Retail

Who's moving the retail flywheel?

On the surface of Indian retail…

- Multi-decadal growth runway
- Low organized penetration (~10% only)
- Rising Indian consumption, evolving taste/preferences

Digging beneath…

Despite the huge opportunity, food & grocery (F&G) and Apparel exhibit divergent trends. While F&G is consolidating, Apparel is gradually fragmenting. Both trends make it **imperative to identify who's got the proverbial flywheel (momentum) moving.** The cogs of this flywheel include (a) Real estate choices (we mapped networks across income profiles and population density of 460+ districts), (b) Assortment/mix and pricing (across 1,50,000 SKUs), (c) Financial position of 40+ retailers.

What we found

1. Strong assortment + smarter pricing + well-calibrated store network = Consistency in performance, categories notwithstanding. **Consistent winners here include D-MART, Trent, V-MART, TCNS Clothing.** FLF's Brand Factory and ABFRL's Pantaloons have improved significantly in recent years and deserve mention.
2. **In F&G, only a few may survive** given that tight spreads and weak cash position of most grocers will run into balance sheets of global competitors over the next 2-3 years. Amazon/Flipkart have bumped up authorized capital of their Indian F&G units in FY19. Even the best may get bruised. Disciplined stock-up grocers with low cost structure are better off. **Stock up works online too!**
3. **Select e-grocers are smartly closing in on pricing, while improving trade margins.** Top e-grocers' revenues are estimated to have jumped 7x to Rs. ~46bn, while cash burn is up only 2.6x to Rs. 8bn over FY16-19.
4. In Apparel, online discounter **Myntra is offering better terms of trade to woo brands. We expect margins (in the Walmart era) to follow;** this spells doom for run-of-the-mill multi-brand formats, already on multiple crutches. Strong private labels are better off.
5. **Low average order values; Rent < fulfillment costs = Safety net for off-price/value fashion.** Globally too, some of the least impacted formats are the ones where consumer savings is a key hook such as discounters in F&G and off-price retailing in apparels.

Initiate coverage on 9 cos (DCF-based valuations)

- **Avenue Supermart:** Standout operator! Alas, valued to the moon and back. SELL, TP Rs 1,250/sh, implied EV/EBITDA ample at 25x Sep-21.
- **Future Retail:** Pledges a concern! Fortunes hinge on Amazon Partnership. Undemanding valuations give comfort. BUY, TP Rs 500/sh, implied EV/EBITDA 14x Sep-21.
- **Trent:** Perfect cross between fast and value fashion, but perfectly priced too. NEUTRAL, TP Rs 490/sh, implied EV/EBITDA 29x Sep-21.
- **ABFRL:** Most well-rounded fashion play. BUY, TP Rs 250/sh, implied EV/EBITDA 22x Sep-21.
- **FLF:** Off-price retail is the key value driver. BUY, TP Rs 550/sh, implied EV/EBITDA 14x Sep-21.
- **TCNS Clothing:** Assortment, pricing, distribution leader in ethnic wear. BUY, TP Rs 770/sh, implied EV/EBITDA 21x Sep-21.
- **V-MART:** Value Fashion tail's loss = VMART's gain. BUY, TP Rs 2,150/sh, implied EV/EBITDA 20x Sep-21.
- **Arvind Fashion:** On course to recovery, after a jolt. BUY, TP Rs 430/sh, implied EV/EBITDA 12x Sep-21.
- **Shoppers Stop:** Most exposed to online intrusion. NEUTRAL, TP Rs 350/sh, implied EV/EBITDA 9x Sep-21.
- **Reliance Retail:** Building India's everything store. FV Rs 315/sh (on RRVL count), contributing to RIL SoTP Rs. 319/sh (on RIL share count).

The Flywheel effect: No matter how dramatic the end result, the good-to-great transformations never happened in one fell swoop. There was no single defining action, no grand program, no one killer innovation, no solitary lucky break, no miracle moment. Rather, the process resembled relentlessly pushing a giant heavy flywheel in one direction, turn upon turn, building momentum until a point of breakthrough and beyond.

- Jim Collins,
Good to Great

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What's Inside?

The 'To be or not to be' moment for grocers: Most grocers in India, do not make a profit spread on their cost structure as they remain sub-scale and cash position to expand remains weak. To add insult to injury, well-funded e-grocers have been smartly turning on the heat (on pricing). Interestingly, for some, trading margins have improved. Global biggies (Amazon/Flipkart) too, seem to be in the midst of revving up their war chest for a full throttle launch in F&G over the next 2-3 years. . **(Amazon Retail bumped up its authorized capital 10x to Rs. 35bn in FY20. Flipkart too, has assigned an authorized capital of Rs. 18.5bn to its F&G unit).** While weak unit economics and sorry cash position of most grocers warrants for partnerships with deep-pocketed peers, not all qualify as candidates. Hence, we believe, most grocers are inching closer to their 'to be or not to be moment'. We reckon even the best may get bruised, disciplined stock-up operators are better off.

- **Pure-play multi-brand stores on multiple crutches:** Global multi-brand department stores have been reeling under the pain of footfall cuts and rising cost of biz (courtesy omni-channel investments). Margins have eroded by 1-10pp over CY13-18. We fail to see why this format shouldn't follow the global playbook in India. In fact, market share loss for some may be even swifter given 1) No differentiation, 2) Sub-optimal scale, 3) higher opex structure (5-10 ppt higher- courtesy higher rents), 4. Increasing payables crutch. Discount-setter Myntra too, seems to be bettering terms of trade to woo brands which should impact this format's fate. Within this cohort, we prefer companies 1) moving towards the bottom of the pyramid via off-price (FLF) or value fashion (Lifestyle International) offerings, 2) with leaner cost structures.
- **Strong private labels – First among equals:** Within apparels, both fast fashion (FF) and strong private labels mimicking FF seem promising themes. However, unlike globally, the FF price hook is absent in India (priced competitively vs legacy brands). Hence, strong private labels (priced sharper) with an FF DNA are better placed to milk the broader market. and in our view, are first among equals within the Pvt. Label/FF cohort. Westside aces on all fronts – assortment, pricing and distribution being a perfect cross between Fast and Value Fashion
- **Women's Ethnic wear – A penetration game:** With top 5 ethnic retailers holding mere 7% category share, women ethnic wear (HDFC est:USD7.7bn), offers one of the highest headroom to grow in apparels. As with other apparel formats, those having nailed the holy troika of retailing right (Assortment, pricing, and distribution) are winners. TCNS seems to tick all boxes. While leverage remains comfortable for most, inventory position, ergo working capital has been deteriorating for some. Hence, we believe, some may shift focus from growth to fixing the burgeoning working capital, presenting a tactical opportunity for asset-light models (TCNS) to gain share.
- **Value Fashion – Where the juice is!** Value fashion (VF) by far remains the biggest opportunity to milk in apparels (HDFC est: ~Rs. 2tn). Our 13-member VF universe comprises mere 13% of the market. That said, the VF tail seems out of gas with productivity declining and payables support rising. **SOMETHINGS GOT TO GIVE! We believe strong incumbents like V-MART are well placed to capitalize on this opportunity.** Winners on the Assortment-Pricing-store density equation are Max Fashion (in Rs. 500-1000 range) and V-MART (in <Rs. 500); also reflects in their industry-leading productivity (Esp. For Max Fashion). Of Note, Pantaloons is expected to catch up on store density and is amongst the most improved VF retailers in recent times.

Initiating Coverage on:

- **D-MART - Valued to the moon and back!** Over the past decade, industry bellwether DMART has accumulated ~Rs 48bn in pre-tax earnings. However, the company has had to inject ~Rs ~53bn to its invested capital base (~10x FY10 levels) to buy this growth. That said, DMART remains the best franchise in trade with (1) A strong recall as a discounter, (2) Track record of consistent growth courtesy its EDLC-EDLP proposition, (3) Best-in-class management. It's capital-intensive ownership model which incidentally is at the core of its EDLC-EDLP strategy does act as gravity to long-term valuation, especially within the context of heightening competitive intensity. We expect DMART to clock revenue/EBITDA/Adj. PAT CAGR of 25/28/28% CAGR over FY19-22E. RoCEs to remain steady and nearly peak out by FY22E at ~21%. **Initiate coverage on DMART with a SELL recommendation** given that current valuations have run past fundamentals and assign a DCF-based TP of Rs 1250/sh implying an EV/EBITDA of 25x (Sept-21)

- **Future Retail - the Contrarian Retailer:** After rummaging through biz with non-core entries and exits, FRL finally seems to have zeroed-in focus on its core - Big Bazaar/FBB (Hypermarket) and EasyDay (Convenience format). While BB remains in steady-state; EasyDay's path to profitability remains a key monitorable. FRL's real money maker though, is its 16mn+ sq. ft strong store network - largest in F&G which could potentially double up as a strong omni-asset given its pan-India presence (437 cities) – The key rationale for Amazon's investment in FRL. **PLEDGES REMAIN HIGH THOUGH!** Ergo, higher cost of equity assigned (16%). While, recent transactions could bring company pledges down (currently 67%+), more needs to be done on this front. Hence, **further capital infusion is a key monitor-able.** We bake in revenue/ LTL EBITDA CAGR of 10/12% over FY19-22E. **Initiate coverage with a BUY** and a DCF-based TP of Rs. 500/sh (post dilution) implying 14x Sept-21 EV/EBITDA.

- **ABFRL - Unparalleled distribution brawn:** ABFRL is the most well-rounded play on fashion as its portfolio straddles across multiple fashion categories and income groups. It boasts of an unparalleled apparel retail footprint of ~7.5mn sq. ft (ex-Reliance Retail). Interestingly, this distribution is one of the leanest in terms of capital needs. Over FY16-19, ABFRL's capital needs hoarded just ~69% of ABFRL's pre-working capital CFO. Very few fashion plays can boast of this, 1. Casualization/Premiumization within its tent-pole brands and 2. Value Fashion play (Pantaloons) are key themes/formats to watch out for. Expect ABFRL to clock revenue/EBITDA/LTL PAT CAGR of 14/23/48% respectively over FY19-22E as both levers – operating and financial go into overdrive. Consequently, RoICs are expected to improve by 390bp to 12.6%. We **initiate coverage on ABFRL with a BUY** and a DCF-based TP of Rs. 250/sh, implying 21x Sept-21 EV/EBITDA.

- **Trent - Perfect cross between Fast and Value Fashion:** Trent's flagship - Westside is a perfect cross between Fast and value fashion. Unlike globally, fast fashion retailers in India have their assortment priced at similar price points to popular brands (Rs. 1500-3000), hence, are restricted to Metros/Tier 1 cities. Westside has managed to exploit this gaping white space for trendy, edgy and fast moving fashion at sub-Rs. 1000 price points consistently over the past decade (56% of SKUs <Rs. 1000 – per our SKU Analysis). This explains its consistent 8% SSSG CAGR over FY09-19. It's tight supply chain, working capital and women-wear-heavy assortment skew also increasingly mimics that of a fast fashion play. The Rs. recent Rs. 9.5bn fund raise should help its expansion cause. Zara JV accounts for >30% of Trent's value; ergo risk of Inditex buying out Trent's stake remains. **While execution remains top-notch; tailwinds seem**

priced in. We bake in 28/27/37% revenue /EBITDA/PAT CAGR and a 300bp improvement in RoCEs over FY19-22E**.** **Initiate with a NEUTRAL** and an SOTP-based TP of Rs. 490/sh, implying 29x Sept-21 EV/EBITDA – highest in our coverage universe.

- **Future Lifestyle Fashions (FLFL): Off Price Retailing + Brands = Potent Cocktail:** FLFL's unique cocktail of Off-price retail (Brand Factory), owned brands, mall-like department stores (Central) makes it one of the more promising retailers within our universe. Brand factory provides scalability and footfalls, while Central and owned brands provide the margins and free cash levers. BF's growth is expected to be largely expansion-led, while Central trains focus on productivity gains. A healthy store age profile should keep SSSG steady for both. Margin gains to remain elusive as mix decisively tilts towards Brand Factory. That said, revenue exposed to disruption should also reduce with BF's increasing relevance in biz. Building in revenue/EBITDA/PAT CAGR of 18/19/20% respectively and a steady return profile over FY19-22E. **Initiate with a BUY** and a DCF-based TP of Rs. 550/sh, implying 14x Sept-21 EV/EBITDA.
- **TCNS Clothing (TCNS) - Getting the troika right!** TCNS is one of the biggest beneficiaries of the unorganized to organized shift in Ethnic wear. It remains a market leader and the fastest growing ethnic wear outfit (47% CAGR over FY14-19) in India outpacing even industry pioneers, some of whom may have out-priced themselves from the market over the years. Underpinnings of TCNS' success lies in it getting the troika of retailing right – Pricing, Assortment and distribution. 1. Our SKU analysis suggests that TCNS sports the sharpest price points across ethnic categories (68% SKUs <Rs. 1000). 2. On Distribution, the outfit has treaded the expansion-unit store economics equation better than most. Both points (1) & (2) feed into industry-leading asset turnover. We bake in revenue/adj. EBITDA/adj. PAT CAGR of ~14/14/12% over FY19-22E with a steady adj. return profile (RoCE: ~21%) given category tailwinds and TCNS' better execution skills. **Initiate coverage with a BUY** and a DCF-based TP of Rs 770/sh implying a 21x Sept-21 EV/EBITDA.
- **V-MART: Story still has legs!** Over the past decade, mass value fashion (VF mass) has been one of the most profitable formats in retail. V-MART has been riding this wave with clockwork-like execution and remains one of the most disciplined operators in trade. It has scaled 10x over FY09-19 entirely through internal accruals. While, competition from national players is increasing, some peers, especially, the tail of VF-mass seem out of gas as they grapple with vendor issues. VMART to be a key benefactor. However, in the short-term it may suffer margin pressure as inventory gets liquidated across the tail-end. We bake in revenue/EBITDA/PAT CAGR of 22/16/17% and a steady return profile (~17%) over FY19-22E. **Initiate coverage with a BUY** and a DCF-based TP of Rs. 2,150/sh, implying an EV/EBITDA of 21x (Sept-21).
- **Shoppers Stop – Amidst tough times!** STOP's model seems outmoded in the current phase of online evolution. We see e-tailers getting aggressive on stitching brand tie-ups over the next 3-5 years, in an attempt to inch closer to profitability. Globally too, Amazon hit profitability for the first time in CY02 when apparel became part of its portfolio. The de-rating cycle of some of the global department stores has been severe and swift (Case in point Matahari). We don't see why India shouldn't follow the global playbook for this format. New management is putting its best foot forward to stay relevant by 1. Beefing up the private label team, 2. Stepping up expansion post a dismal 3 years, 3. Increasing thrust on the high-margin beauty segment. However, we believe given the current phase of online evolution, measures seem too little, too late. We bake in

revenue/EBITDA/LTL PAT 6/10/11% CAGR over FY19-22E. Given undemanding valuations, we **initiate coverage on STOP with a Neutral** stance and a DCF-based TP of Rs 350/sh implying an EV/EBITDA of 9x Sept-21.

- **Arvind Fashion (AFL) - On Course to recovery:** AFL houses a commendable portfolio of lifestyle brands, prestige beauty (Sephora) and value fashion (Unlimited). While AFL grew at an impressive clip (20% CAGR) over FY16-19, it came at the cost of a deteriorating working capital cycle. Consequently, AFL finds itself grappling with multiple concerns across all major formats 1. Burgeoning receivables, 2. Lackluster performance of some of its emerging (EM) brands, 3. Teething issues in value fashion. The company, however, seems to be on course to stage a recovery as it 1. de-focuses on the working capital-heavy MBO channel, 2. Weeds out duds in its EM brands portfolio, 3. Shuts loss-making stores in Unlimited (Value Fashion). A turnaround in power brands seems a foregone conclusion. With the stock available at 1x FY20E Power brand sales, valuations seem undemanding. We bake in revenue/EBITDA CAGR of 5/3% over FY19-22E. **Initiate on AFL with a BUY** and a DCF-based TP of Rs. 430/sh, implying an EV/EBITDA of 12x Sept-21 (45%+ discount to ABFRL).

- **India's Everything store!** Reliance Retail (RR) is the biggest retail outfit by revenue/network size in India (~USD18.6bn/22mn+ sq. ft). It is akin to an Everything store catering to the entire consumer basket. Groceries, Fashion & Lifestyle (F&L) and Consumer Electronics (CE) form its core (~56% of revenue; USD10.5bn). RR's core has grown at an astounding 38% CAGR over FY14-19 and is estimated to be spread across 4500+ stores and >21mn of retail area. That said, capital intensity in the biz remains high with pre-working capital CFO covering under 60% of the capital needs (capex + WC) over FY14-19. Hence, while leverage remains manageable, it has inched up to 1x in FY19 (vs near-zero debt in FY17). An Everything store needs a seamless ecosystem which provides a seamless consumer and merchant experience. Reliance Retail seems primed to position itself as one, given its strong physical infrastructure, a strong 35mn+ Jio subscriber base to leverage upon, a robust digital payment solution and the deepest vendor network in India. We bake in consol revenue/EBITDA/PAT CAGR of 20/26/31% over FY19-22E and **value RR/Core Retail at an EV of Rs.1.98/1.93tn implying an EV/EBITDA of 18/20x (Sept-21) respectively for the consol/Core Retail biz.**

Domestic Peer Comparison: Premium to global peers hinges on growth

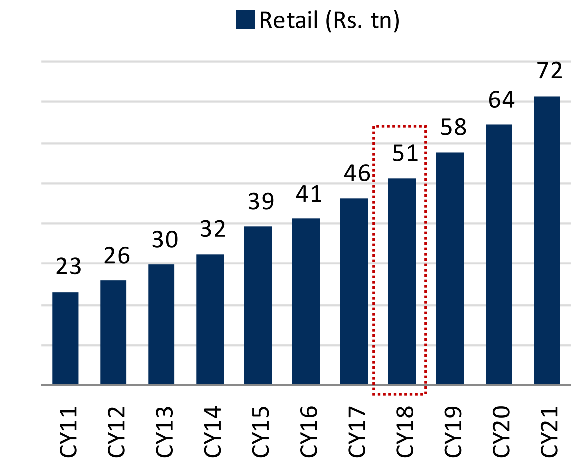
Company	CMP	M cap (Rs bn)	Reco	TP	EBITDA (Rs. bn)			EV/EBITDA (x)			ROE (%)			RoCE(%)		
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Avenue	1,803	1,125	SELL	1,250	22.3	27.9	34.7	50.6	40.4	32.3	23.1	23.0	23.0	20.8	20.8	21.2
ABFRL	225	174	BUY	250	6.7	8.2	10.3	28.0	22.5	17.7	17.2	19.9	18.2	11.6	13.4	12.8
Future Retail	333	167	BUY	500	11.7	20.0	22.2	16.3	10.1	8.9	18.6	15.5	13.3	15.0	12.6	11.4
FLFL	396	75	BUY	550	6.0	7.4	8.8	13.8	11.4	9.5	9.1	10.2	12.5	9.5	10.3	11.8
Shoppers Stop	357	31	NEU	350	2.8	3.1	3.3	10.4	9.0	8.0	8.3	9.0	9.2	8.6	9.3	9.5
Arvind Fashion	321	19	BUY	430	0.6	2.5	3.2	41.6	10.8	8.3	(19.9)	(5.1)	0.6	(3.7)	3.9	6.3
V Mart	1,692	31	BUY	2,150	1.3	1.7	2.1	22.4	18.4	14.8	18.0	17.7	18.0	17.6	17.5	17.9
Trent	499	172	NEU	490	3.0	3.8	4.9	53.3	41.9	33.4	9.7	9.3	10.5	9.0	8.8	9.9
TCNS	674	41	BUY	770	1.9	2.2	2.6	20.4	17.3	14.2	20.8	19.3	19.4	21.2	19.5	19.6

Source: Company, HDFC sec Inst Research

Story in charts

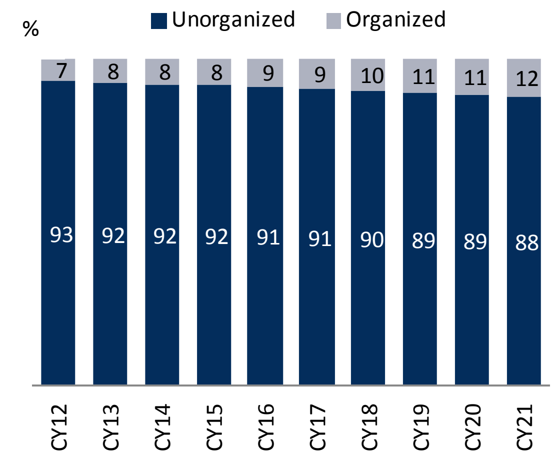
Sizing the Retail Market

Indian retail pegged at >Rs. 50tn



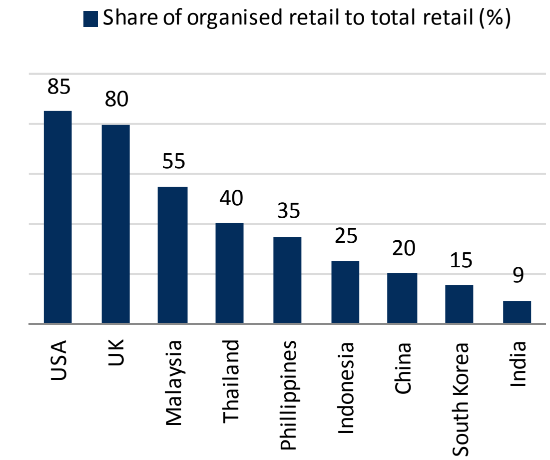
Source: Technopak, HDFC sec Inst Research

Organized play accounts for a mere 10%



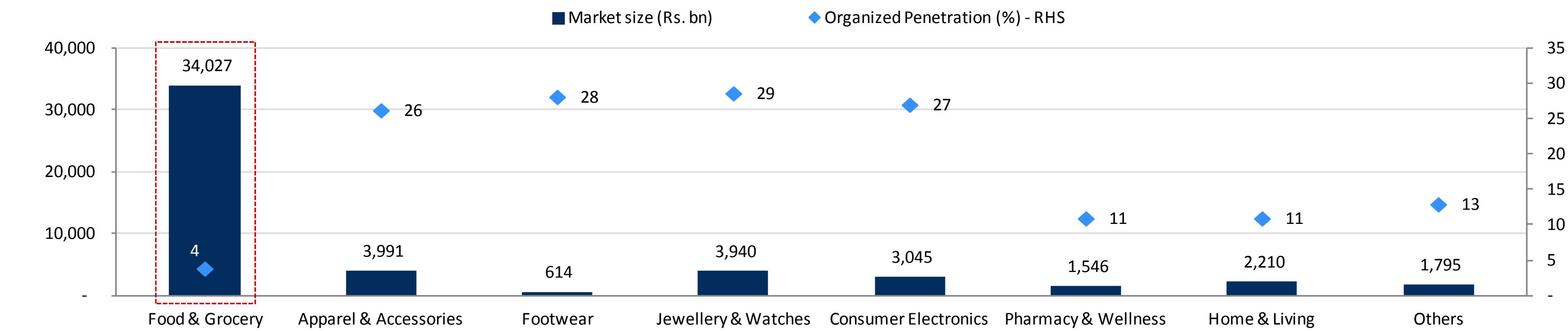
Source: Technopak, HDFC sec Inst Research

Country-wise organized retail penetration



Source: Anarock, HDFC sec Inst Research

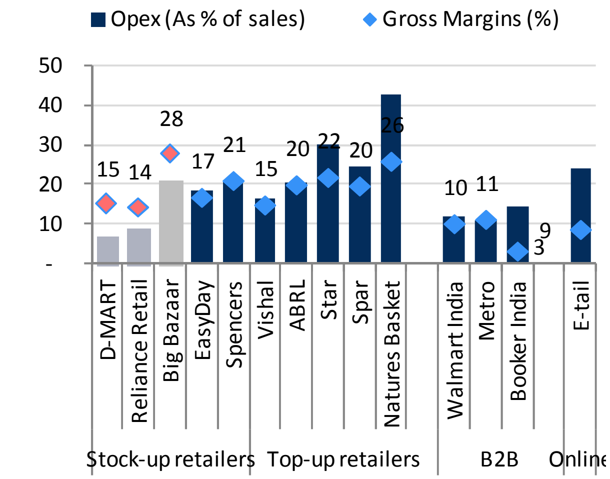
Food & Grocery remains the biggest potential value migration play in Retail



Source: Technopak, HDFC sec Inst Research (CY18)

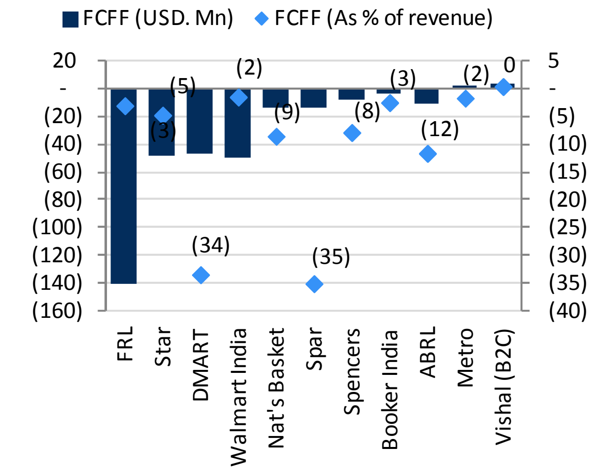
To be, or not to be, that is the question! for most grocers

Only a few grocers make a profit spread



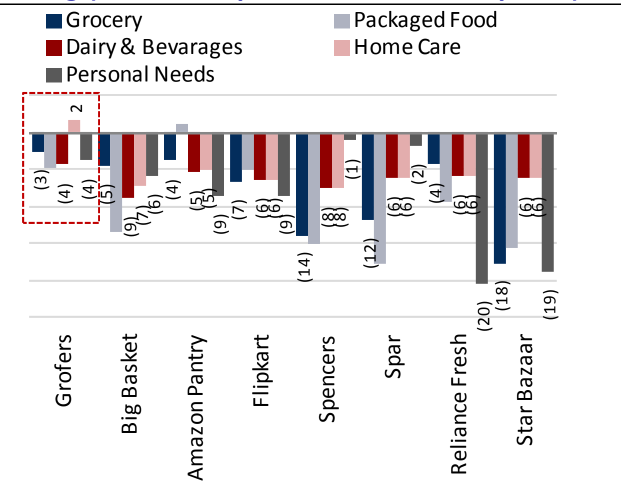
Source: Company, HDFC sec Inst Research, As on FY18 for unlisted retailers

Cash position remains weak for most



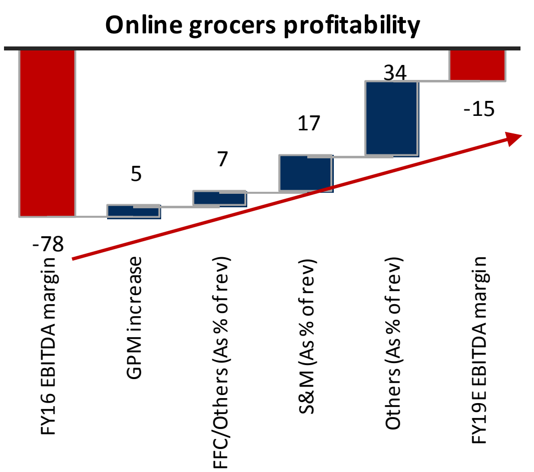
Source: Company, HDFC sec Inst Research, As on FY18 for unlisted retailers

Meanwhile, online grocers turning on the heat in pricing (D-MART's price discount over peers)



Source: Company, HDFC sec Inst Research

Despite rising discounts, online grocers' fixed cost absorption has improved



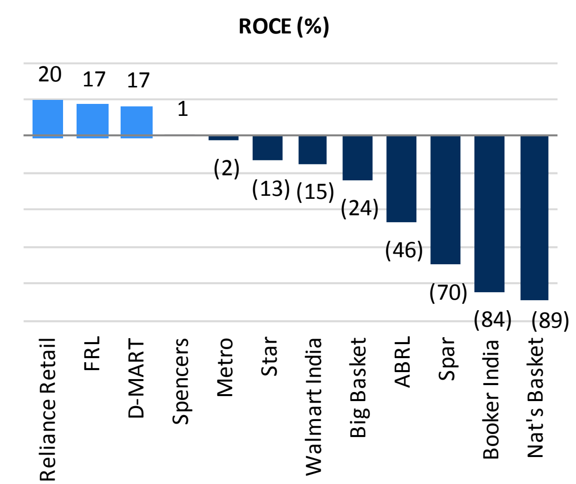
Source: Company, HDFC sec Inst Research

Amazon/Flipkart's aggressive intent in F&G palpable

Flipkart Farmermart	**Incorporated on 4th Oct 2019 with an authorized share capital of Rs. 18.5bn**
Amazon Retail	-Incorporated on 29th May 2017 with an authorized share capital of Rs. 1.55bn -Authorized share capital increased from Rs. 1.55bn to Rs. 1.65bn (11th May 2018) -Authorized share capital increased from Rs. 1.65bn to Rs. 3.55bn (5th Mar 2019) -Authorized share capital increased from Rs. 3.55bn to Rs. 35bn (29th Aug 2019) -Infused Rs.1.72bn on 17th Oct 2019
Grofers	Cumm. funds raised - USD477mn, Series F - USDD247mn
Big Basket	Cumm. funds raised - USD1bn, Series F - USD190mn
ABRL (acquired by Samara/Amazon)	Authorized capital raised from Rs. 35bn to Rs. 85bn in FY19

Source: HDFC sec Inst Research

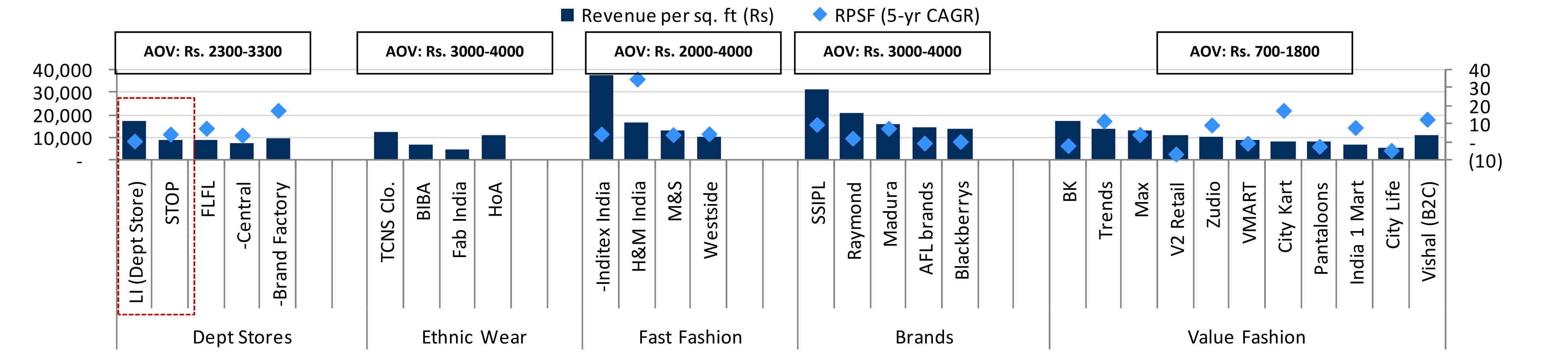
Ergo, only a few may survive



Source: Company, HDFC sec Inst Research (FY18 for unlisted)

Pure-play multi-brand apparel on multiple financial crutches, value fashion insulated

No differentiation & Low sales velocity



Source: Company, HDFC sec Inst Research, Lifestyle Int remains an exception, however, growth has hit pause for its department format in FY19

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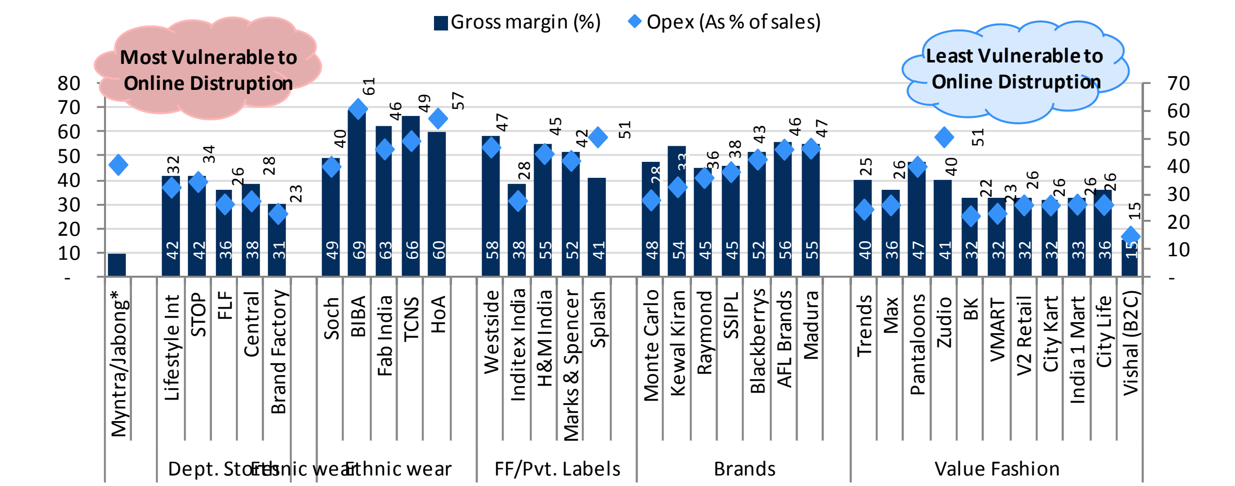
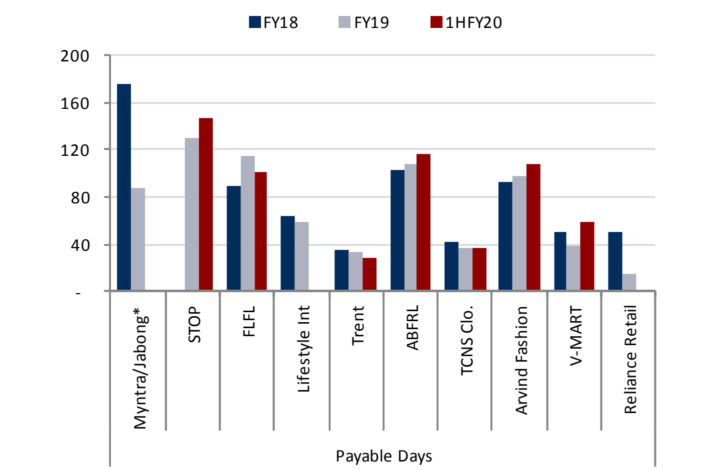
High cost structure & increasing creditors' crutch (Pure play multi-brand formats most vulnerable on this equation)

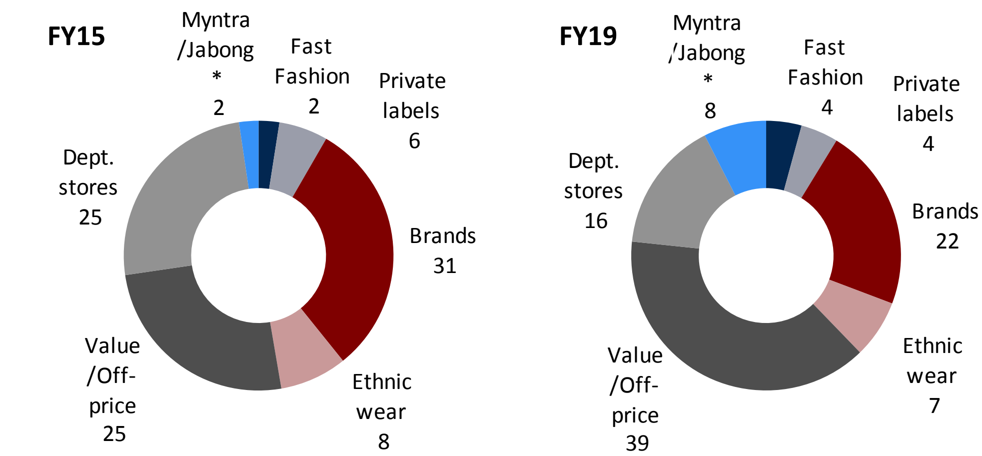


Source: Company, HDFC sec Inst Research, FY18 for most unlisted retailers



Source: Company, HDFC sec Inst Research, *All Flipkart entities combined adjusted for related party transactions (RPT)

Market share loss to e-tailers



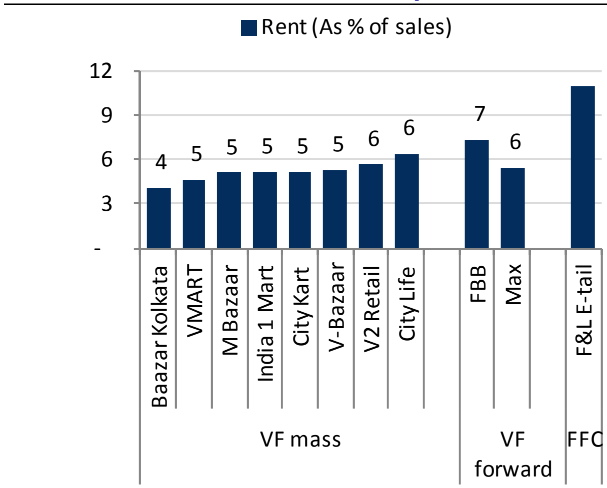
Even at improved scale (hypothetical); Off-price/value fashion seems off-limits for e- tail to venture profitably

	Dept stores	Ethnic wear	Private labels	Off-price	VF forward	VF mass
AoV (Rs.)	**3,129**	**3,600**	**2,332**	**2,300**	**1,600**	**773**
GP (Rs.)	939	1,800	1,049	690	480	232
GM (%)	**30**	**50**	**45**	**30**	**30**	**30**
FFC* (Rs.)	181	186	173	173	166	158
As % of sales	5.79	5.17	7.43	7.52	10.38	20.42
S&M expense	219	252	163	161	112	54
As % of sales	7	7	7	7	7	7
Other expenses	469	540	350	345	240	116
As % of sales	15	15	15	15	15	15
EBITDA	69	822	363	11	(38)	(96)
EBITDA %	**2.2**	**22.8**	**15.6**	**0.5**	**(2.4)**	**(12.4)**
Cost structure (%)	**27.8**	**27.2**	**29.4**	**29.5**	**32.4**	**42.4**

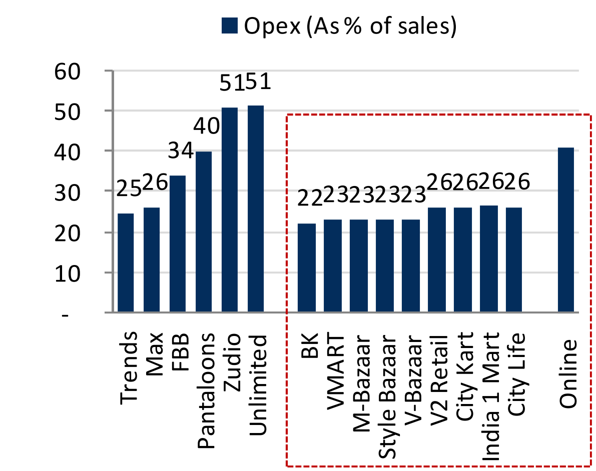
Source: Company, HDFC sec Inst Research, *Adjusted for (RPT)

Hence, prefer companies pivoting towards bottom of the pyramid with leaner cost structure – (Off-price/Value fashion retailers)

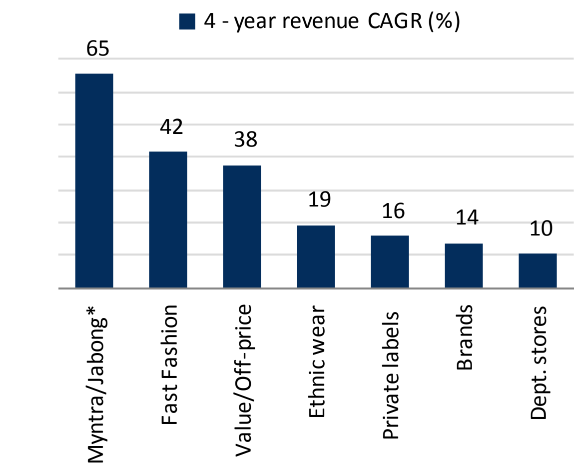
Rent < fulfillment cost = Safety net for value fashion (keeps category off-limits from an online intrusion) Ergo, VF has outperformed most formats



Source: Company, HDFC sec Inst Research, FFC – Fulfillment cost, Myntra/Jabong used as proxy for F&L e-tail FFC

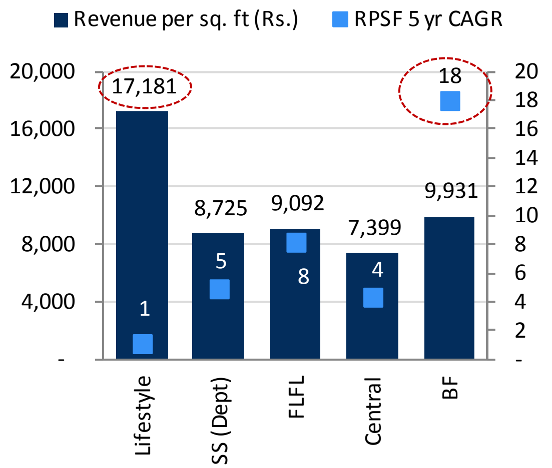


Source: Company, HDFC sec Inst Research estimates for VF forward retailers

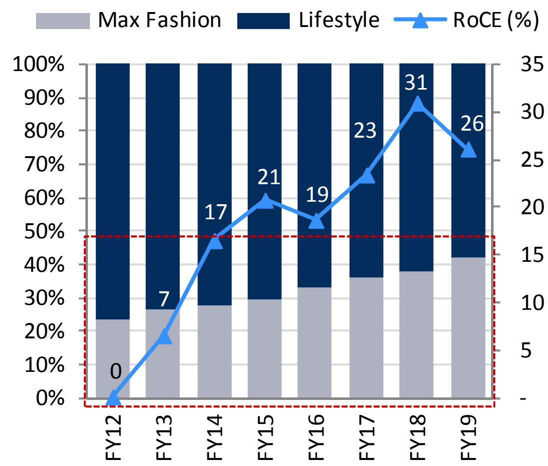


Source: Company, HDFC sec Inst Research (FY15-19), sample set of 38 formats/27 retailers (70% of org. apparel)

Department stores with a second offering positioned as off-price/value fashion have performed better

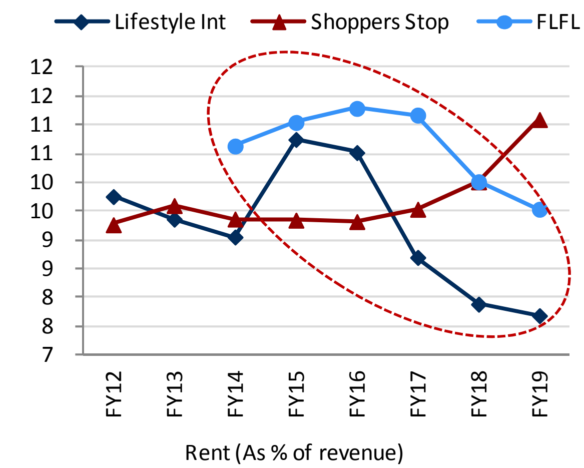


Source: Company, HDFC sec Inst Research (FY19)



Source: Company, HDFC sec Inst Research

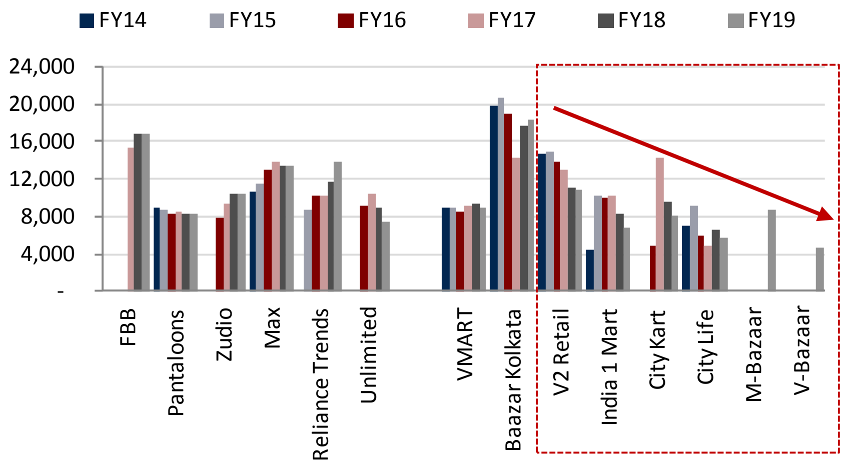
Lifestyle Int & FLF. hammering down rent bills smartly...mix change has certainly helped



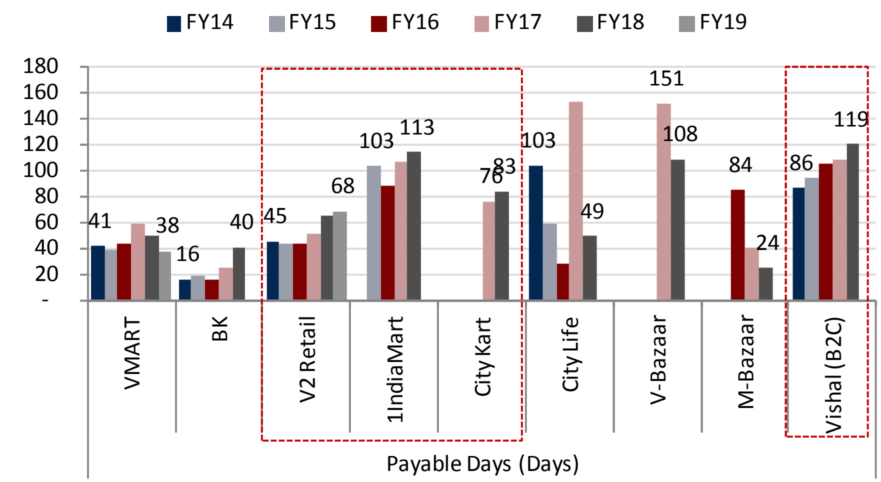
Source: Company, HDFC sec Inst Research

Is the value fashion tail out of gas?

Productivity across the tail is on the decline; to add insult to injury, payables support is increasing. SOMETHING HAS TO GIVE!



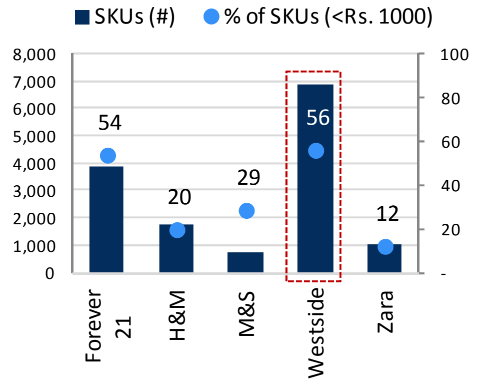
Source: Company, HDFC sec Inst Research



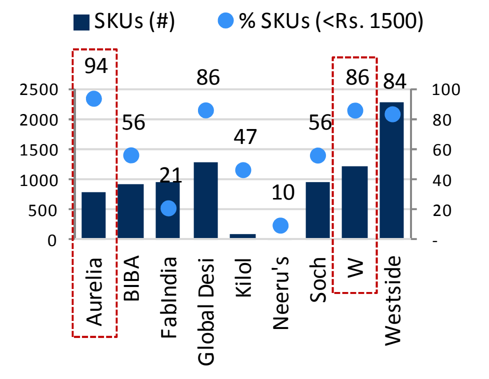
Source: Company, HDFC sec Inst Research

Who's got the troika (Assortment, Pricing, and Distribution) right across formats?

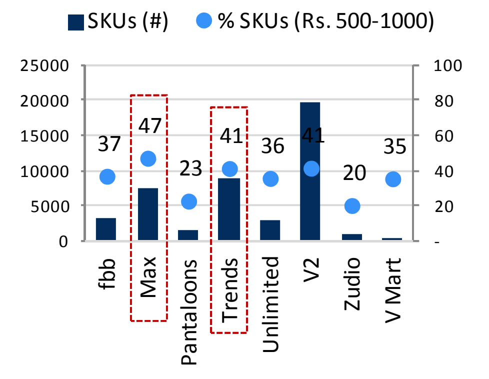
Fast fashion/Pvt. Labels - Westside scores in both – variety & pricing



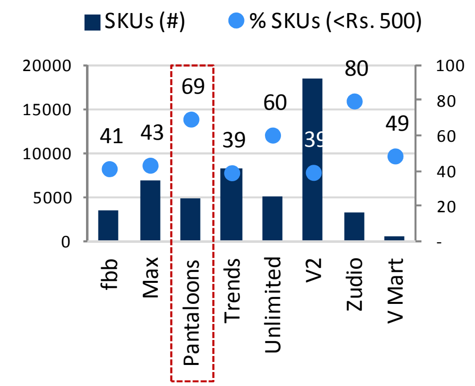
TCNS scores in Women's Fusion Ethnic wear



In Value fashion, Max, Trends lead in the Rs. 500-1000 range



Pantaloons' pricing more pervasive (Strong in the <Rs. 500 range)



Source: Company, HDFC sec Inst Research

Typically, higher presence in High PCI* districts = high productivity, However, real estate choices for private labels, Ethnic wear, Value Fashion should be judged on population density too as the key proposition is pricing, variety and designs

Per capita Income	Population	Districts (#)	Fast Fashion/Pvt. Labels				Ethnic wear								VF forward			VF mass			
			Westside	M&S	H&M	Zara	W	Aurelia	BIBA	Global Desi	AND	Soch	Anokhi	Fab India	Max	Fbb	Pantaloons	V Mart	V2 Retail	BK*	1 India Mart
<100K	461	183	10.9	5.8	-	-	11.6	12.5	9.6	11.6	8.2	6.7	12.5	6.9	7.7	15.9	15.2	77.4	65.5	42.2	89.5
100-150K	201	86	10.9	5.8	7.9	5.3	10.4	11.3	13.4	9.8	9.3	7.6	8.3	10.2	13.3	16.3	15.9	7.5	14.5	21.9	1.8
150-200K	168	64	21.8	15.4	15.8	10.5	17.7	13.1	20.5	17.0	16.5	19.3	8.3	20.3	25.8	20.4	21.2	5.0	1.8	10.9	1.8
200-250K	71	27	10.9	3.8	2.6	-	10.4	13.7	8.4	5.4	4.1	5.0	4.2	7.7	9.3	7.8	7.6	6.3	3.6	4.7	5.3
250-300K	27	5	13.6	7.7	7.9	10.5	6.0	7.1	5.0	4.5	4.1	6.7	8.3	6.9	7.3	10.2	7.6	-	1.8	-	-
300-500K	38	8	24.5	38.5	42.1	47.4	22.1	24.4	27.2	33.0	41.2	51.3	25.0	31.7	29.8	21.2	18.6	1.3	3.6	-	1.8
500K+	20	3	7.3	23.1	23.7	26.3	21.7	17.9	15.9	18.8	16.5	3.4	33.3	16.3	6.9	8.2	14.0	2.5	9.1	20.3	-
RPSF			**10,225**	**13,410**	**16,957**	**37,338**	**12,258**	**6,792**	**11,163**			**5,035**	**12,258**	**6,792**	**13,503**	**16,838**	**8,211**	**8,878**	**10,752**	**17,686**	**8,202**

Source: Company, HDFC sec Inst Research, *PCI – Per capita income

Store networks mapped on per capita income and population density. Winners: Westside, TCNS, Max, V-MART; Pantaloons most improved

Pvt. Labels/Fast fashion

Westside's sharper pricing and higher variety allows it to be more pervasive as an offering, hence the more well-rounded store network. Lower productivity vs peers is a consequence of relatively higher store skew towards low PCI districts. Pure-play fast fashion remains an urban story

Women's Ethnicwear:

TCNS' real estate choices have been more astute vs. peers, as it has focused on putting up EBOs in districts with high population density. This makes the offering more pervasive vs peers. Hence, despite the higher skew in low PCI districts, it outdoes most peers on productivity

Value Fashion (VF):

Max Fashion remains one of the best calibrated growth stories in the category. Presence in high PCI/High population density is the highest among VF forward peers. Hence, higher productivity

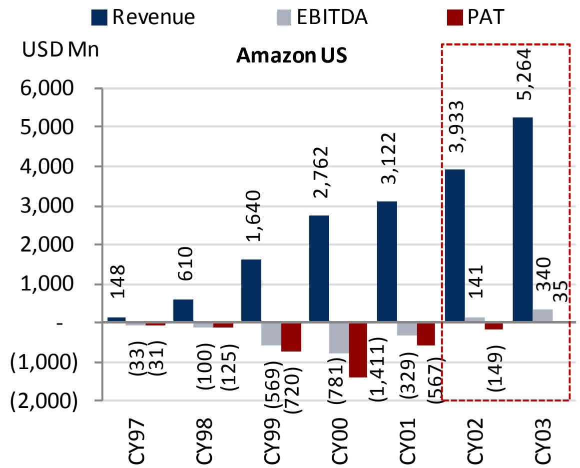
In VF mass, V-MART's real estate choices have been better within class, with better store density in the biggest PCI group (<Rs. 100k)

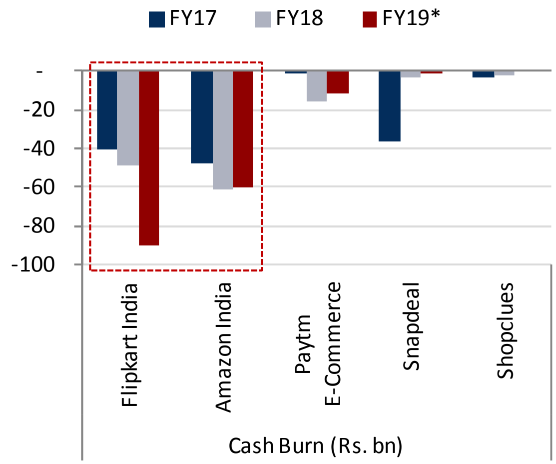
PCI/ Population per km	Population	District (#)	Fast Fashion/Pvt. Labels				Ethnic wear								VF forward			VF mass			
			Westside	M&S	H&M	Zara	W	Aurelia	BIBA	Global Desi	AND	Soch	Anokhi	Fab India	Max	Fbb	Pantaloons	V Mart	V2 Retail	BK#	1 IndiaMart
No of stores (#)			110	52	38	19	249	168	239	112	97	119	24	246	248	245	264	159	55	64	57
<100K	**461**	**183**	**10.9**	**5.8**	**-**	**-**	**11.6**	**12.5**	**9.6**	**11.6**	**8.2**	**6.7**	**12.5**	**6.9**	**7.7**	**15.9**	**15.2**	**77.4**	**65.5**	**42.2**	**89.5**
<500	125	73	1.8	-	-	-	1.2	1.2	1.7	1.8	1.0	0.8	8.3	1.2	1.2	2.9	1.5	10.1	10.9	7.8	7.0
1000-3000	161	45	6.4	5.8	-	-	6.8	9.5	5.4	8.9	6.2	5.0	4.2	4.1	4.4	8.6	7.6	39.0	36.4	21.9	47.4
3000-5000	5	1	1.8	-	-	-	2.4	1.2	1.7	0.9	1.0	-	-	1.2	1.2	2.0	2.7	-	-	-	1.8
500-1000	171	64	0.9	-	-	-	1.2	0.6	0.8	-	-	0.8	-	0.4	0.8	2.4	3.4	28.3	18.2	12.5	33.3
100-150K	**201**	**86**	**10.9**	**5.8**	**7.9**	**5.3**	**10.4**	**11.3**	**13.4**	**9.8**	**9.3**	**7.6**	**8.3**	**10.2**	**13.3**	**16.3**	**15.9**	**7.5**	**14.5**	**21.9**	**1.8**
<500	137	67	5.5	-	2.6	-	4.0	7.1	7.5	3.6	2.1	6.7	-	4.5	6.9	7.3	7.2	3.1	7.3	4.7	-
1000-3000	33	6	0.9	-	-	-	0.8	0.6	0.4	-	1.0	-	-	0.8	1.2	2.9	3.4	1.9	1.8	10.9	-
3000-5000	5	1	-	-	-	-	0.4	-	-	0.9	1.0	-	-	0.4	-	0.8	0.4	-	-	3.1	-
500-1000	26	12	4.5	5.8	5.3	5.3	5.2	3.6	5.4	5.4	5.2	0.8	8.3	4.5	5.2	5.3	4.9	2.5	5.5	3.1	1.8
150-200K	**168**	**64**	**21.8**	**15.4**	**15.8**	**10.5**	**17.7**	**13.1**	**20.5**	**17.0**	**16.5**	**19.3**	**8.3**	**20.3**	**25.8**	**20.4**	**21.2**	**5.0**	**1.8**	**10.9**	**1.8**
<500	110	43	5.5	1.9	2.6	-	3.2	3.0	5.0	2.7	2.1	3.4	-	2.8	4.8	5.7	4.9	0.6	1.8	-	-
1000-3000	8	2	-	-	-	-	1.2	1.8	0.8	-	-	1.7	-	0.8	1.2	1.6	0.8	1.3	-	-	-
5000+	9	2	9.1	7.7	10.5	10.5	8.0	7.1	7.9	7.1	8.2	9.2	8.3	10.6	14.5	8.2	11.4	-	-	10.9	-
500-1000	42	17	7.3	5.8	2.6	-	5.2	1.2	6.7	7.1	6.2	5.0	-	6.1	5.2	4.9	4.2	3.1	-	-	1.8
200-250K	**71**	**27**	**10.9**	**3.8**	**2.6**	**-**	**10.4**	**13.7**	**8.4**	**5.4**	**4.1**	**5.0**	**4.2**	**7.7**	**9.3**	**7.8**	**7.6**	**6.3**	**3.6**	**4.7**	**5.3**
<500	21	10	2.7	-	-	-	1.2	1.2	1.7	0.9	1.0	-	-	0.4	1.2	2.0	1.5	-	-	-	-
1000-3000	23	7	2.7	1.9	-	-	3.6	5.4	2.9	1.8	1.0	2.5	-	4.1	4.8	2.9	1.5	2.5	3.6	4.7	3.5
500-1000	27	10	5.5	1.9	2.6	-	5.6	7.1	3.8	2.7	2.1	2.5	4.2	3.3	3.2	2.9	4.5	3.8	-	-	1.8
250-300K	**27**	**5**	**13.6**	**7.7**	**7.9**	**10.5**	**6.0**	**7.1**	**5.0**	**4.5**	**4.1**	**6.7**	**8.3**	**6.9**	**7.3**	**10.2**	**7.6**	**-**	**1.8**	**-**	**-**
<500	1	1	-	-	-	-	0.4	0.6	0.4	-	-	0.8	-	0.4	-	0.8	-	-	1.8	-	-
1000-3000	16	3	6.4	1.9	-	-	1.2	1.8	1.3	-	1.0	2.5	4.2	3.7	4.4	5.7	2.3	-	-	-	-
500-1000	9	1	7.3	5.8	7.9	10.5	4.4	4.8	3.3	4.5	3.1	3.4	4.2	2.8	2.8	3.7	5.3	-	-	-	-
300-500K	**38**	**8**	**24.5**	**38.5**	**42.1**	**47.4**	**22.1**	**24.4**	**27.2**	**33.0**	**41.2**	**51.3**	**25.0**	**31.7**	**29.8**	**21.2**	**18.6**	**1.3**	**3.6**	**-**	**1.8**
<500	2	1	1.8	-	-	-	0.4	0.6	0.4	-	-	1.7	-	0.4	0.8	1.2	0.8	-	-	-	-
1000-3000	2	1	0.9	-	-	-	1.2	1.2	0.8	0.9	1.0	-	-	0.8	-	0.4	0.8	-	1.8	-	-
3000-5000	10	1	7.3	9.6	13.2	10.5	8.8	12.5	8.4	13.4	16.5	26.9	12.5	13.0	10.1	6.9	6.4	-	-	-	-
5000+	16	2	14.5	28.8	28.9	36.8	11.6	10.1	17.2	18.8	23.7	22.7	12.5	16.7	19.0	11.8	9.5	-	1.8	-	-
500-1000	8	3	-	-	-	-	-	-	0.4	-	-	-	-	0.8	-	0.8	1.1	1.3	-	-	1.8
500K+	**20**	**3**	**7.3**	**23.1**	**23.7**	**26.3**	**21.7**	**17.9**	**15.9**	**18.8**	**16.5**	**3.4**	**33.3**	**16.3**	**6.9**	**8.2**	**14.0**	**2.5**	**9.1**	**20.3**	**-**
1000-3000	3	2	1.8	5.8	5.3	10.5	5.2	5.4	4.6	4.5	5.2	-	12.5	-	2.8	3.3	7.6	0.6	3.6	-	-
5000+	17	1	5.5	17.3	18.4	15.8	16.5	12.5	11.3	14.3	11.3	3.4	20.8	16.3	4.0	4.9	6.4	1.9	5.5	20.3	-

Source: Company, HDFC sec Inst Research

What's up with the online folks?

Some perspective - At similar scale, E-tail's path to profitability was simpler in US, same in India expected to be a long-drawn affair as margin differential remains massive (8-15pp)

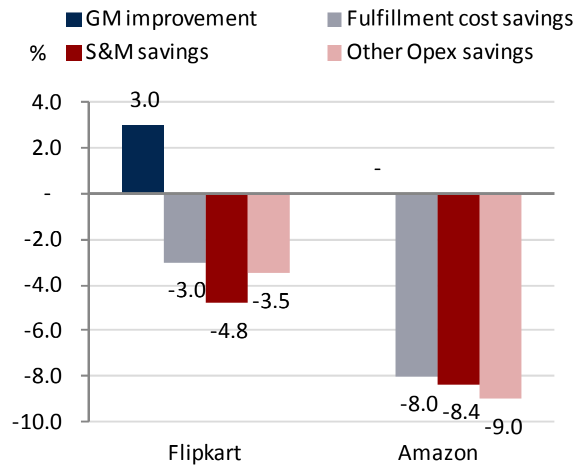




Source: Company, HDFC sec Inst Research, Amazon US used as proxy for E-tail

Source: Company, HDFC sec Inst Research , *FY19 – unadjusted for RPT

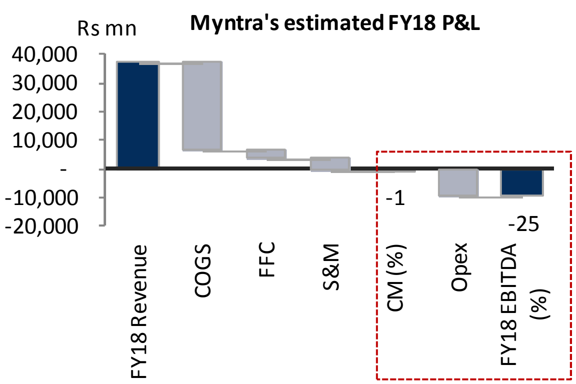
At 5x FY18 scale, savings needed to hit profitability for key e-tailers

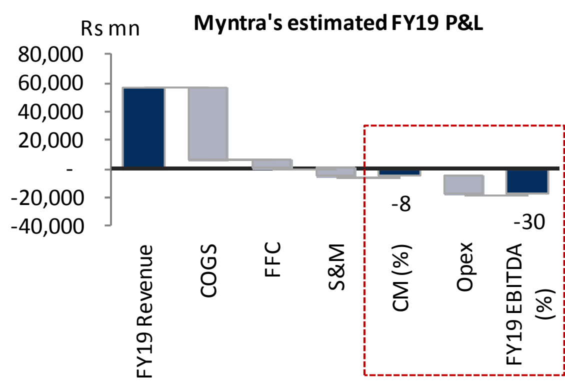


Source: HDFC sec Inst Research, Base year - FY18

Walmart seems to have hit reset on Myntra

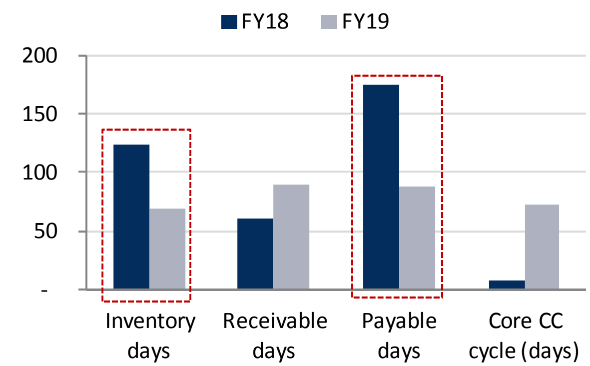
Myntra's cash burn increases as clearance sale is stepped up in FY19





Source: Company, HDFC sec Inst Research

...focus seems to be shifting to bettering terms of trade & improve margins going forward



Source: Company, HDFC sec Inst Research

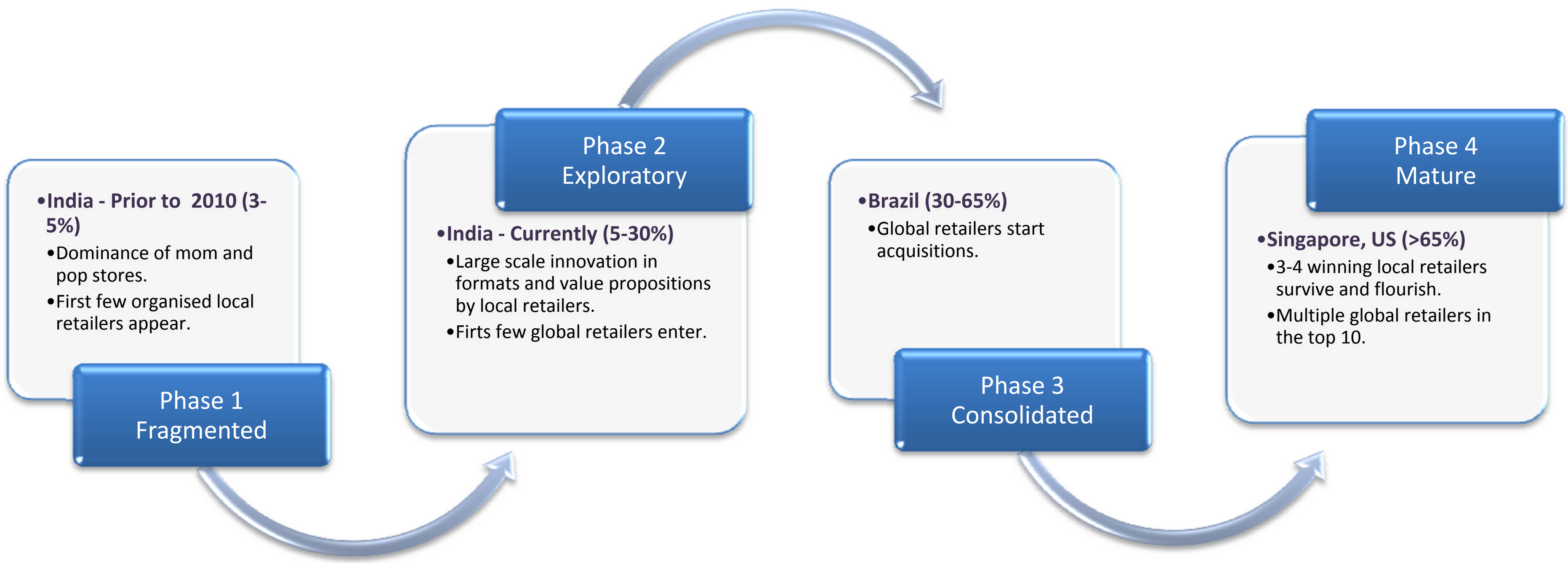
Global Peer Comparison

Company	M Cap (USD mn)	Revenue (USD mn)			Revenue CAGR (FY19-21E)	EBITDA (USD mn)			EBITDA CAGR (FY19-21E)	PAT (USD mn)			PAT CAGR (FY19-21E)	P/E			ROE (%)		
		FY19	FY20E	FY21E		FY19	FY20E	FY21E		FY19	FY20E	FY21E		FY19	FY20E	FY21E	FY19	FY20E	FY21E
US																			
Amazon	906,450	275,054	323,744	381,107	17.4	43,082	53,440	66,024	19.9	19,124	25,701	33,397	27.8	47.4	35.3	27.1	25.9	24.7	32.6
Walmart	285,652	514,135	527,999	545,208	2.6	32,655	32,420	33,102	1.5	14,317	13,643	13,969	(0.4)	20.0	20.9	20.4	14.1	17.9	18.3
Costco	106,865	152,726	163,395	174,854	6.9	6,398	6,805	7,351	8.0	3,540	3,748	4,032	8.3	30.2	28.5	26.5	25.0	23.0	21.5
Best Buy	18,173	42,775	43,538	44,147	1.5	2,662	2,812	2,871	2.3	1,455	1,498	1,514		12.5	12.1	12.0	42.6	43.5	42.3
Dollar General	30,233	25,582	27,548	29,526	7.0	2,598	2,724	2,911	5.9	1,604	1,654	1,779		18.8	18.3	17.0	25.0	24.4	24.4
GAP Inc	8,448	16,659	16,745	16,917	0.7	1,890	1,843	1,869	(2.0)	991	930	962	(5.3)	8.5	9.1	8.8	30.1	21.8	23.5
JCPenney	394	11,751	11,443	11,568	0.7	571	578	675	12.0	(315)	(279)	(206)	(41.2)	(1.2)	(1.4)	(1.9)	(28.4)	(24.8)	(19.9)
Kohl's Corp	10,598	19,213	19,329	19,631	(0.7)	2,417	2,416	2,404	(0.9)	919	973	982	2.3	11.5	10.9	10.8	16.5	17.2	16.9
Macy's	6,751	25,108	24,950	24,992	(0.3)	2,750	2,398	2,308	(7.7)	1,250	971	925	(11.5)	5.4	7.0	7.3	20.3	14.5	12.9
PVH	8,386	9,580	10,035	10,423	4.0	1,290	1,393	1,486	6.1	734	770	844	7.0	11.4	10.9	9.9	12.7	12.6	13.3
Ralph Lauren	9,044	6,283	6,451	6,649	3.0	979	1,047	1,122	7.2	573	602	653	7.8	15.8	15.0	13.9	15.3	18.2	20.8
Ross	34,416	14,926	15,905	16,902	6.7	2,374	2,523	2,683	6.9	1,563	1,635	1,748	6.8	22.0	21.0	19.7	49.1	48.6	51.8
Target	36,576	75,288	77,768	80,116	2.9	6,455	6,657	6,861	1.8	2,885	2,980	3,089	2.7	12.7	12.3	11.8	24.2	25.8	26.2
TJX	63,358	38,842	41,309	43,842	6.0	4,974	5,155	5,498	6.0	3,083	3,182	3,392	5.6	20.6	19.9	18.7	60.5	62.6	64.0
V F Corp	35,822	13,839	14,634	15,390	6.8	2,203	2,423	2,674	10.2	1,497	1,678	1,849	11.8	23.9	21.3	19.4	38.2	35.8	40.4
UK																			
J Sainsbury	5,902	37,827	38,221	38,755	1.0	1,883	1,897	1,922	0.3	620	643	668	2.8	9.5	9.2	8.8	6.0	6.3	6.6
Marks & Spencer	5,745	13,451	13,369	13,418	0.5	1,475	1,433	1,420	(3.7)	523	516	523	1.1	11.0	11.1	11.0	13.5	13.0	12.9
Tesco	30,593	83,634	85,021	86,868	1.7	4,455	5,234	5,505	7.1	1,770	2,154	2,413	14.7	17.3	14.2	12.7	10.5	11.1	11.5
Wm Morrisson Supermarkets	6,618	23,406	23,616	24,245	1.8	1,196	1,244	1,283	3.2	409	435	466	5.7	16.2	15.2	14.2	6.7	7.1	7.5
Europe																			
Carrefour	15,611	86,749	88,782	91,216	1.4	4,037	4,348	4,618	5.1	1,023	1,170	1,308	8.9	15.3	13.3	11.9	9.1	10.1	10.7
Inditex	88,101	29,660	31,669	33,717	6.5	6,249	6,676	7,117	6.7	3,918	4,225	4,523	7.2	22.5	20.9	19.5	24.5	24.8	25.3
H&M	27,266	23,366	24,239	24,972	3.1	2,803	2,970	3,122	(1.1)	1,318	1,407	1,478	(4.9)	20.7	19.4	18.4	22.4	24.4	26.3
Asia																			
Gome	2,087	9,852	10,700	12,736	13.7	107	195	271	59.1	(95)	(24)	84	NM	(22.0)	(87.7)	25.0	(2.0)	0.3	4.1
Matahari	738	732	787	823	6.0	176	180	179	0.6	122	122	122	0.0	6.1	6.1	6.1	70.5	53.8	45.3
Sun Art Retail Group	7,899	15,153	15,678	16,329	3.8	1,047	1,095	1,183	6.3	377	406	433	7.1	21.0	19.4	18.3	10.5	10.7	10.6
Suning.com	15,437	45,247	55,410	64,440	19.3	786	1,102	1,388	32.9	259	567	788	74.5	59.7	27.2	19.6	9.1	3.5	4.2
Alibaba	459,189	54,556	74,032	96,853	31.4	17,395	22,197	29,424	26.2	13,081	16,968	22,287	30.5	35.1	27.1	20.6	16.0	15.8	16.9

Source: Company, HDFC sec Inst Research

Phases of evolution in organized retail?

Where are we?



Source: Mckinsey

- **India's organized playbook differs from the west:** In India, organised retail evolved with apparel and footwear; while food remains small. The organised retail movement kick-started in the late 90s/early 2000s in the apparel and footwear category. This evolution was different from other markets like the US and China, where organised retailing started with Food & Grocery in supermarkets and hypermarkets. Organised apparel and footwear, Jewellery & Watches and Consumer Electronics enjoy the highest penetration in retail in India – with shares ranging from 24%-29%. After 2005, Indian corporate groups like Aditya Birla, Reliance, Tata, RPG and Bharti began to invest significantly in the business of food and other products' retail. Despite large-scale investments, food & grocery, which comprises ~two-thirds the retail market has an organised share of just ~3% and offers significant scope for expansion.

- **Spineless expansion giving way to viable economics:** Most organised Indian retailers have come a long way from their frantic expansive ways over 2004-08, possibly to claim good retail locations or perhaps also to add to their valuations, which were a multiple of retail space, at least during the bull market of 2006-07). No heed was given to beef up the spine of retail (Read: Supply chain and logistics) and assessing store economics remained an elusive concept. This rings particularly true in the F&G space (A tougher biz) which had its fair share of casualties. Shubiksha and Vishal Megamart went belly up as excessive leverage, coupled with poor SKU management led to consistently sub-optimal store economics. ABRL too remained saddled with excessive leverage and operating losses but luckily got an exit. (now acquired by Amazon/Samara).

- **Exploratory phase continues:** While we can see spurts of consolidation (Furture Retail - Easy Day, Heritage, Amazon acquiring ABRL, Spencer Retail – Nature's Basket), the current phase (FY2010-present) marks an era of exploration/innovation across Indian organized retailers in terms of store formats, customer propositions and SKU strategies so as to sync sales velocity and growth with profitability.

-Trent's Star format went through a rejig in store sizes over FY15-FY19 before they zeroed in on the 8000-10,000 sq. footer Star Market format for expansion as the dismal sales velocity in its hypermarket and Daily format dictated the shift.

-D-MART has been consistently increasing store sizes (Avg incremental store size is 1.6x of FY13) to curb congestion in stores.

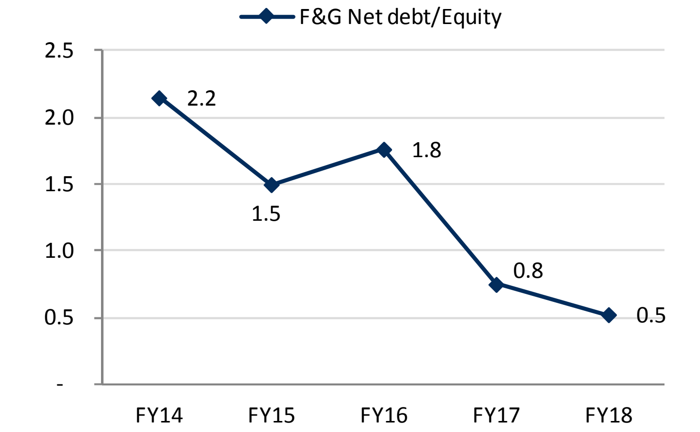
-Future Retail has been rationalizing store sizes to improve store productivity.

-Reliance Retail too seems to have rationalized on its Convenience format over the years and revved up its supermarket format Reliance Smart to improve its stores vitals.

-TCNS Clothing too intends to increase store sizes for better SKU display ergo better footfalls and sales velocity

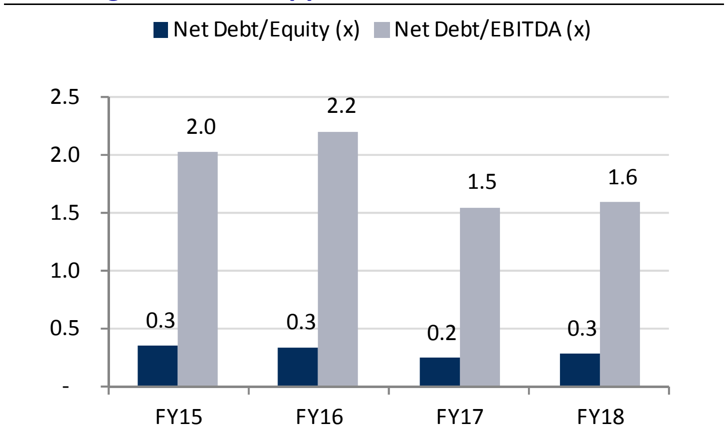
...A natural consequence has been the de-leveraging of balance sheets across retailers since the pre-2010 era.

Balance sheet getting leaner for F&G players



Source: Company, HDFC sec Inst Research
Note: 14 F&G retailers representing >50% of organized F&G pie

Leverage Position: Apparel Retailers

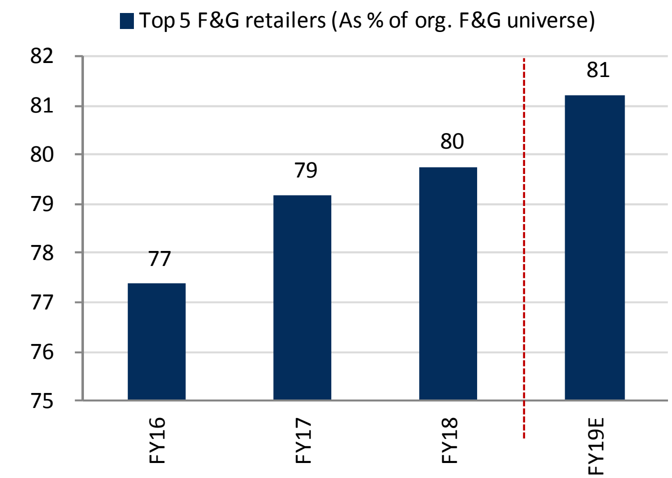


Source: HDFC sec Inst Research
Note: 27 Apparel retailers representing ~70% of organized pie

- **Organized F&G retail getting top heavy:** Like mature markets, India's organized F&G market (est: Rs. 1.32bn) too is increasingly getting top-heavy with inefficient operators falling by the way-side. The **Top five B2C retailers have already cornered 80% of our organized F&G universe (14 companies)** and a shade under 50% of the total organized F&G pie. **We reckon the narrower the basket of successful F&G retail becomes; one could expect the organized-to-unorganized snowball to roll faster. That said, global retailers are expected claim their pound of flesh in the biggest piece of retail in India too.**

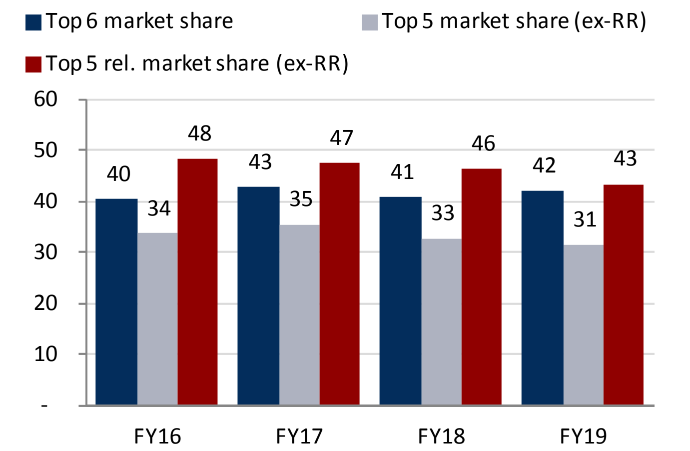
Org. Apparel retail continues to fragment further: While our coverage universe continues to grow at a reasonable clip, the share of the top 5 org. retailers (ex-Reliance Retail's F&L division) has been consistently coming down over the last 3 years as 1. Fragmentation continues across categories with the introduction of new brands/offerings every year. 2. Market share moves towards companies having higher exposure to faster growing categories. The Top 5 Retailers (ex-RR) now account ~31% of the total organized apparel pie. (Our organized universe consists of 26-company/32 formats) accounting for ~70% of the organized pie.

Top 5 grocers gaining market share



Source: HDFC sec Inst Research
Note: 14 F&G retailers representing >50% of organized pie

…while the top in apparel fragmenting



Source: HDFC sec Inst Research
Note: 27 Apparel retailers/33 formats representing ~70% of org. apparel pie, RR – Reliance Retail's Fashion & lifestyle revenue

The rising competitive intensity in F&G and fragmentation in apparel necessitates a success template to identify sustainable and growing formats.

Our template for Retail Success?

- Valuations notwithstanding, we attempt to search for a framework to consistent productivity, profitability rise and return profile. This took us to analyzing the inputs to them - assortment pricing & mix (over 150k SKUs analyzed) and distribution strength/location which in turn feed into sales density, other key variables to assess are 1. Gross Margin per sq. ft (GMRoF) and cost structure, 2. Scalability, 3. Brand Loyalty. 4. Working capital management, 5. Online migration risk (Scope restricted to F&G and Apparel Retail)
- We prefer formats moving down the income pyramid in terms of customer profile as 1. Opportunity size to tap is bigger, 2. Said formats are relatively more insulated from an online onslaught. Retailers with denser networks, sharper assortment pricing and progressive mix vs peers are better placed to milk the penetration opportunity.
- Private labels with a fast fashion DNA and sharp price points (Westside), off-price and value fashion retailers such as Brand Factory, V-MART, Pantaloons, Max Fashion and Zudio are better off in apparel. In F&G, disciplined discounter D-MART has been a clear winner, albeit the ecosystem is fast evolving and online grocers are turning on the heat.

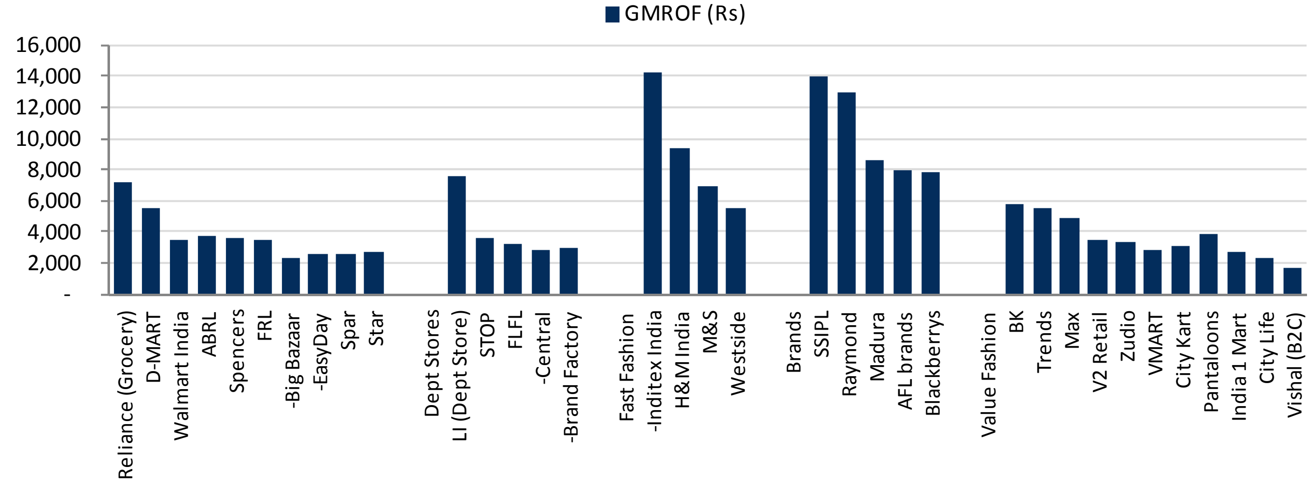
	Assortment Pricing	Assortment Mix	Location	Sourcing/ Supply chain	Scalability	WC management	Online Migration Risk	Productivity	GMROF	Cost structure	EBITDA/ sq. ft	Payable days	CE* per sq. ft
Apparel													
Westside	●	●	◕	●	●	◕	Medium	10,225	5,525	47	1,050	33	4,460
TCNS Clothing	◕	●	◕	◕	◕	◑	Medium	13,446	8,740	49	1,311	37	
V-MART	●	◕	◕	●	●	◕	Low	8,878	2,870	23	823	38	2,281
Pantaloons	●	●	◑	◕	●	◑	Medium	8,211	3,876	40	594	118	1,666
Central	◑	◑	◑	◑	◕	◑	Medium-to-high	7,399	2,826	28	789	115	3,365
Shoppers Stop	◑	◑	◑	◕	◑	◑	High	8,725	3,601	34	561	132	1,699
Lifestyle (Dept store)	◑	◕	◕	◕	◑	◑	High						
Brand Factory	●	◕	◕	◕	◕	◑	Low	9,931	3,029	23	745	115	2,898
FBB	●	◕	◕	●	●	◑	Low	16,838	6,988	33	1,466	64	6,229
Food & Grocery													
D-MART	●	●	◕	●	◕	●	Low	36,909	5,542	7	3,013	8	11,927
Big Bazaar	◕	◕	◕	◕	◕	◑	Low	11,563	2,290	21	590	53	5,492
Easy Day	◑	◕	◕	◕	◑	◑	Low	15,268	2,519	19	-229		4,385
Star Bazaar	◑	◑	◑	◑	◔	◑	High	12,299	2,709	30	-986	38	-108
Spencer	◑	◑	◑	◑	◑	◑	Low	16,935	3,597	21	69		2,520

Source: Company, HDFC sec Inst Research

How do retailers stack up on the template?

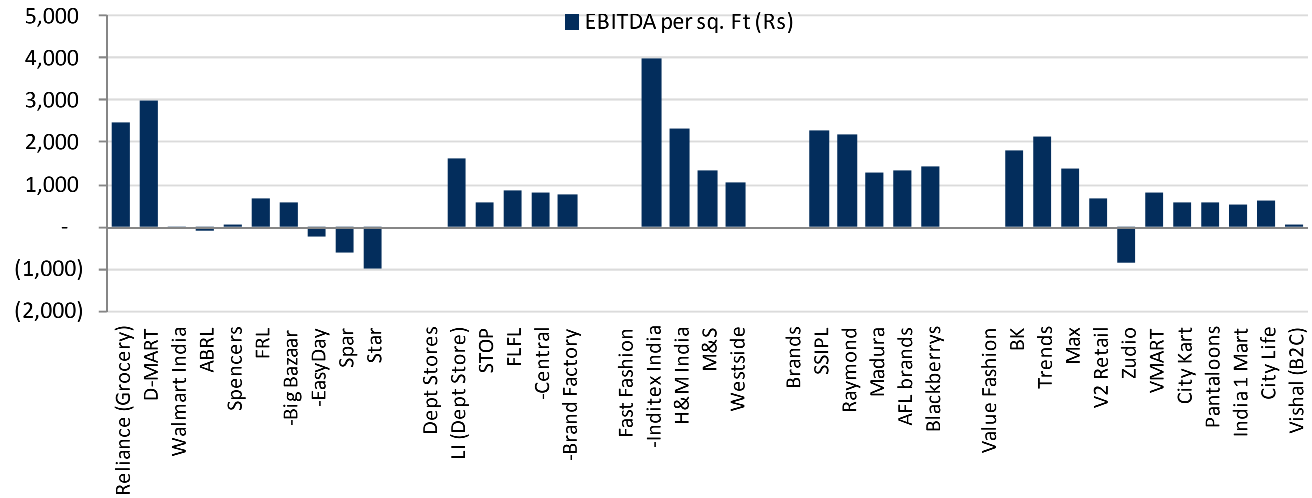
Parameters	Grocers	Apparels
Sales Density: Sales density (revenue per sq. ft) varies across categories. We believe 1. Denser the store network, 2. higher the exposure to high per capita income (PCI) districts and 3. sharper the assortment price; higher the sales density, irrespective of category	D-MART aces peers on all counts, hence, sports one of the highest sales density.	Department store Lifestyle Int and its value fashion offering Max Fashion, Reliance Trends, fast Fashion (FF)/private label retailers Zara, H&M and Marks & Spencer (M&S) sport denser store networks and higher exposure to high PCI districts, hence lead their respective categories in sales density. Top brand portfolios such as Madura also enjoy high sales density.
Gross margin return on footage (GMRoF) and cost structure: GMRoF is key to ascertain the fixed cost absorption ability of a retailer.	We believe grocers relying more on sales density than on gross margins to absorb their operating cost structure are better off as trade margin differential in food/FMCG business isn't much across this cohort. DMART scores on this front too (moat more than priced in though!). Its ownership model helps keep cost structure lean, albeit the ecosystem is fast evolving and online grocers are stepping up the heat on pricing.	Strong private labels/brands enjoy highest GMRoF within our apparel universe. Although, value fashion retailers lag on this front, they largely make up for the GMRoF differential with their much leaner cost structure. Department stores remain laggards on both GMRoF and cost structure (Lifestyle Int. remains an exception).
Scalability: 1. Expansion strategy (Leased vs Owned), 2. Assortment pricing & variety, 3. Distribution strength in low PCI districts helps one assess retailers on scalability.	While D-MART given its predominantly owned store model, manages to squeeze maximum juice from a store's life-time value, scaling up may be a long-drawn affair given the 1. High capital needs in owning a store, 2. Lack of quality real estate up for purchase. While Reliance Smart, owns a meaningful share of its stores, It intends to expand via leased properties at the margin (Rent As % of sales has inched up in FY19), hence, may perhaps be more scalable. FRL with its leased model and stronger distribution strength in low PCI districts may also be more scalable.	Strong Private labels (Westside) scores on scalability as it offers the sharpest price and highest variety in assortment among its peer set, hence is more pervasive as an offering. It scores on low PCI distribution strength too.
Brand Loyalty	Consistently low prices help discounters gain top-of-the-mind recall. D-MART's done well on this front, but peers are fast catching up	Fast fashion retailers such as Zara, H&M and top brands such ABFRL's Madura portfolio score on brand loyalty. Department stores lag on this one as loyalty resides with brands and not the channel.
Working capital management Tighter the working capital cycle coupled with shorter payable crutch; sharper the pricing (given better trade margins to play with), more insulated the format is to a price war, especially in grocery	Most stock-up retailers such as D-MART and Reliance Retail trump top-up grocers such as (EasyDay, Star, Spar, Nature's Basket, etc) on this parameter. This trend repeats online too. **(Read: Cast Study on Grofers)**	Fast fashion (Zara, H&M), and strong private labels (Westside and M&S) sport one of the tightest working capital cycles in apparels followed by select disciplined value fashion plays (V-MART, Baazar Kolkata). As highlighted earlier, smaller the creditors crutch, lower the chances of an online intrusion. Key online fashion retailers have been offering better terms of trade to brands in order to woo them to sell on their platforms. In this back-drop, pure-play department stores with no differentiation in offering and a higher reliance on payables seem most exposed to disruption.
Online migration risk	Grocers with 1. higher exposure to South & North (Star, Spar, Spencers, Vishal Megamart) and 2. a higher reliance on payables are likely to be the first to lose share in our view as both geographies will be key testing grounds for deep-pocketed online retailers.	Top brands (Madura), fast fashion (Zara, H&M, Westside, M&S) remain more insulated than pure-play department stores.

Universe: Gross margin per sq. ft (Rs.) – FY19



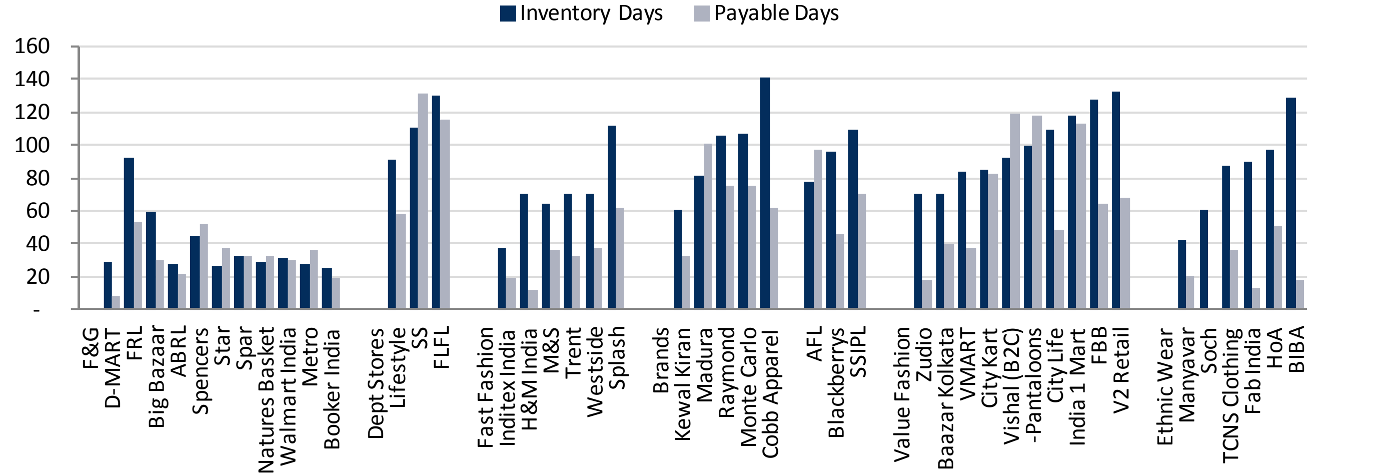
Source: Company, HDFC sec Inst Research (FY19)

Universe: EBITDA per sq. ft (Rs.) – FY19



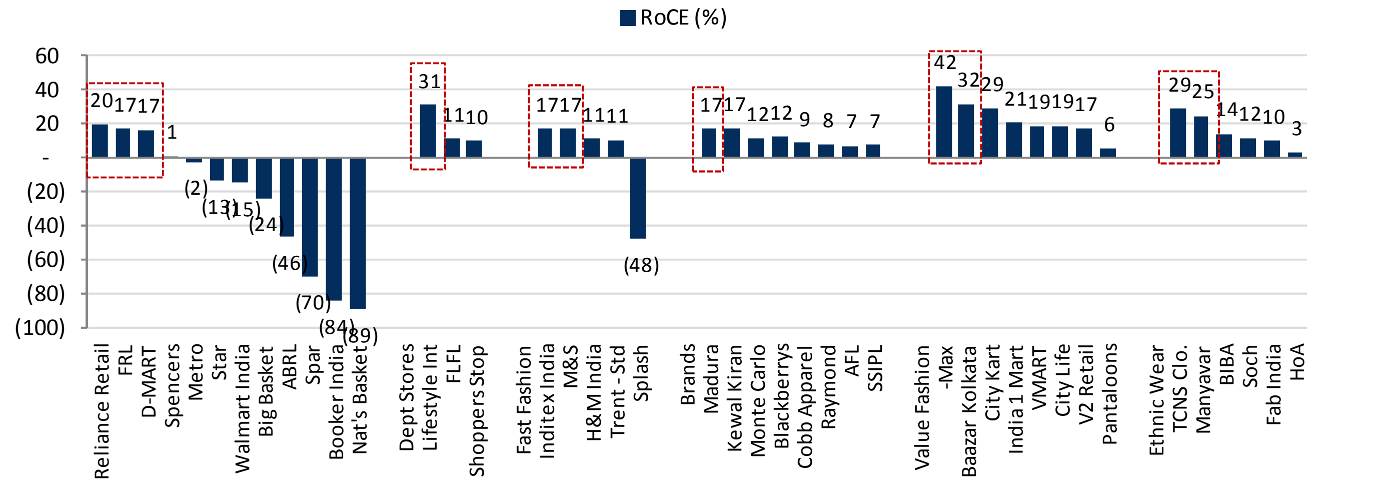
Source: Company, HDFC sec Inst Research (FY19)

Universe inventory and payable days – FY19



Source: Company, HDFC sec Inst Research, for select unlisted retailers FY18 numbers used as FY19 not published at the time of publishing

Universe: return profile (%)



Source: Company, HDFC sec Inst Research, for select unlisted retailers FY18 numbers used as FY19 not published at the time of publishing

Food & Grocery

The "To be or not to be!" moment for grocers

- **With a mere 4% organized share, India's food & grocery (Rs. 34tn) remains the biggest value migration play in retail. Despite the opportunity; majority of grocers will inch closer to their 'to be or not to be' moment as deep-pocketed/well funded e-tailers step up investments in pricing in this low AoV, wafer-thin margin biz. Ergo, expect organized F&G to grow at 2x (24% CAGR) the market pace primarily led by survivors.**
- **Online grocers are increasingly closing in on pricing – A key value proposition of discounters. Interestingly, while discounts rise, the former's margins have been consistently improving (Still not out of the woods though!), implying that trade margins are improving with scale.**
- **In the long-run, an all pervasive online-to-offline biz model is imperative to capture maximum share of the grocery buying habit. That said, in the current phase of evolution, we prefer stock-up formats over top-up formats given 1. The price lever, 2. More profitable revenue mix, 3. Superior unit store economics, 4. Better omni-asset**
- **In this chapter, based on our store mapping across income profiles and population density, we also attempt to understand, how long can D-MART's gravy-train last?**

Stock up formats are Hyper/Hybrid markets which a consumer visits typically once a month to stock up monthly F&G needs

Top-up formats are convenience stores/supermarkets which a consumer visits to replenish/refill gaps post the monthly purchases

- **F&G - Biggest value migration play in Retail:** With a mere 4% organized penetration, F&G remains the biggest potential value migration play in Retail. (~67% of Retail); This presents efficient operators a long runway for growth. Expect organized F&G to grow at 2x the market pace (24% CAGR) over CY18-21 to ~Rs. 2.5tn as Kirana stores (~12mn, account for 96% of trade) cede share.

- **Why are Mom & pop stores ceding share to biggies?**

  1. **Inefficiencies galore:** In its current avatar, general trade remains a highly inefficient retail channel given 1. Near MRP pricing and 2. GMs/PAT margins as thin as 10-12%/2-3% respectively. In comparison, organized discounters manage to pass on scale/efficiency driven benefits through price to consumers. (sell merchandise at an avg discount of 10-20% to MRP) **This explains why our 14-retailer F&G universe grew at over 2x the industry pace (27% vs 12% CAGR over FY15-19)– A classic value migration story.**
  2. **Free home delivery – table stakes now:** Big-box/online retailers have been sharpening their online fulfilment capabilities to match up to the convenience of mom-&-pop stores. Hence, free home delivery (>threshold AoV) is expected to be table stakes as retailers try to sync operations to Indian consumer habits.
  3. **Limited Assortment:** The smaller store sizes of kirana stores limit their ability to offer a wider assortment to consumers. (Typically ~1000 SKUs vs Modern Retail's 3000-8000 SKUs).

- **Organized F&G getting top-heavy:** F&G remains the toughest category to crack in India given low average order values (AoV <USD17-20 vs USD60 in US) and wafer-thin margins (~15-17% vs 20-30% US/UK/China). Hence, opportunity notwithstanding, org. F&G, is getting top-heavy as inefficient operators fall by the way-side. **Top 5 retailers have already cornered >80% share within our F&G universe (14 companies) and >50% share in total organized F&G.**

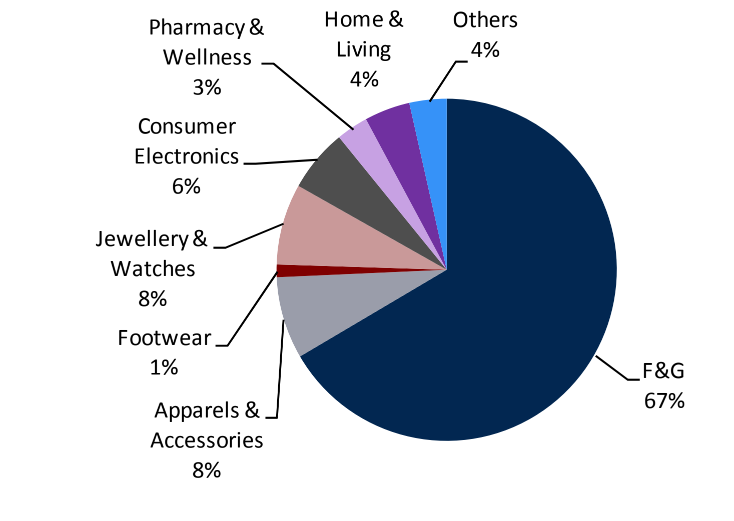
This trend will continue as

A) Cost of retailing inches up

B) Deep-pocketed e-tailers/well-funded online grocers step up investments in pricing.

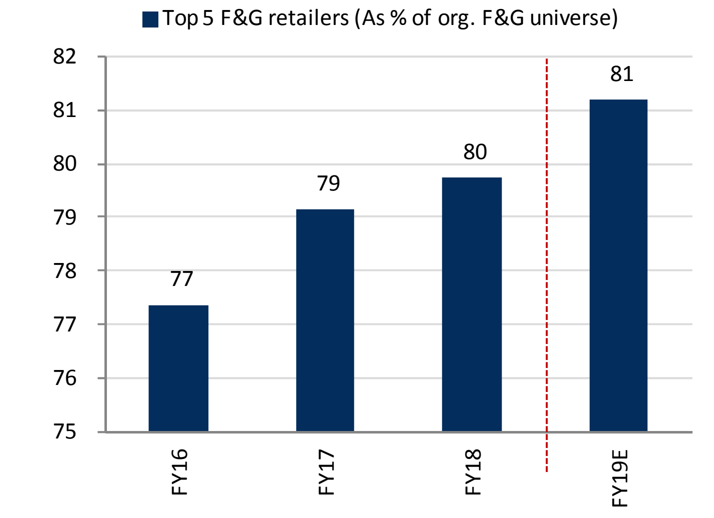
C) Weak cash position of the F&G tail stifles growth

F&G - two-thirds the Rs. 51tn retail market (CY18)



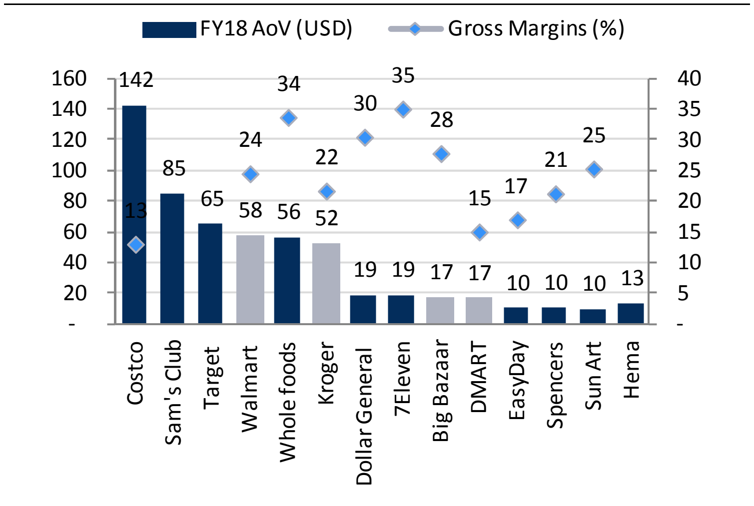
Source: Industry, Company, HDFC sec Inst Research

…organized play getting top heavy



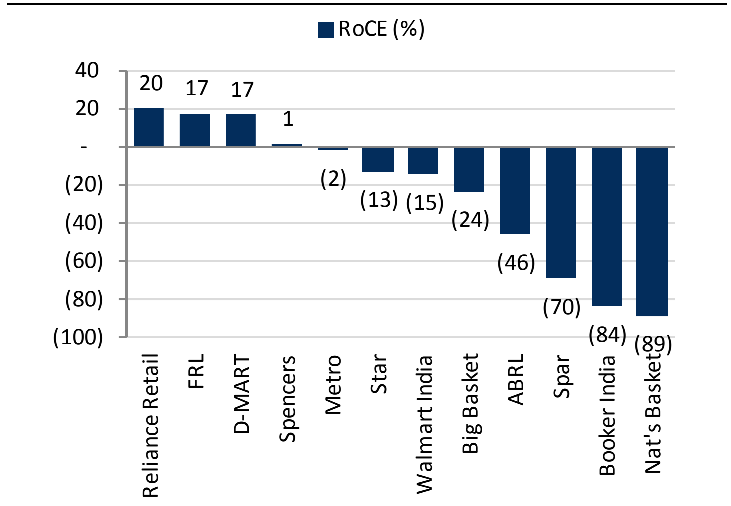
Source: Company, HDFC sec Inst Research, 14 member F&G universe

Low AoV, wafer-thin margins make F&G the toughest biz to crack in India



Source: Perfect Price website, Company, HDFC sec Inst Research

Only a few may survive (Return Profile, %)



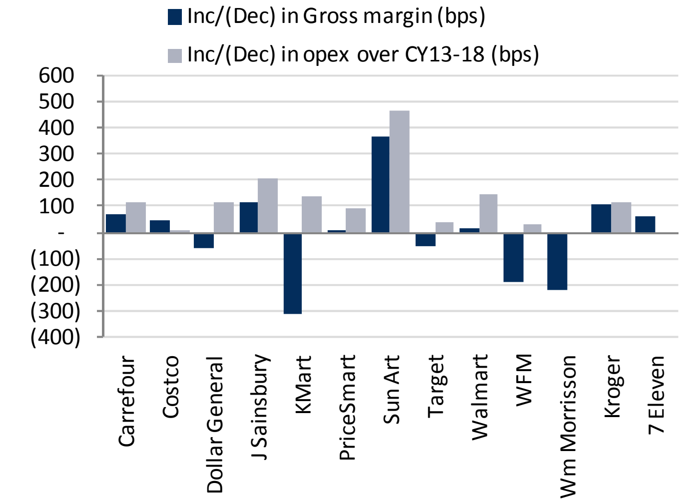
Source: Company, HDFC sec Inst Research, FY18 for unlisted

Imminent increase in cost of retailing + Online heat + Weak cash position warrants partnerships

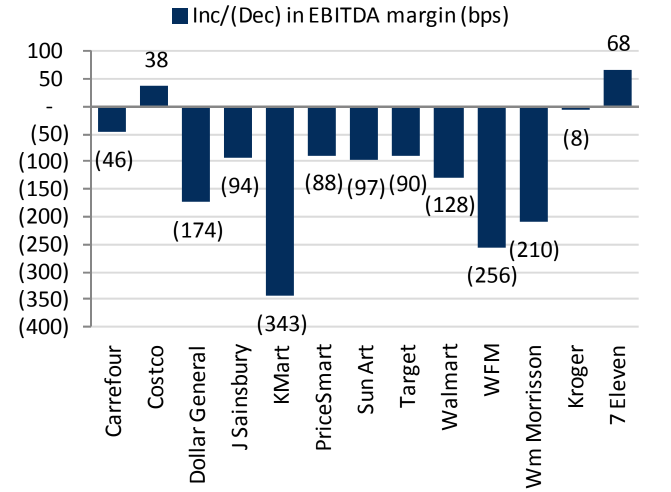
Cost of retailing to inch up

- As highlighted earlier, free home delivery (beyond threshold AoV) is likely to be business as usual as organized F&G retailers 1. Contend for market share gains, 2. Ring-fence their convenience-seeking consumer base. Consequently, cost of retailing is likely to inch up as investment in online fulfilment capabilities increasingly becomes an imperative. **<u>We can see this happening already across the globe too.</u>** However, most Indian B&M grocers currently, have bare-bone investments in the same given 1. Weak cash position, 2. Risk of diluting their already wafer-thin margins, at least in the near-term.

Cost of retailing has inched up globally as investments in online fulfilment capabilities increased (CY13-18)



Source: Company, HDFC sec Inst Research



Source: Company, HDFC sec Inst Research

Online grocers turning on the heat!

- Online grocers while still sub-scale, have been growing exponentially as investments in pricing continue unabated. This cohort has been closing in on the key proposition of discounters such as DMART.
- **...trade margins improving though!** Interestingly, while discounts rise, margin profile – both at the gross and operational level have been improving with each passing year for online grocers. This implies that trade margins are improving as they achieve scale. Also, incremental funding is directed towards footprint expansion and marketing.
- This set of grocers grapple with another set of problems. 1. High customer acquisition cost (marketing spends: 5-6% of sales), 2. Fulfilment costs remain unit economics-crushing (~8-15% currently), Ergo, reducing fulfilment costs is a necessity.
- Interestingly, some online folks are reining in fulfilment costs smartly by getting closer to the consumer via expansion in warehouse/dark store/channel partner footprint. Amazon and Flipkart too, are on the cusp of extracting their pound of flesh in F&G. The former, in order to have latitude in pricing is already working on operating on a low cost structure (i.e. low fulfilment costs) via stake purchases in offline assets (ABRL and FRL).

...and it is being felt by offline grocers already!

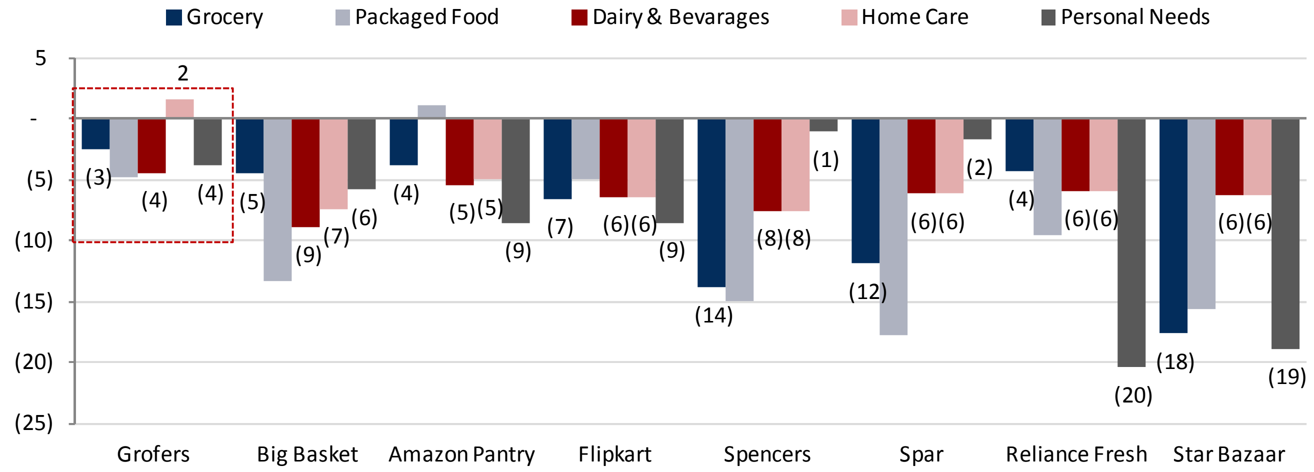
"Price discounting has gone up in the last 1-1.5-years. This is a new variable playing out as earlier competition was not discounting as much as they have begun in the last 12 to 18-months. Hence, it is very tough to predict what will happen next year".
- CEO Neville Noronha at Avenue Supermart's FY19 Annual Analyst Meet

"We witnessed deep and consistent investment in pricing by brick and mortar retailers, primarily to match and/or ward off e-commerce players who were aggressively focused on customer acquisition and hence are passing on huge benefits to recruit customers. This aggressive push by e-commerce has started impacting offline monthly shopping missions, forcing brick and mortar retailers to follow suit in order to stay competitive and relevant for the customer. As seen in other markets, we expect India to go through this phase of intensive price-based competition before reaching a mature environment".
-ABRL in its FY19 Annual Report

Online folks closing in on DMART's lowest price proposition. Grofers is the closest to DMART prices

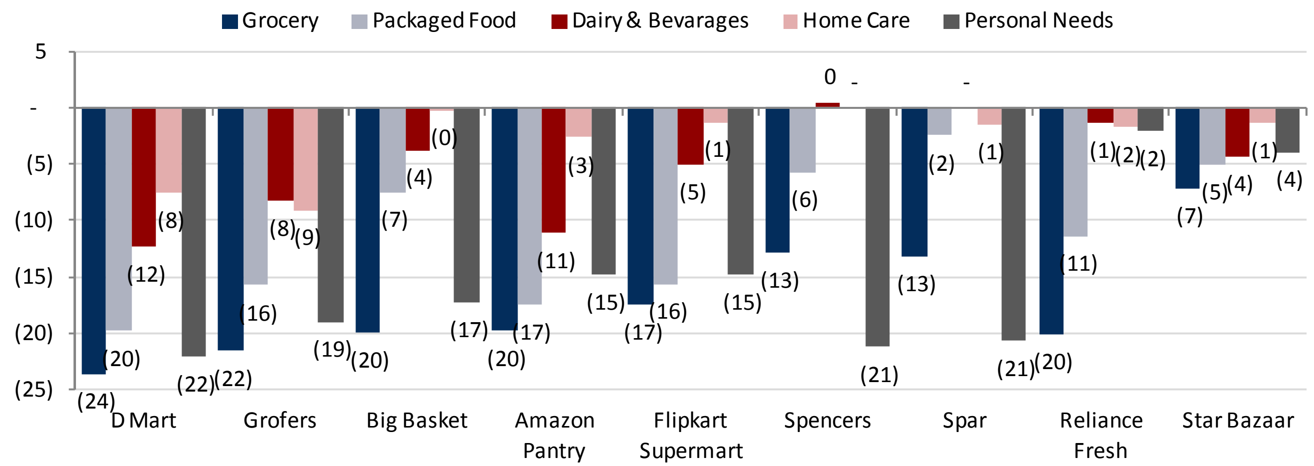
Off late, Amazon too has been working on its grocery pricing and is expected to inch closer to reduce the pricing gap with DMART with each passing month as it is now better placed to operate on a leaner cost structure (i.e., lower fulfilment costs) given the recent offline acquisitions/stake purchases

DMART's discount over peers – Grofers closing in



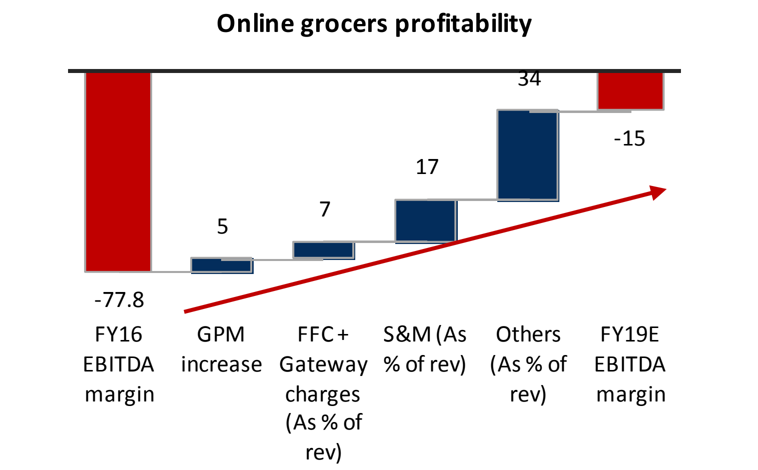
Source: Company websites, HDFC sec Inst Research

Peer-wise discount over MRP



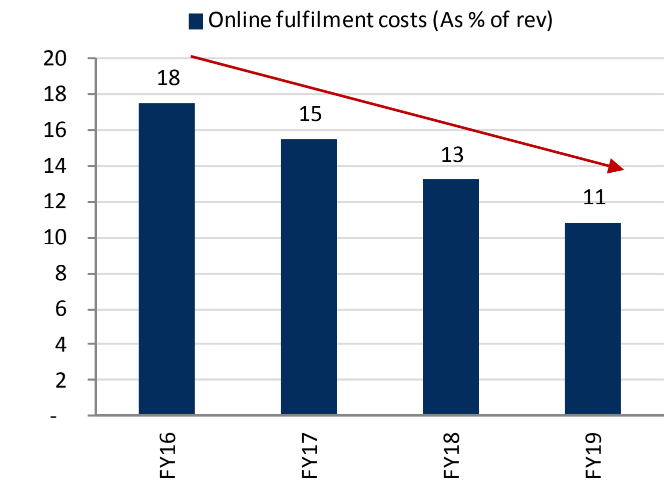
Source: Company websites, HDFC sec Inst Research

Despite rising discounts, online grocers' fixed cost absorption has improved, implying that trade margins have improved



Source: Company, HDFC sec Inst Research estimates

...reducing fulfilment costs have certainly helped



Source: Company, HDFC sec Inst Research estimates

Retailer-wise online delivery offerings

	MOV for free delivery	Delivery charges for value below MOV
Dmart *	No Free Delivery	49/- or 3% of AoV, whichever is higher, Free at PuP. For Both MoV is Rs. 1000.
Grofers	Rs500	Rs29
Big Basket	Rs1000	Rs35 (Rs40 for speciality shop)
Reliance Smart	Rs750	Rs25
Starquick	Rs750	Rs50
Flipkart supermart	Rs600	Rs50
Amazon pantry	Rs599	Rs59(Rs30 for prime members
Express Delivery for Prime Now	Nil	Rs49 (only for prime members)
Spar	Rs399	Rs30
Spencer	Rs130	Rs30

Source: Company, HDFC sec Inst Research

Weak cash position warrants partnerships

- Grocers in the west, given their multi-decadal head-start over online, already have significant scale and cash flows to plough back in building online fulfilment capabilities and compete with e-tailers – An advantage absent back home. (Note: Bulk of capex earmarked globally is for fulfilment needs)
- In fact, barring D-MART, Reliance Retail, Big Bazaar, no grocer/format manages to make even a profit spread on their cost structure. Hence, as global e-tailers/well-funded online folks step up customer acquisition (via increased investments in pricing), the weak cash position of Indian offline F&G retailers (especially, the tail) would warrant either 1.Constant capital infusion or 2.Partnerships with deep-pocketed global retailers to perpetuate their growth narrative.
- We already are seeing initial signs of offline-online collaborations with Amazon/Samara (via Witzig Advisory services) acquiring ABRL and Amazon purchasing a minority stake in Future Retail. Reliance Retail – biggest retailer in India (grocery footprint - 673 stores) may also be looking for strategic partners given the groups focus on de-leveraging.

...Operators with larger footprint are ideal candidates

- A healthy network of store-based fulfilment centres closer to the consumer can substantially reduce online fulfilment costs and are ideal candidates for strategic partnerships with the online folks. Within the Top 16 states, Future Retail (275/292 stores in ~120 districts) and Reliance Retail (est: 673 stores) rank high on this parameter. Future Retail's district coverage is nearly 2.5x that of D-MART. **(Refer to PCI/Population density-wise store analysis for grocers.**

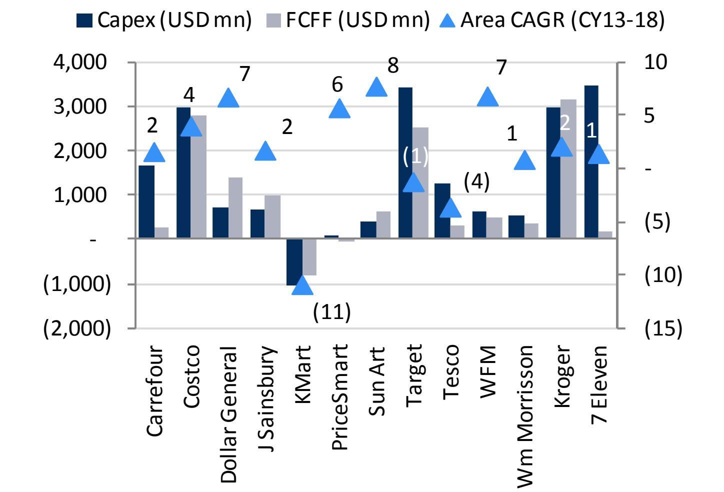
Since Amazon (Global) stepped up focus on F&G (CY13-18), our 14-member global retailer footprint has remained flat, and capital allocation for the latter is now largely earmarked towards building online fulfillment capabilities.

Cash Position of Indian F&G Retailers remains weak. Barring, D-MART, Reliance Retail, Future Retail, no grocer manages to even make a profit spread on their cost structure.

Top few could perpetuate their growth story (read: Reliance Retail, Avenue Supermart) given strong parent balance sheets/impending capital infusion

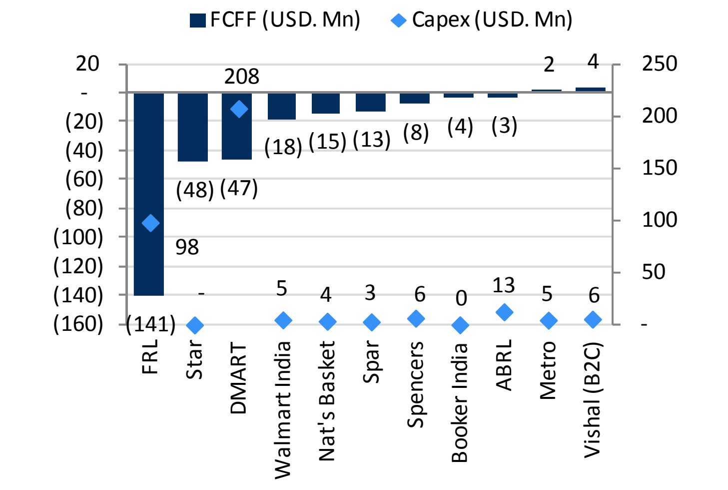
Meanwhile, well-funded online grocers, have been smartly scaling up and hammering down fulfillment costs via channel partner-based deliveries. (Still high though!)

Globally, bulk of the capex is earmarked for fulfilment needs (USD mn)



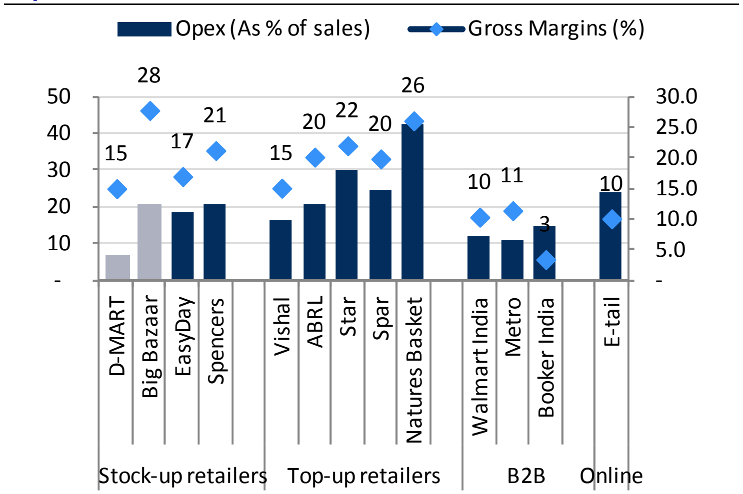
Source: Company, HDFC sec Inst Research

Cash Position of Indian F&G Retailers remains weak



Source: Company, HDFC sec Inst Research

Barring a few, no grocer manages to make a profit spread on its cost structure



Source:Company, HDFC sec Inst Research

...Meanwhile online folks beefing up for a price war

Flipkart Farmermart	Incorporated on 4th Oct 2019 with an authorized share capital of Rs. 18.5bn
Amazon Retail	-Incorporated on 29th May 2017 with an authorized share capital of Rs. 1.55bn -Authorized share capital increased from Rs. 1.55bn to Rs. 1.65bn (11th May 2018) -Authorized share capital increased from Rs. 1.65bn to Rs. 3.55bn (5th Mar 2019) -Authorized share capital increased from Rs. 3.55bn to Rs. 35bn (29th Aug 2019) -Infused Rs.1.72bn on 17th Oct 2019
Grofers	Cumm. funds raised - USD477mn, Series F - USDD247mn
Big Basket	Cumm. funds raised - USD1bn, Series F - USD190mn
ABRL (acquired by Samara)	Authorized capital raised from Rs. 35bn to Rs. 85bn in FY19

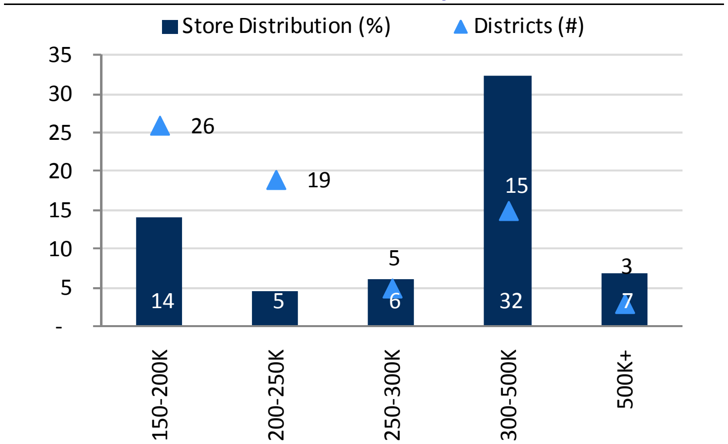
Source: Company, HDFC sec Inst Research

Who wins - Stock up or Top up grocers?

Our propriety model (Maps stores across ~490 districts) suggests that <u>nearly two-thirds of the Top 7 retailers' stores are present in districts (68 districts) with PCI/population density of Rs. 150k+/ > 500 per km respectively and ~40% stores are in districts (18 districts) with PCI/population density of Rs. 300k+/> 500 per km. (India avg: PCI/population density is estimated at Rs. 126k/382 per km).Ergo, the big-box organized play is still largely an urban phenomenon.</u>

- **Who wins?** In the long-run, an all pervasive/Integrated Online-to-offline (O2O) model is imperative to capture maximum share of the grocery buying habit –Stock up and Top up. That said, in the current phase of evolution (heightening competitive intensity), **we prefer stock-up formats over supermarket/modern convenience stores (Top-up formats)** given 1. It's rising share in grocery buying habit given cheaper prices, 2. Ability to differentiate courtesy wider assortment, ergo more profitable revenue mix, 3. Potential to sweat more as an omni-asset, 4. Superior unit store economics. All these inputs feed into a better probability of generating free cash which is key for expansion.
  - **Stock-up's rising share in grocery buying habit:** Grocers have primarily focused on milking India's urban density (low hanging fruit) over the past decade **<u>(~40% of top retailers' stores are in a mere 18 districts).</u>** This consumer set is more likely to bunch up a higher portion of their grocery purchases given 1. Value proposition, 2. High income visibility 3. Paucity of time for frequent visits. Ergo, stock-up grocers are steadily increasing their share in the grocery buying habit.
  - **Wider Assortment and more profitable revenue mix:** In hypermarkets, apparel/GM typically account for 25-35% of revenue. The wider assortment certainly acts as a differentiating lever for the format. The latitude to flex product mix to balance growth/profitability also increases given the margin-accretive profile of these categories. Apparel/GM gross margins range between 25-45% vs Food/non-food FMCG's 15-20%.
  - **Potential to sweat more as an omni-asset:** Typically, 25-30% of a hypermarket's retail area is used for storage purposes which can easily double up as decentralized fulfilment zones for home delivery (Investing in online fulfilment capabilities an increasing imperative). This could bring down unit-economics-crushing fulfilment costs significantly (est: 8-15% for online grocers).
  - **Unit store economics** are superior vs supermarkets.
    ...On the other hand, unlike in the west, supermarket/modern convenience stores have historically found it tough to scale in India given the resilient kirana store network. The latter has been offering convenience as a proposition from time immemorial. Also gross margin levers for small formats are absent as the key offering - fresh/non-food FMCG products have low-margins (15-17%). Current scale and cost structures keep profitability at bay. This business unless done at significant scale, doesn't have the legs to reach profitability. **<u>In our 14 F&G retailer universe, no top-up grocer has hit profitability. Case in point – Aditya Birla Retail</u>**.

PCI-wise store distribution of top retailers

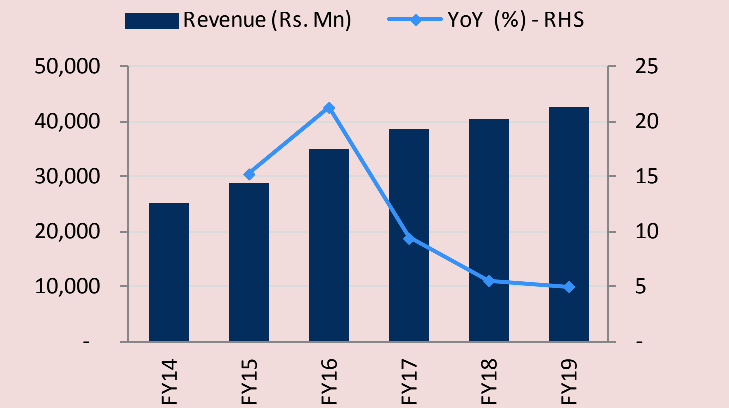


Source: HDFC sec Inst Research

Death by debt – Aditya Birla Retail (ABRL)

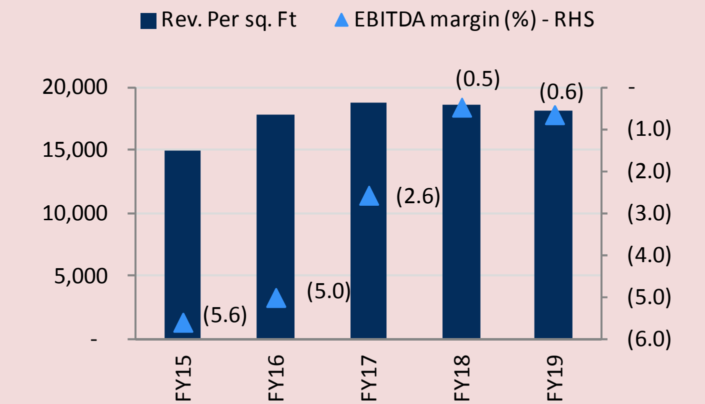
- Aditya Birla retail (ABRL) now acquired by Amazon/Samara entered retail through an acquisition of Trinethra Super Retail in 2007 with over 172 stores back then. Since then the company rebranded the stores with its brand 'More' and has a footprint of over 581 supermarkets and 21 Hypermarkets primarily across the four southern states of Andhra Pradesh, Karnataka, Tamil Nadu and Kerala.
  - **Death by debt:** ABRL's store expansion was largely debt-fuelled. It amassed a debt of Rs. ~40bn through its pre-acquisition history, before nearly crumbling under its burden). Its sales velocity/GMROF of ~18k/~3.7k (HDFC Sec estimates) while improving was nowhere close to the velocity required to service debt. **Cumulative cash burn over FY10-19 stood at >Rs. 52bn.**
  - **The Massive Ask:** Back-of-the-envelope calculations suggest that ABRL would have had to double its sales velocity (i.e, match industry leader D-MART's productivity) and halve its cost structure (~20% in FY19), to have a shot at servicing its debt through internal accruals. **THAT's SOME ASK!**
  - **Amazon: The knight in shining armour:** Given that Amazon had been itching to get into the grocery space, it along with Indian partner Samara bailed ABRL out by acquiring a 62% stake at a valuation of ~Rs. 42bn, effectively paying for its debt (FY18: Rs. 4bn)
    - **What's in it for Amazon?** To be successful in a low AoV/GM grocery play, fulfilment costs need to come down. This can only be achieved with decentralised store-based assets which can double up as fulfilment centres closer to neighbourhoods. We believe that's what Amazon intends to achieve with its acquisition of city-centric assets. Per media articles. Amazon/Samara intends to kick-start expansion again and add ~100-150 stores/year once operational integration is behind them**. Debt has nearly been wiped off in FY19.**
    - Funding should not be a constraint post acquisition as it is backed by deep-pocketed investors. The board increased the authorized share capital from Rs. 35bn to Rs. 85bn and also approved the issuance of Non-Convertible Debentures for an amount of upto Rs. 15bn (Per Annual Report 2019)

ABRL: Clocked 9% revenue CAGR over FY14-19



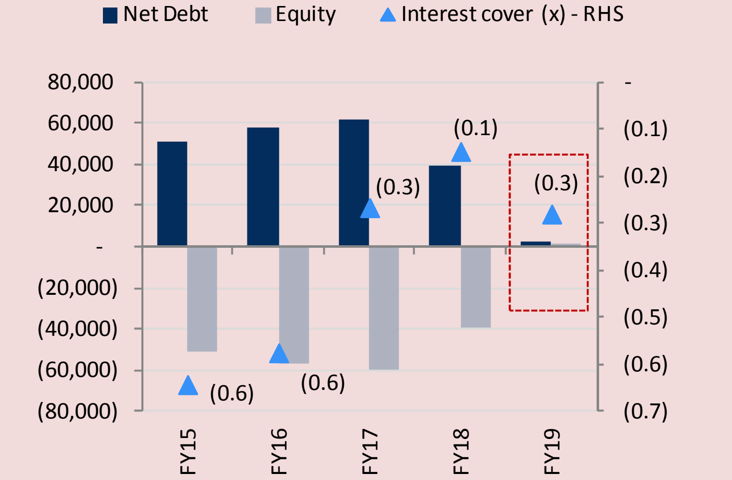
Source: Company, HDFC sec Inst Research

ABRL's Sales density and EBITDA margin (%)...



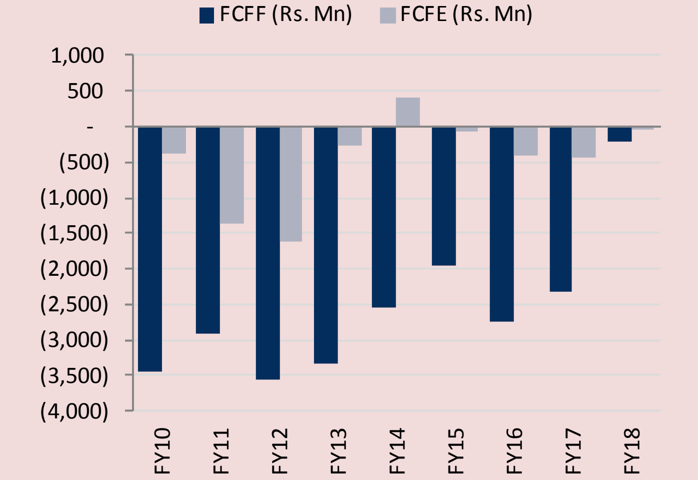
Source: Company, HDFC sec Inst Research

...wasn't enough to service the ballooning debt



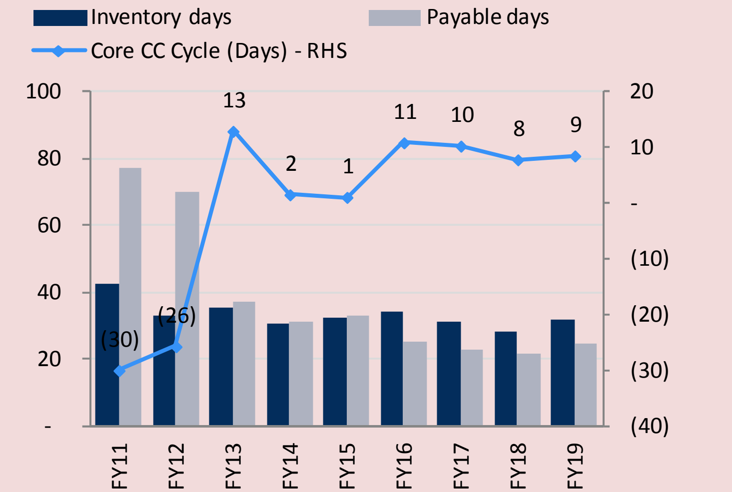
Source: Company, HDFC sec Inst Research

ABRL: Free cash flow profile



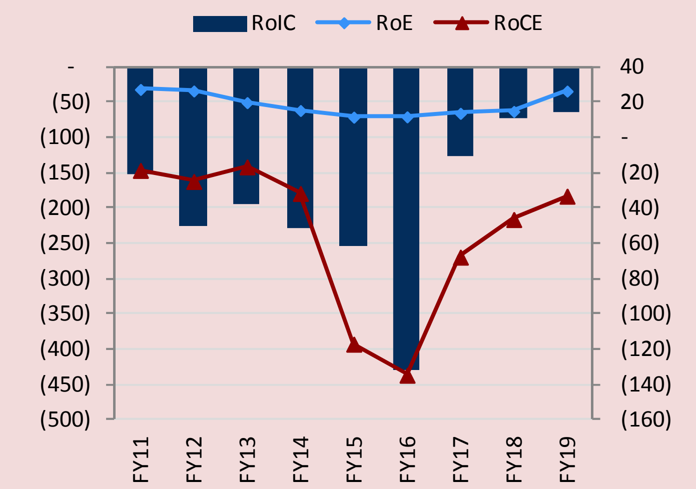
Source: Company, HDFC sec Inst Research

ABRL: Cash conversion cycle



Source: Company, HDFC sec Inst Research

ABRL: Return profile



Source: Company, HDFC sec Inst Research

Stock up grocers enjoy superior unit store economics

Per sq. Ft metrics (Rs.)	DMART	Big Bazaar	Easy Day	More	Spencers	Star	Spar	Nat's Basket
Revenue	36,746	12,868	15,340	18,548	16,935	12,299	13,036	29,842
Gross Profit	5,418	3,551	2,608	3,741	3,597	2,709	2,591	7,493
EBITDA	3,030	920	(77)	(87)	1,016	-	(600)	(5,201)
Capex	12,880	3,000	2,000	4,210	2,500	2,500	4,355	2,550
WC	2,432	1,992	2,385	398	147	(258)	49	482
Capital Employed	15,312	4,992	4,385	4,607	2,647	2,242	4,404	3,032
RoCE (%)	12.6	17.5	(4)	(9)	(17)	(18)	(19)	NA
Payback Period (Years)	7.2	7.9	NA	NA	(11)	NA	NA	NA

Source: Company, HDFC sec Inst Research. Note For FRL, payback is unadjusted for FEL-FRL lease arrangement

The Contrarian Retailer – Future Retail (FRL)

- While most retailers seem to have given up on the small format, FRL with its slew of small format acquisitions (EasyDay from Bharti, Heritage and Nilgiris down South) has taken a contrarian view to peers on the fate of the small format in India. With its membership-based small format Easyday, it intends to aggressively focus of 11 key clusters for expansion. Since the EasyDay acquisition (FY15), FRL has managed to cut cost impressively given its cluster-based approach. (EBITDA margin: -6.5% in FY15 vs -1.5-2% in FY19). FRL intends to hit operational break-even by exit FY20 and is working towards it by closing 50-60 loss-making EasyDay stores in 2HFY20.

What is FRL doing differently?

- **Cluster-based approach:** By focusing on clusters primarily in Tier 1 & 2 cities, Easyday ensures sourcing benefits are significant and can partly be passed on to consumers to create a strong value proposition.
- **Membership-based:** Through its emphasis on a membership program, it intends to achieve two objectives – 1. A sticky consumer base, 2. Data collated through data analytics can be used to fine-tune assortment mix to regional tastes.
- **At scale, can be a strong omni-asset:** Given that there is a natural cap to expansion for hypermarkets below a certain income profile and population density, convenience stores/ supermarkets remains the only vehicle that goes deeper into the neighbourhood and can offer free home delivery at reasonable fulfilment costs. **Caveat – significant scale is a must for profitability.**
- **Can adapt differentiated pricing strategy:** The cluster-based approach can help EasyDay follow different pricing and promotion strategy contingent on the cluster, consumer profile, tastes, etc. This also helps in pushing a particular product depending on its fill and take rates in the cluster.

DMART – The most efficient stock-up operator

- **DMART's success mantra – Lowest Price meets highest population density:** The bedrock of DMART's success has been its Everyday Low Cost-Everyday Low Price (EDLC-EDLP). In other words, scale-led operational and sourcing benefits/savings get fed into lower prices. However, most investors do not fully appreciate the role population density has played in its success. Our district-wise store mapping suggests >61% of DMART's stores are present in districts with a PCI of 300k+ and population density of 3000+/km and Gujarat (District-wise details for Gujarat not available) which translates into higher number of bill cuts vs peers. DMART did 172mn bill cuts in FY19 vs Big Bazaar's ~130mn despite the latter having 2x footprint of DMART. Bill sizes for both are similar ~Rs. 1150-1200).

Per capita income/Population Density-wise store analysis (% distribution)

% Distribution	Districts (#)	D Mart	Big Bazaar	Spencers	Star Bazaar	Spar	Natures Basket	Vishal Megamart
<100K	**212.0**	**0.6**	**15.3**	**18.7**	**-**	**8.7**	**-**	**29.6**
<300	78.0	-	2.2	-	-	-	-	4.4
300-500	20.0	-	0.7	-	-	-	-	1.3
500-1000	65.0	-	1.8	-	-	-	-	6.9
1000-3000	47.0	-	8.4	17.1	-	-	-	13.2
3000-5000	2.0	0.6	2.2	1.6	-	8.7	-	3.8
100-150K	**117.0**	**9.3**	**14.9**	**8.1**	**-**	**-**	**-**	**20.1**
<300	55.0	2.5	1.1	0.8	-	-	-	5.0
300-500	43.0	4.3	6.2	3.3	-	-	-	7.5
500-1000	12.0	2.5	4.4	0.8	-	-	-	6.3
1000-3000	6.0	-	2.5	2.4	-	-	-	1.3
3000-5000	1.0	-	0.7	0.8	-	-	-	-
150-200K	**86.0**	**17.4**	**20.0**	**40.7**	**2.6**	**8.7**	**-**	**18.9**
<300	31.0	5.0	1.8	1.6	-	-	-	3.1
300-500	29.0	3.1	3.3	8.1	-	-	-	5.0
500-1000	21.0	6.2	4.7	-	2.6	-	-	8.2
1000-3000	3.0	2.5	1.5	-	-	-	-	1.3
5000+	2.0	0.6	8.7	30.9	-	8.7	-	1.3
200-250K	**30.0**	**3.1**	**7.6**	**5.7**	**-**	**8.7**	**-**	**6.3**
<300	3.0	-	0.4	-	-	4.3	-	-
300-500	8.0	0.6	1.5	-	-	-	-	0.6
500-1000	12.0	2.5	2.9	1.6	-	4.3	-	4.4
1000-3000	7.0	-	2.9	4.1	-	-	-	1.3

% Distribution	Districts (#)	D Mart	Big Bazaar	Spencers	Star Bazaar	Spar	Natures Basket	Vishal Megamart
250-300K	**6.0**	**8.1**	**9.1**	**-**	**20.5**	**-**	**8.3**	**1.9**
300-500	1.0	-	0.7	-	-	-	-	-
500-1000	2.0	8.1	3.3	-	20.5	-	8.3	1.3
1000-3000	3.0	-	5.1	-	-	-	-	0.6
300-500K	**10.0**	**45.3**	**20.7**	**19.5**	**76.9**	**65.2**	**91.7**	**6.9**
<300	1.0	-	-	-	-	-	-	-
300-500	2.0	-	1.5	-	-	8.7	-	1.3
500-1000	3.0	-	0.7	0.8	-	-	-	1.3
1000-3000	1.0	-	0.4	1.6	-	-	-	1.3
3000-5000	1.0	8.7	6.9	1.6	46.2	34.8	25.0	2.5
5000+	2.0	36.6	11.3	15.4	30.8	21.7	66.7	0.6
500K+	**3.0**	**-**	**7.6**	**6.5**	**-**	**8.7**	**-**	**15.7**
1000-3000	2.0	-	2.9	6.5	-	4.3	-	3.8
5000+	1.0	-	4.7	-	-	4.3	-	11.9
Gujarat	**25.0**	**16.1**	**4.7**	**0.8**	**-**	**-**	**-**	**0.6**
<300	12.0	0.6	1.1	-	-	-	-	-
300-500	5.0	4.3	0.4	-	-	-	-	-
500-1000	8.0	11.2	3.3	0.8	-	-	-	0.6
Grand Total	**489.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, HDFC sec Inst Research

How long can D-MART's gravy train last?

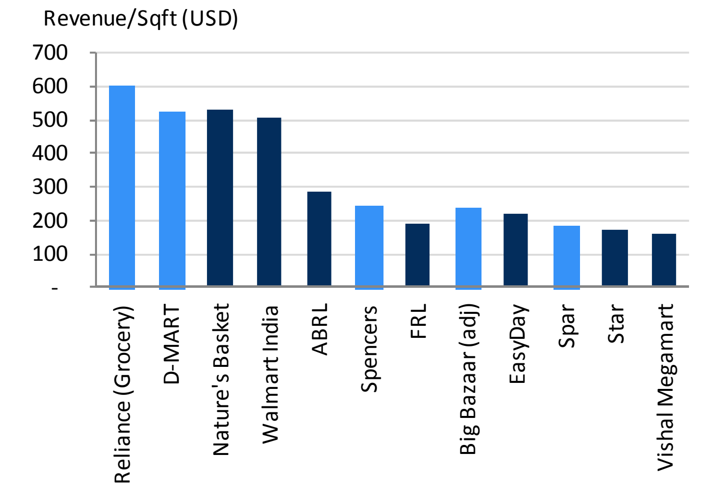
We believe frequency of purchase for Walmart & Krogers may be higher as their assortment of fresh is higher vs nearly non-existent for DMART

If one adjusts for frequency of purchase between DMART (est: 1.5/month) and Walmart (est: 2.5-3/month), the differential in revenue/sq. ft is possibly even higher vs Walmart

DMART trumps most global stock-up grocers incl. Walmart. (Ones highlighted in blue are the closest to DMART in terms of Biz model and product mix)

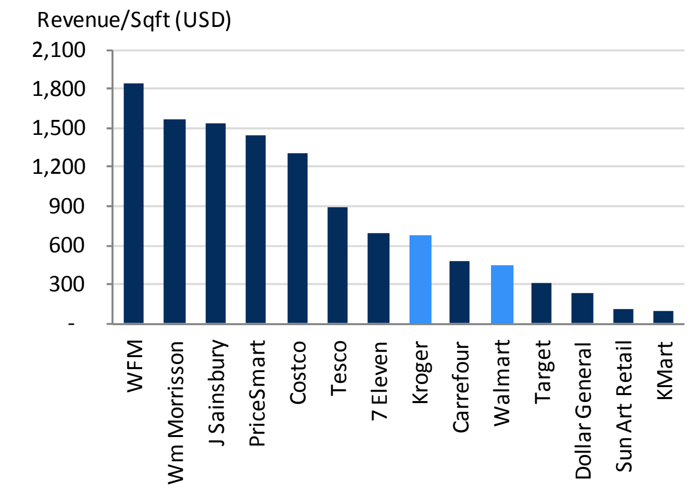
- **Some Perspective:** Our read through across international grocers suggests that the US grocery basket (AoV) is 3x that of top Indian retailers. If one further adjusts for cost parity differential on consumables in India and US (3x), turns out the basket volumes are similar; Yet, DMART scores over most US stock-up retailers in sales velocity. DMART does (USD525/sq. ft vs Walmart/Kroger's USD446/667 respectively). **The variable that moves sales velocity decisively in favour of DMART is the population density of areas it operates in (As highlighted earlier). Hence, the question is how long can this gravy train last?**

Revenue per sq. foot (Indian Grocers)



Source: Company, HDFC sec Inst Research, Note: For unlisted companies, revenue per sq. foot are estimates

Revenue per sq. foot (Global Grocers)

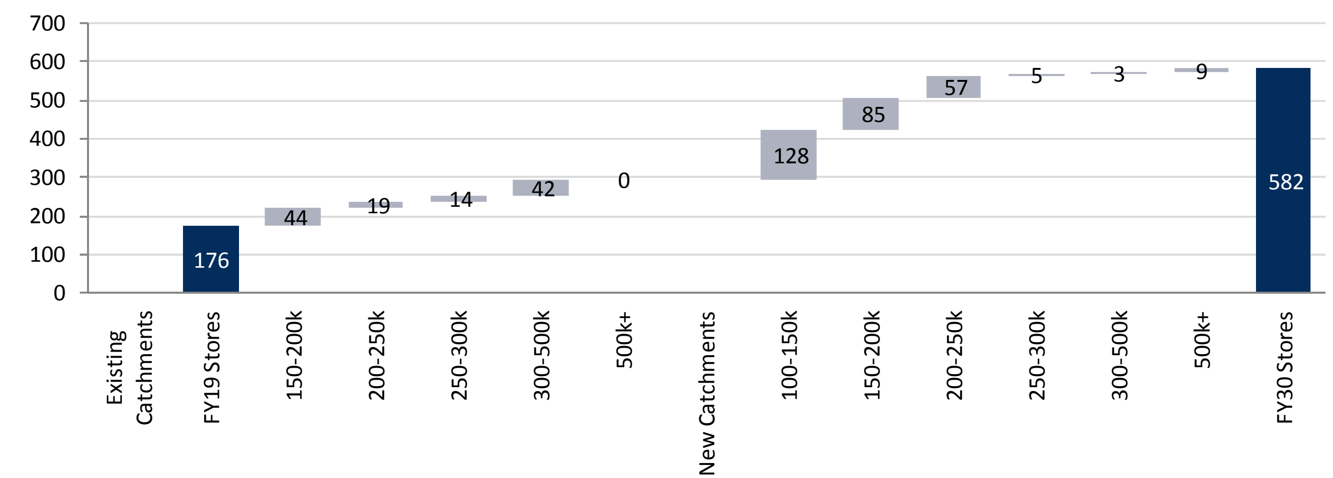


Source: Company, HDFC sec Inst Research

- Our district-wise analysis on store potential based on PCI and population density suggests **that DMART still has a runway to add ~400-420 stores (baked in our numbers) in its existing/similar catchments without a material drop in productivity (assuming a 2.5% CAGR in AoV), i.e, approx. a 9-10 year run-way** (built in our numbers already) However, post that search for greener pastures will be a task, without impacting throughput materially. Current valuations suggests the D-MART's will clock 10/17% SSSG/revenue CAGR, 250bp EBITDA margin improvement and service over a third of Indian households as customers – Now that's a stretch even for D-MART, especially within the context of heightening competitive intensity. Also, the top peers it will be contending with are deep-pocketed global retailers and well-funded vertical grocers, who are expected to give the industry bellwether a run for its money.

Our analysis suggests, D-MART potentially has headroom to add 400-420 stores over the next decade and we are building that in!

DMART's Store Potential based on PCI/Population density profile across 460+ districts



Source: Company, HDFC sec Inst Research

- **There are white spaces to exploit, though:** There could be white spaces to capture for national F&G retailers in South & North given:

  1. Landmark group seems to be stepping off the gas on expansion in grocery (Spar - ~21 stores) and focusing on its cash cow biz - Fashion & Lifestyle (Lifestyle International) instead.

  2. A north-based retailer (Product mix: over 50% of revenue from GM/FMCG) grappling with profitability & vendor issues may have to keep expansion plans in check as it trains focus on improving operational efficiency. Of Note: Big Bazaar and Grofers may stand a better chance at making in-roads given their stronger presence in the north.

Grofers: Stock-up wins online too!

(Annualized GMV run-rate of USD700mn)

Our preference for Stock-up grocers over top-up grocers trickles down to online folks too as the journey to profitability seems less bumpy in the former's case.

- Online F&G penetration remains abysmally low at <1%. While there are two major vertical players catering to the segment - Grofers and Bigbasket; deep-pocketed horizontal retailers have also been making moves to join the race and capture their share of the biggest pie in retail. Grofers' strong catchment remains the Delhi-NCR region; overall presence spans 10 cities. On the other hand, Bigbasket has a presence in 26 cities. Grofers' DNA is primarily that of a stock-up grocer while Bigbasket caters to both stock-up and top-up needs with a higher exposure to the "Fresh Category"

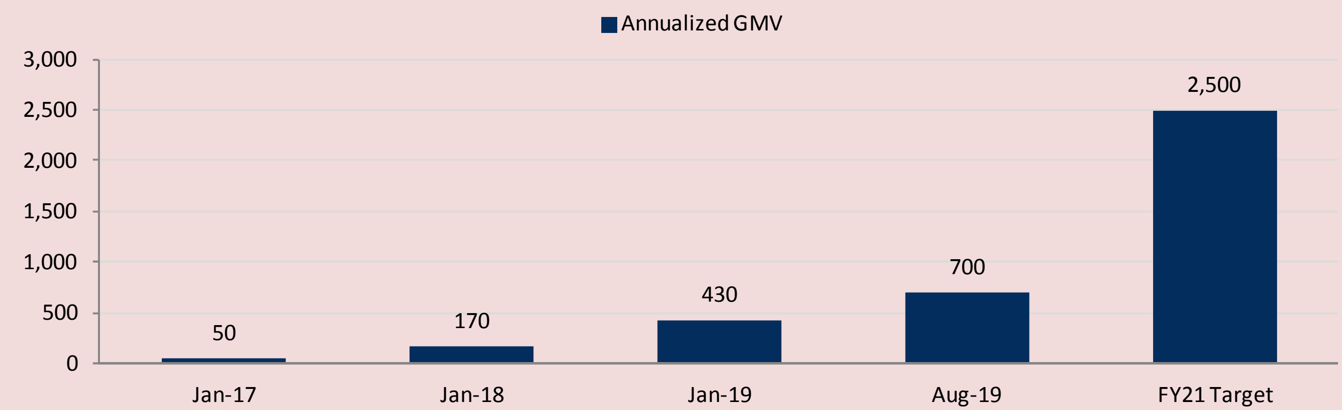
- **The Target Group:** Grofers (Annualized GMV: USD700mn) caters to what it calls "Middle India" – A 300mn consumer base with income levels of Rs. 0.25-0.65mn/year (A USD100bn+ addressable market) who value savings and hence are sticky in nature, while a large portion of Bigbasket's consumer base value convenience over savings which may have a natural cap given the income profile of India. While we don't profess to foresee the complete evolution of online grocery in India and may be Big basket cracks the Fresh space, we do prefer Grofers' stock-up model (Doesn't do Fresh) as 1. it plays to the value-seeking Indian (A larger TG) and 2. keeps cost structures lean. Hence, such models could perhaps be more scalable vs a model playing to the spoilt-for-choices elite.

- **Grofers' pivot to inventory-led model – An imperative:** Grofers started off as a hyper-local delivery service provider in 2013. However, soon pivoted to an inventory-led model as
  1. Demand-supply mismatches across the value chain started hindering consumer experience in its previous avatar. Fill rates never exceeded 70-80% (A complete turn off for the shopper) when it was a pure marketplace vs nearly a 100% fill rate now in its inventory-led model.
  2. Industry interactions also suggests that such a move was imperative as in a hyper-local model, squeezing a commission out of Kirana stores having a GM of 7-8% is a herculean task.
  3. Complete inventory control meant better predictive capabilities of demand, seasonality and targets for brands. In other words, the model is better synced to the entire customer lifecycle.

- **Leveraging mom & pop stores:** >80% of Grofers' delivery is done through its 6000+ strong channel partners (Kirana stores, mobile recharge shops, beauty parlors, tailors, etc), whom they pay ~USD0.65 for last mile delivery. The company intends to take this to 100% by end-FY20. Also it intends to increase its channel partner network aggressively in the next 2-3 years.

- **Lean Cost structure:**
  1. Given the stock-up nature of the business, Grofers offers just ~2000 SKUs vs Big Basket's 20,000. (Bigbasket is estimated to offer ~1500 SKUs just for its Express Delivery Service alone) Of Note; Grofer's SKU strategy mimics that of DMART's - Stocking minimal but fast-moving SKUs. Benefits of such a tight SKU policy typically translates into a) operational cost savings which can then be used to sharpen pricing and develop a sticky consumer base, b. Helps in better trade margin negotiations with brands courtesy the higher throughput per SKU.
  2. Better fulfilment cost absorption: As purchase frequency is lower and AoVs (~USD20 for Grofers) are typically higher for stock-up grocers vs their top-up counterparts, absorption of fulfilment costs is easier. Also, superior warehouse automation by virtue of its integrated tech stack has helped Grofers reduce its fulfilment costs significantly vs peers.
  3. Interestingly, benefits of such a structure can already be seen in Grofer's financial performance who has been smartly navigating the low AoV, low Gross margin and high fulfilment cost equation and is expected to hit contribution/EBITDA break-even by FY20/FY21 respectively.
- **Private label strategy:** While private labels account for over a third of Grofers and Bigbasket's revenue, a big chunk of the latter's private labels are in the Fresh Category wherein the margin edge may not be as sharp as on non-fresh. Even if there are some category-specific edges, the sheer dump in Fresh category given the perishable nature of the product increases cost of doing biz. Also, overall cost of operating a Fresh supply chain is significantly higher vs operating an Ambient one and remains unit economics-crushing. On the other hand, Grofers has a bare-bone presence in Fresh. Hence it's edge on its private label portfolio is ~400bp vs 3P national brands and is possibly higher vs peers.
- **Funding Secured!** Recently, Grofers closed its Series F round and secured USD247mn, taking the cumulative Funds raised to USD477mn vs Bigbasket's ~USD1bn. It intends to use most of the proceeds towards 1. adding Fulfillment center capacity (currently 26 warehouses spanning 1.5mn sq. ft) and upping automation 2. brand building.

Grofers' annualized GMV trends (USD mn)



Source: Company, HDFC sec Inst Research

Annexure:

Category	Brand	Quantity	MRP	D Mart	Grofers	Big Basket	Amazon Pantry	Flipkart Supermart	Spencers	Spar	Reliance Fresh	Star Bazaar	Big Bazaar
Grocery	Saffola Active Oil	1 L	135	105	111	115	109	115	127	129	110	134	135
	Fortune Sunlite Refined Sunflower Oil	1 L	125	99	102	101	101	95	105	89	97	106	108
	India Gate Basmati Rice - Feast Rozzana	5 Kg	500	359	358	360	369	403	399	429	359	478	500
	Tur dal - private label	1 kg	149	115	116	116	116	129	145	134	145	148	144
	Branded sugar	1 kg	55	42	46	46	49	1	48	47	46	45	50
	Tomato	1 kg	170	145	140	149			69	40	44	53	32
	Onion	1 kg	50	36	29	37			122	165	145	153	129
	Potato	1 kg	45	26	25	28				26	20	26	26
	Urad dal	1 kg	115	105	78	96	92	85	115	126	99	90	109
	Moog dal (Tata Sampann)	1 kg	155	119	130	125	129	142	155	139.5	137	154	105
	Toor dal (Tata Sampann)	1 kg	149	119	125	119	116	135	145	134	136	148	144
	Chana dal (Tata Sampann)	500 gms	58	52	47	58	47	58	54	52	54.5	55	41
	Aashirwad Select Sharbati Atta	5 kg	285	214	260	259	254	258	248	249	219	274	229
	Tata salt	1 kg	20	17	18	20	18	20	20	20	20	20	20
Packaged Food	Kellogg's Cornflakes - Original	875 gm	310	270	305	315	270	297	310	295	295	308.45	310
	Tropicana Orange Delight Juice	1 L	110	87	90	94		107	89	89	110	109.5	99
	Parle G Biscuits	800 gm	65	58	60	58.5	63.5	65	58.5	65	65	62	60
	Hide and Seek Biscuits	350 gm	100	66	66	88	100	100	85	100	50	80	80
	Britannia Bourbon	**150 gm**	28	21	27	27	27	28	28	28	25		28
	Britannia Treat Jim Jam Cream Biscuits	150 gm	35	27	28	35	27	35	35	35	31	35	35
	Maggi	560 gm	89	71	74	78	73	75	79	89	89	89	89
	Bournvita	1 Kg	400	328	331	379	378	376	370	400	345	398	400
	Maggi Tomato Ketchup	1 Kg	147	135	125	119		140	147	147	145	146	147
	Heinz Tomato Ketchup	900 gm	165	99	115	149			165	165	129	149	
Dairy	Amul Butter	500 gm	225	210	215	214		225	225	225	225	219	225
	Amul Taaza Toned Milk	1 L	62	57	59	59		62	60	62	62	59	59
	Amul Processed Cheese	1 Kg	410	385	400	409		410	410	410	410	398	410
Beverages	Nescafe Jar	100 gm	285	240	252	251	240	258	270	285	285	264	285
	Society Tea	1 Kg	415	355	355	415	394	415	415	415	390.1	380	415
	Brookebond Red Label Tea	1 Kg	430	355	395	410	370	365	380	430	430	428	430

Category	Brand	Quantity	MRP	D Mart	Grofers	Big Basket	Amazon Pantry	Flipkart Supermart	Spencers	Spar	Reliance Fresh	Star Bazaar	Big Bazaar
Home Care	Surf Excel Quick Wash	2 kg	400	370	376	400	399	400	400	380	376	383	400
	Ariel Complete Detergent Powder	2 kg	540	505	468	540	539	540	540	540	540	540	500
	Surf Excel Matic Top Load	1 L	209	184	186	209	186	194	209	209	211.5	208	235
	Ariel Matic Top Load	1 kg	199	187	196	196	188	197	199	199	197	198	160
Personal Care													
Shampoo	Parachute Coconut Hair Oil	550 ml	219	199	198	228	199	199	219	199	200	222	203
	Head and Shoulder Smooth and Silky	675 ml	450	350	347	360	449	450			440	448	420
	Dove Hair Fall Rescue	650 ml	450	225	384	382	449	360	450	410	450	448	450
	Sunsilk Stunning Black Shine	650 ml	365	245	249	250	245	245	242	355	348	257	350
	TRESemme Smooth and Shine	580 ml	375	335	321	319	338	374	375	345	375	373	275
Soap	Cinthol Lime Soap	4x100 gm	112	90	101	107	104	104	112	112	105	111	112
	Lux Fresh Splash	3x150 gm	108	83	105	108	107	108	108	108	105	108	88
	Dettol Soap	4x125 gm	176	156	172	176	149	176	176	166	188	180	176
	Lifebuoy Soap Total 10	5x125 gm	150	125							140	135	94
	Lifebuoy Handwash	750 ml	175	145	134	135	129	140	175	175	175	173	175
	Pears Soap	3x125 gm	164	129	140	144	155	164	144	154	144	167	164
Toothpaste	Closeup Deep Action Red Hot Gel Toothpaste	2x150 gm	144	109	119	115	122	129	144	128	160	139	144
	Pepsodent Expert Protection Gum Care	2x140 gm	174	155	169	173	147	156	174	174	165.44	173	123
	Patanjali Dant Kanti Dental Cream	200 gm	75	75	75	75	75	75	75	75	75	75	75
	Dabur Red Toothpaste	300 gm	145	116	123	127	124	124	133	145	136.3	135	145
	Colgate Swarna Vedshakti	200 gm	92	85	92	92	88	89	92	92	92	92	92
	Colgate Calci-lock	500 gm	184	150	154	154	152	138	184	184	184	183.1	152

Source: Company, HDFC sec Inst Research, As on 6th December 2019

Formats in F&G Retail

Format	Hypermarkets	Supermarkets	Hybrid Markets	Covenience Stores
Key Players	Big Bazaar, Spencer's, D-MART	Spencer's	Q'Mart etc.	Easy Day, Heritage, Nilgiris, M.K. Retail, Ratandeep and other regional players
Average Store size	30,000-60,000 Sq. Ft.	3,000-6,000 Sq. Ft.	20,000-30,000 Sq.	1,500-2,000 Sq.
Category Mix	-F&G: 30-35% Non Food FMCG: 15-20% GM: 10-14% Apparel: 20-25% Furniture & Furnishing: 2-6%	-F&G: 60-65% Non Food FMCG: 20-25% GM: 10-15% Others: 7-10%	-F&G: 45-50% Non Food FMCG:20-25% GM:10-15% Others: 10-25%	F&G: 45-50% Non Food FMCG:20-25% GM:10-15% Others: 10-25%
Differentiating Factors	**Stock-up Retailers** -Emphasis on shopping experience and wide variety of products	**Top-up Retailers** -Situated near a residential area in order to be convenient to consumers -Emphasis on smart efficiencies with shopping experience and relatively low price points	**Stock-up Retailers** -Hybrid between hypermarkets and supermarkets in terms of retail space and category mix	**Top-up Retailers** -Similar to supermarkets but the focus is more on fast moving products with emphasis on neighbourhood requirements -Have low inventory levels as compared to supermarkets

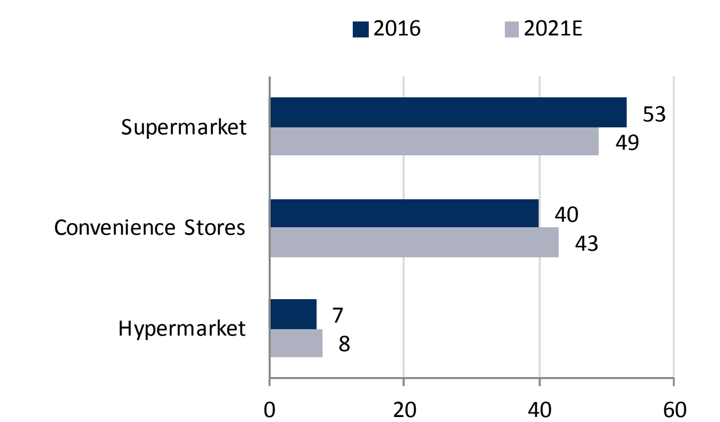
Source: Technopak Report 2017, HDFC sec Inst Research

Category-wise gross margin profile

Category Mix	Gross Margins (%)
Food and Grocery	12-25%
Apparel*	30-50%
Non-Food FMCG*	12-35%
General Merchandise	25-30%
Accessories	20-45%
Furniture & furnishing	30-40%
Footwear*	30-55%
Smart Electronics	7-16%
Others	23-27%

Source: Technopak, HDFC sec Inst Research

Format-wise footprint share (%)



Source: Technopak, HDFC sec Inst Research

Apparels

Trivia: Free Cash Flow (Amazon + Alibaba) ≈ Free Cash flow (~80 international and domestic retailers across categories combined)

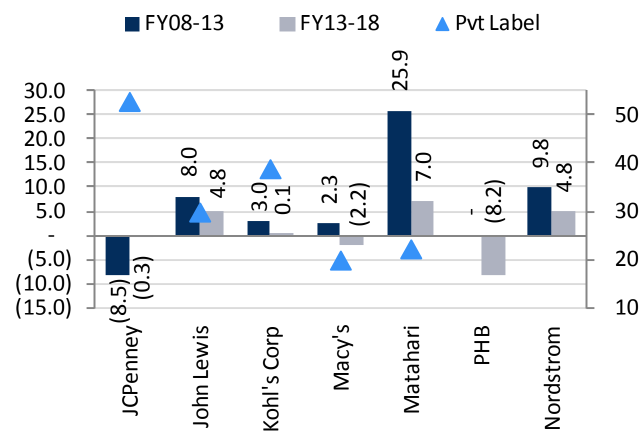
AWS – Amazon Web services – This is a Cloud service offered by Amazon. It accounts for 11% of revenue and 55% of EBITDA

Department stores: Most vulnerable to online migration

- **Globally, no multi-brand department store (ex-Matahari) has managed to clock an inflation-beating SSSG after the two online global giants (Amazon and Alibaba) went full-throttle on their apparel business over the past decade.**
- **Footfall cuts + Increasing cost of doing business have eroded margins by 1-10pp in margins over CY13-18.**
- **While Indian department stores may not be there yet, we reckon they too, will go through the same five stages of online grief just as their global peers did. In fact, market share loss for some may be even swifter given 1. Sub-optimal scale of biz, 2. Lower sales velocity 3. higher opex structure (5-10 ppt higher- courtesy higher rents) in India vs global peers, 4. Payables crutch.**
- **Within this cohort, we prefer companies 1. Better placed in the Rs. 150-300k PCI districts 2. Moving towards the bottom of the pyramid in terms of income profiles via Off-price (Future Lifestyle) or value fashion (Lifestyle International) offerings, 3. With leaner cost structures**

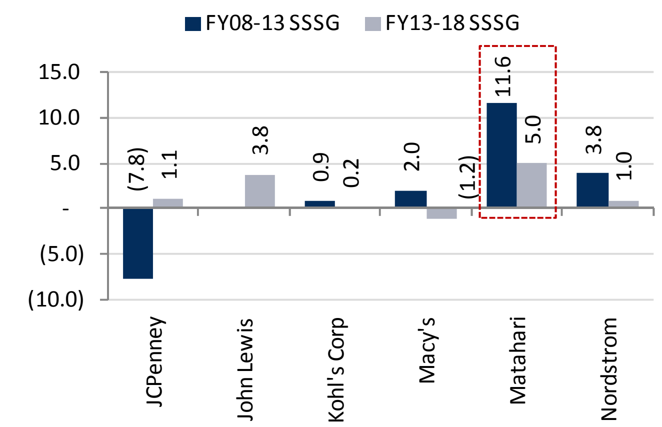
- **Globally, Department stores going through five stages of Online grief:** Globally, no multi-brand department store (ex-Matahari) has managed to clock an inflation-beating SSSG after the two online global giants (Amazon and Alibaba) went full-throttle on their apparel business (FY08-18). Amazon's ability to subsidize retail offerings materially improved over FY08-18 (CFO up 18x, courtesy Amazon Web services' success). Note: Amazon extended its offering to Apparel by CY02 & CY08 in US and UK respectively.

Revenue CAGR of key international Dept. Stores



Source: Company, HDFC sec Inst Research

...Ex-Matahari, no department stores has clocked inflation-beating SSSG



Source: Company, HDFC sec Inst Research

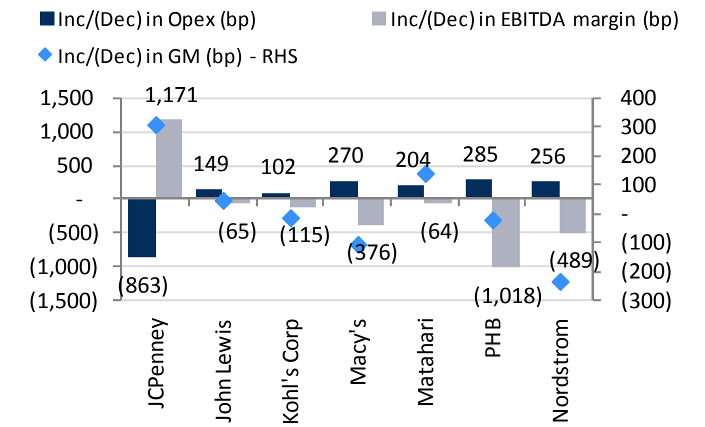
Our read through across global department stores (JCP, John Lewis, Kohl's, Macy's, PHB, Nordstrom) validate that increase in fulfillment costs have significantly increased cost of doing biz.

...Cos of retailing has inched up for online folks too. Its just that margin-heavy cloud services have helped cushion overall margins

Amazon's (Global) ability to subsidize retail offerings materially improved over CY13-18 courtesy AWS's success, hence despite increasing fulfilment costs & burgeoning losses in its international biz, overall EBIT margins have expanded

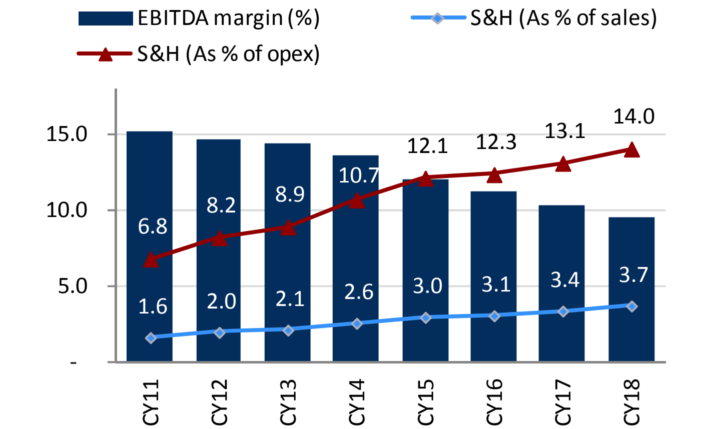
- The double whammy of 1. sagging SSSG, footfall cuts and 2. Increasing cost of doing business (given rising omni-channel investments) have cost most global department stores 1-10pp in margins over CY13-18. Even the best have hit pause (Case study on Matahari).

Margins contracting as cost of doing biz going up given the omni-channel imperative (CY13-18)



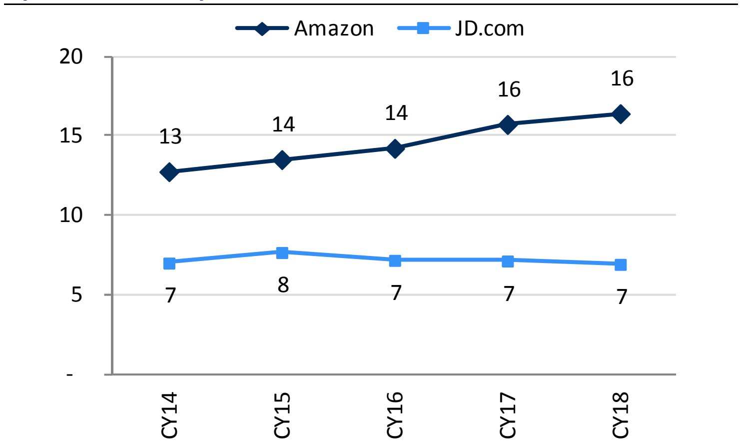
Source: Company, HDFC sec Inst Research

...Exhibit A: Nordstrom's Shipping & Handling (S&H) costs have increased over the years



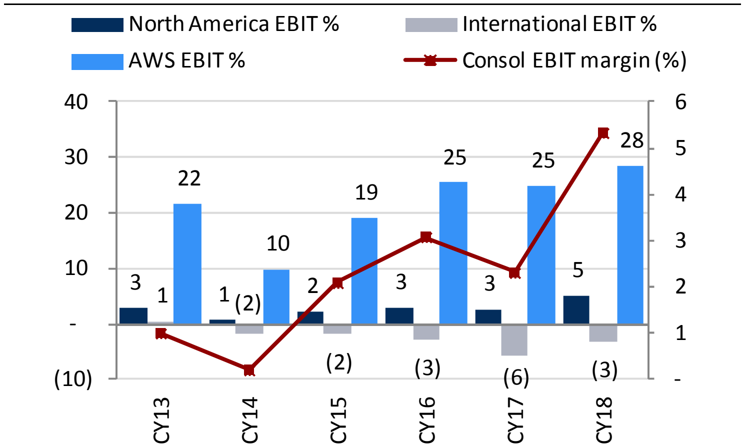
Source: Company, HDFC sec Inst Research
S&H – Shipping & Handling

Globally, Amazon's fulfillment cost inching up too (As % of sales)



Source: Company, HDFC sec Inst Research

Amazon: Segment-wise EBIT margin (%)

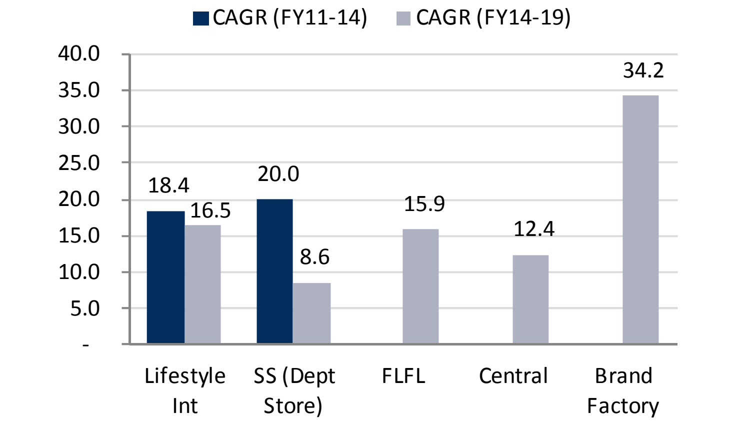


Source: Company, HDFC sec Inst Research

On Multiple crutches that could fall off!

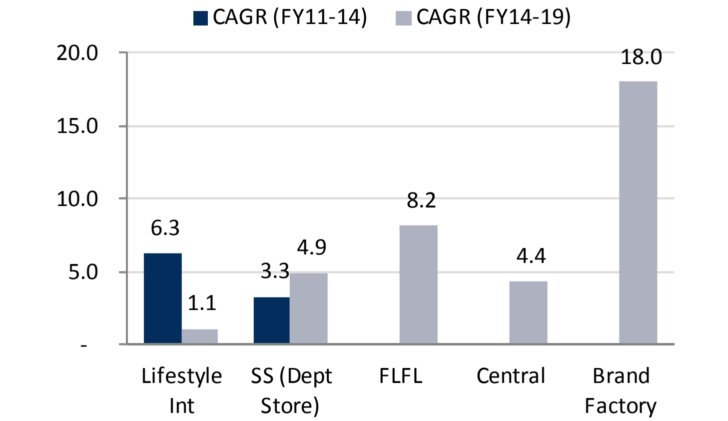
- **India's multi-brand format worked like a dream over a decade!** India's Multi-brand department stores selling 3rd Party brands thrived over a better part of the past two decades (esp. Pre-FY14) as 1. Fragmented nature of the apparel market, 2. Lack of expertise in differentiating private labels and 3. Rising consumer aspirations kept demand for national/international brands high relative to indigenous private labels. The absence of a meaningful alternate/online platform a decade back certainly helped. However, this format is *most susceptible to "death by online" as brand loyalty resides with brands and not platform/retailers. To add insult to injury, e-tailers have been aggressively recruiting customers in apparel over the last 5-6 years. Case in point –Flipkart-owned fashion e-tailer – Myntra has scaled up significantly (>80x in revenue) over FY12-19. On the other hand, stance on expansion across key apparel department players remains dovish.*

Revenue CAGR of key Indian Deparment Stores



Source: Company, HDFC sec Inst Research, Central/BF CAGR (FY15-19)

Revenue per sq. ft CAGR for key Indian Dept. Stores



Source: Company, HDFC sec Inst Research, Central/BF CAGR (FY15-19)

Domestic dept. stores' sales velocity materially lags global peers despite higher population density in Indian Metros/Tier 1 cities (predominant presence) vs Global metros

Despite higher GM; EBITDA margins are similar-to-lower vs global peer courtesy higher rentals. Hence, a payables crutch is needed to ensure capital needs are met through current scale of profitability and to recover cost of capital.

As highlighted earlier, scale and balance sheet strength of Indian department stores don't allow increase in working capital risk. Hence, bulk of the inventory is purchased on Sale or Return (SoR) basis vs outright purchases (global model)

This makes the former more vulnerable to online disruption as Amazon/ Flipkart can leverage their proverbial "infinite balance sheet" to offer better terms of trade as a hook to woo brands to list on their platforms

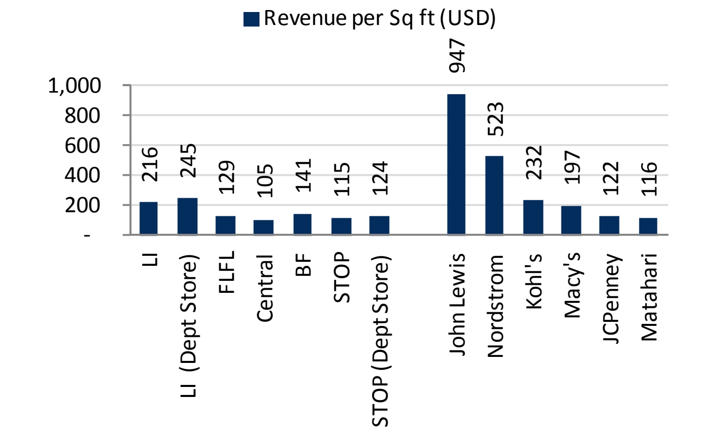
Higher Outright purchases may translate into better trade margins for the online folks which can then be used for sharper pricing. Inventory control also increases with outright purchases

- **Sales velocity lags global peers, financials on multiple crutches:** Even post 20 years of existence, multi-brand department stores significantly lag their global peers in sales velocity (Ex-Lifestyle Int). **Sales velocity needs to be ~20-25% higher from current levels; if one has to make a reasonable spread over their cost of capital.** Current cost structure & balance sheets too have multiple crutches that could fall off; hence the shift from department stores to online could be swifter than what has been witnessed globally.

- **#Crutch 1: High Margins is Online's opportunity:** Domestic department stores have a higher gross margin (GM) profile (5-10 pp) but similar-to-lower EBITDA margins vis-a-vis their global peers. The higher GMs is primarily to mitigate the higher lease rental costs (7-11% of sales vs vs 1-2% for US peers; 7-9% for Matahari/PHB); Note: Indian department stores lease retail space vs 45-55% owned spaces by global peers). The former's **higher gross margin and high opex structure presents an opportunity for e-tailers to exploit,** especially in the light of decreasing fulfilment costs in India (10-16% in FY18).

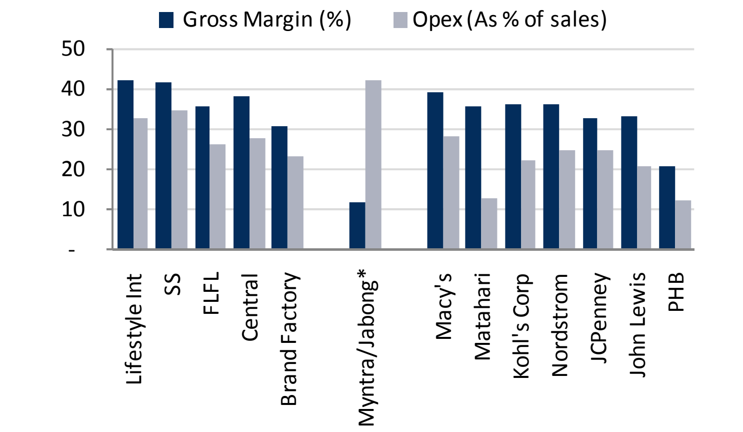
- **#Crutch 2: Payables' crutch:** Heavier reliance on suppliers' credit vs. global peers and other apparel formats. Key fashion e-tailers are increasingly exploiting this crutch by doling out better terms of trade to woo brands on their platforms. **Inkling of this can be seen in Myntra's FY19 financials.** **(Refer to Myntra's FY19 performance).**

Sales velocity materially lags global peers



Source: Company, HDFC sec Inst Research

Crutch 1: Higher gross margins & cost structure makes pure-play multi-brand retailers more vulnerable to online intrusion



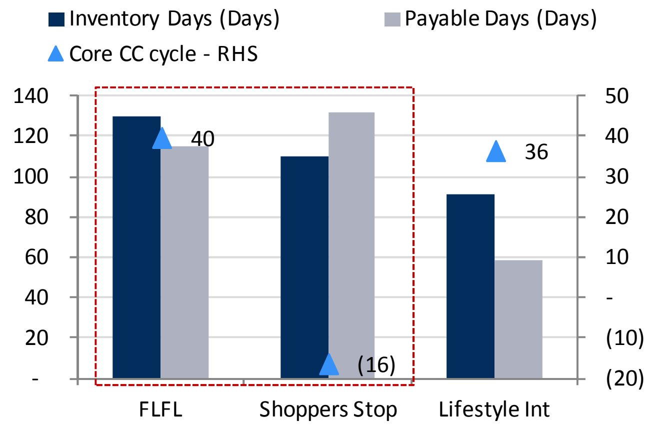
Source: Company, HDFC sec Inst Research

Private labels typically have higher 500-700bp higher gross margins and lend better control on inventory

Note: A sizeable chunk of Lifestyle International's A&P spends may be assigned to Max Fashion – Its value fashion offering. Even if one assumes a 50:50 A&P split across both formats – LI and Max Fashion, the company still spends more than peers

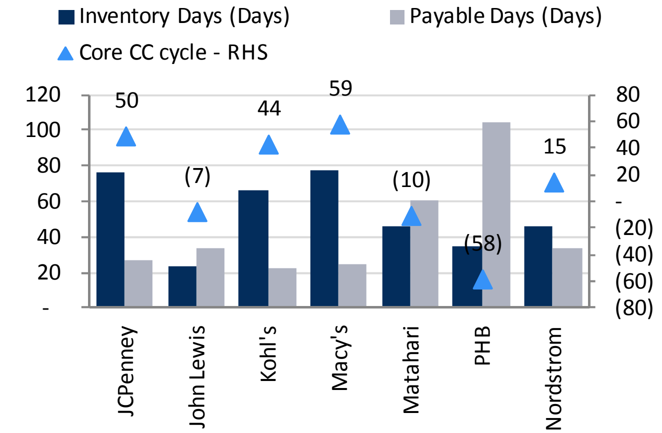
Apart from better store density, real estate choices, and assortment; Lifestyle's strong private label portfolio also helps in productivity, hence it enjoys superior profitability and return profile vs peers

Crutch 2: Payables' support could be exploited by e-tailers too



Source: Company, HDFC sec Inst Research

Cash conversion cycle of global department stores



Source: Company, HDFC sec Inst Research

- **Lack of control on inventory – Big Negative:** Department stores piggyback on national brands for footfalls; ergo do not offer differentiation in offerings. Legacy brands themselves are increasingly facing stiff competition from fast fashion retailers ***(Refer Fast Fashion Section)*** and may have to shift SKU/pricing strategies contingent to the changing ecosystem. This in turn makes department stores' margins and inventory management more vulnerable to deterioration/volatility.

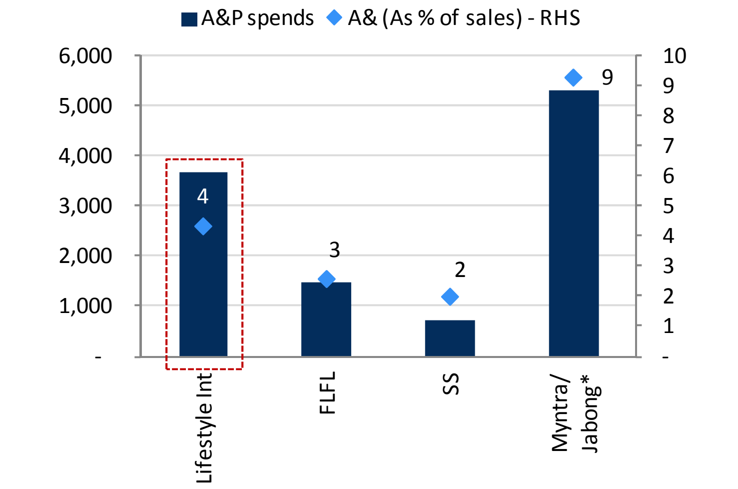
- **Is private label an antidote?** Typically, the awareness and acceptance of private labels improve with (1) higher penetration of modern trade, (2) a relatively concentrated retail market, (3) category-specific factors and (4) positioning versus the target consumer group. While apparel market remains fragmented, share of organised play has nearly doubled over a decade (~26% now). Hence, the relevance of strong private labels is on the rise. Private labels typically have higher 500-700bp higher gross margins and lend better control on inventory. Hence, while strong private labels could certainly be an antidote to a footfall exodus, establishing them is a long-drawn affair. Also, current financial position of a few 3P-selling department stores doesn't permit meaningful/sustained A&P investments in establishing strong private labels. Sure, STOP's and Lifestyle International's respective tie-ups with Amazon/Flipkart could help spur their private label demand, we remain sceptical on the margin edge given the imbalance of negotiating power (in favour of online platforms). Also, they are pitted against a larger universe of brands and private labels online.

- Pure-play private label retailers **(Westside, M&S)** given their distinct positioning in women's apparel, sharper price points and faster go-to-market template, 2. Off-price retailers **(Brand Factory)** and department stores with a differentiated private label strategy **(Lifestyle Int)** have outperformed pure-play 3rd party brand sellers **(Shoppers Stop)** over the last 4-5 years. **Lifestyle's sales velocity is estimated to be 1.5-2x of peers (SS, Central, Westside).**

- Of note, globally too, department stores are focusing on upping their private label quotient to stem the footfall exodus from malls with varied success though.

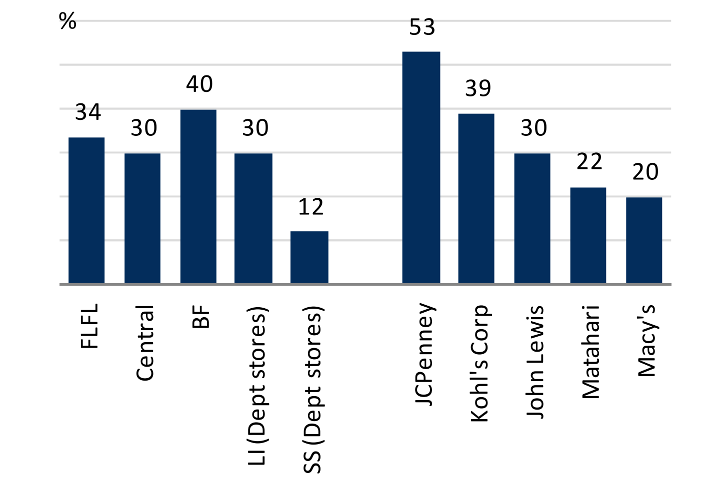
PCI – Per Capital Income

Lifestyle Int's higher A&P spends…



Source: Company, HDFC sec Inst Research

…partly explains consistent traction in its private labels



Source: Company, HDFC sec Inst Research

Location is Key

- **Location! Location! Location!** Avg. store size of Indian department stores are smaller primarily to match per capita income profile and population density of catchments. Only 50/260mn households (HDFC Sec est) with per capita income (PCI) of Rs.150k+ reside in districts with reasonable population density, ergo, location becomes key to store economics of retailers. Especially for lifestyle brands who sell 3rd party brands. (ASP: ~Rs.1200).

- **PCI ranging Rs. 150-300k – A sweet spot:** Industry interactions across multi-brand retailers suggest that **districts with Rs. 150-300k PCI and a population density of >300/sq. km is a sweet spot for productivity increase** today as affinity to spend time in malls/offline is relatively high for this cohort. The same reduces with increasing PCI beyond a point**.** Lifestyle is a clear winner here, followed by Central; STOP lags behind. Edge on this parameter also partly explain Lifestyle Int's industry leading productivity. The breadth of coverage is also higher for Lifestyle Int vs peers in the Rs. 150-300k PCI range. Higher focus of Brand Factory (BF) in the Rs. 150-200k PCI range is because of its off-price value proposition.

Department store mapped on PCI and population density

PCI/Store Distribution (%)	Population (mn)	District (#)	Lifestyle (%)	Districts (#)	Shoppers Stop (%)	Districts (#)	Central (%)	Districts (#)	Brand Factory (%)	Districts (#)	Planet Fashion (%)	Districts (#)
<100K	371	130	7.0	4	2.5	1	2.9	1	3.8	3	18.9	33
100-150K	141	54	11.3	7	11.1	7	5.7	2	8.8	7	19.3	24
150-200K	107	40	21.1	10	19.8	10	11.4	3	25.0	10	19.7	29
200-250K	68	25	11.3	7	2.5	2	8.6	3	6.3	4	13.3	18
250-300K	27	5	11.3	3	6.2	2	25.7	3	7.5	1	9.9	5
300-500K	38	8	26.8	4	35.8	4	34.3	4	43.8	4	12.0	7
500K+	20	3	11.3	3	22.2	3	11.4	3	5.0	1	6.9	2
`	**771**	**265**	**100**	**38**	**100**	**29**	**100**	**19**	**100**	**30**	**100**	**118**

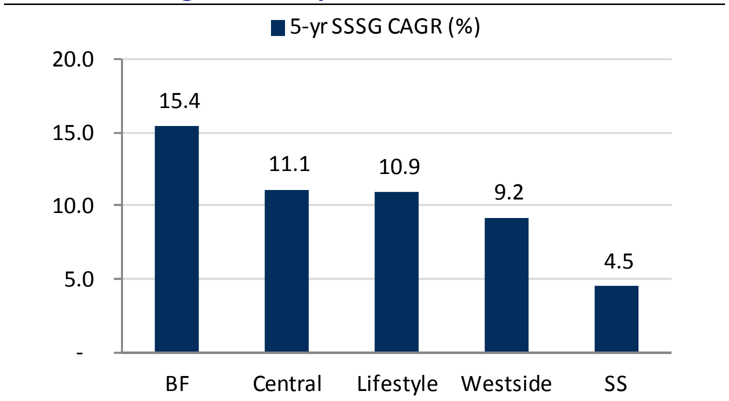
Source: Company, HDFC sec Inst Research, #Data restricted to Top 17 states accounting for over 85-90% of retail spends (FY19)

Healthy store age profile...

Brand/Format	Age <1 yr (%)	Age 1-2 yr (%)	Age >2 yrs (%)
Central	13.6	18.2	68.2
Brand Factory	32.3	11.8	55.9
Lifestyle Int	10.4	14.3	75.3
Westside	16.7	12.0	71.3
Shoppers Stop	-	3.6	96.4

Source: Company, HDFC sec Inst Research

...has bearing on SSSG performance too



Source: Company, HDFC sec Inst Research, Central/BF 3 yr CAGR

RPSF – Revenue per sq. ft

GMRoF – Gross profit per sq. ft

SoR – Sales or Return – A trading model

BF – Brand Factory

Prefer outfits moving towards bottom of the pyramid

Within this cohort, we prefer companies with a second offering positioned towards consumers with lower income profile such as 1. Off-price retailing, 2. Value Fashion as it offers a larger addressable market.

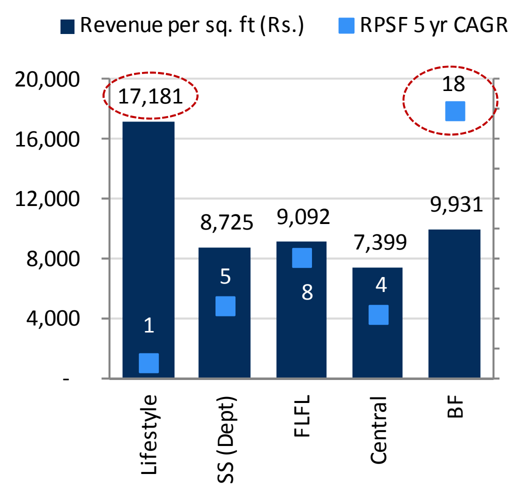
A) Off-price retailing

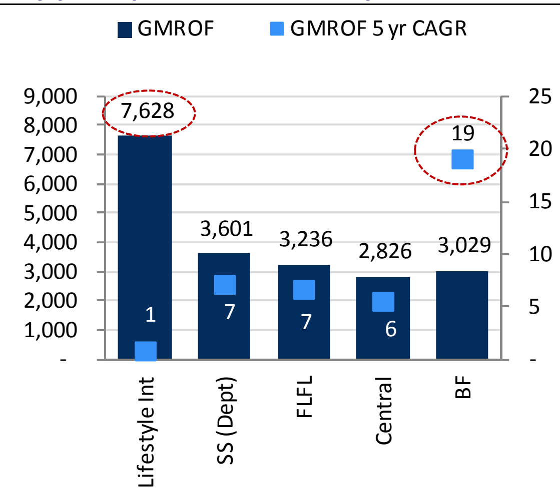
- Off-price formats such as Brand Factory (sell 3P brands at a significant discount of ~20-70%) are perfectly placed to capture the apparel needs of a burgeoning target audience (TG: 170mn) with its “aspiration-meets-affordability” proposition. This can be seen in BF’s expansion strategy too. Over 25% of its stores are placed in districts with PCI between Rs. 150-200k (Considered a sweet spot for Off Price Retailing per industry interactions). While still sub-scale, BF has clocked the highest improvement in productivity/profitability within its peer set.

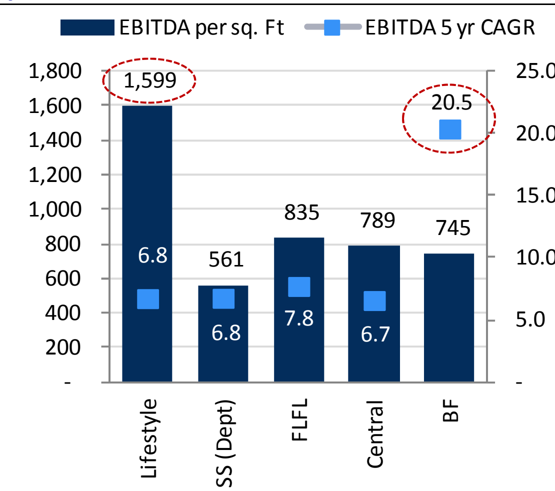
...Sales velocity - a third of global peers, GMs are similar, OPMs are lower by 7-10pp given higher lease rentals in India. Lower sales density and margins coupled with more demanding WC cycle explains the differential in return profile of Brand Factory (BF) and its global peers. (Note: Fixed asset turnover is similar for BF and its global peers). Hence, in the long-run as BF scales given its more pervasive offering vs pure-play department stores, its ability to absorb rentals and other fixed overheads is expected to improve and boost profitability.

__Note:__ Given the scale, global off-price retailers typically buy merchandise outright in order to squeeze in more margins (Currently, 60% of BF’s inventory is purchased on Sales or return (SoR) basis – A trading model with lower margins). Consequently, as BF gains scale and moves further along the learning curve in merchandise buying, it’s ability to purchase inventory outright will increase; ergo tighter WC control and better margins. Note: BF intends to add 25 stores/year over the next 3-5 years.

Lifestyle leads the pack in productivity and profitability per sq. ft; Brand Factory remains the most improved format



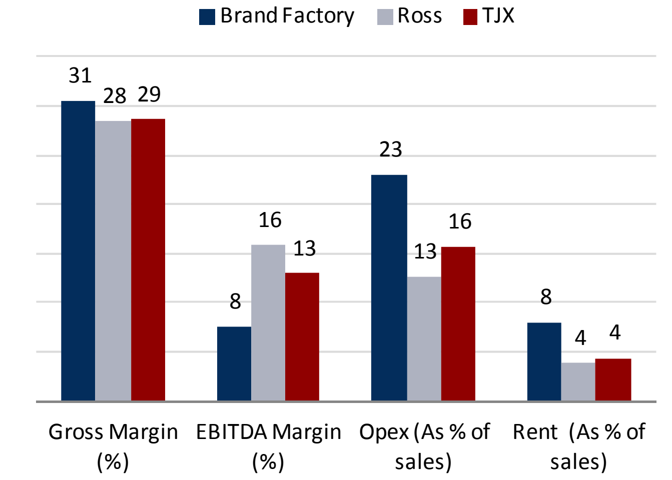




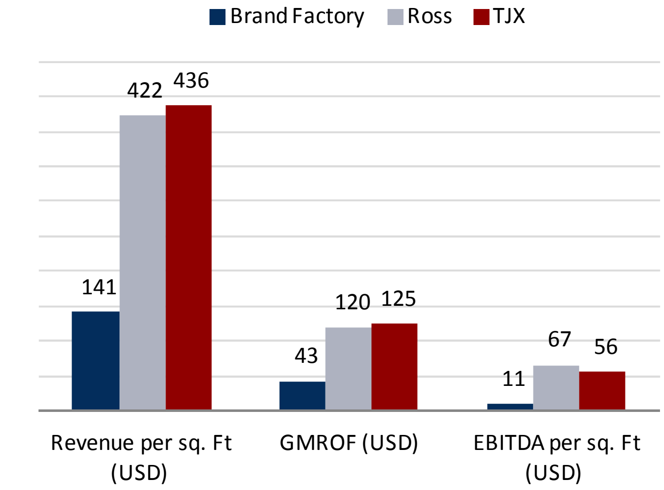
Source: Company, HDFC sec Inst Research

Off-price Retail: Brand Factory vs Global retailers

Brand Factory vs. Global peers: Differential in sales velocity and cost structure…

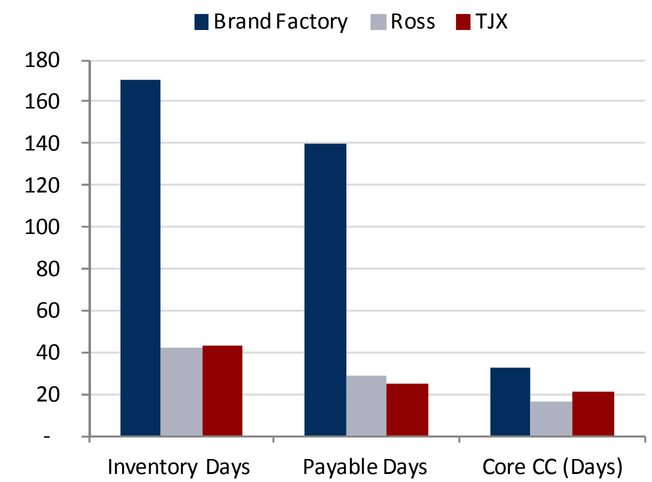


Source: Company, HDFC sec Inst Research



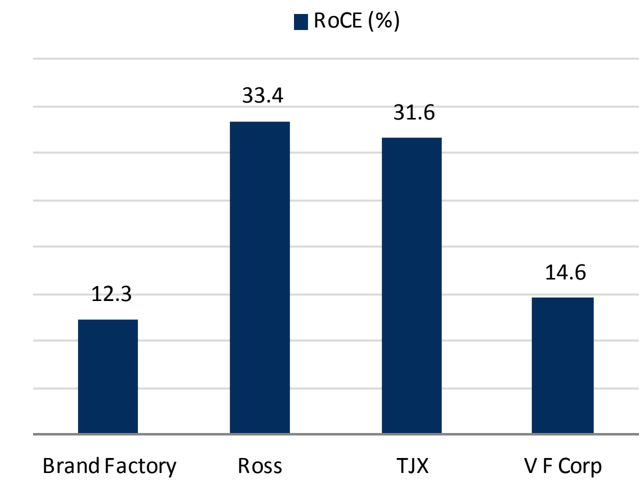
Source: Company, HDFC sec Inst Research

…and cash conversion cycle…



Source: Company, HDFC sec Inst Research

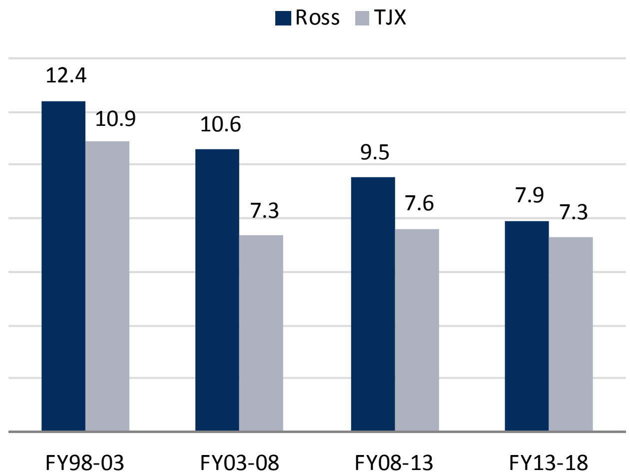
…explains the differential in return profile



Source: Company, HDFC sec Inst Research

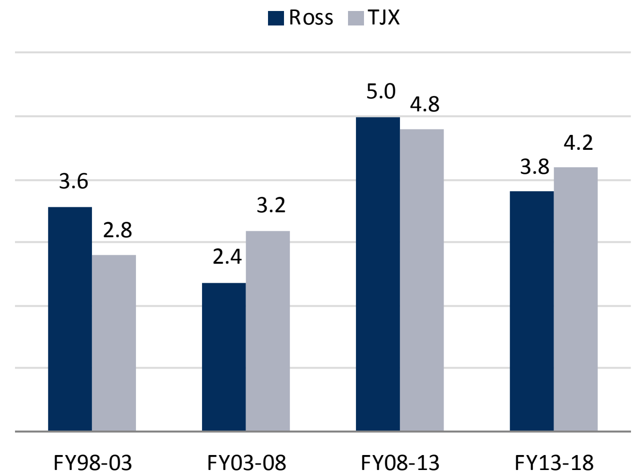
Globally too (US), one of the few apparel formats unfazed by the online steam-roll has been off-price retailing.

Revenue CAGR of global off-price retailers over 5 year blocks (%)



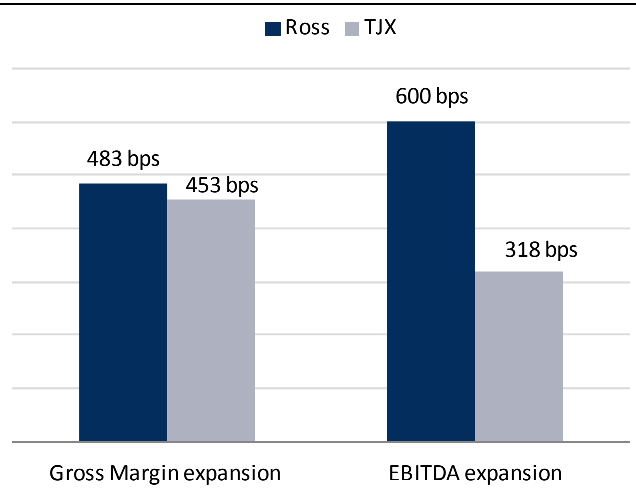
Source: Company, HDFC sec Inst Research

Only format with consistent inflation-beating SSSG (%)



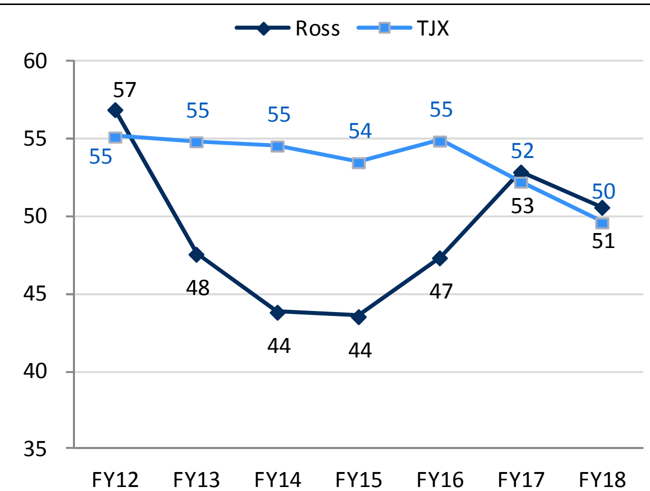
Source: Company, HDFC sec Inst Research

Global off-price retailers' margin improved over CY08-18; when Amazon went full throttle on Apparel



Source: Company, HDFC sec Inst Research

Healthiest RoIC profile across formats (%)



Source: Company, HDFC sec Inst Research

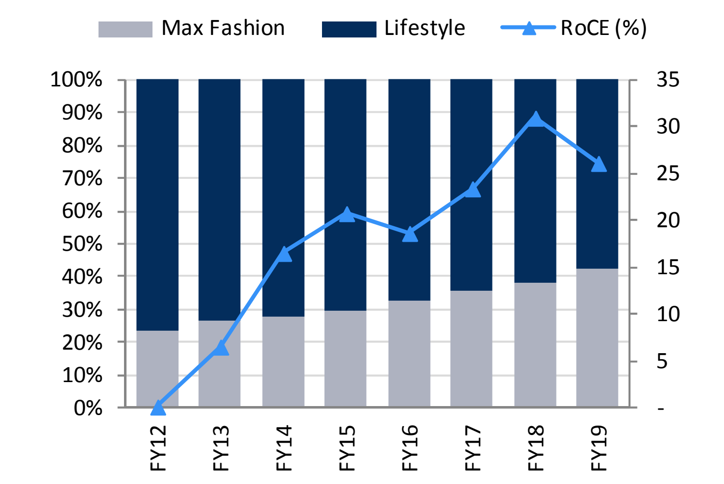
Suspect mix change and more anchor contracts have led to rental savings declining rental costs for Lifestyle. FLFL too has seen a decline in rent bills, Shoppers stop on the contrary has seen a rise in rent bills

B) Value Fashion:

- **Lifestyle's pivot to Max Fashion – A master-stroke:** Given the disruptive headwinds for a pure-play 3P department store; pivoting to the most successful format of the past decade – value fashion (VF) is an obvious choice – as the consumption needs in tier 2 and beyond presents the largest addressable opportunity in apparel retailing in India. (Population of 662mn in ~270 districts). Lifestyle Int (LI) has been one of the pioneers in Value Fashion (VF) and successfully pivoted to VF via Max in FY06. **The latter has nearly doubled its contribution to LI's top-line to over 42% over the last 7-8 years). This shift coincides with an improving return profile as Max is RoCE-accretive.**

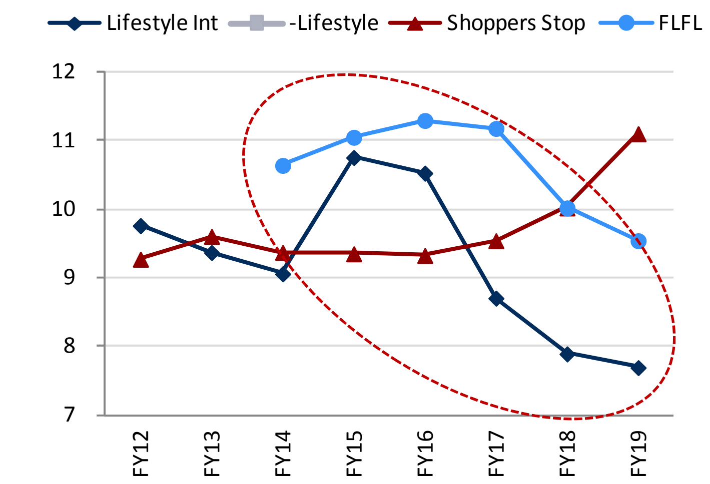
- **Leaner cost structures help:**
  - On-ground channel checks indicate that A. Lifestyle international is increasingly bunching up all its formats (Lifestyle deparment store, Max, Easybuy and Spar) as a bouquet to offer malls. This makes the outfit even more compelling from mall-owners' perspective as this guarantees footfalls and in turn helps lifestyle get better lease rental rates (Given it's anchor tenant status). 2. LI's focus on tapping non-mall catchments in tier 2/tier 3 towns for Max and Easybuy has also helped it cut down on its rental bills since FY15.
  - Increasing BF skew has helped FLFL cut down rental bills too.
  - Note: online fulfilment costs in India for major online retailers hovers ~10-16% and coming down. Hence, leaner outfits become better equipped to take on price-led wars, if any.

Mix change to Max Fashion has aided Lifestyle's return profile (%)



Source: Company, HDFC sec Inst Research

Lifestyle Int/FLFL smartly cutting rent bills (Rent as % of sales)



Source: Company, HDFC sec Inst Research

Even the best hit pause

Case Study: Matahari – Departmental Store (Indonesia)

Matahari is a leading department store in Indonesia whose business format mirrors that of Shoppers Stop and Lifestyle (Dept Store) in India. It has a network of 160 stores (As on CY18) with an average store size of ~69,000 sq. ft. Matahari opened its first store in 1972 and is part of the Lippo group (the largest mall owners in Indonesia). It is positioned as a bridge-to-premium store with a market share of 42% among department stores as on 2018 (vs ~26% in 2013) and focuses on third-party reputed brands (Polo, Clinique, Revlon, Fladeo, Levi's, Cardinal, etc.). Private labels contribute ~31% of total sales. In merchandising, Matahari remains working capital-light as it stocks most inventory on consignment (~63% of sales) rather than purchasing it directly (c.37% of sales). However, Direct purchase (DP) sales have only gained more prominence in the mix over the past decade with scale. While DP sales increases inventory risk, it also gives a retailer far more latitude in making merchandising, pricing and go-to-market strategies in sync with consumer trends unlike 3P brand sellers.

Geographical presence: Apart from its presence in the Jakarta region (high competition from several international department store operators), it has a strong network in non-Jakarta Java regions as well as non-Java islands. Nearly 40% of Matahari's stores are outside Java, where it faces minimal competition.

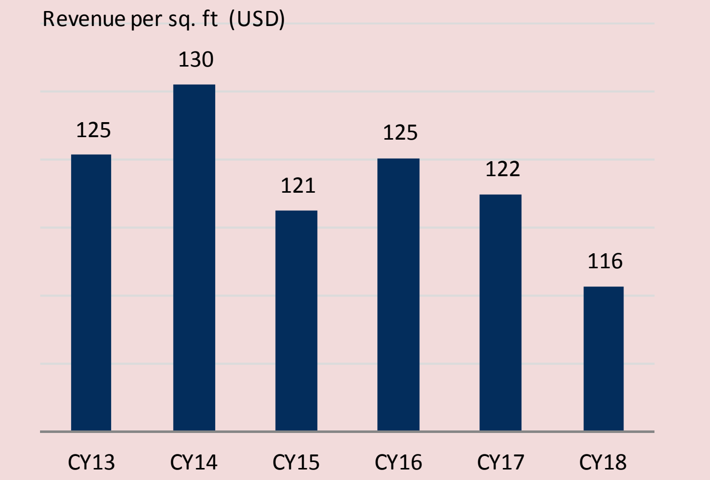
Intermediation cost far lower: Despite Matahari's lower gross margin of ~36% (SS, Central and LI have GMs of ~38-44%); superior cost structure results in a significantly higher EBITDA margin of 15% (SS & LI: 6-10%). RoCEs too are far superior at ~69% due to higher margins and better sweating of assets. Given that the cost of intermediation is significantly lower for Matahari vs Indian peers, the threat from e-tailers tapping inefficiencies are also lower. Reliance on payables is also far lower vs it's Indian peers (60 days vs ~100-130 days for Indian department stores). Despite this, growth/footfalls have hit pause even for an efficient operator like Matahari over the past 2-3 years as consumers increasingly migrate online.

While Matahari (~5mn monthly visits) has also gone omni-channel, success remains elusive as online players like Tokopedia (149mn), Shopee Indonesia (~95mn), Bukalapak (95mn), Lazada Indonesia (47.8mn) and others consistently gain share. Note: The Topography of Indonesia also helps online players as ~65% of Indonesia's 268mn+ population resides in the Java region. This population concentration helps online players reduce fulfilment/delivery costs.

De-rating cycle has been painful: As growth moderated and productivity inched downwards, Matahari's de-rating cycle has been painful since it's peak in Dec-14. The retailer has seen its valuations cut to a third from its peak of 31x trailing P/E/19x trailing EV/EBITDA in Dec-14 to 10x/5.6x trailing P/E and EV/EBITDA resp. by Dec-18.

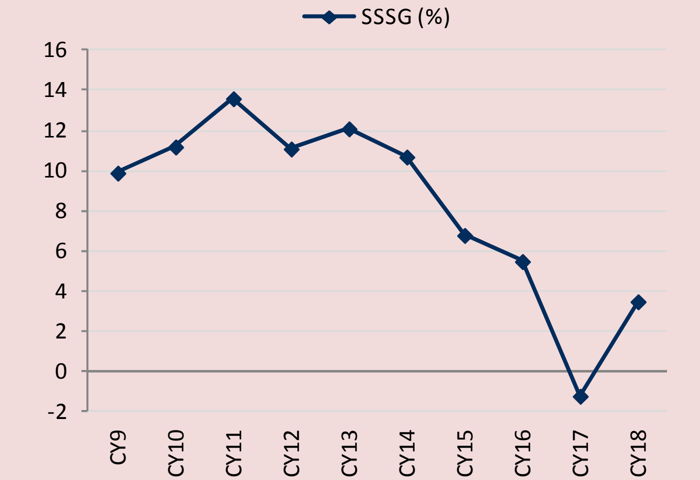
We don't see why the fate of department stores in India don't follow the global playbook. If anything the shift in favour of online could be even swifter for some given high intermediation costs.

Revenue per sq. ft plateuing



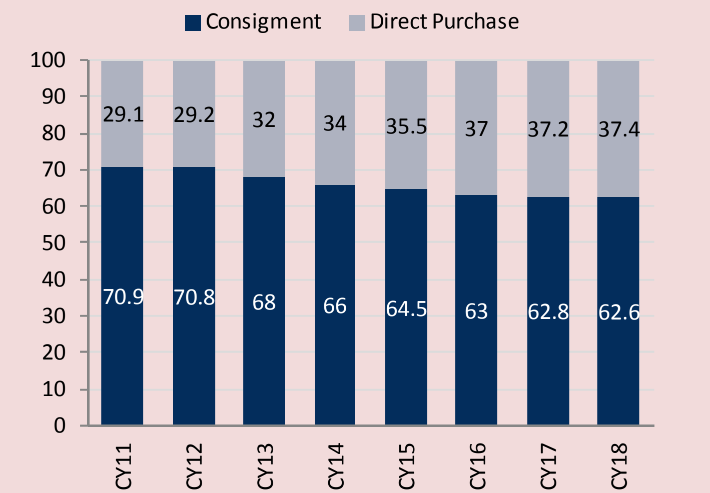
Source: Company, HDFC sec Inst Research

SSSG – A falling knife



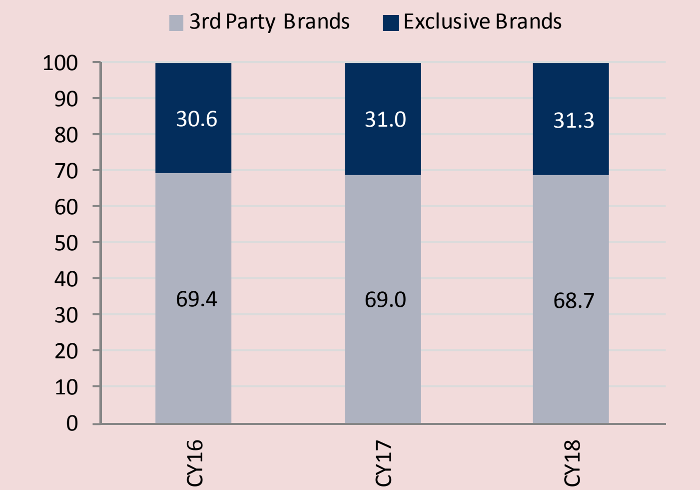
Source: Company, HDFC sec Inst Research

DP Sales inching up



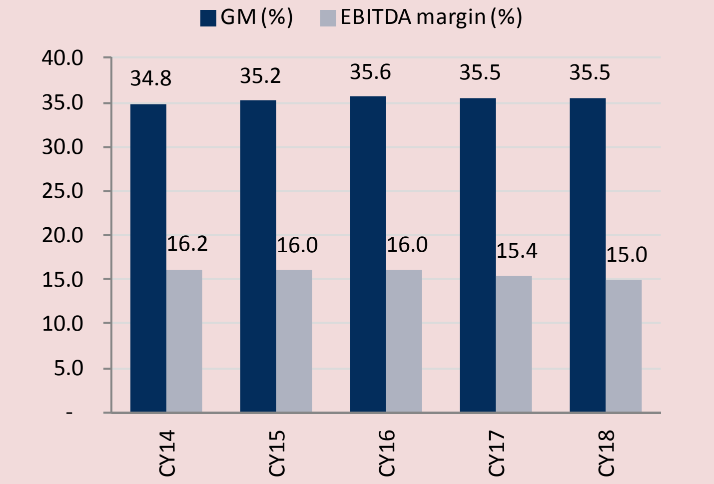
Source: Company, HDFC sec Inst Research

…so is the focus on exclusive brands



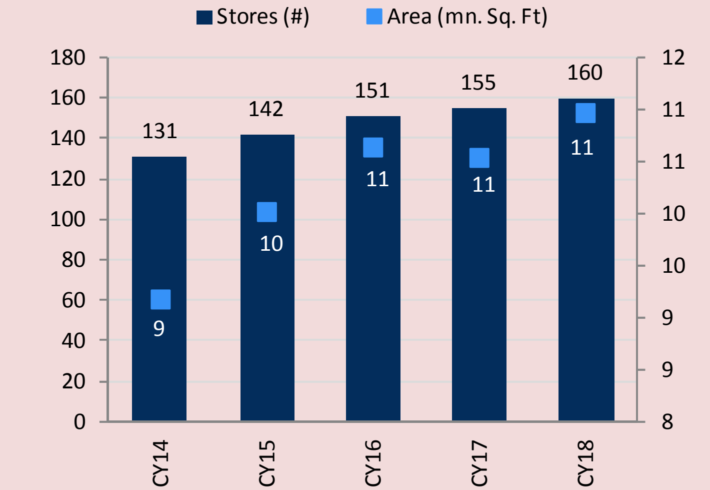
Source: Company, HDFC sec Inst Research

Margin Profile (%)



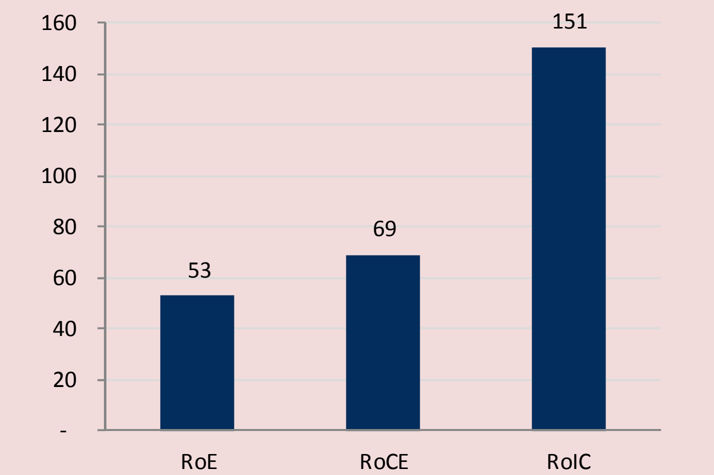
Source: Company, HDFC sec Inst Research

Incrementally, space addition remains lack-lustre



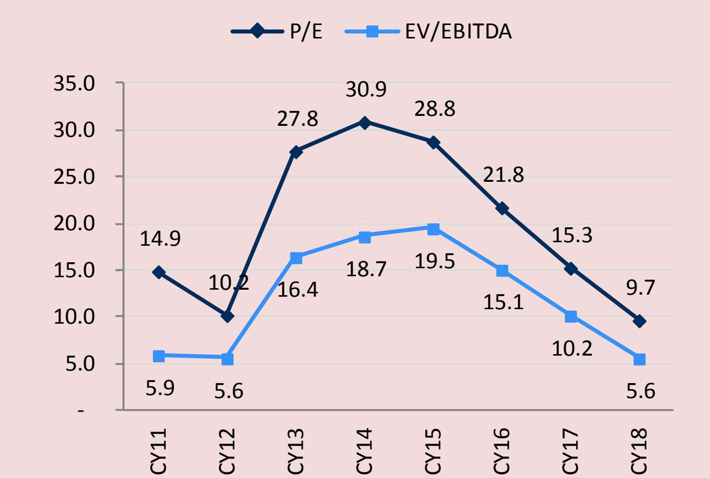
Source: Company, HDFC sec Inst Research

Return Profile (%)



Source: Company, HDFC sec Inst Research

Valuations – A third of its peak



Source: Company, HDFC sec Inst Research

Top Global fast fashion retailers – Inditex (Zara, others), H&M, Fast Retailing (Uniqlo), Primark

Top Global Brands – GAP, PVH, L Brands, Ralph Lauren

We juxtapose Westside and Marks and Spencer with fast fashion peers as their supply chain increasingly mimics that of fast fashion.

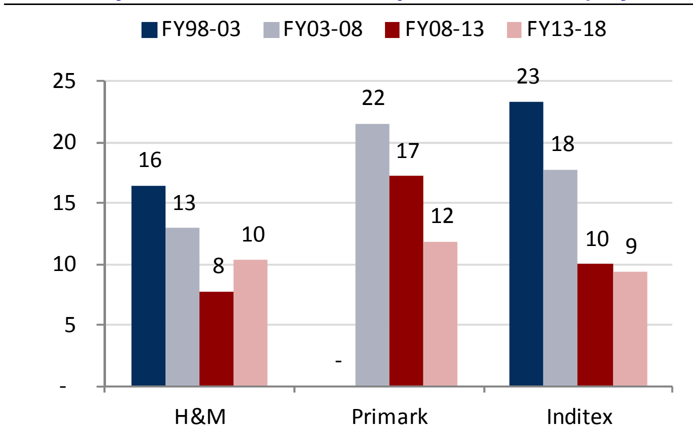
Private labels mimicking fast fashion - First Among Equals

- **Globally, over the past two decades, Fast fashion (FF) retailers have outpaced legacy brands as shoppers increasingly prefer a frequent wardrobe refresh with trendier fashion at a cheaper price tag. Fast fashion (FF) is still at a nascent stage in India key retailers Zara and H&M account for ~Rs. 33bn.**
- **When juxtaposed with department stores, FF and private labels sport a more sustainable model given 1. Control on merchandise, 2. Faster-go-to-market template, 3. Better perceived value for consumers**
- **However, given that the Global FF price hook remains missing in India (priced competitively vs legacy brands); strong private label brands (priced sharper) with a fast fashion DNA are better placed to milk the broader market and in our view, are first among equals.**
- **Westside aces both - assortment pricing (Per analysis on 1,50,000+ SKUs across categories) as well as distribution. It's a perfect cross between Fast and Value Fashion.**
- **Peers have been flooring the pedal on expansion; playing catch-up with poster boy Zara on productivity. Interestingly, the aggression doesn't come at the cost of store economics**

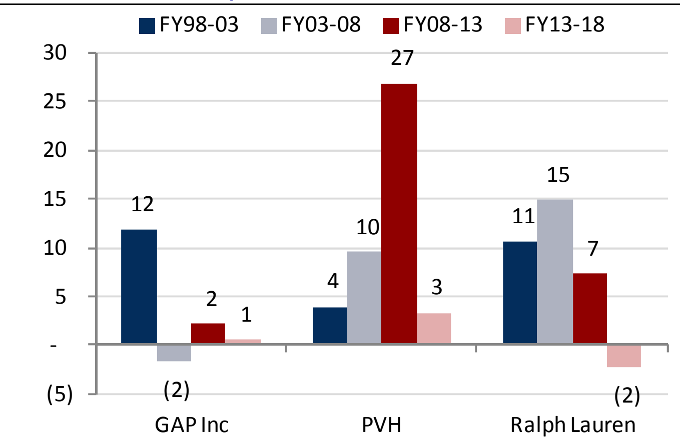
The global precedent

- **Globally, fast fashion has trumped legacy brands:** Globally, over the past two decades, fast fashion retailers have ruled the roost, while legacy brands lost favor. Top fast fashion retailers grew at 12% CAGR over CY05-18, vs top brands' 3% CAGR as shoppers increasingly preferred a frequent wardrobe refresh with trendier fashion at a cheaper price tag. In India, given the general under-penetration, growth story in brands will continue, albeit not apace with their fast fashion/private label peers as a big chunk of their revenue (25-40%) comes from department stores – a slowing format.

Globally fast fashion has outpaced brands (5-year blocks - Revenue CAGR, %)



Source: Company, HDFC sec Inst Research



Source: Company, HDFC sec Inst Research, Note: #PVH acquired Tommy Hilfiger and Warnaco in CY13 & CY18. Hence, CAGR not meaningful

**Brands include: ABFRL's Madura segment, Arvind Fashion's brand segment, Blackberrys, Raymond, Monte Carlo, Cobb Apparel, Kewal Kiran, SSIPL. (Cumm. Revenue ~Rs.165bn)*

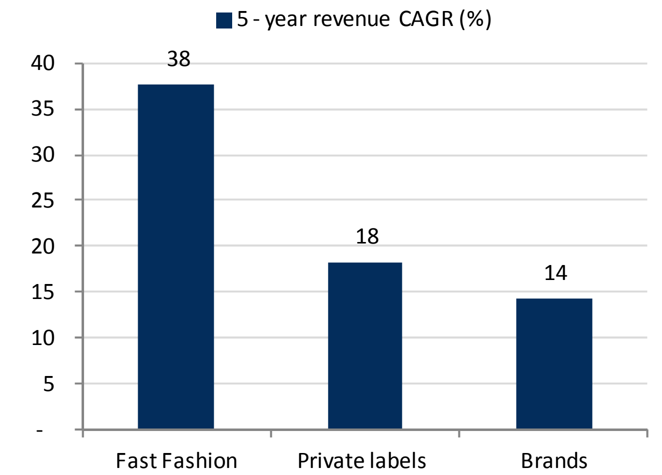
Fast Fashion includes Zara, H&M, Splash, ABFRL's Fast Fashion segment (Cumm. Revenue: ~33bn)

Private labels include only Westside and M&S as their supply chain increasingly mimics that of fast fashion (Cumm. Revenue: Rs. 33bn)

Note: While department stores like Reliance Trends, Central have shown healthy growth, Pioneers such as Shoppers Stop and Lifestyle have slowed down considerably in FY19

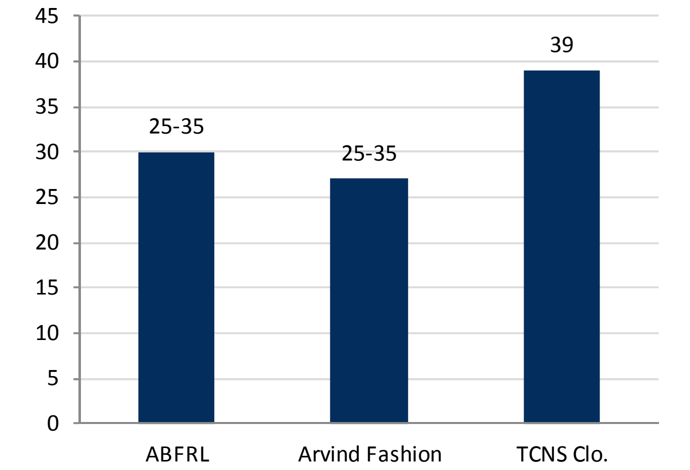
Brands such as ABFRL/TCNS Clothing have been stepping up their EBO expansion and online throughput (currently ~8-12%) to mitigate revenue risk from department stores, this cannot be said for the aggregate universe

In India too, Fast Fashion has outperformed legacy brands and private labels, albeit on a near non-existent base



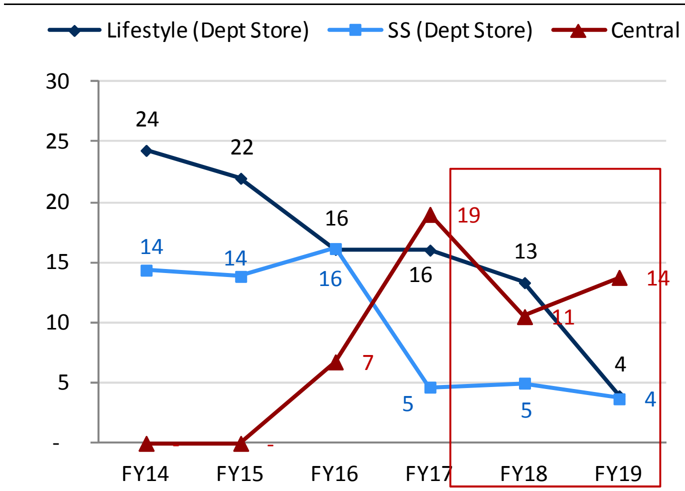
Source: Company, HDFC sec Inst Research, *Sample set used for each

Key legacy brands' revenue exposure from slowing department stores may also be a reason for growth not being apace with Fast Fashion peers



Source: HDFC sec Inst Research estimates

STOP/Lifestyle slowing down (Revenue growth, %)



Source: Company, HDFC sec Inst Research

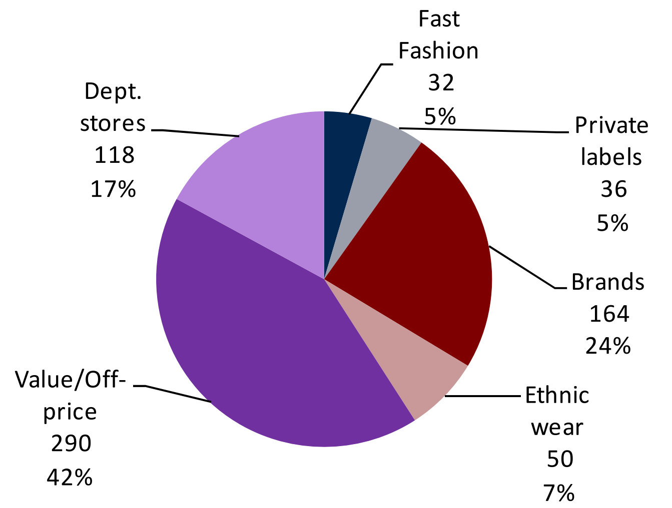
Expansion stance for department stores also remains dovish vs Fast Fashion and Private label retailers

	FY19 Store base	FY20 expected net store additions
Madura	2063	300
Lifestyle (Dept stores)	77	8-10
Shoppers Stop	84	5
Central	44	5
Westside	150	40
H&M	39	12
M&S	76	10
Zara	22	2

Source: Company, HDFC sec Inst Research

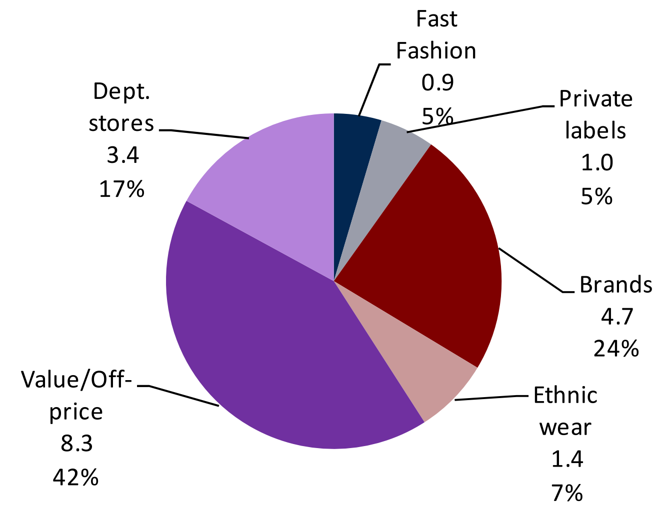
Private labels include only Westside and M&S as their supply chain increasingly mimics that of fast fashion (Cumm. Revenue: Rs. 33bn)

Category sizing (Our universe accounts 70% of the Rs. 1050bn organized apparel market)



Source: Company, HDFC sec Inst Research, 40+ retailer universe used as sample set

Headroom to grow is huge as key FF retailers/Pvt. Label with FF DNA hold just ~2% of apparel pie



Source: Company, HDFC sec Inst Research, Universe represents 70% of organized apparel retail

- **...Meanwhile, top brands have been shortening lead times:** Channel checks suggest product lifecycle within the supply chain has more than halved over the past 2-3 years. (From 6 months to 2-3 months). Top brand/private label retailers such as ABFRL and Westside have also trained focus on reducing lead times and increasing the freshness quotient in stores – A footfall enabler. ABFRL in its FY19 Annual report mentioned that it would be moving from a 4 season cycle to a 12 season cycle to shorten the feedback loop and introduce more fresh apparel drops in stores – Akin to a fast fashion play. Top brands such as the ABFRL's Madura portfolio is also increasingly focusing on its online strategy to improve throughput and be more working capital efficient.

Advantage Fast Fashion/Private label retailers:

- **Advantage Fast Fashion/Private label retailers:** We believe Fast Fashion and private label players have a more sustainable model vs department stores selling 3P brands given 1. Control on merchandise, 2. Faster go-to-market template, 3. Better perceived value in the mind of consumers.
  - **Complete control on merchandise:** Fast Fashion /Private labels control the entire journey of an apparel sold (centralized decisions on merchandise and pricing) given they own the inventory, unlike department stores who have to deal with the different lead times for different brands. This could lead to stock-outs or excess inventory in the channel from time to time in the case of the latter.
  - **Faster go-to-market template:** Quicker implementation of fashion (lower lead time) also improves the freshness quotient across stores – A footfall enabler.
  - **Better perceived value for the consumer:** Private label/FF players have consciously focused on variety vs Depth. Given the focus on women wear who are typically a more discerning target group, the assortment is primarily style/variety-heavy instead of being more deep. This aids footfalls and perceived value for the target group. From an inventory management stand-point, the retailer remains light vs its multi-brand counterparts. Department stores on the other hand, typically don't assume inventory risk as they back inventory with equal or more payables. This payables' crutch as highlighted in the Chapter on department stores can easily be exploited by e-tailers to woo brands on their platforms. Inkling of this can be seen in Myntra's FY19 financials.

- **Strong private labels - First among equals:** While we expect both Fast fashion and strong private labels to grow given their 1. Value proposition for consumers and 2. Sheer under-penetration (~2% share combined) in the apparel pie, **<u>we believe strong private labels such as Westside will be first beneficiaries of laddering in consumer aspirations given its assortment, pricing and distribution footprint and hence tout them as "First among equals" within this cohort</u>**. PS: M&S has been the most improved private label retailer and has successfully staged a turnaround over FY14-18. One could expect M&S to now step up expansion too.

- **Westside – Perfect cross between Fast & Value Fashion:** Unlike Globally, most pure-play fast fashion retailers in India have priced their assortment at similar price points to popular brands (Rs. 1500-3000). Hence, most of them are restricted to Metros/Tier 1 cities given India's current income profile. Westside has managed to exploit this gaping white space for trendy, edgy and fast moving fashion at sub-Rs. 1000 price points consistently over the past decade <u>(56% of SKUs in Westside are retailed <Rs. 1000 – per our SKU analysis). This partly explains the clockwork-like SSSG over FY09-19 (9% CAGR).</u>

Westside's women and kids skew is akin to a fast fashion play

Fast Fashion/private label retailers are far lighter vs their deparment store counterparts in terms of SKUs offered.

Channel checks suggest the difference is in depth while width on offer for fast fashion/private label retailers is higher

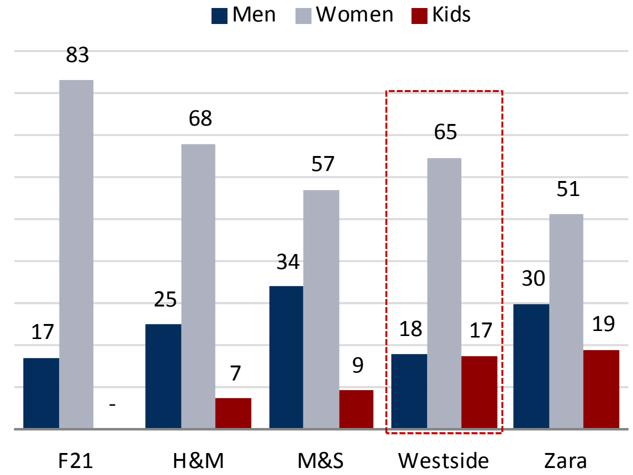
This explains the higher revenue/SKU and tighter inventory cycle for the fast fashion folks

90% of Men's T-Shirts are priced <Rs.1000 for Westside.

Department stores lack Westside's sharpness in assortment, are still competitively priced vs pure play fast fashion (Men T-Shirts <Rs. 1000)

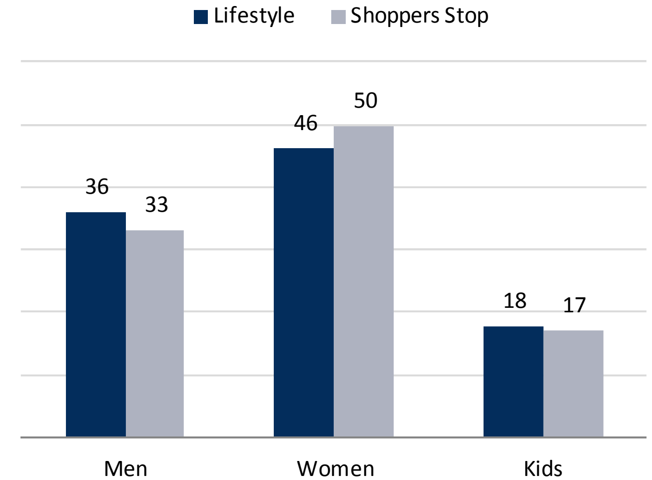
Westside aces assortment pricing

Westside & H&M more skewed towards faster growing Women and Kids Category (In %)



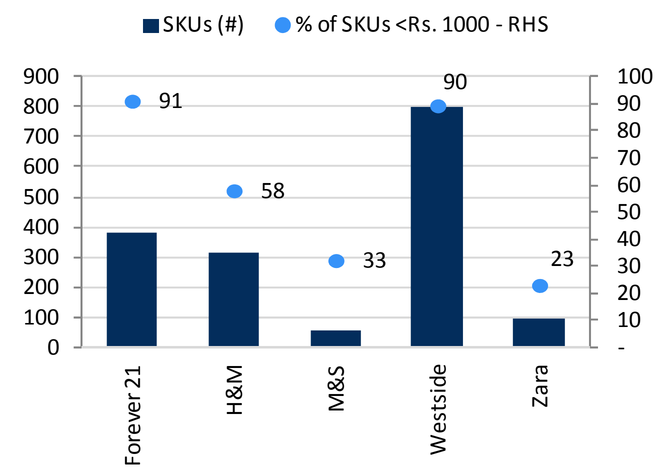
Source: Company, HDFC sec Inst Research

...multi-brand retailers continue to stock a sizeable chunk of SKUs of slower growing Men's category



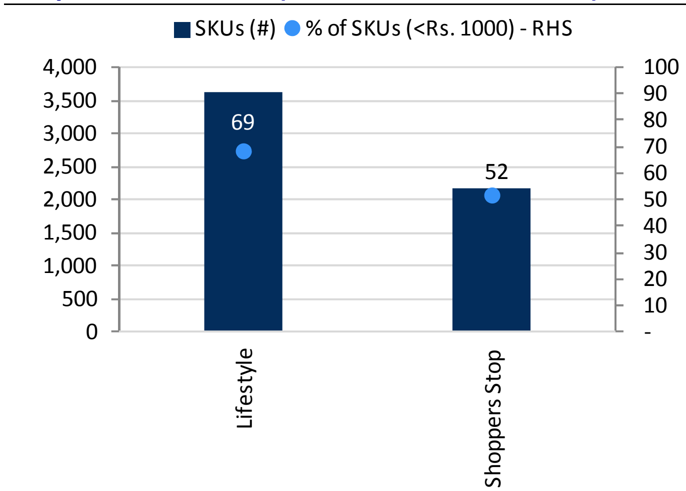
Source: Company, HDFC sec Inst Research

Fast Fashion/Pvt. Labels: Men's T-shirts (<Rs. 1000)



Source: Company, HDFC sec Inst Research

Department stores (Men T-Shirts <Rs. 1000)



Source: Company, HDFC sec Inst Research

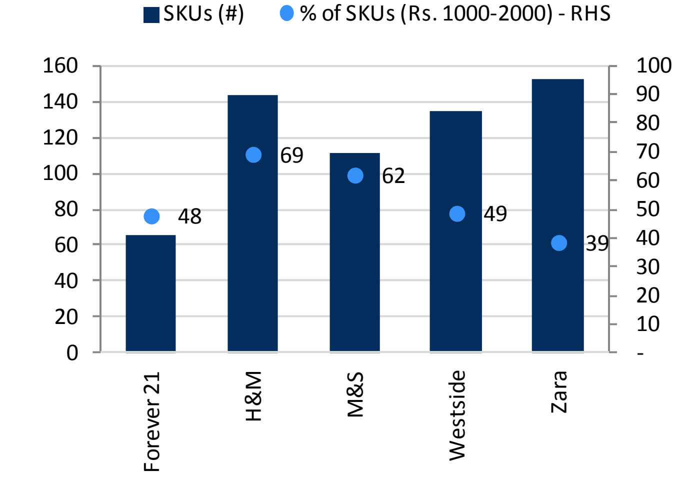
>50% of Casual Shirts in Westside are priced below Rs. 1000. Between Rs. 1000-2000, H&M and M&S have a sharper assortment vs Zara in this category

Department stores lag in this segment too. Within, this cohort, Lifestyle Int seems better off

As per industry interactions, the sweet spot for Men's Trousers/Jeans is Rs. 1000-2000. Westside trumps peers in this category too (83% of SKUs retail between Rs. 1000-2000. H&M and M&S are fast catching up as per channel checks, while Zara remains premium.

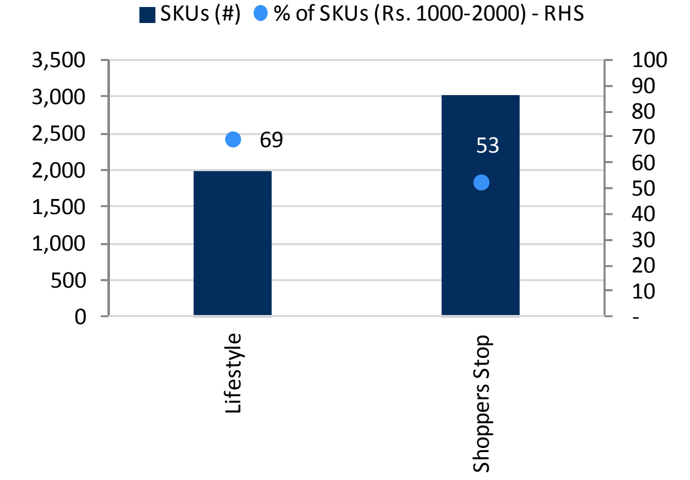
Lifestyle brands fall short here too

Fast Fashion/Pvt. Labels: Casual Shirts (Rs. 1000-2000)



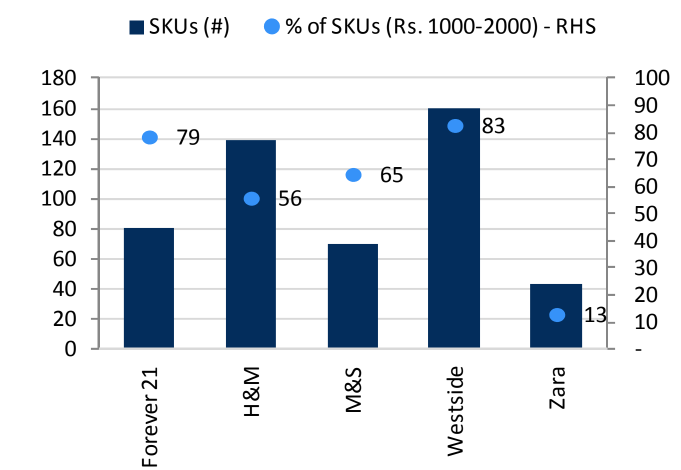
Source: Company, HDFC sec Inst Research

Department stores: Casual Shirts (Rs. 1000-2000)



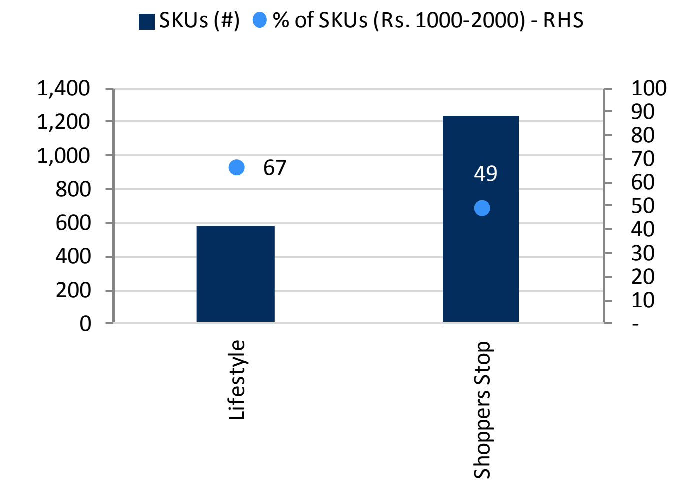
Source: Company, HDFC sec Inst Research

Fast Fashion/Pvt. Labels: Men Trousers-Rs.1000-2000



Source: Company, HDFC sec Inst Research

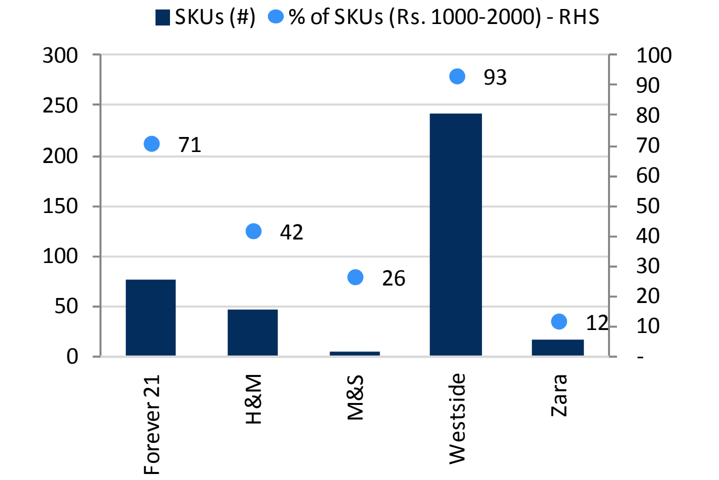
Department stores (Men Trousers Rs. 1000-2000)



Source: Company, HDFC sec Inst Research

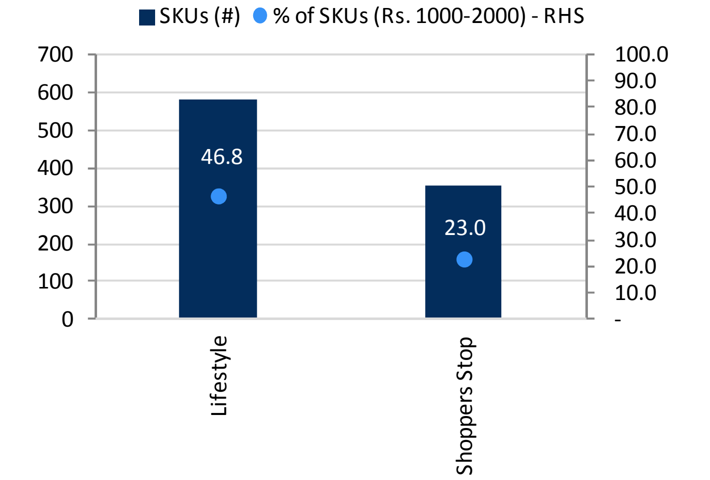
93% of SKUs in Men's Jeans (Westside) are priced between Rs. 1000-2000, Fast fashion and department stores lag here too. H&M is better placed vs Zara and M&S

Fast Fashion/Pvt. Labels: Men's Jeans Rs. 1000-2000



Source: Company, HDFC sec Inst Research

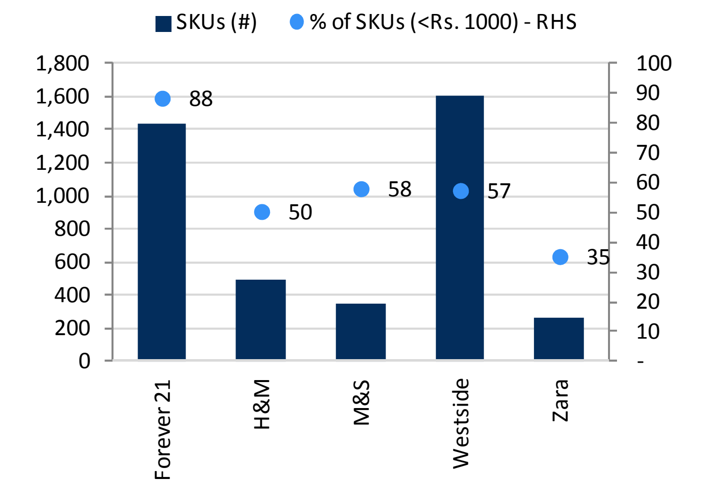
Department stores - Men's Jeans (Rs. 1000-2000)



Source: Company, HDFC sec Inst Research

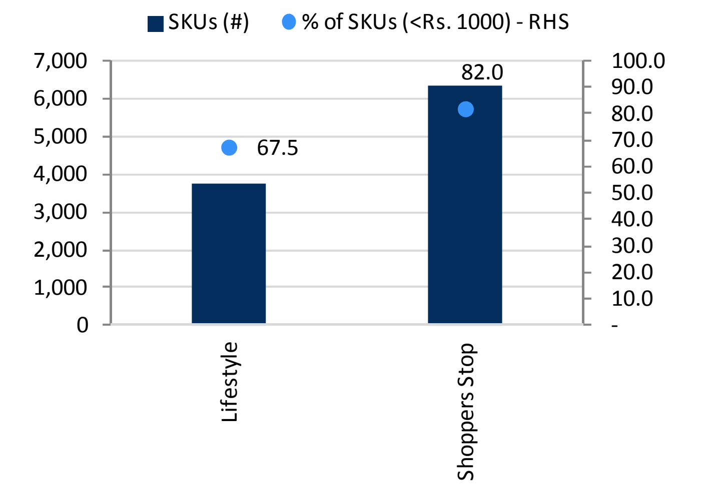
Women tops/tees closely fought by Westside, H&M, M&S (important category)

Fast Fashion/Pvt. Labels: Women tops/tees (<Rs. 1000)



Source: Company, HDFC sec Inst Research

Department stores: Women tops/tees (<Rs. 1000)



Source: Company, HDFC sec Inst Research

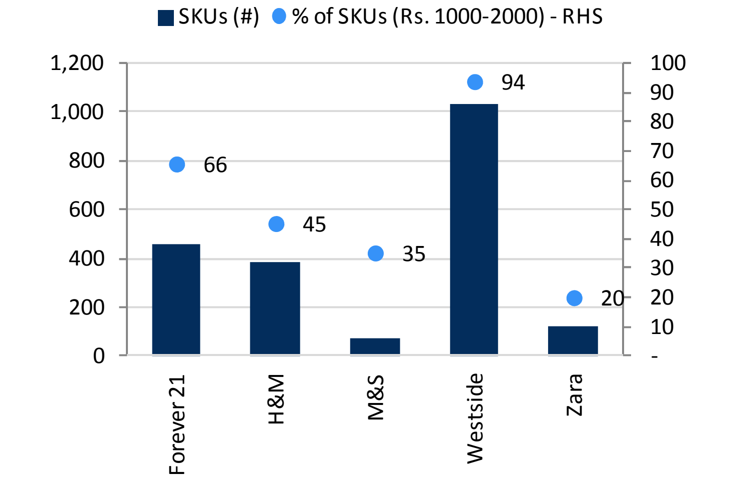
Westside leads in women dresses too. >90% of SKUs priced between Rs. 1000-2000. H&M outdoes Zara and M&S in this category too

Department stores assortment remains relatively regressive in this category

Westside trumps fast fashion and lifestyle brands in Kids too

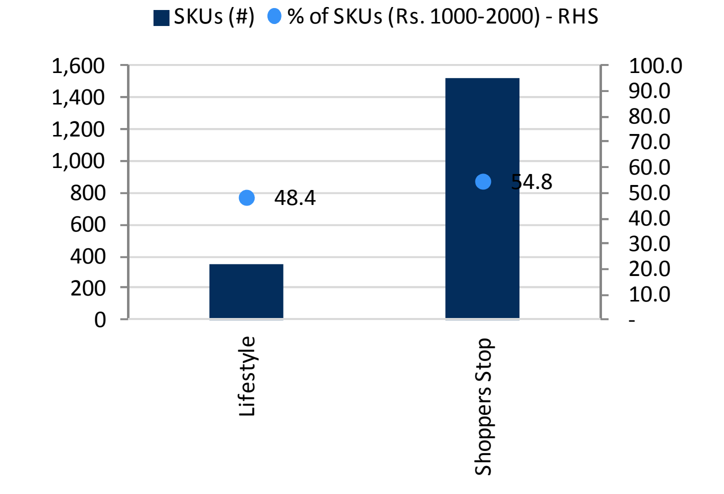
Ex-Westside, H&M and M&S beat Zara in assortment pricing across categories

Fast Fashion/Pvt. Labels: Women Dresses (Rs. 1000-2000)



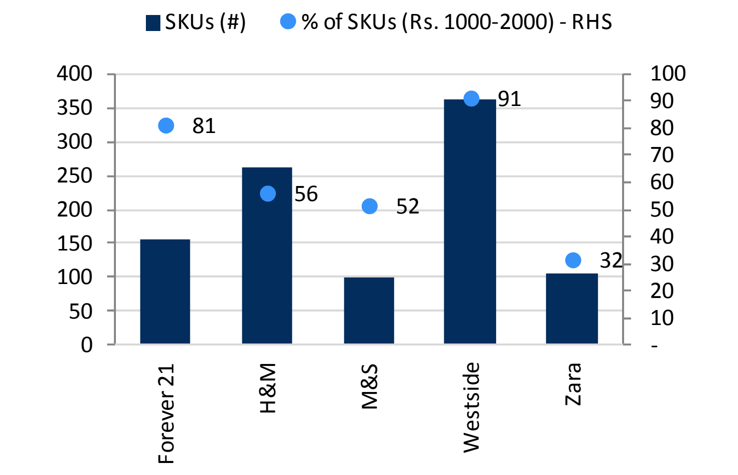
Source: Company, HDFC sec Inst Research

Department stores: Women Dresses (Rs. 1000-2000)



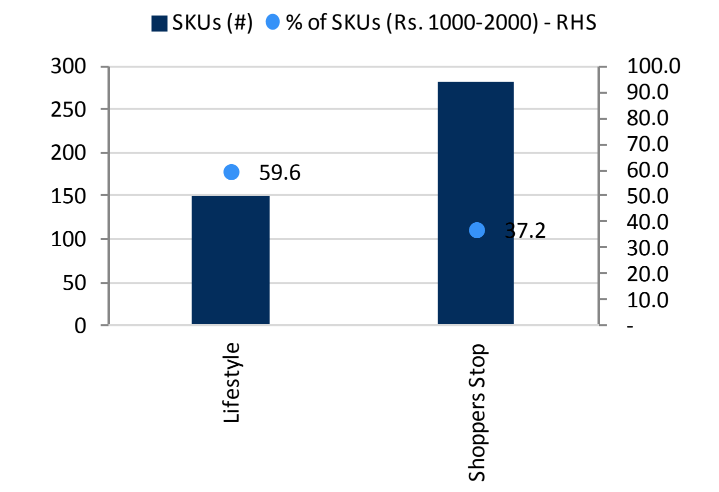
Source: Company, HDFC sec Inst Research

Fast Fashion/Pvt. Labels: Women Pants (Rs. 1000-2000)



Source: Company, HDFC sec Inst Research

Department stores: Women Pants (Rs. 1000-2000)



Source: Company, HDFC sec Inst Research

Note, while Westside trumps fast fashion peers in most categories in terms of pricing, the revenue/SKU, ergo throughput per sq. ft is lower vs Zara/H&M/M&S given 1. Lighter SKU base of the latter, 2. larger Tier 2/3 presence of Westside, where sales velocity is typically lower vs Metros

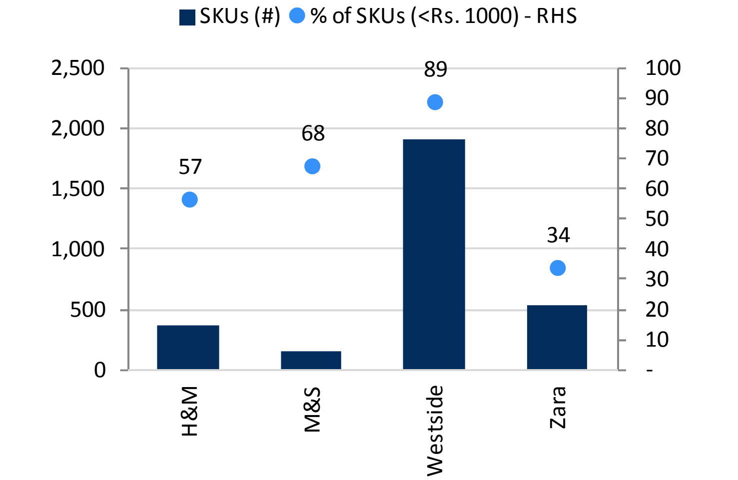
That said, Westside has been taking measures to fasten its go to market time with introduction of select fashion lines in stores which are then mass produced quickly (Lead time: 2 weeks) based on response to the assortment

Note: Westside is not a pure-play fast fashion retailer, its a cross between fast and value fashion.

The sharper pricing is primarily to make the offering more pervasive. Can be seen in its footprint.

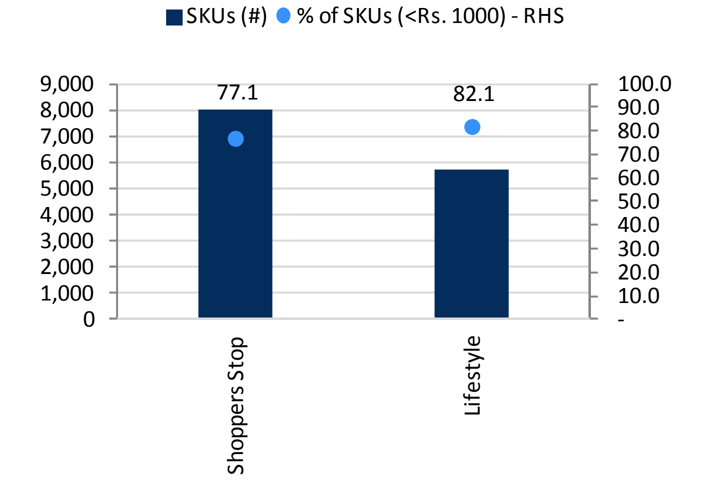
M&S has been the most improved retailer of the lot and has scripted a turnaround since it entered into a JV with Reliance Retail (49% stake)

Fast Fashion/Pvt. Labels: Kids (<Rs. 1000)



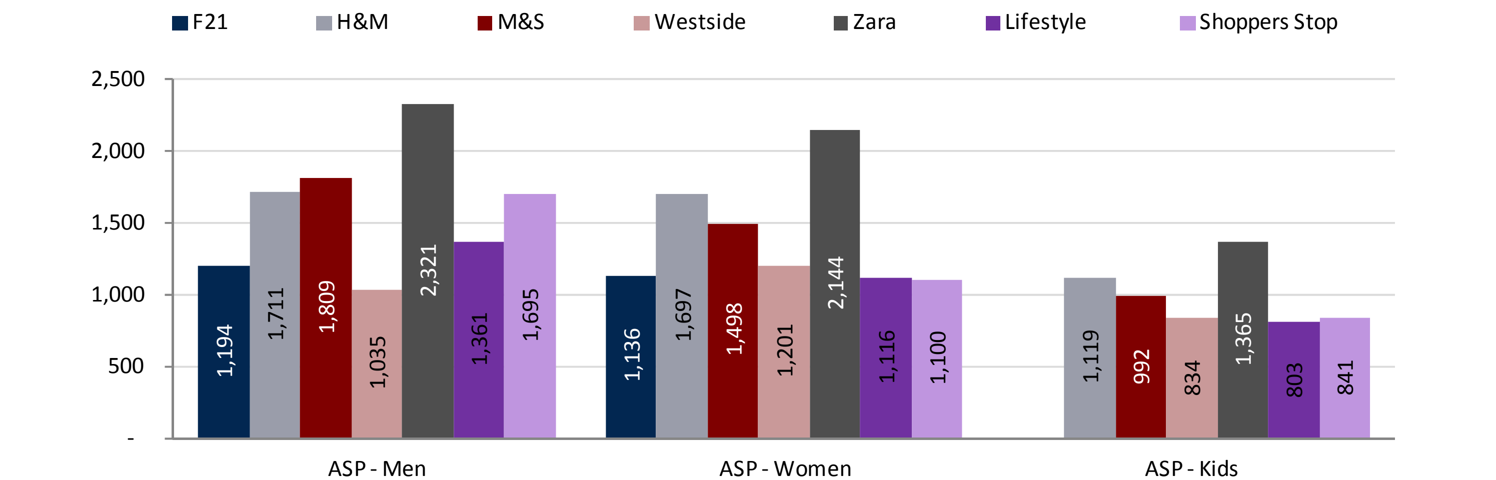
Source: Company, HDFC sec Inst Research

Department stores: Kids (<Rs. 1000)



Source: Company, HDFC sec Inst Research

Westside is 15-55% cheaper vs its Fast Fashion peers



Source: Company, HDFC sec Inst Research. *Weighted avg. selling price based on our set of 1,50,000+ SKUs across apparel categories

Zara, H&M and M&S' higher skew of stores in districts with PCI of Rs 300k+ explains the higher throughput per sq. ft vs Westside

While there is a natural cap on fast fashion expansion beyond top districts given current assortment pricing. We believe the opportunity size even within existing coverage remains significant

Our back of the envelop calculation suggests Zara had ~3-3.5mn shoppers in FY19 – This translates into a mere 5% share in consumer reach

That said, expansion will be measured for Zara as focus remains on a margin recoup. Note: Zara has lost 670bp in gross margins since FY14

On the other hand, H&M, M&S and Westside have been sharpening pricing to be more palatable to the average Indian, hence have a broader presence vs Zara.

Westside remains the best placed in terms of distribution to milk the broader market given its well-rounded distribution + sharper prices

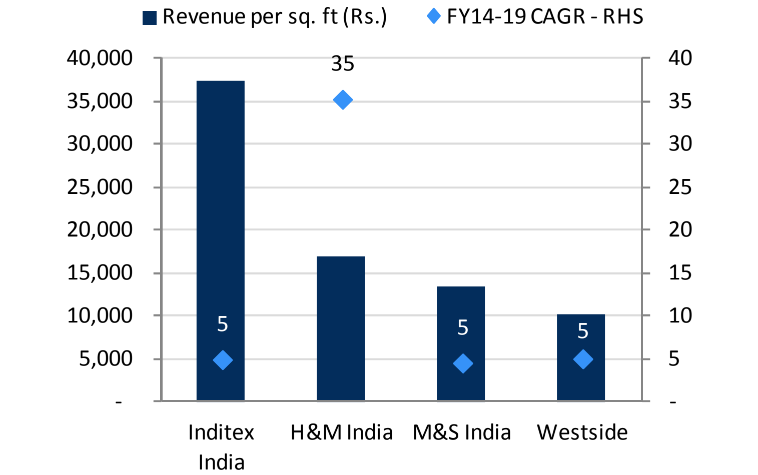
...Aces distribution too

Westside sports a more well-rounded store network, while Fast fashion peers are restricted to 300k+ PCI districts

Per Capita Income/ Population density	Population (mn)	Districts (#)	Westside	M&S	H&M	Zara	F21
<100K	**478**	**210**	**10.7**	**5.8**	**-**	**-**	**5.0**
<500	140	96	1.8	-	-	-	-
1000-3000	162	47	6.3	5.8	-	-	5.0
3000-5000	5	2	1.8	-	-	-	-
500-1000	171	65	0.9	-	-	-	-
100-150K	**221**	**116**	**11.6**	**5.8**	**7.9**	**5.3**	**10.0**
<500	157	97	6.3	-	2.6	-	-
1000-3000	33	6	0.9	-	-	-	-
3000-5000	5	1	-	-	-	-	-
500-1000	26	12	4.5	5.8	5.3	5.3	10.0
150-200K	**184**	**85**	**21.4**	**15.4**	**15.8**	**10.5**	**20.0**
<500	122	60	5.4	1.9	2.6	-	-
1000-3000	8	2	-	-	-	-	-
5000+	9	2	8.9	7.7	10.5	10.5	10.0
500-1000	46	21	7.1	5.8	2.6	-	10.0
200-250K	**72**	**30**	**10.7**	**3.8**	**2.6**	**-**	**-**
<500	21	11	2.7	-	-	-	-
1000-3000	23	7	2.7	1.9	-	-	-
500-1000	28	12	5.4	1.9	2.6	-	-
250-300K	**28**	**6**	**13.4**	**7.7**	**7.9**	**10.5**	**10.0**
<500	1	1	-	-	-	-	-
1000-3000	16	3	6.3	1.9	-	-	-
500-1000	10	2	7.1	5.8	7.9	10.5	10.0
300-500K	**39**	**10**	**25.0**	**38.5**	**42.1**	**47.4**	**35.0**
<500	3	3	2.7	-	-	-	-
1000-3000	2	1	0.9	-	-	-	-
3000-5000	10	1	7.1	9.6	13.2	10.5	15.0
5000+	16	2	14.3	28.8	28.9	36.8	20.0
500-1000	8	3	-	-	-	-	-
500K+	**20**	**3**	**7.1**	**23.1**	**23.7**	**26.3**	**20.0**
1000-3000	3	2	1.8	5.8	5.3	10.5	-
5000+	17	1	5.4	17.3	18.4	15.8	20.0
Grand Total	**1,042**	**460**					

Source: Census 2011, Company, HDFC Securities, Presence highlighted in percentage points

Zara leads in productivity, H&M fast catching up



Source: Company, HDFC sec Inst Research

……as younger store age profile helps

Brand/Format	< 1 yr (%)	1-2 yr (%)	>2 yrs (%)
Zara	9.1	-	90.9
H&M	25.6	33.3	41.0
M&S	9.5	4.8	85.7
Westside	16.7	12.0	71.3
Forever 21	(5.0)	6.0	16.0

Source: Company, HDFC sec Inst Research

Peers floor the (expansion) pedal

- **Peers more aggressive than FF poster boy Zara:** Since its 2015 launch H&M has been in expansion overdrive. It has opened 41 stores over FY16-19 vs Zara's 22 stores since FY10. M&S too, has stepped up expansion, especially since its JV with Reliance Retail. Westside is expected to step up expansion FY20 onwards. Expects to add 30-40 stores annually over FY19-22E (base: 150 stores). While Poster boy Zara still leads in productivity (est. ~Rs. 37k per sq. Ft - 2-4x vs peers), commentary on expansion remains soft. Peers are fast catching up on productivity too given a healthier store age profile.
- **...treading unit economics responsibly too:** Interestingly, H&M and M&S have tread unit economics responsibly, despite their aggressive expansion. 1. Productivity has been rising, 2. Cost structures are getting leaner, 3. Working capital quality is improving, 4. Capex getting lighter as focus moves to tier 2/3 towns (at the margin) and store sizes reduce.
- **Healthy store age profile crucial for SSSG:** A healthy store age profile is crucial for SSSG as higher the proportion of new/ emerging stores, more consistent future SSSG & productivity rise will be as more stores graduate to maturity. While Zara leads the pack in productivity. H&M is fast catching up. Note: Bunching Westside and M&S with fast fashion folks may be unfair, however increasingly their DNA is mimicking that of a fast fashion player – 1. Lead time is reducing, ergo; increasingly lighter working capital, 2. Focus remains women/kids. Channel checks validate the same.
- Westside retails select fashion lines in select stores and successful merchandise is then mass produced and placed in all stores. This helps reduce lead time.

Despite lower prices, gross margins are significantly better for Westside, H&M and M&S led by higher local sourcing vs Zara

Zara has lost 670bp in gross margins since FY14 given 1. price cuts and increase in import duty and direct tax incidence, 2. Rising competitive intensity, 4. Increasing revenue skew towards lower margin categories such as shoes

Westside has been amongst the fastest to add footprint; H&M is faster albeit on a much smaller base

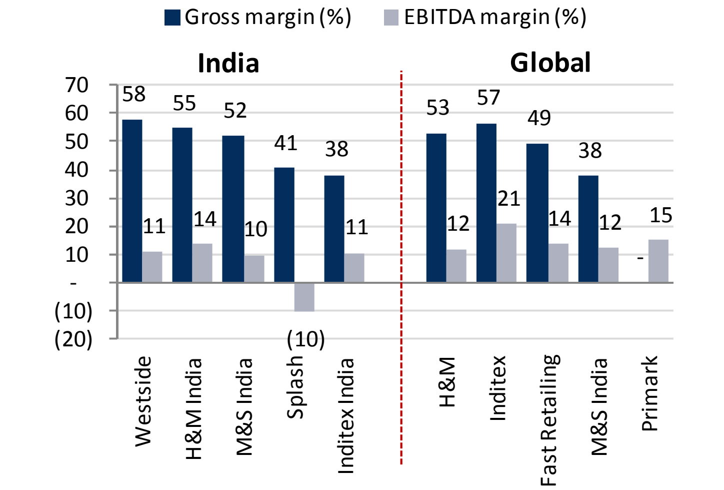
No. Of Stores (#)	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	Area CAGR (FY14-19)
Westside	54	67	70	80	85	93	107	125	150	14%
Inditex India	3	8	9	13	16	18	20	20	22	12%
H&M India	-	-	-	-	-	6	16	29	39	55%
Marks & Spencer	19	24	29	34	46	54	57	63	-	10%

Source: Company, HDFC sec Inst Research. Note H&M and M&S Area CAGR is over FY16-19 (estimates)

- **Pvt label players enjoy better GMs:** In India, private label players enjoy higher gross margins compared to their Fast Fashion counterparts given local sourcing advantages. A large chunk of inventory for global fast fashion retailers (esp. Zara) is imported and attracts a 30% tax incidence (Import duty + GST). Given their current ASPs of Rs. 1500-3000, the latitude to pass on price hikes is missing as most brands/private label players are competitively priced. Recent price cuts (10-15% in FY17) and cuts on entry-level price points in FY19 by Zara given the rising competitive intensity haven't helped GMs either.

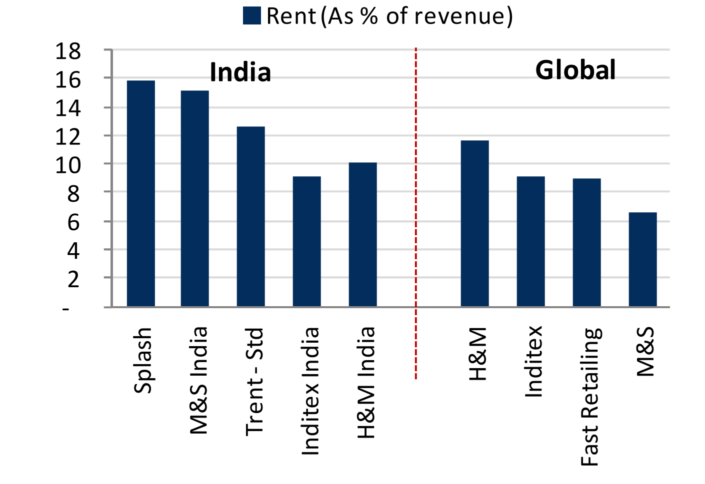
...don't translate into higher EBITDA margins though! Higher GMs for private labels don't translate into higher EBITDA margins (Westside and M&S) as 1. Westside's lease rental bill is typically higher given its large standalone high street footprint. 2. For M&S, smaller store sizes (~11,000 sq. ft vs Zara & H&M's 18,000-20,000 sq. footers) means getting anchor tenant status in malls; ergo favourable rent rates is unlikely. However, this could change with scale-led operating leverage over the next few years. One may argue that the heavy cost structure for private labels may expose them to an online onslaught; however, we believe 1. The strong brand equity enjoyed by some, 2. Scale-led reduction in cost structure should help mitigate some of these concerns.

GM/EBITDA margin profile: Pvt labels/Fast Fashion



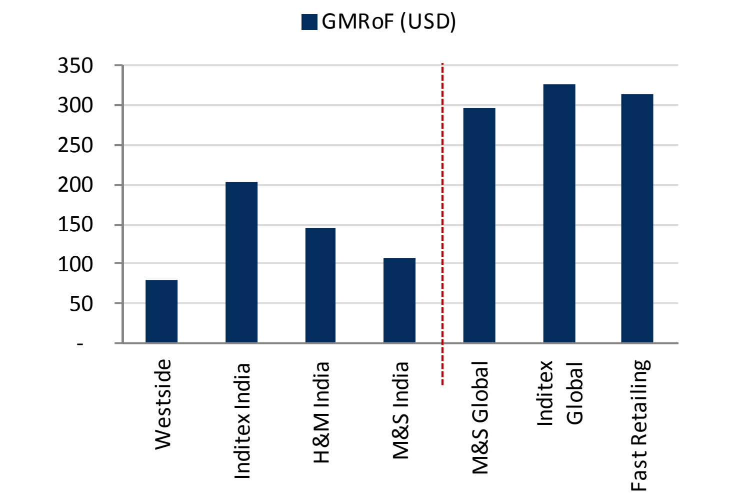
Source: Company, HDFC sec Inst Research

Rent as % of sales



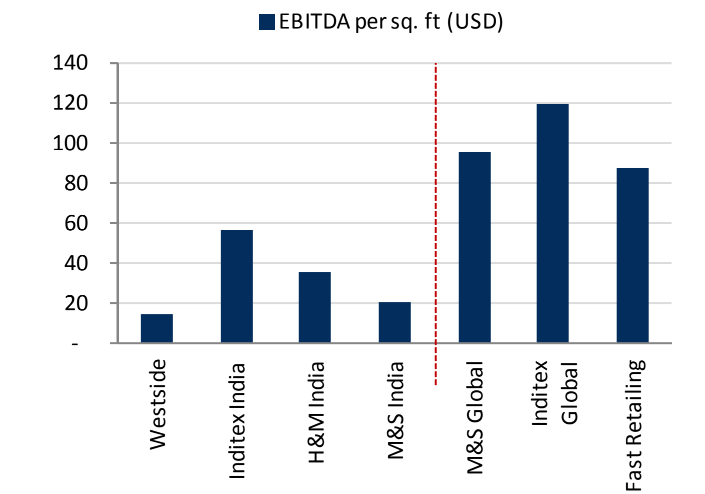
Source: Company, HDFC sec Inst Research

India vs Global differential in GMRoF



Source: Company, HDFC sec Inst Research (estimates for unlisted retailers

India vs Global differential in EBITDA per sq. ft



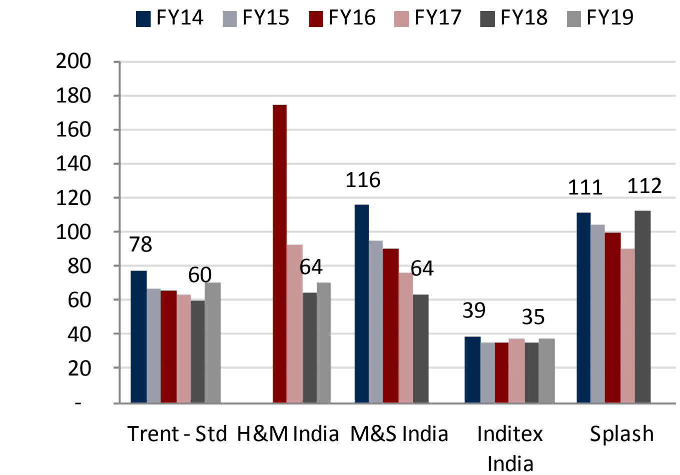
Source: Company, HDFC sec Inst Research

While Zara remains the fastest in turning inventory, peers are fast catching up

Core cash conversion has improved for Trent. Bump up in FY19 is likely due to the aggressive ramp up in its value format Zudio

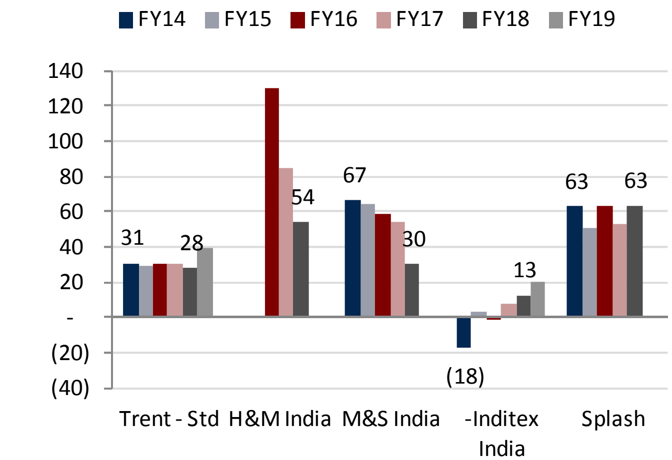
Zara has seen a bump up of 16 Days in its core cash conversion cycle over FY15-19

Fast Fashion/private label inventory days



Source: Company, HDFC sec Inst Research

Cash conversion cycle (days)



Source: Company, HDFC sec Inst Research

Top 6 Ethnic Retailers include TCNS Clothing, Fab India, Biba, Manyavar, House of Anita Dongre (Global Desi & AND) and Soch

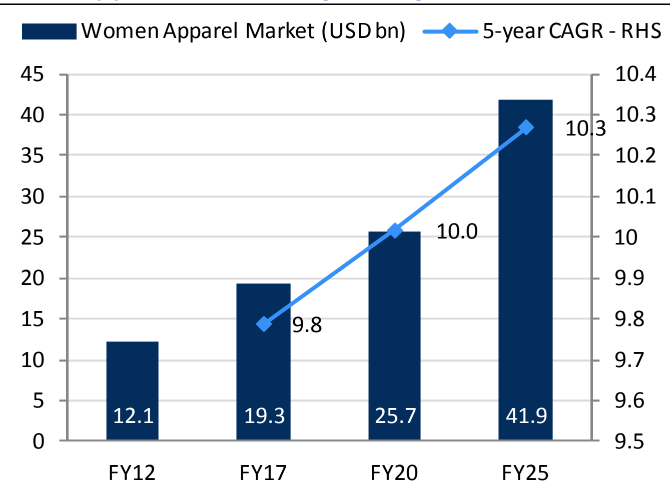
Note: Manyavar is predominantly positioned in Men's ethnic wear

Ethnic Wear - A penetration game

- With Top 5 ethnic retailers holding a 7% share in Women's Ethnic wear (USD7.7bn), the category offers one of the highest headroom to grow across apparel. (Organized ethnic wear now accounts for 20%+ of the market)
- We analyzed assortment, pricing (on 40,000+ ethnic-wear SKUs) and distribution (Store network mapped with income profiles and population density) across retailers to ascertain winners. TCNS seems to check all boxes.
- While leverage remains comfortable, inventory position, ergo working capital for some have been deteriorating over the past few years, hence, we believe, focus for some may shift from growth to fixing the burgeoning working capital. This may tactically give TCNS an opportunity to extend its lead. The latter operates an asset-light distribution framework with a healthy mix of franchised EBOs (within its EBO network), LFS, MBOs and online presence.

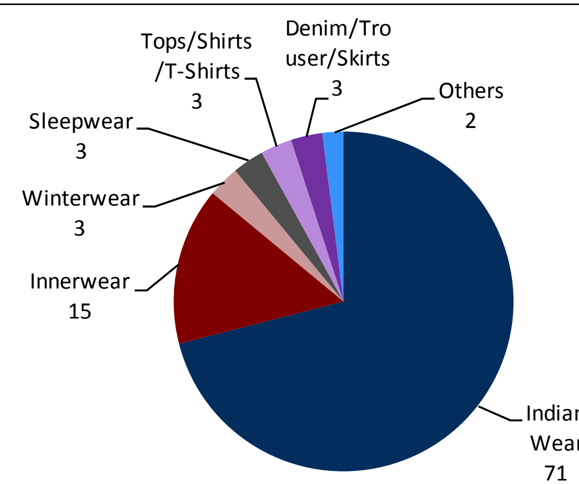
- **Top women's ethnic retailers account for <7% share:** Women's ethnic wear (est: USD7.7bn) accounts for ~a third of the USD23bn (HDFC sec estimate) women apparel market in India and is expected to clock 14% CAGR over FY17-20 (Per technopak). Top 5 women ethnic retailers today occupy ~3%/7% of Indian wear (women) and Ethnic wear market (Women) respectively. Organized ethnic retailers are estimated to have captured ~22% of the market as per Technopak.

Women apparel market is growing at 10% CAGR



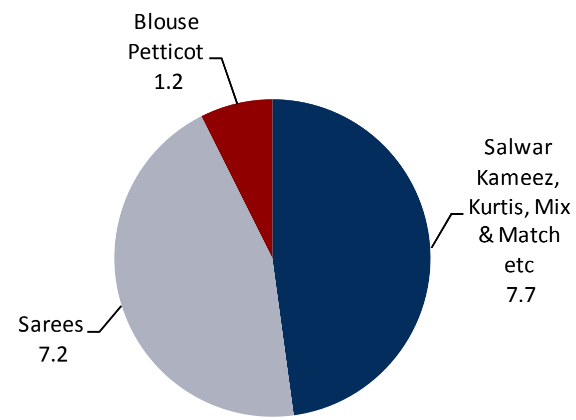
Source: Technopak, HDFC sec Inst Research, TCNS Clothing RHP

Indian wear accounts for >70% of the mkt



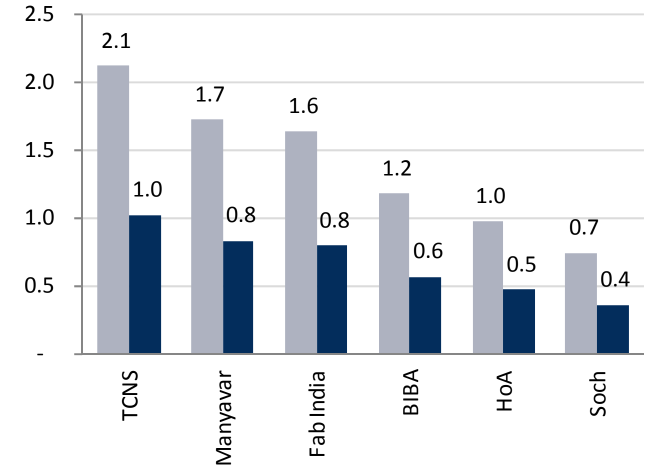
Source: Technopak, HDFC sec Inst Research, TCNS Clothing RHP

Women's Ethnic wear pegged at USD7.5bn+



Source: HDFC sec Inst Research estimates

...Top 5 hold 7% share in Women's Ethnic wear

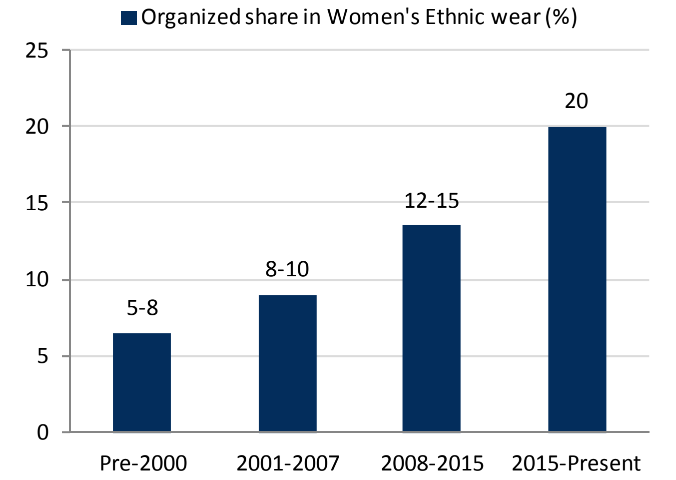


Source: Company, HDFC sec Inst Research

The Journey

Pre-2000	2001-2007	2008-2015	2015-Present
Dominance of Unorganized Players	**Initiation of Organized Retail**	**Growth of Organized Retail**	**Emergence of Industry Leaders**
1. Local boutiques served captive customers	1. BIBA and Fabindia expand their retail footprints	1. Retail brands scale up the penetration of EBOs in metros and mini-metros	1. Retail brands expand beyond metros and mini-metros to other urban clusters
2. Daily apparel needs served through customized tailoring or limited functional ready apparel offering	2. W opens its first EBO	2. Emergence of regional brands	2. Online retail has started gaining traction as a complimentary retail channel
3. Readymade offering limited to occasion apparel	3. Westside expand its retail footprints	3. Growth of LFS formats as an important organized retail channel for women's Ethnic apparel both as private labels and as destination for retail brands	3. Emergence of industry leaders on product differentiation, designs and positioning
4. Retail footprint of organized retailers like Fabindia, Biba restricted to EBOs in few cities and clusters		4. Launch of sub-brands or retail store segmentation by Ethnic apparel retail brands to cater to different needs.	
5. Ethnic apparel private label of Westside		5. Initiation and growth of Ecommerce	

Organized share in Women's Ethnic wear



Source: Company, HDFC sec Inst Research

The legacy

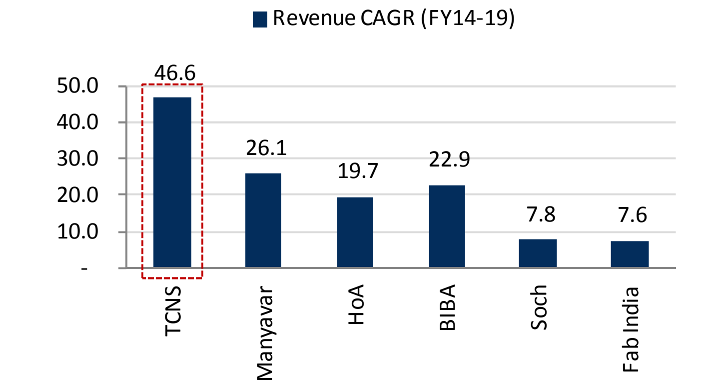
Brand	Footprint	Inception year
W	All-India	2002
Aurelia	All-India	2009
Wishful	All-India	2006
BIBA	North, South, West	1988
Global Desi	North & West	2007
Fab India	All-India	1960
Soch	South	2005

Source: Company, HDFC sec Inst Research

Who's got the troika right?

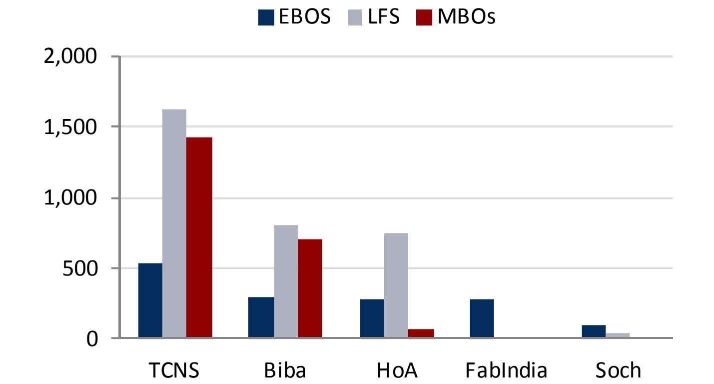
- **TCNS leads the pack in organized play:** TCNS Clothing has outpaced peers over FY14-19 as it got all three crucial pieces of retailing right. Sharpest priced assortment across peers, 2. Denser distribution network - helps create top-of-the-mind recall, aiding footfalls and productivity, 3. Asset-light expansion (~80% of TCNS' incremental revenue over FY17-19 came from LFS, franchised EBOs, MBOs, and online wherein the onus of capex largely resides with the channel and not with TCNS. Ex-LFS and owned EBOs, inventory is also booked outright i.e. doesn't reside on TCNS books.

TCNS has outpaced peers over FY14-19 (%)



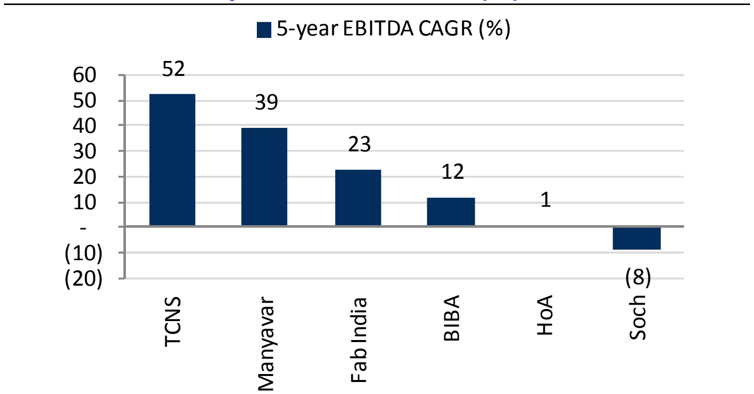
Source: Company, HDFC sec Inst Research

...stronger distribution has certainly helped



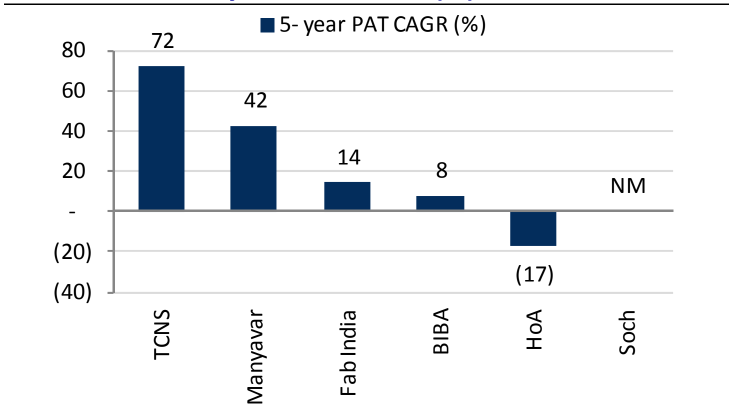
Source: TCNS RHP, HDFC sec Inst Research. Estimates for unlisted

Retailer-wise 5-year EBITDA CAGR (%)



Source: Company, HDFC sec Inst Research

Retailer-wise 5-year PAT CAGR (%)



Source: Company, HDFC sec Inst Research

Our Analysis of 40,000+ Ethnic wear SKUs and store networks suggests that TCNS seems to have got the troika – Pricing, Assortment and distribution right

In one of the biggest segment of Ethnic wear, Kurtas, TCNS has the sharpest price points.

The company has managed to ladder its offering better than peers

Nearly all of Aurelia's Kurtas are priced at <Rs. 1000

W leads the pure-play ethnic wear pack with highest range of Kurtas priced in the Rs. 1000-1500 range

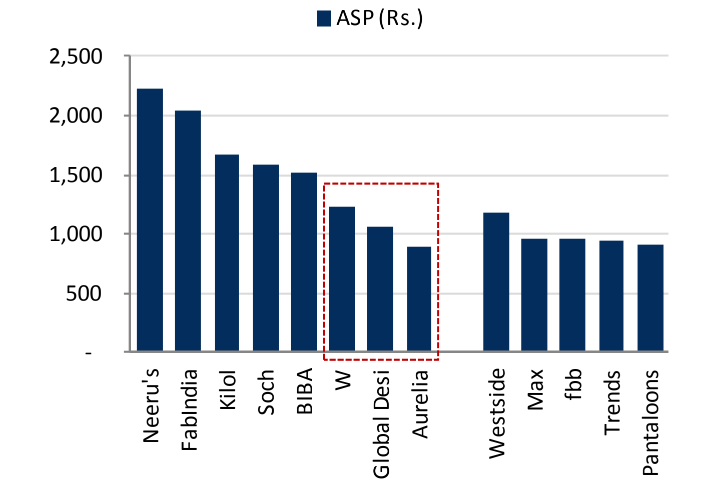
The assortment edge

TCNS has sharper price points (SKU distribution, %)

SKU (%)	< Rs 1000	Rs.1001-1500	Rs.1501-2000	>Rs 2000
TCNS	68	17	8	8
Aurelia	89	5	4	2
W	62	24	7	7
Wishful	23	16	27	35
Global Desi	67	19	8	6
BIBA	39	18	14	30
Soch	38	18	7	37
Kilol	25	21	19	34
FabIndia	11	9	22	58
Neeru's	3	7	17	73

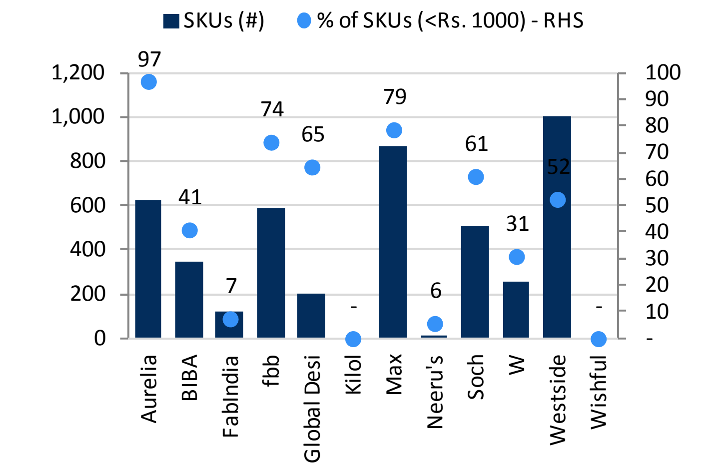
Source: Company, HDFC sec Inst Research

Retailer-wise weighted avg. ASPs



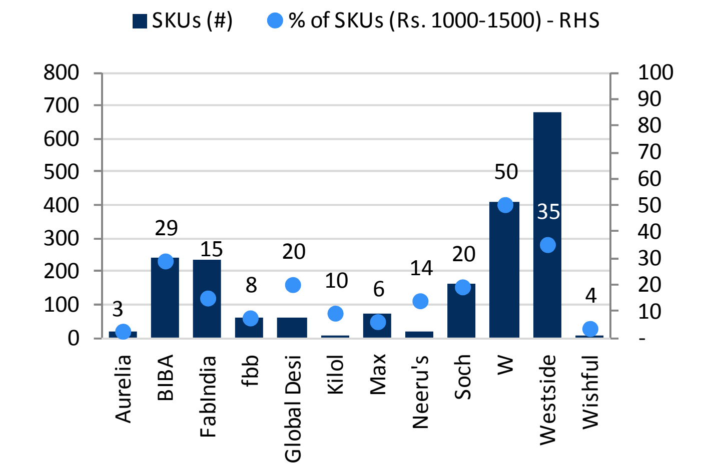
Source: Company, HDFC sec Inst Research

Aurelia leads in Kurtas priced (Rs. <1000)



Source: Company, HDFC sec Inst Research

W leads in Kurtas priced (Rs. 1000-1500)



Source: Company, HDFC sec Inst Research

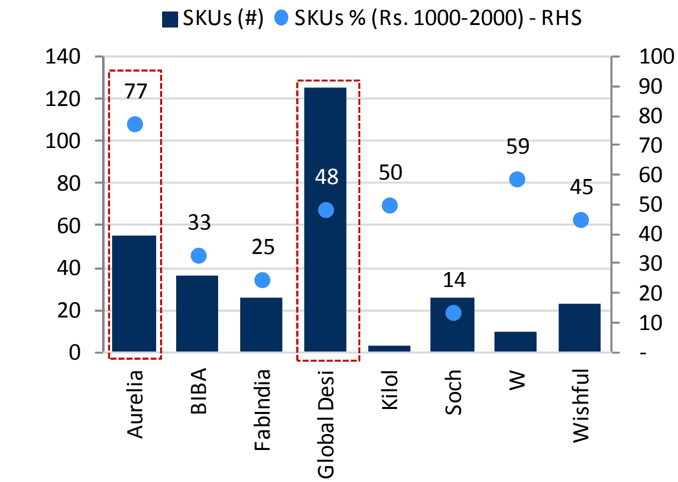
In Dress sets/suits (sweet spot: Rs. 1,000-2,000), Auretlia/W sport highest % of SKUs in the price range. Although Global Desi offers more variety (more SKUs)

...Aurelia and Biba are the sharpest priced in Salwar Churidar, W offers the most SKUs in this segment

Channel checks suggest that Biba has stepped up expansion on Rangriti - its entry point offering to catch up with Aurelia

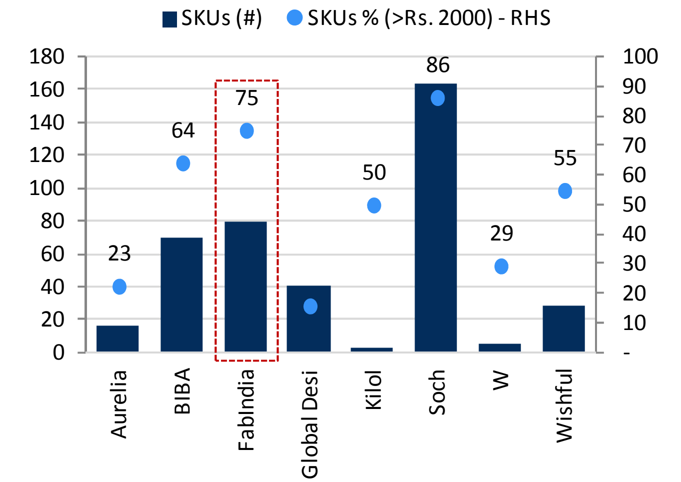
FabIndia seems to have outpriced itself from the market, which is also reflected in its top-line growth (8% CAGR over FY14-19. Top-line growth was stagnant over FY18 due to demonetization-led sourcing issues.

Global Desi offers highest SKUs in Dress sets/suits among ethnic retailers (Rs. 1000-2000)



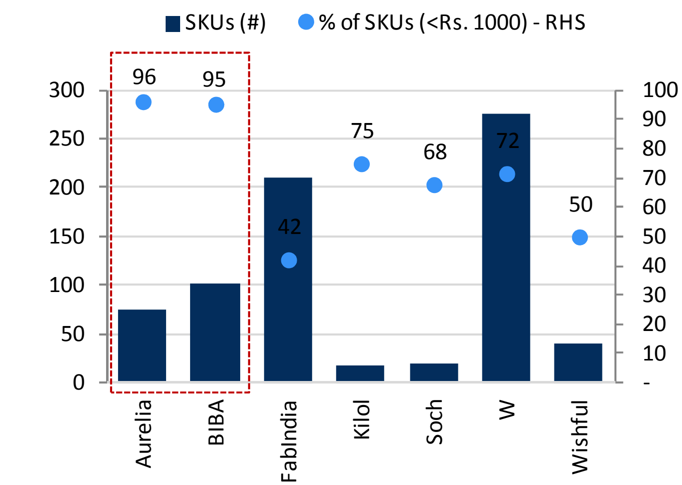
Source: Company, HDFC sec Inst Research

Fab India seems to have out-priced itself in Dresses/suits with >75% of SKUs priced >Rs.2000



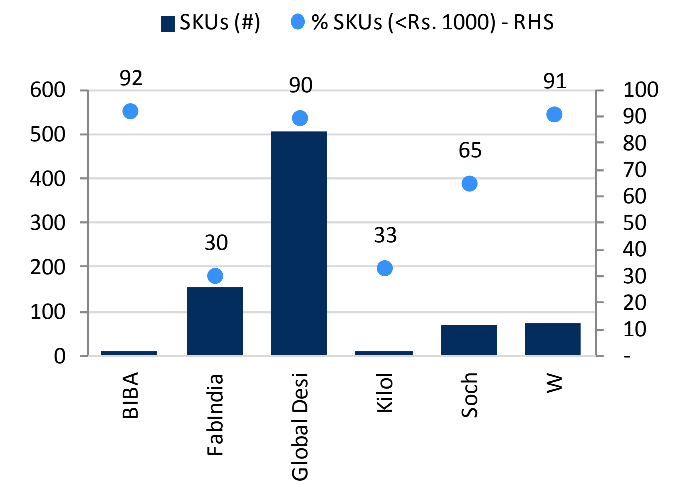
Source: Company, HDFC sec Inst Research

Aurelia and Biba competitively priced in Salwar Churidar/Palazzos, W offers more range in <Rs. 1000



Source: Company, HDFC sec Inst Research

Global Desi trumps the tops/tunics space (<Rs. 1000)



Source: Company, HDFC sec Inst Research

As can be seen from our store mapping, TCNS scores (W + Aurelia combined) in store density almost throughout all income profiles (PCI) and population density

What does this mean?

A dense network helps a retailer/brand in many ways:

1. *Becomes a better omni-asset, as can be sweated more. An assortment shortfall in Store A can be fulfilled via store B*
2. *There could be potential catchment-specific sourcing benefits with scale*
3. *Increases Top-of-the-Mind Recall*

Interestingly, despite a higher presence across lower PCI districts, TCNS leads in sales velocity (ex-Soch).

The denser network could also perhaps be a reason why TCNS turns its EBO inventory faster than its peers as design-to-store lead time may be shorter. (HDFC estimates)

The Distribution Edge

TCNS scores on store-density viz-a-viz peers

Store Distribution (%)

PCI/population density	W	Aurelia	Fab India	BIBA	Soch	Anokhi	Global Desi	Neerus	AND	Kilol
<100K	**2.1**	**2.1**	**1.5**	**1.8**	**1.6**	**1.0**	**1.3**	**1.0**	**1.1**	
<500	1.0	2.0	1.5	1.3	1.0	1.0	1.0		1.0	
1000-3000	2.4	2.3	1.4	1.9	2.0	1.0	1.4	1.0	1.2	
3000-5000	6.0	2.0	3.0	4.0			1.0		1.0	
500-1000	1.0	1.0	1.0	1.0	1.0					
100-150K	**1.9**	**1.4**	**1.6**	**1.5**	**1.5**	**2.0**	**1.2**	**1.0**	**1.1**	**1.0**
<500	1.3	1.2	1.4	1.3	1.6		1.0	1.0	1.0	
1000-3000	2.0	1.0	1.0	1.0					1.0	
3000-5000	1.0		1.0				1.0		1.0	
500-1000	3.3	2.0	2.2	2.2	1.0	2.0	1.5		1.3	1.0
150-200K	**2.1**	**2.0**	**2.2**	**2.0**	**1.9**	**1.0**	**1.7**	**1.0**	**1.8**	**1.0**
<500	1.1	1.0	1.2	1.2	1.0		1.0	1.0	1.0	
1000-3000	1.5	1.5	1.0	1.0	2.0					
5000+	10.0	6.0	13.0	9.5	5.5	1.0	4.0	1.0	4.0	1.0
500-1000	1.3	1.0	1.2	1.6	1.2		1.3		1.2	1.0
200-250K	**2.2**	**2.1**	**2.1**	**2.2**	**1.5**	**1.0**	**1.2**	**1.0**	**1.3**	
<500	3.0	2.0	1.0	2.0			1.0		1.0	
1000-3000	3.0	3.0	2.0	3.5	1.5		1.0	1.0	1.0	
500-1000	1.8	1.7	2.7	1.8	1.5	1.0	1.5	1.0	2.0	
250-300K	**5.0**	**4.0**	**5.7**	**4.0**	**2.0**	**1.0**	**5.0**	**1.0**	**2.0**	
<500	1.0	1.0	1.0	1.0	1.0					
1000-3000	3.0	3.0	9.0	3.0	1.5	1.0			1.0	
500-1000	11.0	8.0	7.0	8.0	4.0	1.0	5.0	1.0	3.0	
300-500K	**11.0**	**8.2**	**13.0**	**10.8**	**15.3**	**2.0**	**9.3**	**1.0**	**10.0**	**1.0**
<500	1.0	1.0	1.0	1.0	2.0					
1000-3000	3.0	2.0	2.0	2.0			1.0		1.0	
3000-5000	22.0	21.0	32.0	20.0	32.0	3.0	15.0	1.0	16.0	1.0
5000+	14.5	8.5	20.5	20.5	13.5	1.5	10.5	1.0	11.5	1.0
500-1000			2.0	1.0						
500K+	**18.0**	**10.0**	**40.0**	**12.7**	**4.0**	**2.7**	**7.0**	**1.0**	**5.3**	**1.0**
1000-3000	6.5	4.5		5.5		1.5	2.5		2.5	1.0
5000+	41.0	21.0	40.0	27.0	4.0	5.0	16.0	1.0	11.0	1.0
Grand Total	**3.5**	**2.9**	**3.6**	**3.0**	**3.3**	**1.6**	**2.6**	**1.0**	**2.7**	**1.0**

Source: Company, HDFC sec Inst Research

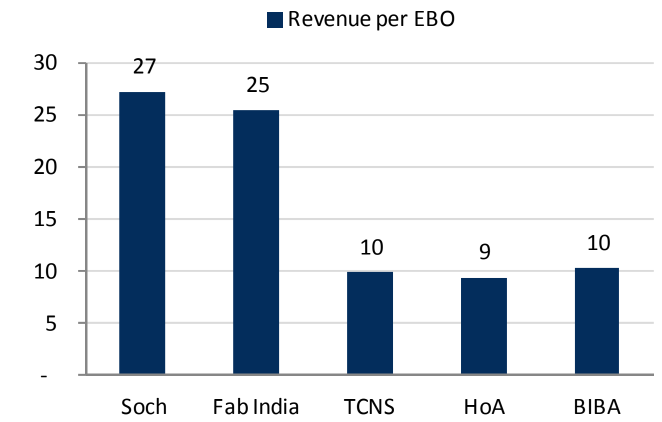
- **Store ageing profile:** TCNS boasts a healthier store age profile vs most peers with 25-30% of it's stores below 2 years of maturity. This should help TCNS clock a reasonably SSSG in the near future. While productivity differential isn't much between TCNS, Biba and HoA; the former sports a leaner cost structure vs key peers. Note: Fab India stores are typically 8-10x the size of its ethnic peers, hence while on a per store basis, productivity seems high; on a square footage basis, it is estimated to be the lowest within the ethnic wear cohort.

Retailer-wise store-age profile

% Distribution	Age <1 yr (%)	Age 1-2 yr (%)	Age >2 yrs (%)
W	12.5	15.0	72.6
Aurelia	14.9	16.3	68.8
Wishful	80.0	20.0	-
Biba	11.7	10.0	78.3
Fab India	2.0	13.9	84.1
House of Anita Dongre (HoA)	-	38.2	61.8

Source: Company, HDFC sec Inst Research

Retailer-wise revenue/EBO (Rs. mn)



Source: Company, HDFC sec Inst Research, unlisted players revenue per EBO are estimates

- **Retailers diverge in expansion strategy:** Most ethnic retailers have expanded their footprint via a mix of Exclusive Brands Outlets (EBOs - leased), Large format department stores (LFS), MBOs and online. Within EBOs, our interactions across ethnic wear retailers suggest that ex-TCNS, most prefer expanding via leased Exclusive Brands Outlets (EBOs) and online in the current phase. This stance, we believe could partly be due to scale constraints which may in turn be limiting franchisee takers. TCNS' strategy deflects from its peers in that it believes to have a healthy mix of franchisee stores too (over 35-40% of its EBO base currently).

- **TCNS - Leanest amongst all:** The strong mix of franchisee EBOs/MBOs/online revenue (~33% of sales in FY19) - booked outright keeps working capital leaner (as inventory not on TCNS's books). Fixed asset turnover also quickens as no capex involved. Hence, TCNS sweats its fixed asset base nearly 2-4 times more vs most peers. Our back-of-the-envelop calculation suggests that even within EBOs, TCNS is estimated to turn inventory faster vs peers. For peers, pace of growth may remain in check as 1. Focus moves to fixing deteriorating working capital, 2 Expansion via leased EBOs (capex-heavy).

High operational cost structure makes the category vulnerable to disruption from online as well as deep-pocketed peers who have ambitions to penetrate aggressively in this category

That said, don't see material disruption over the next 2-3 years though, given the current scale of the organized play.

However. at the risk of being prescriptive, TCNS might need to get leaner on the operational cost front over the medium to long-term, to make it less susceptible to disruption

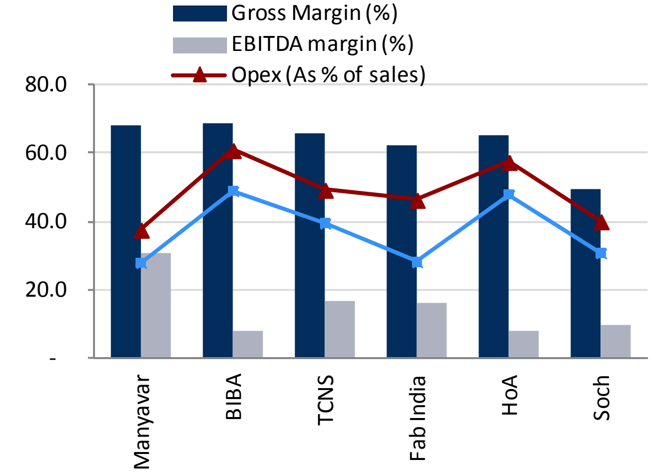
Peer Comparison

Retailer-wise expansion strategy

Ethnic Retailers	Expansion Strategy
TCNS Clothing	EBO -owned & franchised, LFS, online, MBO
Biba	Predominantly EBO -owned, LFS, online, MBO. Franchised EBOs remain limited
FabIndia	EBOs, online
House of Anita Dongre	EBO -owned, LFS, online
Soch	EBO -owned, LFS, online

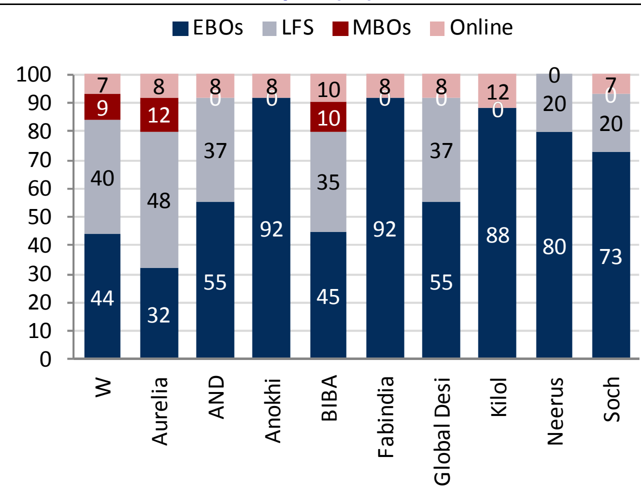
Source: Company, HDFC sec Inst Research

Retailer wise: Margin and Cost structure (%)



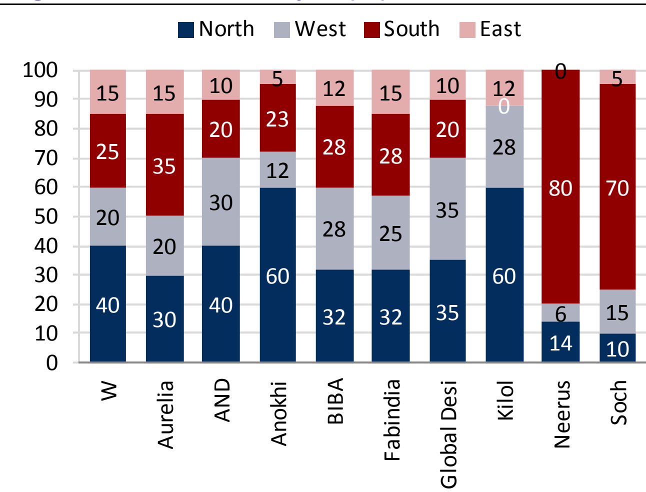
Source: : Company, HDFC sec Inst Research

Channel-wise revenue split (%)



Source: TCNS RHP, HDFC sec Inst Research

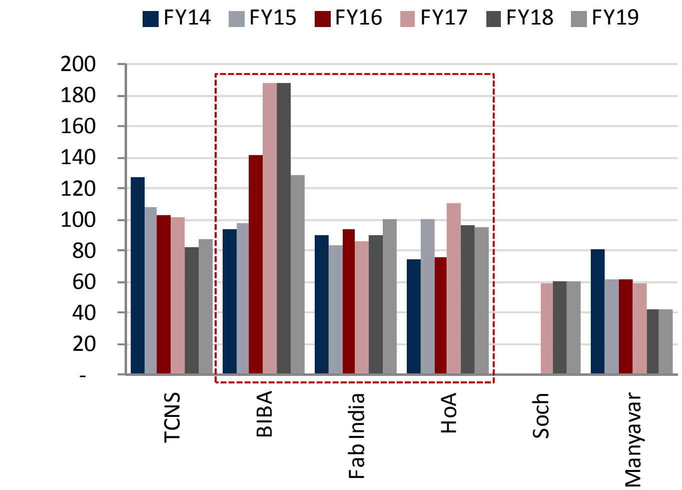
Region-wise revenue split (%)



Source: : TCNS RHP, HDFC sec Inst Research

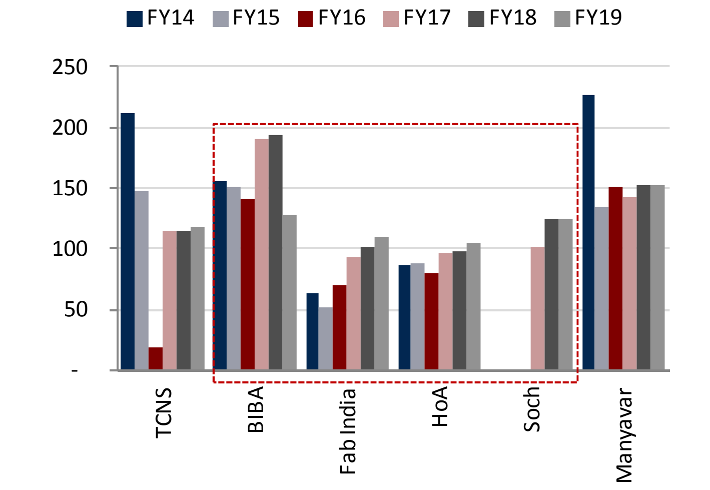
Inventory days and working capital needs have inched up for most peers over the last 4-5 years, while it has improved for TCNS Clothing

Retailer-wise inventory days



Source: Company, HDFC sec Inst Research, , Note FY19 numbers for Biba are not like-to-like due to IND-AS 115 accounting changes

Retailer-wise CC Cycle (days)

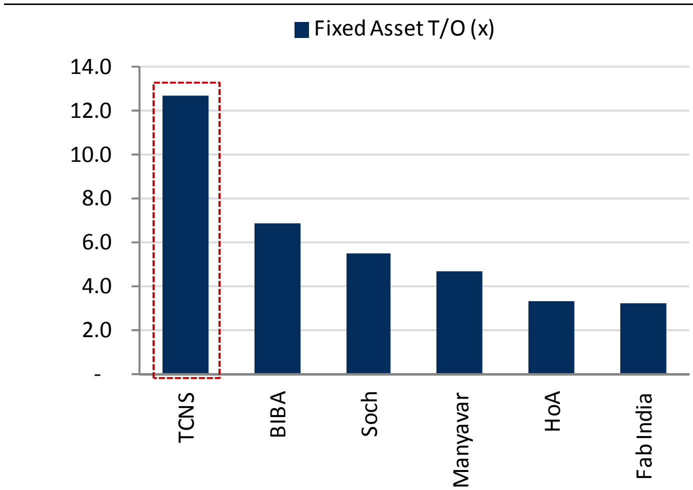


Source: : Company, HDFC sec Inst Research, , Note FY19 numbers for Biba are not like-to-like due to IND-AS 115 accounting changes

Acceptance of TCNS's product across channels (Higher LFS & franchised EBO skew) ensures a higher Fixed asset turnover viz-a-viz peers.

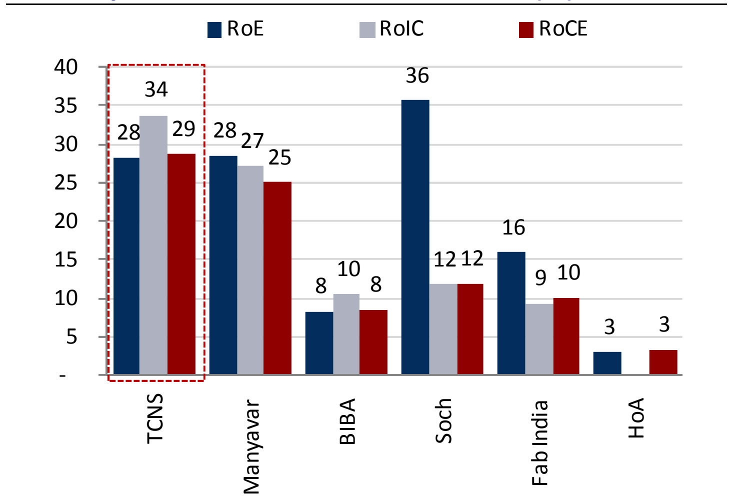
Note this is a scale-led advantage and peers may catch up over a period of time. However, this typically is a long journey

Retailer-wise Fixed Asset Turnover



Source: Company, HDFC sec Inst Research

TCNS sports best-in-class return ratios (%)



Source: : Company, HDFC sec Inst Research

Note: VF forward caters to urban value seekers consequently the SKUs are skewed towards the Rs. 500-1000 price points.
***Retailers incl.* -FBB, Pantaloons, Max, Trends, Zudio, Unlimited**

VF mass focuses on rural value seekers (<Rs. 500 price point)
Retailers incl.* as *VMART, V2 Retail, City Life, Bazaar Kolkata, 1Indiamart and City Kart etc

Value Fashion - where the Juice is!

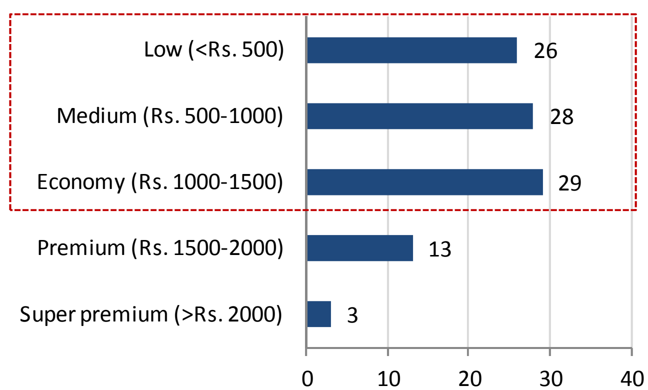
- Popular and mass products (<Rs. 1000) constitute ~54% of the Rs. 3.5tn Indian apparel market and has the biggest target group in India. Top retailers account for a meager 13% of the value fashion (VF) market.
- Format remains amongst the most successful (24% revenue CAGR over FY16-19) & profitable ones across apparel retail. Our 13-member VF universe sports the fastest growing footprint across categories too (estimated 12mn sq. ft added over FY16-19).
- Low cost of biz remains a strong safety net against an online onslaught especially for VF mass retailers.
- Tail of VF mass seems out of gas and may present an opportunity for strong incumbents such as V-MART to make further in-roads.
- Within our VF universe, we prefer outfits with a denser network and sharply priced assortment mix such as Max Fashion and V-MART as this aids productivity and improves top-of-the-mind recall. Of Note, Pantaloons is expected to catch up on the store density front and is amongst the most improved value fashion retailers in recent times.

- **Value Fashion – Biggest play in apparel:** Popular and mass products **(<Rs. 1000)** constitute ~54% of the apparel market and has the biggest target group in India. Penetration-led opportunity for VF retailers remains massive as top players account for a meagre 13% of the value fashion market.

- VF retailers in India have clearly positioned themselves across two price points based on their customer profile.

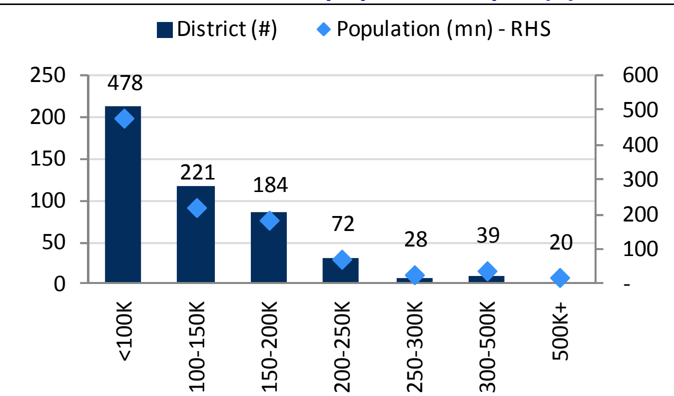
1. VF Forward – focusing on fashion forward clothing at affordable prices (Rs. 500-1000) and largely catering to tier 1/2 cities
2. VF mass retailers (Rs. <500) cater to the aspirations of Tier 2/3 towns.

Price-point share in Apparels (%)



Source: FLFL, HDFC sec Inst Research

Income-wise district and population split (#)

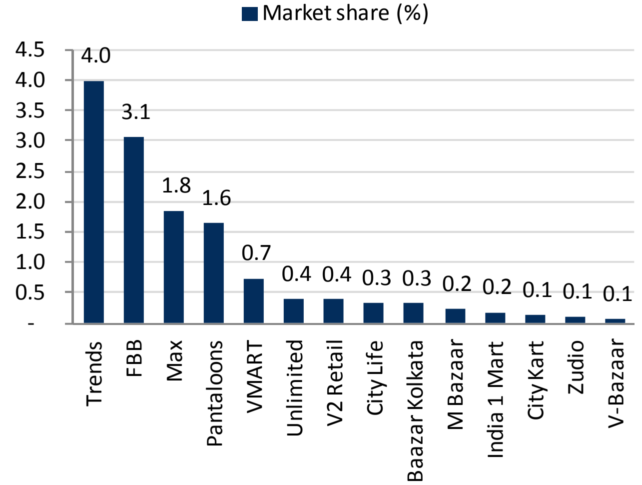


Source: HDFC sec Inst Research. Sample size 463 districts accounting for 85-90% of retail spends in India

The Value fashion format has been one of the most successful and profitable formats across apparel retail.

Once scaled successfully, the return profile on offer is one of the best in industry.

Value Fashion – Revenue market share (%)



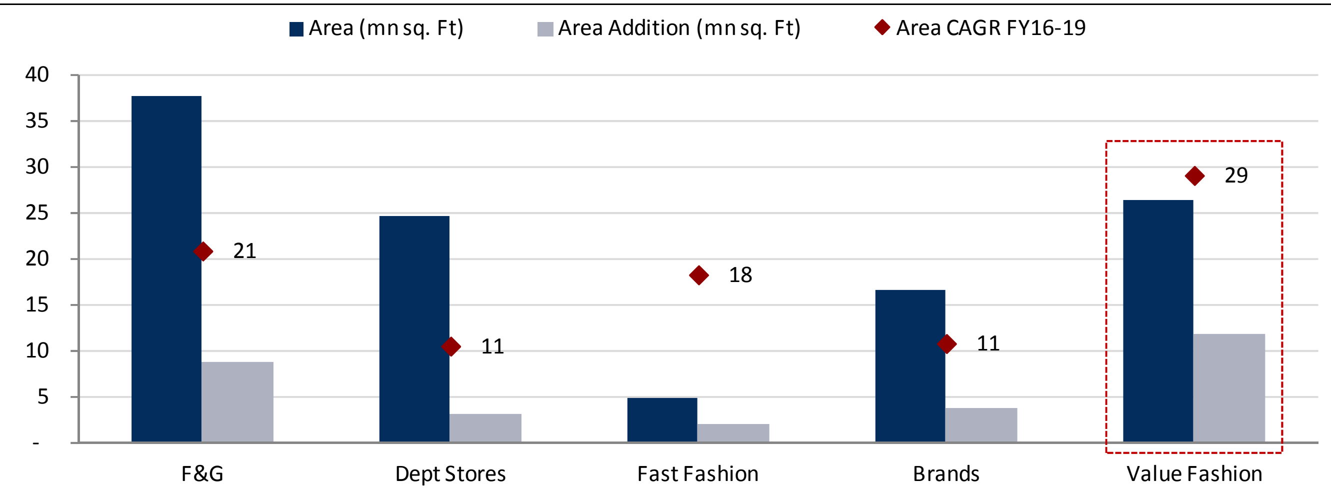
Source: Industry, Company, HDFC sec Inst Research

Tier-wise store distribution (%)

	Tier-1	Tier-2	Tier-3	Tier-4
Fbb	41.3	30.7	25.4	2.5
Pantaloons	44.2	32.5	20.9	2.5
Zudio	64.3	28.6	4.8	2.4
Max	59.4	24.6	13.8	2.2
V Mart	15.9	23.4	46.3	14.5
V2 Retail	16.9	19.5	48.1	15.6
Style Baazar	9.5	7.9	46.0	36.5
Citykart retail	8.1	21.6	51.4	18.9
Citylife	19.1	17.3	43.6	20.0
M Baazar	17.2	13.8	53.4	15.5
Baazar Kolkata	22.6	16.1	30.6	30.6
1 India Mart	12.3	7.4	39.5	40.7

Source: Company, HDFC sec Inst Research

Value fashion has seen the fastest area addition across formats



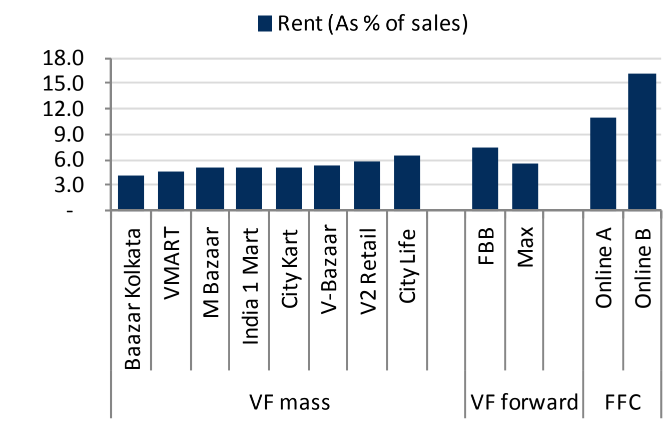
Source: Company, HDFC sec Inst Research

Low cost of biz = Safety net!

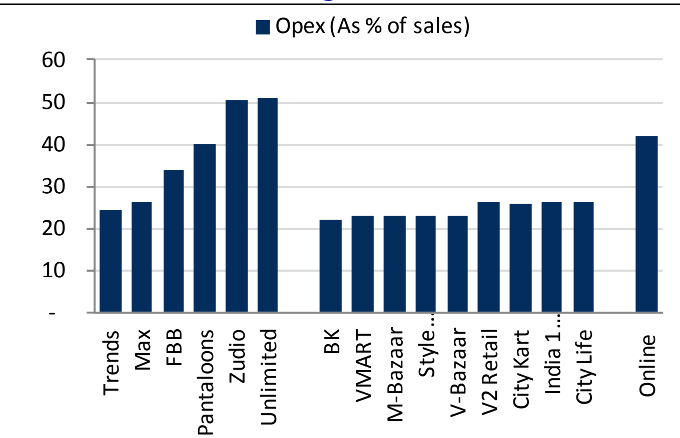
- **Rent < Fulfilment cost = Safety net:** In Retail, the online opportunity primarily stems from category-specific intermediation inefficiencies of Brick & Mortar (B&M) outfits. However, 1. Low average order value AoV) in value fashion (for VF forward: Rs. 1200-1600 and VF mass: Rs. 750-800), 2. Lower gross margins & tight cost structure given lower rentals (VF 4-8%), ensures that the category remains off-limits for online folks to venture into profitably. On the other hand, return rates in apparel for online players (20-30%) remain high and **fulfilment costs for key fashion e-tailers remain elevated (estimated to be 10-15% of sales).** We believe this steep arbitrage in biz acts as a safety net for value fashion, especially VF mass.
- **...Meanwhile**, Industry interactions suggest that while key e-tailers are increasing their omni-assets in tier 2/3 towns, the primary focus remains on milking the urban consumer base. Financials of Walmart-backed Myntra suggests that the fashion e-tailer may have stepped up clearance sales in FY19. (Gross margins down by >600bp, inventory days have nearly halved). Interestingly, payables have halved too (While a step up in clearance sale may be a one-time adjustment as Walmart tightens operations, we suspect, better terms of trade may become a new normal to woo more brands on the platform (Myntra) and extract better trade margins from them. **(Refer Myntra's FY19 performance)**
- It also important to understand that from a capital allocation point of view, F&G is expected to attract a big chunk of Walmart's capital in India. Hence, if the group were to even maintain cash burn, improvement in Myntra's profitability is an imperative. Hence, (at the risk of being prescriptive), a higher focus on brand sales and private labels makes more sense than being aggressive on the low AOV, low margin value fashion segment.

Note, we have arrived at fulfillment costs for online retailers after adjusting for inter-company transactions based on our understanding of the their capital structure (FY18 financials)

Low rentals and leaner cost structure keeps value fashion insulated from a meaningful online intrusion



Source:Company, HDFC sec Inst Research, FFC: fulfillment cost as % of sales

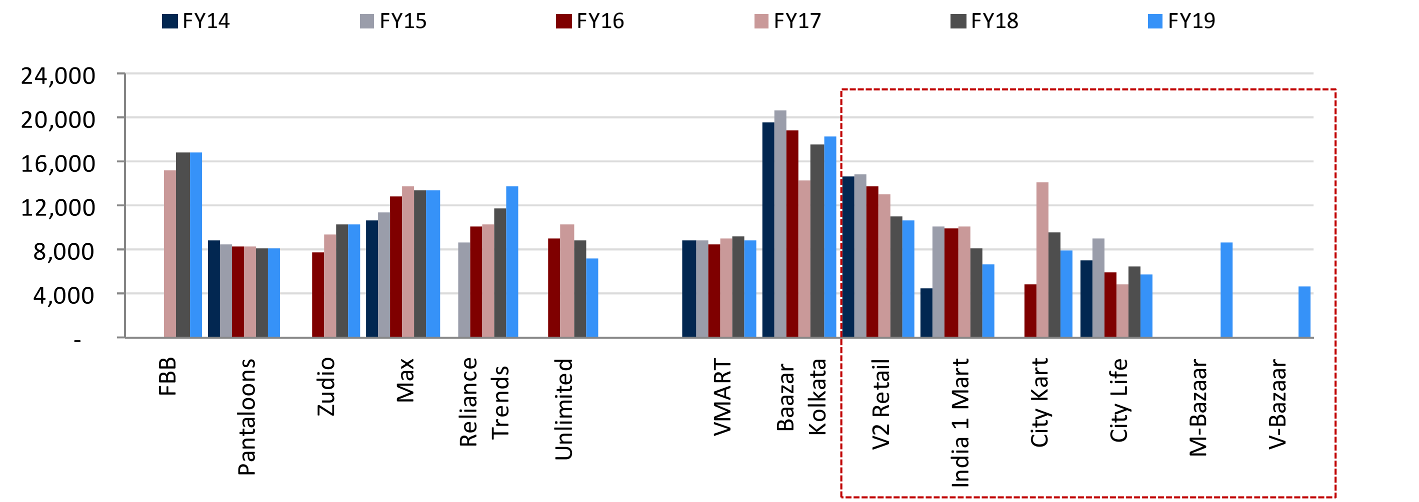


Source: Company, HDFC sec Inst Research, Estimates used for VF forward retailers

Is the tail out of gas?

- **Competitive intensity in VF mass at tipping point!** PE-funded tail-end of VF mass retailers have been expanding their footprint in Tier 3/4 markets (mainstay VMART markets) over the past few years. However, quality of growth remains elusive across the tail. (SSSG seems absent as sales velocity is coming off for most). VMART, on the other hand has remained largely consistent throughout.

In VF mass, sales velocity across the tail seems to be coming off



Source: Company, HDFC Securities, estimates used for VF forward retailers

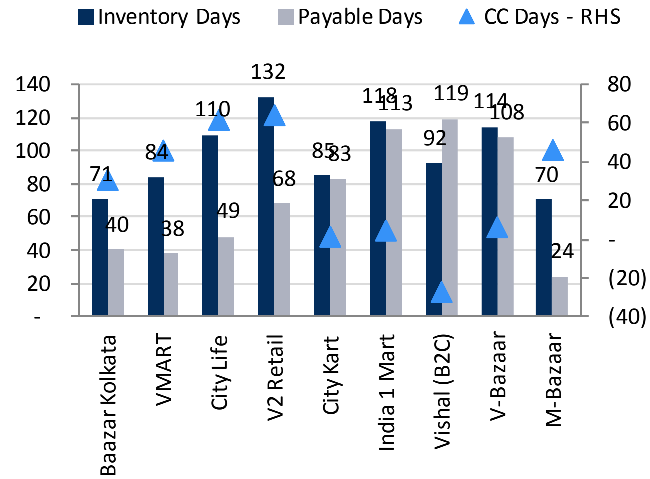
- **Some may well be out of gas!** Vendors of VF mass (tail-end) retailers may very well be at the end of their tether as creditor cycles run up as high as 6 months (on COGS) for some. Unless store productivity and inventory management improves, an existential crisis may be lurking around the corner. VMART will be a key benefactor. While leverage position for some of these troubled firms may be comfortable and the working capital issue could be partly mitigated by raising more debt, others seem precariously placed within the ecosystem. We believe, in the short term, V-MART may suffer margin pressure (as it did in 1QFY20) as inventory gets liquidated across the tail-end, however, in the medium-to-long term, one could expect some consolidation of market share in favour of the industry leader. **Even if V-MART captures 25% of the revenue (of weak operators) at risk, we are looking at a >Rs. 5bn opportunity.**

- Some VF forward formats – Pantaloons, Style-up, Easybuy and FBB have also started entering VMART's bread-n-butter territory (North & East) However, we reckon the focus will be on filling white spaces in higher PCI districts over the next 2-3 years in order to make respective networks denser. Also, the price differential (Avg. VF forward ASP is ~60% higher vs VF mass) remains high. between both formats (VF forward and VF mass), hence, the value proposition differs between the two.

Note:
1. V2 Retail had an investment heavy FY19 given the inventory build up for new stores. Ergo, the –ve CFO. For unlisted players CFO is for FY18.

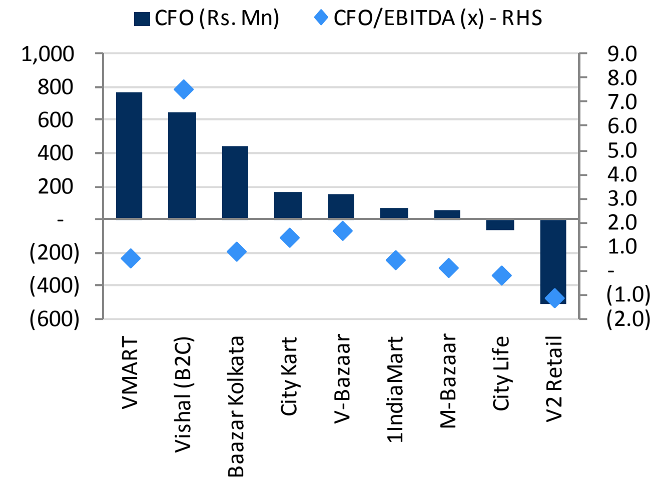
2. VF forward retailers are typically owned by brands/dept stores, which account for lion's share of their CFO generation

Cash conversion cycle across VF mass retailers



Source: Company, HDFC sec Inst Research

Cash generation remains weak for the tail (VF mass)



Source: Company, HDFC sec Inst Research, For unlisted companies, CFO is for FY18, For Vishal B2C (If support of other current liabilities is assumed as debt, then CFO is –ve)

- **Millennials want variety – Who's up for it?** The millennial is a discerning consumer - prefers a buffet over lunch, likewise prefers variety over a fixed shopping basket. Hence, width in assortment balanced with tighter inventory control will separate the men from the boys. Global fast fashion empires have been built on this one insight! An early adopter of this strategy in the value fashion space is Max Fashion. It now operates on an 8 season/year calendar (45 days/season). VMART too is increasingly focusing on width over depth. ABFRL is on the cusp of moving both Madura (brands) and Pantaloons to a 12 season cycle. However, this increases technology and manpower investments as the supply chain needs to be tuned to a much faster feedback loop. We don't see the tail of VF mass being capitalized enough for this yet and incremental funding is getting harder to come by.

- **Winners in our view:** Max Fashion, Pantaloons, VMART, Zudio and Trends most of whom have strong balance sheets courtesy deep-pocketed parents/high cash-flow generating brands/formats to justify such investments.

~47% of Max' stores are located in just 12 high income (PCI)/population dense districts vs ~27% for Pantaloons (10 districts).

30% of Max Fashion's stores are located in districts with PCI of Rs.300k+ and population density of 3000+ per sq. Km or more. This coupled with its assortment mix (strongest in the Rs. 500-1000 range) explains its higher revenue per sq. ft vs peers

Pantaloons is the most widely spread among VF forward retailers.

While entering virgin districts will be on the cards for Pantaloons, we believe, primary focus is expected to be on improving store density within existing presence, especially in the Rs. 100-300k income bracket. Key focus states for expansion are AP, Maharashtra, Rajasthan, Haryana and TN

Who's got the (h)ook? - Distribution & Assortment Edge

- **Tier 1/2 –Advantage Max:** Max Fashion is one of the best calibrated growth stories in value fashion in tier 1/2 cities. **Based on our survey across 463 districts, Max trumps the Per capita income (PCI)/Population density test vs peers. ~47% of its stores are located in just 12 high income (PCI)/population dense districts vs ~27% for Pantaloons.**
- **....What does this mean?** A denser store network means 1. Implementation and roll-out of new fashion lines in stores is quicker and more frequent, ergo freshness quotient remains high throughout the year – Consequently, footfalls and productivity improves. 2. Better top-of-the-mind recall. This explains why Max Fashion sports one of the highest sales densities in value fashion (est: ~13k/sq. ft). **Channel checks** suggest Max Fashion is increasing its presence in North primarily in tier 1/2 cities to de-risk itself from the South market. It intends to take on VF mass retailers in tier 2/3 towns through its Easybuy format (65 stores) – A 5-6k sq. footer. That said, its presence is still largely restricted to the South.
- **Tier 2/3 – Advantage Pantaloons:** While Pantaloons has some white spaces to cover in existing markets, it remains best placed to take on VF mass retailers given a well-rounded store profile (Highest Tier 3/4 presence among VF forward retailers along with FBB) and sharper assortment mix. (Note: Only Zudio's price points are sharper, however, the format is sub-scale to compare currently with peers – Refer to Pg. 93 – SKU Analysis). We expect Pantaloons to work on making its store network denser given the focus on moving from of 4-season to a 12-season model. This should help the format improve lead times, ergo working capital efficiency, increase brand salience and improve productivity for the format.

Max sports a denser store network across VF forward retailers

	Pantaloons		Max		FBB		Pantaloons	Max	FBB
PCI/Population density	Stores	Districts	Stores	Districts	Store	Districts	Store/District		
100-200k	**102**	**56**	**98**	**47**	**91**	**52**	**1.8**	**2.1**	**1.8**
<500	34	30	30	24	32	28	1.1	1.3	1.1
>5000	30	2	36	2	20	2	15.0	18.0	10.0
1000-3000	11	6	6	5	11	6	1.8	1.2	1.8
3000-5000	1	1	-	0	2	1	1.0		2.0
500-1000	26	17	26	16	26	15	1.5	1.6	1.7
200-300k	**40**	**18**	**41**	**15**	**44**	**15**	**2.2**	**2.7**	**2.9**
<500	4	3	3	2	7	4	1.3	1.5	1.8
1000-3000	10	5	23	7	21	5	2.0	3.3	4.2
500-1000	26	10	15	6	16	6	2.6	2.5	2.7
300-500k	**49**	**7**	**74**	**4**	**53**	**8**	**7.0**	**18.5**	**6.6**
<500	2	1	2	1	4	2	2.0	2.0	2.0
>5000	25	2	47	2	29	2	12.5	23.5	14.5
1000-3000	2	1	-	0	1	1	2.0		1.0
3000-5000	17	1	25	1	17	1	17.0	25.0	17.0
500-1000	3	2	-	0	2	2	1.5		1.0
Total	**252**	**112**	**239**	**79**	**236**	**99**	**2.3**	**3.0**	**2.4**

Source: Census, Company, HDFC sec Inst Research, As on FY19 for Top 16 states

Complete footprint for key value fashion retailers

PCI/Population Density	District (#)	No. Of stores					No. Of Districts				
		Pantaloons	Max	Fbb	Zudio	V Mart	Pantaloons	Max	Fbb	Zudio	V Mart
<100k	**209**	**41**	**19**	**40**	**-**	**127**	**29**	**11**	**22**	**0**	**94**
<500	96	5	3	8		18	5	3	7		17
1000-3000	47	20	11	21		63	14	6	9		38
3000-5000	1	7	3	5			1	1	1		
500-1000	65	9	2	6		46	9	1	5		39
>500k	**2**	**20**	**7**	**8**	**-**	**1**	**2**	**2**	**2**	**0**	**1**
1000-3000	2	20	7	8		1	2	2	2		1
100-200k	**201**	**102**	**98**	**91**	**11**	**21**	**56**	**47**	**52**	**9**	**18**
<500	157	34	30	32	1	7	30	24	28	1	7
>5000	2	30	36	20	1		2	2	2	1	
1000-3000	8	11	6	11		5	6	5	6		4
3000-5000	1	1		2			1		1		
500-1000	33	26	26	26	9	9	17	16	15	7	7
200-300k	**36**	**40**	**41**	**44**	**6**	**10**	**18**	**15**	**15**	**5**	**4**
<500	12	4	3	7	2		3	2	4	1	
1000-3000	10	10	23	21	2	4	5	7	5	2	1
500-1000	14	26	15	16	2	6	10	6	6	2	3
300-500k	**10**	**49**	**74**	**53**	**16**	**2**	**7**	**4**	**8**	**3**	**1**
<500	3	2	2	4			1	1	2		
>5000	2	25	47	29	10		2	2	2	2	
1000-3000	1	2		1			1		1		
3000-5000	1	17	25	17	6		1	1	1	1	
500-1000	3	3		2		2	2		2		1
Grand Total	**458**	**252**	**239**	**236**	**33**	**161**	**112**	**79**	**99**	**17**	**118**

Source: Census, Company, HDFC sec Inst Research, As on FY19 for Top 16 states

While the street might be vary of the incremental opportunity for VF mass leader V-MART in the light of increased competitive intensity from VF forward and regional retailers, our network analysis across 463 districts suggests quite the contrary.

Given the precarious position (financial) of the tail of VF mass retailers, the opportunity in mainstay markets (PCI: <Rs. 100k) remain high, the narrative here is largely going to be about market share gain

More importantly, our analysis suggests that there are 24 near virgin districts with PCI of Rs. 100-200k to tap in the North & East and with a population of ~35-40mn (equals V-MART's FY19 footfalls)

V-MART story still has legs!

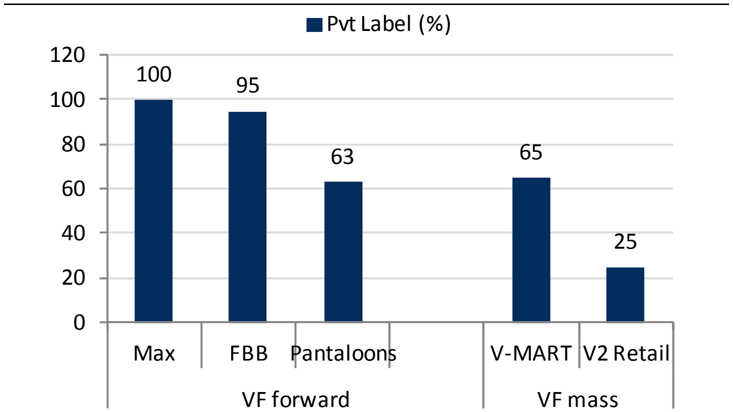
V-MART scores on store density among VF mass peers (store-split based on PCI/population density)

PCI/Population density	Districts (#)	Population (mn)	V-Mart	V2 Retail	Style Bazaar	Citykart Retail	Citylife	M Bazaar	Baazar Kolkata	1 India Mart	Vishal Megamart
<100k	**209**	**478**	**127**	**37**	**34**	**33**	**47**	**30**	**28**	**54**	**47**
<500	96	140	18	7	4		6	3	6	5	9
1000-3000	47	162	63	20	13	24	21	15	14	27	21
3000-5000	1	5								1	6
500-1000	65	171	46	10	17	9	20	12	8	21	11
>500k	**2**	**20**	**1**	**2**	**-**	**1**	**1**	**-**	**-**	**-**	**25**
1000-3000	2	3	1	2		1	1				6
5000+	1	17									19
100-200k	**201**	**407**	**21**	**9**	**15**	**1**	**14**	**16**	**21**	**2**	**62**
<500	157	280	7	5	5	1	3	2	3	0	33
>5000	2	9			1		5	5	7		2
1000-3000	8	40	5	1	7		5	5	7		4
3000-5000	1	5			1			2	2		0
500-1000	33	72	9	3	1		1	2	2	2	23
200-300k	**36**	**100**	**10**	**3**	**4**	**-**	**1**	**2**	**3**	**3**	**13**
<500	12	22		1							1
1000-3000	10	40	4	2	4		1	2	3	2	3
500-1000	14	38	6							1	9
300-500k	**10**	**39**	**2**	**3**	**-**	**-**	**-**	**-**	**-**	**1**	**11**
<500	3	3		1							2
>5000	2	16		1							1
1000-3000	1	2		1							2
3000-5000	1	10									4
500-1000	3	8	2							1	2
Grand Total	**458**	**1,043**	**161**	**54**	**53**	**35**	**63**	**48**	**52**	**60**	**158**

Source: Company, HDFC Securities, Data for Top 16 states as on FY19

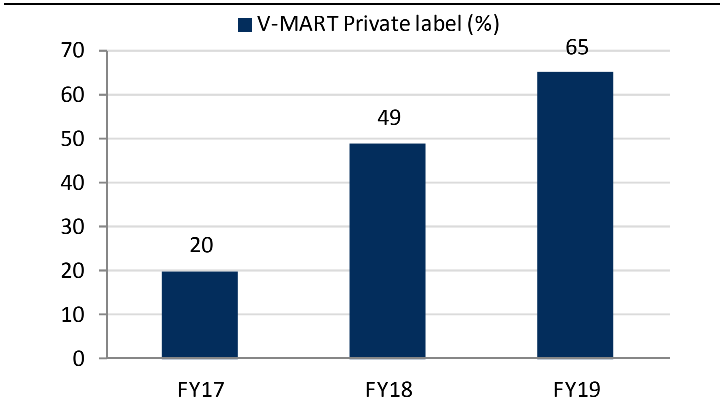
- **V-Mart taking a leaf out of peers' book:** VMART's national peers are playing value fashion primarily through their private labels as it gives complete control on the value chain. V-MART too has significantly beefed up its private label portfolio form 20% in FY17 to 65% in FY19. However, procurement continues to be largely vendor-led. The vendor in turn hires multiple job workers. Hence, GMs on private labels vs rest of the assortment is largely similar as an additional layer of intermediation exists. **However, over the last year, the company has beefed up its design and quality team to implement it's private label 2.0 strategy. Our three store visits a year apart also hint at a spike in aggression in calling out its 9 private labels in stores. Benefits are two-fold:**
  - Higher/consistent contribution of in-house/contract-manufactured private labels means stickier customer base and better inventory control
  - Assortment becomes increasingly margin accretive. (+200-300bp) vs 3P merchandise. Although, expect V-MART to pass on benefits to consumers.

Private labels contribution across VF retailers



Source: Company, HDFC sec Inst Research

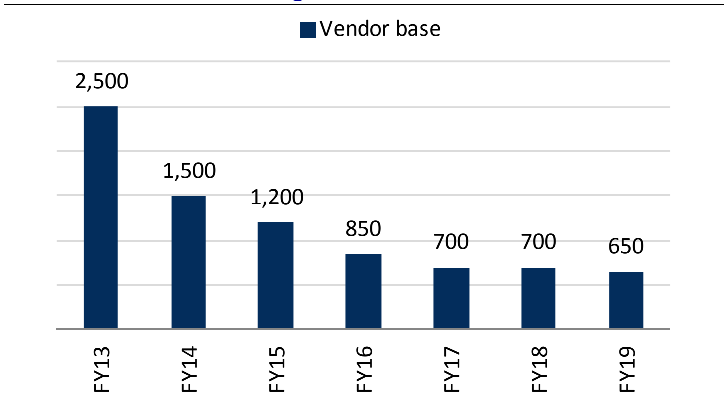
VF added highest retail space over FY16-19



Source: Company, HDFC sec Inst Research

- **Vendor rationalization – Imperative to move to the next orbit:** While the tail suffers, industry leader (VF mass) VMART is preparing itself to move to the next orbit of growth. It has been rationalising its vendor base in order to 1. sharpen its control on private labels and other assortment as well, 2. Extract better sourcing benefits (more volume-based discounts) as it scales further. This explains the 370bp bump up in gross margins over FY15-19.

VMART: Rationalising vendor base



Source: Company, HDFC sec Inst Research (estimates)

Overall Max and Trends seem to have the most well-rounded SKU portfolio across Men, women and Kids in the Rs. 500-1000 price point

...This gets reflected in their productivity too

Zudio & Pantaloons are strong in sub Rs. 500 price point and are best-placed to take on VF mass retailers on pricing. LI through its Easybuy format intends to make in-roads in VF mass market.

Pantaloons assortment positioning is reflective of its higher tier 3 skew vs VF forward peers

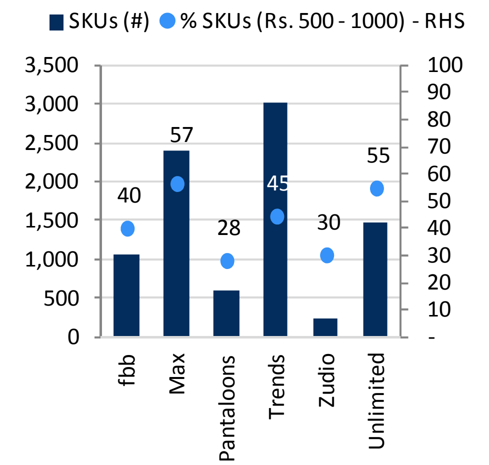
Pantaloons and Zudio are closest to VF mass in terms of pricing

Within apparel, Womens, Kids and Men's casual wear are the fastest growing segments

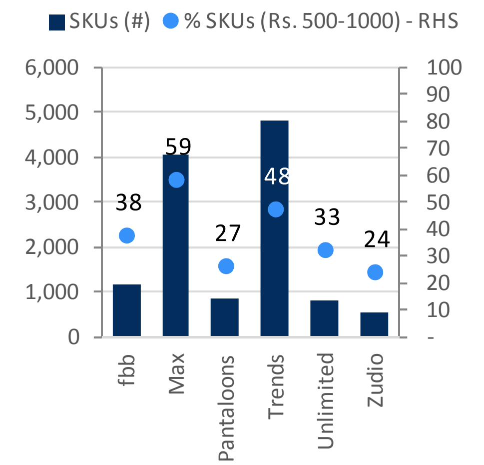
Note: VMART's SKU coverage is a sample set

Merchandise says it all!

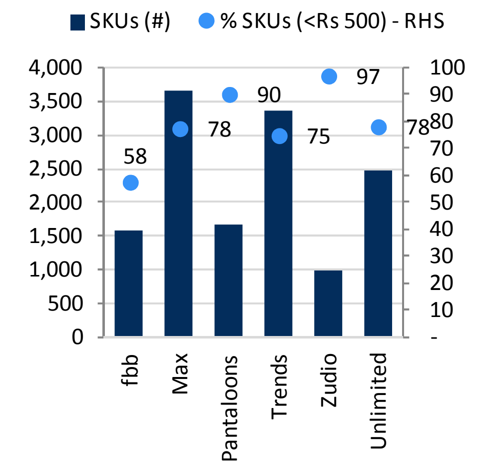
Men SKUs (Rs. 500-1000)



Women SKUs (Rs. 500-1000)

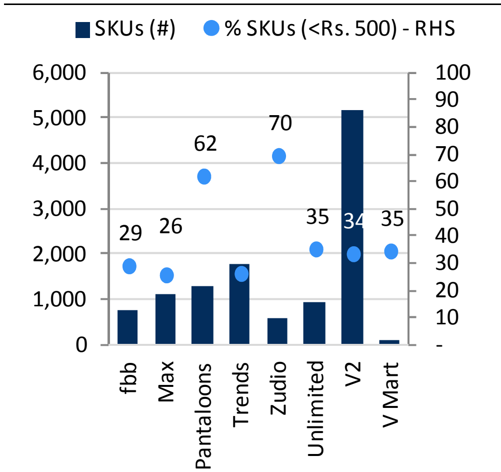


Kids SKUs (<Rs. 500)

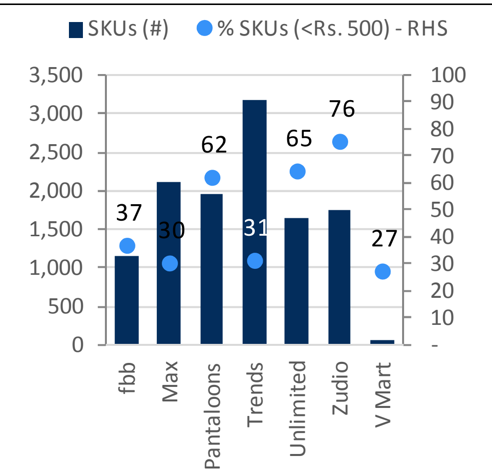


Source: Company websites, HDFC sec Inst Research

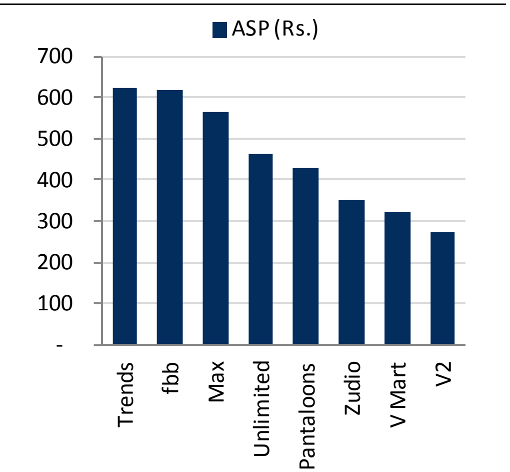
Men SKUs (<Rs. 500)



Women SKUs (<Rs. 500)

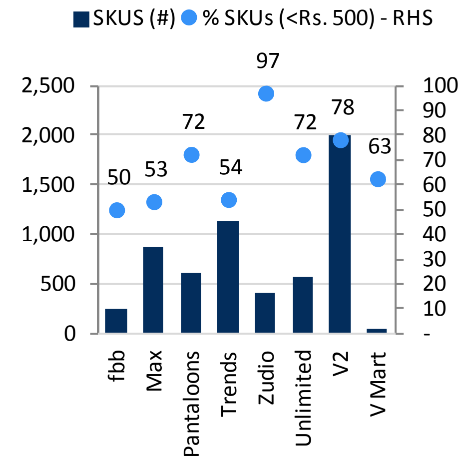


ASPs across value retailers (Rs.)

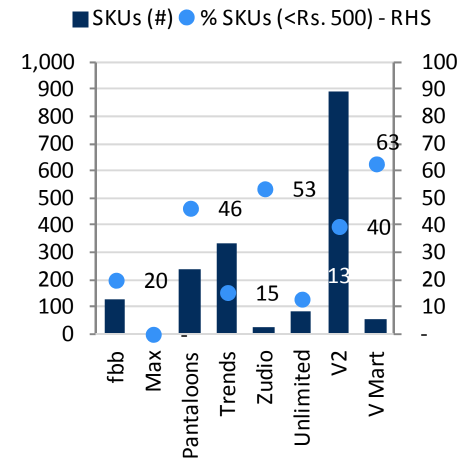


Source: Company websites, HDFC sec Inst Research

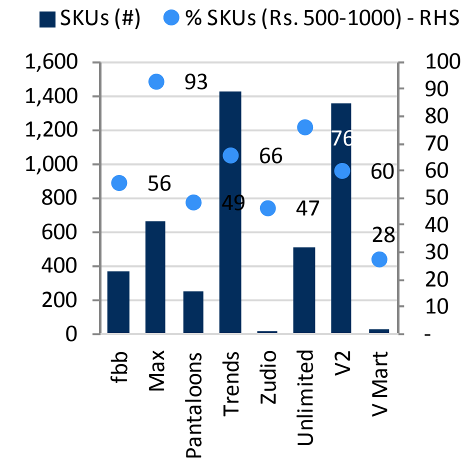
Men T-shirts (<Rs. 500)



Men Casual shirts (<Rs. 500)

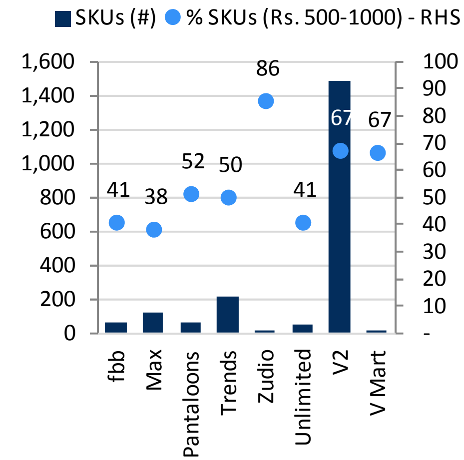


Men Casual shirts (Rs. 500-1000)

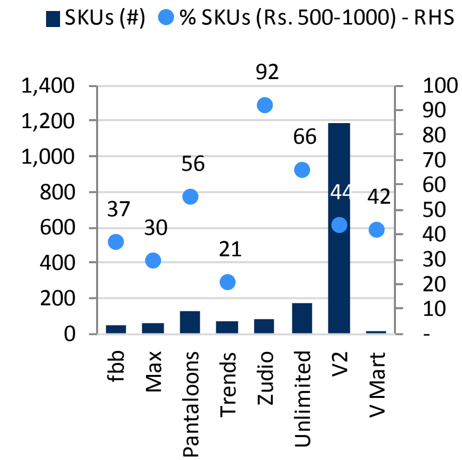


Source: Company websites, HDFC sec Inst Research

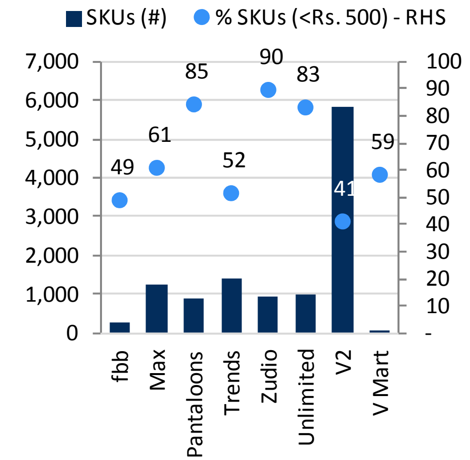
Mens Trousers (Rs. 500-1000)



Mens Jeans (Rs. 500-1000)



Women’s Tops/Tees (<Rs. 500)



Source: Company websites, HDFC sec Inst Research

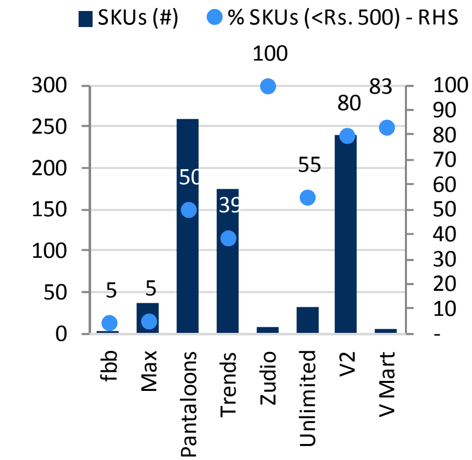
In the faster-than-category growing women's dresses segment, the sweet spot in pricing is typically sub-Rs1000 in value fashion, Max leads while Pantaloons, and Trends compete closely

In Women's pants, the sub 500 price point is dominated by Pantaloons and Zudio, while the Rs. 500-1000 price point is Max/Trends' anchor price point for the category

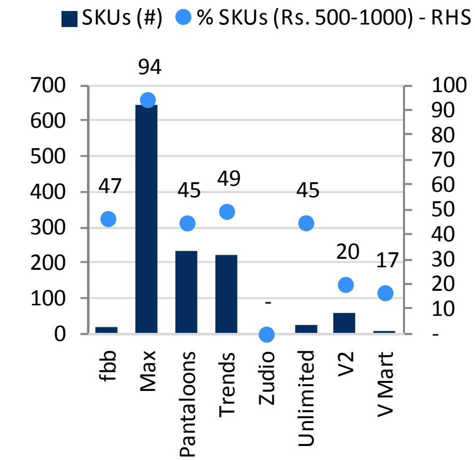
In Women's Jeans Pantaloons leads the VF forward pack in the 500-1000 price point

We refrain reserve comments on Zudio and Unlimited although promising formats as both businesses are sub-scale currently.

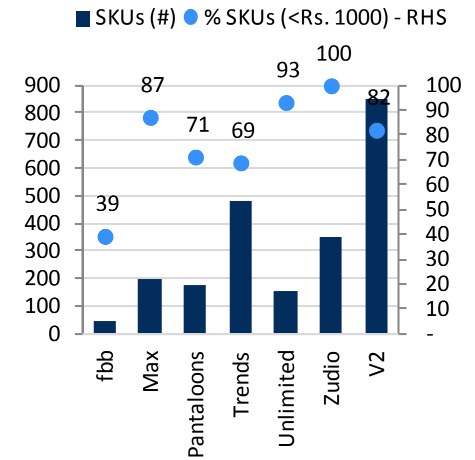
Women shirts (<Rs. 500)



Women shirts (Rs. 500-1000)

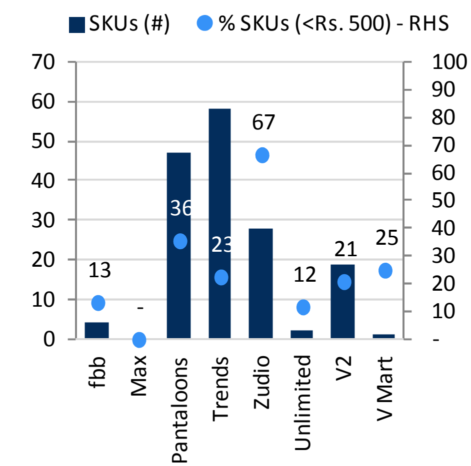


Women Dresses (<Rs. 1000)

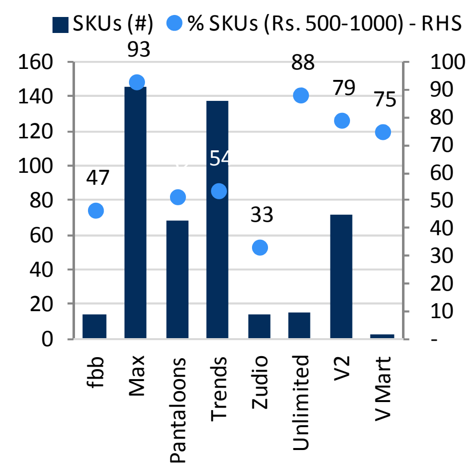


Source: Company websites, HDFC sec Inst Research

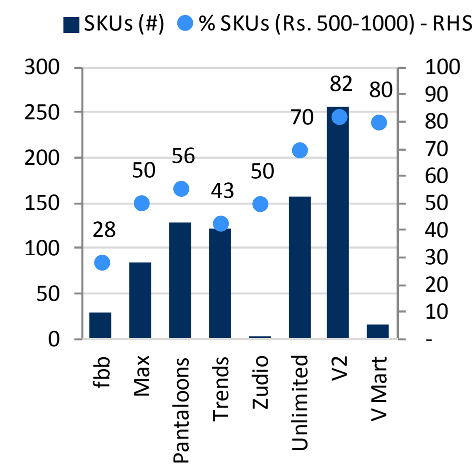
Women's Pant (<Rs. 500)



Women's Pant (Rs. 500-1000)



Women's Jeans (Rs. 500-1000)



Source: Company websites, HDFC sec Inst Research

Typically a strong regional retailer enjoys better productivity, profitability per sq. ft and sourcing benefits within their strong catchments. Assortment leadership also aids productivity.

Unless expansion is disciplined and in clusters, supply chain costs can spiral as one broadens its footprint and one can't afford a high cost structure in VF as profitability hinges on volume/scale

Note:
We've used estimates for VF forward retailers and unlisted retailers.

Comparing Zudio and Unlimited may be unfair as both formats at a nascent stage of evolution

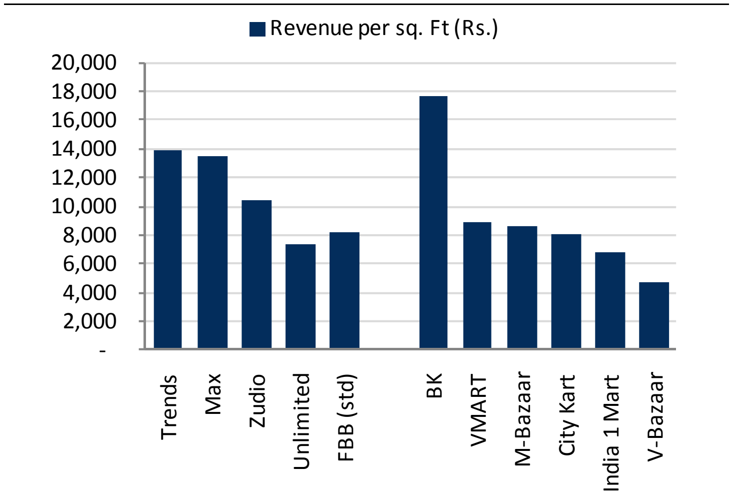
Peer Comparison

- **Productivity leaders in Value fashion:** Productivity leaders typically sport 1. Denser networks, 2. Assortment leadership. Max Fashion and Trends score on this parameter in Value Fashion (Rs. 500-1000) category, while Pantaloon lags. That said, we expect the latter to catch up on productivity in the medium term as its network gets denser. Within, VF mass, Baazar Kolkata (BK) leads the pack. However, store expansion seems to have hit pause for BK as focus moved to restoring productivity post the FY17 dip.

- **Margin Profile and cost structure:** While gross margins in VF forward are higher than VF mass, they don't translate into higher EBITDA margins given the higher opex structure. We reckon higher rents and A&P spends given a higher tier 1/2 presence) bulk up the cost structure for VF forward retailers.

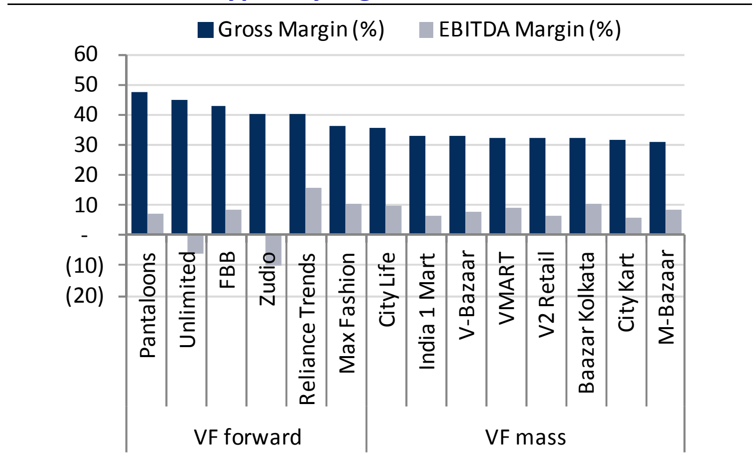
- Unless expansion is disciplined and in clusters, supply chain costs can spiral as one broadens its footprint and one can't afford a high cost structure in value fashion as profitability hinges on volume/scale. **Cost structure is where V-MART scores**, despite average productivity, V-MART's cluster-based expansion has helped it expand at a lean cost structure historically.

Max, Trends, Baazar Kolkata lead their respective formats in productivity



Source: Company, HDFC sec Inst Research, Note data for VF forward retailers are estimates

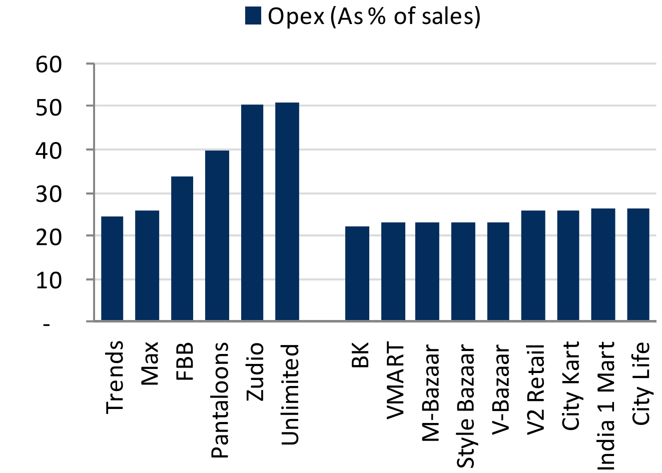
VF forward retailers sport better gross margins; Alas, doesn't translate into higher EBITDA margins as cost structures are typically higher vs VF mass



Source: Company, HDFC sec Inst Research, Note GMs for VF forward retailers are estimates

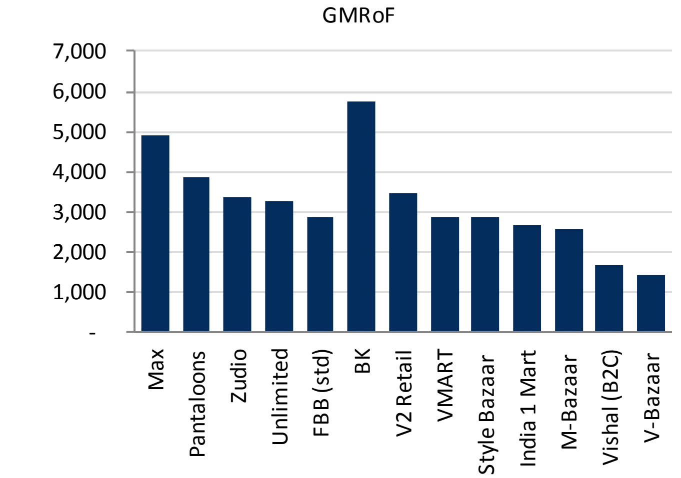
V-MART's cluster-based expansion has helped it expand at a lean cost structure historically. The retailer remains one of the tightest run companies in the VF space

VF mass sports leanest cost structures in industry



Source: Company, HDFC sec Inst Research , Note data for VF forward retailers are estimates

Peer-wise gross profit per sq ft (Rs.)



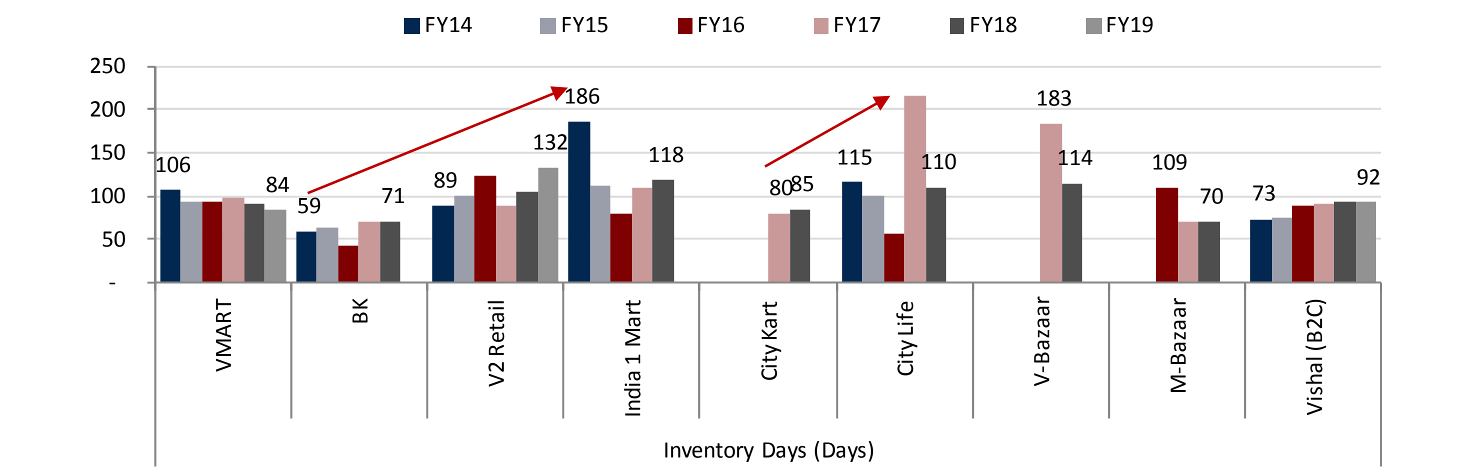
Source: Company, HDFC sec Inst Research, Note: Zudio is at a nascent stage, hence, comparison may be unfair

Sharper real estate choices and disciplined expansion has helped V-MART maintain a higher working capital quality when juxtaposed vs peers. Payable support of the tail has been increasing over the years, while that for V-MART remains consistently low

Inventory days for the tail is also inching up

- **Working capital quality:** V-MART is more disciplined in working capital management too given its sharper real estate choices and disciplined expansion V-MART scores on working capital management too. Peers seem to be slipping on this front as both inventory and payables' support is increasing for most.

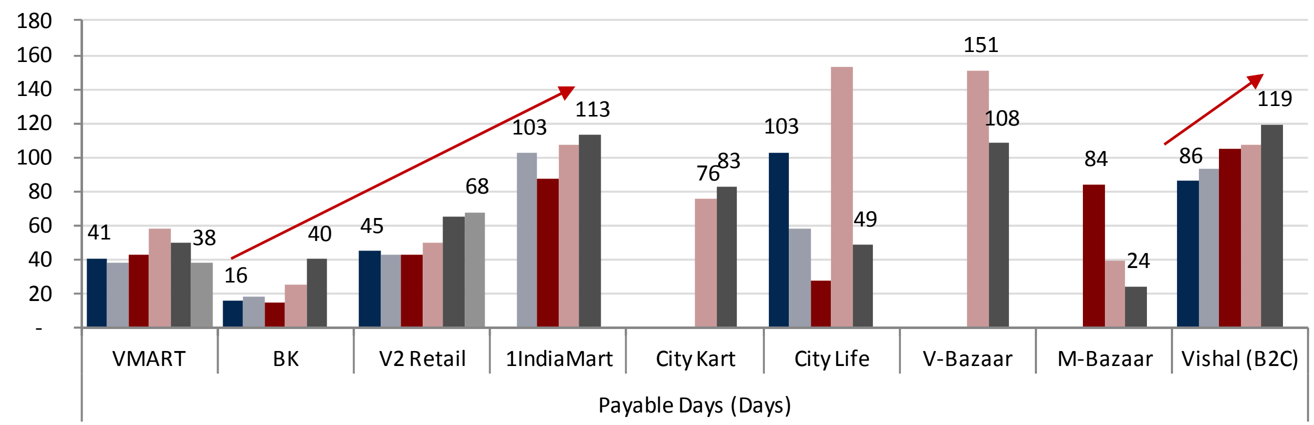
While V-MART's inventory days have declined, the same cannot be said about the tail



Source: Company, HDFC sec Inst Research

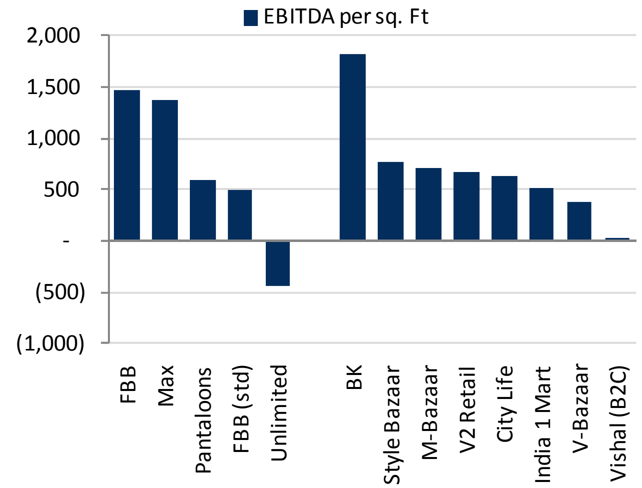
Return profile is hence inflated for some of V-MART's peers given the payables' support

Ex V-MART, payables' support for the VF mass tail has been on the rise; SOMETHING'S GOT TO GIVE!



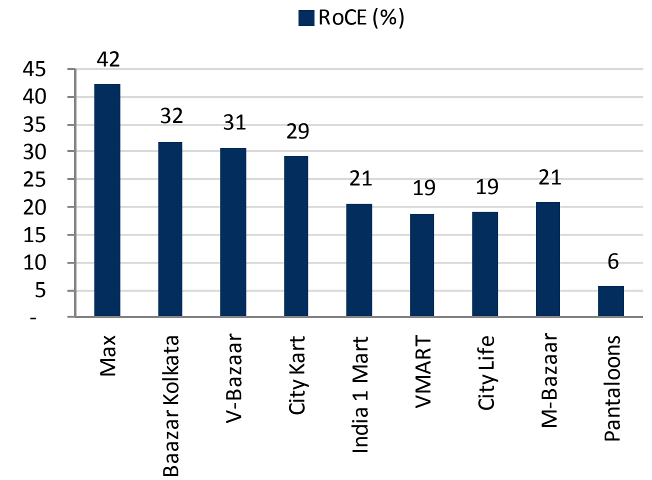
Source: Company, HDFC sec Inst Research

Peer-wise EBITDA per sq ft (Rs.)



Source: Company, HDFC sec Inst Research

Peer-wise return profile



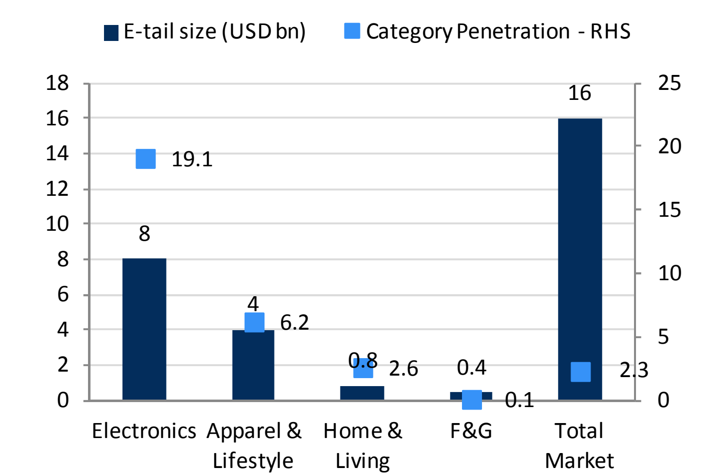
Source: Company, HDFC sec Inst Research

What are the online horizontal folks upto?

- E-tailers' contending basket is getting narrower with only a few serious players standing – Walmart (via Flipkart), Amazon, Reliance and Alibaba (via Snapdeal, PayTM Mall and Bigbasket). Alibaba, seems to have hit pause too in the horizontal space and is primarily focusing on high frequency categories such as F&G.
- Cash burn continues to be an unhealthy concoction of 1. Goods sold at cost/less, 2. Services revenue just about cover fulfillment costs & 3. Elevated marketing spends. To put it simply, Revenue </= Variable cost.
- E-tailers may find themselves in a Catch 22 situation as they tread the scale-profitability equation going forward. Our analysis suggests e-tailer's need 5x FY18 scale, 300bp higher gross margins, 10-25pp lower cost structure to hit profitability. However, to achieve said scale over the next 5-7 years, presence in the low AoV, low GM F&G category is an imperative – A classic catch 22
- While losses continue to mount (Amazon + Flipkart's FY18 cash burn is estimated at >USD2bn), investments continue unabated (Amazon/Flipkart infused ~Rs.73/>30bn in FY19 YTD). That said, we expect "infinite balance sheets" of global retailers to continue funding losses for the foreseeable future in a bid to win India.
- Online biggies' FY19 performance suggests that Amazon has smartly managed to grow while keeping cash burn constant. Meanwhile, Flipkart's cash burn continues to spiral as it grows. Myntra expected to be the key profitability lever going forward. FY19 numbers suggest a massive clearance sale post Walmart's acquisition.

- **Indian E-tail – A four player market:** India is increasingly becoming a four player e-tail market with biggies such as Walmart (via Flipkart), Amazon, Reliance and Alibaba (via Snapdeal, PayTM Mall and Bigbasket) being the last men standing in the race to online supremacy (A USD16-17bn market and growing at a CAGR of 35-40%). **With Alibaba hitting pause on Indian investments in horizontal ventures, the contending basket is getting even narrower.**
- **Regulatory back-drop** Indian government doesn't permit global e-tailers to operate an inventory-led model; but allows 100% FDI via the automatic route in wholesale (B2B) and marketplace models. The stance is primarily to 1. Safeguard the interests of SME retailers who may have to contend with excessive discounting, 2. Create a platform for the large Indian SME base to connect with a broader consumer base. However, hitherto, most big e-tailers used to push bulk of their business on marketplaces through few big sellers also called Alpha Sellers which gave them an unfair sourcing/pricing advantage. To clamp this practise down, Govt has further plugged the gaps in the regulation framework through its December 2018 Press Note. 2.

E-tail market (FY17)



Source: Technopak, HDFC Securities

Key Highlights of Press Note 2:

Regulatory Action	Rationale	Our two cents
1. Inventory of a vendor will be deemed to be controlled by e-commerce marketplace entity if >25% of vendor's purchases are from the marketplace entity or its group companies	a. To broaden e-tailers' seller base and hence to that extent, level the playing field across the seller base and b. To reduce unfair discounting/cashbacks	-Amazon has already reduced its stake in Cloudtail and Appario to <25% in order to be law compliant. However, these entities are likely to be converted to wholesale entities which will then sell to independent sellers who will in turn sell on the platform. -Flipkart had already reduced its stake in WS Retail in FY16 when Press Note 3 was released. All it may have to do is to restrict the sale to a particular vendor to <25% -To cut to the chase, just an additional layer gets added to company structures and business continues as usual
Entity in which the e-commerce marketplace or its group companies have equity participation or control over the inventory cannot sell its products on the platform of such market place companies	Idea was to avoid giving an investee company an unfair advantage in positioning and pricing on the marketplace	Nothing changes as Amazon's stake directly or indirectly in Indian outfits (ABRL, Shoppers Stop, FRL) is <25%
E-commerce marketplace will not mandate any seller to sell any product exclusively on its platform only.	A big chunk of revenue for Big e-tailers comes from their exclusive tie-ups with certain popular brands. This unfairly diverts consumer traffic to a particular platform	Doesn't restrict the seller from exclusively selling on a platform, For Instance: The OnePlus brand continues to sell exclusively on Amazon.

Source: Department of Industrial Policy & Promotion

Trivia: Free Cash Flow (Amazon + Alibaba) ≈ Free Cash flow (~80 international and domestic retailers across categories combined)

Note: Amazon's Cloud Service AWS contributes a mere 11% to Amazon's revenue, but generates ~55% of its EBITDA. If used as proxy for CFO, it's a >USD13bn/yr cash chest growing at a fast clip and readily available for disruption.

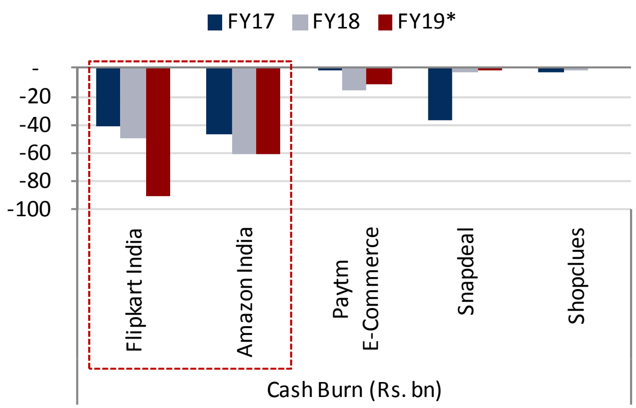
Post a dismal show in China, India is increasingly becoming a big variable in Amazon's global dominance narrative and is expected to attract a sizeable chunk of Amazon's incremental investments. It has already pumped in >USD1bn in FY20 YTD across its entities in India.

Note: We have tried to arrive at an estimated cash burn after adjusting for key related party transactions across the multiple entities/sellers owned partly or fully by the Parent companies of online retailers.

The Capital Divide

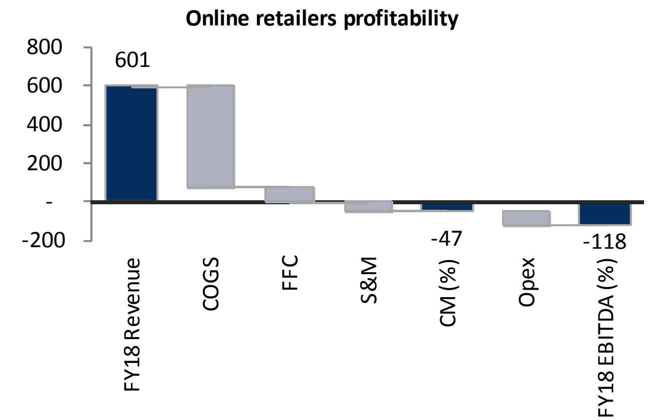
- **The Capital Divide:** Post FY15, capital heft split the winners from the losers in e-tail. Interestingly, the cash burn continues to be an unhealthy concoction of 1. Goods sold at cost or less, 2. Revenue from services just about cover fulfillment costs (~11-16% of sales) and 3. Elevated marketing spends (6-10%). To put it simply, Revenue </= Variable cost. How does one navigate that?
- Clearly only deep-pocketed players with long-term strategic intent such as Amazon, Walmart-backed Flipkart, and Reliance Industries (CY18 FCFF USD18/17/13bn respectively) can afford to perpetuate this cash burn over an extended period of time while fringe operators fall by the way side.
- **The Classic Catch 22:** Our back-of-the-envelop calculation suggests that **key online retailers need atleast 5x FY18 scale, ~300bp higher gross margins, 10-25pp lower cost structure to be profitable. That's a Catch 22 for online folks, as to achieve 5x the scale, presence in the low AoV, low GM F&G space is an imperative.** As the mix increasingly moves towards F&G, maintaining gross margins will be a tough ask at least in the near-to-medium term as global folks pass on most of the sourcing benefits to consumers in a bid to recruit customers.
- **Fashion - The counter-balancing Lever:** Both Amazon and Flipkart (via Myntra) have been upping their game in margin-accretive non-mobile/electronics plays like Fashion/Apparel and Home Goods with brand tie-ups over the last 12-18 months. However, **we reckon the sheer aggression to follow in the low-GM F&G space by the two biggies over the next 5-7 years may cap margin gains, if any.** While channel checks suggest both have been trying to hammer down fulfillment cost with 1. tie-ups across the Kirana network for last-mile delivery, 2. Adding more regional/local fulfillment centers (FCs) to inch closer to the consumer, 3. Inorganic offline stake purchases (ABRL, FRL by Amazon), financials are yet to show material progress on this front. **Amazon seems better placed vis-à-vis Flipkart and is improving each passing year on the gross margin front.**

Cash Burn continues for the online biggies (Rs. Mn)



Source: Company, HDFC sec Inst Research, Note: Cash Burn = PAT + Depreciation

FY18 Online retailers' profitability (Rs. bn)



Source: Company, HDFC sec Inst Research, Used key e-tailers' financials as proxy

The push to extract a bigger pound of flesh in high gross margin categories is evident in Amazon's case as it has been increasing commissions on Apparel, Accessories, ancillary electronics and Shoes.

Commision on large electronics like TVs are reducing to push volumes

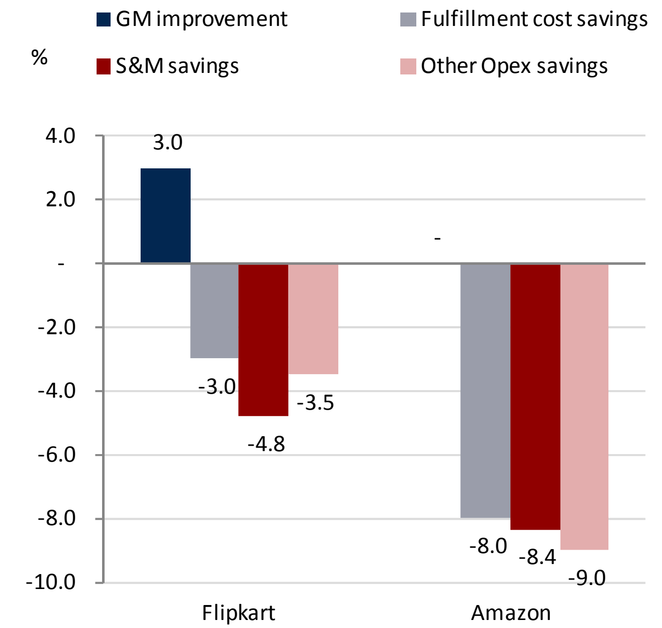
Commissions are reducing on categories like Mobile phones/Tablets in which Amazon has established a strong consumer and seller base

Amazon India's commission rate charged to its vendors

Segment	2015	2019	Sep-19	FY19 vs FY15 (Bps)	Sept-19 vs FY19 (Bps)
Mobile Phones and Tablets	5.0	5.0	6.0	-	100.0
Television	7.0	6.5	6.0	(50.0)	(50.0)
Books	12.0	13.0	13.0	100.0	-
Accessories (electronics, PC, Mobile and Tablet)	12.0	16.0	16.5	400.0	50.0
Electronics – device	8.0	9.0	8.5	100.0	(50.0)
Headsets, Headphones and earphones	12.5	14.0	14.0	150.0	-
Apparel	15.0	16.0	17.0	100.0	100.0
Fashion Jewellery	15.0	23.0	21.5	800.0	(150.0)
Watches	15.0	11.0	13.5	(400.0)	250.0
Luggage	15.0	5.5	5.5	(950.0)	-
Handbags	15.0	11.0	10.0	(400.0)	(100.0)
Eyewear	15.0	8.5	8.5	(650.0)	-
Shoes	15.0	14.0	15.5	(100.0)	150.0
Baby Products	15.0	6.0	6.0	(900.0)	-
Health and Personal care	15.0	11.0	9-11	(400.0)	(100.0)
Personal care appliances	15.0	7.0	9.5	(800.0)	250.0
Toys	15.0	9.5	9.5	(550.0)	-
Kitchen	15.0	11.5	11.5	(350.0)	-
Video Games – Console	8.0	7.0	7.0	(100.0)	-

Source: Company, HDFC sec Inst Research

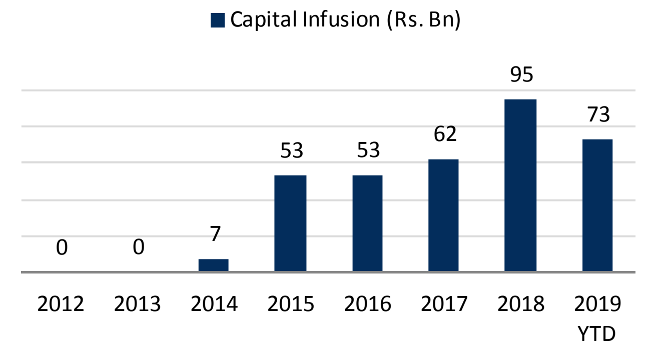
At 5x FY18 scale, savings needed to hit profitability (pp)



Source: Company, HDFC sec Inst Research estimates

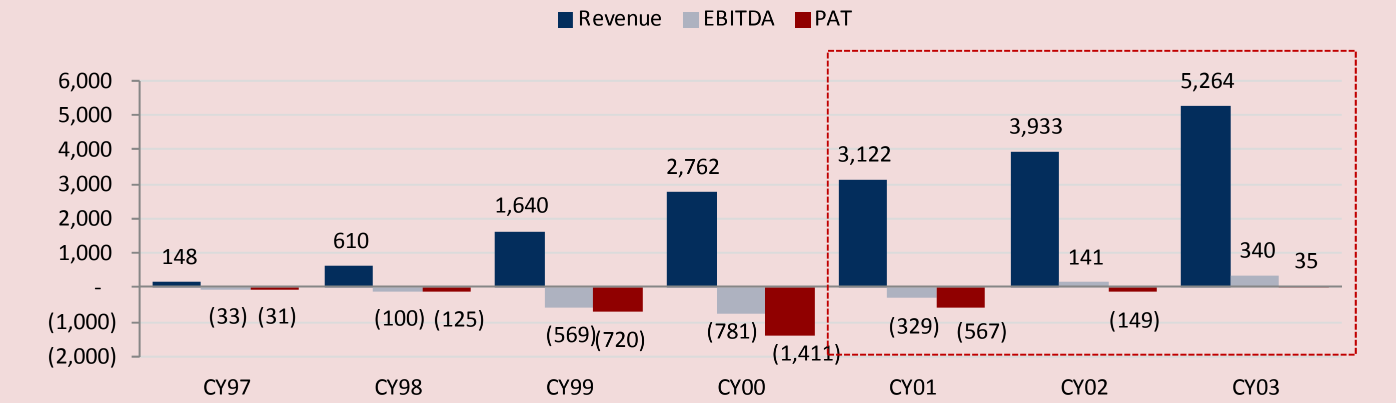
- **Capital infusion continues unabated:** While losses continue to mount, capital infusion in both Flipkart (>Rs 30bn -YTD) and Amazon (Rs. 73bn - YTD) continues unabated as their proverbial "infinite global balance sheets" allow them to perpetuate the "scale at any cost" narrative. This should continue for a while given the current phase of retail evolution (~10% organized penetration). We expect this to continue across categories over the next 3-5 years which will for sure have implications on 1. Formats which are passé (Pure-play department stores), 2. Standardized categories (Consumer Electronics & Appliances, Books), 3. May also impact growth rates of grocers (especially the tail), if investments are stepped up in its food retailing arm (FY19 YTD infusion: A mere Rs. 1.7bn)

Amazon's capital infusion till date (Rs. Bn)



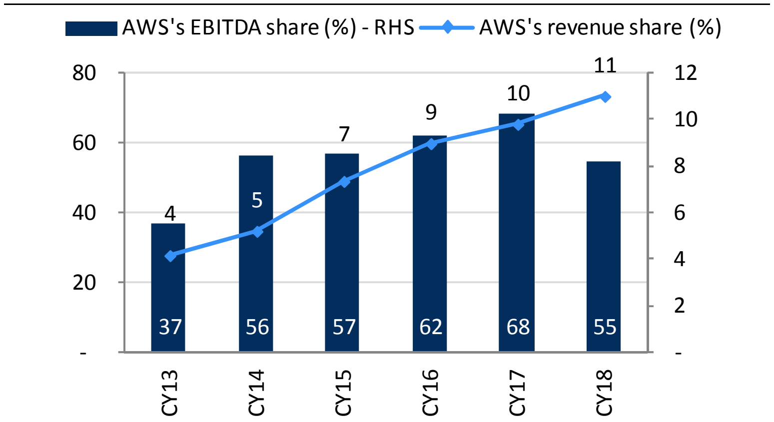
Some perspective: At a scale of ~USD4bn, Amazon (US) operationally broke-even in CY02, 8 years into its existence and 4 years after opening up its operations to 3P sellers. Currently, Amazon India and Flipkart are at around the same scale (FY18 revenue-wise), but continue to bleed over USD2bn (cumulatively) as gross margins in India are 8-15 pp lower vs Amazon's GM (US) in CY02. Note there was no material mix advantage either back then for Amazon US as they started apparels (high GM) only in CY02.

Path to profitability was simpler in the US, the same in India expected to be a long-drawn affair



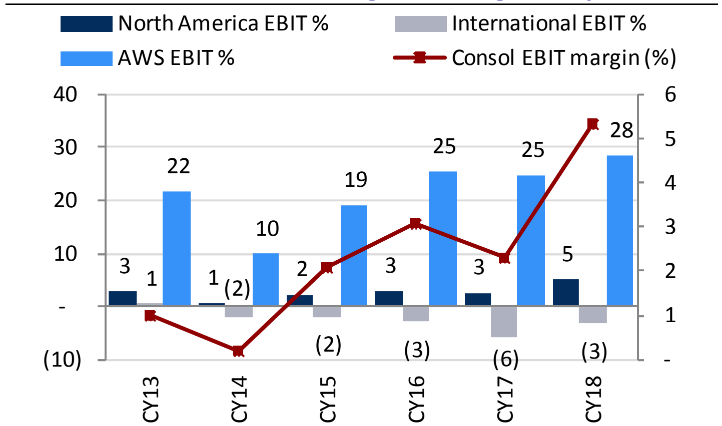
- **AWS – Wind beneath Amazon's wings:** Apart from improving profitability of its North America Retail biz, Amazon's ability to subsidize retail offerings materially improved over CY13-18 (FCFF up 10x) as its Cloud service Amazon Web Services (AWS) gained steam (High cash flow generating biz). Launched in CY08, AWS accounts for a mere 11% of Amazon's revenue but 55% of EBITDA (CY18).

As AWS' share in Amazon increased...



Source: Company, HDFC sec Inst Research

...so did its free cash flow generating ability



Source: Company, HDFC sec Inst Research

Charts depict the FY19 performance of Amazon and Flipkart (unadjusted for related party transactions) across key entities and sellers. Note: A couple of entities are yet to publish their annual filings

Our Initial reading suggests that Amazon has managed to smartly grow at 36% to Rs. (Summation of key entities) while the cumulative cash burn remains at FY18 levels (Rs. 60bn)

Flipkart on the other hand grew 48%, however, there was an 88% bump up in cash burn. This could change in Walmart's first full year of operations as owner of Flipkart (FY20).

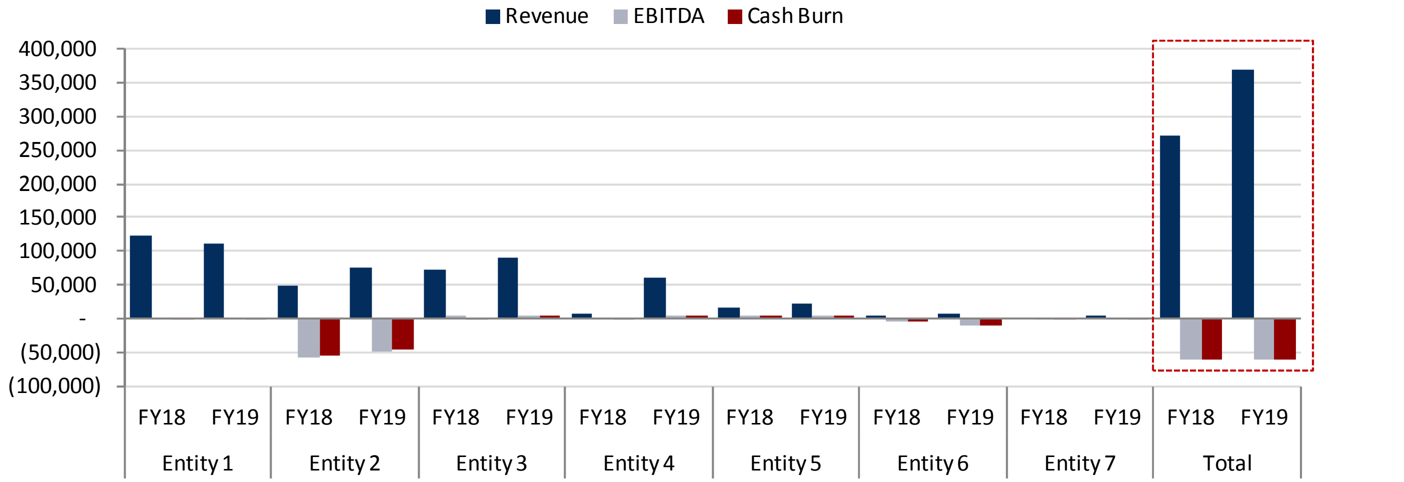
We believe one of the key levers to reduce Flipkart's cash burn will be Myntra and expect the latter to push higher ticket sales in apparel and accessories.

Implications:

1. ***Department stores may face increasing heat as a consequence of this online push***
2. ***Value Fashion retailers will remain insulated for the foresee-able future as current VF (mass) transaction sizes limits the probability of a profitable sale online.***

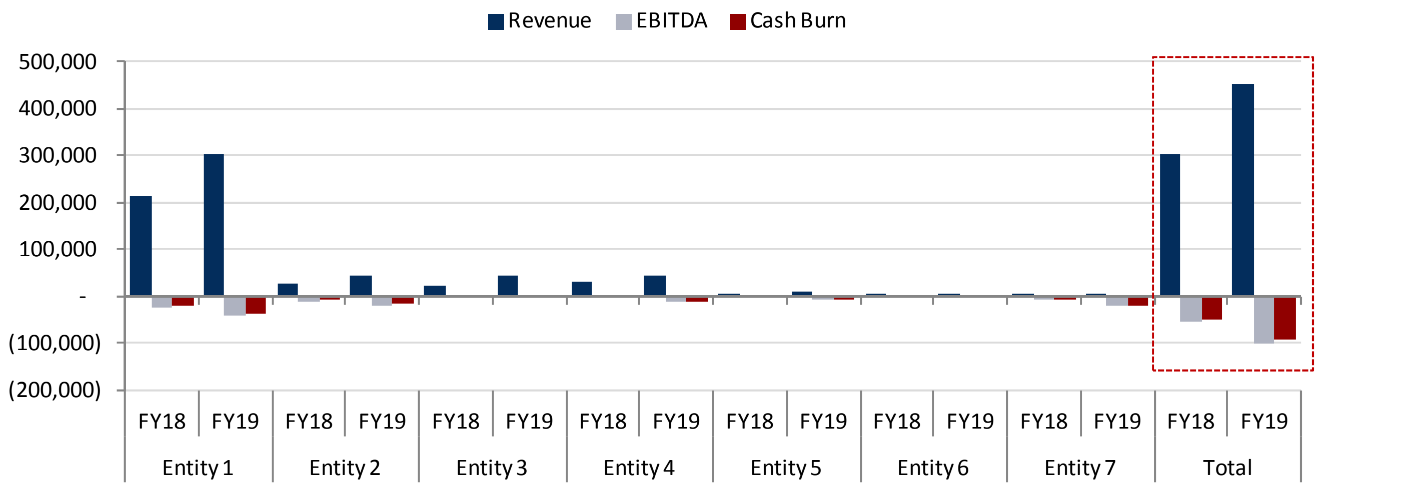
FY19 Scorecard of online biggies in India

Snapshot – Amazon's performance (Rs. Mn)



Source: Company, HDFC sec Inst Research

Snapshot – Flipkart's performance (Rs. Mn)



Source: Company, HDFC sec Inst Research

Cash burn has nearly tripled for Flipkart's fashion vertical

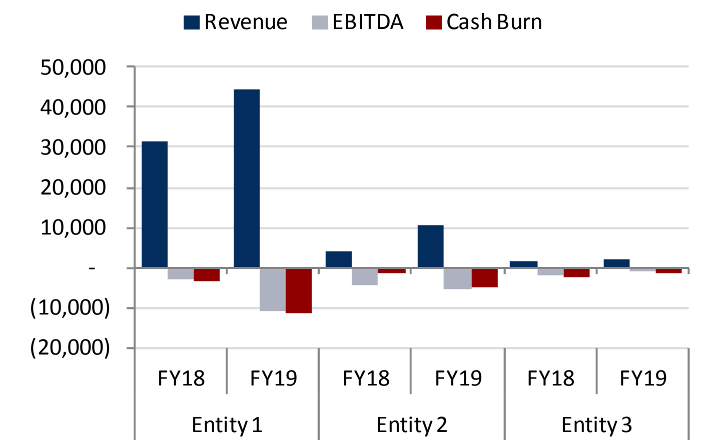
Both inventory and payable cycles have significantly reduced for Myntra.

Implications:

3. ***Department stores may face increasing heat as a consequence of this online push***
4. ***Value Fashion retailers will remain insulated for the foresee-able future as current VF (mass) transaction sizes limits the probability of a profitable sale online.***

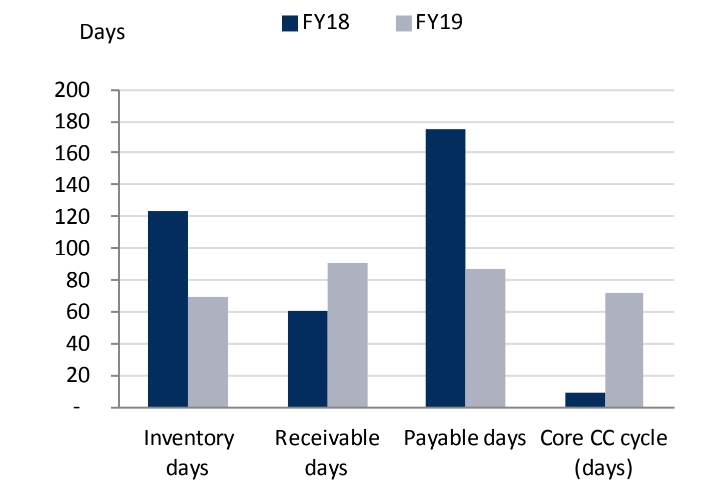
- **How did Flipkart's fashion verticals perform?** Myntra/ Jabong clocked revenue growth of 53% in FY19, however, its cumulative cash burn is estimated to have nearly tripled (ex-related party transactions) during FY19 to ~Rs.18bn primarily led by a 1) 650bp GM contraction, 2) Balooning fulfillment costs.
- **Working capital quality improving:** Focus seemed to be on clearing stock and improving working capital quality post Walmart's entry in Aug-18 as both gross margins and inventory position shrunk. While a big chunk of this clearance sale may be one-off and is expected to partially reverse; directionally, we expect Myntra to run a tighter ship going forward in sync with the DNA of its profit-conscious parent – Walmart. Myntra's entry in international markets (margin-accretive) may help its profitability cause too.
- **Better terms of trade may become a new normal:** Along with inventory, there has been a significant reduction in payable days too. We suspect, favourable terms of trade may become a new normal as Myntra attempts at bringing more brands on board and focus on its private label portfolio (HDFC Sec est: 30-35%). Also, as Myntra scales, outright purchase of inventory is expected to increase. Both these moves are potentially margin-accretive and should help Myntra reduce its cash burn. It is also important to understand that <u>from a capital allocation point of view, F&G is expected to attract a big chunk of Walmart's capital in India. Hence, if the group were to attempt at maintaining cash burn, improvement in Myntra's profitability is an imperative.</u>
- **Who may potentially be the worst hit?** As better terms of trade increasingly makes online platforms a preferred mode of expansion for brands, pure-play 3P brands-selling department stores may be the worst hit as they operate with a big payables' crutch. Also, current financial position of the latter don't permit a reduction in this creditors' support. A few noteworthy brands who have been increasingly focusing on the online channel for growth are Arvind Fashion, ABFRL and TCNS Clothing. All believe that their online channel growth will outpace other channels over the medium-to-long term.

Cash Burn across Flipkart's key Fashion entities (Ra. Mn)



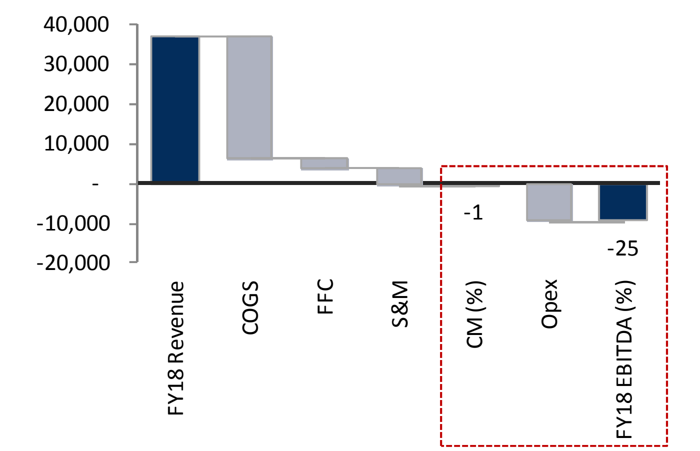
Source: Company, HDFC sec Inst Research

Working capital needs increased, although quality improved in FY19

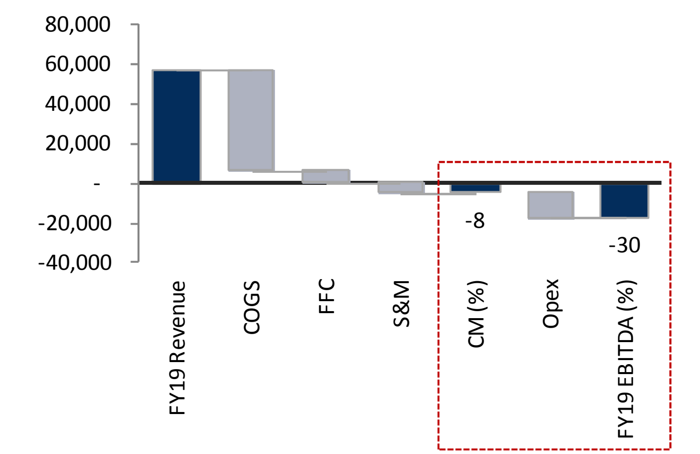


Source: Company, HDFC sec Inst Research Adjusted for RPT

Profitability takes a beating in FY19 as Myntra steps up clearance sale post Walmart's entry (Rs. mn, %)



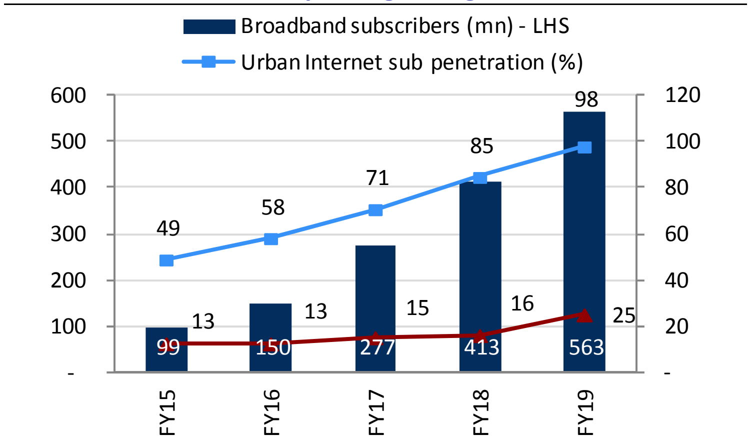
Source: Company, HDFC sec Inst Research



Source: Company, HDFC sec Inst Research

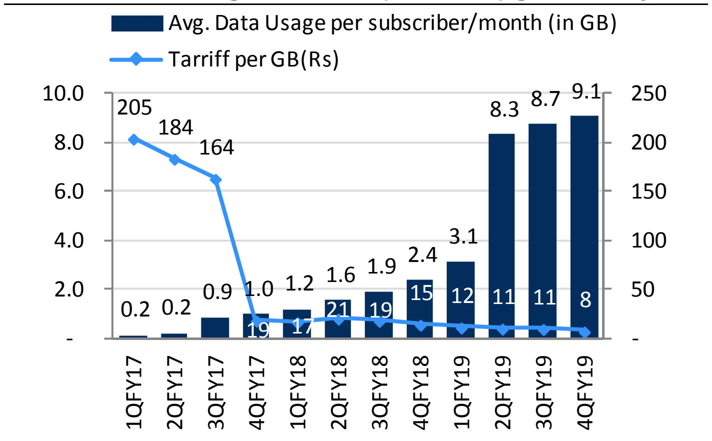
- **Tier II e-tailers – nearing expiry date:** While some Tier II e-tailers such as Shopclues, Craftsvilla, Voonik, Wooplr, etc inch closer to their expiry date amidst the "Go-for-broke" cash burn; some have successfully made smart pivots. **A classic case in point is Snapdeal** which has pivoted to a more sustainable online alternative to our local bazaars selling unbranded offerings.
- India has ~410mn urban internet subscribers (98% penetration) and ~140mn online shoppers, of which ~40mn shop frequently. (i.e, only a 10% serious online shopper penetration). Ergo, the e-tail story in urban India is largely one of converting more internet users to shop and more frequently at that. – A big opportunity in itself.
- On the other hand, with just ~25% internet penetration (227mn internet subscribers) and a significantly lower online shopper base, the Tier II/rural penetration story is a bigger one, albeit it is expected to play out gradually given the trust deficit amongst the rural base for online transactions. Also, these shoppers are more heterogeneous in needs and are value-seekers with a higher tendency for discovery-based shopping vs purposeful shopping. Some perspective on the opportunity; Of the USD218bn non-food retail market, Technopak pegs the unbranded retail market at >USD160bn i.e, 75% of non-food retail.
- This discovery-based, value-seeking consumer behaviour needs to be catered to by a cost-conscious supply chain with reasonable fulfilment costs, everyday low cost of operations and deep-linkages in the value-centric ecosystem. While AoVs are significantly lower than the branded play, GMs in the unbranded market (~30%) far exceed that of the branded play.
- **If successfully done, can create bigger firms. Is there a successful precedent?** Alibaba's Taobao (GMV: Rmb3115bn) is bigger than its popular offering on branded products - TMall (GMV: Rmb2612bn). It has successfully demonstrated the viability of such a model provided there is a tight leash on quality control. Back home, Snapdeal is attempting to replicate that success. We must concede, despite our scepticism on consistent quality control in pure-play marketplaces, initial results are indeed encouraging.

Rural Internet subscription gaining momentum



Source: TRAI, HDFC sec Inst Research

...as the levelling influence (internet) gets cheaper



Source: TRAI, HDFC sec Inst Research

We don't advocate one strategy over the other. Amazon/Flipkart can keep burning cash for extended periods of time to weed out competition, simply because they can! Very few global retailers can parallel their balance sheet strength.

Snapdeal's pivot was imperative given their relative balance sheet strength. That being said, not all platforms on the unbranded play work. For Instance, Shopclues has been struggling since the past two years and is consistently losing consumer traffic & sellers.

Within this context, Snapdeal's steadily increasing consumer traffic and sellers (70mn active users as on date and 500k+ sellers). reflects that Snapdeal's flywheel works! (Doubled its traffic over FY19)

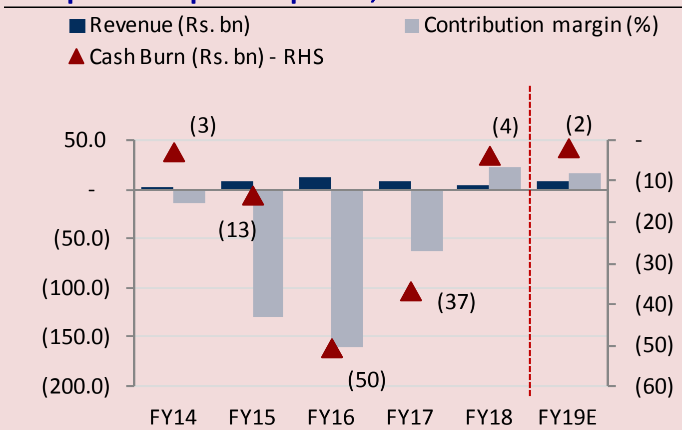
Order volumes are estimated to be 6-8x since FY18. What is even more impressive is that this growth is not bought through excessive leverage. Debt/Equity is at a comfortable 0.6x.

Snapdeal – Attempting an Indian Taobao!

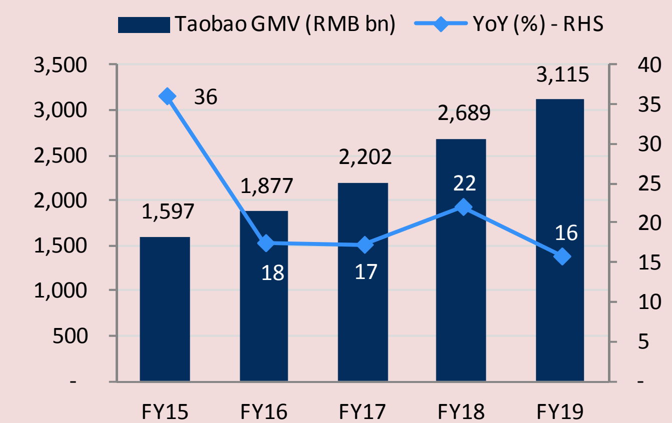
- **The Mistakes**: Snapdeal begun as a platform for small businesses to list their products on. However, over time, the company got swept into the GMV race and dabbled in branded products, which put significant strain on its financials given their low margin profile and the prevailing deep discount syndrome in the market. There was an ardent need to get the house in order.

  …Consequently, In FY17, Snapdeal identified white spaces in the more profitable unbranded market and successfully pivoted back to being a pure marketplace catering to the value-conscious consumer **– A la Taobao. Note: RJio's disruptive data offers certainly helped Snapdeal in recruiting Tier 2/3 consumers faster.**
- **Building blocks in place:** For a successful value-focused pure-play marketplace, 1. KPIs need to be re-aligned from the GMV race to profitable revenue growth, 2. Variety and affordability take centre-stage in positioning; and 3. Navigating quality slips is paramount. **Let's check how key vitals for the outfit have moved since FY17.**
- **Pivot to profitable revenue growth from the GMV chase:✔**
  1. Unlike the biggies, Snapdeal in its new avatar, doesn't participate in sale of products with negative take-rates irrespective of the AoV of the product. This explains the big swing in revenue and profitability over the last 18-24 months. This, at a time when the biggies burnt >USD2bn in FY19 in the race to online supremacy.
  2. Snapdeal's revenue mix also reflects the focus towards profitable growth. 50% of its sales come from the high GM-Fashion & Lifestyle space, 20% from home goods and 15% each from general merchandise and electronics. Even within electronics, lion's share of its revenue comes from mobile covers, accessories, etc which are typically higher gross margin products within electronics. Compared to this, Amazon/Flipkart have a high skew towards low GM electronics such as Smartphones, Television, etc.

Snapdeal: Top-line up 87%; Losses down 53% in FY19



Taobao's GMV growth trend

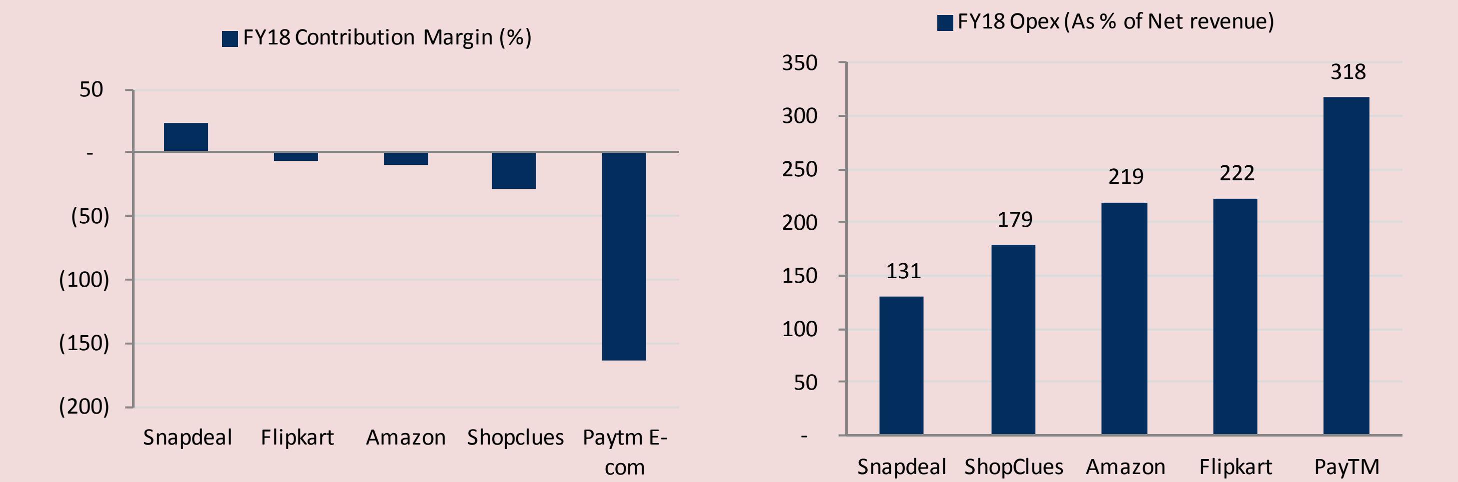


Source: Company, HDFC sec Inst Research

Snapdeal – Attempting an Indian Taobao!

- **Variety and affordability ✔**: Variety and affordability is key for a discovery-based value seeker. Snapdeal ticks this box too with its long-tail of >200mn aggregated products through a large network of 500k+ sellers, shop owners and individual entrepreneurs.
- **Low cost of operations – ✔**:Our Analysis across the online ecosystem suggests that Snapdeal is the closest to recover its complete cost base through its top-line. This reflects the increasing appreciation for unit economics despite growing at a reasonably fast clip.

Snapdeal sports the leanest cost structure among peers



Source: Company, HDFC sec Inst Research, Note Snapdeal's Opex (As % of revenue is for FY19)

- **Quality control – Getting more proactive ✔:** The company has been consistently tightening the leash on product quality control by
  1. Restricting payment to sellers through an escrow mechanism before the transaction period completes (7 day return + payment cycle period).
  2. Providing Brand Shield program to brands that allows Snapdeal to highlight & takedown listings suspected of infringing IPR and compromising quality.
  3. Restricting visibility of products that are newly listed on the platform in the initial phase of a seller's transacting life. This is only stepped up as Snapdeal assesses the sellers risk profile through increasing history of hassle-free transactions. This has helped Snapdeal streamline its processes and give a consistent shopping experience to consumers.

Company Section

Avenue Supermart

SELL

Standout Operator! Alas, valued to the moon and back!

Over the past decade, industry bellwether DMART has accumulated ~Rs 48bn in pre-tax earnings. However, the company has had to inject ~Rs ~53bn to its invested capital base (~10x FY10 level) to buy this growth. That said, DMART remains the best franchise in trade with (1) A strong recall of a discounter, (2) Track record of consistent growth courtesy its EDLC-EDLP proposition, (3) Best-in-class management. Its capital-intensive ownership model which incidentally is at the core of its EDLC-EDLP strategy does act as gravity to long-term valuation, especially within the context of heightening competitive intensity.

We expect DMART to clock revenue/EBITDA/Adj. PAT CAGR of 25/28/28% CAGR over FY19-22E. Consequently expect underlying RoCE to remain steady and nearly peak out by FY22E at ~21%. We initiate coverage on DMART with a SELL recommendation given that current valuations seem to have run past fundamentals and have a DCF-based TP of Rs 1,250/sh implying an EV/EBITDA of 25x (Sept-21)

Investment rationale

- **DMART's success mantra – Lowest Prices meet highest population density:** The underpinning of DMART's success has been its EDLC-EDLP strategy. In other words, savings from scale-led operational and sourcing benefits and an ownership structure, gets fed into prices. However, most investors do not fully appreciate the role population density has played in its success. Our district-wise store mapping suggests 45% of DMART's stores are present in districts with a PCI of 300k+ and population density of 3000+/km (Primarily in Maharashtra and Gujarat). Ergo, the higher number of bill cuts vs peers. DMART did 172mn bill cuts in FY19 vs Big Bazaar's ~130mn despite the latter having nearly double the footprint of DMART. This explains why DMART sports one of the highest sales velocity across global retailers (DMART sales per sq. ft: USD525 vs. Walmart's/Kroger's USD446/USD677. However, this population density tailwind may have a tipping point as DMART steps foot into the hinterland.
- **Runway at best – A decade!** Our district-wise analysis on store potential suggests that DMART still has a runway to add ~400-420 stores in its existing/similar catchments without a material drop in productivity i.e, approx. a 9-10 year run-way. However, post that search for greener pastures will be a task; especially without impacting throughput per sq. ft materially. CMP suggests the runway to be longer.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	199,163	251,353	313,344	384,907
EBITDA	16,422	22,335	27,943	34,742
APAT	9,363	14,590	18,300	23,098
Dil. EPS (Rs/sh)	15.0	23.4	29.3	37.0
P/E (x)	122.4	78.6	62.6	49.6
EV/EBITDA (x)	70.1	51.6	41.2	32.9
ROE (%)	18.3	23.1	23.0	23.0
RoIC (%)	17.5	21.3	21.7	22.7
ROCE (%)	16.8	20.8	20.8	21.2

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP ***(as on 06 Dec 2019)***	**Rs 1,801**
Target Price	**Rs 1,250**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	DMART IN
No. of Shares (mn)	627
MCap (Rs bn) / ($ mn)	1,129/15,860
6m avg traded value (Rs mn)	916

STOCK PERFORMANCE (%)

52 Week high / low: Rs 2,011/1,226

	3M	6M	12M
Absolute (%)	19.9	36.9	21.4
Relative (%)	8.6	35.1	7.8

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	81.2	80.21
FIs & Local MFs	3.58	4.8
FPIs	5.47	6.0
Public & Others	9.75	8.96
Pledged Shares	0	0

Source : BSE

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- **Online folks closing in on pricing:** While the runway for growth remains long given the general under-penetration of the organized F&G play (~4%), DMART's lowest price proposition is increasingly getting challenged by peers, especially online grocers. Global retailers such as Walmart and Amazon are gearing up for an entry in the F&G space too. These players figuratively sport "Infinite" balance sheets and can extend a price war for a long time. Ergo, margin improvement for DMART seems unlikely within the context of heightening competitive intensity. We bake in a steady EBITDA margin of ~9% over FY20-22E. Caveat: DMART Ready – the company's online foray may weigh on margins too in the near to medium term. (not factored in).

  ...but not at the cost of rising cash burn: Interestingly, while the discounts rise for some of the online folks, their margin profiles – both at the gross and operational level have been improving with each passing year, implying that their trade margins are improving as they gain scale. Some e-tailers have also smartly reined in fulfilment costs by inching closer to the consumer via offline asset purchases or by revving up their channel partner/warehouse/dark store network.

- **What does the price say?** DMART's CMP bakes in a scenario wherein by FY39, the stock-up retailer caters to 35% of Indian households' grocery needs and clock a revenue CAGR of >15% over FY19-39. That's a stretch even for DMART. Even, we factor in a generous 25% share for DMART in India's household share by FY39. <u>There is a potential downside risk to our estimates too if the current price war continues and online fulfillment accelerates faster than expected.</u>

- **Supply glut to weigh on stock performance:** Per SEBI regulations, DMART's promoter group needs to reduce its stake to 75% (currently: ~80%) by exit FY20. We reckon, over the next 5 months as the company raises capital via a mix QIP and stake sale the stock could witness a temporary supply glut which could weigh on performance especially given its already punchy valuations.

- **Standout operator, Alas! Valued to the moon and back:** We build in revenue/EBITDA/Adj. PAT CAGR of 25/28/28% CAGR over FY19-22E for DMART. Revenue growth is expected to be a healthy mix of SSSG/expansion (12%/11% CAGR over FY19-22E., We build in 27-30 store additions annually over FY19-22E. Margin gains unlikely despite healthy SSSG as we expect the discounter to pass on savings to consumers and invest in its online foray DMART Ready. Asset turnover to remain steady too. Ergo, underlying RoCE to remain steady at ~21% over FY19-22E. Thus, while DMART remains a standout operator, the ask from growth and its longevity is massive to justify current valuations especially within the context of heightening competitive intensity in F&G. We initiate coverage on DMART with a SELL recommendation and a DCF-based TP of Rs 1,250/sh implying an EV/EBITDA of 25x (Sept-21)

- **Key Risks:** 1. The pace of DMART's market share gain from mom-&-pop store is faster than market share ceded to peers, 2. Peers stumble on other pre-requisites (apart from pricing) such as assortment availability and timely delivery, 3. Avenue successfully scales up its online offering with minimal in-store cannibalization.

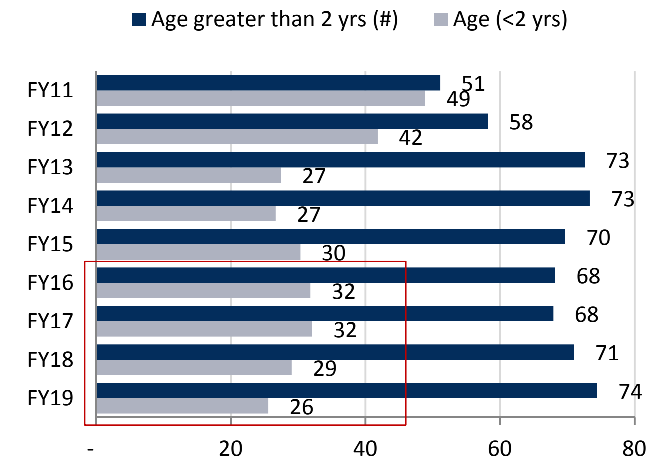
Store age getting older, the need to step up expansion is an imperative to underpin growth run-rate. We reckon the impending capital raise could solve this constraint

Bill size and SSSG may have been aided by high CPI Inflation over FY12-15, we don't expect this to be a support over the next 2-3 years.

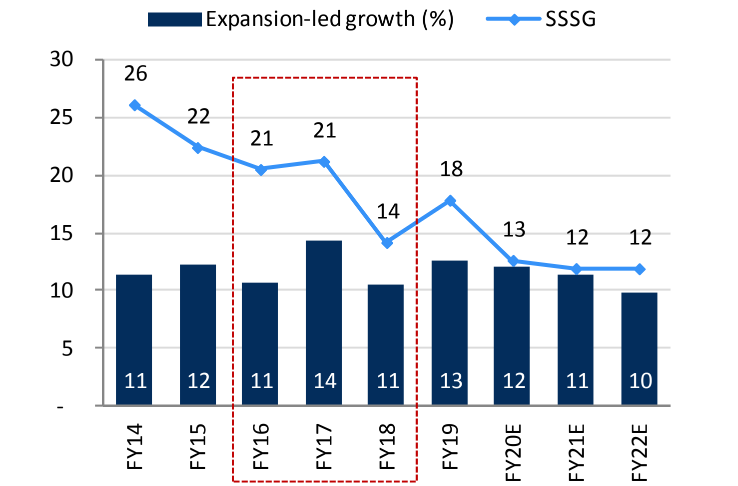
Expect sales velocity to grow at 6% CAGR over FY19-22E

Story in Charts

Tepid store adds over the last 2-3 years has led to healthy but moderating SSSG

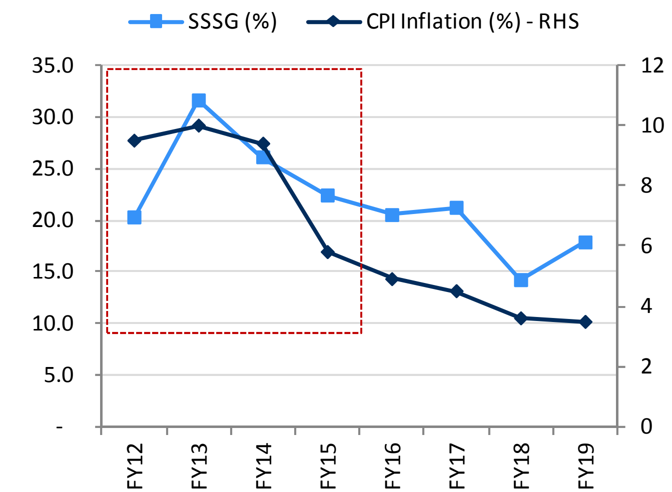


Source: Company, HDFC sec Inst Research



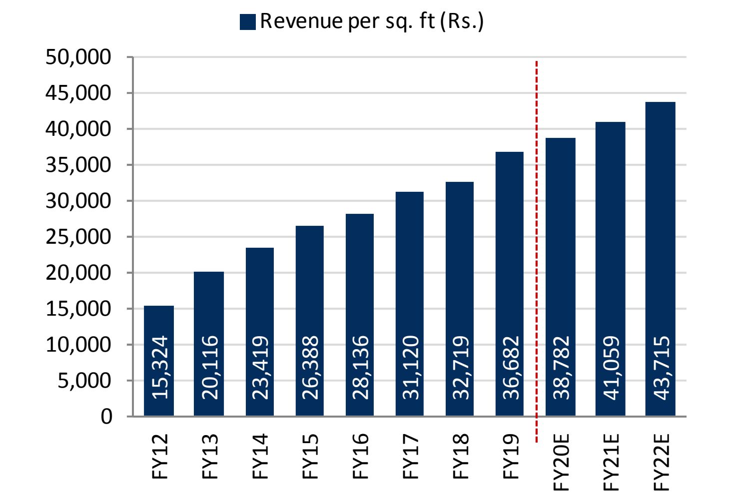
Source: Company, HDFC sec Inst Research

We suspect high CPI may also have aided SSSG over FY12-15



Source: Company, HDFC sec Inst Research

Productivity remains unmatched

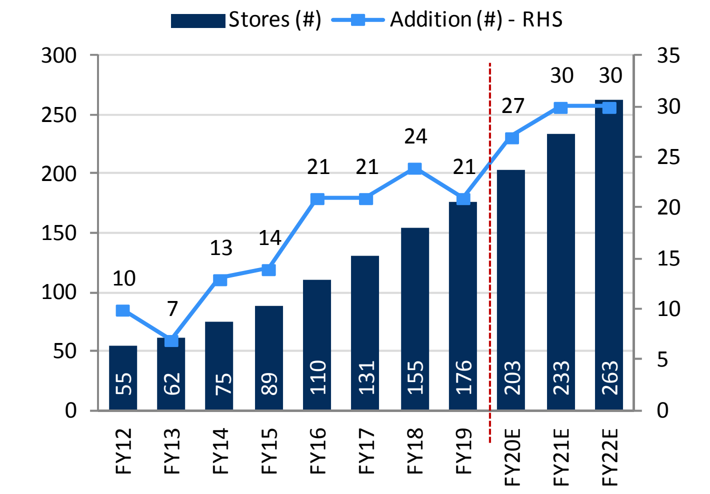


Source: Company, HDFC sec Inst Research

Store/retail space addition pick up to keep SSSG healthy over the next 3-4 years. Although, the 20% SSSG years seem behind

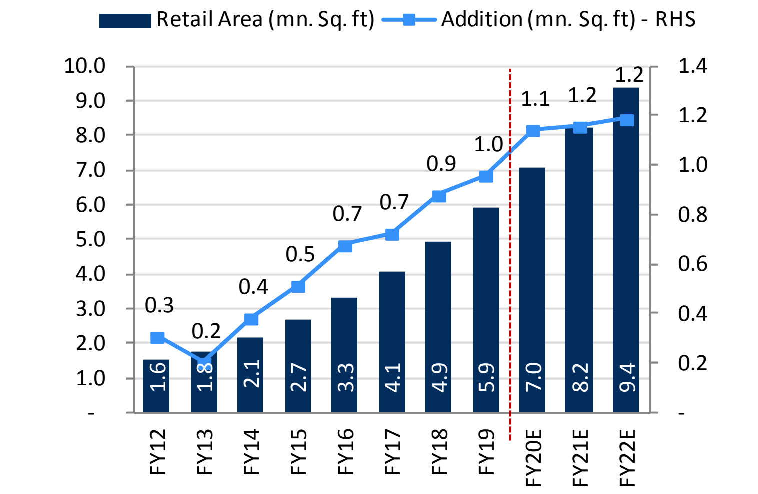
Building in retail area CAGR of 16.7% over FY19-22E

Store adds to pick up



Source: Company, HDFC sec Inst Research

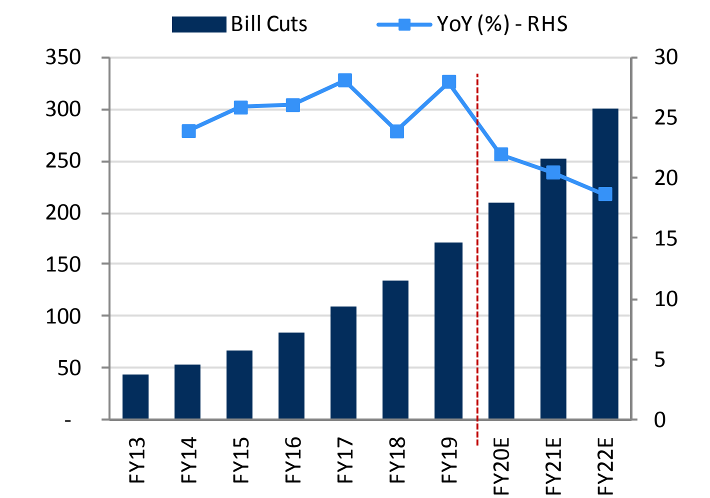
Area addition to be even higher as store size increasing



Source: Company, HDFC sec Inst Research

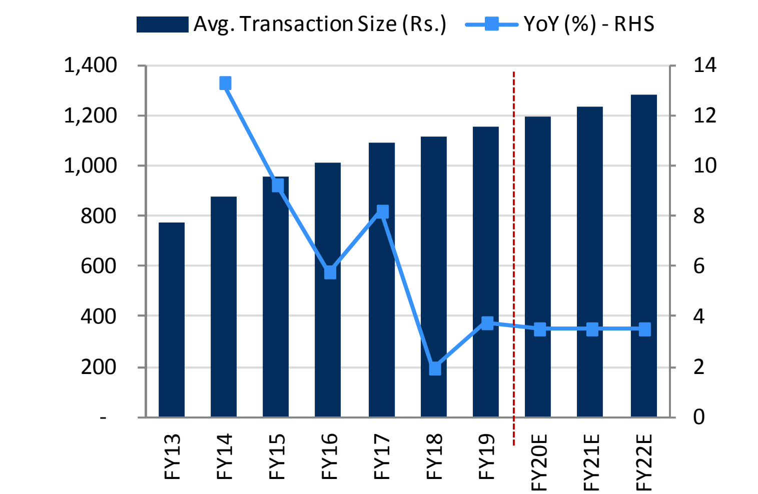
Growth in Bill cuts to remain healthy

Bill Cuts growth to remain healthy at ~21% CAGR



Source: Company, HDFC sec Inst Research

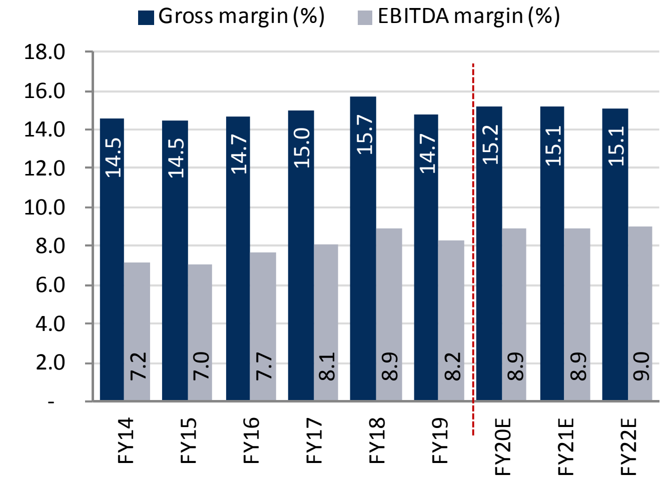
Avg. transaction size to mimic inflation



Source: Company, HDFC sec Inst Research

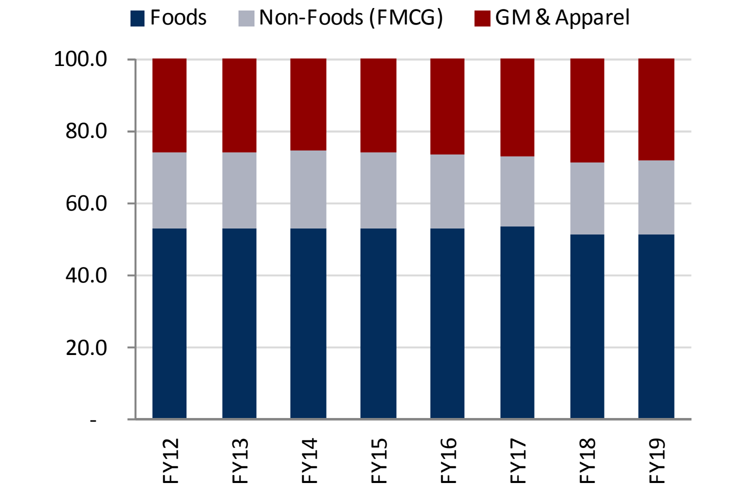
Online folks closing in on the biggest lever – Pricing. This will keep margin gains in check

Margin improvement over FY20-22E unlikely, as competitive intensity increasing and as food skew remains high



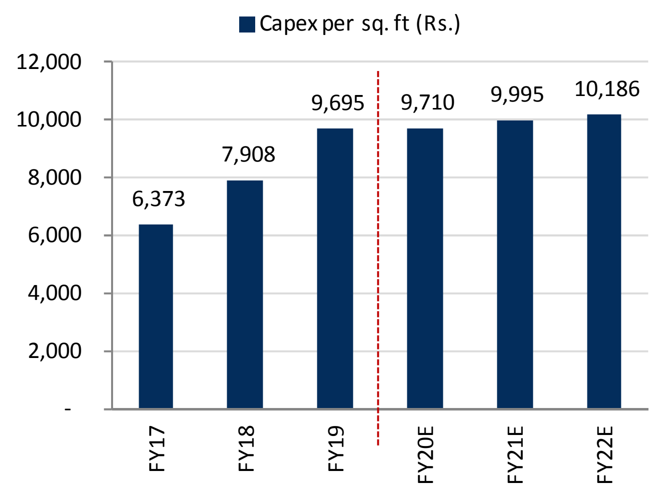
Source: Company, HDFC sec Inst Research

Revenue mix has largely remained unchanged



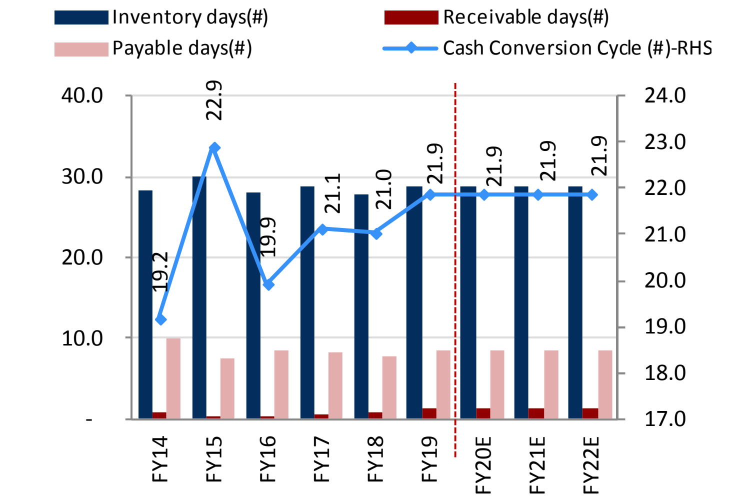
Source: Company, HDFC sec Inst Research

Capital outlay per store inching up



Source: Company, HDFC sec Inst Research

WC to remain tight and stable



Source: Company, HDFC sec Inst Research

Leverage position to remain comfortable, even if the current pace of expansion is stepped up meaningfully.

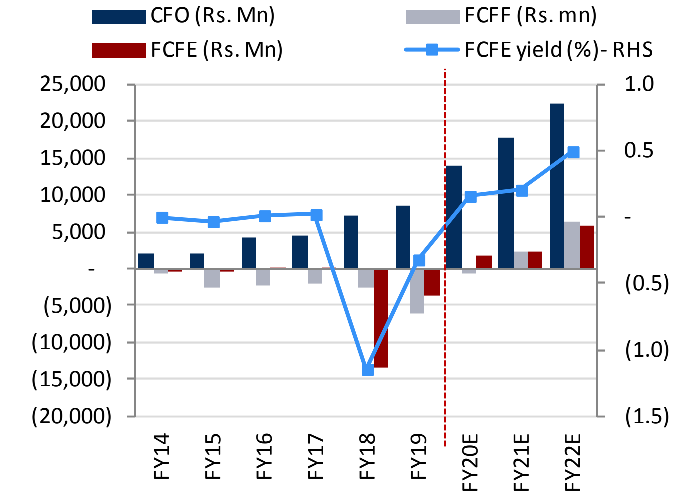
Mr. Damani needs to bring down his stake of ~80% to 75% by exit-FY20. The dilution is expected to be via a mix of stake sale and fresh issuance via QIP.

This could potentially pump in enough gunpowder for the step-up in expansion, if any.

Note the BoD has also approved the issuance of upto Rs. 15bn via NCDs, (Rs. 1bn already issued), DMART could also tap into this source of funding and bring the company WACC down considerably

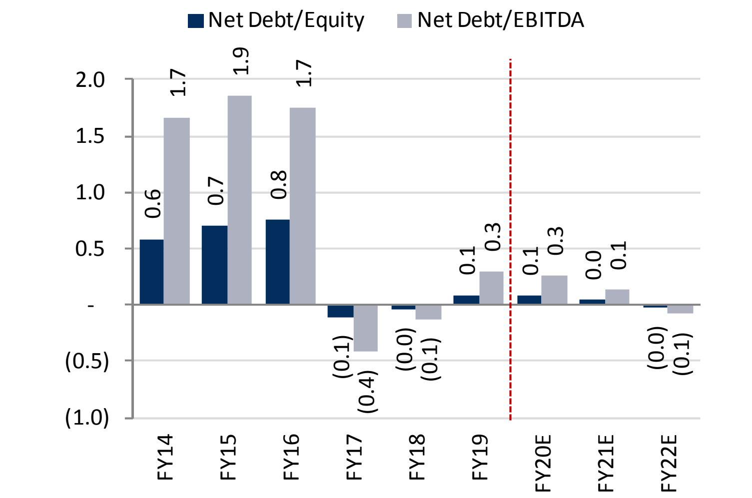
Return profile to remain steady

Improving productivity to aid FCF over FY19-22E



Source: Company, HDFC sec Inst Research

Leverage position remains comfortable



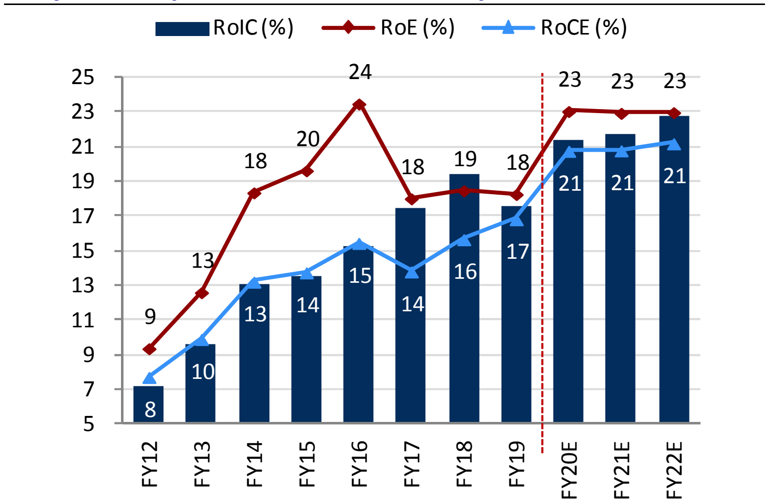
Source: Company, HDFC sec Inst Research

DMART is through its IPO proceeds

Use of IPO Proceeds (Rs. mn)	Planned	Utilization	Balance (As on 2QFY20)
Payment/repayment of NCDs/Debt	10,800	10,800	-
Capex	3,666	3,666	-
General Corporate Purpose	4,234	4,234	-
Total	**18,700**	**18,700**	**-**

Source: Company, HDFC sec Inst Research

Adj. return profile to remain steady



Source: Company, HDFC sec Inst Research

Our PCI/population density-wise district analysis suggests that the DMART may have a decade's room to add another 400-420 stores in its existing/similar catchments.

Key monitor-able though is how it navigates India's income profile and maintains its sales velocity post the decadal run-way.

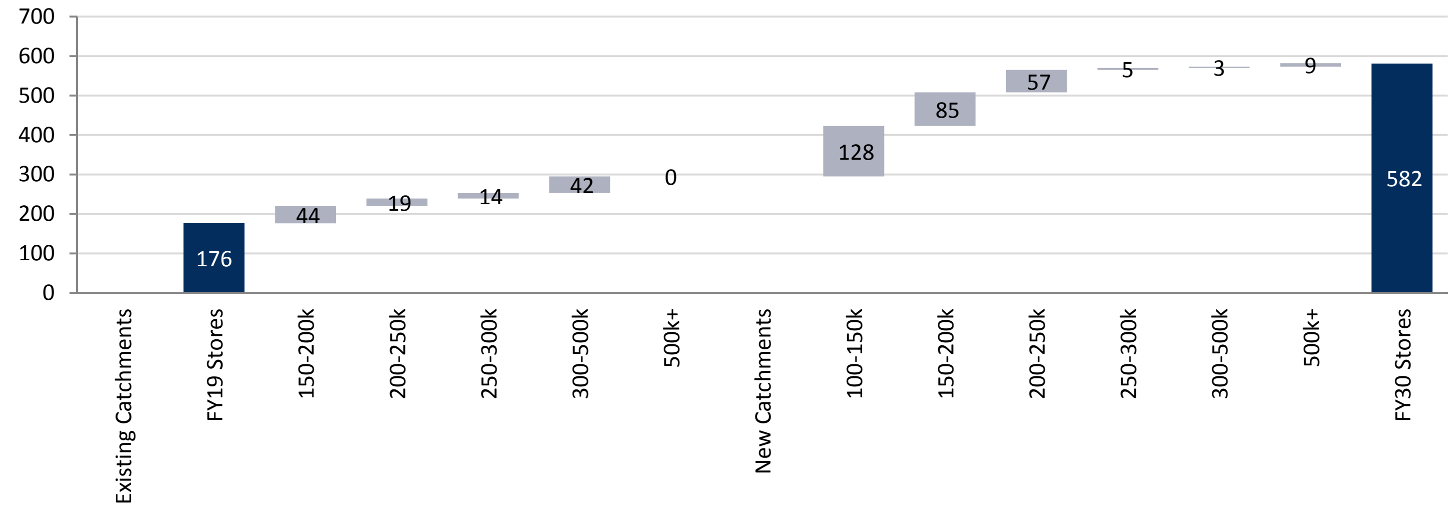
...CMP suggests this gravy-train continues beyond a decade

Despite DMART's capital intensive store ownership model, it sports the best unit store economics in the industry

The ownership framework is justified in DMART's case as its productivity is 2-3x that of peers.

As mentioned in the thematic, we prefer stock-up operators over Top-up peers given their better unit store economics

While the run-way is long, narrative of eternal productivity rise may be tested along the way



Source: Company, HDFC sec Inst Research

Peer-wise Unit store economics:

Per sq. Ft metrics (Rs.)	DMART	Big Bazaar	Easy Day	More	Spencers	Star	Spar	Nat's Basket
Revenue	36,746	12,868	15,340	18,548	16,935	12,299	13,036	29,842
Gross Profit	5,418	3,551	2,608	3,741	3,597	2,709	2,591	7,493
EBITDA	3,030	920	(77)	(87)	1,016	-	(600)	(5,201)
Capex	12,880	3,000	2,000	4,210	2,500	2,500	4,355	2,550
WC	2,432	1,992	2,385	398	147	(258)	49	482
Capital Employed	15,312	4,992	4,385	4,607	2,647	2,242	4,404	3,032
RoCE (%)	12.6	17.5	(4)	(9)	(17)	(18)	(19)	NA
Payback Period (Years)	7.2	7.9	NA	NA	(11)	NA	NA	NA

Source: Company, HDFC sec Inst Research

Online folks closing in on DMART's lowest price proposition. Grofers is the closest to DMART prices

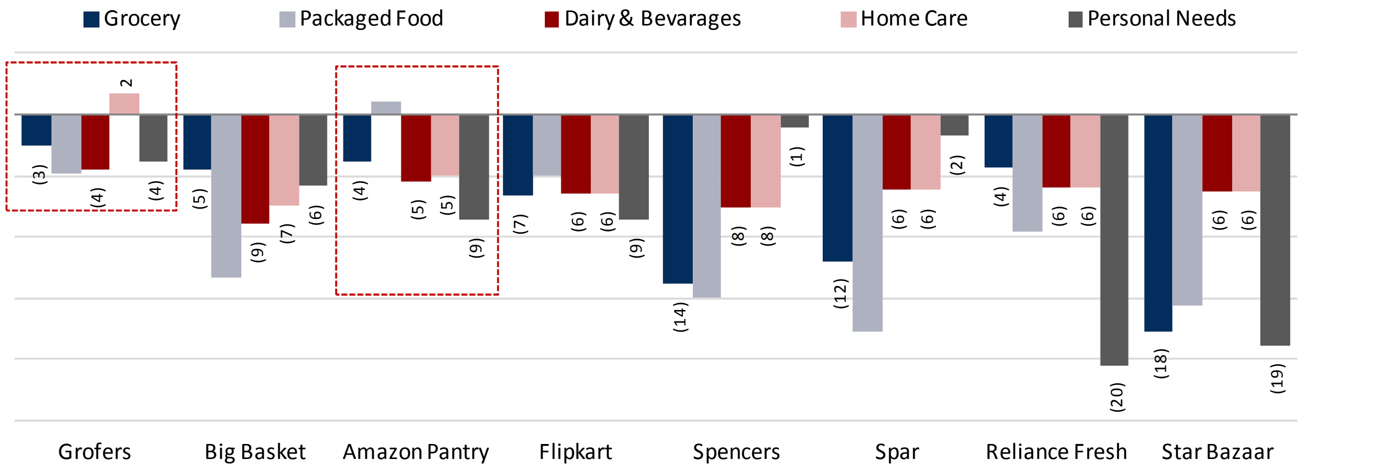
Off late, Amazon too has been working on its grocery pricing and is expected to inch closer to reduce the pricing gap with DMART with each passing year as it is now better placed to cut the flab of its cost structure (Read fulfilment costs) given the recent offline acquisitions

Grofers is expected to increase its channel partner presence in Mumbai and Bengaluru, historically a pain point for the e-tailer. This could potentially help in bringing down its cost structure further which could then be fed into price. It currently has ~6000 such channel partners.

Hence, we reckon defence will be the operating word (at the margin) especially in key D-MART markets

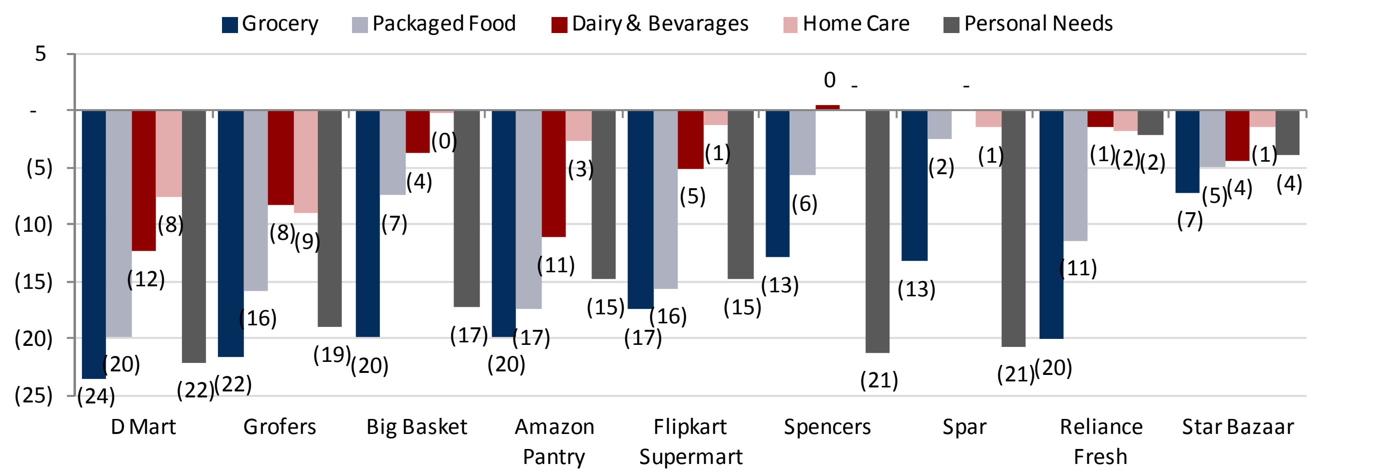
Given D-MART's efficiency, we believe it certainly can defend itself, but it is likely to be at the cost of margins (not factored in)

DMART's discount over peers – Grofers and Amazon closing in



Source: Company websites, HDFC sec Inst Research

Peer-wise discount over MRP



Source: Company websites, HDFC sec Inst Research

Valuation

DCF

	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY35E	FY40E
Revenue	**319,956**	**397,002**	**480,216**	**577,384**	**691,603**	**816,764**	**955,947**	**1,112,988**	**1,276,422**	**1,451,881**	**2,564,002**	**4,003,382**
-No of stores	**233**	**263**	**298**	**338**	**378**	**418**	**463**	**508**	**553**	**598**	**858**	**1,133**
SSSG (%)	*12.9*	*12.8*	*10.7*	*10.0*	*9.8*	*9.2*	*8.7*	*8.3*	*7.3*	*6.9*	*5.1*	*4.5*
Expansion-led growth (%)	*11.6*	*10.0*	*9.3*	*9.3*	*9.1*	*8.1*	*7.7*	*7.5*	*6.9*	*6.4*	*5.1*	*3.9*
EBIT*(1-t)	**18,771**	**23,795**	**29,290**	**35,226**	**42,630**	**50,845**	**60,169**	**70,666**	**80,961**	**91,414**	**165,379**	**258,759**
Depreciation	3,260	3,962	4,739	5,628	6,593	7,605	8,710	9,903	11,143	12,441	20,027	28,977
Capex	(15,141)	(16,073)	(18,300)	(20,505)	(21,291)	(22,475)	(25,219)	(26,185)	(27,184)	(28,600)	(35,611)	(41,196)
As % of revenue	*4.7*	*4.0*	*3.8*	*3.6*	*3.1*	*2.8*	*2.6*	*2.4*	*2.1*	*2.0*	*1.4*	*1.0*
Changes in WC (Winv)	(4,366)	(5,099)	(5,508)	(6,431)	(7,560)	(8,284)	(9,212)	(10,394)	(10,817)	(11,613)	(16,081)	(20,955)
As % of revenue	*1.4*	*1.3*	*1.1*	*1.1*	*1.1*	*1.0*	*1.0*	*0.9*	*0.8*	*0.8*	*0.6*	*0.5*
FCFF	**2,525**	**6,586**	**10,223**	**13,918**	**20,371**	**27,691**	**34,448**	**43,991**	**54,103**	**63,642**	**133,714**	**225,585**
YoY (%)	*(373.1)*	*160.8*	*55.2*	*36.1*	*46.4*	*35.9*	*24.4*	*27.7*	*23.0*	*17.6*	*15.2*	*9.9*
Interest (1-t)	(508)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)
Net Borrowings	500	-	-	-	-	-	-	-	-	-	-	-
FCFE	**2,517**	**6,064**	**9,701**	**13,396**	**19,850**	**27,170**	**33,927**	**43,469**	**53,582**	**63,120**	**133,192**	**225,064**
YoY (%)	*120*	*141*	*60*	*38*	*48*	*37*	*25*	*28*	*23*	*18*	*10*	*10*
PV (FCFF)	**2,388**	**5,572**	**7,736**	**9,418**	**12,330**	**14,992**	**16,682**	**19,049**	**20,955**	**22,048**	**26,515**	**25,596**
Terminal Value												**3,483,763**

Source: Company, HDFC sec Inst Research

DCF Date	**Sep-20**
Kd*(1-t)	**7.5**
Ke	**12.0**
Net Debt (Mar-20E)	5,929
Equity Value (INR m) – standalone	**775,557**
Equity value per share (INR) – std	**1,243**
Sept FY21 Implied EV/EBITDA (x)	24.4
Equity value per share (INR) - consol	**1,250**
Terminal growth rate (%)	5.0
WACC	11.8
CMP	**1,802**
Upside/(Downside)	**-30.6%**

Source: Company, HDFC sec Inst Research

Price implies – A 10% SSSG CAGR, 250bp margin expansion over 20 years

	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY35E	FY40E
Revenue	**319,956**	**397,002**	**484,268**	**587,171**	**709,301**	**849,531**	**1,008,312**	**1,190,298**	**1,397,458**	**1,627,335**	**3,120,539**	**5,370,172**
-No of stores	**233**	**263**	**298**	**338**	**378**	**418**	**463**	**508**	**553**	**598**	**858**	**1,133**
SSSG (%)	*12.9*	*12.8*	*11.7*	*11.1*	*11.0*	*11.1*	*10.5*	*10.1*	*10.2*	*9.8*	*7.5*	*6.8*
Expansion-led growth (%)	*11.6*	*10.0*	*9.2*	*9.1*	*8.8*	*7.8*	*7.4*	*7.2*	*6.6*	*6.0*	*4.8*	*3.7*
EBIT*(1-t)	**18,771**	**23,795**	**29,693**	**36,879**	**45,208**	**55,079**	**66,927**	**80,185**	**95,624**	**112,994**	**230,199**	**410,995**
Depreciation	3,260	3,962	4,739	5,628	6,593	7,605	8,710	9,903	11,143	12,441	20,027	28,977
Capex	(15,141)	(16,073)	(18,300)	(20,505)	(21,291)	(22,475)	(25,219)	(26,185)	(27,184)	(28,600)	(35,611)	(41,196)
As % of revenue	*4.7*	*4.0*	*3.8*	*3.5*	*3.0*	*2.6*	*2.5*	*2.2*	*1.9*	*1.8*	*1.1*	*0.8*
Changes in WC (Winv)	(4,366)	(5,099)	(5,776)	(6,811)	(8,083)	(9,281)	(10,509)	(12,045)	(13,711)	(15,214)	(23,114)	(34,420)
As % of revenue	*1.4*	*1.3*	*1.2*	*1.2*	*1.1*	*1.1*	*1.0*	*1.0*	*1.0*	*0.9*	*0.7*	*0.6*
FCFF	**2,525**	**6,586**	**10,357**	**15,191**	**22,426**	**30,928**	**39,909**	**51,858**	**65,873**	**81,621**	**191,500**	**364,357**
YoY (%)	*(373.1)*	*160.8*	*57.3*	*46.7*	*47.6*	*37.9*	*29.0*	*29.9*	*27.0*	*23.9*	*17.2*	*12.6*
Interest (1-t)	(508)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)	(521)
Net Borrowings	500	-	-	-	-	-	-	-	-	-	-	-
FCFE	**2,517**	**6,064**	**9,836**	**14,669**	**21,905**	**30,407**	**39,387**	**51,337**	**65,351**	**81,100**	**190,979**	**363,835**
YoY (%)	*120*	*141*	*62*	*49*	*49*	*39*	*30*	*30*	*27*	*24*	*10*	*13*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**	**Mar-35**	**Mar-40**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	14.5	19.5
PV (FCFF)	**2,388**	**5,572**	**7,837**	**10,278**	**13,571**	**16,740**	**19,319**	**22,447**	**25,502**	**28,262**	**37,943**	**41,296**
Terminal Value												**5,621,639**

Source: Company, HDFC sec Inst Research

…and over a third of Indian households as consumers – A stretch even for DMART

	Base Case					CMP implies				
	FY19	FY29	FY39	10-yr CAGR	20-yr CAGR	FY19	FY29	FY39	10-yr CAGR	20-yr CAGR
Population (mn)	1,366	1,536	1,735	1.2	1.2	1,366	1,536	1,735	1.2	1.2
No. Of households (mn)	304	357	423	1.6	1.7	304	357	423	1.6	1.7
Bill Cuts	172	789	2,149	16.4	13.5	172	926	2,935	18.3	15.2
Purchase Frequency	18	19	20	0.5	0.5	18	19	20	0.5	0.5
Bill size (Rs.)	1,156	1,508	1,651	2.7	1.8	1,156	1,508	1,651	2.7	1.8
Est. HH DMART services (mn)	10	42	107	15.8	12.9	10	49	147	17.7	14.6
DMART's HH market share (%)	3.1	11.6	25.4	***847 bps***	***2225 bps***	3	14	35	***1049 bps***	***3154 bps***

Source: Company, HDFC sec Inst Research

Capital intensity of the business to act as gravity to punchy multiples in the long-run

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	0.9	1.2	1.9	2.8	3.7	5.0	7.1	9.6	11.7	43.9
Other Income	0.0	0.0	-	-	-	0.0	0.1	0.3	0.4	0.8
Total	**0.9**	**1.2**	**1.9**	**2.8**	**3.7**	**5.0**	**7.2**	**10.0**	**12.1**	**44.7**
Application of funds (Rs bn)										
Working Capital	0.9	0.4	0.7	0.6	1.8	0.6	2.1	2.4	3.3	12.8
Capex	2.2	1.8	2.4	2.7	4.6	6.4	6.5	9.8	14.5	51.1
Investments	0.4	(0.6)	(0.1)	(0.0)	(0.0)	(0.0)	(0.1)	(0.2)	(0.1)	(0.6)
Dividend	-	-	-	-	-	-	-	-	-	-
Borrowings	(1.2)	(0.8)	(1.4)	(1.0)	(2.6)	(2.9)	(3.0)	10.4	(2.6)	(5.1)
Others	(1.5)	0.1	0.1	0.5	0.1	0.9	1.6	(12.8)	(3.6)	(14.6)
Net change in cash	0.1	0.3	0.1	(0.1)	(0.2)	(0.0)	(0.0)	0.3	0.6	1.1
Total	**0.9**	**1.2**	**1.9**	**2.8**	**3.7**	**5.0**	**7.2**	**10.0**	**12.1**	**44.7**
Cumm. WC + Capex as % of sources of funds										**143.1**

Source: Company, HDFC sec Inst Research

Avenue Supermart: Key Assumptions

	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue								
Net Revenue (Rs. Mn)	**64,335**	**85,752**	**118,811**	**150,089**	**199,163**	**253,988**	**319,956**	**397,002**
YoY (%)	*37.5*	*33.3*	*38.6*	*26.3*	*32.7*	*27.5*	*26.0*	*24.1*
SSSG (%)	*22.4*	*20.5*	*21.2*	*14.2*	*17.8*	*13.7*	*12.9*	*12.8*
Expansion-led growth	*12.3*	*10.6*	*14.3*	*10.6*	*12.7*	*12.2*	*11.6*	*10.0*
Margins (%)								
Gross Margin (%)	*14.5*	*14.7*	*15.0*	*15.7*	*14.7*	*15.1*	*15.0*	*15.0*
EBITDA margin (%)	*7.0*	*7.7*	*8.1*	*8.9*	*8.2*	*8.8*	*8.9*	*9.0*
Key Operating Metrics								
Revenue per sq. ft	26,388	28,136	31,120	32,719	35,647	39,189	41,927	45,090
GMROF	3,891	4,211	4,828	5,244	5,418	5,911	6,291	6,763
EBITDA per sq. ft	1,886	2,192	2,606	2,972	3,030	3,447	3,719	4,066
Capital Allocation								
Stores (#)	89	110	131	155	176	203	233	263
Additions (#)	14	21	21	24	21	27	30	30
Capex (Rs. Mn)	**4,646**	**6,444**	**6,532**	**9,828**	**14,544**	**14,641**	**15,141**	**16,073**
Inventory Days (x)	30	28	29	28	29	29	29	29
Receivable Days (x)	0	0	1	1	1	1	1	1
Payable Days (x)	8	9	8	8	8	8	8	8
WC Days (x)	**23**	**20**	**21**	**21**	**22**	**22**	**22**	**22**

Source: Company, HDFC sec Inst Research

Company Profile: Avenue Supermart

- Avenue Supermarts Ltd is in the business of organized F&G retail and operates Hypermarkets under the brand name of D-Mart. The company offers food products, including dairy products, staples, groceries, snacks, frozen products, processed foods, beverages and confectionery, and fruits and vegetables; non-food products comprising home care products, personal care, toiletries, and general merchandise and apparel products, such as bed and bath products, home appliances, crockery products, utensils, etc.

- DMart was founded by Mr. Radhakishan Damani and his family to address the growing F&G needs of the Indian family. From the launch of its first store in Powai in 2002, DMart today has a presence in various locations across Maharashtra, Gujarat, Andhra Pradesh, Madhya Pradesh, Karnataka, Telangana, Chhattisgarh, NCR, Tamil Nadu, Punjab and Rajasthan. Company operates 189 stores as of Mar 2019.

- The company operates predominantly on an ownership model (including long-term lease arrangements, where lease period is more than 30 years).

Key Risks

Name	Description
Inability to offer low prices pursuant to EDLC/EDLP pricing strategy	One of DMart's key strengths has been its ability to offer its customers value-retailing and daily low prices and consequently greater daily savings. If unable to maintain its pricing competitiveness and are not able to effectively respond to competition from existing retailers and prospective entrants and consequent pricing pressures, it will adversely affect the business, financial condition and results of operations.
Inability to obtain suitable locations for expansion on commercially beneficial terms	New store location needs to satisfy various parameters to make an attractive commercial proposition, finalization of location and property acquisition of new stores, which may not progress at expected pace. Inabilities to identify and obtain suitable locations for expansion on terms commercially beneficial to company, may adversely affect expansion and growth plans.
Inventory risk	Any material misjudgment in estimating customer demand could adversely impact the results by causing either a shortage of inventory or an accumulation of excess inventory.
Inability to predict changing customer preferences	The markets for some of the products such as home and personal care and apparel are seasonal & constantly changing with changing in customer preferences, new product introductions. There may be a risk of loss of business due to inability to match the changing customer preferences.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Ignatius Navil Noronha	Managing Director & CEO	He has over 20 years of experience in the consumer goods industry. Prior to joining DMart, he has worked with Hindustan Unilever Limited for eight years during which he worked in the field of market research, sales and modern trade. At the time of leaving HUL, he was designated as the Key Account Manager - Modern Trade.
Mr. Elvin Machado	Director, Business Development	He has over 28 years of experience in the sales and marketing. Prior to joining DMart, he has worked with Hindustan Unilever Limited for approximately 18 years. At the time of leaving HUL, he was designated as the Branch Operations Manager - East (Rural) and he has also worked with Mayo Health Care Private Limited. He is responsible for real estate acquisitions made byDMart.
Mr. Ramakant Baheti	Whole-time Director & Group CFO	He is a chartered accountant and a member of the ICAI. He has 19 years of experience in finance. Prior to joining DMart, he was the Manager-Finance of Bright Star. He was also a director of Damani Share and Stock Brokers Private Limited, a stock broking company.
Mr. Udaya Bhaskar Yarlagadda	Chief Operating Officer, Retail	He has over 18 years of experience in sales and business development. Prior to joining DMart, he has worked with Procter and Gamble Hygiene and Health Care Limited where he held the position of director in customer business development. His current role include managing and leading store operations, merchandising, private labels, marketing and store maintenance.
Mr. Narayanan Bhaskaran	Chief Operating Officer, Supply Chain Management	He has over 22 years of experience in corporate secretarial functions, operations and human resource management. Prior to joining DMart, he has worked with TCL India Holdings Private Limited and Birla Sun Life Distribution Company Limited. Presently, he is managing supply chain management, corporate legal functions and staples business.
Mr. Dheeraj Kampani	Vice President, Buying and Merchandising	He has over 15 years of experience in sales and retail store management. Prior to joining DMart, he has worked with Hindustan Lever Limited and Great Wholesale Club Limited.
Mr. Hitesh Shah	Associate Vice President, Operations	He has over 21 years of experience in sales, marketing and retail store management. Prior to joining DMart, he has worked with Hindustan Unilever Limited.

Source: Company, HDFC sec Inst Research

Income Statement (Standalone)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
Net Revenues	**150,089**	**199,163**	**251,353**	**313,344**	**384,907**
Growth (%)	***26.3***	***32.7***	***26.2***	***24.7***	***22.8***
Material Expenses	126,489	169,799	213,114	265,901	326,645
Employee Expense	2,766	3,350	4,195	5,177	6,250
Contract Labour Charges	3,161	4,043	4,758	5,734	6,796
Electricity and Fuel Charges	1,201	1,502	1,833	2,224	2,643
Other Expenses	3,099	4,046	5,119	6,366	7,831
EBITDA	**13,373**	**16,422**	**22,335**	**27,943**	**34,742**
EBITDA Growth (%)	***38.8***	***22.8***	***36.0***	***25.1***	***24.3***
EBITDA Margin (%)	***8.9***	***8.2***	***8.9***	***8.9***	***9.0***
Depreciation	1,547	1,988	2,594	3,267	3,970
EBIT	**11,827**	**14,434**	**19,741**	**24,676**	**30,773**
Other Income (Including EO Items)	726	514	348	494	826
Interest	594	472	592	714	732
PBT	**11,959**	**14,476**	**19,497**	**24,455**	**30,867**
Total Tax	4,112	5,113	4,907	6,155	7,769
PAT before share of associate earnings	**7,847**	**9,363**	**14,590**	**18,300**	**23,098**
Share of associate earnings	-	-	-	-	-
RPAT	**7,847**	**9,363**	**14,590**	**18,300**	**23,098**
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	**7,847**	**9,363**	**14,590**	**18,300**	**23,098**
APAT Growth (%)	***62.6***	***19.3***	***55.8***	***25.4***	***26.2***
Adjusted EPS (Rs)	**12.6**	**15.0**	**23.4**	**29.3**	**37.0**
EPS Growth (%)	***62.6***	***19.3***	***55.8***	***25.4***	***26.2***

Source: Company, HDFC sec Inst Research

Balance Sheet (Standalone)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	6,241	6,241	6,241	6,241	6,241
Reserves	40,186	49,704	64,294	82,594	105,691
Total Shareholders Funds	**46,427**	**55,945**	**70,535**	**88,835**	**111,932**
Minority Interest	**-**	**-**	**-**	**-**	**-**
Long Term Debt	2,460	1,257	2,257	2,757	2,757
Short Term Debt	1,933	5,695	7,695	7,695	7,695
Total Debt	**4,393**	**6,952**	**9,952**	**10,452**	**10,452**
Net Deferred Taxes	**463**	**641**	**641**	**641**	**641**
Other Non-current Liabilities & Provns	**8**	**8**	**8**	**8**	**8**
TOTAL SOURCES OF FUNDS	**51,290**	**63,545**	**81,135**	**99,935**	**123,032**
APPLICATION OF FUNDS					
Net Block	32,562	42,342	53,635	64,830	75,980
CWIP	1,471	3,766	3,766	3,766	3,766
Other Non-current Assets	1,295	2,120	2,945	3,770	4,595
Total Non-current Assets	**35,327**	**48,228**	**60,345**	**72,365**	**84,340**
Inventories	11,470	15,762	19,893	24,799	30,462
Debtors	334	755	953	1,188	1,460
Other Current Assets	2,912	3,095	3,906	4,869	5,981
Cash & Equivalents	**6,082**	**2,136**	**4,154**	**6,831**	**13,217**
Total Current Assets	**20,797**	**21,748**	**28,905**	**37,687**	**51,120**
Creditors	3,159	4,583	5,784	7,210	8,857
Other Current Liabilities & Provns	1,676	1,848	2,332	2,908	3,572
Total Current Liabilities	**4,834**	**6,431**	**8,116**	**10,118**	**12,429**
Net Current Assets	**15,963**	**15,317**	**20,789**	**27,569**	**38,692**
TOTAL APPLICATION OF FUNDS	**51,290**	**63,545**	**81,135**	**99,935**	**123,032**

Source: Company, HDFC sec Inst Research

Cash Flow (Standalone)

Year ending March	FY18	FY19P	FY20E	FY21E	FY22E
Reported PBT	11,959	14,476	19,497	24,455	30,867
Non-operating & EO Items	(504)	(260)	(348)	(494)	(826)
Interest Expenses	594	472	592	714	732
Depreciation	1,547	1,988	2,594	3,267	3,970
Working Capital Change	(2,401)	(3,213)	(3,454)	(4,103)	(4,736)
Tax Paid	(3,965)	(4,935)	(4,907)	(6,155)	(7,769)
OPERATING CASH FLOW (a)	**7,230**	**8,528**	**13,973**	**17,685**	**22,237**
Capex	(9,828)	(14,544)	(14,712)	(15,287)	(15,945)
Free Cash Flow (FCF)	(2,598)	(6,017)	(738)	2,398	6,292
Investments	164	101	-	-	-
Non-operating Income	13,989	4,436	348	494	826
INVESTING CASH FLOW (b)	**4,325**	**(10,007)**	**(14,364)**	**(14,793)**	**(15,119)**
Debt Issuance/(Repaid)	(11,217)	2,040	2,408	(214)	(732)
FCFE	(13,816)	(3,976)	1,670	2,183	5,561
Share Capital Issuance	-	(0)	-	-	-
Dividend	-	-	-	-	-
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(11,217)**	**2,040**	**2,408**	**(214)**	**(732)**
NET CASH FLOW (a+b+c)	**338**	**561**	**2,018**	**2,677**	**6,386**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	674	1,201	4,154	6,831	13,217

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19P	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	15.7	14.7	15.2	15.1	15.1
EBITDA Margin	8.9	8.2	8.9	8.9	9.0
EBIT Margin	7.9	7.2	7.9	7.9	8.0
APAT Margin	5.2	4.7	5.8	5.8	6.0
RoE	18.5	18.3	23.1	23.0	23.0
RoIC (or Core RoCE)	19.4	17.5	21.3	21.7	22.7
RoCE	15.7	16.8	20.8	20.8	21.2
EFFICIENCY					
Tax Rate (%)	34.4	35.3	25.2	25.2	25.2
Fixed Asset Turnover (x)	4.2	4.2	4.1	4.1	4.2
Inventory (days)	*28*	*29*	*29*	*29*	*29*
Debtors (days)	*1*	*1*	*1*	*1*	*1*
Other Current Assets (days)	*7*	*6*	*6*	*6*	*6*
Payables (days)	*8*	*8*	*8*	*8*	*8*
Other Current Liab & Provns (days)	*4*	*3*	*3*	*3*	*3*
Cash Conversion Cycle (days)	24	24	24	24	24
Net D/E (x)	(0.04)	0.09	0.1	0.0	(0.0)
Interest Coverage (x)	19.9	30.6	33.4	34.6	42.1
PER SHARE DATA (Rs)					
EPS	12.6	15.0	23.4	29.3	37.0
CEPS	15.1	18.2	27.5	34.6	43.4
Dividend	-	-	-	-	-
Book Value	74.4	89.6	113.0	142.3	179.4
VALUATION					
P/E (x)	146.1	122.4	78.6	62.6	49.6
P/BV (x)	24.7	20.5	16.3	12.9	10.2
EV/EBITDA (x)	85.6	70.1	51.6	41.2	32.9
EV/Revenues (x)	7.6	5.8	4.6	3.7	3.0
OCF/EV (%)	0.6	0.7	1.2	1.5	1.9
FCF/EV (%)	(0.2)	(0.5)	(0.1)	0.2	0.6
FCFE/Mkt Cap (%)	(1.2)	(0.3)	0.1	0.2	0.5
Dividend Yield (%)	-	-	-	-	-

Source: Company, HDFC sec Inst Research

Future Retail

BUY

The Contrarian Retailer

After rummaging through biz with non-core entries and exits, FRL finally seems to have zeroed-in focus on its core - Big Bazaar/FBB (Hypermarket) and EasyDay (Convenience format). While BB remains in steady-state; the key monitor-able is how the contrarian bet - EasyDay plays out as no retailer has cracked store economics in the convenience format. That said, EasyDay has put up a commendable show since its acquisition from Bharti and losses have been ebbing.

FRL's real money maker though, is its 16mn+ sq. ft strong store network - largest in F&G which could potentially double up as a strong omni-asset given its pan-India presence (437 cities). We reckon, this to be the key rationale for Amazon's stake purchase in FRL (~4.5% effective stake for Rs. 15bn at a valuation of Rs. ~300bn, implying 15x Sept-21 EV/EBITDA; with a call option to buy more between year 3 & 10). We bake in revenue/ LTL EBITDA CAGR of 10/12% over FY19-22E. Initiate coverage with a BUY and a DCF-based TP of Rs. 500/sh (post dilution) implying 14x Sept-21 EV/EBITDA

PLEDGES REMAIN HIGH THOUGH! Ergo, higher cost of equity assigned (16%). While, recent transactions (Amazon stake purchase, Warrant Issues) among other things could bring down company pledges (currently 67% of promoter holding), more needs to be done on this front. Hence, **further capital infusion is a key monitor-able.**

Investment rationale

- **Big Bazaar (BB), chugging along:** FRL's flagship format (BB) has been chugging along with a 12% revenue CAGR over FY17-19 largely SSSG-led as focus remains on improving productivity. (~Rs.13k/sq. ft; adj. productivity at ~Rs.21k lags behind D-MART ~Rs. 36k). BB has initiated multiple steps to bridge the productivity gap like- 1. Including more SKUs into its recently implemented EDLC-EDLP framework (currently ~1,500/8,000 SKUs), 2. Weeding out slow-moving fashion/GM categories and replacing them with faster moving categories, 3) operational tie-up with Amazon to spur volumes. Hence, we build in an SSSG-heavy 9% revenue CAGR over FY19-22E and 20 store additions annually over FY19-22E for Big Bazaar.
- **Potential off-take boost from Amazon tie-up:** Currently, FRL and Amazon have entered into a gross profit sharing agreement (take rates range between 5-12%) to service Amazon-originated orders from select FRL stores. (20 stores, 4 cities). These stores are clocking an additional 200 orders/day (avg) – This translates into an estimated 16% jump in bill cuts. (not factored in yet). Hence, poses an upside risk to estimates

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	201,649	222,051	245,767	269,521
EBITDA	10,369	11,741	19,965	22,167
APAT	7,328	7,898	9,461	10,797
Dil. EPS (Rs/sh)	14.6	15.7	17.5	19.9
P/E (x)	22.8	21.2	19.1	16.7
EV/EBITDA (x)	18.4	16.3	10.1	8.9
ROE (%)	21.1	18.6	15.5	13.3
RoIC (%)	17.5	15.2	12.7	11.5
ROCE (%)	17.2	15.0	12.6	11.4

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 333**
Target Price	**Rs 500**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	FRETAIL IN
No. of Shares (mn)	503
MCap (Rs bn) / ($ mn)	168/2,352
6m avg traded value (Rs mn)	212

STOCK PERFORMANCE (%)

52 Week high / low: Rs 575/323

	3M	6M	12M
Absolute (%)	(17.8)	(26.8)	(34.7)
Relative (%)	(27.2)	(29.1)	(49.3)

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	47.02	47.02
FIs & Local MFs	15.58	15.21
FPIs	13.66	12.9
Public & Others	23.74	24.87
Pledged Shares	24.22	31.6

Source : BSE

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- **EasyDay – the contrarian bet:** Through a slew of acquisitions over FY16-18 (EasyDay/Heritage), FRL is now the biggest convenience footprint in India (1147 stores; ~2.5mn sq. ft, 352 cities). That said, no retailer has managed to crack store economics in this format given the resilient Kirana network in India. However, the membership-based EasyDay format is inching closer to profitability with each passing year. Margins have improved from -6% in FY16 to -1.5% in FY19. The improving unit economics is a function of multiple hooks – 1. Cluster-based expansion increases top-of-the-mind recall within catchments and reduces logistics cost 2. Data analytics makes assortment better aligned to regional preferences, 3. Membership discounts ensure competitive prices vs the kirana network. Thus, we expect this format to grow at a healthy 17% CAGR over FY19-22E primarily led by improving member density per store Expansion is expected to cool off post an aggressive FY19 as focus shifts to profitability. <u>Note: FRL is planning to shut 50-60 loss making EasyDay stores in a bid to hit break-even in the next 3-6 months.</u>

- **FEL-to-FRL asset transfer may soothe investor nerves:** Per the current structure, FRL leases out store-fit-outs from Future Enterprises (FEL), while capex resides on FEL's balance sheet. This opacity in capital structure has been a cause for concern for investors as assessing underlying business RoCEs gets difficult. Hence, FRL plans to reverse this structure by buying back its assets (Rs. 40bn) from FEL. Funding is expected to be a combination of 1. Amazon money (Rs. 15bn), 2. Promoter warrants (Rs.5bn), 3. Upside from share sales by Bharti/Heritage as both arrangements have claw-back provisions attached 4. Security deposits worth Rs.6bn given to FEL. We conservatively build in the asset purchase by FRL in our FY21 numbers. (Although management expects to close the transaction by exit-FY20). While underlying RoCE is significantly lower (~12% vs proforma 17%), it certainly provides a more transparent picture to the investors.

- **Further capital infusion – A key monitorable:** If the Bharti/Heritage share sale doesn't come through/is delayed, further capital infusion is an imperative for FRL to fund the transaction and reduce pledges. We thus assign a higher cost of equity (16%) to capture this risk and to account for high pledges across the group.

- **Margin levers restricted:** We don't build in a meaningful LTL EBITDA margin expansion as 1. revenue skew increases towards the lower margin EasyDay format (18% in FY22 from 15% in FY19), 2. Margin gain potential from Hypercity comes off as now inching closer to company average. Albeit, we build in lease rental savings post the FRL-FEL transaction.

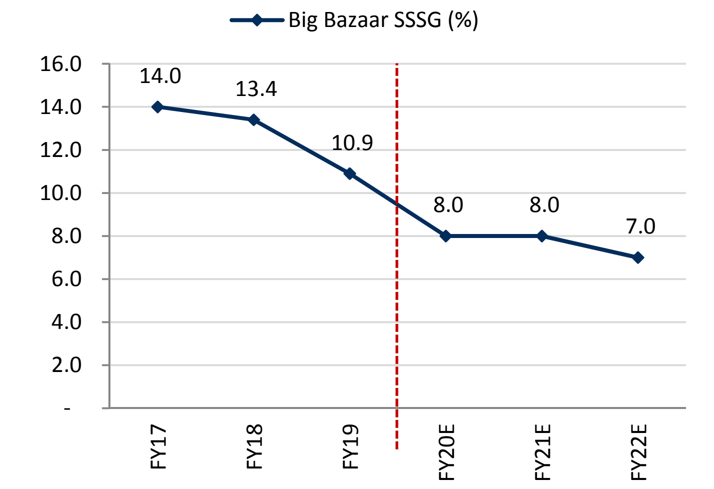
- **STANCE:** Operationally, FRL has been hitting the right notes with BB in steady state and EasyDay focusing on profitable growth (at the margin). That said, <u>unwinding of pledges is key to re-rating of the stock and on that certainly, more needs to be done.</u> Stocks recent correction (>60% over preceding 12 months), presents a good entry point as valuations (9x EV/EBITDA Sept-FY21) remain undemanding. We value FRL with a DCF-based TP of Rs. 500/sh, implying 14x EV/EBITDA Sept-21.

Big Bazaar to focus on productivity increase by
1. Plugging in white spaces in existing geographies and narrowing pricing gap vs peers
2. Including more SKUs into its recently implemented EDLC-EDLP framework (currently ~1,500/8,000 SKUs),
3. Weeding out slow-moving fashion/GM categories and replacing them with faster moving categories
4. Operational tie-up with Amazon to spur volumes.

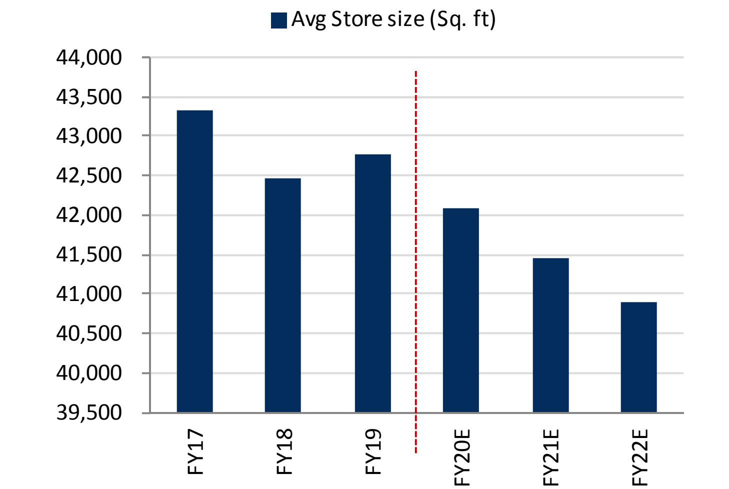
Story in Charts

Big Bazaar chugging along

Big Bazaar: Steady 7-8% SSSG over FY19-22E and right-sizing of store sizes

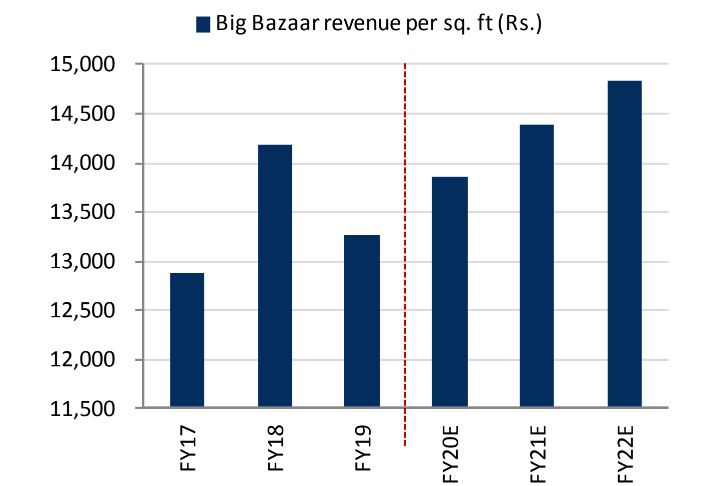


Source: Company, HDFC sec Inst Research



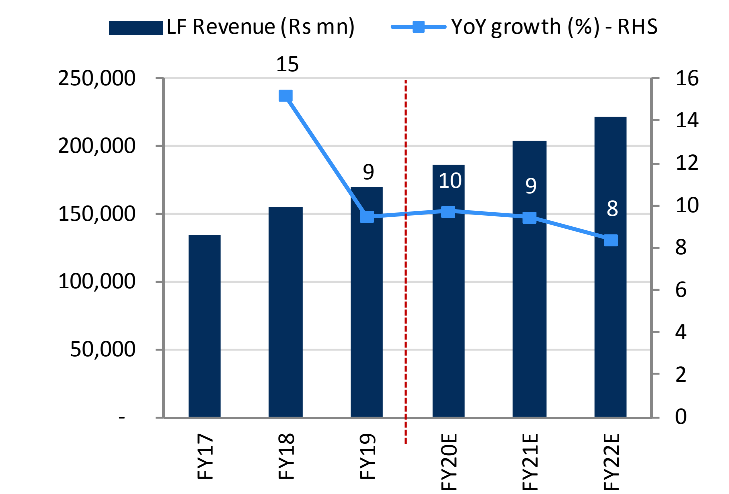
Source: Company, HDFC sec Inst Research

...to nudge productivity higher



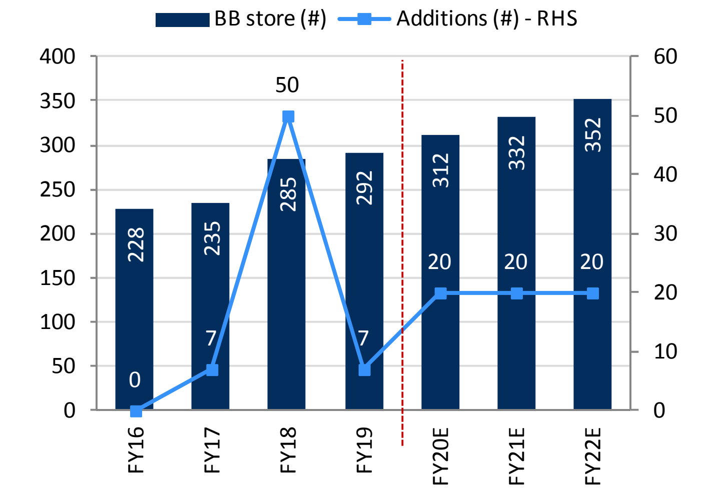
Source: Company, HDFC sec Inst Research

Expect 9% CAGR over FY19-22 for the large format



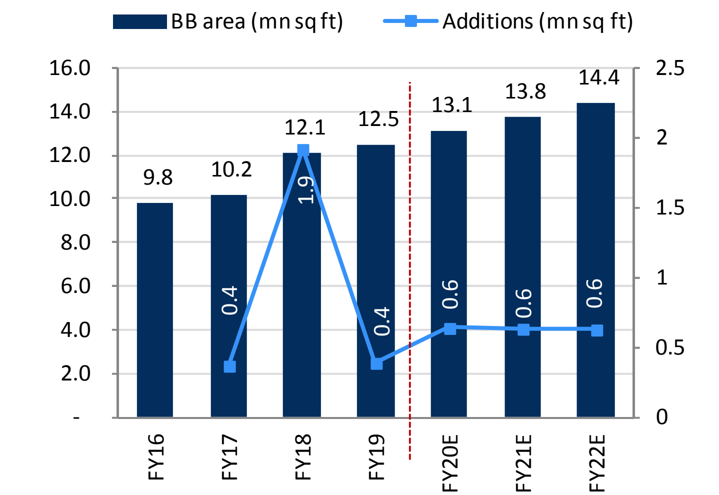
Source: Company, HDFC sec Inst Research

Expect Big-Bazaar to add 20 stores annually



Source: Company, HDFC sec Inst Research

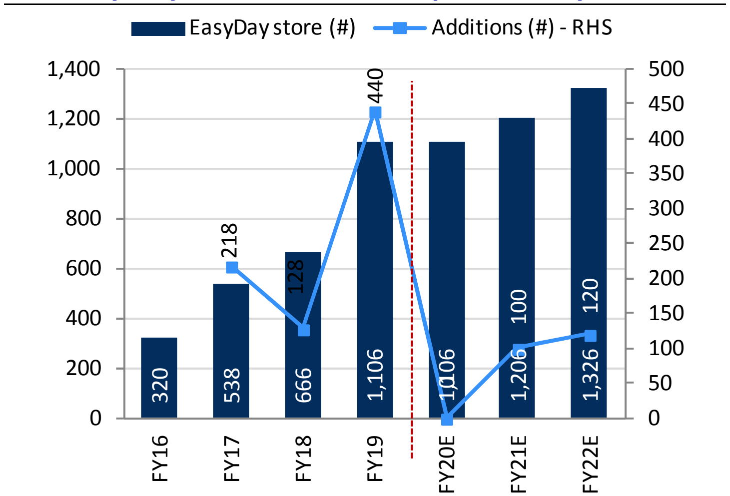
Area addition pace to be even lower (5% CAGR over FY19-22E) as store size decreasing



Source: Company, HDFC sec Inst Research

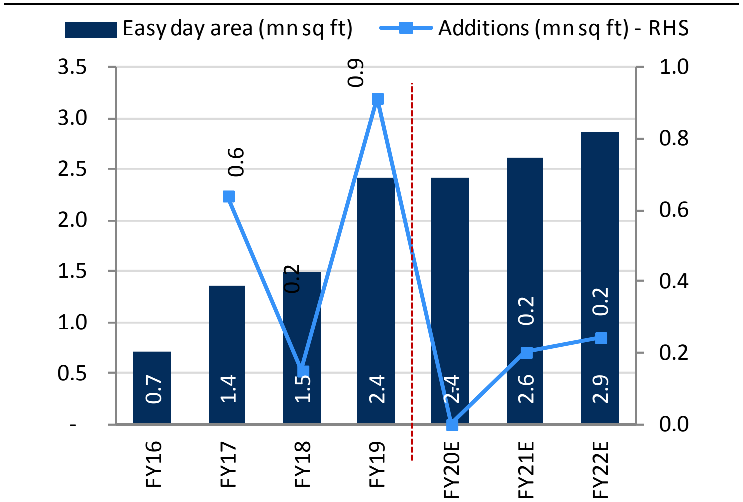
EasyDay nearing moment of truth!

Post an aggressive FY19, store expansion to cool off for Easy Day, as focus shifts on profitability



Source: Company, HDFC sec Inst Research

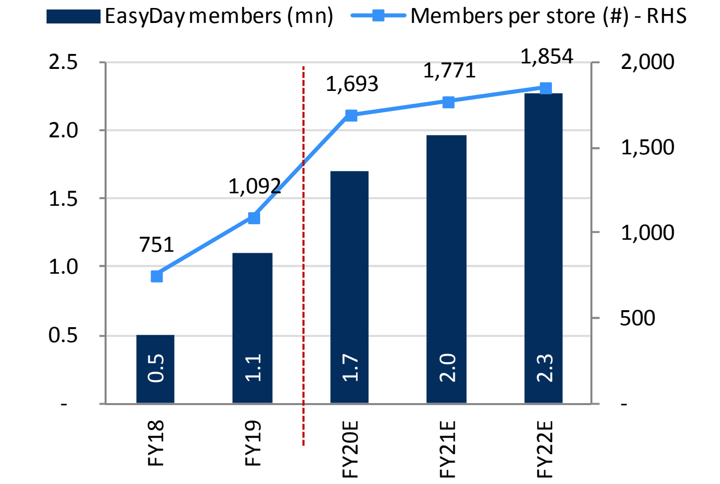
…Building in a modest 6% area CAGR over FY19-22E



Source: Company, HDFC sec Inst Research

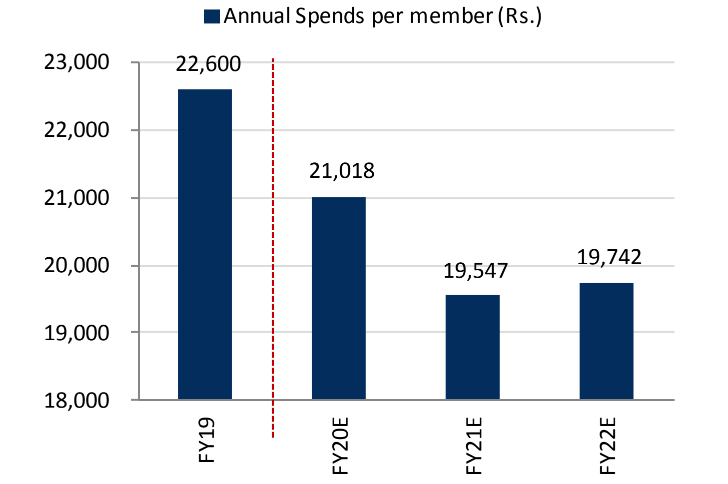
Members per store has been improving

Focus to be on improving members per store



Source: Company, HDFC sec Inst Research

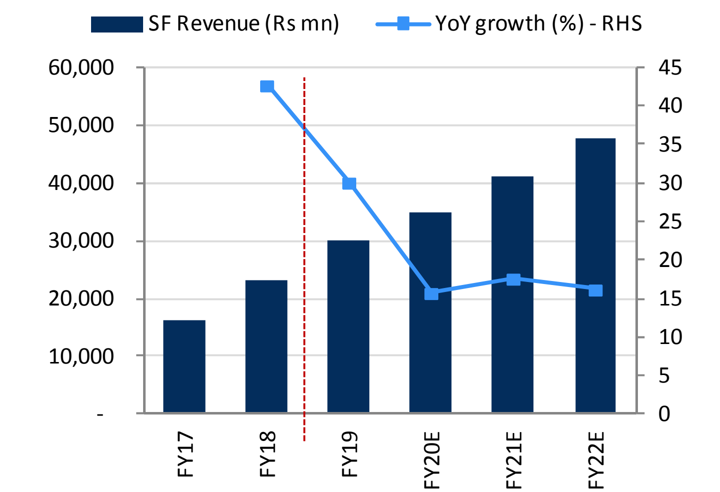
EasyDay: Annual spends per member



Source: Company, HDFC sec Inst Research

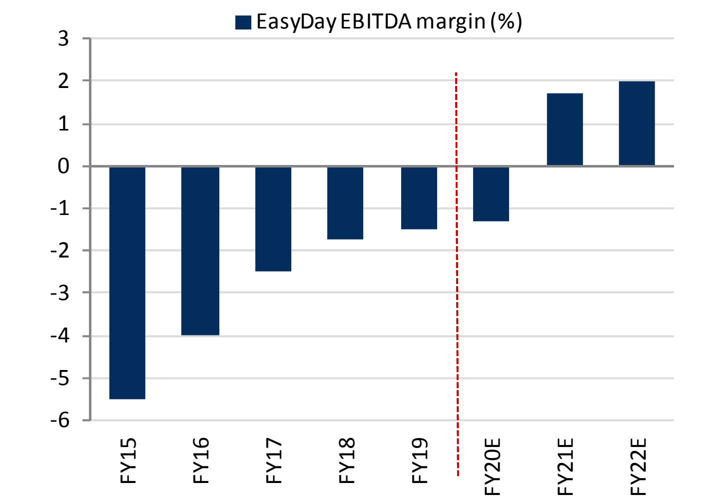
Management intends to shut down 50-60 loss-making EasyDay stores in FY20 and hit break-even in the next 3-6 months, we take a conservative stance build in an FY21 break-even for the small format

Expect 17% CAGR for small format over FY19-22E



Source: Company, HDFC sec Inst Research

...Building in an FY21 EBITDA break-even for EasyDay



Source: Company, HDFC sec Inst Research

High pledges and opaque FEL-FRL asset structure has historically kept investors on the edge when it comes to FRL. Note: FEL owns the store assets, while FRL leases those store fit-outs from FEL and pays a lease rental of ~Rs6.5bn annually.

In order to improve the transparency in asset structure, the management is in the process of bringing store infrastructure on the books of FRL. This should help bring down company pledges/corporate guarantees (Rs. 36bn) for loans of FEL

If we don't account for the potential gains from the upside of Bharti/Heritage's FRL stake sale and the wafer-thin cash & equivalent buffer, FRL will have a Rs. 9bn shortfall to fill via debt and internal accruals. Hence, further capital infusion is key for the growth story to perpetuate

While the company intends to squeeze in Rs. 1.6-2bn efficiency-led savings annually, we prefer to see some execution on this front before baking savings in our numbers.

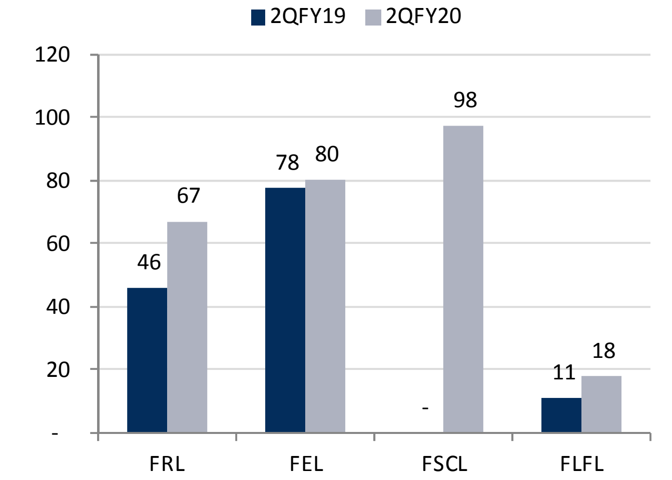
The uncomfortable Group PLEDGES!

Future Group: Entity-wise leverage position (Rs.mn)

	FEL	FRL	FSCL	FLFL	Total
Total Debt	**65,447**	**26,570**	**2,504**	**9,036**	**103,557**
LT Debt	61,526	3,753	2,178	6,733	74,190
ST Debt	3,921	21,787		1,363	27,071
Curr. Portion of LT Debt	-	1,031	326	940	2,296
Equity	**42,874**	**38,520**	**5,422**	**18,270**	**105,086**
Cash & Eq	1,675	2,528	1,243	2,221	7,666
Net Debt/Equity	**1.5**	**0.6**	**0.2**	**0.4**	**0.9**
EBITDA	15,462	10,369	1,269	5,259	32,359
Net Debt/EBITDA	**4.1**	**2.3**	**1.0**	**1.3**	**3.0**

Source: Company, HDFC sec Inst Research

Future group: Entity-wise pledges



Source: Company, HDFC sec Inst Research

The roadmap to bring pledges/corporate guarantees down

FEL-FRL asset transfer to bring down pledges

Particulars	Rs. mn
Gross Value of FEL assets to be bought	40,000
Net amount needed to buy FEL assets	35,000
Sources of funds	
Amazon stake purchase (4.5%)	15,000
Promoter infusion via warrants	5,000
Security deposits with FEL	6,000
Unrealized gains from Bharti stake sale	2,558
Unrealized gains from Heritage stake sale	2,667
Cash & Eq. (Sept-20)	1,949
Total sources of funds	**33,675**
Shortfall to be filled via mix of debt/internal accruals (ex-Bharti/Heritage sale and not accounting for cash & eq. Buffer)	**9,000**

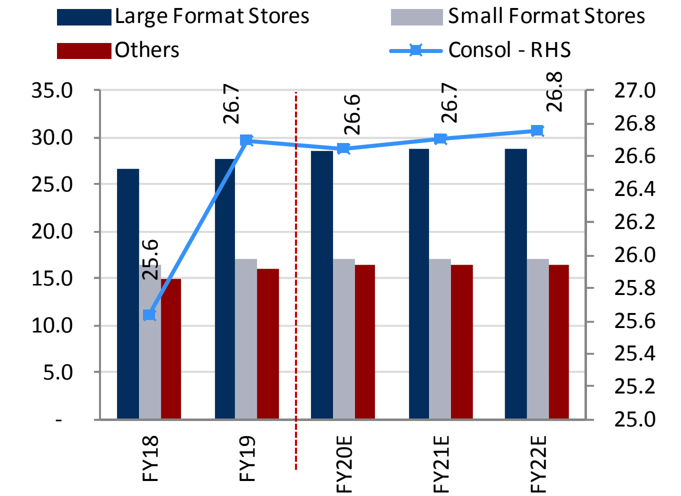
Source: Company, HDFC sec Inst Research

Gross margin is expected to largely remain flat as Easyday's contribution increases in the revenue mix (15 to 18% over FY19-22E)

Note: Implicit in our GM assumption is a GM increase of ~110bp for the large format as FBB's (fashion format) skew increases in Big Bazaar over FY19-22E.

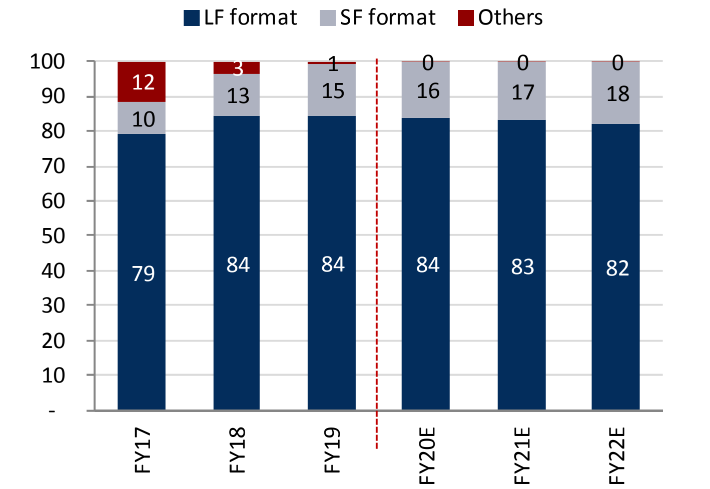
Also, contribution of FBB standalone stores is expected to increase in the mix.

Gross margin improvement unlikely, as mix gets Easyday heavy



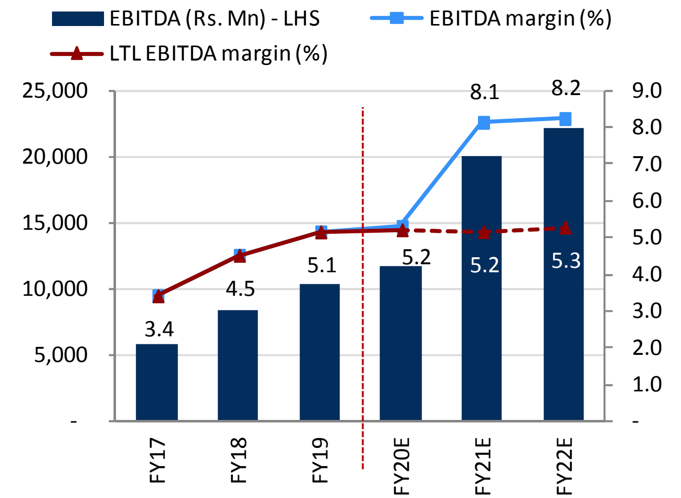
Source: Company, HDFC sec Inst Research

Future Retail: Format-wise revenue mix



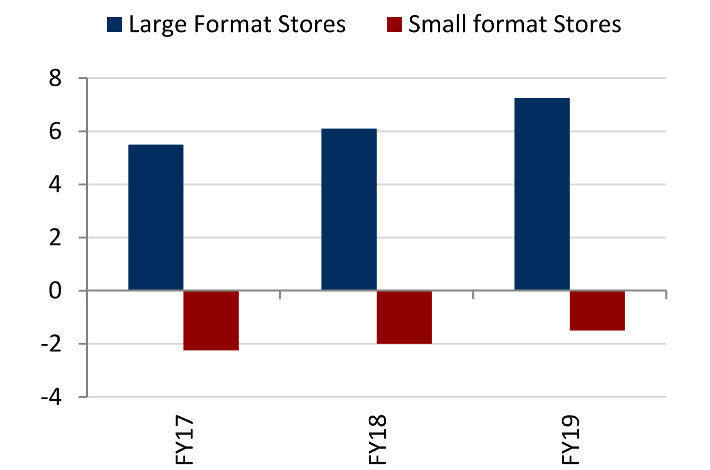
Source: Company, HDFC sec Inst Research

LTL EBITDA margins to largely remain flat hereon



Source: Company, HDFC sec Inst Research

Format-wise EBITDA margins



Source: Company, HDFC sec Inst Research

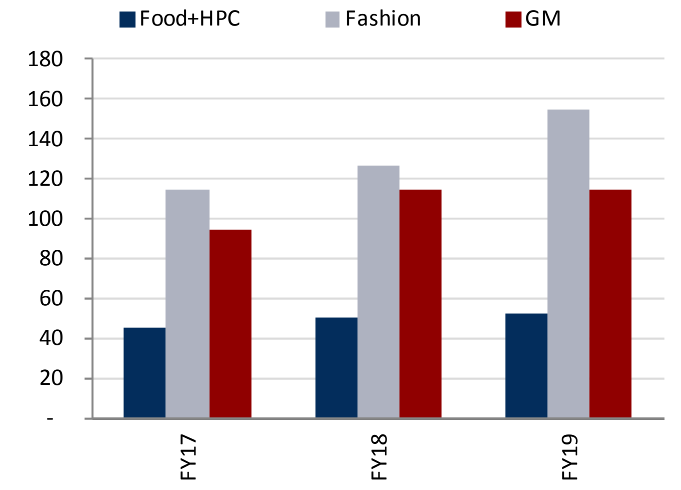
Fashion & General Merchandise have been putting some strain on the working capital

In FY19, FRL added inventory worth Rs. 3.5bn in HyperCity (Its first full year of operations under FRL) This coupled with a softer off-take in fashion & GM and excess support to vendors led to a deterioration in working capital of ~17 days

While the management targets to release Rs. 5bn from inventory itself in FY20 and a 5-6 day inventory reduction annually thereafter, we prefer to see some execution before building the improvement in our numbers.

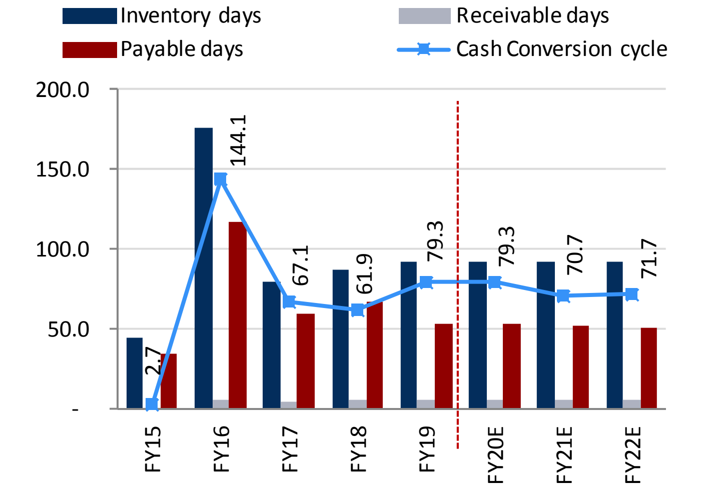
The 10 day WC release in FY21 is primarily due to the release of security deposits by FEL to FRL.

Segment-wise Inventory days



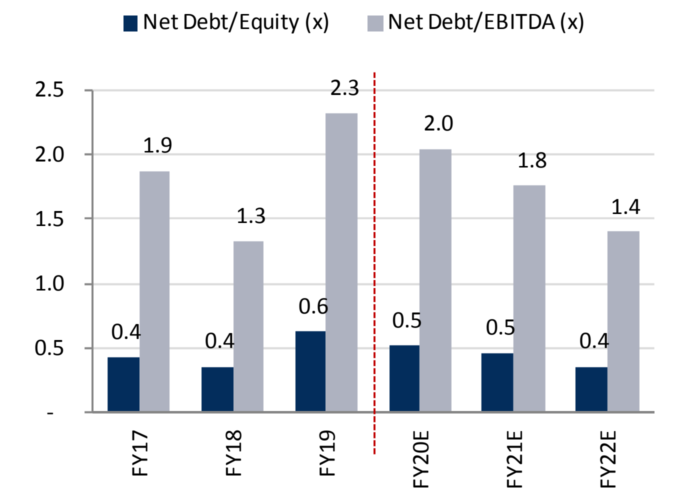
Source: Company, HDFC sec Inst Research

Working capital to remain stable



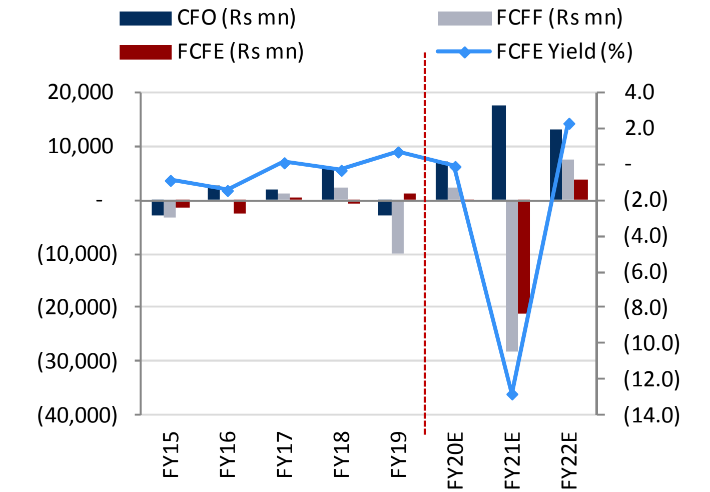
Source: Company, HDFC sec Inst Research

Leverage remains manageable



Source: Company, HDFC sec Inst Research

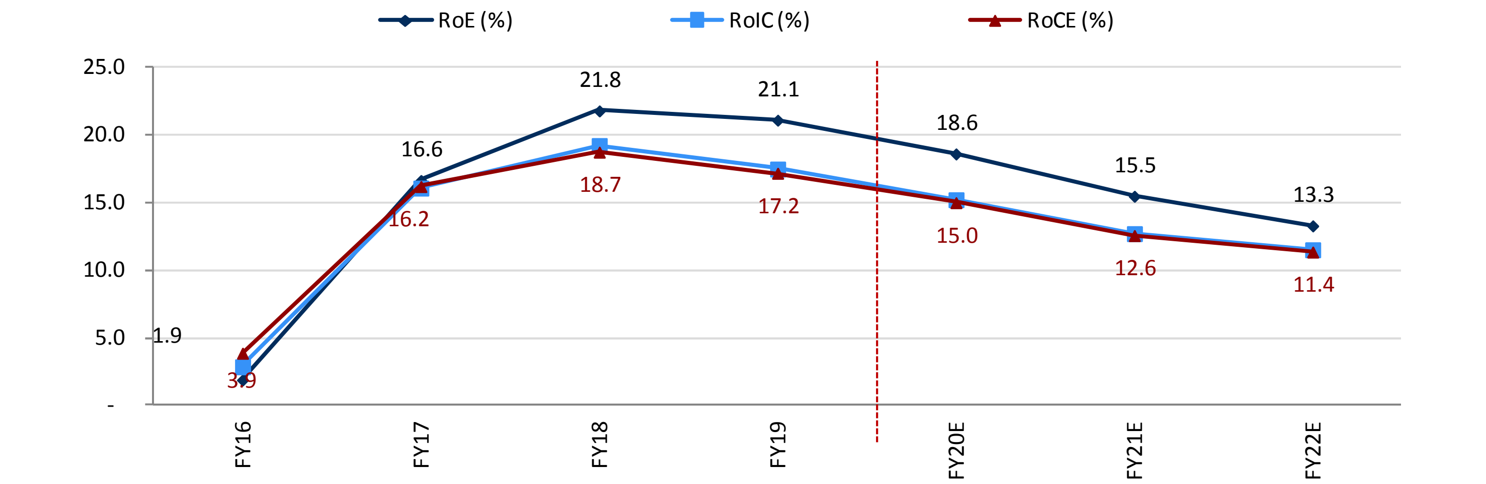
FCFE profile to stabilize by FY22E



Source: Company, HDFC sec Inst Research

Note: Return profile to come down as 1. FEL assets move to FRL's balance sheet. 2. Skew of biz moves towards lower RoCE EasyDay biz

Return ratios to optically come down as FRL purchases its Rs. 40bn - store infrastructure from FEL



Source: Company, HDFC sec Inst Research

Format-wise Unit store economics: (Per sq. ft)

Large Format		Small Format	
Revenue	12,868	Revenue per sq. ft	15,402
Gross Profit	3,575	Gross Profit per sq. ft	2,618
EBITDA	1,301	EBITDA per sq. ft	536
Depreciation	276	Depreciation per sq. ft	361
EBIT	1,025	EBIT per sq. ft	175
Capex	3,500	Capex per sq. ft	2,000
WC	1,992	WC per sq. ft	2,385
Capital Employed	5,492	Capital Employed per sq. ft	4,385
Post Tax RoCE (%)	19.9	Post Tax RoCE (%)	4.0
Payback Period (Yrs)	**5.8**	**Payback Period (Yrs)**	**8.2**

Source: Company, HDFC sec Inst Research

FRL's real money maker is its 16mn sq. ft+ strong store network - largest in F&G which could potentially double up as a strong omni-asset given its pan-India presence (437 cities).

We reckon, this to be the key rationale for Amazon's stake purchase in FRL (~4.5% effective stake for Rs. 15bn at a valuation of Rs. ~300bn, implying 15x Sept-21 EV/EBITDA

Initial results from the FRL-Amazon tie up seem encouraging. Select FRL stores (20 stores, 4 cities) are clocking an additional 200 orders/day (Amazon-originated) – This translates into an estimated 16% jump in bill cuts per store. The operational upside from this tie up is not factored in our numbers. Hence, poses an upside risk to estimates

Per capita income/Population density-wise store map:

% Distribution	Districts (#)	D Mart	Big Bazaar	Spencers	Star Bazaar	Spar	Natures Basket	Vishal Megamart
<100K	**212.0**	**0.6**	**15.3**	**18.7**	**-**	**8.7**	**-**	**29.6**
<300	78.0	-	2.2	-	-	-	-	4.4
300-500	20.0	-	0.7	-	-	-	-	1.3
500-1000	65.0	-	1.8	-	-	-	-	6.9
1000-3000	47.0	-	8.4	17.1	-	-	-	13.2
3000-5000	2.0	0.6	2.2	1.6	-	8.7	-	3.8
100-150K	**117.0**	**9.3**	**14.9**	**8.1**	**-**	**-**	**-**	**20.1**
<300	55.0	2.5	1.1	0.8	-	-	-	5.0
300-500	43.0	4.3	6.2	3.3	-	-	-	7.5
500-1000	12.0	2.5	4.4	0.8	-	-	-	6.3
1000-3000	6.0	-	2.5	2.4	-	-	-	1.3
3000-5000	1.0	-	0.7	0.8	-	-	-	-
150-200K	**86.0**	**17.4**	**20.0**	**40.7**	**2.6**	**8.7**	**-**	**18.9**
<300	31.0	5.0	1.8	1.6	-	-	-	3.1
300-500	29.0	3.1	3.3	8.1	-	-	-	5.0
500-1000	21.0	6.2	4.7	-	2.6	-	-	8.2
1000-3000	3.0	2.5	1.5	-	-	-	-	1.3
5000+	2.0	0.6	8.7	30.9	-	8.7	-	1.3
200-250K	**30.0**	**3.1**	**7.6**	**5.7**	**-**	**8.7**	**-**	**6.3**
<300	3.0	-	0.4	-	-	4.3	-	-
300-500	8.0	0.6	1.5	-	-	-	-	0.6
500-1000	12.0	2.5	2.9	1.6	-	4.3	-	4.4
1000-3000	7.0	-	2.9	4.1	-	-	-	1.3
250-300K	**6.0**	**8.1**	**9.1**	**-**	**20.5**	**-**	**8.3**	**1.9**
300-500	1.0	-	0.7	-	-	-	-	-
500-1000	2.0	8.1	3.3	-	20.5	-	8.3	1.3
1000-3000	3.0	-	5.1	-	-	-	-	0.6
300-500K	**10.0**	**45.3**	**20.7**	**19.5**	**76.9**	**65.2**	**91.7**	**6.9**
<300	1.0	-	-	-	-	-	-	-
300-500	2.0	-	1.5	-	-	8.7	-	1.3
500-1000	3.0	-	0.7	0.8	-	-	-	1.3
1000-3000	1.0	-	0.4	1.6	-	-	-	1.3
3000-5000	1.0	8.7	6.9	1.6	46.2	34.8	25.0	2.5
5000+	2.0	36.6	11.3	15.4	30.8	21.7	66.7	0.6
500K+	**3.0**	**-**	**7.6**	**6.5**	**-**	**8.7**	**-**	**15.7**
1000-3000	2.0	-	2.9	6.5	-	4.3	-	3.8
5000+	1.0	-	4.7	-	-	4.3	-	11.9
Gujarat	**25.0**	**16.1**	**4.7**	**0.8**	**-**	**-**	**-**	**0.6**
<300	12.0	0.6	1.1	-	-	-	-	-
300-500	5.0	4.3	0.4	-	-	-	-	-
500-1000	8.0	11.2	3.3	0.8	-	-	-	0.6
Grand Total	**489.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, HDFC sec Inst Research

Capital Intensity remains high

	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	6.0	8.3	10.5	24.8
Other Income	0.1	0.1	0.2	0.4
Total	**6.1**	**8.4**	**10.7**	**25.2**
				0
Application of funds (Rs bn)				-
Working Capital	4.3	(0.0)	12.5	16.8
Capex	0.9	3.8	6.9	11.5
Investments	-	1.0	1.0	2.1
Dividend	-	-	-	-
Borrowings	1.2	0.4	13.7	15.3
Others	(0.7)	3.2	(23.7)	(21.2)
Net change in cash	0.3	0.0	0.3	0.6
Total	**6.1**	**8.4**	**10.7**	**25.2**
Cumm. WC + Capex as % of sources of funds				**112.5**

Source: Company, HDFC sec Inst Research

Valuation

DCF

	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27	FY28	FY29	FY30
Revenue (INR m)	**245,767**	**269,973**	**295,644**	**325,504**	**353,302**	**383,329**	**414,173**	**446,892**	**477,447**	**508,113**
YoY	*10.7*	*9.8*	*9.5*	*10.1*	*8.5*	*8.5*	*8.0*	*7.9*	*6.8*	*6.4*
EBIT*(1-t)	11701	13341	15063	17025	18933	21001	23112	25180	27144	29229
Depreciation	4328	4386	4613	4888	5162	5417	5670	5920	6147	6351
Capex	-45501	-6326	-6631	-7404	-7571	-7805	-8668	-8931	-9204	-9487
Changes in WC (Winv)	672	-5427	-5851	-6838	-6579	-7194	-7530	-8098	-7811	-10049
FCFF	**22,202**	**5,973**	**7,194**	**7,671**	**9,944**	**11,420**	**12,584**	**14,070**	**16,276**	**16,043**
YoY (%)	*798.7*	*(73.1)*	*20.4*	*6.6*	*29.6*	*14.8*	*10.2*	*11.8*	*15.7*	*(1.4)*
Interest (1-t)	-2362	-2737	-2549	-2175	-1801	-1614	-1614	-1464	-1128	-866
Net Borrowings	10000	0	-5000	-5000	-5000	0	0	-4000	-5000	-2000
FCFE	**29,839**	**3,237**	**(356)**	**496**	**3,143**	**9,806**	**10,970**	**8,606**	**10,148**	**13,177**
YoY (%)	*(16,078.9)*	*(89.2)*	*(111.0)*	*(239.4)*	*533.5*	*212.0*	*11.9*	*(21.5)*	*17.9*	*29.9*
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**
PV (FCFF)	**(13,209)**	**5,962**	**7,170**	**7,637**	**9,886**	**11,338**	**12,478**	**13,934**	**16,097**	**15,846**
Terminal Value										**210,366**

Kd	**10.0%**
Kd*(1-t)	**7.5%**
Ke	**16%**
DCF Date	**Sep-20**
Net Debt (Mar-20E)	24,000
PV-Explicit Period	87,140
PV-Terminal Value	207,783
Equity Value - Standalone (INR m)	**270,923**
Equity value per share (INR)	**500**
Sept-21 EV/EBITDA (x)	14.0
Terminal growth rate (%)	5.0%
WACC	13.0%
CMP	**335**
Upside/(Downside)	**49.4%**

Source:HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer preferences	The markets for some of the products such as home and personal care and apparel are seasonal & constantly changing with changing in customer preferences, new product introductions. There may be a risk of loss of business due to inability to match the changing customer preferences.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Inventory risk	Any material misjudgment in estimating customer demand could adversely impact the results by causing either a shortage of inventory or an accumulation of excess inventory.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Kishore Biyani	Chairman & Managing Director	Kishore Biyani is the founder and Group CEO of Future Group. He has over 26 years of experience and is known as the pioneer of modern retail in India.
Mr. Rakesh Biyani	Joint Managing Director	Mr. Rakesh Biyani has been Joint Managing Director at Future Retail Limited since 2016. He is also on the board of 18 other companies. He leads the strategies related to expansion of the company's flagship retail formats, Central, Big Bazaar and Food Bazaar. He has experience in category management, retail stores operations and Information technology.
Mr. C. P. Toshniwal	Chief Financial Officer	He is a qualified Chartered Accountant and Company Secretary. He started his journey with Future Group in 1997 and has over 2.5 decades of managerial experience. Mr. Toshniwal has experience in the field of Corporate and Strategic Planning, Financial Planning & Restructuring, Risk Management System and Process Implementation, Mergers, Amalgamations, Takeover of Business Enterprises, Raising Capital through innovative financial products
Ms. Gagan Singh	Non-Executive & Independent Director	She is a Chartered Accountant and Cost Accountant. She is an Independent Director on the boards of Timex Group and Future Retail Ltd She served as the Chief Executive Officer of Business at Jones Lang LaSalle India for 10 years until March 2017. She has rich expertise in operations and real estate.
Mr. Ravindra Dhariwal	Non-Executive & Independent Director	He holds an MBA degree from IIM Calcutta and an undergraduate degree from IIT Kanpur. In the past he occupied the position of CEO at Bennett, Coleman & Co. Ltd., President of The International News Media Association and Vice President-Franchise at PepsiCo India.
Mr. Shailendra Bhandari	Non-Executive & Independent Director	He has years of experience in private equity, mutual funds and banking. Mr. Bhandari was the Managing Director and CEO of ING Vysya Bank Limited from 2009 to 2015. He is a seasoned banker with years of experience and an impressive track record of accomplishments.
Ms. Sridevi Badiga	Non-Executive & Independent Director	Ms. Badiga received an MBA from Kellogg School of Management and an undergraduate degree from Hofstra University. Ms. Badiga was an Investment Banker with JPMorgan in New York and Hong Kong in the Power and Infrastructure group, focusing on transactions in Thailand and the Philippines.

Source: Company, HDFC sec Inst Research

Company Profile: Future Retail

- Future retail is the largest organized retailer in India with a total retail space of 16.4 mn sq ft. as of Sep 2019. Post its merger with Bharti retail and demerger of the non-core assets, Future retail has emerged as a pure retail company with an asset light business model.
- Future retail operates through its hypermarket format, Big Bazaar, Hypercity and fbb and its convenience store format, Easy day, Heritage and other formats like Home town, E-zone and foodhall. As of Sep-19, the company operated 1,550 stores comprising 293 Big Bazaar and Hypercity, 95 FBB, 9 Foodhall, 1,147 Easyday, Heritage Fresh and WH Smith stores, and 6 Ezone stores.
- Future Retail is aggressively expanding store footprint by adding 25-30 standalone fbb stores and 20 Big Bazaar (with fbb) stores each year to capture the opportunity in rapidly-growing grocery and value fashion segments. Its sports the widest retail distribution network in India (present in 26 states and 432 cities).

Income Statement (Consolidated)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues	**184,780**	**201,649**	**222,051**	**245,767**	**269,521**
Growth (%)	***8.2***	***9.1***	***10.1***	***10.7***	***9.7***
COGS	137,407	147,811	162,876	180,129	197,404
Employee Expense	9,300	10,744	12,109	13,318	14,805
Power and fuel exp	2,648	3,203	3,527	3,903	4,281
Rent Expense	14,053	14,874	15,988	9,975	10,671
Other Expenses	13,049	14,649	15,810	18,477	20,193
EBITDA	**8,323**	**10,369**	**11,741**	**19,965**	**22,167**
EBITDA Growth (%)	***43.2***	***24.6***	***13.2***	***70.0***	***11.0***
EBITDA Margin (%)	***4.5***	***5.1***	***5.3***	***8.1***	***8.2***
Depreciation	534	1,006	1,415	4,328	4,367
EBIT	**7,789**	**9,363**	**10,326**	**15,637**	**17,800**
Other Income (Including EO Items)	(5,922)	205	229	164	286
Interest	1,754	2,240	2,657	3,157	3,657
PBT	**113**	**7,328**	**7,898**	**12,644**	**14,429**
Total Tax	-	-	-	3,182	3,632
RPAT	**113**	**7,328**	**7,898**	**9,461**	**10,797**
Exceptional Gain/(loss)	(6,039)	-	-	-	-
Adjusted PAT	**6,152**	**7,328**	**7,898**	**9,461**	**10,797**
APAT Growth (%)	***67.0***	***19.1***	***7.8***	***19.8***	***14.1***
Adjusted EPS (Rs)	**12.3**	**14.6**	**15.7**	**17.5**	**19.9**
EPS Growth (%)	***57.0***	***19.0***	***7.8***	***11.0***	***14.1***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	1,004	1,005	1,005	1,084	1,084
Reserves	29,959	37,514	45,413	74,795	85,592
Total Shareholders Funds	**30,963**	**38,520**	**46,418**	**75,879**	**86,677**
Long Term Debt	2,233	3,753	3,753	3,753	3,753
Short Term Debt	10,631	22,817	22,817	32,817	32,817
Total Debt	**12,864**	**26,570**	**26,570**	**36,570**	**36,570**
Net Deferred Taxes	-	-	-	-	-
Other Non-current Liabilities & Provns	**1,185**	**1,370**	**1,370**	**1,370**	**1,370**
TOTAL SOURCES OF FUNDS	**45,012**	**66,460**	**74,358**	**113,820**	**124,617**
APPLICATION OF FUNDS					
Net Block	10,186	14,408	17,829	59,003	60,378
CWIP	336	1,902	1,902	1,902	1,902
Other Non-current Assets	1,330	2,753	2,753	2,753	2,753
Total Non-current Assets	**11,851**	**19,063**	**22,484**	**63,657**	**65,033**
Inventories	44,174	50,656	55,781	61,739	67,706
Debtors	2,701	3,165	3,485	3,857	4,230
Other Current Assets	21,386	28,826	31,742	28,632	31,399
Cash & Equivalents	**1,832**	**2,528**	**2,571**	**1,531**	**5,614**
Total Current Assets	**70,094**	**85,174**	**93,579**	**95,759**	**108,949**
Creditors	34,242	29,373	32,345	35,126	37,783
Other Current Liabilities & Provns	2,691	9,444	10,399	11,510	12,622
Total Current Liabilities	**36,933**	**38,817**	**42,744**	**46,636**	**50,405**
Net Current Assets	**33,161**	**46,357**	**50,834**	**49,123**	**58,544**
TOTAL APPLICATION OF FUNDS	**45,012**	**65,420**	**73,318**	**112,780**	**123,577**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	113	7,328	7,898	12,644	14,429
Non-operating & EO Items	6,023	128	(229)	(164)	(286)
Interest Expenses	1,754	2,240	2,657	3,157	3,657
Depreciation	534	1,006	1,415	4,328	4,367
Working Capital Change	(2,265)	(13,566)	(4,434)	672	(5,338)
Tax Paid	(154)	(156)	-	(3,182)	(3,632)
OPERATING CASH FLOW (a)	**6,006**	**(3,020)**	**7,306**	**17,454**	**13,197**
Capex	(3,759)	(6,880)	(4,836)	(45,501)	(5,743)
Free Cash Flow (FCF)	*2,247*	*(9,900)*	*2,470*	*(28,047)*	*7,454*
Investments	(1,039)	(1,040)	-	-	-
Non-operating Income	108	177	229	164	286
INVESTING CASH FLOW (b)	**(4,689)**	**(7,743)**	**(4,606)**	**(45,337)**	**(5,457)**
Debt Issuance/(Repaid)	(2,789)	11,053	(2,657)	6,843	(3,657)
FCFE	*(541)*	*1,152*	*(187)*	*(21,204)*	*3,797*
Share Capital Issuance	1,484	6	-	20,000	-
Dividend	-	-	-	-	-
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(1,305)**	**11,059**	**(2,657)**	**26,843**	**(3,657)**
NET CASH FLOW (a+b+c)	**12**	**296**	**43**	**(1,040)**	**4,083**
EO Items, Others	139	-	-	-	-
Closing Cash & Equivalents	1,436	2,049	2,571	1,531	5,614

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	25.6	26.7	26.6	26.7	26.8
EBITDA Margin	4.5	5.1	5.3	8.1	8.2
EBIT Margin	4.2	4.6	4.7	6.4	6.6
APAT Margin	3.3	3.6	3.6	3.8	4.0
RoE	21.8	21.1	18.6	15.5	13.3
RoIC (or Core RoCE)	19.2	17.5	15.2	12.7	11.5
RoCE	18.7	17.2	15.0	12.6	11.4
EFFICIENCY					
Tax Rate (%)	-	-	-	25.2	25.2
Fixed Asset Turnover (x)	36.7	21.5	15.6	4.1	4.1
Inventory (days)	*87*	*92*	*92*	*92*	*92*
Debtors (days)	*5*	*6*	*6*	*6*	*6*
Other Current Assets (days)	*42*	*52*	*52*	*43*	*43*
Payables (days)	*68*	*53*	*53*	*52*	*51*
Other Current Liab & Provns (days)	*5*	*17*	*17*	*17*	*17*
Cash Conversion Cycle (days)	62	79	79	71	72
Net D/E (x)	0.4	0.6	0.5	0.5	0.4
Interest Coverage (x)	4.4	4.2	3.9	5.0	4.9
PER SHARE DATA (Rs)					
EPS	12.3	14.6	15.7	17.5	19.9
CEPS	13.3	16.6	18.5	25.4	28.0
Dividend	-	1.00	2.00	3.00	4.00
Book Value	61.7	76.6	92.4	139.9	159.9
VALUATION					
P/E (x)	27.9	23.5	21.8	19.6	17.2
P/BV (x)	5.5	4.5	3.7	2.4	2.1
EV/EBITDA (x)	22.0	18.9	16.7	10.4	9.1
EV/Revenues (x)	1.0	1.0	0.9	0.8	0.8
OCF/EV (%)	3.3	(1.5)	3.7	8.4	6.5
FCF/EV (%)	1.2	(5.1)	1.3	(13.6)	3.7
FCFE/Mkt Cap (%)	(0.3)	0.7	(0.1)	(12.4)	2.2
Dividend Yield (%)	-	-	-	-	-

Source: Company, HDFC sec Inst Research

Aditya Birla Fashion

BUY

Unparalleled distribution brawn

Aditya Birla Fashion & Retail (ABFRL) is a perfect play on Fashion as its portfolio straddles across some of the fastest growing fashion categories and multiple income groups. It boasts of an unparalleled retail footprint of ~7.9mn sq. ft in the apparel space. Interestingly, this distribution is one of the leanest in terms of capital needs. An inkling of this can be seen in ABFRL's cash generation too. Over FY16-19, ABFRL's capex and working capital needs hoarded just ~69% of ABFRL's pre-working capital CFO. Very few fashion plays can boast of this, while still growing. Casualization/Premiumization within its tent-pole brands (Louis Philippe, Van Heusen, Allen Solly, Peter England), the promising innerwear (Van Heusen) and value fashion play (Pantaloons) are key themes/formats to watch out for.

We expect ABFRL to clock revenue/EBITDA/LTL PAT CAGR of 14/23/48% respectively over FY19-22E as both levers – operating and financial go into overdrive. Consequently, RoIC to improve by 390bp to 12.6%. Note: Underlying RoCE (on tangible assets) is >30%. We initiate coverage on ABFRL with a BUY recommendation and a DCF-based TP of Rs. 250/sh, implying a multiple of 22x Sept-21 EV/EBITDA (Pre-IND-AS 116).

Investment rationale

- **Casualization via brand extensions – Wind beneath Lifestyle brands' wings**: ABFRL's Lifestyle brands (Louis Philippe, Van Heusen, Allen Solly, Peter England) have clocked a smart recovery (13% revenue growth in FY19 since their Demon/GST blues over FY16-18 (muted growth) which impacted both its wholesale trade as well as retail operations. We expect brand extensions towards faster growing casual wear, premiumization and an increasing share of the faster growing online channel to underpin a steady 12% CAGR over FY19-22E. Main-line portfolio across brands have come down from >70% in FY10 to 55%. While SSSG is expected to remain healthy at 5%, a big chunk of growth is expected to be expansion-led as the company steps up store adds for the vertical. We build in 250 store adds annually over FY19-22E on a base of 1980 stores (FY19). Interestingly, a bulk of these adds will be franchisee-led, ergo growth will be asset-light.
- **Pantaloons – Primed for growth:** Pantaloons has come a long way since its acquisition from the Future Group. A value proposition and a couple of format re-sizing exercises later (FY13-18); the format seems primed for growth. Our assortment analysis across VF retailers suggests that Ex-Zudio, Pantaloons now offers some of the sharpest price points and a consistently increasing private label portfolio to choose from. This seems well aligned with its strategy to incrementally focus on Tier 2/3 cities. Pantaloons is also expected to step up its expansion (65-70 stores annually) over FY19-22E and is working on making its store network denser. Thus, we believe the format has finally got the holy troika of retailing right – Pricing, Assortment and distribution. We bake in 15% revenue CAGR over FY19-22E, largely expansion-led. SSSG built in is 4.5%.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	81,177	92,660	106,368	121,561
EBITDA	5,541	6,733	8,249	10,262
APAT	3,212	2,683	3,749	4,140
Dil. EPS (Rs/sh)	4.2	3.5	4.9	5.4
P/E (x)	53.3	63.8	45.7	41.4
EV/EBITDA (x)	33.9	27.6	22.2	17.5
ROE (%)	25.5	17.2	19.9	18.2
RoIC (%)	8.7	9.7	12.2	12.6
ROCE (%)	15.8	11.6	13.4	12.8

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 226**
Target Price	**Rs 250**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	ABFRL IN
No. of Shares (mn)	774
MCap (Rs bn) / ($ mn)	175/2,451
6m avg traded value (Rs mn)	94

STOCK PERFORMANCE (%)

52 Week high / low		**Rs 237/175**	
	3M	6M	12M
Absolute (%)	16.2	3.0	24.0
Relative (%)	6.9	0.7	9.4

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	59.1	59.09
FIs & Local MFs	18.43	20.26
FPIs	9.8	9.7
Public & Others	12.67	10.95
Pledged Shares	0	0

Source : BSE

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- **Innerwear – The Dark horse:** In just about two years, ABFRL's innerwear offering (via Van Heusen) has clocked Rs. 2bn in revenues. This of course has been a function of aggressive distribution push and new product launches. Van Heusen's (VH) distribution footprint has increased from non-existent to 18,000 MBOs in 2 years vs Page's ~60,000. We believe, while MBO addition will continue over FY19-22E, ABFRL is likely to milk the existing MBO base as product acceptance and product basket increases. Just to give some perspective, Revenue/MBO for Page is estimated to be >4x that of VH currently, ergo, the headroom productivity rise is significant for VH. As distribution strength increases, the innerwear offering could be extended to other power brands too. We expect, the innerwear biz to touch the Rs. 5bn mark in revenue in FY21E and operationally break-even by FY22E

- **Fast Fashion – A laggard:** ABFRL's fast fashion biz remains the only laggard in its portfolio. With management deciding to discontinue the People brand as a separate retail format and Forever 21 remaining a sub-scale biz pitted against deep-pocketed global fast fashion plays – Zara and H&M, we expect the fast fashion (FF) segment to lose relevance within the Madura portfolio. Building in a mere 2% growth over over FY19-22E with ebbing losses for FF. Expect Fast fashion to account for a mere 5% of Madura's revenue by FY22E.

- **Margin levers galore:** We expect ABFRL's EBITDA margins to expand by ~160bp over FY19-22E given multiple levers - 1. Ebbing Fast Fashion and innerwear losses and 2. scale-led savings in Pantaloons.

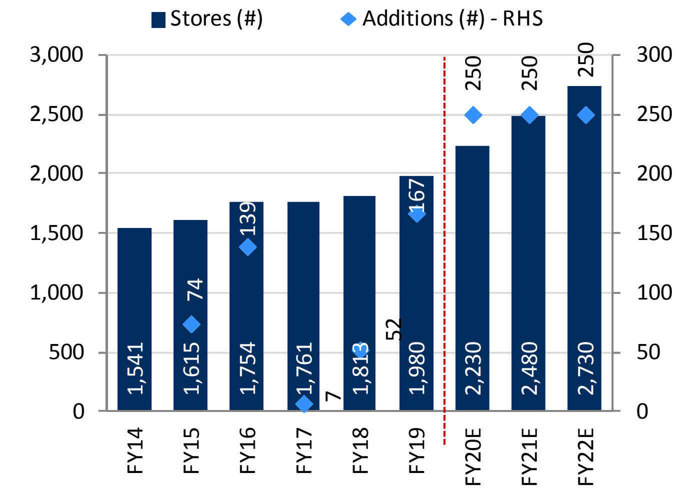
- **Valuation and Outlook:** We expect ABFRL to clock revenue/EBITDA/LTL PAT CAGR of 14/23/48% respectively over FY19-22E as both operating and financial levers go into overdrive with scale. Consequently, RoICs are expected to improve by 390bp to 12.6%. Note: Underlying RoCE (on tangible assets) is >30%. We initiate coverage on ABFRL with a BUY recommendation and a DCF-based TP of Rs. 250/sh, implying a multiple of 22x Sept-21 EV/EBITDA (Pre-IND-AS 116).

Lifestyle brands to step up EBO expansion. Management intends to add 350 net store adds in FY20, we conservatively build in 250.

Younger store age profile typically translates into healthy SSSG in future years

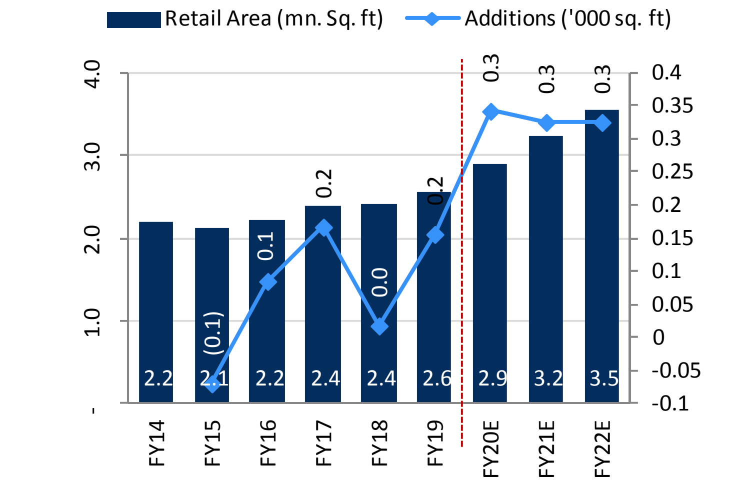
Story in Charts

Lifestyle brands to step up expansion drive



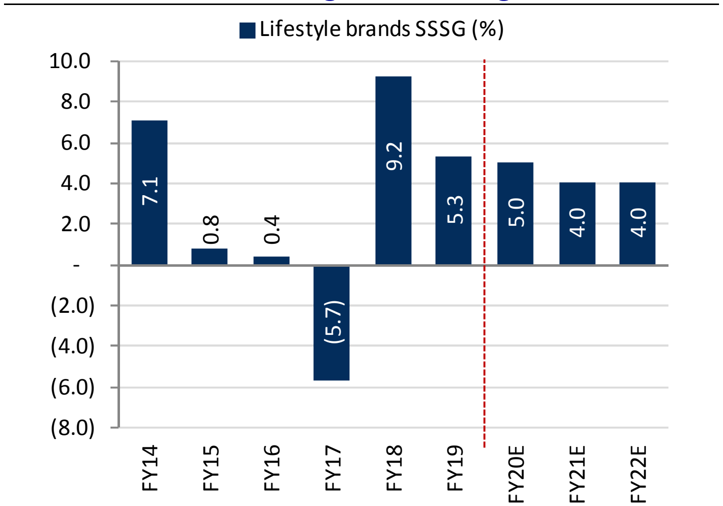
Source: Company, HDFC sec Inst Research

...expected an area CAGR of ~12% over FY19-22E



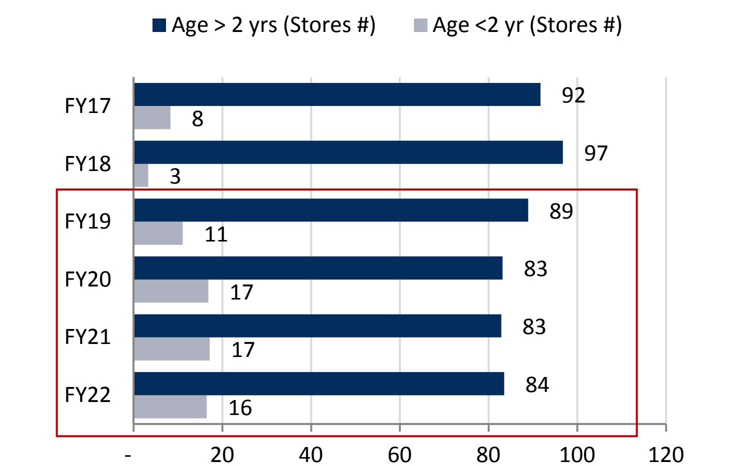
Source: Company, HDFC sec Inst Research

Lifestyle brands have turned a corner after the FY17 store restructuring exercise, ergo SSSG is back



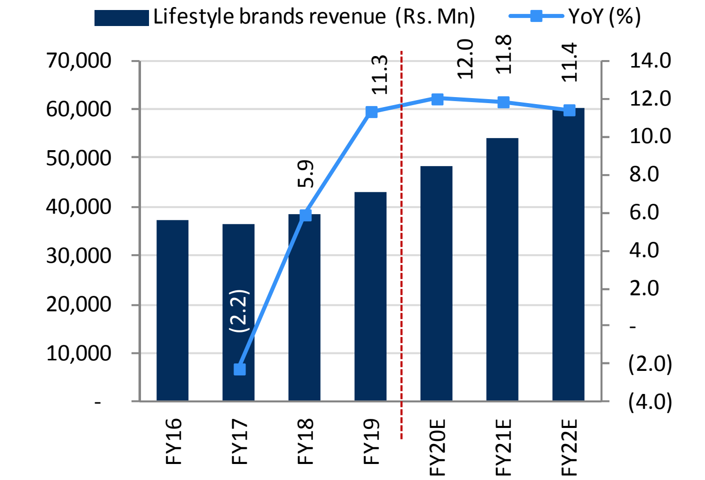
Source: Company, HDFC sec Inst Research

Improving store age profile to keep SSSG moderately healthy



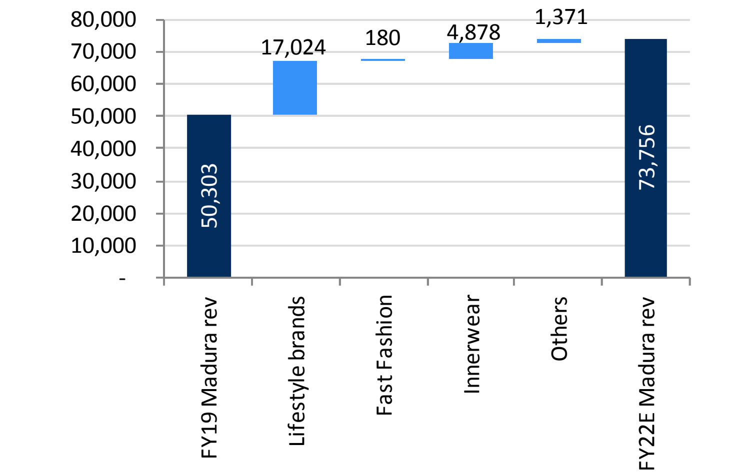
Source: Company, HDFC sec Inst Research

…should translate into 12% CAGR for Lifestyle brands over FY19-22E



Source: Company, HDFC sec Inst Research

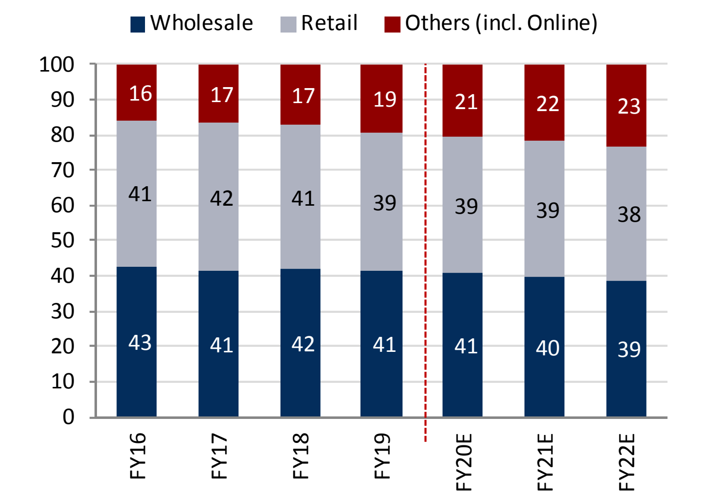
Lifestyle brands & Innerwear to remain growth engines for Madura



Source: Company, HDFC sec Inst Research

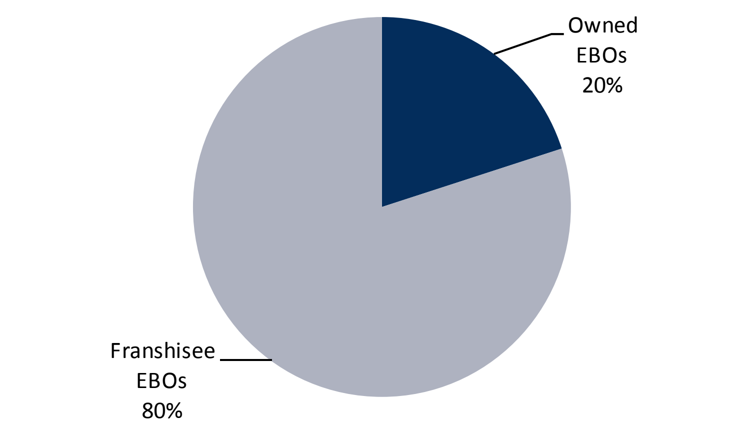
Online contribution inching up, now est. ~8-9% of Lifestyle brands sales

Lifestyle's Channel-wise mix



Source: Company, HDFC sec Inst Research

Lifestyle brands: 80% EBOs are franchised. Ergo works on an asset light model as capex/WC onus is on franchisees



Source: Company, HDFC sec Inst Research

The Madura portfolio has been increasingly pivoting to the faster growing casual/premium and women segments through brand extensions; this is expected to keep its growth momentum going

Main-line categories' share has come down from >70% in FY10 to ~50-55% in FY19

Management intends to extend innerwear category across all four Madura Brands once it touches a reasonable distribution scale of ~40,000 outlets

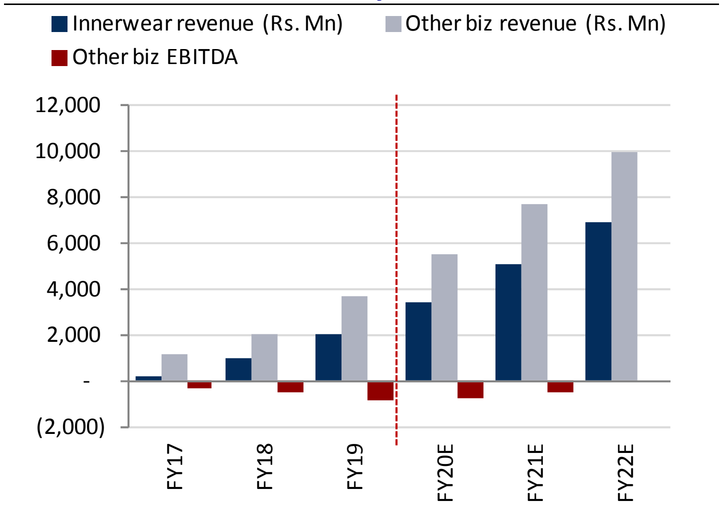
Ebbing losses from other biz (Innerwear and Fast Fashion) should help Madura gain ~230bp in margins over FY19-22E >10%

Brand extensions increasingly pulling their weight

Brands	Rev share (%)	Brands	Rev share (%)	Brands	Rev share (%)	Brands	Rev share (%)
Louis Philippe		**Van Heusen**		**Allen Solly**		**Peter England**	
LP mainline		VH mainline		AS Mainline		PE Mainline	
Jeans Sport	45	V-DOT Sport	35	AS Jeans AS Sports	20	Casuals Red	25
Luxure	30	VH-Women	10	AS Women	15	Sport	20-25
				AS Kids	10	Jeans	
						Ethnic	
						Elite	
						Perform/University	

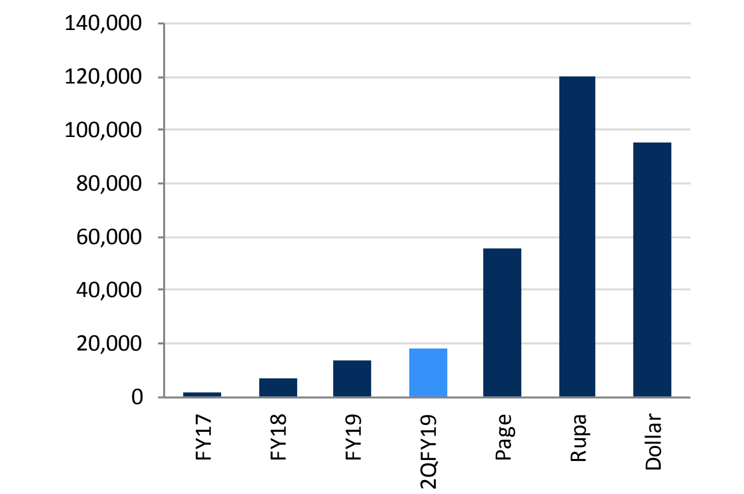
Source: Company, HDFC sec Inst Research

Innerwear to break-even by FY22E



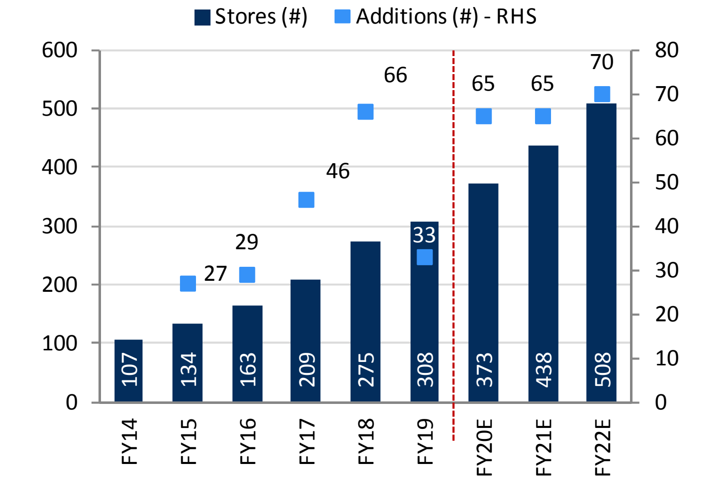
Source: Company, HDFC sec Inst Research

Van Heusen: Upping the ante in distribution



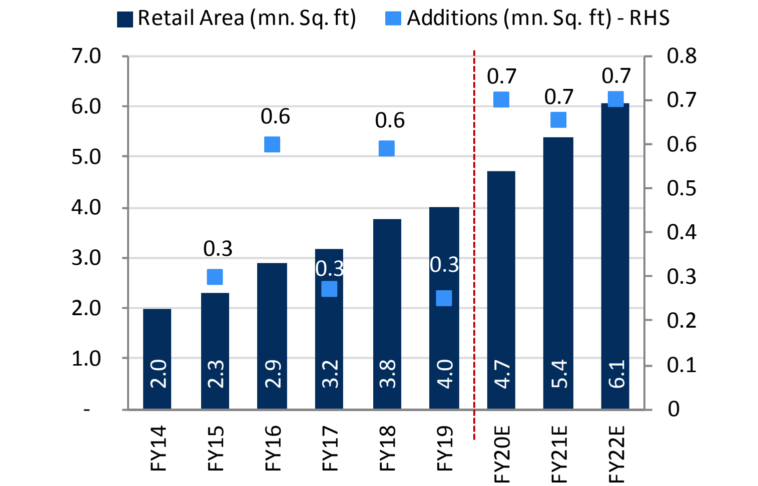
Source: Company, HDFC sec Inst Research

Pantaloons expecting to add 65-70 stores annually



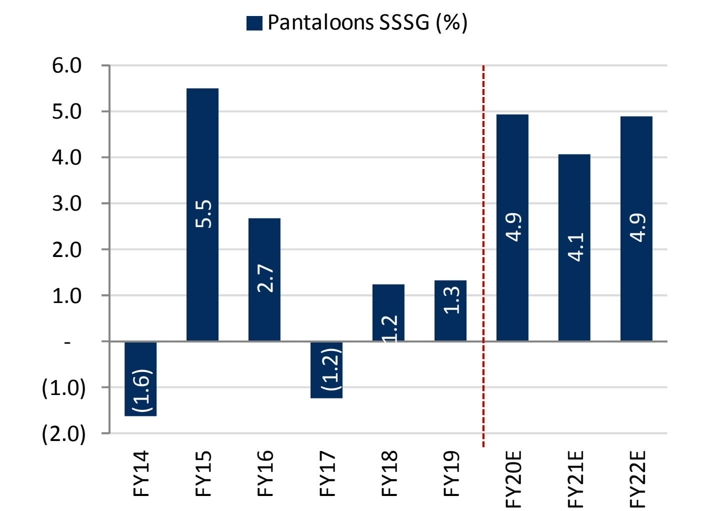
Source: Company, HDFC sec Inst Research

...Expecting a 15% CAGR in retail space over FY19-22E



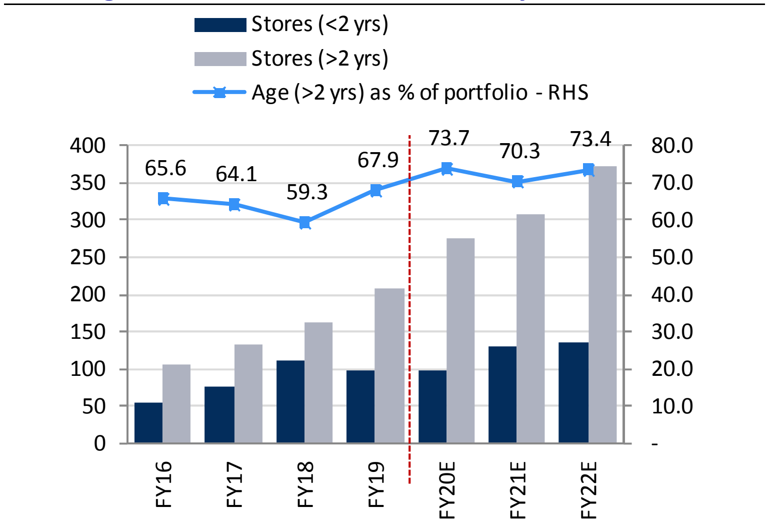
Source: Company, HDFC sec Inst Research

SSSG should inch up...



Source: Company, HDFC sec Inst Research

...as higher share of stores hit maturity



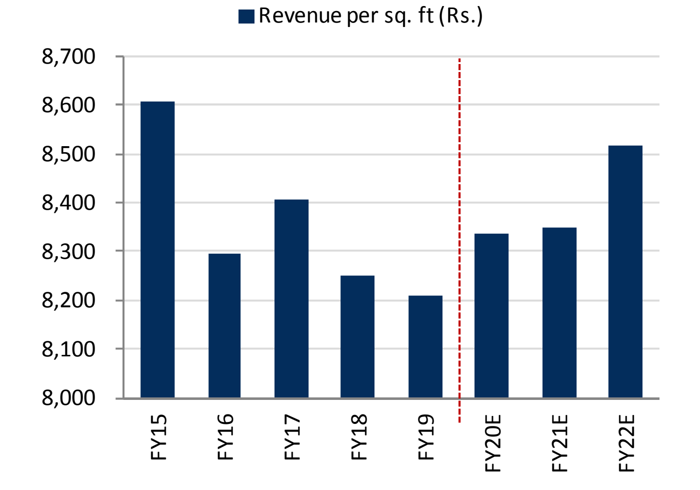
Source: Company, HDFC sec Inst Research

While Pantaloons is increasingly focusing on Tier 2/3 cities, we also expect Pantaloons to plug in white spaces in existing geographies and make the network denser over the next 2-3 years.

This will help Pantaloons 1. Fasten lead time to stores 2. Increase the freshness quotient of merchandise as new fashion drops increase – A footfall and productivity enabler 3. More importantly, profitability per sq. ft increases as the physical assets sweat more

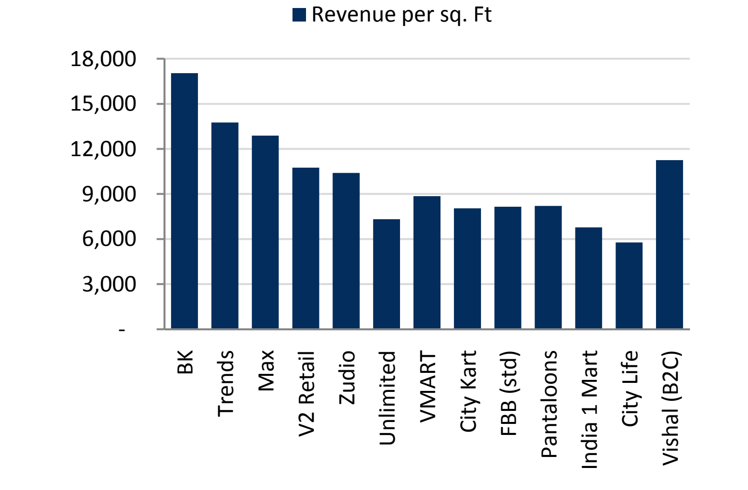
Pantaloon now offers one of the sharpest price points amongst VF forward points (ex-Zudio) based on our SKU analysis

Ergo, revenue per sq. ft should inch up



Source: Company, HDFC sec Inst Research

Peer Comparison Revenue/sq ft (Rs.)



Source: Company, HDFC sec Inst Research

While Max sports a denser store network among VF forward retailers; Pantaloons is more rounded

	Pantaloons		Max		FBB		Pantaloons	Max	FBB
	Stores	Districts	Stores	Districts	Store	Districts	Store/District		
100-200k	**102**	**56**	**98**	**47**	**91**	**52**	**1.8**	**2.1**	**1.8**
<500	34	30	30	24	32	28	1.1	1.3	1.1
>5000	30	2	36	2	20	2	15.0	18.0	10.0
1000-3000	11	6	6	5	11	6	1.8	1.2	1.8
3000-5000	1	1	-	0	2	1	1.0		2.0
500-1000	26	17	26	16	26	15	1.5	1.6	1.7
200-300k	**40**	**18**	**41**	**15**	**44**	**15**	**2.2**	**2.7**	**2.9**
<500	4	3	3	2	7	4	1.3	1.5	1.8
1000-3000	10	5	23	7	21	5	2.0	3.3	4.2
500-1000	26	10	15	6	16	6	2.6	2.5	2.7
300-500k	**49**	**7**	**74**	**4**	**53**	**8**	**7.0**	**18.5**	**6.6**
<500	2	1	2	1	4	2	2.0	2.0	2.0
>5000	25	2	47	2	29	2	12.5	23.5	14.5
1000-3000	2	1	-	0	1	1	2.0		1.0
3000-5000	17	1	25	1	17	1	17.0	25.0	17.0
500-1000	3	2	-	0	2	2	1.5		1.0
Total	**252**	**112**	**239**	**79**	**236**	**99**	**2.3**	**3.0**	**2.4**

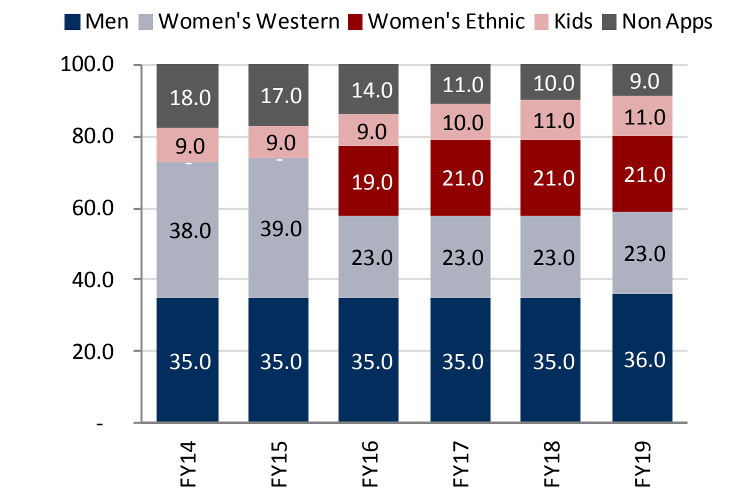
Source: Census, Company, HDFC sec Inst Research, Store data for Top 16 states accounting for >85% of retail spends

Thus with improving 1. distribution strength, 2. a denser network, 3. sharper pricing, 4. assortment gradually tilting towards faster growing categories, and 5. Increasing share of margin-accretive private labels, Pantaloons seems primed for growth

More importantly, the above inputs have made Pantaloons one of the most improved value fashion formats in recent years from a profitability per sq. ft point of view

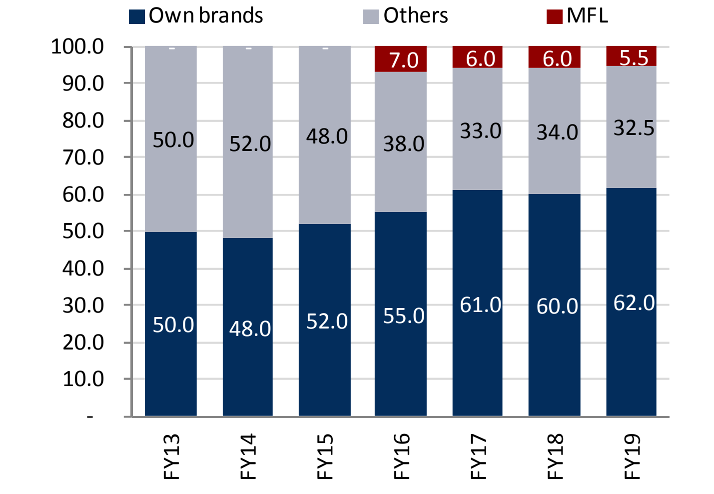
We too build in a steady improvement in per sq. ft profitability as store assets get denser and sweat more

Assortment tilting gradually towards faster growing Women and Kids category



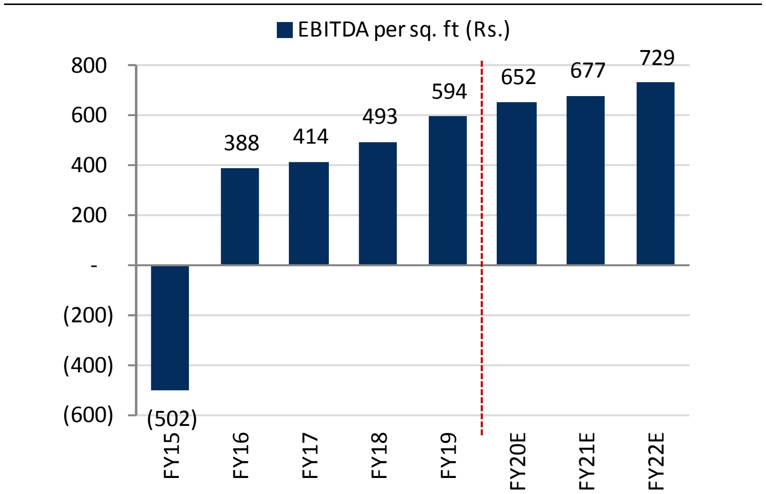
Source: Company, HDFC sec Inst Research

Margin-accretive own brands' contribution in Pantaloons' mix increasing



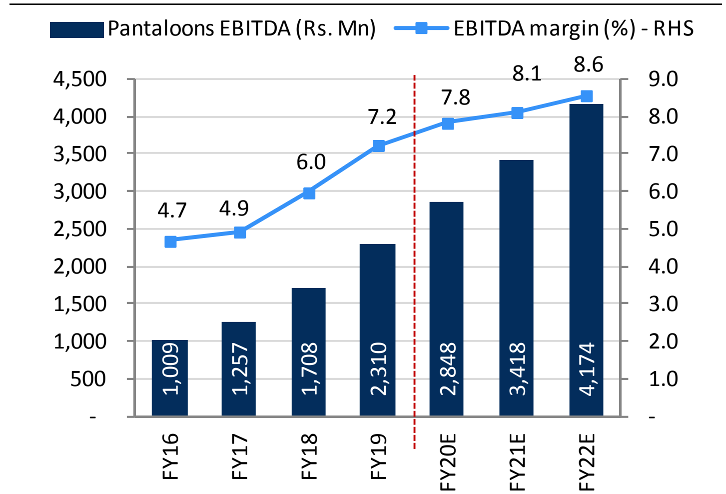
Source: Company, HDFC sec Inst Research

Pantaloons' profitability per sq. ft improving



Source: Company, HDFC sec Inst Research

Expect a ~130bp margin expansion over FY19-22E for Pantaloons

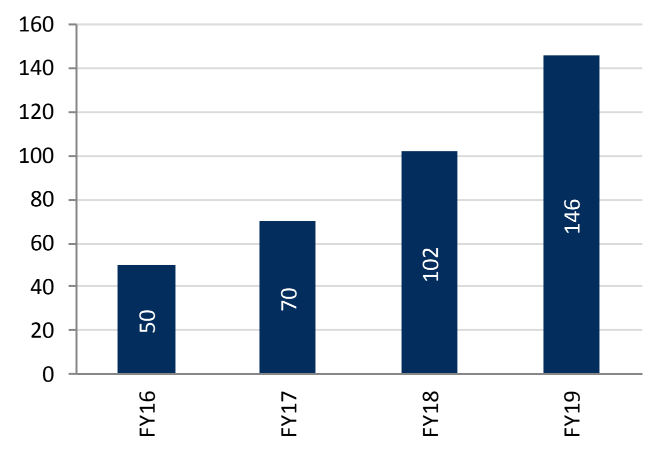


Source: Company, HDFC sec Inst Research

We estimate that it takes Madura/Pantaloons ~3/5 years respectively to hit payback

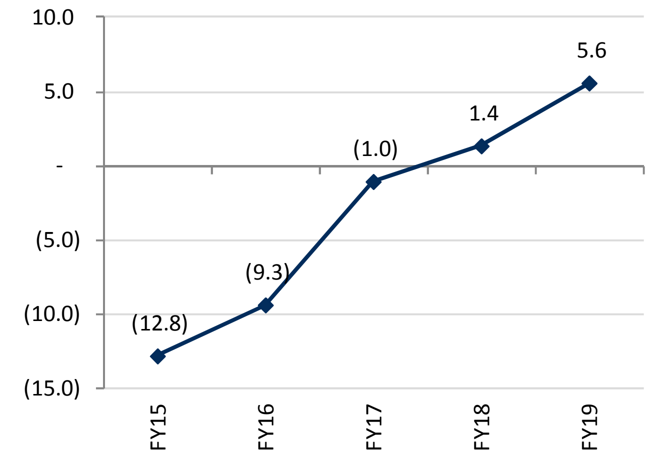
Lifestyle brands continue to enjoy high RoCEs (>60%)

Pantaloons: Loyalty members have nearly tripled in 3 years, implying strong traction for the offering



Source: Company, HDFC sec Inst Research

Pantaloons pre-tax RoCE has significantly improved courtesy its margin swing over FY15-19



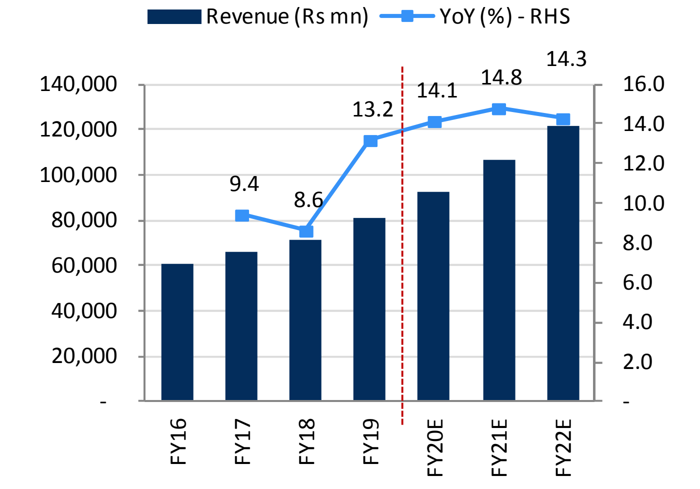
Source: Company, HDFC sec Inst Research

Indicative Unit Store Economics:

Per Sq. ft basis	Lifestyle brands	Madura	Pantaloons
Revenue	17,361	15,961	8,211
EBITDA	2,094	1,275	594
Depreciation	505	440	371
EBIT	1,589	836	223
EBITDA margin (%)	12.1	8.0	7.2
Capex	2,405	2400	2,400
WC	184	1,504	400
Capital Employed	2,589	3,904	2,800
Payback	0.84	3.06	4.72
RoCE	61.4	21.4	8.0
Payback (Years)	1.2	3.1	4.7

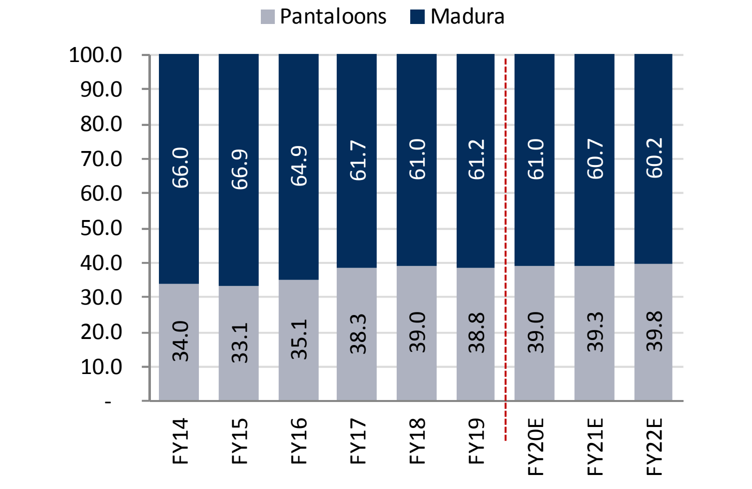
Source: HDFC sec Inst Research

Total Revenue to grow at a 14% CAGR over FY19-22E



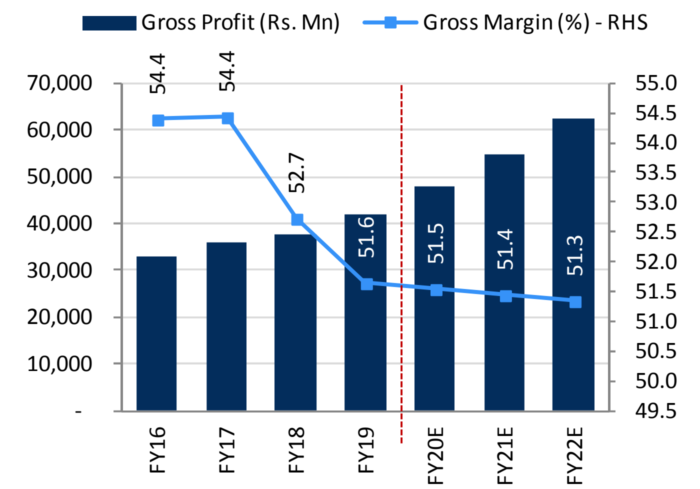
Source: Company, HDFC sec Inst Research

Pantaloons skew in the mix to inch up gradually



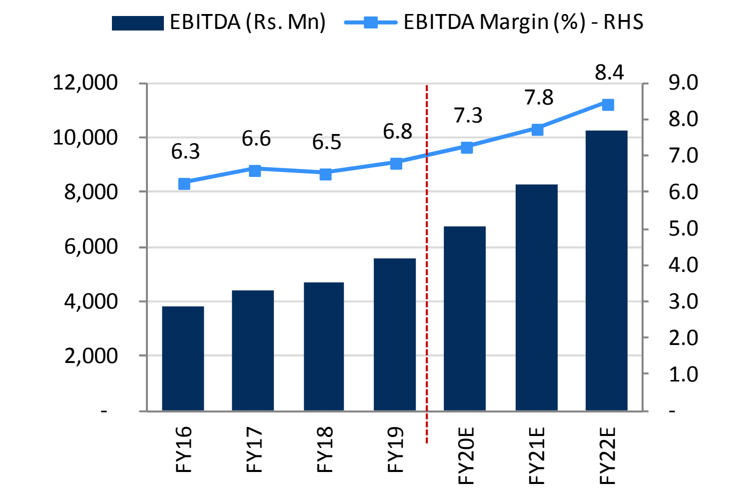
Source: Company, HDFC sec Inst Research

...To weigh in on gross margins



Source: Company, HDFC sec Inst Research

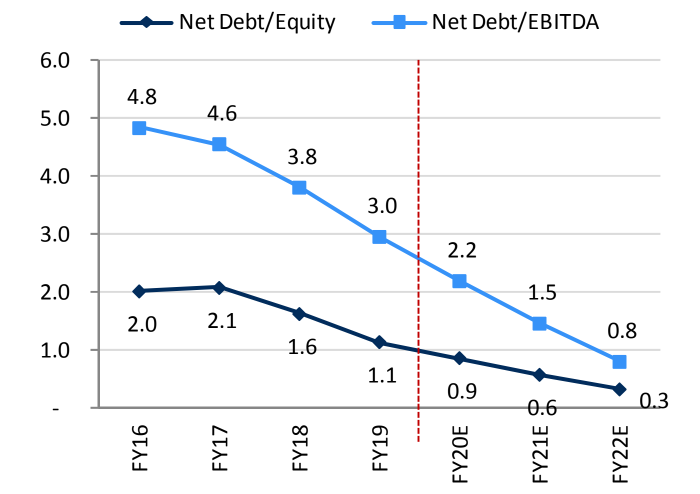
...however, scale-led benefits to ensure EBITDA margin expansion



Source: Company, HDFC sec Inst Research

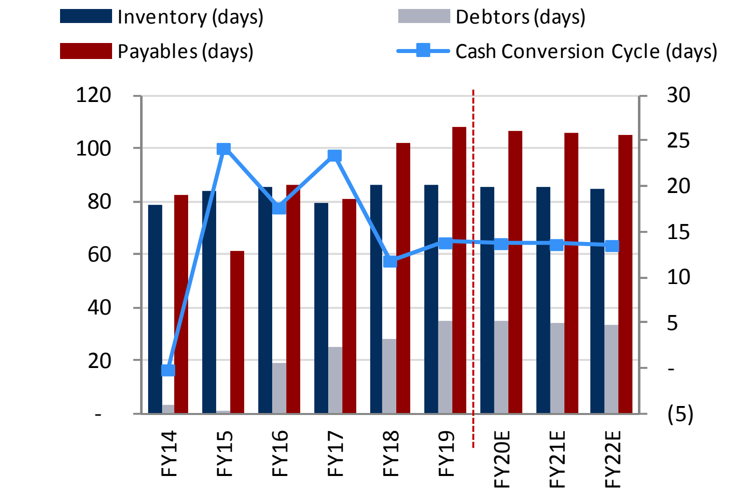
Given the asset-light expansion model (franchisee-led in Madura), overall capex needs remain modest. This coupled with a short cash conversion cycle to ensure free cash generation improves with scale over FY19-22E

Leverage to inch down as internal accruals fund growth



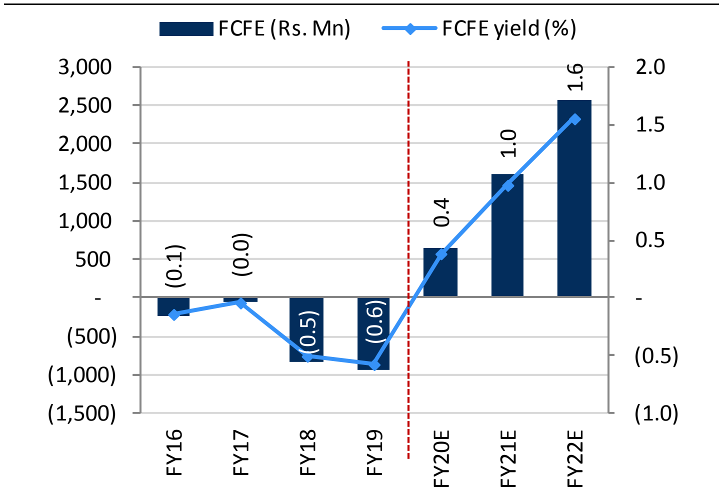
Source: Company, HDFC sec Inst Research

WC Intensity to remain stable at 14 days



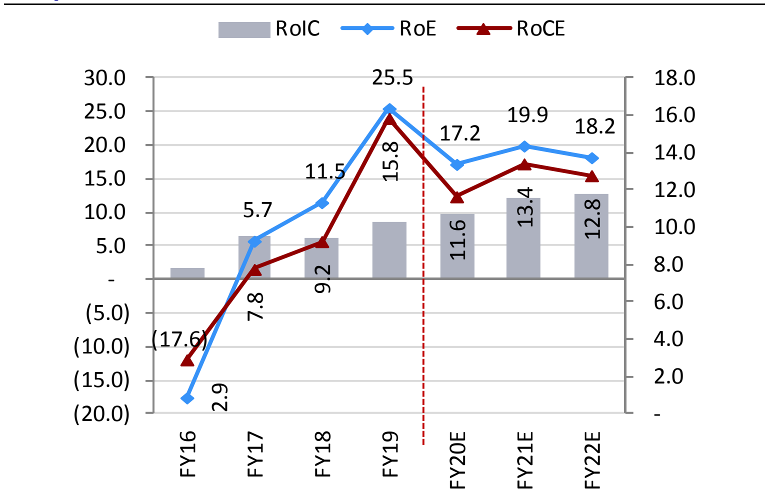
Source: Company, HDFC sec Inst Research

...ergo, free cash generation to improve



Source: Company, HDFC sec Inst Research

Transition to full tax over the next 2 years to keep return ratios in check, albeit underlying profitability to improve



Source: Company, HDFC sec Inst Research

ABFRL: Snapshot (Rs. Mn)

	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Revenue (Rs. Mn)							
Madura F&L	**39,789**	**41,143**	**44,688**	**50,315**	**56,558**	**64,704**	**73,446**
YoY (%)	*6.5*	*3.4*	*8.6*	*12.6*	*12.4*	*14.4*	*13.5*
Lifestyle brands	37,340	36,510	38,660	43,040	48,105	53,912	60,163
Fast Fashion		3,440	3,985	3,580	2,954	3,132	3,354
Other Biz		1,180	2,055	3,680	5,499	7,659	9,929
No. of Stores (#)	**1,902**	**1,935**	**2,042**	**2,249**	**2,539**	**2,829**	**3,119**
Retail Area (mn. Sq. ft)	**2.6**	**2.7**	**2.6**	**2.9**	**3.2**	**3.6**	**4.0**
Revenue per sq. ft (Lifestyle) (Rs.)	6,329	6,680	6,593	6,783	6,818	6,849	6,885
SSSG (%)	*0.4*	*(5.7)*	*9.2*	*5*	*5*	*5*	*5*
Expansion-led growth (%)	*6.1*	*5.4*	*(6.0)*	*1.8*	*5.3*	*6.8*	*6.4*
Pantaloons Revenue	**21,565**	**25,523**	**28,615**	**31,940**	**36,399**	**42,134**	**48,750**
No. of Stores (#)	163	209	275	308	373	438	508
Retail Area (mn. Sq. ft)	2.6	3.2	3.8	4.0	4.7	5.4	6.1
Revenue per sq. ft (Rs.)	8,802	8,842	8,250	8,211	8,335	8,351	8,515
SSSG (%)	*5.1*	*1.7*	*(3.9)*	*1.3*	*4.9*	*4.1*	*4.9*
Expansion-led growth (%)	*10.9*	*16.4*	*16.6*	*10.2*	*8.6*	*11.2*	*10.3*
Total Revenue (Rs. Mn)	**60,346**	**66,330**	**71,814**	**81,177**	**92,221**	**106,002**	**121,255**
EBITDA (Rs. Mn)							
Madura F&L	**3,651**	**3,426**	**3,440**	**4,020**	**5,024**	**6,134**	**7,616**
YoY (%)	*(21.1)*	*(6.2)*	*0.4*	*16.9*	*25.0*	*22.1*	*24.2*
Lifestyle brands	3,580	4,220	4,490	5,190	5,897	6,717	7,616
Fast Fashion		(505)	(535)	(320)	(103)	(47)	-
Other Biz		(335)	(535)	(850)	(770)	(536)	-
Pantaloons	**1,009**	**1,257**	**1,708**	**2,310**	**2,848**	**3,418**	**4,174**
Total EBITDA	**4,398**	**4,830**	**5,051**	**6,190**	**7,698**	**9,340**	**11,528**
Gross Profit (Rs. Mn)	**32,822**	**35,942**	**37,820**	**41,928**	**47,539**	**54,538**	**62,264**
Gross Margin (%)	***54.4***	***54.4***	***52.7***	***51.6***	***51.5***	***51.4***	***51.3***
EBITDA margin (%)							
Madura F&L	***9.2***	***8.3***	***7.7***	***8.0***	***8.9***	***9.5***	***10.4***
YoY (%)							
Lifestyle brands	*9.6*	*11.6*	*11.6*	*12.1*	*12.3*	*12.5*	*12.7*
Fast Fashion		*(14.7)*	*(13.4)*	*(8.9)*	*(3.5)*	*(1.5)*	-
Other Biz		*(28.4)*	*(26.0)*	*(23.1)*	*(14.0)*	*(7.0)*	-
Pantaloons	***4.7***	***4.9***	***6.0***	***7.2***	***7.8***	***8.1***	***8.6***
Total EBITDA	***7.3***	***7.3***	***7.0***	***7.6***	***8.3***	***8.8***	***9.5***

Source: Company, HDFC sec Inst Research

With ~70% of cash infows utlilized towards growth needs (Capex + WC), ABFRL sports one of the most asset-light biz models in retail

Sources of funds (Rs bn)	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	3.9	4.8	5.2	6.2	20.1
Other Income	0.2	0.0	0.1	0.0	0.3
Total	**4.1**	**4.9**	**5.2**	**6.2**	**20.4**
					0
Application of funds (Rs bn)					**0**
Working Capital	3.8	0.8	(3.7)	0.6	1.5
Capex	2.1	4.5	3.3	2.8	12.6
Investments	-	(0.0)	0.0	(0.0)	0.0
Dividend	-	-	-	-	-
Borrowings	(5.4)	(1.9)	1.8	1.6	(3.9)
Others	3.7	1.2	3.6	1.4	9.9
Net change in cash	(0.1)	0.3	0.2	(0.2)	0.3
Total	**4.1**	**4.9**	**5.2**	**6.2**	**20.4**
Cumm. WC + Capex as % of sources of funds					**69.3**

Source: Company, HDFC sec Inst Research

Valuation

DCF

	FY21E	FY22E	FY23E	FY24E	FY25	FY26	FY27	FY28	FY29	FY30	FY31
Revenue (INR m)	**106,002**	**121,255**	**138,043**	**156,609**	**176,297**	**197,992**	**221,099**	**246,174**	**271,929**	**299,200**	
YoY	*14.9*	*14.4*	*13.8*	*13.4*	*12.6*	*12.3*	*11.7*	*11.3*	*10.5*	*10.0*	
-Madura	64,704	73,446	82,845	93,089	103,562	115,299	127,704	141,294	154,769	169,248	
-Pantaloons	42,134	48,750	56,251	64,693	74,031	84,124	94,967	106,606	119,034	131,985	
EBIT*(1-t)	4,130	4,358	5,667	7,260	8,814	10,654	12,805	14,795	16,966	19,283	
Depreciation	3,247	4,423	4,782	5,033	5,153	5,119	4,904	5,040	5,085	5,020	
Capex	(3,871)	(4,279)	(4,619)	(5,158)	(5,545)	(6,157)	(6,614)	(7,300)	(7,835)	(8,461)	
Changes in WC (Winv)	(295)	(300)	(301)	(302)	(280)	(273)	(245)	(223)	(168)	39	
FCFF	**3,212**	**4,202**	**5,529**	**6,833**	**8,142**	**9,342**	**10,850**	**12,311**	**14,048**	**15,881**	**17,231**
YoY (%)	*43.8*	*30.8*	*31.6*	*23.6*	*19.2*	*14.7*	*16.1*	*13.5*	*14.1*	*13.0*	*8.5*
Interest (1-t)	(1,293)	(1,168)	(1,168)	(1,168)	(1,168)	(1,168)	(1,168)	(1,168)	(1,168)	(1,168)	
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**	**Mar-31**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	10.5
PV (FCFF)	**3,067**	**3,658**	**4,389**	**4,944**	**5,371**	**5,618**	**5,949**	**6,153**	**6,401**	**6,598**	**6,526**
Terminal Value										**356,058**	**386,323**

DCF Date	**Sep-20**
Kd*(1-t)	6.4
Ke	13.0
Net Debt (Mar-20E)	11,898
Debt/Equity	1.0
PV-Explicit Period	58,674
PV-Terminal Value	146,323
Equity Value (INR m)	193,099
Equity value per share (INR)	**250**
Sept-21 Implied EV/EBITDA (x)	22.2
Terminal growth rate (%)	5.0
WACC	9.7
CMP	**226**
Upside/(Downside)	**10.7%**

Source: HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Failure to renew agreements with brand owner	The Company has licence to operate 'Forever 21' brand in India. Failure to renew such agreements or early termination may have an impact on business operations and growth.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.

Source: Company, HDFC sec Inst Research

Company profile

- MFL was formed by the consolidation of the branded apparel businesses of Aditya Birla Group (comprising ABNL's Madura Fashion division and other subsidiaries). In May 2015, post the acquisition of and Pantaloons Fashion and Retail (PFRL) from the future group, PFRL was re-christened as Aditya Birla Fashion and Retail Ltd housing both Madura portfolio and Pantaloons.
- Madura Fashion & Lifestyle is the custodian of several iconic brands including - Louis Philippe , Van Heusen, Allen Solly and Peter England. It also includes fast fashion youth brand - People; fully integrated fashion multi-brand outlet chain, Planet Fashion; and several premium international brands together called the collective ABFRL has forayed into the Innerwear space with the launch of Van Heusen innerwear for both men and women. ABFRL has acquired exclusive online and offline rights to market the global brand – 'Forever 21' and its existing store network, in the fast-fashion segment in India.
- Pantaloons segment is engaged in retailing of apparel and accessories, and comprises 331 stores covering retail space of over 4 mn sq ft. It operates across categories of casual wear, ethnic wear, formal wear, party wear and active wear for men, women and kids. Womenswear is the leading category contributing to half of total apparel sales. Non-apparel products include footwear, handbags, cosmetics, perfumes, fashion jewelry and watches. Pantaloons today retails over 200 licensed and international brands, including 24 exclusive in-house brands.

Key Personnel

Name	Designation	Description
Mr. Ashish Dikshit	Managing Director	He has worked in diverse roles across industries and functions over the last 25 years. He started his career at Asian Paints before moving to Madura Fashion and Lifestyle Division of the Company, where he worked in its various functions ranging from Sales, Brand Management, Supply Chain and Sourcing over 15 years. He was appointed President of its Lifestyle Business in 2007 and went on to become its CEO in 2012.
Mr. Vishak Kumar	Chief Executive Officer - Madura Fashion & Lifestyle	He is an IIM Bangalore alumnus and a computer engineer from BIT Ranchi. He joined as a Management Trainee at Madura in 1995 and has been with the Aditya Birla Group since then. He has also served as the CEO of Aditya Birla Retail Limited, the food and grocery arm of Group for over four years.
Mrs. Sangeeta Pendurkar	Chief Executive Officer – Pantaloons	She has over 30 years of experience across diverse sectors like FMCG, pharmaceuticals and financial services. Prior to joining ABFRL, she was the Managing Director for Kellogg India and South Asia. She has held senior positions at Coca-Cola India, HSBC Bank, Hindustan Unilever and Novartis.
Mr. Sooraj Bhat	Chief Executive Officer - Fast Fashion Business	He is an IIM Bangalore alumnus and a mechanical engineer from NIT - Calicut. He joined Madura in 2002 and has been with the company since then. He has also served as the Brand Head of Allen Solly, COO - Allen Solly and Louis Philippe and COO - Fashion Brands before assuming his current role.
Mr. Puneet Malik	Chief Executive Officer – Innerwear Business	He is an alumnus of IIM Bangalore, NIFT Delhi and a Textile Technologist from TIT Bhiwani. He joined Madura in 1994 as a Management Trainee and has been with Aditya Birla Group since then. Over the last 24 years, he has led diverse functions across Manufacturing, Sourcing, Supply Chain, Brand, Retail and Sales. He served as COO - Sales, Planet Fashion and Branded Exports before he conceptualized and started the Innerwear business for ABFRL.
Mr. Jagdish Bajaj	Chief Financial Officer	He has been with the Aditya Birla Group for 28 years and he started his career with the Group in 1989, beginning with Aditya Birla Nuvo Ltd, followed by stints in Grasim, UltraTech Cement and Swiss Singapore. Prior to joining ABFRL, he was the CFO of International Trading biz of Aditya Birla Group.

Source: Company, HDFC sec Inst Research

Income Statement (Consolidated)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
Net Revenues	**71,721**	**81,177**	**92,660**	**106,368**	**121,561**
Growth (%)	***8.6***	***13.2***	***14.1***	***14.8***	***14.3***
Material Expenses	33,901	39,250	44,894	51,643	59,140
Employee Expense	7,723	9,130	10,329	11,751	13,308
Rent Expense	10,429	11,104	12,581	14,336	16,263
Advertisement Expense	3,380	4,415	5,039	5,679	6,490
Other Expenses	11,605	11,738	13,083	14,711	16,099
EBITDA	**4,683**	**5,541**	**6,733**	**8,249**	**10,262**
EBITDA Growth (%)	***7.0***	***18.3***	***21.5***	***22.5***	***24.4***
EBITDA Margin (%)	***6.5***	***6.8***	***7.3***	***7.8***	***8.4***
Depreciation	2,805	2,823	2,863	3,247	4,423
EBIT	**1,878**	**2,717**	**3,870**	**5,001**	**5,839**
Other Income (Including EO Items)	328	648	965	1,085	1,255
Interest	1,716	1,874	1,596	1,561	1,561
PBT	**490**	**1,491**	**3,238**	**4,526**	**5,533**
Total Tax	(688)	(1,721)	556	777	1,393
RPAT	**1,178**	**3,212**	**2,683**	**3,749**	**4,140**
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	**1,178**	**3,212**	**2,683**	**3,749**	**4,140**
APAT Growth (%)	***120.2***	***172.7***	***(16.5)***	***39.8***	***10.4***
Adjusted EPS (Rs)	**1.5**	**4.2**	**3.5**	**4.9**	**5.4**
EPS Growth (%)	***120.2***	***172.7***	***(16.5)***	***39.8***	***10.4***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	7,717	7,735	7,735	7,735	7,735
Reserves	3,214	6,554	9,237	12,986	17,126
Total Shareholders Funds	**10,931**	**14,289**	**16,971**	**20,721**	**24,861**
Preference Share Capital	**0**	**-**	**-**	**-**	**-**
Long Term Debt	11,879	7,238	7,238	7,238	7,238
Short Term Debt	6,735	9,791	9,791	9,791	9,791
Total Debt	**18,614**	**17,029**	**17,029**	**17,029**	**17,029**
Net Deferred Taxes	**(688)**	**(2,634)**	**(2,634)**	**(2,634)**	**(2,634)**
Other Non-current Liabilities & Provns	**1,607**	**1,737**	**1,737**	**1,737**	**1,737**
TOTAL SOURCES OF FUNDS	**30,464**	**30,420**	**33,103**	**36,852**	**40,992**
APPLICATION OF FUNDS					
Net Block	7,227	6,959	7,679	8,302	8,158
CWIP	459	224	224	224	224
Other Non-current Assets	19,875	19,917	19,917	19,917	19,917
Total Non-current Assets	**27,561**	**27,100**	**27,820**	**28,443**	**28,299**
Inventories	16,912	19,213	21,778	24,825	28,171
Debtors	5,518	7,866	8,852	10,015	11,279
Other Current Assets	5,889	8,782	10,024	11,508	13,151
Cash & Equivalents	770	616	2,222	4,924	8,744
Total Current Assets	**29,089**	**36,477**	**42,876**	**51,272**	**61,345**
Creditors	20,093	23,986	27,125	30,847	34,919
Other Current Liabilities & Provns	6,093	9,170	10,468	12,016	13,732
Total Current Liabilities	**26,186**	**33,157**	**37,593**	**42,863**	**48,652**
Net Current Assets	**2,903**	**3,321**	**5,283**	**8,409**	**12,693**
TOTAL APPLICATION OF FUNDS	**30,464**	**30,420**	**33,103**	**36,852**	**40,992**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19P	FY20E	FY21E	FY22E
Reported PBT	490	149	3,238	4,526	5,533
Non-operating & EO Items	237	1,590	(965)	(1,085)	(1,255)
Interest Expenses	1,669	1,846	1,596	1,561	1,561
Depreciation	2,805	2,823	2,863	3,247	4,423
Working Capital Change	760	(937)	(357)	(424)	(465)
Tax Paid	(10)	(196)	(556)	(777)	(1,393)
OPERATING CASH FLOW (a)	**5,951**	**5,276**	**5,820**	**7,048**	**8,405**
Capex	(3,271)	(2,792)	(3,583)	(3,871)	(4,279)
Free Cash Flow (FCF)	*2,680*	*2,484*	*2,237*	*3,177*	*4,126*
Investments	(36)	22	-	-	-
Non-operating Income	55	4	965	1,085	1,255
INVESTING CASH FLOW (b)	**(3,252)**	**(2,766)**	**(2,618)**	**(2,785)**	**(3,024)**
Debt Issuance/(Repaid)	(2,481)	(2,674)	(1,596)	(1,561)	(1,561)
FCFE	*199*	*(189)*	*641*	*1,617*	*2,565*
Share Capital Issuance	12	9	-	-	-
Dividend	-	-	-	-	-
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(2,469)**	**(2,664)**	**(1,596)**	**(1,561)**	**(1,561)**
NET CASH FLOW (a+b+c)	**230**	**(154)**	**1,605**	**2,702**	**3,820**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	726	572	2,179	4,882	8,701

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19P	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	52.7	51.6	51.5	51.4	51.3
EBITDA Margin	6.5	6.8	7.3	7.8	8.4
EBIT Margin	2.6	3.3	4.2	4.7	4.8
APAT Margin	1.6	4.0	2.9	3.5	3.4
RoE	11.5	25.5	17.2	19.9	18.2
RoIC (or Core RoCE)	6.1	8.7	9.7	12.2	12.6
RoCE	9.2	15.8	11.6	13.4	12.8
EFFICIENCY					3.93
Tax Rate (%)	-	-	17.2	17.2	25.2
Fixed Asset Turnover (x)	6.6	6.5	5.8	5.3	5.0
Inventory (days)	*86*	*86*	*86*	*85*	*85*
Debtors (days)	*28*	*35*	*35*	*34*	*34*
Other Current Assets (days)	*30*	*39*	*39*	*39*	*39*
Payables (days)	*102*	*108*	*107*	*106*	*105*
Other Current Liab & Provns (days)	*31*	*41*	*41*	*41*	*41*
Cash Conversion Cycle (days)	11	12	12	12	12
Net Debt (Rs mn)	17,844	16,412	14,807	12,105	8,285
Net D/E (x)	1.6	1.1	0.9	0.6	0.3
Interest Coverage (x)	1.1	1.4	2.4	3.2	3.7
PER SHARE DATA (Rs)					
EPS	1.5	4.2	3.5	4.9	5.4
CEPS	5.2	7.8	7.2	9.1	11.1
Book Value	14.2	18.5	21.9	26.8	32.1
VALUATION					
P/E (x)	145.3	53.3	63.8	45.7	41.4
P/BV (x)	15.7	12.0	10.1	8.3	6.9
EV/EBITDA (x)	40.4	33.9	27.6	22.2	17.5
EV/Revenues (x)	2.6	2.3	2.0	1.7	1.5
OCF/EV (%)	3.1	2.8	3.1	3.8	4.7
FCF/EV (%)	1.4	1.3	1.2	1.7	2.3
FCFE/Mkt Cap (%)	0.1	(0.1)	0.4	0.9	1.5

Source: Company, HDFC sec Inst Research

Trent

NEUTRAL

Perfect cross between Fast and Value Fashion

Trent's flagship offering – Westside (97% private labels) is a perfect cross between two of the fastest growing and most profitable segments in fashion – Fast and value fashion. Unlike Globally, most fast fashion retailers in India have priced their assortment at similar price points to popular brands, hence, are restricted to Metros/Tier 1 cities. Westside has managed to exploit this gaping white space for trendy, edgy and fast moving fashion at sub-Rs. 1000 price points consistently over the past decade. This explains its consistent 8% SSSG CAGR over FY09-19. The recent Rs. 9.5bn fund raise form Tata Sons gives Trent the much needed gunpowder for expansion over FY19-22E.

While execution remains top-notch; tailwinds seem priced in. We bake in 28/27/38% revenue/EBITDA/PAT CAGR and a 300bp improvement in RoIC over FY19-22E to 15% (ex-subsidiary/JV investments). Initiate with a NEUTRAL and an SOTP-based TP of Rs. 490/sh, implying 29x Sept-21 FY/EBITDA – The highest in our coverage universe

Investment rationale

- **Westside – A Clockwork compounding story:** Positioned as a cross between Fast and Value fashion, Westside has consistently milked the gaping white space left by peers for trendy, edgy and fast moving fashion at sub-Rs. 1000 price points over the past decade (56% of SKUs <Rs. 1000 – per our SKU Analysis). **Hence, the assortment naturally lends itself to a wider addressable market vs its fast fashion counterparts.** Given that Westside rotates its inventory faster than most apparel formats, its assortment freshness is also typically higher – A footfall driver. This concoction of sharper prices, fresher assortment and larger target group (TG) explains its clockwork-like 8% SSSG CAGR over FY09-19. We expect Westside to perpetuate its growth story, given that immediate competitors are 1. yet to form deep local sourcing partnerships at scale and 2. Pure-play fast fashion retailers are yet to take a meaningful plunge beyond Metros/Tier 1 cities. Westside is expected to add 35-40 stores annually over FY19-22E; a significant leg up in pace vis-à-vis previous years. Ergo, clock 23% revenue CAGR over FY19-22E.
- **Zudio – On Steroids:** While still early days, our SKU analysis suggests that Zudio offers one of the sharpest prices among VF mass retailers with ~80% of its SKUs retailed at <Rs. 500. and positioned towards the faster growing women and kids category. **The only missing piece is tier 3/4 distribution, which courtesy the Rs. 9.5bn capital infusion is expected to be resolved in the next 2-3 years.** We expect Zudio to add 55 stores annually over FY19-22E. With Infrastructure and backend closely aligned to Westside, expansion is expected to be efficiency-accretive. We expect Zudio revenue to quintuple over FY19-22E to Rs. 9bn over FY19-22E

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	25,317	33,382	42,699	53,249
EBITDA	2,365	2,999	3,848	4,863
APAT	1,279	2,196	2,695	3,258
Dil. EPS (Rs/sh)	3.8	6.2	7.5	9.1
P/E (x)	131.2	82.1	66.9	55.3
EV/EBITDA (x)	71.8	53.9	42.4	33.8
ROE (%)	7.7	9.7	9.3	10.5
RoIC (%)	7.5	8.1	10.1	11.2
ROCE (%)	7.3	9.0	8.8	9.9

Source: Company, HDFC sec Inst Research

INDUSTRY		**RETAIL**
CMP *(as on 06 Dec 2019)*		**Rs 503**
Target Price		**Rs 490**
Nifty		11,922
Sensex		40,445
KEY STOCK DATA		
Bloomberg		TRENT IN
No. of Shares (mn)		355
MCap (Rs bn) / ($ mn)		179/2,512
6m avg traded value (Rs mn)		105

STOCK PERFORMANCE (%)

52 Week high / low: Rs 568/313

	3M	6M	12M
Absolute (%)	9.3	24.7	55.2
Relative (%)	(0.1)	22.3	40.6

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	32.61	37.01
FIs & Local MFs	17.14	15.89
FPIs	22.13	20.98
Public & Others	28.12	26.12
Pledged Shares	0	0

Source : BSE

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- **Star – The only stumbling block:** Trent's F&G offering via the Star brand (A 50:50 JV with TESCO) has been the only stumbling block in its portfolio. Despite a head-start in the space, Star is yet to successfully pivot to a profitable business model. Given that the focus is Fresh (Toughest category to crack courtesy a complex supply chain) and the predominant top-up nature of the format (No top-up retailer is profitable in India), we remain circumspect of Trent's ability to turn this venture around. We do not see losses ebbing over FY19-22E given that Star intends to add 20-25 stores annually. We build in 12% revenue CAGR over FY19-22E

- **Zara - a third of Trent's price tag, margin woes continue:** Notwithstanding industry-leading productivity, Zara's margin woes continue courtesy 1. a string of hikes in tax incidences/duty, 2. Price cuts in response to heightening competition, especially from H&M (FY19 revenue INR12bn+ within 4 years vs Zara's Rs. 14.3bn). While we build in a 190bp gross margin recoup, given Zara's strong brand recall, we admit our estimates may be at risk as Zara's assortment remains the most expensively priced amongst the fast fashion cohort (Per SKU Analysis). We build in 18% revenue CAGR over FY19-22E, largely SSSG-led. Caveat: The Zara JV (accounts for 32% of Trent's EV) is a financial investment by Trent and the risk of Inditex buying out Trent's pie remains.

- **Priced to perfection:** While execution remains top-notch, Trent seems priced to perfection with little on the table for investors at 30x Sept-21 EV/EBITDA (standalone biz). We bake in 28/27/38% revenue/EBITDA/PAT CAGR and a 300bp improvement in RoIC over FY19-22E. Initiate with a NEUTRAL and an SOTP-based TP of Rs. 490/sh, implying 29x Sept-21 FY/EBITDA. Note: We believe a stake buy-out in Zara may command a premium at sale, hence assign a 20% premium to our fair value for the format.

- **Key Risks** 1. Strong double-digit SSSG in Westside, 2) sharp increase in profitability of grocery business. 3. Zara steps up expansion.

Trent – SOTP Valuation

	Methodology	Implied Sept FY21	Multiple	EBITDA	EV (Rs mn)	Per share (Rs.)
Standalone Biz	DCF	EV/EBITDA (x)	23	4,355	98,992	298
THPL (Star)	EV/Sales	EV/Sales	1	(401)	6,642	20
FHL	EV/Sales	EV/Sales	1	6	1,020	3
Zara (incl. 20% premium)	DCF	EV/EBITDA (x)	35	1,448	50,720	153
Consol Enterprise Value		EV/EBITDA (x)	29	5,407	157,374	474
Net Debt					(5,489)	(17)
Consol Equity Value					162,863	490
CMP						**499**
Upside (%)						**(1.9)**

Source: Company, HDFC sec Inst Research

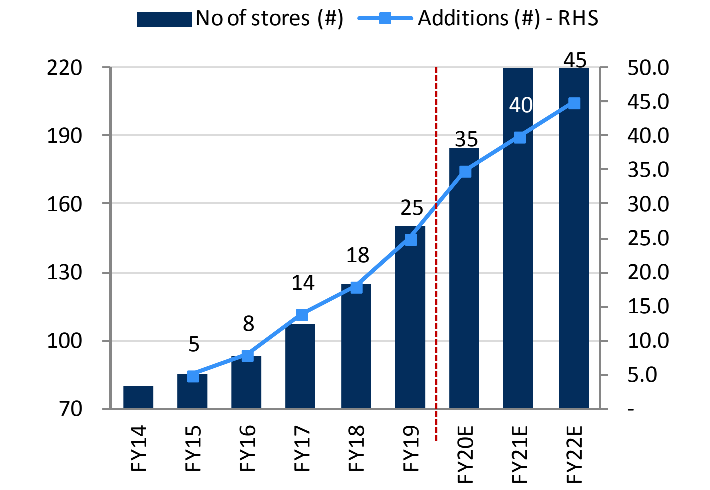
Trent recent Rs. 9.5bn capital raise should put Westside and Zudio on an expansion overdrive

To further the expansion cause, a Board committee has been appointed to consider raising upto an additional Rs. 6bn

The company intends to add ~100 store per year in the Fashion space

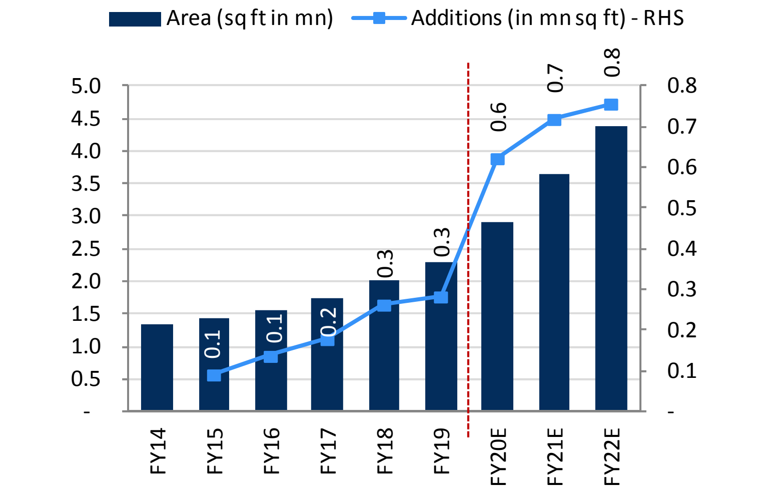
Story in Charts

Store expansion to be stepped up in Westside



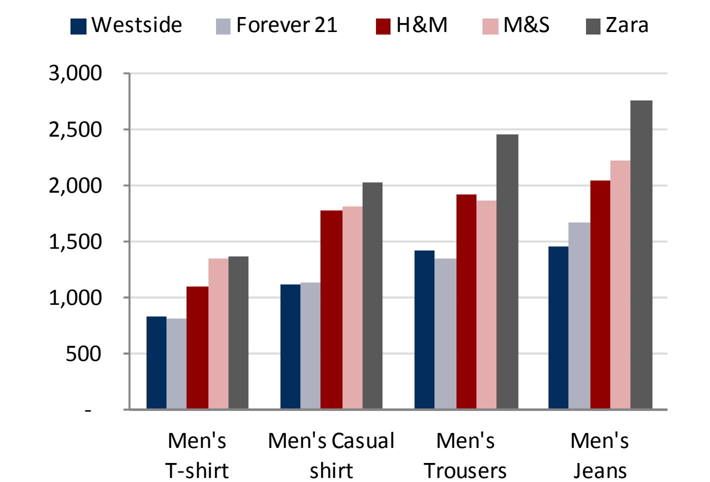
Source: Company, HDFC sec Inst Research

...building in 22% Area CAGR for Westside



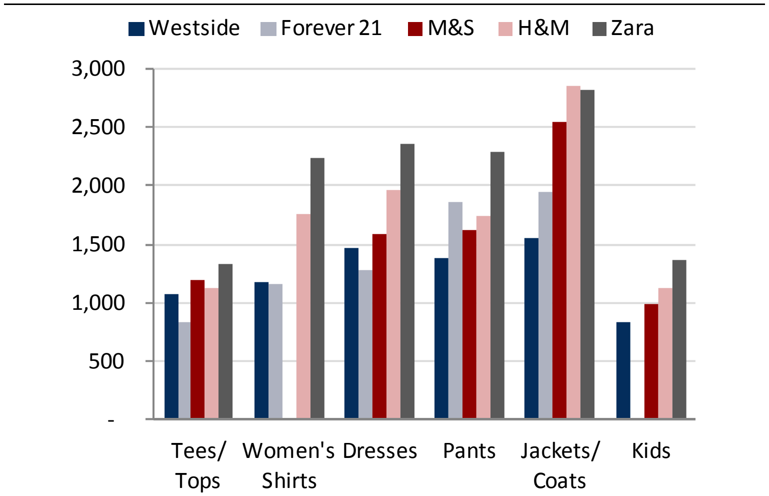
Source: Company, HDFC sec Inst Research

Westside sports the sharpest price tags among peers in Men (ASP, Rs.)



Source: Company, HDFC sec Inst Research

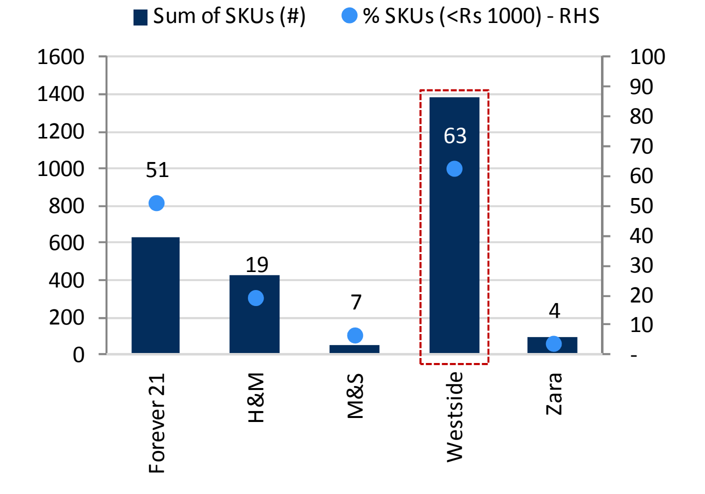
...Ditto for Women and Kids (ASP, Rs.)



Source: Company, HDFC sec Inst Research

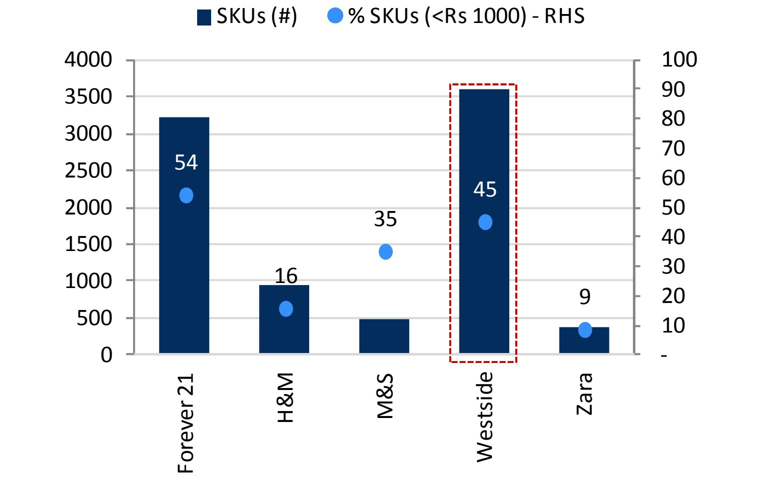
63/45/89% of Westside's SKUs in Men/Women/Kids are priced below Rs. 1000

Highest share of SKU's <Rs. 1000 in Men



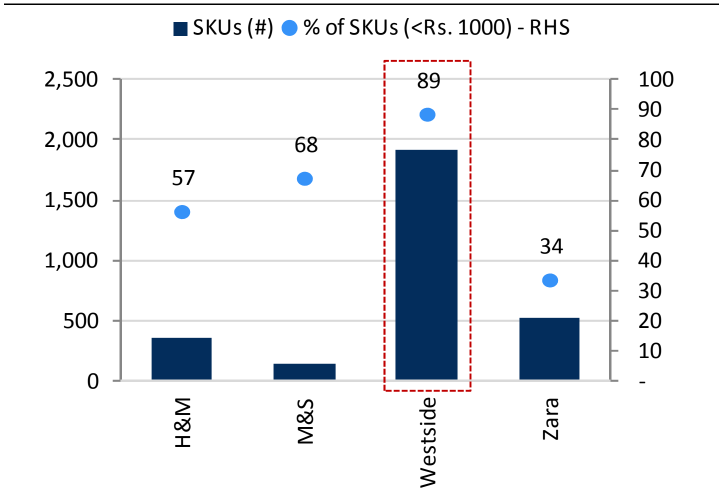
Source: Company, HDFC sec Inst Research

...Ditto for Women (Rs. <1000)



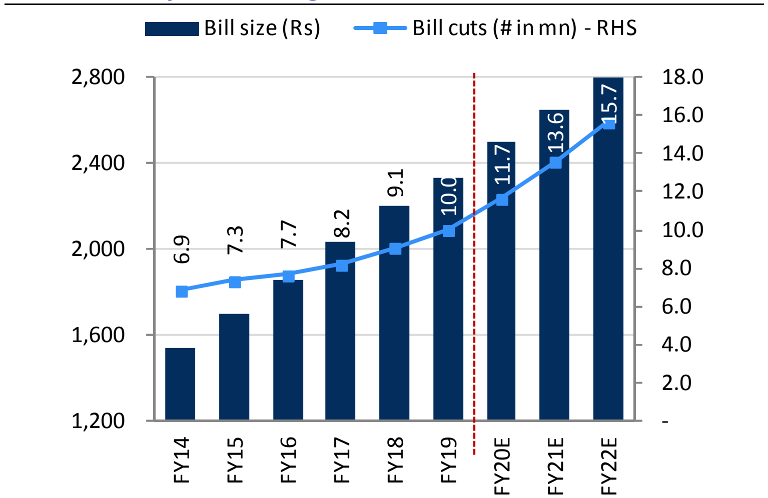
Source: Company, HDFC sec Inst Research

...and Kids



Source: Company, HDFC sec Inst Research

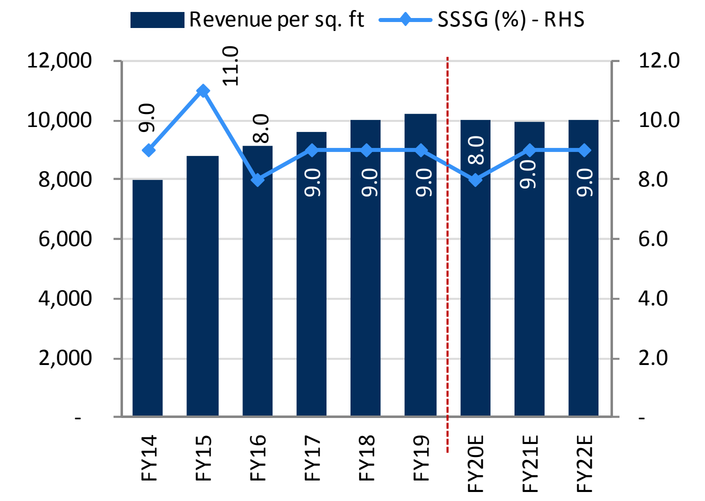
...this attracts footfalls in droves. Can be seen in consistently increasing bill cuts



Source: Company, HDFC sec Inst Research

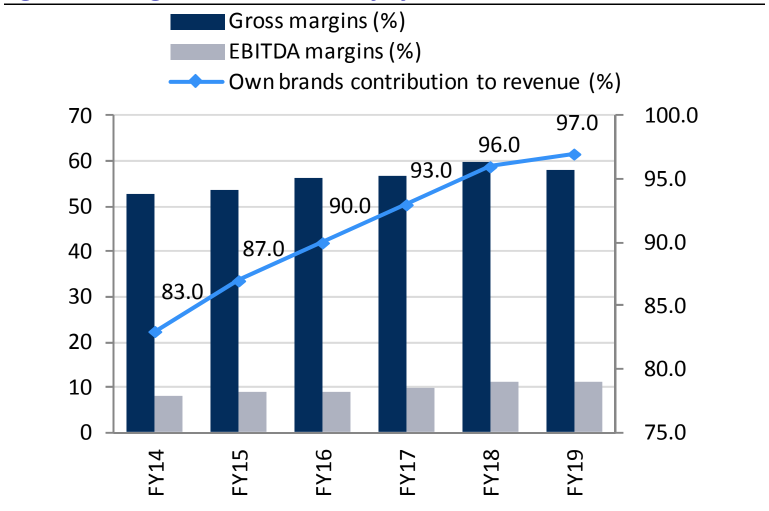
A big chunk of the FY20 capital raise is expected to be spent on aggressively expanding Zudio's store network

SSSG expected to remain healthy given the lack of a competing value proposition



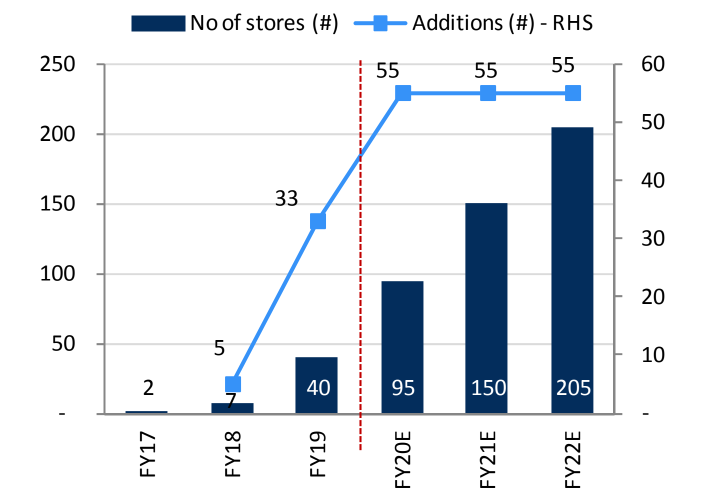
Source: Company, HDFC sec Inst Research

Industry-leading private label share explains the high gross margins Westside enjoys



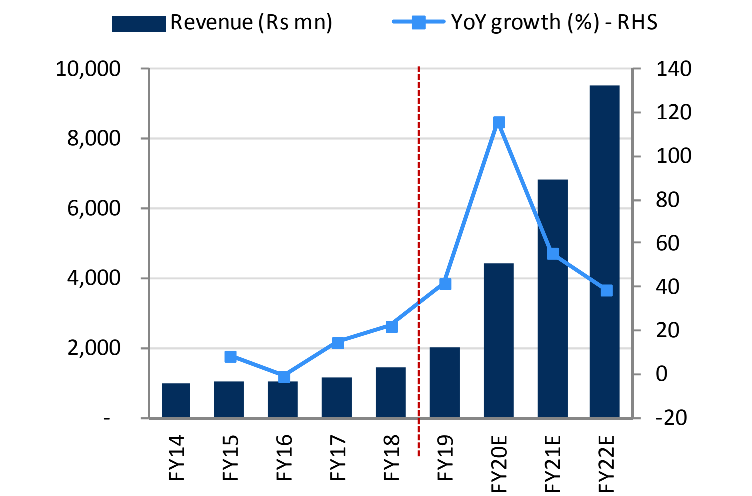
Source: Company, HDFC sec Inst Research

Aggressive expansion in Zudio planned. We bake in in 55 stores/year



Source: Company, HDFC sec Inst Research

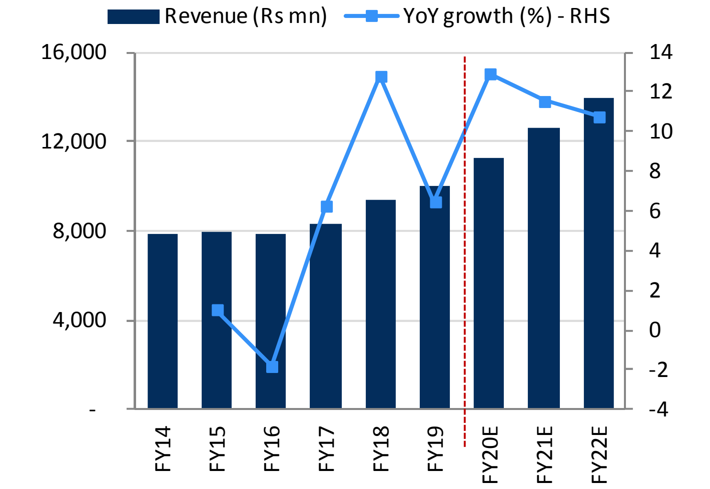
...ergo, 67% CAGR expected in Zudio's top-line over FY19-22E



Source: Company, HDFC sec Inst Research

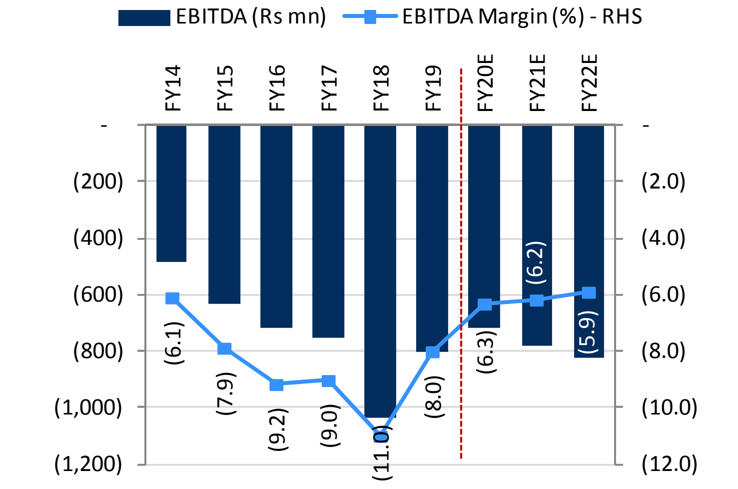
We reckon that further investments in Star are expected to be measured (Building in 20 store adds on a small base) as
1. From Trent's point of view, there are far more profitable and growing formats to place their bets on
2. From its JV partner TESCO's point of view, it doesn't seem likely to step up commitment in India at a time when it is undergoing a massive (£1.5bn) cost rationalization programme globally

Star remains a laggard…building in 12% CAGR over FY19-22E



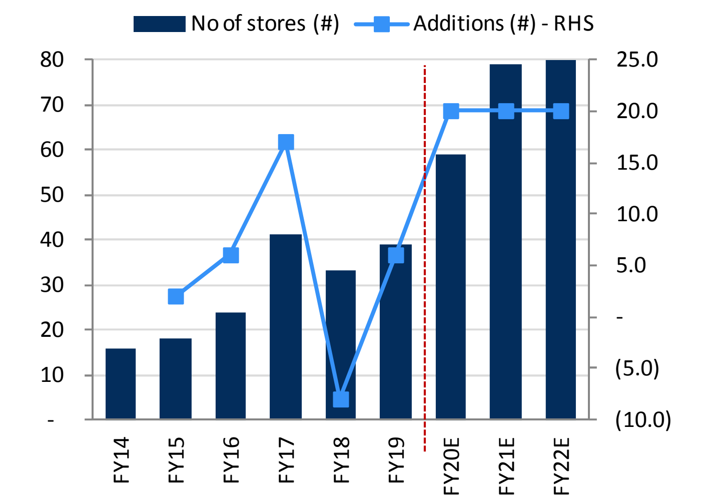
Source: Company, HDFC sec Inst Research

..profitability to remain weak, given the focus on Fresh – A tough category to crack



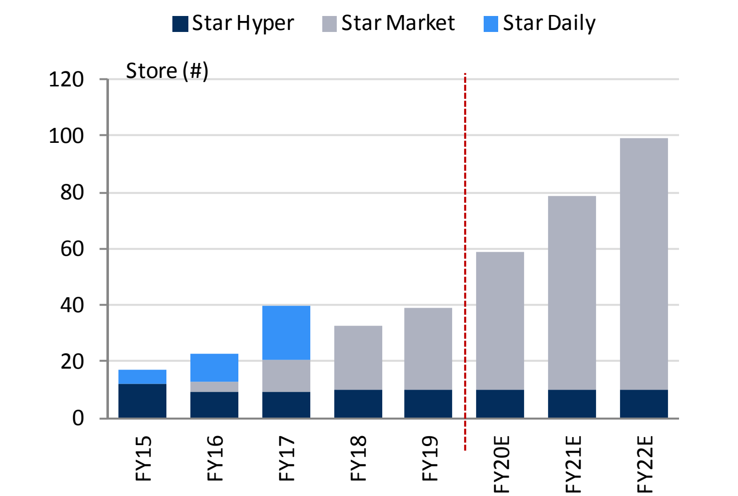
Source: Company, HDFC sec Inst Research

Expect an addition of 20 stores/yr over FY19-22E



Source: Company, HDFC sec Inst Research

..Star market to be the vehicle for expansion (6-7k sq. footers)



Source: Company, HDFC sec Inst Research

Building in 2 store adds annually (on a small base) and SSSG CAGR of 10% over FY19-22E.

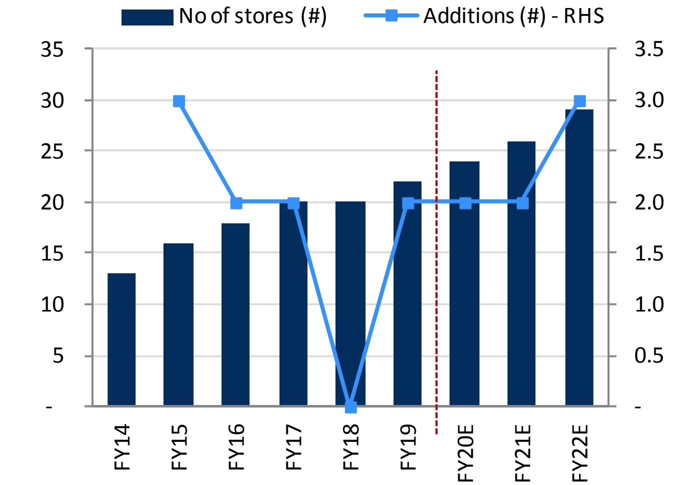
Channel checks suggest that Zara has been re-negotiating better lease rental/CAM terms with malls given its anchor tenant status

We expect Zara to recoup its margins to FY18 levels of 14% by FY22E as
1. GMs recoup 190bp to 40% by FY22 (As it did in FY18 post the price cuts in FY17)
2. Rental savings

Note: Zara's EBITDA margins fell sharply in FY19 (320bp) to 10.7% as gross margin dipped 420bp led by price cuts

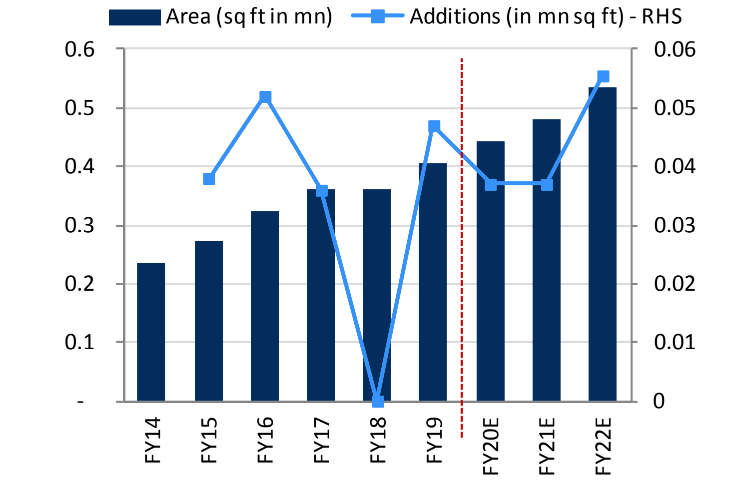
While Zara India's sales velocity (USD532/sq. ft) is nearing its global avg of USD574/sq. ft). GMs are significantly lower for the Indian entity as Zara imports its merchandise which is subject to a tax incidence of ~30%

Zara's store expansion to remain measured



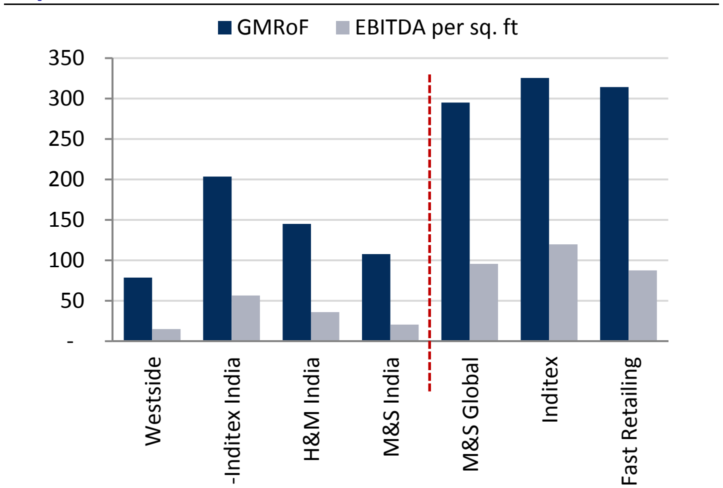
Source: Company, HDFC sec Inst Research

Building in 10% Area CAGR on a small base



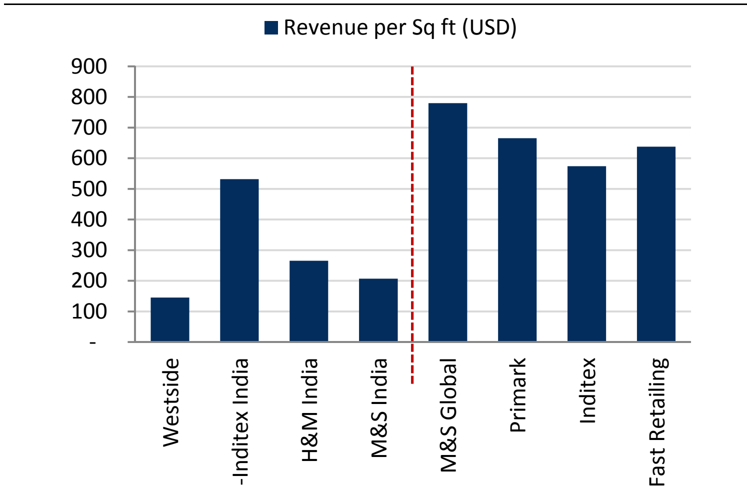
Source: Company, HDFC sec Inst Research

...meanwhile focus to remain on improving profitability per sq. ft which is lower vs its global operation



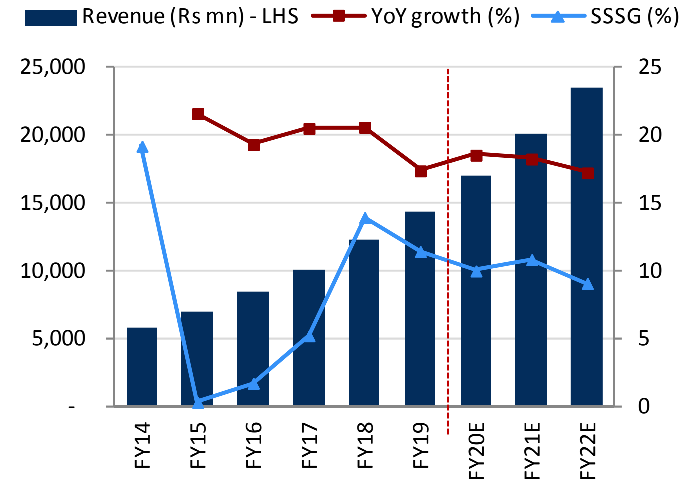
Source: Company, HDFC sec Inst Research

Throughput per sq. ft nearly matches global operations and remains industry-leading



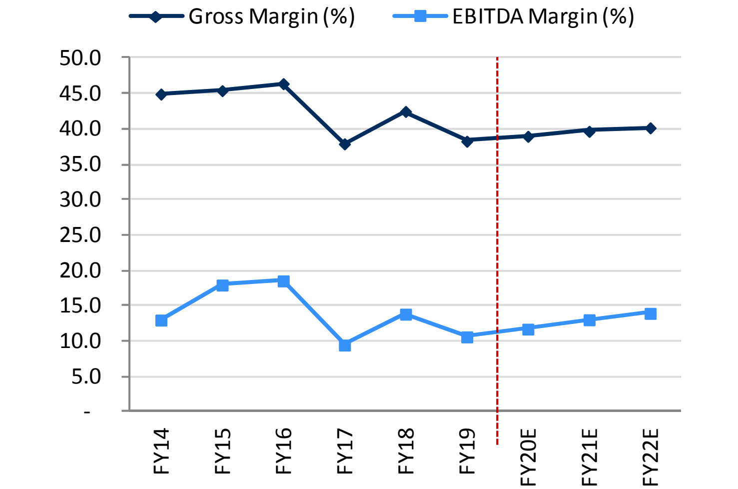
Source: Company, HDFC sec Inst Research, Note: M&S Global sells F&G too globally and hence productivity not comparable

Zara: Building in revenue/SSSG CAGR of ~18/~10% over FY19-22E



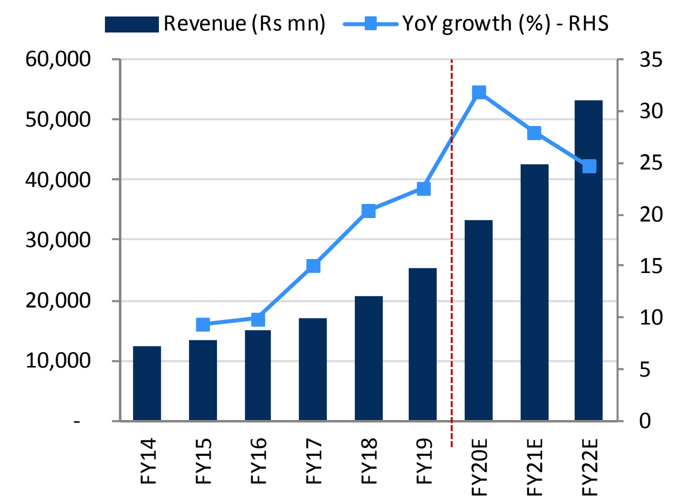
Source: Company, HDFC sec Inst Research

Building in 190/330bp margin expansion over FY19-22E



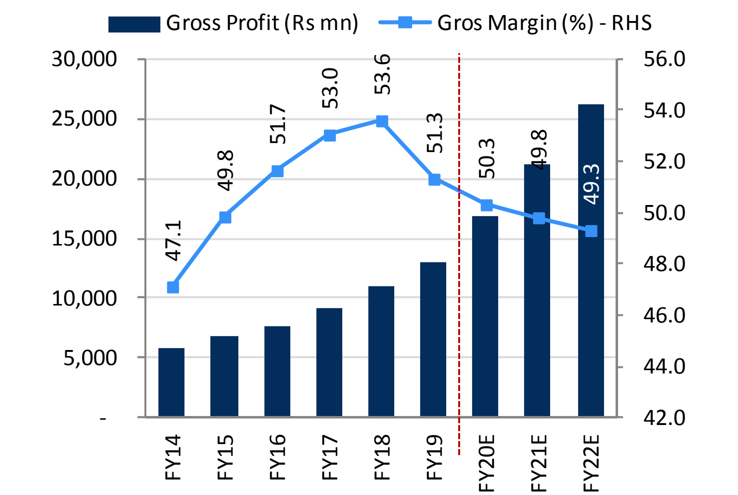
Source: Company, HDFC sec Inst Research

Overall standalone revenue to grow at 28% CAGR over FY19-22E



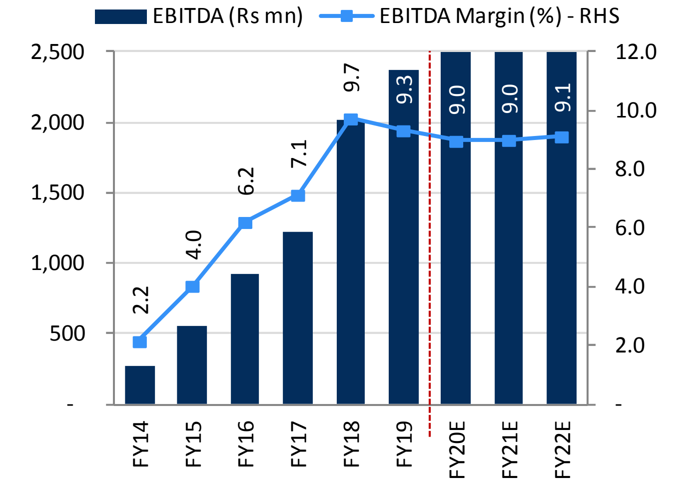
Source: Company, HDFC sec Inst Research

Gross margins to moderate as Zudio's skew increases



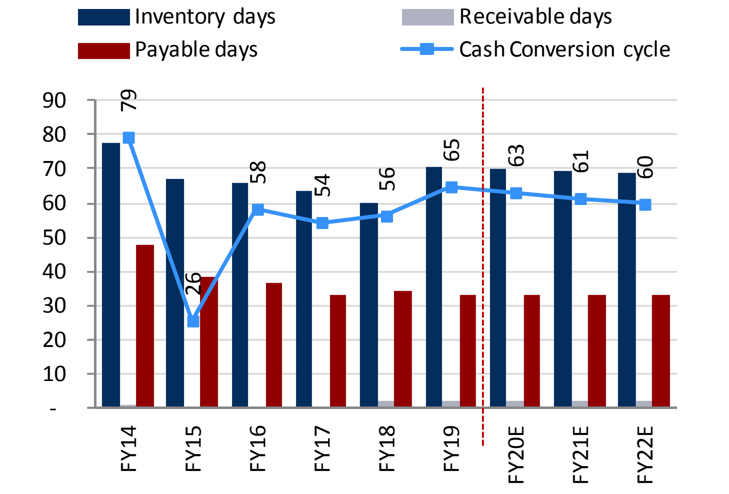
Source: Company, HDFC sec Inst Research

albeit, Zudio's sales velocity and scale-led benefits in Westside to salvage overall EBITDA margins



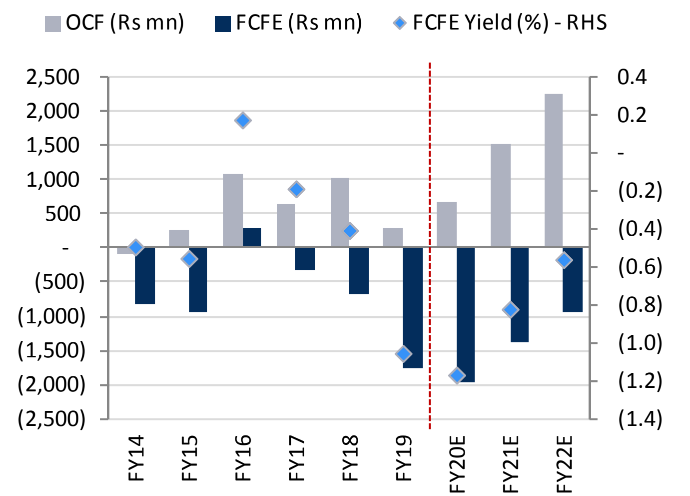
Source: Company, HDFC sec Inst Research

WC to marginally improve as new stores stabilize



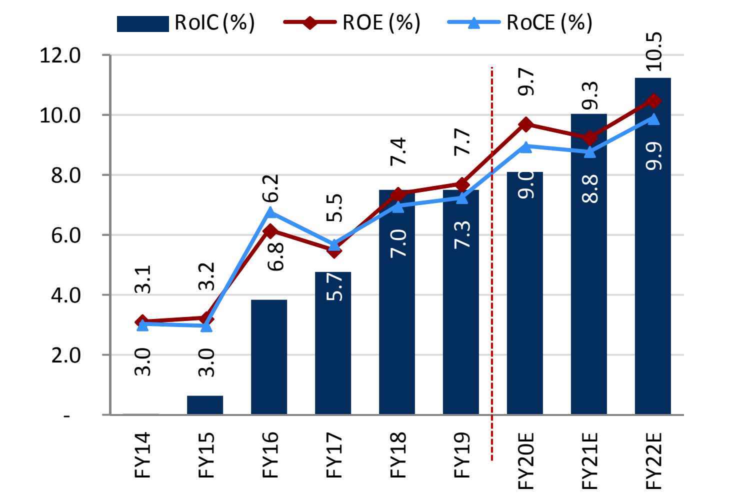
Source: Company, HDFC sec Inst Research

...expect a cumm. OCF of Rs. 4.4bn over FY20-22E



Source: Company, HDFC sec Inst Research

... return ratios to improve by ~300bp over FY19-22E



Source: Company, HDFC sec Inst Research

Trent Standalone: Snapshot

	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Westside								
Revenue (Rs. Mn)	12,484	14,231	16,651	19,981	23,378	29,081	35,811	43,588
YoY (%)	*18.0*	*14.0*	*17.0*	*20.0*	*17.0*	*24.4*	*23.1*	*21.7*
SSSG (%)	*11.0*	*8.0*	*9.0*	*9.0*	*9.0*	*8.0*	*8.5*	*8.5*
Revenue per sq. ft	8,791	9,132	9,581	9,980	10,225	9,993	9,865	9,935
Store (#)	85	93	107	125	150	185	225	270
Zudio								
Revenue (Rs. Mn)	1,040	1,030	1,180	1,440	2,040	4,402	6,851	9,503
YoY (%)	*8.3*	*(1.0)*	*14.6*	*22.0*	*41.7*	*115.8*	*55.6*	*38.7*
Revenue per sq. ft (std stores)				8,518	12,416	9,932	8,443	8,020
Std Store (#)				7	40	95	150	205
Star								
Revenue (Rs. Mn)	7,980	7,836	8,328	9,395	10,005	11,300	12,604	13,963
YoY (%)	*1.1*	*(1.8)*	*6.3*	*12.8*	*6.5*	*12.9*	*11.5*	*10.8*
SSSG (%)	*1.1*	*8.6*	*2.1*	*8.1*	*5.0*	*6.0*	*6.0*	*6.0*
Revenue per sq. ft	11,869	12,540	11,106	11,856	11,990	12,357	11,731	11,310
Store (#)	18	24	41	33	39	59	79	99
Zara								
Revenue (Rs. Mn)	7,039	8,398	10,118	12,200	14,319	16,972	20,067	23,523
YoY (%)	*21.6*	*19.3*	*20.5*	*20.6*	*17.4*	*18.5*	*18.2*	*17.2*
SSSG (%) - estimate	0.3	1.7	5.2	13.9	11.4	10.0	10.8	9.1
Expansion-led growth (%)	21.3	17.6	15.3	6.6	5.9	8.5	7.4	8.1
Revenue per sq. ft	28,536	28,595	29,847	33,888	37,338	39,887	43,388	46,236
Store (#)	16	18	20	20	22	24	26	29

Source: Company, HDFC sec Inst Research

Westside and Zara recover capital in two years, while Star is yet to crack profitable unit economics

	Westside	Star	Zara
Revenue per sq. ft	10,225	11,990	37,338
Gross Profit per sq. ft	5,525	2,709	14,296
Est. Store EBITDA (Rs. Mn)	1,432	(240)	5,115
Store EBITDA margin (%)	14.0	(2.0)	14
EBITDA per sq. ft	1,125	(986)	3,978
EBITDA margin (%)	11.0	(8.2)	10.7
Depreciation	175.1	404	1,210
Est. Store EBIT per sq. ft	1,256	(643)	3,905
EBIT per sq. ft	950	(1,390)	2,767
Capex per sq. ft	2,000	2,200	8,500
WC per sq. ft	998	(105)	2,026
Capital Employed per sq. ft	**2,998**	**2,095**	**10,526**
Post Tax RoCE	21.4	NM	16.8
Payback Period (Yrs)	2.1	NM	2.1

Source: Company, HDFC sec Inst Research

Capital needs have historically remained high

Sources of funds (Rs bn)	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**Total**
Cash from Operations (excl WC change)	0.2	(0.2)	0.3	0.3	0.4	0.8	1.0	1.7	1.6	6.3
Other Income	0.4	0.6	0.3	0.2	0.3	0.5	0.2	0.2	0.2	2.7
Total	**0.6**	**0.4**	**0.6**	**0.5**	**0.7**	**1.3**	**1.2**	**1.9**	**1.8**	**9.0**
Application of funds (Rs bn)										-
Working Capital	0.7	(0.3)	(0.4)	0.0	(1.7)	1.5	0.2	0.6	1.3	1.9
Capex	0.7	0.4	0.2	0.6	1.1	1.3	0.5	1.4	2.9	9.1
Investments	(0.2)	2.8	3.2	0.0	0.4	0.1	(0.2)	(0.9)	(2.2)	3.0
Dividend	0.2	0.2	0.2	0.3	0.3	0.8	0.0	0.4	0.5	2.7
Borrowings	(0.2)	0.4	0.2	-	-	(1.7)	0.0	0.0	(1.0)	(2.4)
Others	(3.4)	(2.7)	(1.5)	0.8	0.7	(0.6)	0.6	0.4	0.2	(5.6)
Net change in cash	2.9	(0.3)	(1.3)	(1.1)	(0.0)	(0.0)	0.1	(0.0)	0.2	0.4
Total	**0.6**	**0.4**	**0.6**	**0.5**	**0.7**	**1.3**	**1.2**	**1.9**	**1.8**	**9.0**
Cumm. WC + Capex as % of sources of funds										**121.6**

Source: Company, HDFC sec Inst Research

Valuation

DCF – Trent - Standalone

	FY21E	FY22E	FY23E	FY24E	FY25	FY26	FY27	FY28	FY29	FY30	FY35	FY40
Revenue (INR m)	**42699**	**53249**	**64584**	**77538**	**91901**	**106932**	**124054**	**141546**	**161385**	**182326**		
YoY (%)	*27.9*	*24.7*	*21.3*	*20.1*	*18.5*	*16.4*	*16.0*	*14.1*	*14.0*	*13.0*		
EBIT*(1-t)	2364	3012	3555	4293	5325	6352	7791	9012	10604	12156		
Depreciation	688	837	992	1154	1320	1492	1669	1849	2033	2221		
Capex	-2509	-2782	-2941	-3239	-3343	-3725	-3840	-4171	-4368	-4719		
Changes in WC (Winv)	-1414	-1529	-1556	-1700	-1665	-1587	-1691	-1533	-1614	-1505		
FCFF	**-871**	**-461**	**50**	**508**	**1637**	**2531**	**3930**	**5157**	**6655**	**8153**	**16825**	**26828**
YoY (%)	*-33.1*	*-47.0*	*-110.9*	*906.7*	*222.0*	*54.7*	*55.3*	*31.2*	*29.0*	*22.5*	*14.0*	*7.0*
Interest (1-t)	-296	-296	-296	-296	-296	-296	-296	-296	-296	-296		
Net Borrowings	0	0	0	0	0	0	0	0	0	0		
FCFE	**-1167**	**-757**	**-245**	**213**	**1341**	**2235**	**3634**	**4861**	**6359**	**7858**		
YoY (%)												
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**	**Mar-35**	**Mar-40**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	14.5	19.5
PV (FCFF)	**(826)**	**(393)**	**39**	**349**	**1,009**	**1,402**	**1,955**	**2,304**	**2,671**	**2,939**	**3,544**	**3,302**
Terminal Value												**444,736**

DCF Date	**Sep-20**
Kd*(1-t)	**7.5**
Ke	**12**
Net Debt (Mar-20E)	(4,391)
PV-Explicit Period	44,253
PV-Terminal Value	54,739
Equity Value (INR m)	**103,383**
Equity value per share (INR)	**311**
Sept FY21 Implied EV/EBITDA (x)	22.7
Sept FY21 Implied P/E (x)	37
Terminal growth rate (%)	5.0

Source: Company, HDFC sec Inst Research

Zara DCF

(Rs. Mn)	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
EBIT*(1-t)	1,597	2,106	2,683	3,400	4,395	5,563	6,985	8,573	10,442	12,489
Depreciation	486	473	471	506	544	603	653	735	792	848
Capex	(315)	(472)	(786)	(944)	(1,101)	(1,101)	(1,258)	(1,258)	(1,258)	(1,415)
Changes in WC (Winv)	(45)	(37)	(116)	(149)	(191)	(221)	(248)	(277)	(298)	(324)
FCFF	**1,724**	**2,070**	**2,252**	**2,814**	**3,647**	**4,844**	**6,131**	**7,772**	**9,678**	**11,598**
YoY (%)	*34.3*	*20.0*	*8.8*	*25.0*	*29.6*	*32.8*	*26.6*	*26.8*	*24.5*	*19.8*
Interest (1-t)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Net Borrowings	-	-	-	-	-	-	-	-	-	-
FCFE	**1,723**	**2,068**	**2,250**	**2,812**	**3,646**	**4,842**	**6,130**	**7,771**	**9,676**	**11,596**
YoY (%)	*34.4*	*20.1*	*8.8*	*25.0*	*29.7*	*32.8*	*26.6*	*26.8*	*24.5*	*19.8*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
PV (FCFF)	**1,630**	**1,747**	**1,696**	**1,892**	**2,190**	**2,597**	**2,935**	**3,321**	**3,692**	**3,950**
Terminal Value										**173,969**

DCF Date	**Sep-20**
Kd*(1-t)	7.5
Ke	12.0
Net Debt (Mar-20E)	(2,164)
PV-Explicit Period	**27,007**
PV-Terminal Value	**59,251**
Equity Value (INR m)	**88,423**
Sept FY21 Implied EV/EBITDA (x)	29.2
Terminal growth rate (%)	5.0
WACC	12.0
Trent's share of equity value (@ 49%)	**43,327**

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer preferences	The markets for some of the products such as home and personal care and apparel are seasonal & constantly changing with changing in customer preferences, new product introductions. There may be a risk of loss of business due to inability to match the changing customer preferences.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Inventory risk	Any material misjudgment in estimating customer demand could adversely impact the results by causing either a shortage of inventory or an accumulation of excess inventory.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Noel Navel Tata	Chairman	He serves as the Group CEO at Tata International Limited and Managing Director since 2010. He has an extensive experience in various fields including marketing, administration, and investments and has been its chairman since 2014. Mr. Tata holds Bachelor of Arts degree in Economics from the University of Sussex, U.K. and I.E.P. from INSEAD, France.
Mr. Philip Auld	Managing Director	Auld, a retail industry veteran from the UK, had joined Trent as CEO in April 2011. Auld worked with both M&S, as head of selling women's wear, and a Netherlands-based female fashion retailer M&S Mode, which was part of the Maxeda Retail Group BV. At M&S Mode, he oversaw the operations of 400 stores in seven European countries in which it operated. Prior to join M&S Mode, Auld was head of clothing at Walmart-run supermarket Asda.
Mr. P. Venkatesalu	Director (Finance) and Chief Financial Officer	At Trent Ltd, he oversees the accounting, secretarial and legal functions. Prior to joining Trent in May 2008, he served as a key member of the Group Finance team in Tata Sons Limited from 2002, with the responsibility to manage select projects and transactions. In this role he was involved in a range of projects/ matters including substantial fund raising across markets, overseas investments, joint venture negotiations, sourcing equity investments and ongoing management of financial risk exposures in Tata Sons and few other Tata entities. The latter part of this assignment also involved managing banking relationships, rating agencies like S&P and Moodys and select regulator interactions.
Mr. Bhaskar Bhat	Non-Executive Director	Bhaskar Bhat is currently the managing director of Titan Company Limited. He has graduated in mechanical engineering from IIT Madras and completed his PGDBM from IIM Ahmedabad. He is also the director for Bosch, Tata Chemicals, Rallis India, Tata SIA (Vistara), Tata Ceramics, Montblanc and Caratlane.
Mr. Zubin Dubash	Non-Executive Director	He is associated with Tata Group since 2000. He also serves as an independent director of Tata Investment Corporation Ltd. Mr. Dubash is a Chartered Accountant form the institute of Chartered Accountants in England and Wales. He also holds an MBA from The Wharton School, Philadelphia in 1986.

Source: Company, HDFC sec Inst Research

Company profile

- As a part of Tata Group, Trent (established in 1998) operates retail stores across four formats: Westside, Zudio, Star and Landmark.
- The company's Westside departmental stores provide women's wear, men's wear, kids' wear, footwear, lingerie, cosmetics, perfumes and handbags, household furniture, and accessories. It also operates a hypermarket and convenience store chain under the Star Market brand, which offer food and groceries, staple foods, beverages, health and beauty products, consumer electronics, home care products, apparel, home décor, vegetables, fruits, and dairy products.
- In addition, the company operates books and music retail chain under the Landmark name that provides toys, adult and young adult books, sports-related merchandise, tech accessories, and gaming and stationery products. Further, it operates value fashion apparel stores for women, men, and children under the Zudio brand.
- Westside accounts for 92% of Trent's standalone revenue and operates 150 stores across India. Zudio and Landmark operate 56 and 5 stores respectively. The company operates 39 Star stores under Trent Hypermarket Private Limited (THPL) which is a 50:50 JV between Trent and Tesco Plc. Also, Trent has two joint ventures with Inditex group of Spain with a shareholding of 49 percent (Inditex Trent Retail India Pvt Ltd) in Zara (Revenue - Rs 14bn, 22 stores) and 49 percent in Massimo Dutti (Revenue - Rs 458mn) stores in India.

Income Statement (Standalone)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues	**20,663**	**25,317**	**33,382**	**42,699**	**53,249**
Growth (%)	***20.4***	***22.5***	***31.9***	***27.9***	***24.7***
COGS	9,588	12,324	16,583	21,425	26,985
Employee Expense	2,026	2,525	3,322	4,232	5,267
A&P Expense	382	430	567	704	851
Rent Expense	2,668	3,180	4,177	5,295	6,513
Other Expenses	3,987	4,494	5,734	7,195	8,770
EBITDA	**2,014**	**2,365**	**2,999**	**3,848**	**4,863**
EBITDA Growth (%)	***64.2***	***17.5***	***26.8***	***28.3***	***26.4***
EBITDA Margin (%)	***9.7***	***9.3***	***9.0***	***9.0***	***9.1***
Depreciation	417	465	551	688	837
EBIT	**1,597**	**1,901**	**2,448**	**3,160**	**4,026**
Other Income (Including EO Items)	426	359	1,201	837	723
Interest	306	368	395	395	395
PBT	**1,716**	**1,892**	**3,254**	**3,601**	**4,353**
Total Tax	549	617	1,058	906	1,096
RPAT before share of associate earnings	**1,167**	**1,275**	**2,196**	**2,695**	**3,258**
Share of associate earnings	-	-	-	-	-
Minority share of Profit/(Loss)	-	-	-	-	-
RPAT	**1,167**	**1,275**	**2,196**	**2,695**	**3,258**
Exceptional (Gain)/loss	-	5	-	-	-
Adjusted PAT	**1,167**	**1,279**	**2,196**	**2,695**	**3,258**
APAT Growth (%)	***42.1***	***9.6***	***71.7***	***22.7***	***20.9***
Adjusted EPS (Rs)	**3.5**	**3.8**	**6.2**	**7.5**	**9.1**
EPS Growth (%)	***42.1***	***9.6***	***59.8***	***22.7***	***20.9***

Source: Company, HDFC sec Inst Research

Balance Sheet (Standalone)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	332	332	355	355	355
Reserves	15,839	16,636	27,788	29,559	31,651
Total Shareholders Funds	**16,172**	**16,968**	**28,144**	**29,915**	**32,006**
Minority Interest	**-**	**-**	**-**	**-**	**-**
Long Term Debt	999	2,996	2,996	2,996	2,996
Short Term Debt	2,915	1,946	1,946	1,946	1,946
Total Debt	**3,914**	**4,941**	**4,941**	**4,941**	**4,941**
Net Deferred Taxes	**(28)**	**(72)**	**(72)**	**(72)**	**(72)**
Other Non-current Liabilities & Provns	**23**	**4**	**4**	**4**	**4**
TOTAL SOURCES OF FUNDS	**20,081**	**21,842**	**33,018**	**34,789**	**36,880**
APPLICATION OF FUNDS					
Net Block	5,779	6,271	7,947	9,769	11,713
CWIP	96	850	850	850	850
Other Non-current Assets	6,119	7,250	7,250	7,250	7,250
Total Non-current Assets	**11,993**	**14,372**	**16,048**	**17,869**	**19,814**
Inventories	3,392	4,894	6,407	8,137	10,075
Debtors	131	141	186	238	297
Other Current Assets	2,701	3,157	4,053	5,044	6,116
Cash & Equivalents	**4,899**	**2,970**	**11,191**	**9,727**	**8,345**
Total Current Assets	**11,122**	**11,162**	**21,838**	**23,147**	**24,832**
Creditors	1,946	2,289	3,018	3,860	4,814
Other Current Liabilities & Provns	1,088	1,403	1,850	2,367	2,951
Total Current Liabilities	**3,034**	**3,692**	**4,868**	**6,227**	**7,765**
Net Current Assets	**8,088**	**7,470**	**16,970**	**16,920**	**17,067**
TOTAL APPLICATION OF FUNDS	**20,081**	**21,842**	**33,018**	**34,789**	**36,880**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	1,716	1,896	3,254	3,601	4,353
Non-operating & EO Items	(40)	(122)	(1,201)	(837)	(723)
Interest Expenses	87	180	395	395	395
Depreciation	424	465	551	688	837
Working Capital Change	(668)	(1,356)	(1,278)	(1,414)	(1,529)
Tax Paid	(491)	(781)	(1,058)	(906)	(1,096)
OPERATING CASH FLOW (a)	**1,029**	**282**	**663**	**1,527**	**2,238**
Capex	(1,369)	(2,890)	(2,227)	(2,509)	(2,782)
Free Cash Flow (FCF)	*(341)*	*(2,609)*	*(1,564)*	*(982)*	*(544)*
Investments	881	2,234	-	-	-
Non-operating Income	186	199	1,201	837	723
INVESTING CASH FLOW (b)	**(302)**	**(457)**	**(1,026)**	**(1,673)**	**(2,059)**
Debt Issuance/(Repaid)	(341)	841	(395)	(395)	(395)
FCFE	*(681)*	*(1,768)*	*(1,959)*	*(1,377)*	*(939)*
Share Capital Issuance	-	-	9,500	-	-
Dividend	(399)	(459)	(521)	(924)	(1,166)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(740)**	**382**	**8,584**	**(1,319)**	**(1,561)**
NET CASH FLOW (a+b+c)	**(12)**	**206**	**8,221**	**(1,464)**	**(1,382)**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	303	509	8,731	7,266	5,884

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	53.6	51.3	50.3	49.8	49.3
EBITDA Margin	9.7	9.3	9.0	9.0	9.1
EBIT Margin	7.7	7.5	7.3	7.4	7.6
APAT Margin	5.6	5.1	6.6	6.3	6.1
RoE	7.4	7.7	9.7	9.3	10.5
RoIC (or Core RoCE)	7.5	7.5	8.1	10.1	11.2
RoCE	7.0	7.3	9.0	8.8	9.9
EFFICIENCY					
Tax Rate (%)	32.0	32.5	32.5	25.2	25.2
Fixed Asset Turnover (x)	3.0	3.4	3.4	3.5	3.5
Inventory (days)	*60*	*71*	*70*	*70*	*69*
Debtors (days)	*2*	*2*	*2*	*2*	*2*
Other Current Assets (days)	*48*	*46*	*44*	*43*	*42*
Payables (days)	*34*	*33*	*33*	*33*	*33*
Other Current Liab & Provns (days)	*19*	*20*	*20*	*20*	*20*
Cash Conversion Cycle (days)	56	65	63	61	60
Net D/E (x)	(0.1)	0.1	(0.2)	(0.2)	(0.1)
Interest Coverage (x)	5.2	5.2	6.2	8.0	10.2
PER SHARE DATA (Rs)					
EPS	3.5	3.8	6.2	7.5	9.1
CEPS	4.8	5.2	7.7	9.5	11.5
Book Value	48.7	51.1	78.8	83.8	89.7
VALUATION					
P/E (x)	143.8	131.2	82.1	66.9	55.3
P/BV (x)	10.4	9.9	6.4	6.0	5.6
EV/EBITDA (x)	82.9	71.8	53.9	42.4	33.8
EV/Revenues (x)	8.1	6.7	4.8	3.8	3.1
OCF/EV (%)	0.6	0.2	0.4	0.9	1.4
FCF/EV (%)	(0.2)	(1.5)	(1.0)	(0.6)	(0.3)
FCFE/Mkt Cap (%)	(0.4)	(1.1)	(1.2)	(0.8)	(0.6)

Source: Company, HDFC sec Inst Research

HDFC securities

INSTITUTIONAL RESEARCH

Future Lifestyle Fashion

BUY

Off Price Retailing + Brands = Potent Cocktail

FLFL's unique cocktail of Off-price retail (Brand Factory), owned brands, Mall-like department stores (Central) makes it one of the most promising apparel retailers within our universe. Brand factory provides scalability and footfalls, while Central and owned brands provide the margins and free cash levers. Lion's share of Brand factory's (BF) growth is expected to be expansion-led, while Central trains focus on productivity gains. A healthy store age profile should keep SSSG steady across both formats though. Gross margin gains to remain elusive as mix decisively tilts towards Brand Factory. Building in revenue/EBITDA/PAT CAGR of 18/19/20% respectively over FY19-22E. While we build in a steady RoCE profile over the next 2-3 years given the impetus on BF's expansion; RoCEs should meaningfully improve post that as the expansion drive cools off. Note: BF is relatively more asset-light vs Central. Initiate with a BUY and a DCF-based TP of Rs. 550/sh, (implied EV/EBITDA: 14x Sept-21).

Investment rationale

- **Central – The mini-mall experience:** Globally, department store sizes are 3-4x that of their Indian counterparts given their experiential positioning. However, in India, income profiles and unit store economics dictate smaller store sizes. Central remains an exception to this rule. Nearly 90% of its stores are on standalone properties with an avg. store size of 90k sq. ft. This helps the format display 550+ brands in one go courtesy its mini-mall like size – a footfall enabler. That said, it is reducing store sizes at the margin to boost productivity (currently Rs. 7800). Central's GMs are ~300-350 lower vs peers, despite a 30% private label share, implying that 3P brands are more competitively priced vs peers in the format. The GM deficit is more than made up for by its leaner cost structure vs peers. We build in a steady 5% SSSG CAGR over FY19-22E given its healthy store age profile, improving owned brands' share and reducing store sizes. We build in 12% revenue CAGR over FY19-22E.
- **Brand Factory – One of its kind:** Off-price retailing is one of the few apparel formats globally to have gone unscathed by the online steam-roll. Such formats sell branded merchandise at steep discounts (typically 20-70%). BF's "affordability-meets-aspiration" proposition places it perfectly to cater to a burgeoning target group having PCI of Rs. 150-200k (est: 170mn). This can be seen in BF's expansion strategy too. 25% of its stores (higher vs fellow department stores) are placed in districts with PCI range of Rs. 150-200k (Considered a sweet spot for Off Price Retailing). Given the scalability of such a biz model, we build in 25% revenue CAGR over FY19-22E, primarily expansion-led. SSSG to remain healthy too at 7% CAGR over FY19-22E.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	57,281	68,013	80,903	95,166
EBITDA	5,259	6,037	7,366	8,798
APAT	1,890	1,861	2,429	3,286
Dil. EPS (Rs/sh)	9.7	9.3	12.1	16.3
P/E (x)	41.8	43.9	33.6	24.8
EV/EBITDA (x)	16.0	14.1	11.6	9.7
ROE (%)	11.3	9.1	10.2	12.5
RoIC (%)	11.0	9.4	10.2	12.0
ROCE (%)	11.4	9.5	10.3	11.8

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 396**
Target Price	**Rs 550**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	FLFL IN
No. of Shares (mn)	201
MCap (Rs bn) / ($ mn)	80/1,120
6m avg traded value (Rs mn)	73

STOCK PERFORMANCE (%)

52 Week high / low **Rs 504/381**

	3M	6M	12M
Absolute (%)	(7.9)	(11.8)	0.2
Relative (%)	(17.3)	(14.1)	(14.3)

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	53	46
FIs & Local MFs	20	19
FPIs	13	22
Public & Others	13	13
Pledged Shares	14	8

Source : BSE

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- **Owned brands to provide some cushion to margins:** FLFL has 22 owned/licensed brands which typically enjoy 4-5pp higher margins vs third-party brands. Of these, the company has identified seven front-runner brands (Lee Cooper, John Miller, Scullers, Jealous 21, Indigo Nation, Bare and aLL) to achieve scale in its brand play. These power brands account 28% of total sales (FY19) and grew at 16% CAGR over FY16-19. We reckon own brands' increase in mix should partially help cushion gross margin impact.

- **EBO de-focus continues:** Over the last 3 years, FLFL has been de-focusing on EBOs as a channel as the cost of doing business via EBOs has been increasing in general for the industry. We too reckon their flagships – Central and BF have a better chance at profitable revenue growth vs EBOs. The company has closed 94 stores over FY16-19 (current count 202 EBOs). That said, certain tent-pole brands such as Lee Cooper and ALL will see some EBO additions given their established brand equity. We expect this channel to grow at a little over 6% CAGR over FY19-22E. Hence, the relevance of this channel is expected to reduce over time for FLFL.

- **Returns hinged on increased asset sweating:** Given that lower margin BF is expected to increase its share in the biz to 45% (currently 38%) by FY22E, we do not build any meaningful operating leverage benefits over FY19-22E. That said, post the investment-heavy FY19-22 period, asset sweating is likely to inch up as throughput per sq. ft increases with stores maturing. Note: BF has a very young store age profile with 41/93 stores being <2 years old.

- **Key Risks:** 1. Promoter group level pledges remain high. 2. Online impact on Central – Department store (50% of revenue) remains high.

- **Off-price retail available at off-price discount:** Recent stock correction, (~12% - 6 months) presents a good entry point as operational vitals remain healthy and valuations remain undemanding at <10x Sept-21 EV/EBITDA, We bake in revenue/EBITDA/PAT CAGR of 18/19/20% respectively and steady return ratios over FY19-22E given the expansion overdrive expected in BF. Intitiate with a BUY and a DCF-based TP of Rs. 550/sh

Perhaps the only department store true to the format's value proposition – Experience

Central's focus to be trained on productivity. Enablers are:
1. Right-sizing avg. Store size
2. Step up in own brands' share
3. Improving store age profile

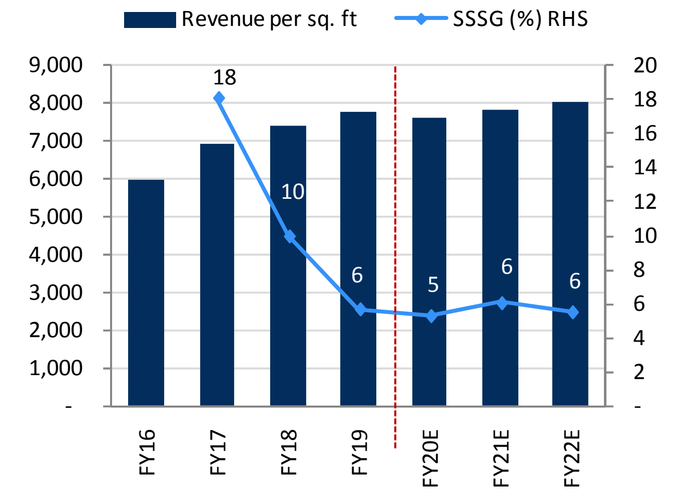
Expect SSSG/RPSF CAGR of 5.6/1% over FY19-22E

Expect measured expansion in Central given the industry headwinds for the format.

Building in 5 store adds annually and 9% Area CAGR over FY19-22E

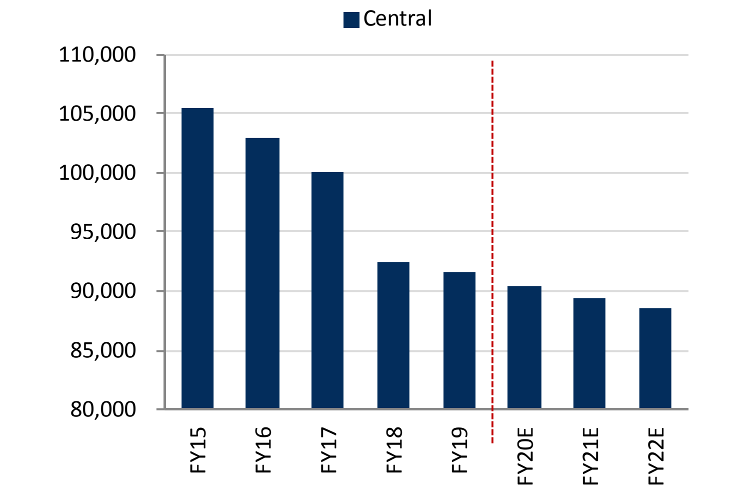
Story in Charts

Expect steady SSSG/productivity increase in Central



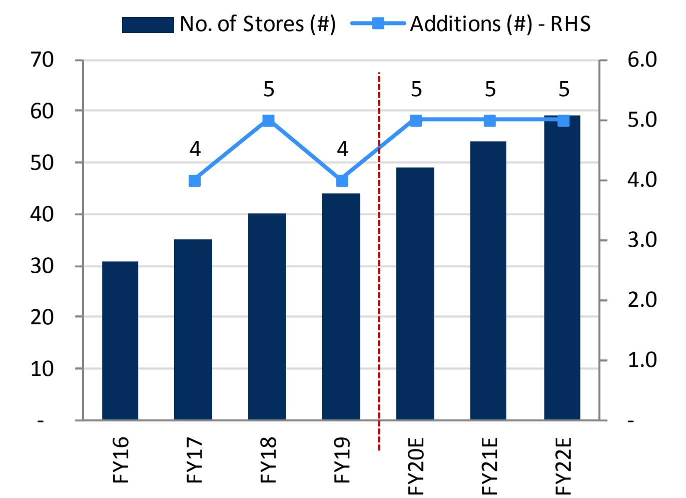
Source: Company, HDFC sec Inst Research

…as store sizes get smaller (Avg store size in sq. ft)



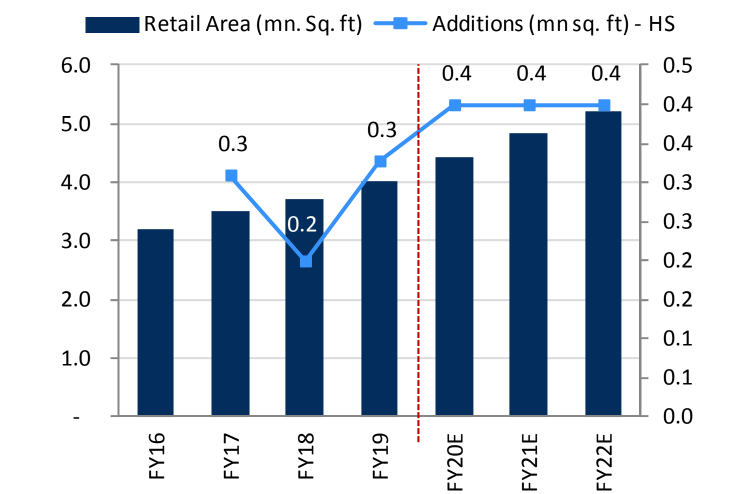
Source: Company, HDFC sec Inst Research

…and as expansion remains measured



Source: Company, HDFC sec Inst Research

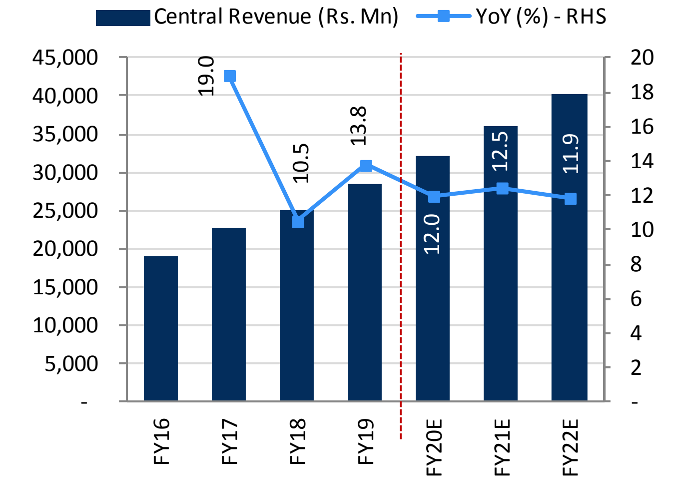
Expect Area CAGR of 9% over FY19-22E



Source: Company, HDFC sec Inst Research

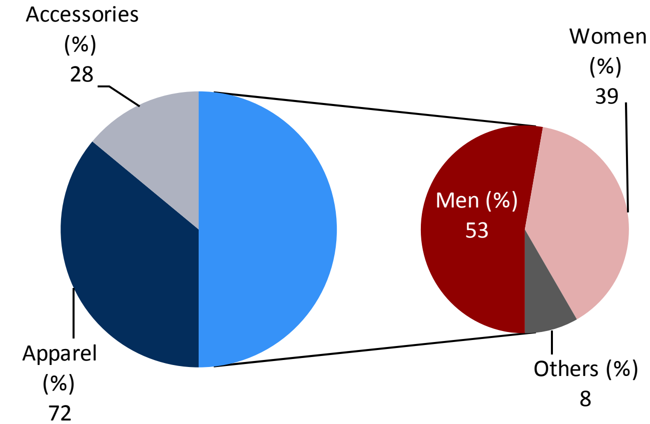
A typical Central store scales up between Year 3 & 4 and stores of that age have been increasing within the portfolio. That explains the steadily improving productivity and margins

Ergo, building in 12% revenue CAGR over FY19-22E



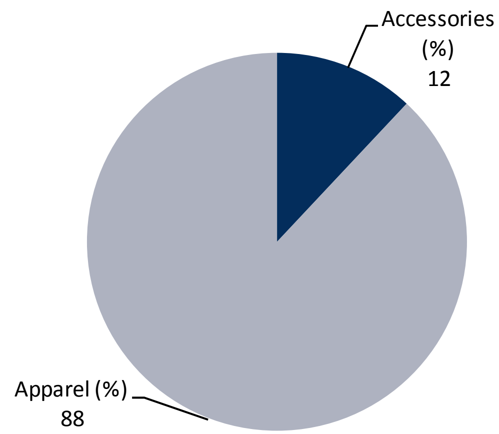
Source: Company, HDFC sec Inst Research

Apparel accounts for >70% share in mix, slower-growing men's category remains dominant in apparels



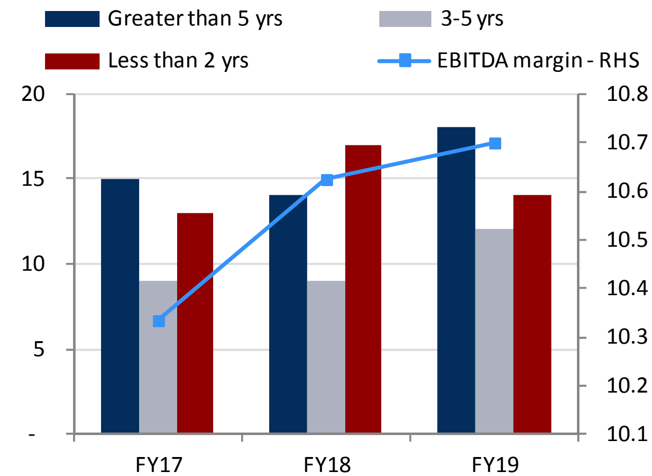
Source: Company, HDFC sec Inst Research

Central: Own brands account for 30% of sales



Source: Company, HDFC sec Inst Research

Central: Store age profile, 3-5yr old stores increasing in mix



Source: Company, HDFC sec Inst Research

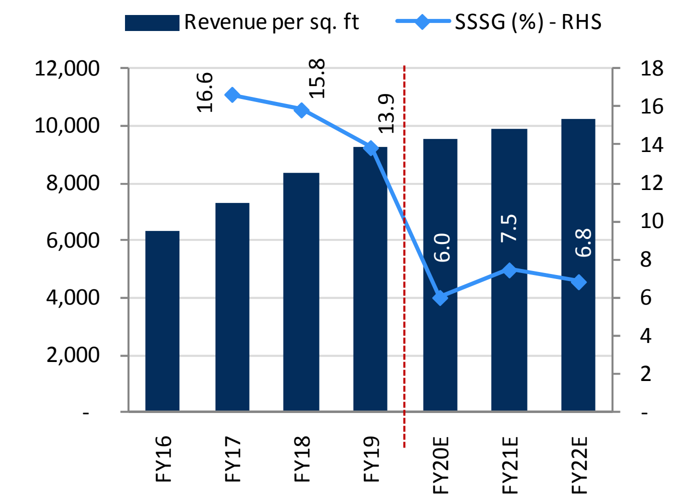
Brand factory to be the growth engine given better scalability of the model

Globally too, one of the few formats gone unscathed from the online onslaught has been off-price retailing

SSSG/RPSF to be healthy given:
1. Right-sizing of stores
2. Healthy store age profile
3. Sales density could increase if in-roads are made in districts with a) PCI ranging Rs. 150-200k and b) Population density >300/km where department store density is as low as 1 store per 1mn in population and even lower for Off-price retailing

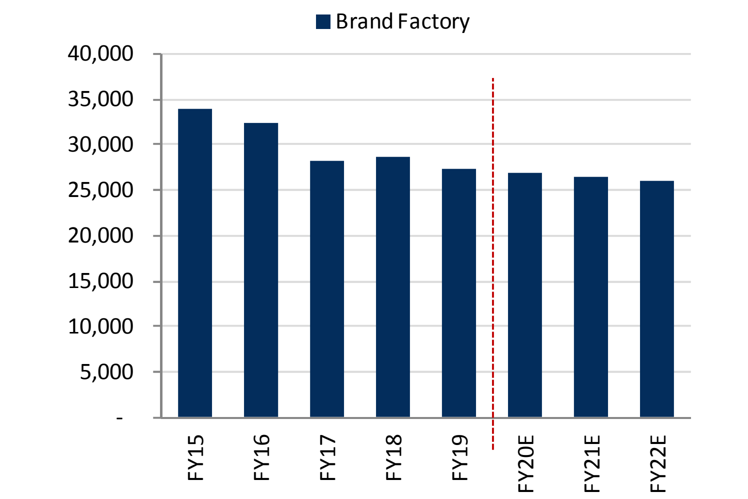
Building in 25+ store adds annually and 21% Area CAGR over FY19-22E

Brand Factory: Expect SSSG/productivity CAGR of 7/3% over FY19-22E



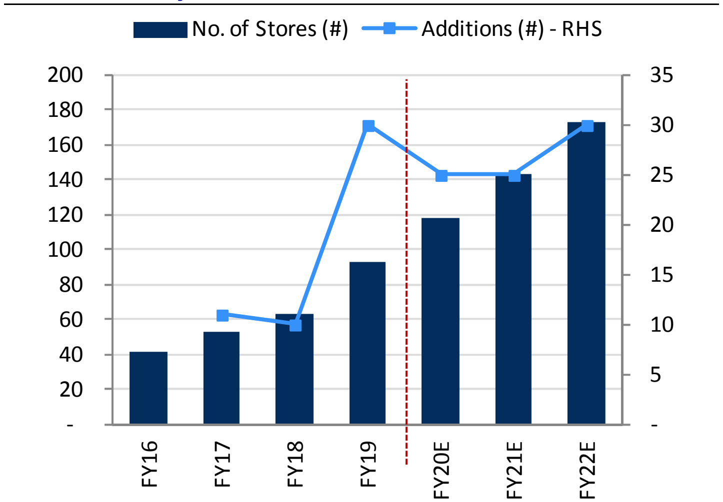
Source: Company, HDFC sec Inst Research

…partly aided by rightsizing of store sizes



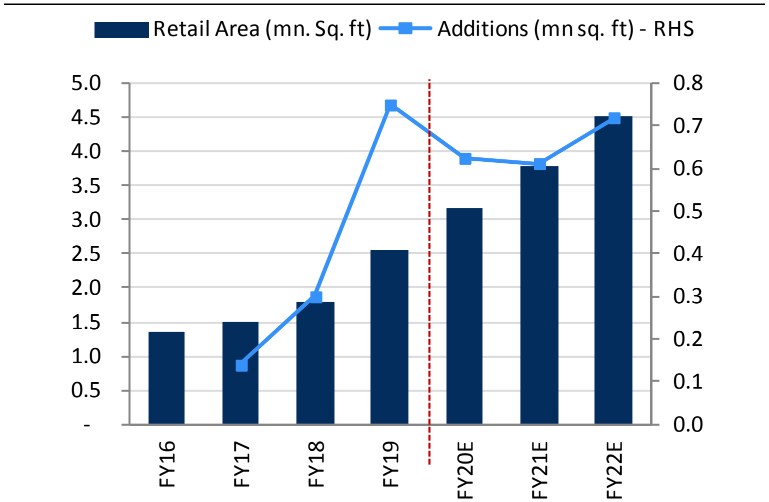
Source: Company, HDFC sec Inst Research

Expect 25+ store adds/yr vs 19 stores added cumulatively over FY17-19



Source: Company, HDFC sec Inst Research

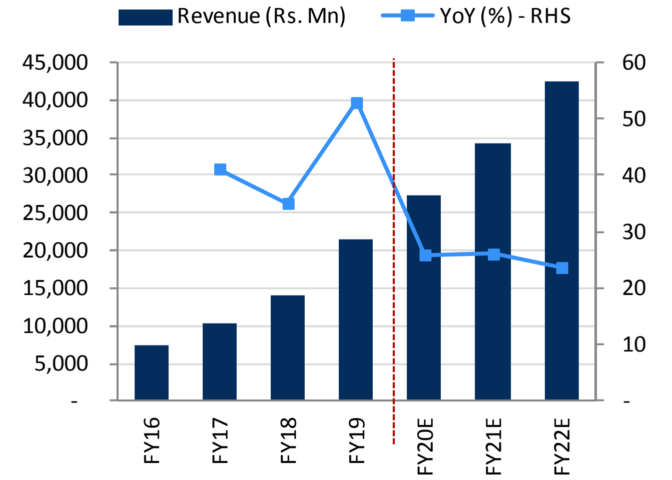
Building in a area CAGR of 21% over FY19-22E



Source: Company, HDFC sec Inst Research

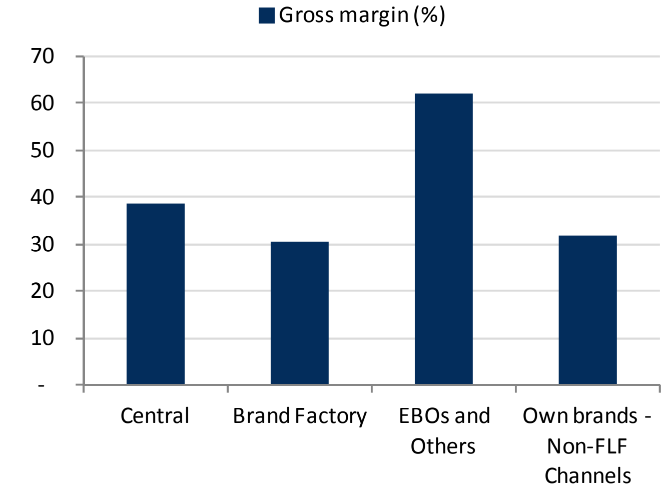
Building in 25% revenue CAGR over FY19-22

Building in 25% revenue CAGR for Brand Factory



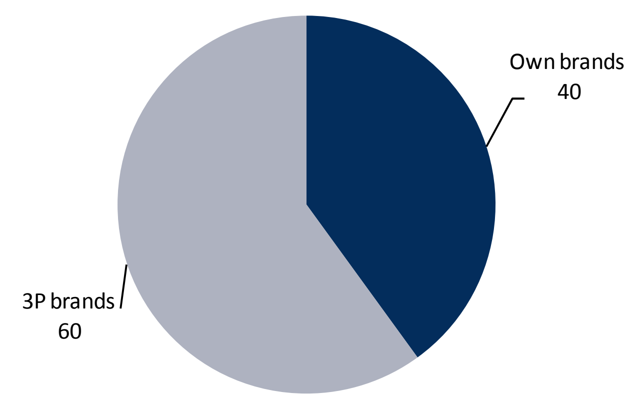
Source: Company, HDFC sec Inst Research

Format-wise gross margin profile



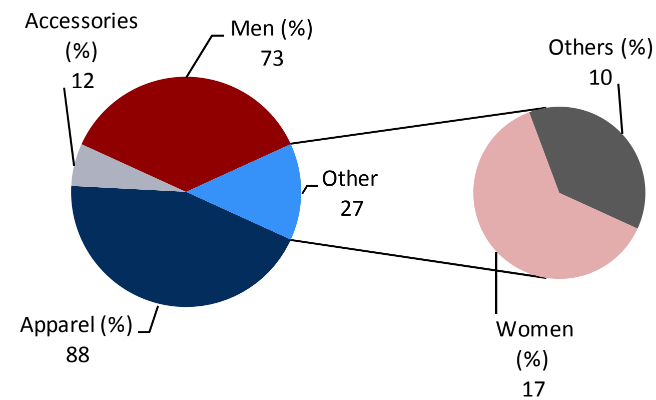
Source: Company, HDFC sec Inst Research

Own brands account for 40% of BF revenues



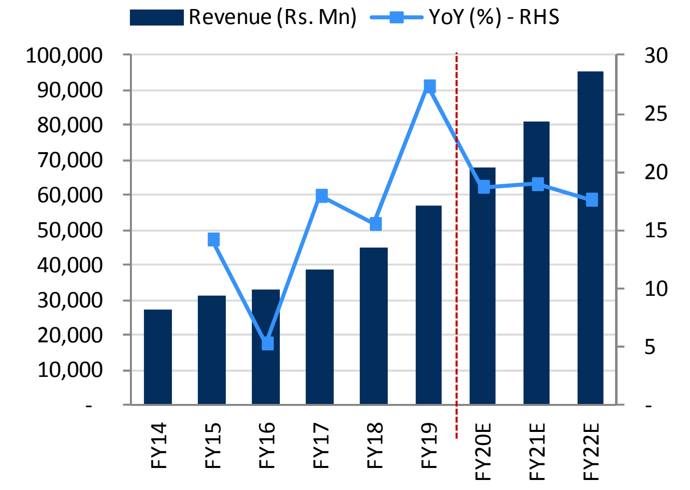
Source: Company, HDFC sec Inst Research

BF remains Men (category) heavy



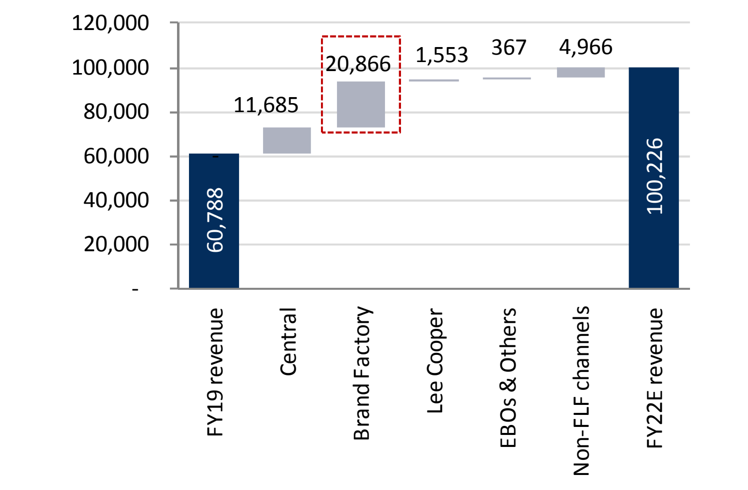
Source: Company, HDFC sec Inst Research

Building in 18% consol rev CAGR over FY19-22E



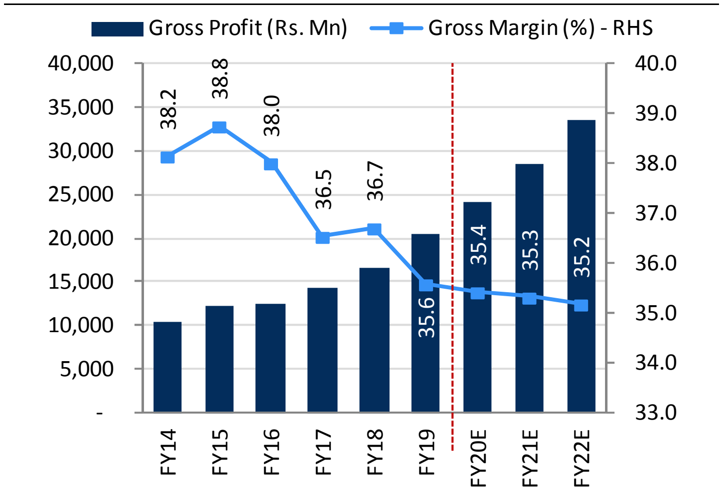
Source: Company, HDFC sec Inst Research

BF to be the biggest contributor to top-line growth



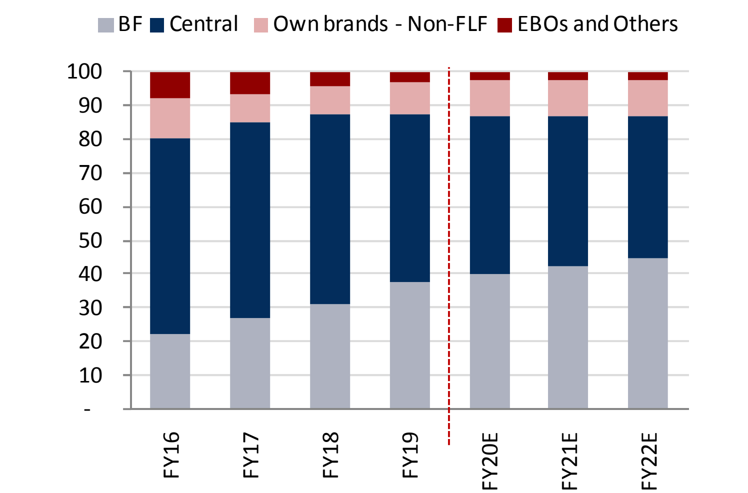
Source: Company, HDFC sec Inst Research

Overall GM to taper down as the BF skew increases over FY19-22E



Source: Company, HDFC sec Inst Research

BF revenue to constitute ~45% of FLFL's revenue from <38% currently



Source: Company, HDFC sec Inst Research

Power brands now account for ~28% of total sales growing at 16% CAGR

Investee brands provide optional value

We build in a largely stable EBITDA margin despite mix-led GM pressure. This is primarily as we expect superior sales velocity in BF and scale benefits in Central to make up for the GM loss

Power brands account for >60% of owned brands revenue (Rs mn)

	FY16	FY17	FY18	FY19	*CAGR
Lee Cooper	2,970	3,200	4,200	5,680	24
John Miller	1,360	1,018	1,332	1,810	10
All	1,100	1,200	1,300	1,690	15
Bare	980	872	1,166	2,010	27
Indigo Nation	940	1,018	999	1,770	23
Scullers	980	1,018	833	1,260	9
Jealous 21	860	727	666	980	4
Others	5,208	5,816	6,161	7,255	12

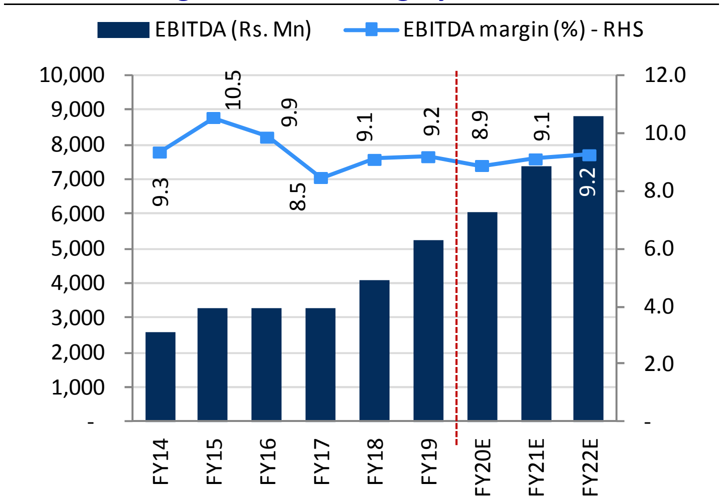
Source: Company, HDFC sec Inst Research, *FY16-19 CAGR (%)

Investee brands portfolio offer an option value. We don't value these given our of lack of understanding on FLFL's exit strategy for them

Investee brand	% stake	Categories
Giovani	96.0	Premium men's brand
Covery Story	90.0	Women's fast fashion
Mother Earth	72.2	Home décor, linen etc.
Spunk	60.0	Leisure wear
Mineral	56.5	Women's wear
Clarks	50.0	Footwear
Holii	50.0	Bags
Tresmode	33.3	Footwear
Famozi	30.0	Footwear
Desi Belle	27.5	Women's wear
Turtle	26.0	Men's wear
Peperone	12.0	Bags

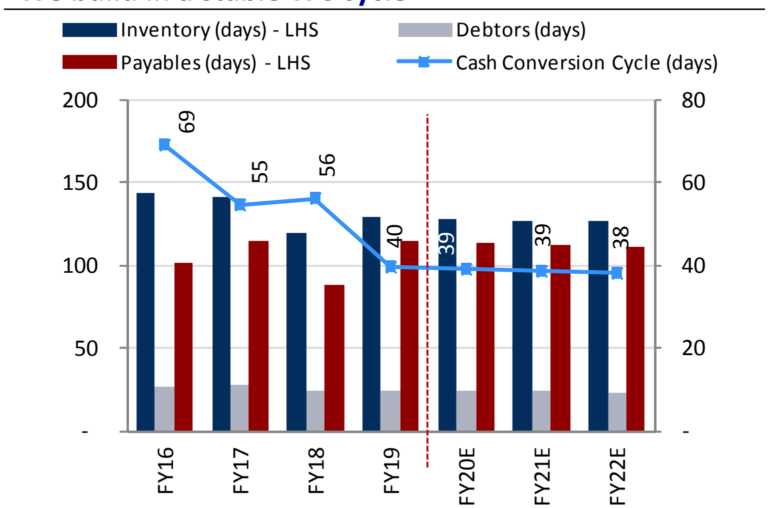
Source: Company, HDFC sec Inst Research

EBITDA margin to remain largely stable



Source: Company, HDFC sec Inst Research

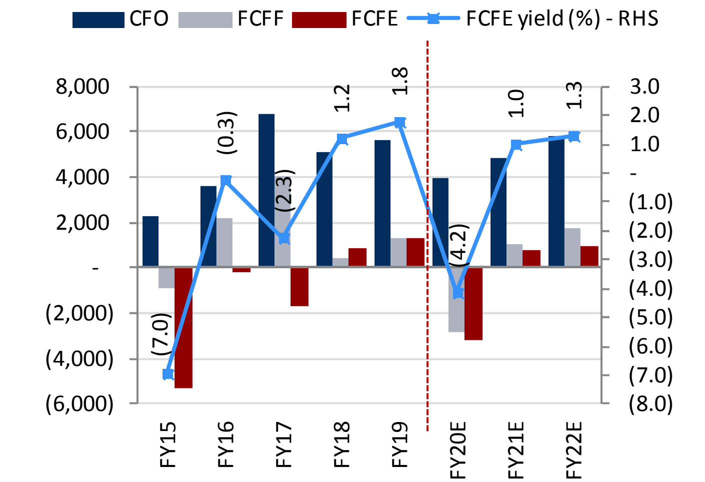
We build in a stable WC cycle



Source: Company, HDFC sec Inst Research

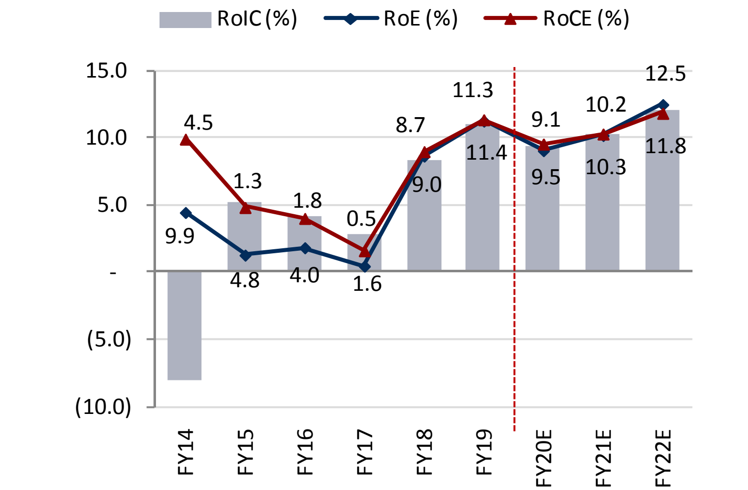
Note, the dip in FY20 FCF is a one-off as we build in stake purchase in Lee Cooper

Free cash generation expected to improve over FY20-22E



Source: Company, HDFC sec Inst Research

Return ratios to improve after an investment-heavy FY20



Source: Company, HDFC sec Inst Research

Central typically achieves full payback in Year 5, While Brand Factory does so between Year 4 & 5

Format-wise unit store economics

Per Sq. ft	Central FY19	BF FY19
Revenue	7,770	9,290
Gross Profit	2,991	2,834
GPM (%)	38.5	30.5
EBITDA	808	697
EBITDA margin (%)	10.4	7.5
Depreciation	233	279
EBIT	575	418
EBIT margin (%)	7.4	4.5
Capex	3,550	2,050
WC	650	1,140
Capital Employed	**4,200**	**3,190**
Post-Tax RoCE (%)	**11.0**	**9.8**
Payback (Yrs)	**5.2**	**4.6**

Source: Company, HDFC sec Inst Research

The Brand + Off Price Retail concoction reduces capital intensity of the model.

FLFL remains one of the leanest in terms of capital needs within our universe

FLFL's Brand + Retail model is one of the least demanding in terms of capital needs

Sources of funds (Rs bn)	FY15	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	3.5	3.4	4.1	4.1	5.3	20.4
Other Income	0.1	0.0	0.2	0.2	0.3	0.9
Total	**3.6**	**3.5**	**4.2**	**4.3**	**5.6**	**21.2**
Application of funds (Rs bn)						
Working Capital	1.2	(0.2)	(1.5)	(1.2)	0.0	(1.7)
Capex	3.2	1.4	2.7	4.6	4.3	16.3
Investments	(0.5)	0.2	(0.3)	0.0	1.4	0.8
Dividend	0.1	0.1	0.1	0.2	0.3	0.7
Borrowings	0.8	1.3	4.6	(1.0)	(1.2)	4.5
Others	0.8	1.1	(1.3)	1.6	0.0	2.2
Net change in cash	(2.1)	(0.5)	0.0	0.2	0.8	(1.5)
Total	**3.6**	**3.5**	**4.2**	**4.3**	**5.6**	**21.2**
Cumm. WC + Capex as % of sources of funds (FY15-18)						**68.5**

Source: Company, HDFC sec Inst Research

Future Lifestyle: Snapshot (Rs. Mn)

FLFL Snapshot (Rs. Mn)	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Revenue (Rs. Mn)	**31,341**	**33,002**	**38,928**	**44,980**	**57,281**	**68,013**	**80,903**	**95,166**
YoY (%)			*18.0*	*15.5*	*27.3*	*18.7*	*19.0*	*17.6*
Central revenue (Rs. Mn)		**19,110**	**22,740**	**25,130**	**28,590**	**32,015**	**36,006**	**40,275**
YoY (%)			*19.0*	*10.5*	*13.8*	*12.0*	*12.5*	*11.9*
-No. of stores (#)		31	35	40	44	49	54	59
-Retail Area (mn. Sq. ft)		3.2	3.5	3.7	4.0	4.4	4.8	5.2
-Avg. Store size (Sq. ft)		102,903	100,000	92,500	91,545	90,367	89,407	88,610
-Revenue per sq. ft (Rs.)		5,991	6,910	7,409	7,770	7,632	7,836	8,010
-SSSG (%)			*18.1*	*10.0*	*5.7*	*5.3*	*6.1*	*5.5*
-Expansion-led growth (%)			*0.75*	*0.47*	*7.61*	*6.32*	*6.02*	*5.98*
BF Revenue (Rs. Mn)		**7,400**	**10,450**	**14,120**	**21,600**	**27,211**	**34,320**	**42,466**
YoY (%)			*41.2*	*35.1*	*53.0*	*26.0*	*26.1*	*23.7*
-No. of stores (#)		42	53	63	93	118	143	173
-Retail Area (mn. Sq. ft)		1.4	1.5	1.8	2.6	3.2	3.8	4.5
-Avg. Store size (Sq. ft)		32,381	28,302	28,571	27,419	26,907	26,486	26,055
-Revenue per sq. ft (Rs.)		6,302	7,341	8,342	9,290	9,506	9,858	10,239
-SSSG (%)			*16.6*	*15.8*	*13.9*	*6.0*	*7.5*	*6.8*
-Expansion-led growth (%)			*21.1*	*16.6*	*34.4*	*18.8*	*17.4*	*15.8*
EBOs and Others revenue (Rs. Mn)		**2,610**	**2,610**	**1,920**	**1,770**	**1,810**	**1,945**	**2,137**
YoY (%)			*-*	*(26.4)*	*(7.8)*	*2.3*	*7.5*	*9.9*
-No. of stores (#)		296	284	229	202	212	222	234
-Retail Area (mn. Sq. ft)		0.5	0.4	0.3	0.2	0.3	0.3	0.3
-Avg. Store size (Sq. ft)		1,655	1,408	1,223	1,200	1,200	1,200	1,190
-Revenue per sq. ft (Rs.)		5,168	5,865	5,647	6,776	7,115	7,471	7,845
Own brands - Non-FLF Channels		**3,882**	**3,128**	**3,810**	**5,321**	**6,977**	**8,632**	**10,288**
YoY (%)			*(19.4)*	*21.8*	*39.7*	*31.1*	*23.7*	*19.2*
Gross Profit (Rs. Mn)	**12,147**	**12,547**	**14,226**	**16,514**	**20,387**	**24,098**	**28,580**	**33,487**
Gross Margin (%)		*38.0*	*36.5*	*36.7*	*35.6*	*35.4*	*35.3*	*35.2*
EBITDA (Rs. Mn)	**3,302**	**3,252**	**3,294**	**4,087**	**5,259**	**6,146**	**7,496**	**8,951**
EBITDA margin (%)	*10.5*	*9.9*	*8.5*	*9.1*	*9.2*	*9.0*	*9.3*	*9.4*
Total								
Retail Area (Rs. Mn)	**4.9**	**5.0**	**5.4**	**5.8**	**6.8**	**7.9**	**8.9**	**10.0**
Revenue per sq. ft	6,690	6,640	7,458	8,046	9,092	9,267	9,666	10,073
GP per sq. ft	2,593	2,524	2,725	2,954	3,236	3,284	3,415	3,544
EBITDA per sq. ft	705	654	631	731	835	837	896	947

Source: Company, HDFC sec Inst Research

Valuation

DCF

	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27	FY28	FY29	FY30
Revenue (INR m)	**80,903**	**95,166**	**110,844**	**128,085**	**146,482**	**165,814**	**186,130**	**207,465**	**229,878**	**253,234**
YoY	*19.0*	*17.6*	*16.5*	*15.6*	*14.4*	*13.2*	*12.3*	*11.5*	*10.8*	*10.2*
EBIT*(1-t)	3228	4113	4840	5877	6843	8150	9233	10807	12263	14236
Depreciation	3052	3302	3789	3989	4484	4584	5053	5061	5500	5379
Capex	-3799	-4054	-4302	-4595	-4631	-4628	-4971	-4971	-5010	-5049
Changes in WC (Winv)	-1677	-1828	-1980	-2145	-2250	-2322	-2396	-2470	-2548	-2535
FCFF	**804**	**1,532**	**2,347**	**3,126**	**4,447**	**5,784**	**6,920**	**8,427**	**10,205**	**12,031**
YoY (%)	*(126.8)*	*90.6*	*53.1*	*33.2*	*42.3*	*30.1*	*19.6*	*21.8*	*21.1*	*17.9*
Interest (1-t)	-1094	-1177	-1252	-1335	-1378	-1383	-1389	-1394	-1400	-1406
Net Borrowings	1200	800	1000	1000	0	0	0	0	0	0
FCFE	**910**	**1,156**	**2,095**	**2,791**	**3,068**	**4,401**	**5,531**	**7,033**	**8,805**	**10,625**
YoY (%)	*(130.2)*	*27.0*	*81.3*	*33.2*	*9.9*	*43.4*	*25.7*	*27.1*	*25.2*	*20.7*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
PV (FCFF)	**765**	**1,317**	**1,823**	**2,195**	**2,823**	**3,319**	**3,590**	**3,951**	**4,325**	**4,609**
Terminal Value										**224,713**

DCF Date	**Sep-20**
Kd*(1-t)	**7.5%**
Ke	**12%**
Net Debt (Mar-19E)	7,886
PV-Explicit Period	28,718
PV-Terminal Value	86,093
Equity Value - Consolidated (INR m)	**106,925**
Equity value per share (INR)	**550**
Sept-21 Implied EV/EBITDA (x)	14.2
Terminal growth rate (%)	5.0%
WACC	10.6%
CMP	**396**
Upside/(Downside)	**38.8%**

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Failure to renew agreements with brand owner	The Company has license to manufacture and market certain brands which include Manchester United, Lee Cooper, Daniel Hechter, UMM, Converse, John Miller, Bare, RIG, Spunk, Lombard, Buffalo, etc. Failure to renew such agreements or early termination will have an adverse impact on business operations and growth.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Kishore Biyani	Managing Director	Kishore Biyani is the founder and Group CEO of Future Group. He has over 26 years of experience and is known as the pioneer of modern retail in India.
Mr. Kaleeswaran Arunachalam	Chief Financial Officer	Mr. Arunachalam is qualified CA and MBA in Finance from Singapore and Bachelor of Commerce. He has overall experience of 15+ years and has gained extensive exposure and expertise in the various facets of the financial and accounting functions across the FMCG, retail and automotive industries both in India and abroad.
Mr. Vishnu Prasad	CEO - Central	Mr. Prasad has over 31 years of experience in sales and retail and has been associated with the Future Group since 2001. He was involved in setting up Big Bazaar stores in the south of the country before moving to FLFL to head the Central business.
Ms. Rachna Agarwal	CEO - FLFL Brands	Ms. Agarwal has over 23 years of experience in brand management and information system management. She has served as the Head of FLFL brands since 2008.
Mr. Suresh Sadhwani	Business head - Brand Factory	Mr. Sadhwani has headed the Brand Factory business since 2014 and has been instrumental in strategizing store expansions. He has over 21 years of experience in the retail business.
Mr. Krishna Thingbaijam	Head - Designing	Krishna Thingbaijam serves as the Head of Designing at Future Lifestyle Fashions Limited. He has had previously served as the Head of Designing at Future Retail Limited. He holds a PGDBM-NIFT.

Source: Company, HDFC sec Inst Research

Company profile

- Future Lifestyle Fashions (FLFL) is the flagship fashion business of Future Group. FLFL operates as an integrated fashion company in India. It primarily operates a chain of department retail format stores under the Central name and fashion discount stores under the Brand Factory name. FLFL was de-merged from the branded fashion business of Future Consumer Limited (erstwhile Future Ventures India Limited) and the Lifestyle Fashion business of Future Retail. FLFL commenced operations in May 2013.
- The company's stores offer men's formals, casuals, youth wear, women's western wear, women's ethnic, sportswear, infant wear, accessories, footwear, luggage, and others; and cosmetics, fragrances, eyewear, watches, accessories, sportswear, toys, mobiles, electronics, home, and others. It offers its products under the COVER STORY, aLL, UMM, Lee Cooper, Bare, Scullers, RIG, Converse, Spalding, Daniel Hechter, Lombard, Urban Yoga, Mohr, Jealous 21, John Miller, Famozi, Desi Belle, Urbana, Mother Earth, Trèsmode, GIOVANI, Mor Pankh, Peperone, MINERAL, Celio, CERIZ, and Hey! brands.
- The company distributes its products through its exclusive brand outlets, department stores, multi brand outlets, and retail chains, as well as through e-commerce sites. It operates 48 Central stores, 100 Brand Factory outlets, and 202 exclusive brand outlets covering 7.3 mn sq ft of retail space.

Income Statement (Consolidated)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues	**44,980**	**57,281**	**68,013**	**80,903**	**95,166**
Growth (%)	***15.5***	***27.3***	***18.7***	***19.0***	***17.6***
COGS	28,466	36,894	43,914	52,324	61,679
Employee Expense	2,649	3,308	3,868	4,567	5,337
A&P Expense	1,107	1,495	1,765	2,087	2,440
Rent Expense	4,528	5,499	6,613	7,693	8,897
Other Expenses	4,143	4,826	5,816	6,866	8,014
EBITDA	**4,087**	**5,259**	**6,037**	**7,366**	**8,798**
EBITDA Growth (%)	***24.1***	***28.7***	***14.8***	***22.0***	***19.4***
EBITDA Margin (%)	***9.1***	***9.2***	***8.9***	***9.1***	***9.2***
Depreciation	1,539	2,071	2,577	3,052	3,302
EBIT	**2,548**	**3,188**	**3,460**	**4,314**	**5,496**
Other Income (Including EO Items)	341	383	411	459	531
Interest	1,033	1,168	1,320	1,462	1,573
PBT	**1,856**	**2,403**	**2,550**	**3,310**	**4,455**
Total Tax	586	465	642	833	1,121
RPAT before share of associate earnings	**1,271**	**1,937**	**1,908**	**2,477**	**3,333**
Share of associate earnings	(10)	(48)	(48)	(48)	(48)
Minority share of Profit/(Loss)	-	-	-	-	-
RPAT	**1,261**	**1,890**	**1,861**	**2,429**	**3,286**
Exceptional (Gain)/loss	-	-	-	-	-
Adjusted PAT	**1,261**	**1,890**	**1,861**	**2,429**	**3,286**
APAT Growth (%)	***1,651.2***	***49.9***	***(1.5)***	***30.6***	***35.3***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	381	389	402	402	402
Reserves	14,915	17,881	22,388	24,481	27,329
Total Shareholders Funds	**15,296**	**18,270**	**22,790**	**24,884**	**27,731**
Minority Interest	**0**	**0**	**0**	**0**	**0**
Long Term Debt	6,123	6,733	7,931	9,131	9,931
Short Term Debt	1,711	2,303	2,078	2,078	2,078
Total Debt	**7,834**	**9,036**	**10,009**	**11,209**	**12,009**
Net Deferred Taxes	**(392)**	**(283)**	**(283)**	**(283)**	**(283)**
Other Non-current Liabilities & Provns	**50**	**63**	**63**	**63**	**63**
TOTAL SOURCES OF FUNDS	**22,788**	**27,086**	**32,579**	**35,872**	**39,519**
APPLICATION OF FUNDS					
Net Block	9,245	12,737	13,918	14,665	15,417
CWIP	2,905	1,578	1,578	1,578	1,578
Other Non-current Assets	1,749	2,526	5,526	5,526	5,526
Total Non-current Assets	**13,899**	**16,842**	**21,023**	**21,770**	**22,522**
Inventories	14,829	20,315	23,934	28,249	32,968
Debtors	3,032	3,903	4,541	5,291	6,093
Other Current Assets	4,959	7,043	8,176	9,504	10,919
Cash & Equivalents	**874**	**2,221**	**2,123**	**2,992**	**4,059**
Total Current Assets	**23,694**	**33,481**	**38,774**	**46,036**	**54,039**
Creditors	10,932	17,999	21,185	24,978	29,121
Other Current Liabilities & Provns	3,872	5,238	6,033	6,955	7,921
Total Current Liabilities	**14,804**	**23,237**	**27,218**	**31,933**	**37,042**
Net Current Assets	**8,889**	**10,244**	**11,556**	**14,102**	**16,998**
TOTAL APPLICATION OF FUNDS	**22,788**	**27,086**	**32,579**	**35,872**	**39,519**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	1,261	1,890	2,550	3,310	4,455
Non-operating & EO Items	1,184	605	(458)	(506)	(579)
Interest Expenses	586	1,168	1,320	1,462	1,573
Depreciation	1,539	2,071	2,577	3,052	3,302
Working Capital Change	967	350	(1,410)	(1,677)	(1,828)
Tax Paid	(456)	(463)	(642)	(833)	(1,121)
OPERATING CASH FLOW (a)	**5,081**	**5,622**	**3,938**	**4,809**	**5,801**
Capex	(4,614)	(4,313)	(6,758)	(3,799)	(4,054)
Free Cash Flow (FCF)	*467*	*1,309*	*(2,820)*	*1,009*	*1,747*
Investments	(10)	(1,361)	-	-	-
Non-operating Income	(253)	(605)	411	459	531
INVESTING CASH FLOW (b)	**(4,877)**	**(6,280)**	**(6,347)**	**(3,341)**	**(3,523)**
Debt Issuance/(Repaid)	183	34	(347)	(262)	(773)
FCFE	*650*	*1,343*	*(3,168)*	*747*	*974*
Share Capital Issuance	4	1,710	3,000	-	-
Dividend	(183)	(281)	(341)	(336)	(439)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**4**	**1,462**	**2,311**	**(598)**	**(1,211)**
NET CASH FLOW (a+b+c)	**209**	**805**	**(98)**	**869**	**1,067**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	452	1,256	1,158	2,027	3,094

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	36.7	35.6	35.4	35.3	35.2
EBITDA Margin	9.1	9.2	8.9	9.1	9.2
EBIT Margin	5.7	5.6	5.1	5.3	5.8
APAT Margin	2.8	3.3	2.7	3.0	3.5
RoE	8.7	11.3	9.1	10.2	12.5
RoIC (or Core RoCE)	8.3	11.0	9.4	10.2	12.0
RoCE	9.0	11.4	9.5	10.3	11.8
EFFICIENCY					0.5
Tax Rate (%)	31.6	19.4	25.2	25.2	25.2
Fixed Asset Turnover (x)	4.1	3.6	3.4	3.4	3.4
Inventory (days)	*120*	*129*	*128*	*127*	*126*
Debtors (days)	*25*	*25*	*24*	*24*	*23*
Other Current Assets (days)	*40*	*45*	*44*	*43*	*42*
Payables (days)	*89*	*115*	*114*	*113*	*112*
Other Current Liab & Provns (days)	*31*	*33*	*32*	*31*	*30*
Cash Conversion Cycle (days)	65	51	51	50	50
Net Debt (Rs mn)	6,960	6,815	7,886	8,216	7,949
Net D/E (x)	0.5	0.4	0.3	0.3	0.3
Interest Coverage (x)	2.5	2.7	2.6	2.9	3.5
PER SHARE DATA (Rs)					
EPS	6.6	9.7	9.3	12.1	16.3
CEPS	14.7	20.4	22.1	27.3	32.8
Book Value	80.3	93.9	113.4	123.8	137.9
VALUATION					
P/E (x)	61.3	41.8	43.9	33.6	24.8
P/BV (x)	5.1	4.3	3.6	3.3	2.9
EV/EBITDA (x)	20.6	16.0	14.1	11.6	9.7
EV/Revenues (x)	1.9	1.5	1.3	1.1	0.9
OCF/EV (%)	6.0	6.7	4.6	5.6	6.8
FCF/EV (%)	0.6	1.6	(3.3)	1.2	2.0
FCFE/Mkt Cap (%)	0.8	1.7	(4.1)	1.0	1.3

Source: Company, HDFC sec Inst Research

TCNS Clothing

BUY

Getting the troika right!

TCNS Clothing (TCNS) has been one of the biggest beneficiaries of the unorganized to organized shift in Ethnic wear. Top 5 Women ethnic wear retailers account for mere 7% of the category. TCNS remains a market leader and the fastest growing ethnic wear outfit (47% CAGR over FY14-19) in India outpacing even Industry pioneers, some of whom may have out-priced themselves from the market over the years. The underpinnings of TCNS' success lies in it getting the holy grail/troika of retailing right – Pricing, Assortment and distribution.

1. Our SKU analysis suggests that TCNS sports the sharpest price points across key ethnic categories. 2. On distribution too, the outfit has managed to tread the expansion-unit store economics equation better than most. 3. Expansion remains asset-light. These inputs feed into industry-leading asset turnover.

We bake in revenue/EBITDA/PAT CAGR of 14/14/12% over FY19-22E with a steady adj. return profile (RoCE: 20%) over FY20-22E given category tailwinds and TCNS' execution skills. Initiate coverage on TCNS with a BUY recommendation and a DCF-based TP of Rs 770/sh implying a P/E of 29x Sept-21 earnings/21x EV/EBITDA.

Investment rationale

- **Best placed on assortment; peers to play catch up**: Our SKU Analysis suggests that W/Aurelia offer the sharpest priced assortment with 62/89% of SKUs priced <Rs. 1000 respectively. Variety on offer is also one of the highest in the category. This makes TCNS' offerings attract a larger target group. This is an important cog in the company's flywheel and explains why TCNS found acceptance across channels. (EBO/LFS/MBO/Online revenue CAGR of 40/56/39/54% over FY14-19). It also explains why the company has managed to have an EBO distribution scale which is 2-6x that of peers across income groups in a short span of time. While some peers are expected to play catch up, we reckon TCNS too will continue milking the large ethnic wear opportunity. We bake in 65-75 EBO and 170-200 LFS door additions annually over FY19-22E. This should help TCNS clock a revenue CAGR of ~14% over the same period.
- **Denser store network lends multiple edges:** TCNS (W + Aurelia) sports a denser network vs peers. There are multiple edges TCNS enjoys because of this - 1. Higher top-of-the-mind recall for its brands, reflects in similar-to-marginally higher productivity despite a higher Tier 2/3 presence vs peers 2. Becomes a more potent omni-asset with seamless inter-store stock movement capabilities 3. Catchment-specific sourcing benefits increase with store density. While we build steady EBO/LFS productivity over FY19-22E, TCNS' store density arbitrage could help spring a positive surprise (in productivity) in the long-term.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	11,480	12,798	14,938	17,167
EBITDA	1,932	1,983	2,273	2,694
APAT	1,478	1,428	1,606	1,893
Dil. EPS (Rs/sh)	23.2	22.2	24.9	29.3
P/E (x)	30.8	32.0	28.7	24.3
EV/EBITDA (x)	21.7	18.3	15.1	12.4
ROE (%)	28.2	20.8	19.3	19.4
RoIC (%)	33.8	27.9	27.6	29.0
ROCE (%)	28.6	21.2	19.5	19.6

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 682**
Target Price	**Rs 770**
Nifty	11,922
Sensex	40,445
KEY STOCK DATA	
Bloomberg	TCNSBR IN
No. of Shares (mn)	61
MCap (Rs bn) / ($ mn)	42/589
6m avg traded value (Rs mn)	8
STOCK PERFORMANCE (%)	
52 Week high / low	**Rs 870/607**

	3M	6M	12M
Absolute (%)	4.1	(19.3)	3.4
Relative (%)	(5.2)	(21.6)	(11.1)

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	32	32.32
FIs & Local MFs	8.56	10.09
FPIs	12.83	12.74
Public & Others	46.23	44.85
Pledged Shares	0	0

Source : BSE

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- **Institutionalized design process reduces fashion risk:** Unlike traditional ethnic wear brands, TCNS' design process is mitigates fashion risk by institutionalizing the design process, having strong feedback loop via regular trade shows and an experienced design team. This is amply reflected in the company's successful design launches (last poor season in FY12). Moreover, TCNS refreshes its products every two–three weeks, which helps it garner more footfalls and reduce design duds quickly. Hence, it also sports a relatively faster inventory cycle vs immediate peers. In the long-run, the high gross margin ethnic wear category may attract competition from both online and offline folks. However, the sheer under-penetration of the organized play should help perpetuate growth stories of strong brand plays such as TCNS (W, Aurelia).

  …Moreover, in the current phase of online evolution, most online folks are focusing on increasing brand tie-ups and on apparel categories with a simpler supply chain to reduce their burgeoning fulfillment cost. This should keep ethnic fusion wear off-limits for a while given its complicated supply chain.

- **Undemanding capital needs to keep free cash generation healthy:** While margins should remain under pressure in FY20 given the stress in the MBO channel (most profitable channel) and the general slowdown, a partial margin recoup could be expected over FY19-22E as volume recovers in the MBO channel. That said, TCNS' capital needs remain low as it operates on an asset light expansion model – LFS/MBO expansion requires no capex. In the case of MBOs/online/franchised EBOs, inventory is sold outright, hence these channel are WC-light too. This should keep free cash generation healthy. We expect TCNS to generate a cumulative FCFE of ~Rs.2.4bn and a largely steady return profile over FY20-22E.

- **Strong brand equity warrants premium:** We bake in revenue/EBITDA/PAT CAGR of 14/14/12% over FY19-22E with a steady adj. return profile (RoCE: ~20%) given category tailwinds and TCNS' better execution skills. Initiate coverage on TCNS with a BUY recommendation and a DCF-based TP of Rs 770/sh implying a P/E of 29x Sept-21 earnings/21x EV/EBITDA.

- **Key Risks:** 1. While Ethnic fusion wear's complex supply chain may keep online folks away for a while, it is a high gross margin product and therein lies the opportunity to disrupt. 2. Fashion Risk remains, 3. Peers catch up to TCNS' designs, pricing and distribution faster than expected.

Story in Charts

TCNS scores over peers on Pricing, Assortment and distribution per our SKU analysis and on our PCI-Population density map.

In one of the biggest segment of Ethnic wear, Kurtis, TCNS has the sharpest price points. ~97% of SKUs in Aurelia is retailed at <Rs. 1000 – TCNS' contemporary Indian wear offering

...Ditto for Salwar Churidar, while Biba is evenly placed in this segment in terms of pricing.

Channel checks suggest that Biba has stepped up its focus on Rangriti - its entry point offering to catch up with Aurelia

FabIndia seems to have outpriced itself from the market, which is also reflected in its top-line growth. Top-line growth has been stagnant over FY18.

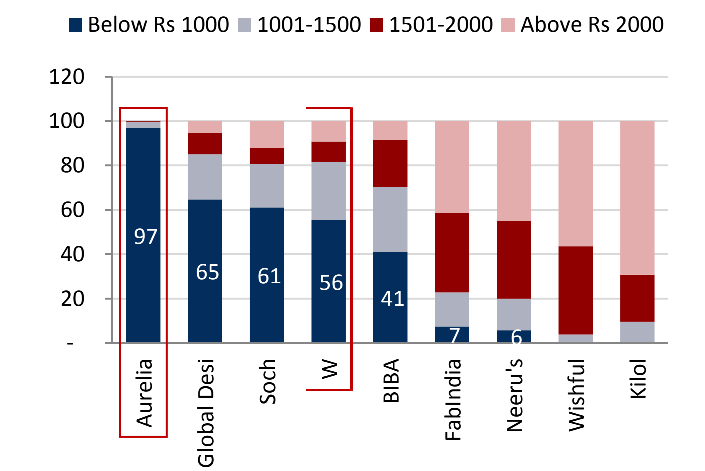
The Assortment Edge

Across Ethnic categories, TCNS sharpest priced

SKU (%)	< Rs 1000	Rs.1001-1500	Rs.1501-2000	>Rs 2000
TCNS	**68**	**17**	**8**	**8**
Aurelia	**89**	**5**	**4**	**2**
W	**62**	**24**	**7**	**7**
Wishful	**23**	**16**	**27**	**35**
Global Desi	67	19	8	6
BIBA	39	18	14	30
Soch	38	18	7	37
Kilol	25	21	19	34
FabIndia	11	9	22	58
Neeru's	3	7	17	73

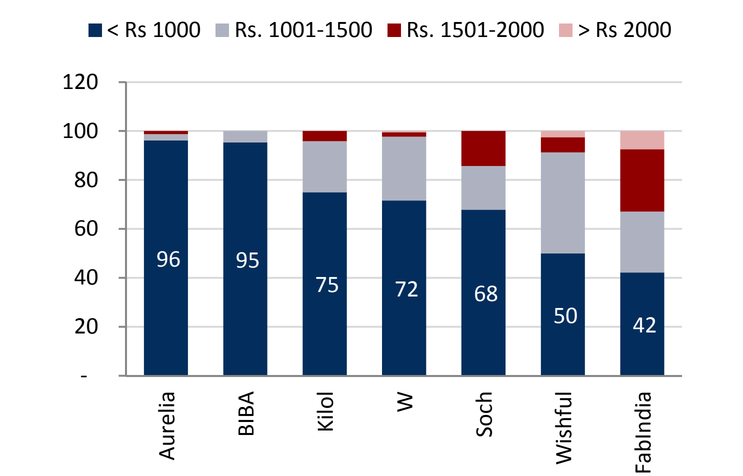
Source: Company, HDFC sec Inst Research

Price-wise SKU break-up (%) for Kurtis



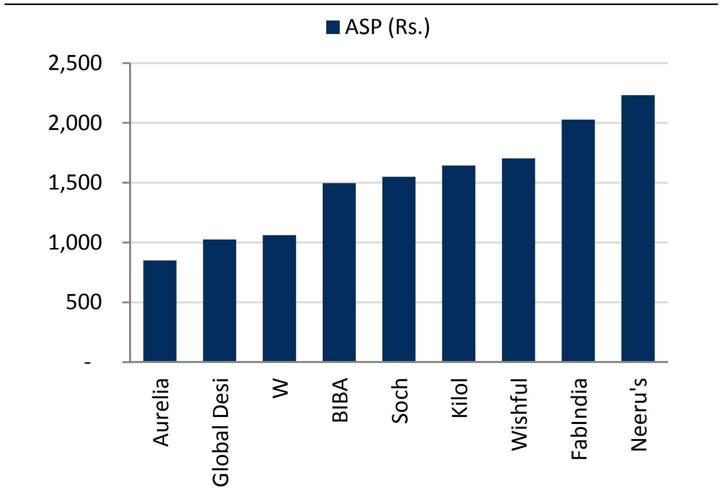
Source: Company websites, HDFC sec Inst Research

Aurelia and Biba competitively priced in Salwar Churidar



Source: Company, HDFC sec Inst Research

W/Aurelia beat peers in pricing



Source: Company, HDFC sec Inst Research

What does this mean?

The denser network helps a retailer/brand in many ways:

1. ***Becomes a better omni-asset, as can be sweated more. An assortment shortfall in Store A can be fulfilled via store B***
2. ***There could be potential catchment-specific sourcing benefits given the scale***
3. ***Increases Top-of-the-Mind Recall***

The Distribution Edge

TCNS scores on store-density viz-a-viz peers

Store Distribution (%) PCI/population density	W	Aurelia	Fab India	BIBA	Soch	Anokhi	Global Desi	Neerus	AND	Kilol
<100K	**2.1**	**2.1**	**1.5**	**1.8**	**1.6**	**1.0**	**1.3**	**1.0**	**1.1**	
<500	1.0	2.0	1.5	1.3	1.0	1.0	1.0		1.0	
1000-3000	2.4	2.3	1.4	1.9	2.0	1.0	1.4	1.0	1.2	
3000-5000	6.0	2.0	3.0	4.0			1.0		1.0	
500-1000	1.0	1.0	1.0	1.0	1.0					
100-150K	**1.9**	**1.4**	**1.6**	**1.5**	**1.5**	**2.0**	**1.2**	**1.0**	**1.1**	**1.0**
<500	1.3	1.2	1.4	1.3	1.6		1.0	1.0	1.0	
1000-3000	2.0	1.0	1.0	1.0					1.0	
3000-5000	1.0		1.0				1.0		1.0	
500-1000	3.3	2.0	2.2	2.2	1.0	2.0	1.5		1.3	1.0
150-200K	**2.1**	**2.0**	**2.2**	**2.0**	**1.9**	**1.0**	**1.7**	**1.0**	**1.8**	**1.0**
<500	1.1	1.0	1.2	1.2	1.0		1.0	1.0	1.0	
1000-3000	1.5	1.5	1.0	1.0	2.0					
5000+	10.0	6.0	13.0	9.5	5.5	1.0	4.0	1.0	4.0	1.0
500-1000	1.3	1.0	1.2	1.6	1.2		1.3		1.2	1.0
200-250K	**2.2**	**2.1**	**2.1**	**2.2**	**1.5**	**1.0**	**1.2**	**1.0**	**1.3**	
<500	3.0	2.0	1.0	2.0			1.0		1.0	
1000-3000	3.0	3.0	2.0	3.5	1.5		1.0	1.0	1.0	
500-1000	1.8	1.7	2.7	1.8	1.5	1.0	1.5	1.0	2.0	
250-300K	**5.0**	**4.0**	**5.7**	**4.0**	**2.0**	**1.0**	**5.0**	**1.0**	**2.0**	
<500	1.0	1.0	1.0	1.0	1.0					
1000-3000	3.0	3.0	9.0	3.0	1.5	1.0			1.0	
500-1000	11.0	8.0	7.0	8.0	4.0	1.0	5.0	1.0	3.0	
300-500K	**11.0**	**8.2**	**13.0**	**10.8**	**15.3**	**2.0**	**9.3**	**1.0**	**10.0**	**1.0**
<500	1.0	1.0	1.0	1.0	2.0					
1000-3000	3.0	2.0	2.0	2.0			1.0		1.0	
3000-5000	22.0	21.0	32.0	20.0	32.0	3.0	15.0	1.0	16.0	1.0
5000+	14.5	8.5	20.5	20.5	13.5	1.5	10.5	1.0	11.5	1.0
500-1000			2.0	1.0						
500K+	**18.0**	**10.0**	**40.0**	**12.7**	**4.0**	**2.7**	**7.0**	**1.0**	**5.3**	**1.0**
1000-3000	6.5	4.5		5.5		1.5	2.5		2.5	1.0
5000+	41.0	21.0	40.0	27.0	4.0	5.0	16.0	1.0	11.0	1.0
Grand Total	**3.5**	**2.9**	**3.6**	**3.0**	**3.3**	**1.6**	**2.6**	**1.0**	**2.7**	**1.0**

Source: Company, HDFC sec Inst Research

While the CC cycle is slightly elevated vs select peers given the higher receivables from LFS/MBOs, TCNS more that makes up for the heavier WC need by its asset-light expansion.

Interestingly, over the last 5 years, cash conversion cycle for most has been inching up, while that for TCNS has been shrinking. The WC quality has also improved over the years, as payable support has reduced for TCNS

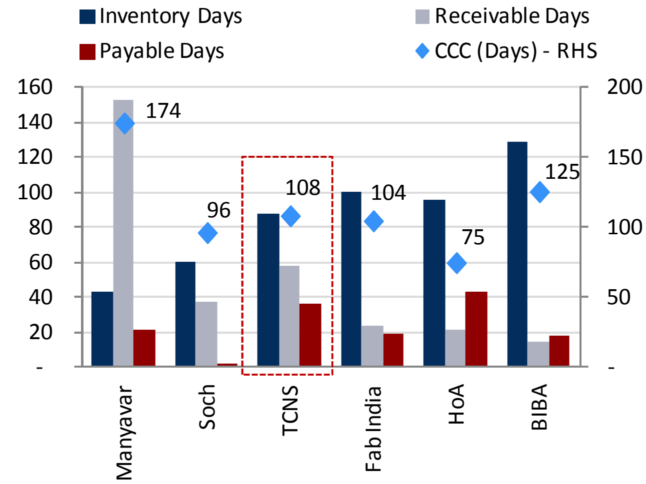
Biba seems to be in trouble with working capital bloating each passing year.

Manyavar predominantly operates in the Men's ethnic space. Hence, not strictly comparable.

Note: Despite sharper prices, TCNS enjoys amongst the highest gross margins in the industry, implying better scale-led sourcing benefits vs peers

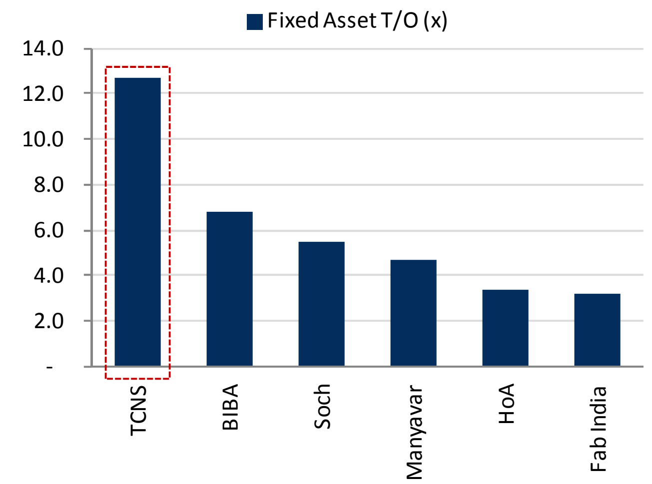
That said, high operational cost structure makes the category itself vulnerable to disruption from online as well as deep-pocketed offline peers with aggressive ambitions to expand in this category

Retailer-wise cash conversion cycle



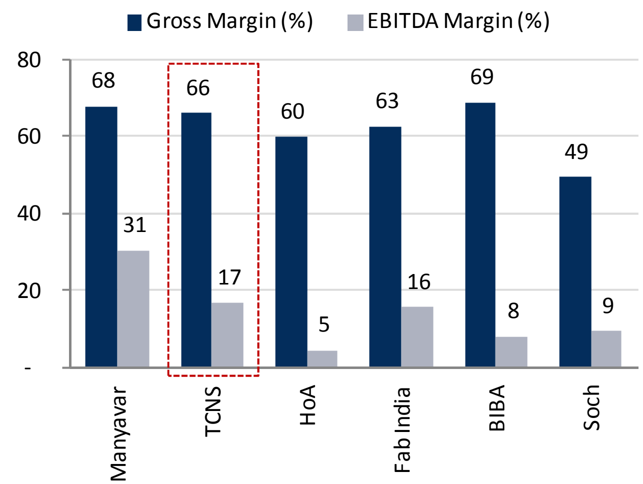
Source: Company, HDFC sec Inst Research

Retailer-wise Fixed Asset Turnover



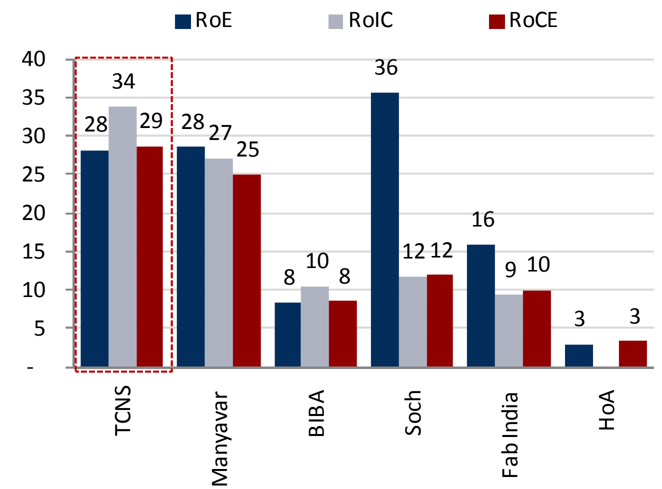
Source: : Company, HDFC sec Inst Research

TCNS enjoys among the best margins in the category



Source: Company, HDFC sec Inst Research

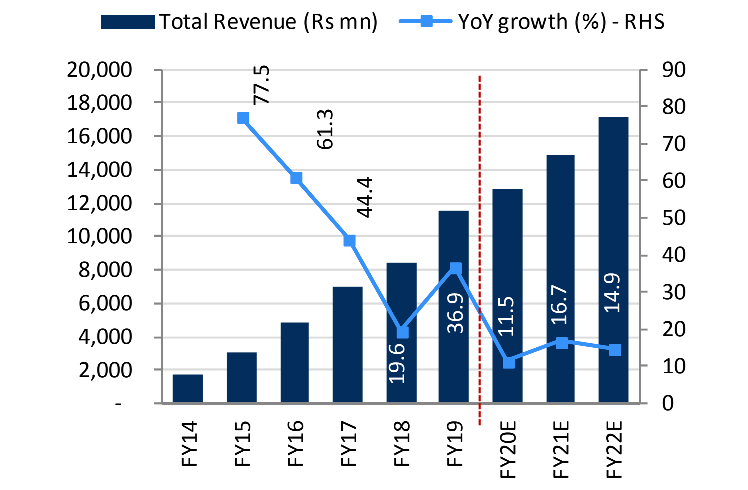
TCNS: Best-in-class return profile



Source: : Company, HDFC sec Inst Research

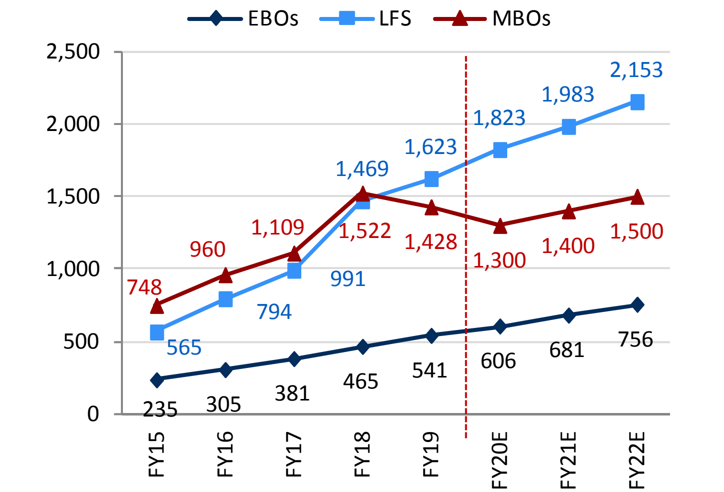
Growth is primarily expected to be underpinned by expansion

Expect revenue to grow at CAGR of 14% over FY19-22E



Source: Company, HDFC sec Inst Research

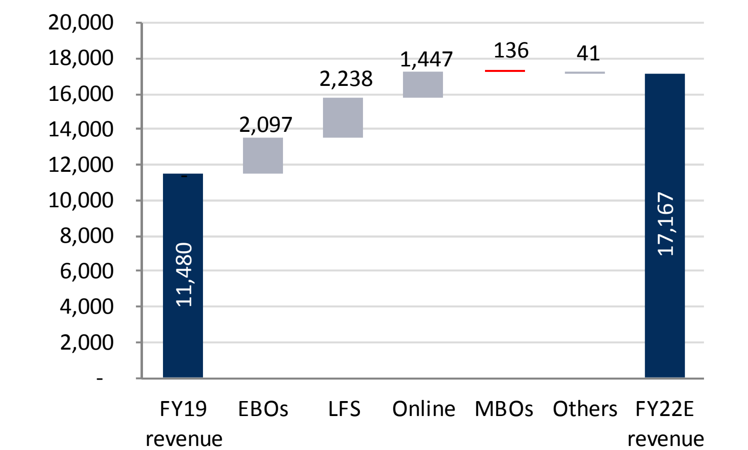
Expect 215 EBO; 530 LFS additions over FY19-22E



Source: : Company, HDFC sec Inst Research

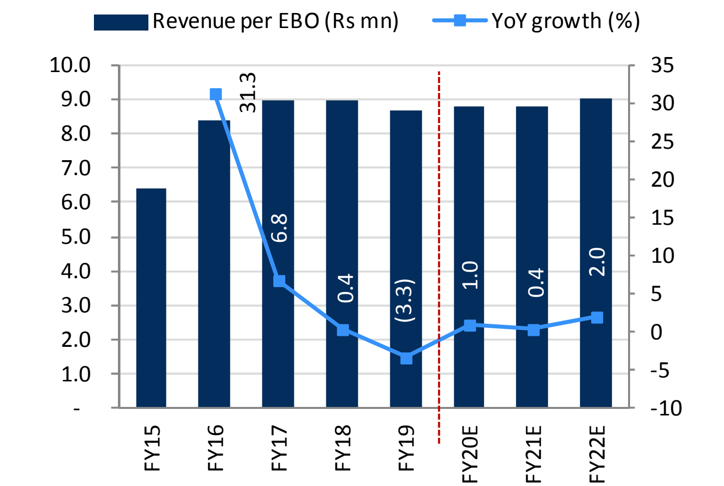
Building in a marginal productivity increase across channels

EBOs/LFS to account for bulk of the growth, online to be the fastest growing channel



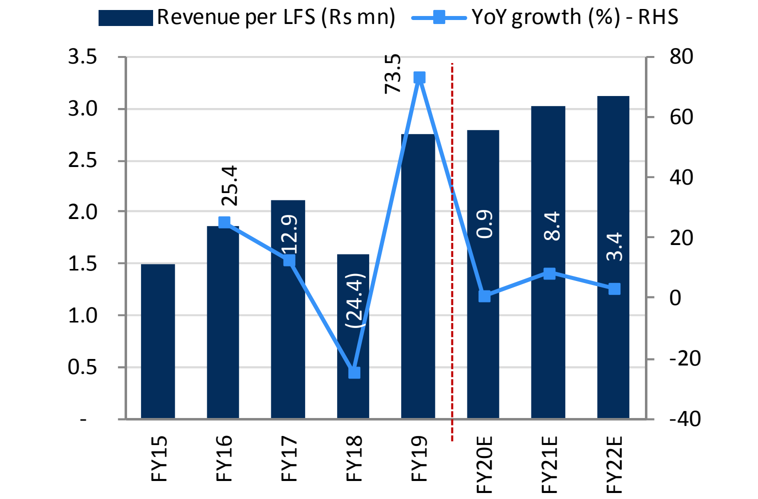
Source: Company, HDFC sec Inst Research

EBO productivity to marginally inch up FY21 onwards



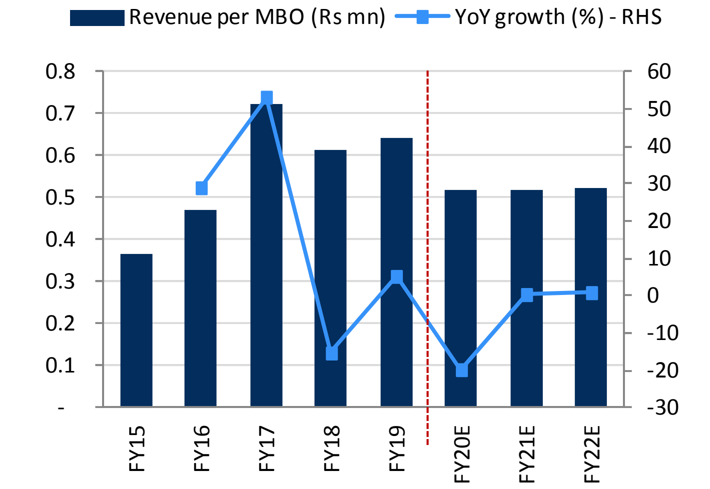
Source: : Company, HDFC sec Inst Research

LFS to show steady rise in productivity too



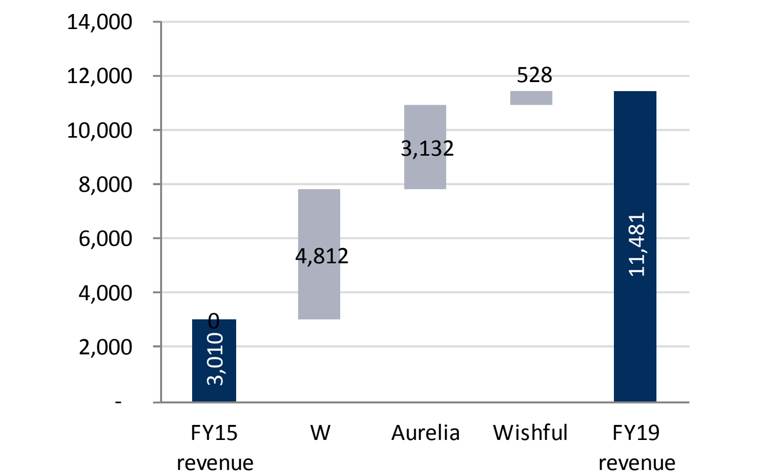
Source: Company, HDFC sec Inst Research

MBO productivity to remain soft given the liquidity squeeze in the channel



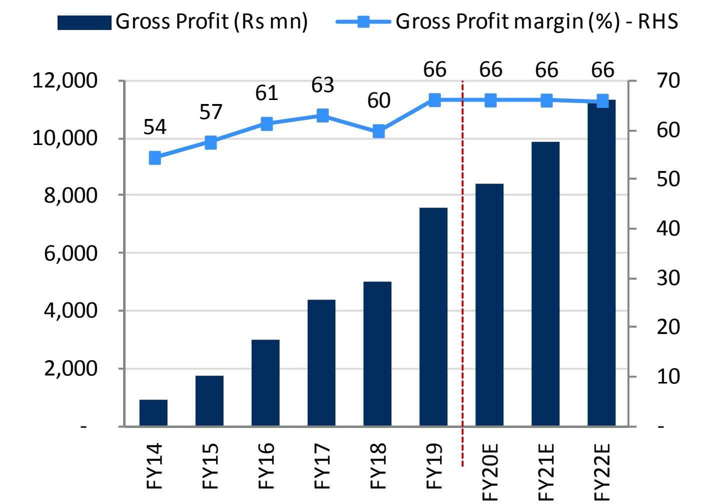
Source: : Company, HDFC sec Inst Research

W/Aurelia remain tent-pole brands for TCNS



Source: Company, HDFC sec Inst Research

Expect steady gross margins over FY19-22E



Source: : Company, HDFC sec Inst Research

Expect reported EBITDA margins to inch up as lost MBO volumes return over FY19-22E

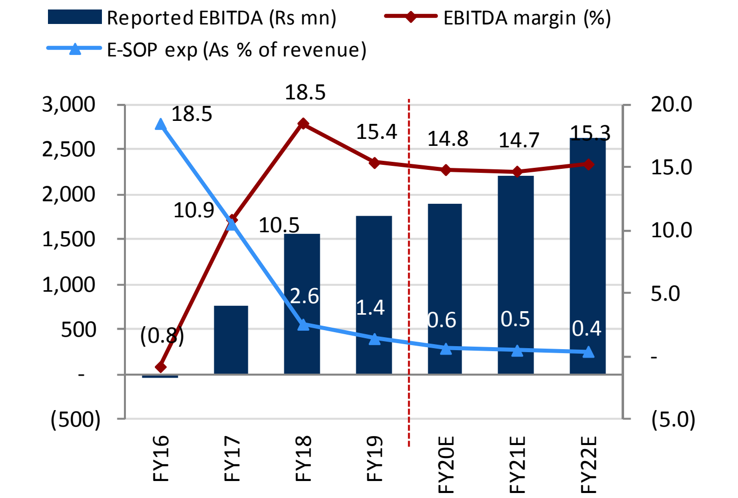
TCNS has been stepping up manufacturing outside the high-cost NCR region. We believe sourcing gains from this would be passed on to consumers. (non-NCR production is now estimated to contribute ~12% of total production)

This in turn may stoke up SSSG, ergo some operating leverage benefits could accrue too

A typical TCNS EBO achieves payback within 18-20 months

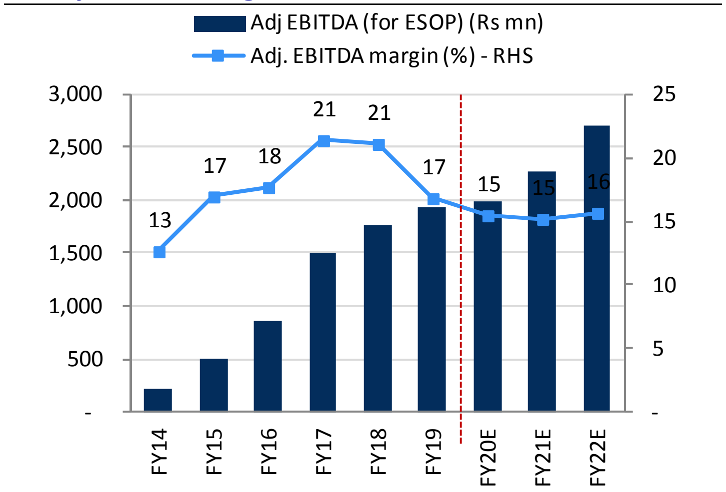
Remains a net cash company

Expect a partial margins recoup over FY20-22E



Source: Company, HDFC sec Inst Research

...Adj. EBITDA to grow at 12%



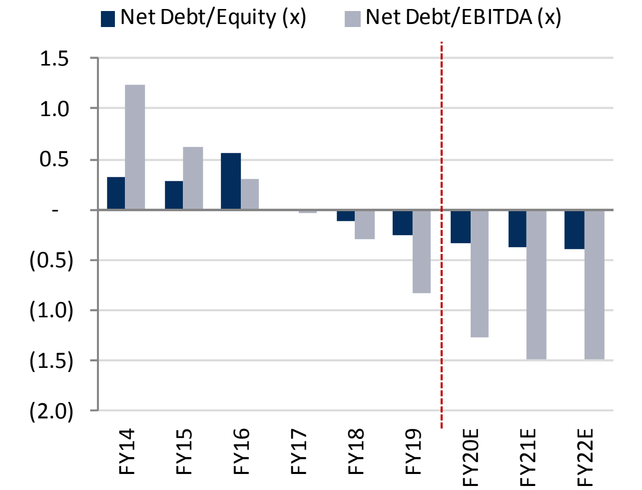
Source: : Company, HDFC sec Inst Research

EBOs payback within 18-20 months

Store Economics - EBO	FY17	FY18	FY19
Revenue	9.0	9.0	8.7
Store-level EBITDA	2.4	2.4	2.4
Store level EBITDA margin (%)	26.5	27.0	27.5
Depreciation	0.2	0.2	0.2
Depreciation (As % of sales)	2.0	1.7	1.9
EBIT	1.49	1.25	1.17
Capex	2.3	2.6	2.8
WC	1.4	1.4	1.3
Capital Employed	**3.7**	**3.9**	**4.1**
Post-tax RoCE		**43.4**	**48.4**
Payback Period (Yrs)	**1.5**	**1.6**	**1.7**

Source: Company, HDFC sec Inst Research

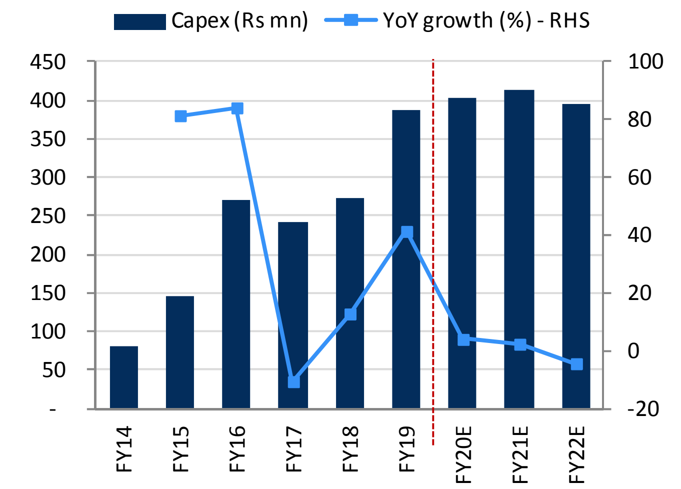
To remain a net cash company



Source: Company, HDFC sec Inst Research

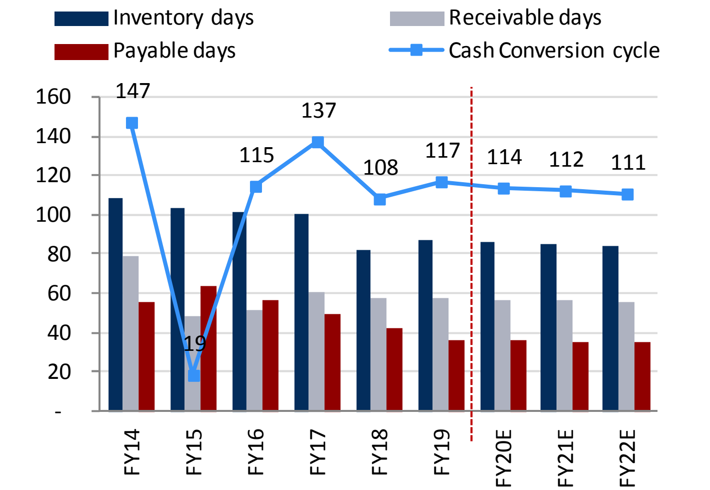
Capex remains undemanding at Rs. ~400mn annually as big chunk of expansion is LFS/online-led

Building capex of Rs. 40mn annually



Source: Company, HDFC sec Inst Research

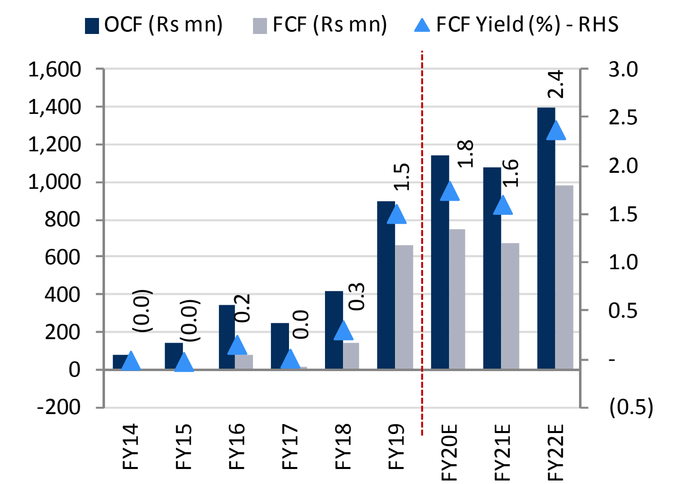
Building in a marginal improvement in WC



Source: Company, HDFC sec Inst Research

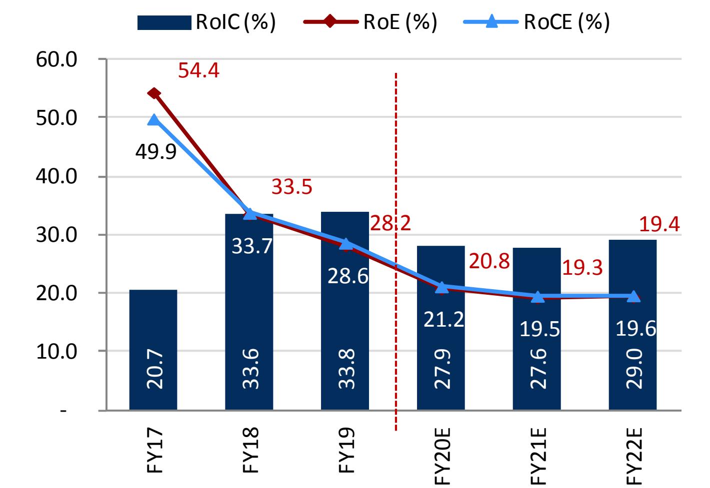
RoCEs to come off in FY20 as
1.We build in a deterioration in asset turnover given the consumer slowdown
2. Company graduates to full tax rate in FY20

Internal accruals sufficient to fund growth



Source: Company, HDFC sec Inst Research

Return profile to remain steady



Source: Company, HDFC sec Inst Research

TCNS Clothing: Snapshot

	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Total revenue (Rs. Mn)									
W		1,967	3,214	4,400	4,856	6,835			
Aurelia		765	1,270	2,181	2,837	3,896			
Wishful		221	374	605	731	750			
SSSG (%)			27.3	8.5	8.0	(3.4)			
Channel-wise revenue									
EBOs	887	1,502	2,559	3,415	4,184	4,707	5,324	6,006	6,803
YoY (%)		*69.4*	*70.4*	*33.4*	*22.5*	*12.5*	*13.1*	*12.8*	*13.3*
Revenue per EBO		*6.4*	*8.4*	*9.0*	*9.0*	*8.7*	*8.8*	*8.8*	*9.0*
LFS	485	840	1,480	2,085	3,922	4,477	5,074	5,983	6,715
YoY (%)		*73.3*	*76.3*	*40.9*	*88.1*	*14.2*	*13.3*	*17.9*	*12.2*
Revenuer per LFS		*1.5*	*1.9*	*2.1*	*2.7*	*2.8*	*2.8*	*3.0*	*3.1*
MBOs	177	274	453	801	931	918	670	724	782
YoY (%)		*55.0*	*65.4*	*76.9*	*16.2*	*(1.3)*	*(27.0)*	*8.0*	*8.0*
Revenue per MBO		*0.4*	*0.5*	*0.7*	*0.6*	*0.6*	*0.5*	*0.5*	*0.5*
Online	148	394	329	719	847	1,263	1,604	2,085	2,710
YoY (%)		*166.5*	*(16.5)*	*118.4*	*17.8*	*49.1*	*27.0*	*30.0*	*30.0*
Others			39	90	126	115	126	140	156
YoY (%)				*129.4*	*39.9*	*(9.2)*	*10.0*	*11.0*	*11.0*
Store Count (#)									
EBOs		235	305	381	465	541	606	681	756
LFS		565	794	991	1,469	1,623	1,823	1,983	2,153
MBOs		748	960	1,109	1,522	1,428	1,300	1,400	1,500
Gross Margin (%)	**54.3**	**57.4**	**61.2**	**62.9**	**65.7**	**66.0**	**66.0**	**65.9**	**65.9**
EBITDA margin (%)	**12.7**	**17.0**	**(0.8)**	**10.9**	**15.6**	**15.4**	**14.8**	**14.7**	**15.3**

Source: Company, HDFC sec Inst Research, *FY18 onwards, financials are on IND-AS 115 basis

Healthy channel mix ensures a lean capital model

Sources of funds (Rs bn)	FY15	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	0.4	0.6	0.9	1.4	1.7	4.9
Other Income	0.0	0.0	0.0	0.0	0.1	0.1
Total	**0.4**	**0.6**	**0.9**	**1.4**	**1.7**	**5.0**
Application of funds (Rs bn)						
Working Capital	0.2	(0.9)	2.0	1.0	(0.2)	2.1
Capex	0.1	0.3	0.2	0.3	0.2	1.2
Investments	0.0	0.0	0.0	0.0	1.2	1.3
Dividend	-	-	-	-	-	-
Borrowings	(0.1)	0.0	0.3	0.1	-	0.3
Others	0.0	1.1	(1.7)	(0.3)	0.6	(0.2)
Net change in cash	0.0	0.0	(0.0)	0.3	(0.2)	0.2
Total	**0.4**	**0.6**	**0.9**	**1.4**	**1.7**	**5.0**
Cumm. WC + Capex as % of sources of funds						**65.7**

Source: Company, HDFC sec Inst Research

Valuation

DCF (INR m)

	FY21E	FY22E	FY23E	FY24E	FY25	FY26	FY27	FY28	FY29	FY30	FY35
Revenue (INR m)	14938	17167	19696	22415	25493	28639	32083	35896	40096	44518	
YoY	*16.7*	*14.9*	*14.7*	*13.8*	*13.7*	*12.3*	*12.0*	*11.9*	*11.7*	*11.0*	
EBIT*(1-t)	1411	1680	2037	2397	2839	3303	3773	4394	5042	5762	
Depreciation	313	380	415	466	484	484	509	477	478	470	
Capex	-403	-413	-396	-481	-491	-506	-522	-537	-554	-571	
Changes in WC (Winv)	-606	-639	-690	-726	-774	-759	-808	-872	-934	-947	
FCFF	715	1008	1366	1657	2058	2522	2952	3462	4032	4715	8917
YoY (%)	*-8.3*	*40.9*	*35.5*	*21.3*	*24.2*	*22.5*	*17.0*	*17.3*	*16.5*	*16.9*	*12.0*
Interest (1-t)	-6	-6	-6	-6	-6	-6	-6	-6	-6	-6	
Net Borrowings	0	0	0	0	0	0	0	0	0	0	
FCFE	709	1002	1360	1651	2,052	2,516	2,946	3,456	4,026	4,709	
YoY (%)	*-8.3*	*41.3*	*35.7*	*21.4*	*24*	*23*	*17.1*	*17.3*	*16.5*	*17.0*	
EOP date	Mar-21	Mar-22	Mar-23	Mar-24	Mar-25	Mar-26	Mar-27	Mar-28	Mar-29	Mar-30	Mar-35
Years to DCF date	**0.5**	**1.5**	**2.5**	**3.5**	**4.5**	**5.5**	**6.5**	**7.5**	**8.5**	**9.5**	**14.5**
PV (FCFF)	**676**	**851**	**1,029**	**1,115**	**1,236**	**1,353**	**1,413**	**1,479**	**1,538**	**1,606**	**1,723**
Terminal Value											**133,752**

DCF Date:	**Sep-20**
Kd*(1-t)	7.5
Ke	12
Net Debt (Mar-21E)	(3,075)
PV-Explicit Period	20,794
PV-Terminal Value	25,849
Equity Value (INR m)	49,717
Equity value per share (INR)	**770**
Sept-21 Implied P/E (x)	28.8
Sept-21 Implied EV/EBITDA (x)	21.2
Terminal growth rate (%)	5.0
WACC	12.0
Terminal FCF multiple (x)	0.9
CMP	**674**
Upside/(Downside)	**14.2%**

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Rising competitive intensity	After a lean FY18 and post the recent management rejig, Biba finally seems ready to steer management bandwidth towards expansion. Rangriti (entry point offering) is expected to take centre stage in terms of expansion plans in the coming years and this can be a much needed pivot for the ethnic wear pioneer's growth trajectory. Industry interactions suggest that FabIndia too has recently cut prices on fusion wear by 15-20%. Private label players and brands such as Westside, ABFRL too are looking to get aggressive in this category over the next 2-3 years.
Online migration	High cost structure vs other formats could make the category more vulnerable to an online onslaught.
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Inability to maintain and grow the image of the brands	The products under brands W, Aurelia and Wishful are well recognized have been developed to cater to customers across the market for women's apparel and have contributed to the success of business. Failure to maintain reputation, enhance brand recognition or increase positive awareness of products, or the quality of products declines, TCNS' business and prospects may be adversely affected.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Onkar Singh Pasricha	Chairman	He is one of the promoters of TCNS. He has more than 40 years of experience in the apparel industry. He holds a bachelor's degree in technology in electrical engineering from Indian Institute of Technology, Delhi.
Mr. Anant Kumar Daga	Managing Director	He holds a bachelor's degree in commerce from the University of Calcutta and a post-graduate diploma in management from IIM, Ahmedabad. He joined TCNS in 2010 as a Chief Executive Officer. Prior to joining TCNS, he has worked with Reebok, India as director (sales) and with ICICI bank.
Mr. Venkatesh Tarakkad	Chief Financial Officer	He is a qualified chartered accountant and costs and works accountant. Prior to joining TCNS, he has worked with CocaCola India, Ernst & Young India, Metro Cash & Carry India, Siam Makro Public Company Limited and CP Wholesale India Private Limited (member of Siam Makro Group).
Mr. Piyush Asija	Company Secretary and Compliance officer	Prior to joining TCNS in 2010, he has worked with Emaar MGF, PACL India Limited, Varsana Ispat and People Strong HR Services. He has 10 years of experience in the field of secretarial and legal compliances..

Source: Company, HDFC sec Inst Research

Company profile

- TCNS Clothing Co. is a branded apparel maker for ethnic women wear, operating three brands - W, Aurelia and Wishful. Products are sold through 568 exclusive brand outlets, 1,774 large format store outlets and 1,273 multi-brand outlets, located in 31 states and union territories in India. In addition to that they also have six exclusive brand outlets in Nepal, Mauritius and Sri Lanka. The company also sells their products through their own website and online retailers.
- The product portfolio includes Top-wear, Bottom-wear, Drapes, Combination-sets and Accessories that cater to a wide variety of the wardrobe requirements of the Indian woman, including every-day wear, casual wear, work wear and occasion wear. Design operations are carried out in-house and manufacturing is completely outsourced through agreements with 78 job workers.
- TCNS Clothing Co., the name behind W was started long back in 1972 by Mr. Trilok Chand and Mr. Narender Singh. The company was primarily a manufacturer & exporter of apparels for men’s, women’s and kid’s wear. W journey started in 2001-2002 from its first store in Lajpat Nagar. In the Year 2006 Wishful was launched especially for occasion wears. In 2011, W was among the first brands to have their own 24*7 fashion destination e-commerce portal. Marking its imprints on the global map, W opened stores in Mauritius, Sri Lanka & Kathmandu in 2016 & 2017.

Income Statement (Consolidated)

Year End (March) (Rs mn)	FY18 (IND-AS)	FY19	FY20E	FY21E	FY22E
Net Revenues	**9,971**	**11,480**	**12,798**	**14,938**	**17,167**
Growth (%)	***18.9***	***15.1***	***11.5***	***16.7***	***14.9***
COGS	3,425	3,899	4,353	5,089	5,857
Selling and distribution	1,717	2,388	2,707	3,285	3,709
Employee Expense	1,021	1,274	1,518	1,673	1,898
ESOPs	215	164	83	75	70
Rent Expense	938	1,099	1,235	1,442	1,648
Other Expenses	1,100	887	1,002	1,177	1,361
Reported EBITDA	**1,554**	**1,768**	**1,900**	**2,198**	**2,624**
Adjusted EBITDA - adjusted for ESOPs	**1,770**	**1,932**	**1,983**	**2,273**	**2,694**
Adj EBITDA Growth (%)	***18.0***	***9.2***	***2.6***	***14.6***	***18.5***
Reported EBITDA Margin (%)	***15.6***	***15.4***	***14.8***	***14.7***	***15.3***
Adjusted EBITDA Margin (%)	***17.8***	***16.8***	***15.5***	***15.2***	***15.7***
Depreciation	167	222	219	313	380
Reported EBIT	**1,388**	**1,546**	**1,681**	**1,885**	**2,244**
Adjusted EBIT	**1,603**	**1,710**	**1,764**	**1,960**	**2,314**
Other Income (Including EO Items)	67	75	125	169	200
Interest	7	5	8	8	8
PBT	**1,448**	**1,616**	**1,798**	**2,046**	**2,437**
Total Tax	467	302	452	515	613
RPAT	**981**	**1,314**	**1,345**	**1,531**	**1,823**
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT (adj for ESOP)	**1,196**	**1,478**	**1,428**	**1,606**	**1,893**
APAT Growth (%)	***(0.0)***	***23.6***	***(3.4)***	***12.4***	***17.9***
Adjusted EPS (Rs)	**21.2**	**23.2**	**22.2**	**24.9**	**29.3**
EPS Growth (%)	***(0.0)***	***9.2***	***(4.0)***	***11.8***	***17.9***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March) (Rs mn)	FY18 (IND-AS)	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	113	123	128	129	129
Reserves	4,202	6,063	7,427	8,996	10,276
Total Shareholders Funds	**4,315**	**6,186**	**7,555**	**9,126**	**10,405**
Preference Share	**-**	**-**	**-**	**-**	**-**
Long Term Debt	2	-	-	-	-
Short Term Debt	1	-	-	-	-
Total Debt	**3**	**-**	**-**	**-**	**-**
Net Deferred Taxes	**(115)**	**(160)**	**(160)**	**(160)**	**(160)**
Other Non-current Liabilities & Provns	**63**	**66**	**66**	**66**	**66**
TOTAL SOURCES OF FUNDS	**4,266**	**6,092**	**7,462**	**9,032**	**10,311**
APPLICATION OF FUNDS					
Net Block	575	592	760	850	883
CWIP	25	3	3	3	3
Other Non-current Assets	198	208	208	208	208
Total Non-current Assets	**798**	**804**	**971**	**1,061**	**1,094**
Inventories	2,239	2,741	3,021	3,485	3,958
Debtors	1,571	1,807	1,997	2,311	2,632
Other Current Assets	735	739	746	851	954
Cash & Equivalents	**512**	**1,608**	**2,500**	**3,375**	**4,006**
Total Current Assets	**5,057**	**6,896**	**8,264**	**10,021**	**11,550**
Creditors	1,144	1,150	1,265	1,456	1,649
Other Current Liabilities & Provns	444	457	510	595	684
Total Current Liabilities	**1,588**	**1,607**	**1,774**	**2,050**	**2,333**
Net Current Assets	**3,468**	**5,288**	**6,490**	**7,971**	**9,217**
TOTAL APPLICATION OF FUNDS	**4,266**	**6,092**	**7,462**	**9,032**	**10,311**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY18 (IND-AS)	FY19	FY20E	FY21E	FY22E
Reported PBT	981	1,616	1,798	2,046	2,437
Non-operating & EO Items	683	157	(125)	(169)	(200)
Interest Expenses	7	5	8	8	8
Depreciation	167	222	219	313	380
Working Capital Change	(971)	(778)	(310)	(606)	(615)
Tax Paid	(452)	(323)	(452)	(515)	(613)
OPERATING CASH FLOW (a)	413	**899**	**1,138**	**1,078**	**1,396**
Capex	(274)	(237)	(387)	(403)	(413)
Free Cash Flow (FCF)	*140*	*662*	*750*	*675*	*983*
Investments	(14)	(1,250)	(300)	(500)	(300)
Non-operating Income	12	53	125	169	200
INVESTING CASH FLOW (b)	(276)	**(1,434)**	**(562)**	**(734)**	**(513)**
Debt Issuance/(Repaid)	(86)	(1)	-	-	-
FCFE	*54*	*662*	*750*	*675*	*983*
Share Capital Issuance	302	389	39	39	-
Dividend	-	-	-	-	(544)
Others	(7)	(5)	(8)	(8)	(8)
FINANCING CASH FLOW (c)	**210**	**383**	**31**	**31**	**(552)**
NET CASH FLOW (a+b+c)	**347**	**(151)**	**607**	**375**	**331**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	367	216	823	1,197	1,528

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18 (IND-AS)	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	65.7	66.0	66.0	66.0	65.9
EBITDA Margin	17.8	16.8	15.5	15.2	15.7
EBIT Margin	16.1	14.9	13.8	13.1	13.5
APAT Margin	12.0	12.9	11.2	10.8	11.0
RoE	27.7	28.2	20.8	19.3	19.4
RoIC (or Core RoCE)	28.9	33.8	27.9	27.6	29.0
RoCE	28.2	28.6	21.2	19.5	19.6
EFFICIENCY					
Tax Rate (%)	32.3	18.7	25.2	25.2	25.2
Fixed Asset Turnover (x)	13.1	12.7	9.9	8.8	8.2
Inventory (days)	*82*	*87*	*86*	*85*	*84*
Debtors (days)	*57*	*57*	*57*	*56*	*56*
Other Current Assets (days)	*27*	*24*	*21*	*21*	*20*
Payables (days)	*42*	*37*	*36*	*36*	*35*
Other Current Liab & Provns (days)	*16*	*15*	*15*	*15*	*15*
Cash Conversion Cycle (days)	108	117	114	112	111
Net D/E (x)	(0.1)	(0.3)	(0.3)	(0.4)	(0.4)
Interest Coverage (x)	206.8	300.8	210.1	235.6	280.6
PER SHARE DATA (Rs)					
EPS	21.2	23.2	22.2	24.9	29.3
CEPS	24.2	26.6	25.7	29.7	35.2
Dividend	-	-	-	-	-
Book Value	76.5	96.9	117.7	141.3	161.1
VALUATION					
P/E (x)	33.6	30.8	32.0	28.7	24.3
P/BV (x)	9.3	7.4	6.1	5.0	4.4
EV/EBITDA (x)	27.8	23.8	21.7	18.3	15.1
EV/Revenues (x)	4.3	3.7	3.2	2.7	2.3
OCF/EV (%)	1.0	2.1	2.8	2.7	3.5
FCF/EV (%)	0.3	1.6	1.8	1.7	2.5
FCFE/Mkt Cap (%)	0.1	1.5	1.7	1.5	2.2
Dividend Yield (%)	-	-	-	-	-

Source: Company, HDFC sec Inst Research

V-Mart

BUY

Story still has legs!

Over the past decade, Mass value fashion (VF mass) has been one of the most profitable formats in Retail. V-MART has been riding the value fashion wave with clockwork-like execution and remains one of the most disciplined operators in trade. It has scaled 10x over FY09-19 almost entirely through internal accruals. Competitive intensity has been rising as new regional and national players attempt at extracting their pound of flesh. However, our analysis & channel checks suggest that the tail of VF-mass seems out of gas as it grapples with vendor issues (creditors' cycle burgeoning). VMART will be a key benefactor. However, in the short term it may suffer margin pressure as inventory gets liquidated across the tail. We bake in revenue/EBITDA/LTL PAT (pre-corporate tax cut) CAGR of 22/16/16% respectively over FY19-22E. Initiate coverage with a BUY recommendation and a DCF-based TP of Rs. 2,150/sh, implying an EV/EBITDA of 20x (Sept-21).

Investment rationale

- **Low AoVs; Rent < Fulfilment cost = Safety net:** In Retail, the online opportunity primarily stems from category-specific intermediation inefficiencies of brick & mortar outfits. Cost of doing business is significantly lower in VF mass vs other apparel/e-tail formats given lower rentals (VF mass 4-5% vs online fulfillment costs of 10-15%) and overall lower cost structures. We believe this steep cost arbitrage in biz coupled with low AoVs of VF mass retailers (Rs. 750-800) act as a safety net vs an online intrusion. Meanwhile, 'Reduce cash burn' seems to be a key theme online folks are training their focus on. Hence, while key e-tailers are increasing their omni-assets in tier 2/3 towns, focus primarily remains on milking the low hanging fruit –Urban consumer base.

- **VF tail's loss = V-MART's gain**: Our analysis of the VF mass tail suggests that vendors of some retailers may be at the end of their tether as creditor cycles run up as high as 6 months (on COGS). Sure, their recent funding rounds buy them a year or two, however, unless store productivity and inventory turns improve and reliance on creditors reduces, **a few blow ups may be lurking around the corner.** VMART will be a key benefactor. However, in the short term the latter may suffer margin pressure as the tail resorts to inventory liquidation. Consequently, we expect a 150bp dip in FY20 margins and no material gains over FY20-22E. That said, V-MART could surprise positively if the market share gain from VF-tail is faster than expected.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	14,337	17,217	20,976	25,834
EBITDA	1,329	1,342	1,660	2,070
APAT	714	805	938	1,132
Dil. EPS (Rs/sh)	39.5	44.5	51.8	62.5
P/E (x)	43.7	38.8	33.3	27.6
EV/EBITDA (x)	23.1	22.9	18.8	15.1
ROE (%)	18.9	18.0	17.7	18.0
RoIC (%)	21.5	19.8	18.6	18.4
ROCE (%)	18.9	17.6	17.5	17.9

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 1,701**
Target Price	**Rs 2,150**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	VMART IN
No. of Shares (mn)	18
MCap (Rs bn) / ($ mn)	31/434
6m avg traded value (Rs mn)	35

STOCK PERFORMANCE (%)

52 Week high / low **Rs 2,867/1,660**

	3M	6M	12M
Absolute (%)	(17.0)	(27.3)	(38.0)
Relative (%)	(26.3)	(29.6)	(52.5)

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	52.46	51.99
FIs & Local MFs	5.7	8.08
FPIs	31.13	28.28
Public & Others	10.71	11.65
Pledged Shares	0	0

Source : BSE

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- **Opportunity remains large:** Apart from opportunities in existing geographies, a little over 50 districts having a PCI <200k, population density >300 per km and a cumulative population of 80-100mn remain completely un-served by organized VF retailers, ergo the penetration opportunity for VF mass pioneers like V-MART is still massive. Some perspective, the addressable market in these districts is ~2.5x that of V-MART's FY19 footfalls.

- **Stepping up on expansion:** While the VF tail has struggled to get store economics right, V-MART has smartly stepped up its expansion to capture market share from the former. Consequently, we build in 24% area CAGR and 55-85 store additions annually over FY19-22E (vs V-MART's decadal 19% CAGR). Hence, bulk of the growth is expected to be expansion-led (16%). We build in an SSSG CAGR of ~5% over FY19-22E. The company is also revving up its back-end and is expected to add another warehouse in FY21 to cater to the expansion-led demand spurt. Current warehouse capacity can service 280 stores. The new warehouse will be able to service 250 additional stores.

- **The Story still has legs!** We expect market specific opportunities to underpin V-MART's growth over the next 2-3 years. We build in a flat return profile over FY20-22E, given the lack of margin levers and the impetus on expansion. Productivity gains could be back-ended. We bake in revenue/EBITDA/LTL PAT (pre-corporate tax cut) CAGR of 22/16/16% respectively over FY19-22E. Initiate coverage with a BUY recommendation and a DCF-based TP of Rs. 2,150/sh, implying an EV/EBITDA of 20x (Sept-21).

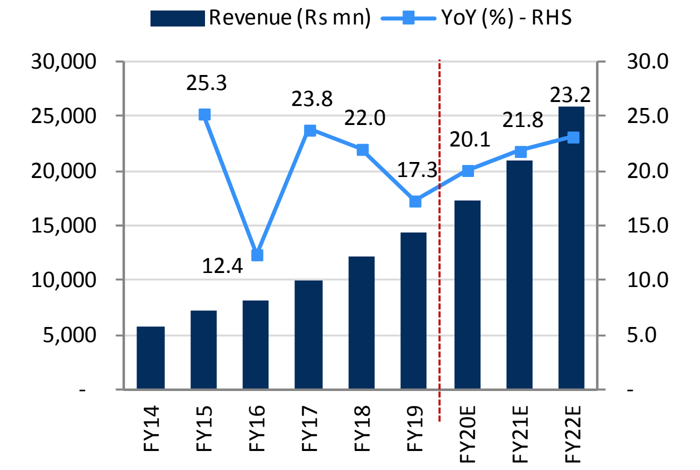
- **Key risks: 1.** National VF retailers succeed in penetrating V-MART's bread-and-butter territories faster than expected and profitably so, 2. The VF mass tail stages a turnaround (unlikely as funding seems to have dried up).

Revenue to grow at 22% CAGR, as V-MART steps up expansion

Building in 54-85 store additions/24% Area CAGR over FY19-22E

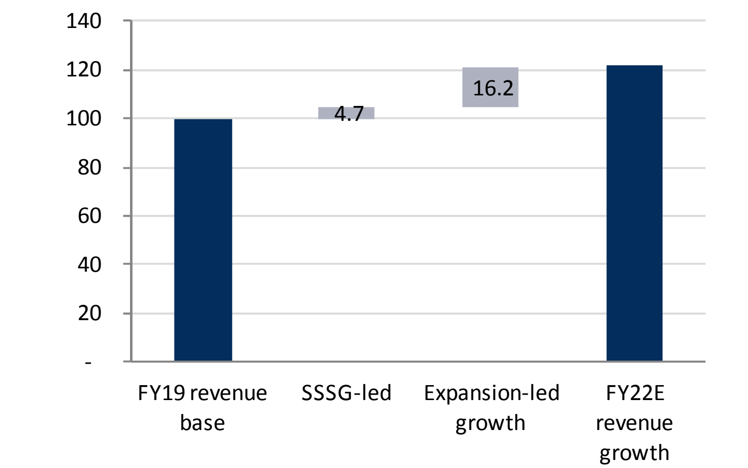
Story in Charts

Revenue to grow at a CAGR of 22% over FY19-22E



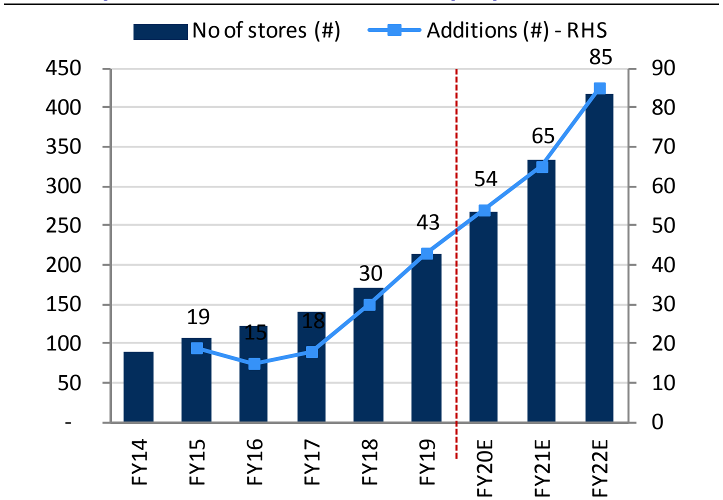
Source: Company, HDFC sec Inst Research

...predominantly expansion-led, while SSSG to remain healthy



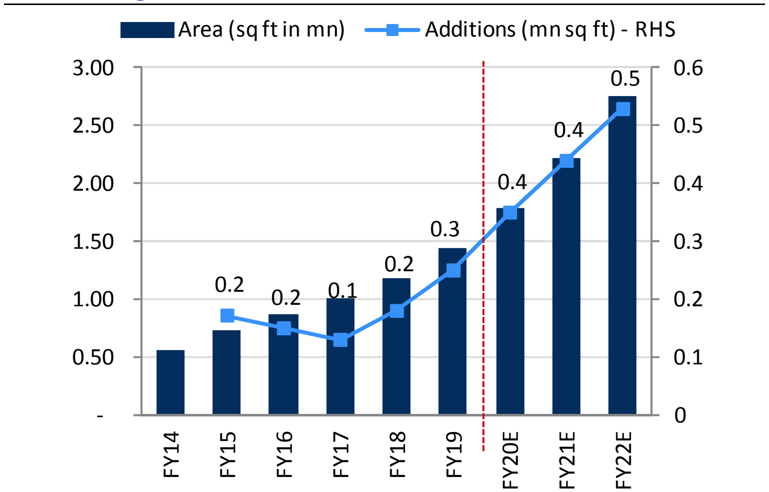
Source: Company, HDFC sec Inst Research, Note: rev. base indexed to 100

We expect store additions to step up



Source: Company, HDFC sec Inst Research

...building in 24% Area CAGR over FY19-22E

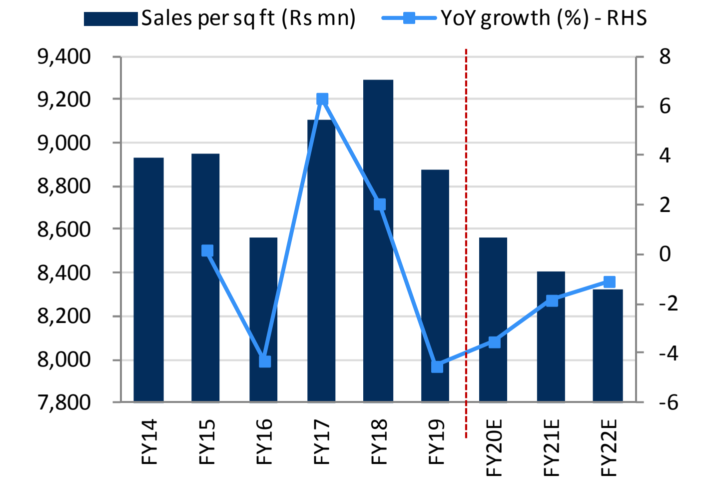


Source: Company, HDFC sec Inst Research

Productivity to moderate as VMART trains focus on on expansion

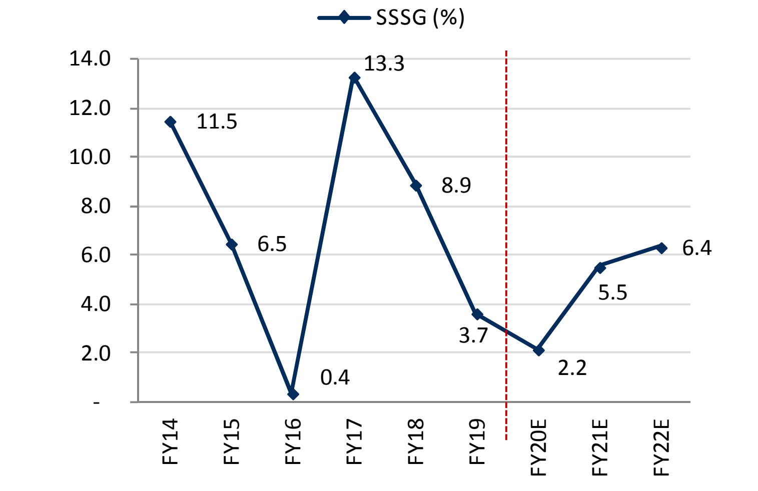
Building in 4.7% SSSG CAGR over FY19-22E, a far cry from its historical 9% CAGR

Productivity to moderate as VMART trains focus on upping the ante on expansion…



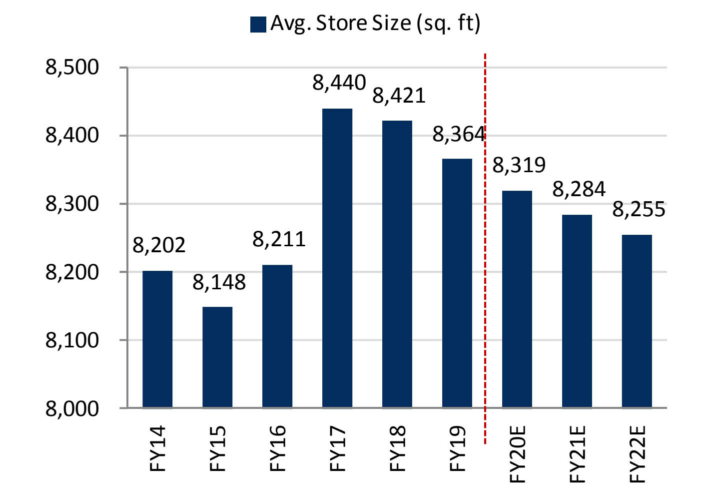
Source: Company, HDFC sec Inst Research

SSSG to moderate in FY20...building in a gradual recovery over FY20-22E



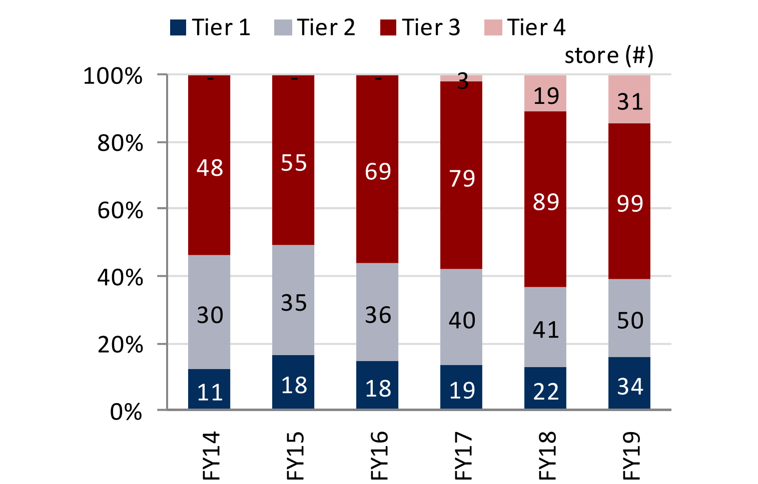
Source: Company, HDFC sec Inst Research

Building in a marginal cut in store sizes…



Source: Company, HDFC sec Inst Research

… as Tier 4 focus increases



Source: Company, HDFC sec Inst Research

Key vitals for V-MART remain healthy. Bill size and Bill Cuts grew 5.6%/13.7% Bill size growth has been in line with ASP CAGR over FY14-19, implying volume purchased per customer hasn't changed materially over the years.

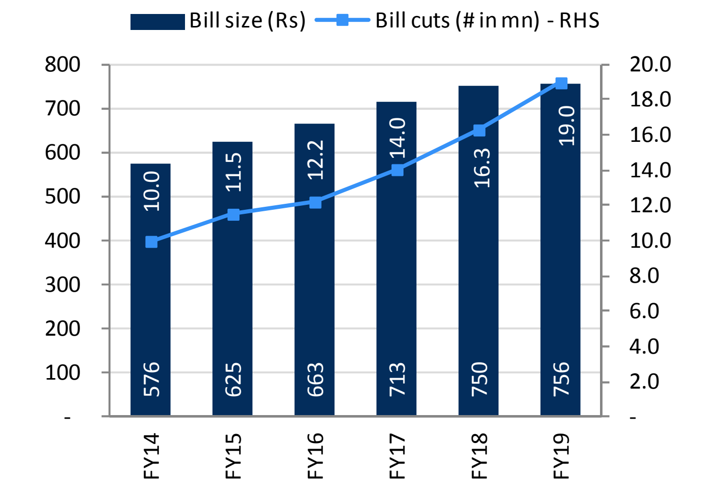
SSSG has predominantly been volume-led over FY16-19 (2QFY20 seems an aberration) & is expected to be so going forward as V-MART steps up focus on Tier 4 towns.

The high-margin apparel skew keeps inching up each passing year as V-MART has stopped opening composite stores which sells F&G too (38 as on FY19)

1. Margin levers missing in near-term as 1. National VF retailers claim their bound of flesh, 2. Select VF mass tail hit liquidation mode given their precarious working capital position.

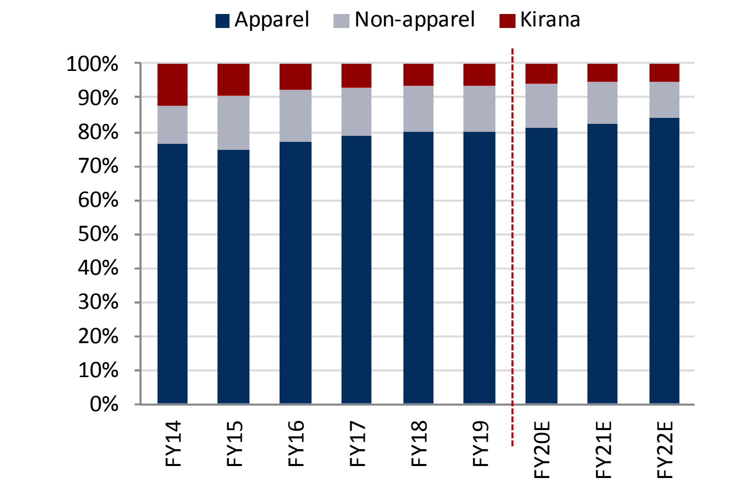
Per our SKU analysis, we reckon, the pricing arbitrage is still significant vs VF forward retailers and V-MART is consistently investing in price. Ergo, should be able to defend its turf

Bill size and Bill cuts have been increasing steadily



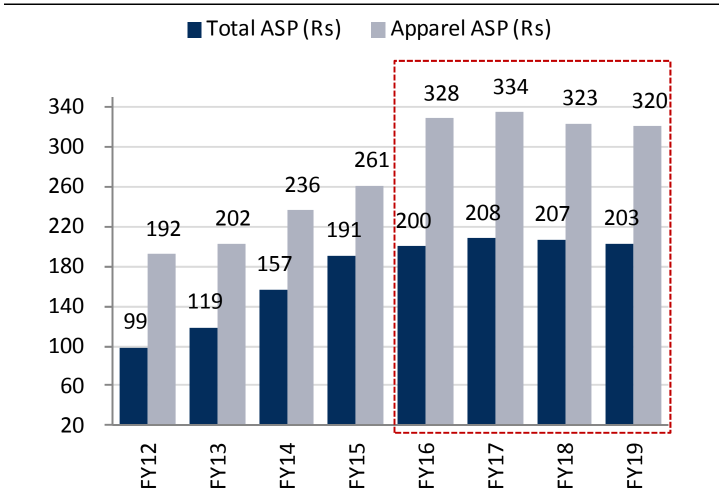
Source: Company, HDFC sec Inst Research

Apparel skew consistently increasing in mix



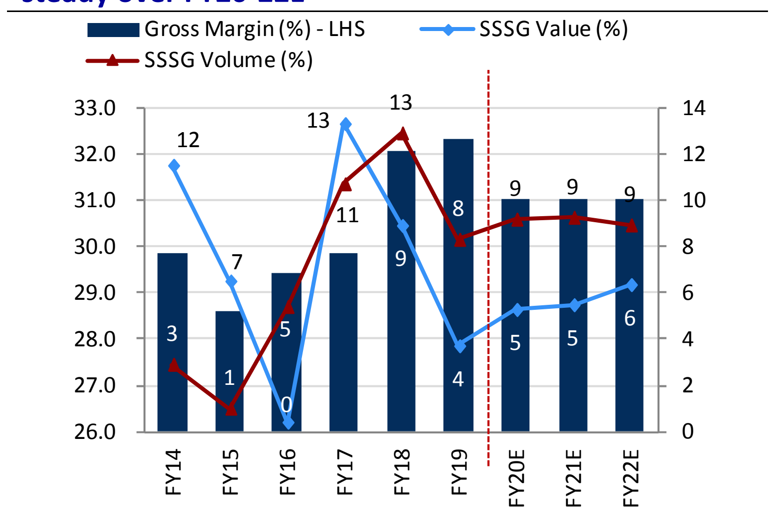
Source: Company, HDFC sec Inst Research

ASP has been largely steady over FY16-19



Source: Company, HDFC sec Inst Research

SSSG going forward to be volume-led, GM to remain steady over FY20-22E

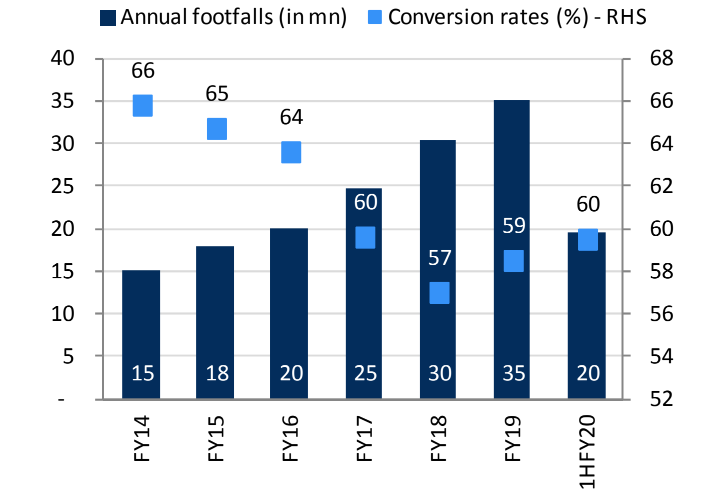


Source: Company, HDFC sec Inst Research

2Q is typically a liquidation-heavy quarter for V-MART. However, V-MART cut back on liquidation in 2QFY20, hence, conservatively increased their provision for dead stock. This should normalize over the course of the year.

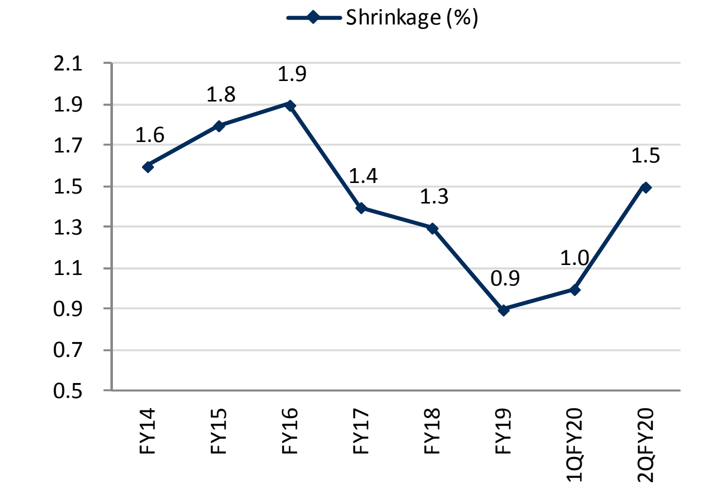
V-MART has only closed 13 stores over FY12-2HFY20. This provides an inkling to V-MART's astute real estate choices – A must have in mass value fashion.

Annual footfalls/Effective footfalls have increased at a CAGR of 18%/15% respectively over FY14-19



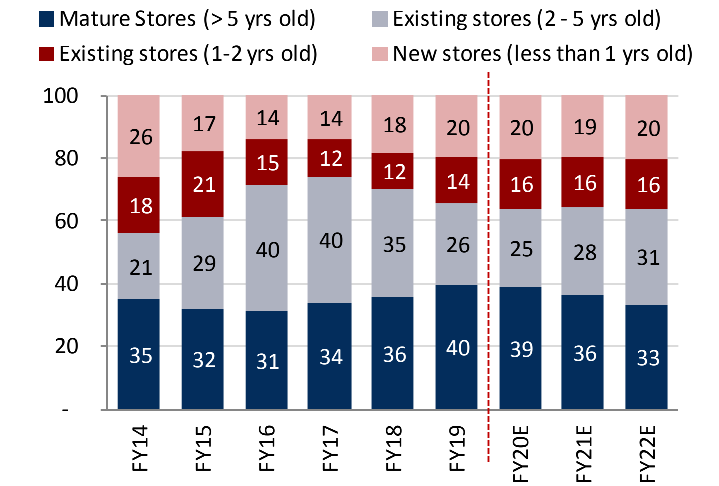
Source: Company, HDFC sec Inst Research

Shrinkage is consistently coming down



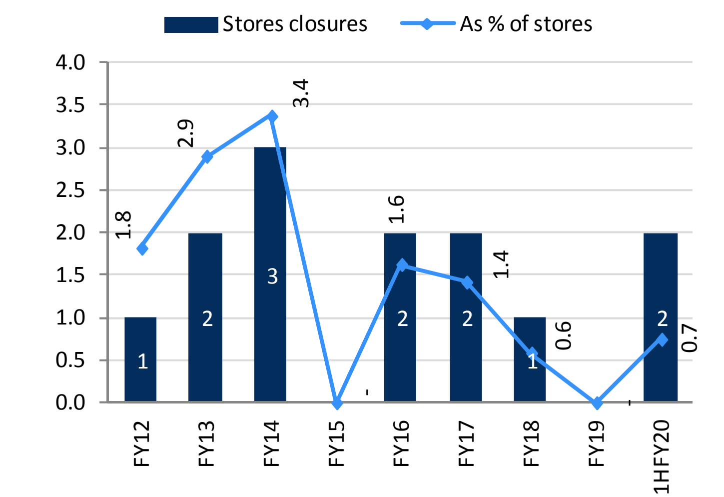
Source: Company, HDFC sec Inst Research

Store portfolio getting younger...key to SSSG in future years



Source: Company, HDFC sec Inst Research

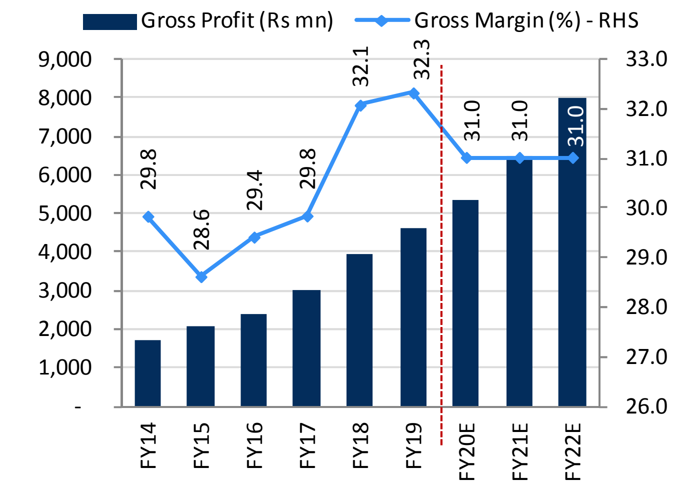
Bare-bone store closures provides an inkling of V-MART's astute real estate choices



Source: Company, HDFC sec Inst Research

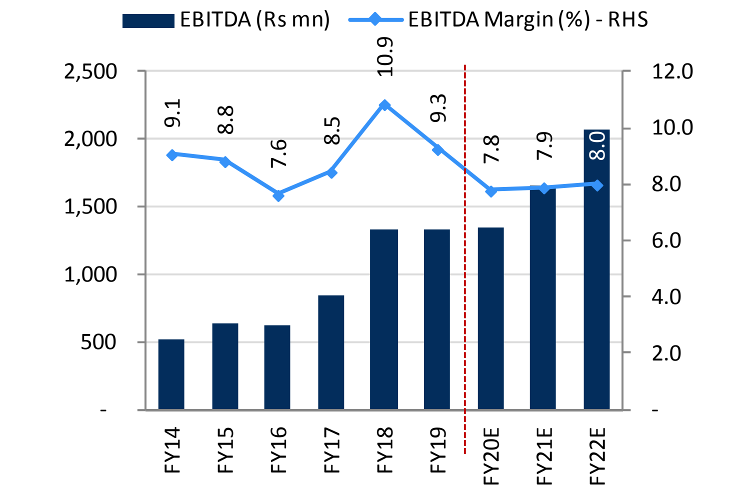
Gross margins to dip in FY20 given 1. the impetus to navigate the consumer slowdown, 2. rise in competitive intensity, 3.Increased liquidation by the tail

Gross margin to remain steady after the FY20 dip



Source: Company, HDFC sec Inst Research

...Ditto for EBITDA margins

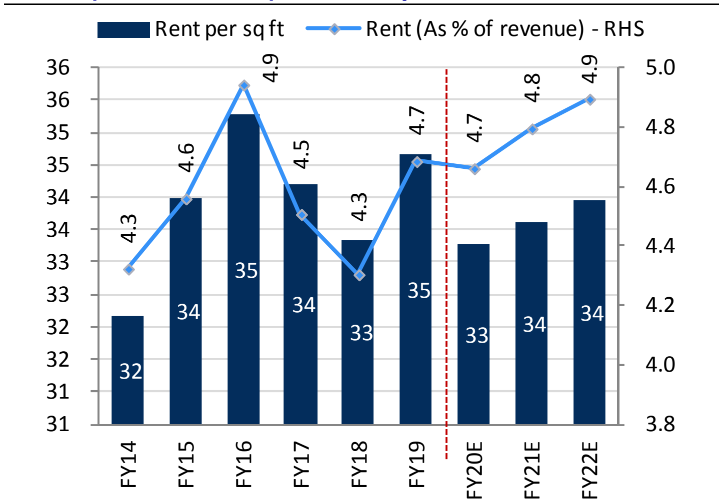


Source: Company, HDFC sec Inst Research

Rent as % of sales to inch up marginally as new store additions outpace productivity gains in the short term

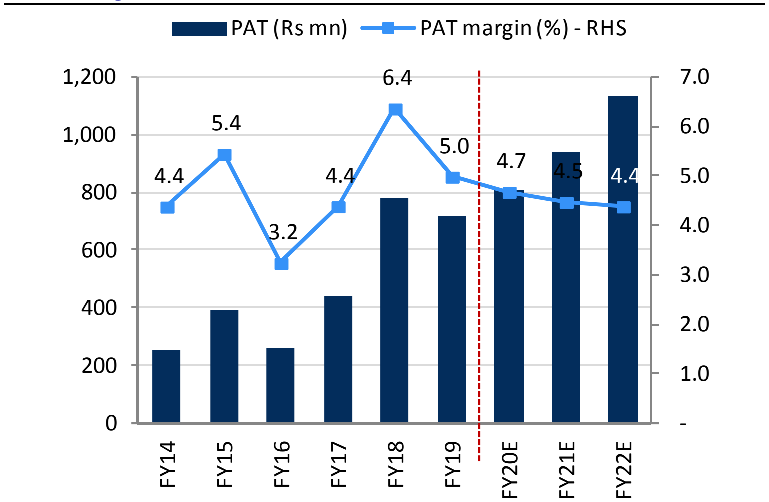
Not building in material operating leverage benefits over FY19-22E

Rent (As % of sales) to inch up



Source: Company, HDFC sec Inst Research

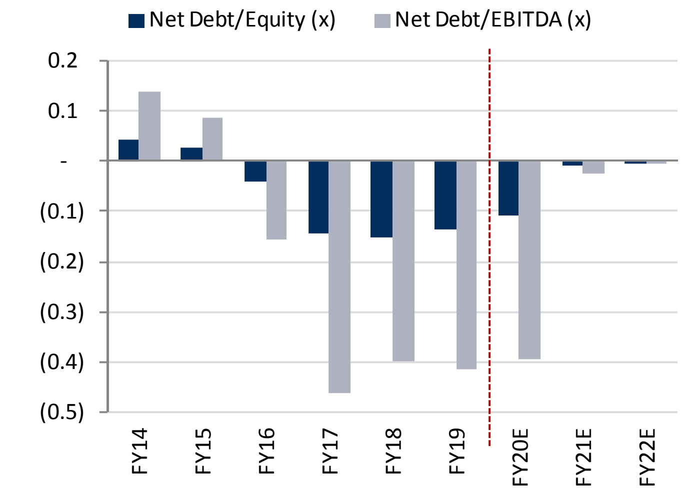
Building in 32% PAT CAGR



Source: Company, HDFC sec Inst Research

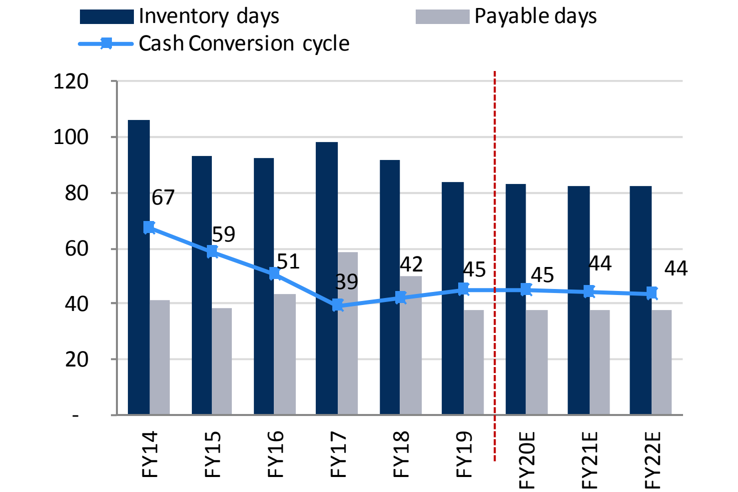
FY20/21 may see a dip in cash generation given the step up in expansion plans. We have also factored in a warehouse addition in North East in FY21, hence the –ve FCFE in FY21. FY22 expected to be business as usual.

V-MART remains a net cash company



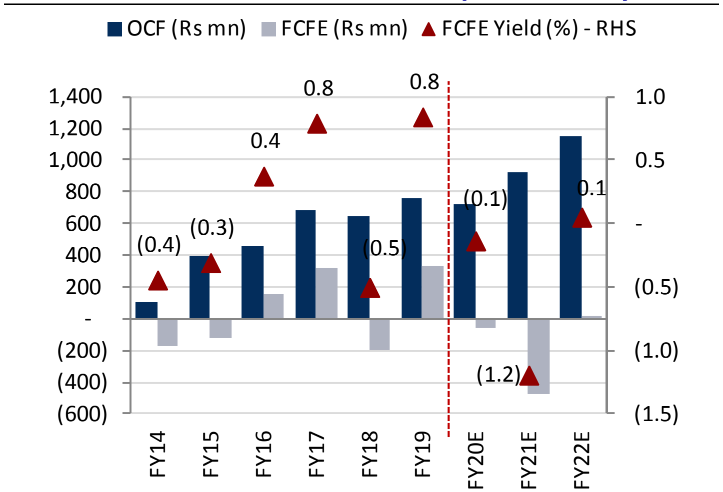
Source: Company, HDFC sec Inst Research

Cash conversion to remain stable



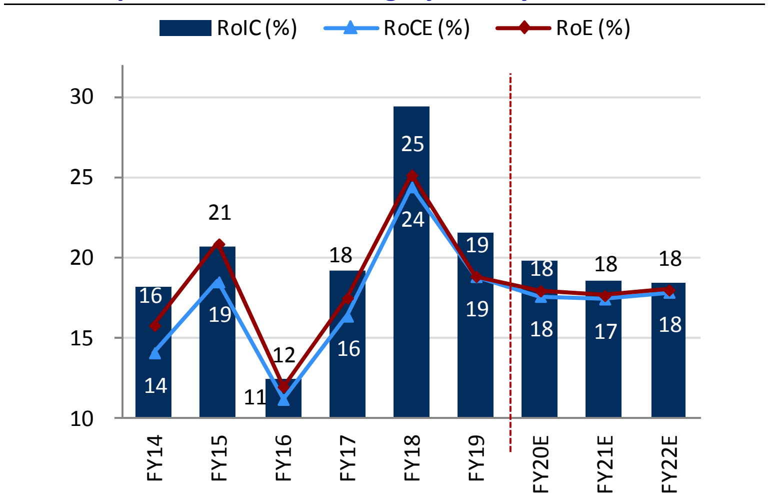
Source: Company, HDFC sec Inst Research

Free cash flow to witness a U-shaped recovery



Source: Company, HDFC sec Inst Research

Return profile to remain largely steady over FY19-22E



Source: Company, HDFC sec Inst Research

V-MART stores hit payback in 2.5 years

	Per Sq. ft	Per Store
Revenue	8,878	74.5
Gross Profit	2,870	24.1
Rent	416	3.5
Other store level opex	1,187	10.0
Store EBITDA	1,267	10.6
Store EBITDA margin	14.3	14.3
Company EBITDA	823	6.9
Depreciation	171	1.4
Company EBIT	652	5.5
Company EBIT post tax	425	3.6
Capex	987	8.0
WC requirement	1,099	9.2
Capital Employed	2,086	17
Post Tax RoCE (%)	20.4	20.4
Payback Period (Years)	2.5	2.5

Source: Company, HDFC sec Inst Research

One of the less demanding retailers within our universe in terms of capital needs

Sources of funds (Rs bn)	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**Total**
Cash from Operations (excl WC change)	0.2	0.3	0.3	0.5	0.6	0.7	0.6	1.0	1.0	5.2
Other Income	(0.0)	(0.0)	0.0	(0.0)	0.0	(0.0)	0.0	(0.1)	0.0	(0.0)
Total	**0.2**	**0.3**	**0.3**	**0.5**	**0.6**	**0.7**	**0.6**	**0.9**	**1.0**	**5.2**
Application of funds (Rs bn)										-
Working Capital	0.1	0.1	0.2	0.3	0.1	(0.0)	(0.0)	0.3	0.4	1.3
Capex	0.2	0.1	0.1	0.1	0.2	0.3	0.3	0.3	0.4	2.0
Investments	-	-	0.4	(0.1)	(0.1)	0.1	0.3	(0.4)	0.3	0.6
Dividend	-	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.2
Borrowings	(0.1)	(0.0)	0.1	(0.1)	0.1	0.0	(0.1)	0.4	(0.2)	0.1
Others	(0.0)	0.2	(0.6)	0.4	0.3	0.2	0.1	0.2	0.1	0.9
Net change in cash	0.0	(0.0)	0.1	(0.1)	0.0	(0.0)	0.0	0.1	(0.0)	0.1
Total	**0.2**	**0.3**	**0.3**	**0.5**	**0.6**	**0.7**	**0.6**	**0.9**	**1.0**	**5.2**
Cumm. WC + Capex as % of sources of funds										**64.9**

Source: Company, HDFC sec Inst Research

V-MART Retail: Snapshot

	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E	FY22E
Revenue (Rs mn)	**2,819**	**3,835**	**5,750**	**7,202**	**8,093**	**10,017**	**12,224**	**14,337**	**17,217**	**20,976**	**25,834**
YoY (%)	*31.3*	*36.0*	*49.9*	*25.3*	*12.4*	*23.8*	*22.0*	*17.3*	*20.1*	*21.8*	*23.2*
SSSG (%)						*13.2*	*8.6*	*3.7*	*2.2*	*5.5*	*6.4*
Expansion-led growth (%)						*9.4*	*12.4*	*13.2*	*17.5*	*15.4*	*15.8*
SSSG - Volume (%)											
Revenue mix (%)											
Apparel	64.0	68.8	76.8	74.7	76.9	78.7	79.7	79.9	80.9	82.1	83.7
Non-apparel	12.0	11.9	11.1	15.9	15.3	14.3	14.0	13.7	13.0	12.2	11.1
Kirana	24.0	19.3	12.2	9.4	7.8	7.0	6.3	6.4	6.1	5.8	5.2
ASP	99	119	156.8	191	200	208	207	203			
-Apparel (ASP)	192	202	235.8	261	327.9	334	323	320			
Trasaction size (Rs)	462	489	576.2	625.4	663	713	750	756			
Bill Cuts (mn)	6.1	7.8	10.0	11.5	12.2	14.0	16.3	19.0			
Stores (#)	55	69	89	108	123	141	171	214	268	333	418
Additions (#)	10	14	20	19	15	18	30	43	54	65	85
Retail Area (mn. Sq, ft)	0.5	0.6	0.7	0.9	1.0	1.2	1.4	1.8	2.2	2.8	3.5
Additions (mn. Sq, ft)	0.1	0.1	0.2	0.2	0.1	0.2	0.3	0.4	0.4	0.5	0.7
Per sq. ft metrics											
Revenue	6,863	7,563	8,928	8,947	8,564	9,107	9,296	8,878	8,567	8,411	8,321
Gross Profit	2,044	2,308	2,664	2,561	2,519	2,718	2,982	2,870	2,658	2,609	2,582
EBITDA	687	785	811	791	654	771	1,010	823	668	665	667
Margins (%)											
Gross margin	29.8	30.5	29.8	28.6	29.4	29.8	32.1	32.3	31.0	31.0	31.0
EBITDA margin (%)	10.0	10.4	9.1	8.8	7.6	8.5	10.9	9.3	7.8	7.9	8.0

Source: Company, HDFC sec Inst Research

Valuation

DCF (INR m)	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27	FY28	FY29	FY30	FY31
Revenue (INR m)	**20,976**	**25,834**	**32,084**	**40,052**	**48,948**	**58,882**	**69,791**	**81,603**	**95,280**	**110,057**	
YoY	*21.8*	*23.2*	*24.2*	*24.8*	*22.2*	*20.3*	*18.5*	*16.9*	*16.8*	*15.5*	
No. of stores (#)	**333**	**418**	**518**	**638**	**758**	**878**	**998**	**1,118**	**1,238**	**1,358**	
YoY	*24.3*	*25.5*	*23.9*	*23.2*	*18.8*	*15.8*	*13.7*	*12.0*	*10.7*	*9.7*	
EBIT*(1-t)	922	1140	1458	1901	2411	3019	3711	4500	5484	6562	
Depreciation	427	546	648	759	868	994	1115	1231	1341	1480	
Capex	-1375	-1100	-1280	-1522	-1531	-1541	-1552	-1562	-1571	-1582	
Changes in WC (Winv)	-424	-541	-686	-861	-936	-1018	-1088	-1143	-1296	-1147	
FCFF	**(450)**	**46**	**139**	**276**	**811**	**1,453**	**2,187**	**3,026**	**3,958**	**5,313**	**6,057**
YoY (%)	*1,819.1*	*(110.2)*	*203.1*	*99.0*	*193.4*	*79.3*	*50.5*	*38.4*	*30.8*	*34.2*	*14.0*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**	**Mar-31**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	10.5
PV (FCFF)	**(426)**	**39**	**105**	**187**	**492**	**789**	**1,062**	**1,315**	**1,540**	**1,850**	**1,887**
Terminal Value											**94,325**
Kd*(1-t)	**7.5%**										
Ke	**12%**										

DCF Date	Sep-20
Net Debt (Mar-20E)	(460)
PV-Explicit Period	8,860
PV-Terminal Value	29,590
Equity Value (INR m)	38,910
Equity value per share (INR)	**2,150**
Sept-21E Implied P/E (x)	40.2
Sept-21E Implied EV/EBITDA (x)	20.6
Terminal growth rate (%)	5.0%
WACC	11.7%
Terminal FCF multiple (x)	15.6
No. of shares (b)	18.1
CMP	**1,692**
Upside/(Downside)	**27.1%**

Source: Company, HDFC sec Inst Research

Key Risks

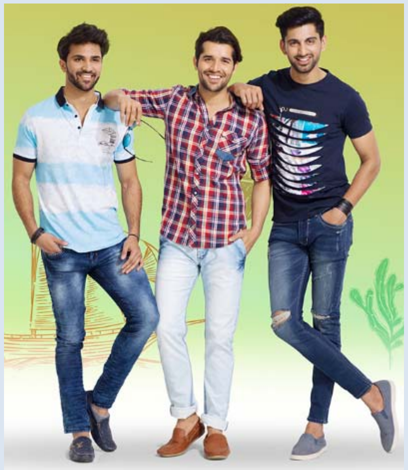
Name	Description
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.
Rising competition	V Mart operates in the industry with limited barriers to entry and has limited product differentiation. Increasing competition in the geographies where company operates may impact future growth.

Source: HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Lalit Agarwal	Chairman and Managing Director (CMD)	He has over 20 years experience in the retail industry. In 2003, with a vision to establish the concept of organized value retailing in certain untapped regions of India, he setup up retail stores under the brand name of 'V-Mart'. Prior to this, he was involved in setting up of a printing and packaging unit, a water theme park in Kolkata and was associated with a retail chain till 2003.
Mr. Madan Agarwal	Whole Time Director	He has more than 3 decades of experience in retail industry. He started his career by opening a retail shop in the year 1975 and later on in 1979 opened another retail store of apparels and footwear in Cuttack known as "Shreeman Shreemati". He provides vital inputs and insights on cost control and oversees the procurement of general merchandise and Kirana Bazaar business verticals of V-Mart.
Mr. Samir Misra	COO	He has 15 years of multi-faceted industry experience with some of the country's leading retailers. Prior to joining V-Mart, he had been associated with the Aditya Birla Group for 8 years, with leadership roles with Pantaloons Fashion Retail & Madura Fashion & Lifestyle. He has led business roles with diversified organizations like Mc Donald's, Marico & Future Group.
Mr. Anand Agarwal	CFO	A CA and CS by qualification, Mr. Anand has more than 22 years of experience in strategic planning, finance, legal, treasury, fund raising, M&As, investor relations and board management. Prior to V-Mart, he has held leadership roles in companies like HT Media and Reebok, and has earlier worked with Ernst & Young.
Mr. Rajan Sharma	President – Sourcing & Procurement	He has over 25 years of experience in Sourcing, Merchandising, Buying, Product development and Sales, working with some of the leading retailers and fashion brands. Prior to joining V-Mart, he worked with Vishal Mega Mart as VP – Apparels for over 8 years. He has acquired experience in Sourcing and Manufacturing for global brands like Limited Express, Lerner's, Lane Bryant, Limited too, J.C. Penny, Walmart, Tommy Hilfiger etc
Mr. Snehal Shah	Sr. VP – Operations & Marketing	He has over 18 years of experience across back & front-end retail operations. He is responsible for the overall operations of stores and distribution centres. He had previously worked with Royal Resorts as a Business Manager for a period of 6 years.
Mr. Srinivasan	VP - Planning and Supply Chain	He has over 17 years of professional experience spread over retail and manufacturing industries, in consulting, planning and managing operations. Prior to V-Mart, he has consulted promoters of many retail companies including brands and departmental stores.

Source: Company, HDFC sec Inst Research



Company Profile: V-Mart Retail

- VMart primarily operates in tier II & tier III cities with a chain of "Value Retail" departmental stores. Its stores cater to the apparel needs of the entire family by offering apparels, general merchandise and kirana goods.
- First incorporated as Varin Commercial Private Limited in West Bengal. In 2003, it opened its maiden store in Ahmedabad, Gujarat. Currently, VMart operates 239 stores across 172 cities in 17 states and union territories, with a total retail area of 2 mn sq. ft.
- It provides a range of apparels and accessories for men, women, boys, girls and toddlers. Its general merchandise includes footwear, home furnishing, kitchenware, toys and games, bags and luggage, and crockery. Its kirana bazaar includes fast moving consumer goods (FMCG) products, packaged food items, beauty and personal care, home care and staple products.

Income Statement (Consolidated)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
Net Revenues	**12,224**	**14,337**	**17,217**	**20,976**	**25,834**
Growth (%)	***22.0***	***17.3***	***20.1***	***21.8***	***23.2***
COGS	8,303	9,703	11,875	14,468	17,819
Employee Expense	984	1,257	1,544	1,871	2,291
A&P Expense	262	339	425	496	598
Rent Expense	526	672	802	1,006	1,264
Other Expenses	821	1,037	1,228	1,475	1,791
EBITDA	**1,328**	**1,329**	**1,342**	**1,660**	**2,070**
EBITDA Growth (%)	***56.7***	***0.1***	***1.0***	***23.6***	***24.7***
EBITDA Margin (%)	***10.9***	***9.3***	***7.8***	***7.9***	***8.0***
Depreciation	229	276	317	427	546
EBIT	**1,099**	**1,053**	**1,025**	**1,232**	**1,523**
Other Income (Including EO Items)	41	(39)	68	44	16
Interest	15	16	18	23	27
PBT	**1,125**	**998**	**1,075**	**1,253**	**1,512**
Total Tax	348	382	271	315	381
RPAT	**777**	**616**	**805**	**938**	**1,132**
Exceptional Gain/(loss)	-	(98)	-	-	-
Adjusted PAT	**777**	**714**	**805**	**938**	**1,132**
APAT Growth (%)	***77.0***	***(8.1)***	***12.7***	***16.5***	***20.7***
Adjusted EPS (Rs)	**42.9**	**39.5**	**44.5**	**51.8**	**62.5**
EPS Growth (%)	***76.7***	***(8.1)***	***12.7***	***16.5***	***20.7***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19P	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	181	181	181	181	181
Reserves	3,293	3,911	4,679	5,562	6,629
Total Shareholders Funds	**3,474**	**4,093**	**4,860**	**5,744**	**6,810**
Long Term Debt	3	0	0	0	0
Short Term Debt	3	219	219	219	219
Total Debt	**6**	**219**	**219**	**219**	**219**
Net Deferred Taxes	**(92)**	**(118)**	**(118)**	**(118)**	**(118)**
Other Non-current Liabilities & Provns	**42**	**60**	**60**	**60**	**60**
TOTAL SOURCES OF FUNDS	**3,430**	**4,254**	**5,021**	**5,904**	**6,971**
APPLICATION OF FUNDS					
Net Block	1,447	1,655	2,094	3,042	3,595
CWIP	35	40	40	40	40
Other Non-current Assets	1	12	12	12	12
Total Non-current Assets	**1,483**	**1,707**	**2,146**	**3,094**	**3,647**
Inventories	3,071	3,290	3,927	4,756	5,822
Debtors	-	-	-	-	-
Other Current Assets	317	431	508	607	734
Cash & Equivalents	**536**	**773**	**750**	**261**	**233**
Total Current Assets	**3,924**	**4,493**	**5,185**	**5,624**	**6,788**
Creditors	1,668	1,483	1,780	2,169	2,671
Other Current Liabilities & Provns	309	464	529	644	793
Total Current Liabilities	**1,977**	**1,946**	**2,309**	**2,813**	**3,465**
Net Current Assets	**1,947**	**2,547**	**2,875**	**2,811**	**3,324**
TOTAL APPLICATION OF FUNDS	**3,430**	**4,254**	**5,021**	**5,904**	**6,971**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19P	FY20E	FY21E	FY22E
Reported PBT	1,125	993	1,075	1,253	1,512
Non-operating & EO Items	8	89	(68)	(44)	(16)
Interest Expenses	15	16	18	23	27
Depreciation	222	268	317	427	546
Working Capital Change	(346)	(270)	(352)	(424)	(541)
Tax Paid	(381)	(332)	(271)	(315)	(381)
OPERATING CASH FLOW (a)	**643**	**763**	**720**	**920**	**1,148**
Capex	(478)	(407)	(756)	(1,375)	(1,100)
Free Cash Flow (FCF)	*166*	*357*	*(36)*	*(455)*	*49*
Investments	395	(339)	437	-	-
Non-operating Income	(68)	12	68	44	16
INVESTING CASH FLOW (b)	**(151)**	**(734)**	**(251)**	**(1,332)**	**(1,084)**
Debt Issuance/(Repaid)	(366)	(19)	(18)	(23)	(27)
FCFE	*(201)*	*338*	*(54)*	*(478)*	*22*
Share Capital Issuance	9	19	-	-	-
Dividend	(27)	(44)	(37)	(55)	(65)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(384)**	**(44)**	**(55)**	**(77)**	**(92)**
NET CASH FLOW (a+b+c)	**109**	**(14)**	**414**	**(489)**	**(28)**
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	196	123	580	91	63

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19P	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	32.1	32.3	31.0	31.0	31.0
EBITDA Margin	10.9	9.3	7.8	7.9	8.0
EBIT Margin	9.0	7.3	6.0	5.9	5.9
APAT Margin	6.4	5.0	4.7	4.5	4.4
RoE	25.2	18.9	18.0	17.7	18.0
RoIC (or Core RoCE)	29.4	21.5	19.8	18.6	18.4
RoCE	24.4	18.9	17.6	17.5	17.9
EFFICIENCY					
Tax Rate (%)	30.9	34.8	25.2	25.2	25.2
Fixed Asset Turnover (x)	6.8	6.4	5.7	4.8	4.7
Inventory (days)	*92*	*84*	*83*	*83*	*82*
Debtors (days)	-	-	-	-	-
Other Current Assets (days)	*9*	*11*	*11*	*11*	*10*
Payables (days)	*50*	*38*	*38*	*38*	*38*
Other Current Liab & Provns (days)	*9*	*12*	*11*	*11*	*11*
Cash Conversion Cycle (days)	42	45	45	44	44
Net D/E (x)	(0.2)	(0.1)	(0.1)	(0.0)	(0.0)
Interest Coverage (x)	71.9	65.3	58.5	54.4	56.7
PER SHARE DATA (Rs)					
EPS	42.9	39.5	44.5	51.8	62.5
CEPS	55.6	54.7	62.0	75.4	92.7
Dividend	2.00	1.70	2.50	3.00	3.50
Book Value	192.0	226.1	268.6	317.4	376.3
VALUATION					
P/E (x)	40.2	43.7	38.8	33.3	27.6
P/BV (x)	9.0	7.6	6.4	5.4	4.6
EV/EBITDA (x)	23.1	23.1	22.9	18.8	15.1
EV/Revenues (x)	2.5	2.1	1.8	1.5	1.2
OCF/EV (%)	2.1	2.5	2.3	3.0	3.7
FCF/EV (%)	0.5	1.2	(0.1)	(1.5)	0.2
FCFE/Mkt Cap (%)	(0.6)	1.1	(0.2)	(1.5)	0.1
Dividend Yield (%)	0.1	0.1	0.1	0.2	0.2

Source: Company, HDFC sec Inst Research

HDFC securities

INSTITUTIONAL RESEARCH

Shoppers Stop

NEUTRAL

Amidst tough times!

Industry pioneer STOP's model seems increasingly outmoded in the current phase of online evolution. We see e-tailers getting aggressive on the high-margin fashion category over the next 3-5 years to inch closer to profitability. The de-rating cycle of some of the global department stores has been severe and swift (Case in point Matahari) and we fail to see why India shouldn't follow the global playbook for this format.

It's not all gloomy, though! The new management is putting its best foot forward to stay relevant by 1) Beefing up the private label team, 2) Stepping up expansion post a dismal 3 years, 3) Non-core exits, 4) Increasing thrust on the high-margin beauty segment. That said, we would like to see some execution on this turnaround narrative before pressing the re-rating trigger. Hence restrict ourselves to a NEUTRAL stance. Undemanding valuations certainly help. We bake in revenue/EBITDA/LTL PAT 6/10/16% CAGR over FY19-22E and have a DCF-based TP of Rs 350/sh implying an EV/EBITDA of 9x Sept-21.

Investment rationale

- **STOP's high margin is e-tail's opportunity:** SS sports one of the highest gross margins (~42%) among departmental stores both –in India and globally; albeit EBITDA margins (~7%) are the lowest within the cohort. Ergo, this heavy cost structure makes it even more vulnerable to online disruption than most global players. Its rent bill (as % of sales) is as high as online fulfillment costs (Despite the sub-scale e-tail trade in India). This arbitrage too is expected to move in favor of the latter as scale improves.

  …Payables crutch makes STOP vulnerable too: Globally, given the scale, bulk of inventory purchases for department stores are on an outright (OR) basis, giving them complete control on inventory and price management. Hence, global peers are less vulnerable to WC and price shocks. Indian department stores' (incl. STOP) current scale doesn't permit higher OR sales, i.e, higher inventory risk. Hence, the format is saddled with high inventory and payables. This payables' crutch could and will be taken off as online retailers use better trade terms to woo brands for more volumes in the medium-to-long term.
- **Balance sheet finally supports expansion!** We reckon, given the low interest cover over FY16-19 (0.6-2x), STOP had to rein in its expansion plans. (Added a mere 7 stores in 3 years). A few non-core exits later (Hypercity, Nuance, and Timezone in FY18), STOP is now a net cash company and finally seems primed to step up expansion. We build in 5 department store/20 beauty store additions annually over FY19-22E. We expect a modest 3% SSSG CAGR for the department store over FY19-22E primarily led by better milking of STOP's first citizen loyalty programme and better online throughput given the recent Amazon tie-up.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	35,779	36,749	39,444	42,377
EBITDA	2,457	2,777	3,069	3,276
APAT	650	789	923	1,021
Dil. EPS (Rs/sh)	7.4	9.0	10.5	11.6
P/E (x)	47.8	39.4	33.6	30.4
EV/EBITDA (x)	11.8	10.3	8.9	7.9
ROE (%)	7.1	8.3	9.0	9.3
RoIC (%)	8.8	10.5	12.3	14.1
ROCE (%)	7.4	8.6	9.3	9.5

Source: Company, HDFC Securities

INDUSTRY	RETAIL
CMP *(as on 06 Dec 2019)*	Rs 357
Target Price	Rs 350
Nifty	11,922
Sensex	40,445
KEY STOCK DATA	
Bloomberg	SHOP IN
No. of Shares (mn)	88
MCap (Rs bn) / ($ mn)	31/441
6m avg traded value (Rs mn)	12

STOCK PERFORMANCE (%)			
52 Week high / low	Rs 560/338		
	3M	6M	12M
Absolute (%)	(11.0)	(26.3)	(27.9)
Relative (%)	(20.4)	(28.6)	(42.5)

SHAREHOLDING PATTERN (%)	Jun-19	Sep-19
Promoters	63.71	63.72
FIs & Local MFs	18.19	22.92
FPIs	7.03	6.92
Public & Others	11.07	6.44
Pledged Shares	8.04	8.04

Source : BSE

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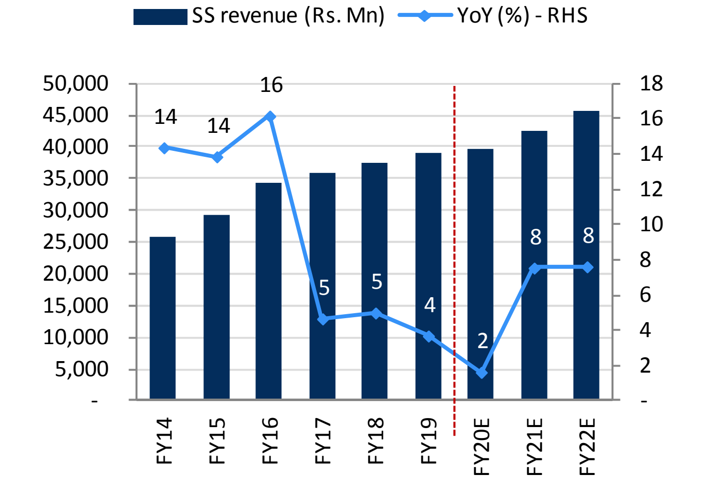
- **Beauty segment may have some legs; although far from a go-to-platform:** STOP's Beauty segment (~16% of revenue) has the offline rights to some commendable global brands such as MAC/Estee Lauder/ Clinique/Bobbi brown). That said, a consumer typically moves online for beauty purchases once a product is tested. This explains why online beauty e-tailer Nykaa has out-scaled STOP's beauty segment in its short history. Nykaa also sells some of STOP's partner brands' merchandise online. (FY18 Nykaa revenue Rs. 4.4bn). While the sheer under-penetration of the category should ensure modest growth for this vertical (HDFC est: 10% CAGR over FY19-22E). it certainly isn't the go-to-platform for beauty purchases. Management has guided for 40 store additions in this vertical in FY20 (HDFC est: 20 stores).
- **Too little; too late:** While STOP may directionally be fixing a few key variables, we believe the measures are too little, too late. It took STOP four years, to beef up its private label team while contribution from private labels continued to languish (Declined from 17% in FY16 to 12% in FY19). At a time when peers such as Lifestyle Int and Central consistently strengthened their private label portfolio (currently ~30%).
- **Not the best in real estate choices:** A deeper look at the store networks of department stores also suggests that STOP has been overly focused on districts with a PCI of 300k+. This cohort of consumers is typically more exposed to online platforms and have a higher affinity for online shopping. With the step up in expansion, STOP may cover some ground, however this comes at a time, when deep-pocketed online folks are training focus on beefing up brand tie-ups and high-ticket apparel sales in search for profitability. Hence, while we build in a step up in revenue (6% over FY19-22E vs -1% over FY14-19), it still remains one of the slowest growing retail outfits in our universe. We build in EBITDA/LTL PAT CAGR of 10%/16% over FY19-22E. Initiate coverage on STOP with a Neutral stance and a DCF-based TP of Rs 350/sh implying an EV/EBITDA of 9x Sept-21
- **Key Risks:** 1) Better-than-expected traction in beauty segment, 2. Private labels perform better than expected, 3. Higher-than-expected store adds in department stores and beauty segment.

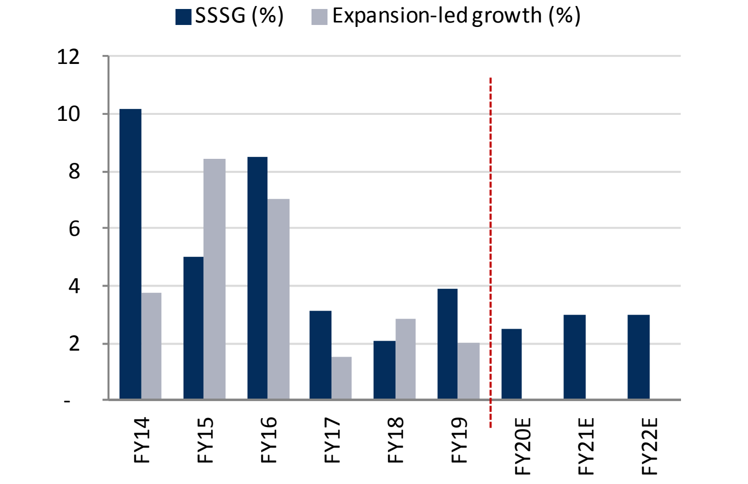
Story in Charts

STOP Dept. store to clock a 6% CAGR over FY19-22E



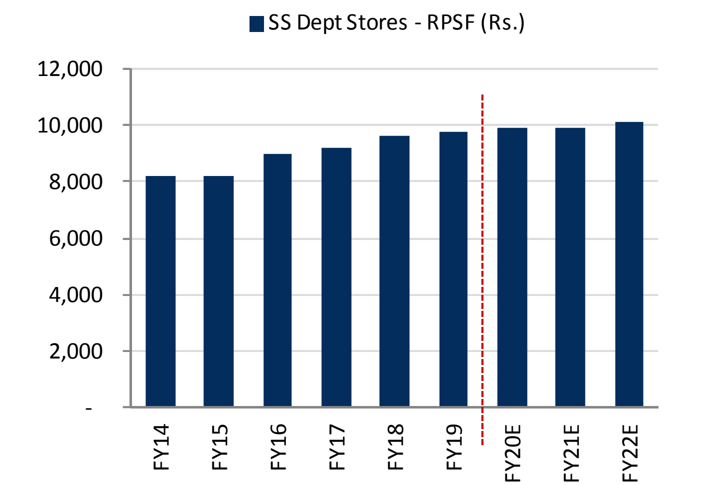
Source: Company, HDFC sec Inst Research

…two-thirds of the growth expected to be SSSG-led



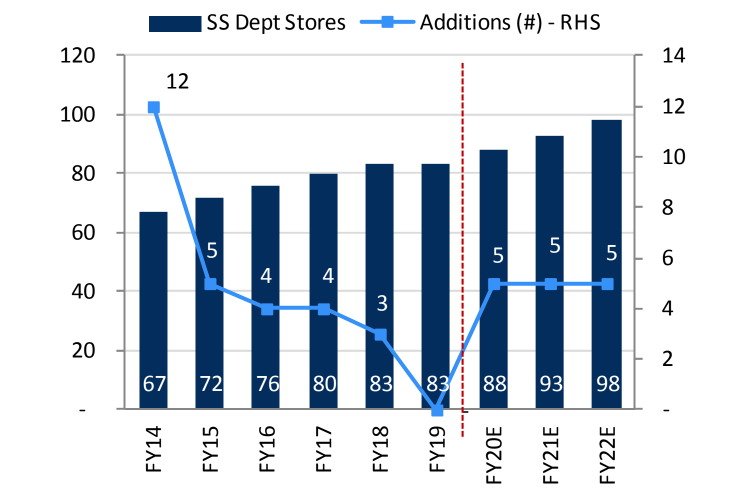
Source: Company, HDFC sec Inst Research

Productivity to remain steady over FY19-22E given the SSSG focus (Rs. per sq. ft)



Source: Company, HDFC sec Inst Research, RPSF – Revenue/sq. ft

Building in 5 store additions annually over FY19-22E



Source: Company, HDFC sec Inst Research

Scrapping the bottom of the barrel

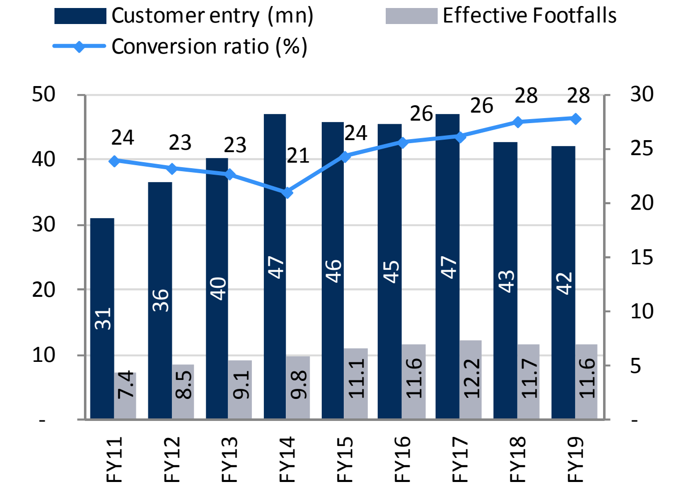
Consistently growing footfalls and conversions are the be all and end all for any retailer. Shoppers Stop akin to department stores globally seems to be on the wrong side of this equation as consumers increasingly shop online within the comfort of their homes

Shoppers Stop's (SS) footfalls are at a 6-year low. While the company has effectively milked its First Citizen loyalty programme to improve conversions, there is a natural cap on doing so. Members' contribution is 80%+ of SS's sales.

So unless, SS successfully recruits fresh and higher spending consumers, biz scalability remains a challenge

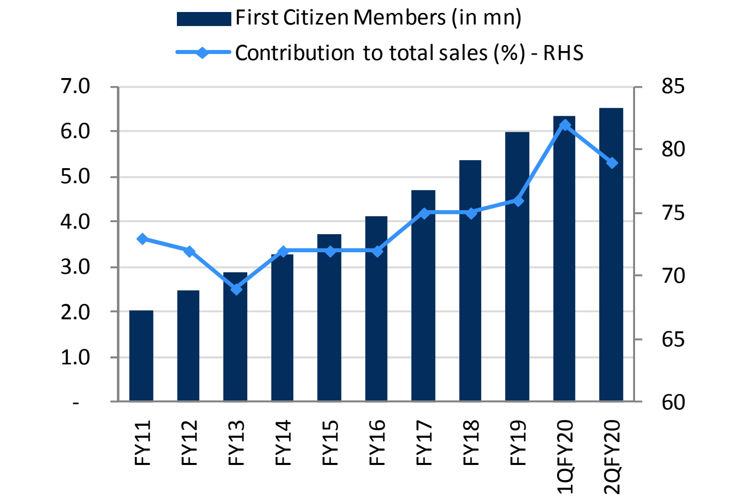
Also note, while, First Citizen Members have grown at a CAGR of 13%, implied spends per member have declined at 6% CAGR over FY16-19

Footfalls and conversion ratio



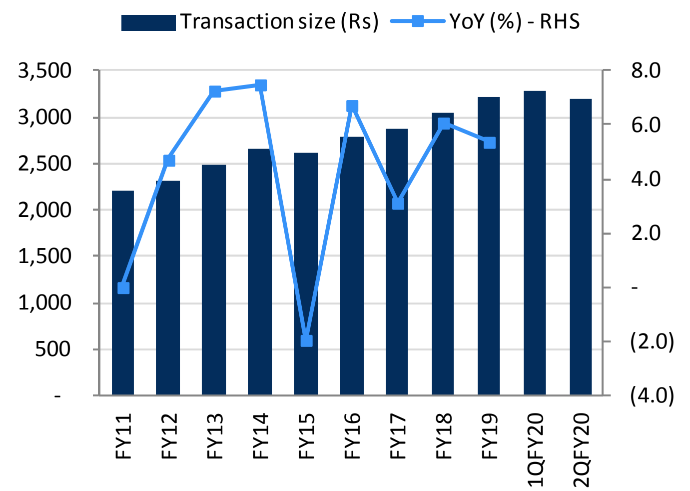
Source: Company, HDFC sec Inst Research

STOP milking loyalty programme well

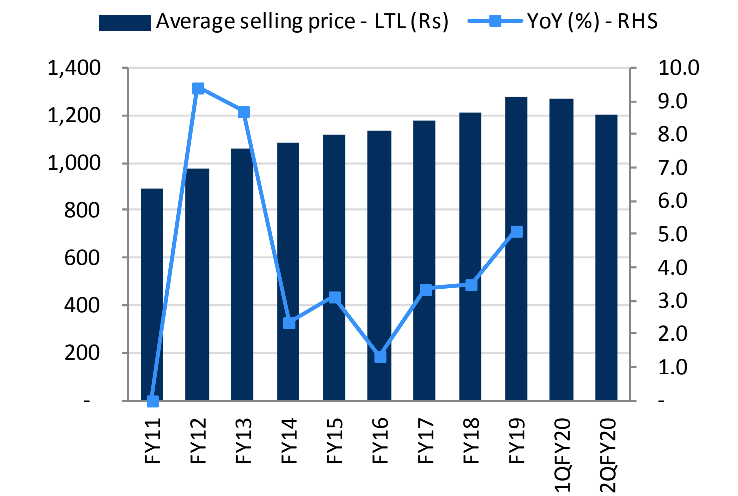


Source: Company, HDFC sec Inst Research

ASP and transaction size have largely mimicked inflation



Source: Company, HDFC sec Inst Research



Source: Company, HDFC sec Inst Research

Strong pull-Pvt labels could be an answer to an audience exodus. STOP is trying to work towards this with

1. ***Increased investments (Rs. 100mn in FY19)***
2. ***Amazon tie-up***
3. ***Re-positioning its key private labels as value fashion plays with sharper price points***

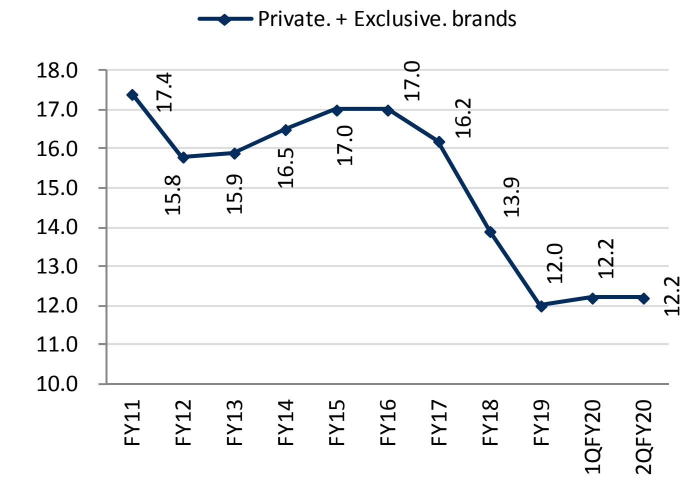
That said, it is a long and hard journey towards establishing pull brands. Consistent ad spends is a pre-requisite and STOP's P&L doesn't permit matching ad spends done by key brand players such as ABFRL (6x that of SS) and Arvind Fashion (2.5x)

Ad spends are key given that SS's audience is typically a metro/Tier 1 consumer who is exposed to a plethora of brands

Sure, the Amazon tie-up could spur demand for SS's private labels, we reckon it would take a few years to assess the salience of these brands

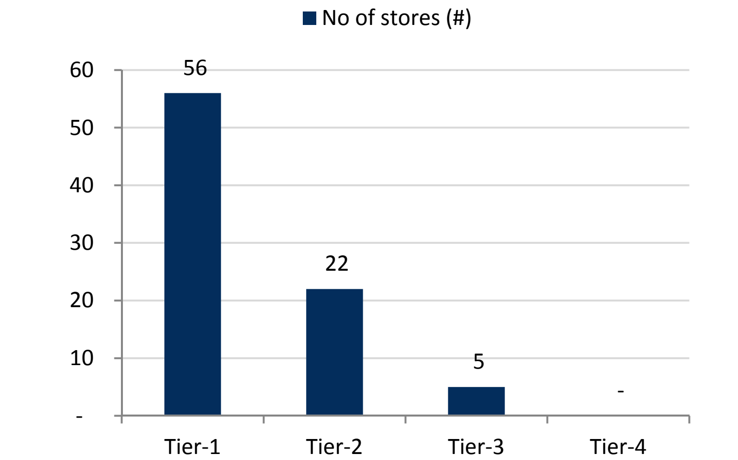
Of the 38% non-apparel revenues, 10% is estimated to be beauty products and rest are accessories/others. Typically a consumer moves to an online purchase in the beauty category once the product is tested

Private label sales have been declining



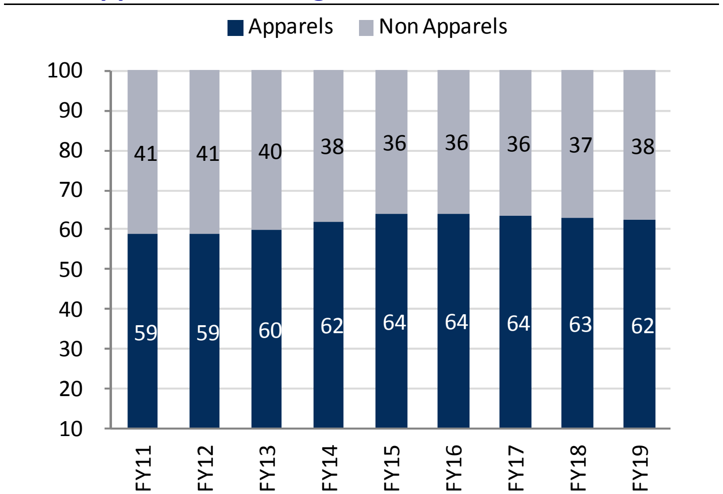
Source: Company, HDFC sec Inst Research

Shoppers stop: Tier-wise stores



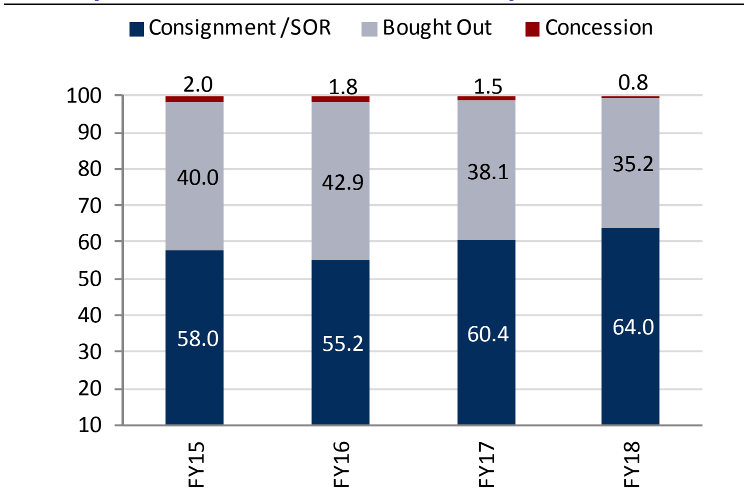
Source: Company, HDFC sec Inst Research

Non-apparel increasing in revenue mix



Source: Company, HDFC sec Inst Research

Nearly two-thirds of STOP's inventory is on SoR



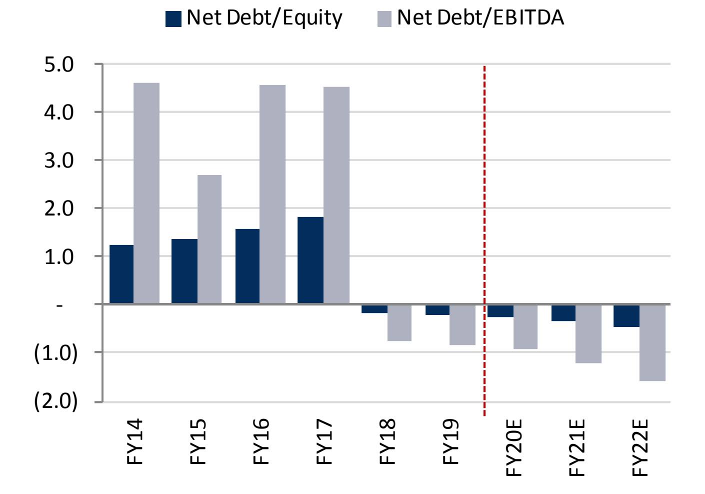
Source: Company, HDFC sec Inst Research

Non-core exits – A much needed respite, else the pain would've been even more debilitating

STOP exited a few non-core businesses – HyperCity, Nuance, and Timzezone over FY17-18, proceeds from which were used to de-lever the balance sheet

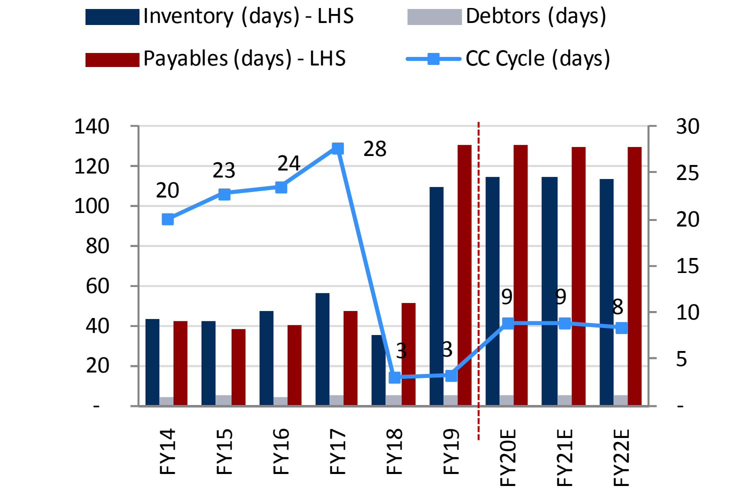
Building in a marginal deterioration in CC Cycle. Payables will be a key monitor-able over the medium to long-term as online steps-up the heat in apparel.

Non-core exits have helped de-lever balance sheet



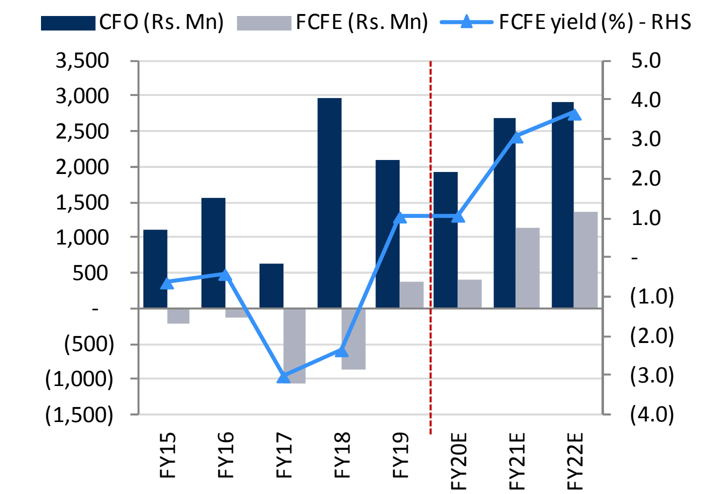
Source: Company, HDFC sec Inst Research

Building in marginal deterioration in CC Cycle



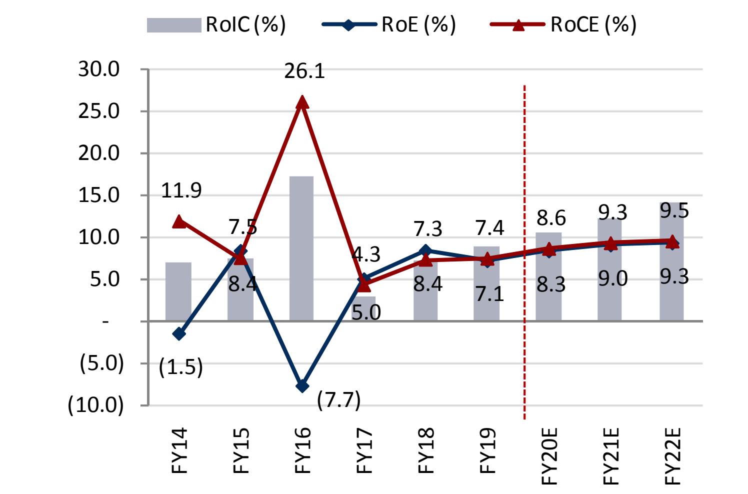
Source: Company, HDFC sec Inst Research

Given the non-core exits over the FY17-18, inherent free cash generation ability has improved



Source: Company, HDFC sec Inst Research

Building in a marginal improvement in return profile



Source: Company, HDFC sec Inst Research

Historically, not the sharpest capital allocator

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	1.0	0.8	0.8	1.2	2.6	1.6	1.1	1.2	2.1	12.4
Other Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.2
Total	**1.0**	**0.8**	**0.8**	**1.2**	**2.6**	**1.6**	**1.1**	**1.4**	**2.1**	**12.7**
										0
Application of funds (Rs bn)										-
Working Capital	0.1	0.7	0.1	0.1	0.6	0.2	(0.0)	(2.5)	0.0	(0.7)
Capex	2.2	1.7	1.2	2.1	1.6	1.7	1.1	0.3	1.1	13.1
Investments	-	0.0	-	0.0	-	-	-	0.2	0.2	0.4
Dividend	0.1	0.1	0.1	0.1	0.1	0.2	-	0.1	0.1	0.7
Borrowings	(0.3)	(1.7)	(0.6)	(1.5)	(1.0)	(0.9)	(0.6)	7.6	0.5	1.5
Others	(0.8)	0.0	(0.1)	0.4	1.3	0.5	1.2	(5.2)	0.0	(2.6)
Net change in cash	(0.2)	(0.1)	0.1	(0.0)	(0.1)	(0.1)	(0.6)	0.9	0.1	0.3
Total	**1.0**	**0.8**	**0.8**	**1.2**	**2.6**	**1.6**	**1.1**	**1.4**	**2.1**	**12.7**
Cumm. WC + Capex as % of sources of funds										**97.4**

Source: Company, HDFC sec Inst Research

Valuation

DCF (Rs. mn)

	FY21E	FY22E	FY23E	FY24E	FY25	FY26	FY27	FY28	FY29	FY30
EBIT*(1-t)	837	887	990	1,234	1,659	2,002	2,403	2,476	2,558	2,628
Depreciation	1,934	2,074	2,170	2,108	1,818	1,630	1,371	1,468	1,548	1,644
Capex	(1,440)	(1,449)	(1,427)	(1,436)	(1,415)	(1,423)	(1,402)	(1,411)	(1,390)	(1,399)
Changes in WC (Winv)	(66)	(14)	(13)	(9)	3	12	20	36	44	52
FCFF	**1,265**	**1,499**	**1,720**	**1,897**	**2,065**	**2,221**	**2,392**	**2,569**	**2,761**	**2,926**
YoY (%)	*148.1*	*18.4*	*14.7*	*10.3*	*8.9*	*7.6*	*7.7*	*7.4*	*7.5*	*6.0*
Interest (1-t)	(66)	(66)	(66)	(66)	(66)	(66)	(66)	(66)	(66)	(66)
Net Borrowings	-	-	-	-	-	-	-	-	-	-
FCFE	**1,199**	**1,433**	**1,654**	**1,831**	**1,999**	**2,155**	**2,326**	**2,503**	**2,695**	**2,860**
YoY (%)	*170.1*	*19.4*	*15.4*	*10.7*	*9.2*	*7.8*	*7.9*	*7.6*	*7.7*	*6.1*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
PV (FCFF)	**1,197**	**1,269**	**1,303**	**1,286**	**1,253**	**1,206**	**1,162**	**1,117**	**1,074**	**1,018**
Terminal Value										**45,550**

DCF Date (Till FY40)	**Sep-20**
Kd*(1-t)	7.4
Ke	12
Net Debt (Mar-20E)	(2,507)
PV-Explicit Period	12,423
PV-Terminal Value	15,854
Equity Value (INR m)	30,783
Equity value per share (INR)	**350**
Sept-21 Implied P/E (x)	31.7
Sept-21 Implied EV/EBITDA (x)	8.9
Terminal growth rate (%)	5.0
WACC	11.7
No. of shares (b)	88.0
CMP	**357**
Upside/(Downside)	**-2.1%**

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Inventory risk	Any material misjudgment in estimating customer demand could adversely impact the results by causing either a shortage of inventory or an accumulation of excess inventory.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. Chandru Raheja	Chairman and Non-Executive Director	Mr. Chandru L. Raheja has extensive experience in the real estate, hospitality and retail industries across India. He has been involved in real estate development for more than four decades.
Mr. B. S. Nagesh	Chairman and Non-Executive Director	He is the Founder of TRRAIN (Trust for Retailers and Retail Associates of India) and the not for profit company TRRAIN Foundation. Mr. Nagesh has been involved with Shoppers Stop and its group companies since its inception in 1991 as its first employee. He stepped out of the day-to-day roles of the business as Managing Director in the year 2009.
Mr. Rajiv Suri	Managing Director & CEO	Mr. Rajiv Suri, 55, is the Managing Director & Chief Executive Officer of the Company. Mr. Suri was appointed as the CEO on January 9, 2018. He brings over 25 years of strategic leadership experience across Europe, Middle East, Africa and Asia. Previously, he was CEO for the Majid Al Futtaim Fashion business, which is spread across close to 140 stores across Dubai, United Arab Emirates, where he led strategic development, growth, transformation, innovation and digitalization.
Mr. Karunakaran	Chief Financial Officer	He joined the company effective June, 2018. He is a qualified Chartered Accountant and Company Secretary, with more than 25 years of experience across retail, manufacturing and pharmaceutical Industry. Prior to Shoppers Stop, he was Head of Finance with Avon and worked at Heinz Asia and Nicholas Piramal India.

Source: Company, HDFC sec Inst Research

Company profile

- Shoppers Stop, part of the K Raheja Group of Companies, is India's leading multi-brand retailer. The company operates stores under 4 retail formats: Departmental stores (Shoppers Stop), Specialty retail stores (MAC, estee Lauder, Clinique and Bobby Brown), home improvement stores (Homestop) and book and music stores (Crossword).
- The company's department stores provide clothing products for men, women, and kids; accessories, fragrances, cosmetics, and footwear; and home furnishing and decor products. It operates through 86 such stores. The Company, through its Website, shoppersstop.com, offers international and national brands in men's, women's and kids apparel; gifts and fashion accessories, men's and women's footwear, home furnishing and decor products.
- Specialty stores - Estèe Lauder offer skincare, makeup, and fragrance products; M.A.C stores provide professional cosmetics; Clinique stores offer skin care products; and Bobbi Brown stores provide cosmetics for the upper premium/prestige segment. Crossword stores offer books, movies, music, toys, stationery, magazines, and CD-ROMs. HomeStop stores provide home decor products, furniture and recliners, bath accessories, bedroom furnishings, mattresses, draperies, carpets, and kitchen gadgets accessories and appliances to modular kitchen.
- As of Sep 30, 2019, it operated 84 Shoppers Stop stores, 126 Specialty retail stores, 39 Crossword and 12 Home Stop stores, with a total retail space of 4.3 mn sq ft.

Income Statement (Consolidated)

Year End (March)	FY18	FY19E	FY20E	FY21E	FY22E
Net Revenues	**36,967**	**35,779**	**36,749**	**39,444**	**42,377**
Growth (%)	***(1.6)***	***(3.2)***	***2.7***	***7.3***	***7.4***
COGS	22,679	20,783	21,309	22,931	24,700
Employee Expense	3,157	3,296	3,378	3,618	3,878
A&P Expense	573	723	706	738	772
Rent Expense	3,766	4,045	4,092	4,311	4,640
Other Expenses	4,678	4,476	4,487	4,777	5,111
EBITDA	**2,115**	**2,457**	**2,777**	**3,069**	**3,276**
EBITDA Growth (%)	***9.9***	***16.2***	***13.0***	***10.5***	***6.8***
EBITDA Margin (%)	***5.7***	***6.9***	***7.6***	***7.8***	***7.7***
Depreciation	1,149	1,406	1,794	1,934	2,074
EBIT	**966**	**1,051**	**983**	**1,135**	**1,203**
Other Income (Including EO Items)	2,325	187	175	206	270
Interest	377	138	89	89	89
PBT	**2,914**	**1,099**	**1,069**	**1,251**	**1,384**
Total Tax	176	449	280	328	362
RPAT before share of associate earnings	**2,739**	**650**	**789**	**923**	**1,021**
Share of associate earnings	-	-	-	-	-
Minority share of Profit/(Loss)	-	-	-	-	-
RPAT	**2,739**	**650**	**789**	**923**	**1,021**
Exceptional (gain)/loss	(2,160)	-	-	-	-
Adjusted PAT	**579**	**650**	**789**	**923**	**1,021**
APAT Growth (%)	***134.1***	***12.3***	***21.4***	***17.0***	***10.6***
Adjusted EPS (Rs)	**6.6**	**7.4**	**9.0**	**10.5**	**11.6**
EPS Growth (%)	***122.3***	***12.2***	***21.4***	***17.0***	***10.6***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19E	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	440	440	440	440	440
Reserves	8,605	8,707	9,416	10,180	11,011
Total Shareholders Funds	**9,044**	**9,147**	**9,856**	**10,620**	**11,451**
Minority Interest	-	-	-	-	-
Long Term Debt	440	20	20	20	20
Short Term Debt	813	724	724	724	724
Total Debt	**1,253**	**745**	**745**	**745**	**745**
Net Deferred Taxes	**(198)**	**(320)**	**(320)**	**(320)**	**(320)**
Other Non-current Liabilities & Provns	**6**	**6**	**6**	**6**	**6**
TOTAL SOURCES OF FUNDS	**10,106**	**9,578**	**10,287**	**11,051**	**11,882**
APPLICATION OF FUNDS					
Net Block	6,630	6,050	5,689	5,195	4,570
CWIP	182	351	351	351	351
Other Non-current Assets	97	97	97	97	97
Total Non-current Assets	**6,908**	**6,498**	**6,136**	**5,642**	**5,017**
Inventories	3,563	10,719	11,578	12,373	13,236
Debtors	477	472	485	521	560
Other Current Assets	3,845	3,988	4,096	4,397	4,724
Cash & Equivalents	**2,885**	**2,758**	**3,251**	**4,444**	**5,885**
Total Current Assets	**10,770**	**17,938**	**19,411**	**21,735**	**24,404**
Creditors	5,191	12,771	13,117	14,025	15,068
Other Current Liabilities & Provns	2,381	2,087	2,144	2,301	2,472
Total Current Liabilities	**7,572**	**14,858**	**15,261**	**16,326**	**17,540**
Net Current Assets	**3,198**	**3,080**	**4,151**	**5,409**	**6,864**
TOTAL APPLICATION OF FUNDS	**10,106**	**9,578**	**10,287**	**11,051**	**11,882**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19E	FY20E	FY21E	FY22E
Reported PBT	2,320	1,099	1,069	1,251	1,384
Non-operating & EO Items	(2,258)	(7)	(175)	(206)	(270)
Interest Expenses	377	138	89	89	89
Depreciation	1,149	1,406	1,794	1,934	2,074
Working Capital Change	1,749	17	(577)	(66)	(14)
Tax Paid	(356)	(565)	(280)	(328)	(362)
OPERATING CASH FLOW (a)	**2,981**	**2,088**	**1,919**	**2,675**	**2,900**
Capex	(297)	(1,133)	(1,432)	(1,440)	(1,449)
Free Cash Flow (FCF)	*2,684*	*955*	*488*	*1,235*	*1,451*
Investments	(200)	(224)	-	-	-
Non-operating Income	146	37	175	206	270
INVESTING CASH FLOW (b)	**(351)**	**(1,320)**	**(1,257)**	**(1,235)**	**(1,178)**
Debt Issuance/(Repaid)	(3,594)	(565)	(89)	(89)	(89)
FCFE	*(910)*	*390*	*398*	*1,146*	*1,362*
Share Capital Issuance	1,959	11	-	-	-
Dividend	(75)	(80)	(80)	(159)	(191)
Others	-	-	-	-	-
FINANCING CASH FLOW (c)	**(1,710)**	**(634)**	**(169)**	**(248)**	**(280)**
NET CASH FLOW (a+b+c)	**920**	**134**	**493**	**1,192**	**1,442**
EO Items, Others					
Closing Cash & Equivalents	53	171	668	1,860	3,302

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19E	FY20E	FY21E	FY22E
PROFITABILITY (%)					
GPM	38.7	41.9	42.0	41.9	41.7
EBITDA Margin	5.7	6.9	7.6	7.8	7.7
EBIT Margin	2.6	2.9	2.7	2.9	2.8
APAT Margin	1.6	1.8	2.1	2.3	2.4
RoE	8.4	7.1	8.3	9.0	9.3
RoIC (or Core RoCE)	7.1	8.8	10.5	12.3	14.1
RoCE	7.3	7.4	8.6	9.3	9.5
EFFICIENCY					
Tax Rate (%)	23.3	40.9	26.2	26.2	26.2
Fixed Asset Turnover (x)	4.8	4.4	3.9	3.6	3.5
Inventory (days)	*35*	*109*	*115*	*115*	*114*
Debtors (days)	*5*	*5*	*5*	*5*	*5*
Other Current Assets (days)	*38*	*41*	*41*	*41*	*41*
Payables (days)	*51*	*130*	*130*	*130*	*130*
Other Current Liab & Provns (days)	*24*	*21*	*21*	*21*	*21*
Cash Conversion Cycle (days)	3	3	9	9	8
Net D/E (x)	(0.2)	(0.2)	(0.3)	(0.3)	(0.4)
Interest Coverage (x)	2.6	7.6	11.0	12.7	13.5
PER SHARE DATA (Rs)					
EPS	6.6	7.4	9.0	10.5	11.6
CEPS	19.6	23.4	29.3	32.5	35.2
Dividend	0.8	0.8	1.5	1.8	2.1
Book Value	102.8	104.0	112.0	120.7	130.1
VALUATION					
P/E (x)	53.7	47.8	39.4	33.6	30.4
P/BV (x)	3.4	3.4	3.2	2.9	2.7
EV/EBITDA (x)	13.9	11.8	10.3	8.9	7.9
EV/Revenues (x)	0.8	0.8	0.8	0.7	0.6
OCF/EV (%)	10.1	7.2	6.7	9.8	11.2
FCF/EV (%)	9.1	3.3	1.7	4.5	5.6
FCFE/Mkt Cap (%)	(2.9)	1.3	1.3	3.7	4.4
Dividend Yield (%)	0.2	0.2	0.4	0.5	0.6

Source: Company, HDFC sec Inst Research

Arvind Fashion

BUY

On Course to recovery

Arvind Fashion Ltd (AFL), an off-shoot of the textile major Arvind Ltd houses the Brands and Retail biz of the group (De-merged in FY19). AFL houses a commendable portfolio of lifestyle brands, prestige beauty brands (Sephora) and value fashion (Unlimited). While AFL grew at an impressive clip (20% CAGR) over FY16-19, the quality of growth remains weak. The company finds itself grappling with multiple concerns across nearly all major formats 1. Burgeoning receivables – as 1/4th of Power brand sales (60% of sales) are pushed through MBOs which typically have a longer credit cycle, 2. Lackluster performance of some of its emerging (EM) brands, 3. Teething issues in value fashion.

However, the company seems to be on course to stage a recovery as it 1. De-focuses on the MBO channel, 2. Weeds out the duds in its Emerging brands portfolio, 3. Shuts loss-making stores in Unlimited. Given the strong brand equity of its power brands, a turnaround in this piece is a foregone conclusion. However, we remain circumspect on the more scalable value fashion play given AFL's lack of execution history. We bake in revenue/EBITDA CAGR of 5/3% over FY19-22E with RoCEs showing a U-shaped recovery. Initiate on AFL with a BUY and a DCF-based TP of Rs. 430/sh, implying an EV/EBITDA of 12x Sept-21 (a near 50% discount to ABFRL).

Investment rationale

- **Power brands – The Cash Machine:** AFL's Power brands portfolio (USPA, Arrow, Flying Machine and Tommy Hilfiger) has posted a solid 19% CAGR over FY16-FY19 (~28bn, Rs. 60% of sales, >100% of EBITDA). That said, growth seems to have hit a pit stop, given the management's strategy to 1. De-focus on the working-capital heavy MBO channel and 2. Re-align its primary and secondary throughput in its quest to have cash flow-accretive growth. Brands with an MBO-heavy distribution (Eg: Arrow) are expected to take a beating in FY20. However, underlying brand equity remains strong and one should expect full recovery by FY21. Growth underpinnings are expected to be brand extension to faster growing sub-categories (Innerwear, Kidswear, Footwear). Hence, we bake in a conservative 5% revenue CAGR/full margin recovery of 170bp over FY20-22E for this segment.
- **Separating the wheat from the chaff:** Duds in AFL's EM portfolio are being weeded out to focus on four promising brands (Calvin Klein, Aeropostale, Ed Hardy, The Children's Place). Ergo, we would see a Rs.2.2bn revenue drop in emerging brands' top-line in FY20 and losses should balloon 7x to Rs. 940mn led by 1. A Rs. 680mn one-time exit charges for discontinued brands (incl. Royalty), 2. MBO-led profitability hit on select brands. That said, as AFL puts this re-alignment behind it, recovery should be quick too. Interestingly, portfolio growth is expected to be asset-light as delivery channel shifts from EBOs to LFS/SIS/online. Expect Core EM brand revenue to grow at 11% CAGR over FY19-22E.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	46,439	43,654	48,398	53,700
EBITDA	2,881	637	2,451	3,190
APAT	215	(2,041)	(461)	57
Dil. EPS (Rs/sh)	3.7	(35.2)	(7.9)	1.0
P/E (x)	91.9	(9.7)	(42.9)	345.4
EV/EBITDA (x)	9.7	43.4	11.2	8.6
ROE (%)	2.0	(19.9)	(5.1)	0.6
RoIC (%)	6.7	(3.8)	3.9	6.4
ROCE (%)	7.3	(3.7)	3.9	6.3

Source: Company, HDFC sec Inst Research

INDUSTRY	**RETAIL**
CMP *(as on 06 Dec 2019)*	**Rs 321**
Target Price	**Rs 430**
Nifty	11,922
Sensex	40,445

KEY STOCK DATA

Bloomberg	ARVINDFA IN
No. of Shares (mn)	59
MCap (Rs bn) / ($ mn)	19/265
6m avg traded value (Rs mn)	30

STOCK PERFORMANCE (%)

52 Week high / low		**Rs 1,090/303**	
	3M	6M	12M
Absolute (%)	(30.8)	(58.0)	-
Relative (%)	(40.1)	(60.3)	-

SHAREHOLDING PATTERN (%)

	Jun-19	Sep-19
Promoters	35.61	35.58
FIs & Local MFs	15.74	20.04
FPIs	18.03	15.69
Public & Others	30.62	28.69
Pledged Shares	1.45	1.45

Source : BSE

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- **Specialty Retail – Potential slingshot to scalability:** AFL's Specialty Retail biz houses 1. Sephora (Prestige Beauty Retailing), 2. Unlimited (Value Fashion), 3. GAP. Of these, Unlimited could certainly be a slingshot to scalability as it lends itself to a broader target group.

  1. **Unlimited:** Phase 1 of Unlimited hasn't been encouraging as the format is yet to find its feet after its proposition change (earlier a liquidation store named Megamart). The management is yet to crack store-economics on this one. That said, AFL, has identified 19 loss-making stores to close by FY20. (11 closed already). Rest of the stores, have double-digit store-level margins. Losses for Unlimited could remain elevated in FY20 given one-time store closure-led losses. However, one can expect a sizeable swing in profitability for Unlimited as it stabilizes over FY19-22E. We expect Unlimited to clock 3% revenue CAGR and build in a Rs. 500mn EBITDA swing over FY19-22E. Expect the format to break-even by FY22E.

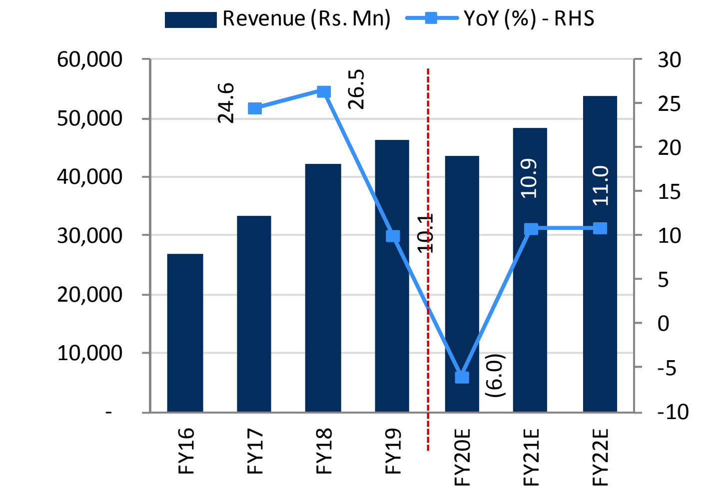
  2. **Sephora:** AFL has exclusive franchise rights for one of the leading global beauty retailers – Sephora. That makes AFL a strong play in the fast growing prestige beauty segment in India. (Expected to clock 25% CAGR to USD1.5bn over FY15-22E). Sephora was launched in India in FY16 with 4 stores and has been profitable since its 2nd year of operations. Given category tailwinds, we expect Sephora to clock 24% CAGR and add 10 stores annually in FY21/F22. Building in a conservative 70bp margin expansion on a low base. An aggressive online roll-out (not factored in), presents upside risk to our revenue estimates.

  3. **GAP:** GAP's multi-layered strategy pivot has helped improve its viability over the last couple of years. The strategy reset is hinged on 1. Higher local procurement (now 60%, expected to inch up every year). This change in procurement strategy has helped GAP sharpen its price and margins. 2. Increasing sales velocity via higher exposure to faster growing kids segment through GAP Kids (Franchisee route), 3. Shift from EBO to shop-in-shop/LFS model making the expansion lighter on the balance sheet, 4. Online thrust. This has helped GAP re-energize its sales velocity (up 60% YoY in FY19). We expect GAP to grow at 24% CAGR over FY19-22E and hit break-even in FY20.

- **On course to recovery:** Given the brand equity of AFL's power brands (60% of sales), a recovery in this segment is a foregone conclusion and a low hanging fruit. This coupled with multiple margin levers and an increasingly lighter expansion strategy should ensure AFL return profile has a U-shaped recovery. (6.3% by FY22 vs -3.7% in FY20E). We remain circumspect on the more scalable value fashion play though, given AFL's lack of execution history and hence build in a gradual recovery. With the stock available at a mere 1x FY20E Power brand sales, valuations seem undemanding. Ergo, initiate on AFL with a BUY recommendation and a DCF-based TP of Rs. 430/sh, implying an EV/EBITDA of 12x Sept-21 (47% discount to ABFRL). The discount seems justified given the lower interest cover and higher WC intensity of the biz vs ABFRL. However, the gap is expected to narrow as AFL gets a fix on its working capital and expansion gets lighter with time.

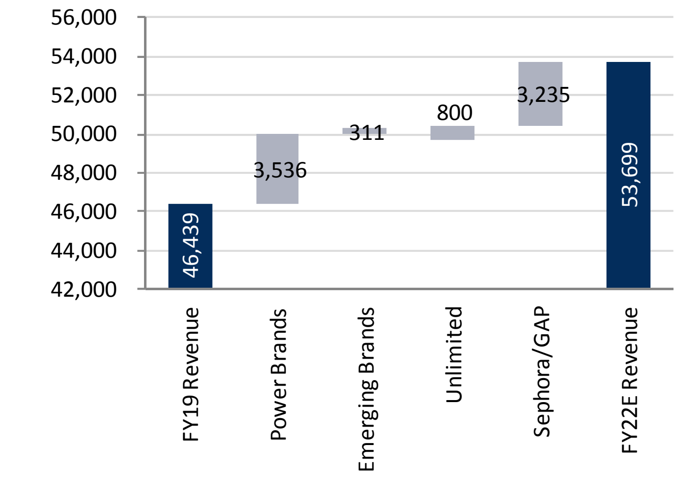
Story in Charts

Revenue to grow at 5% CAGR over FY18-21E



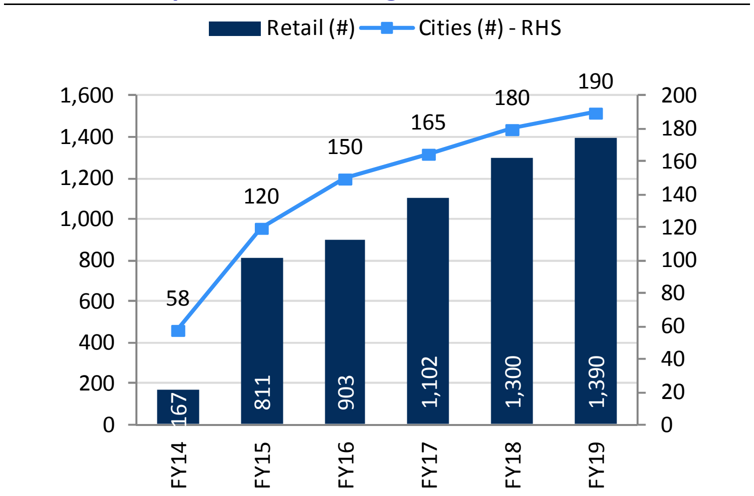
Source: Company, HDFC sec Inst Research

...largely fueled by Power brands, Sephora and GAP



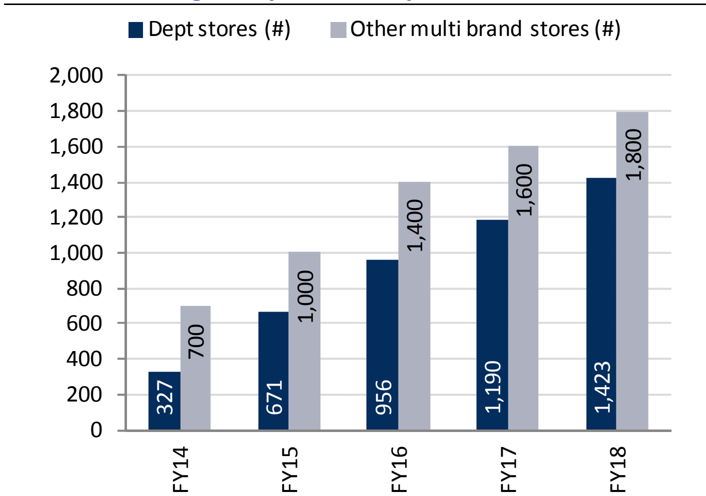
Source: Company, HDFC sec Inst Research

AFL's retail presence nearing 200 cities



Source: Company, HDFC sec Inst Research

...has a strong footprint in department stores too



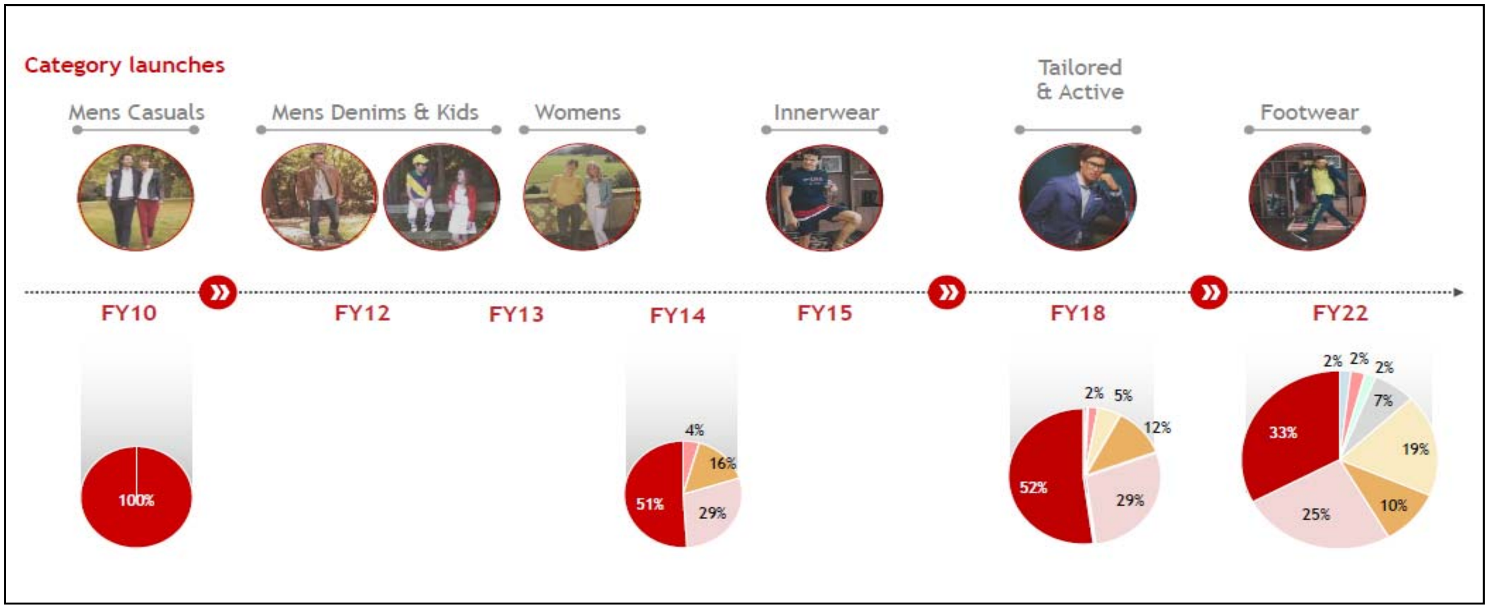
Source: Company, HDFC sec Inst Research

US Polo's brand extension journey has fueled its growth story over the years. Could play out across other select brands too

AFL's portfolio offerings across formats

Source: Company, HDFC sec Inst Research

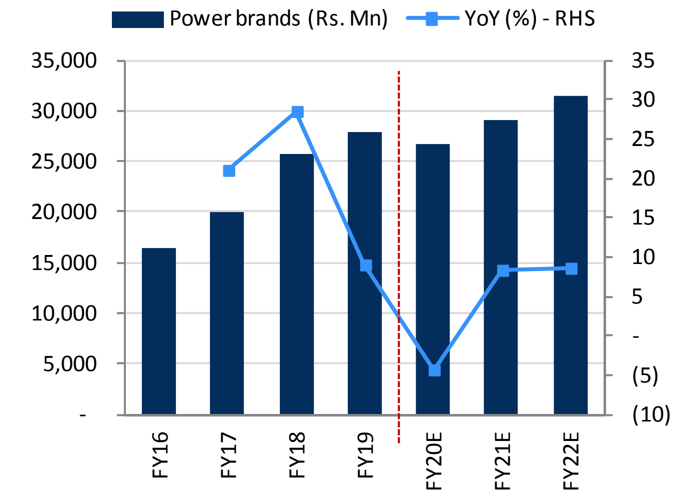
US Polo's brand extension journey:



Source: Company, HDFC sec Inst Research

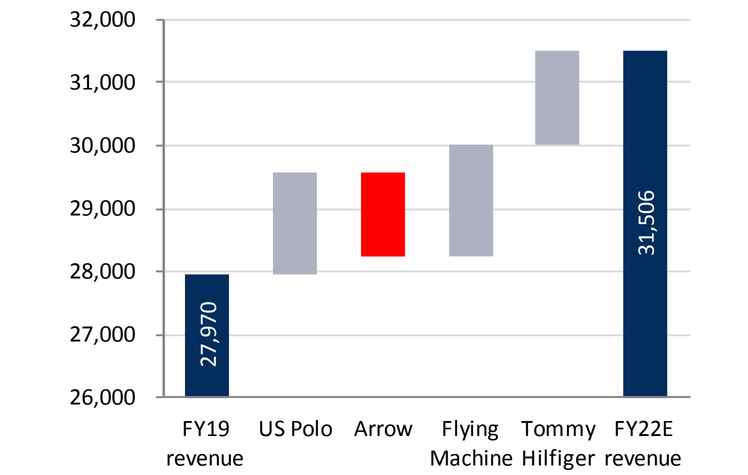
Nearly half of the incremental revenue to be US Polo-led in Power brands

Power brands expected to grow at 4% CAGR over FY19-22E



Source: Company, HDFC sec Inst Research

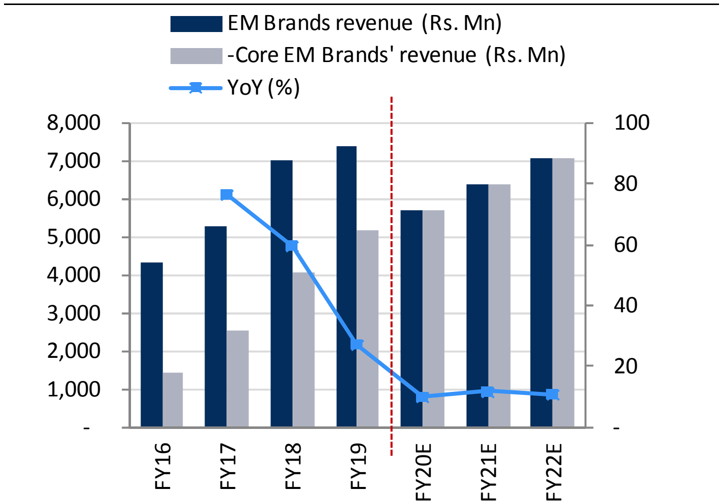
…Nearly half of the incremental growth expected to come from US Polo



Source: Company, HDFC sec Inst Research

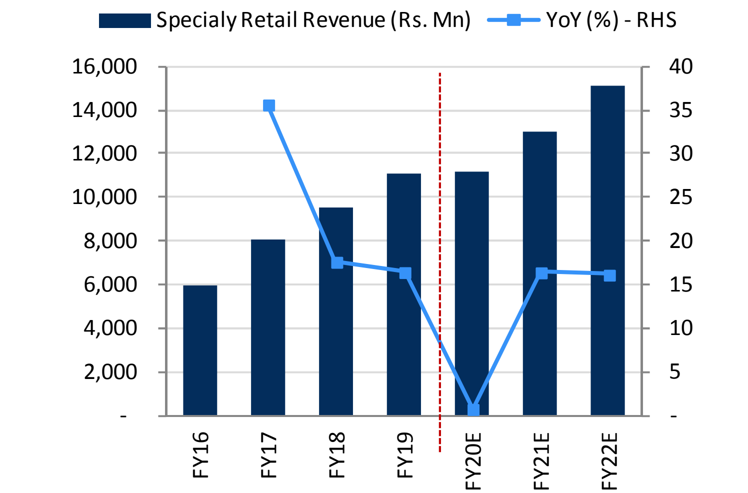
4 non-core emerging brands to be weeded out by FY20. Reported drop in revenue expected to be Rs. 2.2bn.

EM brands set for a rejig



Source: Company, HDFC sec Inst Research

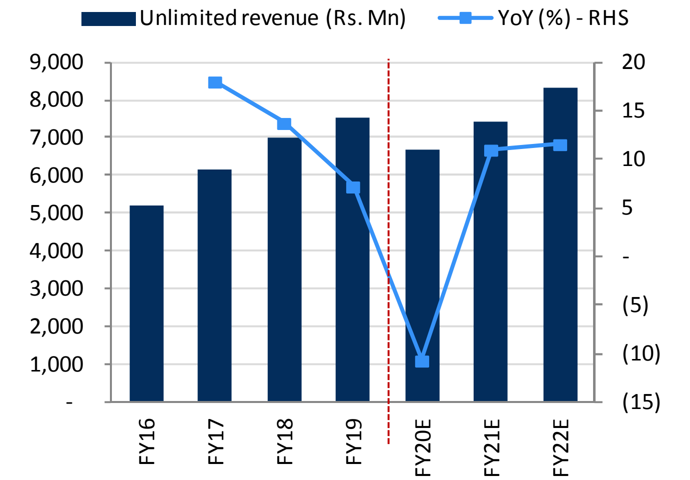
Sephora/GAP to cushion Unlimited's rejig impact in FY20



Source: Company, HDFC sec Inst Research

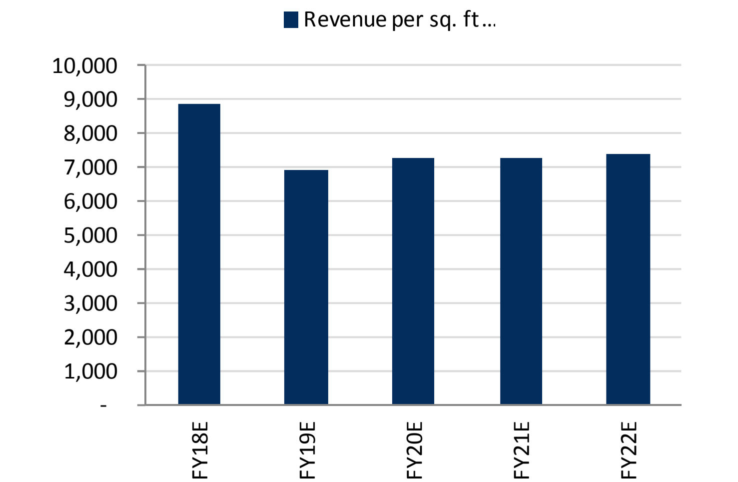
Expect measured growth in Unlimited. Top-line to stabilize by FY21, after the rejig in store portfolio. Building in 3% revenue CAGR and steady productivity over FY19-22E

Unlimited's top-line to stabilize by FY21…building in 3% CAGR over FY19-22E



Source: Company, HDFC sec Inst Research

Expect Unlimited's sales velocity to remain steady over FY19-22E (Rs.)



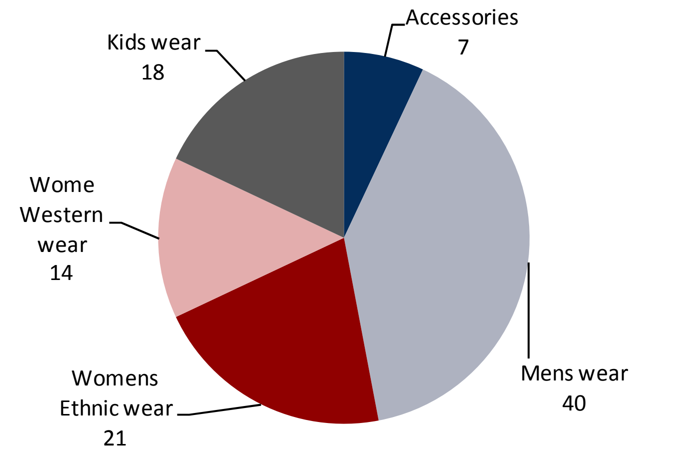
Source: Company, HDFC sec Inst Research

Positioning assortment towards faster growing categories

Sephora and GAP expected to clock 24% CAGR over FY19-22E

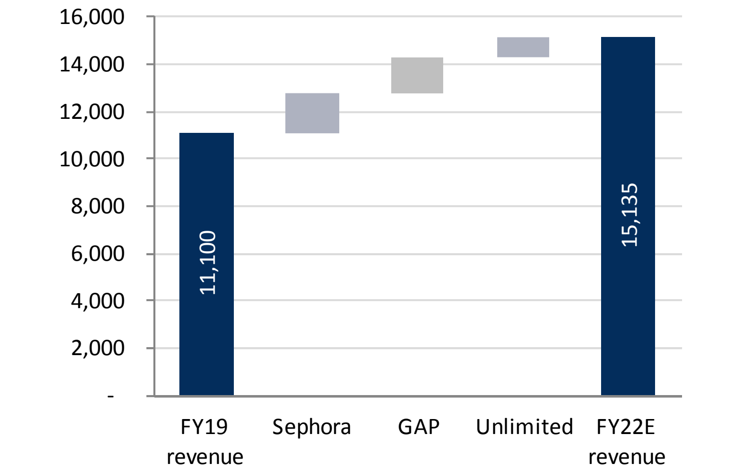
Already EBITDA +ve

Category-wise split of Unlimited's assortment:



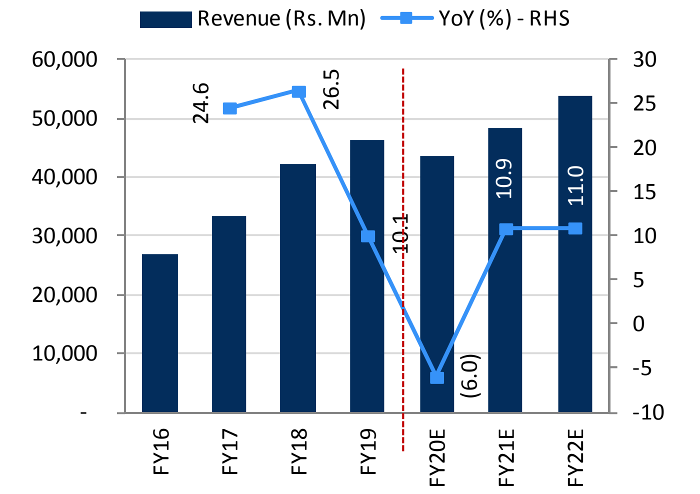
Source: Company, HDFC sec Inst Research

Sephora/GAP to contribute lion's share of Specialty retail's growth over FY19-22E



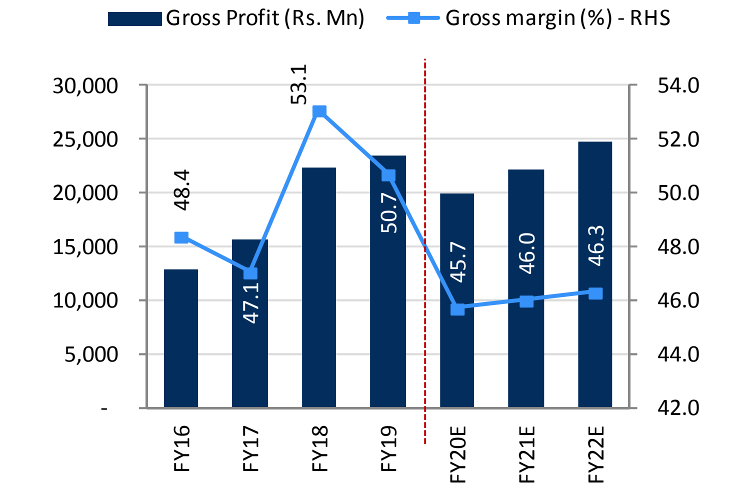
Source: Company, HDFC sec Inst Research

Baking in revenue CAGR of 5% over FY19-22E



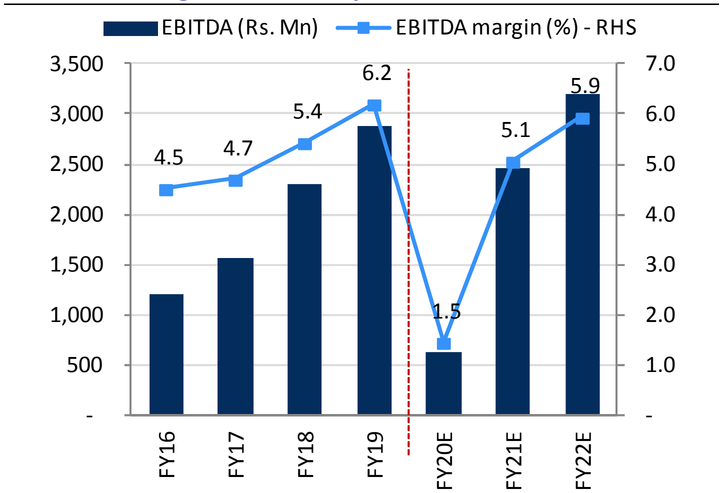
Source: Company, HDFC sec Inst Research

Gross margin to come off as reliance on MBO (Channel with higher profitability) reduces



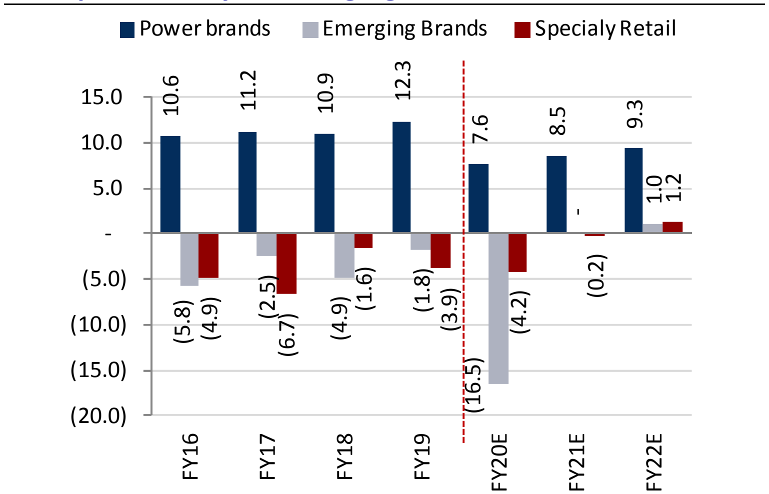
Source: Company, HDFC sec Inst Research

EBITDA margins to inch up...



Source: Company, HDFC sec Inst Research

...as profitability in Emerging brands/Unlimited returns



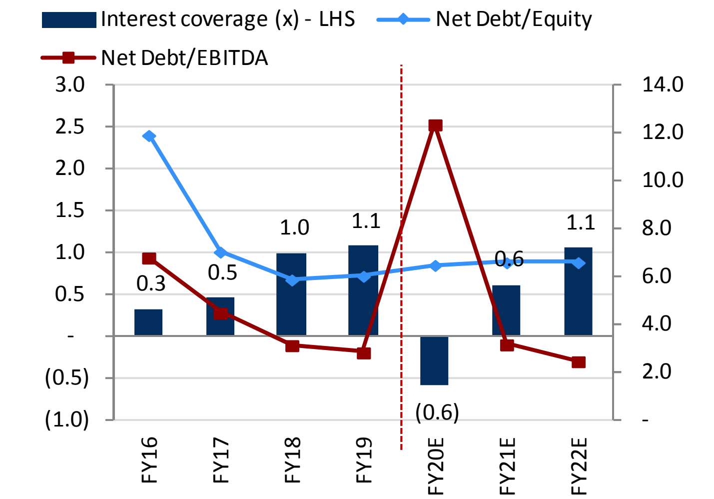
Source: Company, HDFC sec Inst Research

Building in some relief on the Working capital front as company tightens the leash on MBO sales, but it is certainly going to come at the cost of growth.

AFL's board has approved a Rs. 3bn rights issue which should help pare down debt considerably. (Rights issue proceeds not factored in numbers yet)

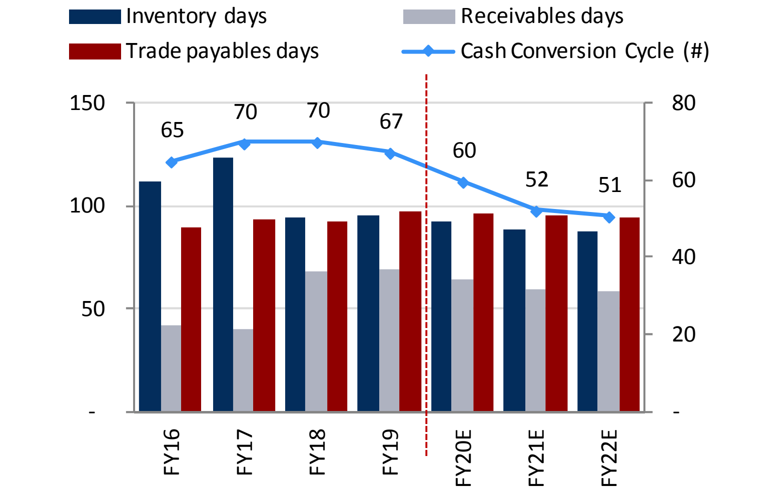
While Return profile is set to improve, we reckon more needs to be done on the WC side to reduce AFL's valuation gap vs ABFRL

Interest cover uncomfortably low, though!



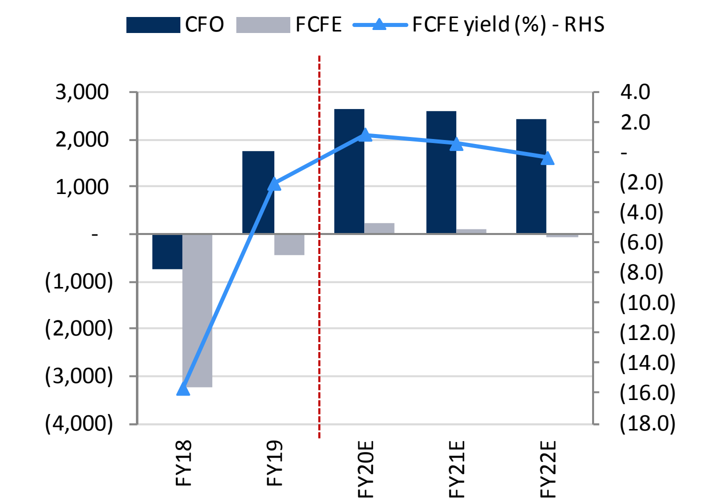
Source: Company, HDFC sec Inst Research

WC tightening in FY20 to release cash…



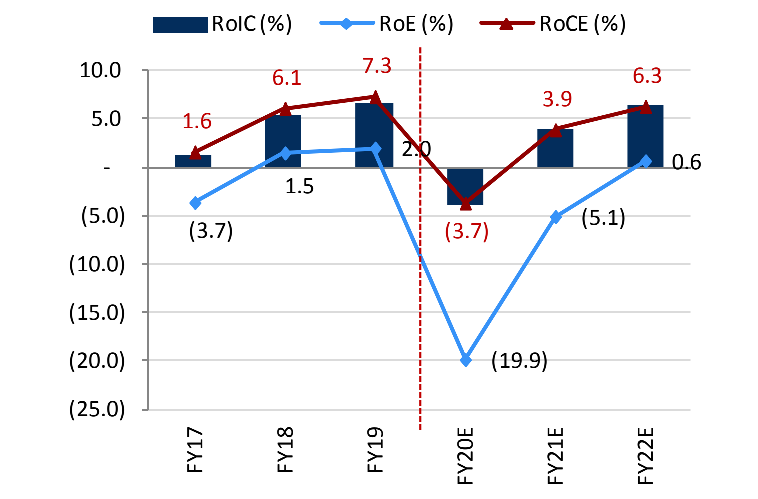
Source: Company, HDFC sec Inst Research, Inventory days includes other returnable assets

…ergo FCFE profile may momentarily improve in FY20



Source: Company, HDFC sec Inst Research

Return profile to witness a U-shaped recovery



Source: Company, HDFC sec Inst Research

Arvind Fashion: Snapshot

	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue (Rs. Mn)	**26,780**	**33,360**	**42,189**	**46,439**	**43,654**	**48,398**	**53,700**
YoY (%)		*24.6*	*26.5*	*10.1*	*(6.0)*	*10.9*	*11.0*
Power brands	**16,490**	**19,960**	**25,650**	**27,970**	**26,769**	**29,006**	**31,506**
YoY (%)		*21.0*	*28.5*	*9.0*	*(4.3)*	*8.4*	*8.6*
-US Polo (HDFC Est)	6,258	7,413	10,273	11,421	10,850	11,827	13,010
-Arrow/FM/TH (HDFC (Est)	10,232	12,547	15,377	16,549	15,919	17,179	18,496
Emerging Brands	**4,320**	**5,300**	**7,010**	**7,370**	**5,697**	**6,365**	**7,059**
YoY (%)		*22.7*	*32.3*	*5.1*	*(22.7)*	*11.7*	*10.9*
-Core Emerging Brands	1,445	2,550	4,070	5,177	5,697	6,365	7,059
-Others	2,875	2,750	2,940	2,193	-	-	-
Specialy Retail	**5,970**	**8,100**	**9,530**	**11,100**	**11,187**	**13,027**	**15,135**
YoY (%)		*35.7*	*17.7*	*16.5*	*0.8*	*16.4*	*16.2*
-Unlimited	5,213	6,153	7,000	7,506	6,704	7,444	8,306
YoY (%)		*18.0*	*13.8*	*7.2*	*(10.7)*	*11.0*	*11.6*
-SSSG (%)				*(25.8)*	*(13.2)*	*6.6*	*0.5*
-Expansion-led growth (%)				*44.4*	*2.9*	*4.2*	*11.0*
-Others	757	1,947	2,530	3,594	4,483	5,584	6,829
EBITDA (Rs. Mn)	**1,210**	**1,570**	**2,300**	**2,880**	**637**	**2,451**	**3,190**
Power brands	**1,750**	**2,240**	**2,790**	**3,440**	**2,044**	**2,474**	**2,938**
YoY (%)		*28.0*	*24.6*	*23.3*	*(40.6)*	*21.0*	*18.7*
Emerging Brands	**(250)**	**(130)**	**(340)**	**(130)**	**(940)**	**-**	**71**
YoY (%)		*(48.0)*	*161.5*	*(61.8)*	*623.1*	*(100.0)*	*-*
Specialy Retail	**(290)**	**(540)**	**(150)**	**(430)**	**(468)**	**(23)**	**181**
YoY (%)		*86.2*	*(72.2)*	*186.7*	*8.8*	*(95.1)*	*(892.0)*
EBITDA margin (%)	**4.5**	**4.7**	**5.5**	**6.2**	**1.5**	**5.1**	**5.9**
Power brands	10.6	11.2	10.9	12.3	7.6	8.5	9.3
Emerging Brands	(5.8)	(2.5)	(4.9)	(1.8)	(16.5)	-	1.0
Specialy Retail	(4.9)	(6.7)	(1.6)	(3.9)	(4.2)	(0.2)	1.2

Source: Company, HDFC sec Inst Research

Valuation

DCF

	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Revenue (INR m)	**48398**	**53700**	**59666**	**66010**	**72916**	**80808**	**89045**	**97094**	**105513**	**114043**
YoY	*10.9*	*11.0*	*11.1*	*10.6*	*10.5*	*10.8*	*10.2*	*9.0*	*8.7*	*8.1*
EBIT*(1-t)	726	1167	1682	2099	2518	3074	3549	4130	4798	5511
Depreciation	1544	1630	1715	1795	1955	2071	2258	2340	2395	2420
Capex	-1001	-1021	-1240	-1264	-1770	-1942	-2109	-2152	-2400	-2451
Changes in WC (Winv)	37	-741	-894	-926	-986	-1112	-1125	-1050	-1064	-1018
FCFF	**1,306**	**1,035**	**1,264**	**1,705**	**1,718**	**2,092**	**2,573**	**3,267**	**3,729**	**4,461**
YoY (%)	*(15.4)*	*(20.7)*	*22.0*	*34.9*	*0.7*	*21.8*	*23.0*	*27.0*	*14.1*	*19.6*
Interest (1-t)	-1187	-1110	-1144	-1198	-1251	-1319	-1386	-1454	-1555	-1689
Net Borrowings	0	0	500	300	500	500	500	500	1000	1000
FCFE	**119**	**(75)**	**620**	**807**	**966**	**1,273**	**1,687**	**2,314**	**3,174**	**3,772**
YoY (%)	*(52.0)*	*(162.7)*	*(931.5)*	*30.2*	*19.6*	*31.8*	*32.5*	*37.2*	*37.2*	*18.8*
EOP date	**Mar-21**	**Mar-22**	**Mar-23**	**Mar-24**	**Mar-25**	**Mar-26**	**Mar-27**	**Mar-28**	**Mar-29**	**Mar-30**
Years to DCF date	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
PV (FCFF)	**1,232**	**870**	**945**	**1,134**	**1,017**	**1,102**	**1,206**	**1,363**	**1,385**	**1,475**
Terminal Value										**63,694**
Kd	**10.0%**									
Kd*(1-t)	**8.3%**									
Ke	**16.0%**									

DCF Date	**Sep-20**
Net Debt (Mar-20E)	7,860
PV-Explicit Period	11,727
PV-Terminal Value	21,051
Equity Value (INR m)	24,919
Equity value per share (INR)	**430**
Sept-21 Implied P/E (x)	(123.5)
Sept-21 Implied EV/EBITDA (x)	11.6
Terminal growth rate (%)	5.0%
WACC	12.4%
Terminal FCF multiple (x)	14.3
No. of shares (b)	58
CMP	**321**
Upside/(Downside)	**33.8%**

Source: Company, HDFC sec Inst Research

Our DCF-based TP of Rs. 430, implies for 12x Sept-21E EV/EBITDA – A 47% discount to larger peer ABFRL

Some of the key reasons and concerns for the discount and consequently higher Ke are:

1. Inventory+Returnable assets and receivables are significantly higher vs peer ABFRL. Receivables are high due to a higher MBO skew for AFL. While FY20 is going to be all about fixing the WC cycle, we prefer to see some execution on this front before pressing the re-rating trigger

2. It is imperative for AFL to succeed at its value fashion play – Unlimited, if it has to gain meaningful scale as a fashion house over the next 3-5 years as the brands business although highly profitable in steady state has a natural growth cap.

While FY20 is expected to be about taking a step back and shutting loss-making Unlimited stores. it would be interesting to see if AFL manages to script a turnaround on this piece of the biz.

Interest cover is also shrinking, ergo execution of turnaround is an imperative. The Rs. 3bn rights will certainly help. (not factored in though)

Key performance Indicators: Arvind Fashion vs ABFRL

	Arvind Fashion					ABFRL				
	FY18	**FY19**	**FY20E**	**FY21E**	**FY22E**	**FY18**	**FY19**	**FY20E**	**FY21E**	**FY22E**
Revenue (Rs. mn)	**42,189**	**46,439**	**43,654**	**48,398**	**53,700**	**71,721**	**81,177**	**92,666**	**106,482**	**121,697**
-Brands	32,660	35,340	32,466	35,370	38,565	44,688	50,315	57,008	65,190	73,894
-Value Fashion	7,000	7,506	6,704	7,444	8,306	28,615	31,940	36,399	42,134	48,750
EBITDA margin (%)										
-Brands	7.5	9.4	3.4	7.0	7.8	7.7	8.0	8.8	9.4	10.3
-Value Fashion	(0.7)	(6.0)	(8.0)	(1.5)	0.5	6.0	7.2	7.8	8.1	8.6
PAT (Rs. mn)	129	215	(2,041)	(461)	57	1,178	3,212	2,683	3,761	4,153
CFO (Rs. Mn)	(754)	1,751	2,640	2,603	2,430	5,951	5,276	5,798	7,028	8,380
FCFF (Rs. Mn)	(2,455)	217	1,770	1,602	1,409	2,680	2,484	2,215	3,157	4,101
CFO/EBITDA	(0.3)	0.6	4.1	1.1	0.8	1.3	1.0	0.9	0.9	0.8
Fixed Asset Turn (x)	7.0	6.4	5.4	5.3	5.3	6.6	6.5	5.8	5.3	5.0
Inventory (days)	**95**	**96**	**92**	**89**	**87**	**86**	**86**	**86**	**85**	**85**
Receivable (days)	**68**	**69**	**64**	**59**	**58**	**28**	**35**	**35**	**34**	**34**
Payable (days)	**92**	**97**	**96**	**95**	**94**	**102**	**108**	**107**	**106**	**105**
WC Cycle (days)	84	86	77	70	68	11	12	12	12	12
Net Debt/Equity (x)	0.7	0.7	0.8	0.9	0.9	1.6	1.1	0.9	0.6	0.3
Interest Coverage (x)	1.0	1.1	(0.6)	0.6	1.1	1.1	1.4	2.4	3.2	3.8
Capex (Rs. mn)	1,701	1,152	870	1,001	1,021	-	-	-	-	-
RoE (%)	1.5	2.0	(19.9)	(5.1)	0.6	11.5	25.5	17.2	19.9	18.2
RoIC (%)	5.3	6.7	(3.8)	3.9	6.4	6.1	8.7	9.7	12.2	12.6
RoCE (%)	6.1	7.3	(3.7)	3.9	6.3	9.2	15.8	11.6	13.4	12.8

Source: Company, HDFC sec Inst Research, Inventor days for AFL = Inventory days + Returnable assets

Demerger of Arvind Ltd

Arvind (Demerged)	Arvind Fashions	Anup Engineering
Arvind listed entity (post demerger) is now the textile company and its principal products/services are finished fabrics and garments.	AFL is a lifestyle powerhouse with a strong portfolio of multiple fashion brands (across subcategories/ price points) and robust retail presence in value fashion and prestige beauty. AFL consolidated pre-demerger share capital will change from face value Rs 2 each to Rs 4 each. Swap ratio for demerger was one equity shares for every five equity shares held in Arvind.	Engineering business including holding in Anup Engineering demerged into Anveshan and then merger of Anup Engineering into Anveshan. Swap ratio for the demerger was one equity shares issued by Anveshan for every 20 equity shares held in Arvind. Swap ratio for merger was seven equity shares to issued by Anveshan for every 10 equity shares held in Anup Engineering.

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Inability to predict changing customer lifestyle and their preferences	Fashion business is seasonal & constantly changing with changing in customer preferences, income levels & demographics. There may be a risk of loss of business due to inability to predict changing customer lifestyle, their preferences, and product designs.
Failure to renew agreements with brand owner	The Company has licence to operate certain Brands in India which includes Tommy Hilfiger, Calvin Klein, US Polo, Arrow, GAP, GANT, Nautica, TCP, Sephora and Elle. Failure to renew such agreements or early termination will have an adverse impact on business operations and growth.
Inability to renew leases of key properties	The business operations are significantly dependent on rented retail outlets. The locations of such retail outlets significantly impact ability to attract customers and helps in brand positioning. Any dispute with landlords, inability to renew leases of key properties, or acquire new properties on lease, or dispute in the title/ownership of the property owned by the landlord can negatively impact operations and future growth.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Disruption in supply chain model	Any disruption in warehouse operations or transportation arrangements or vendor-partnership may adversely affect business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Key Personnel

Name	Designation	Description
Mr. J. Suresh	Managing Director & CEO	Mr. Suresh has over 30 years of experience in the FMCG, Lifestyle Brands & Retail industries. This included an 18-year stint at HUL, where he headed the Sales Operations of the beverages business and was a management committee member of the Foods & Beverages business between 1999 and 2002. After HUL, he joined MTR Foods Ltd as its CEO and turned a regional brand into a national and global brand. He is an MBA from IIM Bangalore.
Mr. Shailesh Chaturvedi	MD & CEO - Tommy Hilfiger Apparels India	Shailesh Chaturvedi is Managing Director and Chief Executive Officer, Tommy Hilfiger Apparels India, a JV between the Murjani Group and Arvind Limited. Mr. Chaturvedi has over 15 years' experience in the branded apparel industry. He is an engineering graduate with a Master's in Business Administration.
Mr. Alok Dubey	CEO - Lifestyle Brands Division	He is the CEO of Lifestyle Business Division and responsible for strategizing, building and growing a spectrum of very successful iconic brands like US Polo Assn, Flying Machine and Ed Hardy. Alok has over 30 years of work experience in the fashion and lifestyle industry of which the last 15 years are with Arvind.
Mr. Anindya Ray	Chief Sourcing Officer	At FL, he is responsible for sourcing, quality, product development, and technical support for the entire Arvind Fashions brands and retail group. Has over 3 decades of experience in buying and merchandising, design, product development, sourcing and quality.
Mr. Pramod Gupta	Chief Financial Officer	Mr. Pramod Gupta, a Chartered Accountant by qualification, is the Chief Financial Officer of Arvind Fashions. In addition to leading Finance and Legal, he is also responsible for outbound Supply Chain. Pramod is an accomplished Finance and Operations Leader, with proven capabilities in managing rapid growth as well as turnaround, He has over 3 decades of experience in Finance, Operations and Supply Chain across diverse industries and organisations like Hindustan Unilever, DHL, Novartis and Microsoft. Prior to joining us, he was the Chief Financial Officer at Rivigo, a Logistics Start-up

Name	Designation	Description
Mr. Vivek Bali	COO – Sephora	He leads the development and execution of the India strategy marketing, category management, store development & operations, and training & development. His expertise spans across the beauty business & non-food FMCG industries and across consumer segments in Premium, Mass and Value. Vivek has previously held leadership roles with Lifestyle at Landmark Group, Reliance Retail Ltd, Avon Beauty products India Pvt Ltd, and Lakme Lever Ltd.
Mr. Himanshu Chakrawarti	CEO – Unlimited	Mr. Chakrawarti joined as Chief Executive Officer for the Unlimited business. Himanshu is a seasoned professional with 28 years of experience in the fields of sales and marketing, business development, strategy & retail operations across diverse industries in organizations such as Lakme Lever Limited, Unistar International, Trent Limited and The Mobile Store Limited. Prior to joining us, Himanshu was the CEO at Hicare Services Pvt Ltd. He has completed his Bachelor's in Technology in Metallurgy from IIT, Kanpur and PGDM in Marketing & Finance from IIM, Bangalore.
Mr. Parag Dani	CEO - Premium to Bridge to Luxury Businesses	In his current role, he is responsible for strategizing, building and growing iconic brands like GAP, GANT, and Nautica. He has previously worked for organizations like Madura Garments, Reliance Retail and Levis and holds an MMS in Marketing from Jamnalal Bajaj Institute of Management Studies.
Mr. Nitin Agarwal	COO - Innerwear Business	He drives strategy, business growth and profitability for Hanes & U.S Polo Innerwear brands. Nitin has over 14 years of experience in supply chain and business consulting with a focus on FMCG and retail sectors. He has previously worked with organizations like Miebach Consulting India Pvt. Ltd and Tata Motors.

Source: Company, HDFC sec Inst Research

Company profile

- Arvind Fashions Limited engages in the distribution and retailing of readymade garment apparels and accessories in India and internationally. Arvind Fashion currently has a portfolio of owned and licensed international brands including US Polo, Arrow, Tommy Hilfiger, Flying Machine, Aeropostale, GAP, Calvin Klein, GANT, Nautica, Unlimited, Sephora, Hanes and others.
- In 1980, Flying Machine, India's first denim apparel brand, was launched to meet the aspirations of the emerging youth segment. Through tie-ups with V.F. Corporation (USA) and Cluett Peabody & Co. USA, for manufacturing and marketing, Arvind was able to offer global apparel brands like Lee Jeans and Arrow Shirts to the Indian market in 1993. The next two decades witnessed Arvind bringing some of the biggest global fashion brands like Calvin Klein, Tommy Hilfiger, US Polo, Gap, Ed Hardy, Hanes, Nautica and Elle to India.
- Arvind Fashion has a pan India presence with more than 1390 stores (As of March 2019), distribution in 200+ cities, presence in all the major malls and departmental stores of India and presence on all the major online market places. It has a total retail space of approx. 2.4 million sq. ft.

Income Statement (Consolidated)

Year End (March)	FY18	FY19	FY20	FY21	FY22
Net Revenues	**42,189**	**46,439**	**43,654**	**48,398**	**53,700**
Growth (%)	***26.5***	***10.1***	***(6.0)***	***10.9***	***11.0***
Material Expenses	19,789	22,887	23,697	26,127	28,829
Employee Expense	3,669	4,078	3,833	4,250	4,661
Rent Expense	2,940	3,424	3,219	3,545	3,906
Commission & Brokerage	5,391	3,800	3,572	3,960	4,394
Admin and other expenses	8,108	9,369	8,696	8,065	8,720
EBITDA	**2,293**	**2,881**	**637**	**2,451**	**3,190**
EBITDA Growth (%)	***46.0***	***25.7***	***(77.9)***	***285.1***	***30.1***
EBITDA Margin (%)	***5.4***	***6.2***	***1.5***	***5.1***	***5.9***
Depreciation	1,389	1,532	1,528	1,544	1,630
EBIT	**903**	**1,350**	**(892)**	**908**	**1,560**
Other Income (Including EO Items)	126	41	15	-	-
Interest	913	1,262	1,525	1,483	1,483
PBT	**116**	**129**	**(2,401)**	**(576)**	**76**
Total Tax	(14)	(86)	(360)	(115)	19
PAT before share of associate earnings	**129**	**215**	**(2,041)**	**(461)**	**57**
Share of associate earnings	-	-	-	-	-
RPAT	**129**	**215**	**(2,041)**	**(461)**	**57**
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	**129**	**215**	**(2,041)**	**(461)**	**57**
APAT Growth (%)	***(168.0)***	***66.3***	***(1,050.2)***	***(77.4)***	***(112.4)***
Adjusted EPS (Rs)	**2.2**	**3.7**	**(35.2)**	**(7.9)**	**1.0**
EPS Growth (%)	***(168.0)***	***66.3***	***(1,050.2)***	***(77.4)***	***(112.4)***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19	FY20	FY21	FY22
SOURCES OF FUNDS					
Share Capital - Equity	232	232	232	232	232
Reserves	10,366	11,062	9,021	8,560	8,618
Total Shareholders Funds	**10,598**	**11,294**	**9,253**	**8,792**	**8,850**
Minority Interest	**873**	**912**	**912**	**912**	**912**
Long Term Debt	806	863	863	863	863
Short Term Debt	6,640	7,378	7,378	7,378	7,378
Total Debt	**7,447**	**8,241**	**8,241**	**8,241**	**8,241**
Net Deferred Taxes	**14**	**-**	**-**	**-**	**-**
Other Non-current Liabilities & Provns	**568**	**669**	**669**	**669**	**669**
TOTAL SOURCES OF FUNDS	**19,500**	**21,116**	**19,075**	**18,615**	**18,672**
APPLICATION OF FUNDS					
Net Block	4,207	4,262	3,604	3,062	2,453
CWIP	6	114	114	114	114
Other Non-current Assets	5,702	6,164	6,164	6,164	6,164
Total Non-current Assets	**9,916**	**10,541**	**9,883**	**9,340**	**8,731**
Inventories	7,273	9,863	8,913	9,483	10,375
Debtors	7,845	8,787	7,662	7,832	8,543
Other Current Assets	6,457	5,932	5,397	5,917	6,492
Cash & Equivalents	**284**	**121**	**381**	**500**	**426**
Total Current Assets	**21,859**	**24,703**	**22,353**	**23,733**	**25,835**
Creditors	10,680	12,390	11,527	12,647	13,886
Other Current Liabilities & Provns	1,595	1,737	1,633	1,811	2,009
Total Current Liabilities	**12,275**	**14,127**	**13,160**	**14,458**	**15,895**
Net Current Assets	**9,584**	**10,576**	**9,193**	**9,275**	**9,941**
TOTAL APPLICATION OF FUNDS	**19,500**	**21,116**	**19,075**	**18,615**	**18,672**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19	FY20	FY21	FY22
Reported PBT	116	129	(2,401)	(576)	76
Non-operating & EO Items	128	54	(15)	-	-
Interest Expenses	913	1,262	1,525	1,483	1,483
Depreciation	1,389	1,532	1,528	1,544	1,630
Working Capital Change	(3,046)	(857)	1,644	37	(741)
Tax Paid	(254)	(369)	360	115	(19)
OPERATING CASH FLOW (a)	**(754)**	**1,751**	**2,640**	**2,603**	**2,430**
Capex	(1,701)	(1,534)	(870)	(1,001)	(1,021)
Free Cash Flow (FCF)	*(2,455)*	*217*	*1,770*	*1,602*	*1,409*
Investments	250	-	-	-	-
Non-operating Income	(40)	35	15	-	-
INVESTING CASH FLOW (b)	**(1,490)**	**(1,499)**	**(855)**	**(1,001)**	**(1,021)**
Debt Issuance/(Repaid)	(738)	(579)	(1,525)	(1,483)	(1,483)
FCFE	*(2,982)*	*(327)*	*261*	*119*	*(75)*
Share Capital Issuance	3,000	34	-	-	-
Dividend	-	-	-	-	-
Others	-	85	-	-	-
FINANCING CASH FLOW (c)	**2,262**	**(459)**	**(1,525)**	**(1,483)**	**(1,483)**
NET CASH FLOW (a+b+c)	**18**	**(208)**	**261**	**119**	**(75)**
EO Items, Others	-	-	-	-	4
Closing Cash & Equivalents	284	121	381	500	426

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20	FY21	FY22
PROFITABILITY (%)					
GPM	53.1	50.7	45.7	46.0	46.3
EBITDA Margin	5.4	6.2	1.5	5.1	5.9
EBIT Margin	2.1	2.9	(2.0)	1.9	2.9
APAT Margin	0.3	0.5	(4.7)	(1.0)	0.1
RoE	1.5	2.0	(19.9)	(5.1)	0.6
RoIC (or Core RoCE)	5.3	6.7	(3.8)	3.9	6.4
RoCE	6.1	7.3	(3.7)	3.9	6.3
EFFICIENCY					
Tax Rate (%)	-	-	15.0	20.0	25.2
Fixed Asset Turnover (x)	7.0	6.4	5.4	5.3	5.3
Inventory (days)	*62.9*	*77.5*	*74.5*	*71.5*	*70.5*
Debtors (days)	*67.9*	*69.1*	*64.1*	*59.1*	*58.1*
Other Current Assets (days)	*55.9*	*46.6*	*45.1*	*44.6*	*44.1*
Payables (days)	*92.4*	*97.4*	*96.4*	*95.4*	*94.4*
Other Current Liab & Provns (days)	*13.8*	*13.7*	*13.7*	*13.7*	*13.7*
Cash Conversion Cycle (days)	80.5	82.2	73.7	66.2	64.7
Net D/E (x)	0.7	0.7	0.8	0.9	0.9
Interest Coverage (x)	1.0	1.1	(0.6)	0.6	1.1
PER SHARE DATA (Rs)					
EPS	2.2	3.7	(35.2)	(7.9)	1.0
CEPS	26.2	30.1	(8.8)	18.7	29.1
Dividend	-	-	-	-	6.0
Book Value	182.7	194.7	159.5	151.6	152.6
VALUATION					
P/E (x)	152.9	91.9	(9.7)	(42.9)	345.4
P/BV (x)	1.9	1.7	2.1	2.2	2.2
EV/EBITDA (x)	11.7	9.7	43.4	11.2	8.6
EV/Revenues (x)	0.6	0.6	0.6	0.6	0.5
OCF/EV (%)	(2.8)	6.3	9.6	9.5	8.8
FCF/EV (%)	(9.1)	0.8	6.4	5.8	5.1
FCFE/Mkt Cap (%)	(15.1)	(1.7)	1.3	0.6	(0.4)
Dividend Yield (%)	-	-	-	-	1.8

Source: Company, HDFC sec Inst Research

Reliance Retail

NOT RATED

India's Everything store

Reliance Retail (RR) is the biggest retail outfit by revenue/network size in India (USD18.6bn/>24mn sq. ft). It is akin to an 'Everything store' catering to the entire consumer basket. Groceries, Fashion & Lifestyle (F&L) and Consumer Electronics (CE) form its core (~56% of revenue; USD10.5bn). RR's core has grown at an astounding 38% CAGR over FY14-19 and is estimated to be spread across 4500+ core retail stores. That said, capital intensity in the biz remains high with pre-working capital CFO covering just about ~58% capital needs (capex + WC) over FY14-19. Hence, while leverage remains manageable, it has inched up to 1x in FY19 (vs near-zero debt in FY17).

An 'Everything store' needs a seamless ecosystem which provides a seamless consumer/merchant experience across multiple consumer baskets. Reliance Retail seems primed to position itself as one, given its strong physical infrastructure, a strong 35mn+ Jio subscriber base to leverage upon, a robust digital payment solution and the deepest vendor network in India.

We bake in consol revenue/EBITDA/PAT CAGR of 20/26/31% over FY19-22E and value RR/Core Retail at an EV of Rs.2/1.9tn, implying an EV/EBITDA of 18/20x (Sept-21) respectively for the consol/Core Retail biz.

Investment rationale

- **Grocery to be the growth anchor**: While Consumer Electronics vertical (CE) was the growth lever contributing 61/47% of incremental revenue/EBITDA over FY15-19, it is expected to cool off courtesy moderating Jio phone sales. Grocery biz is expected to take centre-stage in RR's growth narrative over FY19-22E (to contribute >50%/47% of incremental revenue/EBITDA) as expansion plans are revved up. The company operates the grocery vertical via 3 formats: 1. Reliance Fresh (Convenience store), 2. Reliance Smart (stock-up format) and Reliance Market (Cash & Carry).
- **Stock-up format gaining preference:, ergo productivity should improve:** Perhaps opportunistic, but focus has decisively shifted towards the more profitable stock-up format (Reliance Smart). RR added 124/201 Smart stores (est) in just over 2 years. On the other hand, Reliance Fresh's expansion (top-up format), has been reined in. Understandably so, as the top-up format remains store economics-crushing for all industry participants. F&G productivity has improved significantly over FY16-19 (HDFCSec est. Rs. 42k/sq. ft; 36% CAGR) as a consequence. Given the young store age profile of Reliance Smart, we expect SSSG to be healthy at ~8% CAGR for the grocery biz and build in revenue CAGR of ~35% over FY19-22E.

Financial Summary

(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	1,163,575	1,445,145	1,719,750	2,029,610
EBITDA	60,758	82,602	99,992	120,574
APAT	32,284	49,849	60,064	73,075
FV/E (x)	58.6	38.0	31.5	25.9
EV/EBITDA (x)	32.7	24.0	19.9	16.5
ROE (%)	27.8	31.2	28.0	26.1
RoIC (%)	20.3	21.4	20.8	21.1
ROCE (%)	18.7	19.6	19.3	19.6

Source: Company, HDFC sec Inst Research, *FV = Fair Value

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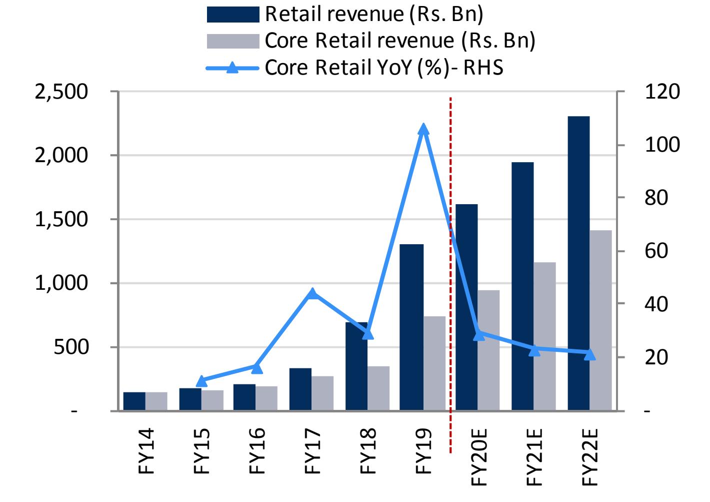
- **Attempting an Indian Ling Shou Tong!** RR's 'New Commerce' initiative is aimed at creating an ecosystem that connects the 3 key stakeholders in retail (Brands, Merchants & Consumers) – A la Ling Shou Tong (Alibaba's B2B play). Being the largest retailer across categories/2nd largest telecom operator (by subscribers), it certainly has the Brands and Consumer leg of the equation sorted and now intends to bridge the only gap – Merchants. The retailer intends to connect ~25-30mn mom-&-pop merchants via its M-POS. Benefits to the latter are multi-fold - 1. Better procurement rates, 2. Better customer profiling, 3. superior inventory management, ergo better margins and 4. Better financing terms. What's in it for RR? - It could charge an origination fee for its services sans the balance sheet risk.

  …Some perspective: Globally, jury is still out on how to localize inventory? Why is this important? – To bring down fulfillment costs. Globally, Amazon and Alibaba have chosen divergent paths to achieve this. While Amazon has been adding fulfillment centers, Alibaba has been building a partner ecosystem to inch closer to the consumer. RR intends to go the Alibaba way. However, roadmap to success remains hazy as 1. In India, only the top 0.5-1mn odd Kirana stores can afford an M-POS, 2. Trust deficit remains, as most may view RR as a competitor rather than a partner 3. Consistent service levels may be a challenge at-least initially. Also, while Alibaba has successfully penetrated to 1/6th the small retailer network in China (6mn), Its China Wholesale commerce vertical still remains sub-scale (USD1.2bn, 2.7% of sales) after 5 years of launch.
- **Most well-rounded fashion & lifestyle (F&L) portfolio in India:** RR's F&L portfolio straddles multiple price points/income groups through multiple formats and categories. The largest within its portfolio is it value fashion format – Reliance Trends/extensions (est: at >Rs.75bn) with a presence of 775 stores. In addition, RR has JVs with 40 international brands (via Reliance Brands – A subsidiary), a presence in footwear (Reliance Footprint) and Jewellery (Reliance Jewels) making the F&L portfolio one of the most well-rounded in India. (F&L grew at 26% CAGR over FY14-19). We expect Trends to be the growth anchor (given its value positioning) and build in a 23% revenue CAGR over FY19-22E for the F&L segment.
- **Consumer Electronics (CE):** CE is RR's biggest (~Rs. 390bn) and fastest growing segment (67% CAGR over FY14-19). The big revenue bump up came in 4QFY18 courtesy JIO phone/device launch. However, the same is expected to moderate going forward, hence we build in moderating growth in CE (16% CAGR) over FY19-22E.
- **Margin levers limited, WC quality improving though!** While RR enjoys best-in-class margins across all categories given its unparalleled scale. (Reported EBITDA/Core Retail EBITDA margin at 4.7/7% (on gross sales). Benefits hereon are expected to be capped as 1. Competitive intensity increases in CE (biggest EBITDA contributor), 2. Omni-investments increase cost of doing biz, 3. Expansion incrementally is lease-driven, implying rising rent bills. Core CC cycle increased in FY19 (38 days), however, WC quality has improved though as both inventory and payable cycles shortened. We reckon this is to ensure RR remains a partner of choice for vendors.
- **STANCE:** We like RR's 'Everything store' DNA as it positions the retailer as an ecosystem for all needs in the minds of the consumer. With RR's increasing relative scale (now >3.5x the 2nd largest retailer), time may just be apt for its retail 'flywheel' to generate its own momentum. While margin gains seem capped, 1. Increasing scale 2. Reducing capital intensity (at the margin) should ensure RR becomes FCFE +ve by FY21E). RoCEs to remain steady. Note: We haven't factored in future cash flow streams from RoCE-accretive businesses such as Cloud biz (a partnership with Microsoft) and New Commerce biz – both expected to commence by Jan-20. We build in revenue/EBITDA/PAT CAGR of 20/26/31% over FY19-22E and value RR at an EV of ~Rs.2tn (USD28.4bn) and its Core Retail biz at Rs. 1.93tn (USD27.6bn) implying an EV/EBITDA of 18/20x (Sept-21) respectively for the consol/Core Retail biz.

Story in Charts

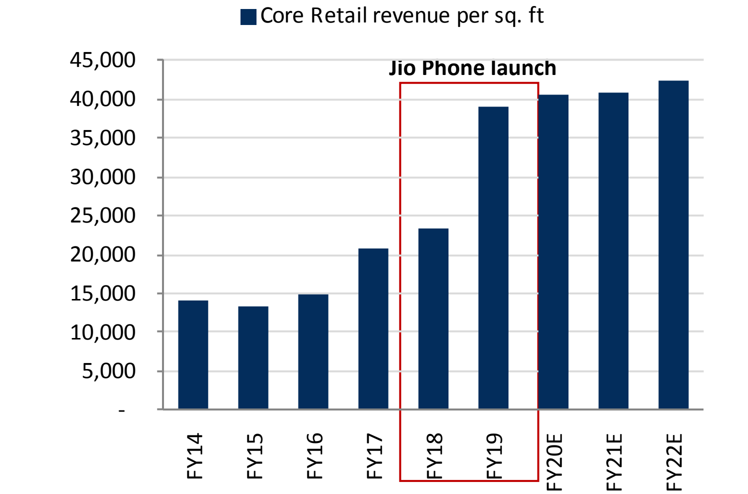
We reckon, the sudden jump in productivity in FY19 is due to the big bump up in consumer electronics revenue post the JIO phone launch

On a high base, Core Retail revenue to grow at ~24% CAGR over FY19-22E



Source: Company, HDFC sec Inst Research

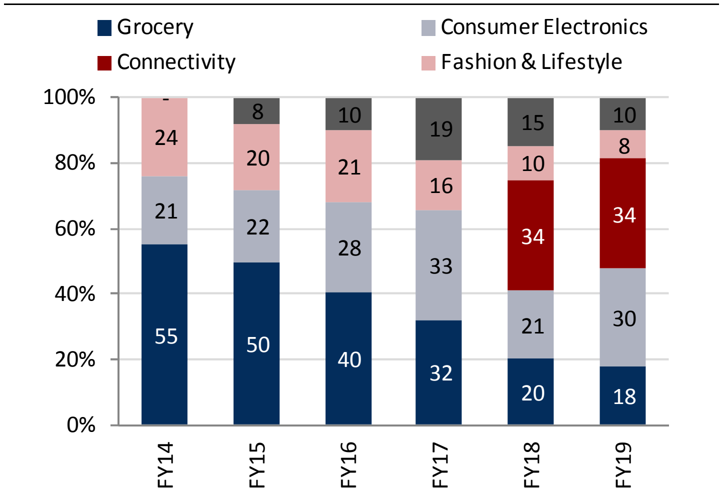
Core Retail productivity estimated at ~39k per sq. ft



Source: HDFC sec Inst Research estimates

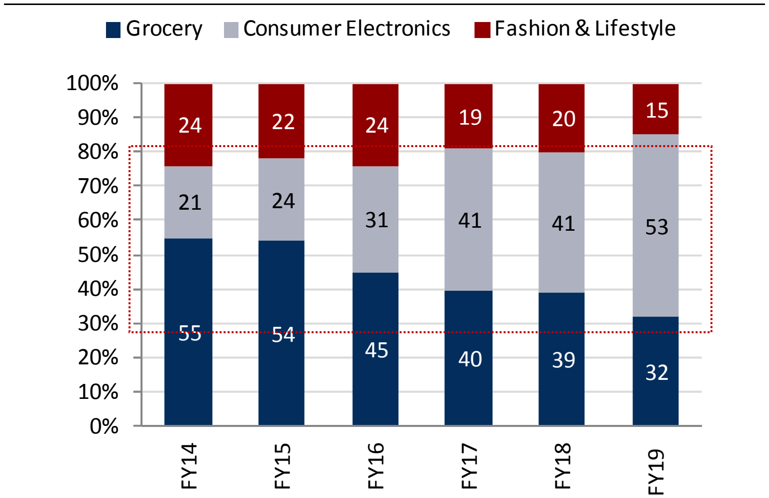
CE now accounts for 53% of core retail sales (up from 41% in FY18)

Retail Revenue Mix



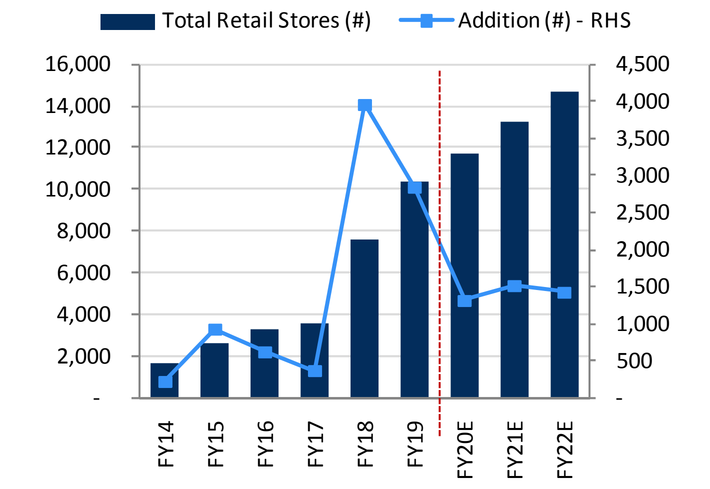
Source: Company, HDFC sec Inst Research

Core Retail Revenue Mix



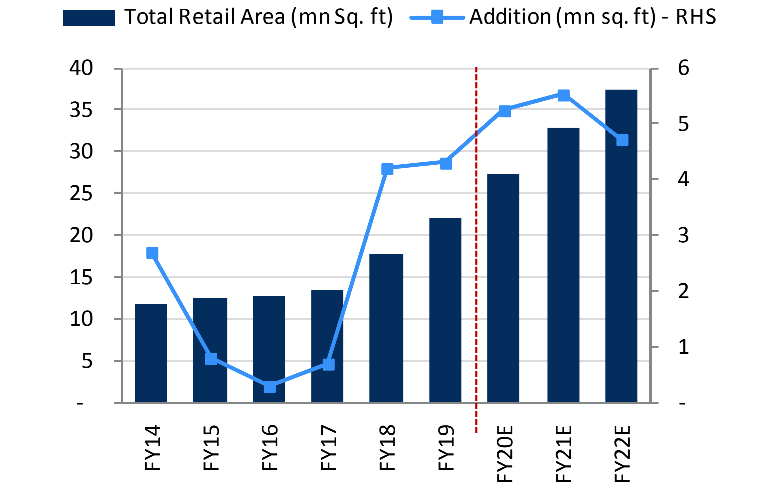
Source: Company, HDFC sec Inst Research

Largest retail network in India - 10,901 stores



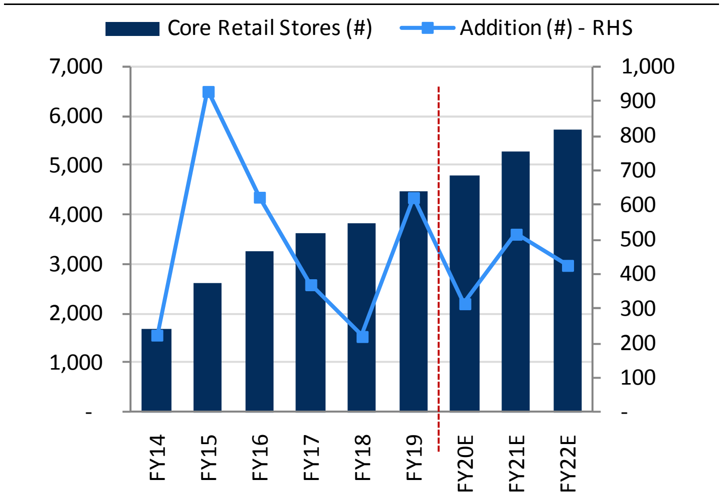
Source: Company, HDFC sec Inst Research

...24.5mn sq. ft in retail space



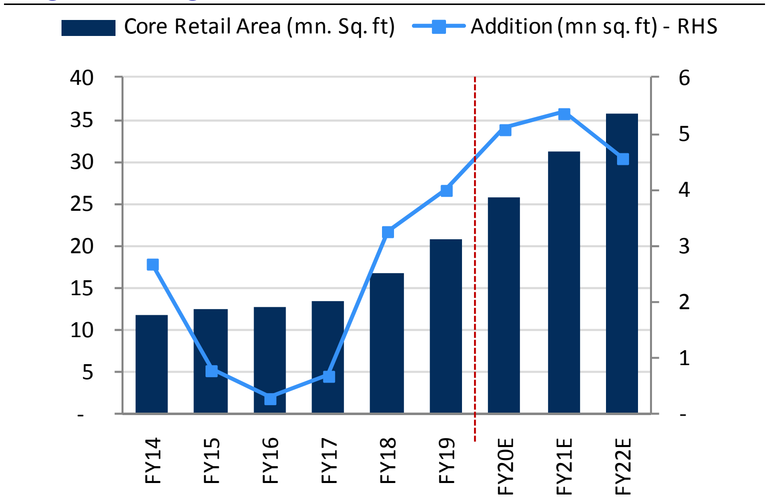
Source: Company, HDFC sec Inst Research

Core Retail to add >1250 stores over FY19-22E



Source: Company, HDFC sec Inst Research

Ergo, building in 20% Area CAGR over GY19-22E



Source: Company, HDFC sec Inst Research

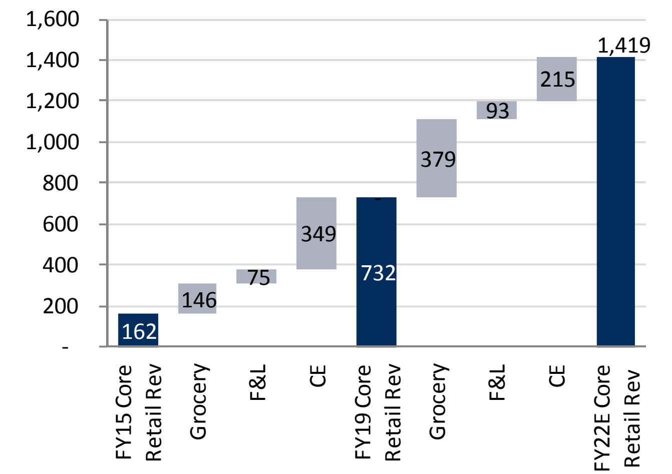
Consumer Electronics added >60%/47% of incremental core retail revenue/EBITDA over FY14-19.

While the last 3-4 years, belonged to CE and connectivity, we expect the CE segment to cool off as Jio device sales cool off.

Grocery is expected to dictate performance over the next 3 years. As can be seen from the step up in expansion in the vertical. Reliance Smart added 124/201 stores within the last 2.5 years

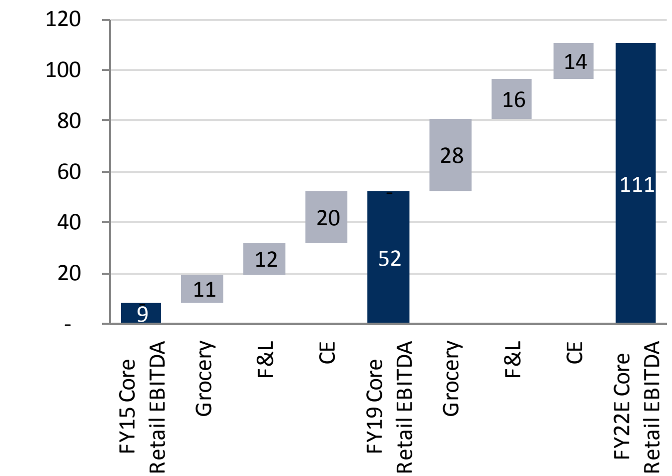
Expect Grocery to contribute >50/47% of incremental revenue/EBITDA over FY19-22E.

FY15-19 was all about Consumer Electronics



Source: Company, HDFC sec Inst Research estimates

…FY19 onwards, Grocery and F&L will key growth anchors



Source: Company, HDFC sec Inst Research estimates

Reliance caters to the entire consumer basket

Grocery	Format	Fashion & Lifestyle	Format	Consumer Electronics	Format
Reliance Fresh	Convenience store	Reliance Trends	Value Fashion	Reliance Digital	Electronics
Reliance Smart	Hyper/Hybrid market	Reliance Footprint	Footwear/Specialty Store	Jio Digital Life	Specialty store (Mobility)
Reliance Market	B2B Cash & Carry biz	Reliance Jewels	Jewellery	Reliance ResQ	After Sales Service
Reliance Smart.in	Online F&G portal	Project Eve	Specialty Store (Apparel)		
		Ajio.com	Online Fashion Portal		

Source: Company, HDFC sec Inst Research

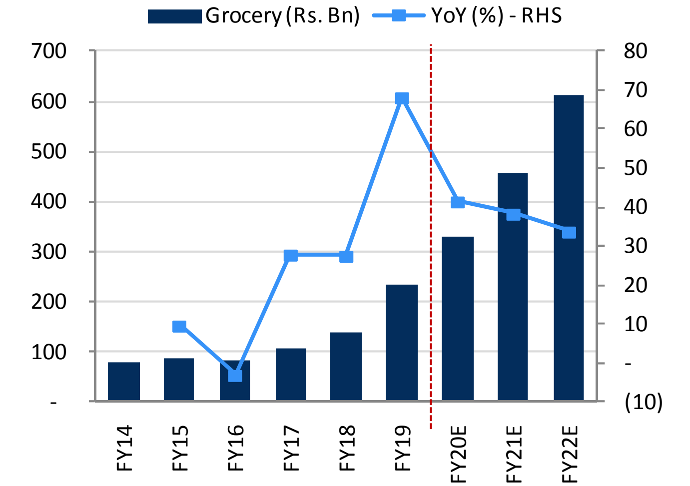
While we expect a robust 35% CAGR in RR's Grocery biz, margin levers seem capped given Grocery expansion incrementally is expected to be lease-driven, hence, rent bills are expected to rise.

An inkling of which can be seen in the FY19 bump up in rent bills (Rent expense increased 143bp YoY to 2.6% of sales)

We reckon, the preferred mode of expansion will be via the stock-up format – Reliance Smart given better unit store economics.

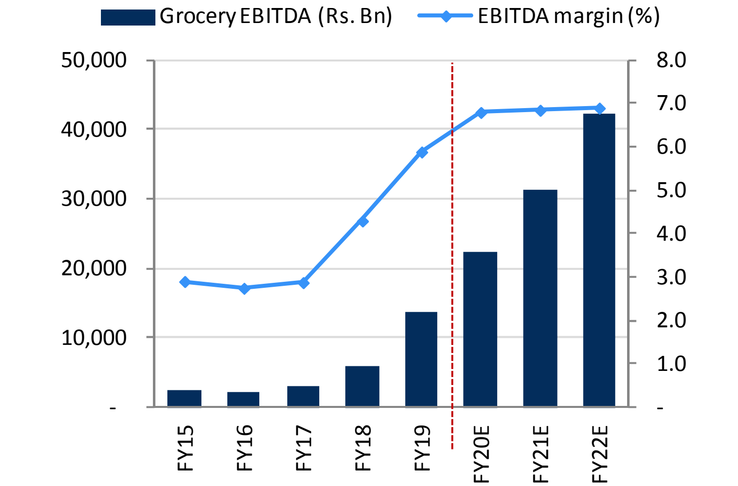
Expansion in convenience format Reliance Fresh has cooled off.

Expect grocery to grow at 35% CAGR



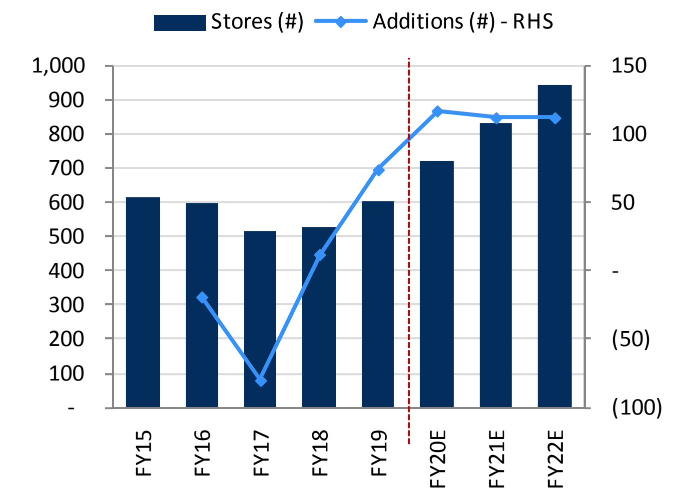
Source: Company, HDFC sec Inst Research estimates

Grocery margins to remain steady over FY20-22E



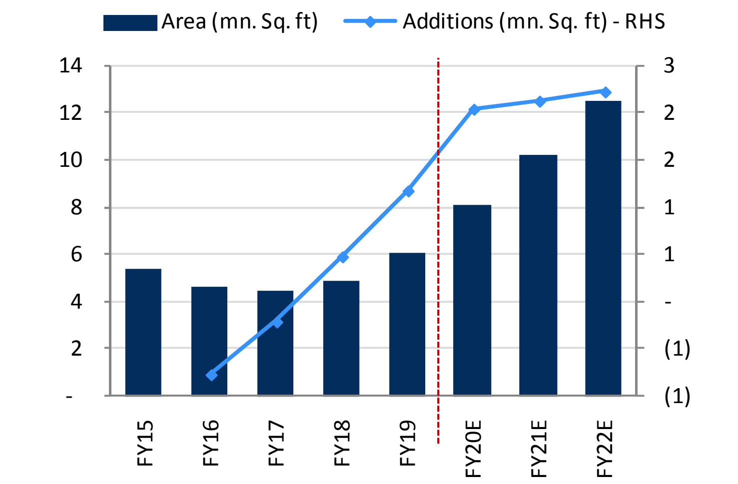
Source: Company, HDFC sec Inst Research estimates

We build in 340+ store additions in Grocery



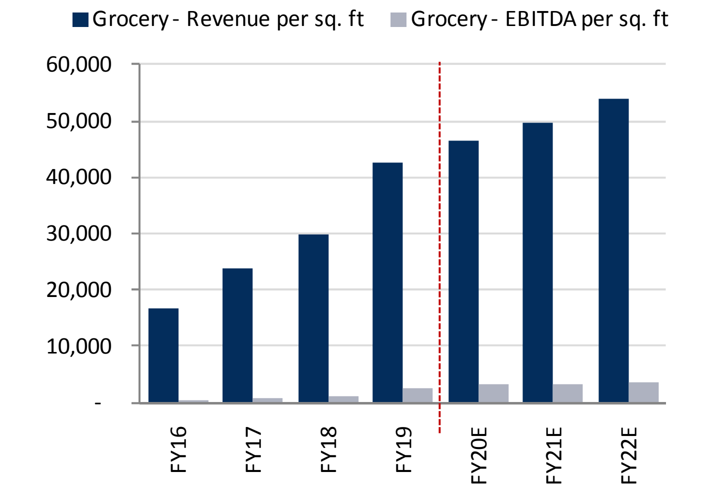
Source: Company, HDFC sec Inst Research

...27% Area CAGR over FY19-22E



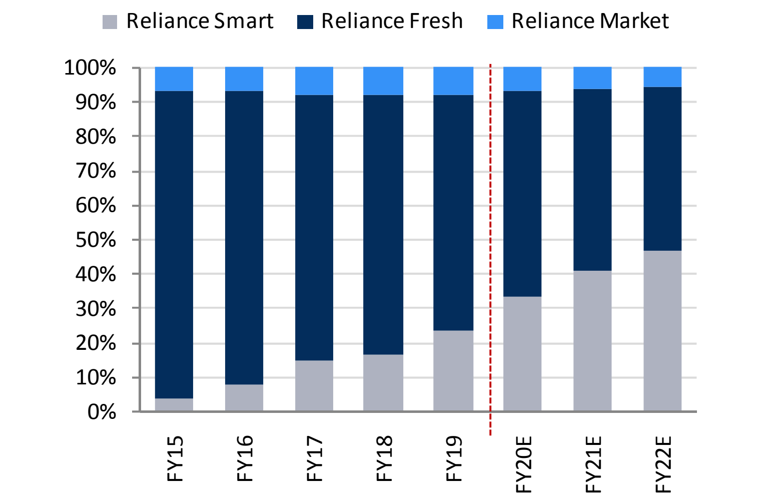
Source: Company, HDFC sec Inst Research

Grocery profitability per sq. ft on the rise as...



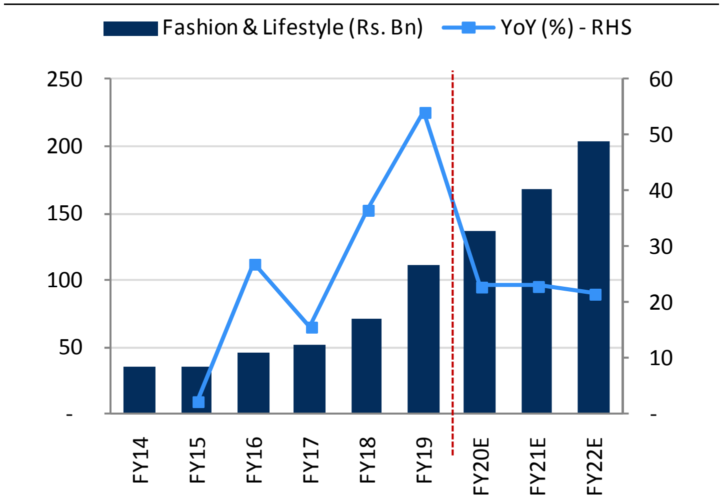
Source: Company, HDFC sec Inst Research estimates

... focus on the more successful stock-up format - Reliance Smart increases



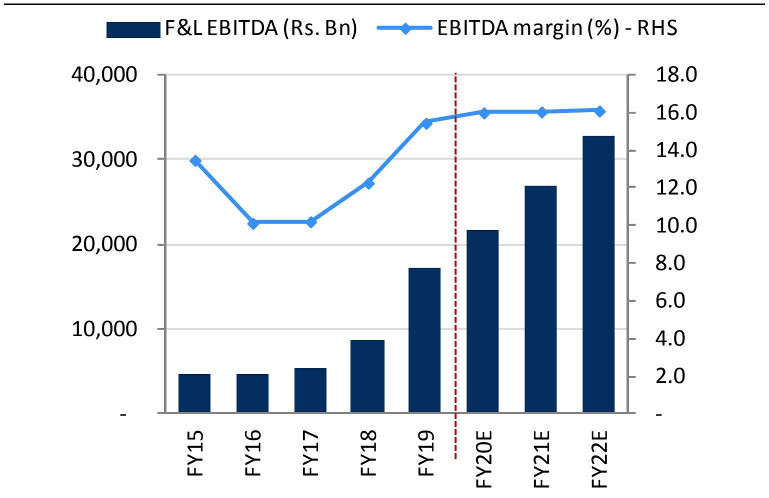
Source: Company, HDFC sec Inst Research estimates

Building in 23% revenue CAGR in F&L over FY19-22E



Source: Company, HDFC sec Inst Research estimates

Enjoy's one of the highest EBITDA margins in F&L given its scale



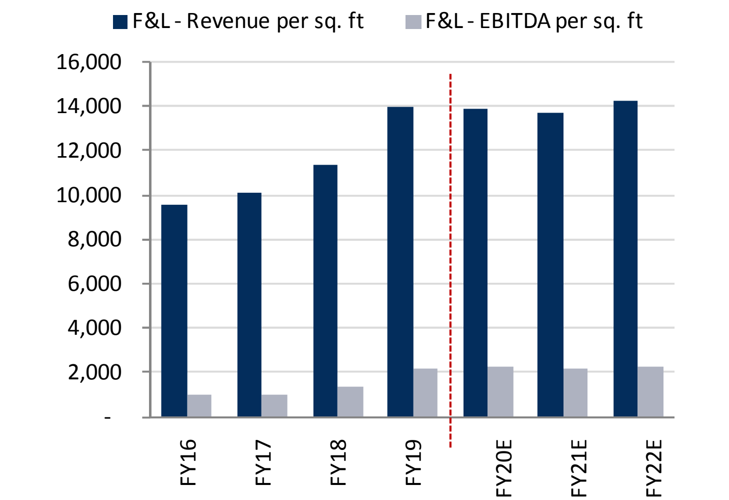
Source: Company, HDFC sec Inst Research estimates

Based on our estimates, RR's F&L enjoys one of the best profitability per sq. ft in the industry given its scale, only Zara and H&M do better

This is typical of a well-scaled value fashion operations (constitutes a lion's share of RR's F&L revenue)

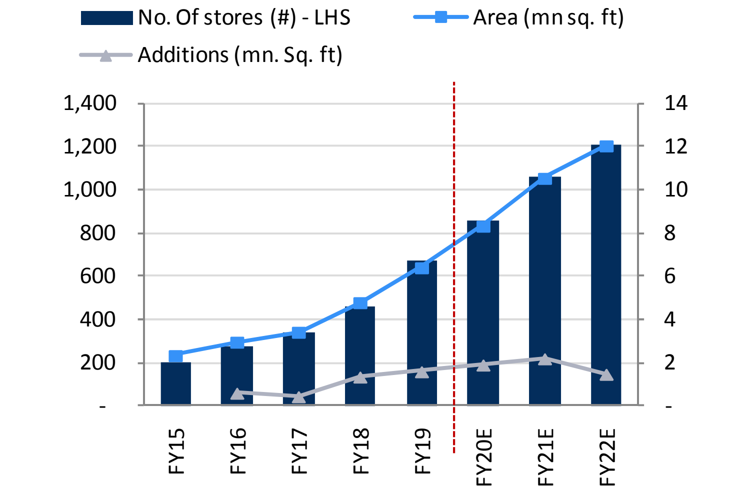
We build in 530 store adds over FY19-22E in the Trends format

Sports one of the best productivity/profitability per sq. ft in industry



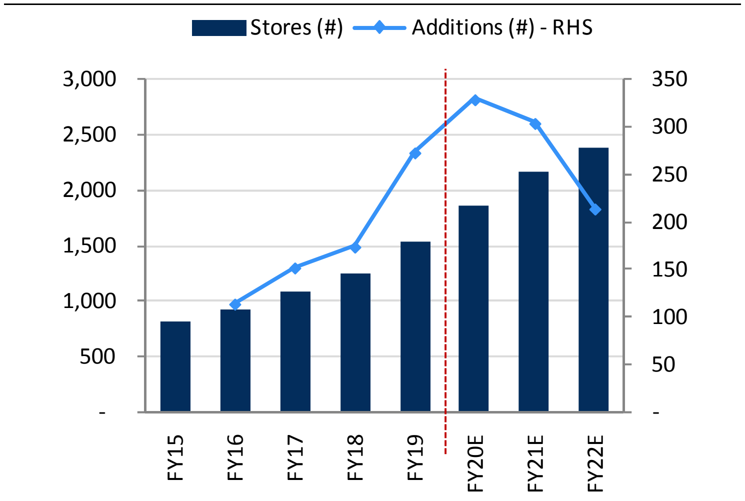
Source: Company, HDFC sec Inst Research estimates

…courtesy its value fashion play – Reliance Trends



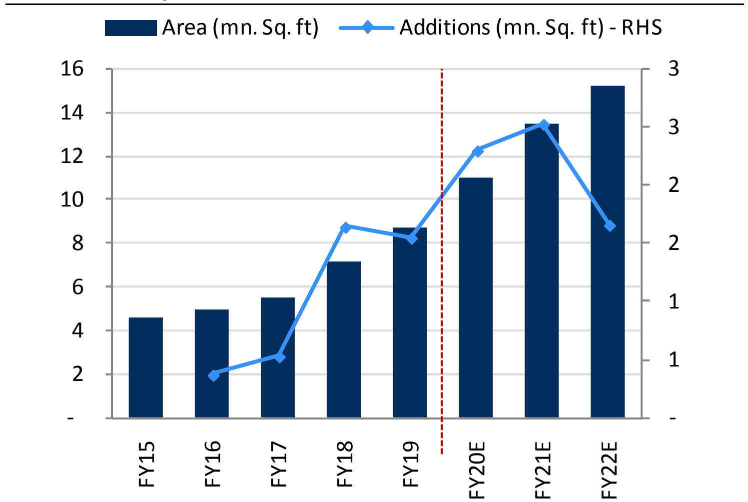
Source: Company, HDFC sec Inst Research estimates

Largest F&L footprint in India



Source: Company, HDFC sec Inst Research estimates

…Building in 21% Area CAGR over FY19-22E (similar to FY16-19)



Source: Company, HDFC sec Inst Research estimates

Reliance Retail's portfolio of formats/Brands

Retail Biz Business / Brand	Product / Service	End Uses
Ajio	Online fashion store	Curated online fashion store offering apparels, accessories, footwear and much more
Jio Stores	Speciality Store for mobility & communication	Latest assortment of mobiles, tablets, laptops, accessories
Project Eve	Apparel speciality store	Speciality stores catering to entire fashion & lifestyle needs of women
Reliance Digital	Electronics speciality store	Offering wide range of consumer electronics, home appliances, entertainment, gaming merchandise
Reliance Footprint	Footwear speciality store	Speciality stores dealing in footwear, handbags and accessories
Reliance Fresh	Neighbourhood store	Dealing in fresh fruits & vegetables, food, grocery and items of daily use
Reliance Jewels	Jewellery speciality store	Fine jewellery with offerings across gold, silver, diamond, precious stones and other precious metals
Reliance Market	Wholesale cash & carry store	Dealing in grocery, clothing, footwear, electronics and general merchandise
Reliance Resq	Consumer electronics after sales service provider	Service provider for consumer electronic products
Reliance Smart	Supermarket	Dealing in fresh fruits & vegetables, food, clothing, footwear, electronics and general merchandise
Reliance Smart.in	Online grocery store	Dealing in fresh fruits & vegetables, food and general merchandise
Reliance Trends	Apparel speciality store	Offers wide range of apparel, handbags, footwear and accessories
Reliance Trends Woman	Apparel speciality store	Offers curated collections of Indian women wear and accessories
In-store Brand		
Avaasa	Ethnic Indianwear inspired by Indian ethos and art forms	Apparel for women
DNMX	Denim inspired casuals	Apparel for men, women and children
Netplay	Smart casuals for the free spirited	Apparel for men
Performax	Activewear for sports and fitness	Apparel and footwear for men, women and children
Point Cove	Smart casuals for kids inspired by California	Apparel for children
Teamspirit	Sport Inspired Casualwear	Apparel for men, women and children
LYF	4G Mobile Handsets and Connectivity Devices	Mobile and connectivity devices
Reconnect	Exclusive Brand from Reliance Digital	Electronic gadgets and accessories
Enzo Matic	Detergent Powder brand	Detergent
Best Farms	Premium Grade Farm Produce brand	Food
Good Life	Clean, Hygienic and Wholesome products brand	Food

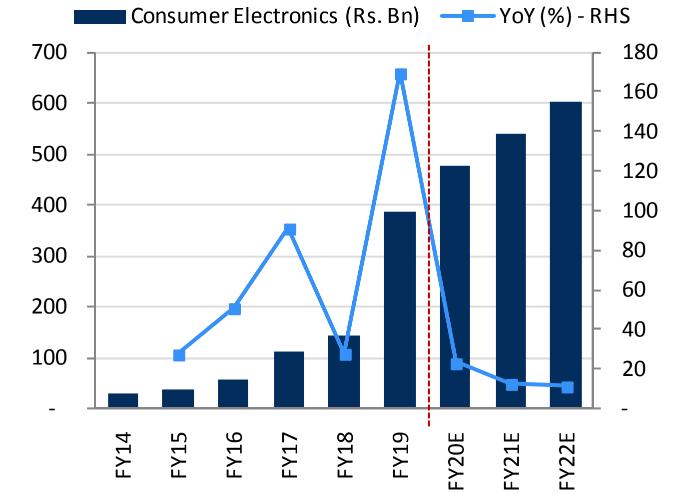
Exclusive Brand Partnership Business / Brand	Product / Service	End Uses
Armani Exchange	Unisex casual wear brand from the Armani house, its global in spirit, this is a brand for the young citizens	Casual wear, Denims
Bally	World's second oldest luxury brand	Shoes, bags and fashion accessories
Bottega Veneta	Italian Luxury accessories brand, founded in 1966, known for discretion, quality, and craftsmanship	Luxury bags, Shoes, Accessories
Brooks Brothers	American iconic brand that has redefined & shaped classic American style for nearly two centuries	Apparel and accessories for men
Canali	Tailor-made Italian luxury men's wear, leader for more than 80 years.	Men's formal wear
Cherokee	Iconic American family lifestyle brand	Apparel and accessories for kids
Coach	Founded in 1941, Coach is a leading design house of modern luxury accessories and lifestyle collections with an all-American attitude	Bags & Accessories
DC	American sportswear brand inspired by skateboarding and snowboarding	Apparel, accessories, footwear and skateboards
Diesel	Iconic Italian lifestyle brand	Apparel, accessories and footwear
Dune	Distinctive fashion footwear & accessories	Accessories and footwear for men and women
Emporio Armani	Emporio Armani is a sub label of Giorgio Armani, includes ready-towear clothes, sunglasses, perfume, accessories and watches.	Luxury Men's wear and Women's wear
Ermenegildo Zegna	Italian luxury men's clothing	Apparel, accessories and footwear for men
Flormar	Leading beauty and colour cosmetic brand	Colour cosmetic products
Furla	Furla deals in Italian handbags, shoes and accessories since 1927. These collections are constructed with high quality craftsmanship and contemporary style	Luxury Bags, Shoes and Accessories
Giorgio Armani	Italian label founded in 1975, known for clean tailored lines and unisex occasion wear	Luxury Men's wear and Women's wear
GAS	Italian clothing brand offering quality products for intelligent, aware consumers, with an international, cosmopolitan attitude	Apparel, accessories and footwear for men & women
G Star Raw	G-Star RAW is a Dutch designer clothing company, known for technologically advanced denims	Denim, casual wear
Hamleys	The finest toy shop in the world	Toys
Hugo Boss	German brand founded in 1924, Sophisticated, modern and iconic Men's wear label, market leaders in the upper premium segment of the global apparel market.	Men's wear, formal and semi formal
Hunkemoller	Leading European lingerie brand	Lingerie, nightwear, swimwear and accessories
ICONIX	Diversified portfolio of fashion and home brands	Apparel, footwear, accessory and home fashion

Business / Brand	Product / Service	End Uses
Istore	Exclusive Apple Products Store	Mobile, Laptops and Connectivity Devices
Jimmy Choo	Jimmy Choo is a 21st century luxury accessories brand, with shoes at its heart, more than 150 stores and is present in the most prestigious department and specialty stores worldwide	Women’s footwear and accessories
Kate Spade	Accessible luxury for women	Handbags, small leather goods, apparel and footwear
Marks & Spencer	Iconic British lifestyle brand	Apparel for women, men and children, lingerie, beauty and home décor
Michael Kors	Luxury accessories and ready-to-wear brand established in 1981. Products include accessories, footwear, watches, jewelry, men’s and women’s ready-to-wear apparel, eyewear and a full line of fragrance products.	Bags, Footwear and accessories
MUJI	Iconic Japanese lifestyle brand	Accessories, home, apparel, travel, beauty, stationery, etc.
Paul & Shark	Italian luxury and casual sportswear brand	Apparel, accessories and footwear for men
Paul Smith	Paul Smith is Britain’s foremost designer, he combines tradition and modernity for his Men’s wear high fashion and formalwear label	Men’s formal wear
Payless	Affordable fashion footwear specialty store	Footwear, handbags and accessories
Thomas Pink	British shirt authority	Apparel and accessories for men
Quiksilver	Premium youth Lifestyle and culture clothing brand representing action sports	Apparel, accessories, footwear, skateboards and surfboards
Roxy	Global lifestyle brand, offering products for every aspect of an active girl’s life	Apparel, accessories, swimwear and footwear for girls
Scotch & Soda	European couture brand	Shoes, bags and fashion accessories
Steve Madden	Fashion forward Footwear & Accessories Brand	Accessories and footwear for men and women
Superdry	Fashion brand that fuses design influences from Japanese graphics and vintage Americana, with the values of British tailoring	Apparel, accessories and footwear
TUMI	Founded in 1975, leading international business, accessory and travel lifestyle brand.	Travel bags, wallets and Bags
Villeroy & Boch	Luxurious and timeless pieces since 1748 for bathroom and wellness, tableware and tiling. Headquartered in Germany, this large manufacturer of ceramics specialises in innovative products	Tableware
Vision Express	Optical specialty store	Spectacles, sunglasses, contact lenses and eyewear care accessories

Source: Company, HDFC sec Inst Research

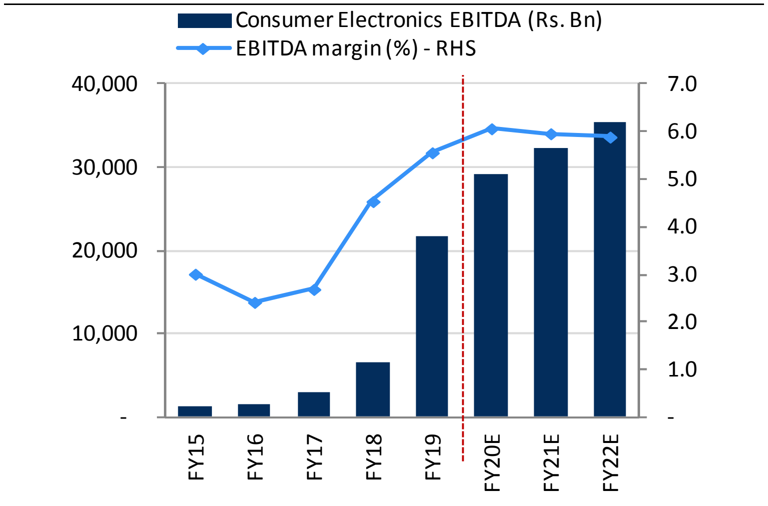
Growth in consumer electronics to cool off as 1. revenue from JIO devices moderate, 2. Given the high base of FY19

Consumer electronics (CE) growth to remain healthy, albeit expected to cool off over FY19-22E



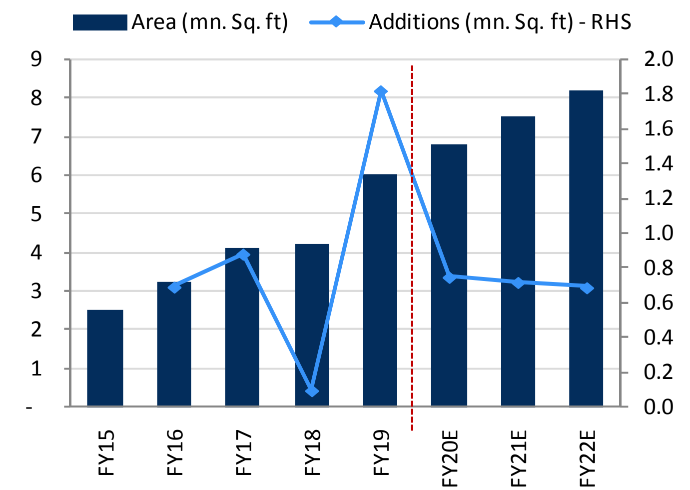
Source: Company, HDFC sec Inst Research estimates

CE EBITDA margins to moderate too as JIO device sales cool off



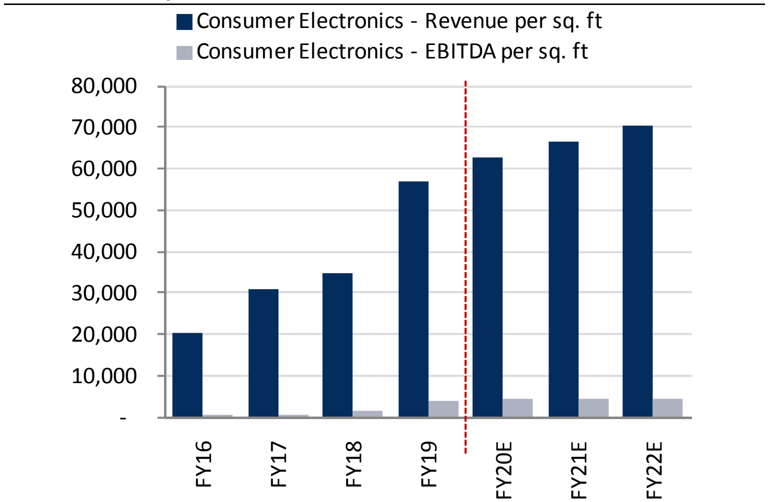
Source: Company, HDFC sec Inst Research estimates

Building in Area CAGR of 11% in CE over FY19-22E



Source: Company, HDFC sec Inst Research estimates

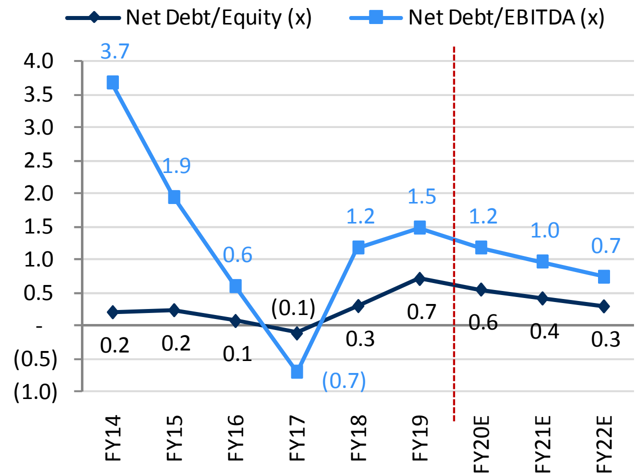
Sales velocity/EBITDA per sq. ft to remain healthy (ex-JIO devices)



Source: Company, HDFC sec Inst Research estimates

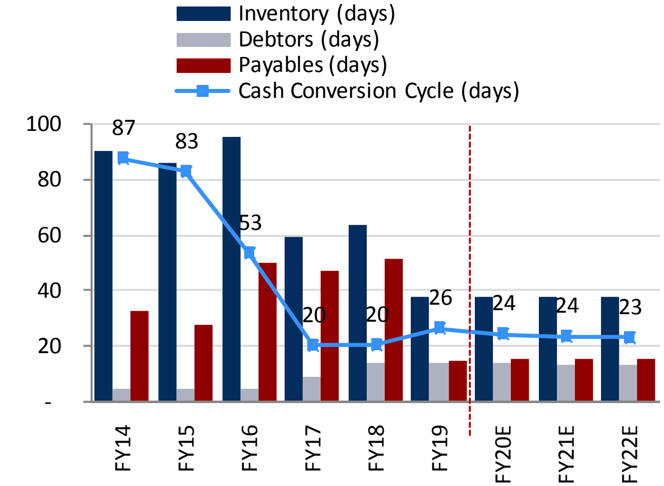
FY19 saw a significant moderation in payables; we suspect funded by debt

Leverage position remains comfortable, inching up though!



Source: Company, HDFC sec Inst Research

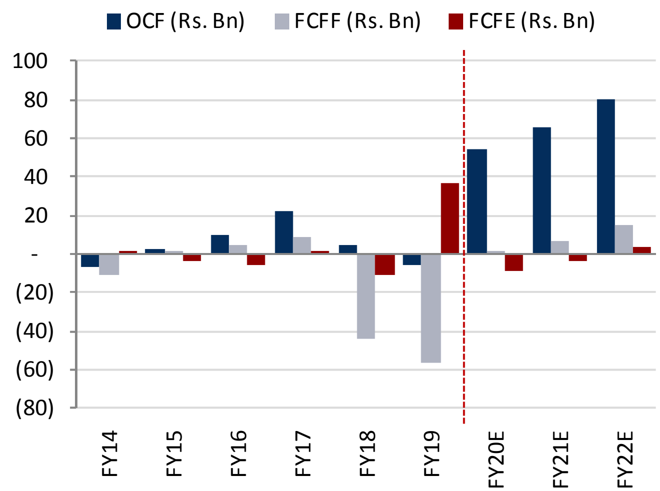
FY19 saw moderation in payables, expect a steady working capital over FY19-22E



Source: Company, HDFC sec Inst Research

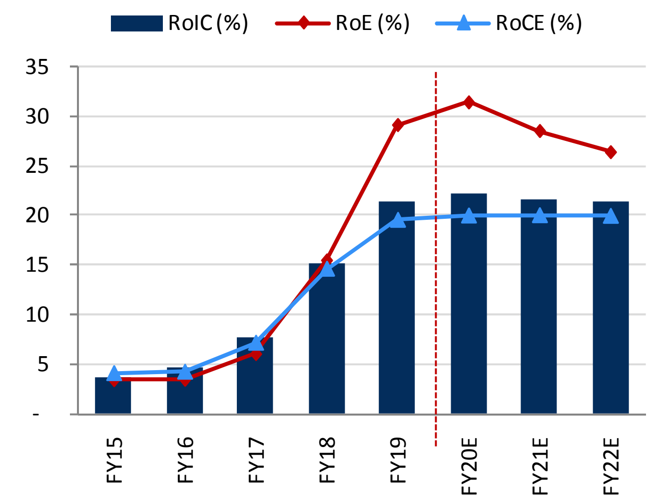
We believe pricing aggression in grocery will continue and hence expect positive free cash generation to be a couple of years out

Inching closer to free cash generation



Source: Company, HDFC sec Inst Research

Returns profile to remain steady



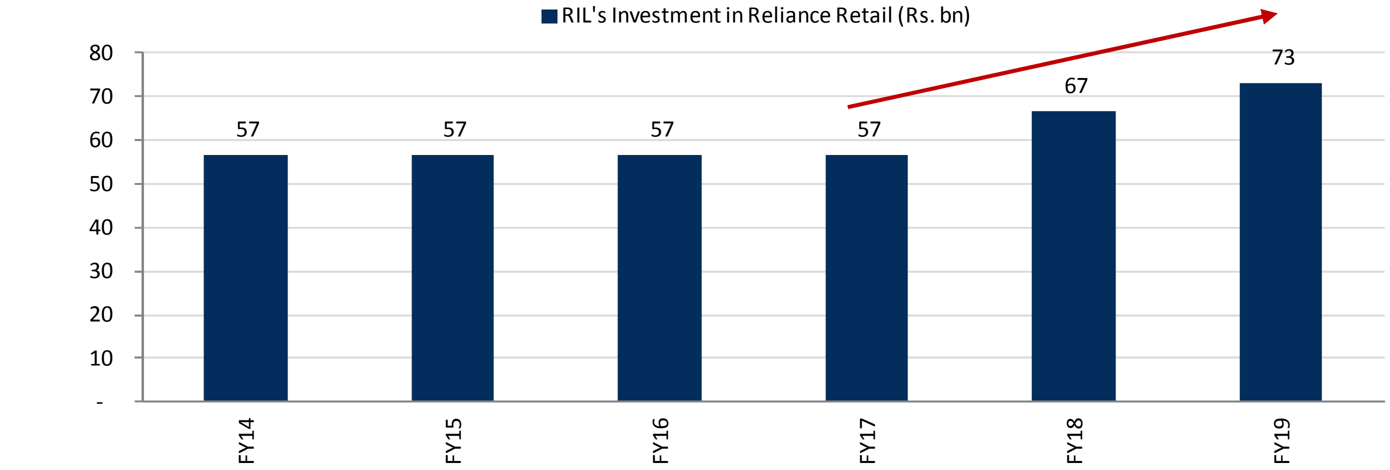
Source: Company, HDFC sec Inst Research

Capital intensity has remained high over the last 5 years

Internal accruals funded about 58% of Capex and WC needs over FY14-19

That said, building massive scale is a must in Retail to weed out competition in the long run which RR has done successfully (>3.5x the size of FRL/D-MART). The scale now may just be enough for funding capital needs going forward

RIL putting money where its mouth is…investments in RRVL increasing



Source: Company, HDFC sec Inst Research

RRVL – is one of the fastest growing retailers, the model has demanded heavy investments to back that growth

	FY14	FY15	FY16	FY17	FY18	FY19	Total
Cash from Operations (excl WC change)	3,527	7,477	7,674	11,846	21,218	51,471	103,214
Other Income	467	198	50	232	54	228	1,229
Total	**3,994**	**7,676**	**7,724**	**12,079**	**21,272**	**51,699**	**104,443**
Application of funds (Rs bn)							
Working Capital	10,771	4,475	(2,657)	(10,529)	16,063	39,067	57,189
Capex	4,139	2,309	5,203	13,594	49,336	49,638	124,218
Investments	-	-	-	-	-	33,801	33,801
Dividend	-	-	-	-	-	-	-
Proceeds from equity/pref. Issuance	2,017	-	-	-	(10,485)	(7,377)	(15,845)
Borrowings	(13,773)	2,427	9,449	7,090	(34,266)	(93,840)	(122,913)
Others	209	(667)	(4,100)	652	996	29,108	26,199
Net change in cash	631	(868)	(171)	1,271	(371)	1,302	1,794
Total	**3,994**	**7,676**	**7,724**	**12,079**	**21,272**	**51,699**	**104,443**
Cumm. WC + Capex as % of sources of funds (FY14-19)							**174**

Source: Company, HDFC sec Inst Research

SOTP - Valuation

	Revenue (Rs. Mn)	Sept-21 EBITDA (Rs. Mn)	Target EV/EBITDA (x)	EV (Rs. Mn)	Rev CAGR (FY19-22E)	EBITDA CAGR (FY19-22E)	Comments
Grocery	440,128	35,023	22	770,504	35.3	42.6	Avenue trading at 30x EV/EBITDA, Our target multiple for Avenue is ~25x. Valuing Reliance's Grocery biz at 12% discount to Avenue
F&L	167,415	29,837	22	656,423	22.6	24.3	@ par with market leader ABFRL (Closest competitor)
Consumer Electronics	540,362	33,879	15	508,186	15.8	18.0	Great Franchise but category at risk of increasingly moving online
Connectivity	620,529	10,053	5	50,263	18.0	11.1	Commodity biz. Just a master distributor
Petro Retail	159,154	1,491	5	7,455	8.0	(2.9)	Commodity biz
Total EV	**1,927,588**	**110,283**	**18.1**	**1,992,830**			
Net Debt				**93,742**			
Equity Value (Rs. Mn)				**1,899,088**			
Per Share* (Rs.)				**315**			
Core EBITDA		**98,739**	**19.6**	**1,935,112**			

Source: Company, HDFC sec Inst Research, Per share equity value on RRVL share count*

Income Statement (Consolidated)

Year End (March)	FY18	FY19	FY20	FY21	FY22
Net Revenues	**621,616**	**1,163,575**	**1,445,145**	**1,719,750**	**2,029,610**
Growth (%)	***86.5***	***87.2***	***24.2***	***19.0***	***18.0***
Material Expenses	544,196	997,931	1,238,696	1,473,211	1,737,636
Employee Expense	8,296	10,784	12,671	13,359	14,751
A&P Expense	7,413	30,472	40,013	50,196	62,285
Other selling and distribution Expense	15,165	27,924	34,681	41,271	48,708
Other Expenses	13,652	35,706	36,482	41,721	45,657
EBITDA	**32,894**	**60,758**	**82,602**	**99,992**	**120,574**
EBITDA Growth (%)	***177.8***	***84.7***	***36.0***	***21.1***	***20.6***
EBITDA Margin (%)	***5.3***	***5.2***	***5.7***	***5.8***	***5.9***
Depreciation	4,646	6,553	9,769	13,503	17,677
EBIT	**28,248**	**54,204**	**72,833**	**86,489**	**102,897**
Other Income (Including EO Items)	467	826	2,995	3,208	3,709
Interest	1,004	6,210	10,095	10,400	10,019
PBT	**27,711**	**48,820**	**65,733**	**79,297**	**96,587**
Total Tax	6,536	17,136	16,545	19,959	24,311
PAT before share of associate earnings	**21,175**	**31,684**	**49,188**	**59,338**	**72,276**
Share of associate earnings	237	600	660	726	799
RPAT	**21,413**	**32,284**	**49,849**	**60,064**	**73,075**
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	**21,413**	**32,284**	**49,849**	**60,064**	**73,075**
APAT Growth (%)	***399.6***	***50.8***	***54.4***	***20.5***	***21.7***
Adjusted EPS (Rs)	**3.6**	**5.4**	**8.3**	**10.0**	**12.2**
EPS Growth (%)	***399.6***	***50.8***	***54.4***	***20.5***	***21.7***

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year End (March)	FY18	FY19	FY20	FY21	FY22
SOURCES OF FUNDS					
Share Capital - Equity	60,000	60,000	60,000	60,000	60,000
Reserves	36,867	75,309	124,497	183,835	256,111
Total Shareholders Funds	**96,867**	**135,309**	**184,497**	**243,835**	**316,111**
Minority Interest	**239**	**1,116**	**1,116**	**1,116**	**1,116**
Long Term Debt	-	3	3	3	3
Short Term Debt	34,480	128,317	136,317	136,317	126,317
Total Debt	**34,480**	**128,320**	**136,320**	**136,320**	**126,320**
Net Deferred Taxes	**(6,801)**	**(798)**	**(798)**	**(798)**	**(798)**
Other Non-current Liabilities & Provns	**-**	**-**	**-**	**-**	**-**
TOTAL SOURCES OF FUNDS	**124,786**	**263,947**	**321,135**	**380,473**	**442,749**
APPLICATION OF FUNDS					
Net Block	34,362	75,898	116,710	154,800	189,893
CWIP	41,635	43,664	43,664	43,664	43,664
Other Non-current Assets	11,243	15,101	15,101	15,101	15,101
Total Non-current Assets	**87,239**	**134,663**	**175,475**	**213,565**	**248,657**
Inventories	108,223	119,784	148,770	177,040	208,938
Debtors	24,459	47,649	59,180	68,541	80,890
Other Current Assets	23,209	24,247	25,843	26,042	25,174
Cash & Equivalents	**5,195**	**37,260**	**37,620**	**42,578**	**50,140**
Total Current Assets	**161,086**	**228,941**	**271,413**	**314,200**	**365,142**
Creditors	87,099	47,027	62,366	74,216	87,589
Other Current Liabilities & Provns	36,441	52,630	63,387	73,075	83,462
Total Current Liabilities	**123,540**	**99,657**	**125,752**	**147,292**	**171,050**
Net Current Assets	**37,546**	**129,284**	**145,661**	**166,909**	**194,092**
TOTAL APPLICATION OF FUNDS	**124,786**	**263,947**	**321,135**	**380,473**	**442,749**

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March	FY18	FY19	FY20	FY21	FY22
Reported PBT	19,476	48,821	65,733	79,297	96,587
Non-operating & EO Items	1,021	301	(2,995)	(3,208)	(3,709)
Interest Expenses	1,004	6,210	10,095	10,400	10,019
Depreciation	4,646	6,553	9,769	13,503	17,677
Working Capital Change	(16,063)	(39,067)	(16,017)	(16,289)	(19,621)
Tax Paid	(4,929)	(10,414)	(16,545)	(19,959)	(24,311)
OPERATING CASH FLOW (a)	**5,155**	**12,404**	**50,040**	**63,743**	**76,642**
Capex	(49,336)	(49,638)	(50,580)	(51,593)	(52,770)
Free Cash Flow (FCF)	*(44,180)*	*(37,234)*	*(540)*	*12,151*	*23,872*
Investments	-	(33,801)	-	-	-
Non-operating Income	62	228	2,995	3,208	3,709
INVESTING CASH FLOW (b)	**(49,274)**	**(83,211)**	**(47,585)**	**(48,385)**	**(49,061)**
Debt Issuance/(Repaid)	33,262	87,657	(2,095)	(10,400)	(20,019)
FCFE	*(10,918)*	*50,423*	*(2,636)*	*1,750*	*3,853*
Share Capital Issuance	10,485	7,377	-	-	-
Dividend	-	-	-	-	-
Others	-	(22,924)	-	-	-
FINANCING CASH FLOW (c)	**43,747**	**72,109**	**(2,095)**	**(10,400)**	**(20,019)**
NET CASH FLOW (a+b+c)	**(371)**	**1,302**	**360**	**4,958**	**7,562**
EO Items, Others	1	1	1	1	1
Closing Cash & Equivalents	2,531	4,096	4,456	9,414	16,976

Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20	FY21	FY22
PROFITABILITY (%)					
GPM	12.5	14.2	14.3	14.3	14.4
EBITDA Margin	5.3	5.2	5.7	5.8	5.9
EBIT Margin	4.5	4.7	5.0	5.0	5.1
APAT Margin	3.4	2.8	3.4	3.5	3.6
RoE	25.1	27.8	31.2	28.0	26.1
RoIC (or Core RoCE)	24.6	20.3	21.4	20.8	21.1
RoCE	23.4	18.7	19.6	19.3	19.6
EFFICIENCY					
Tax Rate (%)	23.6	35.1	25.2	25.2	25.2
Fixed Asset Turnover (x)	11.1	12.6	10.1	8.8	8.2
Inventory (days)	*63.5*	*37.6*	*37.6*	*37.6*	*37.6*
Debtors (days)	*14.4*	*14.9*	*14.9*	*14.5*	*14.5*
Other Current Assets (days)	*13.6*	*7.6*	*6.5*	*5.5*	*4.5*
Payables (days)	*51.1*	*14.8*	*15.8*	*15.8*	*15.8*
Other Current Liab & Provns (days)	*21.4*	*16.5*	*16.0*	*15.5*	*15.0*
Cash Conversion Cycle (days)	19.0	28.9	27.3	26.4	25.9
Net D/E (x)	0.3	0.7	0.5	0.4	0.2
Interest Coverage (x)	28.1	8.7	7.2	8.3	10.3
PER SHARE DATA (Rs)					
EPS	3.6	5.4	8.3	10.0	12.2
CEPS	4.3	6.5	9.9	12.3	15.1
Dividend	-	-	-	-	-
Book Value	16.1	22.6	30.7	40.6	52.7
VALUATION					
P/E (x)	88.7	58.8	38.1	31.6	26.0
P/BV (x)	19.6	14.0	10.3	7.8	6.0
EV/EBITDA (x)	60.6	32.8	24.1	19.9	16.5
EV/Revenues (x)	3.2	1.7	1.4	1.2	1.0
OCF/EV (%)	0.3	0.6	2.5	3.2	3.8
FCF/EV (%)	(2.2)	(1.9)	(0.0)	0.6	1.2
FCFE/Mkt Cap (%)	(0.6)	2.7	(0.1)	0.1	0.2
Dividend Yield (%)	-	-	-	-	-

Source: Company, HDFC sec Inst Research

1 yr PRICE MOVEMENT

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
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