Retail

Recovery trends impacted

Cost focus and liquidity remains key

We hosted various stakeholders from the Apparel market – such as a) brand owners (major brands), b) CMAI (clothing association), and c) mall developers – to get their individual perspectives on the current situation on the ground and the outlook for the Apparel market. Here are the key takeaways:

- **Brand retailer Major Brands believes that although the second wave has displaced recovery trends, the large brands would come out of the pandemic stronger – as productivity in operations, e-commerce sales, and inventory clearance would play a key role.**
- **The CMAI painted a grim outlook – understandably – due to its representation of smaller players. It indicated that a large proportion of smaller players are closing down their businesses, plagued by an uncertain outlook, stretched working capital / liquidity, and rising RM cost.**
- **Mall developer R Retail Venture highlighted that the market was surprised by the pace of recovery from the previous lockdown. Therefore, it may not offer rental waivers across categories, but largely focus on rent deferment – Grade A malls have ~95% occupancies and stand strong, with major growth in small cities/towns, against the high liquidity woes of Grade B/C malls.**

Key takeaways from our meeting with Major Brands – Tushar Ved (Owner)

Mr. Tushar Ved,
VP, Major Brands

Major Brands is a leading franchisee for premier international fashion brands (such as Aldo, Charles & Keith, Inglot, Beverly Hills Polo Club, and Bath & Body Works) pan-India.

- Revenue recovery: Sales reached 70% LTL of pre-COVID levels in Oct/Nov/Dec'20 and 85–90% in Jan/Feb'21. The fresh lockdown has once again had an impact; sales are expected to reach 60–70% of 2019 levels in Aug'21 and 85–90% of 2019 levels in Oct/Nov'21 – owing to the festive season. The brands that can ride out the pandemic are likely to capture a larger share in the markets going ahead as many weaker brands are shutting shop.
- Productivity: An increase in productivity would be reflected with the return of revenue as conscious cost measures have been adopted by retailers. Talks of rental negotiations have been initiated for the ongoing lockdown but this is yet to be decided.
- E-commerce growing exponentially: E-Commerce sales surged 300% in FY20, accounting for 30–50% of total sales across categories. Over the next 2–3 years, online should form 30% of the overall business and could reach 50% in some categories. However, margins are currently impacted due to higher sales of discounted products.
- Resorting to inventory clearance: Retailers would need to resort to offering discounts to clear out the summer spring inventory; inventory for the autumn/winter season may be manageable as there is enough time to plan for it.

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Mr. Rahul Mehta,
Chief Mentor & Previous President, CMAI

CMAI has pioneered Indian apparel industry over four decades with over 20K+ companies including readymade garment, manufacturers, exporters and retailers.

Key takeaways from our meeting with Chief Mentor, Clothing Manufacturing Association of India (CMAI)

- Badly hit during lockdown: Retailers were operating at 70–80% of pre-COVID sales over Jan–Feb'21. However, the industry has once again been put on the back foot due to fresh lockdowns being imposed; the impact from the second wave could be more severe given the already weak conditions of many players.
- RM price rise to hurt winter collection procurement cost: Due to high RM cost, winter'21 collections have been procured at high prices. This would lead to an increase in product prices, but store closures would put massive pressure on the industry.
- Low traction from global players: India has been unable to capitalize on the shift in apparel manufacturing from China due to the former's limited focus on technology, quality, and scale of operations. Manufacturing has shifted to other nations such as Bangladesh, Vietnam, and Cambodia.
- High credit period remains a concern: The credit cycle – which is generally high in the Apparel market – has been stretched further due to pandemic woes, thus squeezing liquidity.

Mr Vrushank Mehta,
CIO, R Retail Ventures

R Retail Ventures is a joint venture to develop Grade A shopping malls and retail store complexes across tier 1, 2, & 3 cities in India.

Key takeaways from our meeting with R Retail Venture – Runwal Group and Warburg Pincus JV (mall developers)

- Rental negotiations may not be as challenging as last year: Mall owners had entered into a revenue share arrangement with retailers until Mar'21, and these are now under negotiation. Mall owners are looking to offer deferments instead of waivers as retailers posted healthy recovery last year.
- Grade A malls see major shift from ailing grade B/C malls: Grade A mall occupancies are still at 90–95% levels, which provides comfort. On the other hand, the share of grade B/C malls would decrease. Grade B/C malls are 80–90% leveraged in terms of LTV – as banks continue to lend to retail and commercial players. Hence, revenue share would be inadequate to pay even six months' worth of EMI installments. As a result, these malls could be forced to convert into either office or residential spaces.
- 2HFY21 category-wise revenue trends: Revenue stood at 70–75% LTL in 2HFY21, with a lower contribution from cinemas and food courts, while jewelry and durables performed better. Furthermore, the festive season helped attract footfall.
- Growth opportunity: There is a huge growth opportunity for retail malls in India given their low presence in smaller cities. Furthermore, customer footfall is forcing the shift in the share of space from the regular grocery categories to other avenues such as cinemas, high-end stores, experience stores, etc.

Detailed notes from our meeting with Major Brands – Tushar Ved (Owner)

About Major Brands

- Global operations: Major Brands operates 75 brands in 14 countries in the Fashion, Footwear, Fast Food, and Accessories segments, among others. It has 1,800 stores globally.
- India operations: It operates through eight brands – Aldo, Aldo Accessories, Charles & Keith, Bath & Body Works, Inglot, Beverly Hills, Polo Club, and Call it Spring – across the top metro cities in India and is largely present in malls. 90% of its products are imports and 10% are locally manufactured.
- Expansion plans: It is looking to add two or three more brands by 2022/23 in India. The management plans to introduce category killer brands such as Zara and H&M. It further seeks to enter value fashion, but plans have been delayed in 2020.
- Strategy: The company models itself as a brand retailer and does not look to sell to other stores, large-format stores, or third parties / distributors. It is focused on both online and offline channels.

COVID-19 impact

- Revenue recovery: It reached 70% LTL revenue in Oct/Nov/Dec'20 and 85-90% in Jan/Feb'21. With the fresh lockdown, revenue may be impacted once again; the company seeks to gain through the online channel in this tough business environment. The management expects revenue to reach 60–70% of 2019 levels in Aug'21 and 85–90% of 2019 levels in Oct/Nov'21 – owing to the festive season.
- Rental savings: The company has received rental concessions from landowners since Apr'20. Additionally, it has deferred payments to its partners, along with cancelling some orders. It has also been offering discounts to clear out inventory.
- Productivity: Productivity has increased as with fewer stores, it can do higher business. Currently, this is not reflected completely due to lower revenues, but with revenue recovery, profitability should improve.
- Structural change: There may be structural changes with brand owners and landlords in the long term. Rentals may be linked to revenue share, with some conditions.
- Change in consumer behavior: The Beauty and Body Care segment is growing at a fair pace. Furthermore, in Apparel, the T-Shirts category is doing very well, while Formal Wear / Suits is lagging behind due to office closures. In Footwear, athleisure products are in high demand. As per the management, 20% of this behavior would stick.

Online business

- Operations: It operates e-commerce sites for Aldo, Bath & Body Works, and Inglot. Moreover, it operates on all the major e-commerce sites in India.
- Strong growth during COVID: Its e-commerce operations grew 300% in 2020 and accounted for ~50% of total sales in some categories and 30% in the rest. The majority of lost retail revenue was covered through increased online sales, but margins were impacted due to the clearing out of inventory. 2020 would be the new base, and it should grow 30% annually.

- Scale: The size of its online sales from its own e-commerce sites is equal to the sales of the third-party e-commerce aggregator websites. Over the long term, the captive site would be converted into an exclusive brand outlet (EBO) selling the complete range.
- Expansion plans: Over the next 2–3 years, online should account for 30% of the overall business and could reach 50% in some categories. It offers fast growth as it does not require new stores for expansion, but offers lower margins due to discounting.
- Pricing differential: It maintains price parity on store and online products, with lower ASP on online, as the customer prefers discounted products. However, on certain luxury sites, the ASP is much higher as customers visiting such sites are willing to pay higher prices.
- High product returns in Fashion category: Product returns are below 15% in categories such as Lingerie, Innerwear, and Beauty as this is not allowed due to the hygiene factor. However, returns are 27–28% in the Fashion category, primarily due to the cash-on-delivery option and size issues.
- Online dominance in Beauty segment: Nykaa's presence is higher in the Beauty category, but Myntra and Amazon are ramping up operations in this category. The majority of Nykaa's customers are females, while Myntra has a more gender-neutral customer base.
- Regular products sticky online: Regular products such as beauty and FMCG are sticky as these are usually convenience-led purchases. Furthermore, the stickiness depends on product quality, experience, delivery turnaround time, price, etc. Customers are usually willing to visit retail outlets for customized and exclusive products.

Consolidation and inventory management

- Consolidation among weak players: The brands that can ride out the pandemic are likely to capture a larger share in the markets going ahead. Furthermore, smaller players with brand strength may survive, but weaker brands would shut shop.
- Inventory clearance: Retailers would need to resort to discounting to clear out summer season inventory; inventory for the autumn/winter season may be manageable as there is enough time to plan for it. Summer inventory may be sold for an extended period.
- Third party: Issues related to receivables, brand ethos, and margins are likely when selling to a third party.

Others

- Addressable market: The price point is lower in value fashion; thus, the addressable market may be wider. At a premium price point, the addressable market is lower. Revenue/sq. ft. is higher in the premium category.
- Offline sales: Once normalcy returns, offline operations are expected to resume and the business would continue to expand – due to the low penetration of stores in many cities and towns.
- Store locations: Value retailers prefer to open up stores on the outskirts of cities as rentals are lower.

- Premium brands: Premium brands do not operate through sub-franchising to ensure the quality of store layouts and customer service is maintained. Such brands could take from up to 6 months to 3 years to achieve breakeven depending on their market penetration.
- Local production: This lowers the cost for the brand as it saves custom duty, freight costs, etc.
- Increase in raw material cost: Increase in cotton and yarn prices may be a temporary phase. The management would pass this on to customers – if prices are raised permanently; it would take a couple of quarters to pass on the cost.
- High streets v/s malls: High streets are unorganized in comparison with malls. The propensity of sales is higher at malls, but conversion is higher at high street outlets. Malls see a higher share of customers of premium products. Furthermore, location and competition management by landlords are better for mall outlets. Hence, high streets are experiencing a higher churn v/s malls.

Detailed notes from our meeting with Chief Mentor, Clothing Manufacturing Association Of India (CMAI)

India's Apparel industry

- Stagnant exports: The size of apparel exports in India has stagnated over the past 5–6 years at ~USD21b. In FY21, it is estimated to have declined to ~USD12b due to loss of business from the pandemic. The domestic Apparel sector had a market size of USD80–85b as of 2019; this is expected to have contracted 20–25% in FY21 on account of pandemic-led losses.
- Unorganized sector: In apparel manufacturing, 80% of the sector remains largely unorganized, while 20% is organized.
- Troubled past few years: The Apparel industry began facing headwinds since events such as the demonetization and the introduction of GST – the sector remains largely unorganized and highly dependent on cash and credit.
- Focus on Kids' Wear and Women's Wear: The Ready-to-Wear Men's segment is the largest category in the Indian Apparel sector. Kids' Wear is witnessing the highest growth, followed by Women's Wear. These segments had remained subdued in the past, but are now seeing fast growth; they are expected to grow robustly in the near term. Casual clothing was already a rising trend in the Men's category; work-from-home has accelerated this trend, along with demand for athleisure In India.

Badly impacted by pandemic

- Late resumption: Apparel manufacturers commenced delayed operations in late November amid a huge inventory pile-up at retailers. Although manufacturers were allowed to operate after the lifting of lockdown restrictions last year, they remained distressed due to no fresh orders – weighed by the lack of demand from retail stores and consumers.
- Back at square one: Retailers were operating at sales of 70–80% pre-COVID levels over Jan–Feb'21. However, the industry has once again been put on the back foot due to fresh lockdowns being imposed; the impact from the second wave could be more severe given the already weak condition of many players.
- High credit period remains a concern: The Apparel Retail industry has low entry barriers, with low capital requirements and the easy availability of products and resources. The credit period has historically been high in the industry, which has burdened manufacturers and vendors. Manufacturers have always been highly dependent on credit, limiting the liquidity and growth prospects in the industry.
- Support from CMAI: CMAI has undertaken measures and programs to support its members – such as introducing the concept of bill discounting and credit funding – which would provide manufacturers easy access to liquidity.

Rise in raw material costs to cause dire impact going ahead

- Lower demand for cotton apparel: Cotton apparel forms 60–70% of India's total exports, while the domestic consumption of cotton apparel stands at ~45%. The Indian markets have high demand for polyester fabric as it is comparatively cheaper than cotton apparel.

- Manufacturers close down factories: A survey conducted six months ago revealed ~30% of CMAI members were considering closing down their businesses. In line with this, as of Mar'21, ~20% of CMAI members had discontinued their operations on account of financial distress in the industry.

Indian Apparel industry loses ground to other nations due to low govt support

- Low support from govt: India has lagged behind other nations in apparel manufacturing due to the lack of support from the government, funding constraints, tax laws, the lack of subsidies, and unfriendly labor laws. These factors have led to low interest from foreign players, and India has lost some ground to neighboring nations.
- Low traction from global players: China was a large market for apparel manufacturing, with exports ~10x that of India's exports – manufacturing capacity has shifted from China to other nations, such as Bangladesh, Vietnam, and Cambodia. India's Apparel industry has a low focus on technology, quality, and scale of operations. As a result, it has failed to attract foreign players that seek alternate opportunities to China.
- Boost to other nations: Chinese companies have invested in Vietnam –they have shifted their manufacturing facilities from China to Vietnam, consequently boosting the latter's Apparel industry. Apparel manufacturing in Bangladesh forms 80% of total exports. Bangladesh may lose some share in the future as the tax concessions it has received from the EU (due to being the least developed country) may end soon, consequently benefiting India.
- Govt schemes: We expect the Export segment to do well going ahead on the back of schemes such as PLI and textile parks. Textile parks have conceptually been a good idea, but historically unsuccessful in India thus far; progress on this front needs to be monitored for the next few years.

Rising RM costs to hurt going ahead

- Rising RM costs: With a rise in the prices of raw materials such as cotton and yarn since Nov'20, the second half of the summer season is likely to be heavily impacted. The surge in COVID cases across the world would lead to subdued demand for apparel in the near term, further increasing the stress on apparel exporters.
- Price impact to be reflected post clearing out of summer collection: Summer season inventory was procured ~six months ago and a price rise on this collection is unlikely. The winter collection, however, has been procured at high prices, and product prices would be raised accordingly. Nevertheless, store closures would create massive pricing pressure on the industry as demand decline would lead to margin pressures for manufacturers and retailers.

Detailed notes from our meeting with R Retail Venture – Runwal Group and Warburg Pincus JV (mall developers)

COVID 19 impact

- Rental agreements: The revenue share arrangements between mall owners and retailers (up to Mar'21) would have been back to the old terms if the COVID situation had normalized. However, due to the continued disruption, in line with last year, mall owners have received requests from their retailers and are in talks to continue with the negotiated new arrangements. While common area maintenance (CAM) would be waived, rental waivers would be limited as retailers have seen strong recovery over the past year. Thus, rent is more likely to be deferred than waived off. On the other hand, land owners are expected to be more accommodating of F&B and other entertainment players by waiving off up to 50% of the minimum guarantee; of the remaining 50%, 35–50% would be payable immediately and the rest would be deferred.
- Store shutdown: COVID has not led to massive vacancies. In large listed/unlisted grade A malls, occupancies are still at 90–95% levels, which provide the comfort that retailers are not looking to shut shop.
- 2HFY21 revenue trends: Revenue stood at 70–75% LTL in 2HFY21 with a lower contribution from Cinemas and F&C, while the Jewelry and Digital categories performed better. Furthermore, the festive season helped attract footfall.
- Agreements with cinemas: CAM was waived off amid cinema closures. It would be resumed once again post the opening up of cinemas, while rent would be charged on a revenue share basis. Given that cinemas are big occupants, their absence would impact malls. Hence, they would be accommodated until closures continue.
- Commercial/Office spaces: While these have seen a big impact and a jump in vacancies, Grade A players have witnessed lower vacancies.

Outlook

- Cinema industry: Cinema expansion plans would remain lackluster in the post-COVID era. Furthermore, the growing adoption of OTT platforms would have some impact on cinema occupancies. While the experience of viewing on the big screen remains attractive, cinemas may have to revisit their pricing to avoid losing customers in the mid-to-lower categories – which would impact earnings.
- Category expansion: Mall owners seek to add categories that are currently non-existent. The number of stores offering better experiences would increase as well as the requirement for skilled employees.
- Growth opportunity: There is a huge growth opportunity for retail malls in India. They have a low presence, which is skewed toward select cities. Furthermore, outlets – such as cinemas, high-end stores, and experience stores – are capturing a higher share of space from groceries/supermarkets/hypermarkets at malls as consumer traffic is increasingly shifting toward these outlets.

Grade A v/s Grade B/C mall developers

- Long-term impact: In the post-COVID era, the share of grade A malls would increase, while that of grade B/C malls would decline. Grade B/C malls are 80–

90% leveraged in terms of loan to total value of the property (LTV). Hence, revenue share agreements would be inadequate to pay even six months' worth of EMI installments. As a result, these malls could be forced to convert into either office or residential spaces.

- Consolidation: The market would consolidate towards Grade A players; renegotiations for higher rentals would be commenced once the market stabilizes. Grade A players are acquiring the B/C players that have applied for restructuring since the completion of the six-month RBI moratorium.
- Pre-COVID performance: Grade A players such as Oberoi and Phoenix have seen a steady 20–25% increase in rentals over the last 4–5 years on account of both the minimum guarantee clause and revenue share gains.

Process of rental agreements

- New agreements: With a typical new contract, revenue share does not kick in for 2–3 years since the signing of the contract and only the minimum guarantee is payable. For the initial 2–3 years, the trading density (TD) of the mall is usually 70–80%. Thereafter, as the mall starts seeing 20–25% growth, the revenue share clause kicks in, providing ~20% of the rental yield; annual rent escalations also lead to an increase in the minimum guarantee amount.
- Revenue share: While the revenue share remains the same over the long term at ~20%, the minimum guarantee is raised depending on the sales growth and TD at the mall increasing by an average of 3–5% annually.

N O T E S

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