DEALMONEY MONTHLY MAGAZINE

Dealmoney

World-Class Financial Services

SECTOR OF THE MONTH

FMCG

PICKS OF THE MONTH

#1 ABFRL.

#2 AVENUE SUPERMART LTD.

EQUITIES | COMMODITIES | WEALTH | MUTUAL FUNDS | INSURANCE

Sector of the Month (Retail):

- India's immense rural population and increasing number of urbanites have created demand for both basic and more sophisticated consumer goods, thereby offering opportunities for companies across the consumer goods manufacturing spectrum.

- In the decades to come, India will see a substantial increase in the number of nuclear families, both rural and urban. The entry of more women into the workforce will translate into higher demand for convenience goods, directly affecting retail offerings.

- Higher affluence will enable many families to move away from a spending pattern dominated by consumer staples, to one that includes a higher proportion of leisure and cultural activities. Thus, the performance of the retail sector in the country will directly reflect India's transition from emerging to advanced economy.

- The retail sector has been one of the driving forces of the Indian economy, expanding its value added at a CAGR of 11% over FY2013-2017, driven by positive demographic trends, ongoing urbanisation and an increasing middle class population, rapidly adopting a consumerist lifestyle. In FY2017, the trade sector accounted for 9.5% of the country's GDP, 5.4% of total FDI and around 8% of national employment. However, organised trade remains at a nascent stage of development, which, given expectations for a robust increase in consumer spending, anticipates a huge growth trajectory facing the retail market. Indeed, it is set to nearly double to USD 1.1tn by FY2020, up from USD 672bn in FY2016, according to India Brand Equity Foundation (IBEF) projections.

- Household final consumption expenditure, a gauge for retail sales revenues, expanded strongly by 11.3% y/y in FY2017, reaching INR 90.5tn, following the positive trend observed over the FY2012-2017 period (CAGR of 12.9%). The latter was sustained by positive demographic trends, easier access to credit, a strong labour market and rising household income. During the year, non-durable goods and services registered the strongest y/y growth at 12.1% and 11.4% respectively, highlighting increased expenditure on essentials such as food and beverages, clothing, and services in the health, education and transport spectrums. Indeed, Indian households' spending structure follows a pattern that is typical of emerging markets – heavily dominated by consumer staples with only a tiny fraction allocated to non-essentials such as leisure and cultural activities, including dining out, travelling, and going to the cinema or to the theatre. The structure of the consumer basket underpins ample growth potential for retail segments offering consumer products with higher value added, such as branded apparel, footwear, consumer electronics, furniture and household goods.

- At INR 27,188bn in FY2017, food and beverages accounted for 30% of overall household spending in the country, while recreation and culture (INR 698bn) made up just 0.8%. Moreover, among non-durables, the food and beverages category registered the strongest y/y increase at 14.2%, followed by clothing and footwear at 7.3%. Interestingly, in the services sector, spending on health and wellbeing accelerated the fastest in y/y terms at 17.2%, closely followed by education at 16.9%. Spending on transportation, which was the third largest item in the consumer basket in FY2017, also grew significantly by 13.5% y/y.

- In 2017, retail sales remained stable at INR 672bn, decreasing by only 1.2% y/y, according to India Brand Equity Foundation (IBEF). Remarkably, about 93% of retail sales during the year were attributable to unorganised trade, indicating strong growth opportunities for modern retail formats.
- E-tailing is another sub-sector with strong growth prospects, given the relatively low level of e-commerce sales (estimated by the consultancy eMarketer at USD 23bn in 2017), the expanding number of internet users (446mn in 2017, up 3.2% y/y) and the entry into the workforce of the millennial and subsequent generations.

- India's retail sector is highly fragmented, with approximately 152,800 active companies at the end of FY2018. However, to this number should be added around 15 million family-run stores and corner stores (called Kirana) operational in the country, as of June 2018, according to IBEF. This market structure demonstrates a highly competitive environment across the majority of retail segments. According to EMIS Insights estimates, the top 15 companies in the retail sector had combined net sales revenues of INR 1.3tn in FY2017.

Sector in Numbers

1st
Most Attractive Developing Retail Investment Destination Globally

17.9%
CAGR
Retail Sales Growth FY 2017-2020t

11%
CAGR
Trade Sector GVA FY 2012-2016

7.1%
CAGR
Household Final Consumption Expenditure FY 2012-2016

USD
672bn
Retail Sales (IBEF)

INR
157.2bn
Foreign Direct Investment

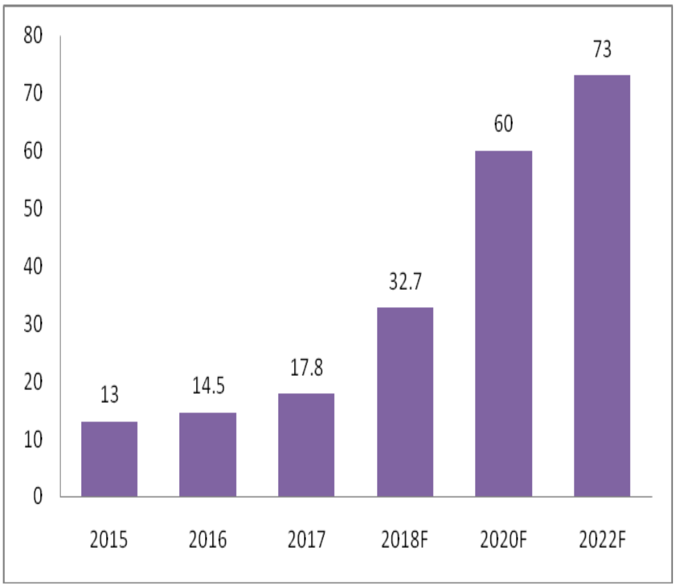
SECTOR'S HIGH GROWTH POTENTIAL IS ATTRACTING INVESTORS

- India has occupied a remarkable position in global retail rankings; the country has high market potential, low economic risk and moderate political risk.
- India's high growth potential compared to global peers has made it more favourable. India is expected to become the world's third-largest consumer economy, reaching US$ 400 billion in consumption by 2025, according to a study by Boston Consulting Group.
- In FDI Confidence Index, India ranked 16th (after U.S., Canada, Germany, United Kingdom, China, Japan, France, Australia, Switzerland and Italy).
- India is ranked first in the Global Retail Development Index 2017, backed by rising middle class and rapidly growing consumer spending.

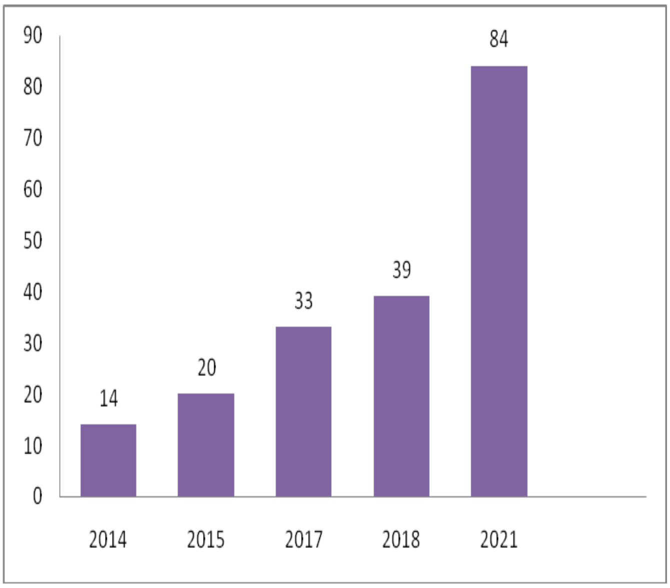
RISING PROMINENCE OF ONLINE RETAIL

- Online retail business is the next generation format which has high potential for growth. Currently, it is estimated to be a US$ 50 billion opportunity. After conquering physical stores, retailers are now foraying into the domain of e-retailing. It had a market size of US$ 18 billion in 2017 and is forecasted to reach US$ 32.70 billion by 2018.
- Online retail market is estimated to reach US$ 60 billion by 2020. The online retail market sales is forecasted to grow at the rate of 31 per cent year-on-year to reach US$ 32.70 billion in 2018. It is projected to reach US$ 73.00 billion by 2022F.
- India's ecommerce industry's sales rose 40 per cent year-on-year to reach Rs 9,000 crore (US$ 1.5 billion) during the five-day sale period ending September 24, 2017, backed by huge deals and discounts offered by the major ecommerce companies. It is forecasted to reach US$ 53 billion by 2018.
- The government plans to allow 100 per cent FDI in e-commerce, under the arrangement that the products sold must be manufactured in India to gain from the liberalised regime.

Online retail in India (US$ billion)



Indian E-Commerce Market (US$ billion)



Growth Drivers

- **Demography:** The growth of the retail sector in India has solid demographic roots. Being the second-largest country in the world in terms of population, India enjoys a “demographic dividend” of almost 1.3bn people as of FY2017. Most importantly, 33% of these people are in the 20-39-year bracket, according to BMI Research. This large, young population forms an excellent consumer base. An increase in income over recent years is another key factor behind the expansion of the retail sector. In FY2017, gross disposable per capita income rose by 44.4% compared to FY2013 levels, reaching INR 118,990. Spending patterns followed suit, with private expenditure per capita growing by 52.5% in FY2017 vs FY2013, to INR 69,322.

- **Household Consumption**: Favourable demographics and an ongoing increase in disposable income have fuelled household final consumption expenditure in India, which witnessed a strong CAGR of 12.5% over FY2013-2017. Given the income structure of Indian society, where the majority of households fall in the below-middle income bracket, household budgets are dominated by essential goods and services. As per BMI estimates, around two-thirds of total household retail spending in 2017 was dedicated to food and non-alcoholic drinks, housing and utilities, transport, and communications. Accordingly, in FY2017, some 90% of household final consumption expenditure fell in the broad categories of services and non-durable goods, as per national statistics data.

- **Retail Sales:** According to a report of the India Brand Equity Foundation (IBEF) from May 2018, retail sales in India expanded at a strong CAGR of 8.2% over the 2013-2017 period. In recent years, growth has been boosted by a rise in personal disposable income, stemming from a strong labour market and growing wages, coupled with positive demographic trends (increasing population and urbanisation rate).

- **FDI:** In recent years, the government has taken several steps to promote FDI as the major entry mode in the retail sector. As of May 2018, the government had allowed 100% of FDI under the automatic route regime (i.e. without prior approval) in the cash and carry (wholesale trade), the marketplace model of e-commerce, as well as in single-brand retail. However, FDI in multi-brand retail has kept its 51% cap and remains contingent on fulfilment of certain conditions regarding local sourcing and investment in back-end infrastructure. One explanation for the government’s reluctance to further facilitate FDI in multi-brand retail is that this would threaten a key political segment – traditional small retailers. Apart from these restrictions, there are no other major entry barriers to new players, which may opt for either greenfield investments or acquisition of local players.

- **Opportunities:** The low share of organised trade (7% in FY2017), coupled with rising household incomes and growing aspirational levels of the population, will drive demand for modern retail formats, which are expected to be one of the growth pillars of the retail sector in the coming years. In terms of product category, rising income and changing consumer habits will propel demand for branded apparel and footwear, jewellery, beauty and personal care products, consumer electronics and household goods. However, food and beverages are expected to retain the largest portion of the consumer basket by 2020, outlining a spending structure that is dominated by essentials and is typical of emerging markets with low purchasing power.

Source: Ace equity, CARE, IBEF

Pick of the Month (Avenue Supermart Ltd.): CMP: 2249 Target: 2560

Avenue Supermarts Limited (ASL), doing business as DMart, owns and operates a chain of hypermarkets and supermarkets. The Company offers foods, kitchenware, garments, footwears, toys, games, bath linen, stationery, grocery, household, and electronic products. DMart serves customers in India.

Strong Q3: Gross margin improved in the consecutive third quarter (30bps in Q3FY20). Comparable EBITDA margin improved by 20bps YoY led by better product mix. We assume higher Gross margin for the near future considering continuous improvement in the first three quarters but continue to assume ~15% for the long-term due to DMart's 'Every Day Discount' model. Expect EBITDA growth of ~29% CAGR over FY19-22E.

Store addition was strong: Revenue growth was at ~24% YoY supported by growth in new store additions. The company has added 7 new stores in Q3FY20 Vs 4 stores YoY. DMart is now considering leased stores also to accelerate growth. Any QIP placement of additional shares will support accelerated store additions. We expect revenue growth at ~26% CAGR over FY19-22E.

BOD approval for QIP issuance to accelerate store additions: BOD has recently approved issuance of 2.5cr equity shares (~Rs47bn at CMP) through a qualified institutions placement. Though this may lead to dilution in EPS (4%), we believe this could support faster pace of store additions.

Valuation: We believe that DMart's strong growth in earnings should continue aided by faster store additions, reduction in debt and tailwinds from GST which will support higher premium in the medium term. Currently, the stock is trading at the PE of 111.2x TTM FY20. We recommend buy in ***Avenue Supermart Ltd.*** at the CMP of **Rs. 2249** with the target price of **Rs.2560.**

NSE / BSE Code	DMART/ 540376
Sector	Retailing
Industry	Retailing
Face value / Book Value (Rs per share)	10
Dividend yield (%)	0.0%
52 H/L (Rs.)	2175/1226
Market Cap. (Rs. Cr)	135313
Shares Outstanding (Cr)	62.78

(In Rs.Cr)	FY16	FY17	FY18	FY19
Net Sales	8,660.5	12,758.2	15,033.2	20,004.5
Sales Growth	34.5	47.3	17.8	33.1
EBITDA	663.6	981.1	1,352.8	1,633.3
EBITDA Margin	7.4	7.9	8.6	7.7
PAT	320.3	491.7	787.8	902.5
NPM%	3.5	3.9	4.8	4.1
Adj. EPS (Rs.)	5.7	7.7	12.9	14.5

	FY16	FY17	FY18	FY19
P/E (x)	0	83.2	102.7	101.7
P/B (x)	0	10.4	17.8	16.5
EV/Sales(x)	0.2	3.1	5.5	4.6
EV/EBITDA(x)	2.5	39.0	58.2	54.8
ROCE(%)	24.2	21.9	24.2	25.8
ROE(%)	23.6	18.3	18.6	17.7

Source: Ace equity, CARE, IBEF

Pick of the Month (ABFRL): CMP: 238.6 Target: 275

Aditya Birla Fashion and Retail Limited, formerly Pantaloons Fashion & Retail Limited, is a fashion and lifestyle company. The Company is engaged in providing branded fashion apparels and accessories, and the retail sale of clothing, footwear and leather articles in stores. It operates through two segments: Madura Fashion & Lifestyle, and Pantaloons.

Management Vision: Planning to open 400 Lifestyle brand stores in FY20; 30-40 People stores should move to Lifestyle. Targeting mid-teens revenue growth for Lifestyle brands and Pantaloons with 2-3% margin improvement for Pantaloons. E-commerce contributed high/low single-digit revenues for Lifestyle/Pantaloons; should see strong growth momentum going forward.

Healthy store growth despite challenges: ABFRL reported a healthy show with topline growth of 14.4% YoY to Rs. 2297.2 crore. Growth was witnessed across categories, with lifestyle brands and Pantaloons reporting sturdy SSSG of 7.0% and 10.4%, respectively. Despite a significant increase in marketing spends and discounting, EBITDA margins remained constant YoY at 7.1% with EBITDA increasing 15% YoY to Rs.164.2 crore. Driven by a steady operational performance, PBT grew 39% YoY to Rs 59.4 crore. Owing to deferred tax adjustment, PAT for the quarter declined 29% YoY to Rs 30.5 crore.

Valuations: The stock is trading at a valuation of 61.4x TTM PE FY20. We recommend ***buy** on* ***Aditya Birla Fashion and Retail Ltd.*** with a price target of ***Rs. 275.***

NSE/BSECode	ABFRL/ 535755
Sector	Retailing
Industry	Retailing
Facevalue/BookValue(`pershare)	10
Dividendyield(%)	0%
52H/L(Rs.)	249/ 180
MarketCap.(Rs.Cr)	18451
SharesOutstanding(Cr)	773.6

(InRs.Mn)	FY16	FY17	FY18	FY19
NetSales	6,033.9	6,602.9	7,172.1	8,117.7
SalesGrowth	226.0	9.4	8.6	13.2
EBITDA	413.3	478.3	508.5	591.3
EBITDAMargin	7.3	7.8	7.5	8.1
PAT	-109.8	53.5	117.8	321.2
NPM%	-1.8	0.8	1.6	4.0
Adj.EPS(Rs.`)	-1.4	0.7	1.5	4.2

	FY16	FY17	FY18	FY19
P/E(x)	0	221.5	98.6	53.2
P/B(x)	12.3	12.4	10.8	12.2
EV/Sales(x)	2.1	2.1	1.9	2.3
EV/EBITDA(x)	29.3	26.8	24.8	28.6
ROCE(%)	4.6	9.5	8.8	12.3
ROE(%)	-17.6	5.8	11.6	25.9

Source: Ace equity, CARE, IBEF

Analysts: -

Brijesh Bhatia - Research Head brijesh.bhatia@dealmoney.in

Rohitkumar Rai - Research Analyst rohitkumar.rai@dealmoney.in

For private circulation only Website: www.dealmoneyonline.com

SEBI Research Analyst Registration No: INH000002319

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