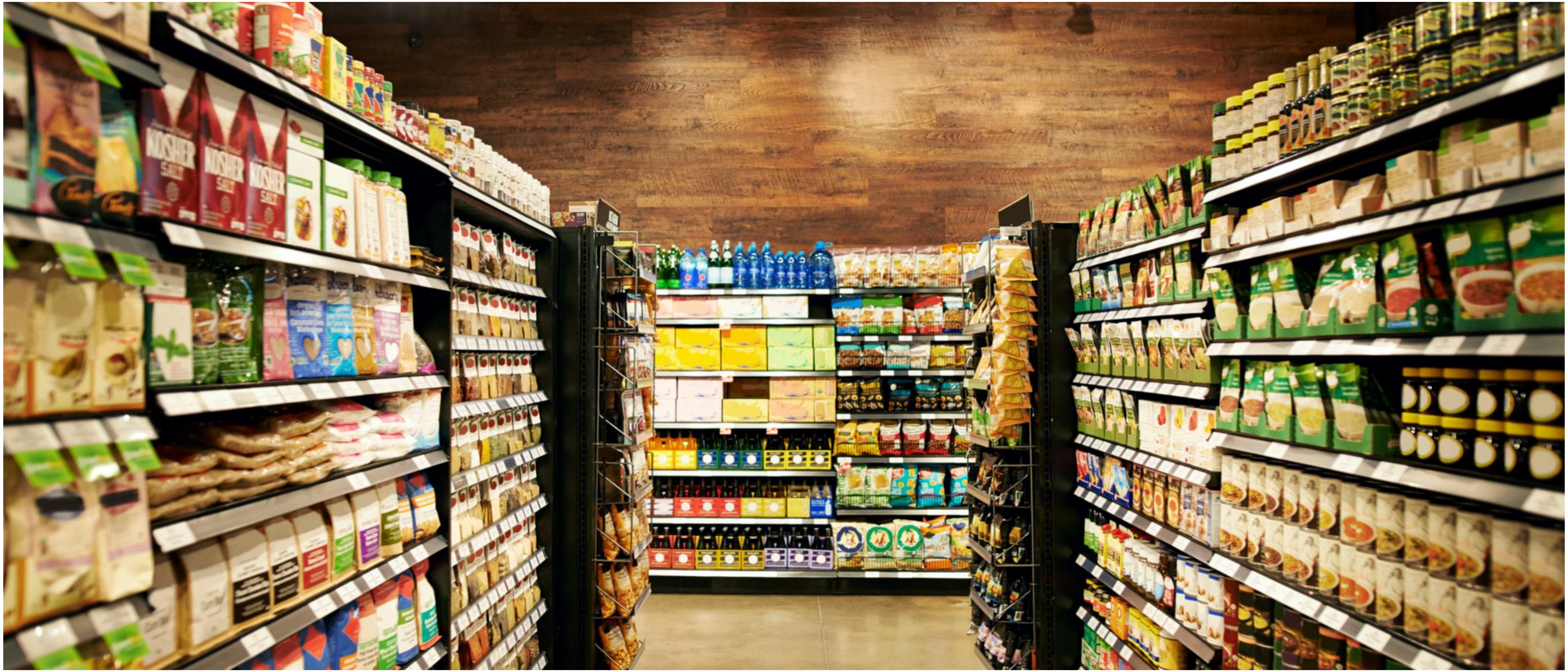
Views excerpted from a panel discussion during the webinar (5/5)

Continued importance of omni-channel presence with customers finding balance between online and offline sales

- As traditional B&M retailers increasingly adopt omni-channel capabilities and establish their online presence, companies are cautious about lowering prices to gain market share as it could negatively affect the industry.
- Alternative approaches such as promotional activities may be more effective.
- Online sales had surged during the pandemic due to restrictions. They remain robust, despite moderation with the return to normalcy.
- The gap in growth rates between online and other channels is likely to narrow.
- Customers are also desirous of an in-store experience which will drive growth in the B&M segment.
- While retailers are focusing on their online presence, concepts such as flat pricing models and short sales commitments are gaining traction, especially in managing working capital and Ebitda. Large format stores are preferred for greater visibility.

Section 3

Poll questions



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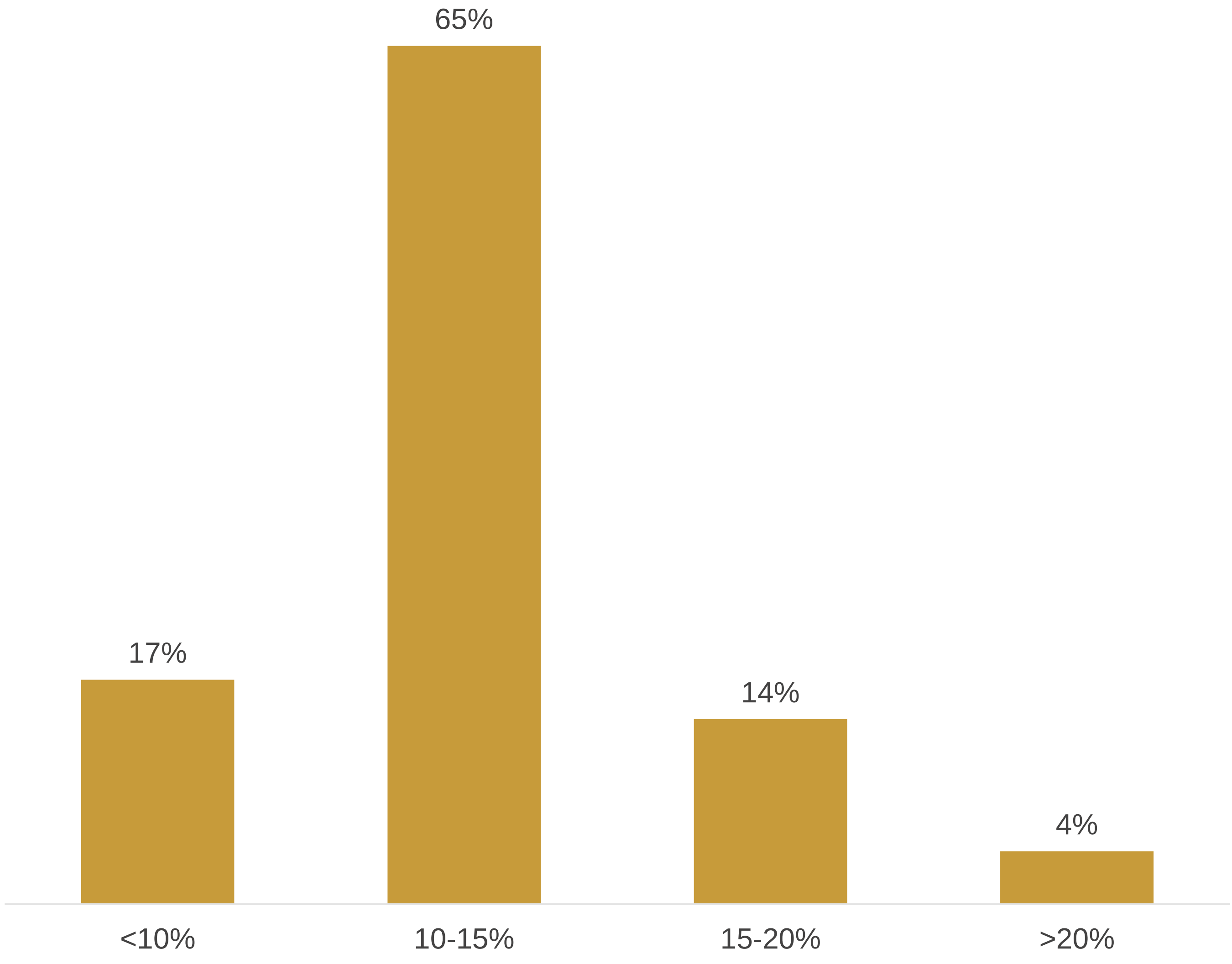
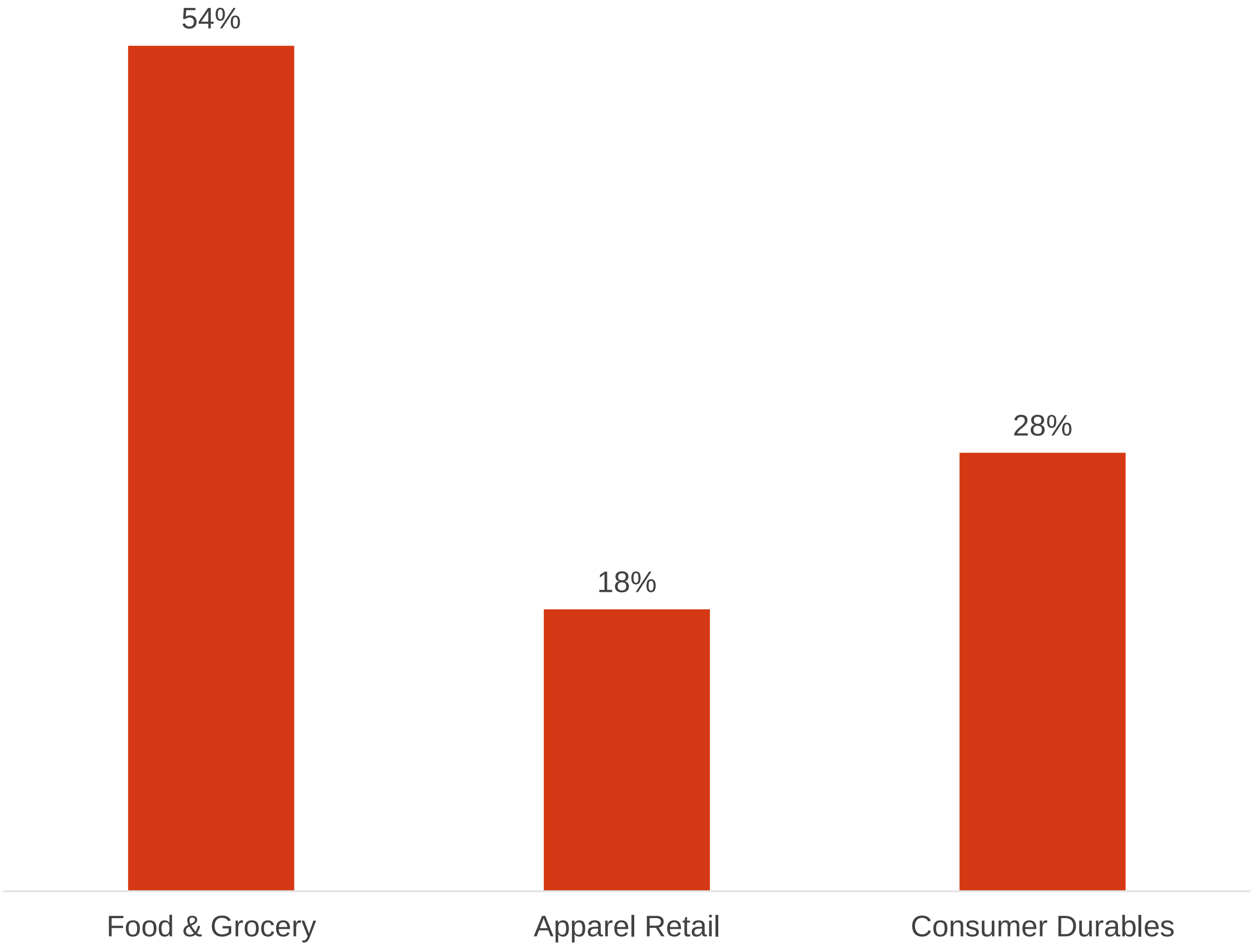
Results of a survey of more than 200 webinar participants (1/3)

Q1. What is your expectation for the organised sector's growth this fiscal?



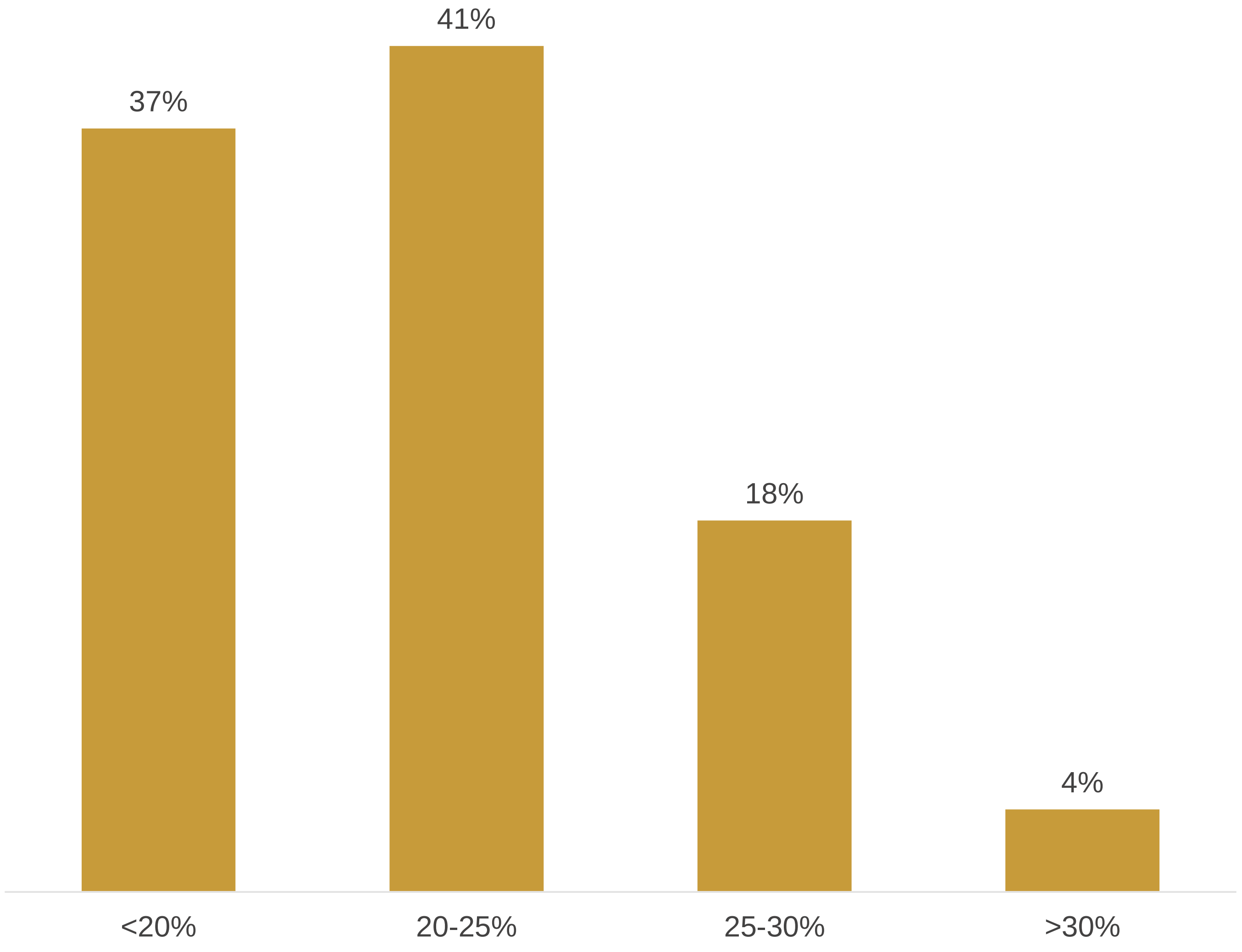
Q2. Which of the following sub-sectors do you expect to grow the fastest?



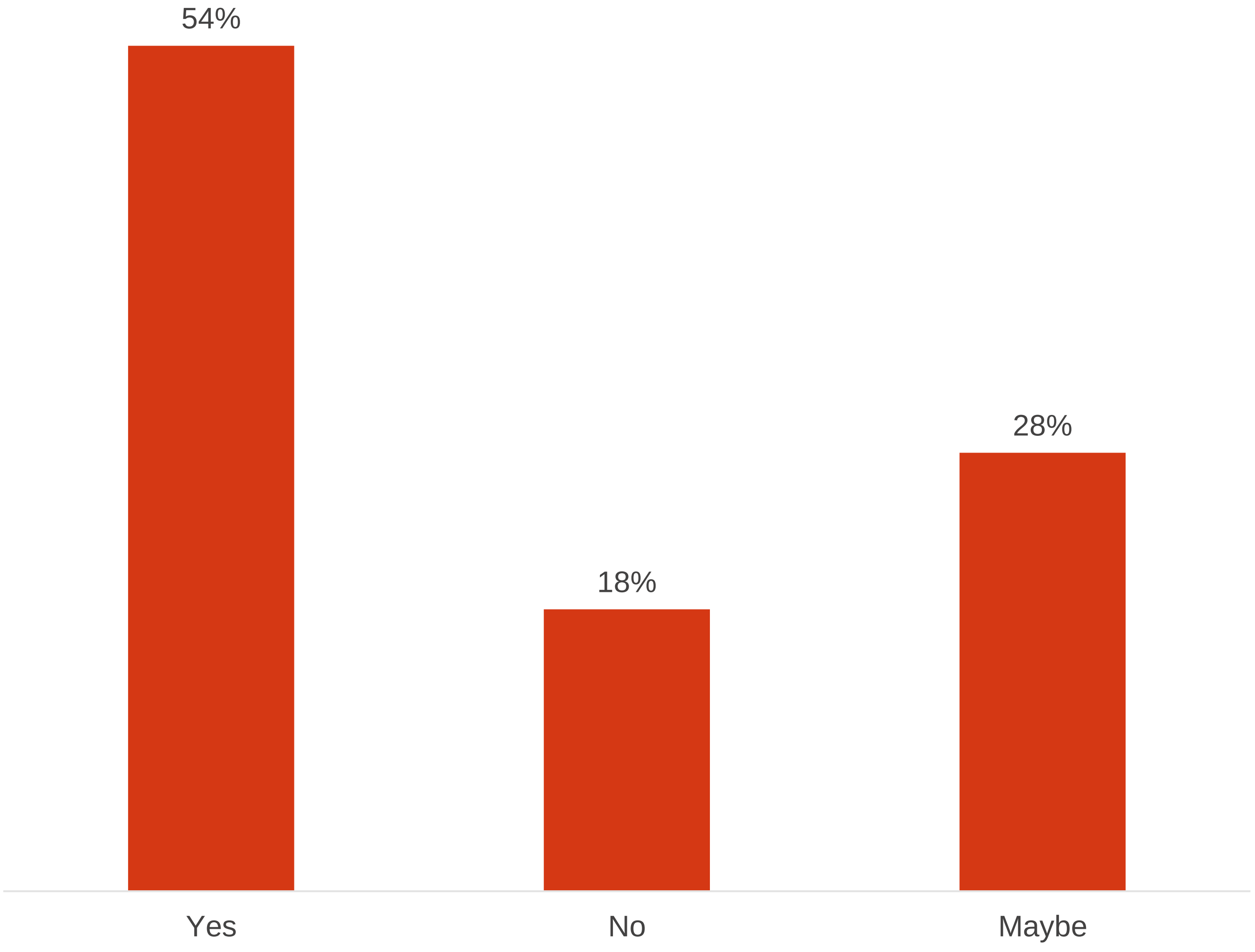
CRISIL Ratings

Results of a survey of more than 200 webinar participants (2/3)

Q3. What is your expectation of the e-retail sector's growth this fiscal?



Q4. Do you expect more consolidation in the sector through acquisitions?



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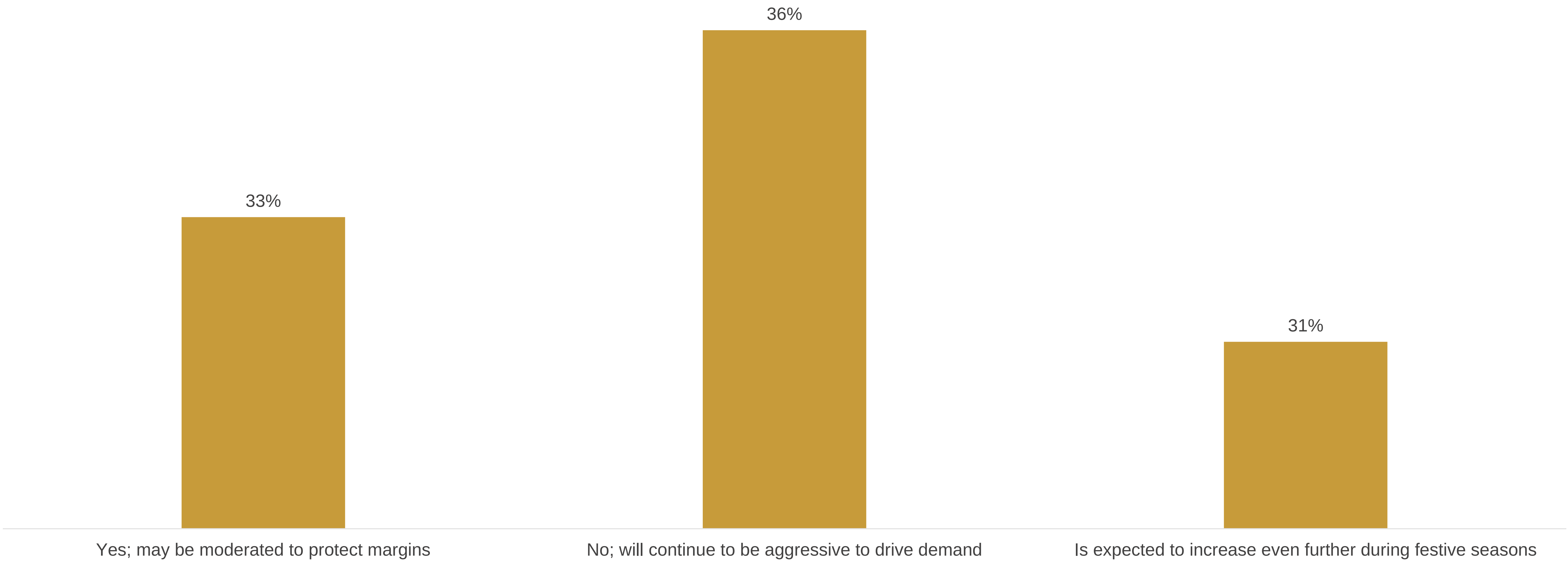
Results of a survey of more than 200 webinar participants (3/3)

Q5. Do you believe advertising and marketing spend will be pruned to protect operating profitability amid competition?



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Thank you

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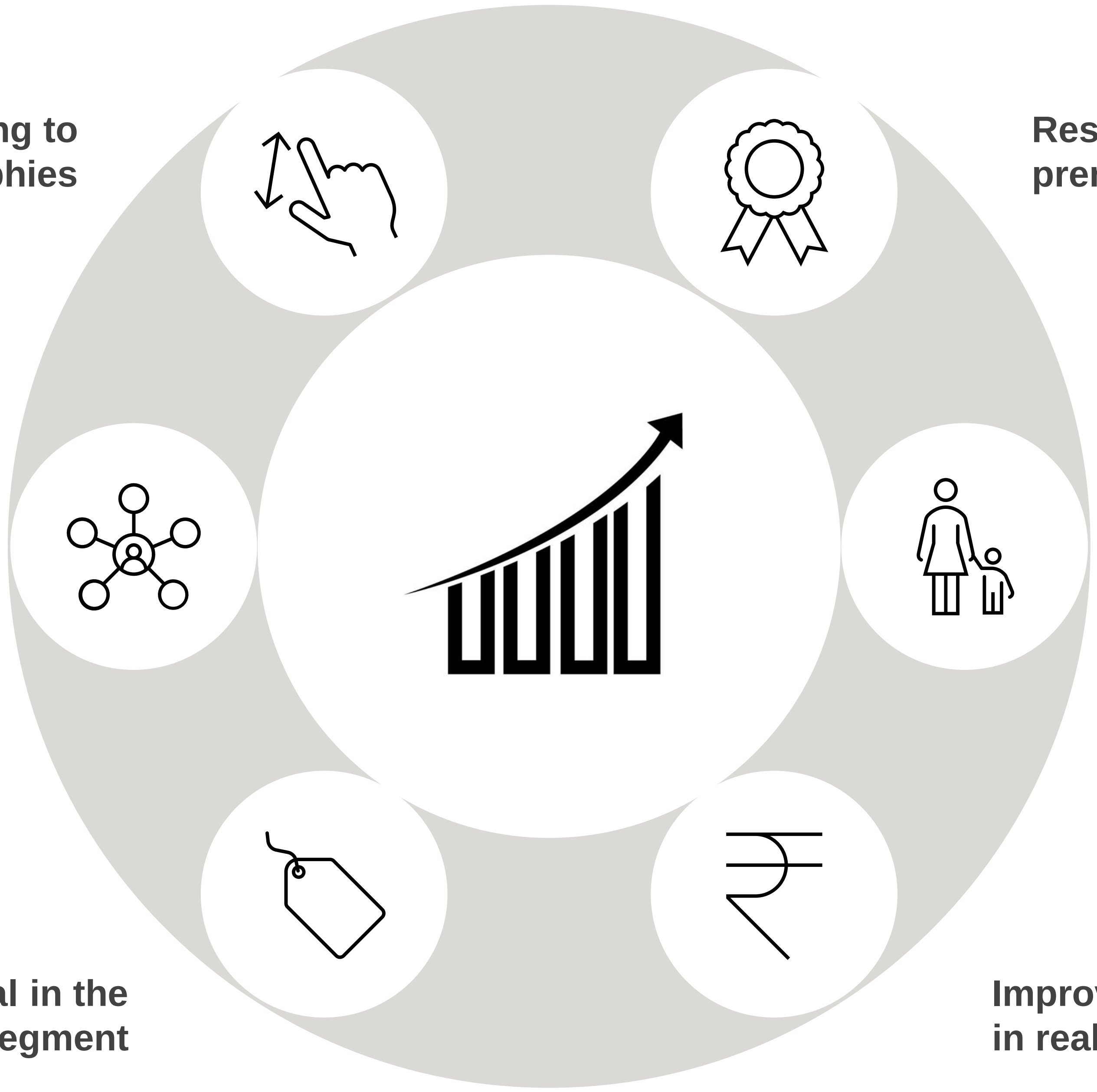
Annexure

Growth drivers for the apparel segment



Expanding to untapped geographies

Resilience in premium segment

Omnichannel presence for enhanced reach

Higher growth in women kidswear

Revival in the value segment

Improvement in realisations

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