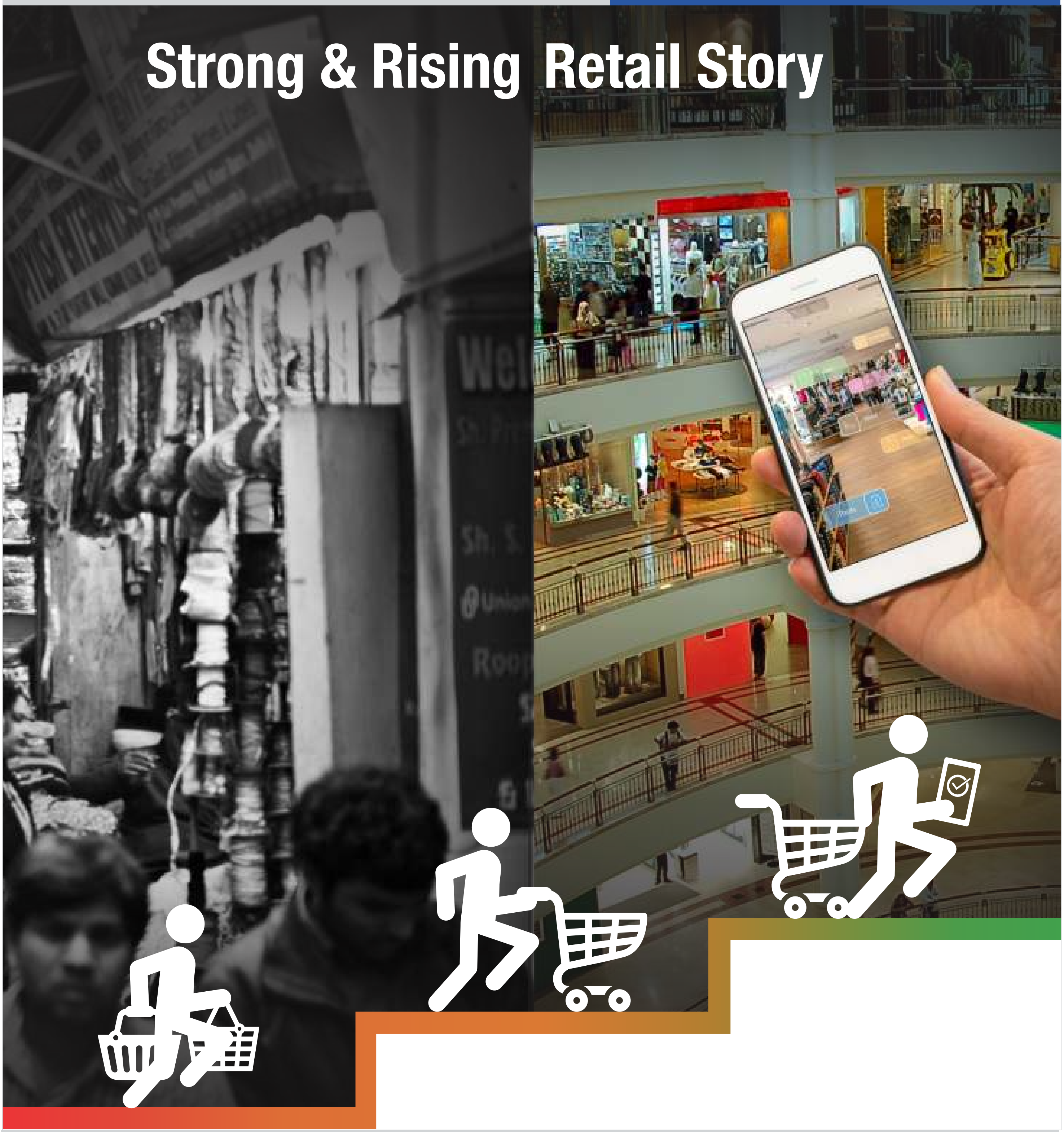
India Retail

Return of the Renaissance

January 8, 2018

Edelweiss
Ideas create, values protect

Strong & Rising Retail Story



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Edelweiss Securities Limited

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Executive Summary

(Click here for video clip)

India's retail tiger is roaring back—up >50-400% in CY17 compared to ~30% Nifty return—and is ready to take the big leap. We expect the dream run to sustain and the sector's revenue to catapult to USD166bn by FY25E from USD55bn in FY16, >13% CAGR. Favourable macros—improving consumer sentiments, rising disposable incomes, urbanisation and lower penetration of organised retail—are envisaged to primarily fuel this boom. Moreover, recent structural reforms—demonetisation and GST—have been potent catalysts. Also, post fiercely fought turf wars, offline and online players seem to have made their peace and are toying with the omni-channel platform in their quest for success.

On the valuation front, at ~20x FY20E average EV/EBITDA, the stocks appear expensive in conventional valuation terms. However, we argue valuations will get richer still, fuelled by high growth rates (18-20% revenue CAGR over FY17-20), improving return ratios (>750bps RoCE jump over FY17-20) and expanding opportunity (USD166bn by FY25 from USD55bn in FY16). Factoring in prime business models, earnings growth, potential improvement in return ratios as well as perceived risk as touch stone of success, <u>we prefer hypermarkets and jewellery players</u> (market share gain from unorganised). Hence, our top picks are Trent (BUY), Future Retail (BUY), Titan (BUY) and Shoppers Stop (BUY). Also, we initiate coverage on Trent (BUY), V-MART (BUY) and D'mart (HOLD). We have also profiled 13 retail players (10 unlisted) which are rendering interesting flavour to the India retail industry.

Potent catalysts in place to fuel retail boom

India's organised retail tale is set for a fortunate twist and catapult to USD166bn by FY25E from USD55bn in FY16, >13% CAGR. The retail boom is envisaged to be fuelled by favourable macros: (i) **<u>rising disposable incomes and improving consumer sentiments</u>**–Per capita income clocked 10.2% CAGR over FY12-15; (ii) **<u>attractive demographics</u>**–Median age of 27 with ~50% of population in working age bracket; and (iii) **<u>rising urbanisation</u>**: 41% of population estimated to reside in urban areas by 2030 from 31.2% in FY11. Recent structural reforms are the icing on the cake, which will further burnish the industry's prospects: a) **GST** is expected to accelerate demand shift to the organised segment as unorganised retailers cede turf due to stringent compliance requirements; and b) post **demonetisation**, we anticipate consumers to stay hooked to modern retail. **Among categories, we estimate food & beverages (F&B), followed by jewellery and apparels to benefit the most from changing consumer habits, huge unorganised market, low penetration, minimal competition and high entry barriers.**

Re-configuring business models to master growth template

Retailers have, over the past few years, tested various business models and have finally identified their operating moat: 1**)** **<u>optimum store size</u>**: Compact hypermarket (20,000–30,000sq ft) and supermarket (3,000-4,000sq ft) formats enhance sales per sq ft by focusing on right assortment; 2) **<u>right product mix</u>**: Players are targeting a balance between food & groceries (F&G) and apparel in their quest for profitability & productivity; and 3) **<u>private labels</u>**: Organised retailers are training focus on private labels **<u>(20% in India versus 35% globally)</u>** as they fetch higher margins and ensure greater customer loyalty. Moreover, considering high real estate cost, most players (except D'mart) have adopted the lease rental model. This lends flexibility in ease of entry and exit if sales per sq ft and returns on invested capital do not meet a company's internal benchmarks.

The right blend: Omni-channel strategy key success mantra

Post bitterly fought turf wars between brick-and-mortar stores and e-commerce companies, players have gleaned that **offering a complete and seamless consumer experience is mantra to success.** Hence, while online retailers are shifting offline (Amazon's tie up with Shoppers Stop), we anticipate offline stores to resort to the digital medium to target consumers (Future Retail shifting to Retail 3.0). In our view, omni-channel strategy is the way ahead. Among categories, while F&G is likely to be resistant to e-commerce play, electronics and low-value jewellery are most likely to warm up to the platform. Branded apparels are envisaged to deploy omni-channel strategy with online as well as offline presence.

Premium valuations to sustain

Retail sector stocks have been on a roll in CY17—up >50-400% compared to ~30% Nifty return. At ~20x FY20E average EV/EBITDA the stocks may look expensive in conventional valuation terms. However, we argue that valuations will get richer still fuelled by high growth rates, improving return ratios and expanding opportunity pie.

We have valued companies on EV/EBITDA basis (except Titan, which we value on P/E basis) since: (i) leverage ratios for companies are diverse; and (ii) considering debt levels and capex, the flow from EBITDA to PAT is insignificant at this juncture. To arrive at our top picks, we have distilled companies through the sieve of prime business models, earnings growth and potential improvement in return ratios as well as perceived risk. Factoring these parameters, **we prefer hypermarkets and jewellery players** (market share gain from unorganised). Hence, **our top picks are Trent (BUY), Future Retail (BUY), Titan (BUY) and Shoppers Stop (BUY).** We initiate coverage on Trent (BUY), V-MART (BUY) and D'mart (HOLD).

Our preferred picks: Pecking order

Trent: Triple treat.

Future Retail: In pole position

Titan: Lustrous growth

Shoppers Stop: Trajectory well etched out

Future Lifestyle: *Brand Factory Central* advantage

V-MART Retail: Value play on small town

ABFRL: Peerless brand brawn

Avenue Supermarts: Deep MOAT; Valuation a concern

Table 1: Edelweiss retail coverage snapshot

Company	Reco/ Rating	CMP (INR)	TP (INR)	Upside (%)	Revenue (INR bn)			EBITDA (INR bn)			EBITDA CAGR	EBITDA margins (%)			RoCE (%)			EV/EBITDA (x)		
					FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	(FY17-20)	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
ABFRL	Buy	171	206	20.5	76	86	99	6	9	11	34.5	8.0	9.9	10.8	11.2	15.9	19.4	25.2	17.5	13.5
D'mart	Hold	1,160	1,290	11.2	154	198	250	13	17	23	32.1	8.6	8.8	9.0	25.6	29.4	32.1	53.8	41.0	31.4
FLF	Buy	352	439	25.0	46	56	68	4	6	7	26.8	9.7	10.2	10.7	11.2	15.7	20.9	16.3	12.4	9.7
FRetail	Buy	511	677	32.4	201	255	300	17	23	26	20.6	8.5	8.8	8.8	21.5	24.1	27.1	31.0	24.4	18.7
Shoppers	Buy	536	733	36.8	55	50	55	3	4	5	39.4	5.1	8.0	8.5	9.1	15.2	17.7	19.6	13.6	11.3
Titan	Buy	845	977	15.6	158	188	223	16	20	25	29.6	10.1	10.9	11.3	33.3	36.1	37.6	46.5	36.2	29.4
Trent	Buy	327	394	20.4	22	27	33	2	3	4	41.3	8.0	9.7	10.9	9.8	13.0	15.4	63.4	41.5	29.8
V-MART	Buy	1,479	1,744	17.9	12	15	18	1	1	2	27.0	8.3	9.0	9.6	23.5	28.1	31.4	26.2	19.6	15.2
					724	**875**	**1,045**	**62**	**83**	**102**		**8.6**	**9.5**	**9.8**				**35.2**	**25.8**	**19.9**

Table 2: Global valuation snapshot

Name of the Company	Mcap (INR bn)	Enterprise Value (INR bn)	EBITDA Margin FY18 (%)	EV/EBITDA FY18 (x)	EPS FY17-19 CAGR (%)	RoE FY18 (%)
Inditex	6,893	6,443	21.4	15.4	10.8	25.2
H&M	2,172	2,130	15.0	9.1	(4.2)	27.1
Mr. Price	319	313	19.2	17.3	14.6	38.7
TJX Companies	3,080	3,038	12.9	10.3	6.9	56.2
Fast Retailing	2,696	2,479	12.5	17.1	6.6	16.5
Walmart	18,548	21,215	6.7	10.0	1.3	16.5
Costco	5,252	5,243	4.3	13.9	6.5	24.3

Source: Edelweiss research

*Note: * Data for H&M and Fast retailing is for CY*

*** CMP and Mcap is as on Jan 4, 2018*

Edelweiss Coverage Universe: Retail

Trent: Trent provides unique opportunity to invest in 3 power brands—*Westside, Star Bazaar* and *Zara*. Aided by strong management and focus on all 3 brands, we expect the company to clock 72% EPS CAGR over FY17-20. We initiate coverage with **'BUY/SO'** recommendation/rating. Our SOTP valuation assigns EV/EBITDA of 25x FY20E to *Westside* business, 15x FY20E EV/EBITDA to *Zara* business and P/Sales of 1.5x FY20E to *Star Bazaar* to arrive at target price of INR394.

Future Retail: On sustained strong SSSG, improving margin and better inventory turns, we estimate ~1,044bps jump in RoE to 27.1% over FY17-20. We maintain **'BUY/SO'** and TP of INR677 as we roll over to FY20E and assign 25x EV/EBIDTA.

Titan: We envisage Titan's healthy momentum to sustain led by share gains, entry in new segments and retail expansion. Moreover, rising share of studded jewellery, cost optimisation and operating leverage are likely to aid margin. We maintain **'BUY/SO'** and TP of INR977 as we roll over to FY20E and assign 52x EPS.

Shoppers Stop: SSL is well placed as: 1) its omni-channel strategy will receive a boost post tie up with Amazon India; and 2) funds raised via the deal will be used to prune debt. We roll over to FY20E and assign 15x EV/EBITDA to arrive at target price of INR733. At CMP, the stock is available at 11.3x FY20E EV/EBITDA. We maintain **'BUY/SO'**.

Future Lifestyle Fashions: We estimate 10% SSSG in *Central* in FY20 aided by recovery in urban consumption and better execution. We roll over to FY20E and on account of sharpened focus on power brands and closing of loss-making stores (*Planet Sports*), we assign 12x FY20E EV/EBITDA and arrive at TP of INR439. We maintain **'BUY/SP'.**

V-MART Retail: On sustained strong SSSG, improving margins and better inventory turns, we estimate 27% EBITDA CAGR coupled with ~570bps jump in RoE to 21.5% over FY17-20. We initiate coverage with **'BUY/SP'** and TP of INR1,744 (18x FY20E EV/EBIDTA).

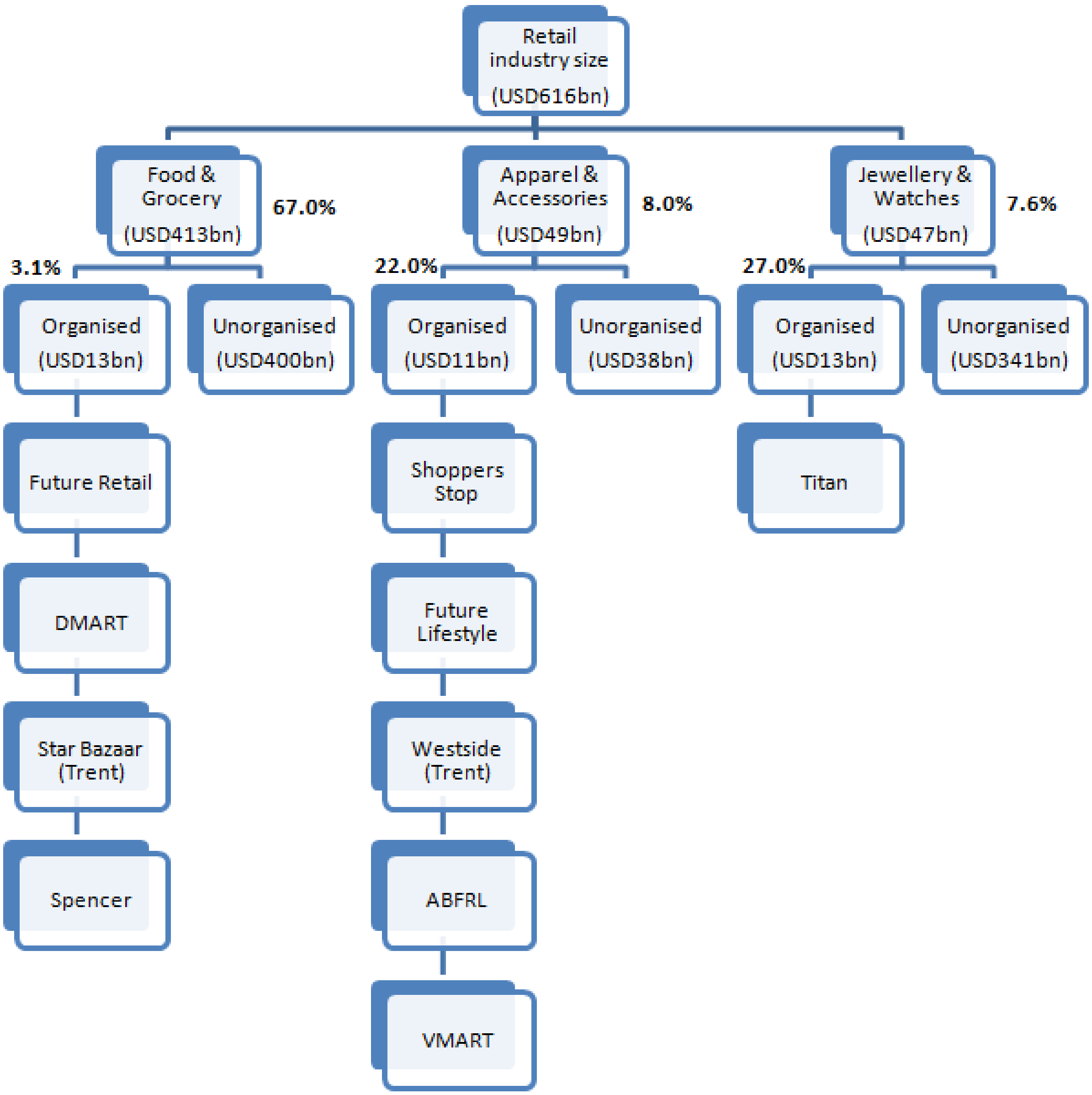
Aditya Birla Fashion and Retail: Anchored by revival of Madura and Pantaloons, we are confident of improvement in ABFRL's return ratios—~1,174bps jump in RoCE to 19.4% in FY20. We assign target multiple of 16x FY20E EV/EBITDA and arrive at TP of INR206. We maintain **'BUY/SP'**.

Avenue Supermarts: While we aver that D'mart is a perfect play on the Indian retail story, we abide by Warren Buffet's admonition, " an investor should understand that price is what you pay, value is what you get." Hence, with limited upside from current level (31.4x FY20E EV/EBITDA), we initiate coverage with **'HOLD/SU'** and TP of INR1,290.

Risk and concerns

Overall potential of India's organised brick-and-mortar retail is undeniably a potent opportunity. However, key risk is availability of real estate at the right location at reasonable cost. In the past, limited availability of quality real estate coupled with high rentals and non-adherence to committed schedule by builders have resulted in slower store additions for some retailers. Apart from this, limited feasible real estate inventory coming into the market every year and entry of global fashion giants may lead to some space crunch for strong domestic players. It may also trigger higher rental cost, thereby deferring the payback period and thereby RoCE. Another perceived risk is threat from online players. However, we believe, the risk has ebbed significantly compared to 2 years ago on account of business sanity within online players as well as some regulatory changes.

Fig. 1: Indian retail sector—Snapshot



Source: Edelweiss research

Apparel companies: Comparison (FY17)

Chart 1: FLF leads the pack with highest revenue/margins

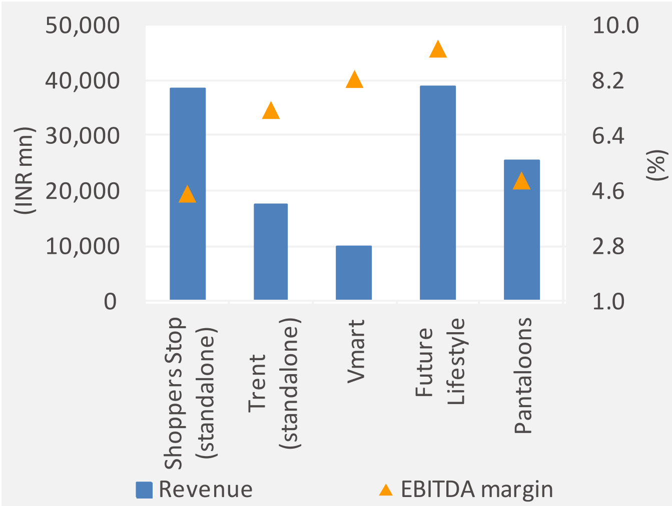


Chart 2: FLF's Central leads with highest SSSG

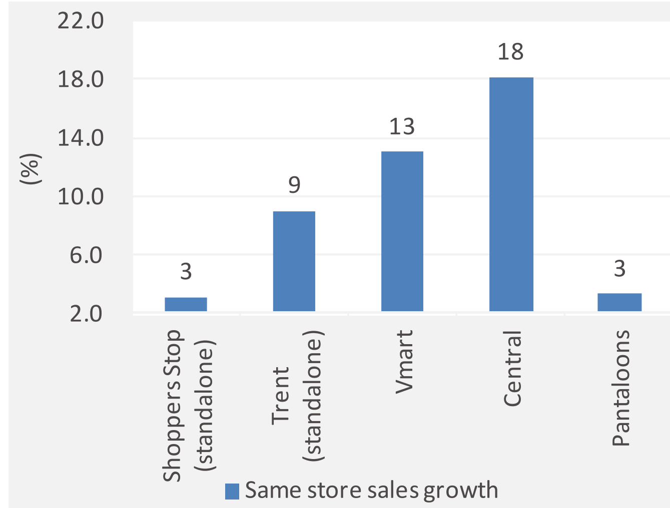


Chart 3: V-MART Retail recorded highest sales per sq foot

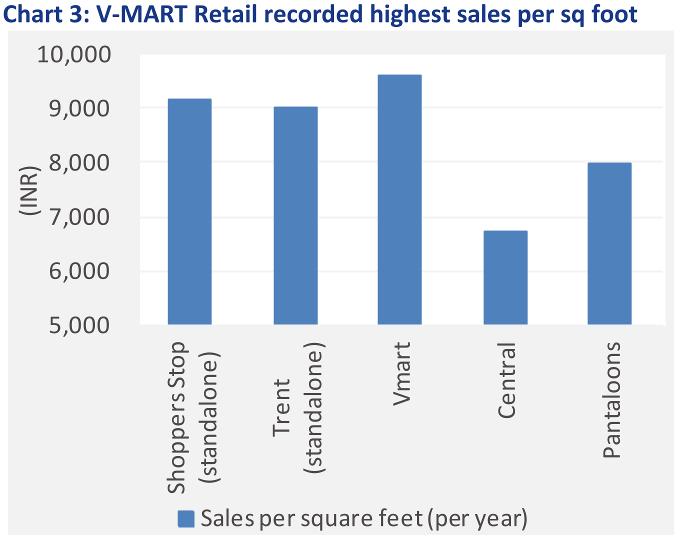
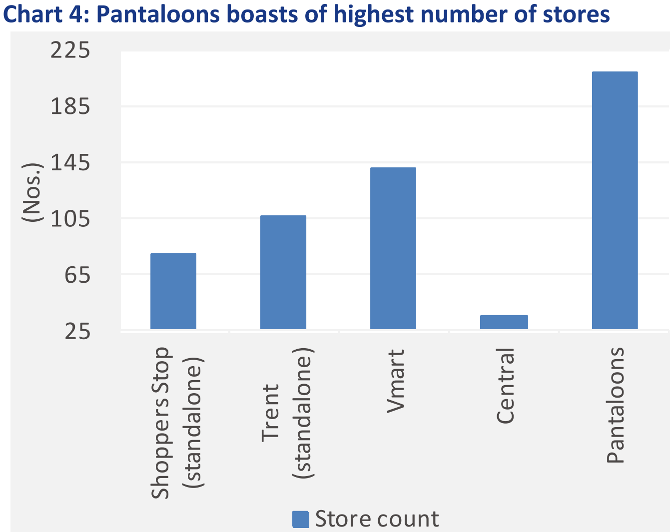


Chart 4: Pantaloons boasts of highest number of stores



Source: Edelweiss research

Chart 5: Trent to clock highest revenue CAGR (FY17-20)

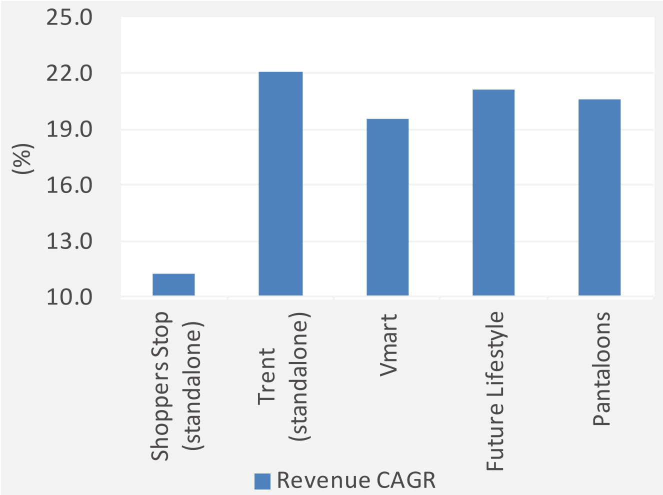


Chart 6: Pantaloons to post highest EBITDA CAGR (FY17-20)

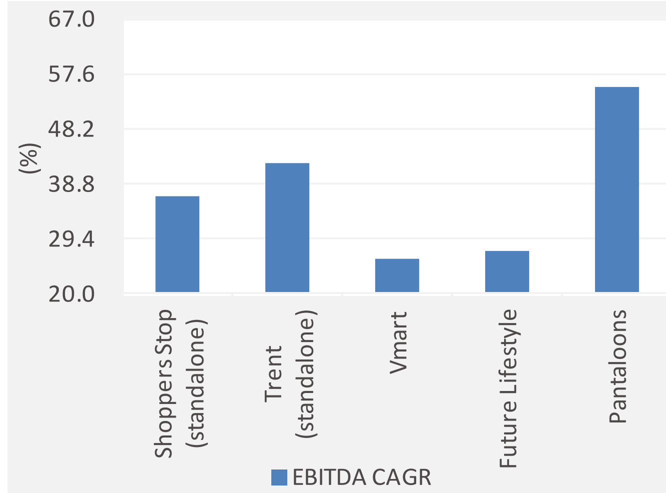


Chart 7: Trent to record highest margin improvement (FY17-20)

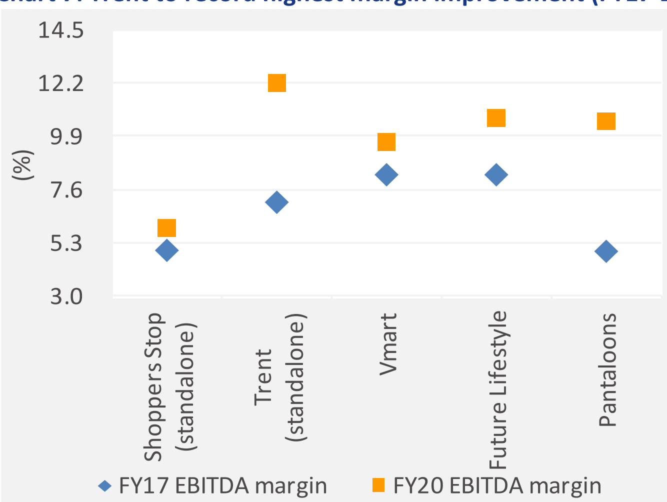


Chart 8: SSL to record highest RoCE increase over FY17-20

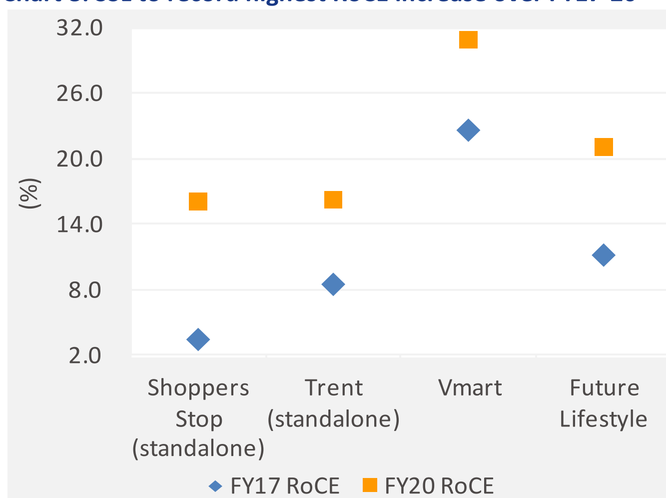


Chart 9: FLF has highest number of inventory days

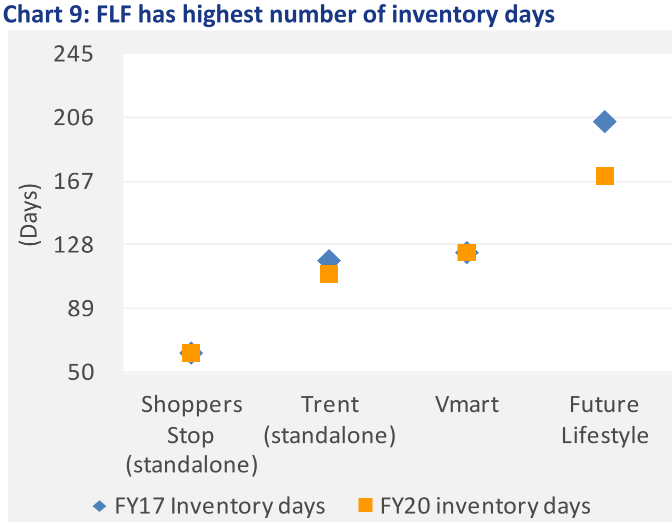
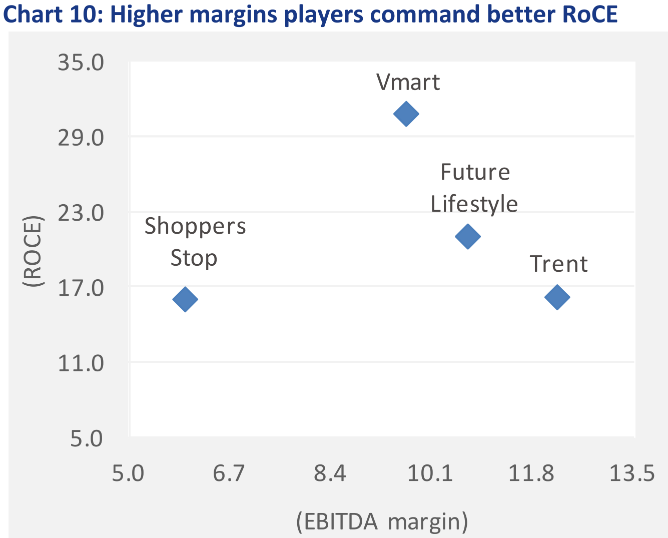


Chart 10: Higher margins players command better RoCE



Note: Underlying business models for different companies are different and hence not strictly comparable

Source: Edelweiss research

Grocery companies: Comparison

Chart 11: D'mart has highest EBITDA margin in FY17

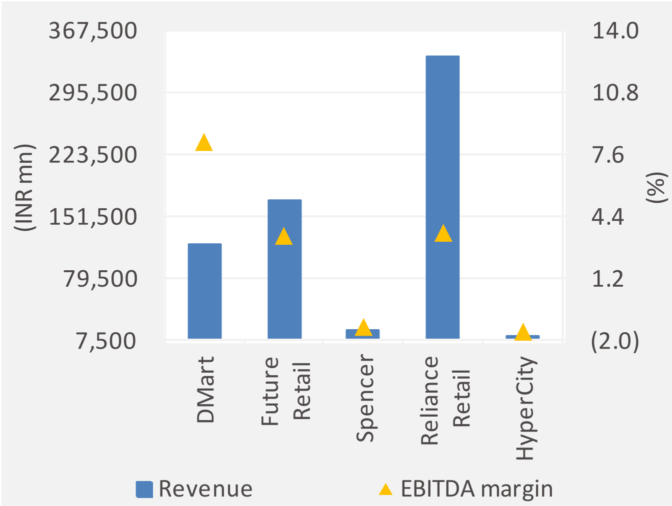


Chart 12: D'mart recorded highest SSSG in FY17

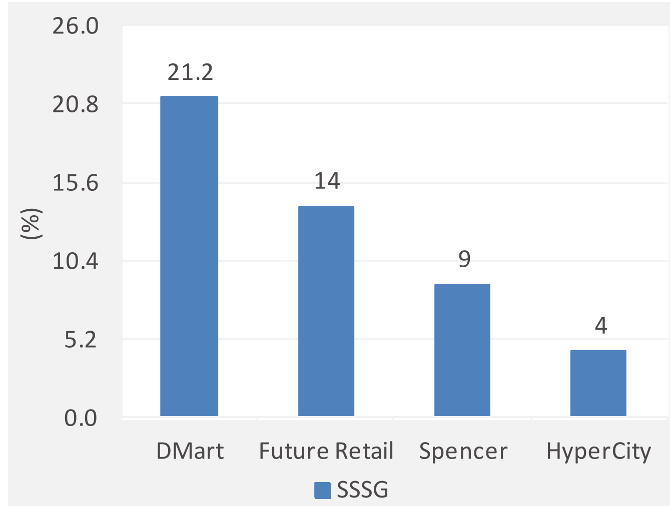


Chart 13: D'mart has highest sales per sq ft in FY17

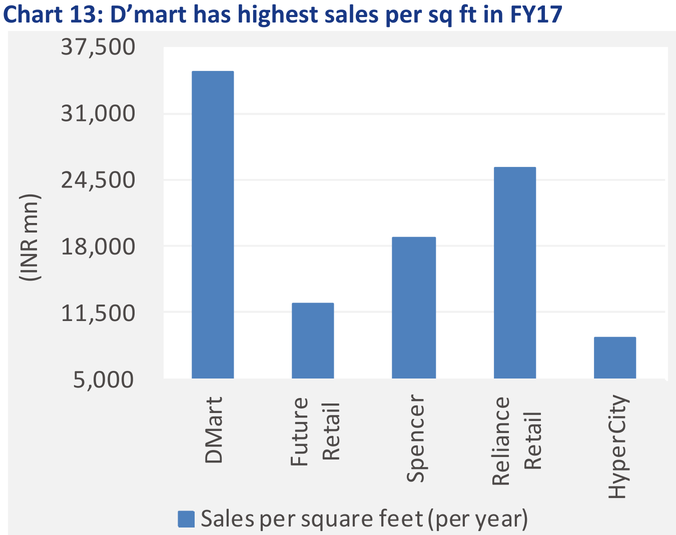
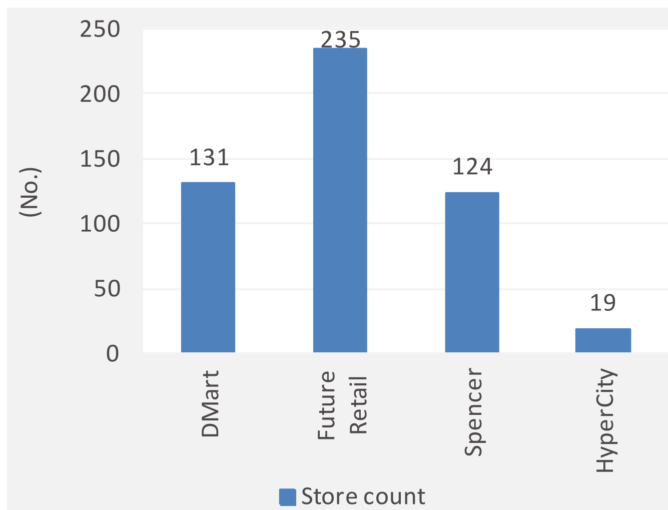


Chart 14: Future Retail leads in terms of size



Source: Company, Edelweiss research

Note: Key financial numbers for Reliance Retail includes revenues, etc of petroleum outlets and digital business

Chart 15: D'mart to clock highest revenue CAGR over FY17-20

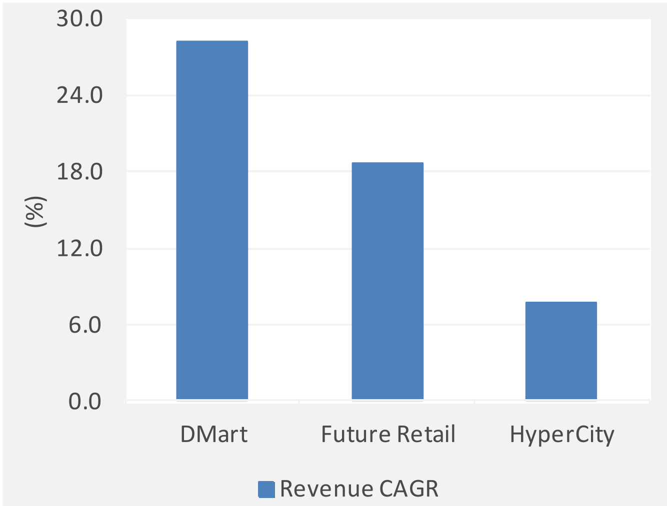


Chart 16: D'mart to post highest EBITDA CAGR over FY17-20

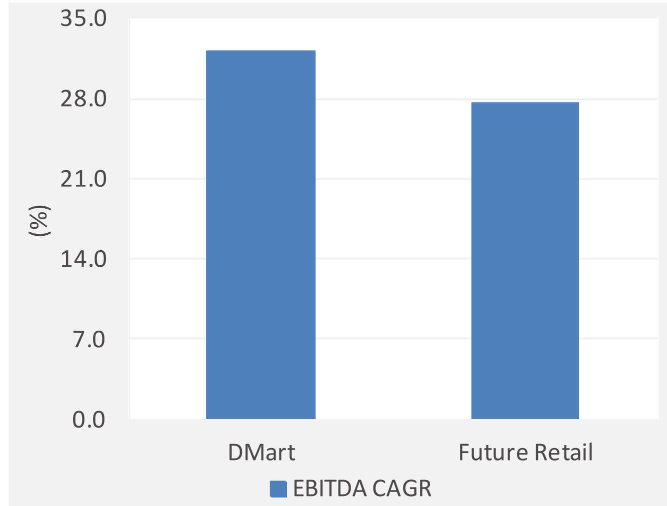


Chart 17: EBITDA margin to improve over FY17-20

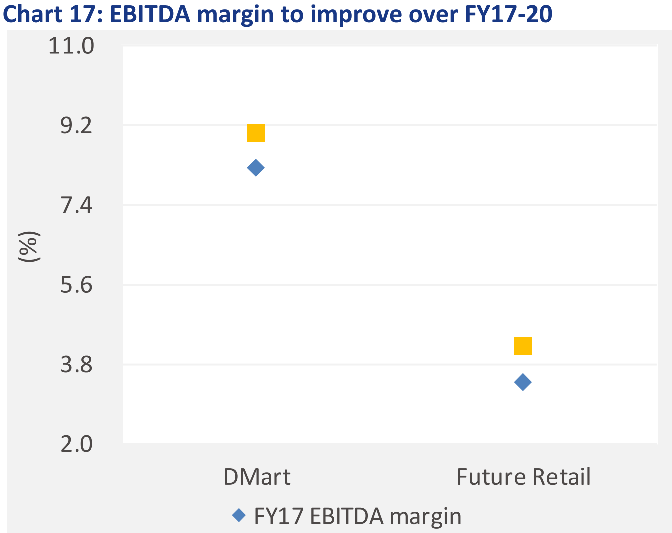


Chart 18: RoCE to surge over FY17-20

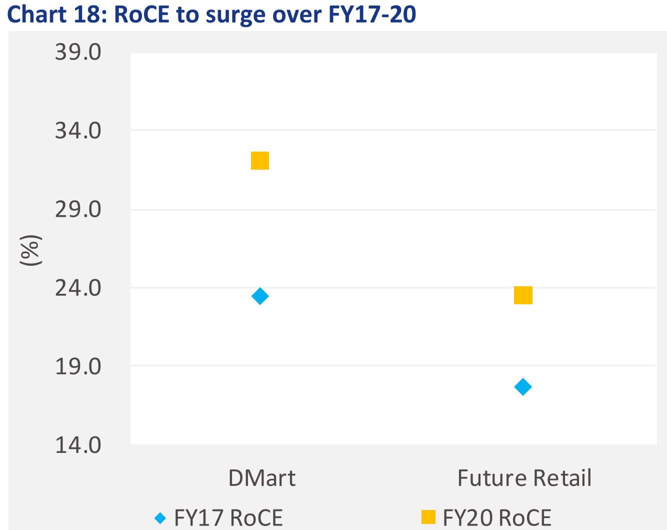


Chart 19: Inventory days to improve for Future Retail

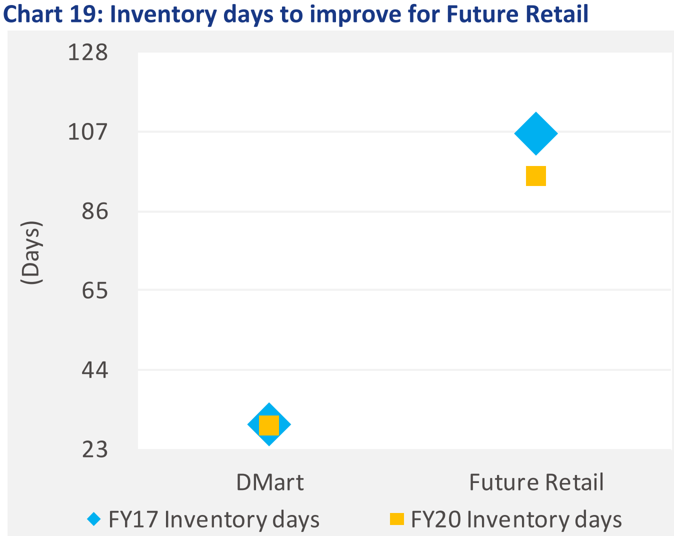
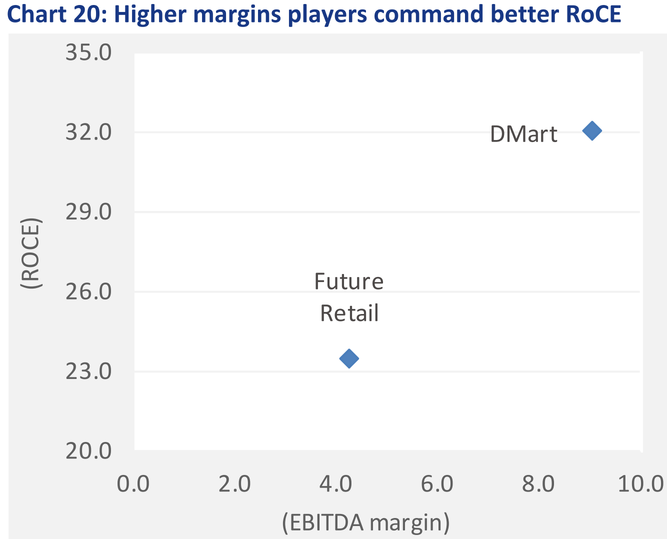


Chart 20: Higher margins players command better RoCE



Source: Edelweiss research

Table 3: Apparel comparisons

	Shoppers Stop (standalone)		Trent (Standalone)		VMART		FLF (Central)*		Pantaloons	
	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17
Revenue (INR mn)	35,993	38,664	14,919	17,381	8,093	10,017	33,002	38,771	21,570	25,520
Raw material cost (INR mn)	23,125	25,058	7,213	8,275	5,712	7,028	20,455	24,452	NA	NA
Rental cost (INR mn)	3,128	3,480	1,874	2,278	400	479	3,727	4,157	NA	NA
EBITDA (INR mn)	1,791	1,743	928	1,257	620	826	3,252	3,580	1,030	1,260
Key metrics										
Same store sales growth (%)	8.5	3.1	7.9	9.0	(1.1)	13.0	10.3	18.1	5.9	3.3
Footfalls (mn)	45.4	46.8	25.2	26.1	20.0	24.8	NA	NA	NA	NA
Transaction size (INR)	2,791	2,878	1,860	2,029	663	713	NA	NA	NA	NA
Sales per sq ft per year (INR)	8,974	9,171	9,167	9,004	9,072	9,588	6,196	6,735	8,296	7,975
Apparel contribution (%)	64.2	63.6	-	77.0	78.4	78.7	NA	NA	NA	NA
Shrinkage (as % of sales)	0.36	0.37	0.22	0.16	1.90	1.40	NA	NA	NA	NA
Store count (no)	77	80	93	107	123	141	31	35	163	209
Total sq ft (mn)	3.9	3.9	1.6	1.9	1.0	1.2	3.2	3.5	2.6	3.2
Average store size (sq ft)	51,269	48,133	17,500	17,500	8,244	8,475	75,249	88,291	15,951	15,311
% of sales										
Gross margin	35.8	35.2	52	52	29.4	29.8	38.0	36.9	NA	NA
Employee cost	6.8	7.1	8.9	9.6	7.7	7.8	5.7	5.3	NA	NA
Rental cost	8.7	9.0	12.6	13.1	4.9	4.8	11.3	10.7	NA	NA
EBITDA margin	5.7	5.0	6.2	7.1	7.7	8.2	9.9	9.2	NA	NA
YoY growth (%)										
Revenue	10.7	7.4	9.9	16.5	12.4	23.8	5.3	17.5	NA	NA
Raw material	11.3	8.4	5.9	14.7	11.1	23.0	6.6	19.5	NA	NA
Rental cost	9.7	11.3	75.7	21.6	21.8	19.8	7.6	11.6	NA	NA
EBITDA	(33.2)	(2.7)	28.5	35.5	(2.5)	33.1	(1.5)	10.1	NA	NA

*Note: *Revenue, raw material, rental, EBITDA are overall numbers and not specific to Central*

Source: Edelweiss research

Table 4: Food & grocery comparisons

	DMart		Future Retail		Spencer		Reliance Retail		HyperCity	
	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17
Revenue (INR mn)	85,838	118,977	68,451	170,751	17,965	20,124	183,300	264,377	9,787	11,794
Raw material cost (INR mn)	73,035	100,810	50,651	128,344	14,292	15,982	148,189	214,025	7,441	8,693
Rental cost (INR mn)	204	354	6,043	13,595	940	1,063	6,399	5,805	563	651
EBITDA (INR mn)	6,636	9,812	834	5,813	(617)	(260)	9,120	11,632	(275)	(181)
Key metrics										
Same store sales growth* (%)	21.5	21.2	NA	14.0	NA	NA	NA	NA	NA	NA
Sales per sq ft per year* (%)	28,660	32,026	NA	12,309	17,424	18,912	14,320	19,583	7,871	9,118
Store count*	110	131	228	235	118	124	3,245	3,616	17	19
Total sq ft (mn)*	3.3	4.1	9.8	10.2	1.1	1.2	12.8	13.5	1.3	1.3
Average store size (sq ft)*	30,273	31,298	43,026	43,319	23,306	22,949	3,945	3,733	74,313	69,660
% of sales										
Gross margin	14.9	15.3	26	25	20.4	20.6	19.2	19.0	24.0	26.3
Employee cost	1.7	1.6	4.8	4.7	7.6	7.2	2.9	2.4	7.9	8.6
Rental cost	0.3	0.3	8.8	8.0	5.2	5.3	3.5	2.2	5.8	5.5
EBITDA margin	7.7	8.2	1.2	3.4	(3.4)	(1.3)	5.0	4.4	(2.8)	(1.5)
YoY growth (%)										
Revenue	33.3	38.6	NA	149.4	7.9	12.0	13.8	44.2	(7.6)	20.5
Raw material	33.1	38.0	NA	153.4	6.2	11.8	14.8	44.4	0.8	16.8
Rental cost	54.6	73.7	NA	125.0	13.5	13.0	3.8	(9.3)	6.2	15.6
EBITDA	44.6	47.9	NA	597.2	(15.8)	(57.9)	14.7	27.5	(136.9)	(34.0)

**Key metrics for Future Retail is only Big Bazaar*

Source: Edelweiss research

Table 5: Jewellery and watches

	Titan		PC Jewellers	
	FY16	FY17	FY16	FY17
Revenue (INR mn)	112,759	129,789	72,321	80,994
Raw material cost (INR mn)	81,807	94,292	62,165	70,724
Ad spends (INR mn)	4,295	4,630	285	223
EBITDA (INR mn)	9,347	11,555	7,530	7,540
Reported PAT (INR mn)	6,745	6,973	3,993	4,305
% of sales				
Gross margin	27.4	27.3	14.0	12.7
Ad spends	3.8	3.6	0.4	0.3
EBITDA margin	8.3	8.9	10.4	9.3
PAT margins	6.0	5.4	5.5	5.3
YoY growth				
Revenue	(5.4)	15.1	13.9	12.0
Raw material	(6.5)	15.3	15.5	13.8
Ad spends	12.4	7.8	(38.6)	(21.8)
EBITDA	(18.6)	23.6	4.0	0.1

Source: Edelweiss research

"Online retail has a threat from us, we don't"

Kishore Biyani, CEO, Future Group

Potent catalysts in place to fuel retail boom

Favourable macros: (i) rising disposable incomes; (ii) attractive demographics; (iii) increasing urbanisation; and (iv) lower penetration of organised retail, are envisaged to propel India's apparel and organised brick & mortar (B&M) retail industry.

Moreover, recent structural reforms—demonetisation and GST—are making the demand shift from unorganised to organised inevitable in the domestic retail industry.

Historically, the retail sector posts hockey stick growth once a country's per capita crosses the USD2,000 mark. Currently, India's per capita income is at ~USD1,800, close to crossing the USD2,000 mark.

Hence, we estimate the organised B&M segment to catapult to USD166bn by FY25 from USD55bn in FY16, >13% CAGR.

We expect food & groceries (F&B), followed by jewellery & watches and apparels & accessories to benefit from changing consumer habits, huge unorganised market, low penetration, minimal competition and high entry barriers.

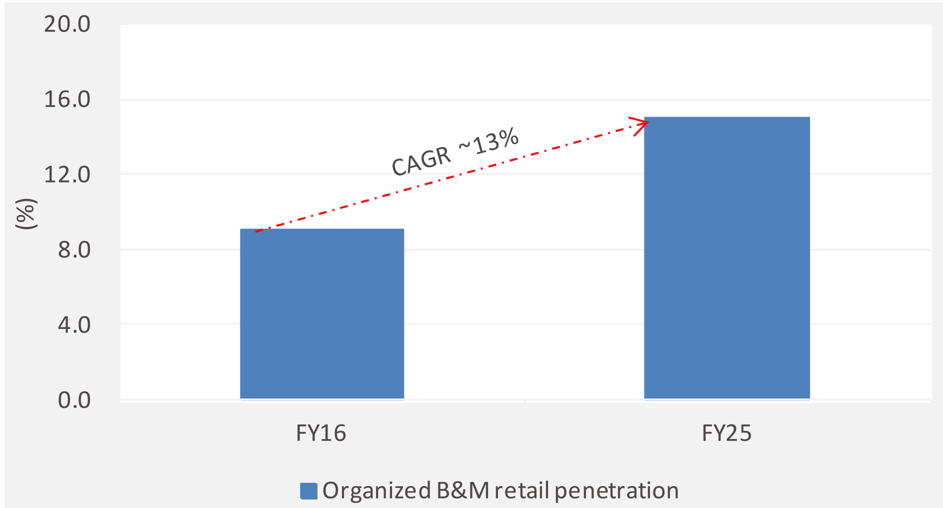
Favourable macros burnish prospects of organised players

India has replaced China as the numero uno retail destination in 2017 Global Retail Development Index. This was fuelled by increased consumer spending, rising mobile & internet penetration, favourable foreign investment milieu, bold action by the Government of India on cashless transactions and GST.

India's apparel and organised brick and mortar (B&M) retail industry is at a nascent stage with per capita consumption and penetration at extremely low levels (9% penetration in CY16 versus 85% penetration in US). Hence, this entails huge growth opportunities. Luxuries of the past are increasingly becoming necessities of today's lifestyle. Moreover, India's favourable demographics—world's youngest nation with ~50% population below 25 years—is an added advantage for the organised retail and apparel sectors.

Hence**, we estimate organised B&M retail penetration, which stood at 9% in FY16 (USD55bn of USD616bn), to catapult to 15% (USD161bn of USD1,072bn) in FY25.** This is envisaged to be driven by:

Chart 21: Organised B&M retail to post 13% CAGR over FY16-25E



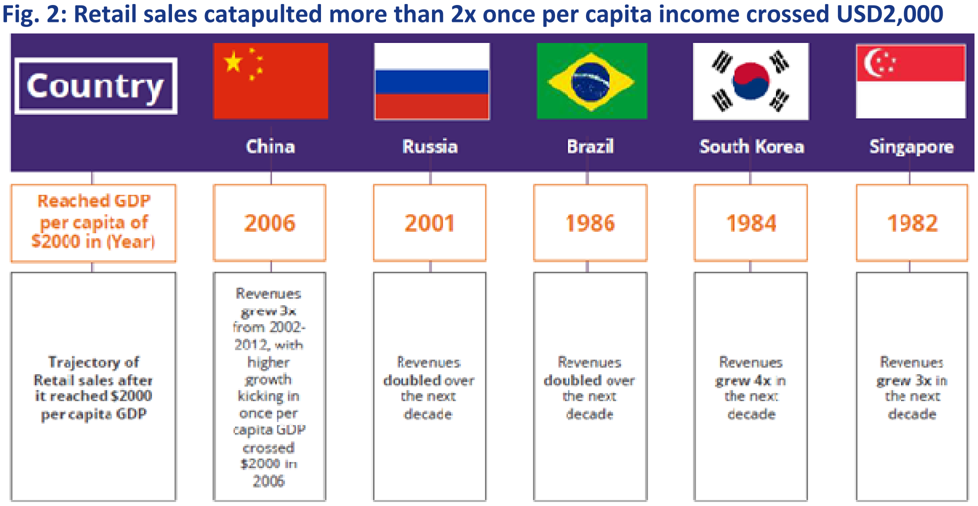
Source: Edelweiss research

A) Rising disposable incomes and improving consumer sentiments: Discretionary spending has high correlation with disposable incomes. Disposable income is a function of economic growth, a lynchpin for new jobs creation. Recovery in discretionary spending will help revive growth of India's organised retail market.

The country's per capita income has scaled up steadily—10.2% CAGR over FY12-17—which is envisaged to trigger higher discretionary spending. This is expected to rise further once the anticipated GDP recovery kicks in.

Further, historically, the retail sector posts hockey stick growth once a country's per capita crosses the USD2,000 mark. Currently, India's per capita income is at ~USD1,800—close to crossing the USD2,000 mark.

Fig. 2: Retail sales catapulted more than 2x once per capita income crossed USD2,000



Source: Edelweiss research

Chart 22: India's per capita income rising steadily

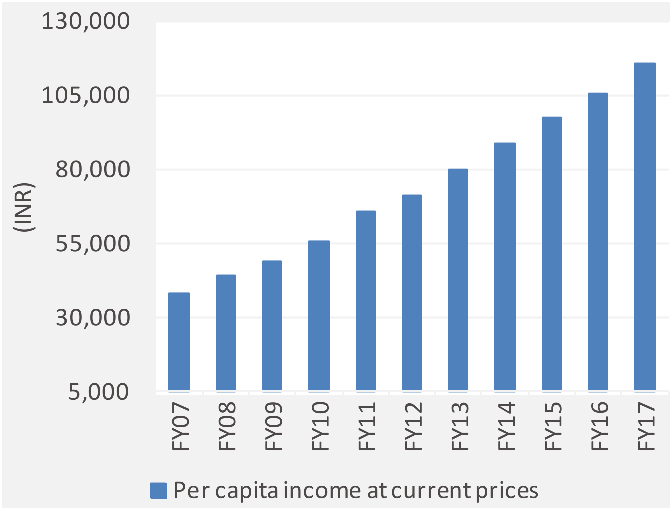
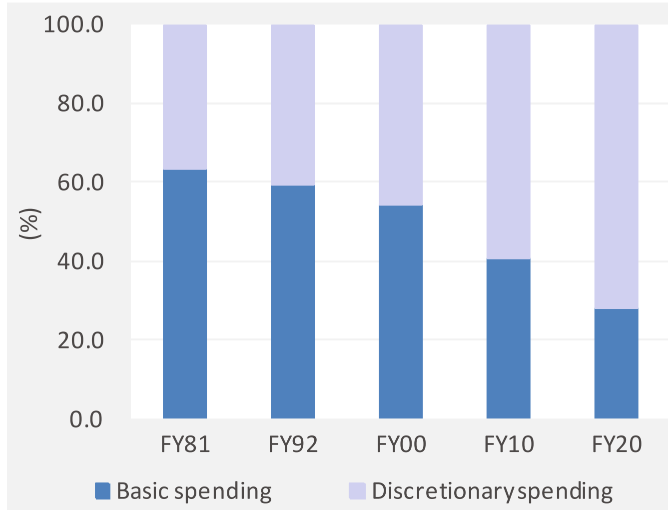
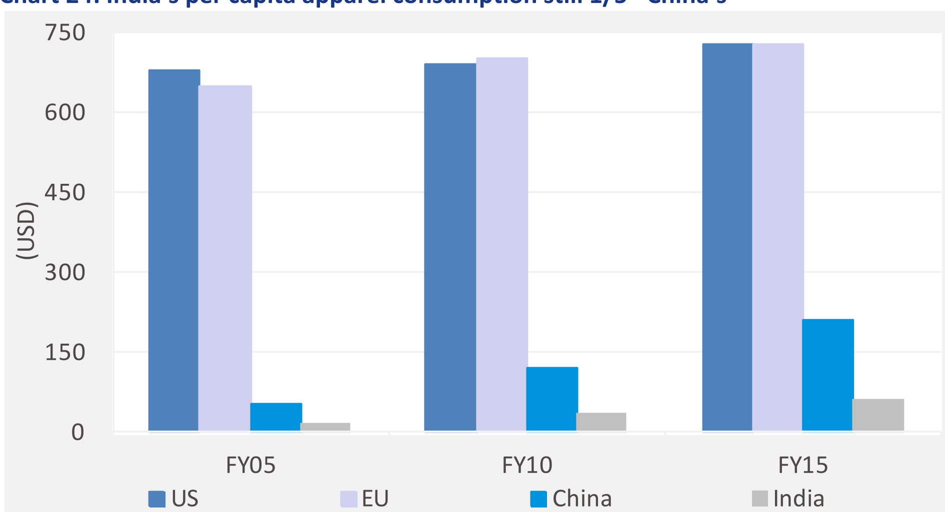


Chart 23: Discretionary spends also on the rise



Source: Industry, Edelweiss research

Chart 24: India's per capita apparel consumption still 1/5th China's



Source: Industry, Edelweiss research

B) Attractive demographics: India, being a relatively young country, has low dependency ratio (ratio of children and elderly to working age population). The ratio began dipping from 1970s and the share of working population in total population grew, becoming a huge potential strength for India.

With median age of 27, India's demographics are currently one of the most favourable in the world. Further, 50% of the population is in the working age bracket (20-60 years), which has high propensity to spend and hence discretionary consumption is poised to grow rapidly.

Chart 25: India blessed with favourable demographics

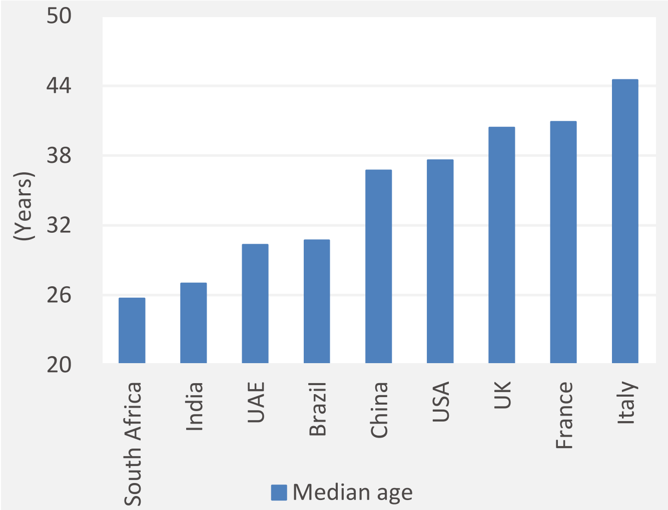
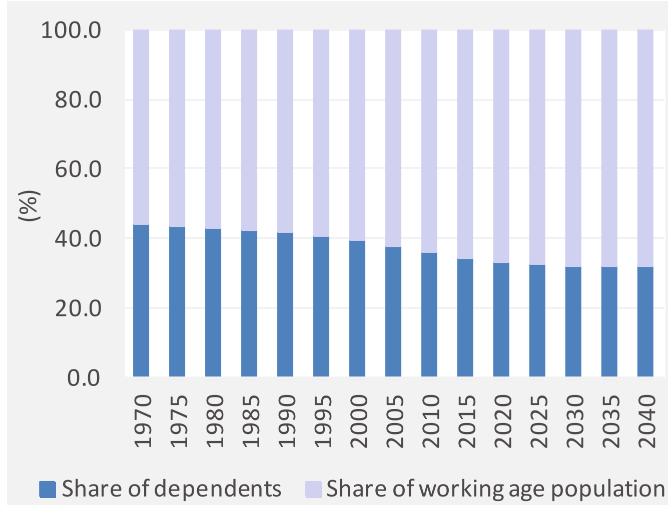
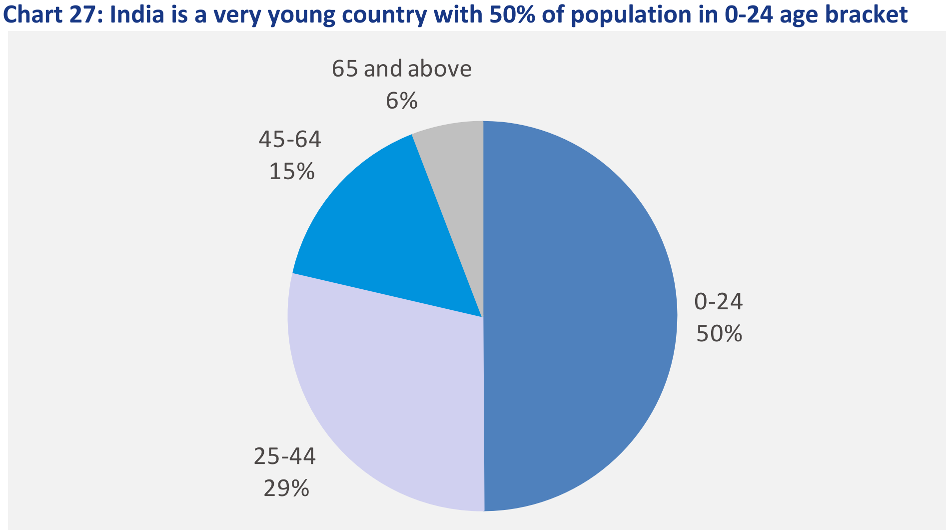


Chart 26: Share of working population on the rise



Source: Industry, Edelweiss research

Chart 27: India is a very young country with 50% of population in 0-24 age bracket



Source: Industry, Edelweiss research

C) Rising urbanisation: Urbanisation is envisaged to improve the standard of living. As per 2011 census, urban population share to total residents increased to 31.2% from 28.5% in 2001. According to a UN report on World Population, 40.8% of India's population is expected to reside in urban areas by 2030.

Chart 28: Proportion of urban income to increase as urbanisation rises...

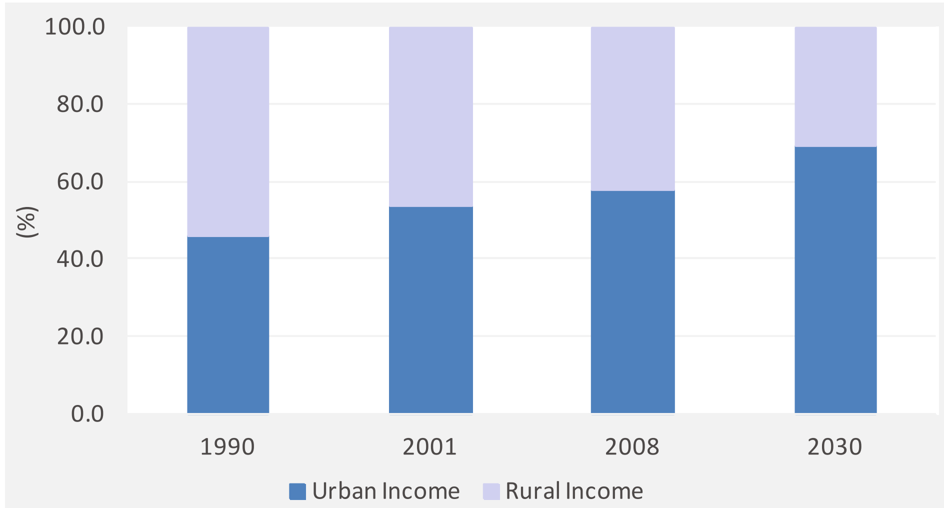


Chart 29: Rate of urbanisation to increase...

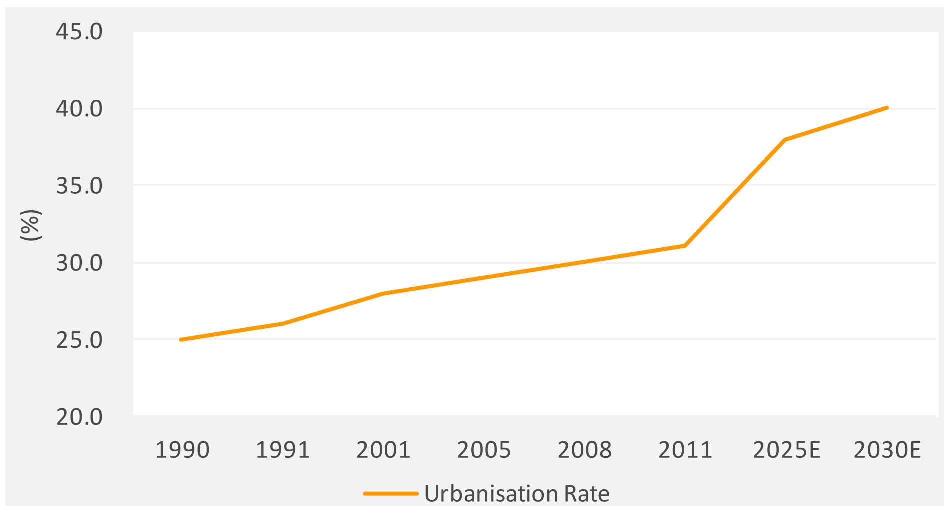
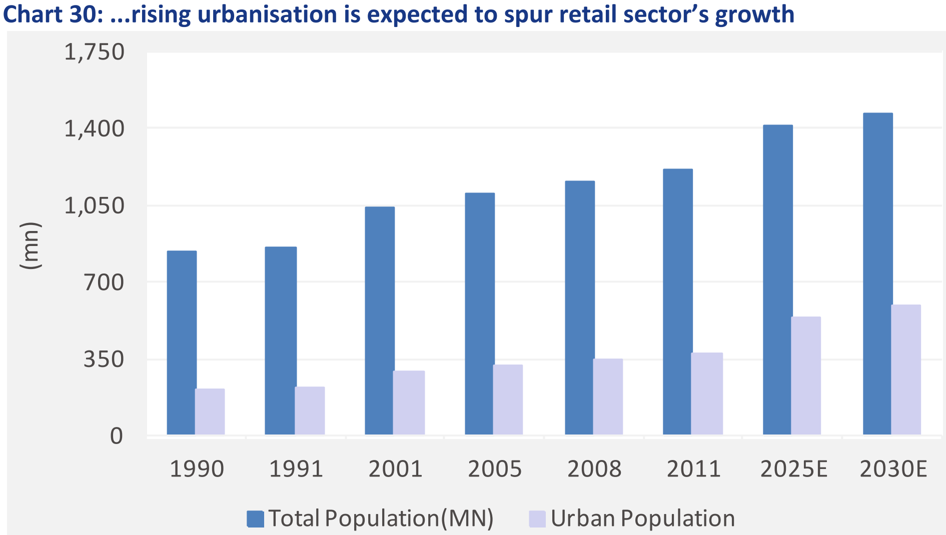


Chart 30: ...rising urbanisation is expected to spur retail sector's growth



Source: Industry, Edelweiss research

Unorganised share to shrink at faster clip

Under the GST regime, the unorganised market will face regulatory hurdles and find it difficult to evade the tax net. Hence, we envisage organised B&M retail penetration to improve to 12% in FY20 from 9% in FY16.

The most important organised categories are F&G (USD13bn), apparels & accessories (USD11bn) and jewellery & watches (USD13bn). We expect a combination of factors like lower penetration & competition and higher entry barriers to fuel growth in these categories. We expect F&G, followed by jewellery & watches and then apparels & accessories to benefit.

Table6: Retail penetration (%) to improve from 9.0% in FY16 to 12.0% in FY20

	FY16			FY20		
	Retail market size (USD bn)	Organised retail market size (USD bn)	Organised as % of overall retail	Retail market size (USD bn)	Organised retail market size (USD bn)	Organised as % of overall retail
Food & Grocery	413	13	3.1	634	31	4.9
Apparel & Accessories	49	11	22.0	74	24	32.3
Jewellery & Watches	47	13	27.0	77	23	29.8
CDIT	35	9	25.1	63	20	31.6
Home & Living	27	3	10.0	42	5	12.0
Pharmacy & Wellness	18	2	10.1	28	3	11.7
Footwear	7	3	40.5	12	5	43.4
Others	20	2	12.1	30	4	13.4
Total	**616**	**55**	**9.0**	**960**	**115**	**12.0**

Source: Technopark Analysis, Edelweiss research

Table 7: Share of organised brick & mortar retail (%) in FY16

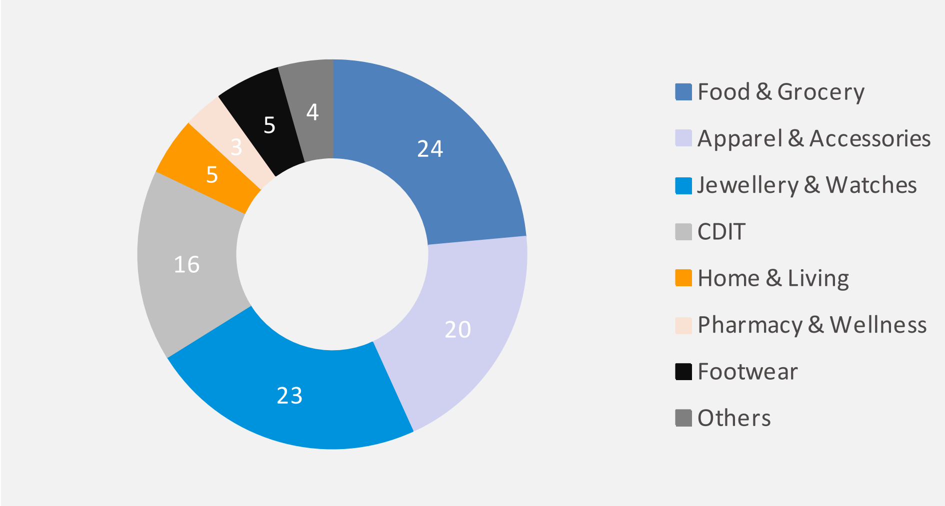
	Market size (USD bn)	Penetration (%)
Total retail size (USD bn)	616	
Total organised retail size (USD bn):	55	9.0
Organised retail break up (USD bn)		**Share of organised retail market**
Food & Grocery	13	23.6
Apparel & Accessories	11	19.7
Jewellery & Watches	13	22.9
CDIT	9	15.9
Home & Living	3	4.8
Pharmacy & Wellness	2	3.3
Footwear	3	5.4
Others	2	4.4

*Note: *Others incl Books & Stationery, Toys, Eyewear, Sports Goods, Alcoholic Beverages & Tobacco, etc*

** Accessories includes Bags, Belts, Wallets*

Source: Technopark Analysis, Edelweiss research

Chart 31: F&G had the highest share of organised brick & mortar retail in FY16



Source: Edelweiss research

Organised share **in the F&G segment—**least organised penetration at 3.1% in FY16—is projected to jump to 4.9% in FY20. Further, its contribution to overall organised B&M retail stood the highest at 23.6% (USD13bn of USD55bn) in FY16, which is set to increase to 26.9% (USD31bn out of USD115bn) in FY20E aided by improved assortment and convenience.

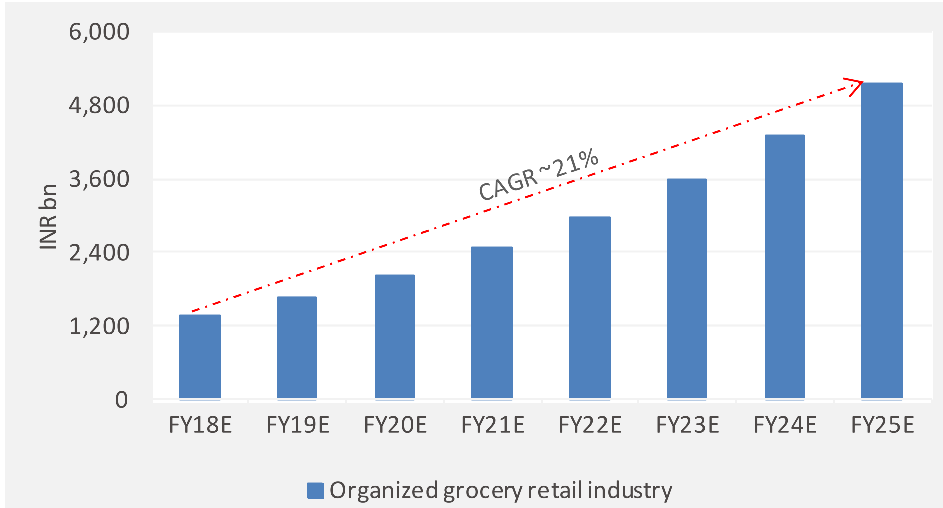
F&G retailers are readying to realign category offerings, rationalise space and consolidate formats over the next few years, leading to margin efficiency and profitability. It will also boost productivity and efficiency, driving higher organised retail penetration in the segment. Further, the category has been witnessing major consolidation—Future Group bought Bharti Retail (Easy Day), Heritage Retail (At Fresh), Hypercity and Nilgiri. Post consolidation, apart from regional players, Spencers, Star Bazaar, D'mart, Reliance Mart and Future Group will be the only national players to benefit from scale and geographical penetration.

Table 8: F&G segment to corner 6.4% share of organised retail penetration in FY25E

	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E
Indian GDP at current price (INR bn): A	168,539	187,078	207,657	230,499	255,854	283,998	315,238	349,914
Private consumption expenditure (INR bn): B	99,090	109,990	122,089	135,518	150,425	166,972	185,339	205,726
Private consumption expenditure as a % of GDP: C=B/A	58.8	58.8	58.8	58.8	58.8	58.8	58.8	58.8
Food and beverages consumption (INR bn): D	31,709	36,297	41,510	47,431	54,153	61,780	70,429	80,233
Food and beverages as % of consumption: E=D/B	32.0	33.0	34.0	35.0	36.0	37.0	38.0	39.0
Population of India (mn): F	1,323	1,343	1,363	1,384	1,404	1,425	1,447	1,468
Food and beverages per capita spends (INR): G=D/F	23,966	27,028	30,454	34,284	38,564	43,344	48,682	54,640
Organised grocery retail industry (INR bn): H	1,363	1,670	2,034	2,466	2,978	3,583	4,296	5,135
Organised grocery as a % of food and beverages: I=H/D	4.3	4.6	4.9	5.2	5.5	5.8	6.1	6.4
Per capita spend on organised grocery (INR): J=H/F	1,031	1,243	1,492	1,783	2,121	2,514	2,970	3,497

Source: Industry, Edelweiss research

Chart 32: F&G segment estimated to clock 21% CAGR over FY18-25



Source: Edelweiss research

"Things are playing well for us post demonetisation and now GST. Migration is happening quite rapidly to organised sector players, particularly Tanishq"

Mr. Bhaskar Bhat, MD, Titan

Organised share **in jewellery & watches** is estimated to expand to 29.8% in FY20 from 27.0% in FY16. Though penetration is high, we expect strong entry barriers, lower competition and demand shift to organised players to aid this category. Unorganised jewellery retailers are facing tough times due to GST and demonetisation. Further, PAN card requirement above INR0.2mn is also impeding their growth. Moreover, in the organised sector, Titan and PC Jewellers have established strong brand equity, which will benefit from the shift in demand from unorganised to organised players as the increase in regulatory compliance is hurting the latter.

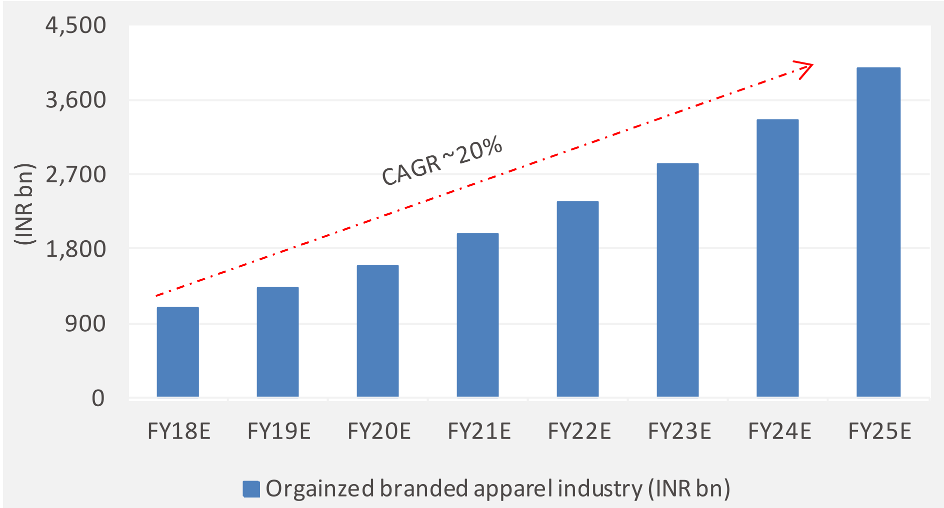
In the **clothing** segment, organised share is projected to touch 32.3% in FY20 from 22.0% in FY16. Strong entry barriers (in terms of brand name) and demand shift to organised players are envisaged to aid this category.

Table 9: Organised apparels to corner 28% of organised retail penetration in FY25E

	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Indian GDP at current price (INR bn): A	168,539	187,078	207,657	230,499	255,854	283,998	315,238	349,914
Private consumption expenditure (INR bn): B	99,090	109,990	122,089	135,518	150,425	166,972	185,339	205,726
Private consumption expenditure as a % of GDP: C=B/A	58.8	58.8	58.8	58.8	58.8	58.8	58.8	58.8
Clothing consumption (INR bn): D	5,450	6,269	7,203	8,267	9,477	10,853	12,418	14,195
Clothing consumption as a % of expenditure: E=D/B	5.5	5.7	5.9	6.1	6.3	6.5	6.7	6.9
Population of India (mn): F	1,323	1,343	1,363	1,384	1,404	1,425	1,447	1,468
Clothing and footwear per capita (INR): G=D/F	4,119	4,669	5,285	5,975	6,749	7,615	8,583	9,667
Organised branded Apparel industry (INR bn): H	1,090	1,317	1,585	1,984	2,369	2,822	3,353	3,975
Organised apparel as % of spending on clothing: I=H/D	20.0	21.0	22.0	24.0	25.0	26.0	27.0	28.0
Per capita spend on organised apparel (INR): J=H/F	824	980	1,163	1,434	1,687	1,980	2,318	2,707

Source: Industry, Edelweiss research

Chart 33: Organised apparel segment estimated to post 20% CAGR over FY18-25



Source: Edelweiss research

Assumptions used to determine India's organised apparel and F&G market:

- We expect India's nominal GDP by expenditure (referred to as India's GDP) to grow at 11% over FY18-25.
- Expenditure towards clothing as % of GDP in FY17 stood at 4.0%, which is expected to remain steady over FY18-25.
- Expenditure towards food & beverages as % of GDP stood at 30.0% in FY17, which is expected to improve to 39% in FY25 aided by increase in per capita incomes.
- Over the past 4-5 years, India's population has been rising at a steady ~1.2% per annum. We are assuming ~1.0% population growth rate p.a. till FY25.
- India's organised apparel market, as per various industry sources, was pegged at INR650bn as at FY15. This industry size indicates that the proportion of organised apparel spending as a % of overall clothing spending is mere ~16.2%. Following rising aspirations, overall economic growth, increasing urbanisation, etc., we expect per capita spending towards organised retail to increase to 28% in FY25.
- India's organised grocery market, as per various industry sources, was estimated at INR910bn as at FY16. This industry size indicates that the proportion of organised grocery spending as a % of overall food & beverage spending stood at mere ~3.9% in FY16. Following market share gain (unorganised to organised shift), we expect per capita spending towards organised retail to increase to 6.4% in FY25.
- **Based on the above calculations, we estimate the organised apparel market/F&G to touch ~INR4tn/INR5tn by FY25, CAGR of ~20.3%/20.8% over FY18-25E respectively**.

"India moving towards formal economy with demonetisation"

Mr. Amitabh Kant, CEO, Niti Ayog

Demonetisation drives organised retail

Demonetisation led to modern retail stickiness: Demonetisation led to significant liquidity crunch at the consumer level, which impelled consumers to go cashless. This was reflected in the sharp rise in the proportion of non-cash payments at various retailers. On an average, the proportion of non-cash spending by consumers at retail outlets catapulted from ~45% to ~80% during demonetisation.

Table 10: Proportion of non-cash payment still at elevated levels

	Proportion of non-cash payment (%)		
	Pre demonetisation	Immediately post-demonetisation	Current levels
Shoppers Stop	55	90	60
Reliance Retail	35	70	40
ABFRL	50	85	55
PVR	50	80	50

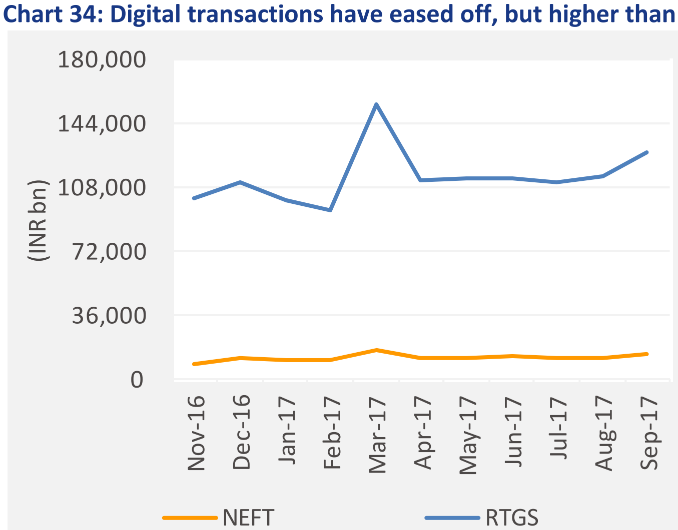
Source: Edelweiss research

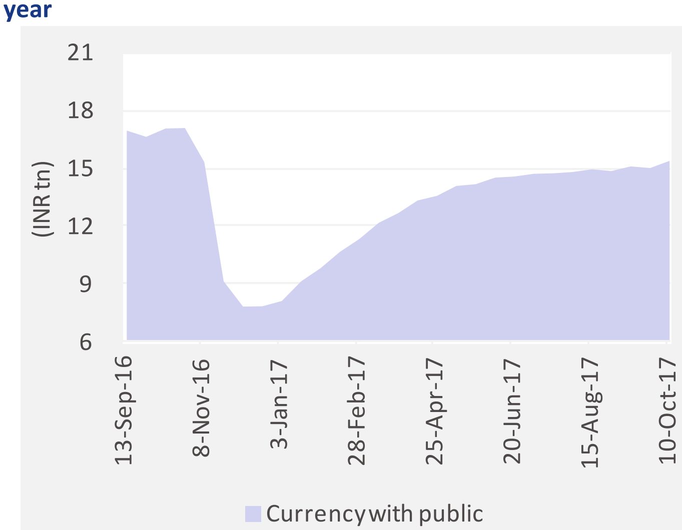
Though the proportion of spending by consumers at retail outlets has reverted to almost initial levels, demonetisation led to increased sampling of modern retail stores. Thus, we believe, consumers are shifting to modern retail aided by improved assortments and convenience.

Digital payments inching up: Though demonetisation did push cashless economy, it has been working slowly. RBI data indicates that usage of wallets, non-UPI banking apps and Aadhaar-enabled transactions has inched up post demonetisation and is slightly higher than pre-demonetisation level.

Though digital transactions have fallen off the peak (during demonetisation), they are still higher than pre-demonetisation level.

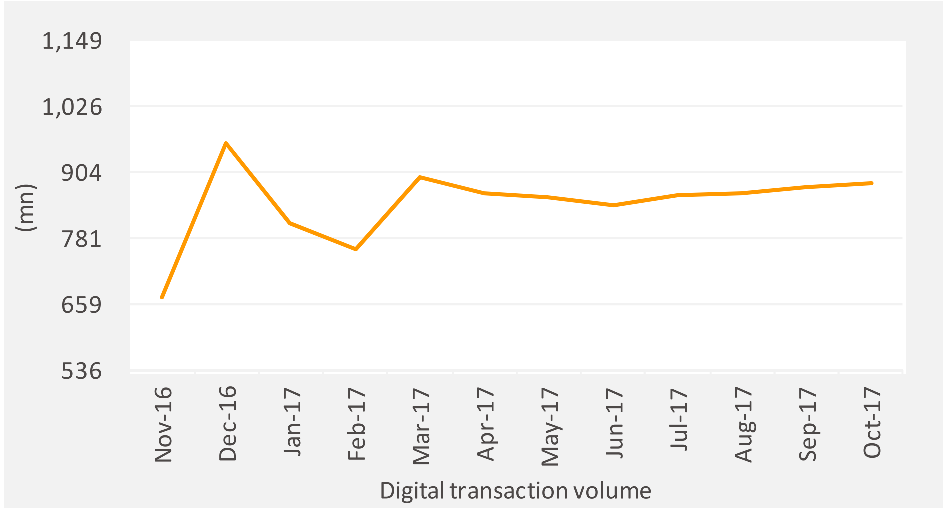
Chart 34: Digital transactions have eased off, but higher than last year





Source: RBI, Edelweiss research

Chart 35: Digital transaction volume have fallen but higher than last year



Source: RBI, Edelweiss research

Resilience on credit cards trends up: Demonetisation also boosted credit card use. Initially, consumers were cautious of using credit cards. However, during demonetisation, the usage increased significantly. Though now it has dipped slightly, consumers are comfortable using them. Therefore, **we expect consumers to use the leverage as an additional source of income and increase their discretionary spends**. Consumer spending data indicates sharp increase in volume of transactions via cards across various retail outlets and the trend is structural.

Chart 36: Outstanding credit bills (% personal loans) inched up since demonetisation

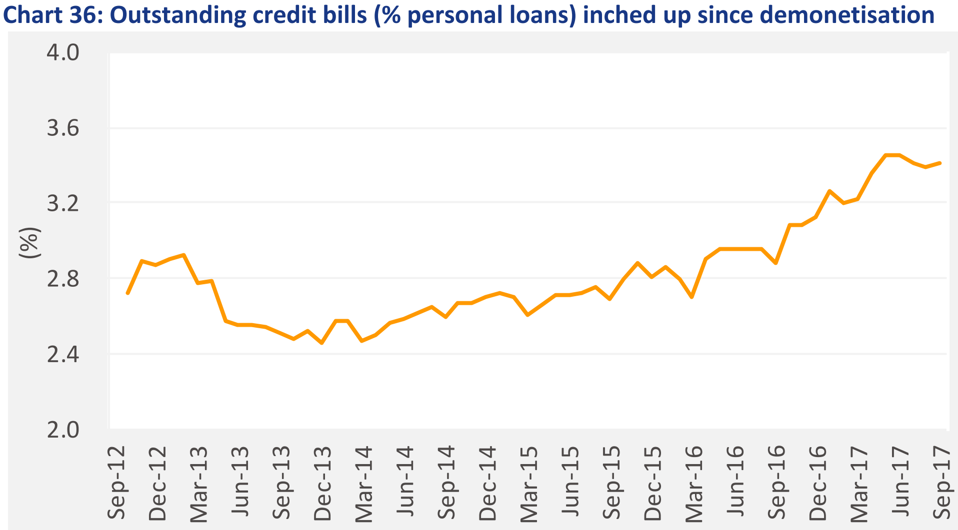
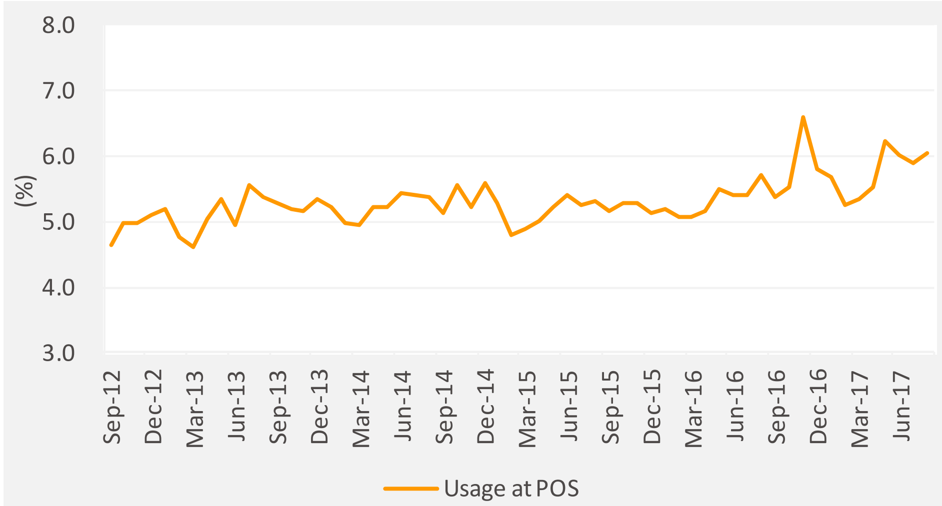
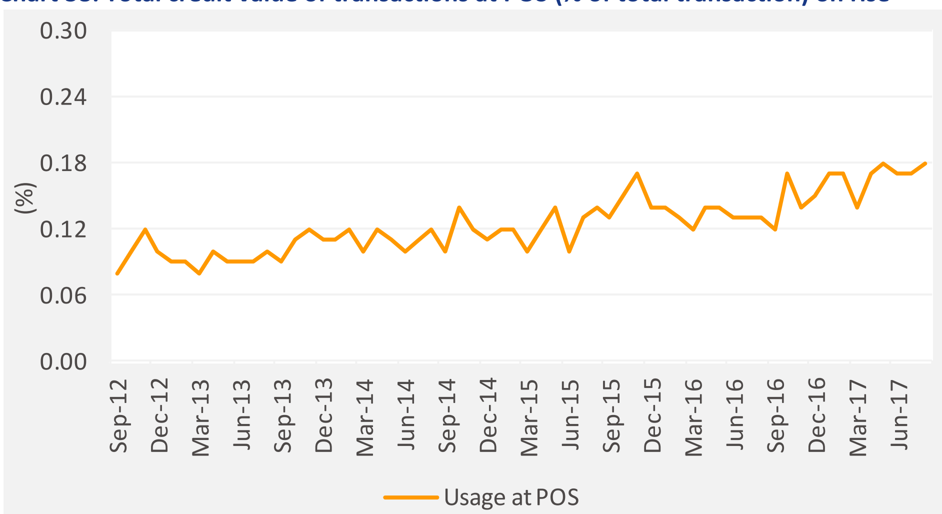


Chart37: Total credit card transactions at POS (% of total transactions) moving up



Source: Industry, Edelweiss research

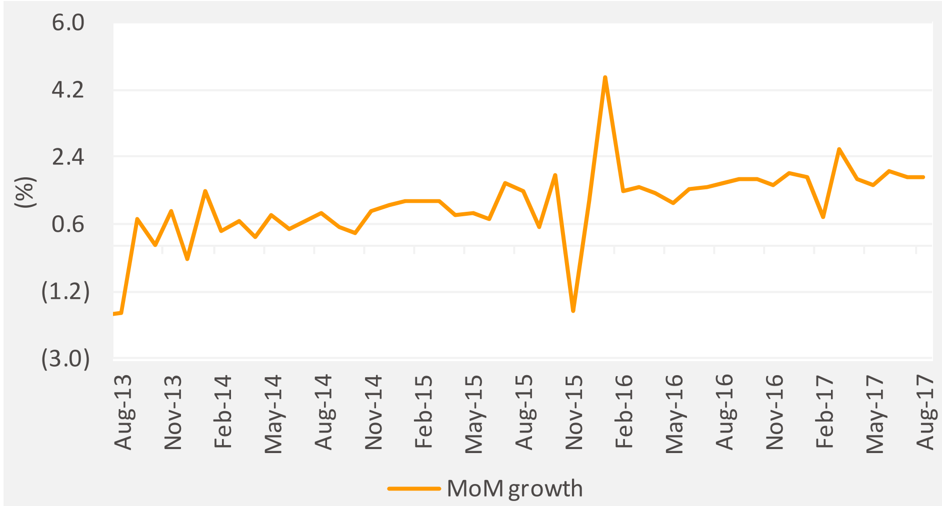
Chart 38: Total credit value of transactions at POS (% of total transaction) on rise



Source: Edelweiss research

The proportion of **total credit card transactions, as a percentage of total transactions, increased to ~5.84% (average for past many months post demonetisation) from ~5.31% (average for past 1 year pre demonetisation).** Similarly, the proportion of outstanding credit card bills in total personal loans stood higher at 3.42% in September 2017, up from 2.88% in September 2016.

Chart 39: Credit card addition



Source: Edelweiss research

What happens to spending when the proportion of cards and bank deposits increases?

Various global studies indicate that consumers not only tend to spend more when using a credit card, but also indulge in impulse buying, thus triggering consumption. Another reason is the ease of payment compared to cash (sometimes non-availability of cash can lead to postponement or loss of consumption, which is not the case with card payments). Consumption is also higher while making a card payment as usually consumers are more cautious while making cash payment as it is tangible.

Empirical evidence indicates increased spending via cards

- As per a Dun & Bradstreet study, consumers spend 12-18% more when using credit cards instead of cash. McDonald's reports its average ticket size is USD7 when consumers use credit cards versus USD4.50 for cash.
- A 2012 study by Promothesh Chatterjee and Randall L. Rose observed that consumers who use credit cards tend to focus on the product's benefits as opposed to the cost.
- As per behavioural economics, consumers who use plastic are unconsciously willing to spend more than those who pay with cash, a phenomenon known as the "credit card premium."
- Also, there are lot of offers on usage of debt and credit cards—cash back, minimum purchase, loyalty points, etc.,—which also goad consumers to spend more.

Addition of credit and debit cards has seen a sharp increase, especially post demonetisation, though their penetration is still minuscule—credit cards at mere ~0.03 per person, while that of debit cards is 0.7 per person. This penetration gathered pace post demonetisation.

For FY17, number of transactions using credit cards grew by 47% and a staggering 140% for debit cards

Usage of cards high during e-commerce festival season

Digital transactions trumped cash on delivery as India's preferred payment option for online purchases during the FY17 mega festive sales, indicating significant progression for the electronic marketplace and payments sectors. E-commerce as well as digital payments companies reported an increase in electronic payments during FY17 festive sales hosted by top online marketplaces.

In case of Amazon India, ~55% of all transactions during its flagship *Great Indian Festival sale* were via mix of net banking and debit & credit card payments. While for Paytm Mall, which hosted its first festive season sale, fewer than 1% of all orders were paid for by cash on delivery, mainly because of the company's high cash-back offers for payments made via its digital wallet.

Digital transactions help e-commerce companies with fewer cancellations and prune cash management costs. Although cash-on-delivery provided a significant nudge to e-commerce adoption in a country wary of shopping online, it imposed substantial financial cost on online retailers. This was also because **cash on delivery contributed to high rejection rates of orders, typically in categories such as fashion.**

"We focus on existing markets which we know well. When a store is generating high ROI and is flooded with customers, that's the time to add a new one"

Neville Noronha, MD, Avenue Supermarts

Re-configuring business models to master growth

Bigger players—D'mart, Future Retail, Future Lifestyle—have learnt the tricks of the trade and have zeroed in on the ingredients that will ensure success:

1) **Optimum store size:** **Compact hypermarket (20,000–30,000sq ft) and supermarket (3,000-4,000sq ft) formats improve sales per sq ft by focusing on right assortment.**

2) **Right product mix:** **Players are focusing on F&G and apparel in their quest for profitability and productivity.**

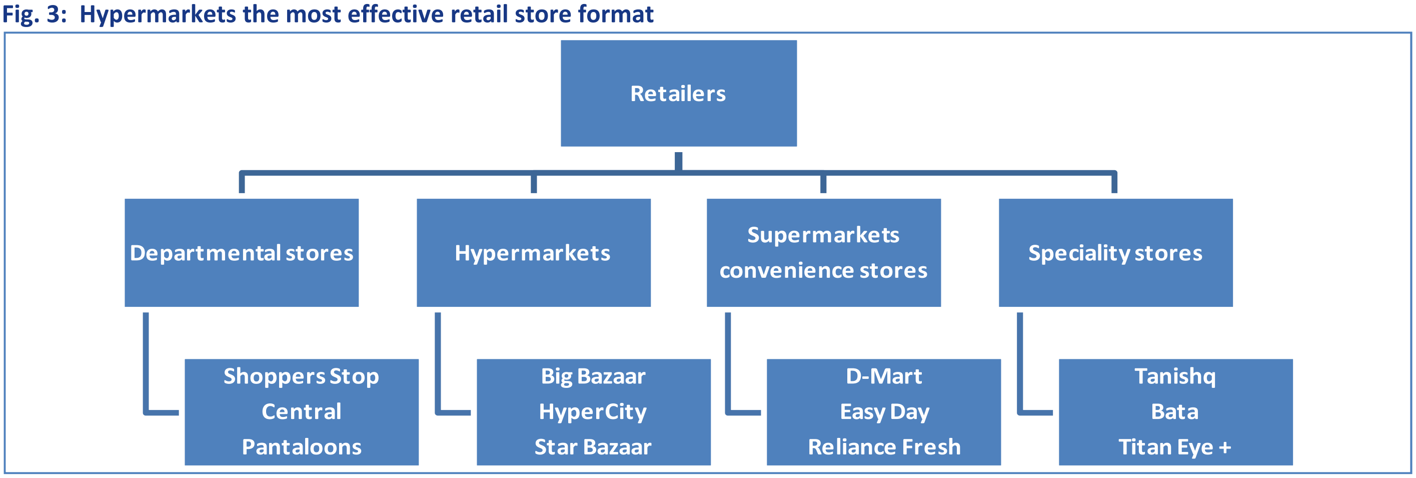
3) **Private labels:** **Organised retailers prefer private labels (20% in India versus 35% globally) as they fetch higher margins, greater customer loyalty and there's clear product differentiation.**

Physical retailers re-engineering the way to do business

Organised physical retailers in India have a long operations history—while hypermarket retail outlet *Big Bazaar* opened its first store in 2001, departmental stores *Pantaloons* and *Shoppers Stop* opened their first stores in 1997 and 1991, respectively. Despite this, physical retailers have struggled to make profits and suffered from high debt.

These retailers have been grappling to crack the right model to operate, while ensuring footfalls and controlling costs amidst rising rentals, etc. Moreover, advent of e-commerce took a significant toll on physical retailers. E-commerce players managed to transfer footfalls to online clicks, which is not only convenient for consumers, but also cheaper (heavy discounts offered by online retailers on account of PE funds' backing).

Fig. 3: Hypermarkets the most effective retail store format



Source: Edelweiss research

Over the past few years, retail companies have gone through multiple phases: 1) deep discounts from online channels have taken a toll on apparel departmental stores; 2) value retailers gained significantly post demonetisation resulting in increased use of non-cash means of payment; and 3) select specialty retailers wrested share from unorganised players anchored by rising preference of brands. The good performance was selective (select retail companies are performing well) and not secular. For instance, Tanishq is an outperformer in the jewellery market, D'mart in value retail, Max & Westside in departmental stores, etc.

However, now other big players with a long history of existence have learnt the tricks of the trade and are taking steps to ensure success. **In our view, larger players have higher chances of success versus new entrants not only because of the former's brand goodwill, but also because of the extensive store presence they have built over the years.**

Be it departmental store, hypermarket, supermarket or specialty store only few of the companies in each of these segments have been able to crack the model, learning from past business trends. A few of these trends are:

Optimal store format size to improve sales per sq ft

Learning from experience, organised retailers have zeroed in on the right model for optimum store size. Case in point: *Shoppers Stop* has restructured its store size and reduced wastage of space and unwanted assortments from a store, resulting in new store size of ~45,000 sq ft (earlier 55,000 sq ft). This will not only reduce the store launch time, but also prune rent per store, which is expected to significantly enhance probability of success.

Table 11: Optimal store size (sq ft) to improve sales per sq ft

Companies	Departmental stores	
	2012	2016
Shoppers Stop	55,000 to 60,000	45,000 to 50,000
Central	90,000 to 100,000	90,000 to 100,000
Zara	25,000 to 30,000	25,000 to 30,000
Massimo Dutti*	8,000 to 10,000	5,000 to 6,000
Pantaloons	15,000 to 20,000	15,000 to 20,000
VMart	8,000 to 9,000	8,000 to 9,000
Westside	15,000 to 20,000	15,000 to 20,000

Companies	Supermarkets	
	2012	2016
DMart	28,000 to 32,000	28,000 to 32,000
Reliance Fresh	3,000 to 5,000	3,000 to 4,000
Food Bazaar	16,000 to 18,000	16,000 to 17,000
Spencer Supermarket	3,500 to 4,500	2,750 to 3,000
More	2,000 to 5,000	2,000 to 2,500

*Note: * global average*

Source: Technopak research, Edelweiss research

Another case in point is the Tata Group, which ran 3 formats under the *Star* brand (daily, market and hyper). Of the ~42 stores, it is planning to shut smaller format *Star Daily*, which will help cut rental cost, while simultaneously catering to those catchment areas through the online channel.

Retailers in India are looking at smaller, but efficient store sizes across formats as large floor area in high potential catchments is difficult to get due to limited availability and high rentals. **In our view, the 2 formats that have the winning edge are mid-size or compact/hybrid hypermarkets of 20,000–30,000sq ft and supermarkets of 3,000-4,000sq ft. These will enable focus on key categories and clusters rather than spread across categories.**

Right product mix in right format to drive profitability

Depending on product mix, supermarkets and hypermarkets work on 2 different models to achieve profitability and productivity. While s**upermarkets focus on high sales productivity with low-margin products (F&G), hypermarkets focus on large volumes with a mix of high- and low-margin products.**

F&G contributes 60-65% to the category mix in supermarkets, followed by non-food FMCG at 15-20%. Contribution of general merchandise to sales is 10-15%. High dependency on F&G category results in lower margins for supermarkets. Thus, profitability of these formats can be attributed to high efficiencies.

Table 12: Category contribution across formats

Formats	Food & Grocery (%)	Non FMCG (%)	Others (%)
Hypermarkets	30-35	15-20	45-55
Hybrid Supermarkets	45-50	20-25	25-35
Supermarkets	60-65	20-25	10-20
Modern Convenience Stores	65-70	20-25	5-15

Source: Edelweiss research

In hypermarkets, F&G contributes ~30-35% to category mix, followed by general merchandise at 20-25%. The non-food FMCG contribution to sales is 15-20%. Higher mix of other categories, with higher margins primarily drives profitability of hypermarkets.

In our view, the hybrid supermarket space with average store size of 20,000-30,000sq ft is the ideal as it helps achieve higher productivity versus hypermarkets and provides more variety to consumers than supermarkets.

Ownership model works better in short term, but lease is the way forward

DMart has consciously followed a strategy of owning and constructing stores rather than leasing, as adopted by other retailers. For any store opening, the company follows either of the models: (i) purchase the land and construct the store; or (ii) take the land on long-term (>30 years) lease and construct the store. In the rarest situation where either of the above is not possible, it takes the store on lease.

Purchasing land and constructing store entail huge initial cash outflow. Even if one factors in interest cost on capital employed, the payback period will still be under 4 years. This signifies that by the time the store matures, capex has already been recovered and hence post that majority of the EBITDA will flow to PAT. Key international retailers like Wal-Mart, Costco & IKEA and domestic retailers like D'mart have been following this model and have managed to control operational costs.

Table 13: Payback period for D'mart - Self-owned versus leased stores

INR mn	FY15	FY16	FY17
No. of stores (Nos.)	89	110	131
New stores opened (Nos.)	14	21	21
Retail business area (mn sq ft)	2.7	3.3	4.1
Gross Block (INRmn)	15,281	21,918	27,764
Gross Block per store (INRmn)	172	199	212
Revenue	64,394	85,838	118,977
Rental cost saving - assumed at 8% of sales	5,152	6,867	9,518
Rent cost saving per store	58	62	73
Payback period to cover rental (Yrs)	**3.0**	**3.2**	**2.9**

Source: Company, Edelweiss research

"Private brands not only fetch higher margins (~500 - 700bps), but also ensure that inventory is well managed"

However, the approach of owning stores hurts expansion (difficult to obtain land in all catchment area). Therefore, in our view, though owning the store works well in the short term, it will hurt expansion. **Therefore, we prefer rental over the lease model**.

High private labels share to drive margins

Organised retailers aim to create a niche for their brands in the domestic market by continuously investing in and growing their private labels business. Acceptance of private labels continues to increase across product categories including food & non-food FMCG, apparels and consumer durable segments.

Table 14: High private label contribution results in high margins (%)

Companies	Private label
Shoppers Stop	15.0
Central	35.0
Pantaloons	67.0
Trent	93.0

Source: Edelweiss research

Organised retailers prefer private labels as they fetch higher margins, greater customer loyalty, there's clear product differentiation and imparts higher bargaining power with suppliers. While globally general merchandise retailers operate at private label mix of ~35%, the corresponding figure for the Indian retail industry currently stands at ~20%. Going ahead, private labels segment is expected to continue to grow in the Indian retail industry.

Fig. 4: Haute curry: SSL's private label Westside's private label for millennials

Source: Edelweiss research

"We have the cash flow to make growth happen"

Mr. Kishore Biyani, Chairman, Future Group

Balance sheet strength improving

Retail companies have significantly sharpened focus on improving return ratios. Return ratios spurt has been led by improvement in inventory days on account of shorter season cycles and faster liquidation of slow-moving inventory.

With improvement in working capital and lower debt across retail companies, we expect RoCE to improve significantly. Case in point is Future Lifestyle, where inventory days have improved from 221 in FY16 to 203 in FY17; they are expected to improve to 170 days by FY20 aided by shorter season cycles and availability of Brand Factory which act as faster liquidation channel for slow moving inventory. Also, gross debt/equity ratio is estimated to improve from 0.7x in FY16 to 0.2x in FY20.

Table 15: Improving inventory days and leverage ratios

	Inventory Days			Improving debt ratios - D/E ratio		
	FY15	FY17	FY20	FY15	FY17	FY20
ABFRL	143	172	172	3.8	2.3	1.2
Future Lifestyle	209	203	170	0.8	0.4	0.2
Shoppers Stop	60	62	62	1.4	1.9	1.0
Trent	94	118	110	0.2	0.2	0.1
VMart	125	123	123	0.1	0.1	0.1
Future Retail	NA	106	95	NA	0.4	0.2
DMart	31	29	29	0.6	0.3	0.0

Source: Company, Edelweiss research

Product and customer is the king

"Data is the new oil. We need to find it, extract it, refine it, distribute it and monetize it"

David Buckingham

Data analytics helps target right consumers

The retail industry engages in intelligent marketing wherein it informs registered customers of the new schemes/offers for specific products based on their previous purchases. For instance, customers who have a history of purchasing from kids section receive an SMS about promotional schemes in the kids category. Players also intend to push cross-promotional schemes across different verticals. For instance, customers buying noodles are most likely to be potential customers for a store's kids section and hence will receive promotional schemes from the kids section. **In our view, the company which deploys data analytics will be way ahead of peers as it will be able to market the right product to the right consumer**.

Table 16: High sales contribution from loyal consumers

Companies	Loyal customers (mn)	Sales contribution (%)
Shoppers Stop	5	77.0
Future Pay app	3	NA
Pantaloons	9	91.0
Reliance Retail	30	NA
Westside	4	NA
Lifestyle brands (ABFRL)	10	53.0

Source: Edelweiss research

Price matching features to win consumers

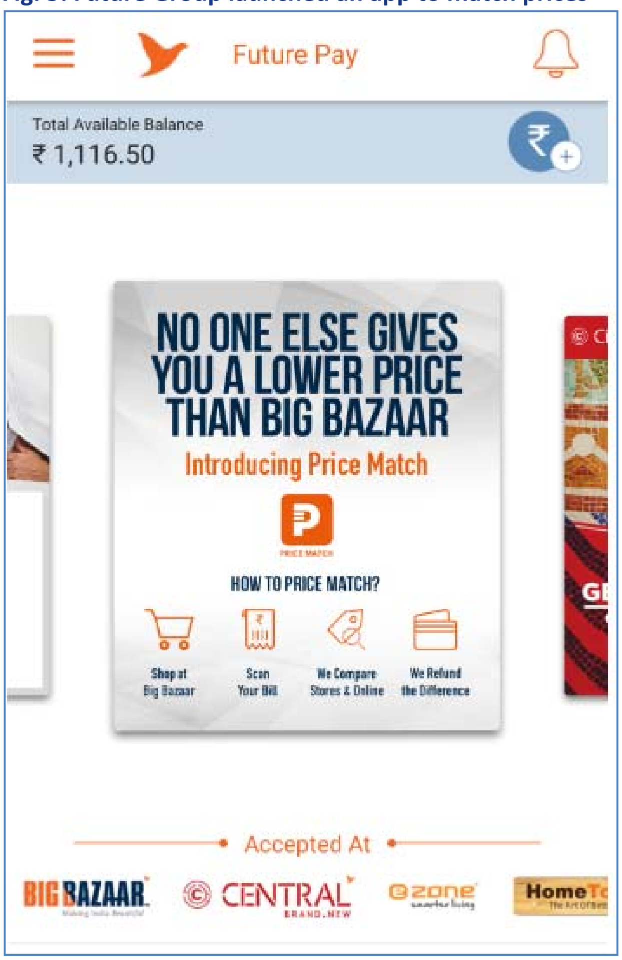
Offering customers best possible prices has always been an important part of business. However, over the past few years, the focus has been on retaining consumers. Currently, it's not just enough to offer a good price, as many consumers want the stores that they visit frequently to match the competitor's price.

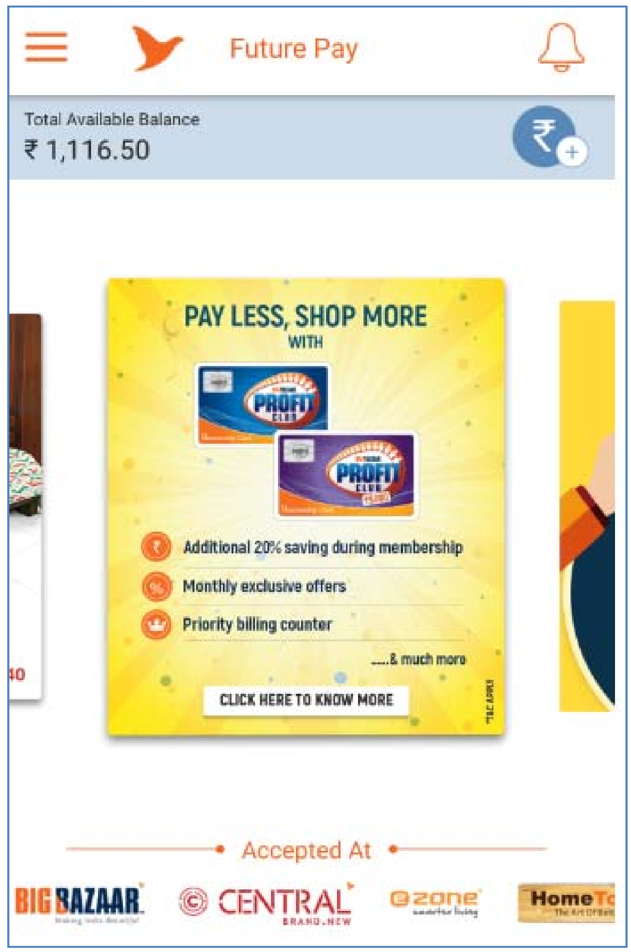
Positives of price matching:

- If an existing customer asks to match or beat a competitor's price, it's fairly easy to assume that this customer is loyal and would rather purchase directly from that store.
- Price matching is one way to retain customers, defend market share and keep the company a dominant player. It's a critical approach to increase customer retention.

We believe matching prices of competitors can be a good way to keep customers happy.

Fig. 5: Future Group launched an app to match prices





Source: Edelweiss research

Innovation key

Retailers push promotions to attract consumers. We enumerate some of these initiatives here.

Flash sale (also called daily deals or deal-of-the-day) is an e-commerce business model in which a website/mall puts on sale a single product over 24-36 hours. Potential customers register as members of flash sale websites and receive online offers and invitations by email or social networks. It works well with brands and products which have garnered sufficient demand and enthusiasm towards the respective product well before launch/flash sale. For example, launch of the Xiaomi phone on Flipkart and Yu Youreka phone on Amazon.

Why malls/e-commerce companies go for flash sales?

- Creates popularity and awareness about products.
- Generates interest if the product offers good value to customers.
- Pushes customers into action to buy the product by influencing their psychology (by creating the feeling of “scarcity“).
- Reduces inventory and other fixed capital costs, thereby improving profit margin.

In India, Flipkart pioneered the flash sale concept with Xiaomi mobile phone launch. After this, Flipkart released so many mobiles on flash sale to gain user attraction. In every flash sale, more than 50,000 mobiles were sold within a span of 2-3 seconds.

B&M retailers are also investing in omni-channel strategies and experimenting with global models such as flash sales by offering a single product for sale for a period of 24-36 hours.

Fig. 6: Flipkart pioneered the concept of flash sales by introducing

Source: Edelweiss research

Another strategy opted by Amazon India to acquire customers was **ambush marketing.** The company bundled its gift coupons with products of ITC, Nestle and Coca-Cola being sold on the shelves of large organised retail chains such as Big Bazaar, Hyper-City, Star Bazaar, D-Mart, Walmart-owned Best Price Modern Wholesale, Big-Basket and others. These bundled items encourage consumers to shop online as they carry cash back offers. Hence, brick-and-mortar retailers are omitting these bundled items from their stores as they see this as a move by Amazon to acquire their customers.

Right blend: Omni-channel strategy success mantra

Post bitterly fought turf wars between brick-and-mortar stores and e-commerce companies, players have gleaned that offering a complete and seamless consumer experience is mantra to success. Hence, while online retailers are shifting offline (Amazon's tie up with Shoppers Stop), we anticipate offline stores to resort to the digital medium to target consumers (Future Retail shifting to Retail 3.0).

In our view, omni-channel strategy is the way ahead. Among categories, while F&G is likely to be resistant to e-commerce play, electronics and low-value jewellery are most likely to warm up to the platform. Branded apparels are envisaged to deploy omni-channel strategy with online as well as offline presence.

Major consolidation over; few large players to survive

The e-commerce boom (2010-16): India, being the world's second largest internet subscribers' market, global private equity giants like Naspers and Softbank invested in India in e-commerce companies in their bid to monetise opportunities. While Nasper & Tencent invested in Flipkart, Softbank invested in Snapdeal and Amazon in Amazon India. Even Alibaba/Alipay invested in PayTM, India's largest mobile wallets company which has expanded as a marketplace entity now.

A few years ago, all e-commerce companies were focusing on garnering scale by gaining market share and focusing on gross merchandise value (GMV). They advertised heavily to educate the market and sold products at deep discounts compared to B&M stores. Though deep discounts and heavy advertising (funded by private equity players) led to huge losses, e-commerce companies were banking on the change in consumer purchase habits as it provided convenience, ample choices to choose from and discounted products. This impacted B&M stores.

Fig. 7: Sales season by e-commerce players

Source: Edelweiss research

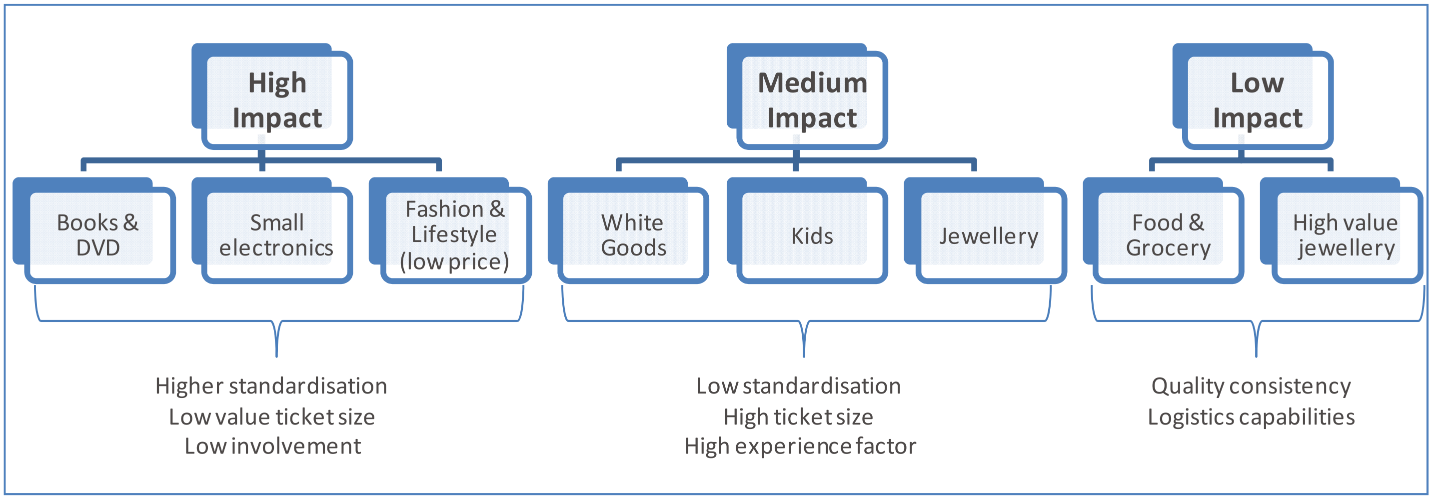
However, in the past 1 year, funding from private equity players has dried up with the focus now shifting to profitability, leading to cut in deep discounts. In such a scenario, most e-commerce companies will face cash crunch, leading to operational issues. Thus, we expect the Indian e-commerce market to witness a grand clash only between two well funded players—Amazon and Flipkart. Both players have taken a long-term view on business and are unlikely to shy away from making big investments and sacrificing near-term profits, if needed, to gain sustainable long-term advantage. Further, Alibaba is also eyeing this market through PayTM Mall (a TMall equivalent company).

Online penetration differs across categories

E-commerce spurt prompted B&M stores to revisit their strategies. They realised that certain categories were impacted more by e-commerce. Delving deeper, these companies realised that consumers preferred to see, touch and feel (low standardization) the product before purchasing it. For instance, electronics focused formats and home focused stores came under heavy pressure. The initial market share loss was due to heavy discounting. However, once the cut in discounts started, consumers continued to purchase electronics online, signifying that higher standardisation products will be purchased online. However online will not affect categories like F&G (where quality consistency is needed) or high value jewellery (intricate designs).

We expect categories like F&G to be resistant to e-commerce companies. However, categories like electronics and low value jewellery may see a shift to e-commerce channel. Branded apparels will pursue omni-channel strategy and be present in online as well as offline channels.

Fig. 8: Online impact on categories



Source: Edelweiss research

Apparels: The apparels market in India was pegged at INR3,201bn in FY16 and is estimated to clock 10.9% CAGR over FY16-20. However, organised apparel segment is expected to clock 21.9% CAGR over FY16-20 aided by shift of demand from unorganised to organised players.

B&M retailers are investing heavily in apparels as margins are higher compared to other categories; margins in private labels can go up to 50-60% (current 40%). However, with the birth of the e-commerce industry, B&M retailers are feeling the pinch. Consumers select (trial & fit) clothes and shoes from B&M retailers, but order them online at a much cheaper price (e-commerce companies are pricing products at huge discounts).

However, now, with deep discounts off the table, in our view, B&M retailers will do better. Further, most of these retailers are implementing omni-channel strategies. Consumers can order online and then go to the store to check the fit and then accept the product. These initiatives will help B&M retailers make a comeback after losing market share to e-commerce companies.

Shoppers Stop has invested INR400mn in its omni-channel strategy and expects ~10-15% revenue via online sales. Other companies like Lifestyle and Pantaloons too are present online.

Fig. 9: Pantaloons—Making its presence felt online

Source: Edelweiss research

Food & groceries: The F&G market in India was estimated at INR26,845bn in FY16 and expected to post 11.3% CAGR over FY16-20. However, organised segment is expected to post 24.3% CAGR over FY16-20 aided by market share shift from unorganised to organised segment. Though e-commerce players like *bigbasket.com* and *grofers* have snatched market share from B&M retailers, in our view, assorting vegetables as per customer's order is a mammoth task. Further, ensuring quality vegetables is difficult. Most e-commerce companies like *localbanya.com* tried and failed. We believe, online grocery is no longer just about volumes or convenience as the real differentiation has to be quick delivery.

In our view, *bigbasket.com* and *grofers* are doing a good job. However, they are still making losses. Ease of shopping, assortments available and free & quick home delivery are aiding these e-commerce companies. Further, they are offering products like cut vegetables, imported fruits & vegetables, which were not available initially in B&M shops. Other players like Amazon, Star Bazaar and D'mart also testing waters with online food & groceries. Offline players such as Reliance Fresh and Godrej Nature's Basket have launched omni-channel initiatives, though the scale is not too big right now.

Star Bazaar (Tata Group) is venturing into the online grocery business under *Starquik* brand. A pilot venture will be rolled out within the next 2 months as an online channel for Trent Hypermarket, an equal joint venture between Tata and British retailer Tesco.

DMart's strategy to counter competition from Amazon, Big Basket, etc., is to have an e-commerce portal solely to make customers' life more convenient so that they do not have to visit a store. However, the differentiating factor is instead of offering free home delivery, DMart has opened DMart Ready Stores where the company will supply from its mother stores and the customer will just need to take delivery of products from those outlets. The strategy is to have DMart Ready Stores in neighbourhood areas.

Fig. 10: New users will get cash back

Source: Edelweiss research

Jewellery & watches industry: The domestic jewellery & watches industry was pegged at INR3,042bn in FY16 and is estimated to register 13.4% CAGR over FY16-20. However, organised jewellery is expected to clock 16.1% CAGR over FY16-20 aided by market share shift from unorganised to organised segment. Pegged at ~INR8-10bn (~0.3% of overall jewellery market), the online jewellery segment has 3-4 serious players (CaratLane and Candere among them) and several newbies on the block. The top 2 players command about 80% of this pie.

Titan and Kalyan Jewellers have acquired online jewellery players to firm up their online presence. Kalyan Jewellers acquired online jewellery player Candere for INR35-400mn to augment presence in the fast-expanding online market space. Further, the company expects the online jewellery market to offer tremendous opportunity and contribute 5-7% to its top line over the next 5 years. In May 2016, Titan acquired 62.0% stake in Chennai-based e-tailer CaratLane for INR3,570mn.

Fig. 11: Jewellery players' online presence

Source: Edelweiss research

Online moving to offline

Most online companies gained prominence in 2014 when the battle among Flipkart, Snapdeal and Amazon was intense. As a result, consumers went online and tried to monetise the deep discounts available. However, with deep discounts coming off, online transactions started dwindling. Plus, consumers were also wary of the fact the fake products might be sold online (recent example being fake Skechers sold on Flipkart). Companies like Lenskart and Nykaa realised that to provide a complete experience to consumers, they need to be present offline as well.

There is only one boss, the customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else"

Sam Walton, Founder, Walmart

In our view, going ahead most online retailers will shift to offline mode as well to provide a complete and seamless consumer experience. Hence, this shows that offline retail is the way forward for most of the online companies. Further, opening of offline stores by online companies will attract footfalls which can be a potential target for other B&M companies. Also, certain online companies are tying up with B&M companies to increase their presence offline which will drive latter's sales.

Case in point being Amazon, which has tied up exclusively with Shoppers Stop (SSL). This gives Amazon India the right to open experience stores (enables customers test products available online) at SSL's outlets. Further, Amazon India purchased 5% stake in SSL which shows the confidence of largest e-commerce company in offline retailing.

In 2014, Lenskart, the online eyewear retailer, took a step towards building offline presence, given the increasing number of requests from consumers who still prefer trying products before buying. According to the company, there is a significant number of people who would buy at their outlets even when they shift online. In sum, to be relevant and accessible, physical stores are needed. Thus, Lenskart has 350 stores in ~90 cities (both tier-1 and 2).

Similar movement was seen by online beauty brands retailer Nykaa. It already has 8 stores in Delhi - NCR, Mumbai, Bengaluru, Amritsar and Pune under the *Luxe* and *On Trend* categories. The *Luxe* stores will mostly have luxury and premium brands.

Fig. 12: Online players opening retail stores

Source: Edelweiss research

Oppo is planning to open own stores, paving the way for the Chinese smart phone maker to sell directly to consumers and add to its existing wholesale business. The move will help Oppo expand its reach in the world's third-largest smartphone market.

Online fashion retailer Myntra expects to clock 10-15% sales from brands available on online and offline platforms in the next five years. The company won the rights to manage fashion brands *Esprit* and *Mango's* offline stores in India and opened the first *Mango* store in Delhi. It is planning to open 25 *Mango* stores in the next five years with five slated to open by end CY17. Similarly, it plans to open 15 offline stores of *Esprit* over the same time.

Retail 3.0: Blend of online and offline

Globally, 2.5bn plus consumers are connected to the internet. In India, ~400mn consumers are connected to internet, of which ~300mn are smartphone users. These consumers, on an average, spend ~3 hours a day on the internet. By 2020, India is expected to have 650mn (250mn English users, 200mn Hindi users and 200mn other languages) internet users with 500mn smartphone users consuming 10GB of data. Thus, digital is a bridge between the consumers and sellers. Using this bridge, online can drive offline business as consumers will use best of both the platforms. Hence, companies can blend the best of both the platforms to provide seamless experience to consumers.

Table 17: Internet users in India

mn	CY17	CY20
Internet users	400	650
Smartphone users	300	500
English	200	250
Hindi	100	200
Other languages	100	200

Source: Industry, Edelweiss research

The offline channel enables the consumer experience the brand (touch, smell, visible senses) while digital enhances only visible senses however provides assortments and convenience. However, going ahead, online and offline channels will be blended to provide seamless experience to consumers. Digital can provide deep understanding of consumer behaviour using data analytics and will be used to personalise targeting.

Fig. 13: Owning the customer's ecosystem

Source: Edelweiss research

Premium valuations to sustain

Though all retail categories are expected to perform extremely well, we expect F&G, followed by jewellery and apparels to benefit due to lower penetration, less competition and high entry barriers.

Market prices of retail stocks have gone up >50-400% in CY17. This has propelled the overall retail sector valuation to an average of ~20x FY20 EV/EBITDA. This valuations have been re-rated on the back of high growth rates, improving return ratios as well as opportunity size.

We believe, that the premium valuations are here to stay with good getting better – high growth rates (18-20% revenue CAGR over FY17-20) as well as improving return ratios (>750bps RoCE expansion over FY17-20).

The domestic retail market was pegged at USD616bn in FY16, of which organised retail constituted ~9% (versus overall retail market of USD386bn in FY12, of which organised retail was ~7%). Though all retail categories are expected to perform well, we expect companies in Hypermarkets and jewellery to be top beneficiaries. We also like apparels companies who will benefit due to lower penetration, less competition and high entry barriers.

F&G (highest market size of USDINR413bn in FY16), which is the least penetrated with 3.1% organised share in FY16, is projected to clock robust growth and capture 4.9% share of organised retail by FY20. Organised share in jewellery (market size USD47bn in FY16) is projected to jump to 29.8% in FY20 from 27.0% in FY16. Organised pie in the apparel segment (market size USD49bn in FY16) is estimated to catapult to 32.3% in FY20 from 22.0% in FY16.

The retail sector witnessed strong re-rating apart from better macro, especially post mid-FY17 led by: a) B&M stores doing exceptionally well riding demonetisation & GST; and b) lower online discounts proved that consumers are buying online only due to discounts, which are not sustainable in the long term.

Above mentioned opportunity size and lower penetration infuses confidence in ability of retail companies to post an average revenue CAGR of ~18-20% over FY17-20 coupled with >750bps RoCE expansion.

Valuations for retail companies have gone up (trade at ~20x FY20 EV/EBITDA) on the back of high growth rates, improving return ratios and opportunity size and we believe this valuation band will be the new normal. We are valuing companies using EV/EBITDA basis (except Titan which we value on P/E basis) since: (i) the leverage ratios for companies are quite different; (ii) considering debt levels and capex, the flow from EBITDA to PAT is insignificant today.

Our top picks are a mix of companies with prime business models, earnings growth, and potential improvement in return ratios as well as perceived risk. Factoring these parameters along with the opportunity landscape, we like hypermarkets and jewellery players (market share gain from unorganised). Hence, **our top picks are Trent (BUY), Future Retail (BUY),**

Titan (BUY) and Shoppers Stop (BUY). We initiate coverage on Trent (BUY), V-MART (BUY) and D'mart (HOLD)**.**

Table 18: Relative comparison across companies

	ABFRL	Future Lifestyle	V-MART Retail	Shoppers Stop	Trent	Future Retail	D'mart	Titan
Sales growth	◔	◑	◕	◑	◑	◕	◕	◑
Brand strength	◕	◕	◑	◑	◕	◕	◕	◕
Opportunity from unorganised	◑	◑	◑	◑	◕	◕	◕	◕
Same store sales growth	◔	◑	◑	◑	◑	◕	◕	◕
Rental cost (% of revenues)	◔	◑	◕	◑	◑	◑	◕	◕
Private Labels	◑	◕	◑	◔	◕	◕	◑	◕
Sales per sq ft	◑	◑	◕	◑	◕	◑	◕	◑
RoCE improvement	◕	◕	◑	◕	◑	◑	◑	◑
Inventory days	◑	◑	◑	◕	◑	◑	◕	◑

Note: Full blue color shows better ranked than other companies

Source: Edelweiss research

Our preferred picks: Pecking order

- **Trent:** Triple treat.
- **Future Retail**: In pole position
- **Titan:** Lustrous growth
- **Shoppers Stop:** Trajectory well etched out
- **Future Lifestyle:** *Brand Factory Central* advantage
- **V-MART Retail:** Value play on small town
- **ABFRL:** Peerless brand brawn
- **Avenue Supermarts:** Deep MOAT; Valuation a concern

Table 19: Edelweiss coverage snapshot

Company	Reco/ Rating	CMP (INR)	TP (INR)	Upside (%)	Revenue (INR bn) FY18E	FY19E	FY20E	EBITDA (INR bn) FY18E	FY19E	FY20E	EBITDA CAGR (FY17-20)	EBITDA margins (%) FY18E	FY19E	FY20E	RoCE (%) FY18E	FY19E	FY20E	EV/EBITDA (x) FY18E	FY19E	FY20E
ABFRL	Buy	171	206	20.5	76	86	99	6	9	11	34.5	8.0	9.9	10.8	11.2	15.9	19.4	25.2	17.5	13.5
D'mart	Hold	1,160	1,290	11.2	154	198	250	13	17	23	32.1	8.6	8.8	9.0	25.6	29.4	32.1	53.8	41.0	31.4
FLF	Buy	352	439	25.0	46	56	68	4	6	7	26.8	9.7	10.2	10.7	11.2	15.7	20.9	16.3	12.4	9.7
FRetail	Buy	511	677	32.4	201	255	300	17	23	26	20.6	8.5	8.8	8.8	21.5	24.1	27.1	31.0	24.4	18.7
Shoppers	Buy	536	733	36.8	55	50	55	3	4	5	39.4	5.1	8.0	8.5	9.1	15.2	17.7	19.6	13.6	11.3
Titan	Buy	845	977	15.6	158	188	223	16	20	25	29.6	10.1	10.9	11.3	33.3	36.1	37.6	46.5	36.2	29.4
Trent	Buy	327	394	20.4	22	27	33	2	3	4	41.3	8.0	9.7	10.9	9.8	13.0	15.4	63.4	41.5	29.8
V-MART	Buy	1,479	1,744	17.9	12	15	18	1	1	2	27.0	8.3	9.0	9.6	23.5	28.1	31.4	26.2	19.6	15.2
					724	**875**	**1,045**	**62**	**83**	**102**		**8.6**	**9.5**	**9.8**				**35.2**	**25.8**	**19.9**

Source: Edelweiss research

Table 20: Global valuation snapshot

Name of the Company	Mcap (INR bn)	Enterprise Value (INR bn)	EBITDA Margin FY18 (%)	EV/EBITDA FY18 (x)	EPS FY17-19 CAGR (%)	RoE FY18 (%)
Inditex	6,893	6,443	21.4	15.4	10.8	25.2
H&M	2,172	2,130	15.0	9.1	(4.2)	27.1
Mr. Price	319	313	19.2	17.3	14.6	38.7
TJX Companies	3,080	3,038	12.9	10.3	6.9	56.2
Fast Retailing	2,696	2,479	12.5	17.1	6.6	16.5
Walmart	18,548	21,215	6.7	10.0	1.3	16.5
Costco	5,252	5,243	4.3	13.9	6.5	24.3

*Note: * Data for H&M and Fast retailing is for CY*

*** CMP and Mcap is as on Jan 4, 2018*

Source: Edelweiss research

Portfolio Snapshot

Table 21: Weights assigned to Edelweiss coverage universe - Retail

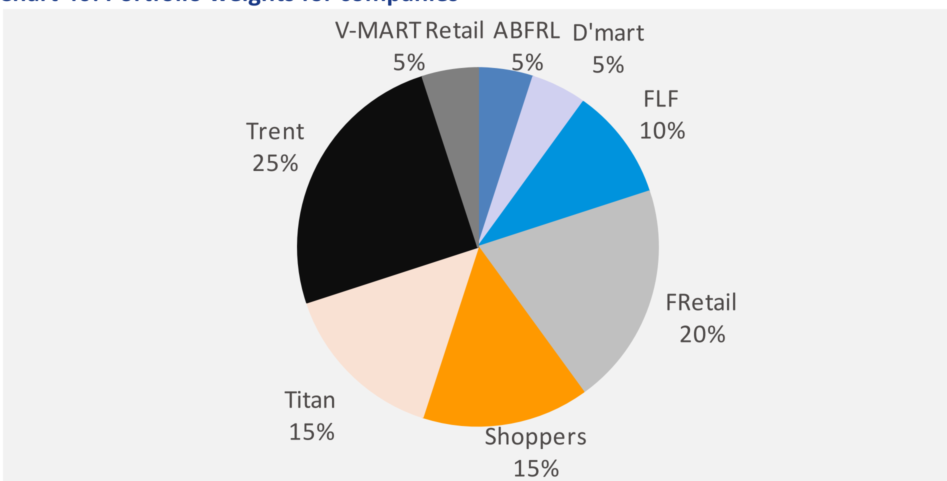
Companies	Target FY 20E EV/EBITDA(x)	Mkt cap (INR bn)	Mkt cap by weights (%)	Weights (%)	CMP (INR)	TP (INR)	% upside
ABFRL	16.0	132	6.2	5.0	171	206	20.5
D'mart	35.0	724	34.3	5.0	1,160	1,290	11.2
FLF	12.0	67	3.2	10.0	352	439	25.0
FRetail	25.0	255	12.1	20.0	511	677	32.4
Shoppers	15.0	47	2.2	15.0	536	733	36.8
Titan	52.0	750	35.6	15.0	845	977	15.6
Trent	SoTP	109	5.2	25.0	327	394	20.4
V-MART Retail	18.0	27	1.3	5.0	1,479	1,744	17.9

*Note: *In case of Titan, it is target FY20 P/E multiple*

**Trent: EV/EBITDA of 25x FY20E to Westside business, EV/EBITDA of 15x FY20E to Zara business and P/Sales of 1.5x FY20E to Star Bazaar*

Source: Edelweiss research

Chart 40: Portfolio weights for companies



Source: Edelweiss research

Table 22: Classification of brands across segments

Categories	ABFRL	Raymond's	Future Lifestyle	Inditex Trent	Arvind
Mass					
Fast fashion	People Forever 21		Cover Story Jealous 21 Indigo Nation	Zara	
Sub premium (INR2500-3000)	Peter England	Color Plus Parx Makers	aLL - A Little Larger Scullers John Miller Bare Converse		Arrow US Polo Flying Machine
Premium (INR3000-3800)	Louis Philippe Van Heusen Allen Solly	Raymond Park Avenue	Lee Cooper Urbana	Massimo Dutti	Calvin Klein GANT GAP Tommy Hilfiger
Super Premium (INR4000-4500)	HACKETT LONDON				
Luxury (above INR4500)	The Collective				

Source: Edelweiss research

Table 23: Gender wise brand classification

Categories	ABFRL	Raymonds	Future Lifestyle	Inditex Trent	Arvind
Men	Peter England Louis Philippe	Raymond Park Avenue Color Plus	Urbana Indigo Nation John Miller Turtle		Calvin Klein GANT Nautica
Unisex	People Van Heusen Allen Solly		Lee Cooper Scullers Bare aLL - A Little Larger	Zara Massimo Dutti	
Women	Forever 21		Jealous 21 Cover Story		
Sports/Leisure			Urban yoga Umbro Converse		
Footwear/Others			Ceriz Clarks tresmode		

Source: Edelweiss research

Table 24: Acquisitions in Retail space

Company	Acquisition / JV	Sector	Rationale	Comments	Year
Future Retail	Hypercity (Shoppers Stop)	Organized Retail	Future retail will gain access to prime locations and Hypercity's private labels	HyperCity's EV is INR 9,110mn ; FRL will pay the consideration partly in cash (INR 1,550 mn) and partly via share issue (INR 5,000 mn)	2017
Flipkart	Myntra	E-commerce - Fashion	Expanding market dominance in online apparel	INR20bn acquisition	2014
Amazon	Shoppers	Offline Retail	Amazon pursuing omni-expansion into offline retail	5% equity in Shoppers Stop worth INR 1795 mn	2017
Trent	Tesco	Retail	Tesco entered	50:50 JV with Tesco contributing £85 million	2014
V2 Retail	Lighthouse ventures	Organized Apparel	One-stop apparel shopping solution for complete family, offering a wide, diverse range of apparel at affordable prices	It has invested INR 760 mn	2017
Future Group	Fab Furnish (Rocket Internet)	Ecommerce	Help grow the online presence of their brand Home Town	INR 200 mn	2016
Future Retail	Heritage Foods retail business	Organized retail	Complement its existing network of 379 small format EasyDay stores	Heritage foods will get 3.65% stake in Future retail or freshly issued shares worth INR 2950 mn	2016
Pantaloons	ABFRL	Apparel	India's largest pure-play fashion and lifestyle company with a strong bucket	For a shareholder holding 100 shares in ABNL will hold 100 shares in ABNL and in addition will get 520 shares of PFRL	2015

Source: Edelweiss research

Companies

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AVENUE SUPERMARTS

Deep MOAT; Valuation a concern

India Equity Research | Retail

Avenue Supermarts (D'mart), India's profitable food & grocery (F&G) retailer, is amongst the few retailers which has not only cracked the retail business model, but also sustained >20% same stores sales growth (SSSG). Commendably, D'mart has maintained its inventory turnover at an impressive ~30 days (peers at >75 days) due to the sharp focus on everyday consumption items. With good getting better, we expect D'mart to clock revenue, EBITDA and PAT CAGR of 28.1%, 32.1% and 41.4%, respectively, over FY17-20. We also expect RoE to improve by ~350bps over FY17-20. However, considering that stock is fairly valued, we initiate coverage with 'HOLD/SU' and assign 35x EV/EBITDA multiple (~40% premium to FRL's target multiple) to arrive at TP of INR1,290.

Knows what works, knows what's best

Retail entails having the right format, scale, size and execution strategy, and D'mart clearly has impressive credentials and prowess in all these mentioned aspects. In spite of its capital-intensive model (works on ownership model instead of lease model), D'mart not only clocks best-in-class EBITDAR margins (8.5% versus peers' average of 6.6%) and RoCE, but has also managed its leverage ratio (debt to equity at 0.3x) well. Finally, gross margins (~15%) may be low, but D'mart has sustained EBITDA margins at ~8% levels, a sheer outcome of strong inventory throughput and tight leash on costs.

Why the growth potential is intact?

During FY13-17, D'mart clocked revenue, EBITDA and PAT CAGR of 37.4%, 46.2% and 50.3%, respectively. Drawing on proven execution capabilities, sustained >20% SSSG, stable stores expansion, humongous store expansion opportunities (68% of stores in only 2 states) and steady margin booster, <u>we expect D'mart to register revenue, EBITDA and PAT CAGR of 28.1%, 32.1% and 41.4%, respectively, over FY17-20</u>. Key growth catalysts are: 1) customer loyalty; 2) likely shift of consumers towards mall like organised shopping experience; and 3) introduction of private labels.

Outlook and valuations: Valuation a hitch; initiate with 'HOLD'

While we aver that D'mart is a perfect play on the Indian retail story, we abide by Warren Buffet's admonition - an investor should understand that *"Price is what you pay, value is what you get"*. Hence, with limited upside from current levels (31.4x FY20E EV/EBITDA), we initiate coverage with **'HOLD/SU'** and TP of INR1,290.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	118,977	154,418	197,727	250,268
EBITDA (INR mn)	9,812	13,326	17,426	22,597
Adjusted Profit (INR mn)	4,788	7,898	10,325	13,546
Diluted EPS (INR)	8.5	12.7	16.5	21.7
EPS growth (%)	*48.7*	*49.2*	*30.7*	*31.2*
EV/EBITDA	73.0	53.8	41.0	31.4
ROAE (%)	17.9	18.6	20.1	21.4

Edelweiss
Ideas create, values protect

EDELWEISS 4D RATINGS

Absolute Rating	**HOLD**
Rating Relative to Sector	Underperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: NA, B:DMART IN)*

CMP	:	INR 1,160
Target Price	:	INR 1,290
52-week range (INR)	:	1,289 / 558
Share in issue (mn)	:	624.1
M cap (INR bn/USD mn)	:	724 / 11,370
Avg. Daily Vol.BSE/NSE('000)	:	2,145.0

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	82.2	82.2	82.2
MF's, FI's & BK's	3.5	3.5	3.8
FII's	3.8	3.8	3.7
Others	10.5	10.5	10.3

** Promoters pledged shares (% of share in issue) : Nil*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.9	0.9	(2.0)
3 months	7.3	5.5	(1.8)
12 months	27.1	80.9	53.8

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Bird's eye view (operating parameters across retailers)

Table 1: Bird's eye view of retailers

	DMart		Future Retail		Spencer		Reliance Retail		HyperCity	
	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17
Revenue (INR mn)	85,838	118,977	68,451	170,751	17,965	20,124	183,300	264,377	9,787	11,794
Raw material cost (INR mn)	73,035	100,810	50,651	128,344	14,292	15,982	148,189	214,025	7,441	8,693
Rental cost (INR mn)	204	354	6,043	13,595	940	1,063	6,399	5,805	563	651
EBITDA (INR mn)	6,636	9,812	834	5,813	(617)	(260)	9,120	11,632	(275)	(181)
Key metrics										
Same store sales growth* (%)	21.5	21.2	NA	14.0	NA	NA	NA	NA	NA	NA
Sales per sq ft per year* (%)	32,026	34,992	NA	12,309	17,424	18,912	14,320	19,583	7,871	9,118
Store count*	110	131	228	235	118	124	3,245	3,616	17	19
Total sq ft (mn)*	3.3	4.1	9.8	10.2	1.1	1.2	12.8	13.5	1.3	1.3
Average store size (sq ft)*	30,273	31,298	43,026	43,319	23,306	22,949	3,945	3,733	74,313	69,660
% of sales										
Gross margin	14.9	15.3	26	25	20.4	20.6	19.2	19.0	24.0	26.3
Employee cost	1.7	1.6	4.8	4.7	7.6	7.2	2.9	2.4	7.9	8.6
Rental cost	0.3	0.3	8.8	8.0	5.2	5.3	3.5	2.2	5.8	5.5
EBITDA margin	7.7	8.2	1.2	3.4	(3.4)	(1.3)	5.0	4.4	(2.8)	(1.5)
YoY growth (%)										
Revenue	33.3	38.6	NA	149.4	7.9	12.0	13.8	44.2	(7.6)	20.5
Raw material	33.1	38.0	NA	153.4	6.2	11.8	14.8	44.4	0.8	16.8
Rental cost	54.6	73.7	NA	125.0	13.5	13.0	3.8	(9.3)	6.2	15.6
EBITDA	44.6	47.9	NA	597.2	(15.8)	(57.9)	14.7	27.5	(136.9)	(34.0)

*Note: *Key metrics for Future Retail is only for Big Bazaar*

Source: Company, Edelweiss research

Investment Rationale

A. Impeccable business model

D'mart works on the EDLP/EDLC model which equips it to offer low prices daily which is driven by low procurement and operational costs. This philosophy is also adopted by Walmart globally. Company's product mix has been almost the same over the past >5 years, a rare feat to achieve. This has also helped D'mart retain a product price differential of >10 %.

It pays creditors in ~8-10 days so manufacturers are more than willing to pass on cash discounts, which it in turn passes on to customers. With steady and consistent format and product assortment, D'mart registered steady ~26% CAGR in the number of bills and ~11% CAGR in revenue per retail business area (sq ft) over FY13-17.

D'mart has started selling its private labels, akin to other large retailers, which is margin accretive. Having said that, D'mart is conscious of the extent to which it will focus on private label. Private label is a small portion currently and we don't expect the share to ramp up meaningfully.

a. Genesis of EDLP/EDLC strategy

D'mart, a fast emerging pan-India supermarket chain, is focused on offering value retailing to its customers through its Every Day Low Pricing (EDLP) / Every Day Low Cost (EDLC) model. **The EDLP/EDLC model equips D'mart to offer low prices daily which is driven by low procurement and operational costs as against special promotion of only certain products or during a specific day or part of the year.** D'mart stores also sport a modern ambience along with having a careful product assortment that gives the feel of a big retail mall.

Case Study: The Winning Walmart Model

Walmart's success in past few decades is undoubtely **an outcome of legendary business acumen, right business strategy and philosophy – *"To provide customers with Everyday Low Prices"*.** Going by Walmart's history and current operations gives us an understanding of the success quotient of supermarkets – **Sell Cheap**.

How does Walmart manage to Sell Cheap? The retail behemoth's strategy of offering low prices primarily hinges on building scale and volumes. Sam Walton, founder of Walmart, was seized of the fact that even if Walmart's margins were slimmer than competition, he could offset the same through volumes i.e. by *focusing on throughput and inventory turnover, and gradually volumes would permit economies of scale, and a level of bargaining power that would enable Walmart recarve the retail landscape*.

What's worth noting is that this model – built on low prices, large scale, and at minimal cost – was never changed, instead it only gained momentum which was used to acquire even more clout and even lower prices, at an larger scale, at lower costs to itself.

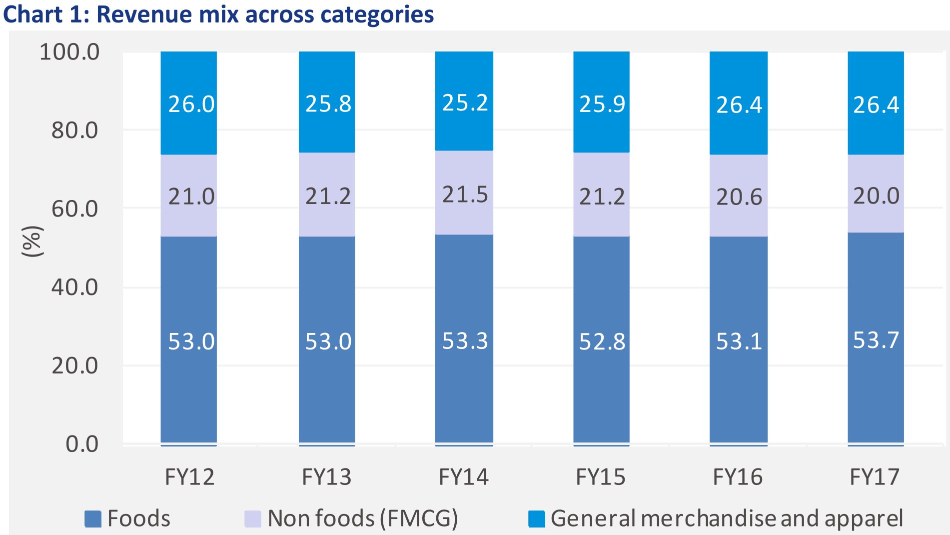
This strategy has made Walmart, a giant, but yet one of the finest retailers globally.

How similar is D'mart's business model to Walmart's gameplan. *"Start with low-cost products that consumers need on a daily basis and that you can sell for slightly below MRP. This allows you to rack up a great inventory turnover ratio. Then use that quick inventory turnover to negotiate better prices with manufacturers, which in turn allows you to support your low prices"* – **this is D'mart's mantra**.

b. Strict adherence to model

D'mart's strategy is absolutely similar to Walmart's framework. And D'mart has adhered to its strategy since inception till date, that is, it has stuck with its time-tested model since the past >15 years. As a result, **D'mart's product mix has been almost the same in past >5 years**, a rare feat to achieve. **The company's unchanged strategy has helped it retain a price differential of >10 % versus other retailers**, and also resonates well with the lower and middle class consumer segments – these segments tend to become more sticky and loyal.

Chart 1: Revenue mix across categories



Source: Company, Edelweiss research

Table 2: Prices of staples across D'mart, Big Bazaar, Reliance Mart and Star Bazaar

Products	SKU	D'mart	Reliance Retail	Big Basket	Cheapest
Soaps					
- Cinthol Lime soap	500 gm	100.0	112.0	108.0	D'mart
- Dove cream soap	75 gm	45.0	48.0	48.0	D'mart
- Lux Velvet touch soap	75 gm	22.4	30.4	24.3	D'mart
Detergents					
- Tide Jasmine & Rose	1 kg	93.0	99.0	99.0	D'mart
- Surf Excel Detergent bar	800 gm	79.0	92.0	86.0	D'mart
- OK Wheel bar	150 gm	11.3	12.0	NA	D'mart
Toothpaste					
- Colgate Total	100 gm	65.8	77.0	70.8	D'mart
- Dabur Red	300 gm	117.0	142.0	127.8	D'mart
- Close Up	300 gm	115.0	139.0	100.0	Big Basket
Juices					
- Tropicana 100% Orange	1 litre	112.0	120.0	120.0	D'mart
- Real Activ 100% Mixed Fruit	1 litre	95.0	120.0	112.0	D'mart
- B'Natural Litchi	1 litre	59.0	99.0	84.2	D'mart

Source: Company, Edelweiss research

Note: Since Big Bazaar does not have a retail online website, we have not been able to collate comparable data for Big Bazaar

Prices as on Dec 8, 2017

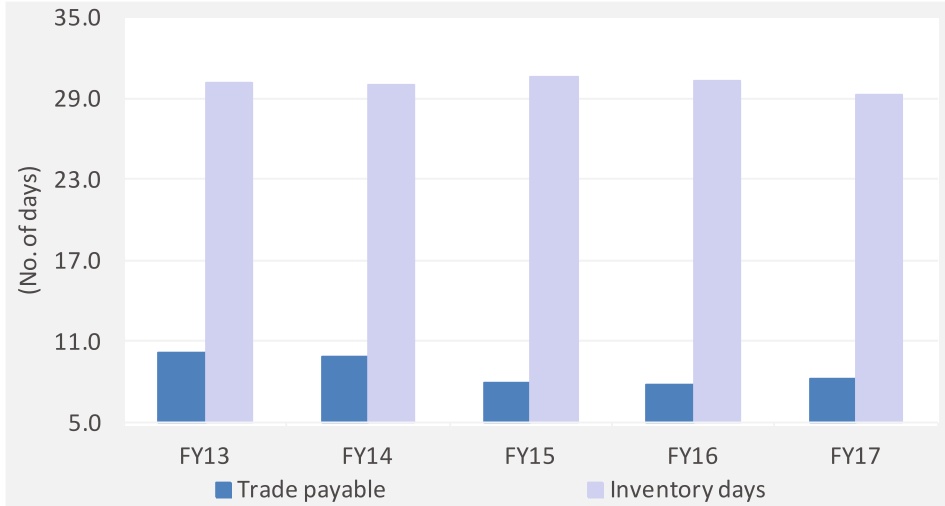
c. Consistency in availability of products

D'mart's discounting strategy is quite different from other retailers. Whileit is EDLP for D'mart, other retailers are seen offering special discount on specific days/events, etc. We believe D'mart's EDLP provides comfort and consistency to customers and induces them to walk into any of its stores any day with the mental comfort of getting products at best prices. This, coupled with the comfort that the products sold at D'mart are consistently available on the shelves boosts customers comfort while entering the store at any point in time. **This is achieved with effective and scientific assortment of products in each cluster, while keeping in mind the local needs, taste and preferences.** D'mart also leverages its knowledge of consumer spending patterns and behaviour and rely on the data available to keep abreast with changing consumer behaviour. Towards this end, D'mart continues to introduce new products depending on customer needs in all or limited stores.

d. Shorter creditor days, the key to low prices

D'mart manages to sustain consistency in products as it is well supported by creditors' payment terms, that is, **D'mart pays creditors in flat 8-10 days (as evident from its creditors' payable days chart)**. Since D'mart pays its creditors in max 8-10 days, manufacturers are more than willing to pass on cash discounts/early payment discounts to D'mart, which it inturn passes on to customers. **We believe this strategy upholds the company's business model and is hence sustainable.**

Chart 2: Improving to steady creditor and inventory days

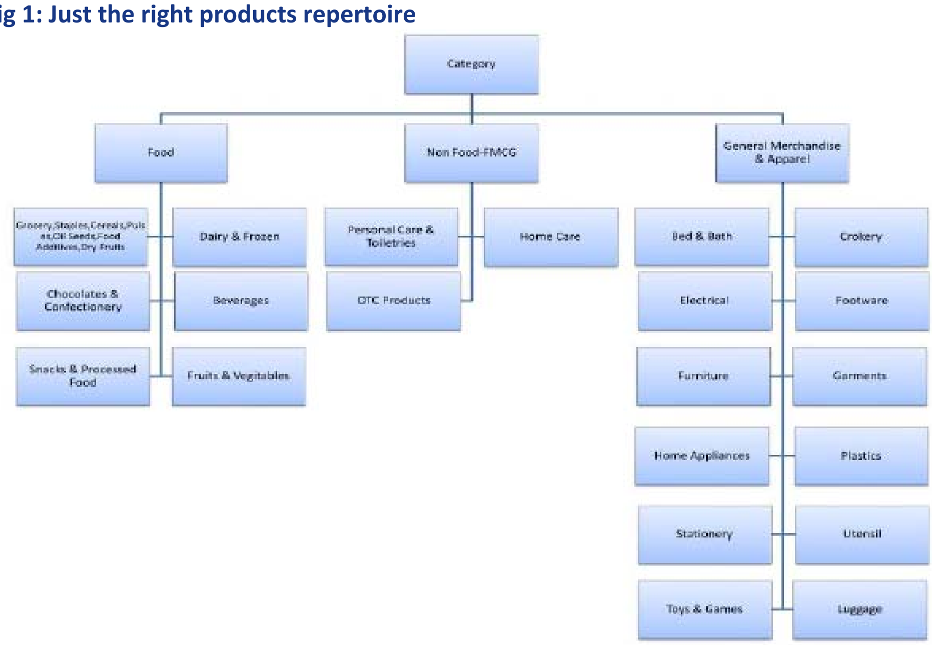


Source: Company, Edelweiss research

e. **Right product mix, assorted offerings and higher inventory turn**

Food retailing is all about format and execution. In our view, D'mart has zeroed in on the right model/format wherein: 1) D'mart's varied products are targeted at the lower-middle, middle and aspiring upper-middle class customers; 2) D'mart endeavours to provide its customers value for money when they shop at D'mart. Hence, the products are at perfect price points; 3) Its assorted products are primarily from the foods, non-foods (FMCG) and general merchandise & apparel product categories; and 4) Majority of its products cater to basic needs of customers rather than being discretionary spends. This helps improve inventory turn. D'mart has maintained this strategy, rectified errors in the process, improved its offerings and services and thereby achieve siginificant operating efficiencies.

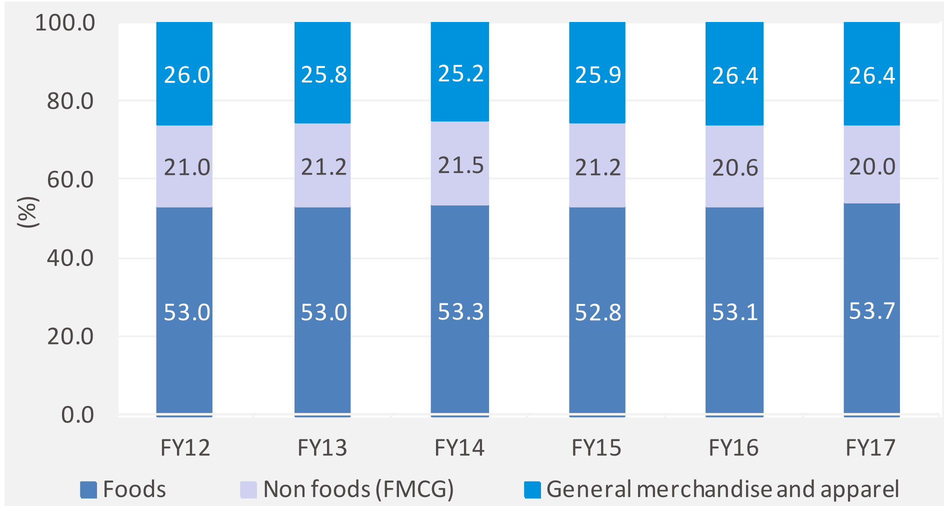
Fig 1: Just the right products repertoire



Source: Company, Edelweiss research

Its sound business model has enabled D'mart embark on a steady trajectory which is amply reflected in its revenue mix generated from foods, non-foods and others categories, which has remained almost the same in past >5 years.

Chart 3: Revenue mix across categories

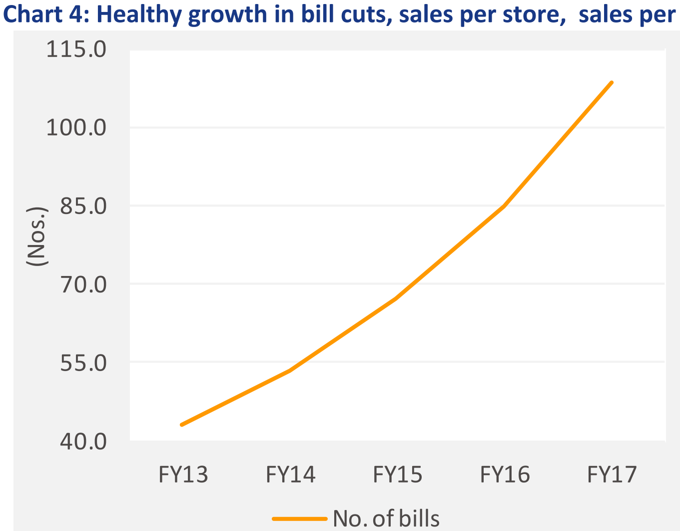


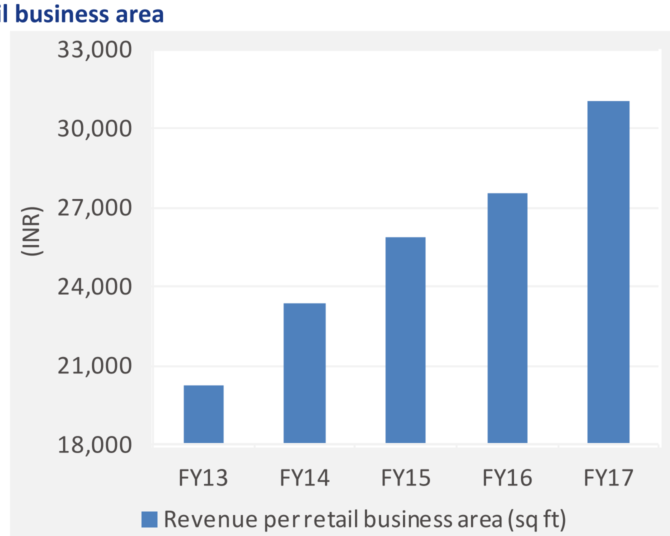
Source: Company, Edelweiss research

f. Same format stores attracting higher footfalls

D'mart has maintained same format across its stores so that customers enjoy the same comfort and feel in shopping at any of its stores. Since for a customer, apart from the shopping it is the experience which matters and hence having the same format gives much comfort to the customer while visiting not his routine D'mart store but any other store at other area. Steady format and product assortment has seen D'mart log steady ~26% CAGR in number of bills and ~11% CAGR in revenue per retail business area (sq ft) over FY13-17– this was inspite of D'mart adding ~2.6mn retail sq ft during the period.

Chart 4: Healthy growth in bill cuts, sales per store, sales per retail business area





Source: Company, Edelweiss research

Table 3: Robust sales per sq ft

Retailer	Sales per sq ft (INR) - 2012	Sales per sq ft (INR) - 2016
Hypermarkets		
Reliance Mart	5,000 - 6,000	8,500 - 9,500
Star Bazaar	6,500 - 7,500	11,000 - 13,000
Big Bazaar	5,500 - 6,500	9,500 - 10,500
Spencers Hypermarkets	6,000 - 7,000	16,000 - 17,000
More	4,500 - 5,500	8,500 - 9,500
Hypercity	5,000 - 6,000	7,000 - 8,000
Supermarkets		
D'mart	12,000 - 12,500	28,000 - 30,000
Reliance Fresh	9,000 - 10,000	17,500 - 18,500
Food Bazaar	7,500 - 8,500	15,000 - 15,500
Spencers Supermarkets	7,000 - 8,000	17,500 - 18,500
More	5,000 - 6,000	8,000 - 9,000
EasyDay	7,500 - 8,500	15,000 - 16,000
Regional Players	8,500 - 9,500	17,000 - 17,500

Source: Company, Edelweiss research

D’mart has been able to achieve strong no. of bills and sale per sq ft partially on the back of product mix compared to peers – higher the foods proportion better the sales per sq ft. Of course, gross margins may not be as superior as compared to general merchandise and apparel but with improvising throughput, the gross margins tends to improve.

Table 4: Product mix - D’mart versus other retailers (as at FY17)

Particulars	D'mart	FRL	Spencer's	Reliance Retail
Foods	53.7	38.0	81.0	32.0
Non foods (FMCG)	20.0	15.0	15.0	NA
General merchandise and apparel	26.4	47.0	4.0	15.0
Others	NA	NA	NA	53.0

Source: Company, Edelweiss research

g. Minimal out-of-stock occurences; customised regional offerings

Minimal product shortages and limited out-of-stock occurenceshas ensured growth sustenance. Relatively, D’mart has adopted the model that CostCo has been using globally, viz., keep limited stock but have them in bulk, unlike Walmart where there is something for everyonebut there are possibilities of stock out. D’mart also focuses on customising its product assortment in each store keeping in mind local demands and preferences. This has been achieved as D’mart follows cluster based store expansion, has strong back-end distribution and packing centres and robust IT system, among others.

h. Margin accretive private labels, a natural progression

D’mart has started selling its own private labels not only in foods and staples segments but also in other products such as kitenware, etc, akin to other large retailers. D’mart buys these products in bulk, packages and then sells them under its own brand post the madatory quality inspections and checks. For a retailer, it’s a natural progression since private labels are margin accretive. Having said that, D'mart will be limiting the segments in which it offers private labels. This, especially since private labels will take up shelf space which would otherwise be available for other moving items and if the inhouse products do not move it will impact inventory days and thus SSSG. Private label sales currently contribute small proportion and we are not building any margin expansion on the back of increasing share of private label in overall sales mix.

B. Prudent store expansion strategy

For any of store opening, D'mart either: (i) Purchases the land and constructs the store; or (ii) takes land on long term lease (>30 years) and construct the store. In the rarest of situations where either of the above is not possible, D'mart will take space on rent in a mall. As per our proprietary model, payback period for D'mart in an owned model is ~3 years, excluding notional interest cost.

For D'mart, though it works on ownership model, we do not expect store expansion to slow down drastically, only that the pace seen till FY17 may not sustain.

Even on EBITDAR basis, D'mart is clearly ahead with 8.5% EBITDAR margins versus 4.0-6.6% of competitors, except for Future Retail whose EBITDAR margin is at 11.4%.

D'mart's strategic cluster-based approach for store expansion seeks to leverage its backend distribution centres in the states where it has deeper penetration and potential.

With ~68% of stores solely located in Maharashtra and Gujarat, D'mart has the rest of India to explore and further fuel its expansion spree.

a. Own stores – Maximum payback period of 4 years

It is D'mart's strategy to build its own stores rather than taking space on lease, as commonly prevalent among other retailers. For any of its store opening, D'mart follows either of the strategies: (i) purchasing the land and constructing the store; or (ii) taking the land on long term lease (>30 years) and constructing the store. In the rarest of situations where either of the above is not possible, D'mart takes the store space on lease in a mall. This strategy is not new to retail industry – majority of Walmart stores are also owned.

Purchasing land and constructing stores entails huge initial cash outflow. But as per our proprietary model, payback period for D'mart is ~3 years, excluding notional interest cost. Even if notional interest cost on capital employed is factored in, payback period would still be under 4 years. Thus, by the time a store matures, capex is recovered and the flow EBITDA to PAT increases.

Table 5: Payback period - Self-owned versus leased stores

INR mn	FY15	FY16	FY17
No. of stores (Nos.)	89	110	131
New stores opened (Nos.)	14	21	21
Retail business area (mn sq ft)	2.7	3.3	4.1
Gross Block (INRmn)	15,281	21,918	27,764
Gross Block per store (INRmn) (i)	172	199	212
Revenue	64,394	85,838	118,977
Rental cost saving - assumed at 8% of sales	5,152	6,867	9,518
Rent cost saving per store (ii)	58	62	73
Payback period to cover rental (Yrs) (iii) = (i) / (ii)	**3.0**	**3.2**	**2.9**

Source: Company, Edelweiss research

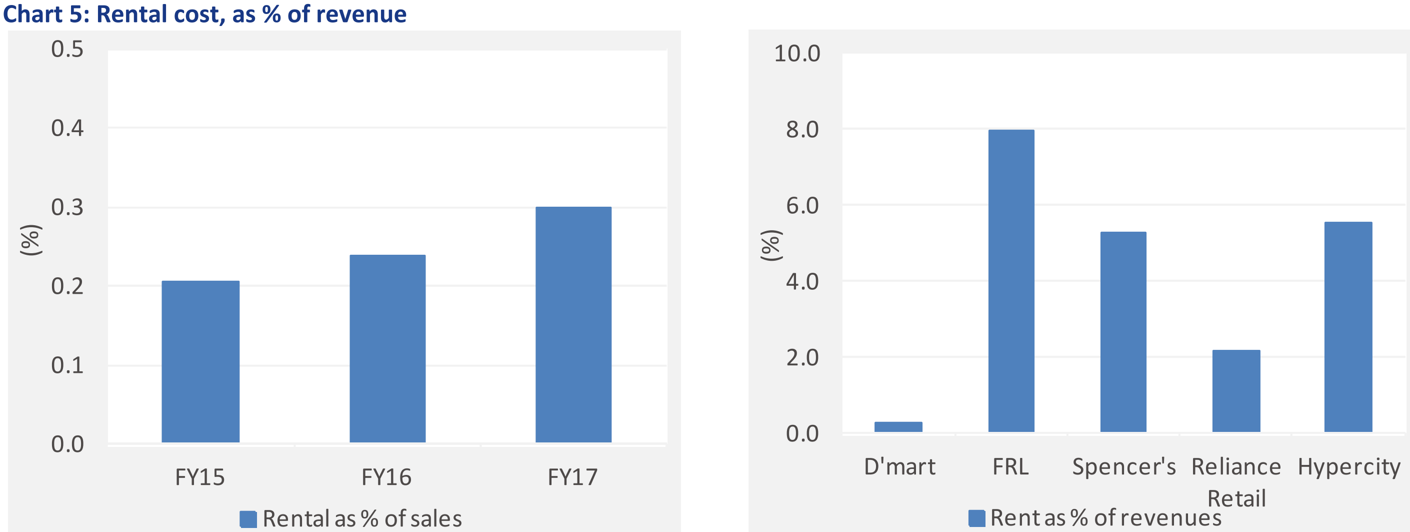
b. **Is scalability an issue for self-owned stores?**

Walmart has majority of self-owned stores and has yet reached ~12,000 stores globally and >5,000 stores in USA. Likewise, for D'mart too we do not see a situation where store expansion will slow down drastically. **Having said that, pace of store expansion seen till FY17 may not sustain.**

Since D'mart has adopted the ownership model, it ensures that before land is acquired the required planning and surveyis completed to gauge: 1) population density; 2)customer and vehicular traffic; 3) customer accessibility; 4) potential growth of local population and economy, area development potential, proximity; and 5) performance of competitors, among others. This ensures,to a large extent,high probability of the stores achieving healthy SSSG and targeted return on invested capital within the specified time period.

Thus, while this strategy may see calibrated store expansion, it gives comfort with regards to the stores achieving the desired returns in terms of SSSG growth. Also, with majority of the storesbeing self owned, rental cost is barely 0.3% of revenue versus 2-8% for competition.

Chart 5: Rental cost, as % of revenue



Source: Company, Edelweiss research

c. **Better profitability ratios not backed by lack of rental cost**

It is commonly assumed that since D'mart has limited stores, it has been able to adopt the ownership model resulting in comparatively better operating ratios. To debunk this belief, we analysed margin performance of retailers on EBITDAR (EBITDA before rent) i.e. eliminated the differences resulting from rent cost. **Even on EBITDAR basis, D'mart is clearly ahead with 8.5% EBITDAR margins versus 4.0-6.6% of competitors, except for FRL whose EBITDAR margin at 11.4% is superior to D'mart's.**

Table 6: EBITDAR margins across retail players

FY17 (INRmn)	D'mart	FRL	Spencer's	Reliance Retail	Hypercity
EBITDA	9,812	5,813	(171)	11,632	(181)
EBITDA margin (%)	*8.2*	*3.4*	*(0.8)*	*4.4*	*(1.5)*
EBITDAR	10,167	19,408	892	17,437	470
EBITDAR margin (%)	*8.5*	*11.4*	*4.4*	*6.6*	*4.0*

Source: Company, Edelweiss research

d. Cluster based approach

D'mart's strategic cluster-based approach for store expansion seeks to leverage its backend distribution centres in the states where it has deeper penetration and potential. Accordingly, D'mart opens stores on first mover advantage and adjacencies i.e. a new store is opened within few kms of existing outlets and distribution centres.

Various aspects are borne in mind when opening new stores, such as, population density, customer traffic and vehicular traffic, customer accessibility, potential of the population and economy, estimated spending power, future development trends, payback period, proximity and performance of competitors, etc. D'mart has also largely kept the layout and design same across stores to maintain the predicatability factor for customers whenever they enter any of the D'mart stores.

So, how do these cluster stores help? Presence of cluster stores within a particular region allows D'mart to have better understanding of local needs and preferences based on which the store offerings arecustomised. Furthermore, these cluster stores have led to: 1) higher penetration; 2) better cost efficiencies due to economies of scale derived from it's supply chain; 3) better inventory management; and 4) concentrated brand visibility due to focused implementation of marketing and advertising initiatives.

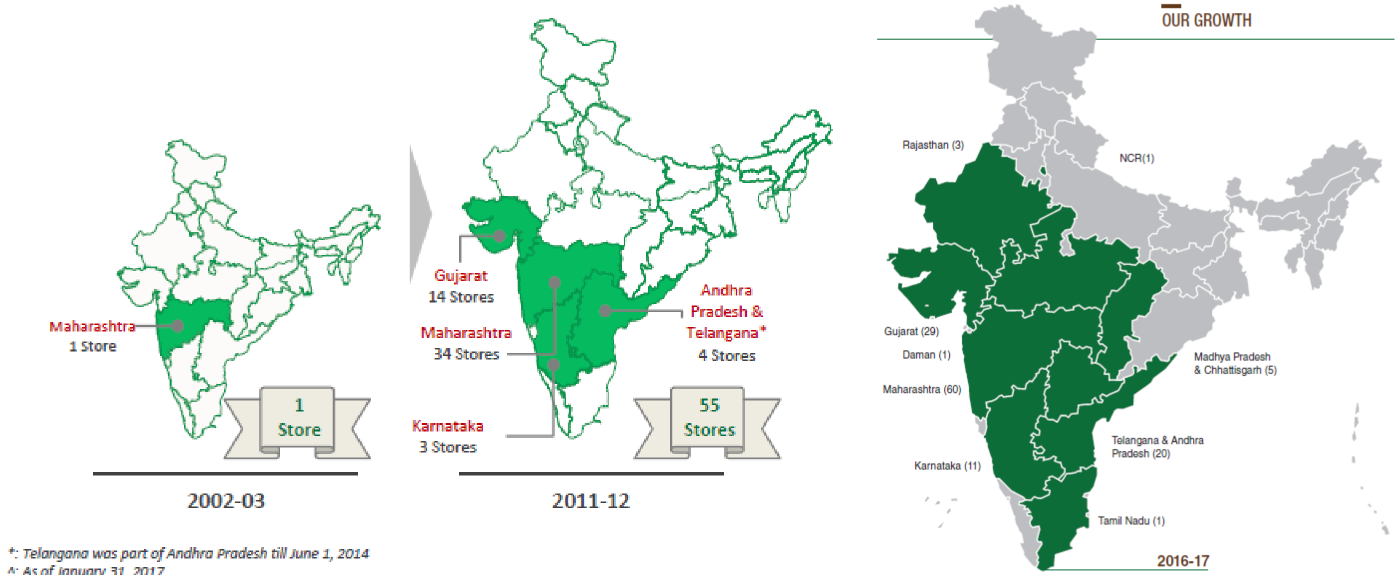
State-wise break-down of the number of stores amply reflects the cluster based approach adopted by D'mart – of the 131 stores as at FY17, 45% are in Maharashtra and 22% in Gujarat.

Table 7: Gradual store expansion with heavy penetration in promising states

States	Store presence (Nos.)					
	FY12	FY13	FY14	FY15	FY16	FY17
Maharashtra	34	40	46	50	58	60
Gujarat	14	14	17	22	26	29
Telangana & AP	4	5	7	10	16	20
Karnataka	3	3	5	5	6	11
MP & Chattisgarh				2	4	5
Rajasthan						3
Tamil Nadu						1
Daman						1
NCR						1
Total	**55**	**62**	**75**	**89**	**110**	**131**

Source: Company, Edelweiss research

Fig 2: Gradual store expansion highlights the scientific approach



Source: Company, Edelweiss research

The above chart clearly showcases D'mart's cluster-based expansion strategy.

A major cost for retailers are their back-end distribution and packing centres which also support the supply chain of their retail stores' network. Here D'mart's cluster expansion is quite ideal as its stores are supported by the right mix of supplies from the distribution centres or through direct procurement from suppliers. **As at FY17, D'mart had 23 distribution centres and 5 packing centres in Maharashtra, Gujarat, Telangana and Karnataka**. Such proximity of distribution and packing centres to itsretail store network offers following benefits:

- Reduces costs and time due to centralised procurement of certain products;
- Improvescontrol on inventory with lesser stockshortages in stores due to use of stock replenishment systems;
- Improves margins due to efficienct supply chain management; and
- Streamlines and consolidates administrative functions and logistics procedures.

e. Huge untapped store expansion opportunities

With ~68% of stores solely located in Maharashtra and Gujarat, D'mart has the rest of India to explore and further fuel its expansion spree(not present in >20 states and UT's). Notably, in existing geographies D'mart has concentrated presence.

We believe D'mart's expansion strategy will further strengthen its market position with the opening of new stores within existing clusters. Thus, newer stores will be opened in existing geographies of Maharashtra and Gujarat – which will further enhance D'mart's prominence and leadership in these states, as well as deepen penetration in Andhra Pradesh, Telangana, Madhya Pradesh, Karnataka and Chattisgarh. New stores in existing clusters will also enable D'mart to further optimally utilise its distribution centres.

Opening stores in newer geographies will not be a challengeas: 1) D'mart already has a strong franchisee, which should make it relatively easier to enter new geographies; 2) Its brand equity is such that it is almost a fad with customers to shop at D'mart. This customer loyalty will help D'mart record strong SSSG in newer geographies too. However, cluster based expansion methodolgy will slower the store expansion in newer geographies.

Funding the store expansion will not be a financial strain for D'mart as*:* 1) D'mart is flush with capital post its IPO wherein it raised INR18.7bn; 2) As at FY17, the company had enough headroom to raise debt, if required considering their net debt/equity ratio is at negative 0.2x. Even after factoring in addition of 20/25/25 stores in FY18/19/20, net debt/equity ratio remains at **negative 0.2x** on robust free cash flows that it can generate.

C. D'mart Ready beckons e-savvy patrons

With online shopping becoming the buzz word, D'mart too has rolled out its online platform. D'mart holds 49.2% stake in its online venture with the balance stake directly held by the promoters. This holding pattern seeks to prevent D'mart from incurring losses that Avenue E-commerce will initially report.

D'mart is seized of the fact that online comes with a baggage of logistics costs. To counter this, the company doesn't offer free home deliveries. Customers have the option of paid home delivery or to collect goods from nearby D'mart Ready Stores.

a. Riding the e-commerce band wagon

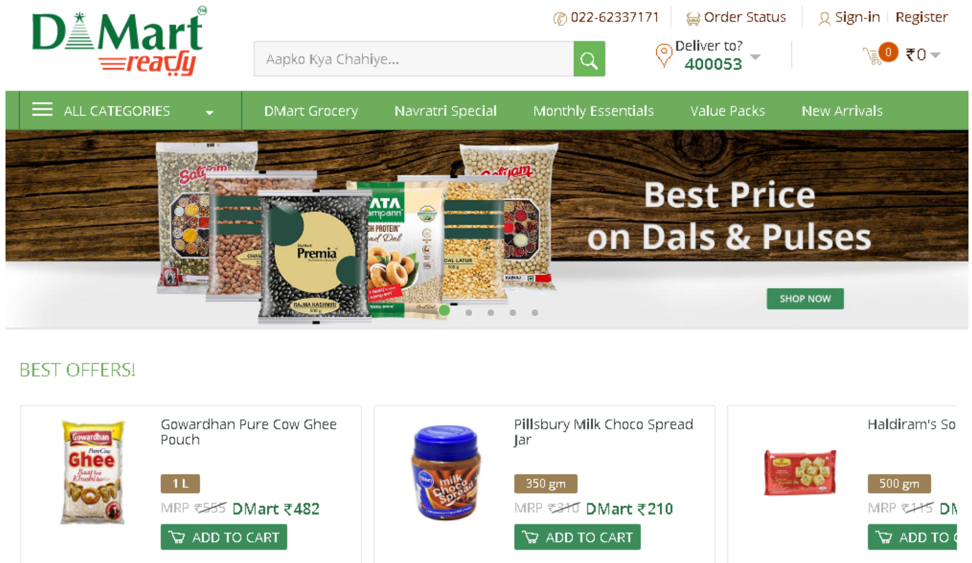
E-commerce is the current buzzword in retail. But, there's fierce competiton amongst the online players particularly in white goods and fashion segments, though lower in grocery segment. To elucidate why there is lower competition in online foods and grocery segment, India's largest retailer by revenue, Future Retail is not present online. However, there are other domestic and global players who have entered this space such as Big Basket, Grofers, Reliance Fresh and Amazon Pantry. To ensure that D'mart does not miss the online bus, Avenue E-commerce was incorporated, which is solely engaged in e-commerce. Currently, D'mart holds 49.2% stake in its online venture with balance stake directly held by the promoters. This holding pattern seeks to prevent D'mart from incurring the initial losses in its e-commerce venture, a prudent move to keep D'mart's core earnings potential intact. Till date, D'mart has invested INR345.2mn in this new venture.

b. High on patron expectations

To counter the tough competition from Amazon, Bigbasket, etc., D'mart has also set up its e-commerce portal. This has made the shopping much more convenient for its patrons, particularly so as they don't have to visit the store. **What's favourable for D'mart is that it doesn't offer free home delivery. Instead, it offers 2 options, either to opt for paid home delivery or customers can drop by the newly opened D'mart Ready Stores (which receives customer orders from mother stores) to take delivery of their products.**

The focus is on having D'mart Ready Stores in all neighbourhood areas. Till date, D'mart has opened >40 D'mart Ready Stores in Mumbai and management has called out that initial traction has met expectations.

Fig. 3: D'mart Ready Portal



Source: Company, Edelweiss research

D. Culminating into an enviable financial performance

D'mart's core MOAT has translated not only into strong revenue growth, but also robust profitability and return ratios.

During FY12-17, D'mart sustained consistent SSSG above the 20% print. This, coupled with strong store (76 stores added) and retail space (2.55mn sq ft) additions translated into 40% revenue CAGR over the mentioned period.

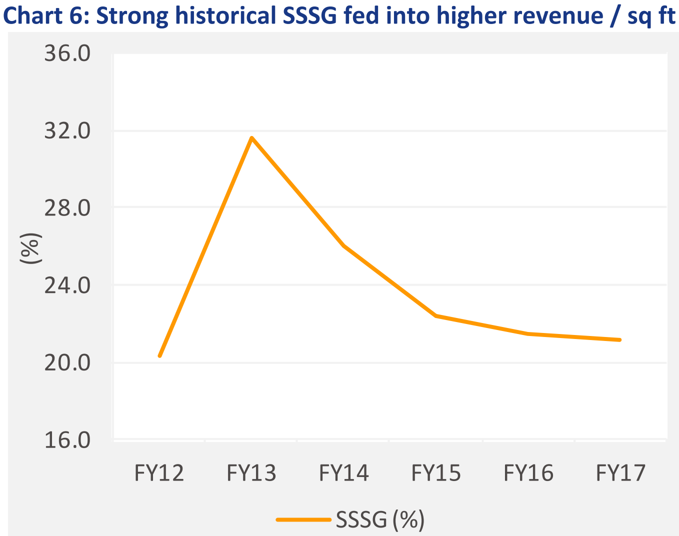
The company's competitive prices are derived from right product assortment, lower payable days, right location size and cluster-based store expansion, among others. Consequently, a strong SSSG helped D'mart expand gross/EBITDA margins from 14.5%/6.4% in FY13 to 15.3%/8.2% in FY17.

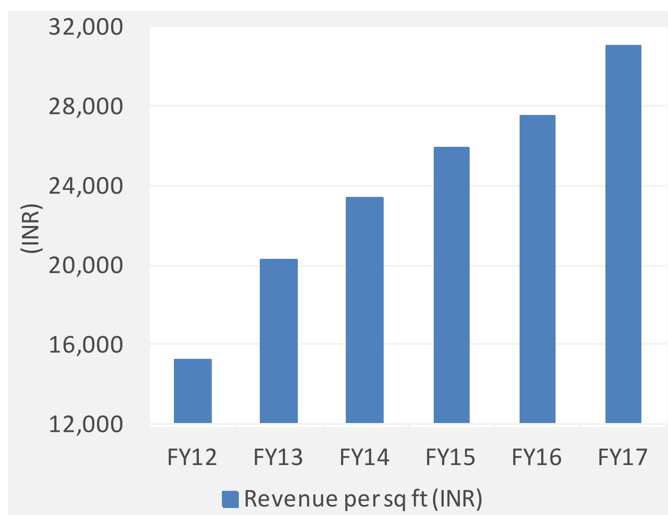
Commendably, D'mart has not only been sustaining best-in-class EBITDA and PAT margins, but superior return ratios too. Even post the fund raising of INR18.7bn, the company's RoE stood at 17.9% for FY17 (versus 23.6% in FY16).

(i) Strong SSSG, revenue trajectory

For D'mart, its core MOAT has seamlessly translated not only into strong revenue growth, but robust profitability and return ratios too. Historically, SSSG stood consistently above the 20% print (FY12-17). Notably, such impressive SSSG was achieved in spite of rising competitive intensity – *D'mart calculates SSSG for the stores that have been in operation for more than 24 months*. This, coupled with strong store addition (76 stores added) and retail space addition (2.55mn sq ft) translated into **40% revenue CAGR over the mentioned period**.

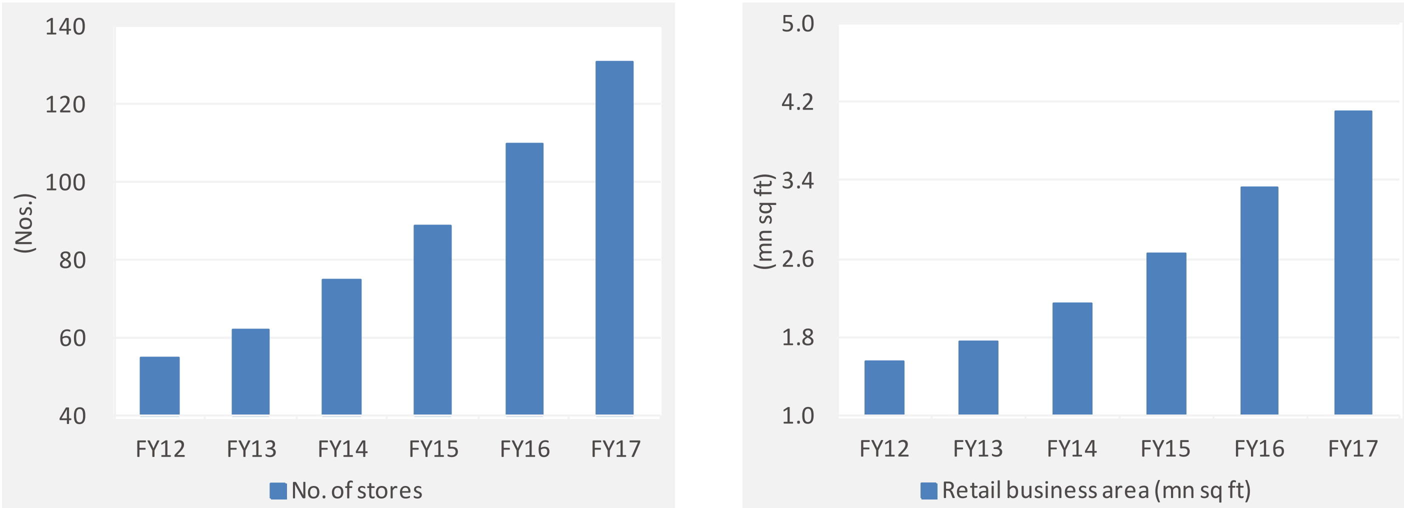
Chart 6: Strong historical SSSG fed into higher revenue / sq ft





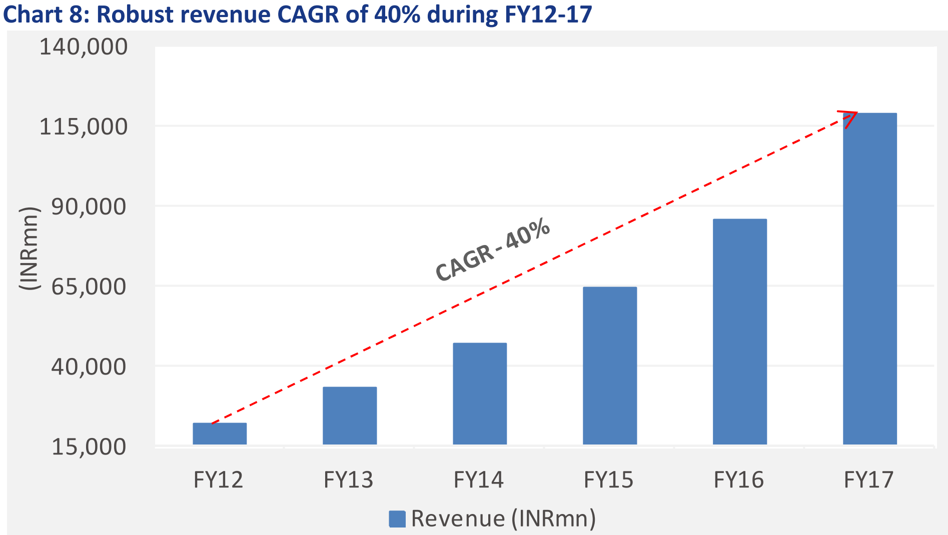
Source: Company, Edelweiss research

Chart 7: On strong footing in terms of store expansion



Source: Company, Edelweiss research

Chart 8: Robust revenue CAGR of 40% during FY12-17



Source: Company, Edelweiss research

(ii) Margins on upper trajectory

The EDLP model is D'mart's underlying strength. the platform has ensured higher throughput per store along with higher inventory turnover. As mentioned earlier, the company offers competitive prices drawing on its right product assortment, lower payable days, right location size and cluster-based store expansion, among others.

D'mart also exudes discipline in its payable days – historically at 8-10 days. This has helped the company gain better rates from the manufacturers. From our interactions with the large staple companies we understand that these companies are more than happy to offer differentiated rates to D'mart as they are assured of receiving their payment within 8-10 days. This apart, in view of D'mart's strong and stable relationships with the staple companies, the latter are more than willing to extend a promotional activity specifically dedicated for D'mart.

Almost nil rental cost is another catalyst that drives D'mart's margins. Bagging the best deals from manufacturers as well as savings in rental cost have aided D'mart pass on the best rates to its patrons.

D'mart's gross/EBITDA margins have improved from 14.5%/6.4% in FY13 to 15.3%/8.2% in FY17.

Chart 9: Rising gross/EBITDA margins

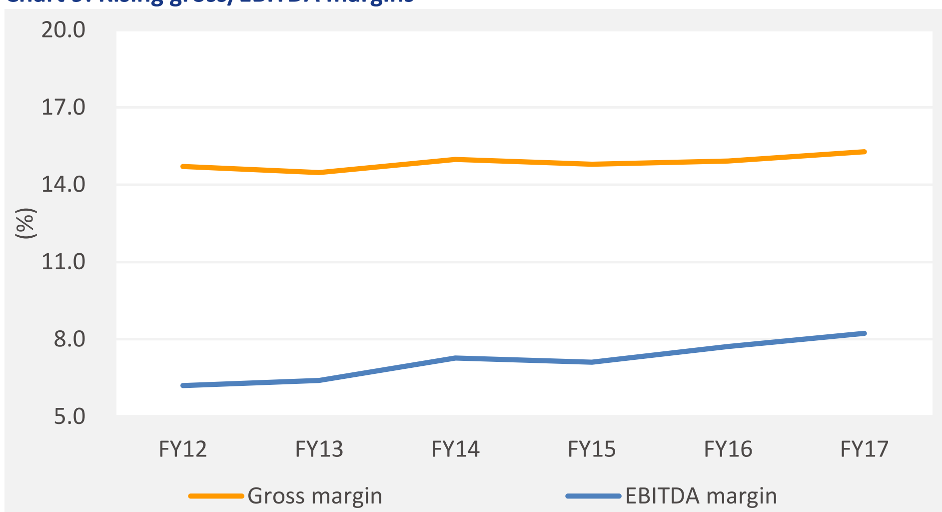
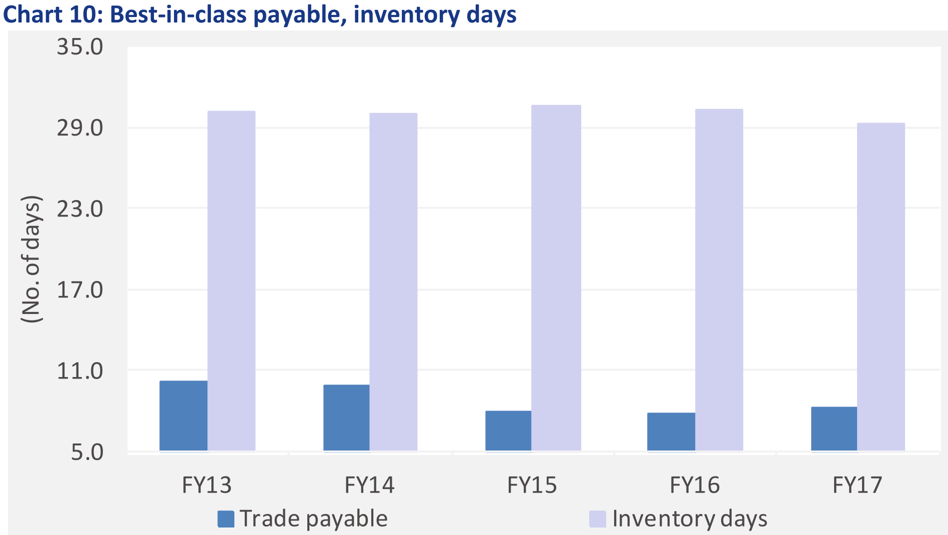


Chart 10: Best-in-class payable, inventory days

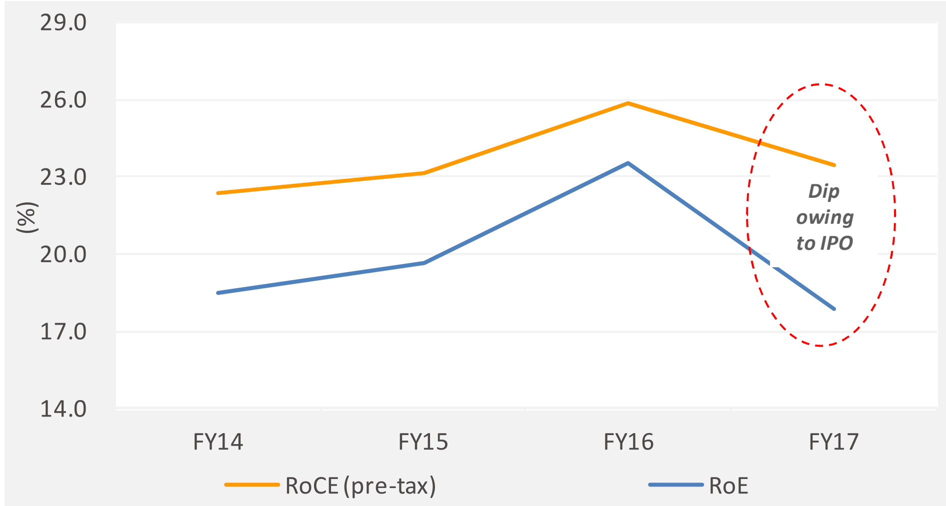


Source: Company, Edelweiss research

(iii) Eventually, translating into best-in-class return ratios

In retail, where on one hand peers have been facing a challenge making profit, D'mart has been sustaining best-in-class EBITDA and PAT margins as well as superior return ratios. **Even post fund raising of INR18.7bn, D'mart's FY17 RoE stood at 17.9%. (versus 23.6% in FY16)**.

Chart 11: Stellar return ratios



Source: Company, Edelweiss research

Outlook and Valuation

Over FY13-17, D'mart clocked balance sheet growth of 41.3% CAGR (27.6% during FY13-16, excluding funds raised in IPO). As against this balance sheet growth, revenues, EBITDA and PAT grew by 37.4%, 46.2% and 50.3% over the said period. This amply reflects in RoE expansion from 18.5% in FY14 to 23.6% in FY16 (RoE for FY17 was 17.9% owing to fund raising).

Going forward, we expect sales, EBITDA and PAT CAGR of 28.1%/32.1%/41.4% over FY17-20. We believe there are few concept stocks which have traded at premium valuations and will continue to trade at those rich valuations because there is immense MOAT, management pedigree and earnings visibility for these stocks. Though we believe D'mart falls within this category of concept stocks, considering it has run up >2.5x in less than 1 year, it offers limited upside at CMP. We initiate coverage with 'HOLD/SU' and a TP of INR1,290.

Enviable return ratios - D'mart, one of the few retailers in India with **enviable return ratios**, has sustained robust SSSG (>20%) in past few years. In our view, this strong momentum in SSSG will extend over next 2-3 years as well led by changing consumer shopping habits (as mentioned in industry section), consolidation of distribution network (wholesale is consolidating), increased penetration in territories where opportunities are immense and favourable macros.

Margins to sustain its uptrend, but at a reduced pace - we expect D'mart to: 1) remain beneficiary of favourable rates from FMCG companies considering creditors' payable days are a mere 8-10 days; 2) reap leverage benefits once the new stores reach vintage stage; 3) control inventory turnover ratio; and 4) sustain favourable assortment, among others.

Balance sheet: moving from strength to strength - D'mart grew its balance sheet by 27.6% CAGR during FY13-16 (excluding the IPO proceeds of INR18.7bn garnered in FY17) as against revenue/PAT CAGR of 36.9%/50.5% during the mentioned period. This highlights the company's fine asset turnover and prudent capital allocation policies. Going forward, we expect revenue/EBITDA/PAT to grow at 28.1%/32.1%/41.4% CAGR over FY17-20. This would still be far superior than balance sheet CAGR of ~13% over the period. Ergo, D'mart is well poised to sustain strong RoE – we expect RoE to improve from 17.9% in FY17 to 21.4% in FY20.

D'mart is one of the few retailers to have successfully cracked the retail model, and with note-worthy financials. Meanwhile, other retailers have either been grappling with losses (as they continue to struggle to get the model right, be it product assortment, brand assortment, etc) or trying out various models in their pursuit to zero in on the model that best suits them. **D'mart's caliberated branch expansion plan has clearly paid off, as is reflected in its financial parameters or return profile.**

Arguing why 35x EV/EBITDA

"Most of the growth stocks seldom trade at low multiples. In fact, it only makes sense that faster growing companies sell at higher multiples than slower growing companies. The really exciting, fast growing companies with big potential are not going to be found in the bargain

bin. Like people say, you don't find top-notch merchandise at a dollar store. As a matter of fact, the really great companies are almost always going to appear expensive". This is anapt quote from the book,' Trade like Market Wizards'.

(a) **Comparatively better placed across operating parameters:** We believe D'mart is better placed than its peers on almost all operating parameters and deserves to command premium valuation. Also, D-mart has consistently stuck to its business strategy since inception, a rare feat in industry.

(b) **Deserves premium valuation:** We would like to highlight Walmart's valuation 15-18 years back when its SSSG was at high single to low double digits. Then, the stock traded at 28x 12-months trailing EV/EBITDA, while peer CostCo traded at ~16x 12-months trailing EV/EBITDA. Thus, Walmart traded at high (~75% premium) over CostCo. Drawing strong parallels between D'mart and Walmart, we expect D'mart also to trade at a premium versus peers.

(c) **Concept stocks:** Historically, the Indian markets have had few concept stocks which continue to trade at premium valuation on almost all parameters – examples are Bajaj Finance, Gruh Finance, Eicher Motors, etc.

We believe D'mart is a perfect concept stock which will continue to fetch premium valuations. But, juxtaposing it with **Warren Buffet's admonition, an investor should understand that *"Price is what you pay, value is what you get"*. Thus, inspite of factoring in revenue, EBITDA and PAT CAGR of 28.1%/32.1%/41.4% over FY17-20E, we initate with a 'HOLD/SU' and TP of INR1,290 (35x EV/EBITDA multiple) since at CMP stock seems to be fairly valued.**

Key Risks

Sustaining of EDLP program

D'mart effectively runs its business on EDLP model, which has prevailed in part due to strong supplier and vendor relationships and pricing strategies. The risk here is if the company is unable to source products at favourable rates, its ability to offer products at low prices on daily basis will be compromised. This may result in either margins not sustaining or the company increasing its product prices, which may lead to shift of customers' loyalty to other retailers.

Purchase of real estate or entering long-term lease arrangements

Another MOAT for D'mart is the potential to identify and add stores at strategic locations by either buying the real estate or taking it on long term lease. This arrangement entails huge initial cash outflow, which may involve taking higher debt. In the scenario where new stores fail to pick up as anticipated, then incremental debt taken for same would need to be serviced from cash flows of other stores, which could impact overall profitability of business.

Revenue concentration in Western India (Maharashtra and Gujarat)

Currently, D'mart has 68% of stores in the 2 states of Maharashtra and Gujarat. At present, GDP of both these 2 states is strong and expected to remain robust going ahead as well. However, if economic, political and demographic challenges arise in these geographies, revenue potential of the D'mart stores could take a beating. Also, the company is present in relatively more prosperous states leading to rising competitive intensity, which could in turn disrupt business operations.

Increasing competitive intensity from e-commerce companies

While D'mart has widespread presence, strong brand equity and customer loyalty in the geogrpahies where it is present, one cannot rule out customers shifting allegiance to other avenues of shopping, viz., e-commerce. Pertinently, e-commerce is high on convenience. Therefore, any future change in trends / shift in consumers' shopping patterns may hamper D'mart's revenue potential. To highlight here, recently D'mart has also forayed into e-commerce though it significantly lags in the curve. Additionally, existing e-commerce players either have recourse to easy funding (aided by big funds) or backed by global giants. Hence, for D'mart to sustainably counter such competition may not be an easy task.

Change in FDI norms

Currently, D'mart generates >50% of its revenues from food business. The government has already allowed foreign direct investment (FDI) in the food processing sector. Additionally, the government is also contemplating liberalising rules relating to multi-brand retail. This will open up foreign investment in a big way, which may pose a threat to existing retail players like D'mart and Future Retail, among others.

Company Description

D'mart is an emerging national supermarket chain with focus on value retailing. The company has been one of the largest and most profitable F&G retailers in India. It offers a wide range of products with focus on foods, non-foods (FMCG) and general merchandise & apparel product categories.

In 2002, D'mart opened its first store in Mumbai. As at March 2017, the company had 131 stores with retail business area of 4.1mn sq ft.

Table 8: Gradual store expansion with deep penetration in promising states

	Store presence					
(Nos.)	FY12	FY13	FY14	FY15	FY16	FY17
Maharashtra	34	40	46	50	58	60
Gujarat	14	14	17	22	26	29
Telangana & AP	4	5	7	10	16	20
Karnataka	3	3	5	5	6	11
MP & Chattisgarh				2	4	5
Rajasthan						3
Tamil Nadu						1
Daman						1
NCR						1
Total	**55**	**62**	**75**	**89**	**110**	**131**

Source: Company, Edelweiss research

Business Model

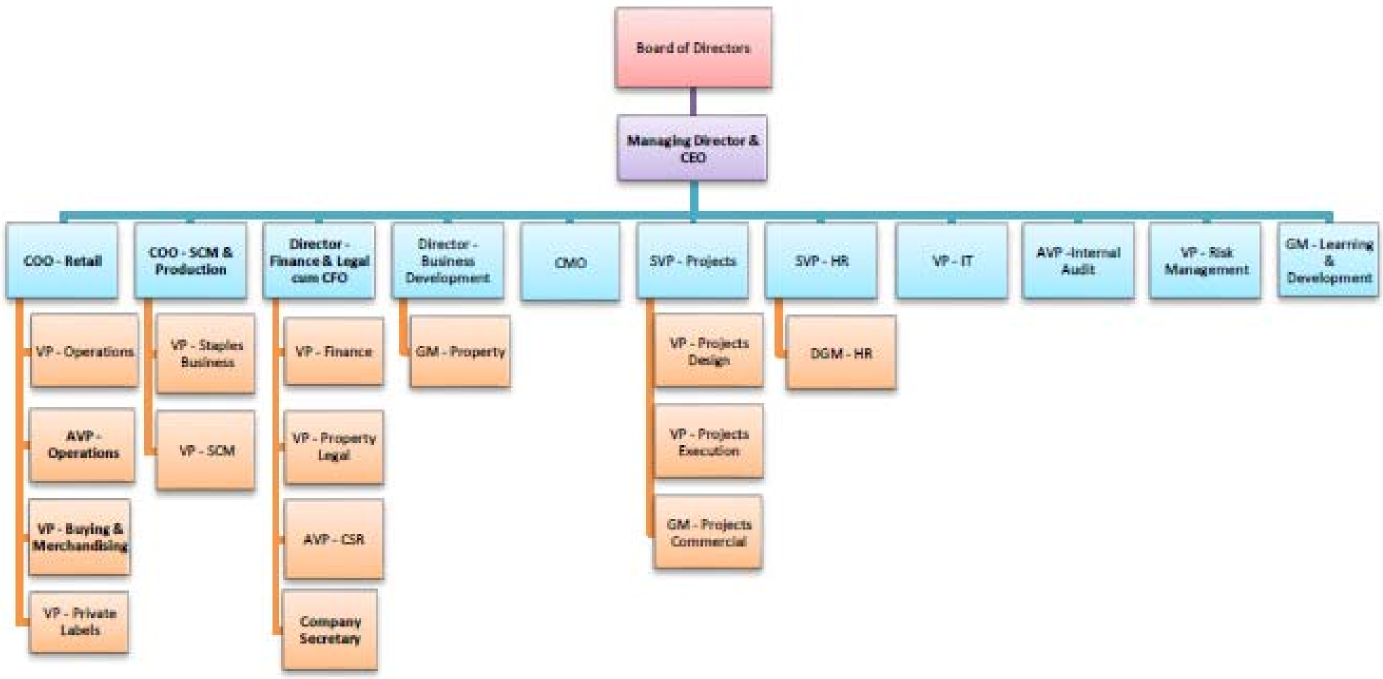
D'mart operates and manages all its stores. The company operates predominantly on ownership basis (including long-term lease arrangements, where lease period is of more than 30 years and the building is owned by D'mart) instead of rental model. It opens stores using cluster-based approach on the basis of adjacencies and focuses on efficient supply chain that targets densely-populated residential areas with a majority of lower-middle, middle and aspiring upper-middle class consumers. D'mart's distribution and packing centres form the backbone of its supply chain that supports its retail store network. As of FY17, D'mart had 22 distribution and 6 packing centres.

D'mart runs its business on the basic concept of retailing quality goods at competitive prices based on its EDLP model. The company majorly sells everyday products, which comprises basic rather than discretionary spending. D'mart's store offerings provide customers with a distinctive shopping experience, comprising a wide range of everyday value retail products sold via modern ambience and giving the feel of a large retail mall. The company endeavours to facilitate one-stop-shop convenience for its customers' everyday shopping needs, along with competitive pricing due to local market knowledge, careful product assortment and supply chain efficiencies.

While expanding its network, D'mart carefully chooses location of the new stores within its existing clusters and distribution centres. In the process of opening new stores, multiple factors are taken into account, including population density, customer traffic and vehicular traffic, customer accessibility, potential growth of local population and economy, area development potential and future development trends, estimated spending power of the population and local economy and payback period, estimated on the basis of expected sales potential, strategic benefits, proximity and performance of competitors and store site characteristics. The hallmark of D'mart stores is that the layout and design is consistent and predictable which makes shopping easier for its patrons.

Management Overview

Fig 4: Management structure



Source: Company, Edelweiss research

Mr. Ramesh Damani, Chairman: Mr. Damani holds a graduation degree in Commerce from H.R. College of Commerce, Economics from University of Bombay and also holds a post graduation degree in Business Administration, Marketing from California State University, Northridge. He has over 18 years of experience in securities market.

Mr. Ignatius Navil Noronha, Managing Director: Mr. Noronha joined the company on January 27, 2004 as Head - Operations. He was appointed CEO in 2007 and became MD & CEO in 2011. Mr. Noronha joined D'mart when it had only 3 operational stores. He has been involved in the formation and execution of the overall strategy encompassing the entire spectrum of retail business. His key responsibilities included building the team from its formative days and grooming them, instituting appropriate processes and technology and acquiring and setting up stores in new territories. He is also actively involved in guiding and directing leadership teams in developing, implementing and monitoring various processes, which are critical for seamless functioning and growth of the organisation. Mr Noronha is responsible for driving overall growth and vision of D'mart.

Mr. Ramakant Baheti, Chief Financial Officer: Mr. Baheti was appointed CFO of D'mart on May 1, 2014. He joined the company when it was incorporated and has been instrumental in giving shape to the promoter's vision, processes and overall business strategy. Currently, his functions include formulation and execution of finance and legal strategy including finance control, planning and accounting, identification and finalisation of store locations and due diligence of property.

Mr. Elvin Machado, Wholetime Director: Mr. Machado was appointed Wholetime Director on June 10, 2015. Since then he has been involved in regional store operations, which involves managing day-to-day operations and compliances. Currently, his functions include business development - property acquisition, due diligence, coordination and liasoning with government agencies and local bodies.

Mr. Udaya Bhaskar Yarlagadda, Chief Operating Officer, Retail: Mr. Yarlagadda holds a graduate degree in Mechanical Engineering from Regional Engineering College (REC), Rourkela, and a post graduate diploma in Management from Indian Institute of Management (IIM), Kolkatta. He has over 18 years of experience in sales and business development. Prior to joining D'mart, he worked with Procter & Gamble Hygiene and Health Care where he was director, customer business development. At present, his functions include managing and leading store operations, merchandising, private labels, marketing and store maintenance.

Mr. Narayanan Bhaskaran, Chief Operating Officer, Supply Chain Management and Production: Mr. Bhaskaran holds graduation degree in Commerce from University of Madras, post graduation in Human Resource Management from XLRI - Xavier School of Management, Jamshedpur and has completed an Advanced Programme in Supply Chain Management from Indian Institute of Management (IIM), Kolkatta. Mr Bhaskaran is an associate member of the Institute of Company Secretaries of India. He has over 22 years of experience in corporate secretarial functions, operations and human resource management. Prior to joining Dmart, he worked with TCL India Holdings and Birla SunLife Distribution Company. He joined as Vice President – HR and was involved inhuman resource management. At present, he is engaged in supply chain management, corporate legal functions and staples business.

Mr. Dheeraj Kampani, Vice President, Buying and Merchandising: Mr. Kampani holds a diploma in International Trade from Bhavan's Rajendra Prasad Institute of Communication and Management and post graduation degree in Business Management from Nagpur University. He has over 15 years of experience in sales and retail store management. Prior to joining D'mart, he worked with Hindustan Unilever and Great Wholesale Club. He joined as Regional Manager - Operations. From the regional positions previously held by him, he was given the responsibilty of heading the garment category. At present, he heads the buying and merchandising function of Dmart.

Mr. Hitesh Shah, Associate Vice President – Operations: Mr. Shah holds a graduate degree in commerce from Gujarat University. He has over 21 years of experience in sales, marketing and retail store management. Prior to joining D'mart, he worked with Hindustan Unilever. He joined D'mart as Regional Manager - Purchase and has been involved in merchandising of FMCG in Gujarat and subsequently, he shifted to operations at circle level. At present, his functions include day-to-day operational management of the stores and compliance.

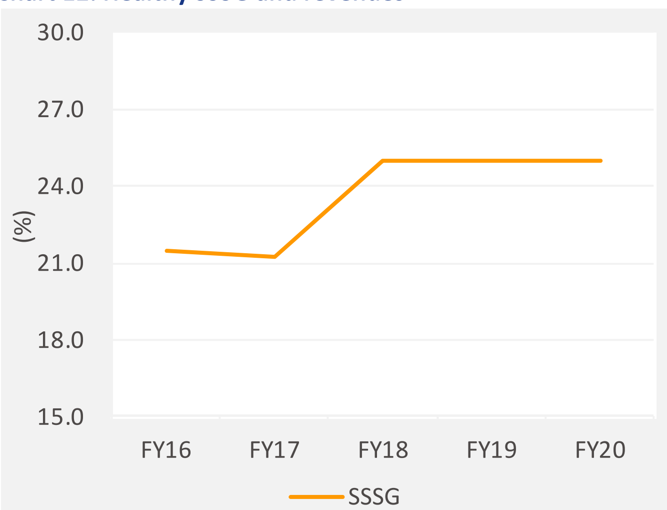
Ms. Ashu Gupta, Company Secretary: Ms Gupta holds a graduation degree in Business Administration from Guru Nanak Dev University, Amritsar. She is an associate member of the Institute of Company Secretaries of India. She has over 10 years of experience in corporate, legal and secretarial functions. Prior to joining D'mart, she worked with NAM Securities as a Company Secretary.

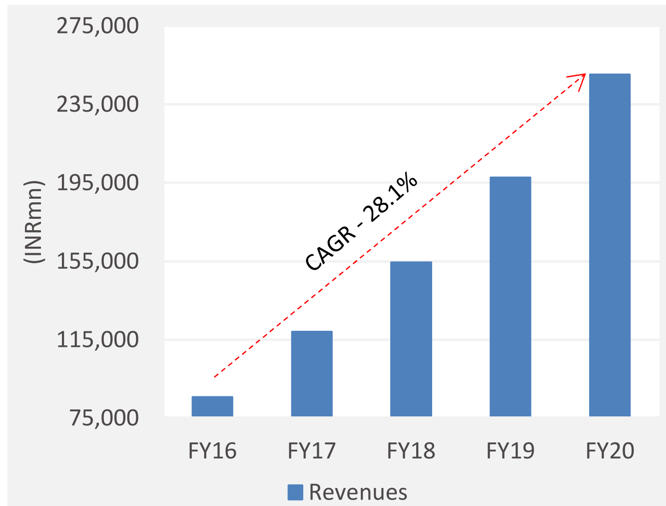
Financial Outlook

Strong SSSG translating into robust revenue trajectory

Historically, D'mart has sustained its strong SSSG in turn bolstering revenues. We forecast the company to record 25% SSSG each across FY18/19/20. We are confident of D'mart recording such strong SSSG primarily owing to vintage of >40 stores opened in past 2 years. After adding 21 stores each in FY16 and 17, we expect the company to add 20 stores in FY18 and 25 stores each in FY19 and FY20. Building in the above, we expect D'mart to clock revenue CAGR of 28.1% over FY17-20.

Chart 12: Healthy SSSG and revenues





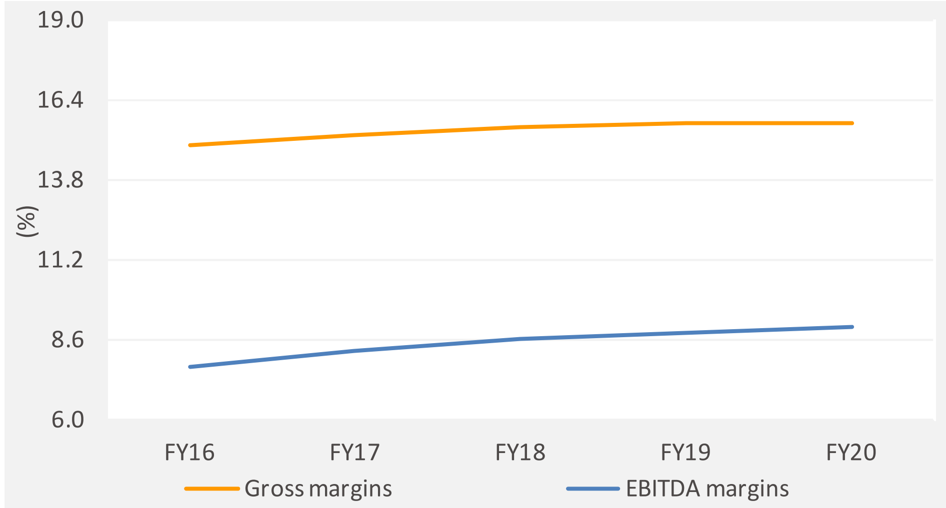
Source: Company, Edelweiss research

Expansion in margins to continue, albeit on reduced pace

Gross margin of F&G retailers is typically in higher single to low double digits. But, what's of utmost importance is their relationship with the vendors and strength of their throughput. Since D'mart's business model has remained unchanged since inception, it has been able to build efficiencies as well as nuture long-term relationships with vendors (by making payments in <10 days). This has helped it avail costing benefits, in turn improving its gross margins from 14.5% in FY13 to 15.3% in FY17. We are seized of the fact that further improvement in gross margins would be tough and have hence built in gross margin improvement to 15.6% at the top end by FY20 (15.3% in FY17), thus factoring in mere 20bps rise in gross margin. We believe gross margin could further improve if the proportion of private labels increases, which would then pose upside risk to our numbers.

We expect EBITDA margin to expand from 8.2% in FY17 to 9.0% in FY20 primarily led by operational efficiencies. We believe this is achievable with improvement in throughput of the ~40 stores opened in past 2 years. However, the scorching 180bps jump in EBITDA margin seen during FY13-17 to 8.2% from 6.4% may not be repeated over FY17-20 (expect EBITDA margins to expand 80bps over FY17-20). **Based on above estimates, we expect overall EBITDA to grow at 32.1% CAGR over FY17-20 (clocked 46.2% FY13-17).**

Chart 13: Gross, EBITDA margin trajectory to sustain uptrend

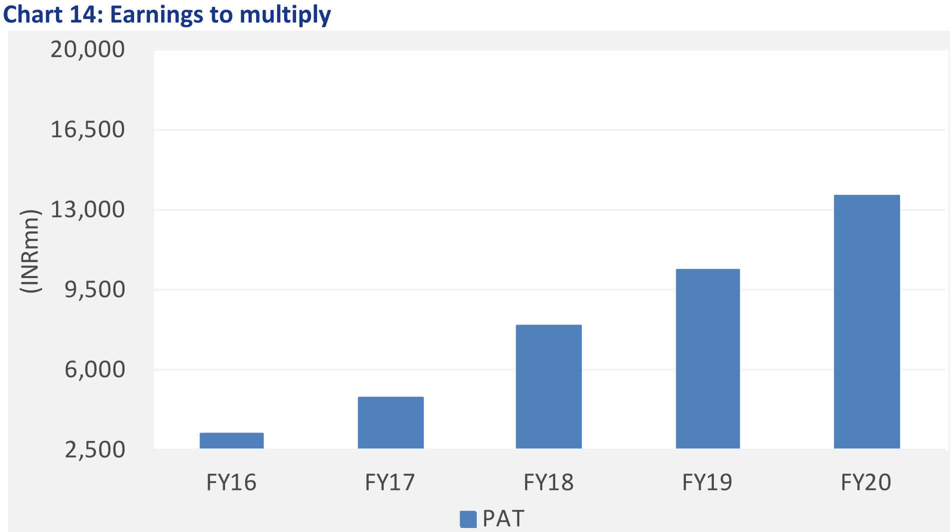


Source: Company, Edelweiss research

Strong earnings compounder

We observe that investors are constantly scouring for ideas which are earnings compounder. According to us D'mart is one such earnings compounding story. During FY13-17, the company clocked PAT CAGR of over >50% and we believe this compounding story is sustainable going forward as well. Our premise is earnings are not backed by inorganic acquisitions or one-time gains, but largely supported by business operations. Hence, we expect PAT to compound at ~41.4% CAGR over FY17-20.

Chart 14: Earnings to multiply

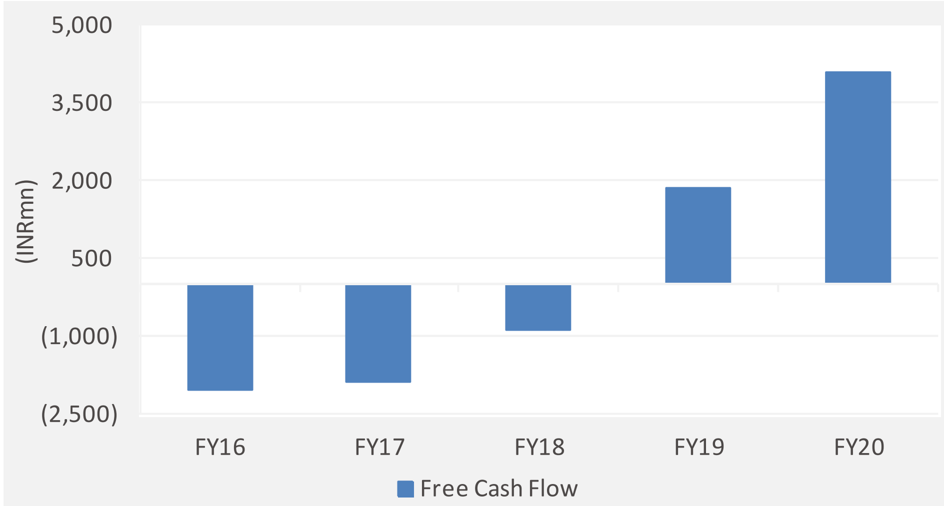


Source: Company, Edelweiss research

Free cash flow to turn positive

Till FY17, D'mart did not generate free cash flows. Going ahead however, we envisage the company to clock sustainable free cash flows, aided by its recent IPO proceeds and rationalisation of store expansion.

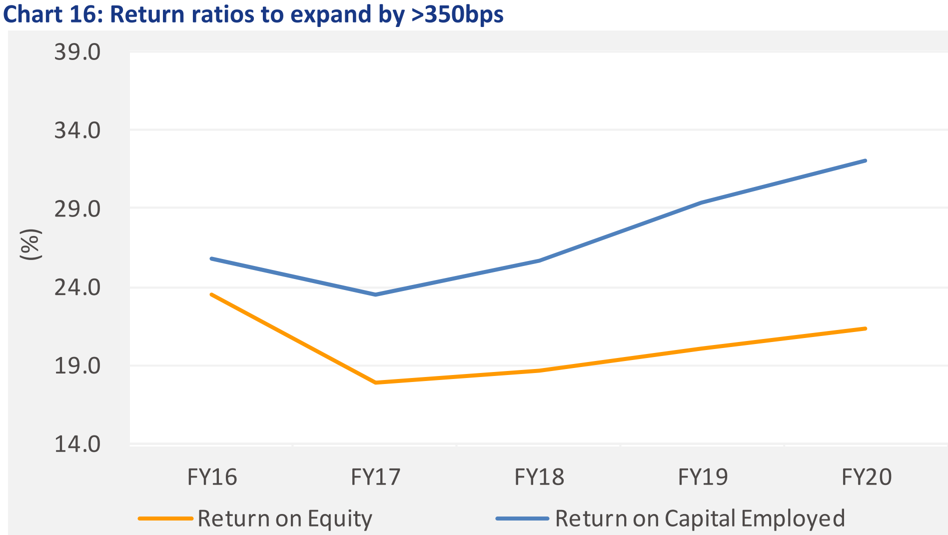
Chart 15: Free cash flow to turn positive



… along with surge in return ratios

D'mart's RoE improved from 18.5% in FY14 to 23.6% in FY16. Post the recent equity dilution, RoE dipped to 17.9% in FY17. Going ahead, with 41.4% earnings CAGR over FY17-20E, we expect RoE and RoCE to expand from 17.9%/23.5% in FY17 to 21.4%/32.1% in FY20.

Chart 16: Return ratios to expand by >350bps



Source: Company, Edelweiss research

Financial Statements

Key assumptions

Year to March	FY17	FY18E	FY19E	FY20E
GDP(Y-o-Y %)	6.6	6.8	7.4	
Inflation (Avg)	4.5	4.0	4.5	
Repo rate (exit rate)	6.3	5.8	5.8	
USD/INR (Avg)	67.1	65.0	66.0	
Company				
Revenue growth (Y-o-Y %)				
No. of stores	131	151	176	201
New store addition	21	20	25	25
Retail space (mn sq ft)	4.1	4.7	5.5	6.3
SSSG	21.2	25.0	25.0	25.0
EBITDA margin assumptions				
COGS as % of sales	84.7	84.5	84.4	84.4
Staff costs as % of sales	1.6	1.5	1.5	1.5
Rent exp. as % of sales	0.3	0.3	0.3	0.3
Other general exp. as % of sales	5.1	5.0	4.9	4.7
EBITDA margin	8.2	8.6	8.8	9.0
Financial assumptions				
Tax rate (%)	35.3	35.0	35.0	35.0
Dividend as % of net profit	-	-	-	-
Depreciation as % of gross block	4.6	4.5	4.5	4.5
Int. rate on o/standing debt (%)	11.3	9.5	9.5	9.5
Debtor days	0.5	0.3	0.3	0.3
Inventory days	29.3	29.5	29.0	29.0
Payable days	8.2	8.5	8.3	8.0
Cash conversion cycle (days)	21.5	21.3	21.1	21.3
Capex (INR mn)	6,450	9,221	8,000	8,500

Income statement **(INR mn)**

Year to March	FY17	FY18E	FY19E	FY20E
Net revenues	118,977	154,418	197,727	250,268
Cost of materials	100,810	130,538	166,882	211,181
Gross profit	18,167	23,880	30,845	39,087
Employee costs	1,925	2,389	3,059	3,874
Rent and lease expenses	354	460	589	746
Others	6,075	7,706	9,770	11,871
EBITDA	9,812	13,326	17,426	22,597
Depreciation	1,278	1,553	1,902	2,273
EBIT	8,534	11,772	15,524	20,324
Interest Expense	1,220	755	351	209
Other income	286	1,133	712	725
Profit before tax	7,600	12,150	15,885	20,840
Provision for tax	2,683	4,253	5,560	7,294
Less: Adjustments and MI	(129)	-	-	-
Reported Profit	4,788	7,898	10,325	13,546
Adjusted Profit	4,788	7,898	10,325	13,546
No. of Shares outstanding	624	624	624	624
Adjusted Basic EPS	7.7	12.7	16.5	21.7
No. of Dil. shares outstanding	565	624	624	624
Adjusted Diluted EPS	8.5	12.7	16.5	21.7
Adjusted Cash EPS	10.7	15.1	19.6	25.3
Tax rate	35.3	35.0	35.0	35.0

Common size metrics (%)

Year to March	FY17	FY18E	FY19E	FY20E
Cost of materials	84.7	84.5	84.4	84.4
Gross margins	15.3	15.5	15.6	15.6
Employee costs	1.6	1.5	1.5	1.5
Rent and lease expenses	0.3	0.3	0.3	0.3
Other general expenditure	5.1	5.0	4.9	4.7
EBITDA margin	**8.2**	**8.6**	**8.8**	**9.0**
EBIT margin	7.2	7.6	7.9	8.1
Net profit margin	4.0	5.1	5.2	5.4

Growth metrics (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	38.6	29.8	28.0	26.6
EBITDA	47.9	35.8	30.8	29.7
PBT	54.5	59.9	30.7	31.2
Adjusted Profit	49.5	64.9	30.7	31.2
EPS	48.7	49.2	30.7	31.2

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	6,241	6,241	6,241	6,241
Reserves & Surplus	32,177	40,075	50,400	63,946
Shareholders' funds	38,418	46,316	56,641	70,187
Minority Interest	1	1	1	1
Long term borrowings	9,809	4,309	2,309	1,309
Short term borrowings	1,388	388	388	388
Total Borrowings	11,198	4,698	2,698	1,698
Long Term Liabilities & Prov.	16	16	16	16
Deferred tax liability	505	505	505	505
Sources of funds	**50,138**	**51,535**	**59,861**	**72,406**
Gross Block	30,767	38,267	46,267	54,767
Net Block	25,440	31,451	37,549	43,775
Capital work in progress	1,529	3,250	3,250	3,250
Intangible Assets	64	-	-	-
Total Fixed Assets	27,033	34,701	40,799	47,025
Non current investments	489	489	489	489
Cash and cash equivalents	18,885	11,864	12,079	15,692
Inventories	9,479	10,550	13,259	16,779
Sundry Debtors	210	127	163	206
Loans & Advances	1,659	2,317	2,317	2,317
Other Current Assets	471	8	8	8
Total Current Assets (ex cash)	11,819	13,003	15,747	19,310
Trade payable	2,607	3,040	3,772	4,629
Other CL& Short Term Prov.	5,481	5,481	5,481	5,481
Total CL & provisions	8,087	8,521	9,253	10,109
Net current assets (ex cash)	3,732	4,482	6,494	9,200
Uses of funds	**50,138**	**51,536**	**59,861**	**72,407**
Book Value per share (INR)	68.0	74.2	90.8	112.5

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported profit	4,788	7,898	10,325	13,546
Add: Depreciation	1,278	1,553	1,902	2,273
Interest (Net of Tax)	789	491	228	136
Others	(2,139)	(869)	(589)	(652)
Less: Changes in WC	138	750	2,012	2,706
Cash from operations	4,578	8,323	9,854	12,597
Less: Capex	6,450	9,221	8,000	8,500
Free cash flow	**(1,872)**	**(899)**	**1,854**	**4,097**

Cash flow metric

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	4,578	8,323	9,854	12,597
Financing cash flow	20,253	(7,255)	(2,351)	(1,209)
Investing cash flow	(24,842)	(8,246)	(7,288)	(7,775)
Change in cash	(11)	(7,179)	215	3,613
Capex	6,450	9,221	8,000	8,500
Dividends paid	-	-	-	-

Ratios

Year to March	FY17	FY18E	FY19E	FY20E
Return on Average Equity (ROAI	17.9	18.6	20.1	21.4
Pre-tax Return on Capital Empl	23.5	25.6	29.4	32.1
Debtors Days	0.5	0.3	0.3	0.3
Inventory Days	29	30	29	29
Payble Days	8	9	8	8
Cash Conversion Cycle	22	21	21	21
Current Ratio	3.8	2.9	3.0	3.5
Gross Debt/EBITDA	1.1	0.4	0.2	0.1
Gross Debt/Equity	0.3	0.1	0.0	0.0
Adjusted Debt/Equity	0.3	0.1	0.0	0.0
Net Debt/Equity	(0.2)	(0.2)	(0.2)	(0.2)
Interest Coverage Ratio	7.0	15.6	44.2	97.3

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total asset turnover	3.1	3.0	3.5	3.8
Fixed asset turnover	5.1	5.4	5.7	6.2
Equity turnover	4.4	3.6	3.8	3.9

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adjusted Diluted EPS (INR)	8.5	12.7	16.5	21.7
Y-o-Y growth (%)	*48.7*	*49.2*	*30.7*	*31.2*
Adjusted Cash EPS (INR)	10.7	15.1	19.6	25.3
Diluted Price to Earnings Ratio	136.8	91.7	70.1	53.4
Price to Book Ratio (P/B) (x)	17.0	15.6	12.8	10.3
Enterprise Value / Sales (x)	6.0	4.6	3.6	2.8
Enterprise Value / EBITDA (x)	73.0	53.8	41.0	31.4
Dividend Yield (%)	-	-	-	-

Additional Data

Directors Data

Ignatius Noronha	CEO, MD & Director	Ramakant Baheti	CFO & Whole-Time Director
Elvin Machado	Director of Business Development & Whole-Time Director	Ramesh Damani	Chairman of the Board
Chandrashekhar Bha	Member of the Board of Directors	Manjri Chandak	Member of the Board of Directors

Auditors - Dalal & Shah

*as per last annual report

Holding - Top 10

	Perc. Holding		Perc. Holding
NORONHA IGNATIUS NAVIL	2.2	HDFC ASSET MANAGEMENT CO LTD	1.25
NOMURA	1.02	AXIS ASSET MANAGEMENT CO LTD	1.01
ICICI PRUDENTIAL ASSET MGMT CO	0.48	CAPITAL GROUP COMPANIES INC	0.44
VANGUARD GROUP	0.29	WASATCH ADVISORS INC	0.21
DSP BLACKROCK INVESTMENT MANAGER	0.17	GRANTHAM MAYO VAN OTTERLOO & CO	0.11

**in last one year*

Bulk Deals

Date	Acquirer/Seller	B /S	Qty Traded	Price
21-Mar-17	Nomura India Investment Fund Mother Fund	Buy	3,233,983	605
29-Mar-17	Valiant Mauritius Partners Ltd	Buy	157,519	630
29-Mar-17	Credit Suisse (Singapore) Ltd A/C Credit Suisse (Singap	Sell	157,519	630

**in last one year*

INITIATING COVERAGE

TRENT

Triple treat

India Equity Research| Retail

Edelweiss
Ideas create, values protect

Trent, among the earliest entrants in the organised retail sector in India, primarily operates stores under 3 brands— *Westside* (private labels), *Star Bazaar* (Food & Grocery) and *Zara* (fast fashion). We initiate coverage with 'BUY' as: i) we estimate Westside to clock 12% and 10% YoY SSSG in FY19 and FY20, respectively, spearheaded by prudent focus on superior RoCE private labels, improved inventory turns & store expansion; ii) we perceive *Star Market's* fresh food offerings underpinned by great quality at reasonable prices proposition as a winning combo; and iii) though a mere financial investment at this juncture, we believe Trent offers a unique opportunity to play the *Zara* growth story. Also, potential 49% stake sale could fetch premium valuations given Zara's strong brand power. Hence, we estimate Trent to clock 72% EPS CAGR over FY17-20E.

Private labels, improved inventory turns scripting *Westside* story

The flagship *Westside* format is estimated to sustain 12% YoY SSSG each in FY18 and FY19, followed by 10% in FY20 aided by: i) focus on high RoCE exclusive private labels; and ii) improved throughput via higher inventory turns (4 fashion cycles compared to 2 earlier). Further, we expect improvement in Trent's EBITDA margin—10.9% in FY20 from 6.9% in FY17—due to operating leverage.

Banking on *Star Market* for growth; *Zara* potent option value

We believe *Star Market's* (5,000–10,000 sq ft store size) focus on fresh food offerings at reasonable price is a winning combo. This prudent strategy is envisaged to attract higher footfalls, which, in turn, can be leveraged to market other branded offerings. Management views its commitment to *Zara* primarily as a financial investment. However, in our view, **Trent offers an opportunity to play the *Zara* growth story (12% revenue CAGR over FY17-20E). Moreover, if it sells its 49% stake in *Zara*, it is bound to fetch premium valuations given the latter's robust brand equity.**

Outlook and valuations: All rounder; initiate with 'BUY'

Trent provides unique opportunity to invest in 3 power brands —*Westside*, *Star Bazaar* and *Zara*. **We expect the company to clock 72% EPS CAGR over FY17-20.** We initiate coverage with **'BUY/SO'** recommendation/rating. Our SOTP valuation assigns EV/EBITDA of 25x FY20E to *Westside* business, EV/EBITDA of 15x FY20E to *Zara* business and P/Sales of 1.5x FY20E to *Star Bazaar* to arrive at target price of INR394.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	18,339	21,561	26,870	32,625
EBITDA (INR mn)	1,257	1,725	2,610	3,546
Adjusted Diluted EPS (INR)	1.8	4.3	6.6	9.1
EPS growth (%)	25.4	142.4	53.7	37.8
Diluted P/E (x)	183.8	75.8	49.3	35.8
EV/EBITDA (x)	87.8	63.4	41.5	29.8
ROAE (%)	3.9	8.8	12.2	14.7

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: TREN.BO, B: TRENT IN)*

CMP	: INR 327
Target Price	: INR 394
52-week range (INR)	: 361 / 195
Share in issue (mn)	: 332.3
M cap (INR bn/USD mn)	: 109 / 1,709
Avg. Daily Vol.BSE/NSE('000)	: 270.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	32.6	32.6	32.6
MF's, FI's & BK's	11.8	11.7	11.9
FII's	26.7	26.7	26.7
Others	28.9	29.0	28.8

** Promoters pledged shares (% of share in issue) : Nil*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.9	0.3	(2.6)
3 months	7.3	11.3	4.0
12 months	27.1	62.6	35.5

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January 2, 2018

Investment Rationale

Private labels, improved inventory turns scripting Westside story

Flagship *Westside* format prudently focuses on exclusive private labels. These yield superior RoCE, enable active control across the value chain and enhance customer stickiness, in turn leading to higher wallet share.

This, coupled with focus on providing great shopping experience (innovations such as *Gourmet West* and *Lakeland*), has enabled *Westside* report: 1) double digit EBITDA margin (~10%) in FY17; and 2) high single digit SSSG for *Westside* (9.0% YoY in FY17) over the past 4 years.

Also, the company is shifting from 2 to 4 seasons, which is is envisaged to lead to improved inventory turns, which will boost throughput.

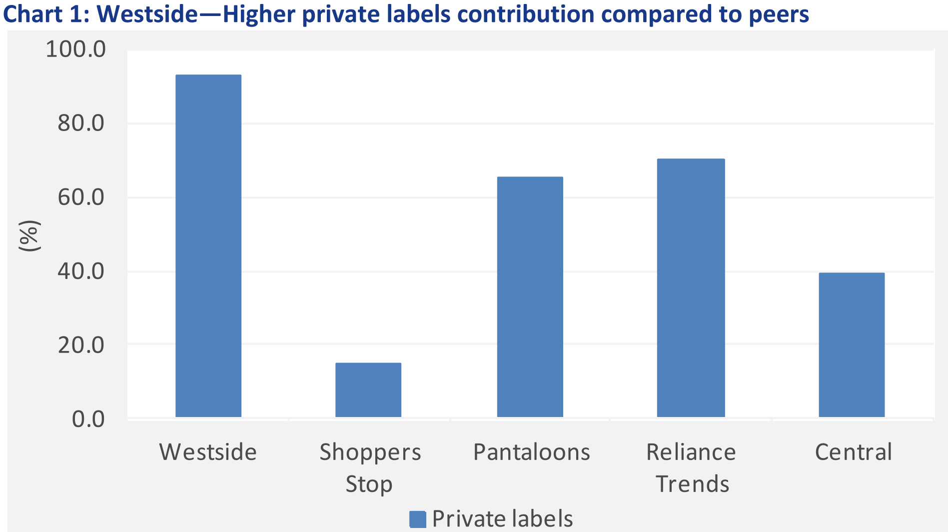
Factoring the above, we estimate Westside to continue to clock 12% and 10% YoY SSSG in FY19 and FY20, respectively.

Exclusive and private brands: The wind beneath its wings

Trent's flagship format *Westside* offers apparel, footwear and accessories for men, women and children, along with furnishings, decor and a wide range of home accessories. Operating with a predominantly exclusive brands model, *Westside* continues to demonstrate the ability to compete effectively in the market place, despite stiff global competition for mind space and wallet share. **Exclusive brands contribute ~93% to overall revenue and the format, in turn, accounts for ~97% of Trent's standalone revenue**.

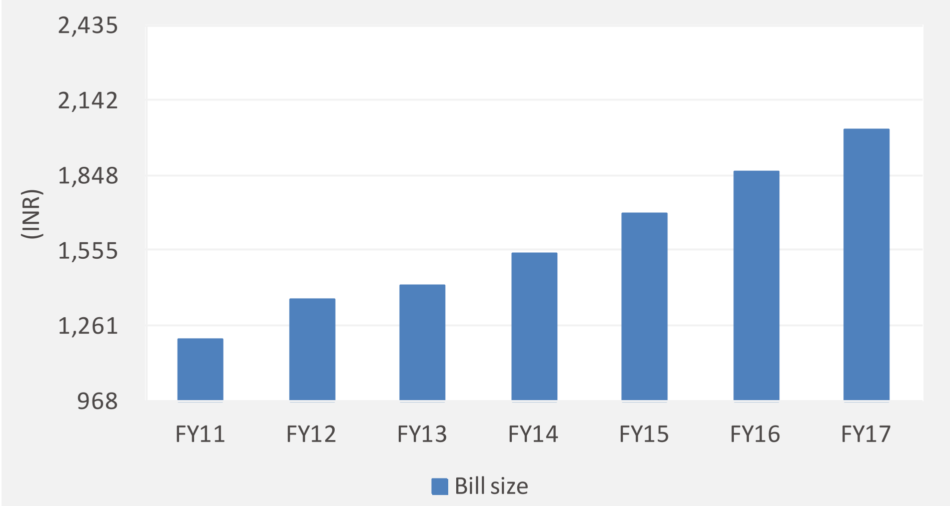
In our view, this is more robust than the department store model (predominantly retail third party brands) as: a) exclusive private labels yield better RoCE & high walk ins; b) enable active control across the value chain with respect to design, branding, sourcing, logistics, distribution, pricing, display & promotion; and c) enhances stickiness & results in loyalty, which in turn leads to higher wallet share.

Chart 1: Westside—Higher private labels contribution compared to peers



Source: Company, Edelweiss research

Chart 2: Stickiness resulting in impressive growth in bill size



Source: Company, Edelweiss research

Revamped inventory management to boost throughput

In India, there are only 2 seasons (number of times a new collection comes to the store) compared to 6 globally. Trent, in line with peers, is increasing the number of fashion seasons to 4. This is envisaged to lead to improved inventory turns, which is likely to boost throughput.

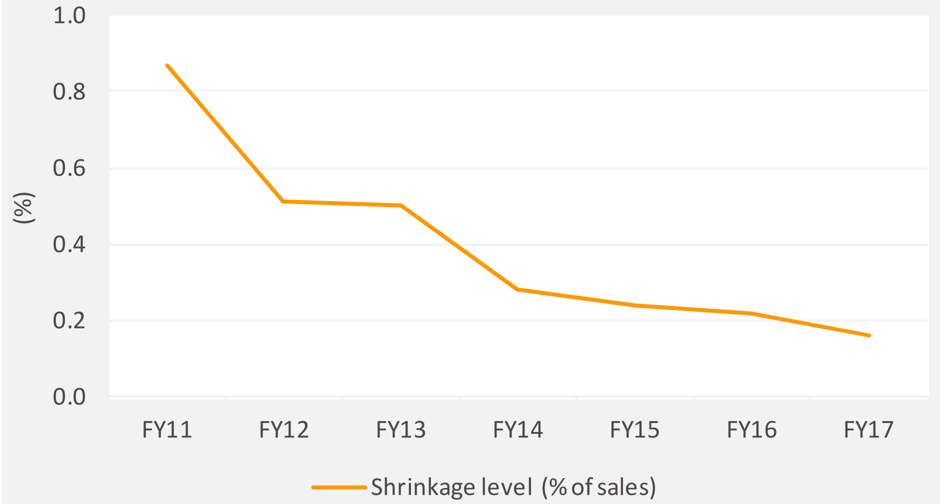
Further, the company follows a stringent end-of-season-sales (EOSS) policy—has 2 sale seasons in a year (January and July)—and does not shift the sale season even though peers do it to battle intensifying competition (seen in Q1FY18 wherein peers advanced sale season to mid-June due to GST rollout, while Trent started in July). Trent's stringent sales season policy helps prevent brand dilution.

Table 1: Improvement in inventory days aided by more fashion seasons

	FY16	FY17	FY18E	FY19E	FY20E
Inventory (INR mn)	2,792	3,054	3,631	4,466	5,170
Inventory turns	2.6	3.1	3.2	3.3	3.3
Inventory days	140	118	115	112	110

Source: Company, Edelweiss research

Chart 3: Shrinkage % of revenue reduced to 0.16% in FY17 from 0.87% in FY11



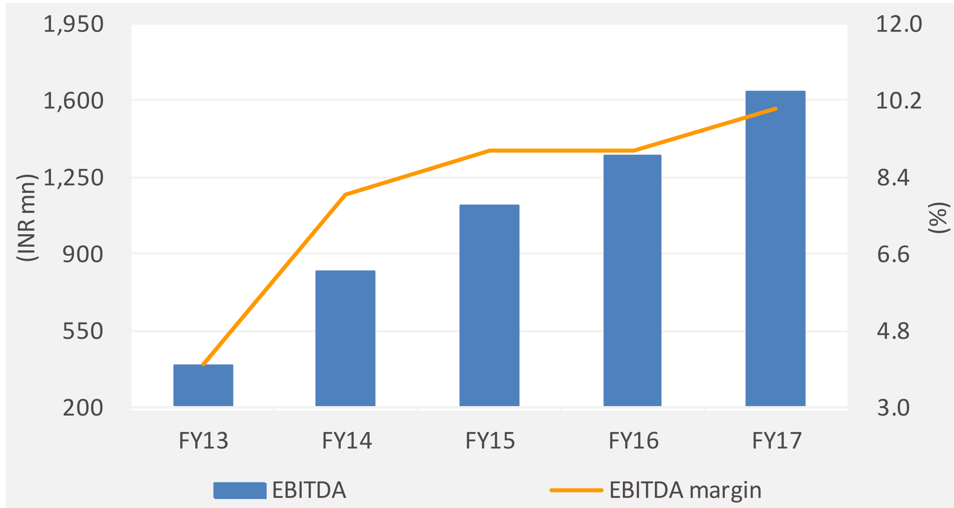
Source: Company, Edelweiss research

'Fashion theatre' push enhancing shopping experience

In the retail industry, a great shopping experience is of paramount importance. Store location, display, variety, store ambience, customer service and convenience are some of the key parameters that enhance customer experience. Though Indian customers are primarily value seekers, a better store ambience and customer service & convenience do lead to customer loyalty.

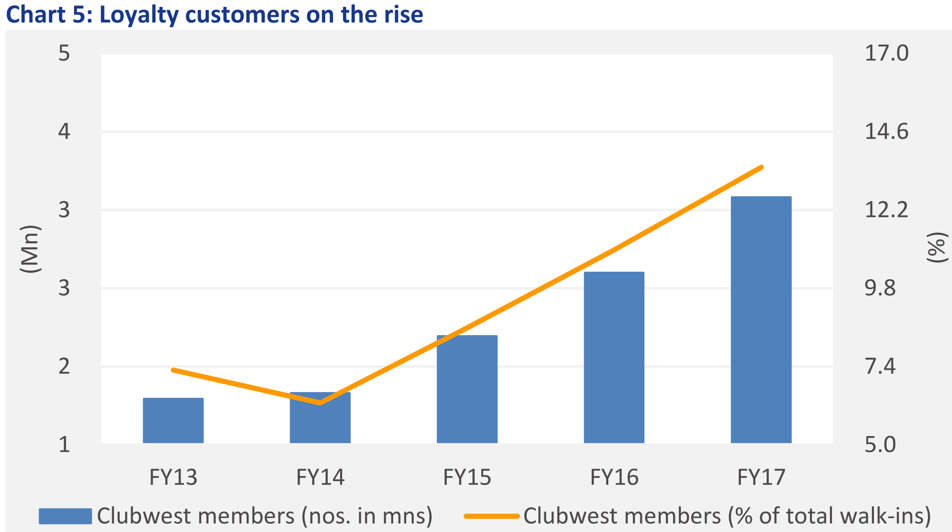
Trent is working towards delivering *'fashion theatre'* experience—upgrading to an international look & feel and optimise space allocation for categories. Further, it is taking several initiatives to deliver improved customer service in stores—various digital payment modes have been introduced and staff training has been enhanced to provide assisted selling in select categories. In our view, these initiatives will lead to enhanced customer experience and loyalty.

Chart 4: Private labels and operational efficiencies boosting EBITDA margin



Source: Company, Edelweiss research

Chart 5: Loyalty customers on the rise



Source: Company, Edelweiss research

Higher private labels, prudent inventory management spurring store expansion

Limited availability of quality real estate coupled with high rentals and non-adherence to committed schedule by builders have resulted in slower store additions. Hence, over the past few years, Trent has added ~8-10 *Westside* stores per year (except in FY17 when it added 17 stores). Given that *Westside* is not solely dependent on malls (only 66 of 107 stores in malls in FY17), our expectation of 15 stores addition per year is reasonable.

Apart from adding stores, the company has also improved its sales per sq ft to ~INR9,000 plus in FY17 from ~INR7,173 in FY11. The improvement was driven by focus on private labels, better inventory selection, focus on enhancing shopping experience and average size of new store at 17,500 sq ft versus 20,000 sq ft initially. Further, these initiatives in new stores are spurring sales per sq ft as well.

Table 2: Improvement in sales per sq ft

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Westide stores	54	67	70	80	85	93	107	122	137	152
Gross additions	11	13	7	10	8	10	17	15	15	15
Closures	-	-	4	-	3	2	3	-	-	-
Sales per sq ft (INR mn)	7,173	7,009	7,639	7,615	8,448	9,167	9,004	10,084	11,294	12,423

Source: Company, Edelweiss research

Sharpening focus on omni-channel strategy

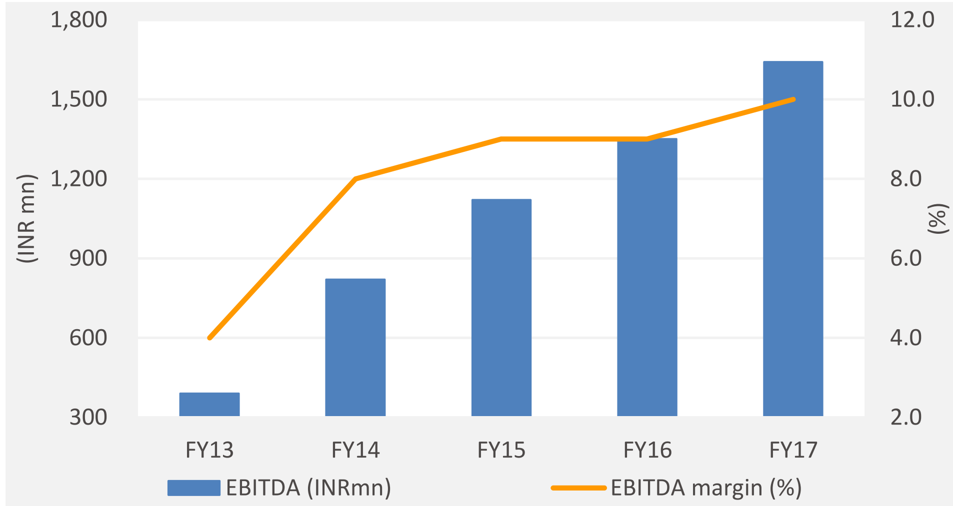
Until recently, e-commerce was the bane of brick-and-mortar players as they were greatly impacted by the high discounts offered by the former. However, realising that the platform is here to stay and instead of criticising it, players like Trent have joined the online bandwagon.

Overall, e-commerce is fast emerging as the new growth opportunity for brick-and-mortar players to expand reach. *Shoppers Stop* is already in the process of strengthening its online presence, further aided by exclusive tie up with Amazon India. In fact, offline players are moving towards omni-channels (mix of physical and online platforms), with focus on improving online platform and integrating their physical & online presence.

Online fashion retailing is expected to gain traction in India in ensuing years. With an aim to address this fast-emerging market and especially to boost convenience for customers seeking to shop online, Trent has strengthened its exclusive online offer on *Tatacliq.com*.

Tata CLiQ is a domestic e-commerce website selling apparel, footwear, electronics, watches and accessories. The website caters to luxury product segments as well across these categories. Customers can order, collect, return and exchange products either online or from physical partner stores. Tata CLiQ is run by Tata Unistore, part of the Tata Group, with **90% ownership by Tata Industries and 10% with Trent**. In our view, it will enhance brand visibility and bolster the company's omni-channel strategy.

Chart 6: Strong trajectory in online play



Source: Company, Edelweiss research

Fig. 1: Luxury product segment in Tata CLiQ

Source: Edelweiss research

Factoring the above, we estimate Westside to continue to clock 12% and 10% YoY SSSG (14.0/12.0% YoY SSG in Q1FY18/Q2FY18) in FY19 and FY20, respectively.

Star Bazaar: Banking on *Star Market* format to spearhead growth

Trent, after experimenting with *Star Bazaar* format size, has zeroed in on *Star Market* (5,000–10,000 sq ft store size) as most sustainable platform for expansion.

Winning combo: Focus on fresh food offerings by emphasizing great quality at reasonable prices proposition is bound to lure footfalls. These footfalls can, in turn, be leveraged for branded offerings.

The dark horse: Unlocking *Star Bazaar's* apparels into standalone store under the *Zudio* brand (MRP 10-15% lower than nearest peer Max Fashion) targeting tier II & III cities could prove to be a prudent move.

We increasingly believe that the Star Market format affords the most sustainable platform for expansion and the rollout could be further accelerated if we continue to see encouraging results
*– **FY17 Trent Annual Report***

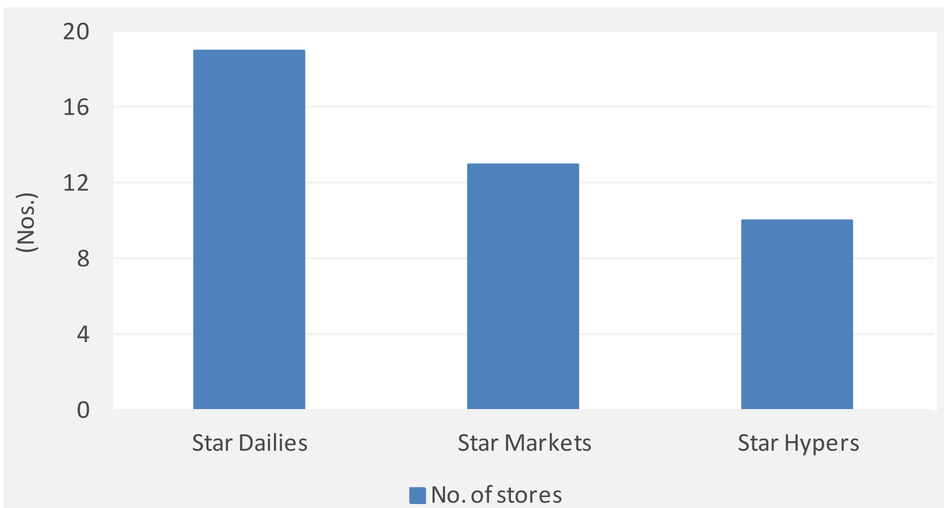
Zeroing on the right format size

Trent, over the past few years, has experimented with various formats to zero in on the apt format size for *Star Bazaar*. Commencing operations as a discount hypermarket format (~30,000 sq ft), over the years, it has introduced 2 other formats—*Star Daily* (~2,000 sq ft) and *Star Market* (~8,000 sq ft).

The company, bolstered by experience, realised that the hypermarket format is best suited to operate standalone stores rather than from malls as: a) rather than navigating a mall with a shopping trolley, customers prefer quick & direct access to parking lots; and b) the hypermarket format results in substantial common area maintenance charges in shopping malls, which are negligible in standalone stores. **Unless the overall package in a mall is extremely attractive, the company is averse to open hypermarkets inside large malls.**

Further, Trent, after testing *Star Daily* and *Star Market* formats, has come to the conclusion that ***Star Market* (store size in 5,000-10,000 sq ft range) is the most sustainable platform for expansion.** The rollout could be further accelerated if *Star Market* evinces good response.

Chart 7: Number of stores across different formats



Source: Company, Edelweiss research

Branded & fresh food offerings: A winning combo

In our view, own branded private labels are key for a sustainable business model. In this context, Trent has sustained focus on expanding its range of private label products in *Star Bazaar* stores. In FY17, the company launched private labels for a range of roasted snacks, basmati rice, body & hand wash and powder detergents. The own branded range now includes over 200 plus private label SKUs across staples, beverages, cleaning aids, ready foods and health & beauty.

Further, *Star Bazaar* focuses on providing customers quality & reasonably priced fresh produce and meat & fish, positioning itself as a distinct retailer with "fresh food" USP. The company now directly engages with ~200 farmers and ~70% of vegetables are now directly sourced and serviced via a network of collection and distribution centers.

In our view, branded labels and fresh food is a deadly combo. Focus on fresh food offerings by emphasizing the proposition of great quality at reasonable prices is likely to lead to higher footfalls, which in turn can be targeted for branded offerings.

Zudio: Hidden gem

Spurred by the success of value fashion offered in *Star Bazaar* stores, Trent, on an experimental basis, opened its first value fashion store *Zudio* in Bengaluru in FY17. *Zudio* is priced 10-15% lower than nearest peer *Max Fashion*, on an average, and the performance has exceeded management's expectation. The company has already opened its second store in the Garden City.

We perceive *Zudio* to be a hidden gem. The right strategy (not cannibalise *Westside* stores) can propel its performance in tier II & III cities.

Fig. 2: Zudio store—Could be the dark horse

Source: Edelweiss research

Cluster-based approach

In terms of geographies, cluster-based approach has worked for all peer companies like Dmart, Vmart, Spencer's, among others. Trent will continue to pursue a clustered approach for *Star Bazaar* stores in Maharashtra, Karnataka and Telangana with the target to create local scale and be closer to customers.

Table 3: Trent hypermarket's EBITDA margin to improve significantly

INR mn	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenues	6,242	7,838	8,346	9,014	9,735	10,514
COGS	5,103	6,304	6,655	7,121	7,593	8,096
Gross profit	1,139	1,534	1,691	1,893	2,142	2,418
Employee expenses	513	591	663	676	730	789
SG&A and other costs	1,311	1,663	1,782	1,803	1,850	1,893
Total expenditure	1,824	2,253	2,445	2,479	2,580	2,681
EBITDA	**(685)**	**(720)**	**(753)**	**(586)**	**(438)**	**(263)**
EBITDA margin (%)	**(11.0)**	**(9.2)**	**(9.0)**	**(6.5)**	**(4.5)**	**(2.5)**
D&A expense	154	214	278	297	321	347
EBIT	(839)	(933)	(1,031)	(883)	(759)	(610)
Add: Other income	402	484	475	500	550	600
Less: Interest expense	79	113	80	100	120	140
PBT	(516)	(562)	(636)	(483)	(329)	(150)
Less: Provision for tax	-	2	(0)	-	-	-
Recurring net income	(516)	(564)	(636)	(483)	(329)	(150)
Add: Exceptional items	-	(159)	-	-	-	-
Reported net income	(516)	(723)	(636)	(483)	(329)	(150)

Source: Company, Edelweiss research

Zara potent option value; cost synergies to prune *Landmark* losses

Though management views its commitment to *Zara* primarily as a financial investment, Trent offers a unique opportunity to play the *Zara* growth story. If Trent decides to sell its 49% stake in *Zara*, we expect the transaction to happen at premium given the latter's strong brand power.

***Landmark's* losses are anticipated to ebb further due to consolidation with *Westside* on account of cost synergies.**

Huge opportunity to play *Zara* growth story

Zara and Massimo Dutti: Trent has 2 separate joint ventures with Spain's Inditex Group with a shareholding of 51% (Inditex): 49% (Trent)—one for *Zara* and the other for *Massimo Dutti* stores in India. The *Zara* JV currently operates 20 stores. Inditex, the majority partner, controls entirely the core customer proposition with respect to the fashion offer.

Zara reported 20.4% YoY revenue growth in FY17 despite stiff competition from *H&M*, reflecting its brand prowess. Further, the company added merely 2 stores in FY17 (20 *Zara* stores as of FY17), implying that revenue growth was spearheaded by strong SSSG.

Despite double digit sales growth, *Zara's* EBITDA margin plummeted 911bps in FY17 (to 9.5% from 18.6% in FY16) due to 12% countervailing duty (levied in FY17), which singed gross margin. Global rationalisation of prices (cut by 10-15% due to competition) and INR tailwind also dented gross margins. Post GST, we expect the company to enjoy the input/output set off, helping margin to recoup. Though Trent perceives its commitment to this JV primarily as a financial investment, it offers investors a unique opportunity to play the *Zara* growth story. In case, Trent decides to sell its 49% stake in Zara, we expect the transaction to happen at premium given the strong brand power and performance of the company. Hence it will beneift Trent.

Table 4: Zara's EBITDA margin estimated to improve to 20.6% in FY20

INR mn	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenues	6,898	8,401	10,118	11,332	12,692	14,215
Revenue growth (%)		*21.8*	*20.4*	*12.0*	*12.0*	*12.0*
COGS	4,408	4,499	6,281	6,006	6,600	7,250
Gross profit	2,490	3,903	3,837	5,326	6,092	6,966
Employee expenses	289	295	340	385	432	483
SG&A and other costs	2,004	2,045	2,537	2,833	3,173	3,554
Total expenditure	2,293	2,340	2,878	3,218	3,605	4,037
EBITDA	**197**	**1,563**	**960**	**2,108**	**2,488**	**2,928**
EBITDA margin (%)	**2.9**	**18.6**	**9.5**	**18.6**	**19.6**	**20.6**
D&A expense	347	354	346	385	432	483
EBIT	(150)	1,209	614	1,723	2,056	2,445
Add: Other income	28	24	206	210	240	250
Less: Interest expense	-	-	2	-	-	-
PBT	(123)	1,233	818	1,933	2,296	2,695
Less: Provision for tax	-	429	249	599	712	835
Recurring net income	(123)	804	569	1,333	1,584	1,860
Reported net income	(123)	804	569	1,333	1,584	1,860

Source: Edelweiss research

Landmark: Losses ebbing

Landmark has evolved into an entertainment format offering a range of curated products including toys, books and sports merchandise. In recent years, its back-end operations have been significantly integrated with the *Westside* format to drive synergies and contain overhead costs. This has resulted in consolidation and, therefore, the company now has only 5 independent stores and 11 shop-in-shop formats inside *Westside*. In addition to independent stores, *Landmark* merchandise is also retailed via select *Westside* locations.

To cater to emerging lifestyles trends and be relevant to customers, *Landmark* is working on product portfolio, which is calibrated to trending products with focus on toys, front-list books, latest gadgets and sports. Freshness and exclusivity will be the driving force for all product categories across *Landmark* going forward.

It has also been incrementally taking steps to increase customer engagement. E.g., holding events such as *Rubik's challenge* and *Lego challenge* to establish better connect with children— Landmark stores' prime customers.

In FY17, *Landmark* stores' SSSG was 19% versus 7% in base. Consequent to various strategies pursued and measures taken, the format has registered store level profitability. **In our view, losses from _Landmark_ will dip further due to consolidation with _Westside_ on account of cost synergies.**

Table 5: Lower losses in Landmark to aid standalone EBITDA margin expansion

INR mn	FY12	FY13	FY14	FY15	FY16	FY17
Revenues	8,218	9,358	12,416	13,580	14,919	17,381
Revenue growth (%)		*13.9*	*32.7*	*9.4*	*9.9*	*16.5*
COGS	4,461	4,898	6,565	6,810	7,213	8,275
Gross profit	3,757	4,460	5,851	6,770	7,707	9,106
Employee expenses	679	729	1,045	1,240	1,323	1,661
Rent and leases	562	639	1,039	1,067	1,874	2,278
Adver & sales promotion	512	279	337	404	424	461
SG&A and other costs	2,133	2,342	3,162	3,510	3,158	3,479
Total expenditure	3,886	3,989	5,583	6,221	6,779	7,879
EBITDA	**(129)**	**472**	**268**	**549**	**927**	**1,226**
EBITDA margin (%)	**(1.6)**	**5.0**	**2.2**	**4.0**	**6.2**	**7.1**
D&A expense	160	166	256	398	345	376
EBIT	(288)	305	12	151	582	850
Add: Other income	903	604	648	745	888	590
Less: Interest expense	77	79	71	70	376	337
PBT	537	831	589	825	1,094	1,103
Less: Provision for tax	(27)	185	140	389	227	282
Recurring net income	564	645	449	436	867	822
Add: Exceptional items	(92)	(23)	93	564	(1)	247
Reported net income	473	623	543	1,000	866	1,069

Source: Edelweiss research

Valuation

Trent was among the earliest entrants in the organised retail sector in India and has focused on developing a robust business model in each of the retail formats pursued. The company primarily operates stores across 3 formats—*Westside, Star Bazaar* and *Landmark*. In our view, the businesses should be separately valued as each entails distinct value proposition.

Standalone business (*Westside + Landmark*)

We estimate *Westside* to continue to report 12%, 12% and 10% YoY SSSG (14.0% and 12.0% YoY SSSG in Q1FY18 and Q2FY18, respectively) FY18, FY19 and FY20, respectively, anchored by focus on private labels and enhancing shopping experience. We expect improvement in EBITDA margin which will play out due to double digit SSSG aided by operating leverage. Further, lower losses in *Landmark* will also improve EBITDA margin. We assign 25x FY20E EV/EBITDA, on account of better growth (aided by private labels) and margin prospects.

Star Bazaar

Trent's focus on branded private labels and providing its customers quality & reasonably priced fresh produce and meat & fish is a win-win strategy. Focus on fresh food offerings by emphasizing the proposition of great quality at reasonable prices is bound to attract higher footfalls. These footfalls can then be targeted for branded offerings. Moreover, housing of *Star Bazaar's* private apparels into a standalone store under the *Zudio* brand can yield significant benefits in tier II & III cities. Hence, we assign 1.5x FY20E P/sales.

Zara

Zara reported 20.4% YoY revenue growth in FY17 despite stiff competition from *H&M*, reflecting its brand prowess. Further, the company merely added 2 stores in FY17 (20 *Zara* stores as of FY17), implying that revenue growth was aided by strong SSSG. Hence, we assign 15x FY20E EV/EBITDA.

Hence, we arrive at target price of INR394, entailing 20% upside. We initiate coverage on Trent with **'BUY/SO'** recommendation/rating. The stock is currently trading at 29.8x FY20E EV/EBITDA.

Table 6: Valuation snapshot

		FY20E INR mn	Methodology	Target multiple	Per share contribution
Standalone business	EBITDA	3,856	EV/EBITDA	25.0x	96,407
Star Bazaar (50%)	Sales	5,257	P/Sales	1.5x	7,886
Zara business (49%)	EBITDA	1,435	P/EBITDA	15.0x	21,523
Others (Fiora Hypermarket)	Sales	1,016	P/Sales	2.0x	2,032
EV (INR mn)					1,27,848
Less debt (INR mn)					2,759
Add: cash + investments (INR mn)					5,767
Market cap (INR mn)					1,30,857
No of shares (mn)					332
Value of share (INR)					**394**

Source: Edelweiss research

Key Risks

Real estate: Limited availability of quality real estate coupled with high rentals and non-adherence to committed schedules by builders pose significant challenge to deployment of strategic expansion plans.

Cost pressures: There has been significant inflation in manpower costs and common area maintenance charges in malls in the past few years. Any further rise may impact profitability in a subdued environment.

Retail real estate availability and costs: A significant number of global retailers are already present in India with other global brands (especially under single-brand umbrella) planning to roll out stores. Consequently, the shortage of quality malls/ standalone real estate in High Street locations is an impediment to expansion plans of organised retail in the near term. We believe, emphasis on standalone properties is critical to mitigate this risk, to an extent.

With GST subsuming service tax, malls owners want *Zara* to bear the entire burden of the new 18% tax. Initially, service tax on rent was a cost and hence mall owners had agreed to pay half the cost (special arrangement). Now *Zara* gets input credit for the GST, so it is no longer a cost. Therefore, mall owners are refusing to continue with this special arrangement.

Talent availability: Availability of relevant talent at acceptable compensation levels continues to be an issue. And, employing expatriates with attendant higher costs becomes inevitable in certain areas due to paucity of talent as players attempt to scale up significantly.

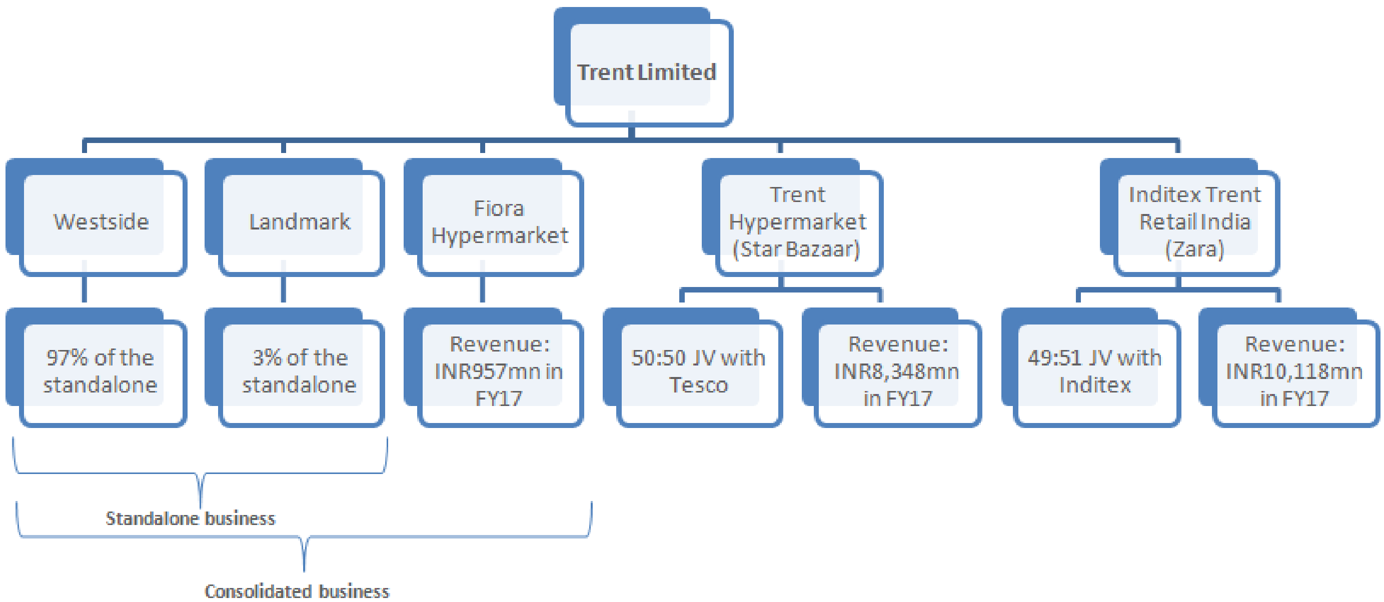
Electricity availability & costs: Electricity is one of the largest components of cost and has increased significantly in recent years, especially in Maharashtra. Separately, higher power deficits in select cities have led to increased load shedding, implying more reliance on generators, which has added to costs—Trent's stores in Chennai a case in point.

Discounting by online retailers: Several online players have disrupted the retail market, over the past few years, with discounting funded by overseas shareholders. Sustainability of such discounting is debatable, but players need to, nevertheless, handle the onslaught and continue to be relevant to target audience. The recent clarification from the Department of Industrial Policy and Promotion (DIPP) on 100% FDI in e-commerce marketplaces is likely to facilitate formalisation of presence and hopefully adoption of more sustainable business models.

Company Description

Trent, an early entrant in India's organised retail sector, has been focusing on developing a robust business model in each of its retail formats. The company primarily operates stores across 3 formats, viz., *Westside*, *Star Bazaar* and *Landmark*. On April 1, 2013, *Landmark* was merged with the company; earlier, it was a wholly-owned subsidiary post buyout from TVS Shriram Growth Fund I.

Fig. 3: Trent's business model



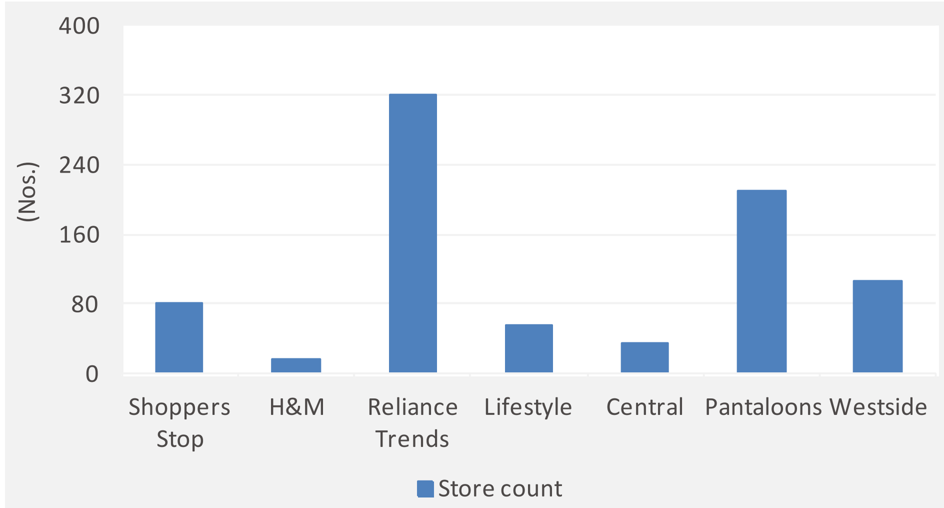
Source: Company, Edelweiss research

Westside

Westside is Trent's flagship format. It offers an exclusive range of self-owned branded fashion apparel, footwear and accessories for men, women and children. It also offers furnishings, decor and a range of home accessories. There were 107 Westside stores in FY17 (66 malls/ shopping centres and 42 standalone stores).

Trent introduced *Gourmet West* offering premium food and beverages in Westside stores. It is a shop in shop in certain key Westside stores. Further, the company introduced fashionable kitchenware for customers in Pune and Bengaluru through an exclusive tie up with Lakeland—a British company famous for its creative kitchenware across the world. Moreover, new in-house brands such as *Wunderlove* (lingerie), *Sassy Soda* (fashion for young curvier woman) and *StudioWest* (cosmetics) have seen encouraging customer off-take and helped strengthen Westside's position as a complete shopping destination. It is planning to accelerate expansion in coming years by focusing broadly on 2 formats—flagship stores and curated smaller stores in non-metros/ emerging micro-markets.

Chart 8: Store count of different companies in FY17



Source: Company, Edelweiss research

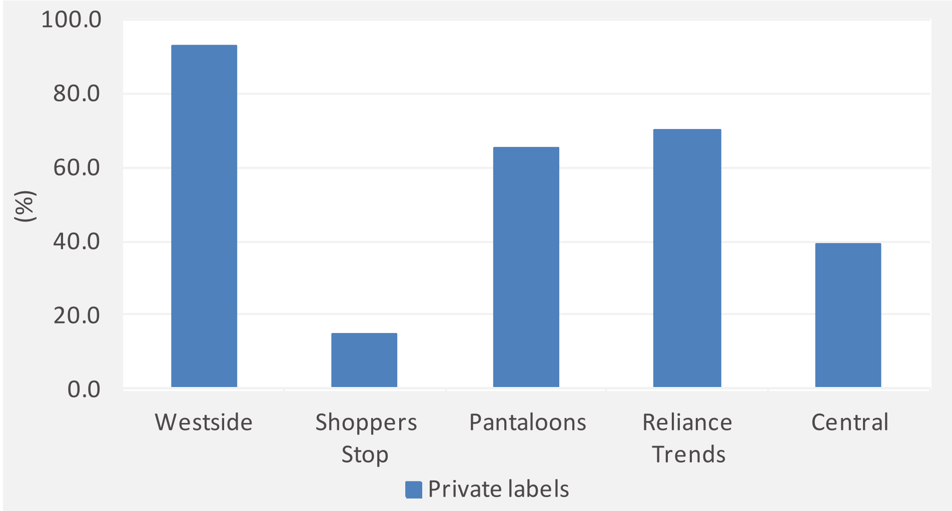
Table 7: Westside stores in India

Westside stores	FY12	FY13	FY14	FY15	FY16	FY17
Andhra Pradesh	-	2	3	3	3	4
Assam	1	1	1	1	1	1
Chandigarh	1	1	2	2	2	-
Chhattisgarh	2	2	2	2	2	2
Delhi	5	5	6	6	7	7
Goa	1	1	1	1	2	2
Gujarat	6	7	7	8	8	10
Haryana	2	1	1	2	1	1
Jammu & Kashmir	1	1	1	1	1	1
Karnataka	8	8	8	9	10	10
Kerala	-	1	2	2	3	3
Madhya Pradesh	4	3	3	3	3	4
Maharashtra	17	15	17	17	18	18
Punjab	1	1	1	3	3	5
Rajasthan	2	3	3	3	4	6
Tamil Nadu	4	5	6	6	6	8
Telangana	3	3	3	4	4	5
Uttar Pradesh	5	6	8	7	8	11
Uttarkhand	-	1	1	1	3	3
West Bengal	4	4	5	4	4	4
Orissa						1
Nagaland						1
Sikkim						1
Total	**67**	**70**	**80**	**85**	**93**	**107**

Source: Company, Edelweiss research

Private labels*:* Westside is ranked in the top quartile in terms of proportion of private label merchandise to overall revenue. Higher private label content not only results in better margin, it also offers other benefits such as control over merchandise design and quality.

Chart 9: Private labels contribution



Source: Company, Edelweiss research

Format*:* Westside's store size is based on various factors i.e., potential customers in the area, rental charges, standalone store versus mall presence, etc. However, the company's analysis indicates that size exceeding 20,000 sq ft is not feasible and could entail viability issues.

Chart 10: Store size comparison (sq ft)

Source: Company, Edelweiss research

Innovations and tie ups: Westside continues to introduce new categories—own-branded body & bath products—targeting customers based on their needs, purchasing power and appetite for fashion.

Gourmet West*:* Trent launched its premium and beverage offering *Gourmet West (*shop-in -shop format) at various Westside stores in Mumbai, Bengaluru, Hyderabad, Chandigarh and Surat. It is planning to expand *these* stores at select Westside locations. Currently, Trent operates *Gourmet West* in 10 Westside stores.

Lakeland: Trent introduced fashionable kitchenware for customers in Pune and Bengaluru through an exclusive tie up with Lakeland (British company famous for its creative kitchenware globally) in FY14. We expect this exclusive tie up to help Westside deliver an enhanced shopping experience for customers. Lakeland currently operates primarily through shop-in-shop format within Westside with 2 stores in Bengaluru and 1 in Pune.

Westside continues to launch or refresh its brands, particularly those available exclusively at its stores.

Fig. 4: Private brands

Bombay Paisley
- Chic western & contemporary ethnic wear for the experimental & vibrant youth

Gia Curves
- Fashionable city and casual collection for curvy women

L.O.V
- Smart, casual, feminine offer for 25+ women

Wardrobe
- Trendy 9-to-9 fashion for woman

Zuba
- Premium Indian wear offering in silk and handloom blends with handcrafted embroidery

NUON
- Young casual fashion brand

ASCOT
- Modern classic lifestyle brand for the discerning man

E.T.A
- Understated casual wear for contemporary men

WESTSPORT
- Functional & stylish casual mens apparel

Source: Company, Edelweiss research

Star Bazaar

Star Bazaar continues to view food & grocery (F&G) retailing as a huge opportunity, worthy of being seriously pursued. F&G remains one of the largest categories and is estimated at ~60% of consumer spending. However, an economically viable business model is critical due to the significantly lower gross margins in F&G vis-à-vis other categories.

Trent Hypermarket (THL) operates in the ultra-competitive food, grocery and daily needs segment under the Star banner. Star Bazaar is a discounted hypermarket and convenience store. Each Star Bazaar is modeled to be a one-stop shop offering a wide range of products including staple foods, beverages, health & beauty products, apparel, home furnishings, vegetables, fruits, dairy and non-vegetarian products.

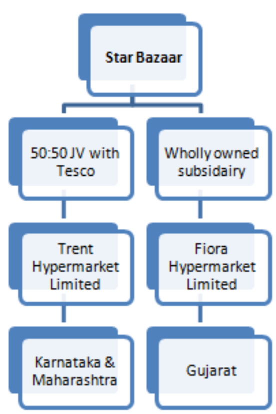
Joint venture with Tesco

In FY14, Trent, along with THL, entered into definitive agreements with Tesco Overseas Investments (Tesco Overseas), a wholly-owned subsidiary of Tesco, UK. The agreements envisaged Tesco to purchase part of the equity shares currently held by the company in THL for ~INR1,500mn and separately subscribe to additional THL equity shares for ~INR7,000mn. **Post conclusion of the proposed investment, Westside and Tesco will each hold 50% stake in THL. The deal was executed at 2x EV/Sales in FY14**.

However, Gujarat and Tamil Nadu have not permitted FDI in multi-brand retail. Hence, Westside divested the stores in these states in April 2014 into a separate wholly-owned subsidiary Fiora Hypermarket (FHL). The company does not envisage expansion of Star banner stores other than in Gujarat. In H2FY15, FHL closed operation of the lone Star Bazaar store in Chennai due to lack of supply chain proximity. It also shut another store in Ahmedabad in light of long-term sustainability issues. FHL also launched, on limited trial basis, a grocery online portal *www.my247market.com* to explore the online grocery retailing opportunity in proximity to select Star banner stores.

The proposed JV will focus on evolving a sustainable store models that will be mutually beneficial. Trent intends to concentrate store presence in Maharashtra and Karnataka and expects to open 3-5 new stores p.a. Further, the company does not envisage expansion of Star banner stores in FHL. The proposed JV expects to operate under multiple banners like *Star Bazaar*, *Star Market* and *Star Daily.*

Fig. 5: Star Bazaar holding



Source: Edelweiss research

Star Bazaar: Key initiatives

- **Emphasis on food as well as non-food merchandise**

  Star Bazaar continues to expand in the non-food category. This category also saw introduction of cleaning fluids, soaps along with private label products. Leveraging its association, some best-selling Tesco products were also made available exclusively at Star Bazaar outlets.

- **Own label offerings**

  Trent continues to lay emphasis on private labels with launch of a number of exclusive products including ghee, noodles, biscuits, ketchup, tea and packaged drinking water. Fruits and vegetables pre-packs were also launched under the "*Eat Fresh*" brand across formats, which have been well received.

Hypermarket: Key learnings

Based on empirical evidence, Trent believes that its hypermarket format is best suited to operate on standalone rather than in malls due to the following reasons:

- Customers prefer quick & direct access to parking and public transport options rather than navigating the mall with a shopping trolley. Hence, shopping malls do not necessarily generate higher footfalls versus standalone stores.
- Given its economics, a hypermarket cannot afford to incur substantial common area maintenance charges in shopping malls. These charges are primarily electricity expenses related to air conditioning, etc., of common areas of a mall. These charges are negligible in case of standalone stores.
- From an operational perspective, standalone stores enable much easier and through-the-day replenishment of stores, unlike mall stores.

Star Bazaar: Different store size

In FY14, Star Bazaar's first express 2,000 sq ft outlet *Star Daily* was opened at Pune to meet daily needs of the immediate catchment area. The intent was to leverage the supply chain gains of being in proximity to a Star Bazaar hypermarket store and simultaneously be easily accessible to customers within dense catchments.

Table 8: Different Star Bazaar formats

Format	Store size (sq ft)	Details
Star Bazaar	30,000	A hypermarket store format that is spread over a large area of 30,000 sq ft and offers entire spectrum of product categories ranging from fresh food, groceries, apparel and general merchandise. The company provides a range of more than 30,000 items at prices showcased in a modern shopping environment.
Star Market	7,500	A supermarket store format from 5,000 to 15,000 sq ft that satisfies the needs of the customer by providing for a top up or a weekly/monthlyshop in fresh offerings including meats, groceries, dairy, bakery, ready to eat, health & beauty and general merchandise products.
Star Daily	2,500	A neighborhood store from 2,000 to 5,000 sq ft that satisfies the needs of the customer by providing for a top up or a weekly shop in fresh offerings including meats, groceries, dairy, bakery, ready to eat, health & beauty and basic general merchandise products.

Source: Company, Edelweiss research

In FY17, THL operated 19 *Star Dailies*, 13 *Star Markets* and 10 *Star Hypers* in Mumbai, Pune and Bengaluru. To provide the best "fresh" offerings to customers, Trent has started sourcing directly from farms. Around 70% of vegetables are now directly sourced and serviced through a network of collection and distribution centers.

Landmark

Trent offers a curated range of toys, front-list books and sports merchandise through its *Landmark* stores. Back-end operations of the format have been integrated with that of the *Westside* format to drive synergies and contain overhead costs. In addition to the independent stores, *Landmark* merchandise is also retailed through select *Westside* locations.

In FY13, Trent purchased TVS Shriram Growth Fund I's (the Fund) entire stake, a minority shareholder in Landmark, a subsidiary of Trent. Consequently, Landmark became a wholly-owned subsidiary of the company. The Fund retains the option to invest in a minority stake in Westland (also a subsidiary of the company). Further, on April 1, 2013, Landmark was merged with the company. Also, Landmark shop-in-shops are being gradually rolled out across select Westside stores entailing growth and to achieve synergies.

In April 2015, Trent launched Sport Zone (Sonae SR operates the largest chain of sports shops in Portugal under the *Sport Zone* banner) at its Bengaluru store as an integral part of the Landmark offer. Innovative products & equipment developed and marketed by Sport Zone will be available to Indian customers at select Landmark stores managed by the company.

Zara

Trent is in JV with the Inditex Group of Spain—Inditex's shareholding at 51% and Trent's at 49%. In FY10, the company invested INR317mn in the JV and the first 3 stores—2 in Delhi and 1 in Mumbai—were opened. Customers' response was encouraging and the JV entity (Inditex Trent Retail India) clocked revenue of INR1,470mn in FY11. Plans are afoot to open more *Zara* stores in India over the next 3-4 years in major metros.

Separately, the company has also entered into a Memorandum of Understanding (MoU) with the Inditex Group to develop and promote *Massimo Dutti* stores in India. As per the MoU, ZARA Holding BV (an Inditex Group company) will hold 51% and Trent 49% in the proposed JV.

Management Overview

Mr. Noel Naval Tata (Chairman): Mr. Tata is the Chairman of Trent and Managing Director of Tata International. He is also the Chairman of Tata Investment Corporation. He completed his management education at the INSEAD Business School in France. He began his career at Tata International, the Tata Group's arm for products and services offered abroad. In June 1999, Mr. Tata became the Managing Director of the Group's retail arm Trent.

Mr. Zubin S. Dubash: Mr. Dubash serves as an Executive President of ATC Tires at Alliance Tire Group. He is also the Group Chief Financial Officer at WNS Global Services. He was employed at Tata prior to 2000. He serves as an Independent Non-Executive Director of Trent. Mr. Dubash is a Chartered Accountant from the Institute of Chartered Accountants in England and Wales. He holds a Bachelor's Degree in Commerce from Mumbai University and a Master's in Business Administration from The Wharton School, Philadelphia.

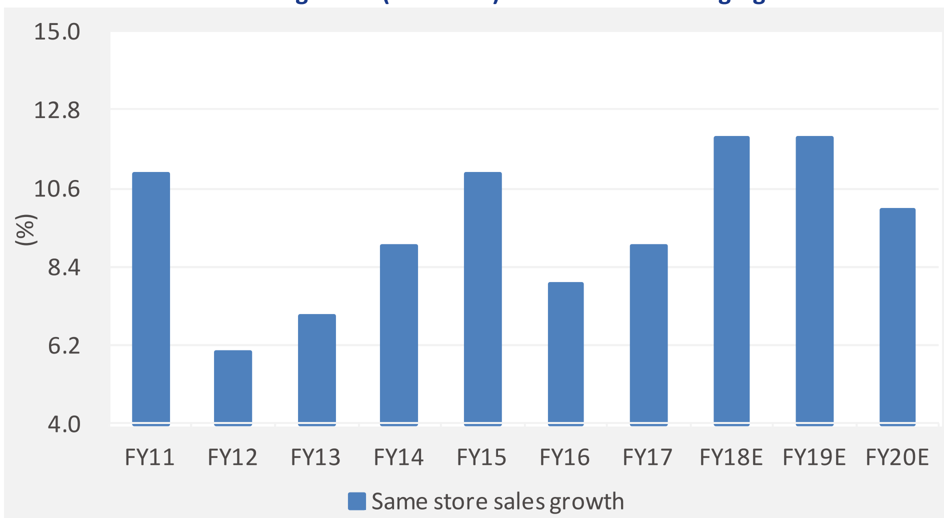
Mr. Bhaskar Bhat: Mr. Bhaskar Bhat, B.Tech, PGDM, has been Managing Director of Titan Company since April 1, 2002, and also serves as its Chief Executive Officer. He started his career as a Management Trainee at Godrej & Boyce Manufacturing in 1978. He has been the Chairman of Tata Ceramics since March 5, 2012. Mr. Bhat has been Chairman of the Board at Rallis India since December 25, 2015 and its Non-Independent & Non-Executive Director since October 8, 2015. He has been a Non-Independent Non-Executive Director at Trent since September 27, 2010. Mr. Bhat has completed his Post Graduate Diploma in Management from Indian Institute of Management (IIM), Ahmedabad, and is a B.Tech in Mechanical Engineering from the Indian Institute of Technology (IIT), Madras.

Financial Outlook

22% revenue CAGR over FY17-20E

We estimate Trent to add 15 new *Westside* stores each in FY18, FY19 and FY20 with SSSG at 12%, 12% and 10% in FY18, FY19 and FY20, respectively aided by strong private labels. The company clocked INR9,000 revenue per sq ft in FY17, which is likely to improve to ~INR12,500 (up 11.3% YoY) aided by private labels and low double digit SSSG. Hence, we estimate 21.2% revenue CAGR over FY17-20.

Chart 11: Same store sales growth (Westside) to record double digit growth



Source: Edelweiss research

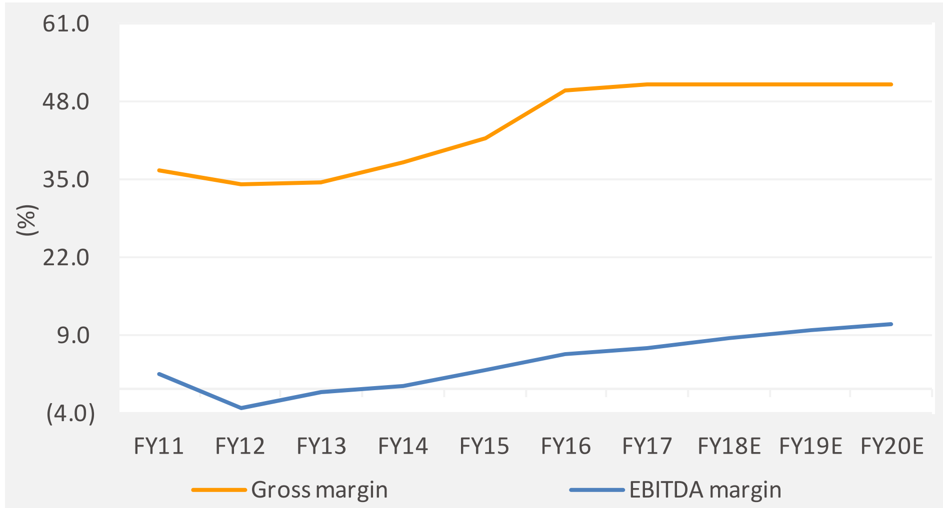
EBITDA margin to improve

Though we do not expect much improvement in gross margin, we estimate slight improvement in EBITDA margin due to operating leverage, which will play out due to double digit SSSG. Further, lower losses in *Landmark* will also improve EBITDA margin.

Trent has the largest proportion of private labels amongst peers (higher gross margin products compared to kirana). Any improvement in gross profit will be contributed by increase in private labels, which seems unlikely as they already contribute 93% to revenue.

Hence, we estimate almost stable gross margin of ~50.8% each in FY19 and FY20. However, we expect EBITDA margin to improve to 9.7% and 10.9% in FY19 and FY20, respectively, from 6.9% in FY17.

Chart 12: Gross and EBITDA margins improving

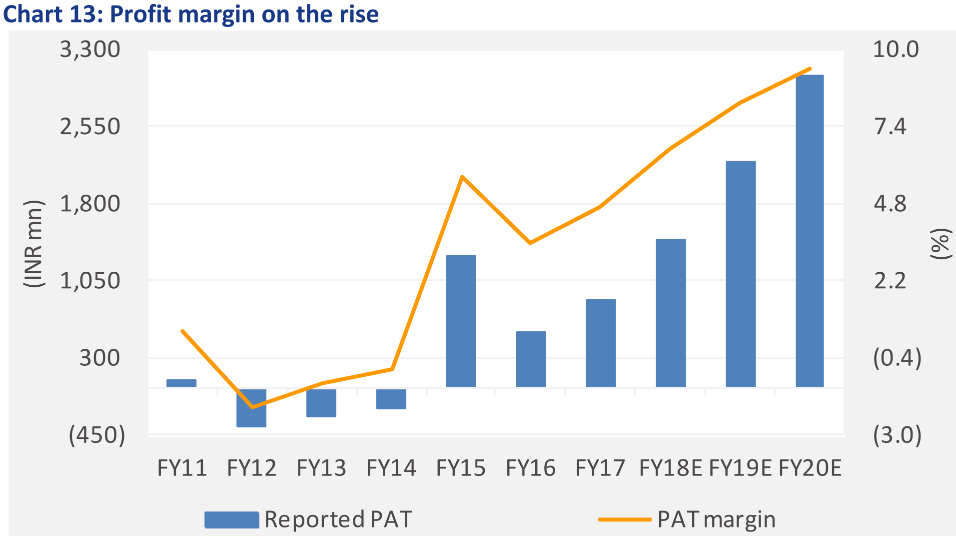


Source: Edelweiss research

Net profit 72.5% CAGR in FY17-20

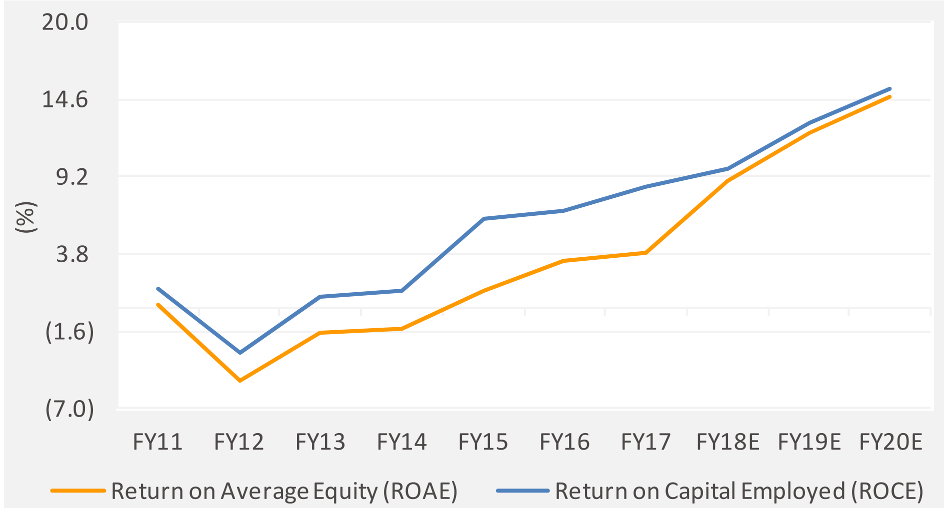
Trent clocked 104.3% PAT CAGR over FY15-17 aided by strong top-line growth and sharpened focus on efficiencies. With controlled cost and reduced losses in JVs, we estimate PAT to clock 72.5% CAGR over FY17-20.

Chart 13: Profit margin on the rise



Source: Edelweiss research

Chart 14: RoAE and RoCE are improving aided by SSSG



Source: Edelweiss research

Financial Statements

Key assumptions

Year to March	FY17	FY18E	FY19E	FY20E
GDP(Y-o-Y %)	6.6	6.5	7.1	
Inflation (Avg)	4.5	4.0	4.5	
Repo rate (exit rate)	6.3	5.8	5.8	
USD/INR (Avg)	67.1	65.0	66.0	
Company Assumptions				
Revenue growth (Y-o-Y %)				
Westside-SSSG growth (%)	9.0	12.0	12.0	10.0
Star Bazaar growth (%)	6.2	8.0	8.0	8.0
Inditex business growth (%)	21.4	12.0	12.0	12.0
No. of Westside stores	107	122	137	152
EBITDA margin assumptions				
COGS as % of sales	49.2	49.2	49.1	49.0
Rent as % of sales	12.6	12.5	12.5	12.5
Ad spends as % of sales	2.6	2.5	2.5	2.4
Financial assumptions				
Tax rate (%)	38.7	33.0	33.0	33.0
Debtor days	2	2	2	2
Inventory days	118	115	112	110
Payable days	62	62	62	62
Cash conv. cycle (days)	58	55	52	50
Depreciation as % of gross bloc	5.4	5.4	5.4	5.3
Capex (INR mn)	914	925	925	1,025

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenues	18,339	21,561	26,870	32,625
Cost of materials	9,028	10,608	13,193	15,986
Gross profit	9,311	10,953	13,677	16,639
Employee expenses	1,925	2,264	2,821	3,426
Rent expense	2,317	2,695	3,359	4,078
Advertisement & sales costs	481	539	672	783
S G &A expenses	3,331	3,730	4,215	4,805
Total operating expenses	8,054	9,229	11,067	13,092
EBITDA	1,257	1,725	2,610	3,546
Depreciation & amortization	413	470	525	575
EBIT	844	1,255	2,085	2,972
Less: Interest Expense	338	340	330	320
Add: Other income	605	610	620	630
Add: Exceptional items	268	-	-	-
Profit before tax	1,379	1,525	2,375	3,282
Less: Provision for Tax	431	503	784	1,083
Add: Share of profit from assoc.	(90)	412	612	836
Reported Profit	859	1,433	2,203	3,035
Less: Excep. Items (Net of Tax)	268	-	-	-
Adjusted Profit	591	1,433	2,203	3,035
No. of Shares outstanding (mn)	332	332	332	332
Adjusted Basic EPS	1.8	4.3	6.6	9.1
No. of Dil. shares OS (mn)	332	332	332	332
Adjusted Diluted EPS	1.8	4.3	6.6	9.1
Adjusted Cash EPS	3.0	5.7	8.2	10.9

Common size metrics- as % of ne

Year to March	FY17	FY18E	FY19E	FY20E
Cost of materials	49.2	49.2	49.1	49.0
Employee expenses	10.5	10.5	10.5	10.5
Rent and lease	12.6	12.5	12.5	12.5
S G &A expenses	18.2	17.3	15.7	14.7
Total operating expenses	43.9	42.8	41.2	40.1
Depreciation & Amortization	2.3	2.2	2.0	1.8
Interest expenditure	1.8	1.6	1.2	1.0
EBITDA margin	6.9	8.0	9.7	10.9
EBIT margin	4.6	5.8	7.8	9.1
Net profit margins	3.2	6.6	8.2	9.3

Growth metrics

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	15.4	17.6	24.6	21.4
EBITDA	35.5	37.2	51.3	35.9
PBT	68.6	10.6	55.7	38.2
Adjusted Profit	25.4	142.4	53.7	37.8
EPS	25.4	142.4	53.7	37.8

Balance sheet				(INR mn)
As on 31st March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Share capital	332	332	332	332
Reserves & surplus	15,145	16,578	18,781	21,816
Shareholders funds	15,477	16,910	19,113	22,148
Minority interest	8	8	8	8
Long term borrowings	998	950	900	850
Short term borrowings	1,909	1,909	1,909	1,909
Total Borrowings	2,907	2,859	2,809	2,759
Long Term Liab. & Provisions	176	176	176	176
Deferred Tax Liability (net)	90	90	90	90
Sources of funds	**18,657**	**20,042**	**22,195**	**25,180**
Gross Block	7,272	8,197	9,122	10,147
Net Block	5,136	5,618	6,051	6,538
Capital work in progress	55	55	55	55
Intangible assets	351	374	392	405
Total Fixed Assets	5,542	6,047	6,498	6,998
Non current investments	9,880	9,880	9,880	9,880
Cash and cash equivalents	1,263	2,241	3,261	5,784
Inventories	3,054	3,631	4,466	5,170
Sundry debtors	59	163	114	222
Loans & advances	1,420	1,420	1,420	1,420
Other Current Assets	948	948	948	948
Total current assets (ex cash)	5,480	6,162	6,947	7,760
Trade payable	1,422	2,202	2,305	3,156
Ot. Cur. Liab. & Short Term Prov	2,086	2,086	2,086	2,086
Total current liabilities & prov.	3,508	4,287	4,391	5,242
Net current assets (ex cash)	1,973	1,874	2,556	2,518
Uses of funds	**18,657**	**20,042**	**22,195**	**25,180**
Book value per share	47	51	58	67

Free cash flow				(INR mn)
Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Reported Profit	859	1,433	2,203	3,035
Add: Depreciation	413	470	525	575
Interest (Net of Tax)	207	228	221	214
Others	(211)	(498)	(511)	(524)
Less: Changes in WC	244	(98)	682	(38)
Operating cash flow	1,024	1,732	1,755	3,338
Less: Capex	914	925	925	1,025
Free cash flow	**111**	**807**	**830**	**2,313**

Cash flow metrices				
Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Operating cash flow	1,024	1,732	1,755	3,338
Financing cash flow	(514)	(388)	(380)	(370)
Investing cash flow	(437)	(365)	(355)	(445)
Net cash flow	74	978	1,020	2,523
Capex	(914)	(925)	(925)	(1,025)
Dividends paid	-	-	-	-

Profitability & liquidity ratios				
Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
ROAE (%)	3.9	8.8	12.2	14.7
Pre-tax (ROCE) (%)	8.5	9.8	13.0	15.4
Inventory days	118	115	112	110
Debtors days	2	2	2	2
Payable days	62	62	62	62
Cash Conversion Cycle	58	55	52	50
Current Ratio	1.9	2.0	2.3	2.6
Gross Debt/EBITDA	2	2	1	1
Gross Debt/Equity	0.2	0.2	0.1	0.1
Adjusted Debt/Equity	0.2	0.2	0.1	0.1
Interest Coverage Ratio	2.5	3.7	6.3	9.3

Operating ratios				
Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Total asset turnover	1.1	1.1	1.3	1.4
Fixed asset turnover	3.6	3.8	4.3	4.9
Equity turnover	1.2	1.3	1.5	1.6

Valuation parameters				
Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Adjusted Diluted EPS (INR)	1.8	4.3	6.6	9.1
Y-o-Y growth (%)	*25.4*	*142.4*	*53.7*	*37.8*
Adjusted Cash EPS (INR)	3.0	5.7	8.2	10.9
Diluted Price to Earnings Ratio (	183.8	75.8	49.3	35.8
Price to Book Ratio (P/B) (x)	7.0	6.4	5.7	4.9
Enterprise Value / Sales (x)	6.0	5.1	4.0	3.2
Enterprise Value / EBITDA (x)	87.8	63.4	41.5	29.8
Dividend Yield (%)	-	-	-	-

Additional Data

Directors Data

Philip Auld	MD & Non - Independent Executive Director	P. Venkatesulu	Executive Director of Finance, CFO & Executive Director
Noel Tata	Chairman of the board	Simone Tata	Chairman Emeritus
Bahram Vakil	AZB & Partners	Harish Bhat	Tata Sons Limited
Abhijit Sen	General Atlantic Llc	Zubin Dubash	ATC Tires Pvt. Ltd
Bhaskar Bhat	Member of the board of directors	Simon Susman	Additional Director
Sonia Singh	Additional Director		

Auditors - N.M. Raiji & Co.

*as per last annual report

Holding - Top 10

	Perc. Holdings		Perc. Holdings
ARISAIG PARTNERS ASIA PTE LTD	9.89	DODONA HOLDINGS LTD	5.36
HDFC ASSET MANAGEMENT CO LTD	3.28	FRANKLIN RESOURCES	3.24
PRAZIM TRADING & INV CO	2.85	DERIVE TRADING PVT LTD	2.74
RELIANCE CAPITAL TRUSTEE CO LTD	2.68	AMANSA CAPITAL PVT LTD	2.54
SBI LIFE INSURANCE CO LTD	1.88	SUNDARAM ASSET MANAGEMENT CO LTD	1.6

** as per last available data*

Bulk Deals

Date	Acquirer/Seller	B /S	Qty Traded	Price
20-Mar-17	Prazim Trading & Investment Company Pvt Ltd	Buy	9,212,230	248
20-Mar-17	Pi Opportunities Fund 1 Lt	Sell	9,212,230	248

**in last one year*

Insider Trades

Reporting Date	Acquirer / Seller	B/S	Quantity Traded
23-Sep-16	TATA SONS LIMITED	Buy	3,877,140

**in last one year*

INITIATING COVERAGE

V-MART RETAIL

Value play on small town

India Equity Research| Retail

V-MART Retail (VMart), modelled on the cornerstone of *value retailing,* is a pioneer in opening stores in the mofussil towns and cities (tier II and III) of India. The company's USP - caters to aspirational middle class (focused on youth and young families), saw it record healthy RoE of 15.8% in FY17. We believe VMart is well-poised to clock revenue and EBITDA CAGR of 21% and 27%, respectively, over FY17-20E, drawing on its distinguished cluster approach, tight leash on costs (lower rental cost of <5% versus average ~10% for peers) and faster payback period. GST-led benefits and higher share of private labels are potent stock catalysts, in our view. We initiate coverage with 'BUY' and TP of INR1,744, based on 18x EV/EBITDA.

Strategic approach to unlock regional potential

VMart is a pioneer in opening stores in the smaller cities, largely in UP and Bihar. **The company's cluster-based store expansion saw it register RoCE of 34% and 45% in Bihar and UP, respectively, in FY17**. This approach has been enhancing VMart's brand visibility accompanied by numerous benefits, viz: i) better understanding of customer preferences; ii) cost-efficient logistics; iii) effective implementation of marketing activities; and iv) better utilisation of manpower. We expect VMart to open 28/28/25 new stores over FY18/19/20 (~50% of which likely in UP and Bihar). Accordingly, we estimate VMart to register 9%/13%/11% SSSG in FY18/19/20.

Execution prowess – from strength to strength

VMart enjoys highest revenue/sq ft at INR9,588 versus peers' average of INR8,221. Presence in tier III cities helps it garner higher revenue/sq ft and breakeven within 3 years thereof. The shift in product mix from kirana (low margin) to fashion (high margin) has also helped in improving revenue/sq ft. **Efficient rental cost (rise of mere 4.0% YoY each in FY19/20) and increasing share of private labels (spurt from current 25% to 80% over next few years) will lend further fillip to EBITDA margin by 140bps.**

Outlook and valuations: Value play; initiate with 'BUY'

On sustained strong SSSG, improving margins and better inventory turns, we expect 27% and 31% EBITDA and EPS CAGR, respectively, coupled with ~570bps jump in RoE to 21.5% over FY17-20. We initiate coverage with **'BUY/SP'** and TP of INR1,744 (18x FY20E EV/EBIDTA). At CMP, stock is trading a 15.2x FY20 EV/EBITDA.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	10,017	12,073	14,822	17,531
Rev. growth (%)	23.8	20.5	22.8	18.3
EBITDA (INR mn)	826	1,006	1,334	1,690
Adjusted Profit (INR mn)	395	480	666	880
EPS growth (%)	49.6	21.6	38.7	32.2
Diluted P/E (x)	67.6	55.6	40.1	30.3
EV/EBITDA (x)	32.0	26.2	19.6	15.2
ROAE (%)	15.8	16.5	19.5	21.5

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: VMAR.BO, B: VMART IN)*

CMP	: INR 1,479
Target Price	: INR 1,744
52-week range (INR)	: 1,586 / 459
Share in issue (mn)	: 18.1
M cap (INR bn/USD mn)	: 27 / 421
Avg. Daily Vol.BSE/NSE('000)	: 1,277.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	54.4	54.4	54.4
MF's, FI's & BK's	2.5	2.5	2.5
FII's	28.9	28.9	28.9
Others	14.2	14.2	14.2

** Promoters pledged shares (% of share in issue) : Nil*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.9	9.0	6.1
3 months	7.3	2.9	(4.4)
12 months	27.1	215.3	188.2

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January 2, 2018

Investment Rationale

Strategically placed to tap regional potential

VMart is a pioneer in opening stores in the smaller towns and tier II and III cities of India. This has seen VMart garner higher market share in these mofussil towns/cities. Going ahead, as spending habits in these cities evolves, VMart with rising/highest market share will be a beneficiary.

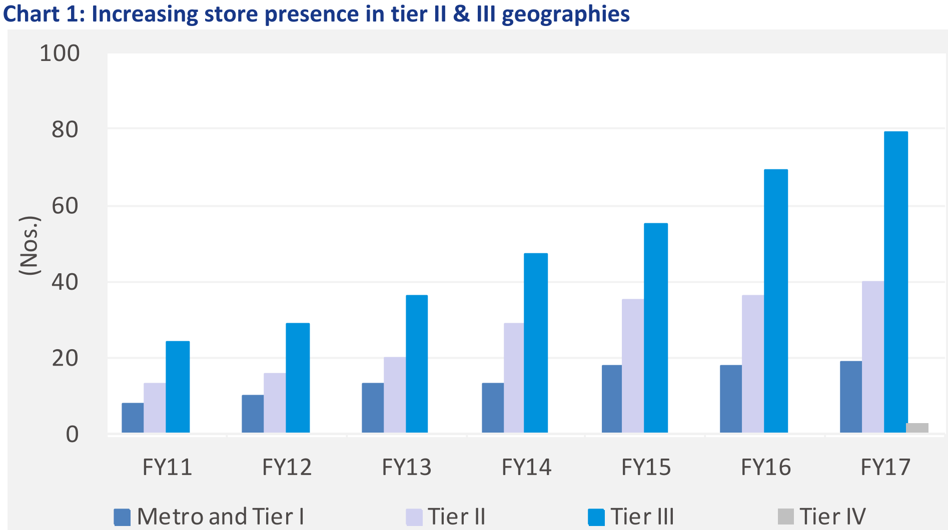
The company follows cluster-based store expansion. This model, not only helps in enhancing brand visibility, but also offers plethora of benefits, such as: i) understanding customer preferences; ii) achieivng cost-efficient logistics; iii) effective implementation of marketing activities; and iv) better utilisation of human resources. It also helps the company have better understanding of customer preferences across the cluster and effective advertisement at lowest cost. Overall, the cluster-based approach helps in building a strong brand image.

We expect VMart to continue with its cluster-based approach and open ~50% of stores in Uttar Pradesh (UP) and Bihar. Going ahead, we expect the company to open 28/28/25 stores each in FY18/19/20 each.

First-mover advantage in tier II and III cities

VMart enjoys first-mover advantage in tier II and III cities having pioneered and opened its stores in the smaller Indian towns and cities like Ujjain, Sultanpur and Motihari. Higher presence in these cities has resulted in a niche market for the company - its USP is meeting requirements of the aspirational middle class (focus on youth and young families) at lower prices. With spending habits evolving in these regions, we believe VMart's value retailing (competitive pricing) will further bolster its market share going ahead.

Chart 1: Increasing store presence in tier II & III geographies



Source: Company, Edelweiss research

Table 1: Geographic spread of stores

No. of stores	FY14	FY15	FY16	FY17	% share
Jammu & Kashmir	1	1	1	2	1.4
Haryana	1	1	1	1	0.7
Delhi	3	3	3	3	2.1
Punjab	4	4	4	3	2.1
Chandigarh	1	1	1	1	0.7
UP	41	50	53	59	41.8
Bihar	16	21	27	31	22.0
MP	4	4	4	4	2.8
Rajasthan	4	4	4	4	2.8
Gujarat	7	7	7	6	4.3
Uttarakhand	3	5	5	5	3.5
Jharkhand	4	7	7	8	5.7
West Bengal	-	-	2	4	2.8
Odisha	-	-	4	10	7.1
Total stores	**89**	**108**	**123**	**141**	

Source: Company, Edelweiss research

About VMart's store presence, the focus is on UP and Bihar accounting for ~64% of its stores network. While one may argue that further expansion in these states may be low, we think otherwise. There are still >1,000 towns where the tehsil population is higher than 0.1-0.2mn and town population is >0.1mn. Thus, there exists huge scope and opportunity in the existing belt where VMart is already present. Apart from UP and Bihar, there is immense scope for VMart to penetrate deeper into adjacent geographies, such as, West Bengal, Odisha, and other north east geographies, etc., where players are limited.

Fig. 1: Presence in UP – Still room to grow

Source: Company, Edelweiss research

Numerous benefits of cluster-based expansion, penetration

VMart follows cluster-based store expansion which strengthens its presence in a particular region as it opens new departmental stores within a radius of 100-150kms from its existing stores. Not only does this enhance its brand visibility, but also offers plethora of benefits such as: i) allows better understanding of customer preferences; ii) facilitates effective implementation of marketing activities; iii) entails cost-efficient logistics; and iv) allows better utilisation of human resources.

The company has access to a lot of customer data to analyse and understand their preferences across the entire cluster. Such data also helps in effective advertisements at low cost. Further, inter-store stock movement and rotation between stores is also easy and quite smooth. For instance, excess inventory from a metro store is often transferred to nearby stores in the semi-urban areas, as these areas tend to catch up with the changing fashion trends at the same pace as the tier I cities. But, consumers in tier III cities aspire for the same trend with lower purchasing power. This is where VMart intervenes. Through its cluster stores the company provides a unique proposition to tier III consumers. As a result, VMart has built a strong brand image, higher inventory churn and lower dead stock.

Value retailing via one-stop family outlets

VMart stores are a *one-stop family shopping destination* with a comprehensive portfolio of product offerings that cater to the needs of an entire family at competitive prices (value retailing). It has also internally classified its store as *Aspire, Plus, Corporate* and *Budget,* which ensures that the right products reache the right stores and to the target customers. The wide range of products on offer for the entire family include formals, casuals and ethnic wear, wedding wear for men, women, boys, girls and infants, accessories, footwear, fashion jewellery, books and stationery, products for infants, home furnishings, kitchenware, crockery, gifts and novelties, toys, games, bags and luggage, purses and clutches, FMCG products, packaged food items, beauty and personal care, home care and staples.

Fig. 2: Store classification

Aspire

Fashion stores primarily catering to the requirements of the youth and young families

Plus

Composite departmental stores catering to all the age groups

Corporate

Departmetal stores specifically targeted at corporate class

Budget

Composite departmental stores catering to the requirements of all age groups with a focus on providing economic products

Source: Company, Edelweiss research

Execution focused

VMart enjoys one of the highest revenue per square (sq) feet (ft) in the retail segment. The company's presence in tier III cities helps it garner higher revenue per sq ft. As such, we expect the company to report 9%/13%/11% YoY SSSG in FY18, FY19 and FY20, respectively.

The company aims to achieve payback period at store and corporate levels in 24-30 and 36 months, respectively. In fact, it proactively redesigns store interiors to improve SSSG once payback is achieved.

Shift in product mix from kirana (low margin) to fashions (high margin) is expected to positively benefit VMart.

Efficient rental cost, focus on private labels and intelligent marketing should further aid the company's growth.

Boasts of highest revenue/sq ft

VMart's presence in tier III cities (largely untapped by other retailers) helps it garner higher revenue per sq ft - enjoys one of the highest revenue per sq ft in retail segment (INR9,588 versus peers' average at INR8,221). Given continued expansion in tier III cities, its revenue per sq ft will remain strong. The company has in fact called out that as they move to tehsils, they will open 6,000 sq ft stores as against the current 8,000-9,000 sq ft stores. This move will ensure that revenue per sq ft remains strong. Rising urbanisation in tier III cities will further aid VMart's growth. Thus, we expect the company to report 9%/13%/11% YoY SSSG in FY18, FY19 and FY20, respectively.

Chart 2: Highest presence in tier III cities

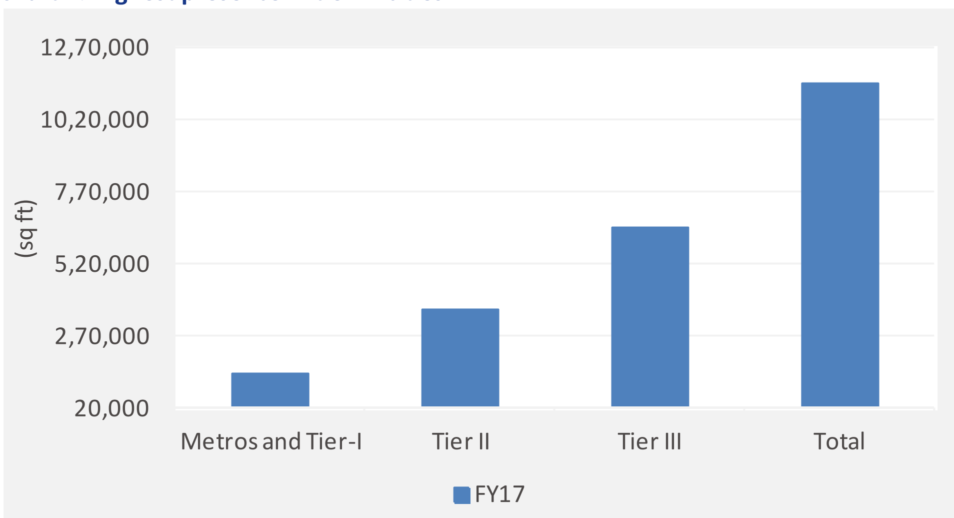


Table 2: Tier III cities accounts for highest revenue contribution

Sales Per Sq. Ft. Per Annum (INR)	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Metro & Tier-I	6,507	6,260	6,756	8,376	9,308	8,220	9,156
Tier II	5,638	6,497	8,100	10,368	8,849	8,232	9,000
Tier III	6,172	7,145	8,904	9,636	9,965	9,792	10,008
Total	**6,084**	**6,780**	**8,220**	**8,796**	**9,504**	**9,072**	**9,588**

Source: Company, Edelweiss research

Table 3: Improving revenue per sq ft (tier-wise per month)

	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Metro and Tier I	542	522	563	698	776	685	763
Tier II	470	541	675	864	737	686	750
Tier III	514	595	742	803	830	816	834
Total	507	565	685	733	792	756	799

Source: Company, Edelweiss research

Table 4: VMart - Improving trend in average revenue per sq ft

	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenue (INR mn)	3,835	5,750	7,202	8,093	10,017	12,073	14,822	17,531
Area covered ('000) sq ft	558	730	883	1,014	1,195	1,433	1,671	1,884
Avg sales per sq ft (p.a.)	7,563	8,928	8,930	8,532	9,069	9,188	9,550	9,864

Source: Edelweiss research

Table 5: Comparison (sales per sq ft) | VMart, Shopper's Stop, Trent

Sales per square feet (per month)	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Shoppers Stop (standalone)	710	651	653	686	687	748	764
Trent (Westside)	598	584	637	635	704	768	750
VMART	507	565	685	733	792	756	799
Pantaloons	NA	NA	616	679	658	691	665

Source: Company, Edelweiss research

Store breakeven within 3 years

To open a 8,000-9,000 sq ft store, VMart usually incurs capex of ~INR1,400/sq ft. Therefore, capex required to open a store is ~INR11-13mn. The company requires similar funding for stocking inventory at the new store. Thus, total capex requirement is INR22-26mn.

Payback period at store and corporate levels is 24-30 and 36 months, respectively. Once payback happens, VMart does not wait for growth deceleration, but proactively redesigns the store interiors to improve its SSSG.

Table 6: Revenue per store to achieve payback

Payback period	
Store capex ('000)	11,000
Working capital ('000)	11,000
Total capex	22,000
Sales per sq ft per month	850
Total sq ft	8,400
Total revenue pa ('000)	85,680
Gross profit (33%)	28,274
Rent (4.7% of the sales)	4,027
Ad spends (2.5% of the sales)	2,142
Salary (6.5% of the sales)	5,569
Power (3% of the sales)	2,570
Other expenses (3.5% of the sales)	2,999
Store EBITDA ('000)	10,967
Store EBITDA margin	12.8
Store level payback (years)	**2.0**
Corporate overhead (4% of the sales)	3,427
Corporate level EBITDA ('000)	7,540
Corporate level EBITDA margin	8.8
Corporate level payback (years)	**2.9**

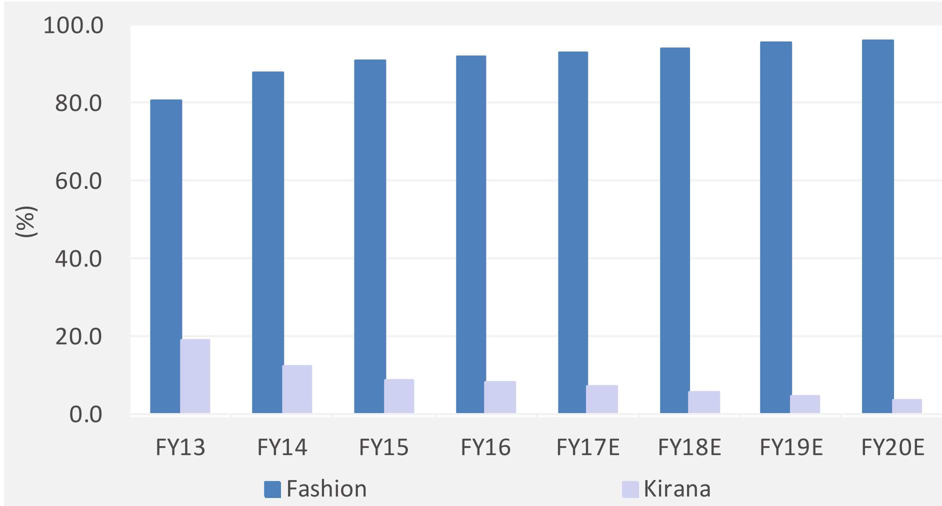
Source: Edelweiss research

We expect VMart to open 28, 28 and 25 stores each in FY18, FY19 and FY20, respectively, out of which major stores will open in tier II and III cities. The company expects to open 50% of the stores in UP and Bihar.

Shift in product mix to bolster margins

From March 2012, VMart decided not to open any stores with a kirana segment sharpen focus on its key high-margin fashion business. The company has been developing new products to strengthen its fashion offerings. Normally, customers do not shop for apparels with a pre-decided brand in mind, but look for good quality, trendy and affordable merchandise. Thus, the share of kirana had fallen from 24.1% in FY12 to 7.2% in FY17. We expect management to continue to drive the fashion segment resulting in 96.1% contribution by FY20. However, kirana products are needed to attract footfalls. Thus, based on experience, taste and preferences of customers, as an exception from February 2017, VMart opened kirana segments at 5 of its old stores in Orissa, West Bengal and UP (Sambalpur, Behrampur and Bhadrak in Orissa, Jalpaiguri in West Bengal and Shahganj in UP).

Chart 3: Improving share of apparels



Source: Company, Edelweiss research

Efficient rental cost

Lease rental is one of the largest cost for any retailer. Hence, to be successful in retail, a player needs to manage rental costs effectively. VMart has successfully controlled its lease rentals by determining the right location and optimal size of a store resulting in reduced operating costs. VMart's lease rentals stood at 4.8% of sales in FY17 compared to 9.0% of Shoppers Stop on standalone basis. Besides the location advantage, the company signed long-term lease agreements for 9-12 years with escalation cost of 10-12% every 3 years.

Table 7: Comparison of lease rental among companies

Companies	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Shoppers Stop (standalone)	8.5	8.6	8.9	8.8	8.8	8.7	9.0
Trent (Westside)	5.9	6.8	6.8	8.4	7.9	7.5	13.1
VMart	5.5	4.9	4.4	4.3	4.6	4.9	4.8

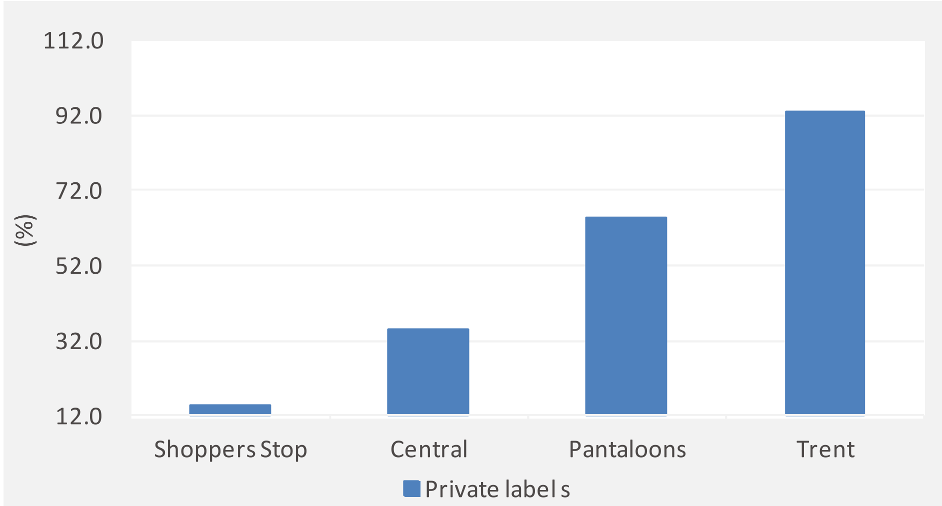
Source: Edelweiss research

Hence, on account of its low-cost structure, even during a challenging environment, the company enjoys one of the highest operating margins versus peers. On strong execution, we continue to believe that VMart's rental and employee costs will be lower than peers. Hence, we forecast lease rental/store/sq ft to increase by 4.0% YoY each in FY19 and FY20.

Focus on private labels persists

VMart proposes to enhance focus on high-margin private labels (accounts for 25% of sales). Also, private labels require low investments in raw material sourcing, technical know-how, brand building and new product development. For VMart, it would be very easy to inch up its share of private labels since end vendors are largely the same. The company targets to inch up private labels' contribution to 80% over next few years.

Chart 4: Private labels compared | Shopper's Stop, Central, Trent, Pantaloons



Source: Edelweiss research

Data mining to intelligent marketing

VMart engages in *Intelligent Marketing* wherein it informs registered customers of the new schemes or offers for specific products based on customers' previous purchases. For example, customers who have a history of purchasing from the kids section receive an SMS about the promotional schemes in the kids section. The company is also involved in cross-promotional schemes across verticals. For example, customers buying noodles from the stores are most likely to be potential customers for its kids section and hence will also be informed about the promotional schemes in the kids section.

Macro tailwinds to boost SSSG

Growing consumption and affordability are the 2 major macro tailwinds seen across India.

India is witnessing rapid urbanisation fuelled by burgeoning economic growth. We believe rising number of nuclear families will benefit this trend. Pertinently, average number of persons per household has reduced from 5.55 in FY81 to 4.91 in FY11. For VMart, strong presence in Uttar Pradesh (UP; third largest GSDP state after Maharashtra and Tamil Nadu and Bihar) is expected to be a major catalyst.

A growing economy has also seen increased participation of female workforce in the country's economic activities - female workforce which accounted for 20.1% of the total workforce in FY71 catapulted to 53.4% in FY09.

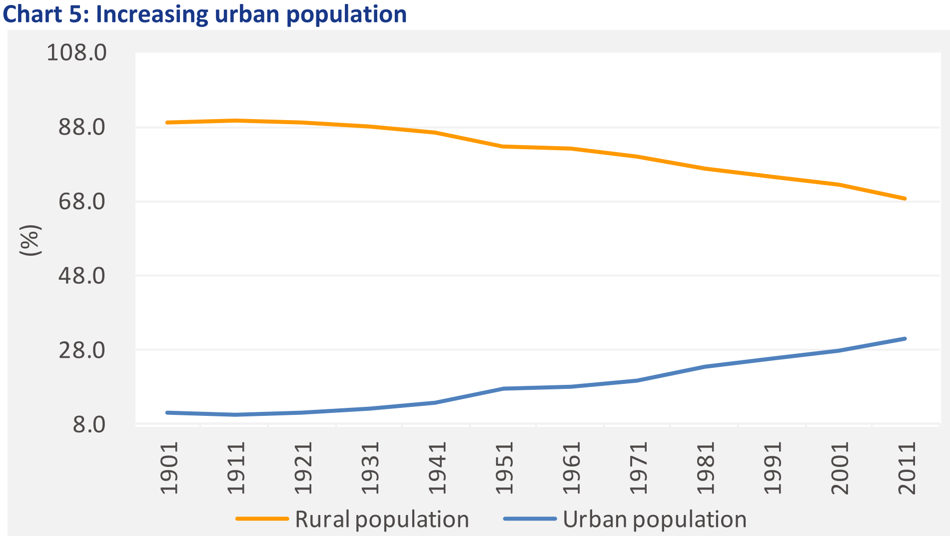
On favourable macros, we estimate VMart to register 9%/13%/11% SSSG in FY18/19/FY20.

Growing consumption

Semi-urban, rural areas to drive growth

India is witnessing rapid urbanisation fuelled by economic prosperity in those areas. As such, aspiration of higher income, better standard of living, etc., have been luring more and more people from the villages to settle in the towns and cities. Over the years, the share of rural population in total population has declined from 80.1% in 1971 to 68.8% in 2011.

Chart 5: Increasing urban population

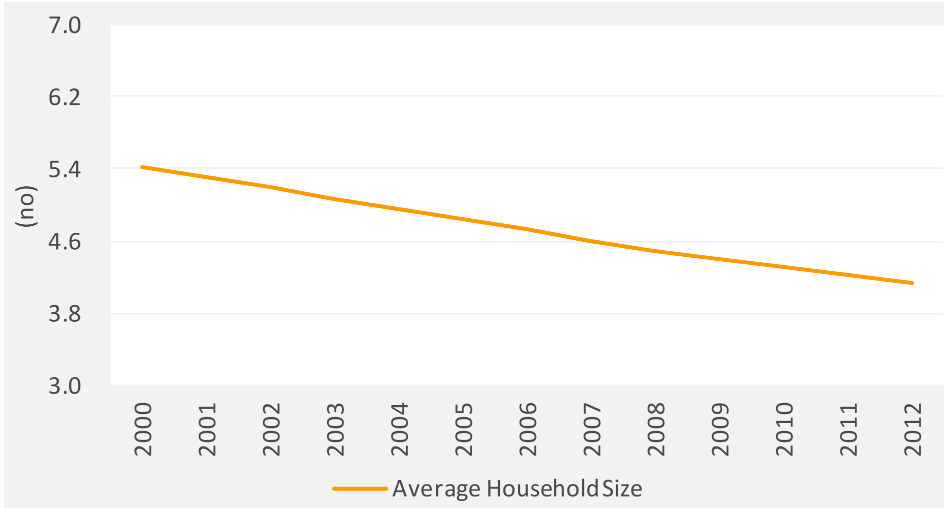


Source: Census, Edelweiss research

Rising number of nuclear families

The massive growth of population, increased urbanisation and unavailability of large real estate spaces have led to growth of nuclear families in the country. The average number of persons per household has reduced from 5.55 in FY81 to 4.91 in FY11. The growing number of households has not only pushed the demand for necessities, but the combined mix of greater purchasing power and willingness to spend has resulted in nuclear families shifting focus towards purchase of discretionary products as well.

Chart 6: Declining average household size



Source: tekcarta, Edelweiss research

Healthy GDP growth in Uttar Pradesh, Bihar

UP is the third largest GSDP state after Maharashtra and Tamil Nadu. The state reported ~5-6% YoY GSDP in FY15. Though Bihar is lower down in the list, GSDP of ~9.5% in FY15 was one of the highest.

VMart owns 59 out of its 141 stores (42% of overall stores) in UP, which contribute 50% of overall revenue. In Bihar, the company owns 31 out of its 141 stores (22% of overall stores) which contribute 22% of revenues. Following rapid urbanisation in UP (20.8% in CY01 to 22.3% in CY11) and Bihar (10.5% in CY01 to 11.3% in CY11), VMart is strategically placed to reap the benefits. With the same political party at the Centre as well as the state, potential prosperity and urbanisation in UP is very high. Loan waivers could also prop up demand in favour of VMart.

Table 8: Rising urbanisation in Uttar Pradesh…

Year	Rural	Urban
2011	77.7	22.3
2001	79.2	20.8

Table 9: …and Bihar

Year	Rural	Urban
2011	88.7	11.3
2001	89.5	10.5

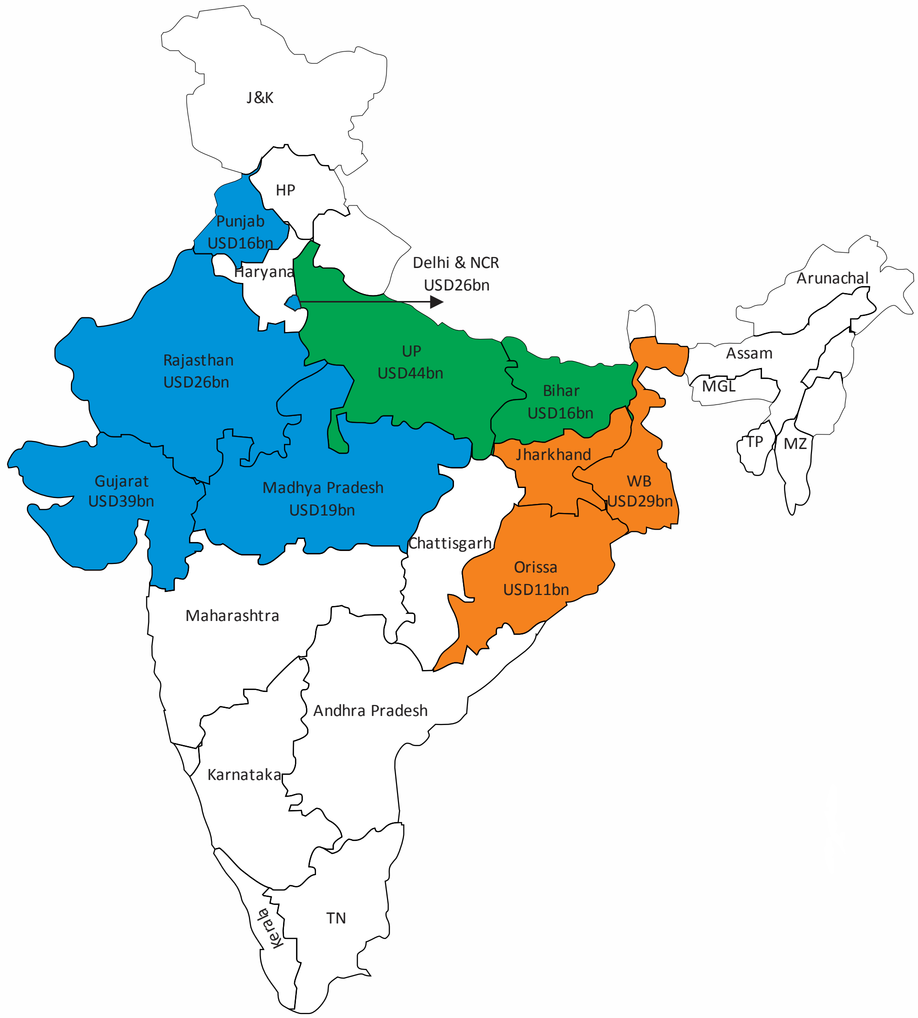
Source: Census, Edelweiss research

Table 10: State GDP growth (FY13-17)

State\Union Territories	FY13	FY14	FY15	FY16	FY17
Andhra Pradesh	0.1	8.5	8.0	11.0	NA
Arunachal Pradesh	2.1	9.3	9.7	3.1	NA
Assam	2.9	4.9	7.9	NA	NA
Bihar	3.9	5.0	13.0	7.1	NA
Chhattisgarh	5.0	9.8	7.6	NA	NA
Goa	(15.4)	(11.9)	9.6	NA	NA
Gujarat	10.9	7.6	7.8	NA	NA
Haryana	6.9	5.6	8.0	NA	NA
Himachal Pradesh	6.4	7.1	7.5	NA	NA
Jammu & Kashmir	2.9	6.2	(0.3)	NA	NA
Jharkhand	8.2	1.6	12.5	12.1	NA
Karnataka	6.2	10.5	7.3	7.3	NA
Kerala	6.5	3.9	7.3	NA	NA
Madhya Pradesh	11.4	3.6	5.4	8.0	12.2
Maharashtra	6.6	6.2	5.8	NA	NA
Manipur	0.5	8.7	6.5	NA	NA
Meghalaya	2.2	1.8	2.1	6.4	6.7
Mizoram	7.2	16.2	6.6	NA	NA
Nagaland	5.1	11.1	2.1	NA	NA
Odisha	4.6	8.7	6.0	6.0	7.9
Punjab	5.3	6.3	4.9	NA	NA
Rajasthan	4.2	6.1	6.1	NA	NA
Sikkim	2.3	6.1	6.3	6.5	NA
Tamil Nadu	4.8	6.9	6.9	8.8	NA
Telangana	2.4	6.4	8.8	9.2	NA
Tripura	8.7	9.3	9.9	NA	NA
Uttar Pradesh	4.3	6.4	6.3	7.1	NA
Uttarakhand	7.2	8.2	5.0	8.7	NA
Andaman & Nicobar Islands	4.5	8.3	7.5	NA	NA
Chandigarh	8.0	8.0	9.3	10.3	NA
Delhi	6.6	6.9	8.0	8.8	8.3
Puducherry	2.9	10.7	6.6	7.7	7.5

Source: Planning Commission, Edelweiss research

Fig. 3: Retail spend in select states



Source: Technopark, Edelweiss research

Highlighted states represent VMart's areas of operation (green - highest stores, orange - potential store opening, blue - few stores)

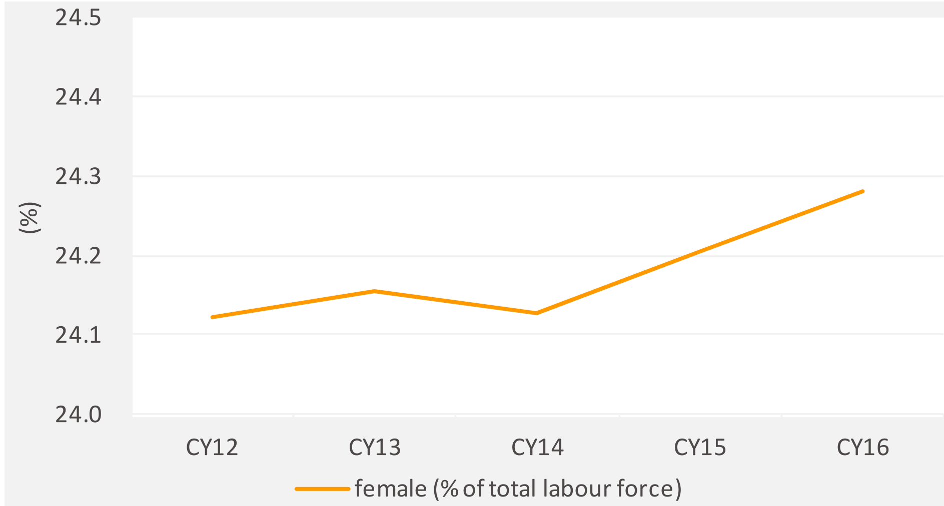
Growing affordability

Increasing percentage of working women

With a burgeoning Indian economy, participation of the female workforce in the country's economic activities has increased considerably. Female workforce, which accounted for 20.1% of total workforce in FY71, scaled up to 53.4% in FY09. Notably, the percentage of working women engaged in organised industrial activities also grew from 19% in FY05 to 19.9% in FY10. The higher purchasing power in the hands of working women versus the housewives comparatively enhances the ability of former to spend much more.

Further, the time constraint factor also needs to be accounted for by the working women while making purchases of various day-to-day requirements. Capitalising on same, organised retailers have been increasingly emphasising on the *one-stop shop* concept wherein all household requirements (from food & grocery to apparels)is met under a single roof.

Chart 7: Increasing proportion of female workforce

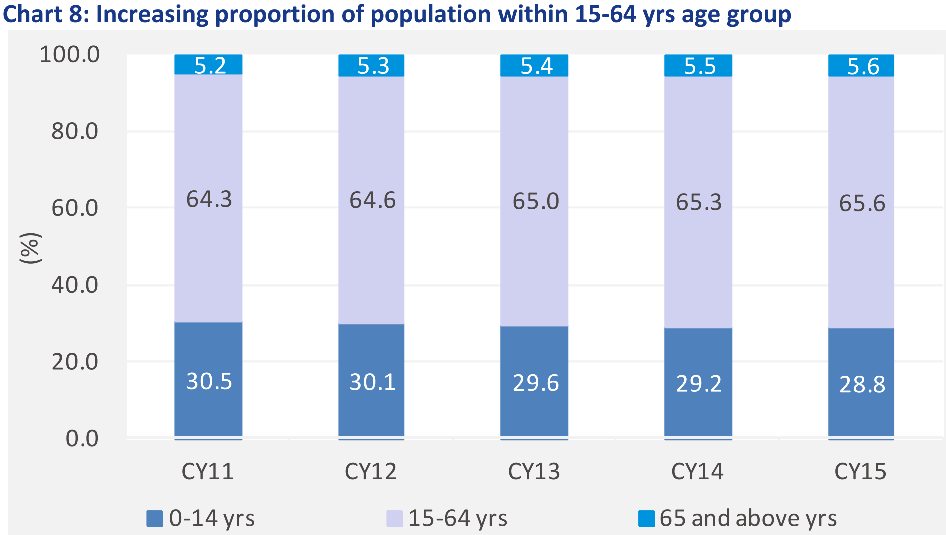


Source: World Bank, Edelweiss research

Higher earning population

The growing Indian population has resulted in simultaneous increase in the earning population (in the 15-60 years age group) - increased from 55.4% in 1991 to 64.9% in 2011. The populace in the age group of >60 years witnessed a decline from 7.32% of the total populace in 1991 to 5.5% in 2011. Populace in the age group 0-14 years also witnessed a decline with a corresponding fall in share from 37.3% in 1991 to 29.7% of the total populace in 2011. Considering the huge size of the Indian population, a lower median age implies higher number of working people, thereby clearly outlining the immense earnings and spending potential of the Indian populace, on which domestic retail could thrive.

Chart 8: Increasing proportion of population within 15-64 yrs age group



Source: World Bank; Edelweiss research

Key pointers on the radar

Relaxation of FDI norms for single brand retailing

In FY12, the government relaxed the FDI norms for single-brand retailing thereby raising the limit of foreign investments from 51% to 100%. Prima facie this was an encouraging move for industry. As Indian retailers are cash deprived, any inflow from foreign retailers (new joint ventures (JVs) or foreign retailers increasing their stake in existing JVs) would be beneficial to Indian retailers. However, certain conditions accompanying FDI in single brand retail deterred entry of retail foreign players into India.

Conditions:

(i) In case of foreign share in JV's exceeding 51%, sourcing of 30% of value products / raw materials should preferably be from the MSME/ village, cottage industries, artisans and craftsmen (wherever feasible).

(ii) The foreign retailer has to invest a minimum USD100mn with 50% of the said investments in backend infrastructure and supply chain management operations.

Relaxation of FDI norms for multi brand retailing

The government has approved entry of foreign multi-brand retailers - FDI up to 51% in Indian retail allowed.

Internet, a potential threat

There is a rising trend among Indian consumers to buy products online attracted by the higher discounts. We believe this spurt in e-retailing could be a potential challenge to VMart's business model as well as growth prospects. Although there is limited customer overlap between online retail and VMart, we believe as aspirations of tier III and IV cities rise, the potential threat from online shopping increases. Online retailers are focussed on electronics and branded apparels. The company caters to the lower and lower middle class segment, whose aspirations are high, but current scope of online shopping is limited. Hence, the treat is minimal. However, any shift in shopping pattern in this class of segment will hurt VMart's growth potential.

Outlook and Valuation

Advantage organised retail

Of the USD616bn Indian retail market, organised retail accounts for ~9% (overall retail market was USD386bn in FY12 of which organised was ~7%). Apparels and accessories contribute 22% to organised retail. VMart is present in this segment and will continue to benefit from increasing population, rapid urbanisation and presence in tier II and III cities. We believe the company is well poised to tap big opportunities in tier II and III cities where its potential customers do not have access to aspirational products. Further, VMart enjoys an edge in cost structure (lowest rental costs) over its peers.

GST benefits

We expect VMart to benefit from GST. Currently, the company pays 5-6% VAT on products. With readymade garments priced lower than INR1,000 attracting mere 5% GST, we believe the company will benefit from same. We believe with VMart's average selling price at INR208, impact of GST would be limited.

VMart is a play on organised retail largely in UP, Bihar and other North Eastern geographies. The company will be a key beneficiary of recovery in discretionary spending as well as potential shift in spending pattern from unorganised to organised retail chain. **Further, improving share of private labels from current levels of 25% to 80% will boost margins.**

Anchored by robust growth potential, margin improvement and huge opportunities we assign a target multiple of **18x FY20E EBITDA and arrive at a target price of INR1,744.** Our target multiple is justified given that VMart has a better margin profile, return ratios and growth prospects. Further, we expect the company to log **31% EPS CAGR over FY17-20 and RoE expansion from 15.8% in FY17 to 21.5% in FY20.** We remain positive on the stock from long-term perspective as we believe that though new competition may emerge in their dominant geographies, it will likely not disrupt the growth trajectory, but rather only expand the consumption pattern from unorganised to organised format. We initiate coverage with **'BUY/SP'**. The stock is currently trading at 15.2x FY20E EV/EBITDA.

Table 11: Valuation justification

	Power	Comments
Brand value	**High**	VMart is a renowned brand in tier II and III cities. It is famous among aspirational and middle class consumers.
Market share	**Improving**	The company continues to expand in tier II and III cities especially in Uttar Pradesh and Bihar which will bolsters market share.
Pricing power	**Medium**	The company caters to aspirational and middle class populace in tier II and III cities. However, spending power of these segment is limited. Hence it is not easy to take price hikes.
Competition	**Low**	The company does not face competition from unorganised markets.
Free cash flow	**Medium**	Though the company is in the expansion mode and plans to open 28 stores each in FY18 and FY19, it will still generate free cash flow.
RoAE improvement	**Positive**	RoAE is expected to improve from 15.8% in FY17 to 21.5% in FY20.

Source: Edelweiss research

Key Risks

Changing customer preferences may impact demand

VMart has a wide range of offerings such as apparels, non apparels, home decor, accessories, footwear, kirana and FMCG products. However, the company's success will hinge on its ability to forecast, anticipate and respond to changing customer preferences and trends in a timely manner. Failure to perceive prevailing trends or forecast changes could result in merchandise obsolescence, thereby increasing dead stock and loss of brand image among customers.

Disruptions in transport network may hamper operations

With VMart having 1 distribution centre, it uses trucks to deliver the products to the stores. However, the company does not have any definitive agreements with any third party transport service providers and engages them on need basis. Thus, any issues in transport operations may adversely affect its business.

Intensifying competition

The company faces competition from both existing retailers (organised and unorganised), and potential entrants to retail industry that could affect its profitability. In the organised space, Vishal Mega Mart and Big Bazaar are its competitors. With new entrants venturing into retail industry and existing players consolidating their positions, competition could intensify. Some competitors have access to significantly higher resources and hence are equipped to compete more effectively. Owing to rising competition: 1) VMart may have to price its products at levels that may impact margins; 2) may see rise in capital expenditure incurred to differentiate from peers; and 3) advertising and distribution expenditures will increase, which may materially mar profitability.

Company Description

V-Mart Retail (VMart), incorporated in 2002, is a medium size hypermarket format retail chain. The company has emerged as one of the pioneers in extending its retail footprint beyond the metros to tier-II and III locations. It operates a chain of department stores that offer apparels, general merchandise (non-apparel and home mart) and kirana bazaar products (FMCG and packaged foods) that cater to the entire family primarily in tier II and III cities.

The company has adopted the concept of "value retail", which is based on the customers' socio-economic condition, purchasing power, demographics and shopping trends. It caters to the aspiring middle-class populace targeting the fashion-led aspirations of the youth and young families.

Fig 4: VMart| Different format

VMART Aspire

VMART Aspire caters to the youth segment with apparel which is in-sync with the latest trends. The company stays abreast of market developments to purchase and stock merchandise accordingly

VMART Plus

VMART Plus caters to all age groups and serves the basic as well as discretionary needs of customers. Since these stores serve customers of all age groups and sections of the society, the company stock merchandise accordingly and are situated in selective are areas which are highly pupulated with kids and senior citizens.

VMART Corporate

VMART Corporate targets office goers (both made and female) and the product line has been internally termed. These stores are located in areas where the population mostly comprises working professionals.

VMART Values

VMART Values caters to all age agroups and focuses on cost competitive quality products keeping in mind the economic profileof the inhabitants of the regions.

Source: Company, Edelweiss research

Presence

Commissioning stores in the metros is an easier proposition, but VMart built its business model around emerging India (tier-II and III cities), where there was a huge gap between aspirational growth and presence of organised retail. In FY16, the company's tier III presence stood at 56%.

VMart is predominantly present in North and East India across smaller towns, including Bhavnagar, Jamnagar, Gandhidham, Junagarh, Mehsana, Motihari, Azamgarh, Begusarai and Jaunpur. In these towns, where VMart is first of its kind store, its basic shopping facilities have grabbed much attention. The facilities include air-conditioned premises, trial rooms, , 100% power back-up, food joints (some outlets) and toilets – most of these are missing in traditional apparel outlets/ departmental stores.

Also, most shops in the small towns work for a restricted number of hours and are generally shut in the afternoon, and also take weekly offs. The VMart stores, on the other hand, are open 13 hours a day, 7 days a week and 365 days of the year. Membership cards, acceptance of debit/credit cards, and shopping vouchers are some of the other benefits. As modern shopping outlets are a new concept in the smaller towns, VMart has been able to consistently grow its SSSG in past 4 years.

Table 12: Store presence

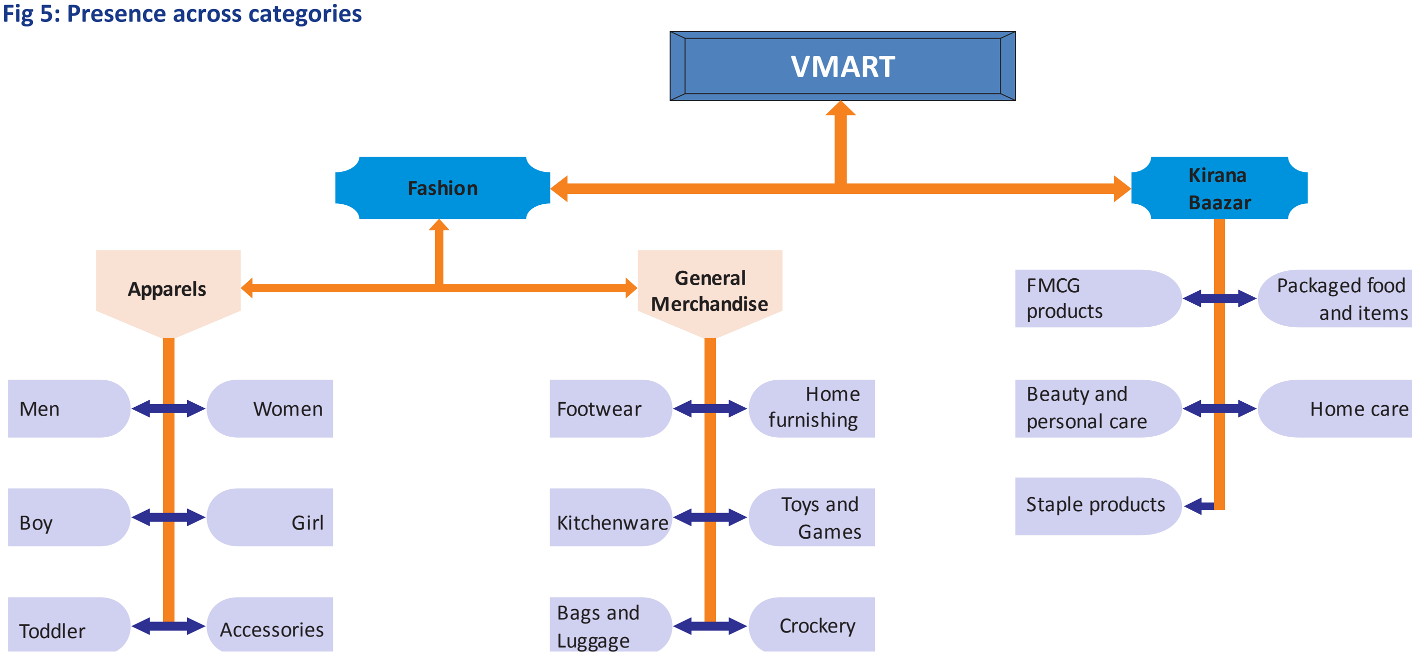
Stores (nos)	FY14	FY15	FY16	FY17	% share
Jammu & Kashmir	1	1	1	2	1.4
Haryana	1	1	1	1	0.7
Delhi	3	3	3	3	2.1
Punjab	4	4	4	3	2.1
Chandigarh	1	1	1	1	0.7
UP	41	50	53	59	41.8
Bihar	16	21	27	31	22.0
MP	4	4	4	4	2.8
Rajasthan	4	4	4	4	2.8
Gujarat	7	7	7	6	4.3
Uttarakhand	3	5	5	5	3.5
Jharkhand	4	7	7	8	5.7
West Bengal	-	-	2	4	2.8
Odisha	-	-	4	10	7.1
Total stores	**89**	**108**	**123**	**141**	

Source: Company, Edelweiss research

Categories

VMart offers products in 3 segments - apparels, general merchandise (clubbed under fashion) and kirana. However, the kirana business derived gross margins of ~12% as compared to 30% plus margins in fashion (apparels and non-apparels).

Fig 5: Presence across categories



Source: Edelweiss research

Inventory management

VMart has a policy of provisioning for shrinkage once every quarter. This results in shrinkage ratio reducing in those quarters when the actual stock taking happens. Generally, the company follows stock taking in the second or fourth quarter.

Further, there is always the danger of an increase in inventory during a sales slowdown. Generally, the company responds to weak retail sentiment through various initiatives. For instance, it moderated the number of warehouses from 4 to a centralised Bilaspur (Haryana) facility in FY15, impact of which began to show in FY16. Not only did VMart more than double its warehousing space, but also witnessed several upsides due to storage efficiency.

Vendor management

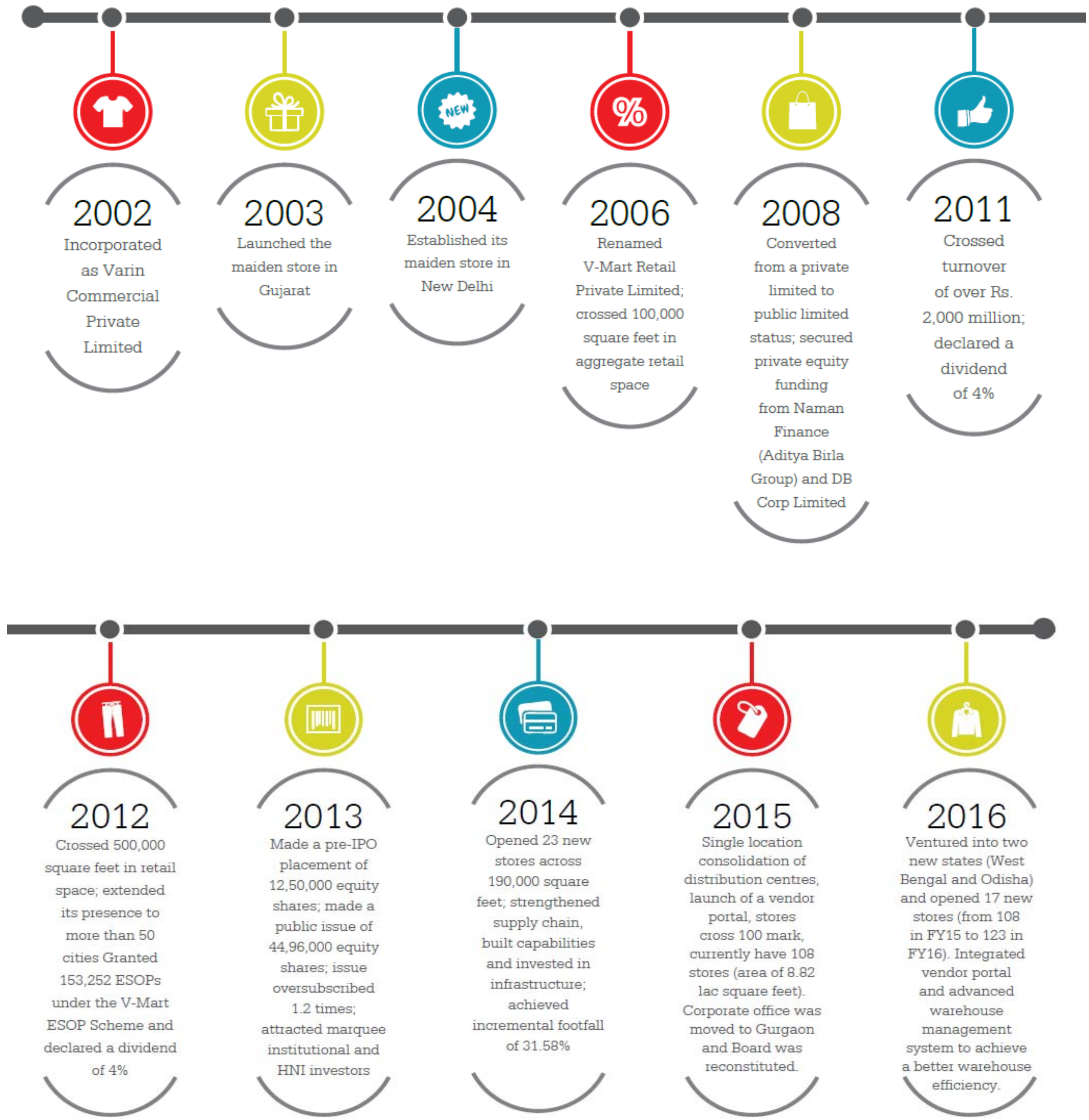
The company sources apparels from ~700-800 suppliers and no supplier accounts for more than 1% of purchase. Currently, it is undergoing vendor consolidation resulting in better scale. This gives strong bargaining power to VMart to source at best possible rates. It sources the products for all stores in bulk, which results in lower sourcing rates. Besides, VMart does not have any system of selling goods on consignment basis and 100% of apparels are purchased and sold.

During a slowdown year when inventory begins to accumulate, there is a premium on getting clarity about which vendor's output lies where, of what design and in what quantity. In its business-strengthening initiative, VMart launched a vendor-dedicated portal to enhance vendor-centric merchandise visibility across each store.

This information, available at the click of a button, made it possible for vendors to take proactive calls in re-pricing their stock to accelerate sales flows; besides, stock movements generate leads regarding which vendors should deliver their next consignment to the centralised warehouse facility (neither overstocking nor stocking out), resulting in better warehouse space efficiency.

Besides, VMart has moderated the number of vendors from 1,200 to 700-800 for superior value; it is focused on fastest moving SKUs (as opposed to providing an entire range), helping move stocks faster.

Fig.6: Life cycle of VMart



Source: Company, Edelweiss research

Fig. 7: SWOT analysis

Source: Edelweiss research

Porter's 5 forces

Entry barrier: We classify entry barriers as low to moderate due to following factors:

- Requirement of various licenses from multiple government authorities is a major barrier
- Capex requirement for commercial retail space is moderately high

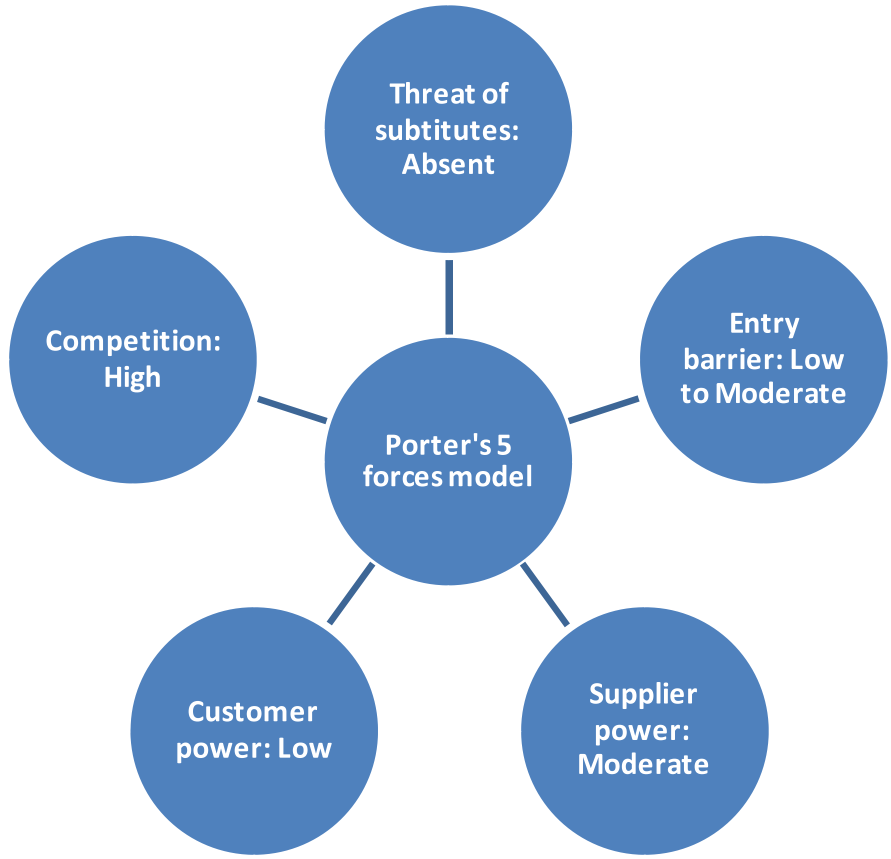
Threat of substitutes: The threat of substitutes can be classified as absent as the products cannot be substituted by any other businesses.

Bargaining power of customers: We believe that bargaining power of customers can be classified as absent as the product sales happen at MRP, which leaves minimal scope for customers to bargain in organised space.

Bargaining power of suppliers: We believe that bargaining power of suppliers can be classified as low to moderate as the company purchases goods from 700-800 active vendors.

Industry rivalry: To attract footfalls, there is intense competition among the retailers. Hence, industry rivalry can be classified as high.

Fig. 8: Porter's 5 forces



Source: Edelweiss research

Board of Directors

Mr Lalit Agarwal - **Chairman and Managing Director**

Mr Lalit Agarwal holds a Bachelor‟s Degree in Commerce from Mumbai University, and a Diploma in Financial Management from Narsee Monjee Institute of Management Studies, Mumbai. 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. He has over 16 years experience in the retail industry. With a vision to establish the concept of organised value retailing in certain untapped regions of India, he set up retail stores under the brand name of "VMart" in 2003. He spearheads the company and is responsible for formulating and implementing the business plans.

Mr Madan Agarwal - Whole-time Director

Mr Madan Agarwal holds a Bachelor's degree in Arts from City College, Calcutta University. He has more than 3 decades of experience in retail industry. He started his career by opening a retail shop in 1975 and later in 1979 opened another retail store of apparels and footwear in Cuttack called "Shreeman Shreemati.

Senior Management

Mr Rajan Sharma - President (Sourcing & Procurement)

Mr Sharma has more than 20 years of experience in sourcing & procurement of merchandising. He holds an M.Com Degree from Delhi University. Previously, he worked with TPG Whole Sales Pvt. Limited.

Mr Anand Agarwal - Chief Financial Officer

Mr Anand Agarwal is a CA and CS with 20 years of experience in technology, retail, sports & education industries. He worked with Ernst & Young, Reebok India and HT Media in various leadership roles. He had also been a tech entrepreneur in the past having himself launched one of India's first ISP's in 1999.

Ms Snehal Shah - Senior Vice President (Operations & Marketing)

Ms Shah holds a Bachelor's Degree in commerce from K P B Hinduja College of Commerce, Mumbai, holds a Diploma in Computer Management from Datapro and Certificate in Management from Crestcom, USA. He has around 1 decade of work experience in retail industry

Mr M. Srinivasan - Vice President (Supply Chain Management)

Mr Srinivasan is a Chemical Engineer from A.C. College of Technology Chennai and holds a PGDM in Finance & Operations from IIM, Lucknow. He has ~15 years of experience in supply chain management in planning, operations, process consulting and system development & implementation. Earlier, he had worked with companies like Reliance Industries, HP, Tesco and Resurgent.

Mr Venugopal Konchada - Vice President (Store Operations)

Mr Konchada is a senior retail professional with extensive 25 years of experience. He has handled numerous senior level positions and attained proficiency in developing new markets, establishing business tie-ups and achieving targeted goals across operations.

Mr Ramesh Agarwal - Vice President (Supply Chain Management and FMCG)

Mr Ramesh Agarwal has 34 years of experience in the retail, garment manufacturing, restaurants and electric fan spare parts industries. He developed more than 200 FMCG private labels at Vishal Retail in 2007. At VMart, he has successfully consolidated all warehouses at one location.

Financial Outlook

Revenue to register 20.5% CAGR

We expect VMart to add 28, 28, and 25 new stores each in FY18, FY19 and FY20, respectively, with focus on tier II and III cities. Rising aspirations, particularly witnessed in tier II and III cities, we believe will benefit VMart. We expect the company to open half the stores in UP and Bihar. In our view, increasing population and rapid urbanisation in these states will support SSSG. Overall, we expect: 1) VMart's market share to further ramp up in UP and Bihar on the back of increased store expansion in those geographies; and 2) additional benefits of cluster based approach to play out in terms of better revenue per sq ft.

We expect VMart to report 9%, 13% and 11% SSSG in FY18, FY19 and FY20, which would translate into 20.5% revenue CAGR over FY17-20E.

Chart 9: SSSG to sustain high single to low double digit trajectory

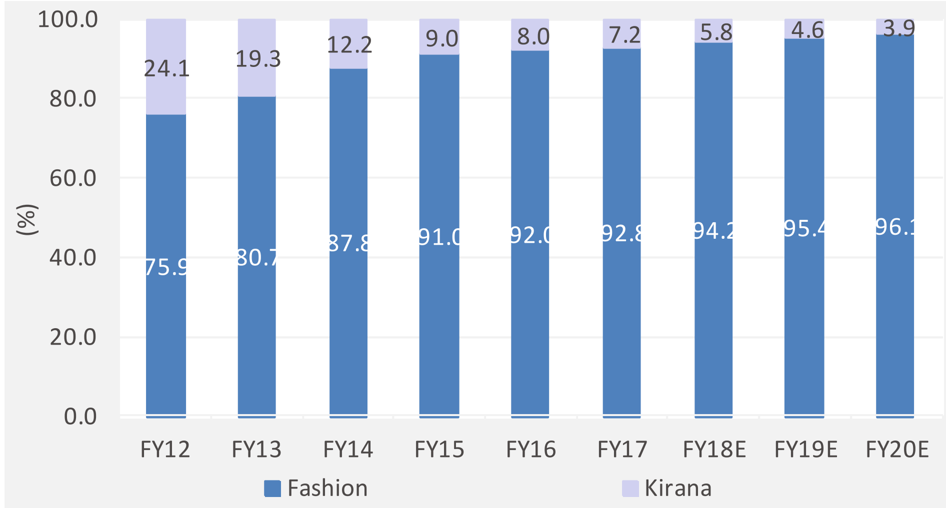
Source: Company, Edelweiss research

Gross, EBITDA margins expansion here to stay

VMart has started focusing on its high-margin fashion business as against low-margin kirana segment. We believe this shift will not only improve gross margins, but also lend impetus to EBITDA margins. Gross margin will receive further leg-up from improvement in private labels' share, in our view. Besides, the company also has tight control over costs. For instance, it enjoys lowest rental cost versus peers.

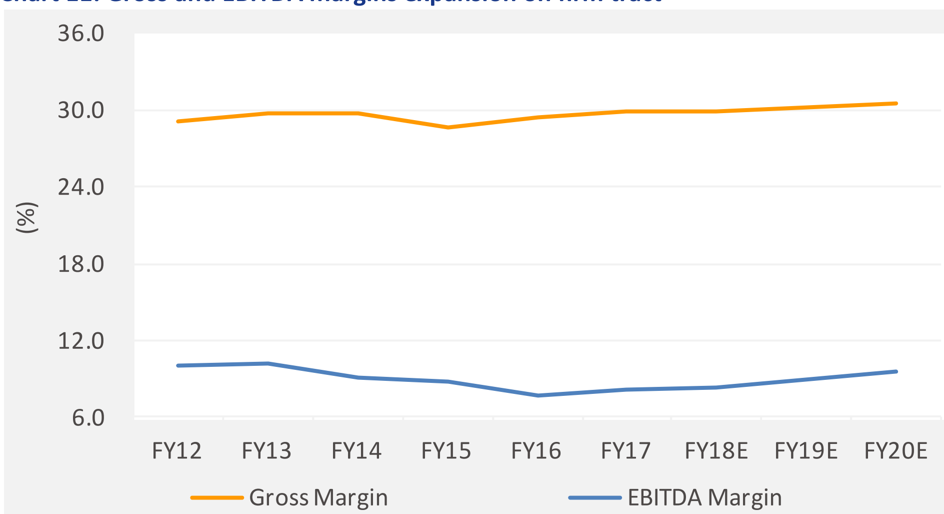
During FY11-17, gross margin contribution improved from 28.1% to 29.8%, which we estimate going ahead will improve further to 30.5% by FY20. While ascertaining this gross margin expansion, we are conservatively not factoring in improvement in share of private label. Any increased in share of private labels, will further propel gross margins. On the back of operating leverage, we expect EBITDA margins to improve from 8.2% in FY17 to 8.3%, 9% and 9.6% in FY18, FY19 and FY20, respectively.

Chart 10: Rising contribution from high-margin fashion segment



Source: Company, Edelweiss research

Chart 11: Gross and EBITDA margins expansion on firm tract

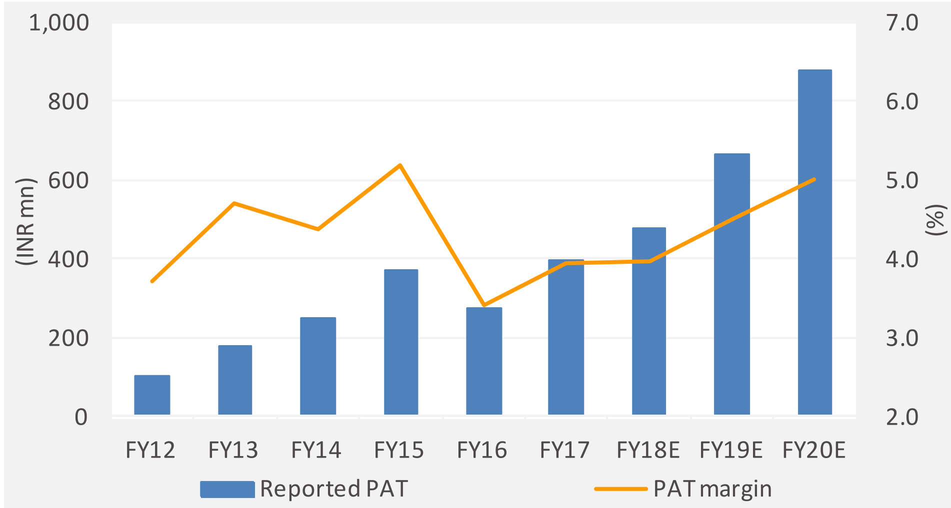


Source: Company, Edelweiss research

Net profit to log 30.6% CAGR over FY17-20

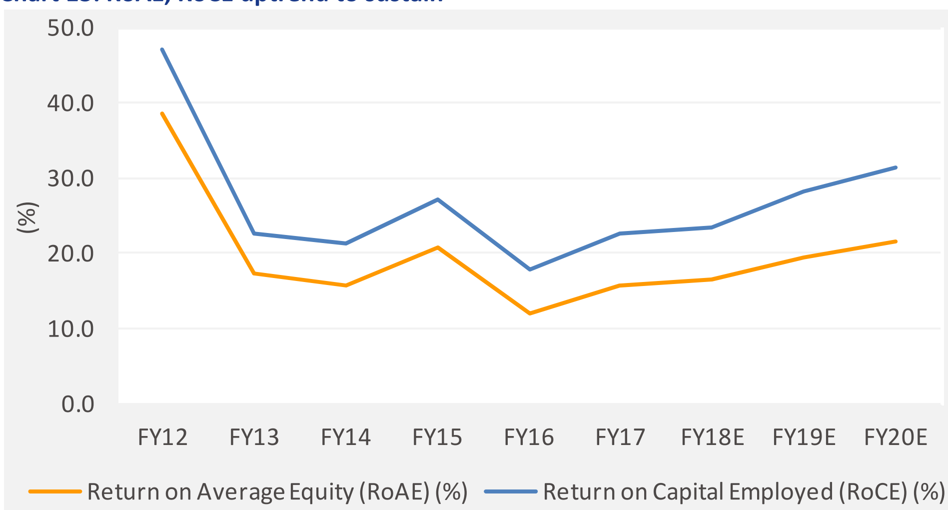
VMart reported 22.6% PAT CAGR during FY11-17, aided by strong top-line growth and enhanced focus on efficiencies. We expect the company to continue to focus on top line and well supported by higher SSSG and margins. Overall, on contained costs, we expect PAT to increase by 30.6% CAGR over FY17-20.

Chart 12: Net profit to clock 31% CAGR coupled with 110bps margins expansion



Source: Company, Edelweiss research

Chart 13: RoAE, RoCE uptrend to sustain



Source: Company, Edelweiss research

Financial Statements

Key assumptions

	FY17	FY18E	FY19E	FY20E
GDP(Y-o-Y %)	6.6	6.8	7.4	
Inflation (Avg)	4.5	4.0	4.5	
Repo rate (exit rate)	6.3	5.8	5.8	
USD/INR (Avg)	67.1	65.0	66.0	
Company assumptions				
Sales assumptions	0.1	0.1	1.1	
Same store sales growth (fashion)	13.0	9.0	13.0	11.0
Kirana stores (YoY growth)	11.1	(2.0)	(2.0)	(2.0)
Total no. of stores	141	169	197	222
New store sales (INR mn)	5,230	5,230	5,400	5,500
Cost assumptions				
COGS (% of revenue)	70.2	70.1	69.8	69.5
Employee expenses (% of revenue)	7.8	7.6	7.5	7.4
Rent expenses (% of revenue)	4.8	5.1	5.0	5.0
Advertising & Sales Promotion	2.3	2.5	2.5	2.5
SG&A and other costs	6.8	6.4	6.2	6.0
Financial assumptions				
Inventory days	123	123	123	123
Payable days	66	66	66	66
Interest rate on o/standing debt (%)	11.3	8.5	9.1	8.6
Depreciation as % of gross block	10.2	10.5	10.5	10.4
Capex (INR mn)	400	391	391	377
Tax rate	34.3	35.0	35.0	35.0

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenues	10,017	12,073	14,822	17,531
Cost of materials	7,028	8,463	10,346	12,184
Gross profit	2,990	3,610	4,476	5,347
Employee expenses	777	918	1,112	1,297
Rent expense	479	611	741	869
Advertisement & sales costs	226	302	371	438
S G & A expenses	682	773	919	1,052
Total operating expenses	2,164	2,603	3,143	3,657
EBITDA	826	1,006	1,334	1,690
Depreciation & amortization	220	268	309	346
EBIT	606	739	1,024	1,344
Less: Interest Expense	35	30	30	25
Add: Other income	31	30	30	35
Profit before tax	601	739	1,024	1,354
Less: Provision for Tax	206	259	359	474
Reported Profit	395	480	666	880
Adjusted Profit	395	480	666	880
No. of Shares outstanding (mn)	18	18	18	18
Adjusted Basic EPS	21.9	26.6	36.9	48.8
No. of Dil. shares outstand.(mn)	18	18	18	18
Adjusted Diluted EPS	21.9	26.6	36.9	48.8
Adjusted Cash EPS	34.1	41.4	54.0	68.0
Dividend per share (DPS)	-	3.2	4.4	5.8
Dividend Payout Ratio (%)	-	9.9	9.9	9.9

Common size metrics- as % of net revenues

Year to March	FY17	FY18E	FY19E	FY20E
Cost of materials	70.2	70.1	69.8	69.5
Employee expenses	7.8	7.6	7.5	7.4
Rent and lease	4.8	5.1	5.0	5.0
S G & A expenses	6.8	6.4	6.2	6.0
Total operating expenses	21.6	21.6	21.2	20.9
Depreciation and Amortization	2.2	2.2	2.1	2.0
Interest expenditure	0.4	0.2	0.2	0.1
EBITDA margin	8.2	8.3	9.0	9.6
EBIT margin	6.0	6.1	6.9	7.7
Net profit margins	3.9	4.0	4.5	5.0

Growth metrics

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	23.8	20.5	22.8	18.3
EBITDA	33.1	21.9	32.5	26.8
PBT	42.1	22.9	38.7	32.2
Adjusted Profit	49.8	21.5	38.7	32.2
EPS	49.6	21.6	38.7	32.2

Balance sheet

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	181	181	181	181
Reserves & surplus	2,523	2,946	3,532	4,308
Shareholders funds	2,703	3,126	3,713	4,489
Long term borrowings	6	6	6	6
Short term borrowings	349	349	300	270
Total Borrowings	355	355	306	276
Long Term Lia. & Provisions	148	148	148	148
Deferred Tax Liability (net)	(70)	(70)	(70)	(70)
Sources of funds	**3,135**	**3,558**	**4,096**	**4,842**
Gross Block	2,096	2,468	2,839	3,196
Net Block	1,275	1,387	1,461	1,485
Capital work in progress	12	12	12	12
Intangible assets	27	39	48	54
Total Fixed Assets	1,315	1,438	1,521	1,552
Non current investments	58	58	58	58
Cash and cash equivalents	648	727	891	1,320
Inventories	2,692	2,852	3,486	4,106
Loans & advances	208	208	208	208
Total current assets (ex cash)	2,900	3,060	3,694	4,314
Trade payable	1,599	1,539	1,881	2,215
Other CL & Short Term Provisions	186	186	186	186
Total current lia. & provisions	1,785	1,724	2,067	2,401
Net current assets (ex cash)	1,115	1,335	1,627	1,913
Uses of funds	**3,135**	**3,559**	**4,097**	**4,842**
Book value per share	150	173	206	249

Free cash flow

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	395	480	666	880
Add: Depreciation	220	268	309	346
Interest (Net of Tax)	23	20	20	16
Others	138	(20)	(19)	(26)
Less: Changes in WC	90	220	292	285
Operating cash flow	687	528	683	931
Less: Capex	400	391	391	377
Free cash flow	**288**	**136**	**292**	**554**

Cash flow metrices

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	687	528	683	931
Financing cash flow	49	(87)	(158)	(160)
Investing cash flow	(728)	257	(361)	(342)
Net cash flow	8	698	164	429
Capex	(400)	(391)	(391)	(377)
Dividends paid	-	(48)	(66)	(87)

Profitability & liquidity ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	15.8	16.5	19.5	21.5
ROCE (%)	22.6	23.5	28.1	31.4
Inventory days	123	123	123	123
Payable days	66	66	66	66
Cash Conversion Cycle	57	57	57	57
Current Ratio	2.0	2.2	2.2	2.3
Gross Debt/Equity	0.1	0.1	0.1	0.1
Adjusted Debt/Equity	0.1	0.1	0.1	0.1
Interest Coverage Ratio	17.2	24.6	34.1	53.8

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total asset turnover	3.5	3.6	3.9	3.9
Fixed asset turnover	8.3	8.8	10.1	11.5
Equity turnover	4.0	4.1	4.3	4.3

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adjusted Diluted EPS (INR)	21.9	26.6	36.9	48.8
Y-o-Y growth (%)	*49.6*	*21.6*	*38.7*	*32.2*
Adjusted Cash EPS (INR)	34.1	41.4	54.0	68.0
Diluted P/E Ratio (P/E) (x)	67.6	55.6	40.1	30.3
Price to Book Ratio (P/B) (x)	9.9	8.5	7.2	5.9
Enterprise Value / Sales (x)	2.6	2.2	1.8	1.5
Enterprise Value / EBITDA (x)	32.0	26.2	19.6	15.2
Dividend Yield (%)	-	0.2	0.3	0.4

Peer comparison

Name	Market cap	EV / EBITDA (X)		EV / Sales (X)		ROAE (%)	
	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Aditya Birla Fashion and Retail	2,087	25.3	17.6	2.0	1.7	15.3	26.1
Avenue Supermarts	11,370	53.8	41.0	4.6	3.6	18.6	20.1
Future Lifestyle	1,053	16.3	12.4	1.6	1.3	7.5	11.9
Future Retail	4,059	31.7	25.0	1.3	1.0	21.5	24.1
Shoppers Stop	701	19.5	13.5	1.0	1.1	2.7	16.0
Titan	11,968	47.2	36.7	4.7	3.9	23.1	25.1
Trent	1,709	63.4	41.5	5.1	4.0	8.8	12.2
V-Mart Retail	421	26.2	19.6	2.2	1.8	16.5	19.5

Additional Data

Directors Data

Mr. Lalit Agarwal	Chairman and Managing Director (CMD)	Mr. Madan Agarwal	Whole Time Director
Mr. Aakash Moondhı	Director	Mr. Murli Ramachandran	Director
Ms. Sonal Mattoo	Director		

Auditors - Walker Chandiok & Co

*as per last annual report

Holding - Top 10

	Perc. Holding		Perc. Holding
JWALAMUKHI INV HLDGS	9.88	WASATCH ADVISORS INC	7.03
FIL LIMITED	5.63	DHAWAN ASHISH	4.97
KANDOI MADAN GOPAL	3.79	NORGES BANK	2.96
GOVERNMENT PENSION FUND - GLOBAL	2.96	FID FUNDS MAURITIUS LTD	2.95
FMR LLC	2.22	GRANTHAM MAYO VAN OTTERLOO & CO	1.94

**in last one year*

Bulk Deals

Date	Acquirer/Seller	B /S	Qty Traded	Price
15-Feb-17	Hemant Agarwal	Sell	150,000	615
20-Jul-17	Gmo Emerging Domestic Opportunities Fund	Buy	286,335	1,143
20-Jul-17	Fidelity Funds-Asian Smaller Companies Pool	Sell	439,760	1,143

**in last one year*

Insider Trades

Reporting Date	Acquirer / Seller	B/S	Quantity Traded
23-Mar-16	Smiti Agarwal	Sell	95,000
16-Feb-17	Hemant Agarwal	Sell	240,000

**in last one year*

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COMPANY UPDATE

ADITYA BIRLA FASHION AND RETAIL

Peerless brand brawn

India Equity Research| Retail

BRAVEHEART SERIES

Edelweiss
Ideas create, values protect

Aditya Birla Fashion and Retail (ABFRL) is one of the largest branded clothing players with 5 brands clocking >INR10bn sales each. In 2014, the company acquired Pantaloons to get a foothold in the women's wear segment. Commendably, within 3 years, it not only turned around the acquisition's ailing operations but also increased its private label share (~62%). ABFRL has also ventured into fast fashion via *Forever21* and innerwear under the *Van Heusen* brand, thereby now housing full bouquet of segments in the apparel category. Anchored by these potent growth boosters, we estimate ABFRL to post sales and EBITDA CAGR of 14.3% and 34.5%, respectively, over FY17-20. As we roll over to FY20E, we assign 16x EV/EBITDA and arrive at TP of INR206. Maintain 'BUY'.

Madura: Worst likely behind; well placed to ride recovery

Entry into high-growth segments — innerwear, women's casual & formal wear, kid's wear — burnishes Madura's prospects. Moreover, expansion in East & West India and smaller markets will be the next growth avenue **(we estimate it to add 80 and 100 stores p.a. in FY19 and FY20, respectively).** Hence, we estimate 8.1% revenue CAGR over FY17-20 with EBITDA margin set to improve from 8.5% in FY17 to 13.6% in FY20E.

Pantaloons: Turnaround story; margin set to recoup lost ground

Pantaloons has successfully emerged as a strong value fashion retailer. Management targets: (i) to accelerate revenue growth (led by store expansion); (ii) expand margins (more private labels, prune sale period); and (iii) achieve cash independence (better return ratios—value fashion from discounted fashion). **We forecast margins to improve to 10.6% in FY20 (4.9% in FY17), propelled by superior throughput, increasing seasons, reducing sale period and increase in share of private labels.**

Outlook and valuations: Primed for growth; maintain 'BUY'

Anchored by revival of Madura and Pantaloons, we are confident of jump in ABFRL's return ratios (~1,174bps jump in RoCE to 19.4% in FY20 over FY17). We assign target multiple of 16x FY20E EV/EBITDA and arrive at TP of INR206. We maintain **'BUY/SP'**. At CMP, the stock trades at 13.5x FY20E EV/EBITDA.

Financials

Year to March	FY17E	FY18E	FY19E	FY20E
Revenues (INR mn)	66,029	75,620	86,065	98,576
EBITDA (INR mn)	4,375	6,050	8,520	10,646
Adjusted Profit (INR mn)	535	1,585	3,349	5,115
Adjusted Diluted EPS (INR)	0.7	2.1	4.4	6.7
Diluted P/E (x)	*245.8*	*83.0*	*39.3*	*25.7*
EV/EBITDA (x)	35.0	25.2	17.5	13.5
ROAE (%)	5.7	15.3	26.1	30.0

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

MARKET DATA *(R: PNTA.BO, B: ABFRL IN)*

CMP	: INR 171
Target Price	: INR 206
52-week range (INR)	: 189 / 136
Share in issue (mn)	: 771.7
M cap (INR bn/USD mn)	: 132 / 2,087
Avg. Daily Vol.BSE/NSE('000)	: 730.7

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	59.3	59.3	59.3
MF's, FI's & BK's	14.7	14.7	15.0
FII's	11.7	11.7	11.1
Others	14.4	14.4	14.5

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Retail Index
1 month	2.4	3.2	5.8
3 months	5.2	6.7	14.8
12 months	24.6	27.7	46.1

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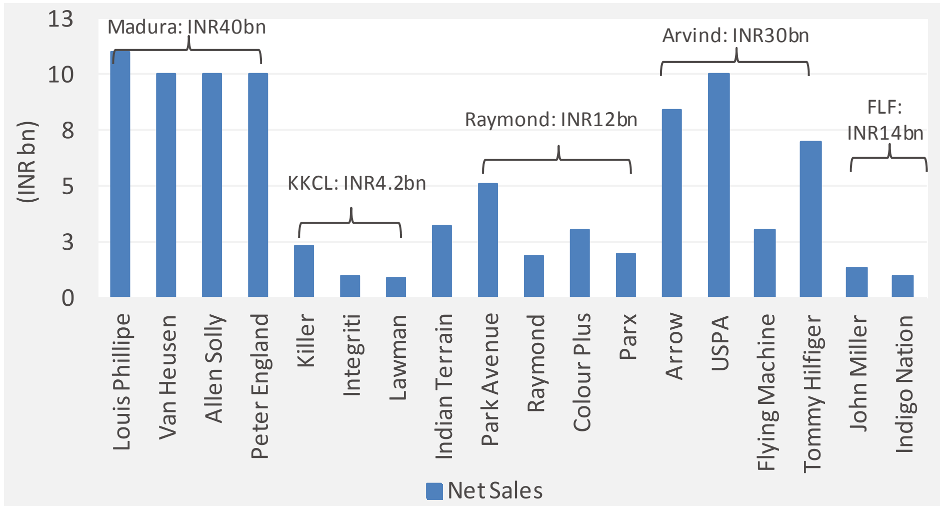
Madura: Worst likely behind; well placed to ride recovery

Formidable player in mid- high-end apparel segments

Madura is a powerhouse of 4 strong brands—*Louis Philippe*, *Van Heusen*, *Allen Solly* and *Peter England*. Each brand generates turnover of >INR10bn (at MRP), amongst the highest in industry. While *Louis Philippe* and *Van Heusen* are positioned as premium formal men's wear, *Allen Solly* and *Peter England* are positioned as smart causal and sub-premium brands, respectively. Thus, the company has a strong portfolio of brands that straddles across price points (from mid to premium range).

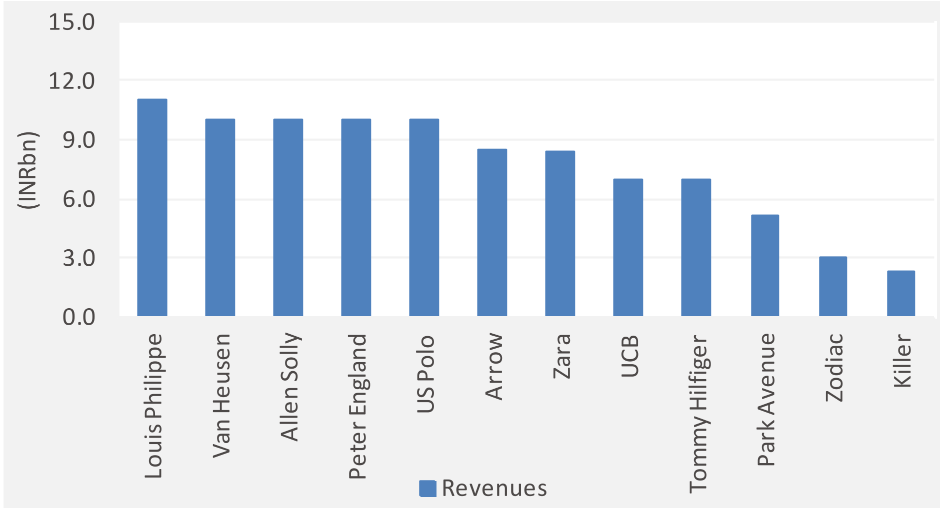
Chart 1: Madura—Market size of brands vis-à-vis competition



Source: Companies, Edelweiss research

Note: Above numbers are approximates

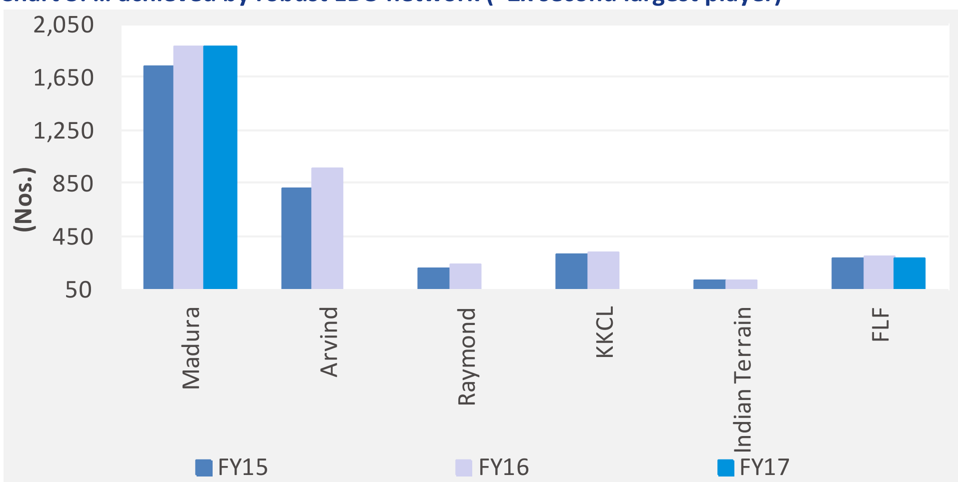
Chart 2: Sales turnover of top brands—Madura's brands outpacing competitors…



Source: Companies, Edelweiss research

Note: Above numbers are approximates

Chart 3: … achieved by robust EBO network (>2x second largest player)



Source: Companies, Edelweiss research

Diversification in adjacent categories: Potent growth catalyst

As per a Nielsen study, extensions of existing FMCG brands are 5x more successful than launching a new brand in India. A study of top brands in 46 FMCG categories and 82 brand extensions in food and non-food categories indicates that in addition to promoting brand equity, brand extensions can add incremental sales of up to 38% and contribute 30% to parent brand sales.

Realising the power of synergy and equipped with 4 brands that are pioneers in their segments, Madura has now diversified into adjacent categories such as men's casual wear, women's wear, children's wear and inner wear, either as sub-categories of existing brands or as new brands. This has been achieved via a conscious strategy wherein it intends to transcend its image of being a mere men's formal wear brand. This venture should also augur well for the company since the new categories it is entering are poised to grow at a faster clip than its bread-and-butter men's formal wear segment—while women's and kid's wear segments are poised to grow at >15%, overall men's formals is poised to grow at ~10% CAGR over FY14-25, according to industry estimates. Further, Madura's entry into inner wear also augurs well for overall growth since the inner wear industry in India is estimated to post 13-14% CAGR over next couple of years. Madura's strong brand equity in men's wear will not only ensure strong growth in adjacent categories, but also help the company rapidly scale up in women's and kid's wear segments.

In order to extend Madura's presence in casual segment, ABFRL has also tied up to bring American Eagle (American mid range casual clothing wear) into India.

Table 1: Women's, kid's wear offer strong growth potential...

Size (USD bn)	2014	2020E	2025E	CAGR 2014-25E
Women's western wear	0.7	2.5	7.5	~20%
Women's ethnic	1.7	2.7	5.2	~15%
Total women's wear	2.4	5.2	12.7	~16.5%
Kids	2.7	4.7	7	~15%

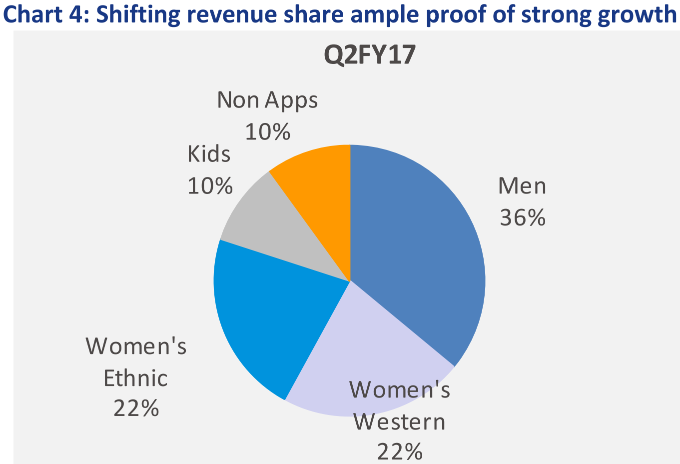
Table 2: ...versus formal men's wear

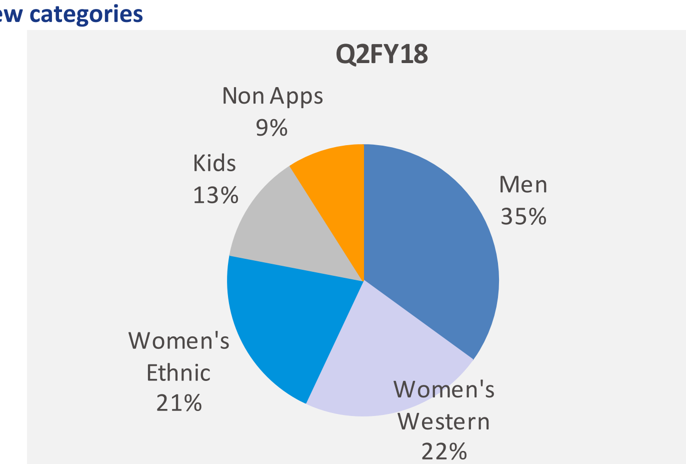
Size (USD bn)	2014	2020E	2025E	CAGR 2014-25E
Men's Formal	3.6	5	9	~10%
Men's casual	1.4	5	12.5	~20%
Total Men's wear market	5	10	21.5	~15%

Source: Industry, Edelweiss research

Madura has also launched accessories like belts, wallets, purses, watches, etc., under its main 4 brands. Despite the diversification, we believe the men's casual segment will continue to be the company's biggest growth driver.

Chart 4: Shifting revenue share ample proof of strong growth in new categories





Source: Company, Edelweiss research

Innerwear: To fuel next leg of growth

ABFRL recently entered men's innerwear and athleisure (emerging segment of multi-purpose wear from gym to street, etc) segments under the *Van Heusen* brand. As per the company, men's innerwear and athleisure market in India was worth ~INR200bn in 2014, which is estimated to grow at 13-14% p.a. to INR680bn by 2024, implying humungous size and growth potential. Within the overall inner wear segment, the premium segment is expected to grow at an even faster pace. Further, considering that ~90% of this segment is unorganised, potential for growth in men's and women's segments is immense.

To start, Madura has introduced the range in Bengaluru, Chennai and Hyderabad via local distribution model. The brand has been launched in 4 collections:

- **Classic:** It will offer features like all-day fresh and colour fresh.
- **Platinum:** The range will offer sophisticated styling and elevated comfort with Pima cotton.
- **Signature:** Fashion innerwear with flexi stretch feature for body defining fit.
- **Active:** True sports innerwear with swift-dry feature.

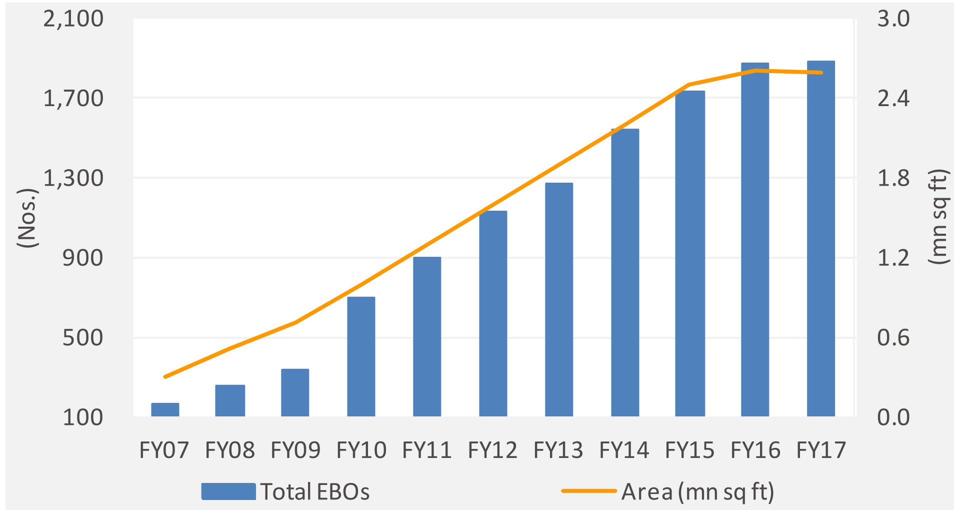
Game plan: Madura believes its *Van Heusen* brand has enough scope to emerge a strong No. 2 brand. In every market that the company plans to enter, it is eyeing to mimic Page's distribution network over long term. Madura believes its innerwear brand entry via *Van Heusen* brand, has better product quality, function values and properties and will offer some sense of fashion and design in innerwear. **In short span, the company has already become No. 2 brand in premium innerwear segment).** While *Van Heusen Classic* is priced at same level as Page's offering (*Classic* will constitute 65% of Madura's portfolio), *Superior lines* will be priced at a premium of ~7-10%. Thus, Madura is banking on brand strength, superior quality and similar pricing to wrest market share from Page.

We believe while initially the segment's gross margin will be lower than Page's, once the segment attains scale, margins will improve gradually. Also, Madura will be investing in a phased manner, which will not impact the company's overall margins.

Robust distribution channel imparts competitive edge

Madura boasts of a strong distribution network of 1,878 EBOs spread over 2.6mn sq ft as of FY17 (1,893 EBOs as at H1FY18), clocking an impressive 15.2% CAGR over FY10-17 in terms of store addition. A strong retail network acts as a strong entry barrier, making it difficult for competitors to match Madura's scale.

Chart 5: Impressive EBO expansion



Source: Company, Edelweiss research

Going ahead, we expect Madura's retail expansion to be gradual as it has already achieved a high base of 1,893 EBOs by H1FY18. On an average, we forecast the company to add close to 80 EBOs in FY19 and 100 in FY20.

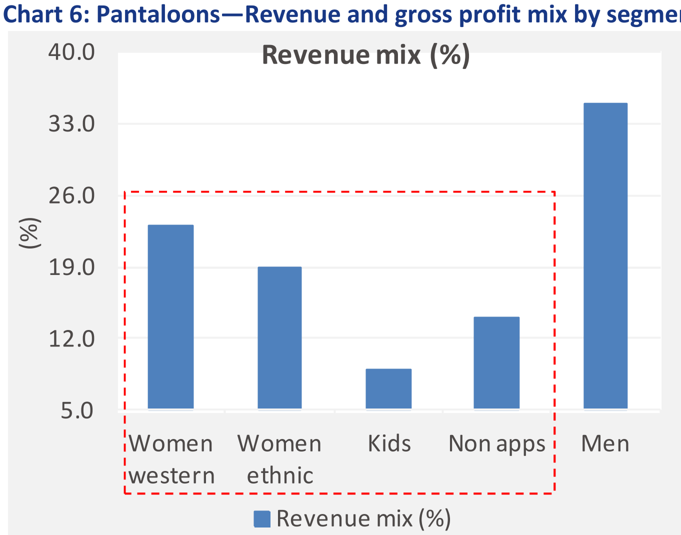
Pantaloons: Turnaround story; margin set to recoup lost ground

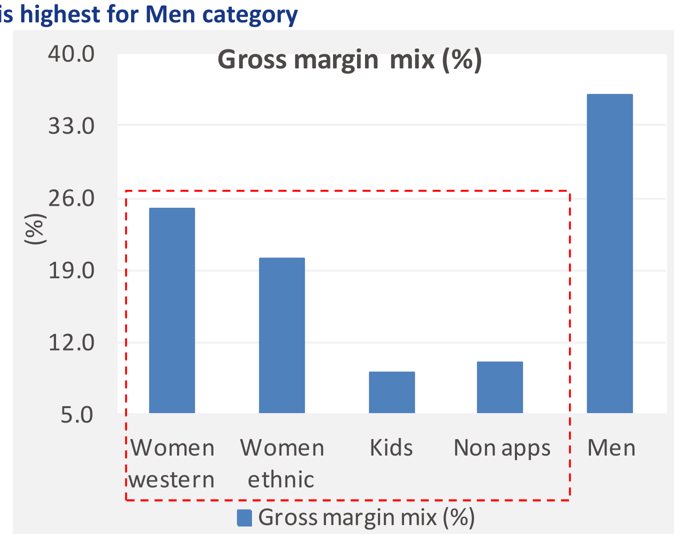
Transformation largely done; it's now time to grow

Pantaloons was started by the Future Group as a discount apparel store in 1997. Over the years, it has gradually transitioned from being a discount store to a full, but reasonably priced, value fashion player.

In FY13-14, the Aditya Birla Group acquired Pantaloons and subsequently undertook a scheme of arrangement, pursuant to which ABFRL was born. Pantaloons houses India's leading women's wear brand. With this acquisition, ABFRL via Madura and Pantaloons now straddles the entire value chain—men's, women's and children's wear.

Chart 6: Pantaloons—Revenue and gross profit mix by segment is highest for Men category





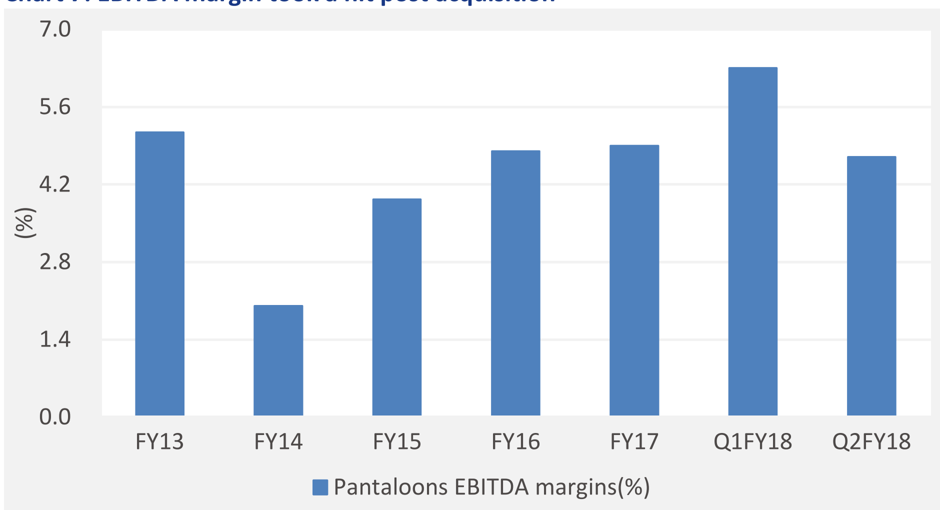
Source: Company, Edelweiss research

Post the Pantaloons acquisition, ABFRL has: (i) revamped Pantaloons' business model; (ii) undertaken some course correction primarily related to right and affordable pricing (cut prices ~20%); (iii) reduced reliance on end of season sale (EOSS); (iv) refurbished existing stores; and (v) chalked out new strategy to enhance growth, among others.

Margins poised for gradual uptrend as clean-up is complete

Post acquisition, ABFRL rationalised ramp up of stores and revamped Pantaloons' business strategy. As a logical corollary, Pantaloons' EBITDA margin dipped in FY14 following the sharp jump in staff costs (new management hired 200 mid level executives in finance, legal and other teams). However, this aberration now stands corrected as Pantaloons has started gaining from the stores that have reached vintage and new store size has been rationalised. This is already evident from the jump in EBITDA margin from 2% in FY14 to 4.7% in Q2FY18. Anchored by the company's new business strategy, we estimate Pantaloons' overall margin to improve gradually from 4.7% in Q2FY18 to 10.5% in FY20.

Chart 7: EBITDA margin took a hit post acquisition

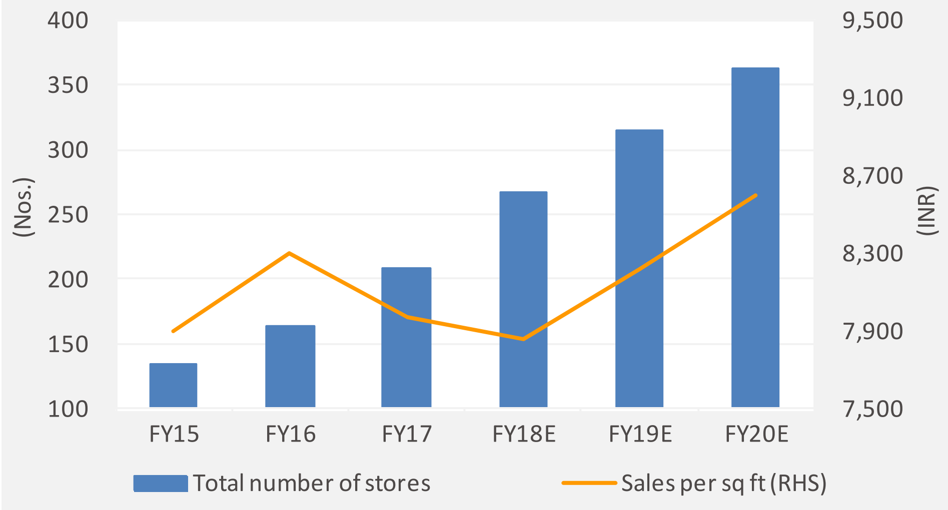


Source: Company, Edelweiss research

Store additions to accelerate

Historically, Pantaloons has been a strong brand, especially in East India. However, during FY10-13, the company started losing ground due to lack of store additions (only 21 were added), which hurt growth. One year after ABFRL acquired Pantaloons there was strong ramp up in store additions, as delineated in management's growth map. Total number of Pantaloons stores (excluding factory outlets) increased from 68 in FY13 to 243 by Q2FY18. Going forward too, Pantaloons is likely to add 50-60 stores annually.

Chart 8: Ramp up in Pantaloons outlets

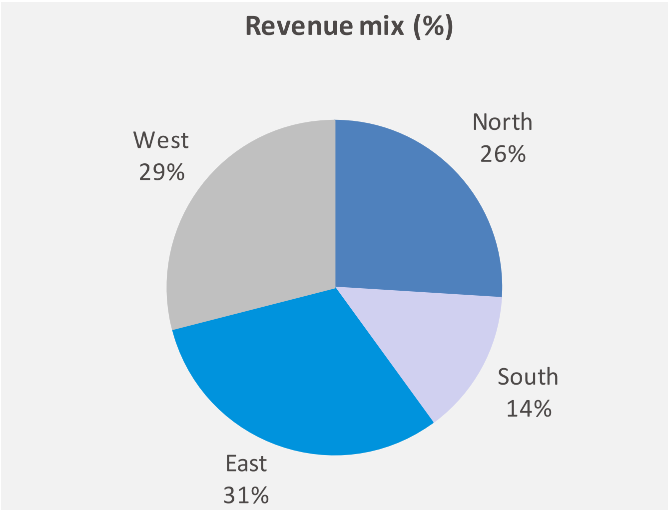


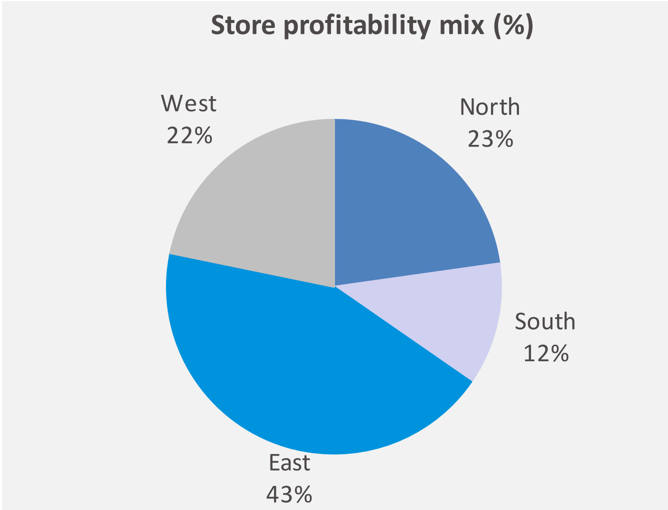
Source: Company, Edelweiss research

Pantaloons is the market leader in East India. It is now targeting expansion to South and other regions of the country. It already has strong brand recall in other parts of the country, which will make it easy for the retail store to attract footfalls in smaller cities where aspiration levels remain high.

Strong branch ramp up will propel Pantaloons' revenue trajectory. As stores mature, operating leverage will kick in, which will also improve margins. Further, the company has been steadily expanding its stores network in East India—a high-margin geography owing to lower rentals, etc. This is another reason why we envisage further jump in the company's margins.

Chart 9: Revenue, profitability by geography (highest in East)





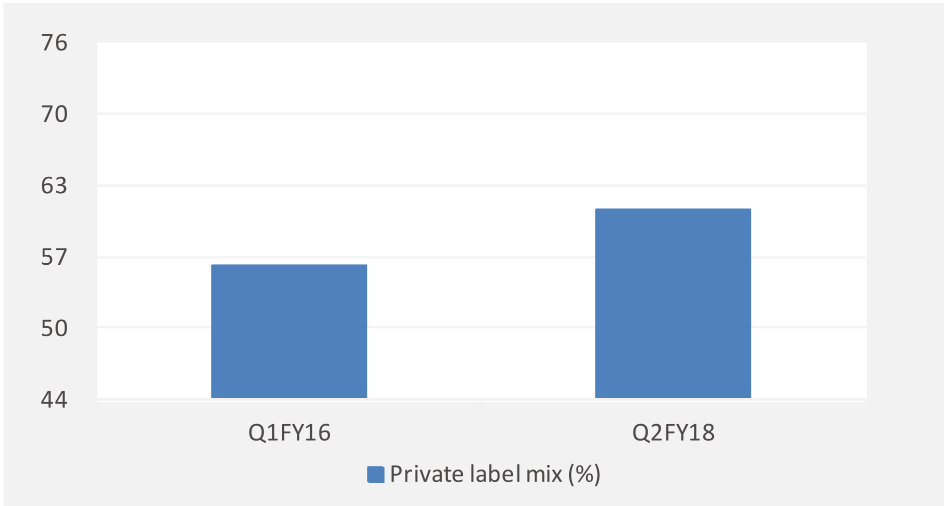
Source: Company, Edelweiss research

As Pantaloons rationalises its store size it will still house all key brands under one roof which will help curtail rental expenses. Thus, we estimate sales per sq ft to increase from INR7,975 to INR8,599 over FY17-20E.

Proportion of own brands rising; better control on pricing, assortment

From FY14, Pantaloons decided to expand its self-owned brands portfolio by: (i) Setting up a new in-house "Design Studio", recruiting experts in product design, brand aesthetics and fixture design; and (ii) Launching 6 new brands to fill gaps in overall portfolio. Consequently, there was strong ramp up in the proportion of own brand sales from 56% in Q1FY16 to 62% in Q2FY18 (~40% during acquisition). It is also working on increasing the number of fashion seasons. This will lead to fresh and latest design options resulting in higher off-take by consumers. With better cost control and higher pricing power, Pantaloons is expected to clock better margins in private labels.

Chart 10: Private labels' mix improving



Source: Company, Edelweiss research

Shifting to value fashion to drive throughput

The value fashion segment is the first step towards organised retail market for customers moving up from unorganised/mom & pop retailers. This space is less crowded with only Pantaloons, Max Fashion and Reliance Trends, among few others in the fray. Since entering the segment in 2007, Pantaloons has made a mark in this fast-growing segment.

Value fashion means retailing products at lower prices and not selling at huge discounted rates. The segment has helped Pantaloons keep its products in the affordable price range, while maintaining brand value. The company is also paring non-moving inventory and accessories and filling the space with new assortments and value-focused brands, which will drive footfalls. High-margin own brands are also being focused on, which will further improve return ratios and sales per sq ft.

Sales per sq feet of value fashion players like Max is highest at ~INR10,900. Currently, Pantaloons' sales per sq ft is lower at sub-INR8,000 levels. However, with higher number of branches, vintage of stores and addition of smaller stores, we anticipate the company's sales per sq ft to increase from INR7,975 to ~INR8,599 over FY17-20E. This will be achieved through implementation of its new strategy that targets higher throughput, better assortment and focus on customer satisfaction.

Outlook and valuations: Primed for growth; maintain 'BUY'

ABFRL is the No.1 player in the men's wear market on account of Madura and No. 1 in the women's wear led by Pantaloons. The company will be key beneficiary of recovery in discretionary spending and is better placed to gain from it compared to other branded apparel players owing to its sheer scale and widespread network.

Madura's growth and margins, which were impacted by heightened competition from e-commerce players, higher ad spends and lower operating leverage, have likely bottomed out. We envisage gradual recovery, riding renewed focus on new & fast-growing segments which would aid growth and improve throughput per outlet. Entry into the online segment and focus on becoming the largest brand therein are also likely to boost growth over the long term. Pantaloons is a turnaround story and is expected to sustain its robust run and gradual margin improvement.

We expect the company to record high single digit to low double-digit SSSG fueled by its new business model with focus on right pricing and fashion. The company's initiatives like increasing private labels, enhancing inventory turns and reducing sale season period are bound to lead to sustained margin improvement.

Anchored by strong growth visibility, pick up in SSSG with margin improvement in Madura, turnaround in Pantaloons and entry into adjacent high-growth segments, we are confident of jump in ABFRL's. As we roll over to FY20, we assign target multiple of 16x FY20E EBITDA and arrive at a target price of INR206.

Company Description

In May 2015, ABFRL came into being following consolidation of ABNL's branded apparel business of Madura and Pantaloons. Post consolidation, Pantaloons was renamed Aditya Birla Fashion and Retail (ABFRL). ABFRL brings with it learnings and businesses of 2 renowned Indian fashion icons/brands, Madura and Pantaloons. This amalgamation has helped ABFRL emerge as India's No. 1 fashion lifestyle entity.

Madura has a vast retail network comprising exclusive outlets, premium multi-brand and department stores – total presence of 1877 stores. Four of its brands are among India's top fashion names, with MRP sales in excess of INR10bn each. Pantaloons brand is now present in 78 plus Indian cities/towns through 146 stores. Forever21 is a fashion retailer of women's, men's and kids clothing and accessories and is known for offering the hottest, most current fashion trends at great value to consumers.

Investment Theme

Aditya Birla Fashion and Retail (ABFRL) is one of the largest branded clothing players with 5 brands clocking >INR10bn sales each. ABFRL has now ventured into fast fashion via Forever 21and innerwear under the Van Heusen brand thereby now housing full bouquet of segments in the apparel category. Anchored by these potent growth boosters, we estimate ABFRL to post sales and EBITDA CAGR of 16.4% and 29.2%, respectively, over FY16-19 and 24.1% RoE by FY19.

Key Risks

Slow GDP revival leading to lower traction in discretionary spending

While foreign brands such as Zara, Tommy Hilfiger, etc., have already established themselves, other brands such as H&M, GAP, among others, are venturing inthe Indian market thereby heightening competition.

Implementation of GST with anticipated tax neutral rate of 18%could lead to higher tax outgo of 5-7% for branded apparel players.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.5	7.1	7.7	-
Inflation (Avg)	4.8	5.0	5.2	-
Repo rate (exit rate)	6.3	6.3	6.3	-
USD/INR (Avg)	67.5	67.0	67.0	-
Company				
Capex (INR mn)	3,031	3,129	3,006	1,426
Revenue growth Pantaloon	18.3	21.7	21.1	19.0
Revenue growth Madura	3.4	11.3	9.0	11.0
SSSG growth - Pantaloon (%)	3.3	4.0	9.0	9.0
SSSG growth EBOs - Madura (%)	(6.7)	3.0	6.0	7.0
Net Store addition - Pantaloon	46.0	58.0	48.0	48.0
Net Store addition - Madura	5.0	60.0	80.0	100.0
Forever 21 (revenue growth %)	31.7	36.1	26.4	20.9
Pantaloons - EBITDA as % of sales	4.9	8.2	10.3	10.6
Madura - EBITDA as % of sales	8.5	10.4	12.3	13.6
Debtor days	21	21	21	21
Inventory days	172	172	172	172
Payable days	181	181	181	181
Cash conversion cycle	13	13	13	13
Dep. (% gross block)	28.2	26.0	25.0	25.0
Tax rate (%)	-	20.0	20.0	20.0

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	66,029	75,620	86,065	98,576
Materials costs	30,087	34,483	38,557	43,965
Gross profit	35,942	41,137	47,508	54,611
Employee costs	7,058	7,864	8,693	9,858
Rent and lease expenses	10,871	11,494	12,565	14,195
Other Expenses	13,638	15,729	17,729	19,912
EBITDA	4,375	6,050	8,520	10,646
Depreciation	2,425	2,768	3,134	3,202
EBIT	1,951	3,281	5,387	7,444
Add: Other income	381.5	450.00	450.00	500.00
Less: Interest Expense	1,797	1,750	1,650	1,550
Profit Before Tax	536	1,981	4,187	6,394
Less: Provision for Tax	-	396	837	1,279
Reported Profit	536	1,585	3,349	5,115
Adjusted Profit	536	1,585	3,349	5,115
Shares o /s (mn)	769	769	769	769
Diluted shares o/s (mn)	769	769	769	769
Adjusted Diluted EPS	0.7	2.1	4.4	6.7

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Rent and lease expenses	16.5	15.2	14.6	14.4
Materials costs	45.6	45.6	44.8	44.6
EBITDA margins	6.6	8.0	9.9	10.8
Net Profit margins	0.8	2.1	3.9	5.2

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	9.4	14.5	13.8	14.5
EBITDA	15.6	38.3	40.8	25.0
Adjusted Profit	-	196.0	111.3	52.7
EPS	-	196.0	111.3	52.7

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	7,733	7,728	7,728	7,728
Reserves & Surplus	1,849	3,434	6,783	11,899
Shareholders' funds	9,582	11,162	14,511	19,627
Total Borrowings	22,213	23,800	23,800	23,800
Long Term Liabilities	756	756	756	756
Sources of funds	**32,551**	**35,718**	**39,067**	**44,183**
Gross Block	7,916	9,846	11,652	11,877
Net Block	6,275	4,832	3,725	981
Capital work in progress	250	250	250	250
Intangible Assets	18,596	20,400	21,379	22,346
Total Fixed Assets	25,121	25,481	25,354	23,578
Non current investments	2,184	2,184	2,184	2,184
Cash and Equivalents	676	2,971	5,915	12,118
Inventories	14,313	18,258	18,161	23,366
Sundry Debtors	4,539	4,237	5,751	5,689
Loans & Advances	2,565	2,566	2,566	2,566
Other Current Assets	962	972	981	991
Current Assets (ex cash)	22,378	26,032	27,459	32,612
Trade payable	15,511	18,654	19,547	24,012
Other Current Liab	2,297	2,297	2,297	2,297
Total Current Liab	17,808	20,951	21,844	26,309
Net Curr Assets-ex cash	4,571	5,081	5,614	6,303
Uses of funds	**32,551**	**35,718**	**39,067**	**44,183**
BVPS (INR)	12.5	14.5	18.9	25.5

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	536	1,585	3,349	5,115
Interest (Net of Tax)	1,797	1,400	1,320	1,240
Others	(113)	(100)	(120)	(190)
Less: Changes in WC	461	501	524	678
Operating cash flow	4,183	5,152	7,159	8,689
Less: Capex	3,031	3,129	3,006	1,426
Free Cash Flow	**1,152**	**2,023**	**4,153**	**7,263**

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	5.7	15.3	26.1	30.0
ROACE (%)	7.7	11.2	15.9	19.4
Inventory Days	172	172	172	172
Debtors Days	21	21	21	21
Payable Days	181	181	181	181
Cash Conversion Cycle	13	13	13	13
Current Ratio	1.3	1.4	1.5	1.7
Gross Debt/EBITDA	5.1	3.9	2.8	2.2
Gross Debt/Equity	2.3	2.1	1.6	1.2
Adjusted Debt/Equity	2.3	2.1	1.6	1.2
Interest Coverage Ratio	1.1	1.9	3.3	4.8

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	2.1	2.2	2.3	2.4
Fixed Asset Turnover	2.7	3.0	3.4	4.1
Equity Turnover	7.1	7.3	6.7	5.8

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	0.7	2.1	4.4	6.7
Y-o-Y growth (%)	*(148.8)*	*196.0*	*111.3*	*52.7*
Adjusted Cash EPS (INR)	3.9	5.7	8.4	10.8
Diluted P/E (x)	246.7	83.3	39.4	25.8
P/B (x)	13.8	11.8	9.1	6.7
EV / Sales (x)	2.3	2.0	1.7	1.5
EV / EBITDA (x)	35.1	25.3	17.6	13.5

Peer comparison valuation

	Market cap	EV / EBITDA (X)		EV / Sales (X)		ROAE (%)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Aditya Birla Fashion and Retail Ltd	2,087	25.3	17.6	2.0	1.7	15.3	26.1
Jubilant Foodworks	1,922	30.0	23.2	3.7	3.3	18.1	21.8
Shoppers Stop	701	19.5	13.5	1.0	1.1	2.7	16.0
Titan Company	11,968	47.2	36.7	4.7	3.9	23.1	25.1
Wonderla Holidays	322	19.6	13.2	6.4	5.5	10.8	15.1
Median	-	25.3	17.6	3.7	3.3	15.3	21.8
AVERAGE	-	28.3	20.8	3.6	3.1	14.0	20.8

Source: Edelweiss research

Additional Data

Directors Data

Mr. PranabBarua	Managing Director	Mr. Sushil Agarwal	Non-Executive Director
Mr. ArunThiagarajan	Non Executive - Independent Director	Mr. Bharat Patel	Non Executive - Independent Director
Ms. Sukanya Kripalu	Non Executive - Independent Director	Mr. Sanjeeb Chaudhuri	Non Executive - Independent Director

Auditors - M/s SRBC & Co. LLP

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Grasim industries lt	11.32	Igh holdings pvt ltd	11.02
Tgs investment & tra	9.1	Umang commercial co	8.42
Trapti trading and i	6.35	Hindalco industries	5.83
Turquoise investment	4.34	Franklin templeton i	4.27
Life insurance corp	4.1	Franklin resources	3.09

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

COMPANY UPDATE

FUTURE LIFESTYLE FASHIONS

Brand Factory Central advantage

Edelweiss
Ideas create, values protect

India Equity Research| Retail

Future Lifestyle Fashions (FLF) is an integrated play on brands (30 owned, licensed and investee) and retail presence (>5.4mn sq ft). Drawing on these diferentiating factors, FLF registered strong SSSG (16.4%) in FY17 and outperformed peers. Going ahead, we expect ~11%/10% SSSG in Brand Factory (BF) and Central in FY20 led by: 1) scale up of retail channels across segments – Central in premium and BF in value; 2) right mix of brands – owned (~38.3% of revenue) and third party; 3) power brands, which would fuel growth; and 4) better inventory management. Hence, we estimate sales/EBITDA CAGR of 20.7%/26.8% over FY17-20 with RoE improving to 16.4% in FY20 (2.8% in FY17). Maintain ´BUY'.

Power brands treading high growth path

FLF's strong brands straddle different price points, segments and distribution channels. **Own brands not only fetch higher margins (~500-700bps)**, but also ensure that inventory is well managed. The **6 power brands are now at the forefront**, each with turnover of >INR1bn at MRP (*Lee Cooper* at >INR6.5bn) and revenue CAGR of 8.1% over FY14-17 (CAGR of 11.9%, excluding one-time supply chain impact).

Enviable retail presence

While Central is a large format departmental store, BF is helping counter the e-commerce threat. **Central and BF clocked strong SSSG in FY16/17 (10%/18% and 8%/17%)**, which is expected to sustain, aided by store premiumisation, better layout, increased advertisement and branding, as well as professionalisation. Strong retail channels also help FLF in **positioning its own brands – proportion of which is set to increase from 38.3% in FY17 to 39.6% in FY20E**.

Outlook and valuations: On growth trajectory; maintain 'BUY'

We expect 10% SSSG in Central in FY20, aided by recovery in urban consumption and better execution. We roll over to FY20 and on account of sharpened focus on power brands and closing of loss-making stores *(*Planet Sports), we assign 12x FY20E EV/EBITDA and arrive at TP of INR439. We maintain **'BUY/SP'.** At CMP, the stock is trading at 9.7x FY20E EV/EBITDA.

Financials

Year to March	FY17	FY18	FY19E	FY20E
Revenues (INR mn)	38,771	45,783	56,372	68,259
Rev. growth (%)	*17.5*	*18.1*	*23.1*	*21.1*
EBITDA (INR mn)	3,580	4,443	5,750	7,301
Adjusted Profit (INR mn)	460	1,277	2,157	3,246
No. of Shares outstanding (mn)	190	190	190	190
Adjusted Diluted EPS (INR)	2.4	6.7	11.3	17.1
EPS growth (%)	144.3	177.9	68.9	50.5
Diluted P/E (x)	145.4	52.3	31.0	20.6
EV/EBITDA (x)	20.4	16.3	12.4	9.7
ROAE (%)	2.8	7.5	11.9	16.4

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Equalweight

MARKET DATA *(R: FLFL BO, B: FLFL IN)*

CMP	: INR 352
Target Price	: INR 439
52-week range (INR)	: 412 / 127
Share in issue (mn)	: 190.4
M cap (INR bn/USD mn)	: 67 / 1,053
Avg. Daily Vol.BSE/NSE('000)	: 298.3

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	60.6	60.4	60.5
MF's, FI's & BK's	17.5	14.1	13.6
FII's	5.1	7.0	6.5
Others	16.8	18.5	19.4

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Retail Index
1 month	(2.9)	3.1	6.4
3 months	2.2	6.6	15.5
12 months	166.2	27.5	48.2

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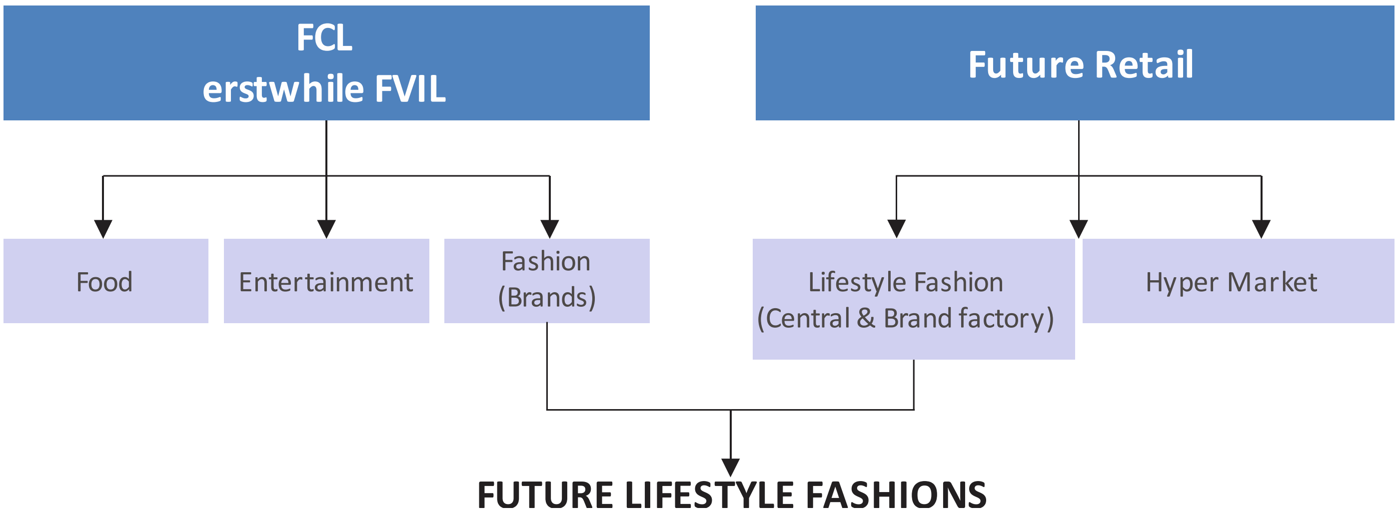
January 2, 2018

Integration rewards galore

In 2013, the Future Group restructured its fashion business from its 2 listed entities, viz., Future Consumer (housed the brands business including *Lee Cooper*, *John Miller*, *aLL*, *BARE* and *Indigo Nation,* among others) and Future Retail (the group's retail arm comprising Central and Brand Factory) into Future Lifestyle Fashions (FLF).

Fig. 1: FLF – Sharpening focus on apparels



Source: Company

Benefits of this integration are manifold, viz., 1) The fashion brands and retail format are now housed under one entity, FLF; 2) Focus is now trained on fashion and lifestyle, which has resulted in emerging synergies; and 3) The integrated model of brands and retail channels has proved to be a natural hedge against the risks of slowdown in any one of the models.

- **Mix of brands and retail – a better model**

  The integrated model – a mix of brands and retail channel, cushions the company's growth as it is not solely dependent on either the brands or retail channels for overall growth. Both its brands and retail channels help in creating a diversified portfolio while simultaneously acting as a hedge against the risks of slowdown in any one of the models. Operating only as a retail channel, the company would have to depend on growth of other brands in its channel and hence largely become a quasi-real estate provider. Likewise, by just holding the brands, the company would be dependent on other retail channels to showcase the brands and would entail payment of ~ 35-40% as channel margins to the large format retailers.

  FLF is now well entrenched to capitalise on India's burgeoning fashion segment and register higher growth, riding the good mix of brands (30 brands) and retail channel outlets. **<u>While the company's own brands contribute 38.3% to revenues (which is margin accretive too), ~70% of branded sales are undertaken through its retail platform</u>.**

- **Rational expansion of retail channels**

  FLF, through its retail channels – Central, Brand Factory and other EBOs (Planet Sports, aLL, etc), has strong network of 350 stores (37 Central, 57 BF and rest are EBOs) covering ~5.5mn sq ft extending to ~90 cities, and making it one of the largest networks in India. A diversified and integrated model (an array of brands available through its retail chain) supports FLF's store expansion programme - it can play with its brand portfolio depending on the type of brand and areas where stores need to be opened.

Table 1: Extensive store network...

(Nos.)	FY17	Q1FY18	Q2FY18
Central	35	36	37
Brand Factory	53	54	57
EBO's	284	267	256
Total	372	357	350
Area (mn sq ft)	5.4	5.2	5.5

Source: Company, Edelweiss research

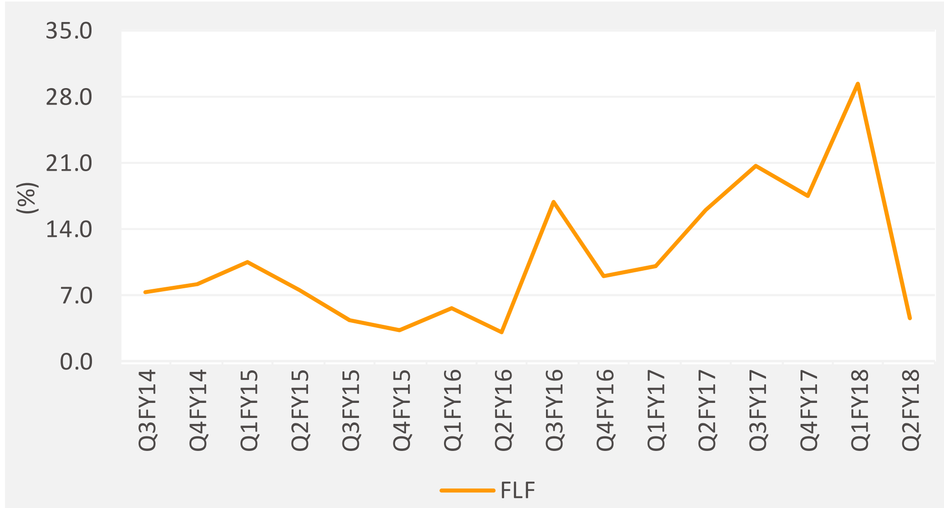
Chart 1: ...one of the largest in India

Source: Company, Edelweiss research

- **Sharp focus on bolstering SSSG**

  The integrated model also helps in better managing SSSG since FLF has better control over both its owned and licensed brands and retail outlets, unlike a pure retail chain where brand positioning is largely dependent on the discretion of the retailers. **Around 70% of FLF's branded sales are undertaken through its own retail outlets.**

Chart 2: Strong SSSG, despite tough business environment



Source: Company, Edelweiss research

With an integrated entity in place (dedicated focus on brands via in-house retail channels), FLF is now well placed to take further measures to ramp up SSSG. The company is focused on ensuring strong SSSG with focus on primary catalysts such as: 1) Getting the right display; 2) Monitoring inventory supply chain; and 3) Emphasis on store format, design and layout.

Central – Premium high-street mini mall fast gaining currency

A. Distinguished features…

- **Large size stores generally located on high streets**

  Central is FLF's departmental store that seeks to position itself as the neighbourhood mall for customers. With high-street large format stores and average size ranging from 0.1-0.15mn sq ft (Shopper's Stop store size ranges from 35,000-40,000 sq ft), Central offers a complete shopping experience to consumers.

- **Mall-like experience**

  Central has managed to sustain strong SSSG (average SSSG of 12% in past 3 years) as most (~70-80%) of the stores are predominantly located on high streets. These large departmental stores are also being positioned as a mini mall - has a mini cafeteria (coffee shops/food court), PVR in some stores, and seeks to offer customers a complete experience by replicating, to some extent, the visit to a regular mall. **Central stores are present at standalone locations, which not only allows fashion shopping but also offers an opportunity to shop from >1,000 best brands** across categories including electronic goods and accessories, apparels, cosmetics, fragrances, eyewear, watches, accessories, sportswear, toys, mobiles, electronics and home products. Apart from these, some of the stores have a complete range of music, books, fine dining restaurants, discotheques, multiplex as well as special sections (travel, finance, investment, etc).

- **Premiumising brands**

  FLF is further up-trading its brands– launched Central High Definition (HD). At Central HD, offerings are premiumised and ambience upgraded which enhances the freshness quotient. In fact, FLF has launched its first next generation Central HD store at Aerocity, New Delhi. This store offers world-class designs with over 500 brands displayed in HD exhibiting the latest fashion trends. At these HD stores, the company uses smart and technology-led interfaces for display and provides differentiated customer service initiatives, such as, free home delivery, in-store wi-fi networks, personal shoppers, infant care rooms, easy billing, etc. As at FY17 end, FLF had 2 HD stores (Delhi and Bangalore). Thereon, the company has added 2 more HD stores.

Fig. 2: Central HD offers premium experience to consumers

Source: Company, Edelweiss research

- **Emerging preferred destination for branded players**

  EBOs have always been a key distribution channel for apparel players. Apart from being a distribution channel, EBOs also help in better branding of products. However, with the advent of malls, MBOs and e-commerce has seen more and more consumers preferring to patronise MBOs as against EBOs, primarily due to the number of options available at the former. Increasingly, MBOs appear to be more attractive than EBOs. MBOs also focus on increasing the proportion of their own private label brands to drive profitability, which leaves lesser space for third party brands. Consequently, Central has emerged as a preferred destination for third party brands since: (i) It operates on a large size model which has enough scope for brand additions; and (ii) FLF showcases each brand under one roof with a wall-to-wall presentation which helps the brands gain better presentation and visibility, almost similar to EBOs.

B. Brand Factory – Unique monopolistic business model

- **Ensures better inventory management**

BF is a liquidation platform for old and stagnant inventory not only for FLF but also for other brands, such as, Arvind, ABFRL, etc. Consequently, stocks in the retail channels - Central, EBOs, etc., remain fresh in turn ensuring better footfalls. Being a liquidation channel, BF offers customers an entire range of brands at a discount/reduced prices. **It offers 20-70% discounts across products and has 60% of business coming from national brands.**

- **Physical answer to online players with no offline competition**

In a way, a physical player, BF, offers competition to the online players considering that it sells similar off-season merchandise at discounted prices (similar to online players that offer discounts through the year). BF sells the brands at a discount through the year, thus ensuring footfalls and not losing them to online players. Also, BF does not face competition within offline players as it is the only liquidation channel in industry.

- **Propels FLF's revenues, transcending business cycles**

BF seeks to cater to consumers who aspire to own brands, but at a value. Shopping at BF gives consumers an opportunity to upgrade to higher brands at a reasonable cost. Similarly, during tough times, BF ensures better growth from consumers who are down-trading. Thus, irrespective of the business cycle, FLF's revenue growth is maintained. Lately, FLF has been focusing on revamping BF – has changed the look and feel of the stores, altered the store layout, etc., and has also been advertising the products, especially via print media. **This has resulted in BF's SSSG improving along with higher throughput per outlet (increased from INR5,105 per sq ft in FY15 to INR7,299 per sq ft in FY17)**.

Strong brands synonymous with higher growth, margin expansion

- **Renowned brands in kitty**

FLF has an eclectic array of 30 brands (own, licensed and investee) straddled across price points, segments (men's, casual, women's, ethnic, sports and leisure wear, footwear, etc) and are sold across channels (MBOs, EBOs and FLF's own retail channels). Currently, FLF has 18, own (8) and licensed (10) brands. FLF is one of the few companies in India which has such renowned brands (other players being ABFRL and Arvind). Hence, it is not just a retail outlet providing real estate space to third party brands, but also a player with a strong brand repertoire. Having such large share of own/licensed/investee brands facilitates better control of inventory, which leads to higher growth due to brand pull apart from being margin accretive.

Table 2: Strong brand portfolio straddles price points, segments and channels

	% contribution	Owned Brands	Licensed Brands	Investee Brands
Men's wear	**26**	Indigo Nation Urbana	Lombard John Miller Daniel Hechter	Giovani Turtle
Women's wear	**10**	Mohr Jealous 21		Cover Story Mineral Desi belle
Unisex	**53**	Scullers aLL	Lee Cooper UMM Bare Rig	
Sports/ Leisure wear	**6**	Urban Yoga	Umbro Champion Converse	Spunk
Footwear/ Accessories etc	**5**	Ceriz		Tresmode Mother Earth Clarks Famozi Holii Peperone

Source: Company, Edelweiss research

- **Six power brands at forefront of growth, profitability…**

  Fine-tuning its brands strategy, FLF has identified 6+1 Power brands (a strategy followed by FMCG players who train sharp focus on key brands) which it believes have the potential to become big and bolster revenue and profitability. **The 6 power brands are *Lee Cooper, John Miller, Scullers, Jealous 21, Indigo Nation* and *aLL*** (*Bare* is the upcoming power brand). The company has not only appointed a dedicated team to track these brands, but also proposes to allocate more resources and capital to drive growth in these brands.

Fig. 3: Six power brands in focus

POWER BRANDS

Source: Company, Edelweiss research

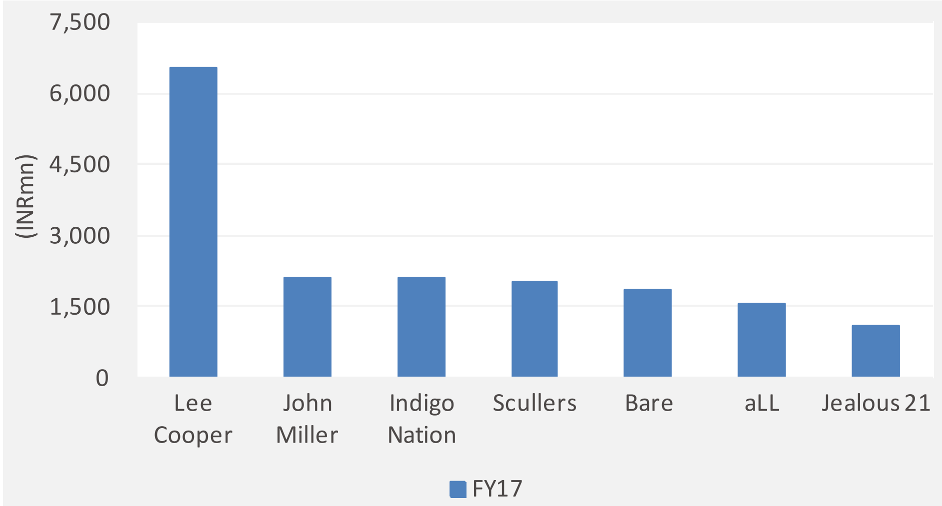
Table 3: Snapshot of key brands (including the 6 power brands)

Brand	Category	Target Customer	Competitors	Distribution channel	Avg Price points (INR)	Revenues (INRmn)
Lee Cooper	Denim and casual wear	Young men and women	Levi's, Pepe Jeans, Wrangler, Lee, Killer	Central, Brand Factory, EBO's, MBO's and E-com platforms	Lee Cooper originals-INR1,500; Lee Cooper - INR2,500	3,200
John Miller	Formal men's wear	Mid level executives	Peter England, Excalibur	Central, Brand Factory, EBO's, MBO's and E-com platforms	1,200	1,200
Scullers	Casual and sportwear	Men, women and kids	Parx, Color Plus	Central, Brand Factory, EBO's, MBO's and E-com platforms	1,700	1,100
aLL	Plus-sized clothing	Overweight crowd	Plus size of other brands	Central, EBO's, Own website	1,200	1,200
Indigo Nation	Formal and casual men's wear	Urban Indian male	Wrangler, Parx	Central, Brand Factory, EBO's, MBO's and E-com platforms	1,500	1,100
BARE	Denim and casual wear	All demographies	Lee, Pepe Jeans, Colour Plus, Indian Terrain, Allen Solly	Central, Brand Factory, EBO's, MBO's and E-com platforms	1,000	1,100
Jealous 21	Denim and casual wear	Women	Forever New, Levi's, Pepe Jeans	Central, Brand Factory, EBO's, MBO's and E-com platforms	1,500	900

Source: Company, Edelweiss research

The Power brands have already crossed the INR1bn mark, in terms of MRP sales to customers, and brands such as *Lee Cooper* are already in the INR6.5bn brand category. For any brand, initially it is very tough to cross the INR1bn mark. But, when the same is achieved crossing the INR5bn mark becomes relatively easier as the brand becomes well known and distribution expansion becomes easier. **Gross margin also improves as the brand becomes big. The bigger brands help in better negotiation with the suppliers, in turn improving margins.**

Chart 3: FLF's key brands, MRP sales-wise (all above INR1bn)

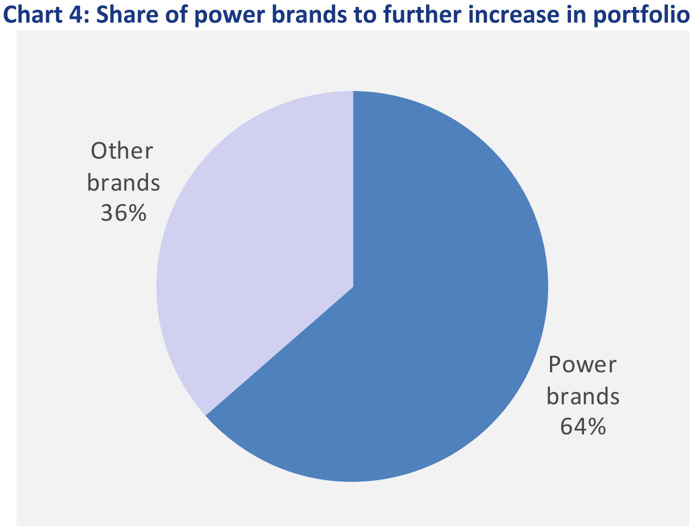


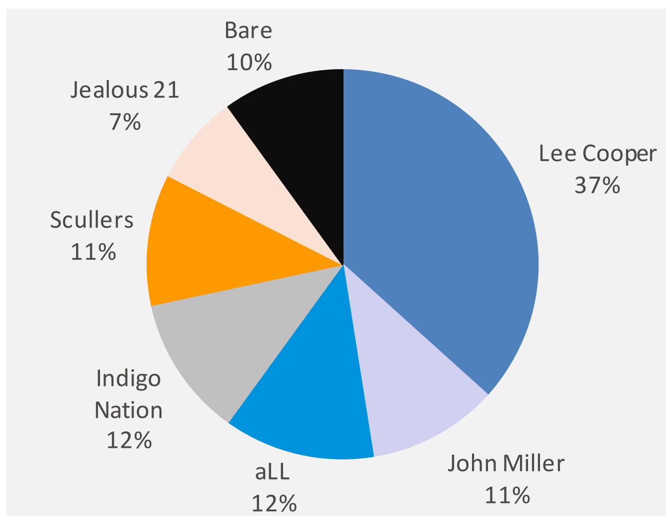
Source: Company, Edelweiss research

- **Power brands to propel share of own/licensed brands**

  Going ahead, power brands will play a key role in increasing the share of own and licensed brands in FLF's overall branded portfolio. Currently, 38.3% of overall sales come from own/brands and of these power brands accounted for ~64% in FY17. With sharper focus, Power brands are expected to clock higher growth rates owing to their better brand value and size. As such, the share of own and licensed brands will increase and within that the share of Power brands will further rise. We expect share of own and licensed brands to increase from 38.3% in FY17 to 39.6% in FY20, and within this the share of Power brands to increase from 63.6% in FY17 to 64.5% in FY20. FLF expects Power brands to contribute ~70% by FY22.

Chart 4: Share of power brands to further increase in portfolio

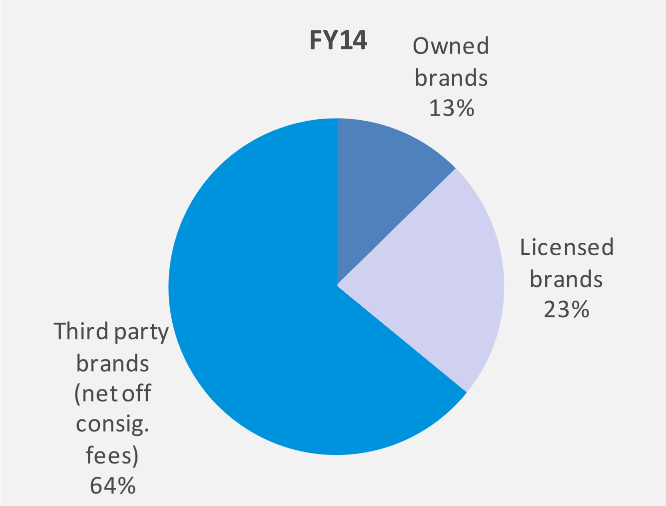


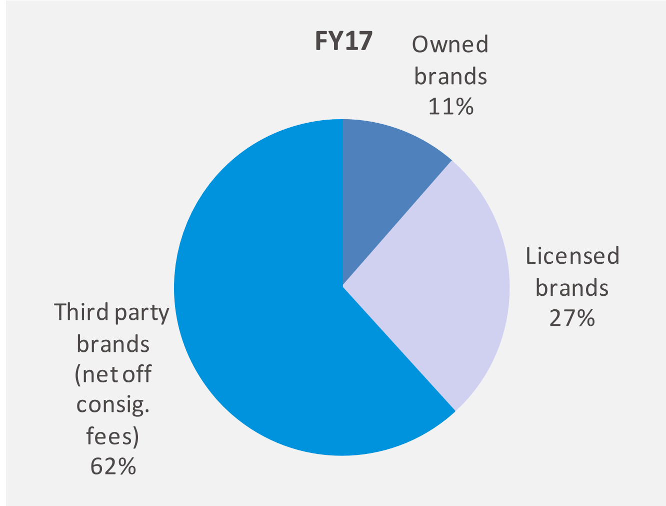


Source: Company, Edelweiss research

Share of own/licensed brands is expected to further increase following faster growth in Power brands versus third-party brands. This will be led by higher focus by FLF to drive growth in these brands not only in terms of allocating more resources and capital, but also by having better placement in its own retail outlets of Central and BF.

Chart 5: Share of third-party brands on decline, albeit marginally (as per company)





Source: Company, Edelweiss research

- **Investee brands – A strong bouquet**

  Apart from possessing a strong portfolio of own and licensed brands, FLF has also invested in other brands (known as investee brands) which are helmed by talented designers/entrepreneurs at an early stage – the company starts with a small investment and picks up stake in brands that have huge value unlocking potential as they grow big. This is over and above the gains from stake sale, which can be used for deleveraging. This also helps FLF in learning and gaining access to new categories, such as, fast fashion, accessories, handbags, footwear, etc.

Table 4: Investee brands and FLF's stake in them

Investee brand	FLF's stake (%)	Segment
Giovani	96.0	Premium brand for men
Cover Story	90.0	Fast Fashion for women
Mother Earth	72.2	Home décor, apparel, linen etc
Spunk	60.0	Leisure wear
Mineral	56.5	Women's wear
Clarks	50.0	Footwear brand for men and women
Holii	50.0	Leather bags
Tresmode	33.3	Shoes
Famozi	30.0	Shoes
Desi Belle	27.5	Women's wear
Turtle	26.0	Men's wear
Peperone	12.0	Handbags

Source: Company, Edelweiss research

Humungous value unlocking potential in investee brands

Recently, FLF transferred its investment in the investee companies to its wholly-owned subsidiary, FLF Lifestyle Brands. Post this consolidation of holdings in investee brands, FLF sold 51% stake in FLF Lifestyle Brands for ~INR4.5bn and made a gain of INR380mn. Thereon, FLF now holds 49% stake in FLF Lifestyle Brands. On a weighted average basis, the company holds ~30% stake in these investee brands. **At turnover of ~INR6bn as at FY17, the deal was concluded at strong EV/sales of ~4.9x on FY17 trailing basis**.

The potential of FLF's investments in investee brands is humungous – of FLF's investments in investee brands, it has till date exited from only 2 investments (*BIBA* & *AND)* and raked in a staggering 6x and 24x returns over 5-6 years, respectively. This reflects the underlying potential of unlocking from which FLF is well poised to benefit. In our valuation, we have not ascribed any upside from FLF's holding in FLF's lifestyle brands, thereby posing an upside risk to our valuation.

FLF shall pare debt utilising the stake sale proceeds which will help cushion its leverage.

Table 5: Stakes divested in BIBA, AND

	BIBA	AND
Entry year	2007	2008
Exit Year	2013	2013
Stake acquired and exited	25.8	22.9
Acquisition price (INR mn)	420.0	60
Exit price (INR mn)	2,350.0	1450
Stake sale valuation	15x FY14 EBITDA	15x FY14 EBITDA
Return on investment	6x	24x

Source: Company, Edelweiss research

Outlook and valuations: On growth trajectory; maintain 'BUY'

FLF is one of the largest branded apparels and physical retailers in India with total retail space of 5.4mn sq ft spread across 90 cities (ABFRL is present across ~6mn sq ft) and a diversified portfolio of 30 brands straddling different segments (men's, women's and kids wear) and price points. The company has been logging strong SSSG (double-digit in past 4 quarters) and outperforming industry growth, led by better inventory management, focus on premiumisation, better store layout, inventory liquidation and strong brands.

From its strong portfolio of own, licensed and investee brands, the company has identified 6 power brands to drive growth (*Lee Cooper* being the largest), which are currently contributing ~64% to FLF's total brands (the share is expected to further increase due to higher focus and better brands). Power brands are margin accretive – as these brands gain scale, operating leverage sets in leading to better margins. Investee brands, on the other hand, provide an opportunity for stake sale as the brands grow. On strong performance (robust SSSG), expected margin improvement (led by higher contribution by own brands and within that power brands) and strengthening balance sheet, we estimate RoCE to jump from 6.9% in FY17 and 20.9% in FY20, further aided by better inventory turns and margin improvement.

We assign a target multiple of 12x FY20E EV/EBITDA to arrive at our target price of INR439. We believe that FLF being an integrated model is a much better bet than other retailers as well as ABFRL, which boasts of size, stronger brands and retail space too.

Company Description

FLF was formed from the de-merged branded fashion business of Future Consumer (erstwhile Future Ventures India) and the Lifestyle Fashion business of Future Retail. FLF commenced operations in May 2013. Starting from a small portfolio, it now boasts of ~30 brands spread over retail footprint of 5.4mn sq ft. Post demerger, FLF has continued to build and strengthen its portfolio as a lifestyle fashion arm of Future group. In its fourth successful year of operations, FLF has reinforced its position as a leading fashion retailer with a strong fashion portfolio in India.

Investment Theme

The Indian retail landscape is evolving with interplay of several demographic and economic factors. The big opportunity lies in the growing share of organised retail with the growing trend among consumers to allocate a larger share of income to consumption and gradual improvement in lifestyle. The improving liquidity is also positive as it means better delivery of retail space for expansion. FLF is a niche play with strong brand position in the lifestyle space. The strong positioning and brand recall gives the company a strategic advantage in the light of increasing competition. With its steadfast focus on systems and processes and its ability to attract global brands as venture partners, it is well placed to emerge as a leading departmental store player in the long run.

Key Risks

Slower GDP revival leading to lower traction in discretionary spending

Currently, FLF's target customers are in tier I & II geographies. Clothing and footwear spending is discretionary and correlated with increase in consumer confidence index, GDP revival, etc. Any delay in revival of GDP and slowdown in these geographies can impact the company's growth.

Heightened competition

Many foreign brands are enhancing presence in India to cash in on the humongous growth opportunity. While foreign brands such as Zara, Tommy Hilfiger, etc., have already established themselves, other brands such as H&M and GAP, among others, are venturing into India's fast fashion market. Entry of these foreign brands, more sale period and offers will keep the competitive intensity high.

Threat from e-commerce

FY15 and FY16 were marked by aggressive discounts and sale seasons by e-commerce companies, leading to shift in customers' loyalty. FLF has Braand Factory to counter the threat from e-commerce. However, any other unexpected action taken by e-commerce companies may may hamper FLF's SSG and hence its growth.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.5	7.1	7.7	-
Inflation (Avg)	4.8	5.0	5.2	-
Repo rate (exit rate)	6.3	6.3	6.3	-
USD/INR (Avg)	67.5	67.0	67.0	-
Company				
Central - SSS growth (%)	18.1	12.0	11.0	10.0
Brand factory - SSS growth (%)	16.6	15.0	12.0	11.0
Central - Total stores	35	40	45	50
Brand factory - Total stores	53	61	69	77
Capex (INR mn)	1,655	2,475	2,510	2,547
Shoppers-COGS (% of rev)	63.1	62.9	62.7	62.5
Staff costs (% of rev)	5.3	5.5	5.2	5.1
Electricity (% of rev)	2.5	2.5	2.4	2.4
Rent costs (% of rev)	11.3	10.7	10.1	10.5
Debtor days	20	18	16	14
Inventory days	203	185	175	170
Payable days	153	153	153	150
Dep. (% gross block)	7.9	8.8	8.6	8.6
Tax rate (%)	24.0	28.0	28.0	28.0

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	38,771	45,783	56,372	68,259
Materials costs	24,452	28,783	35,328	42,640
Gross profit	14,319	17,000	21,045	25,618
Employee costs	2,049	2,518	2,931	3,481
Electricity expenses	951	1,145	1,353	1,638
Rent and lease expenses	4,157	4,624	5,919	7,099
Other Expenses	2,682	3,205	3,777	4,505
Ad. & sales costs	900	1,065	1,314	1,594
Total operating expenses	10,739	12,556	15,294	18,318
EBITDA	3,580	4,443	5,750	7,301
Depreciation	1,869	1,848	2,024	2,245
EBIT	1,710	2,595	3,726	5,055
Add: Other income	66.25	69.56	73.05	76.7
Less: Interest Expense	1,172	877	786	624
Add: Exceptional items	(3)	-	-	-
Profit Before Tax	602	1,788	3,013	4,508
Less: Provision for Tax	145	501	844	1,262
Less: Minority Interest	-	10	12	-
Reported Profit	457	1,277	2,157	3,246
Exceptional Items	(3)	-	-	-
Adjusted Profit	460	1,277	2,157	3,246
Shares o /s (mn)	190	190	190	190
Diluted shares o/s (mn)	190	190	190	190
Adjusted Diluted EPS	2.4	6.7	11.3	17.1
Dividend per share (DPS)	0.8	2.2	3.7	5.6
Dividend Payout Ratio(%)	33.2	33.0	33.0	33.0

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Rent and lease expenses	10.7	10.1	10.5	10.4
Materials costs	63.1	62.9	62.7	62.5
Staff costs	5.3	5.5	5.2	5.1
S G & A expenses	6.9	7.0	6.7	6.6
EBITDA margins	9.2	9.7	10.2	10.7
Net Profit margins	1.2	2.8	3.8	4.8

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	17.5	18.1	23.1	21.1
EBITDA	10.1	24.1	29.4	27.0
Adjusted Profit	144.8	177.9	68.9	50.5
EPS	144.3	177.9	68.9	50.5

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	380	380	380	380
Reserves & Surplus	16,350	17,122	18,424	20,385
Shareholders' funds	16,730	17,502	18,804	20,765
Minority Interest	-	10	22	22
Short term borrowings	2,123	1,973	1,473	973
Long term borrowings	4,701	4,701	3,951	3,201
Total Borrowings	6,824	6,674	5,424	4,174
Long Term Liabilities	833	839	881	925
Def. Tax Liability (net)	649	649	649	649
Sources of funds	**25,036**	**25,674**	**25,781**	**26,535**
Gross Block	18,242	20,667	23,128	25,625
Net Block	12,644	13,251	13,722	14,016
Capital work in progress	1,898	1,898	1,898	1,898
Intangible Assets	99	120	134	143
Total Fixed Assets	14,642	15,269	15,755	16,057
Non current investments	70	70	70	70
Cash and Equivalents	661	1,106	950	72
Inventories	14,180	14,997	18,879	20,841
Sundry Debtors	1,889	2,627	2,316	2,921
Loans & Advances	5,954	5,624	5,973	6,257
Other Current Assets	144	151	158	166
Current Assets (ex cash)	22,166	23,399	27,325	30,185
Trade payable	11,331	12,800	16,818	18,229
Other Current Liab	1,172	1,370	1,502	1,619
Total Current Liab	12,503	14,170	18,320	19,848
Net Curr Assets-ex cash	9,663	9,229	9,006	10,337
Uses of funds	**25,036**	**25,674**	**25,781**	**26,535**
BVPS (INR)	88.0	92.1	99.0	109.3

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	457	1,277	2,157	3,246
Add: Depreciation	1,869	1,848	2,024	2,245
Interest (Net of Tax)	890	632	566	449
Others	587	186	160	98
Less: Changes in WC	(1,315)	(440)	(266)	1,287
Operating cash flow	5,117	4,383	5,172	4,751
Less: Capex	2,481	2,475	2,510	2,547
Free Cash Flow	**2,635**	**1,908**	**2,662**	**2,204**

Cash flow metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	5,117	4,383	5,172	4,751
Investing cash flow	876	(2,405)	(2,437)	(2,471)
Financing cash flow	(5,841)	(1,533)	(2,890)	(3,159)
Net cash Flow	152	445	(155)	(879)
Capex	(2,481)	(2,475)	(2,510)	(2,547)
Dividend paid	(91)	(506)	(854)	(1,285)

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	2.8	7.5	11.9	16.4
ROACE (%)	6.9	11.2	15.7	20.9
Inventory Days	203	185	175	170
Debtors Days	20	18	16	14
Payable Days	153	153	153	150
Cash Conversion Cycle	70	50	38	34
Current Ratio	1.8	1.7	1.5	1.5
Gross Debt/EBITDA	1.9	1.5	0.9	0.6
Gross Debt/Equity	0.4	0.4	0.3	0.2
Adjusted Debt/Equity	0.4	0.4	0.3	0.2
Interest Coverage Ratio	1.5	3.0	4.7	8.1

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	1.4	1.8	2.2	2.6
Fixed Asset Turnover	3.1	3.5	4.1	4.9
Equity Turnover	2.4	2.7	3.1	3.5

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	2.4	6.7	11.3	17.1
Y-o-Y growth (%)	*144.3*	*177.9*	*68.9*	*50.5*
Adjusted Cash EPS (INR)	12.3	16.4	22.0	28.9
Diluted P/E (x)	145.4	52.3	31.0	20.6
P/B (x)	4.0	3.8	3.6	3.2
EV / Sales (x)	1.9	1.6	1.3	1.0
EV / EBITDA (x)	20.4	16.3	12.4	9.7
Dividend Yield (%)	0.2	0.6	1.1	1.6

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		EV / Sales (X)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Future Lifestyle Fashions Limited	1,053	52.3	31.0	16.3	12.4	1.6	1.3
Aditya Birla Fashion and Retail Ltd	2,078	83.0	39.3	25.2	17.5	2.0	1.7
Future Retail	3,962	41.0	28.5	31.0	24.4	1.3	1.0
Jubilant Foodworks	1,860	71.6	51.6	29.0	22.4	3.7	3.3
Shoppers Stop	704	301.5	41.3	19.6	13.6	1.0	1.1
Titan Company	11,802	70.6	55.3	46.5	36.2	3.7	3.1
Wonderla Holidays	321	41.6	26.9	19.6	13.2	6.4	5.5

Source: Edelweiss research

Additional Data

Directors Data

Mr. Kishore Biyani	Group CEO, Future Group	Mr. Rakesh Biyani	Non Executive Director
Ms. Avni Biyani	Non Executive Director	Mr. C.P. Toshniwal	Non Executive Director
Mr. Shailesh Haribhakti	Non-Executive Independent Director	Dr. Darlie Koshy	Non-Executive Independent Director
Mr. Bijou Kurien	Non-Executive Independent Director	Ms. Sharda Agarwal	Non-Executive Independent Director
Ms. Sukanya Kripalu	Non Executive - Independent Director		

Auditors - Auditor - M/s NGS & Co., LLP

Holding – Top10

	Perc. Holding		Perc. Holding
Ryka commercial vent	54.96	Pioneer investment f	8.16
L&t mutual fund	3.4	Pi opportunities fun	3.26
Timf holdings	2.68	Bennett coleman & co	2.4
India opportunities	2.27	Future ideas co ltd	1.89
Bhanshali lata	1.84	Idfc mutual fund	1.52

*in last one year

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
31 Mar 2017	Pioneer Investment Fund	Buy	15527950	254.90
31 Mar 2017	Pi Opportunities Fund 1 Lt	Sell	11627950	254.90
31 Mar 2017	Pi Opportunities Fund I	Sell	3900000	254.90

*in last one year

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
06 Apr 2017	Future Corporate Resources Limited	Sell	60438173.00
06 Apr 2017	PIL Industries Limited	Sell	8858262.00
06 Apr 2017	Future Capital Investment Pvt. Ltd.	Sell	2820000.00
06 Apr 2017	Weavette Business Ventures Limited	Sell	1808708.00
05 Apr 2017	PIL Industries Limited	Sell	8858262.00

*in last one year

COMPANY UPDATE

FUTURE RETAIL

In pole position

India Equity Research| Retail

Future Retail (FRL), India's numero uno grocery and second largest fashion retailer, clocked impressive double-digit same stores sales growth (SSSG), pruned inventory (down 5 days) and improved RoE to ~17% in FY17. Still a lot of steam is left—inventory day improvement (expect 95 inventory days in FY20 from 106 in FY17) and double digit SSSG in Big Bazaar over FY18-20E bode well for the company. We expect margin to improve gradually steered by private labels and Easy Day turnaround. Hence, we estimate FRL to post sales, EBITDA and PAT CAGR of 20.6%, 31.1% and 51.7%, respectively, over FY17-20. As we roll forward to FY20, we assign 25x EV/EBITDA and arrive at TP of INR677. Maintain 'BUY'.

Structural shift to sustain SSSG

Structural catalysts such as: 1) demonetisation resulting into consumers walking into modern retail stores; as well as 2) GST-led consolidation favouring modern trade channel have turned tide in favour of such retailers. FRL, with extensive reach (914 stores), consumption events (public holiday etc), brand investments (fbb sponsoring IPL), loyalty programmes (members spend 3x non-members) and big data analytics (28.5mn members) are fast emerging consumers' delight. Testimony of the same will be reflected in **strong SSSG of Big Bazaar, fbb and Easy Day, which are estimated to clock 12%, 17% and 9% in FY19 and 11%, 15% and 8% in FY20, respectively.**

Rising throughput per store amidst widening network

Despite robust Easy Day and fbb store expansion plans, on back of strong SSSG, the sales per sq ft will be on an uptrend (average increase of ~5% over FY17-20). This improvement will be led by store rationalisation (size of Big Bazaar down ~14%), higher private labels in mix (~30% of total), enhanced fashion focus (in fbb) & Easy Day and HyperCity turnaround (supply chain and cost stabilisation). This is also likely to improve EBITDA margin to ~4.4% by FY20 from 3.4% in FY17.

Outlook and valuations: On right course; maintain 'BUY'

On sustained strong SSSG, improving margin and better inventory turns, we estimate ~1,044bps jump in RoE to 27.1% over FY17-20. We maintain **'BUY/SO'** and TP of INR677 as we roll over to FY20E and assign 25x EV/EBIDTA. At CMP, the stock is trading at 18.7x FY20 EV/EBITDA.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	170,751	201,468	255,139	299,570
Rev. growth (%)	*149.4*	*18.0*	*26.6*	*17.4*
EBITDA (INR mn)	5,813	8,226	10,372	13,110
Adjusted Profit (INR mn)	3,683	6,102	8,954	12,858
Diluted EPS (INR)	7.8	12.5	17.9	25.8
Enterprise Value / EBITDA (x)	43.1	31.0	24.4	18.7
ROAE (%)	16.6	21.5	24.1	27.1

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

MARKET DATA *(R: , B: FRETAIL IN)*

CMP	: INR 511
Target Price	: INR 677
52-week range (INR)	: 659 / 126
Share in issue (mn)	: 492.7
M cap (INR bn/USD mn)	: 252 / 4,059
Avg. Daily Vol.BSE/NSE('000)	: 894.8

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	47.7	49.5	49.5
MF's, FI's & BK's	5.0	4.9	4.7
FII's	17.5	17.4	17.3
Others	29.8	28.1	28.5

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Media Index
1 month	3.8	3.2	6.3
3 months	11.2	6.7	15.9
12 months	28.0	27.7	32.0

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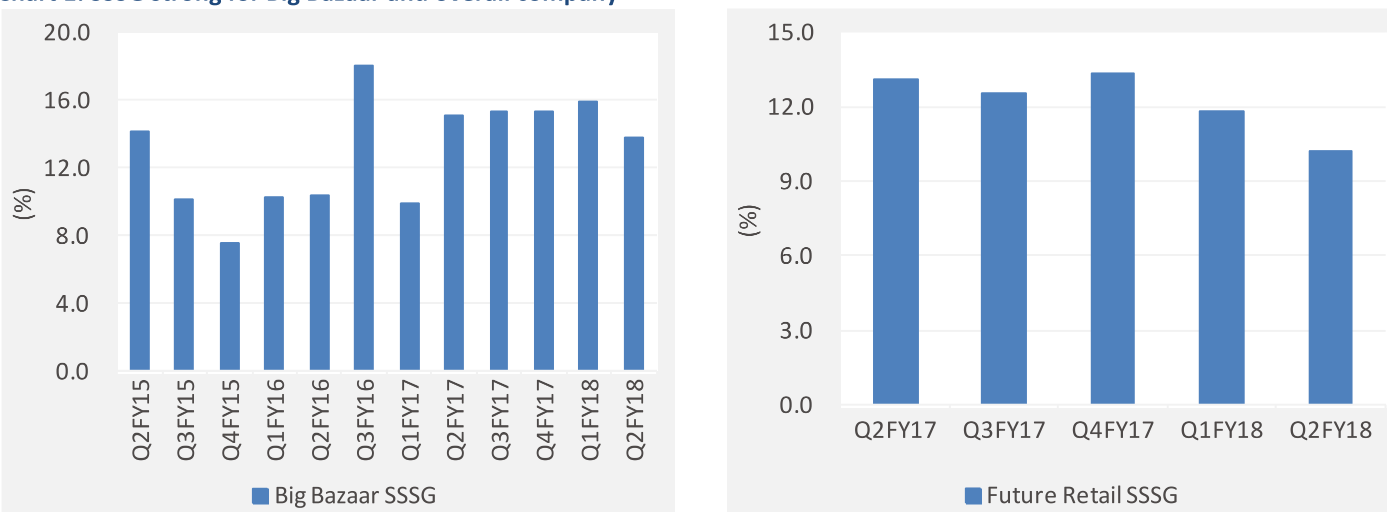
January 2, 2018

Structural shift in SSSG

FRL's SSSG has been improving, a phenomenon not limited to the past 4 quarters. The company has been recording robust SSSG in its value retail format **Big Bazaar since Q1FY15, which instills confidence that Big Bazaar is witnessing sustainable secular improvement.** Over the past couple of quarters, FRL has been consistently recording healthy SSSG in overall business as well as in Big Bazaar. The company's initiatives such as improvement in product assortment, best price to consumers, use of data analytics, etc., have been propelling SSSG. Demonetisation has also engineered a change in buying behaviour of consumers.

Chart 1: SSSG strong for Big Bazaar and overall company



Source: Edelweiss research

We estimate Big Bazaar to maintain SSSG of 14%, 12% and 11% for FY18, FY19 and FY20 respectively.

- **Fashion at Big Bazaar focusing on faster growing segments**

  FRL is focusing on volumes in the fashion business and has one of the most competitive pricing for its fashion offerings. The target is to lower price points by 3-5% every year aided by economies of scale. Better/same quality fashion products, at competitive pricing, have not only been attracting new consumers, but have also seen higher repeat purchases. The company is planning to continue fbb's strong run aided by focus on women's ethnic wear and men's & women's casual wear, which are amongst the fastest growing categories in the apparel segment.

  While the Future Group is the largest fashion retailer in India, FRL is the second largest domestic fashion retailer.

- **Customer loyalty programmes, price matching to catapult spends per head**

  FRL's different loyalty programmes: 1) provide strong data base of consumers; 2) will bolster overall spends per consumer; and 3) enhance overall visits per head in a year of loyal consumers—**loyalty programme customers, on an average, spend ~3x more than non-members, while their annual spends over the year are almost 10x a non-member.**. FRL's loyalty programmes have attracted strong membership of 28.5mn with estimated 20mn unique customers.

- **FRL's loyalty programmes**
  - Big Bazaar Profit Club offers additional free shopping value to customers who pay INR10,000 upfront and visit stores at least 12 times in a year.
  - The Payback Loyalty Programme in partnership with American Express allows consumers to earn and utilise loyalty points from shopping.
  - In the Easy Day format, FRL offers a loyalty programme Easy Day Savings Club wherein consumers can avail 10% discount on all bills up to a limit of INR50,000 per annum by paying one-time annual fee of INR999. The scheme pilot project has been successful—during the pilot phase (3 months), average spends per member stood at INR12,424. Members can also avail other benefits such as free vouchers, free home delivery, etc.

FRL has started the Future Pay wallet concept to ensure that it does not lose customers to competition. Future Pay is a digital loyalty wallet that helps in shopping across Future Group outlets and that too cashless. The wallet has a price match feature which compares the price of a product on the customer's bill with the competitor's advertised prices. And, if it finds a lower price, it credits the difference to the customers' Future Pay Wallet. Future Pay currently has ~1.6mn users.

Healthy store expansion with improvement in throughput/sq ft

FRL has total retail space of 13.6mn sq ft with presence in 26 states and 253 cities, which in our view is one of its biggest advantages. Considering the company's deep reach, focus is on increasing overall throughput per outlet, for which ensuring healthy SSSG is a key criteria. **Besides, the store expansion strategy will also ensure that the company does not cannibalise its own stores.**

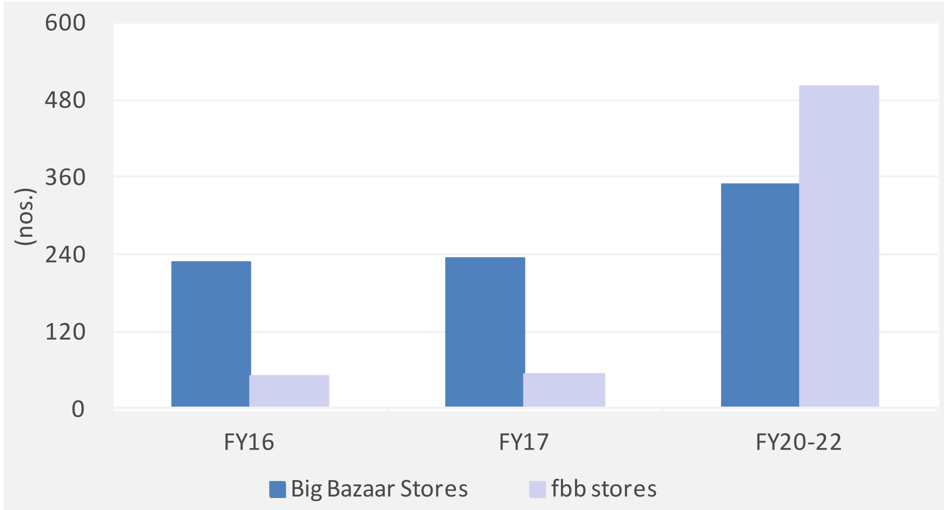
Table 1: Footprint across stores

Store format	Total Stores	Sq ft area (mn)	States	Cities
Big Bazaar	257	10.6	26	130
FBB	57	0.6	18	35
Easy Day	537	1.3	13	11 clusters
Foodhall	7	0.1	4	4
ezone	19	0.2	7	20
Home Town	37	0.9	12	21
Total	**914**	**13.6**	**26**	**253**

Source: Company, Edelweiss research

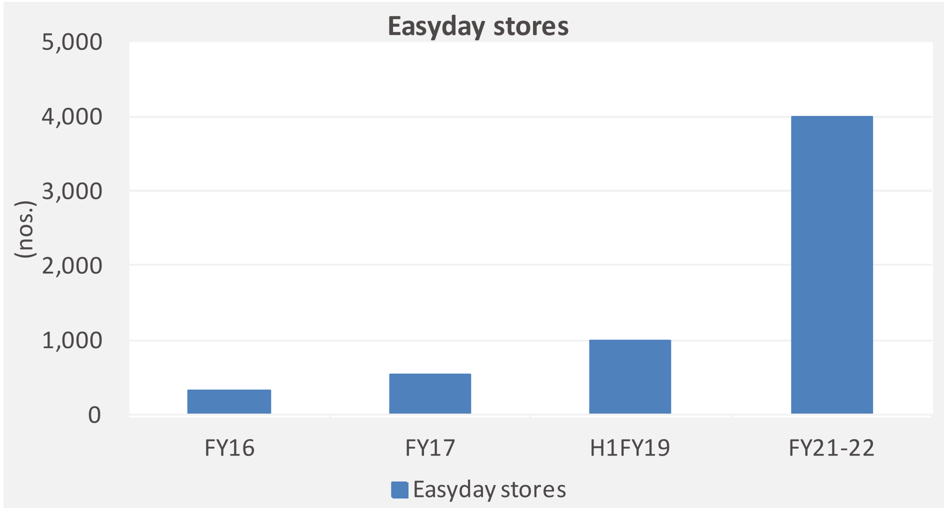
On the anvil are aggressive long-term plans for most of FRL's formats. Separate strategies have been etched out for each of the formats.

Chart 2: Big Bazaar expansion steady; fbb expansion aggressive (as per company)



Source: Company, Edelweiss research

Chart 3: Easy Day expansion – Aggressive on cluster model (as per company)



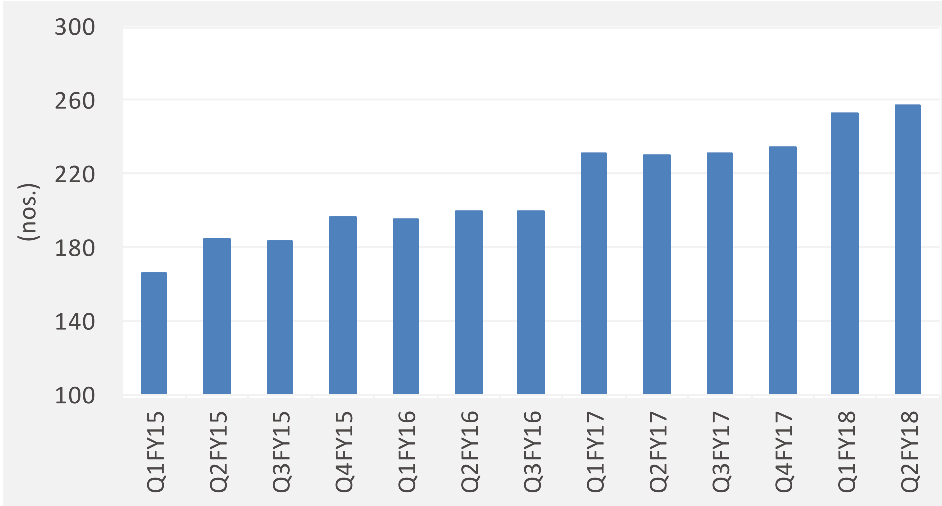
Source: Company, Edelweiss research

Big Bazaar: Steady store additions

FRL does not plan to be aggressive in store openings of its hyper-market format Big Bazaar. **Hence, a store will be opened only after ensuring that it does not cannibalise the super market format, which in our view is the right strategy.** Having already achieved significant scale in the hyper-market format with an area of 10.6mn sq ft, the company's focus is on increasing overall throughput/sq ft—throughput/outlet has been improving with the target to add 15 Big Bazaar stores per annum.

To ensure that overall throughput of Big Bazaar stores increases, per store area size has been reduced without impacting productivity—area/store has been cut from 50,000sq ft to 43,000sq ft. Also, new stores will be of smaller size—35,000-45,000sq ft. The company is targeting 350 Big Bazaar stores by 2021. Throughput per sq ft for Big Bazaar has improved from INR9,000 in FY12 to ~INR12,300 in FY17. We estimate this improvement to sustain helped by increasing footfalls, better inventory management and some store rationalisation.

Chart 4: Store additions slower in past few quarters



Source: Company, Edelweiss research

fbb: fbb stores have been gaining traction and clocking SSSG of ~20%, albeit on a low base. It was earlier part of Big Bazaar, but now the focus is more on expanding standalone stores as the potential of value fashion business is huge. Fashion accounts for ~35% of FRL's total revenue and at all-India level, it is the second largest fashion retailer. Even taking into account Future Lifestyle Fashion, Future Group is the largest fashion player in India with combined sales of ~INR97bn in FY17. This entails significant sourcing benefits for the company.

FRL is targeting aggressive roll out of fbb stores—eyeing total count to 500 plus over the next 3-5 years from 57 stores in H1FY18. Since it operates in value fashion retail, fbb stores operate in areas where they can garner better footfall (mix of malls and high street)—volume focus will result in better inventory turns. However, to leverage value proposition the company proposes to increase overall size of stores in the 12,000-15,000 sq ft range (currently ~10,000 sq ft), similar to Pantaloons, as a larger store enables better display of assortments with larger variety of inventory, resulting in higher bill amount per customer. The company is cautious while expanding fbb (number of stores in Q1FY16 was 51, which at Q2FY18 end stood at 57) as it has been trying to crack the right model, right assortment, team, etc., which is now complete. The focus is now on expanding the brand.

Table 2: FBB stores and average size

FBB	Q3FY15	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Total Stores	38.0	52.0	51.0	50.0	51.0	50.0	50.0	54.0	54.0	54.0	57.0
Store Size (mn sq ft)	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6
Average size per store (sq ft)	11,316	10,192	10,196	10,400	10,196	10,000	10,000	10,000	10,185	10,185	10,175

Source: Company, Edelweiss research

Easy Day: Post acquiring Easy Day, FRL's focus was on cost reduction, closure of loss-making stores (now largely done), changing store layout, shelf arrangement, etc. FRL has figured out the hyper market model with Big Bazaar, while the convenience store is a relatively new territory for it. It has been trying to crack the model and took some notes from the Walmart team. Now, Easy Day is focused on expansion—it has adopted the cluster approach and identified 11 consumption micro markets (11 clusters) where its expansion will roll out over the next 15-18 months. NCR, Mumbai, Chennai, Hyderabad and Bengaluru are the top-5 cities of India in terms of GDP per capita, entailing huge opportunity for organised retail and form part of the cluster defined by the company.

Table 3: Consumption clusters (11) identified for expansion

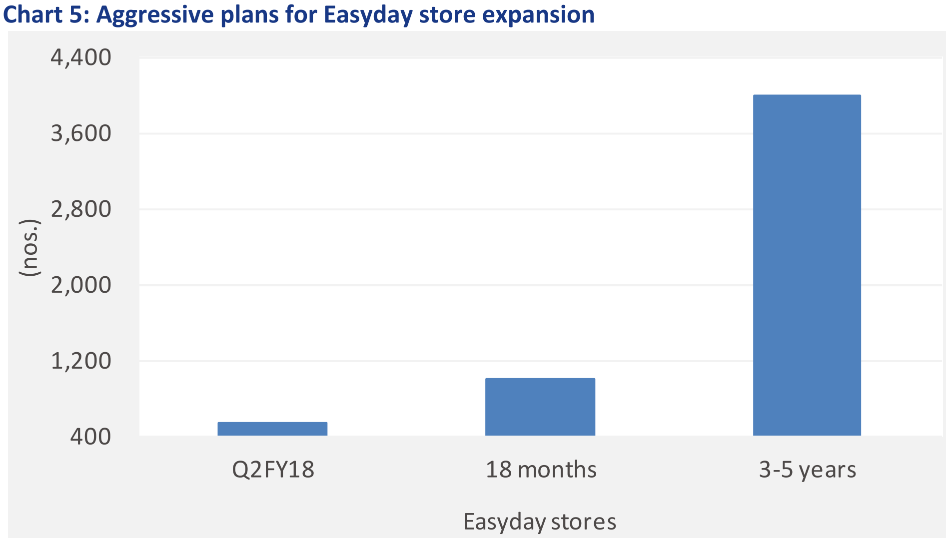
Consumption cluster	Easyday stores	Population (in mn - 2011 Census)	Total household in mm(assuming 5 member in each house)	Households per Easyday
NCR (largest cluster)	143	46.1	9.2	64,434
Haryana	30	27.8	5.6	185,333
Mumbai	27	12.5	2.5	92,593
Bengaluru	31	8.5	1.7	54,839
Hyderabad	80	6.8	1.4	17,000
Chennai	36	4.7	0.9	26,111
Jaipur	9	3.1	0.6	68,889
Lucknow	37	2.8	0.6	15,135
Ludhiana	118	1.6	0.3	2,712
Jammu	7	0.5	0.1	14,286
Haridwar	20	0.2	0.0	2,300
Total Stores	**538**	**114.6**	**22.9**	**42,602**

Source: Company, Edelweiss research

FRL is planning to take overall Easy Day store count to 1,000 within the next 18 months, while its long-term plan is to have 4,000 stores by 2022. **The focus is on ensuring that the supermarket format of Easy Day meets the daily and weekly requirements of consumers (to make it their neighbourhood store), while the hypermarket format of Big Bazaar caters to the monthly consumption basket of urban India.**

On an average, still ~42,600 households have only one Easy Day store in the clusters identified; this offers ample scope for further expansion—cluster approach is the right strategy as it helps in fragmenting the market with one brand, thereby making it difficult for another brand to enter that market.

Chart 5: Aggressive plans for Easyday store expansion

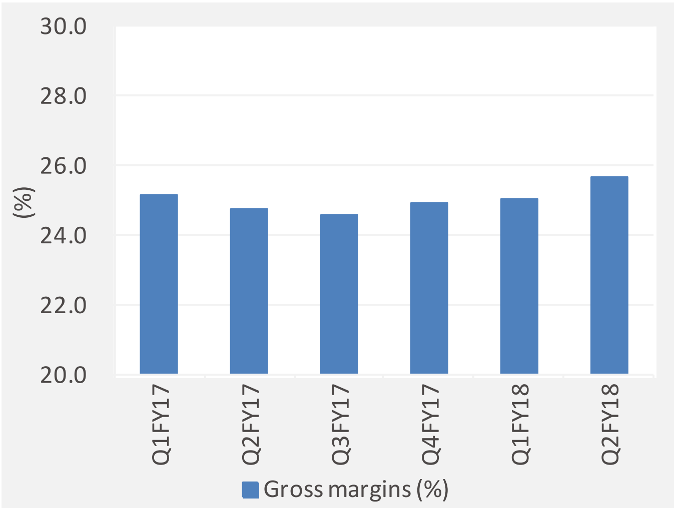


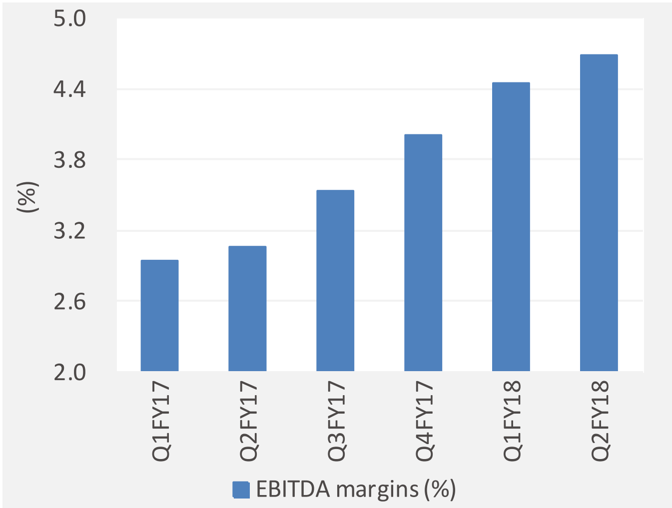
Source: Company, Edelweiss research

Private labels, convenience stores to ramp up margins

After spelling out its strategy for expansion and key assortment, margin improvement is next on management's agenda. Operating leverage (being addressed by focusing on SSSG improvement) remains one of the key margin drivers—increasing overall share of private label brands, higher throughput/outlet in Big Bazaar format and turnaround of Easy Day. Currently, FRL is operating at consolidated gross and EBITDA margins of 24.8% and 3.4%, respectively, which are set to improve aided by the above factors. We estimate EBITDA margin to improve ~97bps YoY to 4.4% by FY20.

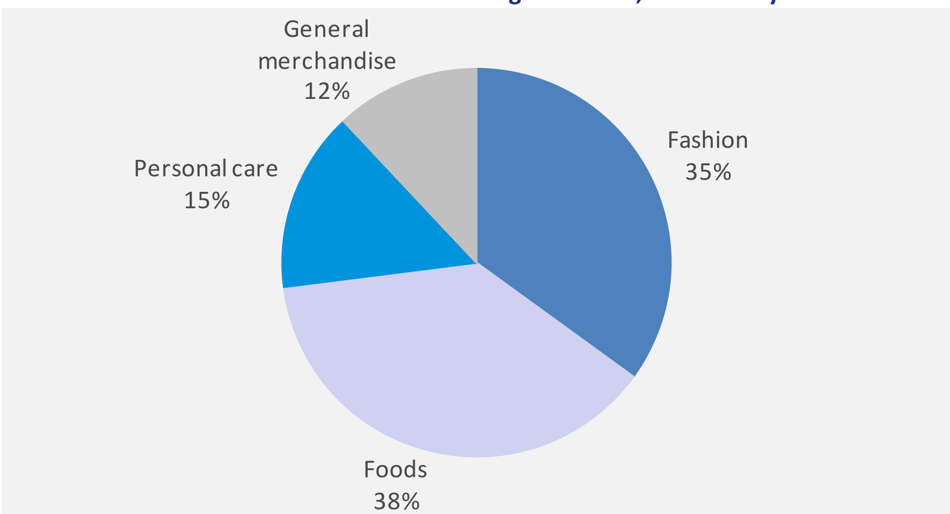
Chart 6: Overall margins an uptrend





Source: Company, Edelweiss research

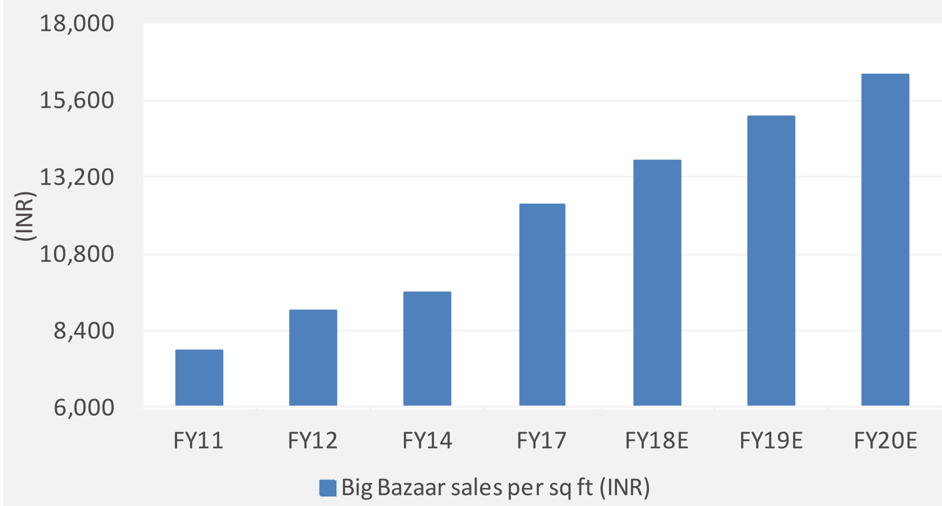
Chart 7: Overall revenue mix - Food has the highest share, followed by fashion



Source: Company, Edelweiss research

In case of Big Bazaar, FRL is planning to gradually increase throughput/outlet, in turn resulting in margin accretion. The company is focused on driving higher value per customer through its loyalty programmes aided by data analytics. We have enumerated the factors that will boost SSSG, which along with lower size should help increase throughput/ outlet for Big Bazaar and in turn ramp up overall margin.

Chart 8: Higher sales/outlet on strong SSSG in turn boasting margin



Source: Company, Edelweiss research

Big Bazaar's margin improved led by various measures initiated by FRL on the store front. Segment margin improved from 7.6% at start of CY14 and hit a high of 11.6% in Q3FY15. However, it dipped to 9.1% in Q3FY16 just before FRL acquired Easy Day.

Rising contribution of private label brands is another vital factor driving overall margin—**private labels fetch higher margins (500-800bps) and we believe Big Bazaar's foods business has adequate room to increase the contribution of private labels.** Already, ~95% of Big Bazaar's total fashion (fbb) comprises private labels, with food accounting for ~15-17%, home ~20% and general merchandise ~5%. Overall, with private labels accounting for ~30%, there's enough scope to increase proportion of private label brands in overall business, especially in foods and personal care.

Table 4: Proportion of private label brands –Huge scope in food

Segment	Private label (%)
Fashion (including fbb)	95.0
Food	15.0
Home	20.0
General Merchandise	5.0
Company level	30.0

Source: Company, Edelweiss research

Easyday: The delta to margin

Easy Day is the other potent margin kicker. Management expects Easy Day to achieve breakeven in FY18 from EBITDA loss in FY17. Post acquisition of Easy Day, the primary focus was on cutting costs, shutting down loss-making stores, changing store layout, shelf arrangement, etc. Post closure of loss-making stores, FRL revamped the assortment strategy to drive better throughput (assortment with better shopping experience at attractive pricing and loyalty benefits).

Going forward, the company is planning to sharpen focus on private label brands in Easy Day stores. **The target is to take overall private label brands to 60% from current 20%.** Though Easy Day is a new area of operation for FRL, it has already built back end capacity to handle

5,000 stores, identified 3,000 SKUs for each store for assortment, a cost control drive is ongoing to achieve EBITDA improvement and the cluster approach with the Easy Day savings club will ensure that throughput/outlet is healthy.

Table 5: Initiatives driving Easyday turnaround

Backend	Store level	Consumer
Built capacity to handle 5000 stores	Identified ~3000 SKUs for each store	Easyday saving club: Ensure customer stickiness
Have set up centralised procurement mechanism	Operate in 11 clusters with better customer understanding	Home delivery in select locations
Entered into strategic tie ups with FMCG companies	Running cost control to turn EBITDA break even	Neighbourhood store
	Each store decide mix of local products	Assortment of essential and aspirational products - considering local and national needs
	Inhouse training of managers	Accepting payments in all modes

Cost in Easyday is lower owing to lower employee cost, rentals, operating and A&P spends. **Over the next 2-3 years, convenience stores could clock EBITDA margin of ~3.5-4%, while steady state EBITDA margin could be ~5.5%.**

Outlook and valuations: On right course; maintain 'BUY'

FRL has been clocking robust SSSG over the past 4 quarters. We expect this to sustain led by changing consumer habits (thanks to demonetisation), consolidation in distribution network (wholesale getting consolidated) and various initiatives to reduce inventory & assortment, etc. The company's margin is expected to improve gradually led by better mix and turnaround in Easyday business. Balance sheet improvement will be led by further improvement in inventory days.

Improvement in financial metrics apart, FRL has successfully realigned to have in place an asset-light model with better return ratios. Notably, FRL is one of the few players to have successfully cracked this model along with being profitable (D-Mart being the bellwether) and with reach across the country (914 stores in 253 cities).

We value the stock at 25x FY20E EV/EBIDTA to arrive at target price of INR677. We maintain **'BUY/ Sector Outperformer'** recommendation/rating.

Company Description

Future Retail (FRL, housing Big Bazaar, FBB, Easy Day, ezone, Foodhall) is a pioneer of retail market in India with market leadership in the food and grocery retail market (market share of 13% in 2016). The company, which is the largest organised retailer in India, has total retail space of 13.6mn sq ft with presence in 26 states and 253 cities with a total store count of 914 stores at the end of H1FY18. A major realignment and consolidation exercise was undertaken to make FRL a asset light and a pure play retail company with strong presence in multiple formats – hypermarket and supermarket. In May 2015, the company acquired the supermarket format, Easy Day, from Bharti Group and enhanced its overall presence across the country. Recently it also acquired the retail operations of Heritage foods and expanded into Southern India.

Investment Theme

Brighter GDP growth prospects and changing consumer behaviour in favour of larger discretionary and organized spends has set the stage for a healthy growth in the retail space. Future retail with the largest store network will be the biggest beneficiary of the increasing change in consumer spending habits. Also in the current restructured form, Future Retail is asset light and generates free cash flow thereby giving investors a pure play retail company. Having cracked the Hypermarket model with Big Bazaar, the company is on the journey of store expansion and turnaround in the convenience store format, Easy Day. This along with increase in the private label mix will bolster margins.

Key Risks

Economic slowdown: A slowdown in economy and GDP growth rate can have significant impact on company's overall footfalls and SSSG.

Increase in inventory levels: Rise in inventory has been a concern for Future group investors. Though various measures have been taken to reduce inventory days and the same are bearing results, the risk of increase in inventory always lingers due to slowdown in SSSG.

Reckless diversification and expansion: This remains a key risk though the company has hived off non-retail portion of business. Diversification in non-related areas and aggressive acquisitions not only result in business risks, but can also increase debt that has been taken for any acquisition.

Failure of supermarket model: Future Group has a long experience in running the hypermarket format. However, they are new to super markets which has not been a successful format for most players in India.

Intensifying competition: Heightened competition from both brick and mortar and online players could impact overall SSSG of FRL. Competition from online delivery players, such as, bigbasket.com. grofers.com, Amazon etc., remains a key threat.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	-
Inflation (Avg)	4.5	4.0	4.5	-
Repo rate (exit rate)	6.3	5.8	5.8	-
USD/INR (Avg)	67.1	65.0	66.0	-
Company				
No. of stores - BB	235.0	257.0	272.0	287.0
No. of stores - FBB	54.0	104.0	154.0	204.0
No. of stores - Easyday	538.0	763.0	988.0	1,213.0
No. of stores - Others	74.0	22.0	22.0	22.0
Retail Sp (mn sq.ft)- BB	10.2	11.1	11.7	12.3
Retail Space (mn sq. ft) - FBB	0.6	1.1	1.6	2.2
Retail Space (mn sq. ft) - Easyday	1.4	1.9	2.5	3.0
Capex (INR mn)	870	300	1,000	1,000
SSSG - Big Bazaar	14.0	14.0	12.0	11.0
SSSG - FBB	20.0	20.0	17.0	15.0
SSSG - Easyday	8.0	9.0	9.0	8.0
COGS as % of sales	75.2	75.0	74.7	74.8
Staff costs (% of rev)	4.7	4.6	4.7	4.5
Rent costs (% of rev)	8.0	7.8	7.7	7.6
Other expenses as % of sales	8.8	8.5	8.8	8.8
Debtor days	5	5	5	5
Inventory days	106	100	95	95
Payable days	79	80	80	80
Cash conversion cycle	32	25	20	20
Int rate on debt (%)	18.9	19.0	9.6	8.3
Dep. (% gross block)	34.3	34.0	34.0	34.0
Dividend payout	-	7.2	6.0	2.4

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	170,751	201,468	255,139	299,570
Materials costs	128,344	151,074	190,655	224,014
Gross profit	42,407	50,394	64,484	75,556
Employee costs	8,034	9,328	11,994	13,564
Rent and lease expenses	13,595	15,715	19,564	22,639
Other Expenses	14,965	17,125	22,555	26,242
EBITDA	5,813	8,226	10,372	13,110
Depreciation	326	425	1,068	1,444
EBIT	5,487	7,802	9,304	11,666
Add: Other income	238.00	200.00	1,100.00	2,392.36
Less: Interest Expense	2,042	1,900	1,450	1,200
Profit Before Tax	3,683	6,102	8,954	12,858
Reported Profit	3,683	6,102	8,954	12,858
Adjusted Profit	3,683	6,102	8,954	12,858
Shares o /s (mn)	472	490	499	499
Adjusted Basic EPS	7.8	12.5	17.9	25.8
Diluted shares o/s (mn)	472	490	499	499
Adjusted Diluted EPS	7.8	12.5	17.9	25.8
Adjusted Cash EPS	8.5	13.3	20.1	28.7
Dividend per share (DPS)	-	0.7	0.9	0.5
Dividend Payout Ratio(%)	-	7.2	6.0	2.4

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Rent and lease expenses	8.0	7.8	7.7	7.6
Materials costs	75.2	75.0	74.7	74.8
Staff costs	4.7	4.6	4.7	4.5
Other expenses	8.8	8.5	8.8	8.8
Interest Expense	1.2	0.9	0.6	0.4
EBITDA margins	3.4	4.1	4.1	4.4
EBIT margins	3.2	3.9	3.6	3.9
Net Profit margins	2.2	3.0	3.5	4.3

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	149.4	18.0	26.6	17.4
EBITDA	597.2	41.5	26.1	26.4
PBT	2,340.6	65.7	46.8	43.6
Adjusted Profit	2,340.6	65.7	46.8	43.6
EPS	125.0	59.6	44.0	43.6

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	944	979	998	998
Reserves & Surplus	24,593	30,255	42,225	50,771
Shareholders' funds	25,537	31,235	43,223	51,769
Short term borrowings	10,776	10,000	10,000	9,500
Long term borrowings	8	-	2,560	2,560
Total Borrowings	10,784	10,000	12,560	12,060
Long Term Liabilities	1,896	1,896	1,896	1,896
Sources of funds	**38,217**	**43,131**	**57,679**	**65,725**
Gross Block	950	1,250	2,250	3,250
Net Block	5,656	5,531	7,437	7,282
Total Fixed Assets	5,656	5,531	7,437	7,282
Cash and Equivalents	1,560	5,394	14,616	22,141
Inventories	37,352	41,390	49,155	55,657
Sundry Debtors	2,281	2,760	4,599	3,902
Loans & Advances	17,074	19,074	21,519	23,519
Other Current Assets	5,452	5,452	5,997	5,997
Current Assets (ex cash)	62,159	68,676	81,269	89,075
Trade payable	27,800	33,112	41,090	48,220
Other Current Liab	3,358	3,358	4,553	4,553
Total Current Liab	31,158	36,471	45,643	52,773
Net Curr Assets-ex cash	31,000	32,206	35,627	36,302
Uses of funds	**38,217**	**43,131**	**57,679**	**65,725**
BVPS (INR)	54.1	63.8	86.6	103.8

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	3,683	6,102	8,954	12,858
Add: Depreciation	326	425	1,068	1,444
Interest (Net of Tax)	2,042	1,900	1,450	1,200
Others	106	(200)	(1,469)	(3,454)
Less: Changes in WC	4,186	1,206	1,524	3,924
Operating cash flow	1,970	7,021	8,480	8,124
Less: Capex	870	300	1,000	1,000
Free Cash Flow	**1,100**	**6,721**	**7,480**	**7,124**

Cash flow metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	1,970	7,021	8,480	8,124
Investing cash flow	(757)	(100)	(100)	1,192
Financing cash flow	(884)	(3,088)	842	(1,791)
Net cash Flow	329	3,833	9,222	7,525
Capex	870	300	1,000	1,000
Dividend paid	-	439	536	291

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	16.6	21.5	24.1	27.1
ROACE (%)	17.7	20.6	21.4	23.5
Inventory Days	106	100	95	95
Debtors Days	5	5	5	5
Payable Days	79	80	80	80
Cash Conversion Cycle	32	25	20	20
Current Ratio	2.0	2.0	2.1	2.1
Gross Debt/EBITDA	1.9	1.2	1.2	0.9
Gross Debt/Equity	0.4	0.3	0.3	0.2
Adjusted Debt/Equity	0.4	0.3	0.3	0.2
Net Debt/Equity	0.4	0.1	-	(0.2)
Interest Coverage Ratio	2.7	4.1	6.4	9.7

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	5.0	5.0	5.1	4.9
Fixed Asset Turnover	41.3	36.0	39.3	40.7
Equity Turnover	7.7	7.1	6.9	6.3

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	7.8	12.5	17.9	25.8
Y-o-Y growth (%)	*125.0*	*59.6*	*44.0*	*43.6*
Adjusted Cash EPS (INR)	8.5	13.3	20.1	28.7
Diluted P/E (x)	67.0	42.0	29.2	20.3
P/B (x)	9.7	8.2	6.0	5.0
EV / Sales (x)	1.5	1.3	1.0	0.8
EV / EBITDA (x)	44.1	31.7	25.0	19.1
Dividend Yield (%)	-	0.1	0.2	0.1

Peer comparison valuation

	Market cap	Diluted P/E (x)		EV / EBITDA (x)		ROAE (%)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Future Retail	4,059	42.0	29.2	31.7	25.0	21.5	24.1
Aditya Birla Fashion and Retail Ltd	2,087	83.3	39.4	25.3	17.6	15.3	26.1
Future Lifestyle Fashions Limited	1,080	53.6	31.7	16.7	12.7	7.5	11.9
Jubilant Foodworks	1,922	73.9	53.3	30.0	23.2	18.1	21.8
Shoppers Stop	701	299.9	41.1	19.5	13.5	2.7	16.0
Titan Company	11,968	71.4	56.2	47.2	36.7	23.1	25.1
Wonderla Holidays	322	41.7	27.0	19.6	13.2	10.8	15.1

Source: Edelweiss research

Additional Data

Directors Data

Mr. Kishore Biyani	Chairman and Managing Director	Chairman and Managing Director	Joint Managing Director
Mr. Shailendra Bhandari	Independent Director	Ms. Sridevi Badiga	Independent Director
Mr. Rajan Bharti Mittal	Non Executive Director	Ms Gagan Singh	Independent Director
Mr. Ravindra Dhariwal	Independent Director		

Auditors - M/s. NGS & Co.

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Suhani trading & inv	47.43	Cedar support servic	8.83
Brand equity treatie	5.07	Bennett coleman & co	4.97
Arisaig india fund l	4.66	Verlinvest sa	2.18
Wgi em smaller co fu	2.06	Government pension f	1.47
L&t mutual fund	1.29	Counseled merchantil	1.21

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
06 Apr 2017	Gargi Business Ventures Private Limited	Buy	1684663.00
06 Apr 2017	Future Capital Investment Private Limited	Sell	531375.00
06 Apr 2017	Ryka Commerical Ventures Private Limited	Sell	1684663.00
06 Apr 2017	Gargi Business Ventures Private Limited	Buy	531375.00
06 Apr 2017	Future Corporate Resources Limited	Buy	1875000.00

**in last one year*

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COMPANY UPDATE

SHOPPERS STOP

Trajectory well etched out

India Equity Research| Retail

Shoppers Stop (SSL) is one of India's largest fashion retailers to reap benefits of the recent improvement in discretionary spends. We believe management's renewed focus on departmental stores (divested HyperCity to Future Retail), tie-up with Amazon India and focus on private labels (currently 14.7%) will help SSL improve its RoE to 19.3% in FY20E. We also expect margins to uptrend gradually steered by private labels and closure of loss-making stores. We estimate SSL to post EBITDA CAGR of 39.4% over FY17-20. Maintain 'BUY'.

Tie-up with Amazon India, a long term positive

The SSL-Amazon India tie-up, in our view, places SSL at vantage point to reap benefits from its partner's enviable digital presence wherein: 1) **SSL management expects INR2bn sales from digital post the tie up with Amazon and 6-8% EBITDA margin in FY19;** 2) **We expect SSL to leverage Amazon India to increase its private labels contribution (14.7% in Q2FY18);** and 3) SSL has allotted 4.39mn **shares (divested ~5% stake) to Amazon India at INR407.78/share,** aggregating to ~INR1,793mn. **With Amazon India an investee in SSL will boost confidence of the latter's investors.**

Departmental stores centre of focus

We believe SSL divesting its entire stake (51.09%) in HyperCity to Future Retail (FRL) is a win-win proposition for both players. SSL will utilise the sale proceeds of INR3,346mn to pare debt. Also, sharpened focus on its core departmental business (further strengthened post the recent Amazon deal) is likely to improve EBITDA margin to 8.5% in FY20E (peers' 8-10%) from 3.5% in FY17.

Outlook and valuations: Headed in right direction; maintain 'BUY'

SSL is well placed as: 1) Its omni-strategy will receive a boost post its tie up with Amazon India; and 2) Funds raised through the deal will be used to cut debt. We roll over to FY20E and assign 15x EV/EBITDA to arrive at target price of INR733. At CMP, the stock is available at 11.3x FY20E EV/EBITDA. We maintain **'BUY/SO'**.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	49,101	54,875	49,988	55,439
Rev. growth (%)	10.8	11.8	(8.9)	10.9
EBITDA (INR mn)	1,743	2,812	4,007	4,723
Adjusted Profit (INR mn)	(655)	156	1,139	1,539
Adjusted Diluted EPS (INR)	(7.9)	1.8	13.0	17.5
Diluted P/E (x)	(68.3)	301.5	41.3	30.6
EV/EBITDA (x)	31.0	19.6	13.6	11.3

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

MARKET DATA *(R: SHOP.BO, B: SHOP IN)*

CMP	: INR 536
Target Price	: INR 733
52-week range (INR)	: 603 / 281
Share in issue (mn)	: 83.5
M cap (INR bn/USD mn)	: 45 / 701
Avg. Daily Vol.BSE/NSE('000)	: 40.0

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	67.1	67.1	67.1
MF's, FI's & BK's	13.4	13.4	13.4
FII's	4.3	4.3	4.2
Others	15.1	15.1	15.4

** Promoters pledged shares (% of share in issue) : 21.8*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Retail Index
1 month	0.1	3.2	5.8
3 months	11.0	6.7	14.8
12 months	83.2	27.7	46.1

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January 2, 2018

Amazon pact's immense benefits

Structural shifts (demonetisation and GST) in India's retail space have seen SSL realign its business strategy wherein: 1) To capitalise on the digital wave, the company has tied up with Amazon India, which attracts ~400-600mn monthly eyeballs, a big potential customer base for SSL. The partnership will see Amazon India leverage SSL's physical space, while the latter will utilise the former's widespread digital presence to create a superlative retail omni-channel; and 2) By divesting 5% stake to Amazon India, SSL proposes to use the sale proceeds (~INR1,793mn) to pare debt.

A win-win deal …

The SSL-Amazon India tie-up, in our view, places SSL at vantage point to reap benefits from its partner's enviable digital presence wherein: 1) SSL management expects INR2bn sales from digital and overall EBITDA margin of 6-8% in FY19; 2) We expect SSL to leverage Amazon India to increase its private labels contribution (14.7% in Q2FY18); and 3) SSL has allotted 4.39mn shares (divested ~5% stake) to Amazon India at INR407.78/share aggregating to ~INR1,793mn. We believe having Amazon India as an investee is expected to boost confidence of SSL's investors.

Wider market penetration

SSL's store outlet count indicates that while it has higher presence primarily in the metros and other big cities of India, its supply network in tier II/III regions is relatively small. In that respect, Amazon India will offer an exclusive space on its webpage for SSL's products, thus enhancing the visibility of the latter's products in turn aiding top-line growth. More so, the page will be entirely managed by SSL. The company will also have access to ~400-600mn monthly eyeballs, a high potential customer base.

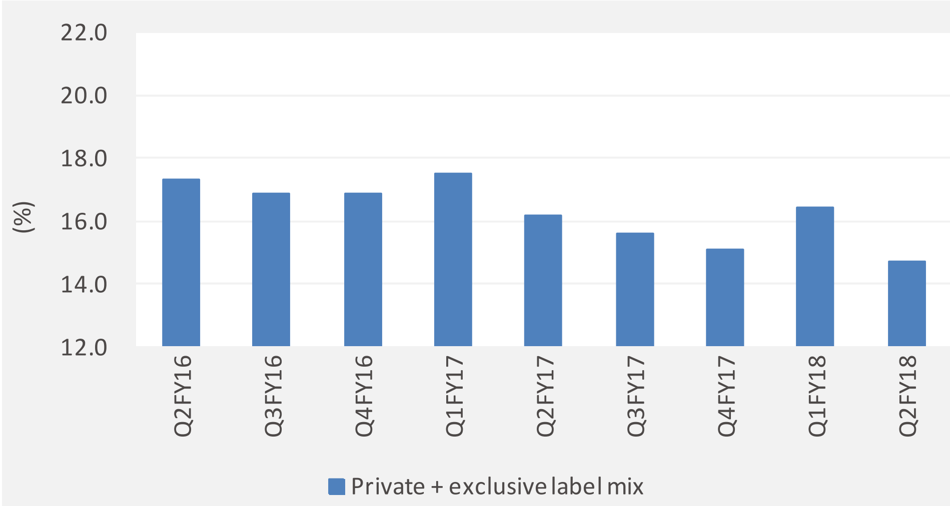
Fig. 1: Amazon deal with Shoppers Stop

Source: Edelweiss research

Private labels contribution to improve

SSL's in-house brands will also draw better consumer attention. A major positive is that Amazon India is barred to have similar tie ups with other brick and mortar stores (Central, Pantaloons, Westside and Reliance Retail). Thus, SSL's private labels will get high visibility on Amazon India's website. A margin-accretive profile, increased customer loyalty, clear product differentiation and higher bargaining power with suppliers are some of the major factors that give the private-label brands of company a major edge over brands of manufacturers sold under the same roof.

Chart 1: Private label's contribution in the range of 14-18%

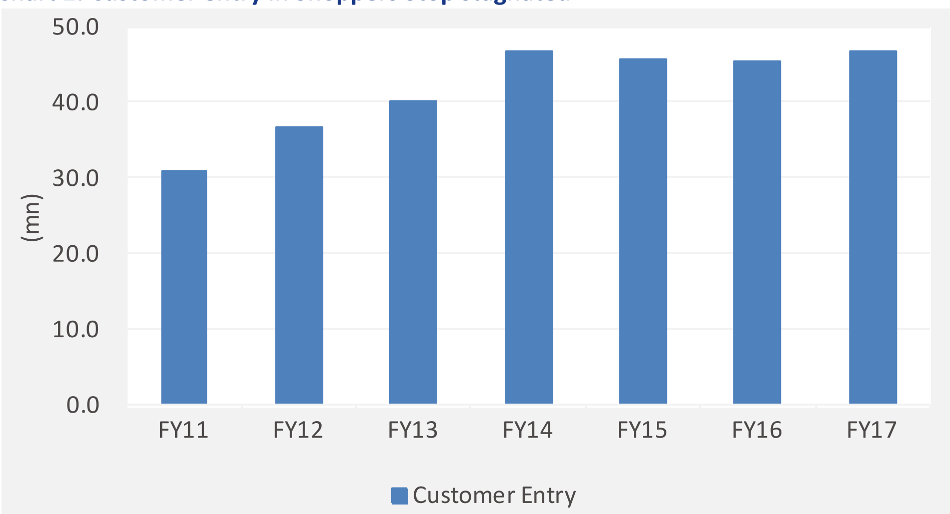


Source: Edelweiss research

Experience stores to attract footfalls

Amazon India has the right to open experience stores at SSL's outlets. In these experience stores, Amazon India lets customers test the products available online. But, consumers cannot buy the products from the experience stores. We expect this to result in huge consumer traction or higher footfall at SSL outlets. Hence, we expect SSL to display its private labels near the experience stores which could lead to better conversions.

Chart 2: Customer entry in Shoppers Stop stagnated



Source: Edelweiss research

Indirect play on Amazon India

SSL has allotted 4.39mn shares (divested ~5% stake) to Amazon India at INR407.78/share, aggregating to ~INR1,793mn. In our view, with Amazon India as an investee in SSL will not only boost confidence of the latter's investors, the Amazon India experience stores will allow investors to take indirect call on Amazon India.

HyperCity divestment to improve departmental performance

SSL has divested its entire 51.09% stake in HyperCity to FRL. Divestment proceeds would be around INR3,346mn, which SSL plans use to pare debt. Such sharpened focus on core departmental business (strengthened further post the recent Amazon deal) is likely to improve SSL's EBITDA margin to 8.5% in FY20 (peers': 8-10%) from 3.5% in FY17.

Debt reduction on track

HyperCity's EV is pegged at INR9,110mn (0.78x FY17 EV/sales), of which consideration stood at INR6,550mn and debt at INR2,560mn. FRL will pay the consideration partly in cash (INR1,550mn) and partly via share issue (INR5,000mn @INR537 per share). SSL will receive INR3,346mn (INR792mn cash and balance in the form of FRL shares) for its stake sale. The deal is expected to conclude in March 2018. HyperCity's valuation at 0.78x FY17 EV/sales (our estimate 0.5x) is a positive for SSL. Funds raised via HyperCity sale and preferential issuance to Amazon India will leave SSL with minimal debt and help sharpen focus on departmental business.

Table 1: HyperCity— EV break-up (INR mn)

Enterprise value: A	9,110
Debt: B	2,560
Consideration: C = A-B	6,550
Consideration break up	
FRL shares	5,000
Cash	1,550
Shoppers Stop	
Stake owned in HyperCity (%)	51.09
Consideration	3,346
FRL shares	2,555
Cash	792

Source: Edelweiss research

Deal contours

- HyperCity's EV pegged at INR9,110mn.
- HyperCity's debt at INR2,560mn.
- Therefore, FRL bought HyperCity at INR6,550mn—part cash and part share consideration.
- FRL will issue shares worth INR5,000mn @ INR537 per share.
- Balance INR1,550mn consideration will be paid via cash.
- SSL held 51.09% stake in HyperCity. Therefore, the company will receive the cash and shares of FRL proportionately.
- SSL will receive INR3,346mn partly in cash (INR792mn) and partly by way of FRL shares.
- The deal is expected to conclude in March 2018.

Departmental stores EBITDA margin to improve

With the sale of HyperCity, SSL will sharpen focus on its departmental stores business. Further, with Amazon India as its stakeholder, we expect efficiencies of the departmental business to improve. The private labels business, which has been lagging since many years, is also expected to receive a leg up. Overall, we estimate consolidated EBITDA margin to improve to 8.5% in FY20 from 3.5% in FY17 as the HyperCity sale eliminates 150bps drag.

Valuation: Headed in right direction; maintain 'BUY'

SSL is one of the best run retail companies in India and envisaged to reap benefits of its expansion strategy. We expect the company's SSSG to be aided by normal monsoons and improvement in discretionary spends led by implementation of OROP and Seventh Pay Commission coupled with direct benefit transfers. SSL has maintained momentum in its retail space expansion even amidst slowdown, which is likely to aid future growth (to open at least 3-4 departmental stores per annum). The company's omni-channel strategy to counter online competition is also on track.

The government's directive is aimed at curbing irrational discounts by online players. Stress in many online players is a positive for physical retailers. However, entry of single brand retailers, such as, H&M and Forever21 and heightened competitive intensity following acquisition of Myntra by Flipkart will remain key monitorables.

In our view, SSL is well strategised to galvanise future growth as: 1) Its investments in omni channels will receive a boost post its tie up with Amazon India; and 2) Funds raised through preferential allotment to Amazon India and sale of HyperCity will be used to reduce debt.

We change our valuation methodology for SSL from EV/sales to EV/EBITDA post the sale of HyperCity to capture improvement in the company's EBITDA margin. We assign 15x FY20E EV/EBITDA to arrive at a revised target price of INR733. We maintain **'BUY/SO'**.

Company Description

SSL, part of the K Raheja Group of Companies, is a focused luxury segment department store player. It has presence in high opportunity segments like home improvement through Home Stop; infant and mothers to be care through Mothercare (a franchise with Mothercare PLC); cosmetics and beauty care through M.A.C. and Clinique (a retail agreement with Estee Lauder); the books and music space through Crossword; and in airport retailing through a JV with Nuance from Switzerland.

Investment Theme

The Indian retail landscape is evolving with interplay of several demographic and economic factors. The big opportunity lies in the growing share of organised retail with the growing trend among consumers to allocate a larger share of income to consumption and gradual improvement in lifestyle. The improving liquidity is also positive as it means better delivery of retail space for expansion. SSL is a niche play with strong brand position in the lifestyle space. It has assiduously positioned itself as a retailer since 1991 of superior quality products and services, offering an international shopping experience. This strong positioning and brand recall gives the company a strategic advantage in the light of increasing competition. With its steadfast focus on systems and processes and its ability to attract global brands as venture partners, it is well placed to emerge as a leading departmental store player in the long run.

Key Risks

Store rollout delays

A large number of retailers are facing delays in roll outs due to delays by developers. This is a significant risk and can lead to cost overruns. Additionally, delays can also lead to capital crunch with a large number of stores bunching up.

Increased competition

Pressure on margins due to cost escalation and competition

Escalation in lease rentals

Escalation in lease rentals and administration expenses can impact margins.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.5	7.1	7.7	-
Inflation (Avg)	4.8	5.0	5.2	-
Repo rate (exit rate)	6.3	6.3	6.3	-
USD/INR (Avg)	67.5	67.0	67.0	-
Company				
Revenue growth (Y-o-Y %)				
SS-deptstore-Totalstores	80	85	90	95
SS depstore-New addition	4	5	5	5
SS - SSS growth (%)	3.1	9.0	9.0	9.0
HyperCity gross sales growth (%)	15.5	9.0	9.0	-
EBITDA margin (%)				
Capex (INR mn)	621	2,273	1,930	1,900
Shoppers-COGS (% of rev)	64.8	64.3	64.6	64.5
HyperCity COGS as % of sales	73.7	80.0	74.0	-
Staff costs (% of rev)	7.5	7.5	7.5	7.4
A&P as % of sales	2.3	2.3	2.3	2.2
Electricity (% of rev)	2.5	2.6	2.6	2.5
Rent costs (% of rev)	8.3	8.5	8.5	8.5
Financial assumptions				
Debtor days	4	4	4	4
Inventory days	62	62	62	62
Payable days	52	52	52	52
Dep. (% gross block)	20.3	10.2	10.2	10.2
Tax rate (%)	41.8	41.0	41.0	41.0

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	49,101	54,875	49,988	55,439
Materials costs	31,892	35,436	30,835	34,195
Gross profit	17,210	19,439	19,154	21,244
Employee costs	3,886	4,116	3,749	4,103
Electricity expenses	1,282	1,427	1,300	1,386
Rent and lease expenses	4,285	4,664	4,249	4,712
Other Expenses	4,833	5,158	4,699	5,100
Ad. & sales costs	1,181	1,262	1,150	1,220
Total operating expenses	15,467	16,627	15,147	16,521
EBITDA	1,743	2,812	4,007	4,723
Depreciation	1,510	1,681	1,712	1,948
EBIT	233	1,130	2,296	2,776
Add: Other income	250.63	250.00	150.00	150.00
Less: Interest Expense	874	900	800	800
Add: Exceptional items	(128)	-	-	-
Profit Before Tax	(518)	480	1,646	2,126
Less: Provision for Tax	203	244	426	506
Associate profit share	(63)	(80)	(80)	(80)
Reported Profit	(784)	156	1,139	1,539
Exceptional Items	(128)	-	-	-
Adjusted Profit	(655)	156	1,139	1,539
Shares o /s (mn)	83	88	88	88
Diluted shares o/s (mn)	83	88	88	88
Adjusted Diluted EPS	(7.9)	1.8	13.0	17.5
Dividend per share (DPS)	-	0.5	3.9	5.3
Dividend Payout Ratio(%)	-	30.0	30.0	30.0

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Rent and lease expenses	8.7	8.5	8.5	8.5
Materials costs	65.0	64.6	61.7	61.7
Staff costs	7.9	7.5	7.5	7.4
S G & A expenses	9.8	9.4	9.4	9.2
EBITDA margins	3.5	5.1	8.0	8.5
Net Profit margins	(1.3)	0.3	2.3	2.8

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	10.8	11.8	(8.9)	10.9
EBITDA	(2.7)	61.3	42.5	17.9
Adjusted Profit	(62.7)	123.8	629.7	35.1
EPS	(62.7)	122.6	629.7	35.1

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	418	440	440	440
Reserves & Surplus	4,375	6,245	6,974	7,960
Shareholders' funds	4,792	6,685	7,414	8,399
Minority Interest	52	52	52	52
Short term borrowings	5,618	5,618	5,618	5,618
Long term borrowings	3,710	3,710	3,000	3,000
Total Borrowings	9,327	9,327	8,618	8,618
Def. Tax Liability (net)	(43)	(43)	(43)	(43)
Sources of funds	**14,129**	**16,021**	**16,041**	**17,026**
Gross Block	8,766	10,266	11,766	13,266
Net Block	7,597	7,557	7,528	7,303
Capital work in progress	147	520	550	550
Intangible Assets	1,680	1,886	2,104	2,281
Total Fixed Assets	9,425	9,964	10,182	10,134
Non current investments	199	199	199	199
Cash and Equivalents	76	1,319	1,280	2,166
Inventories	5,776	6,361	5,620	6,207
Sundry Debtors	568	603	554	613
Loans & Advances	3,136	3,136	3,136	3,136
Other Current Assets	1,342	1,342	1,342	1,342
Current Assets (ex cash)	10,822	11,442	10,652	11,298
Trade payable	4,908	5,417	4,786	5,287
Other Current Liab	1,485	1,485	1,485	1,485
Total Current Liab	6,393	6,902	6,271	6,772
Net Curr Assets-ex cash	4,429	4,540	4,381	4,526
Uses of funds	**14,129**	**16,021**	**16,041**	**17,026**
BVPS (INR)	57.4	76.1	84.4	95.6

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	(784)	156	1,139	1,539
Add: Depreciation	1,510	1,681	1,712	1,948
Interest (Net of Tax)	-	603	536	536
Others	1,041	47	114	114
Less: Changes in WC	463	111	(159)	146
Operating cash flow	1,304	2,377	3,660	3,991
Less: Capex	621	2,273	1,930	1,900
Free Cash Flow	**683**	**104**	**1,730**	**2,091**

Cash flow metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	1,304	2,377	3,660	3,991
Investing cash flow	(1,498)	(2,023)	(1,780)	(1,750)
Financing cash flow	176	836	(1,920)	(1,354)
Net cash Flow	(18)	1,190	(39)	887
Capex	(621)	(2,273)	(1,930)	(1,900)
Dividend paid	-	(47)	(342)	(462)

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	(13.1)	2.7	16.0	19.3
ROACE (%)	3.4	9.1	15.2	17.7
Inventory Days	62	62	62	62
Debtors Days	4	4	4	4
Payable Days	52	52	52	52
Cash Conversion Cycle	13	13	13	13
Current Ratio	1.7	1.8	1.9	2.0
Gross Debt/EBITDA	5.4	3.3	2.2	1.8
Gross Debt/Equity	1.9	1.4	1.2	1.0
Adjusted Debt/Equity	1.9	1.4	1.2	1.0
Interest Coverage Ratio	0.3	1.3	2.9	3.5

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	3.5	3.6	3.1	3.4
Fixed Asset Turnover	5.3	5.9	5.2	5.8
Equity Turnover	9.8	9.5	7.0	7.0

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	(7.9)	1.8	13.0	17.5
Y-o-Y growth (%)	*(62.7)*	*122.6*	*629.7*	*35.1*
Adjusted Cash EPS (INR)	10.2	20.9	32.5	39.7
Diluted P/E (x)	(67.9)	299.9	41.1	30.4
P/B (x)	9.3	7.0	6.3	5.6
EV / Sales (x)	1.1	1.0	1.1	1.0
EV / EBITDA (x)	30.9	19.5	13.5	11.3
Dividend Yield (%)	-	0.1	0.7	1.0

Peer comparison valuation

	Market cap	EV / EBITDA (X)		EV / Sales (X)		ROAE (%)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Shoppers Stop	701	19.5	13.5	1.0	1.1	2.7	16.0
Aditya Birla Fashion and Retail Ltd	2,087	25.3	17.6	2.0	1.7	15.3	26.1
Jubilant Foodworks	1,922	30.0	23.2	3.7	3.3	18.1	21.8
Titan Company	11,968	47.2	36.7	4.7	3.9	23.1	25.1
Wonderla Holidays	322	19.6	13.2	6.4	5.5	10.8	15.1
Median	-	25.3	17.6	3.7	3.3	15.3	21.8
AVERAGE	-	28.3	20.8	3.6	3.1	14.0	20.8

Source: Edelweiss research

Additional Data

Directors Data

Chandru L. Raheja	Chairman	B. S. Nagesh	Vice Chairman
Ravi C. Raheja	Non Executive Director	Neel C.Raheja	Non Executive Director
Nitin J. Sanghavi	Director	Deepak Ghaisas	Director
Nirvik Singh	Director	Gulu L. Mirchandani	Director
Shahzaad Dalal	Director		

Auditors - Deloitte Haskins & Sells, Mumbai

Holding – Top10

	Perc. Holding		Perc. Holding
Palm shelter estate	14.14	Anbee construction p	12.43
Cape trading pvt ltd	12.43	Reliance capital tru	8.92
Raghukool estate dev	6.69	Capstan trading pvt	6.53
Casa maria propertie	6.29	Aditya birla sun lif	5.04
K raheja corp pvt lt	4.07	Icici prudential lif	3.48

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
31 Mar 2017	Raghukool Estate Developement Llp	Sell	2670000	360.00
31 Mar 2017	Casa Maria Properties Llp	Sell	2660000	360.00
31 Mar 2017	Anbee Constructions Llp	Buy	3874639	360.00
31 Mar 2017	Capstan Trading Llp	Sell	2670000	360.00
31 Mar 2017	Cape Trading Llp	Buy	4125361	360.00

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
07 Apr 2017	Casa Maria Properties LLP	Sell	2660000.00
07 Apr 2017	Cape Trading LLP	Buy	4125361.00
07 Apr 2017	Raghukool Estate Development LLP	Sell	2670000.00
07 Apr 2017	Capstan Trading LLP	Sell	2670000.00
07 Apr 2017	Anbee Constructions LLP	Buy	3874639.00

**in last one year*

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COMPANY UPDATE

TITAN COMPANY

Lustrous growth

India Equity Research| Retail

Titan Company (Titan) is envisaged to be one of the best plays on the anticipated urban recovery. Moreover, we expect the company to wrest market share from the unorganised segment aided by GST and stringent regulations in the jewellery segment. Management continues to maintain FY18 jewellery growth guidance at 25% YoY. Focus on wedding jewellery, ramp up in studded share (29.2% in FY17 from ~27-28% in FY13), turnaround in watches & eyewear divisions, option value in *Taneira* and online play through CaratLane bode well for company. Maintain 'BUY'.

Formalisation of economy burnishing organised players' prospects

Organised players are slowly and steadily gaining share, which is expected to accelerate due to GST rollout. **Further, strict regulations like mandatory PAN card for purchases above INR200,000 and no cash beyond INR200,000 have forced consumers to shop from organised players as operations are difficult for local players.** Thus, greater transparency and compliance with indirect taxes is a long-term positive for organised players like Titan.

Wedding segment focus to boost market share

Wedding jewellery (~60% of jewellery market) entails low gross margin compared to studded jewellery. However, Titan's focus on the former resulted in premiumisation of the segment (as seen in Q2FY18), which has better gross margin than plain gold segment. **In our view, Titan's focus on the wedding segment will result in increase in market share, leading to higher sales.** Further, the share of studded jewellery in Titan's portfolio improved from ~27-28% in FY13 to 29.2% in FY17 and the company intends to raise it to ~40% over the long term as diamond jewellery earns 2.5x gross margin compared to gold jewellery (which in turn earns 2.5x gross margin compared to gold coins and bars).

Outlook and valuations: Positive; maintain 'BUY'

We envisage Titan's healthy momentum to sustain led by share gains, entry in new segments and retail expansion. Moreover, rising share of studded jewellery, cost optimisation and operating leverage are likely to aid margin. We maintain **'BUY/SO'** and TP of INR977 as we roll over to FY20E and assign 52x FY20E EPS. The stock is currently trading at 45.0x FY20E EPS.

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	129,789	157,852	187,905	222,624
Rev. growth (%)	*15.1*	*21.6*	*19.0*	*18.5*
EBITDA (INR mn)	11,555	15,943	20,482	25,157
Adjusted Profit (INR mn)	8,000	10,645	13,536	16,682
Adjusted Diluted EPS (INR)	9.0	12.0	15.2	18.8
EPS growth (%)	*18.6*	*33.1*	*27.2*	*23.2*
Diluted P/E (x)	93.8	70.5	55.4	45.0
EV/EBITDA (x)	63.9	46.5	36.2	29.4
ROAE (%)	20.6	23.1	25.1	26.2

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

MARKET DATA *(R: TITN.BO, B: TTAN IN)*

CMP	: INR 845
Target Price	: INR 977
52-week range (INR)	: 872 / 326
Share in issue (mn)	: 887.8
M cap (INR bn/USD mn)	: 750 / 11,968
Avg. Daily Vol.BSE/NSE('000)	: 1,955.7

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY17
Promoters *	52.9	53.1	53.1
MF's, FI's & BK's	5.6	5.4	5.4
FII's	21.7	21.6	21.1
Others	19.8	19.9	20.4

** Promoters pledged shares (% of share in issue) : NIL*

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Retail Index
1 month	5.0	3.2	5.8
3 months	44.6	6.7	14.8
12 months	153.2	27.7	46.1

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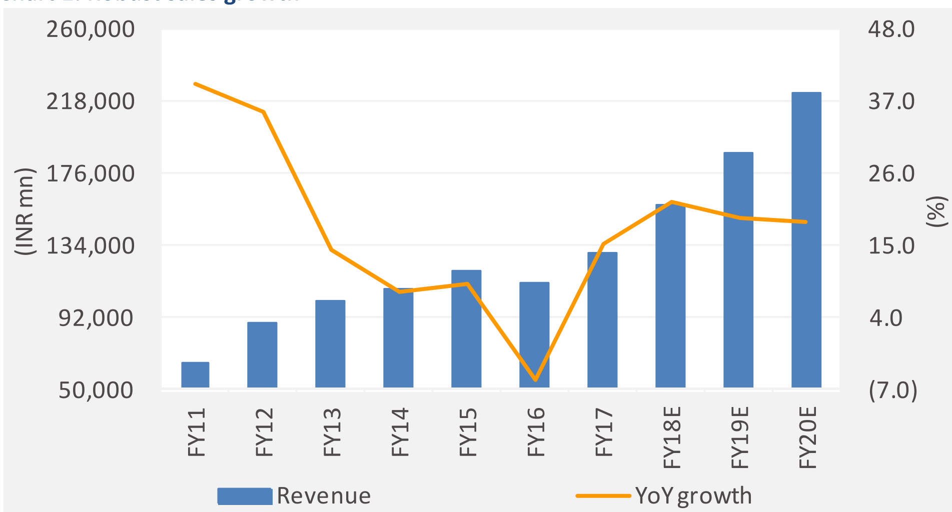
January 2, 2018

Formalisation of economy burnishing organised players' prospects

Organised players are slowly and steadily gaining share in the jewellery market from almost negligible ~15 years ago to ~10% now. Implementation of the INR200,000 PAN card rule, the demonetisation exercise & its impact on cash transactions, the Income tax department's raids on many jewelers and the no cash beyond INR200,000 rule from April 1, 2017, have made operations difficult for medium and small jewelers, whose dependence on cash transactions are exceedingly high. Simultaneously, customers of such jewellers have become wary of shopping with them due to fear of being dragged into the Income Tax Department's net. Titan's new customer acquisition has palpably improved since November 2016. We believe these new customers are much more comfortable with organised jewellers (like Titan); the trend was apparent in Q2FY18 as well.

Chart 1: Robust sales growth



Source: Edelweiss research

Further, the rollout of GST is expected to drive more transparency and compliance. A level playing field will bridge the undue advantage that informal players had over formal peers in the past. Greater transparency and compliance with indirect taxes are bound to entail long-term benefits for organised players like Titan.

Focus on wedding segment to boost sales

The wedding segment accounts for nearly 60% of the jewellery market and Tanishq's presence in this is minuscule. Though the segment entails low gross margin compared to studded jewellery, Titan's focus has resulted in its premiumisation of wedding jewellery (as seen in Q2FY18), which carries better gross margin than plain gold segment. In our view, Titan's sharpened focus on the wedding segment will boost its market share, in turn propelling sales.

Fig. 1: Wedding collection launched by Titan

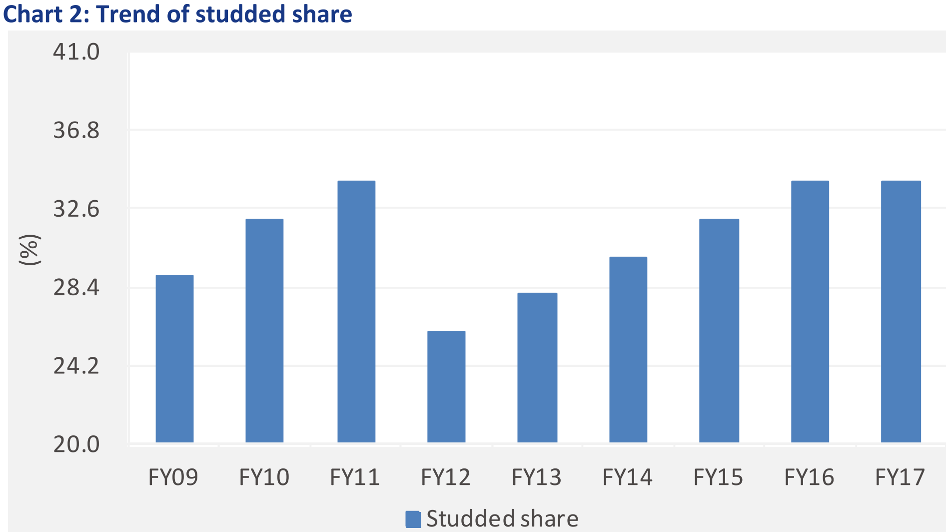
Source: Edelweiss research

Increase in studded share potent margin kicker

The share of studded jewellery in Titan's portfolio was ~27-28% in FY13, which improved to 29.2% in FY17 and the company intends to raise it to ~40% over the long term. Increased studded share will not only reduce dependence on volatile gold prices (reduces dependence on gold as diamond jewellery is typically made in lower carats and needs less quantity of gold), but will also improve margin. Increase in studded share leads to improvement in margin as diamond jewellery earns 2.5x gross margin compared to gold jewellery (which in turn earns 2.5x gross margin compared to gold coins and bars).

High-value diamond jewellery segment accounts for more than two-thirds of the total diamond jewellery segment and again, Tanishq is a small player here. **We expect studded share to rise in line with the company's long-term plan to increase saliency of studded jewellery.**

Chart 2: Trend of studded share

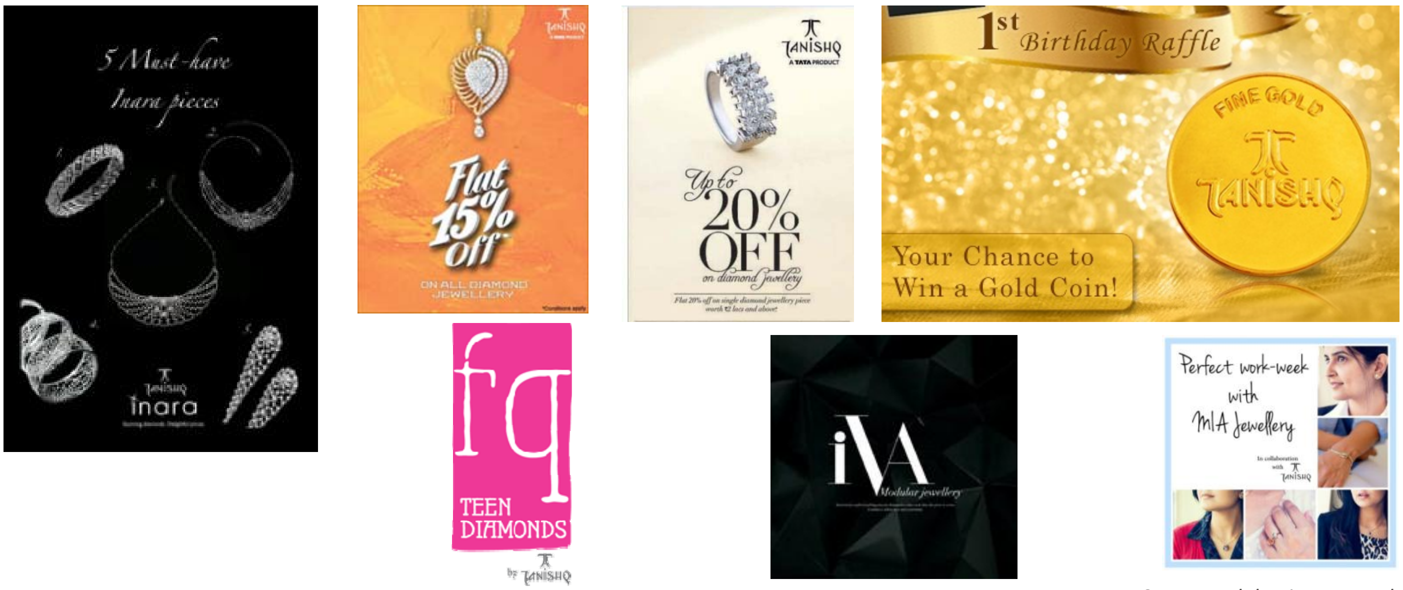


Source: Edelweiss research

Activations to boost studded share

Titan's sub-brand ***Mia*** under *Tanishq* is targeted at working women. Under this collection, the company offers affordable diamond jewellery (rings, earrings, pendants, bracelets) for corporate environment for daily use. *Tanishq's* ***Inara*** collection (crafted in real diamonds) of diamond jewellery in the sub-INR50,000 range (pendants, rings and earrings) is aimed to engage customers looking for low ticket size items in studded jewellery. *Tanishq*'s fashion jewellery collection ***IVA*** (18kt gold range that starts at INR20,000) is available in stores across Delhi, Mumbai, Bengaluru, New Delhi, Kolkata, Pune, Ludhiana, Chandigarh and Hyderabad.

Fig. 2: A slew of Titan's activations to boost studded sales



Source: Edelweiss research

Watches: Corrective action under way, worst behind

With a gradual shift in consumer perception of watches from a utility device to an accessory, the entire watch industry has seen lower growth amidst discretionary slowdown. However, market for premium watches, though minuscule, is expanding at a rapid pace as they are seen as status symbols. Further, the introduction of technology, smart watches and other disruptive trends have revitalised the market and rekindled interest in watches as a fashion statement. Also, e-commerce is a new platform on which consumers are buying watches. The sea change in the watches market had a bearing on Titan's watches segment growth. Its watches business sought to reinvent itself through directional shift, wherever required, to develop an effective portfolio of brands, channels and markets.

To cope with changing times, Titan has sharpened focus on high priced watches, improving brand image and plugging product gaps. The company brought all its brands (*World of Titan, Sonata* and *Fastrack*; *Helios* continues to remain a separate business) under a single management team. Earlier, each brand operated on its own with distinct management teams.

Table 1: Watches segment performance (INR mn)

	FY12	FY13	FY14	FY15	FY16	FY17
Sales	15,381	16,866	18,005	19,188	19,504	20,322
YoY (%)	*20.9*	*9.7*	*6.8*	*6.6*	*1.6*	*2.8*
EBIT	2,179	2,021	1,889	2,065	1,688	1,718
YoY (%)	*17.0*	*(7.3)*	*(6.5)*	*9.3*	*(18.2)*	*1.8*
EBIT margin (%)	14.2	12.0	10.5	10.8	8.7	8.7

Source: Edelweiss research

Focus across price points and on smart products

Several initiatives were undertaken during the year to acquire consumers looking for lower priced watches. Titan introduced over 100 new products in the *Karishma* range; *Sonata* launched new variants in metal *(Astra*) and plastic; and *Fastrack* introduced the exciting *Star Wars* and *Bare Basics* collections. Titan's brands have aggressively gained shelf space in dealer outlets with shop-in-shop counters and impressive visual merchandising.

Post the launch of *Titan JUXT* in January 2016, the year has seen introduction of smart watches from its brand stable. The launch of *JUXT PRO*, the fully loaded, touch screen smart watch, was a runaway success. In fact, the entire inventory was sold out in just 6 months.

Fig. 3: New watches launched by Titan

Source: Edelweiss research

This was followed by the launch of *Sonata ACT*—India's first safety watch for women. Addressing a critical need like safety, *ACT* has evinced excellent response from consumers. The marketing campaign has received several accolades at the coveted Goa Fest. Topping the launches, year-end saw the introduction of *Fastrack's* smart band *REFLEX;* initial sales have been more than encouraging.

Titan has made significant investments in innovation and R&D leading to several key outcomes— in-house development of India's first safety watch (*ACT*), slimmest ceramic watch (*Edge*) and gold filigree watches for *Nebula*. Another special innovation was the introduction of a unique ID system for watches. Every original Titan watch can now be identified from duplicates. The team has also developed several new movements in FY17 including variants of the *Edge* movement with date function.

Titan's premiumisation journey

Continuing on its premiumisation journey, brand *Titan* launched exciting products like the *Titan Edge Ceramic* (slimmest ceramic watch in the universe) and collections like the *Raga Aurora* and *Regalia Rome*. FY17 witnessed the launch of *Titan Octane*, a sub-brand of sporty watches, with a high-visibility campaign.

With significant investments in digital marketing, the campaign helped Titan gain further relevance among consumers. The slew of new product introductions in *NEO* & *Purple* saw a positive retail off take. These initiatives have helped improve Titan's brand perception as a contemporary watch that complements premium lifestyles.

Fig 4: Titan Octane

Source: Industry, Edelweiss research

Eyewear: Eye on growth path

Titan Eye plus celebrates 10 years of its existence in 2017. It is by far the market leader with a chain of 472 stores in 203 towns across India. With 0.31mn square feet of prime retail space, ~6mn loyal customers and investments in lens manufacturing in Bengaluru, Delhi, Mumbai and Kolkata, the business is profitable and poised for further growth.

The company opened 95 new stores in FY17 and closed 25 unprofitable ones, resulting in overall count of 472 stores. A new low-cost store format was established in FY17 to address demand in small towns (21 such stores were opened in FY17).

Table 2: Eyewear segment performance (INR mn)

	FY12	FY13	FY14	FY15	FY16	FY17
Sales	1,974	2,329	2,981	3,320	3,712	4,046
YoY (%)	*26.0*	*18.0*	*28.0*	*11.3*	*11.8*	*8.4*
EBIT	(45)	(31)	38	249	195	204
EBIT margin (%)	*(2.3)*	*(1.3)*	*1.3*	*7.5*	*5.2*	*5.5*

Source: Edelweiss research

The company undertook a number of initiatives to drive same store growth. A few of these are:

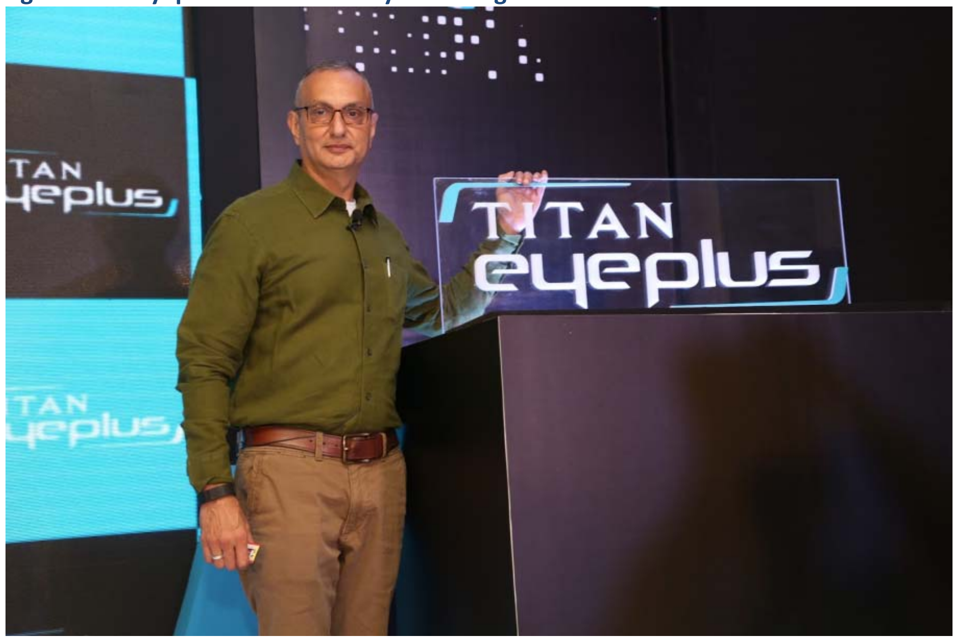
Effort to deliver spectacles within 30 minutes has been successful and has emerged as a differentiator at Titan Eyeplus stores.

Innovations like the 'Flip' range of frames (frames that have multiple temples) have done exceedingly well at stores.

Fog-free and digital lenses manufactured in-house have evoked an excellent response from consumers.

Operational of frame manufacturing facility (expected to be launched in FY18) will help in variety of frame designs which will help generate consumer interest.

Fig. 5: Titan eyeplus brand in the eyewear segment



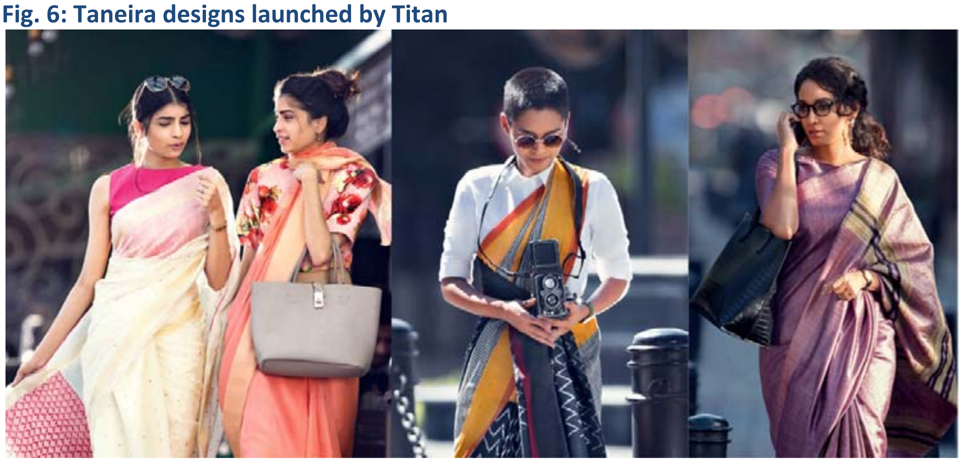
Source: Industry, Edelweiss research

Ethic wear: Option value

Titan has identified one more potential category to venture into i.e., Indian ethnic wear. The space is being explored through its *Taneira* brand, which is initially introducing hand-woven sarees. Becoming the youngest brand under the Titan umbrella, *Taneira* aims to revive one of the oldest occupations in India—handloom weaving. It will provide customers with authentic, handwoven sarees made with natural materials, celebrating the Indian craftsmanship, heritage and exclusive designs. This category exhibits good potential and could become Titan's fourth lifestyle vertical in the future.

With over 3,500 unique pieces across sarees, lehengas, yardages, stoles and dupattas priced from INR2,000 to INR2.5 lakh, *Taneira* stores offer the convenience of a full-fledged style studio.

Fig. 6: Taneira designs launched by Titan



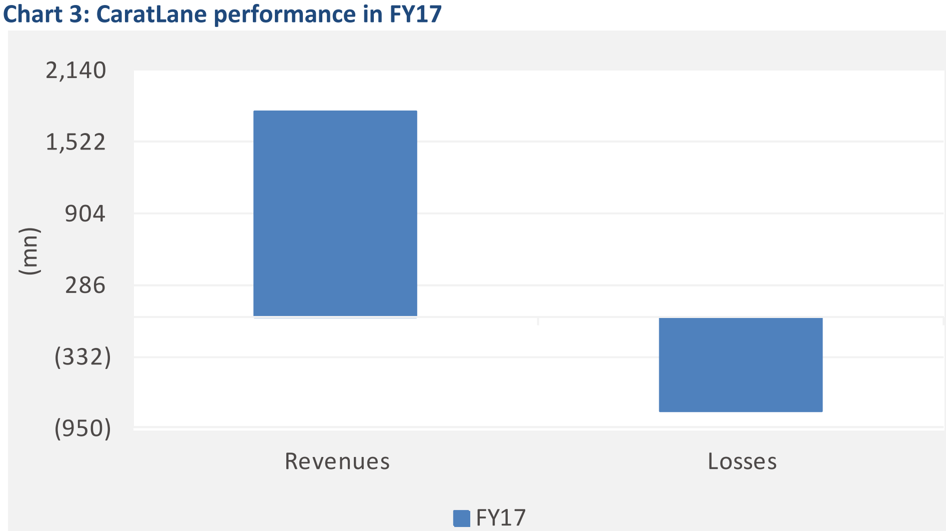
Source: Edelweiss research

CaratLane: Online play

Titan acquired majority stake in CaratLane, which manufactures jewellery and has significant online presence. CaratLane became a subsidiary on August 4, 2016, and clocked turnover of INR1,778mn in FY17.

Titan is an omni-channel player with extensive physical stores and its in-house online portals (including Caratlane) showcasing its products. This heightens customer reach. Research indicates that standardised products sell more easily online and FY17 saw online sales of its standardized watches grow well, affirming the same. Growth was aided by in-house e-commerce platforms and major e-tailers hosting its product ranges. As a foundation for its omni-channel play, the company is putting in place digital systems for order management and data warehousing.

Chart 3: CaratLane performance in FY17



Source: Edelweiss research

Fig 7: CaratLane

CARATLANE
A TANISHQ Partnership

Source: Edelweiss research

Outlook and valuations: Positive; maintain 'BUY'

We believe, Titan will be one of the key beneficiaries as discretionary spends recover. With robust balance sheet, strong brand equity and professional management team in place we remain bullish on the company.

Titan, over the past 3 years, has traded at an average PE of ~29x due to its sustained strong earnings (CAGR of 19.7% over FY17-20E). With most regulatory concerns priced in, we believe re-rating is on the cards as steady shift of preference for organised jewellers over unorganised jewelers and its studded share increases.

We roll over to FY20E and assign a target PE of 52x FY20 EPS to arrive at target price of INR977 and maintain **'BUY/Sector Outperformer'**.

Company Description

Titan was incorporated in 1984 as a joint venture between the TATA Group and Tamil Nadu Industrial Development Corporation (TIDCO), a Government of Tamil Nadu undertaking. The company manufactures and markets quartz watches since 1987 and is now India's leading watch manufacturer and retailer. Gradually, jewellery, precision engineering, eyewear, accessories, and licensed products were added to the watches portfolio. The Titan brand was extended to Tanishq and other retail businesses. Jewellery business now contributes ~80% to sales with Tanishq being the largest (has jewellery retail space of ~0.7mn sq ft) and most reputed jeweller in the organized space.

Investment Theme

The Indian retail landscape is evolving with interplay of several demographic and economic factors. The long-term prospects backed by changing consumer behaviour in favour of larger discretionary spending, has set the stage for a healthy growth in the retail space over the next five years. The big opportunity lies in the growing share of organised retail with growing trend among consumers to allocate a larger share of income to consumption and gradual improvement in lifestyle.

Titan has assiduously positioned itself in the premium designer jewellery space. We believe Titan has the ability to create significant value with its large distribution presence, strong brand, designing skills and proven execution track record. Titan has proved its metal time and again by emerging strong and successful against various regulatory hurdles that have emerged over the past one year. With robust balance sheet, strong brand equity and professional management team in place we remain bullish on Titan.

Key Risks

Reduction in customs duty: Customs duty which is currently at 10% has lead to rampant smuggling and it is likely that it will be reduced in the near term. Any reduction in custom duty will lead to write back in inventory.

Deterioration of macro conditions: Poor macro outlook could lead to prolonged slowdown in the company's growth as the company's revenues depend on discretionary spend.

Volatility in gold prices: Gold prices have a significant bearing on gold demand. Any steep rise in prices results in lower demand, and investment buying that comes in is low margin.

Margin pressure due to deterioration in product mix and investment buying: Down trading in watches and jewellery divisions on account of fall in discretionary spending and higher growth in tier II and IV towns could impact margins.

Business seasonal, restricted to marriage season and festivals: The jewellery segment is seasonal with respect to marriage season and festivals. Additionally, the number of wedding dates varies in a year. This could impact the company's revenue.

Regulatory hurdles: As gold is one of the key import articles, Government actions to curb its demand thereby impacts the jewellery business by reducing demand and/or increasing costs like customs duty, lease rate, etc if not eased / tightened further pose a risk to the jewellery business.

Financial Statements

Key Assumptions

Year to March	FY17	FY18E	FY19E	FY20E
Company				
GDP(Y-o-Y %)	6.5	7.1	7.7	-
Inflation (Avg)	4.8	5.0	5.2	-
Repo rate (exit rate)	6.3	6.3	6.3	-
USD/INR (Avg)	67.5	67.0	67.0	-
Watch - growth (%)	2.8	8.0	14.0	15.0
Jewellery - growth (%)	19.0	25.0	20.0	19.0
Eyewear - growth (%)	8.4	6.0	15.0	18.0
EBITDA margin (%)	0.1	0.1	0.1	1.1
Capex (INR mn)	4,909	1,968	2,100	2,200
COGS as % of sales	72.7	72.5	72.0	71.7
Staff costs (% of rev)	6.1	5.4	5.3	5.2
A&P as % of sales	3.6	3.4	3.3	3.3
Financial assumptions	-	-	-	-
EBITDA margin	8.9	10.1	10.9	11.3
Debtor days	10	10	10	10
Inventory days	181	181	185	185
Payable days	87	87	87	87
Cash conversion cycle	104	104	108	108
Dep. (% gross block)	10.2	10.4	10.8	10.7
Tax rate (%)	25.6	28.0	28.0	28.0
Interest rate on cash	5.7	7.0	8.0	8.0

Income statement (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Net revenue	129,789	157,852	187,905	222,624
Materials costs	94,292	114,443	135,292	159,622
Gross profit	35,497	43,409	52,613	63,003
Employee costs	7,939	8,524	9,959	11,576
Other Expenses	11,374	13,575	15,972	18,923
Ad. & sales costs	4,630	5,367	6,201	7,347
EBITDA	11,555	15,943	20,482	25,157
Depreciation	1,105	1,484	1,763	1,976
EBIT	10,450	14,459	18,719	23,180
Add: Other income	704.9	862.93	717.98	742.88
Less: Interest Expense	377	546	645	761
Add: Exceptional items	(1,027)	-	-	-
Profit Before Tax	9,750	14,776	18,792	23,162
Less: Provision for Tax	2,760	4,137	5,262	6,485
Associate profit share	18	(6)	(6)	(6)
Reported Profit	6,973	10,645	13,536	16,682
Exceptional Items	(1,027)	-	-	-
Adjusted Profit	8,000	10,645	13,536	16,682
Shares o /s (mn)	888	888	888	888
Adjusted Basic EPS	9.0	12.0	15.2	18.8
Diluted shares o/s (mn)	888	888	888	888
Adjusted Diluted EPS	9.0	12.0	15.2	18.8
Adjusted Cash EPS	10.3	13.7	17.2	21.0
Dividend per share (DPS)	3.0	3.6	4.6	5.6
Dividend Payout Ratio(%)	33.5	30.0	30.0	30.0

Common size metrics

Year to March	FY17	FY18E	FY19E	FY20E
Materials costs	72.7	72.5	72.0	71.7
Staff costs	6.1	5.4	5.3	5.2
Ad. & sales costs	3.6	3.4	3.3	3.3
Other expenses	8.8	8.6	8.5	8.5
Depreciation	0.9	0.9	0.9	0.9
Interest Expense	0.3	0.3	0.3	0.3
EBITDA margins	8.9	10.1	10.9	11.3
EBIT margins	8.1	9.2	10.0	10.4
Net Profit margins	6.2	6.7	7.2	7.5

Growth ratios (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	15.1	21.6	19.0	18.5
EBITDA	23.6	38.0	28.5	22.8
PBT	12.3	51.5	27.2	23.3
Adjusted Profit	18.6	33.1	27.2	23.2
EPS	18.6	33.1	27.2	23.2

Balance sheet (INR mn)

As on 31st March	FY17	FY18E	FY19E	FY20E
Share capital	888	888	888	888
Reserves & Surplus	41,436	48,344	57,129	67,956
Shareholders' funds	42,324	49,232	58,017	68,844
Minority Interest	264	264	264	264
Long Term Liabilities	1,211	1,211	1,211	1,211
Def. Tax Liability (net)	(33)	(33)	(33)	(33)
Sources of funds	**43,766**	**50,674**	**59,459**	**70,286**
Gross Block	13,271	15,271	17,371	19,571
Net Block	8,638	9,154	9,491	9,715
Capital work in progress	1,432	1,400	1,400	1,400
Intangible Assets	3,337	3,337	3,337	3,337
Total Fixed Assets	13,408	13,891	14,229	14,452
Non current investments	370	370	370	370
Cash and Equivalents	11,958	8,605	8,916	11,503
Inventories	49,257	56,751	68,573	80,904
Sundry Debtors	2,076	2,433	2,896	3,431
Loans & Advances	3,530	4,325	5,148	6,099
Other Current Assets	3,791	3,791	3,791	3,791
Current Assets (ex cash)	58,655	67,300	80,408	94,226
Trade payable	28,423	27,291	32,263	38,065
Other Current Liab	12,201	12,201	12,201	12,201
Total Current Liab	40,625	39,492	44,464	50,266
Net Curr Assets-ex cash	18,030	27,808	35,944	43,960
Uses of funds	**43,766**	**50,674**	**59,459**	**70,286**
BVPS (INR)	47.7	55.5	65.4	77.5

Free cash flow (INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Reported Profit	6,973	10,645	13,536	16,682
Add: Depreciation	1,105	1,484	1,763	1,976
Interest (Net of Tax)	271	393	465	548
Others	(314)	147	175	207
Less: Changes in WC	(9,475)	9,778	8,136	8,016
Operating cash flow	17,509	2,891	7,802	11,398
Less: Capex	4,909	1,968	2,100	2,200
Free Cash Flow	**12,600**	**923**	**5,702**	**9,198**

Cash flow metrics

Year to March	FY17	FY18E	FY19E	FY20E
Operating cash flow	17,509	2,891	7,802	11,398
Investing cash flow	(7,242)	(1,968)	(2,100)	(2,200)
Financing cash flow	(4,643)	(4,276)	(5,390)	(6,611)
Net cash Flow	5,624	(3,353)	311	2,587
Capex	(4,909)	(1,968)	(2,100)	(2,200)
Dividend paid	(3,135)	(3,736)	(4,751)	(5,856)

Profitability and efficiency ratios

Year to March	FY17	FY18E	FY19E	FY20E
ROAE (%)	20.6	23.1	25.1	26.2
ROACE (%)	28.3	33.3	36.1	37.6
Inventory Days	181	181	185	185
Debtors Days	10	10	10	10
Payable Days	87	87	87	87
Cash Conversion Cycle	104	104	108	108
Current Ratio	1.7	1.9	2.0	2.1
Net Debt/Equity	(0.3)	(0.2)	(0.2)	(0.2)
Interest Coverage Ratio	27.7	26.5	29.0	30.4

Operating ratios

Year to March	FY17	FY18E	FY19E	FY20E
Total Asset Turnover	3.2	3.3	3.4	3.4
Fixed Asset Turnover	13.2	12.9	14.8	17.2
Equity Turnover	3.3	3.4	3.5	3.5

Valuation parameters

Year to March	FY17	FY18E	FY19E	FY20E
Adj. Diluted EPS (INR)	9.0	12.0	15.2	18.8
Y-o-Y growth (%)	*18.6*	*33.1*	*27.2*	*23.2*
Adjusted Cash EPS (INR)	10.3	13.7	17.2	21.0
Diluted P/E (x)	95.0	71.4	56.2	45.6
P/B (x)	18.0	15.4	13.1	11.0
EV / Sales (x)	5.7	4.7	3.9	3.3
EV / EBITDA (x)	64.8	47.2	36.7	29.8
Dividend Yield (%)	0.4	0.4	0.5	0.7

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
Name	(USD mn)	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Titan Company	11,968	71.4	56.2	47.2	36.7	23.1	25.1
Jubilant Foodworks	1,922	73.9	53.3	30.0	23.2	18.1	21.8
Shoppers Stop	701	299.9	41.1	19.5	13.5	2.7	16.0
Wonderla Holidays	322	41.7	27.0	19.6	13.2	10.8	15.1
Median	-	72.7	47.2	24.8	18.3	14.5	18.9
AVERAGE	-	121.7	44.4	29.1	21.6	13.7	19.5

Source: Edelweiss research

Additional Data

Directors Data

Mr. Bhaskar Bhat	Managing Director	Mr. T.K.Balaji	Non-Executive, Independent Director
Ms. Vinita Bali	Non-Executive, Independent Director	Ms. Hema Ravichandar	Non-Executive, Independent Director
Mrs. Ireena Vittal	Non-Executive, Independent Director	Prof. Das Narayandas	Non-Executive, Independent Director
N N Tata	Director	Harish Bhat	Director
Mr T K Arun	Director	Mr. Ashwani Puri	Director

Auditors - Deloitte Haskins & Sells

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Tamilnadu industrial	27.88	Tata sons ltd	20.84
Jhunjhunwala rakesh	6.53	Matthews intl capita	2.95
Life insurance corp	2.14	Tata investment corp	2.01
Tata chemicals ltd	1.56	Jhunjhunwala rekha r	1.53
Blackrock	1.27	Vanguard group	1.23

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

COMPANY PROFILE

AMAZON INDIA

Eyeing top slot in e-commerce

India Equity Research| Retail

Amazon India (Amazon), the Indian arm of the global e-commerce behemoth, Amazon Inc., commenced operations in 2013 by only selling books and video content. However, over a period of time, the company has added other categories and widened its offerings. Commendably, post launch, Amazon rapidly garnered over 100mn customers and shipped products to ~97% of India's pin codes. Currently, it has on board over 250,000 sellers offering more than 100mn products. Amazon's India unit operates as a marketplace where sales are conducted on behalf of the sellers. Amazon Inc has committed USD5bn to drive its India operations and emerge as a leader in the immensely competitive e-commerce market. 'NOT LISTED'.

India focus market for parent

Amazon Inc has commited USD5bn to drive India operations and emerge as a leader in the competitve e-commerce market. In just 5 years since launch, Amazon has mustered over 100mn customers and more than 250,000 sellers and 41 fulfillment centers. Amazon's global selling programme was launched in the country in May 2015 and now has a seller base of 27,000 selling Indian products on 10 of its global marketplaces.

Tie-up strategy to enhance offline, rural presence

In-line with the parent's acquisition of whole foods in June 2017, Amazon acquired 5% stake in Shopper's Stop (SSL) in September 2017. Amazon, through its experience stores, expects to leverage the physical space of SSL as customers would have access to Amazon's online products. Amazon has also tied up with Vakrangee Kendras to sell products in rural India. Amazon provides all promotional materials to these kendras. It could gain significantly from this channel as internet penetration in India is very low but bound to rise led by the proliferation of smartphones and advent of 4G. Apart from this Vakrangee has also embarked on a rapid expansion mode for its kendras to roll out 75,000 kendra's by FY20 from >30,000 kendra's currently.

Outlook and valuations: Well placed to tap growth; 'NOT LISTED'

Parent's commitment of USD 5bn capital along-with its emergence in the offline and rural channels through Shoppers Stop and Vakrangee augurs well for the company in its fight to become the leader in e-commerce in India. The company is **'NOT LISTED'**.

Financials

Year to March	FY15	FY16
Net Sales (INR mn)	9,771	22,171
YoY growth (%)		126.9
EBITDA (INR mn)	(16,822)	(34,640)
EBITDA margin (%)	(172.2)	(156.2)
PAT (INR mn)	(17,237)	(35,719)
PAT margin (%)	(176.4)	(161.1)

** Amazon Seller Services Pvt. Ltd* *Source: VCCEdge*

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

“A brand for a company is like a reputation for a person. You earn reputation by trying to do hard things well.” – Jeff Bezos, CEO and Founder, Amazon

Parent’s commitment to India fuelling growth

Amazon’s total investment in India stands at USD5bn. With investments of US3bn announced in June 2016 and USD2bn announced in July 2014, the company has already undergone two rounds of massive funding. It has also been investing heavily in logistics and payments services. Amazon started off with 100 sellers and 1 fulfilment centre in 2013. In the past 4 years, sellers have risen to over 250,000 and fulfilment centres stand at 41 across 13 states. Nearly 27,000 of its sellers belong to its global selling programme which allows it to sell across the globe. For Amazon, over 65% of total orders and over 50% of overall sellers are secured from Tier II and smaller cities.

As per the company, Amazon Seller Services’s revenue rose 41% YoY in FY17 with revenues of INR31.3bn. Amazon’s wholesale unit in India reported a staggering rise in turnover of ~2,700x in FY17. This surge in turnover followed the government’s stipulation towards early 2016 that sales from a single vendor could not exceed 25% of gross sales of an online marketplace. Thereon, Amazon decided to use Amazon Wholesale India as a distributor, (especially of smartphones), to numerous new vendors on its marketplace, while toeing the government’s policy.

Tie ups to boost offline retail, rural presence

In Sept 2017, Amazon India picked up 5% stake in retailer Shoppers Stop, for INR1,793mn. Amazon’s strategy is to set up its experience centres/brick-and-mortar outlets at 80 SSL stores in order to be better connected to current/prospective customers, wherein buyers can touch and feel the products at specific locations before buying the same online. The tie-up is beneficial as the cost of setting up such a large network of stores without matching revenue contribution would have been significant for Amazon.

Amazon has also tied up with Vakranjee Kendras to sell in rural India. Vakrangee has been building an ecosystem of small outlets to fill the last-mile gap for retail firms in rural areas. The company has over 30,000 business correspondent bank branches/ Vakrange Kendras through which it also offers insurance, e-commerce and e-governance services. Amazon provides all promotional material for these stores. Amazon could gain significantly from this channel as Internet penetration in India is very low but bound to rise due to profileration of smartphones and advent of 4G.

Fig. 1: Amazon’s India expansion into rural India

Source: Company, Edelweiss research

Eyeing offline tie-ups to combat Flipkart's online retail fashion

Flipkart is market leader in online fashion retail with 70% market share. Amazon is striving to reduce this gap by tieing up with major offline retailers. It is working at reviving sales of its fashion business by forging alliances with popular brands that have high recall among the urban consumers.

Table 1: Acquisitions in fasion space by ecommerce companies

Date	Description
May-14	Flipkart buys Myntra for more than USD330mn
Jul-16	Flipkart buys Jabong for USD70mn
Aug-16	Flipkart-Myntra buys a majority stake in HRX for an undisclosed amount
Sep-17	Amazon buys 5% equity in Shoppers Stop for INR1,790mn

Source: Edelweiss research

Company Description

Amazon India (Amazon) launched operations in India in June 2013. Amazon is a fully-owned subsidiary of US-based e-commerce giant, Amazon Inc. The company launched its web-site Amazon.in, offering customers a wide variety of choice in books, movies and television shows. On the first day of operations, Amazon had received more than 10,000 orders. Amazon delivers to most of the serviceable PIN codes in India. At current juncture, it has more than 250,000 Indian sellers and 41 fulfillment centers situated across 13 states.

Parent Amazon Inc., was set up in 1994 by Jeff Bezos. With sales and growth nearing saturation levels in the US, Amazon was looking to explore other countries for future growth. The company saw high potential in India and launched operations in 2013. In a short span of time, Amazon has become a force to reckon with in the Indian e-commerce space. The company hawks millions of products on its platform and vast registered customer base. It offers products across categories such as mobile phones, computers and accessories, men's and women's fashion, books, sports & fitness, electrical & electronic items, movies, music, cars, motorbike, baby products, toys, grocery items, etc. Amazon also operates global stores, where customers can buy directly from sellers in the US.

Recently, Amazon Prime was launched in India, which provides users access to various services such as streaming video, music, e-books, latest offers, etc.

Funding

Amazon founder, Jeff Bezos, made an investment of USD5bn in Amazon India. However, it may take Amazon India several more years to generate profits, even as Jeff Bezos remains quite bullish on India and committed to more investments, whenever required.

Acquisitions

Parent Amazon has acquired several companies across the globe. For India, it has a different strategy to fuel growth. In India, Amazon acquired payments company, Emvantage Payments in 2016. Emvantage, an Indian player, offered services similar to PayPal. Its platform enabled online merchants to accept credit/debit cards. Amazon is also contemplating to acquire Bigbasket.

Fig 2: Amazon Inc. has commited investments of USD5bn in India

Key Personnel

Mr. Amit Agarwal, Country Head, Amazon India

Mr. Amit Agarwal obtained his B.Tech. degree in Computer Science in 1995 from IIT Kanpur and went on to complete his masters in the same discipline from Stanford University in 1997. He began his stint at Amazon in February 1999 in Seattle. At the time he joined Amazon, the company was only into book sales and interested in expanding its operations. Mr. Agarwal played a pivotal role in accomplishing the company's vision and mission. He started working at Amazon as a software developer and steadily rose to the top ranks becoming one of the youngest team members of the Senior Leadership Team (S-Team) of chief executive officer and president, Jeff Bezos.

Mr. Manish Tiwary, Vice president, Category Management

Mr. Manish Tiwary, ex-head of Unilever in the Gulf region is an Indian Institute of Management - Bangalore graduate. He joined Hindustan Unilever in 1996 working across roles like handling Ponds brand, handling relationship with big retailers like Reliance and Walmart India ultimately rising to position of Executive Director in 2012. In 2014, he moved as managing director to Unilever Gulf. He joined Amazon in June 2016 as head of category management.

Mr. Sriraman Jagannathan, Vice President, Payments

Mr. Sriram's 28 years of experience in financial services comprises 20 years at Citibank, 5 years at Bharti Airtel and a year at IDFC Bank. He ran the digital businesses for Citi from 2000 in India and from 2005 in Japan. He returned from Japan to launch and scale Airtel Money as an early mover in payments in 2010. In 2015, IDFC, the newest universal bank, provided him an opportunity to build strategic alliances with telcos, transport companies, etc., while developing a digital payments and lending arm. Mr. Sriram has been heading the Payments Team at Amazon since Jan 2016. His team seeks to create the best payment experience for customers and merchants in India by 2020. He is a qualified engineer from IIT, Delhi and an MBA from IIM, Ahmedabad.

COMPANY PROFILE

BIGBASKET

Extends success in online grocery

India Equity Research| Retail

Bigbasket, founded in December 2011 by four seasoned entrepreneurs, is one of the largest online food and grocery players in India with operations spread across 18 cities. The company pioneered grocery e-tailing in India by successfully cultivating both the supply and demand sides of the nascent market. A unique inventory management system differentiates bigbasket from others in the fray – it offers the largest online assortment with 19,000 plus products and 1,000 brands across fruits, vegetables, staples, meat, beverages and personal care categories. The company has also developed strong relationships with suppliers and enjoys benefits of scale. In the past 4 years, its own branded products (fruits, vegetables, staples and meat products, among others) recorded strong growth with high acceptance across the country. 'NOT LISTED'.

Expanding presence to drive revenue growth

Bigbasket has completed full rollout in 17 tier-II cities. Across eight tier-I cities the company has launched its Express delivery and is meeting budgets. Post such expansion, it's **daily order volume is now 50,000 and the target is to achieve INR25bn gross merchandize value in 2018.** Bigbasket now operates 25 warehouses and 63 dark stores.

Strengthening existing processes

Through its cost-effective customer acqusition programmes, bigbasket intends to attract new users, retain customers via loyalty programmes and extend growth in its private labels business. Management is focused on growing its existing businesses by increasing average order values, improving operational efficiencies, having additional private labels and deepening market share in existing cities.

Outlook and valuations: Profitability in the horizon; 'NOT LISTED'

Being the largest player in the online food and grocery category we expect bigbasket to be a major beneficiary of the burgeoning growth in the domestic online grocery segment. Along with impetus on its private labels, warehousing and strong internal processes at the helm, **management believes bigbasket is on track to operationally breakeven by FY19.** The stock is '**NOT LISTED'.**

Financials

Year to March	FY13	FY14	FY15	FY16
Net Sales (INR mn)	194	751	1,837	5,275
YoY growth (%)		*286.8*	*144.7*	*187.2*
EBITDA (INR mn)	(8)	(23)	(75)	(941)
EBITDA margin (%)	*(4.1)*	*(3.1)*	*(4.1)*	*(17.8)*
PAT (INR mn)	(9)	(24)	(76)	(1,034)
PAT margin (%)	*(4.4)*	*(3.1)*	*(4.1)*	*(19.6)*

** Innovative Retail Concept Pvt. Ltd.* *Source: VCCEdge*

EDELWEISS RATINGS	
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January 2, 2018

Expansion into newer cities to drive revenue growth

Bigbasket, India's largest online supermarket, was initially launched in Bengaluru in October 2012.Towards mid-2013, the company decided to push the pedal on expansion and by early 2014, Bigbasket expanded operations to Chennai, Pune and the National Capital Region (NCR), with a warehouse in each of the cities. Bigbasket then, tied up with the Times Group’s Brand Capital to advertise itself and roped in actor, Shah Rukh Khan as its brand ambassador in 2015. It expanded further to Kolkata and Ahmedabad, and set its sight on the tier II cities. By the beginning of 2016, it fanned out to 17 tier II cities. We feel Bigbasket can be big beneficairy of further expansion into tierI and II cities. It currently operates 25 warehouses and 63 dark stores.

“Your quality perception is not driven by you stocking Surf Excel. The perception that Bigbasket is good on quality – that’s driven by fresh produce and staples like rice, meat, diary (milk and ice cream may be branded, but last-mile cold chain adds to complexity). This segment is the most complex and that is our biggest differentiator” - *Hari Menon, CEO, Bigbasket*

By FY18, Bigbasket targets to achieve GMV of INR25bn. It took the company six years to reach the current daily order volume of 50,000 after putting all the processes in place. During the period, it has set up the infrastructure and perfected its business model. Bigbasket has operations in Bengaluru, Hyderabad, Pune, Mumbai, Chennai, Delhi-NCR, Ahmedabad, Patna, Kolkata, Jaipur, Vijayawada, Indore, Punjab and Lucknow.

Table 1: Present across 25 cities

Top Cities	
Bangalore	Chennai
Mumbai	Pune
Delhi-NCR	Ahmedabad
Hyderabad	Kolkata

Source: Edelweiss research, Yourstory.com

Private labels overall account for 35% of the company's GMV

Strengthening existing processes

In the past 6 years, Bigbasket has set up infrastructure and tried to perfect its business model. The company has been focusing on scaling up its fresh produce and private labels businesses. The entire sourcing process is a strong moat that Bigbasket has built. The company registers gross margins of ~24%, driven by a mix of fresh produce, private labels and branded goods. Since bigbasket brands its fresh produce, this falls under its private label segment. For its non-fresh produce private labels, the Bengaluru-based company has different processes for different categories. In bakery, for instance, it has outsourced the baking though the service provider follows Bigbasket's recipes. In case of staples like rice, the company procures products in bulk from mills and a service provider fumigates, cleans and breaks the bulk into smaller packs for the company. **Private labels overall account for 35% of the company's GMV. Of this, fruits and vegetables account for 18%.** Bigbasket also distributes its private label through ~2,000 kirana stores. **Bigbasket ended FY17 with INR14.1bn in revenue and broke even in the 2 key markets of Bengaluru and Hyderabad in its slotted delivery business.**

Bigbasket has remained ahead of the crowd as it was betting big on fresh produce (fruits and vegetables) and staples, and building private brands around them right from day one.

Fig. 1: Big basket has a 90-min express delivery that caters to ordering perishables

Source: Company

“Two brands I am proud to have been a part of : Tata and bigbasket” - *Ratan Tata, Former chairman, Tata sons*

Company Description

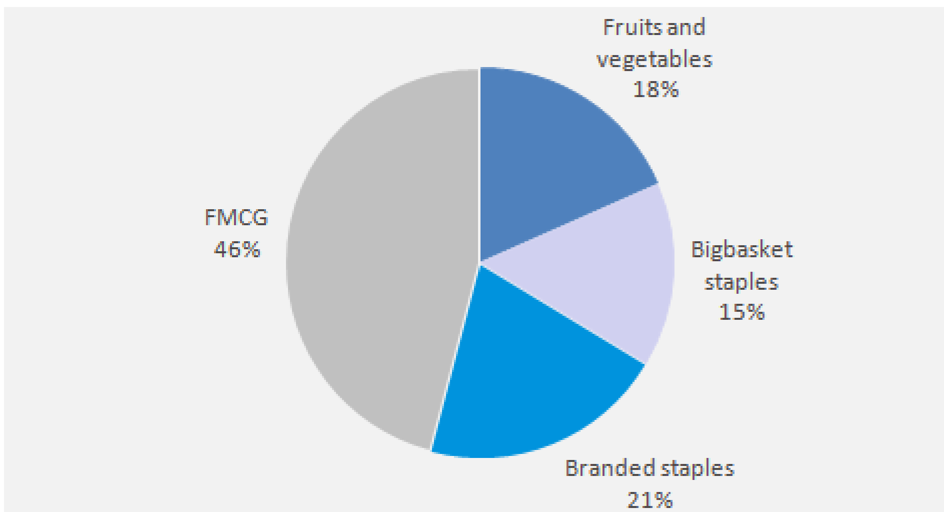
Bigbasket is India’s largest grocery e-tailer. It was founded in 2011 by Fabmall founders, V S Sudhakar, Hari Menon, VS Ramesh, Vipul Parekh and Abhinay Choudhari. Bigbasket has to-date **raised ~USD300mn over 6 rounds**. The company’s online grocery stores are present in more than 25 cities across India, including Bengaluru, Hyderabad, Mumbai, Pune, Chennai, Delhi, etc. Food and grocery accounts for bulk of the USD616bn retail market. However, it is still early days in online grocery, with all firms together selling USD1bn worth of products in 2017. In 2016, online grocery sales in the US stood at ~USD20.5bn, according to Nielsen whereas in China online sales account for 3.1% of overall grocery market.

Table 2: Milestones

Year	Description
2012	Bigbasket was launched in Mumbai and Hyderabad around October 2012
2014	Towards 2014 , it expanded to Chennai, Pune and NCR with a warehouse in each city
2015	Roped in Shahrukh Khan as brand ambassador
2016	Spread to 10 Tier-I cities and 15 Tier -II cities
2017	Achieved turnover of INR14bn in FY17

Source: Industry, Edelweiss research

Chart 1: Revenue mix



Source: Industry, Edelweiss research

Chart 1: Revenue has increased at ~190% CAGR since 2013

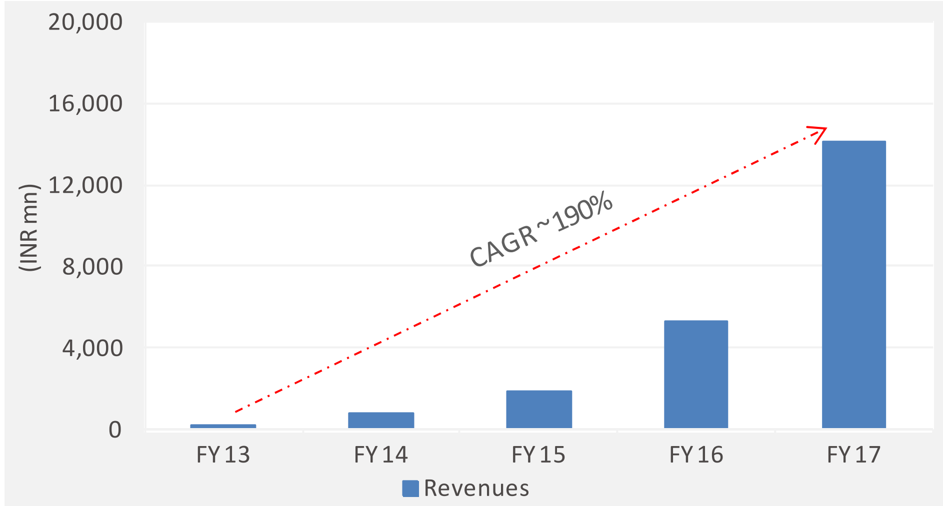


Table 3: Different rounds of funding

Funding Date	Round	Amount (USD)	Investors
Dec-11	Seed	1mn	
Mar-12	Series A	10mn	Ascent Capital
Apr-14	Debt	3mn	
Sep-14	Series B	32mn	Helion Venture partners ; Zodius
Aug-15	Series C	50mn	Bessemer Venture Partners
Mar-16	Equity	150mn	Abraaj Group ; Bessemer Venture Partners
Mar-17	Debt	6.9mn	Trifecta Capital
Oct-17	Debt	55mn	Trifecta Capital

Fig 2: Bigbasket launched a successful ad campaign featuring Shahrukh Khan

Source: Crunchbase, Edelweiss research

Key Personnel

Mr. Hari Menon – CEO & co-founder

Mr. Hari Menon is the CEO and co-founder of Bigbasket. Previously he was the founder and CEO of Tumri Inc., an internet ad technology company that was acquired by Collective Media. As CEO, Mr. Menon was responsible for defining the strategic vision and direction of Tumri's technology solutions. A serial entrepreneur before launching Tumri, he founded 2 startups, Accordia (acquired by Bristlecone Inc.) and SixthDimension (acquired by Comverge Nasdaq: COMV). Prior to the entrepreneurial ventures, Hari was responsible for strategic and product marketing at Aspect Development (acquired by i2 Technologies). Prior to Aspect Development, Hari was a member of the Strategy Practice consulting team at Accenture. Mr. Menon started his career in Silicon Valley as a software engineer with Consilium Inc. He holds an MBA from Carnegie Mellon University and an MS in industrial engineering and operations research from Oklahoma State University. At CMU, Mr Menon won the Faculty Award for Academic excellence and the Thomas Murrin award for operations management.

Mr. Abhinay Choudhari – Co-founder, Head of new initiatives

Mr. Chodharis the co-founder and head of New Initiatives at Bigbasket.com. In past 5 years of its launch in December 2011, Bigbasket.com has emerged as India's leading online grocer with presence across 12 cities. He guided his company from initial stages to one of the leading online grocers in India. Prior to this, he had set up Stylecountry.com in 2000 and run pure play e-tailing business in India for branded personal lifestyle products by building alliances with 30 leading personal lifestyle brands of India in categories like apparels, accessories, watches, footwear, etc. Before venturing into the entrepreneurship journey, Mr Choudhari worked as a consultant with companies like Infosys, iGate and NetKraft. He completed his under graduation from CAE, Jabalpur and is an IIM graduate from Ahmedabad.

Mr. V.S. Sudhakar – Co-founder

Mr Sudhakar co-founded Bigbasket in 2011. He has been working with many early stage companies including Vaatsalya, a 17 hospital chain, Edusports which runs fitness and sports training in over 300 schools in India and overseas and Delyver, a neighbourhood e-commerce company He had the unique distinction of starting and building India's first internet services company- Planetasia.com. He served as Chief Executive Officer of Planetasia.com, where he put the team together, developed the strategy, and pioneered the business successfully in a fledgling industry. He served as Country Manager at Ungermann Bass Networks Inc. (later bought over by Newbridge), a leading American networking company. He is an alumnus of IIM Ahmedabad and NIT, Allahabad.

Mr. Vipul Parekh – Co-founder, Head of finance and marketing

Mr Parekh is a serial entrepreneur and is of the cofounders of Bigbasket.com, India's largest online grocery business. He is currently the CMO and CFO of Bigbasket.

COMPANY PROFILE

FLIPKART

On consolidation mode

India Equity Research| Retail

Edelweiss
Ideas create, values protect

Flipkart is one of India's leading e-commerce companies headquartered in Bengaluru. The company was set up in October 2007 by Sachin Bansal and Binny Bansal. It initially started as an online book store but later, as the company's popularity grew, it also started selling other items such as music, movies and mobile phones. Flipkart has 100 million registered users and more than 100 thousand sellers on its e-commerce platform. The company has invested in 21 state-of-the-art warehouses to ensure prompt delivery to its customers. The Flipkart website attracts 10 million page hits every day and around 8 million shipments are processed every month. Flipkart mobile app has more than 50 million app users. It employs more than 33,000 people and as of April 2017, the company was valued at USD11.6bn. 'NOT LISTED'

Fresh capital to help consolidate leadership position

Flipkart recently raised USD2.5bn from Softbank and USD1.4bn from Ebay, Microsoft and Tencent. The company will utilize these funds to: 1) drive its sales growth; 2) fend rival Amazon; 3) make higher investments to gain market share; and 4) narrow its losses. Currently, Flipkart enjoys 40-45% market share in the Indian e-commerce market. The company now targets to expand its user base and improve customer loyalty rates over next 2-3 years.

Monopoly in online fashion to drive future growth

One ecommerce area where Flipkart has been dominant is the Fashion vertical. Fashion is a USD100bn market, of which currently 3% is online and offers a take rate of 25-30%. The company has reportedly maintained market leadership in fashion, since its launch on the platform in 2012 and currently has 65-70% market share.

Outlook and valuations: Growth to bolster; 'NOT LISTED'

Flipkart is poised for high growth riding the boom in the e-commerce industry. With funds of USD4bn in its kitty, we feel Flipkart is well placed for steady future growth. The company is '**NOT LISTED'.**

Financials

Year to March	FY13	FY14	FY15	FY16
Net sales (INR mn)	11,801	28,049	90,322	128,180
YoY growth (%)	*476.2*	*137.7*	*222.0*	*41.9*
EBITDA (INR mn)	(1,864)	(3,821)	(7,776)	(4,843)
EBITDA margin (%)	*(15.8)*	*(13.6)*	*(8.6)*	*(3.8)*
PAT (INR mn)	(1,925)	(4,004)	(8,282)	(5,446)
PAT margin (%)	*(16.3)*	*(14.3)*	*(9.2)*	*(4.2)*

** Flipkart India Pvt. Ltd.* *Source: VCC Edge*

EDELWEISS RATINGS	
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January 2, 2018

In August 2017, Softbank acquired 20% of Flipkart for USD2.5bn

Fresh capital to consolidate leadership position

Flipkart recently raised USD2.5bn from Softbank and USD1.4bn from Ebay, Microsoft and Tencent. This money will help the company make a series of strategic investments and acquisitions to stay on top in the cut-throat e-retail space along with focus on market share gains. It is also looking at investing USD3- 4bn over next 5 years to create a strong logistics network, with focus on technology. Focus on high-value categories like mobiles and large goods has enabled Flipkart to have highest percentage of high-spending shoppers on its platform. The company is now trying to sell more products in untapped categories to existing users. It is also looking to grow its market share in the television category by over 3x.

Fig. 1: Big billion day is India's largest online shopping festival

Source: Industry, Edelweiss research

"We used to stand outside Gangram book stores on Church Street and handover Flipkart bookmarks to the people coming out with books" – Co-founder, Sachin Bansal

Flipkart Moat in fashion lends it an advantage over Amazon

One ecommerce area where Flipkart has been dominant is the Fashion vertical. Overall, online fashion accounts for 3% of the USD100bn fashion market and has a take rate of 25-30%. Fashion segment is a high margin segment compared to the rest of the segments. The company is also expanding its private labels (fetches high-margin) in addition to exploring exclusive brand partnerships to open up newer revenue opportunities in fashion. Flipkart along with its subsidies Myntra and Jabong control 70% of the online fashion retail market in India. Flipkart has also been increasing its focus on private labels, which offer higher margins. While e-tailers make gross margins of 35% to 45% on regular brands, it can be as high as 60-65% for private brands.

Myntra bought majority stake in the fitness and sportswear brand, HRX, launched by actor Hrithik Roshan, to boost its private labels business. Myntra owns 11 private labels, including Roadster, All About You, HRX, Wrogn, Anouk and Ether. Most of these private labels were launched by celebrities who also co-own these brands.

Table 1: Recent acquisitions in online fashion

Date	Description
May-14	Flipkart buys Myntra for more than USD330mn
Jul-16	Flipkart buys Jabong for USD70mn
Aug-16	Flipkart-Myntra buys a majority stake in HRX for an undisclosed amount
Sep-17	Amazon buys 5% equity in Shoppers Stop for INR1790mn

Source: Industry, Edelweiss research

Company Description

Founded in October 2007, Flipkart is one of India's leading e-commerce marketplaces, with headquarters in Bengaluru. Flipkart was set up by Sachin Bansal and Binny Bansal and the company initially started as an online book store. As the e-commerce revolution gained momentum in India, Flipkart grew at an accelerated pace and added several new product ranges in its portfolio. As of now, the company offers more than 80mn products across more than 80 categories, such as, mobile phones & accessories, computers and accessories, laptops, books and e-books, home appliances, electronic goods, clothes and accessories, sports and fitness, baby care, games and toys, jewellry, footwear, etc. Flipkart has 100mn registered users and more than 100 thousand sellers on its e-commerce platform. The company has invested in 21 state-of-the-art warehouses to ensure prompt delivery to its customers. The Flipkart web-site attracts 10mn page hits every day and ~8mn shipments are processed every month. Flipkart has also introduced its mobile app, which has become quite popular, with more than 50mn app users.

Table 2: Flipkart's journey

Years	Description
2007	Flipkart was founded in 2007 and in its initial phase of operation sold only books
2008	Flipkart opens first office in Bengaluru
2009	Raised USD1mn funding from Accel Partners in Series A
2011	Launches digital wallet ; Acquires chakpak and Mime360
2012	Launches mobile shopping app ; Acquires electronics e-tailer Letsbuy
2013	Raises USD160 mn in funding ; Adopts marketplace model, opening up platform to sellers
2014	Acquires fashion e-tailer Myntra ; Kicks off India's largest online sale - Big Billion Day
2016	Binny Bansal takes over as CEO ; Crosses milestone of 100 mn registered customers ; Acquires jabong
2017	Kalyan Krishnamurthy named new CEO ; Flipkart raises USD1.4bn from Tencent, EBAY and Microsoft ; Raises USD2.5bn from Softbank Vision Fund

Source: Company

Funding Rounds

Flipkart has received more than USD6.5bn funds till date, with the largest funding (USD1bn) coming in July 2014, and USD1.4bn and USD2.5bn inflows were seen in April and August 2017 . Some of the top investors in Flipkart include Naspers, Steadview Capital, Tiger Global Management, DST Global, Accel Partners, Dragoneer Investment Group, Baillie Gifford, GIC, Greenoaks Capital, ICONIQ Capital, Microsoft, Morgan Stanley, Qatar Investment Authority, and Sofina.

Table 3: Funds raised by Flipkart

Year	Funding Round	Money Raised (USD)	Investors
Oct-09	Series A	1mn	Accel Partners
Jun-10	Series B	10mn	Tiger Global Management
Jun-11	Series C	20mn	Tiger Global Management
Aug-12	Series D	150mn	Accel Partners ; Tiger Global; Naspers; ICONIQ Capital
Oct-13	Series E	160mn	Tiger Global Management ; Vulcan Capital; Morgan Stanley; Dragoneer Investment Group ; Sofina
May-14	Series F	210mn	DST Global ; Naspers ; Tiger Global Management ; Iconiq
Jul-14	Series G	1bn	GIC ; Sofina ; Morgan Stanley; Naspers ; Tiger Global ;
Dec-14	Series H	700mn	Steadview Capital ; T.Rowe.Price ; Naspers ; Baillie Gilford ; Greenoaks Capital ; Qatar Investment authority
Jul-15	Private Equity round	700mn	Tiger Global ; Steadview Capital
Apr-17	Private Equity round	1.4bn	Tencent ; Microsoft ; Ebay
Aug-17	Private Equity + Secondary Market	2.5bn	Softbank
Sep-17	Debt Financing	INR 10 bn	Axis bank

Source: Crunchbase

Acquisitions

The e-commerce space is witnessing fierce competition as evident from the slew of mergers and acquisitions that have marked the e-commerce sector in recent years. Flipkart too acquired a range of businesses in recent years to boost its product and service offerings. Some key acquisitions by Flipkart include Myntra, eBay India, PhonePe, Jabong, Letsbuy.com, WeRead, Mime360, chakpak.com, Appiterate, FX Mart and ngpay.

Table 4: Acquisitions done by Flipkart

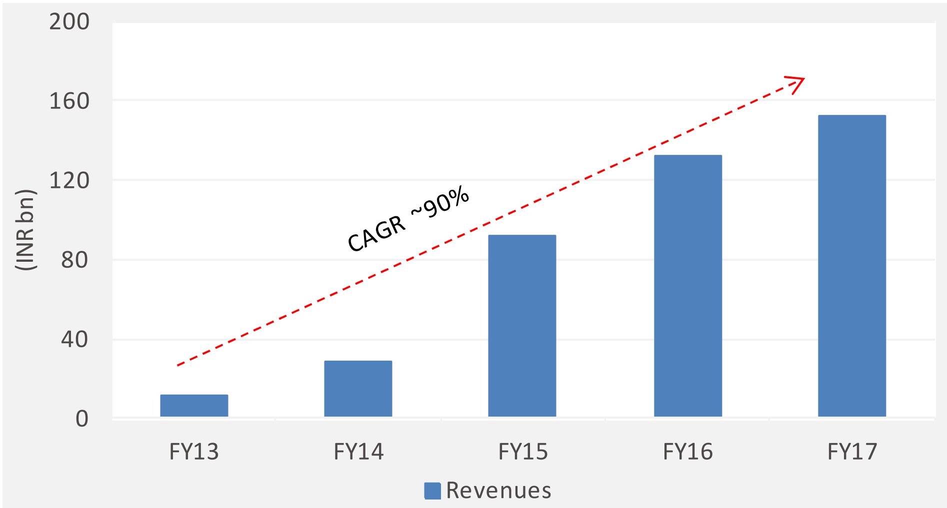
Years	Description
2010	We Read, a social group discovery tool
2011	Mime360, a digital content company
2011	Chakpak.com - a Bollywood news site that offers updates, news, photos and videos. Flipkart acquired the rights to Chakpak's digital catalogue which includes 40,000 filmographies, 10,000 movies and close to 50,000 ratings
2012	Letsbuy.com, an Indian e-retailer in electronics. Flipkart has bought the company for an estimated USD25 million. Letsbuy.com was closed down and all traffic to Letsbuy has been diverted to Flipkart
2014	Acquired Myntra.com in an estimated INR20 billion (USD310 million) deal
2015	Flipkart acquired a mobile marketing start-up Appiterate as to strengthen its mobile platform
2016	Flipkart's Myntra acquires rival fashion shopping site Jabong for USD70 mn
2016	In April, Flipkart acquired payment start-up PhonePe
2017	In January, Flipkart funded Parenting Network Tinystep With USD2 Million
2017	In April, in exchange for an equity stake in Flipkart, eBay agreed to make a USD500 million cash investment in and sell its eBay.in business to Flipkart; however, according to a company statement eBay.in would continue to operate as a separate entity from Flipkart
2017	In July, Flipkart offered Snapdeal a amount of USD700-800 million dollar, but Snapdeal rejected its deal as they wanted a sum of minimum USD1billion cash

Source: Industry, Edelweiss research

Fig. 2: The Bansals initially ventured out as online retailer of books

Source: Company Annual Report

Chart 1: Flipkart grew at scorching ~90% CAGR during FY13-17



Source: VCCEdge

Key Personnel

Mr. Binny Bansal – Group CEO

Mr. Binny Bansal co-founded Flipkart Online Services Pvt. Limited in 2007 and has been its the Group Chief Executive Officer (CEO) since January 2017, previously he served as CEO between January 2016 to January 2017. Mr. Binny Bansal oversees operational activities across divisions like warehousing, logistics and customer support. Previously, he had a brief stint at Amazon before taking the entrepreneurial plunge with Flipkart. An active sportsman, he used to captain his school basketball and soccer teams. Mr. Binny Bansal holds a degree in Computer Engineering from IIT, Delhi.

Mr. Sachin Bansal – Non-Executive Chairman

Mr. Sachin Bansal co-founded Flipkart Online Services Pvt. Limited in 2007 and was its CEO until January 2016. Mr. Sachin Bansal oversees all customer-facing activities of Flipkart ranging from technology to marketing. He is also in charge of the corporate divisions including the finance and legal departments. In 2006, he joined Amazon.com in India. But, he later quit to set up Flipkart. He has been Non-Executive Chairman of Flipkart Online Services Pvt. Ltd. since January 2016. He graduated from IIT, Delhi with a degree in Computer Engineering.

Mr. Kalyan Krishnamurthy – CEO

Mr. Kalyan Krishnamurthy has been the CEO of Flipkart Online Services Pvt. Limited since January 2017 and previously served as its Head of Category Management. Mr. Krishnamurthy served as Managing Director and Director of Finance & Portfolio Companies at Tiger Global Management LLC. He served as Interim Chief Financial Officer (CFO) at Flipkart Online Services Pvt. Limited. from May 2013 to November 5, 2014. Prior to Tiger Global, Mr. Krishnamurthy held various senior positions, such as, Director of Financial Planning & Analysis at eBay Asia-Pacific and Country Finance Director (South-East Asia, Hong Kong) at eBay. He also worked with Procter & Gamble. Mr. Krishnamurthy served as a Director of Sunshine Teahouse Pvt. Ltd. He holds an MBA degree from Asian Institute of Management, the Philippines and another MBA in Finance from UIUC College of Business, Illinois (US).

COMPANY PROFILE

HENNES & MAURITZ (H&M)

India entry with a bang

India Equity Research|Retail

Hennes & Mauritz (H&M) is a Swedish multinational clothing & retail player known for its fast-fashion clothing for men, women, teenagers and children. H&M and its associated brands operate in 62 countries with over 4,100 stores and employ ~132,000 personnel. It is the second largest global clothing retailer, just after the Spain-based Inditex (parent company of Zara). The company has a significant online presence, with online shopping available in 32 countries. H&M opened in India in New Delhi in September 2015. It has since expanded to 11 cities throughout India. We believe H&M, with its strong brand, fast fashion and competitive pricing, is well poised to tap growth in the Indian apparel industry. 'NOT LISTED'.

Leveraging strong brand for pan-India presence

Even though H&M opened its first store 2 years back it has been aggressively expanding its presence across major Indian cities. The company has ventured into 4 new cities in 2017 which has taken the number of stores to ~25 in 2017. It will not restrict itself only to metros, but will look to grow its store chain in new markets as well. H&M's global fashion, quality and competitive pricing continue to attract footfalls into malls. It stocks an impressive combination of fast fashion items created in-house and also teams up with designers for one-time collections. H&M holds large inventory of basic, everyday items sourced from India and Bangladesh, which makes it cost competitive than rivals like Zara, M&S and GAP.

Pricing strategy paying off as sales double

After opening its first store in September 2015, H&M India's unit reported revenue of INR 6,405mn with net profit of INR112mn for FY17 through its 15 stores. This implies good demand for its products. H&M stores generated revenue of INR7,040mn between December 2016 and August 2017, up from INR2,910mn a year ago, which is ~INR580mn per store annually, higher than any competitor in the country.

Outlook: Sanguine prospects; 'NOT LISTED'

H&M, with its fast fashion, competitive prices and good store expansion, looks well placed to tap growth in the Indian apparel industry. Management is all set to open 50 stores by 2020. The company is **'NOT LISTED'**.

Financials

	FY15	FY16	FY17
Net Sales (INR mn)	459	1,942	6,405
YoY growth (%)			229.9
EBITDA (INR mn)	17.8	112.0	582.0
EBITDA Margin (%)	3.9	5.8	9.1
PAT (INR mn)	(3.0)	14.5	112.3
PAT Margin (%)	(0.6)	0.7	1.8

**H and M Hennes And Mauritz Retail Pvt. Ltd.* *Source: VCCEdge*

EDELWEISS RATINGS	
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January 2, 2018

Leveraging on strong brand for pan India presence

H&M is set to bolster its presence in India with ~25 stores by opening 6 new stores by December 2017. At present, H&M India has 15 stores in 9 cities. H&M, which entered India 18 months ago, has been doing very well. Its growth strategy is to locate stores in malls in tier-I & II cities and run its own outlets. Its moat lies in fashion and quality at the best price in a sustainable way.

H&M entered India through 100% FDI route for single brand trade. The company has long-term plans to grow to 50 stores by 2020 and invest over INR 7bn in India going ahead. It has production offices in Delhi and Bengaluru and employs 1,200 personnel. There are no plans for any joint ventures. According to management, India has huge potential going by performance of H&M in past 18 months and market feedback. Implementation of GST and saturation in Chinese textile market along with the problems facing Bangladesh hold big promise for the Indian textile sector.

Fig.1: Expansion into Tier-1 cities is a growth catalyst

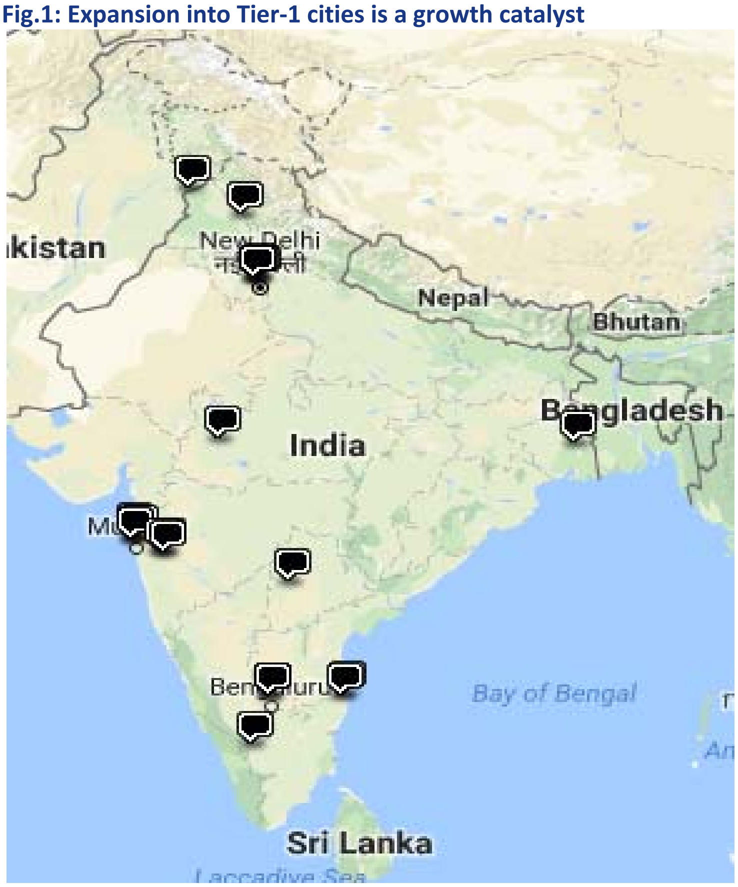


Table 1: Within 2 years of India entry, H&M has become a leading player in the Indian apparels industry

	H&M India	Zara India
Revenues for FY 17 (INR mn)	6,400	10,230
Stores	20	20
Revenue/Store (INR mn)	320	512
Positioning	4th largest international apparel brand in India	Largest international apparel brand in India
Online Store	To be launched in 2018	Launched in October 2017

Source: Industry, Edelweiss research

“In our industry, being first in a market is not everything. Customer loyalty is. Loyalty is not one by being first. It is won by being best” – Stefan Persson, Chairman , H&M

Turned profitable in 6 months

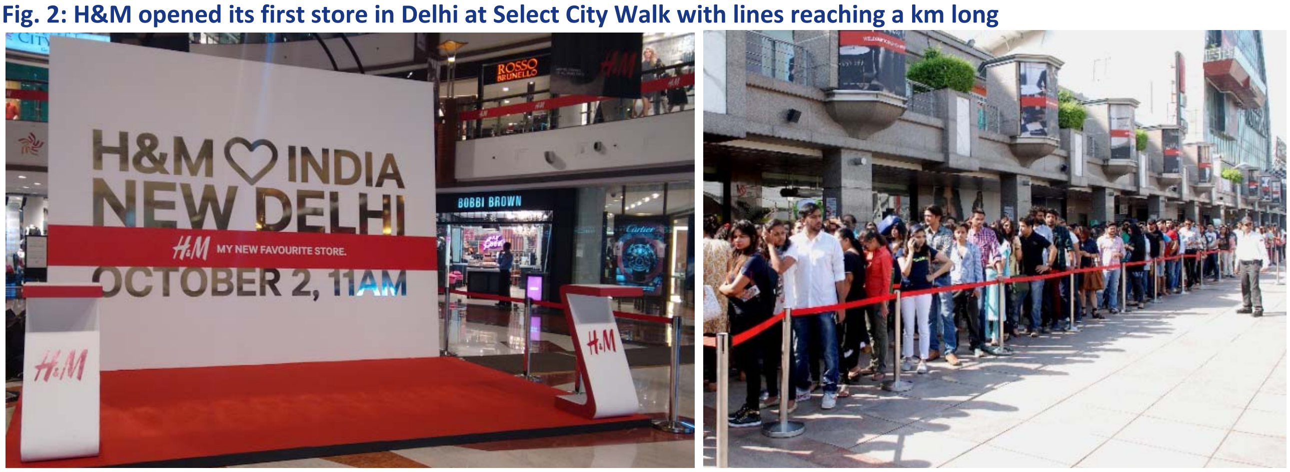
H&M has come halfway as far as Zara did in 7 years of presence in India. H&M’s latest annual report stated its India unit posted INR4.45bn in sales for the year ending November 2016. Zara reported sales of INR8.42bn for the year ended March 2016. Spanish fast fashion brand Zara, which opened its first store in 2010, had set the benchmark as the fastest-growing — and now the biggest — international apparel brand in India. However, it is now being overshadowed by H&M, whose performance was the best the retail market has seen in the apparel space. The Swedish brand had 12 operational stores during December 2015-November 2016. A reason for this explosive growth may be that H&M is 15-20% cheaper than rival Zara. H&M is different from Zara because it stocks fast fashion items designed in-house and teams up with designers to create one-time collections. It also keeps large inventory of basic, everyday items sourced from India and Bangladesh at lower prices than most of its rivals — a move that had prompted Zara to slash prices by 10-15% for some of its merchandise last year.

Table 2: H&M well positioned compared to other international apparel brands

Brand	Positioning
Zara	15-20% costlier than H&M
H&M	Affordable pricing for fast fashion
Gap	40-50% costlier than Zara , H&M

Source: Industry, Edelweiss research

Fig. 2: H&M opened its first store in Delhi at Select City Walk with lines reaching a km long



Source: Industry, Edelweiss research

H & M Hennes & Mauritz AB

Company Description

Hennes & Mauritz AB (H&M) is a Swedish multinational clothing-retail company, known for its fast-fashion clothing for men, women, teenagers and children. H&M and its associated brands operate in 62 countries with over 4,100 stores and employ ~132,000 personnel. It is the second largest global clothing retailer, just after Spain-based Inditex (parent company of Zara). The company has significant online presence, with online shopping available in 32 countries, COS in 19 countries, Monki and Weekday in 18 countries each, Other Stories in 13 countries, and Cheap Monday in 5 countries.

H&M ventured into India in September 2015. The company has since expanded to 11 cities throughout India, which apart from the metropolitan cities, is present in Amritsar, Chandigarh, Indore, Pune, Hyderabad, Coimbatore and Bengaluru. It clocked more than INR 17.5mn sales on the opening day in New Delhi in October 2015.

Table 3: Milestones

Years	Description
2015	H&M launched first store in India in September at New Delhi
2016	Opened 12 stores from Dec 15 - Nov 16 ; achieved profitabilty in first 6 months
2016	Opened its 4000th store globally at Mall of India, Noida
2017	Became the 4th largest international apparel player in India and is planning to open more than 20 stores by end of 2018

Source: Industry, Edelweiss research

Product Portfolio

Table 4: Portfolio offered by H&M

Ladies	Mens	Kids
Tops	Hoodies & Sweatshirts	Tops & T-shirts
Shirts & Blouses	Sweaters & Cardigans	Jumpers & Cardigans
Basic	Outerwear	Outdoor Clothing
Cardigans & Jumpers	Jeans	Basics
Hoodies & Sweatshirts	Trousers	Bodies
Knitwear	T-Shirts & Tanktops	Trousers & Leggings
Dresses	Shirts	Jeans
Skirts	Blazer & Suits	Sets & All-in-ones
Trousers	Shoes	Dresses & Skirts
Jumpsuits	Basics	Shoes
Jeans	Underwear & Loungewear	Nightwear
Outerwear	Socks	Accessories
Blazers	Sportswear	Socks & Tights
Shorts	Accessories	Cartoons & Comics
Lingerie	Shorts	
Socks & Tights	Swimwear	
Nightwear & Loungewear		
Accessories		
Bags		
Shoes		
Swimwear		
Plus Sizes		
Maternity Wear		

Source: Industry, Edelweiss research

Key Personnel

Mr. Stefan Persson – Chairman

Mr Stefan Persson took over his father's apparel business, H&M, in 1982. Although the company went public in 1974, it is Mr Persson who scaled the company to become the global behemoth it is today. Under his leadership, the company has grown to employ 94,000 people across more than 43 countries. H&M's revenue now exceeds USD 16bn. Mr Persson was particularly successful in pioneering celebrity and designer collaborations, bringing high fashion names in the fast fashion market. Notably, H&M has collaborated with Stella McCartney , Donatella Versace , Karl Lagerfeld , Commes des Garçons, Matthew Williamson , Lanvin, Marni, Sonia Rykiel, Maison Martin Margiela and Jimmy Choo. The retailer's most recent collaboration with cult Parisian designer, Isabel Marant, will hit stores this November.

Mr. Karl-Johan Persson – CEO, H&M Group

Before taking over as chief executive officer Mr Karl-Johan Persson held an operational role within H&M from 2005, including working as head of expansion, business development, brand and new business. Since 2000 Mr Persson has been a member of the boards of H&M's subsidiaries in Denmark, Germany, the US and the UK. Between the years 2006 and 2009 he was also a member of the board of H & M Hennes & Mauritz AB. Between 2001 and 2004 Mr Persson was CEO of European Network. Mr Persson holds a BA in Business Administration from the European Business School in London.

Mr. Janne Einola – Country Manager, H&M India

Prior to taking over as country manager, India, Mr Einola was the deputy country manager for the brand in the Baltics and Finland. He has been travelling to newer and "interesting" markets hoping to make H&M more accessible to shoppers beyond the metros.

COMPANY PROFILE

LIFESTYLE INTERNATIONAL

Going strong

India Equity Research| Retail

Edelweiss
Ideas create, values protect

Lifestyle International (Lifestyle), part of Landmark group, is a departmental store format in India and one of the largest apparel companies in the organised space. It houses a number of national and international brands of apparels, shoes, accessories, sunglasses, watches and beauty products. The company currently has 64 stores across the country and is planning to ramp up the number to 90, strengthen its presence on e-commerce platforms and expand in Tier-II cities. Currently, Delhi, Mumbai and Bengaluru contribute 50% to sales. Similar to other departmental stores, Lifestyle also offers a Landmark rewards loyalty programme, which helps members earn reward points on purchases. Its other format, Max Fashion has also grown at a rapid pace – from adding mere 20-25 stores per annum till 2013 to 50 stores in 2017. 'NOT LISTED'.

Leveraging offline retail leadership to venture into omni channel

Lifestyle is currently one of the largest players in the organised retail space. It currently has 64 stores, which it is planning to ramp up to 90 over the next 3-4 years. The retailer is also planning further expansion into Tier-2 cities. Lifestyle has embarked on ramping up its omni-channel by recently launching its own e-commerce portal. Lifestyle brands are available on other e-commerce sites as well. The Lifestyle Group posted 25% CAGR over FY13-16 despite the onslaught of e-commerce. The company is targeting 20-25% revenue CAGR to reach INR85bn in sales over the next 3-4 years.

Max Fashions eyeing nation-wide footprint

Max has grown at a rapid pace since inception in 2006—from adding 20-25 stores per annum till 2013 to 50 stores in 2017 taking the total store count to 210 as at Nov 2017. The company is planning to leverage the nationwide acceptance of its brands and expand in India, with special focus on North and East markets. Private labels constitute 97% of Max's portfolio.

Outlook and valuations: Sanguine prospects; 'NOT LISTED'

Lifestyle, with its omni-channel strategy, along with mix of private brands is poised to benefit from growth in the organised apparel space. The company is **'NOT LISTED'**.

Financials

Year to March	FY13	FY14	FY15	FY16
Net Sales (INR mn)	27,420	34,530	43,520	53,090
YoY growth (%)	*17.8*	*25.9*	*26.0*	*22.0*
EBITDA (INR mn)	1,450	2,860	3,650	4,120
EBITDA margin (%)	*5.3*	*8.3*	*8.4*	*7.8*
PAT (INR mn)	340	1,040	1,610	1,850
PAT Margin (%)	1.2	3.0	3.7	3.5

** Lifestyle International Pvt. Ltd.* *Source: VCCEdge*

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

Lifestyle has focused on a patient expansion strategy but this may change going forward

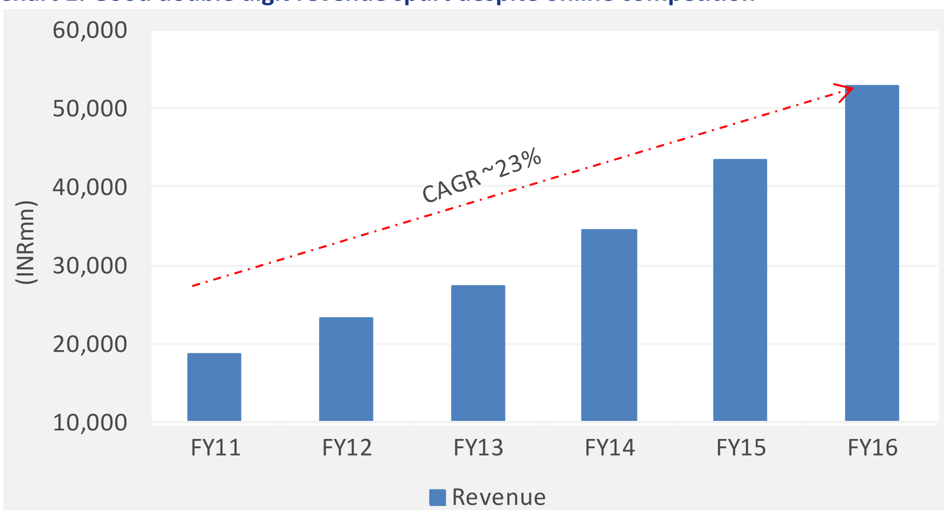
Leveraging leadership in offline retail to expand omni channel

Lifestyle is the fifth largest organised apparel retailer in India, according to Euromonitor. It posted 25% revenue CAGR over FY13-16, despite competition from online retail. The company is planning to increase the number of stores from current 64 to 90 over the next 3-4 years.

It is now building an omni-channel network, wherein it wants to offer customers the convenience of online shopping, but without diluting brands. This is in line with other brick–and-mortar retailers expanding to omni channel. As discounting by e-tailers has reduced, Lifestyle is expected to post higher operating margin and faster revenue growth over the next 3 years. Patient expansion has been Lifestyle's signature strategy over the past decade, but the company's top-line growth is set to accelerate now, with the opening of 6-8 Lifestyle stores every year for the next 2-3 years.

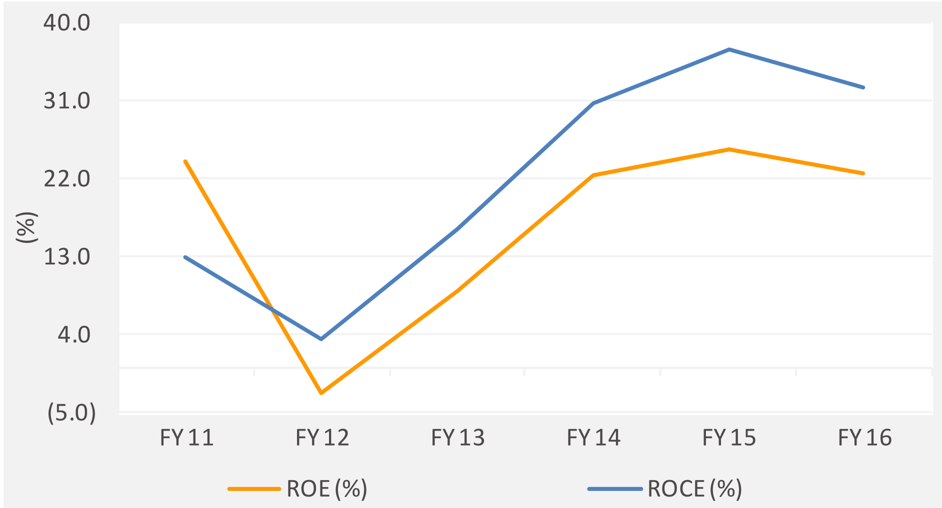
The company also has its own private labels under the Forca brand (menswear casual brand endorsed by Tiger Shroff), Code (menswear brand by Lifestyle which comprises formal wear and casual ensemble) and Melange (fusion Indian ethnic wear label endorsed by actress Kangana Ranaut) and Ginger brands which target young women in the 18-21 age group.

Chart 1: Good double digit revenue spurt despite online competition



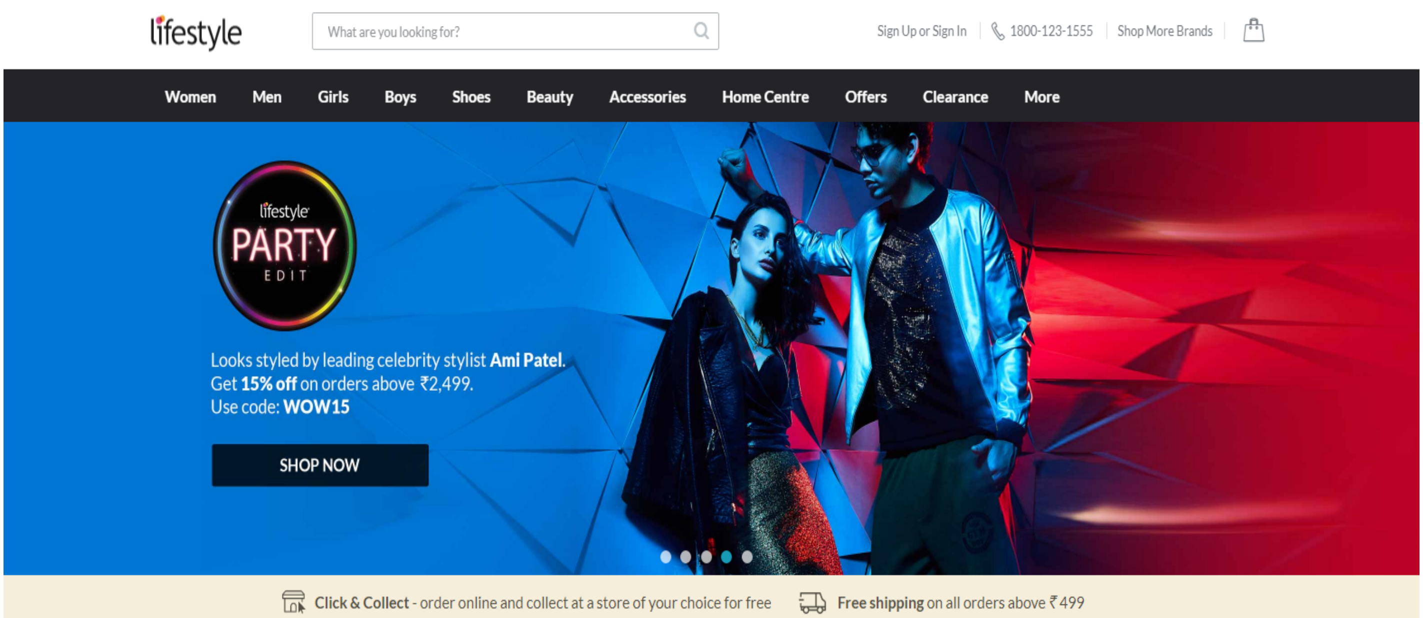
Source: VCCEdge

Chart 2: RoE and RoCE remain high



Source: VCCEdge

Fig. 1: Lifestyle store's online website



Max targeting INR50 bn revenue in the next 3 years

Max has grown rapidly since inception in 2006—from mere 20-25 stores per annum till 2013, to 50 stores opened in FY17. Management is planning to leverage on the nationwide acceptance of the brand and focus on continuing the expansion all over India, with a focus on the northern and eastern markets.

The company has expanded cautiously with store closure rate of less than 1%. It is currently a 97% private label brand and has 99% penetration success rate.

Max has now become the single-largest fashion retailer in India

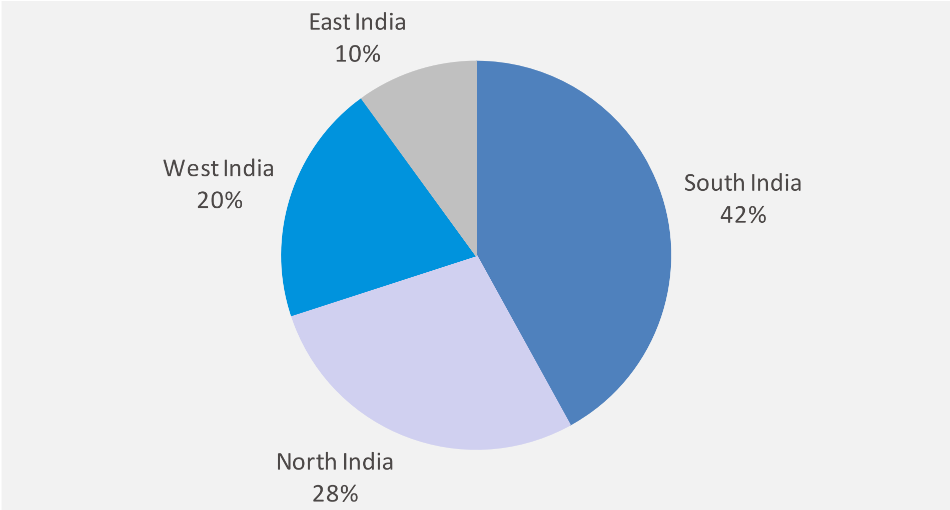
Max is clocking around INR24bn sales annually and growing at 32-33% per year. It has now become the largest single mono-brand fashion retailer in India. The company operates on a 100% private label format. The size of the store is uniform i.e., 10,000 sq ft, so that the customer gets a similar and familiar experience. About 98% of Max stores are profitable and very few have shut down.

Max's mission is to establish a customer connect revolving around the idea of making every day fashionable at an affordable price. It has also been about democratizing fashion by addressing the needs of the contemporary middle class and meeting the emerging needs of customers, not only in terms of fashion, but also towards covering their interests, aspiration and careers. Max is one of the few brands to address the current aspirational youth as well as establish itself as a destination for a contemporary family. It is a provider of an end-to-end fashion solution for families, yet 70% of its shoppers are below the age of 30. Max sees it as an achievement, as it has seamlessly managed to capture the top-of-mind awareness of both.

Fig.2: Max store sizes uniform at 10,000 sq ft

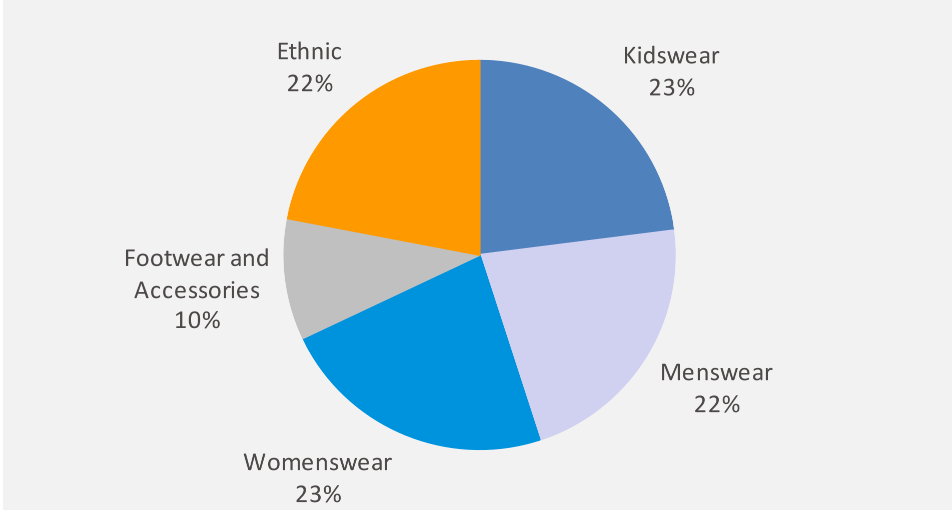
Source: Industry, Edelweiss research

Chart 2: South India the largest market for Max with 42% revenue contribution



Source: Industry, Edelweiss research

Chart 3: Max Fashions revenues are uniformly spread across different categories



Source: Industry, Edelweiss research

Company Description

Lifestyle and Max Fashion belong to the Landmark group, which is based out of Dubai. The group has presence in retail, hospitality and healthcare sectors. Its total revenue is close to USD6bn and it operates over 2,200 outlets, covering over 30mn sq ft across 21 countries.

Lifestyle is a multi-format, multi-brand, labour intensive retail business. The department store format was incorporated in 1999 in India which houses a number of national and international brands of apparels (men, women and kids), shoes, accessories, sunglasses, watches, beauty products, etc. It currently has 64 stores occupying more than 2.5mn sqft space.

Similar to the group's other departmental stores, Lifestyle offers a Landmark rewards loyalty programme which helps members earn reward points on purchases and customers can then use the accumulated points for further purchase at Landmark stores. Lifestyle also has its own private labels under the *Forca* brand (menswear casual brand endorsed by Tiger Shroff), *Code* (menswear brand by Lifestyle which comprises formal wear and casual ensemble) and *Melange* (fusion Indian ethnic wear label endorsed by actress Kangana Ranaut). Lifestyle has grown beyond a department store retailer and now comprises a home products format—Home Centre and value fashion chain Max.

Max Fashion

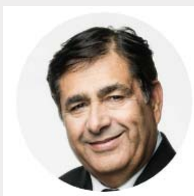
Max, a retail value fashion brand, ventured into India in 2006 with its first store in Indore. Max offers a vast variety of apparel, footwear and accessories at attractive price points and the company has one of the highest throughputs in the industry. The proportion of private label brands in Max is ~97% . It has more than 210 stores in India with presence in about 75 cities. Max covers a total area of ~1.8 mn sq ft. The average size of a Max store is in the 25,000-35,000 sq ft range. The company also runs the Landmark loyalty programme and has a base of over 5.5mn customers.

Key Personnel

Mr. Micky Jagtiani, Founder Chairman, Landmark Group

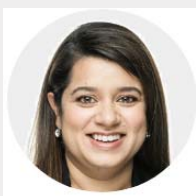
Mr. Micky Jagtiani has created and led more than 27 diverse brand concepts. He has spearheaded growth of the Landmark Group across different regions. Mr. Jagtiani leads by example and inspires a culture of integrity.

Ms. Renuka Jagtiani, Chairwoman and CEO, Landmark Group
For over 20 years, Ms. Renuka Jagtiani has guided the Group's corporate strategy and grown Landmark's fashion and hospitality businesses. She led strategic expansion in new countries, launched the Landmark International franchise division, initiated e-commerce platform and has driven the Group's CSR initiatives.



Mr. Manu Jeswani, Group Director, Landmark Group

Mr. Manu Jeswani has built the Middle East's largest footwear brand portfolio, while spearheading Centrepoint and the property division.



Ms. Aarti Jagtiani, Group Director, Landmark Group
Ms. Aarti Jagtiani played a key role in creating Home Centre, the largest home retailer in the Middle East, and leads the expansion of the home division and the Oasis Mall division.

Mr. Vipen Sethi, Group Director, Landmark Group
Mr. Vipen Sethi leads the Corporate Centre. He is the force behind the company's growth and is responsible for Regional Offices, Banking & Finance, Supply Chain and Information Technology.

Mr. Kabir Lumba, Head of India Business, Landmark Group

Mr. Kabir Lumba has been Head of India Business at The Landmark Group since September 2015. He served as the Managing Director and Executive Director of Lifestyle International. He served as Deputy Chief Executive of Lifestyle Department Store Chain at The Landmark Group until September 2015.

COMPANY PROFILE

LENSKART

Eye on growth

India Equity Research| Retail

Lenskart is one of India's fastest and largest eyewear companies. It was set up in 2010 by Peyush Bansal and Amit Chaudhary. Lenskart offers a unique combination of strong online business, physical stores, huge ad spends and home eye check up service through which it reaches 100,000 customers per month. Currently, the company runs 350 physical stores across 90 cities and is planning to add another 150 by March 2018. Same sales growth was pegged at 30% in FY17. The company has raised INR7bn from various sources and is planning to utilise it to enhance presence in offline retail and offer differentiated offerings like 3D try-on and home eye check up services. Lenskart currently has presence across 90 cities and is looking to expand across more tier-II cities. 'NOT LISTED'.

Leveraging differentiated offerings to expand reach

Lenskart initially started by launching a website in 2010, post which it expanded into offline retail. Differentiated offerings such as 3D try-ons and home eye check up services render it unique among other large eye wear retailers like Titan Eye. Through various incentives like first frame free and other seasonal offerings, Lenskart has become one of the go-to stores for consumers scouting for cheaper alternatives.

Investing in capacity expansion; widening retail presence

The company currently manufactures ~5,000 frames per day. It has invested INR500mn in a manufacturing and assembling facility in Manesar, which will increase its capacity to 20,000 frames per day. Lenskart has also strengthened its presence in retail stores through the franchisee-led model. It currently has 350 stores across 80 cities and is planning to add 150 stores by March 2018.

Outlook and valuations: On the rise; 'NOT LISTED'

Lenskart currently is one of the largest players in the eye wear industry in India. In FY17, it recorded revenue of INR1.8 bn with a loss of INR1.2bn. The company estimates revenue to jump to INR6bn by FY18. The company has till date raised around INR 7bn from various sources, with private equity firm TPG Global being one of the lead investors. The company is **'NOT LISTED'.**

Financials

Year to March	FY16	FY17
Net Sales (INR mn)	990	1,781
YoY growth (%)	*NA*	*79.8*
EBITDA (INR mn)	(1,104)	(1,102)
EBITDA margin (%)	*(111.4)*	*(61.9)*
PAT (INR mn)	(1,143)	(1,161)
PAT margin (%)	*(115.4)*	*(65.2)*

** Lenskart Solutions Pvt. Ltd.* *Source: VCCEdge*

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

All of Lenskart's offline stores are operating under the franchisee model where the company has to shell out 30% as margin for the franchisee

Leveraging differentiated offerings to expand reach

Lenskart primarily sells its products online, but has since expanded to offline retail as well with presence across 90 cities. The company is looking to expand across more tier-II cities in 2018 including Coimbatore, Lucknow, Ahmedabad, Surat, Kanpur, Chandigarh, Guwahati, Bhubaneswar, etc.

The recent rounds of funding will provide Lenskart the capital to launch further new features and expand operations. For example, the 3D try-on service is being used by 6,000-7,000 people daily on their mobile phones to check frames that will suit them. Now, the company is working on a technology to bring eye checkups on its app.

Investing in capacity expansion; widening retail presence

Lenskart currently manufactures around 5,000 frames per day. It has invested INR500mn in a manufacturing and assembling facility in Manesar, which will increase its capacity to 20,000 frames per day.

The company has also strengthened its presence in retail stores through franchisee-led model. It currently has 350 stores across 90 cities and is planning to reach 500 cities by March 2018. Even though it started as an online store, it entered the offline channel in 2014 with 3 company-owned stores in Delhi. It has since expanded to other cities. The company is now using data from its app to identify clusters where people are using its app as potential areas to set up new stores. The share of offline retail has now increased to 50% of total revenue.

The average ticket value for a pair of spectacles is between INR2,000-2,500

Company Description

Lenskart owns and operates an online shopping portal for men and women eyewear in India. It provides goggles, contact lenses, sunglasses, as well as frames and sunglasses for kids. The company also owns and operates eyewear retail stores in India and provides home eye check up services in Mumbai, Bengaluru, Chennai, Hyderabad, Kolkata, Pune, Delhi, Gurgaon, Noida, Faridabad and Ghaziabad.

The company was incorporated in 2008 and is based in New Delhi, India, with retail stores in 90 cities across the country. With a rapidly growing business reaching out to over 100,000 customers a month via a unique combination of a strong online business as www.lenskart.com, uniquely designed physical stores, as well as a first-of-its kind 'home eye check up' service, Lenskart is revolutionizing the eyewear industry in India.

Table 1: Company timeline

Year	Description
2010	Founded in October 2010
2014	Entered into offline retail
2016	Raised USD60 mn in Series D round
2017	Signs Katrina Kaif as the first brand ambassador; Expanded offline retail stores to 500

Source: Industry, Edelweiss research

Table 2: Various rounds of funding

Year	Funding Round	Money Raised (USD)	Investors
10-Jan-11	Series A	4 mn	IDG Ventures India
1-Dec-12	Series B	10 mn	IDG Ventures India, Unilazer ventures
2-Jan-15	Series C	22 mn	TR Capital, TPG
5-Apr-16	Series D	60 mn	IDG Ventures India, TPG Growth, IFC Venture Capial Group, Adveq
6-Sep-16	Unknown	30 mn	Premji Invest
9-Jan-17	Unknown	3.5 mn	Unilazer Ventures

Source: Crunchbase

Table 3 : List of competitors

Lenskart top competitors
LensBazaar.com
Optiaxis.com
Deals4opticals
sunglass hut
IDEE eywaer
Coolwinks.com
Titaneye
gkboptical.com

Source: Edelweiss research

Product portfolio

Lenskart provides various eye services:

Eye glasses

Lenskart website contains a wide range of eye glasses under different brands. It has 2 in-house brands *Vincent Chase* and *John Jacobs* along with other premium brands like *Ray Ban, Oakley, Carrera,* etc. Lenskart has become popular as it has introduced new schemes such as First frame free and Buy 2 for INR2,500 with lenses.

Sun glasses

Lenskart, on its website and in retail stores, offers sun glasses and prescription sun glasses. It has a large variety of sun glasses ranging from in-house brands and other international brands like *Ray Ban, Calvin Clien, Tom Ford,* etc.

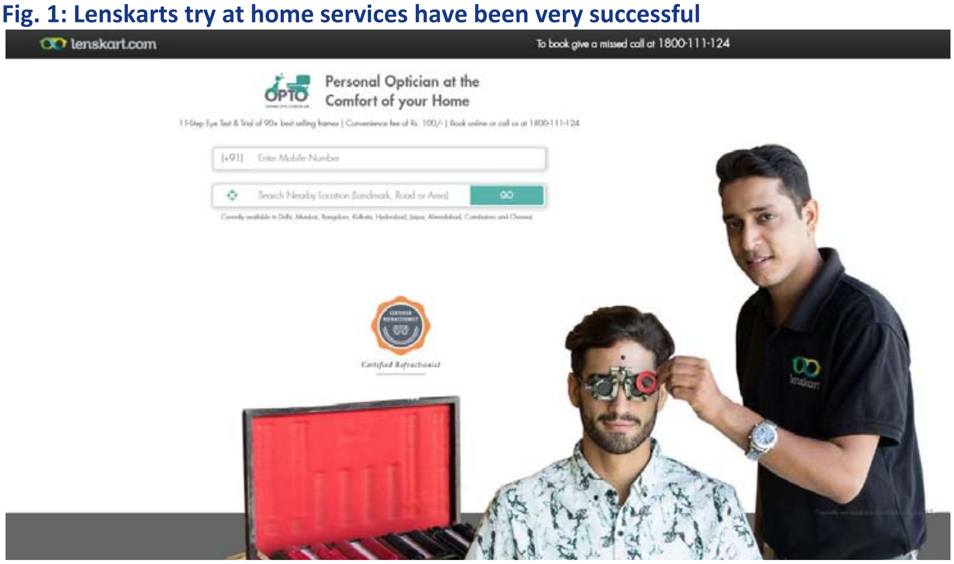
Contact lenses

Lenskart.com has the biggest collection of discounted contact lenses consisting of all top-notch brands (viz. Johnson & Johnson, Bausch & Lomb, Ciba Vision to name a few) and disposable, toric, coloured or bi-focal contact lenses. Contact lenses are 15-20% cheaper than the MRP. This renders Lenskart competitive in the contact lens market as eye wear retail stores mostly offer a discount of 10%.

Try at home

This is a unique service introduced by Lenskart where a certified refractionist comes to your place where he measures your eyewear and carries the best-selling 1,000 frames. Then one can make a purchase with the prescription online on the phone or via their executive.

Fig. 1: Lenskarts try at home services have been very successful



Source: Company

Key Personnel

Mr. Peyush Bansal, CEO

Mr. Peyush Bansal is the CEO and Founder of Lenskart. A veteran in the e-commerce space with close to 9 years of work experience, Mr. Bansal set up the company in 2010. He came from a business background and had a professional stint at Microsoft, which helped him gain vast knowledge on managing and driving Lenskart as a leader.

Mr. Amit Chaudhary, COO

Mr. Amit Chaudhary is the COO and co-founder of Lenskart. He holds Bachelor of Engineering in Information Technology from Birla Institute of Technology.

COMPANY PROFILE

NYKAA

India's answer to Sephora

India Equity Research| Retail

Nykaa commenced operations in April 2012 as a multi-brand online beauty retailer and has since extended its presence via its mobile app and brick-and-mortar stores. Currently, the company has 5 stores— two each in Delhi & Mumbai and one in Bengaluru. It sells more than 100,000 products across 850 brands, international & Indian, luxury & mass, and is constantly adding new labels to its kitty. The average ticket size is between INR1,250 and INR1,500. Nykaa's customer acquisition cost (as per company), a key metric for e-commerce companies, has dipped to less than INR200 currently from INR650. It currently has warehouses in Delhi, Mumbai & Bengaluru and ships 15,000 orders daily. It operates on an inventory-led model. 'NOT LISTED'.

Omni-channel strategy to spearhead pan-India expansion

Nykaa, which started as an e-commerce player, has adopted a new multi-channel strategy in 2015. The company is eyeing pan-India presence via opening 1 store every month from 2018 and is targeting 30 luxury stores by 2020. The omni-channel strategy offers customers ease of shopping, either online or by visiting a store.

Gaining momentum underpinned by inventory-led model

The company follows an inventory-led model wherein it has tied up with multiple international cosmetic brands. Nykaa ensures that it sources genuine products directly from brands and fresh products from warehouses. This not only reduces shipping time, but also gives customers in tier-II & III cities easier access to international brands. This prudent strategy has enabled Nykaa build significant brand loyalty, leading to its average ticket price being double that of other e-commerce players.

Outlook and valuations: Taking right steps; 'NOT LISTED'

Nykaa, anchored by its omni-channel strategy, inventory-led model and private labels, is well poised to capture growth in online beauty retailing. Management expects the company to leverage its private brands to launch new products and move towards achieving EBITDA positive by FY19. The company is **'NOT LISTED'.**

Financials

Year to March	FY15	FY16
Net sales (INR mn)	169	584
YoY growth (%)		*244.8*
EBITDA (INR mn)	(147)	(333)
EBITDA margin (%)	*(86.8)*	*(57.0)*
PAT (INR mn)	(93)	(257)
PAT margin (%)	(54.7)	(44.0)

** FSN E-commerce ventures Pvt. Ltd.* *Source: VCC Edge*

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

“The cosmetics industry in India grew at CAGR of 21.3% between 2011 and 2016 in terms of value” - Euromonitor

“When a consumer is willing to trust a retailer, she is also willing to trust the retailer’s own brand”
Ms. Falguni Nayar, Founder and CEO. Nykaa

Omni-channel strategy to lead to Pan India expansion

Nykaa launched its first brick-and mortar store in 2015. It has since opened five stores – two in Delhi, two in Mumbai and one in Bengaluru. The company’s omni-channel strategy is to be at every touch point for customers.

Nykaa is now targeting 30 luxury stores by 2020. The company’s stores offer brands like *Estée Lauder, Clinique, L’Occitane, Ciaté, L.A. Girl* along with *Nykaa Beauty*, the in-house range of cosmetics. As quite a few international brands are not available in tier II & III cities, some of Nykaa’s most loyal customers come from smaller cities in Bihar and Jharkhand, through repeat purchases.

Potent levers – Inventory-led model as well as private labels

Nykaa is trying to model itself on the international beauty retailer Sephora and follows a differentiated inventory-led business model. The company has tied up with multiple international cosmetic brands and makes sure that it sources genuine products directly from these brands and procures fresh products from warehouses. Nykaa also does not believe in the discounting model.

As Nykaa has significantly built brand loyalty, its customer acquisition cost has slowly and steadily dipped to sub-INR200 over the past few years. This loyalty has made the average ticket size in the range of INR1,250-1,500. Private labels currently account for ~10% of the sales.

In 2015, to cash in on the goodwill generated from its unique customer base, the company introduced its own brand Nykaa. It first launched a line of nail enamels, which has since expanded to include kajals, lipsticks, body mists & lotions, among other items, which have become best sellers. Its in-house nail colors sell 8-10x more than the next best-selling nail color brand on its website.

The byword for top end beauty products in India

Young, urban and beauty-conscious shoppers are spending between INR150 and INR3,000 on lip colours, BB creams, face masks, concealers and eye shadows. This substantially burnishes prospects of a beauty e-commerce player like Nykaa. Although still nascent—Nykaa receives about 15,000 orders a day—the company is making commendable progress in a space dominated by large foreign as well as domestic companies such as Amazon and Purple, as well as offline retailers like Sephora.

Currently, while Amazon commands the highest volume of sales in the category, Nykaa generates the highest value per order at ~INR1,500. While 50% of Nykaa’s orders are under INR1,000, a sizeable 20% are INR5,000 plus.

Company Description

Nykaa.com is a premier online beauty and wellness destination. It offers beauty and wellness products for men and women at best prices. The products are 100% genuine and authentic, sourced directly from brands.

In a mere three years, Nykaa has emerged as the largest beauty destination in India with half a million customers depending on it not just for their favourite brands, but also for advice, updates, expert tips and videos on how to look and feel gorgeous.

With almost 850 plus curated, well priced and 100% genuine brands and >1 lakh products, Nykaa prides itself for offering a comprehensive selection of makeup, skincare, hair care, fragrances, bath & body, luxury and wellness products for women and men. The company ships across the length and breadth of the country to almost every zip code using the services of leading courier companies.

Make up is the fastest growing category for Nykaa, especially products in the mid-to-premium price range

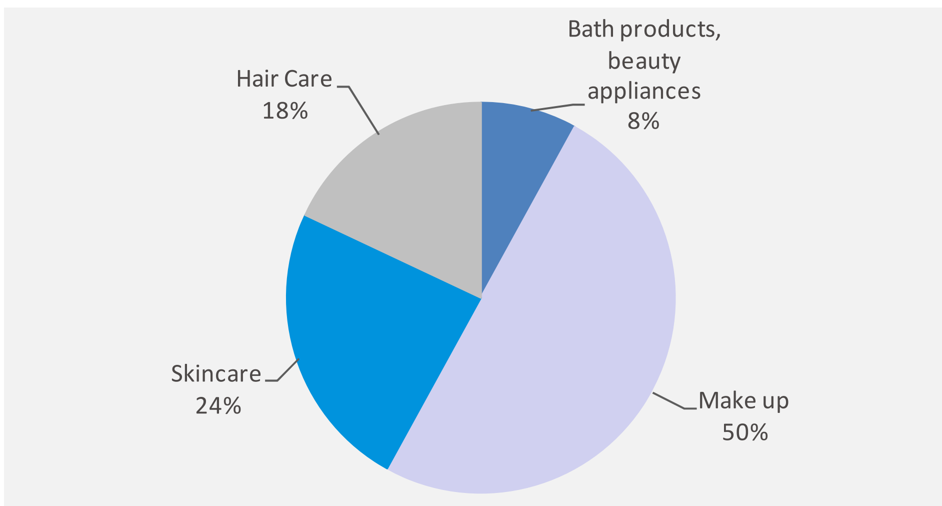
Table 1: The journey so far

Years	Description
2012	Founded in 2012 by Falguni Nayyar, ex MD of Kotak Mahindra Investment Bank
2013	Tied up with labels like HUL, L'Oreal Pasris, P&G
2015	Launches its own private label called "Nykaa"
2016	Entered offline retail under the brand "Nykaa Luxe"
2017	Recorded a 250% YoY growth in revenues

Source: Company

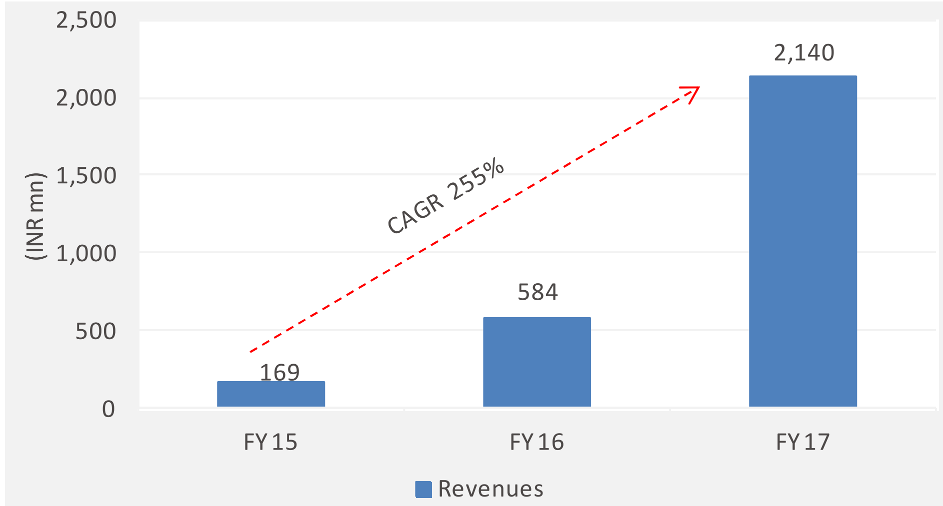
Make up accounts for 50% of the company's sales, skincare 24-25%, hair care 18% while bath products, perfumes and other beauty products account for the balance.

Chart 1: Revenue mix



Source: Company, Edelweiss research

Chart 2: Revenue growth



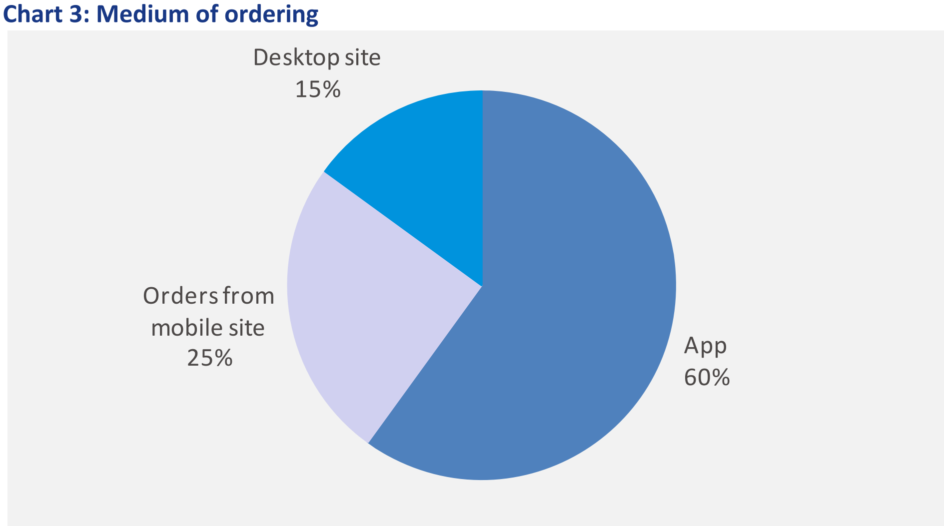
Source: VCCEdge

Table 2: Funds raised by Nykaa

Date	Round	Amount (USD)	Investors	Valuation
1-Jul-14	Series A	3.4mn	HNI's and NRI's	
1-Oct-15	Series B	9.5mn	Tech Pro ventures, TVS Capital Funds, Harsh Mariwala, Atul Nishar	
1-Sep-16	Series B	12mn	Harsh Mariwala , Sunil Munjal	
16-Dec-16	Series B	3.3mn	Max ventures	INR8bn

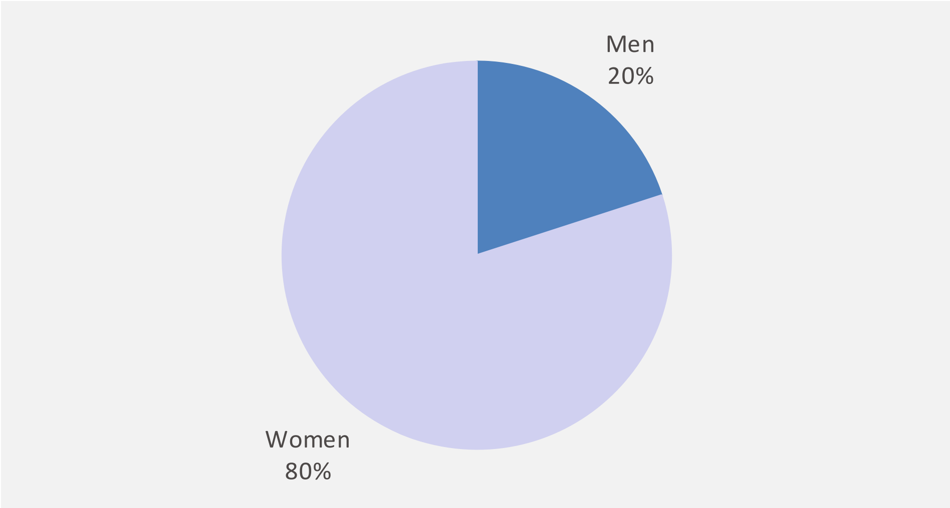
Source: Crunchbase

Chart 3: Medium of ordering



Source: Company, Edelweiss research

Chart 4: Customer demographics



Source: Company, Edelweiss research

Key Personnel

Ms. Falguni Sanjay Nayar, Founder and CEO

Ms. Falguni Sanjay Nayar is currently working as Founder, Chief Executive Officer and Independent Director with Fsn E-Commerce Ventures (Nykaa.com) and Country Advisor with Temasek Holdings Advisors India. Prior to this, she worked as Managing Director with Kotak Investment Banking and as a Manager with A.F. Ferguson. She also serves on the board of Dabur India as a Director. Ms. Nayar holds a Post Graduate Diploma in Management from Indian Institute of Management, Ahmedabad, and Bachelor of Commerce degree in Economics from Sydenham College of Commerce and Economics.

Mr. Hitesh Malhotra, Chief Marketing Officer

Mr. Hitesh Malhotra, a management graduate from UC- Berkeley, has been involved in versatile roles throughout his career. His experience ranges from strategy formation and all level analytics at Levi Strauss, USA, to best-in-class performance marketing at MakeMyTrip.com and Nykaa.com. Using innovative marketing tools, Mr. Malhotra has developed a good understanding of online consumer behaviour, and therefore, has been a part of path breaking campaigns that have elevated the course of businesses.

Mr. Nihir Parikh, Chief Business Officer

Mr. Nihir Parikh is the Chief Business Officer at Nykaa.com. He is MBA from INSEAD, MS from Stanford University and BE from Mumbai University. He began his career as an engineer at Genentech, US. Mr. Parikh has also advised startups in India including FitPermit, Giftery and Aurality. After his stint at Genentech, Mr. Parikh moved to GE as a Business Development Manager wherein his key expertise was focusing on strategy. He also launched a new business vertical called Enterprise Solutions.

COMPANY PROFILE

PAYTM

Seeking synergistic growth

India Equity Research| Retail

EDELWEISS RATINGS

Absolute Rating	NOT LISTED

Paytm launched in August 2010 by offering mobile recharge and utility bill payments. Today, it offers a full market place for consumers on its mobile app and India's largest mobile commerce platform. Paytm is the consumer brand of India's leading mobile internet company One97 Communications. Its investors include Ant Financial (AliPay), SAIF Partners, Sapphire Venture and Silicon Valley Bank. Paytm also has the unique advantage of being able to access Alibaba's larger ecosystem—all its acquisitions across the world which can help Paytm expand beyond India in the future. Paytm Mall is Paytm's e-commerce arm. The parent company had to separate its e-commerce and payments businesses in order to get a nod from the Reserve Bank of India to launch its payments bank. Paytm Mall claims to have more than 140,000 sellers and 68mn SKUs. Like most horizontal market places, it also sells mobiles, electronics, fashion, groceries etc. It offers consumers combined features of a 'mall' and 'bazaar'. 'NOT LISTED'.

Advantage of accessing Alibaba's network

Alibaba currently is the largest shareholder of Paytm with 40% stake. Paytm can thus benefit from the network and backing of the world's largest e-commerce company. The required financial backing can help it invest in sellers, marketing and optimizing logistics network.

Paytm Mall fighting to be in the top 3

The competition for the third spot in e-commerce is amongst Snapdeal, Shopclues and Paytm Mall. Paytm is resorting to deep discounting in the form of cashbacks to gain market share. It already has 140,000 sellers on board across categories. Paytm Mall's O2O (online-to-offline model) gives it an edge in the industry. It has onboarded 1,000 brand stores and 15,000 brand authorised retailers. The company recently earmarked USD35mn to invest in its logistics network to expedite delivery speed.

Outlook and valuations: To reap synergistic gains; NOT LISTED

With the e-commerce industry at an inflection point, Paytm could emerge as a big beneficiary of the formalisation of the economy and growth in the e-commerce industry. The company is **'NOT LISTED'**.

Financials

Year to March	FY13	FY14	FY15	FY16
Net sales (INR mn)	2,281	2,100	3,369	9,445
YoY growth (%)	*(5.7)*	*(7.9)*	*60.4*	*180.4*
EBITDA (INR mn)	706	286	(3,375)	(15,037)
EBITDA margin (%)	*31.0*	*13.6*	*(100.2)*	*(159)*
PAT (INR mn)	312	57	(3,720)	(15,350)
PAT margin (%)	13.7	2.7	(110.4)	(163)

** One 97 Communications Ltd* *Source: VCCEdge*

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January 2, 2018

“The biggest myth is that Indians want old ways of doing things. We have been shocked by how fast digital payment took off” – Vijay Shekhar Sharma, Founder, Paytm

Advantage of accessing Alibaba’s network

The Alibaba Group currently holds 40% stake in Paytm (32% owned by Ant Financial and 8% by Alibaba). For Alibaba, entering the Indian market through Paytm will mark an expansion of its global footprint and offer a chance to be part of the world's most attractive market for online retail. On the other hand, Paytm has the unique advantage of being able to access Alibaba’s larger ecosystem—all its acquisitions across the world, including e-commerce company Lazada Group in Southeast Asia and Chinese government-owned Suning Commerce —which can help the company expand beyond India in the future.

Paytm Mall targeting No.3 spot in e-commerce

Paytm Mall has raised USD200mn from Alibaba and Saif Partners. Equipped with capital, it is now targeting the No.3 spot in e-commerce. For Diwali, the company had lined up an INR10bn marketing and promotional expenditure. Paytm Mall has over 140,000 sellers on board across categories like fashion, electronics, consumer durables and home furnishings among others. Also, reassuring quality standards, Paytm claims that only trusted sellers passing strict quality guidelines and qualification criteria will be allowed on the ‘Mall’. All products listed on the mall will also go through Paytm certified warehouse and shipping channels ensuring guaranteed consumer trust.

Additionally, with Paytm Mall, the company aims to offer a unique combination of the Mall and Bazaar concepts to Indian consumers. Basically, Paytm Mall will focus on structured categories and brand authorised stores. It will also focus on electronics, top fashion brands and FMCG categories, while Paytm ‘Bazaar’ section will focus on fashion, home furnishing and goods from small sellers.

The company is also targeting growth in verticals such as FMCG. Over 60% of all Paytm Mall customers have shopped FMCG products on the platform and the category has registered a repeat rate of over 70%.

Company Description

Paytm is India's largest mobile commerce platform. It initially started off by offering mobile recharge and utility bill payments and today offers a full market place to consumers on its mobile apps. Paytm has over 200mn registered users and in a short span it has scaled to more than 60mn orders per month. It is the consumer brand of India's leading mobile internet company One97 Communications. One97 investors include Ant Financial (AliPay), SAIF Partners, Sapphire Venture and Silicon Valley Bank. One 97 communication has raised USD728mn.

As part of the process of rolling out payments bank Paytm has separated the e-commerce business (Paytm Mall) from its main app, which will make the transition to the payments bank. Paytm has now become the only company with payments and e-commerce businesses to be valued at more than USD1bn as separate entities.

Table 1: Key milestones

Year	Description
Feb-14	Launched Beta on mobile in Feb 2014
Sep-14	Launched on web in Sep 2014
Nov-14	Partnered with Uber for payments
Feb-15	Alibaba pumped in USD575mn to become the largest shareholder in One97 Communication
Jul-15	Reached 100 mn in wallet downloads
Oct-16	Starts movie and travel bookings vertical
Mar-17	Crossed the milestone of 200mn wallets ; Paytm Mall raises USD200mn from Alibaba
May-17	Raised a USD1.4bn round from Softbank

Source: Company

Product Catgories

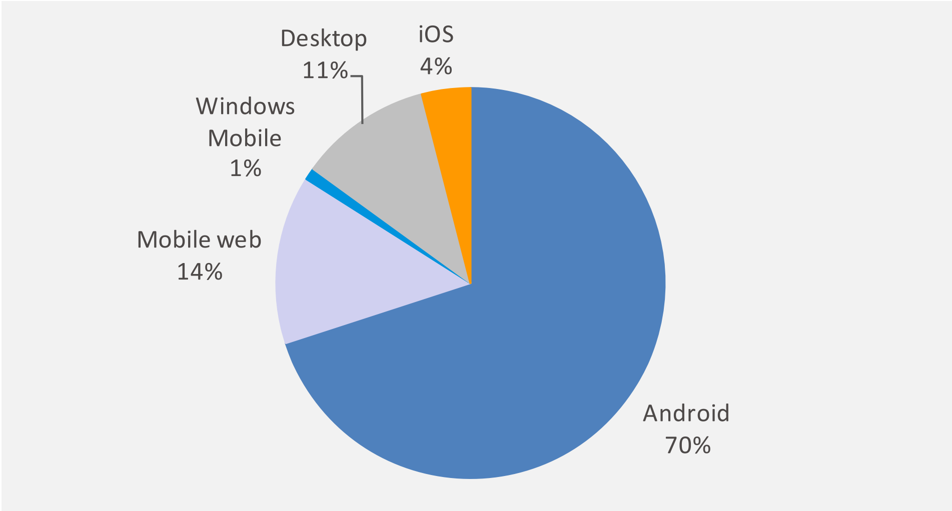
Paytm operates in the following product segments:

Table 2: Paytm operates across various product categories

Financial Products	Mutual Funds/Golds/Deposits
	Loans/Finance/Insurance
	Selling of mutual funds/gold/allowing deposits for investment
	Finance to merchants and consumers; Insurance
Payments	Mobile/DTH recharge
	Prepaid recharge and postpaid payment of mobile/DTH bills
	landline/utilities
	Fixed line and utilities (electricity, water) bill payment
Travel and Ticketing	Air/hotel/bus/movies
	Offering travel and movie tickets to consumers
E-commerce	E-commerce vertical lists products from across categories. Competes with Flipkart, Amazon , Snapdeal
Deals	Discount deals across categories such as restaurant, beauty services and entertainment

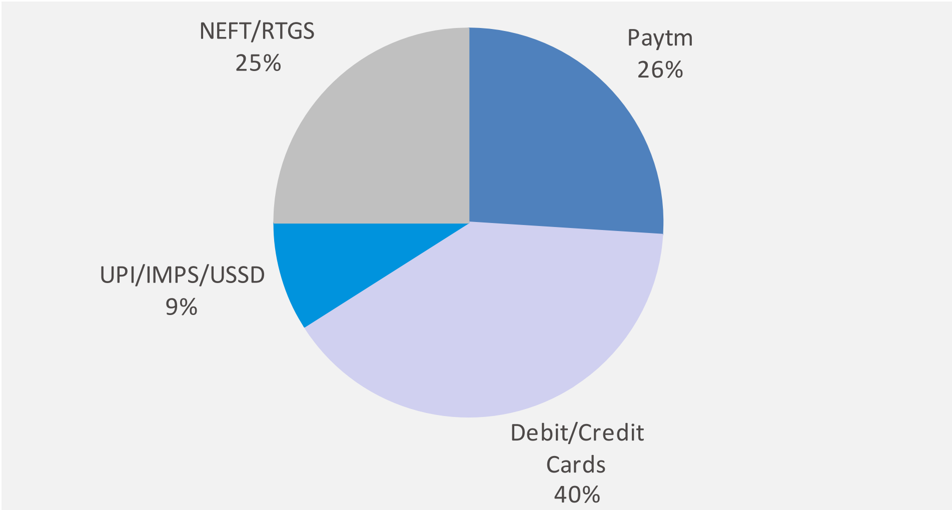
Source: Company, Edelweiss research

Chart 1: Mobile forms 89% of all customers usage



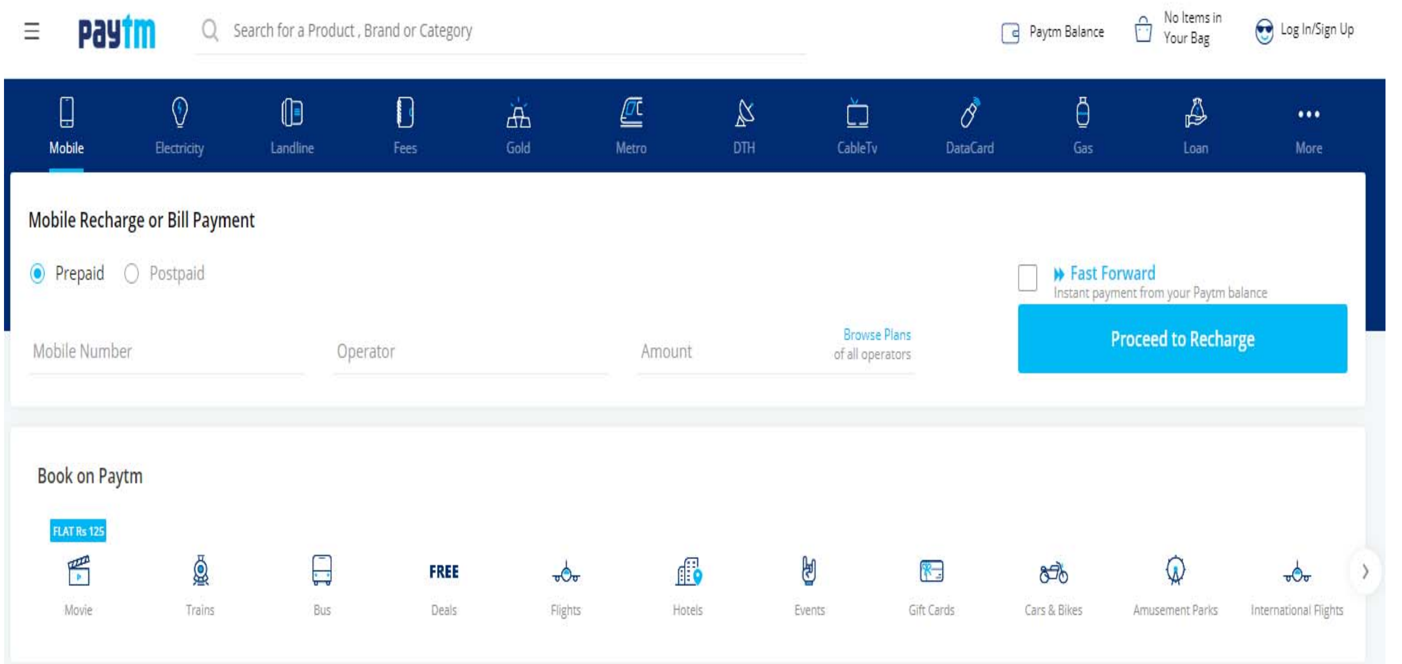
Source: Company

Chart 2: Paytm's share in digital payment transactions stands at 26%



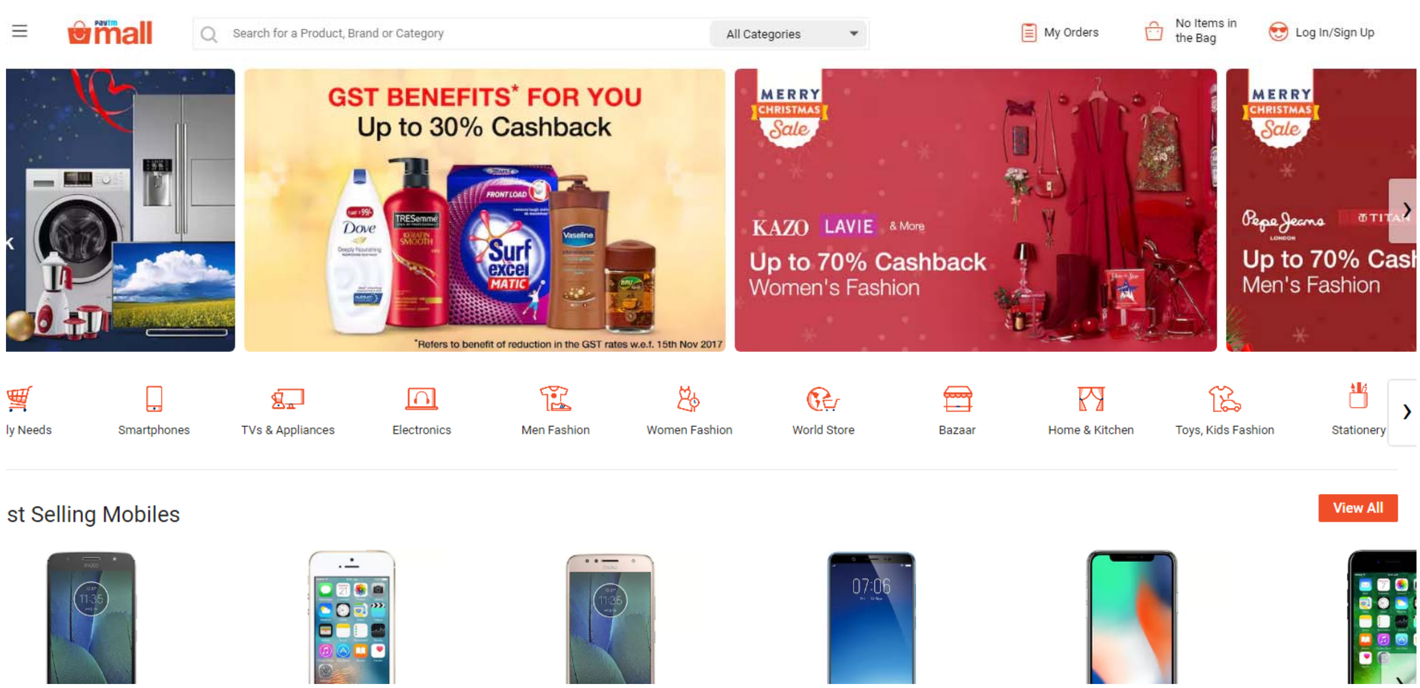
Source: Company

Fig. 1: Paytm offers a wide variety of payments services on its platform



Source: Company

Fig. 2: Paytm Mall is the marketplace offering of Paytm



Source: Company

Table 3: Paytm funding rounds

Date	Round	Amount (USD)	Investors
Oct-08	Series A	25 mn	Saif Partners, Silicon Valley Bank
Jan-09	Series B	Undisclosed amount	Silicon Valley bank, Saif Partners, Intel Capital
Oct-11	Series C	10 mn	Sapphire Ventures
Feb-15	Series D	200 mn	Ratan Tata, Ant Financial
Sep-15	Series E	680 mn	K2 Global, Ant Financial, Alibaba
Aug-16	Venture round	60 mn	Mountain Capital
Dec-16	Series F	60 mn	Secondary market
Mar-17	Series G	42 mn	Alibaba
May-17	Series H	1.4 bn	Softbank

Source: Crunchbase

Key Personnel

Mr. Vijay Shekhar Sharma, Chairman

Vijay Shekhar Sharma is a Founder and Chief Executive Officer of One 97 Communications Ltd. and Paytm E-Commerce Pvt. Ltd. and Partner of One97 Mobility Fund and Global Super Angels Forum. Prior to this, he worked as a Chief Technical Officer at Startec Global Systems India, Tech Head at India Today Group Online, Team Member-Technical at Intersolutions India Pvt. Ltd. and Business Development at RiverRun Software Group and Director at Oorja Mobile Services Pvt. Ltd. He also serves as a Director on the boards of PayTM Mobile Solutions Pvt. Ltd., Paytm Payments Bank Ltd., One 97 Communications Ltd., One 97 Communications India Ltd., One97 Enterprise Mobile Solutions Pvt. Ltd., Applied Life Pvt. Ltd., Paytm E-Commerce Pvt. Ltd., and Paytm Financial Services Ltd. Prior to this, he served as Director on the board of Earth Education Valley Pvt. Ltd., RainingClouds Technologies Pvt. Ltd., Santa Claus Couriers Pvt. Ltd., Aryan Ayurveda Pvt. Ltd., Little Internet Pvt. Ltd., and Nominee Director at MobiSwipe Technologies Pvt. Ltd. He also serves as the Adviser to the board of NoBroker Technologies Solutions Pvt. Ltd. Vijay holds Bachelor of Engineering in Electronics and Communications from Delhi College of Engineering.

Mr. Madhur Deora , CFO

Mr. Madhur Deora has been Chief Financial Officer and Senior Vice President of One97 Communications Limited since October 6, 2016. Mr. Deora has been Chief Financial Officer and Senior Vice President of Paytm Mobile Solutions Private Limited since October 6, 2016. Mr. Deora is responsible for building and managing Paytm's newly formed financial services business. Mr. Deora has over 17 years of experience in investment banking and served in Citi's investment banking business as Managing Director. He joined Salmon Smith Barney, which was later acquired by Citicorp to form Citibank. He is known for helping JustDial with its IPO in 2013 and led the fundraising discussions for Paytm with Alibaba in 2015. He studied economics at Wharton.

Mr. Rahul Saini, Head of Product design

Mr. Rahul Saini is the Head of Product Design at One 97 Communications Ltd. He also serves as a Mentor at Global Super Angels Forum. Prior to this, he worked as a Founder and Head of Product at VideoPind, as a Creative Head at Creative Karma Interactive Technology Studio, Head Product Design and Creative Director at Speak Wireless and XG Infomedia Group. He also worked as a Manager-Creative Design at ACL Mobile Ltd., as a Creative Lead-Interactive at FishEye Software Inc. and was also associated with Asia Cybernet Ltd. Rahul holds a Bachelor's in Arts from Delhi University.

COMPANY PROFILE

PC JEWELLER

Shining bright

India Equity Research| Retail

PC Jewellers (PCJ) is one of India's leading jewellery companies in India in the organized retail sector. The company's businesses include manufacture, retail and export of jewellery across a wide range of products. It has a strong presence in the North and Central India and is aiming at a pan India presence through the franchisee route. It currently has a network of 79 stores across 62 cities. PCJ's revenues have grown at 19% CAGR over FY13-17 led by wedding demand, store expansion and strong advertisements. PC Jewellers moat lies in its strength as a wedding jewellery player, large format showrooms, extension of franchisee model, competitive pricing and comfort on gold purity. 'NOT RATED'

Well geared to tap burgeoning opportunities

Management perceives demand shift in favour of organised jewellery retailers post government initiatives such as demonetisation and GST implementation—PCJ has gained some market share post these initiatives. From around 10% in 2008, the share of organised jewellery chains in India's overall jewellery sales has catapulted to ~20% now. PCJ is well placed to tap this shift via new product launches and aggressive store expansion. The company expects the domestic business to post 30% CAGR in FY18.

Expanding footprint pan-India

Though PCJ is an established player predominantly in North & Central India, it has been expanding footprint in other regions such as Karnataka. As of H1FY18, the company has 79 stores with 9 franchise stores and is now opening 1,500-2,000 sq ft stores in Tier-II & III locations. It is also planning to open stores under the franchisee model as unorganised players are eager to tie up with organised retailers. Moreover, it has re-branded its online vertical *Aucent*, which has been clocking good growth.

Outlook and valuations: To reap synergistic gains; NOT RATED

With the organised jewellery industry at an inflection point, PCJ is likely to be a big beneficiary of the shift from unorganised to organised players. This favourable environment can lead to expansion in the number of retail stores and enable it to earn pan-India player tag. The stock currently trades at PE of 20.5x FY17. The stock is **'NOT RATED'**.

Financials

Year to March	FY14	FY15	FY16	FY17
Revenues (INR mn)	53,248	63,485	72,321	80,994
Rev. growth (%)	*NA*	*19.2*	*13.9*	*12.0*
EBITDA (INR mn)	5,978	7,240	7,530	7,540
Adjusted Profit (INR mn)	3,678	3,782	3,993	4,305
Adjusted Diluted EPS (INR)	20.5	21.1	22.3	24.0
EPS growth (%)	*NA*	*2.8*	*5.6*	*7.8*
Diluted P/E (x)	24.0	23.3	22.1	20.5
EV/EBITDA (x)	15.6	12.7	12.6	11.4
ROAE (%)	23.9	20.6	18.5	15.1

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA *(R: PCJE.BO, B: PCJL IN)*

CMP	: INR 492
Target Price	: NA
52-week range (INR)	: 496 / 176
Share in issue (mn)	: 2,248.9
M cap (INR bn/USD mn)	: 194 / 17,464
Avg. Daily Vol.BSE/NSE('000)	: 1,248.9

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	60.5	60.5	60.5
MF's, FI's &	2.4	3.1	9.6
FII's	31.0	30.4	31.0
others	6.1	6.0	6.1

** Promoters pledged shares (% of share in issue) : NIL*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	3.6	19.5	15.9
3 months	7.5	32.4	24.9
12 months	26.4	138.4	112.0

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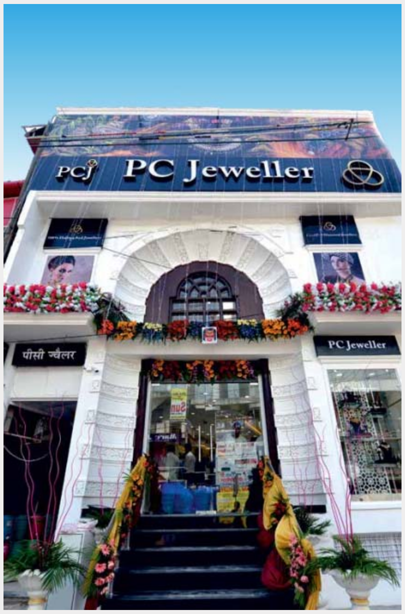
January 2, 2018



PC Jeweller store in Agra

Demand shift to organised retail to boost growth

Formalisation of the economy has unleashed significant structural changes and has given organised players players like PCJ an opportunity to enhance their market shares. The total share of the organised jewellery market currently stands at ~20% and is envisaged to increase further primarily led by a series of regulations like levy of 1% excise duty on gold jewellery, requirement of PAN card for purchases over INR0.2mn, demonetisation and implementation of 3% GST. Hence, management estimates 30% growth in the domestic business in 2018 and expects exports to grow 10-15%.

Chart 1: Domestic business as a % of sales is bound to increase

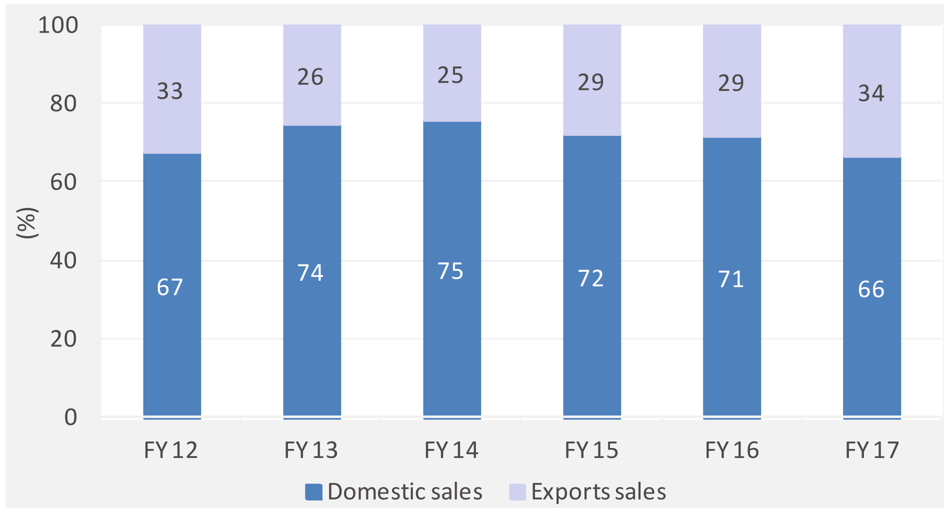
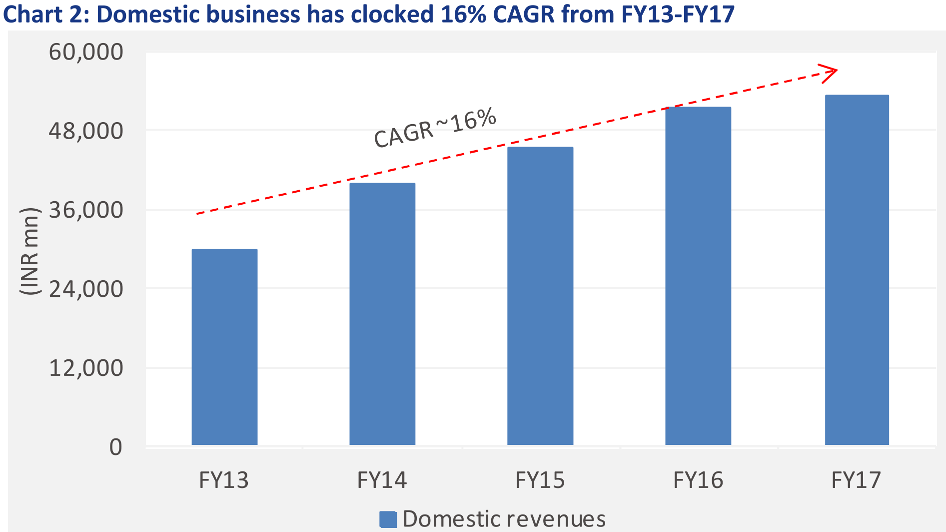


Chart 2: Domestic business has clocked 16% CAGR from FY13-FY17



Source: Company, Edelweiss Research

Transforming into a pan India player

PCJ currently has 79 stores with 33 added in the past one and half years. In YTD FY17, it has added 9 stores (including 4 franchisee stores). The company initially focused on large format showrooms (5,000sq ft average size) to establish a strong presence in the wedding jewellery segment. This proved to be a successful strategy to tap this segment, which now contributes 85% to the company's domestic jewellery sales. With government reforms opening a plethora of opportunities, PCJ is now adding smaller stores in small towns as well as spokes for larger stores in cities it is already present in. It has set an ambitious store addition target and is focusing more on tapping new mass markets where the opportunity of gaining share from the unorganised segment is high. PCJ has started opening smaller format stores in tier-II & III locations, with average store size of 1,500-2,000sq ft. Along with its own stores in these smaller markets, it will also use the franchising model to expand.

"Customers won't put their hard-earned cash just anywhere. Trust and goodwill can fill your coffers" - Balram Garg , Managing Director

Chart 3: New added stores are in Tier I & Tier II

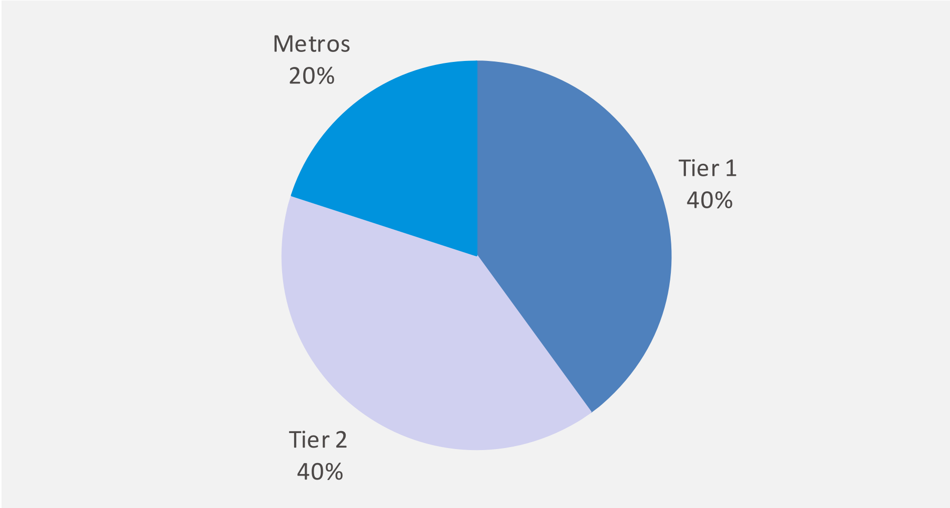
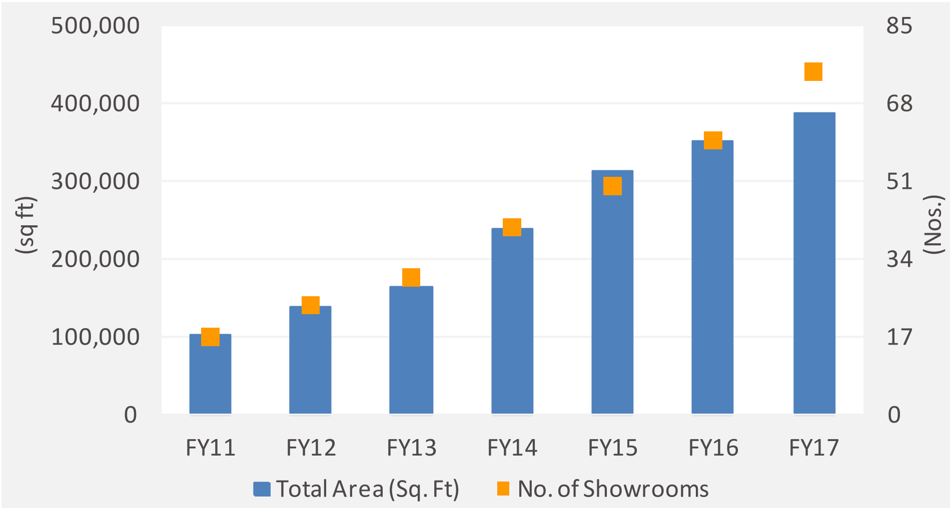


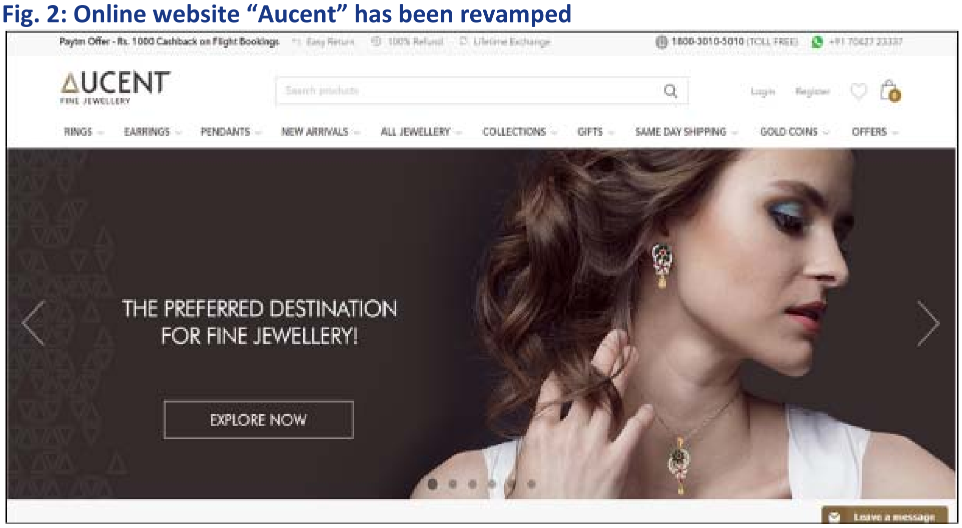
Chart 4: The total number of stores has been rising consistently



Source: Company, Edelweiss research

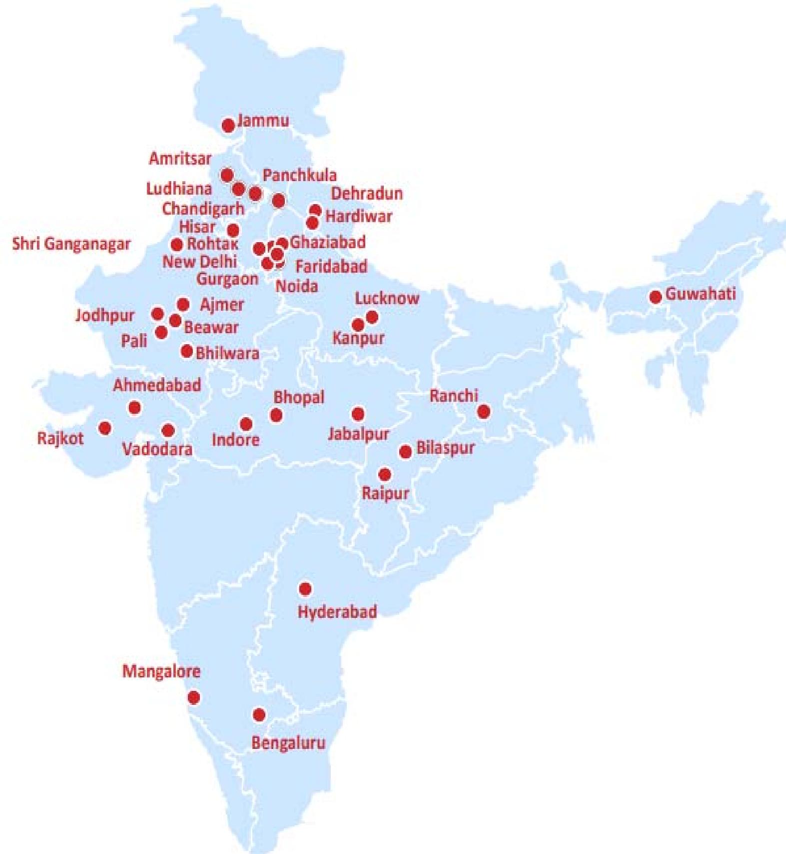
Fig. 1: Concentrating on premium Azva brand

Fig. 2: Online website "Aucent" has been revamped



Source: Company

Fig. 3: Pan India presence of PC Jewellers retail stores



Source: Company

Company Description

PCJ, incorporated in 2005, is a leading organised jewellery retailer with a strong brand presence in North and Central India. Its operations include manufacturing, retailing and export of jewellery. The company has 79 showrooms (including 9 franchisee stores) in 62 cities and more than 18 states, with an operational space of 4 lakh sq ft as of October 2017. In addition to the network of showrooms, PCJ also has 5 manufacturing facilities for meeting its in-house requirements.

Table 1: Company history

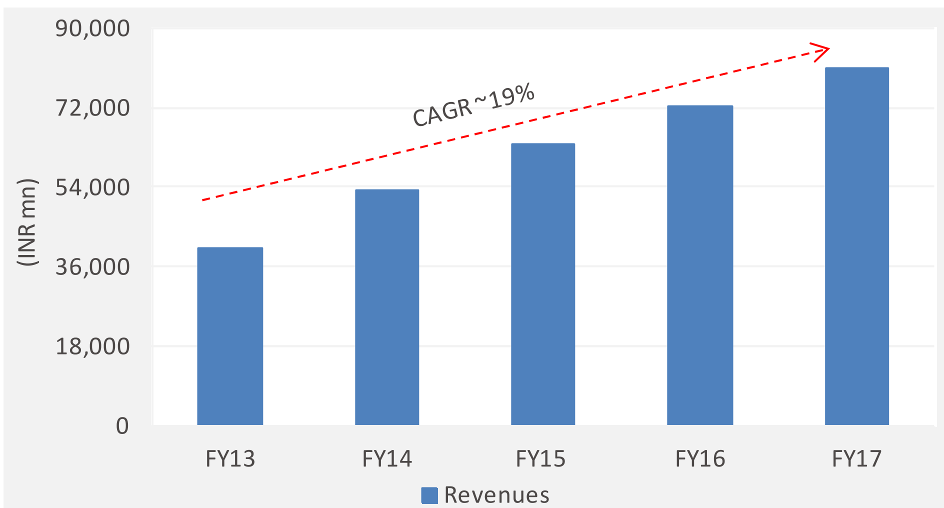
Year	Description
2005	Company was incorporated as 'P Chand Jewellers Private Limited'; Opening of showroom at Karol Bagh (New Delhi)
2007	Opening of two showrooms at Noida and Panchkula ; Commencement of export operations from the manufacturing unit at the Noida SEZ
2008	Opening of two showrooms at Faridabad and Dehradun
2009	Commencement of operations at the manufacturing unit in Selaqui, Dehradun
2010	Opening of nine showrooms at Preet Vihar (New Delhi), Ghaziabad, Gurgaon, Lucknow, Indore, Bhopal, Raipur, Jodhpur and Bhilwara
2011	Commencement of operations from the second export unit in the Noida SEZ
2014	The Company opened its 48th showroom at Bareilly (U.P.)
2015	PC Jeweller celebrates at its 54th showroom and 1st showroom in Yamuna Nagar
2016	PC Jewellers acquires AZVA brand

Source: Company

Revenues

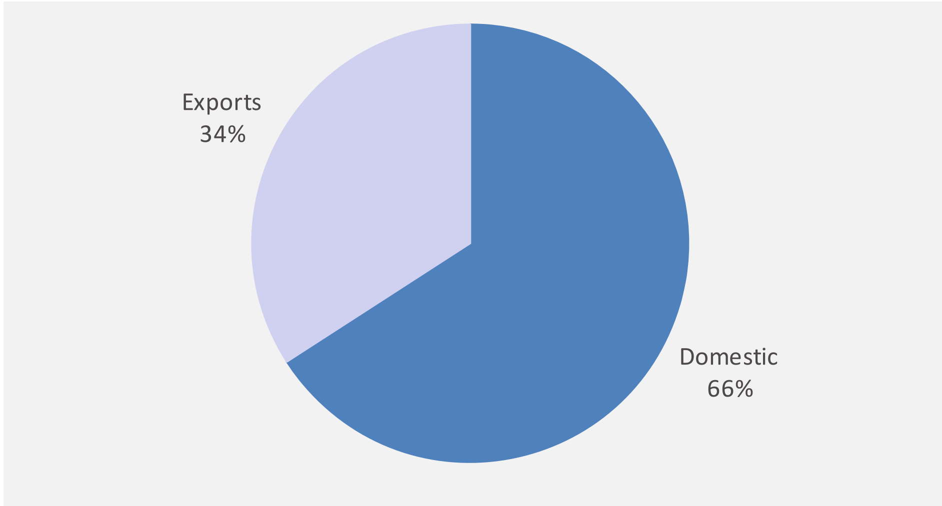
PCJ is well placed to gain from favourable industry growth drivers of rising shift to organised jewellery, increasing urbanisation and higher disposable incomes. The company is also planning to tap the burgeoning organised jewellery market by aggressive store expansion in Tier I & II cities via own and franchisee route and innovation-led growth.

Chart 5: PC Jeweller has clocked 19% revenue CAGR over FY13 to FY17



Source: Company

Chart 6: Domestic operation contribute lion's share of revenue



Source: Company

Table 2: PC Jeweller operating metrics

	FY13	FY14	FY15	FY16	FY17
Domestic revenues	29,876	40,021	45,387	51,507	54,215
Growth (%)	46.5	34.0	13.4	13.5	5.3
EBIT (INR mn)	**2,629**	**3,186**	**4,507**	**6,174**	**6,456**
EBIT margin (%)	8.8	8.0	9.9	12.0	11.9
No. of showrooms	30	41	50	60	75
Retail space (sq. ft.)	**190,472**	**250,398**	**313,296**	**352,313**	**387,123**
Growth (%)	38.1	31.5	25.1	12.5	9.9
Average store size (sq. ft.)	6,349	6,107	6,266	5,872	5,162
Average revenue/store (INR mn)	**996**	**976**	**908**	**858**	**723**
Average revenue/sq. ft. (INR)	181,947	181,554	161,034	154,767	146,637

Source: Company, Edelweiss research

Key Personnel

Mr. Padam Chand Gupta, Chairman

Mr. Gupta has more than 20 years of experience in the jewelry industry and is part of the company since incorporation.

Mr. Balram Garg, Managing Director

Mr. Garg is involved in the company since incorporation and has over 20 years of experience in the jewelry industry.

Mr. Ramesh Kumar Sharma, Executive Director and Chief Operating Officer

Mr. Ramesh Kumar Sharma has been the Chief Operating Officer at PC Jeweller Limited since September 2011. Mr. Sharma has worked with State Bank of Bikaner and Jaipur and has 29 years of experience in forex, credit & administration in different positions. He joined PC Jeweller Limited in April 2007. He has been Whole-Time Director at PC Jeweller Limited since February 7, 2014. Mr. Sharma served as Whole-Time Director of PC Jeweller Limited from January 2008 to September 2011. He is also Certified Associate of Indian Institute of Bankers.He has over 29 years experience in foreign exchange, credit and administration sectors. He holds a bachelors degree and a masters degree in commerce from University of Rajasthan, Jaipur.

Dr. Manohar Lal Singla, Independent Director

Dr. Manohar Lal Singla has been an Independent Non-Executive Director at PC Jeweller Limited since September 20, 2011. Dr. Singla has over 25 years experience in academics. He is a Professor of Management at the Faculty of Management Studies, University of Delhi, New Delhi. Dr. Singla holds a Bachelors degree in Engineering (Mechanical) from Punjab University (Guru Nanak Engineering College, Ludhiana), a Masters degree in Business Administration and Doctor of Philosophy in Management from the University of Delhi, New Delhi.

Mr. Krishan Kumar Khurana, Independent Director

Mr. Khurana has been an Independent Non-Executive Director of PC Jeweller Limited since September 20, 2011. He served as a Director at Shree Ganesh Forgings Ltd from January 19, 2005 to October 2010. Mr. Khurana is a practising advocate of the Supreme Court of India and the High Court of New Delhi. He represents the State of Punjab in his capacity as an Additional Advocate General. Mr. Khurana holds B.Sc. Engineering Degree from Punjab Engineering College, Chandigarh and Post Graduate Diploma in Electrical Engineering from REC – Kurukshetra. He holds a master's degree in arts from Kurukshetra University, Kurukshetra. Mr. Khurana holds a bachelors degree in law from the University of Delhi.

Mr. Miyar Ramanath Nayak, Independent Director

Mr. Nayak was associated with the banking industry for over 40 years and has experience in the field of gold banking, treasury and forex operations, credit risk management and branch banking.

Mr. Suresh Kumar Jain, Independent Director

Mr. Jain worked at Bank of India in various capacities including General Manager. He has over 36 years of experience as banker in domestic and international markets. He has vast experience in the field of International Banking, Human Resource Development, Development of MSMEs, Commercial & Retail Banking, appraisal of large Credit, Loan Syndications, Trade Finance, Product Marketing and Bank Management. He has been an Independent Director of PC Jeweller Limited since September 19, 2015. He is a Certified Associate of Indian Institute of Bankers and holds a Diploma in Personnel Management & Labour Welfare from Punjab University. He holds an M.A. in Economics from Kurukshetra University and a Bachelor's degree in Science from Punjab University.

Financial Statements

Income statement				(INR mn)
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Net revenues	53,248	63,485	72,321	80,994
Cost of materials	44,782	53,823	62,165	70,724
Gross profit	8,467	9,662	10,156	10,271
Employee costs	447	556	707	786
Advt.& sales costs	376	464	285	223
Others	1,665	1,402	1,634	1,722
EBITDA	5,978	7,240	7,530	7,540
Depreciation	123	230	226	220
EBIT	5,855	7,010	7,304	7,320
Interest Expense	1,519	2,209	2,447	2,747
Other income	472	592	507	1,092
Exceptional items	(114)	-	-	-
Profit before tax	4,694	5,393	5,364	5,664
Provision for tax	1,131	1,611	1,371	1,359
Reported Profit	3,563	3,782	3,993	4,305
Excep. Items (Net of Tax)	(114)	-	-	-
Adjusted Profit	3,678	3,782	3,993	4,305
No. of Shares outstanding	179	179	179	179
Adjusted Basic EPS	20.5	21.1	22.3	24.0
No. of Dil. shares OS	179	179	179	179
Adjusted Diluted EPS	20.5	21.1	22.3	24.0
Adjusted Cash EPS	21.2	22.4	23.6	25.3
Dividend per share (DPS)	3.0	3.2	3.4	1.0
Dividend Payout Ratio (%)	14.6	15.2	15.0	33.5
Tax rate	24.1	29.9	25.6	24.0

Balance sheet				(INR mn)
As on 31st March	**FY14**	**FY15**	**FY16**	**FY17**
Share capital	1,791	1,791	1,791	1,791
Reserves & Surplus	15,032	18,113	21,483	31,876
Shareholders' funds	16,823	19,904	23,274	33,668
Long term borrowings	4	4	582	577
Short term borrowings	10,030	6,810	8,819	6,340
Total Borrowings	10,034	6,814	9,401	6,917
Long Term Liab. & Prov.	18	29	43	62
Deferred tax liability (net)	(107)	(125)	(164)	(295)
Sources of funds	**26,767**	**26,621**	**32,555**	**40,351**
Gross Block	1,187	1,695	1,120	1,277
Net Block	839	896	899	837
Total Fixed Assets	850	896	899	837
Non current investments	1	1	1	1,339
Cash and cash equivalents	5,150	2,872	2,938	9,411
Inventories	23,771	32,299	38,711	41,186
Sundry Debtors	6,232	7,675	9,082	12,744
Loans & Advances	6,044	3,128	5,388	5,906
Other Current Assets	170	120	300	453
Total Current Assets (ex cas	36,217	43,221	53,481	60,289
Trade payable	12,841	18,094	21,706	28,070
Other Current Liabilities & S	2,610	2,275	3,058	3,455
Total Current Liabilities & P	15,451	20,369	24,764	31,525
Net Current Assets (ex cash	20,766	22,852	28,717	28,764
Uses of funds	**26,767**	**26,621**	**32,555**	**40,351**
Book Value per share (INR)	94	111	130	188

Common size metrics (%)				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Cost of materials	84.1	84.8	86.0	87.3
Employee costs	0.8	0.9	1.0	1.0
Advertising & sales costs	0.7	0.7	0.4	0.3
Other general expenditure	3.1	2.2	2.3	2.1
Depreciation	0.2	0.4	0.3	0.3
Interest Expense	2.9	3.5	3.4	3.4
EBITDA margin	11.2	11.4	10.4	9.3
EBIT margin	11.0	11.0	10.1	9.0
Net profit margin	6.9	6.0	5.5	5.3

Free cash flow				(INR mn)
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Reported Profit	3,563	3,782	3,993	4,305
Add: Depreciation	123	230	226	220
Interest (Net of Tax)	1,153	1,549	1,821	2,088
Others	(753)	705	(4)	(1,100)
Less: Changes in WC	11,942	2,925	5,332	(2,872)
Operating cash flow	(7,856)	3,342	704	8,386
Less: Capex	317	519	(575)	157
Free Cash Flow	(8,173)	2,823	1,279	8,229

Growth metrics (%)				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Revenues	NA	19.2	13.9	12.0
EBITDA	NA	21.1	4.0	0.1
PBT	NA	14.9	(0.5)	5.6
Adjusted Profit	NA	2.8	5.6	7.8
EPS	NA	2.8	5.6	7.8

Cash flow metric

Year to March	FY14	FY15	FY16	FY17
Operating cash flow	(7,856)	3,342	704	8,386
Financing cash flow	5,708	(5,657)	165	892
Investing cash flow	2,462	2,126	(863)	(6,446)
Change in cash	314	(190)	6	2,832
Capex	(317)	(519)	575	(157)
Dividends paid	(537)	(573)	(600)	(179)

Ratios

Year to March	FY14	FY15	FY16	FY17
ROAE (%)	23.9	20.6	18.5	15.1
Pre-tax ROCE (%)	31.0	28.4	26.3	23.0
Debtors Days	33	26	27	25
Inventory Days	247	190	227	206
Payble Days	138	105	127	128
Cash Conversion Cycle	143	112	127	103
Current Ratio	2.7	2.3	2.3	2.2
Gross Debt/EBITDA	1.7	0.9	1.2	0.9
Gross Debt/Equity	0.6	0.3	0.4	0.2
Adjusted Debt/Equity	0.6	0.3	0.4	0.2
Net Debt/Equity	0.3	0.2	0.3	(0.1)
Interest Coverage Ratio	3.9	3.2	3.0	2.7

Operating ratios

Year to March	FY14	FY15	FY16	FY17
Total asset turnover	2.5	2.4	2.4	2.2
Fixed asset turnover	64.5	72.7	80.6	93.3
Equity turnover	3.5	3.5	3.3	2.8

Valuation parameters

Year to March	FY14	FY15	FY16	FY17
Adjusted Diluted EPS (INR)	20.5	21.1	22.3	24.0
Y-o-Y growth (%)	*(56.7)*	*2.8*	*5.6*	*7.8*
Adjusted Cash EPS (INR)	21.2	22.4	23.6	25.3
Diluted Price to Earnings Ra	24.0	23.3	22.1	20.5
Price to Book Ratio (P/B) (x)	5.2	4.4	3.8	2.6
Enterprise Value / Sales (x)	1.7	1.5	1.3	1.1
Enterprise Value / EBITDA (x)	15.6	12.7	12.6	11.4
Dividend Yield (%)	0.6	0.7	0.7	0.2

COMPANY PROFILE

RELIANCE RETAIL

Geared on high growth path

India Equity Research| Retail

Reliance Retail (RR) ventured into retail business in 2006 and has since cemented its position as the largest retailer in India. We believe RR is well placed to further consolidate its position and emerge as a lead player in the USD616bn Indian retail industry. The company's diversified retail portfolio includes neighbourhood stores, supermarkets, wholesale cash & carry stores, specialty stores and online stores. In all, it has 3,679 stores (including Reliance Digital) spread across 750 cities serving more than 4mn customers every week. RR is now fine-tuning on its omni-channel game plan to fuel future growth. 'NOT LISTED'.

Omni channel, the new growth avenue

RR's omni-channel or its online journey (www.reliancefreshdirect.com later renamed to www.reliancesmart.in) began in 2015 with presence in Mumbai, Pune and Bengaluru. In April 2016, the company launched its fashion e-commerce portal under the *Ajio* brand. Jio broadband services further supported its online venture. Reliance can leverage its Jio network to tap business stores and supply them from Reliance Market. RR has also partnered with e-tailer, Grofers for food and groceries in 14 cities. Plans are also afoot to widely penetrate the rural and semi-urban markets of India for achieving 30% YoY growth over the next decade. RR is all set to take on Amazon and Flipkart through its wide array of products with the promise of same/next day delivery in small towns (where aspiration is a problem) and through exclusive deals.

Strong partnerships in global brands

RR enjoys strong partnerships with global brands like Brooks Brothers, Diesel, Hamley, Marks and Spencer, Armani, Hugo Boss , Michael Kors, etc. Also, Reliance Digital, the largest category in the company's retail revenue mix, continues to do well. It has the most comprehensive range of TV's across price points. RR has strengthened its core value service proposition with one day delivery and installation within 48 hours.

Outlook and valuations: Improving traction; 'NOT LISTED'

We believe RR can emerge as a big competitor to organised Brick & Motor retailers as well as e-commerce companies drawing on its financial muscle and strong partnerships with global brands. '**NOT LISTED'.**

Financials (INR mn)

Year to March	FY14	FY15	FY16	FY17
Revenue	127,520	162,017	183,300	264,377
Rev. growth (%)		27.1	13.1	44.2
EBITDA (INR mn)	4,648	7,950	9,118	11,602
EBITDA margin (%)	3.6	4.9	5.0	4.4
Adjusted Profit (INR mn)	2,721	2,725	3,056	4,426
PAT margin (%)	2.1	1.7	1.7	1.7

Source: Reliance Industries

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

Omni channel to drive future growth

RR has turned aggressive with its new omni channel strategy. In 2014, the company had launched its e-commerce store, RelianceFreshDirect.com to deliver grocery products in the neighbourhood of Mumbai. In June 2016, it launched its online fashion portal, **ajio.com.**

Through **Jio online** and its retail network of 3,679 stores (including reliance digital stores), RR is thriving on a multi-channel model. Meanwhile, Ajio has roped in brands from Diesel, Ermenegildo Zegna, Marks and Spencer, Paul & Shark, Thomas Pink , Kenneth Cole, etc.

Ajio, launched in 2016 as the fashion portal, Ajio.com, has physical presence across 363 Trends stores. The Ajio labels are different from those sold by Reliance Trends and Reliance Brands. Ajio plans to leverage Reliance Jio's digital platform as well as the 3,000-strong RR network for deliveries and returns. Online fashion segment in India is currently estimated at USD2bn and is forecast to swell to USD20bn by 2020 to become the single largest online category, surpassing consumer electronics.

The company has also strengthened its presence in the **luxury** segment by acquiring 40% stake in Genesis luxury fashion, which operates brands such as Armani, Burberry, Coach and Michael Kors. As on September 2017, RR operated 3,679 stores across 750 cities with an area of over 14.2mn sq ft. It also has a strong distribution channel reach and partnered with over 750,000 retailers across the country.

Strong partnerships with global brands

RR enjoys strong partnerships with global brands like Brooks Brothers, Diesel, Hamley, Marks and Spencer, Armani, Hugo Boss, Michael Kors, etc.

Fig. 1: Positioning of different brands

Source: Company, Edelweiss research

Table 1: Brands portfolio

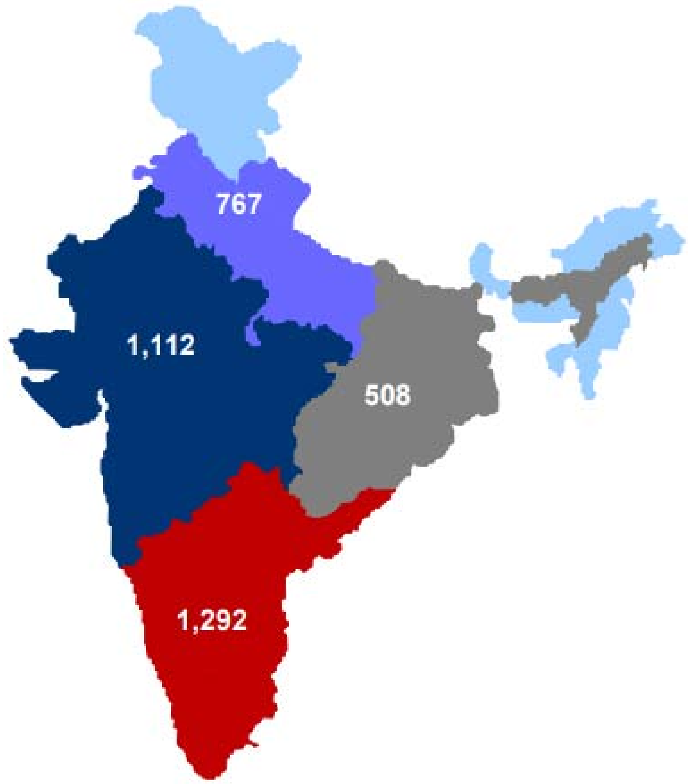
Exclusive Brand Partnership	Product/Service	End Uses
Bally	World's second oldest luxury brand	Shoes, bags and fashion accessories
BCBG Max Azria	Contemporary women's clothing brand	Apparel, accessories and footwear
Brooks Brothers	American iconic brand that has redefined & shaped classic American style for nearly two centuries	Apparel and accessories for men
Cherokee	Apparel, accessories, footwear and skateboards	Apparel, accessories, footwear and skateboards
DC	American sportswear brand inspired by skateboarding and snowboarding	Apparel, accessories, footwear and skateboards
Diesel	Iconic Italian lifestyle brand	Iconic Italian lifestyle brand
Dune	Distinctive fashion footwear & accessories	Accessories and footwear for men and women
Ermenegildo Zegna	Italian luxury men's clothing	Apparel, accessories and footwear for men
Flormar	Leading beauty and colour cosmetic brand	Colour cosmetic products
GAS	Italian clothing brand offering quality products for intelligent, aware consumers, with an international,cosmopolitan attitude	Apparel, accessories and footwear for men & wome
Hamleys	The finest toy shop in the world	Toys
Hunkemoller	Leading European lingerie brand	Lingerie, nightwear, swimwear and accessories
ICONIX	Diversified portfolio of fashion and home brands	Apparel, footwear, accessory and home fashion
Juicy Couture	Casual luxury lifestyle brand	Apparel, accessories and footwear
Kate Spade	Accessible luxury for women	Handbags, small leather goods, apparel and footwear
Kenneth Cole	Urban fashion & Lifestyle brand that exudes metropolitan lifestyle of New York city	Apparel, accessories and footwear
Marks & Spencer	Iconic British lifestyle brand	Apparel for women, men and children, lingerie, beauty and home décor
MUJI	Iconic Japanese lifestyle brand	Accessories, home, apparel, travel, beauty, stationery
Paul & Shark	Italian luxury and casual sportswear brand	Apparel, accessories and footwear for men
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
REISS	Affordable luxury fashion brand	Apparel, accessories and footwear
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	Apparel, accessories and footwear
Vision Express	Optical specialty store	Spectacles, sunglasses, contact lenses and eyewear care accessories

Source: Company, Edelweiss research

Pan India presence

RR has the highest number of stores in South India followed by West India. Reliance Trends continues to find strong traction with improved store experience. Tier II & III cities contribute 2/3rds of the total revenues.

Fig. 2: Pan Indian presence of Reliance Retail outlet



**excludes 472 owned Petri Retail fuel outlets*

Source: Company, Edelweiss research

Company Description

RR enjoys the distinction of being the largest retailer in the country and operates neighbourhood stores, supermarkets, cash & carry stores, specialty stores, and online stores. The company is a part of Reliance Industries (RIL) which is helmed by Mr Mukesh Ambani as Chairman and Managing Director. RR entered the retail business in 2006 and currently is one of the largest retailers in India. The various formats are:

Reliance Fresh: RIL commenced its entry into the retail business with the opening of *Reliance Fresh*. This business operates in the neighbourhood store format and the company sells over 200 metric tonnes of fruits and over 300 metric tonnes of vegetables every day.

Reliance Smart and Smart.in: Reliance Smart is the advanced supermarket format of the company. This store serves fresh produce, bakery, dairy products, home and personal care products, general merchandise and in many cases are co-located with the fashion & electronics store, Reliance Trends and Reliance Digital, making it a complete shopping destination. Reliance smart.in is the online grocery web-site of the company where a consumer can buy fresh fruits & vegetables, cereals, packaged food, bakery & dairy, frozen & pet food, household cleaning items to specialised beauty & personal care products from a single virtual store.

Reliance Market: Reliance Market is the wholesale cash and carry store chain that seeks to support growth of kirana stores and provides them with a modern distribution system by eliminating the intermediary. RR opened the first Reliance Market in 2011 and since then Reliance Market has grown rapidly expanding to 37 cities and serving over 2.5mn member partners.

Reliance Digital: Reliance Digital is the country's largest consumer electronics store chain operated through Reliance Digital and Digital Express Mini stores. Reliance Digital offers widest range of products (over 200 national and international brands) including audio & video products, digital cameras, durables like air conditioners, refrigerators, washing machines, microwave ovens, water purifiers, kitchen and home appliances, gaming consoles & games, computers, laptops, tablets & peripherals, mobile and fixed line instruments as well as a wide range of accessories and new-age gadgets across major product categories.

Reliance Trends: Reliance Trends is the lifestyle department store chain of the company that offer products across categories of womenswear, lingerie, menswear, kidswear and fashion accessories. The outlets have a mix of own, national and international brands.

Reliance Footprint: These stores have a range of international, domestic and company-owned brands across men's footwear, women's footwear, kids footwear, handbags, backpacks, luggage, socks, belts, wallets and shoe care products. The company also has online presence in footwear via footprint360, which sell footwear and accessories online which is delivered to the consumers or a pick-up from the nearest store can also be arranged.

Reliance Jewels: It is the fine jewellery retail chain of the company. The brand offers varied designs of jewellery at competitive prices.

AJIO: This fashion and lifestyle brand is available online through the company's web-site. It

AJIO.COM

Reliance Retail has the distinction of being the largest retailer in the country and operates neighborhood stores, supermarkets, cash & carry stores, specialty stores and online stores.

Reliance Retail has created the widest reach in the organised retail segment in India with 3,616 stores operational in 702 cities

is RR's first pan-Indian ecommerce venture. AJIO deals in womenswear, menswear, kidswear and technology. It combines convenience of technology with the aesthetics of contemporary fashion by featuring a carefully handpicked selection of premium gadgets and tech accessories.

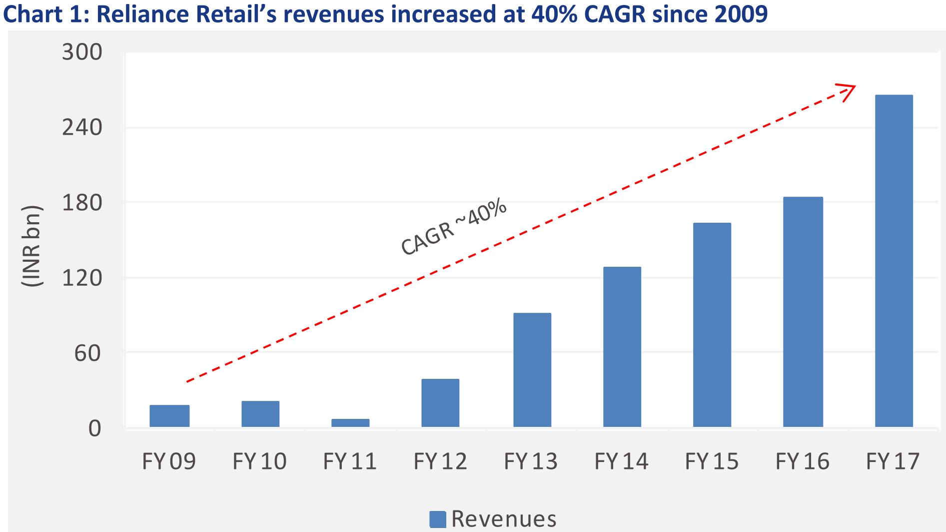
Brand partnership: RR has partnered with many international brands and has a portfolio of over 40 international brands across the entire spectrum of luxury, bridge to luxury, high–premium and high–street lifestyle. Some of the key brands are Bally, Brooks Brothers, Diesel, Dune London, Gas, Hamleys, Kenneth Cole, Marks & Spencer, Muji, Superdry, etc.

Table 2: Reliance Retail store-wise network

Type	Stores	Cities	Format
Reliance Fresh	500	80	Neighbourhood Stores
Reliance Smart	77	54	Supermarket
Reliance Market	41	38	Wholesale cash & carry
Reliance Digital & Jio Stores	200	700	Consumer Electronics Store
Reliance Trends	355	190	Specialty store in apparel
Reliance Footprint	255	NA	Specialty store in footwear
Reliance Jewels	52	36	Fine jewellery store
Partner brands	431	NA	International brands offering apparel, shoes, bags, accessories

Source: Company, Edelweiss research

Chart 1: Reliance Retail's revenues increased at 40% CAGR since 2009



Source: Company, Edelweiss research

Table 3: Milestones

Year	Description
2006	Reliance Retail opens its first Reliance Fresh store in Hyderabad
2007	Launches Reliance Digital, a consumer electronics retail chain
2008	Opens its first fashion and lifestyle store under Reliance Trends and Reliance Footprint brands
2010	Crosses 1,000 stores mark; Announces partnership with Zegna, Quick Silver and Steve Madden
2011	Achieves USD1bn revenue mark; Launches Reliance market , a cash and carry store chain
2012	Announces partnerships with Iconix, Kenneth Cole, Thomas Pink and Brooks Brothers
2013	Achieves EBITDA breakeven
2014	Becomes the largest retailer in India
2016	Launch of multichannel initiative, www.ajio.com; www.footprint360.com
2017	Achieves USD5bn revenue mark

Source: Company

Key Personnel

Mr. Damodar Mall – CEO, Reliance Retail

Mr. Damodar Mall is currently the Chief Customer Strategy Officer of Reliance Retail. He is the ex-Director, Integrated Food Strategy at Future Group and was part of Mr. Kishore Biyani's core strategy team at Future group. Mr. Mall is a business graduate from IIM, Bangalore and an engineer from IIT Bombay. He won the gold medal in marketing at IIM Bangalore. He had earlier been responsible for promoting a supermarket chain with R K Damani in 1999-2000.

Mr. Bijay Sahoo – President and Chief People Officer

Mr. Bijay Sahoo has over 24 years of experience in leadership positions in prominent national and global corporations. He specialises in Human Resource Management, Leadership Development, Organisation Development and Change Management. He is currently the President – HR and responsible for RIL's emerging consumer businesses, such as, RR and 4G Infotel. He is a Board Member of Reliance Fresh, Reliance Trends, Reliance Digital and Reliance Footprint. He is part of the Central Leadership Team and an "Executive Council Member" of RR, Value Format. Prior to this role, Mr. Sahoo was the Vice President and Global Head HR of Wipro Technologies. In this role, he developed and practiced many innovative and successful talent strategies, policies, processes, compensation and benefits programs for Wipro's global operations and handled many mergers and acquisitions internationally.

Mr. Shawn Gray – COO, Value Formats

Mr. Shawn Gray has been Chief Operating Officer of Value Formats for Reliance Retail since September 2011. Mr. Gray served as Vice President of Operations at Wal-Mart (China) Investment Co., Ltd. until June 2011. He was with Walmart for over 19 years, having spent nearly 13 years in China where he led the team that opened and integrated hypermarkets.

Mr. Darshan Mehta – President & CEO, Reliance brands

Mr. Darshan Mehta, is president and chief executive of Reliance Brands which has partnered with international brands including Ermenegildo Zegna, Diesel, Paul & Shark and Kenneth Cole to open stores (online and offline) targeting the expanding Indian market. Mr. Mehta entered the fashion industry by chance; a chartered accountant by profession, he joined the Lalbhai Group in 1984 as chief financial officer.

COMPANY PROFILE

SPENCER RETAIL

On the cusp of turnaround

India Equity Research| Retail

Edelweiss
Ideas create, values protect

Spencer's Retail (SR) is the retailing vertical of Calcutta Electric Supply Corporation (CESC). The company's first store was set up way back in 1862 in Chennai. Currently, it operates 125 stores including 40 large-format stores across 35 cities in the country with all-India footfall of ~4mn per month. It has 40 hypermarkets, 17 super markets and 68 daily stores. In FY17, SR ventured into omni-channel retailing with the launch of its online shopping facility via its website, www.spencers.in. In FY17, it clocked same store sales growth (SSSG) of almost 9% YoY, with average revenue per sq ft of INR18,912. SR has broken-even at the EBITDA level in H1FY18 and the company expects operating performance to improve going forward. 'Not listed'

Improving operating performance

SR's performance has improved significantly over the past few years as the company shut loss-making stores and focussed on profitable expansion. The total number of Spencer stores has dipped from 182 to 125 due to the company shutting under performing daily stores. The company has 40 hypermarkets (20,000-35,000 sq ft), 17 super markets (5,000-10,000 sq ft) and 68 daily stores (2,000-3,500 sq ft). SR has broken even at the EBITDA level in H1FY18 and expects operating performance to improve going forward.

Betting on omni-channel presence

The retailer has its own e-commerce platform, Omnipresent Retail India through a 100% subsidiary, to facilitate online ordering and home delivery of groceries and other items. It is planning to cover 10-12 cities in the hyper delivery model for online orders.

Outlook and valuations: Change is underway; 'NOT LISTED'

With improving operating performance, focussed expansion of stores and omni channel presence, management believes SR is on track to profitablity in a few years. The company is '**NOT LISTED'.**

Financials

Year to March	FY14	FY15	FY16	FY17
Net sales (INR mn)	14,513	16,657	17,965	20,124
YoY growth (%)		*14.8*	*7.9*	*12.0*
EBITDA (INR mn)	(768)	(733)	(617)	(260)
EBITDA margin (%)	*(5.3)*	*(4.4)*	*(3.4)*	*(1.3)*
PAT (INR mn)	(1,454)	(1,516)	(1,425)	(1,076)
PAT margin (%)	*(10.0)*	*(9.1)*	*(7.9)*	*(5.3)*

Source: CESC

EDELWEISS RATINGS	
Absolute Rating	NOT LISTED

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January 2, 2018

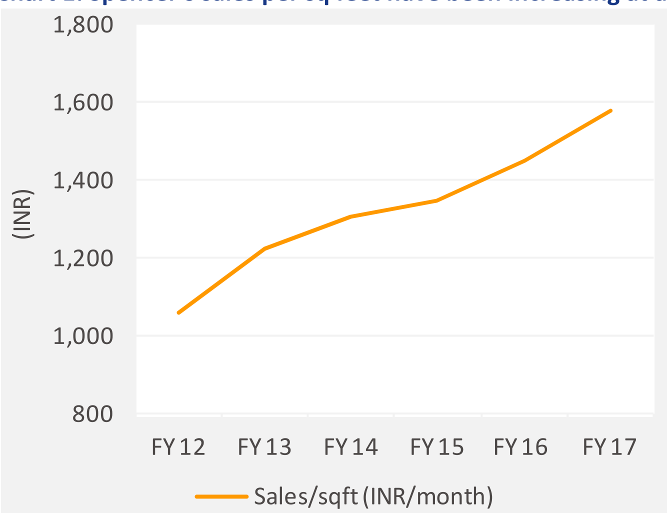
> "Spencer's has made cash breakeven in the first quarter of FY18"
> Mr. Sanjiv Goenka, Chairman

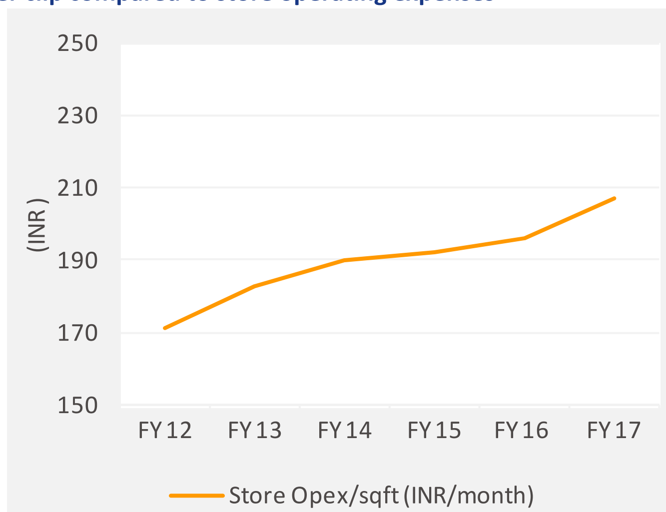
Improving operating performance

SR has broken-even at the EBITDA level and the company expects operating performance to improve going forward. Its avergae sales per sq ft has been inching up—from INR1,060 per month in FY12 (INR12,720 p.a.) to INR1,576 in FY17 (INR18,912 p.a.). This improvement has been on account of closure of loss-making stores and focussing on profitable expansion. The company currently has 40 hypermarkets (20,000-35,000 sq ft), 17 super markets (5,000-10,000 sq ft) and 68 daily stores (2,000-3,500 sq ft).

The total number of Spencer stores has dipped from 182 to 125 primarily led by the company shutting daily market stores, which have dipped from 141 to 68. This has led to improving gross margin per sq ft—from INR199 to INR308 over FY12 – 17. The focus continues to be on growing the top line, keeping costs under control and revamping/exiting non-performing stores. SR is sharpening focus on improving the non-food business and in-store experience as well as building team capability to bolster growth.

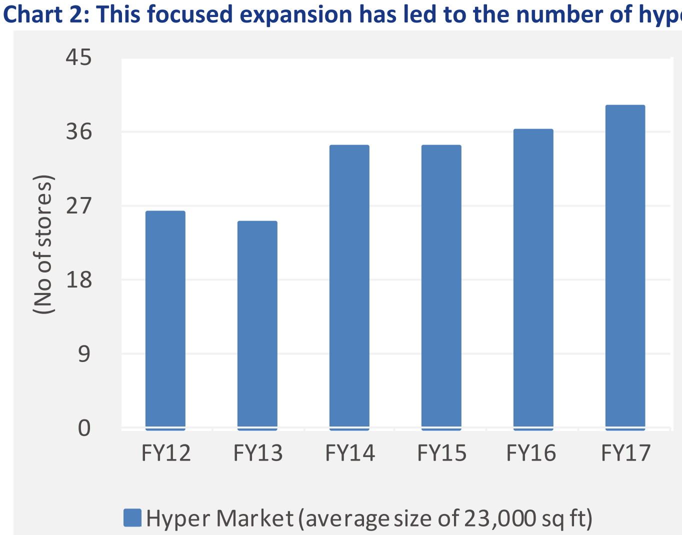
Chart 1: Spencer's sales per sq feet have been increasing at a faster clip compared to store operating expenses

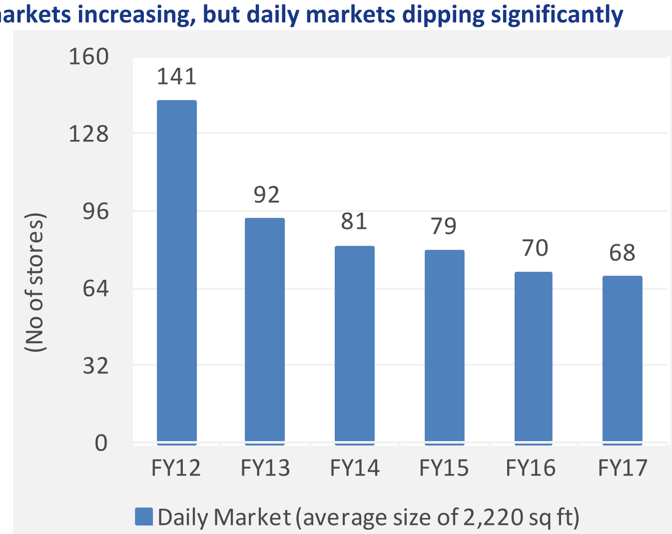




Source: Company, Edelweiss research

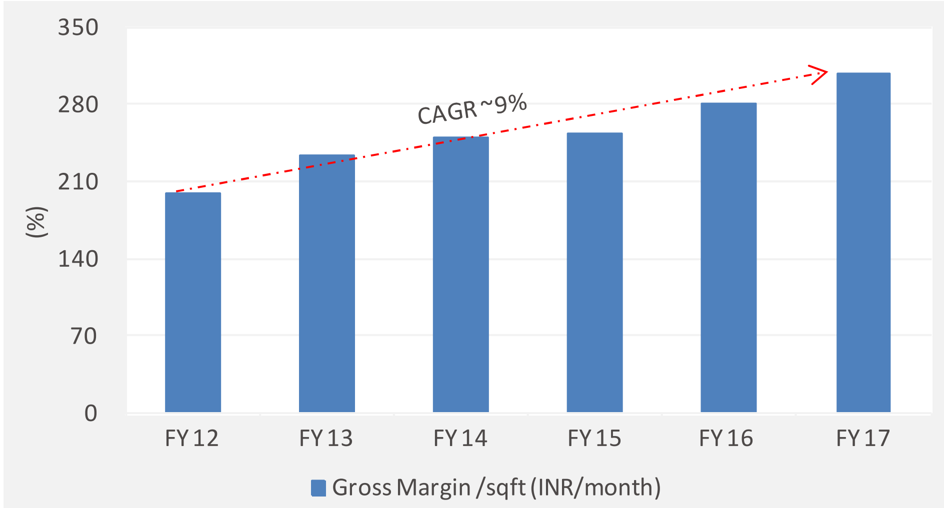
Chart 2: This focused expansion has led to the number of hypermarkets increasing, but daily markets dipping significantly





Source: Company, Edelweiss research

Chart 3: Gross margin per sq ft has clocked 9% CAGR from FY12-17



Source: Company, Edelweiss research

Online grocers together sold USD1 bn worth of products in 2017

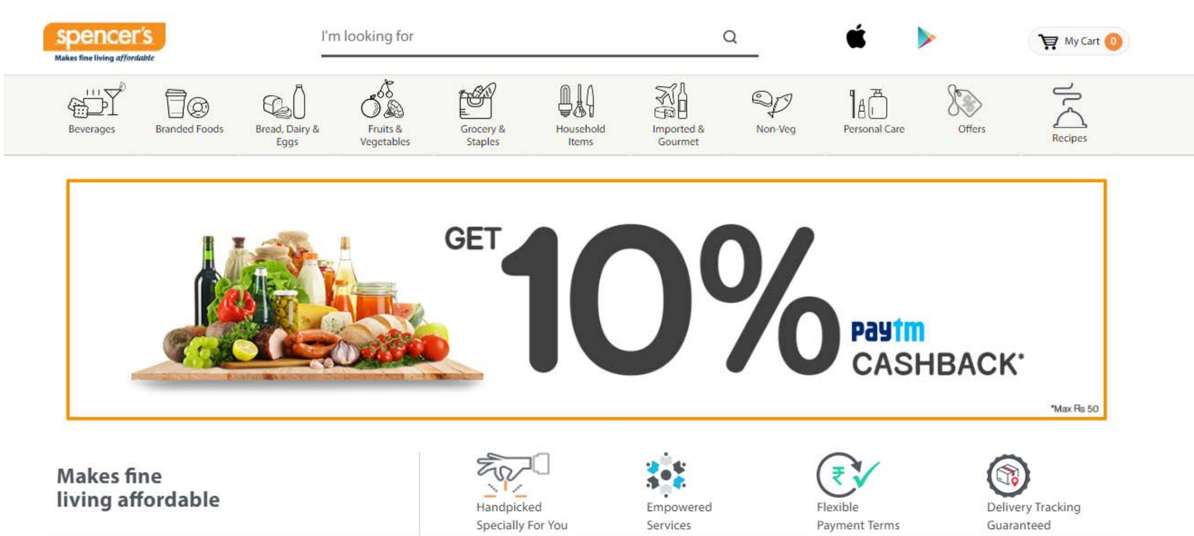
Betting on omni-channel presence

SR is steadily expanding its omni-channel presence and is planning to cover 10-12 cities in the hyper delivery model for online orders. The retail chain launched its online channel in 2016 which is available across Hyderabad, Chennai, Kolkata, Delhi-NCR region and Vishakhapatnam. SR proposes to cover around 10-12 cities for online shopping.

Currently, SR operates 125 stores, including 40 large-format ones in 35 cities in India and the company will leverage these physical stores for online order deliveries. The response from online orders has been encouraging and the company is planning on expanding the coverage.

Grocery makes up for a bulk of the USD616bn Indian retail market. It is also still early days in online grocery, with players cumulatively clocking sales of USD1bn in FY17.

Fig. 1: SR—Online website



Source: Company

Company Description

SR, operating under brand Spencer's, is the retail offering of the RP Sanjiv Goenka group. It has 3 formarts: (i) hypermarkets (20,000-35,000 sq ft), (ii) super markets (5,000-10,000 sq ft); and daily stores (2,000-3,500 sq ft). Daily stores, which are 2,000-3,500 sq ft, cater to daily & weekly needs of consumers and stock an assortment of fruits and vegetables, food and non-food FMCG products, staples and frozen foods. Hypermarkets, which are 20,000-35,000 sq ft, stock an assortment of food, fashion, home & personal care, general merchandise, electrical & electronics, staples, frozen foods and specialty products. SR also has its own brands across food, fashion, home and general merchandising. Some of its brands are *Tasty wonders, Trusted value, Clean home, Mark Nicolas, Care & esentialz,* among others.

Currently, SR operates 125 stores across 35 cities. The company's other major bet is its omni-channel presence. The retailer has its own e-commerce platform, Omnipresent Retail India through a 100% subsidiary to facilitate online ordering and home delivery of groceries and other items. The company is planning to roll out 50-60 hypermarket stores over the next 4 years.

Table 1: Different store formats

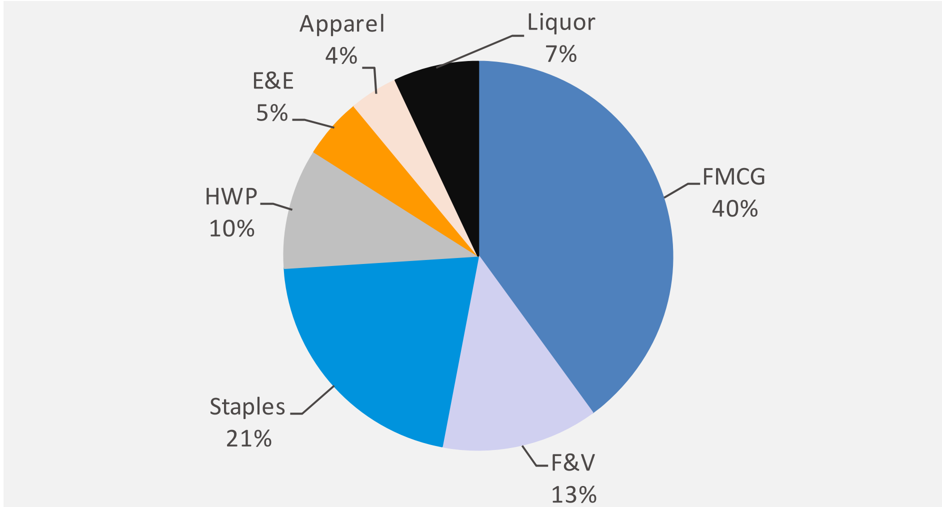
INR mn	FY12	FY13	FY14	FY15	FY16	FY17
Hyper Market (average size of 23,000 sq ft)	26	25	34	34	36	39
Super Market (average size of 6,700 sq ft)	15	14	13	13	12	17
Daily Market (average size of 2,220 sq ft)	141	92	81	79	70	68
Total	182	131	128	126	118	124

Source: Company, Edelweiss research

Fig. 2: Spencer store

Source: Company

Chart 4: Revenue mix as at H1FY18



Source: Company, Edelweiss research

Key Personnel

Mr. Shashwat Goenka, Head, Retail

Mr. Shashwat Goenka currently heads SR as Sector Head. After graduating from the Wharton School at the University of Pennsylvania, he joined the group and worked across many of its companies including Power, Manufacturing, Media & Entertainment. In his current role as Sector Head, Mr. Goenka leads the management of SR. Currently, he is on the Board of Firstsource Solutions (the group's BPO services company), Phillips Carbon Black (one of the largest producers of carbon black in India) and Retailers Association of India.

Mr. Vipin Bhandari, Deputy CEO

Mr. Vipin Bhandari has been Deputy Chief Executive Officer of SR since August 2015. Earlier, he served as Chief Executive Officer of HyperCITY Retail (India) since August 2014. Mr. Bhandari was earlier with Dubai-based Landmark Group, having worked across retail formats in Dubai and India. He served as Chief Operating Officer at Max Hypermarkets India. He is a chartered accountant by qualification.

COMPANY PROFILE

TRIBHOVANDAS BHIMJI ZHAVERI

Old is gold

India Equity Research| Retail

Tribhovandas Bhimji Zaveri (TBZ) is a 150-year-old jewellery retailer in India with 33 showrooms in 26 cities across 11 states, with a total carpet area of approximately 100,000 sqft. The company is primarily focused on gold and diamond-studded jewellery along with foray into platinum and jadau jewellery. Its flagship showroom in Zaveri Bazar, Mumbai, was established in 1864. Since 2001, TBZ has opened several showrooms, and currently has 33 outlets out of which 4 are franchisee. TBZ has recently expanded through the franchisee route and the new thrust on an asset light model augers well for the company. With increasing formalisation of the economy and customers increasingly seeking extraordinary jewellery designs of the finest quality and craftsmanship, we believe that TBZ is well-positioned to tap the growth in the Indian gems and jewellery industry. 'NOT RATED'.

Leveraging of strong brand to drive sales

TBZ has been a very strong brand historically since its iconic store opened in Zaveri Bazar in 1864. TBZ's moat lies in its jewellery designs and providing consumers with a wide range of designs tailored for diverse purposes beyond the traditional Indian wedding jewellery. Additionally, it has been also been enhancing overall consumer experience by providing a better ambience at the showrooms.

Expansion through franchisee route to improve operating metrics

The company is going through planned expansion of self owned and franchisee-owned stores, while trying to optimise costs. It plans to increase its retail presence to 150,000 sq ft. TBZ plans to carry out 75% of expansion through the franchisee route and balance 25% through addition of own stores.

Outlook and valuations: Positive; 'NOT RATED'

We expect TBZ due its strong brand equity, exquisite designs and expansion through franchisee route to be a big beneficiary of the growth in the organised market. The stock currently trades at 42.5x FY17.

Financials (INR mn)

Year to March	FY14	FY15	FY16	FY17
Revenues (INR mn)	18,181	19,342	16,548	17,002
Rev. growth (%)	*NA*	*6.4*	*(14.4)*	*2.7*
EBITDA (INR mn)	1,327	748	396	722
Adjusted Profit (INR mn)	551	173	(231)	185
Adjusted Diluted EPS (INR)	8.3	2.6	(3.5)	2.8
EPS growth (%)	*NA*	*(68.6)*	*(233.6)*	*(180.1)*
Diluted P/E (x)	14.3	45.5	(34.1)	42.5
EV/EBITDA (x)	9.6	17.8	35.3	18.1
ROAE (%)	4.6	3.8	(5.1)	4.1

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA *(R: TBZL.BO, B: TBZL IN)*

CMP	: INR 123
Target Price	: NA
52-week range (INR)	: 148 / 61
Share in issue (mn)	: 66.7
M cap (INR bn/USD mn)	: 8 / 129
Avg. Daily Vol.BSE/NSE('000)	: 619.5

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	74.1	74.1	74.1
MF's, FI's &	0.1	0.1	0.1
FII's	2.0	2.0	3.3
others	23.8	23.8	22.5

** Promoters pledged shares (% of share in issue) : 0*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	3.6	(2.3)	(5.9)
3 months	7.5	4.9	(2.0)
12 months	26.4	98.1	54.5

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January 2, 2018

Leveraging strong brands to bolster sales

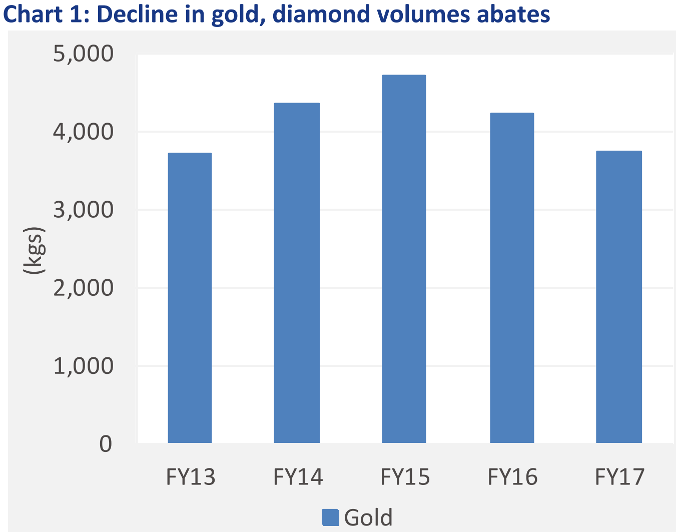
TBZ has been one of the oldest jewllery brands in the country. Its iconic store at Zaveri Bazaar was established in 1864. Since FY16, TBZ has ventured into the franchisee route to become available at under-served areas like Bihar and Jharkhand.

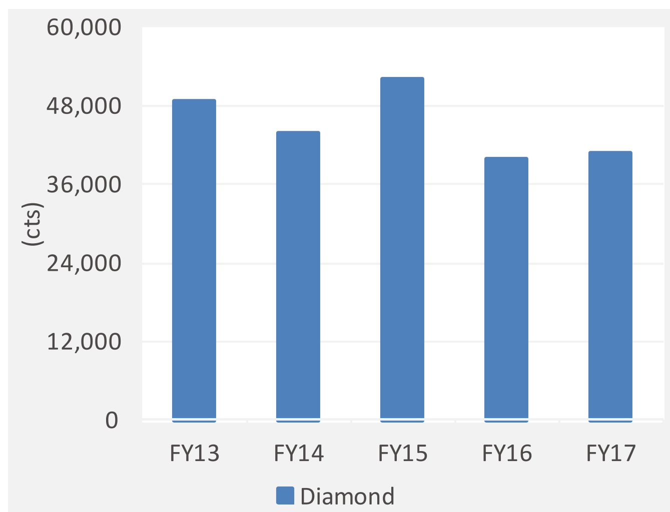
The company has been a very strong brand historically and offers extraordinary jewellery designs of finest quality and craftsmanship. It is in the midst of planned expansion of self-owned and franchisee stores, while trying to optimise costs. TBZ's moat lies in its jewellery designs and offering its patrons with a wide range of designs meeting diverse occasions beyond the traditional Indian wedding jewellery. Additionally, it has been enhancing overall consumer experience by providing better ambience at its showrooms.

Declining revenue per store

During March and April 2016, TBZ's business was impacted by the country-wide agitations by the gems & jewellery industry protesting the imposition of 1% excise duty. Business operations took some time to stabilise, however, this impacted overall revenues and profits during FY16 and FY17. DeMon also impacted jewellery sales in November 2016, though the situation gradually improved over Q4 FY17.

Chart 1: Decline in gold, diamond volumes abates



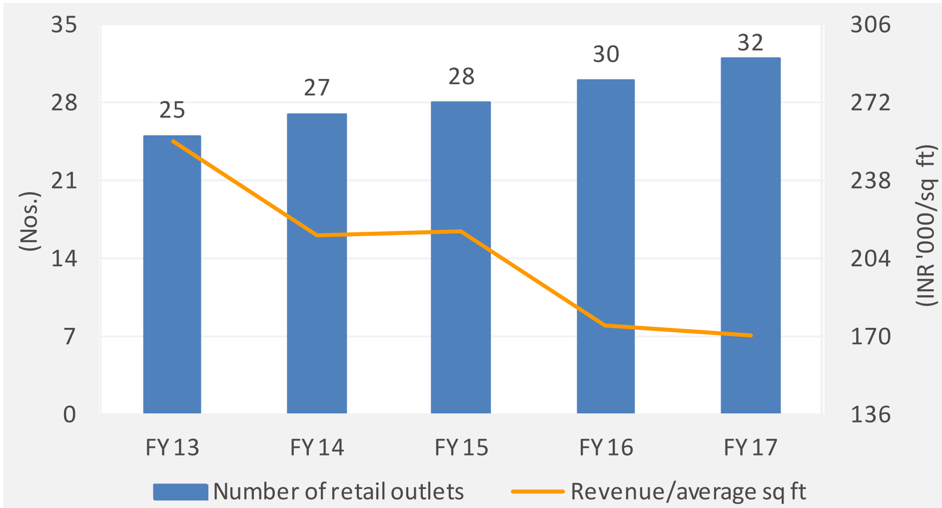


Source: Company, Edelweiss research

Expansion through franchisee route to improve operating metrics

TBZ has an expansion plan to increase its retail space from ~100,000 sq. ft. at present to ~150,000 sq. ft. by 2020. TBZ plans to carry out 75% of expansion through the franchisee route and balance 25% through addition of own stores. It opened its first franchisee store in Dhanbad in November 2015. It has since opened 4 more franchisee stores. The company plans to focus more on franchisee stores and reduce dependence on own stores (60:40 mix). This will help it scale up its domestic operations at faster pace without expanding its balance sheet size, resulting in improved return ratios.

Chart 2: Expansion via franchisee route



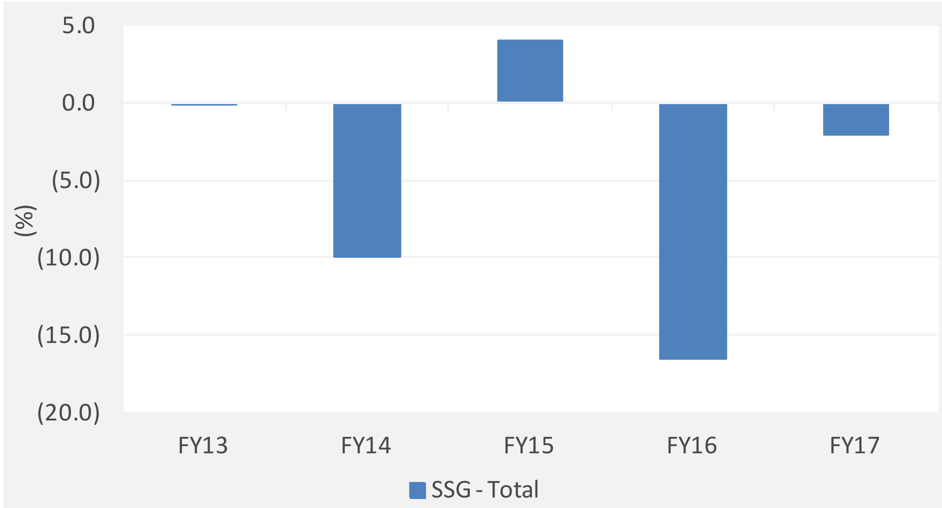
Source: Company, Edelweiss research

Table 1: Stores snapshot

Number of stores	Till date
Large format	28
Small format	5
Total stores	33
Total area (sq ft)	~100,000

Source: Company, Edelweiss research

Chart 3: Weak SSG at the cusp of turnaround



Source: Company, Edelweiss research

Company Description

TBZ is a 150-year-old jewellery retailer in India with 33 showrooms in 26 cities across 11 states, with a total carpet area of ~100,000 sq ft. The stores are focused on gold and diamond-studded jewellery. The company is also present in platinum and jadau jewellery. Designing and manufacturing of products are done either in-house or by third parties.

All its showrooms trade under the name of "Tribhovandas Bhimji Zaveri". Its flagship showroom in Zaveri Bazar, Mumbai, was established in 1864. Since 2001, TBZ has opened 33 showrooms across the country including 4 franchisee stores. The company's presence in the Indian market has been marked by a number of firsts such as it was the first to offer buyback guarantee on gold jewellery, to promote the concept of light-weight jewellery and to offer certified solitaire diamonds.

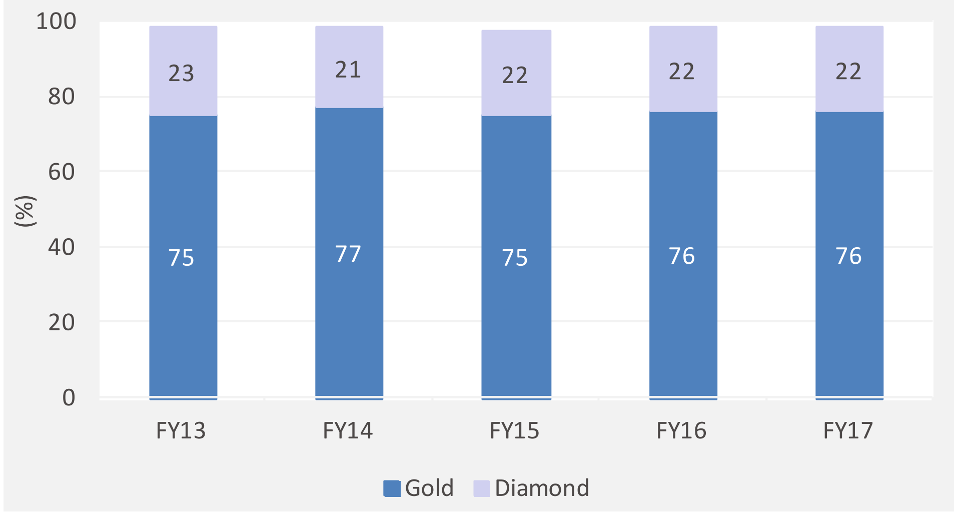
Table 2: Milestones

Years	Description
1864	Flagship store opened in Zaveri Bazaar, Mumbai
1938	First to offer buyback guarantee
1995	First to launch light weight jewellery
2001	Mr Shrikant Zaveri took over the business
2004	Introduced 100% pre-hallmarked jewellery
2008	Retail footprint crosses 42k sq ft across 13 stores
2009	Turnover crossed INR5,000mn in FY09
2011	Diamond facility expansion - ~6k to ~24k sq ft
2012	Listed on BSE & NSE with IPO of INR2,000mn
2013	Retail footprint crosses 84k sq ft across 20 cities; sales crossed INR16,000
2015	First franchise store opened at Dhanbad, Jharkhand in Nov 15
2016	Second franchise store opened at Patna, Bihar in Aug 16
2017	Third franchise store opened in Ranchi, Jharkhand in Mar 17; fourth franchise store opened in Jamnagar, Gujarat in Apr 17

Source: Company

The proportion of gold to diamond sales has been constant at ~76:24.

Chart 4: Revenue mix



Source: Company

Manufacturing set up

Gold jewellery manufacturing is outsourced to various vendors. TBZ has a nation-wide network of 150 vendors. Each vendor has an annual gold processing capacity of more than 100kgs. These vendors have been associated with the company since generations and are experts in handmade regional jewellery designs. Dimaond jewellery manufacturing happens in-house leading to exclusive designs, lower costs and higher margins. TBZ has a manufacturing facility at Kandivali, Mumbai spread over ~24,000 sq ft with capacity of ~200,000 cts (on dual shift basis). The facility also has capacity for 4,000 kg of gold refining and 4,500 kg of gold jewellery components manufacturing.

Fig. 1: Renowned exquisite designs

Source: Company

Key Personnel

Mr. Shrikant Zaveri, Chairman

Mr Zaveri has rich experience of more than 34 years in the Gems and Jewellery industry. He has completed his education up to matriculation. He took over as the managing partner of the business in 2001. He continued his forefather's business with 1 flagship store at Zaveri Bazar, and put in immense efforts. Mr. Zaveri was the founding member and chairman of the Gems and Jewellery Trade Federation. He was awarded the Retail Jewellery Award for lifetime achievement in 2007. He also won the Retail Leadership Award from the Asia Retail Congress in 2013.

Ms. Binaisha Zaveri, Whole-time Director

Ms. Zaveri holds a bachelors degree in marketing and finance from the Stern School of Business, New York. She joined the business in 2004 and has an experience of more than 12 years. She is involved in all aspects of business including human capital management, operations, finance, business development, marketing and merchandising. She is actively involved and has been a key player in the opening of showrooms in 23 cities across 10 states.

Ms. Raashi Zaveri, Whole-time Director

Ms. Raashi Zaveri holds a bachelors degree in finance and entrepreneurship from the Kelly School of Business, Indiana University and is a graduate gemologist from the Gemological Institute of America. She joined the business in 2008 and has experience of more than 8 years. She is involved in the management of TBZ's enterprise resource planning systems and actively engaged in accounting, merchandising and general corporate management.

Mr. Kamlesh Vikamsey, Independent Director

Mr. Vikamsey is a bachelor in commerce from the University of Mumbai and a qualified chartered accountant. He has more than 33 years of experience in Accounting and Finance, Taxation, Corporate and Advisory services. He is a Member of Independent Management Advisory Committee (IMAC) of International Telecommunication Union (ITU), Geneva, Switzerland, External Audit Committee (EAC) of International Monetary Fund (IMF), Washington D.C., USA Audit Committee of United Nations Childrens Fund (UNICEF), New York, USA. Mr. Vikamsey joined the TBZ Board on August 26, 2010 and made valued contribution to the Board of Directors. He is Chairman of the Audit Committee and member of the Nomination and Remuneration Committee.

Mr. Ajay Mehta, Independent Director

Mr. Mehta holds a bachelors degree in science from University of Mumbai and a masters degree in chemical engineering from the University of Texas. He has over 31 years of experience with chemical, petrochemical, fertiliser, manufacturing and investment companies. He is presently the Managing Director of Deepak Nitrite. He is a member of the executive Committee of Maharashtra Chamber of Commerce, Industries and Agriculture and various other developmental institutions and social organisations.

Financial Statements

Income statement (INR mn)

Year to March	FY14	FY15	FY16	FY17
Net revenues	18,181	19,342	16,548	17,002
Cost of materials	15,097	16,701	14,195	14,519
Gross profit	3,085	2,641	2,353	2,484
Employee costs	614	567	660	743
Advertisement & sales costs	442	633	509	374
Others	702	692	789	645
EBITDA	1,327	748	396	722
Depreciation	100	84	101	87
EBIT	1,227	665	295	635
Interest Expense	464	502	557	502
Other income	66	145	46	34
Exceptional items	-	87	-	-
Profit before tax	830	395	(216)	166
Provision for tax	279	135	15	(19)
Reported Profit	551	260	(231)	185
Excep. Items (Net of Tax)	-	87	-	-
Adjusted Profit	551	173	(231)	185
No. of Shares outstanding	67	67	67	67
Adjusted Basic EPS	8.3	2.6	(3.5)	2.8
No. of Dil. shares OS	67	67	67	67
Adjusted Diluted EPS	8.3	2.6	(3.5)	2.8
Adjusted Cash EPS	9.7	3.8	(2.0)	4.1
Dividend per share (DPS)	2.3	1.0	-	-
Dividend Payout Ratio (%)	27.4	38.6	-	-
Tax rate	33.7	34.1	(7.1)	(11.4)

Common size metrics (%)

Year to March	FY14	FY15	FY16	FY17
Cost of materials	83.0	86.3	85.8	85.4
Employee costs	3.4	2.9	4.0	4.4
Advertising & sales costs	2.4	3.3	3.1	2.2
Other general expenditure	3.9	3.6	4.8	3.8
Depreciation	0.5	0.4	0.6	0.5
Interest Expense	2.5	2.6	3.4	3.0
EBITDA margin	**7.3**	**3.9**	**2.4**	**4.2**
EBIT margin	6.8	3.4	1.8	3.7
Net profit margin	3.0	0.9	(1.4)	1.1

Growth metrics (%)

Year to March	FY14	FY15	FY16	FY17
Revenues	NA	6.4	(14.4)	2.7
EBITDA	NA	(43.6)	(47.1)	82.4
PBT	NA	(52.4)	(154.7)	(177.0)
Adjusted Profit	NA	(68.6)	(233.6)	(180.1)
EPS	NA	(68.6)	(233.6)	(180.1)

Balance sheet (INR mn)

As on 31st March	FY14	FY15	FY16	FY17
Share capital	667	667	667	667
Reserves & Surplus	3,810	3,988	3,757	3,942
Shareholders' funds	4,477	4,656	4,424	4,610
Long term borrowings	165	120	75	1
Short term borrowings	5,469	5,667	6,384	5,474
Total Borrowings	5,634	5,787	6,459	5,475
Long Term Liab. & Provisions	63	77	90	91
Sources of funds	**10,107**	**10,519**	**10,974**	**10,176**
Gross Block	1,262	1,333	1,439	1,448
Net Block	921	1,017	1,034	983
Capital work in progress	16	50	-	18
Intangible Assets	19	27	19	10
Total Fixed Assets	956	1,093	1,053	1,011
Non current investments	30	31	31	31
Cash and cash equivalents	729	326	383	306
Inventories	11,119	11,137	11,256	10,272
Sundry Debtors	29	8	7	22
Loans & Advances	204	253	243	310
Other Current Assets	24	5	6	3
Total Curr. Assets (ex cash)	11,375	11,403	11,512	10,607
Trade payable	799	1,109	913	773
Ot. Cur. Liab. & Sh. Term Prov.	2,184	1,228	1,093	1,005
Total Current Liab. & Prov.	2,983	2,337	2,005	1,778
Net Current Assets (ex cash)	8,392	9,066	9,507	8,829
Uses of funds	**10,107**	**10,519**	**10,974**	**10,176**
Book Value per share (INR)	67	70	66	69

Free cash flow (INR mn)

Year to March	FY14	FY15	FY16	FY17
Reported Profit	551	260	(231)	185
Add: Depreciation	100	84	101	87
Interest (Net of Tax)	307	331	596	559
Others	387	104	(50)	(75)
Less: Changes in WC	1,254	589	328	(753)
Operating cash flow	90	190	89	1,509
Less: Capex	154	44	106	5
Free Cash Flow	(64)	146	(17)	1,504

Cash flow metric

Year to March	FY14	FY15	FY16	FY17
Operating cash flow	90	190	89	1,509
Financing cash flow	481	(524)	36	(1,535)
Investing cash flow	(558)	264	(109)	7
Change in cash	13	(70)	17	(19)
Capex	(154)	(44)	(106)	(5)
Dividends paid	(151)	(67)	-	-

Ratios

Year to March	FY14	FY15	FY16	FY17
ROAE (%)	4.6	3.8	(5.1)	4.1
ROCE (%)	8.7	7.9	3.2	6.4
Debtors Days	39	4	5	6
Inventory Days	579	243	289	271
Payble Days	263	21	23	21
Cash Conversion Cycle	356	227	271	255
Current Ratio	4.1	5.0	5.9	6.1
Gross Debt/EBITDA	4.2	7.7	16.3	7.6
Gross Debt/Equity	1.3	1.2	1.5	1.2
Adjusted Debt/Equity	1.3	1.2	1.5	1.2
Net Debt/Equity	1.1	1.2	1.4	1.1
Interest Coverage Ratio	2.6	1.3	0.5	1.3

Operating ratios

Year to March	FY14	FY15	FY16	FY17
Total asset turnover	1.6	1.9	1.5	1.6
Fixed asset turnover	(18.2)	19.5	15.8	16.6
Equity turnover	1.5	4.2	3.6	3.8

Valuation parameters

Year to March	FY14	FY15	FY16	FY17
Adjusted Diluted EPS (INR)	8.3	2.6	(3.5)	2.8
Y-o-Y growth (%)	*(100.7)*	*(68.6)*	*(233.6)*	*(180.1)*
Adjusted Cash EPS (INR)	9.7	3.8	(2.0)	4.1
Diluted Price to Earnings Ratio	14.3	45.5	(34.1)	42.5
Price to Book Ratio (P/B) (x)	1.8	1.7	1.8	1.7
Enterprise Value / Sales (x)	0.7	0.7	0.8	0.8
Enterprise Value / EBITDA (x)	9.6	17.8	35.3	18.1
Dividend Yield (%)	1.9	0.8	-	-

COMPANY PROFILE

V2 RETAIL

New play from old guard

India Equity Research| Retail

Edelweiss
Ideas create, values protect

V2 Retail (V2), signifying 'Value and Variety', is one of the fastest growing organized retail apparel companies (revenue CAGR of 27.3% over FY14-17) in India. In its first innings as Vishal Retail, the company suffered losses and the *Vishal* brand was sold in 2011. It has since made a fresh start and currently operates 44 stores across 13 states (primarily in Tier II & III cities) with a total retail area in excess of 0.5mn sq ft. The company primarily focuses on private labels and is scaling up in-house brands across all price points. V2 primarily caters to the 'neo middle class' and 'middle class' living in small towns. It clocked revenue of INR4,714mn and adjusted PAT of INR373mn in FY17. 'NOT RATED'.

Value and variety bolster brand equity

V2 stands for 'Value and Variety', which is its key guiding principle. The company targets customers in Tier II & III cities. V2 provides a wide assortment of apparel and has more than 10,000 SKUs. It is a one-stop family shop which provides a range of products that suit everyone's budget. V2's prices are lower than competitors due to lower mark up margins and stringent cost control. Average selling price differential between V2 and other organised apparel players is ~30-50%.

Prudent cluster-based strategy to expand reach

The company, akin to Vmart and DMart, follows cluster-based strategy to expand its store base. From 6 in 2012 to 44 stores in H1FY18, the company has predominantly expanded in Bihar and UP. This strategy helps tailor inventory as per customer needs of a particular cluster and hence enables it develop own brands and increase the share of private labels. This will help improve SSSG for V2.

Outlook and valuations: Sanguine prospects; 'NOT RATED'

Management's sharpened focus on own brands along with further expansion into tier III towns place V2 ideally to cash in on growth in the organised retail apparel industry. At CMP, the stock trades at 36.9x FY17 EV/EBITDA. The stock is **'NOT RATED'.**

Financials (INR mn)

Year to March	FY14	FY15	FY16	FY17
Revenues (INR mn)	2,289	2,868	3,199	4,714
EBITDA (INR mn)	42	277	314	390
Adjusted Profit (INR mn)	(45)	98	83	139
No. of Shares outstanding (mn)	22	24	25	31
Adjusted Diluted EPS (INR)	(2.0)	4.1	3.3	4.5
EPS growth (%)	(134.3)	(305.6)	(19.1)	34.7
Diluted P/E (x)	(230.7)	112	138.7	102.9
EV/EBITDA (x)	253.2	39.9	38.0	36.9
ROAE (%)	(1.7)	3.6	2.9	4.1

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA *(R: VIRL, B: VREL IN)*

CMP	: INR 464
Target Price	: NA
52-week range (INR)	: 555 / 113
Share in issue (mn)	: 33.9
M cap (INR bn/USD mn)	: 16 / 253
Avg. Daily Vol.BSE/NSE('000)	: 298.6

SHARE HOLDING PATTERN (%)

	Current	Q2FY18	Q1FY18
Promoters *	51.0	51.0	51.0
MF's, FI's & BK's	2.1	2.6	2.1
FII's	6.0	8.80	6
Others	40.9	37.6	41.0
** Promoters pledged shares (% of share in issue)*	:		*36.5*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	3.6	9.0	5.4
3 months	7.5	2.9	(4.6)
12 months	26.4	215.3	188.9

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January 2, 2018

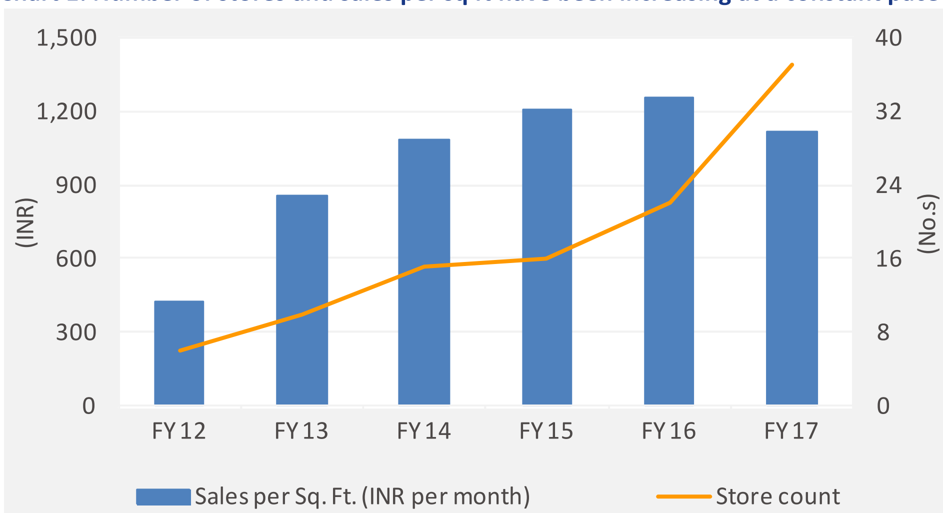
Value and variety bolster brand equity

V2 is one of the fastest growing retail companies in India (revenue CAGR of 27.3% over FY14-17) operating across tier II & III cities. The company operates on principles of value and variety at reasonable price to customers. It primarily caters to the neo middle class and middle class living in small towns. V2 has expanded operations to 13 states across 35 cities and 44 stores. Its total retail area is in excess of 0.5mn sq ft.

The company opened 15 stores in FY17 and intends to open 15 more in FY18 (7 stores already opened in H1FY18). All V2 stores are air conditioned, have trial rooms and modern shopping environment, with the average store size being 10,000-12,000 sq ft. V2 is a one-stop family shop that provides a rich shopping experience at prices lower than competitors due to lower mark up margins and stringent cost control.

"I started the store myself, I sold from the counter, I bought everything myself, I did the accounts. I believed that I could do everything efficiently but what I learnt was that even if your second in command does the same job half-efficiently, you should pass on the load." – Ram Chandra Agarwal, Managing Director

Chart 1: Number of stores and sales per sq ft have been increasing at a constant pace



Source: Company, Edelweiss research

Table 1: Strong presence across states with underpenetrated retail organised market

States	Number of stores
Bihar	14
Uttar Pradesh	8
North East	4
Odisha	2
Jharkhand	1
West Bengal	1
Himachal Pradesh	1
Karnataka	1
NCR	3
Uttarakhand	2

Source: Company, Edelweiss research

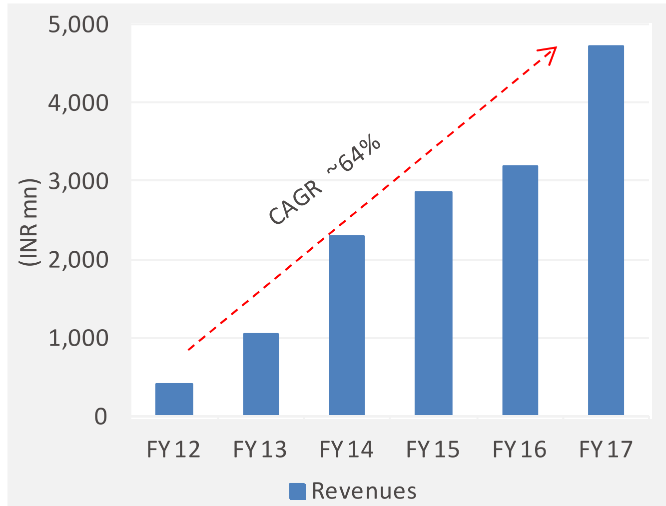
Prudent cluster-based approach to expand reach

V2 follows cluster-based strategy to expand its store base, akin to VMart and DMart. From 6 stores in 2012 to 44 in H1FY18, the company has increased its store count at ~44% CAGR. The company added 15 stores in FY17 and is planning addition of 15 more in FY18 (7 already added in H1FY18). Clustering helps tailor inventory as per customer needs of a particular area and thus enables the retail chain to serve its customers in an effective manner.

This approach has led to V2 clocking 27.3% revenue CAGR over FY14-17. Its EBITDA margin has also improved from 1.9% in FY14 to 8.3% in FY17.

Fig. 1: V2 stores

Chart 2: Revenue has clocked 64% CAGR over FY12-17



Source: Company, Edelweiss research

Company Description

V2 (formerly Vishal Retail) was incorporated in 2001 with an objective of providing merchandise to masses at affordable prices. The company went Public in 2007. The brand *Vishal* was sold in 2011 due to operational losses.

The company, renamed V2 Retail, primarily operates in Tier II & III cities with a chain of *V2 Retail* stores offering apparels and general merchandise, catering to the entire family. The company currently operates 44 stores spread across 13 states with a total retail area in excess of 0.5mnsq ft. It has posted per sq ft sales of more than INR1,100 per month for the past 3 years—the best amongst apparel retailers.

V2 is a one-stop family shop with a comprehensive portfolio of offerings to suit everyone's budget. Its value offerings are smart, trendy and fashionable apparels at affordable prices. Variety represents providing latest style and fashion across categories under one roof. Red represents smart fashion for the masses. V2 was amongst the pioneers in setting up modern ambience retail stores across various small towns and cities like Patna, Roorkee, Varanasi, Bhuvaneshwar, Ghazipur.

Table 2: The journey so far

Year	Milestones
2001	Incorporated in 2001 as Vishal Retail
2007	Went Public and raised INR1,100mn
2008	Turnover of approx INR10bn
2011	Brand 'Vishal' sold due to operational losses.Changed name from Vishal Retail to V2 Retail
2012	First store in Jamshedpur
2013	Turnover crossed INR1,000mn
2014	Stores increased to 16 with more than 2 lakh sq. feet of retail space. Turnover crossed INR2,250mn
2016	Number of stores increased to 22, V2 crossed an aggregate of more than 2.60 lakh square feet of retail space and turnover crossed INR3,150mn
2017	Number of stores increased to 37. Crossed an aggregate more than 4.60 lac square feet of retail space. Turnover crossed INR4,700 mn in FY17

Source: Company, Edelweiss research

Chart 3: Revenue mix

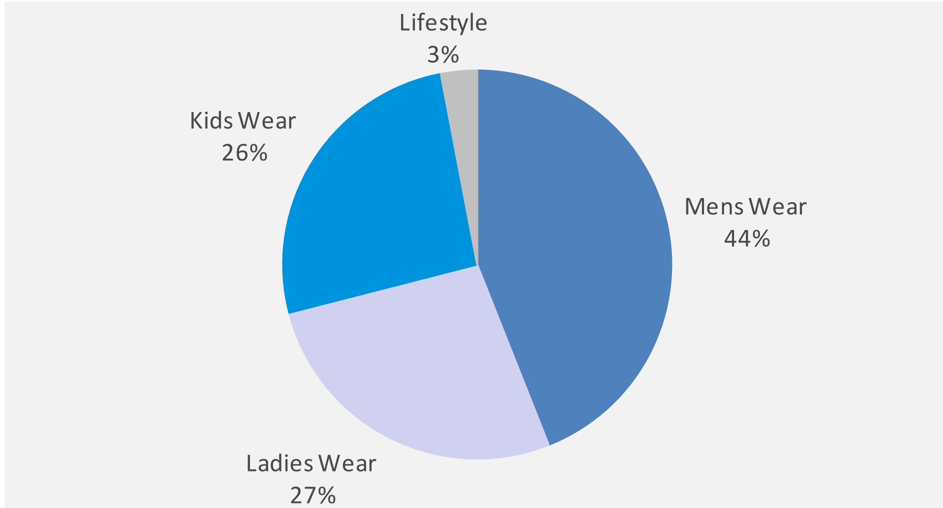
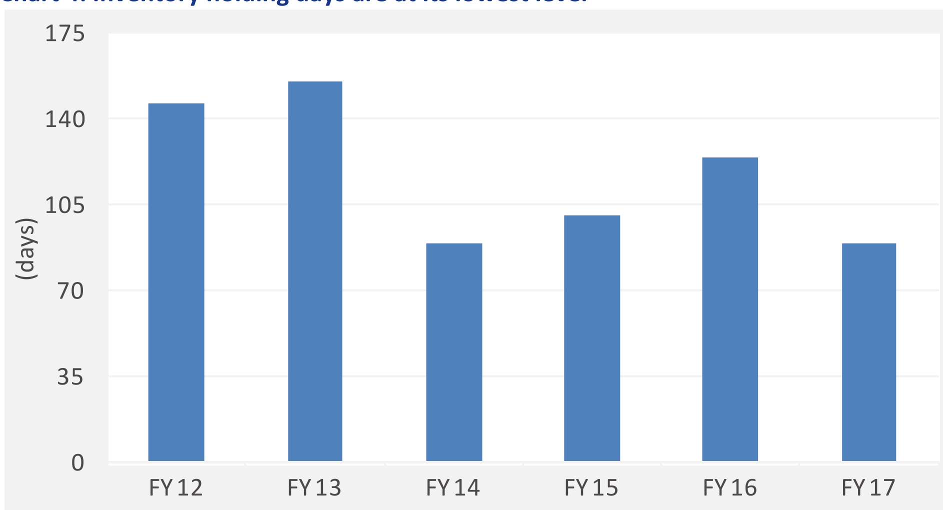


Chart 4: Inventory holding days are at its lowest level



Source: Company, Edelweiss research

Key Personnel

Mr. Ram Chandra Agarwal, Chairman & Managing Director

Mr. Agarwal holds a bachelor's degree in Commerce. He has more than 25 years' entrepreneurial and business experience. He has been a member of the Board of Directors since inception. Mr. Agarwal provides strategic direction to V2. He is the pioneer in value retailing and brought this concept in India. He was conferred several awards at different forums such as Ernst & Young Entrepreneur of the year award in 2008 and 4Ps Power Brand Award in 2007.

Mrs. Uma Agarwal, Whole Time Director

Mrs. Agarwal holds a bachelor's degree in Arts. She has more than 15 years' experience in the retail industry. She has been a member of V2's Board of Directors since inception and oversees its marketing strategies.

Mr. Akash Agarwal, Head - Procurement

Mr. Agarwal is a Commerce graduate. He has more than 5 years of experience in the retail industry.

Mr. Nikhkil Kansal, Retail Head

Mr. Kansal holds a degree in Executive Management Program in Sales & Marketing from IIM Lucknow and Post Graduate Diploma in Business Management from IMT Ghaziabad. He has more than 17 years of experience in the retail industry. Prior to joining V2, he worked with Reliance Retail.

Mr. Pratik Adukia, Head – Merchandising

Mr. Adukia is a Commerce graduate and CA Inter. He has more than 15 years of experience in the retail industry.

Mr. Vipin Kaushik, Chief Financial Officer

Mr. Kaushik is a Chartered Accountant. He has more than 11 years of experience in accounts & finance. Prior to joining V2, he has worked with ONICRA Credit Rating Agency of India and Delhivery.

Mr. Abhishek Khemka, Head - Planning & Sourcing

Mr. Khemka is a Commerce graduate. He has more than 19 years of experience in the retail industry. Prior to joining V2, he has worked with CityKart Retail.

Mr. Gaurav Bajaj, GM - Merchandising

Mr. Bajaj holds a degree in PGDBM (Retail Management) and BE (Electronics). He has more than 20 years of experience in the retail industry. Prior to joining V2, he has worked with Club Central.

Financial Statements

Income statement				(INR mn)
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Net revenues	**2,289**	**2,868**	**3,199**	**4,714**
Cost of materials	1,722	2,054	2,244	3,333
Gross profit	567	814	956	1,381
Employee expenses	159	183	230	333
Rent expense	154	146	179	255
Advertisement & sales costs	35	26	26	80
Electricity expenses	47	50	53	93
S G &A expenses	130	131	154	230
Total operating expenses	525	536	641	991
EBITDA	42	277	314	390
Depreciation & amortization	35	21	44	67
EBIT	8	257	270	323
Less: Interest Expense	81	97	132	86
Add: Other income	22	25	25	20
Add: Exceptional items	-	-	39	233
Profit before tax	(51)	184	202	490
Less: Provision for Tax	(8)	87	80	117
Reported Profit	(43)	98	122	372.55
Less: Prior Period (Net of Tax)	(2)	-	-	-
Less: Exceptional Items (Net of Tax)	-	-	39	233
Adjusted Profit	(45)	98	83	139
No. of Shares outstanding (mn)	22	24	25	31
Adjusted Basic EPS	(2.0)	4.1	3.3	4.5
No. of Dil. shares outstanding (mn)	22	24	25	31
Adjusted Diluted EPS	(2.0)	4.1	3.3	4.5
Adjusted Cash EPS	(0.5)	5.0	5.1	6.7

Common size metrics- as % of revenue				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Cost of materials	75.2	71.6	70.1	70.7
Employee expenses	7.0	6.4	7.2	7.1
Rent and lease	6.7	5.1	5.6	5.4
S G &A expenses	5.7	4.6	4.8	4.9
Total operating expenses	22.9	18.7	20.0	21.0
Depreciation and Amortization	1.5	0.7	1.4	1.4
Interest expenditure	3.5	3.4	4.1	1.8
EBITDA margin	1.9	9.7	9.8	8.3
EBIT margin	0.3	8.9	8.5	6.8
Net profit margins	(2.0)	3.4	2.6	3.0

Growth metrics				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Revenues	116.6	25.3	11.6	47.3
EBITDA	(61.8)	553.5	13.3	24.0
PBT	(150.6)	462.7	9.7	141.9
Adjusted Profit	(134.3)	316.4	(14.6)	67.4
EPS	(134.3)	305.6	(19.1)	34.7

Balance sheet				(INR mn)
As on 31st March	**FY14**	**FY15**	**FY16**	**FY17**
Share capital	224	236	249	309
Reserves & surplus	2,407	2,512	2,711	3,464
Shareholders funds	2,631	2,747	2,960	3,773
Minority Interests	-	-	-	-
Long term borrowings	377	151	431	-
Short term borrowings	-	-	-	88
Total Borrowings	377	151	431	88
Long Term Liabilities & Provisions	51	75	96	121
Deferred Tax Liability (net)	(2,711)	(2,624)	(2,544)	(2,427)
Sources of funds	349	349	943	1,555
Gross Block	187	239	378	670
Net Block	140	181	285	508
Capital work in progress	0	12	39	40
Intangible assets	-	-	-	-
Total Fixed Assets	141	192	324	548
Non current investments	314	304	254	158
Cash and cash equivalents	21	11	31	65
Inventories	555	793	1,089	1,146
Sundry debtors	0	1	3	0
Loans & advances	59	88	195	286
Other Current Assets	0	0	0	0
Total current assets (ex cash)	615	882	1,288	1,432
Trade payable	282	338	366	622
Other Current Liabilities & ST Prov.	512	735	635	71
Total current liabilities & prov.	794	1,074	1,002	693
Net current assets (ex cash)	(179)	(192)	286	739
Uses of funds	349	349	943	1,555
Book value per share	117	117	119	122

Free cash flow				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Reported Profit	(43)	98	122	373
Add: Depreciation	35	21	44	67
Add: Interest Expense (net of tax)	69	52	80	66
Others	6	130	70	(81)
Less: Changes in WC	(52)	(55)	468	428
Operating cash flow	118	355	(151)	(4)
Less: Capex	82	52	139	292
Free cash flow	36	303	(289)	(296)

Cash flow metrices				
Year to March	**FY14**	**FY15**	**FY16**	**FY17**
Operating cash flow	118	355	(151)	(4)
Financing cash flow	(43)	(304)	260	162
Investing cash flow	(71)	(62)	(89)	(124)
Net cash flow	3	(10)	21	34
Capex	(82)	(52)	(139)	(292)
Dividends paid	-	-	-	-

Profitability & liquidity ratios

Year to March	FY14	FY15	FY16	FY17
Return on Avg. Equity (ROAE) (%)	(1.7)	3.6	2.9	4.1
Return on Cap. Emp. (pre-tax) (%)	1.9	9.5	9.4	9.4
Inventory days	44	209	221	203
Debtors days	0.0	31.0	28.3	20.3
Payable days	22	158	156	153
Cash Conversion Cycle	21.8	81.7	93.2	70.2
Current Ratio	1	1	1	2
Gross Debt/EBITDA	8.9	0.5	1.4	0.2
Gross Debt/Equity	0	0	0	0
Adjusted Debt/Equity	0.1	0.1	0.1	0.0
Interest Coverage Ratio	0.1	2.6	2.0	3.7

Valuation parameters

Year to March	FY14	FY15	FY16	FY17
Adjusted Diluted EPS (INR)	(2.0)	4.1	3.3	4.5
Y-o-Y growth (%)	*(134.3)*	*305.6*	*(19.1)*	*34.7*
Adjusted Cash EPS (INR)	(0.5)	5.0	5.1	6.7
Dil. Price to Earnings Ratio (P/E) (x)	(230.7)	112.2	138.7	102.9
Price to Book Ratio (P/B) (x)	3.9	4.0	3.9	3.8
Enterprise Value / Sales (x)	4.7	3.9	3.7	3.0
Enterprise Value / EBITDA (x)	253.2	39.9	38.0	36.9
Dividend Yield (%)	-	-	-	-

Operating ratios

Year to March	FY14	FY15	FY16	FY17
Total asset turnover	11.5	8.2	5.0	3.8
Fixed asset turnover	20.7	17.9	13.7	11.9
Equity turnover	1.7	1.1	1.1	1.4

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Aditya Birla Fashion and Retail Ltd	BUY	SP	L	Future Lifestyle Fashions Limited	BUY	SO	L
Future Retail	BUY	SO	H	Jubilant Foodworks	HOLD	SP	M
Shoppers Stop	BUY	SO	L	Titan Company	BUY	SO	L
Wonderla Holidays	BUY	SP	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Retail

Aditya Birla Fashion and Retail Ltd, Future Lifestyle Fashions Limited, Future Retail, Jubilant Foodworks, Shoppers Stop, Titan Company, Wonderla Holidays

Recent Research

Date	Company	Title	Price (INR)	Recos
21-Nov-17	**Future Retail**	Vision 2047: Tathastu; *Company Update*	516	Buy
16-Nov-17	**Wonderla Holidays**	Price hikes dampen show; *Result Update*	368	Buy
07-Nov-17	**Future Retail**	Big Bazaar sustains double digit growth run; *Result Update*	523	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

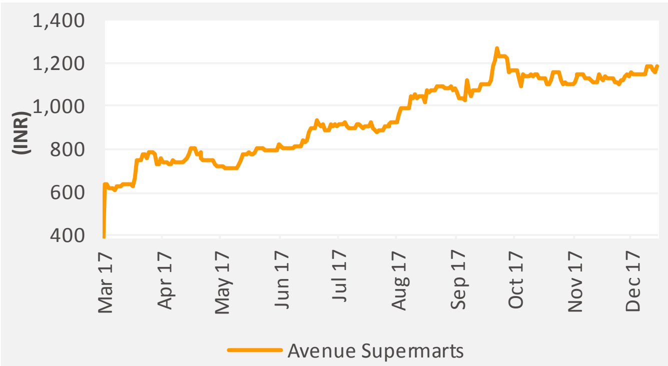
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

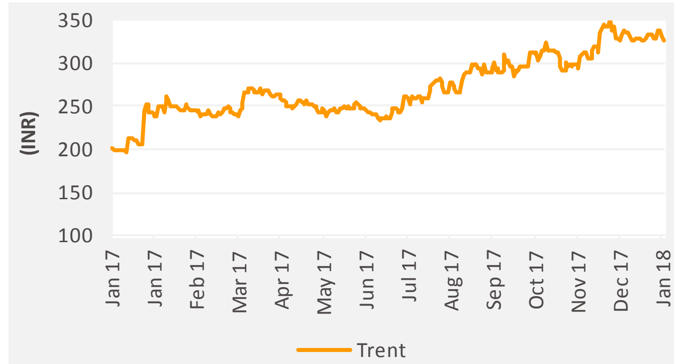
	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

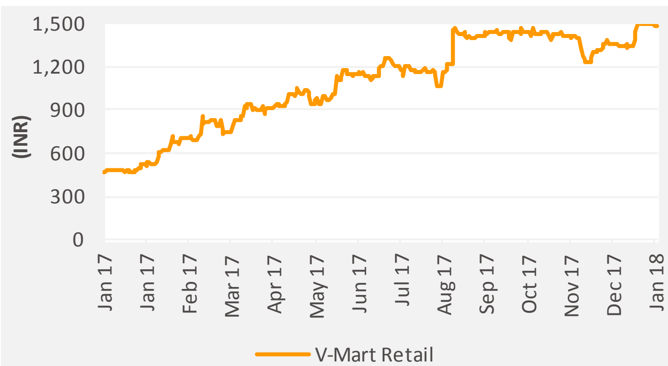
Rating Interpretation

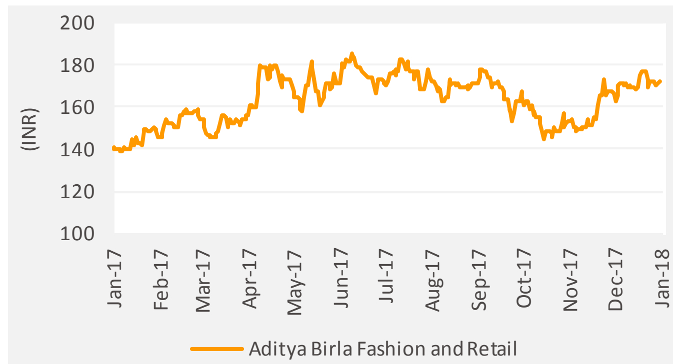
Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

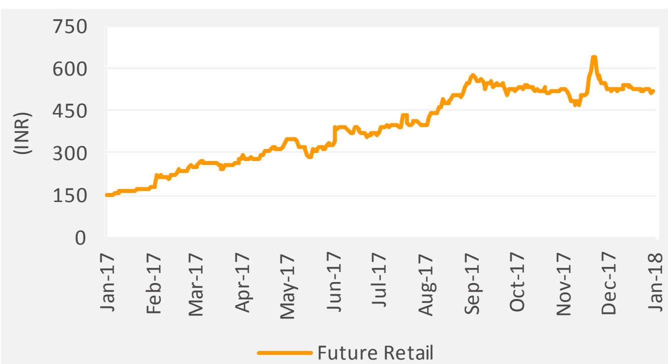
One year price chart

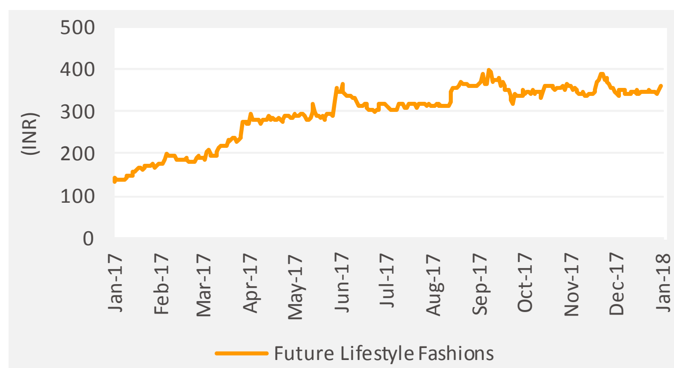


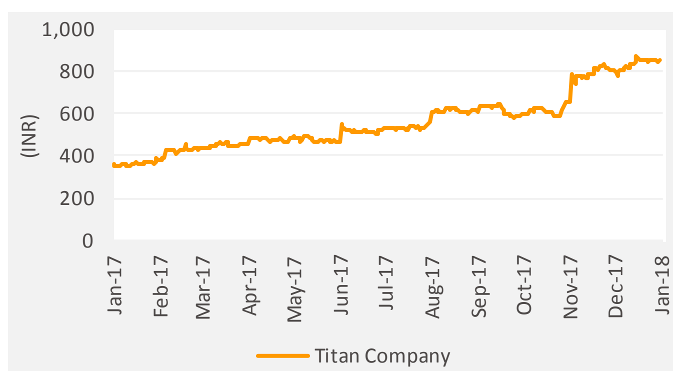


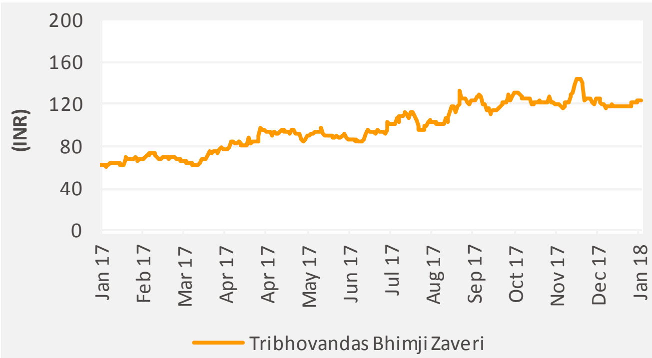








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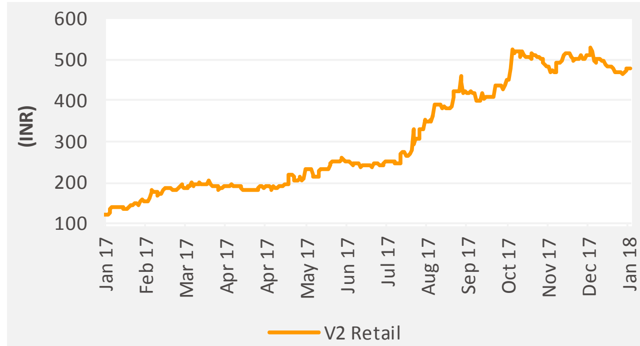
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Aug 17
Sep 17
Oct 17
Nov 17
Dec 17
Jan 18
V2 Retail


600
500
400
300
200
100
(INR)
Jan 17
Feb 17
Mar 17
Apr 17
Apr 17
May 17
Jun 17
Jul 17
Aug 17
Sep 17
Oct 17
Nov 17
Dec 17
Jan 18
PC Jewellers

NOTES:

NOTES:

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