



The Land of Opportunities

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Retail



Blended distribution network (physical + online) is the way forward

RETAIL: THE LAND OF OPPORTUNITIES



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The Land of Opportunities

Biz models rightly evolving to suit 'New-age Retail'

Huge runway for growth

The Indian organized retail market appears set for a stellar run, with its size likely to triple by FY25. While the industry is undergoing constant disruption, one thing has remained steady – consumers' affordability is on the rise and aspirations are growing more than ever. This trend particularly bodes well for food & grocery (F&G) and apparel categories, which are likely to deliver a strong CAGR (FY17-21) of 27% and 22%, respectively. To cater to robust demand, ~4,000 new store additions will likely be required over the next eight years (2017-25), offering a huge runway of 15% CAGR in retail footprint over the next eight years. Household retail spends, too, are shifting from traditional kirana shops to modern retail formats, which are gaining share due to better price offerings and greater convenience of shopping.

E-commerce – more a friend than foe

We believe the Indian retail industry is at the crossroads. The rising base of tech-savvy millennials, the improving internet ecosystem in India and the inherent benefit of convenience are undoubtedly fuelling demand for e-commerce. On one hand, this is creating cracks in the traditional brick-and-mortar business, but on the other, almost all companies are premising their growth strategies on developing their online channels – more so on building an omni-channel model. Many retailers and e-commerce firms are coming together to build a blended distribution network. Retailers appear to have ascertained that e-commerce is more of a friend than a foe.

E-commerce also has its own restrictions. It has largely penetrated standardized categories like electronics, and to some extent, lifestyle and branded apparel. However, its relevance in F&G is limited due to factors like varied quality, customization, supply logistics and product perishability. Further, online shopping has plateaued, with maturing of sales in top 10-15 cities, which contribute 75% of total sales. To drive incremental growth, e-commerce companies need to expand to smaller cities, which will trigger a significant rise in their already high logistics costs. The new ecommerce policy also supports offline retail by disallowing online players to offer deep discounts, cash backs and exclusive product sale.

Measured growth with focus on profitability and RoCE

Indian retailers have seen healthy expansion in their store footprint, driving revenue and earnings growth. Unlike the previous cycle in the early 2000s when euphoric expansion in retail footprint led to a sharp fall in store profitability and eventual rationalization and downsizing, the existing retail expansion is far more measured and primarily fueled by internal accruals and not leveraged expansion. To reduce operating cost and drive an efficient working capital cycle, we see most companies focusing on (a) leaner store layouts, (b) cluster-based growth, (c) private labels and (d) membership-based model. This has led to an improvement in per store economics and an expansion in the EBITDA margin across retail companies over the last 2-3 years. The outlook on the returns profile has also improved significantly.

In the rally over late 1990s to early 2000s, US retailers garnered 1.5-2x higher P/E v/s long-term average

Prefer stocks with healthy growth/RoCE and valuation buffer

Rich valuations – paying premium for growth

Retail stocks have shown an excellent performance over the last two years, led by healthy earnings growth coming from impressive SSSG and measured expansion. The higher earnings multiple the industry commands now highlights the improving investor confidence in India's retail models that earlier looked vulnerable, operating on wafer-thin margins and incapable of competing with the large e-commerce platforms.

We draw an inference from the global rally of retailers in the late 1990s and early 2000s, when US retailers garnered nearly 30x one-year forward multiples, 1.5-2x the long-term average. Given the strong and secular growth potential in India's retail market for the next 8-10 years, retail stocks may remain expensive, partly capturing the growth beyond one year. We prefer stocks with healthy growth/RoCE, and valuation buffer.

We initiate coverage with Buy on Aditya Birla Fashion and Retail, Future Retail, Future Lifestyle, Trent, Spencers Retail, and Neutral on Shoppers Stop and V-Mart. We maintain Sell on Avenue Supermarts. We do not have a rating on Reliance Retail.

Exhibit 1: Valuation comparison

Company	MCap (INR b)	CMP (INR)	TP (INR)	Upside (%)	Reco	EPS (INR)			EPS CAGR FY19-21 (%)	RoE (%)			P/E (x)		EV/EBITDA (x)	
						FY19E	FY20E	FY21E		FY19E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
DMART	904	1,446	1,300	-10%	Sell	15.3	19.7	26.1	31	19	20	21	73	55	43	33
ABFRL	169	219	260	19%	Buy	2.6	4.0	5.8	49	17	21	24	54	38	24	19
FRETAIL	224	447	580	30%	Buy	13.7	15.4	17.5	13	20	19	18	29	26	19	15
FLFL	93	478	585	22%	Buy	8.6	10.6	14.1	28	10	11	13	45	34	15	12
VMART	48	2,653	2,880	9%	Neutral	41.6	49.0	60.2	20	20	19	19	54	44	29	23
TRENT	117	353	440	25%	Buy	4.2	5.9	7.8	36	8	11	13	60	45	41	33
SHOP	40	458	520	13%	Neutral	9.9	13.3	16.6	30	9	11	12	34	28	14	11
SPENCER	13	164	200	22%	Buy	0.04	0.4	0.9	NM	0	2	5	424	179	168	85

Source: MOFSL, Company

THE OFFERINGS

1. Aditya Birla Fashion and Retail
2. Avenue Supermarts
3. Future Retail
4. Future Lifestyle
5. Shoppers Stop
6. Spencers Retail
7. Trent
8. V-Mart
9. Reliance Retail



Brand Factory – discount store has a differentiated value proposition

ABFRL – Ready for take off

ABFRL holds a healthy and diversified portfolio mix consisting four leading menswear brands, Pantaloons in the value-fashion retail format, men/women's innerwear through Van Heusen's brand extension, and women's fast-fashion venture – Forever 21. Pantaloons has undergone revamp over the years post its acquisition to tap the lucrative value-fashion format. We expect strong SSSG and 65 store additions to drive 17%/24% revenue/EBITDA growth over FY19-21. Recently launched men's innerwear under the well-known Van Heusen brand should see robust ~2x revenue growth and lower EBITDA losses by FY21 driven by distribution ramp-up. The lifestyle segment consisting four marquee brands and product extensions should achieve moderate growth over FY19-21. We expect healthy overall revenue/EBITDA CAGR of 14%/23% over FY19-21. Overall EBITDA margin should expand ~125bp to 8.7% by FY21 on the back of (a) break-even in the innerwear and fast-fashion businesses, (b) steady uptick in Pantaloons' private label mix (70-75%) and (c) the company's strategy of franchisee-led store additions, which should provide an impetus to RoCE. We initiate with a **Buy** rating and an SOTP-based TP of INR260. We ascribe 23x FY21 EBITDA of INR6.7b for the lifestyle segment given its strong brand value. We expect Pantaloons to drive earnings growth for ABFRL and ascribe 18x FY21 EBITDA of INR3.9b for this segment. We ascribe 1x FY21 sales for the fast-fashion and other businesses. This implies ~10% premium to the target EV/EBITDA multiple for our apparel coverage.

Avenue Supermarkets – well-oiled growth engine

Avenue Supermarkets (DMART) has consistently outperformed its peers, as its low-cost structure driven by (a) better product assortment, scale and vendor mix, and (b) cost savings from supply chain efficiencies and owned stores (no rentals) provides an edge in a highly competitive market. As nearly one-third of its stores are still in the early growth phase, productivity should inch up, though recent management commentary on SSSG has been cautious, given the rising scale. This, coupled with judiciously targeted underserved store locations, bodes well for SSSG. We expect 25% revenue CAGR over FY19-21, driven by 22% SSSG and healthy 26 store additions annually. Management cited that it will cap incremental margin expansion to gain competitive edge in pricing. We build in a steady EBITDA margin over FY19-21, driving EBITDA/PAT CAGR of 27%/31%. We maintain **Sell** (considering rich valuations) with a target price of INR1,300, ascribing 30x (~35% discount to two-year average of 45x, since IPO) FY21E EBITDA of INR27b.

Future Lifestyle – integrated play on brand and retail

FLF's unique business model – a combination of branded apparel and large-format retailing – gives it a competitive edge over peers. Increasing revenue share of private labels with a thrust on power brands, and burgeoning demand for fashion should provide impetus to gross and EBITDA margins, allowing it to earn 200-300bp higher EBITDA margin than the pure retail or brand formats. FLF's combination of owned/licensed brands along with retail format also allows better inventory control. We expect healthy 18% CAGR in consolidated revenue over FY19-21, driven by robust SSSG and store additions in both Central and Brand Factory. We expect 21% EBITDA CAGR and 28% PAT CAGR over FY19-21. We recommend **Buy** with a target

price of INR585, ascribing 15x (~20% premium to three-year average) EV/EBITDA, given its strong performance over the last two years.

Multi-format approach with a focus on private labels and apparels

Future Retail – scaling new heights

FRL operates under a multi-format pattern (Big Bazaar – Hypermarket, Easyday – Daily) and has a balanced product category portfolio (food & grocery, apparel, and general merchandize). We expect a CAGR of 10% in large format (incl. Big Bazaar) revenue and 30% in small format (incl. Easyday) revenue over FY19-21, driven by healthy SSSG and store additions. This, along with the increasing share of margin-accretive private labels and apparel products, should lead to 80bp EBITDA margin expansion over FY19-21. Further, recently announced of INR20b promoter warrants issue should be utilized in releasing FRL assets from FEL, a move that will clean FRL's asset ownership structure, turn EPS accretive, and yet garner 12% RoCE with further improvement potential. We recommend **Buy** on FRL with a target price of INR580, ascribing 20x (at three-year average) FY21E EBITDA of INR15b. FRL trades at ~50% discount to DMART. With growth levers in place and return ratios set to take off, the valuation gap should reduce, in our view.

Shoppers Stop – rejigging private labels

Shoppers Stop – balance sheet cleaned up, at cusp of revival

After a sluggish performance over the last three years, Shoppers Stop completed its clean-up in FY18, consolidating stores, selling off loss-making Hypercity, and deleveraging its balance sheet. With all growth levers in place – rationalization of stores, thrust on core business and rejig of private label brands – we believe SHOP's growth trajectory is at the cusp of revival. We expect increased pace of store adds, revival of SSSG, hive off of loss-making non-core business and efficiency measures to drive consolidated revenue CAGR of 9% and EBITDA/PAT CAGR of 18%/30% over FY19-21. Internally funded capex and zero gearing should drive RoIC. We believe earnings revival and RoIC improvement are not fully captured. We recommend **Neutral** with a TP of INR520, assigning 13x (~40% discount to target EV/EBITDA multiple of our apparel coverage) EV/EBITDA to Shoppers Stop and 1x EV/sales to Crosswords on an FY21E basis.

Spencer – well capitalized for growth

Spencer's Retail – turned profitable

Spencer's Retail has turned EBITDA-positive (FY19E), with the closure of loss-making dailies, after suffering a disconcerting FY18 impacted by liquor ban on highways, key store renovation and GST rollout. Management plans to (a) accelerate the pace of store additions, (b) increase the share of private labels and apparel with the recently launched value apparel brand 2Bme and (c) ramp up omni-channel presence. We expect Spencer's to clock 14% revenue CAGR and improve EBITDA margin by 140bp as store rationalization and inherent operating leverage drive profitability. Though the business is yet to attain a steady state, we believe (a) proven execution with recent turnaround and (b) measured growth targets with right store size would improve RoIC to 6% by FY21. We recommend **Buy**, valuing Spencer's Retail at INR200/share (0.5x FY21E sales).

**Trent – value format
Zudio could turn
sizeable in three years**

Trent – Westside, a steady path; Zara, Star Bazaar could give upside kicker

Trent has created a strong brand Westside, with a thrust on women-centric fashion and private labels. Furthermore, rejig in the operational strategy of Star Bazaar and Zudio stores have put Star at an inflection point – we expect EBITDA losses to trim down to 4% by FY21 (from 7% FY19E). We expect consolidated revenue CAGR of 19% over FY19-21, primarily driven by Westside. Healthy private label mix and operating efficiency should drive 100bp margin expansion to 10% by FY21. We recommend **Buy** with a TP of INR440, ascribing (a) Westside and Zara 25x (~20% premium to the target EV/EBITDA multiple of our apparel coverage) FY21E EBITDA and (b) THPL 1x FY21E sales. Trent has a healthy business portfolio, but current valuations fairly capture the earnings. Faster-than-expected recovery in THPL and accelerated SSSG in Westside could result in further upside.

**VMart – playing the
shift from unorganized
to organized in tier 2-3
cities**

V-Mart Retail – play on rural India’s modern retail shift

V-Mart Retail (VMART) is capitalizing on the shift from the unorganized to the organized segment in apparel retailing. It has consciously targeted tier-2 and tier-3 cities (~80% presence) of India, offering 25-30% lower prices than most national/regional apparel chains. It’s small (~8.4ksf) store size and high 65% private label share have enabled healthy productivity growth to INR9k/sf (FY19E) and an enviable ~10% EBITDA margin. Given the strong growth opportunity and VMART’s measured expansion through internal accruals, we expect 17% revenue CAGR and EBITDA/PAT CAGR of 21%/20% over FY19-21. Healthy RoIC of 22% by FY21 and strong earnings growth favor rich valuations. We ascribe 25x (~40% premium to three-year average) to FY21E EBITDA, arriving at a TP of INR2,880. Recommend **Neutral**.

**Reliance Retail –
reaping gains from the
deepest network**

Reliance Retail – consistent growth + increasing scale

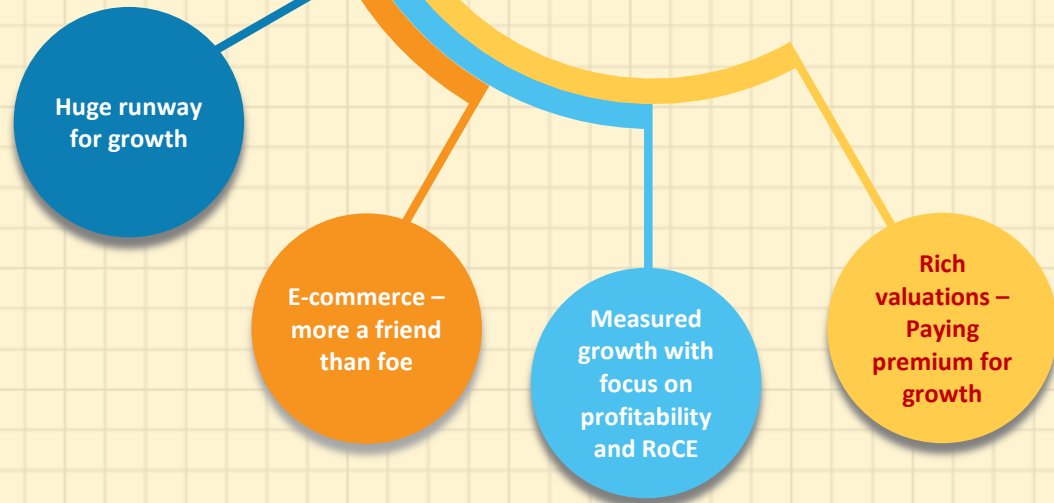
Reliance Retail has the largest organized F&G and fashion business in India, with a widespread core network of ~4,300 stores (FY19E). Over the last 3-4 years, the company has aggressively expanded across verticals. Rapid expansion and consequent healthy growth have brought scale benefits, with the core EBITDA margin expanding 260bp YoY to 6.9% over FY16-19E. We expect the company to grow its core (ex-petro/connectivity) revenue/EBITDA by 28%/34% over FY19-21, driven by its expanding footprint across businesses. Reliance Retail has been undertaking various omni-channel initiatives, including (a) the launch of its online fashion portal (AJIO.com) and F&G portal (Reliancesmart.in), (b) the integration of stores for online order fulfillment and (c) operationalization of kiosks across fashion stores. We, thus, believe that Reliance Retail is well positioned to tap India’s large and expanding retail market, given its (a) vast physical presence across multiple product categories, (b) strength of Jio’s digital/distribution platforms and subscriber base, (c) foray in payment banks and (d) support from deep-pocketed promoter group.

THE OFFERINGS

1. Aditya Birla Fashion and Retail
2. Avenue Supermarts
3. Future Lifestyle
4. Future Retail
5. Shoppers Stop
6. Spencers Retail
7. Trent
8. V-Mart
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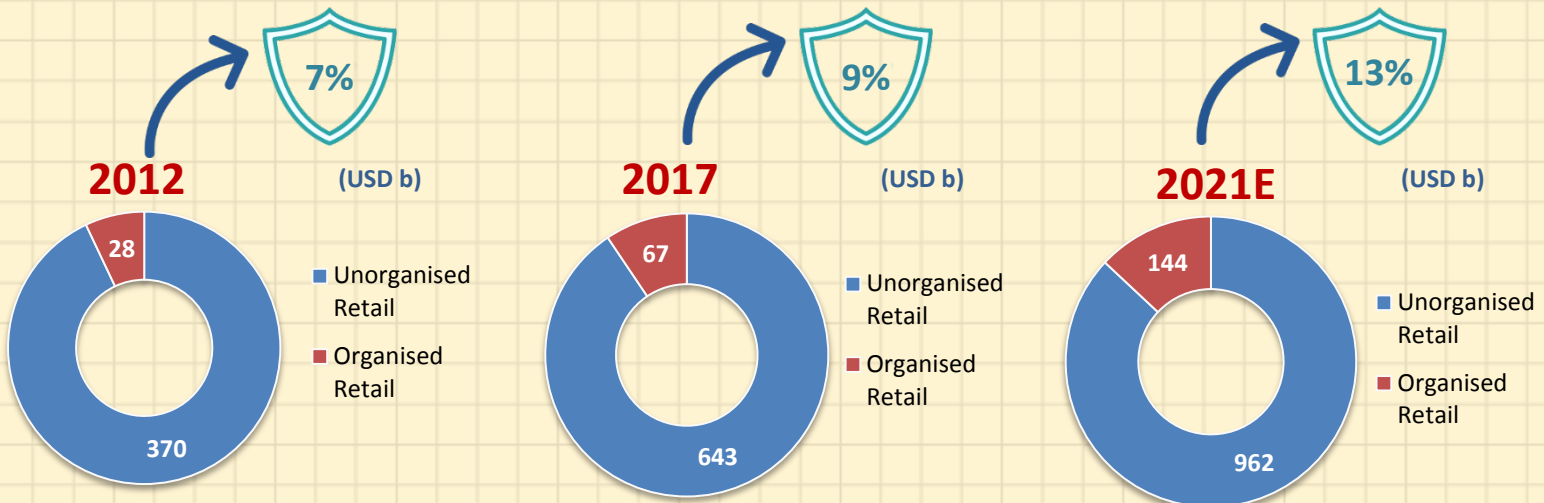


The Land of Opportunities



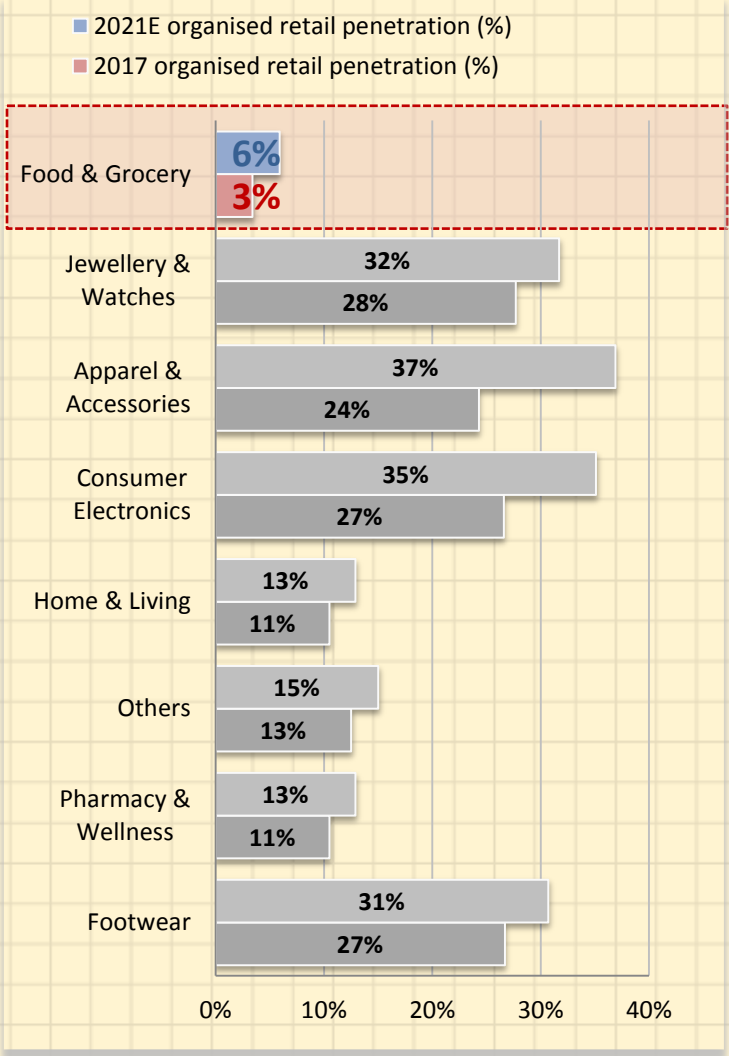
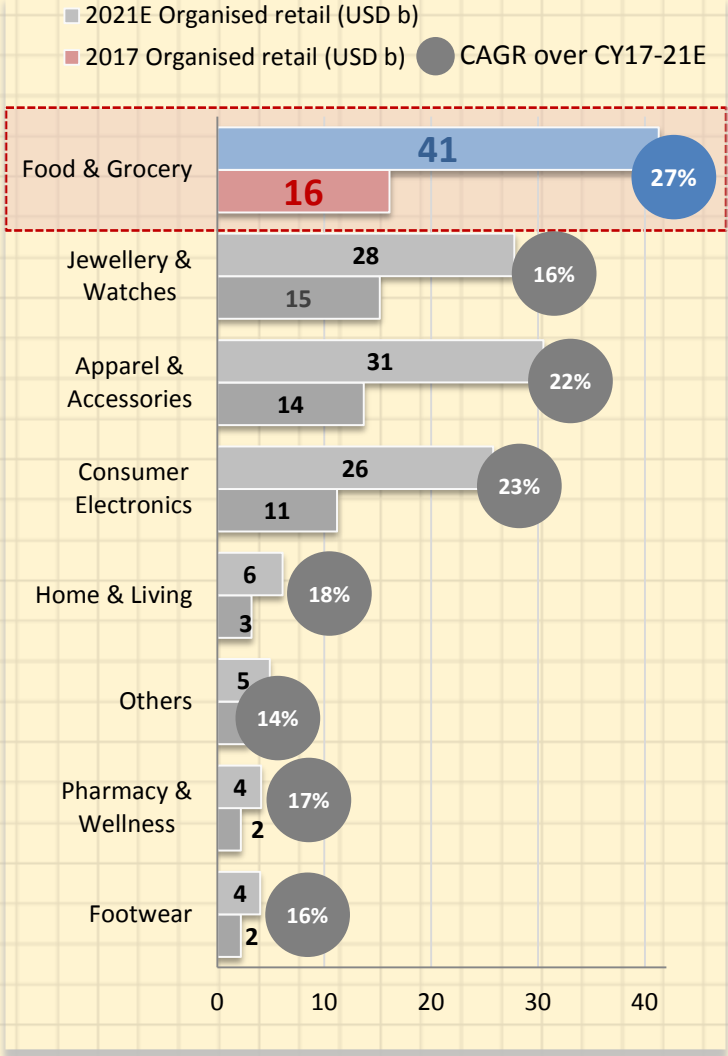
“ Biz models rightly evolving to suit ‘New-age Retail’ ”

Organized Retail Industry

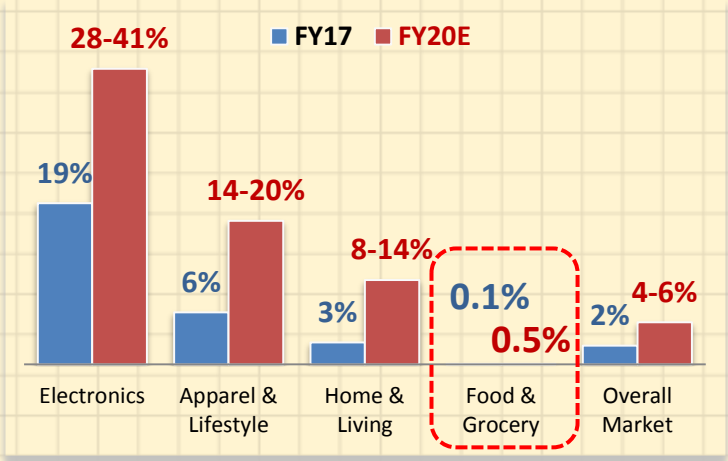


PENETRATION

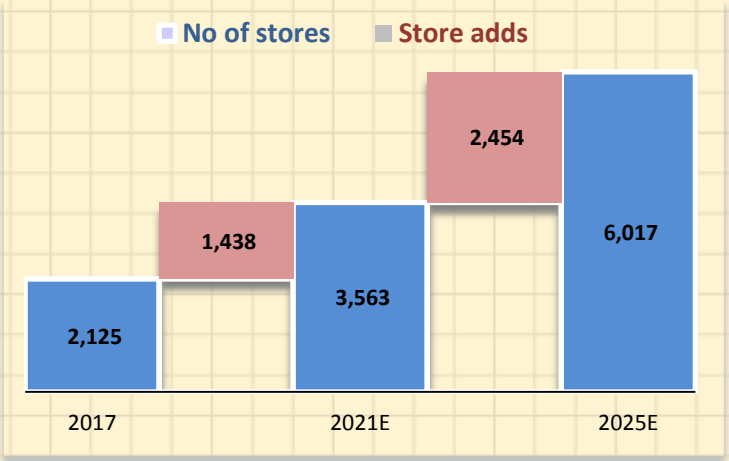
Significant room for increasing penetration in organized F&G (%)



F&G e-tail penetration at near zero



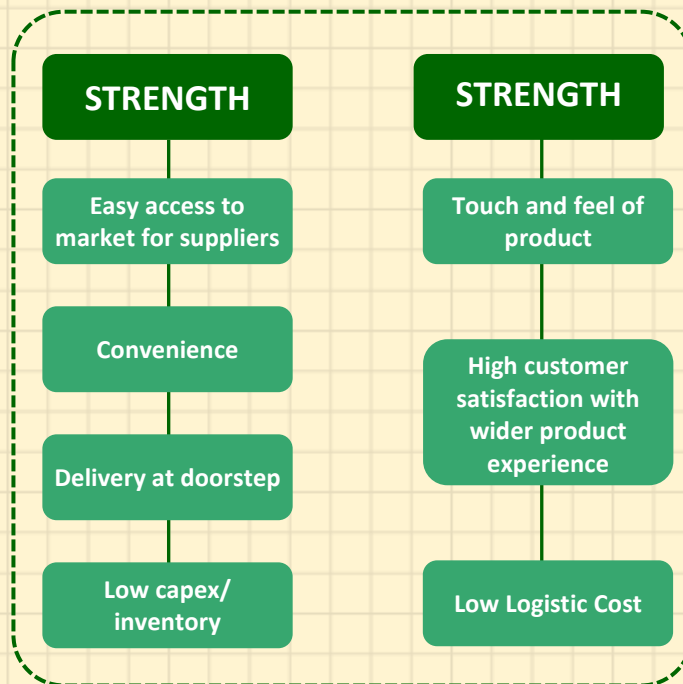
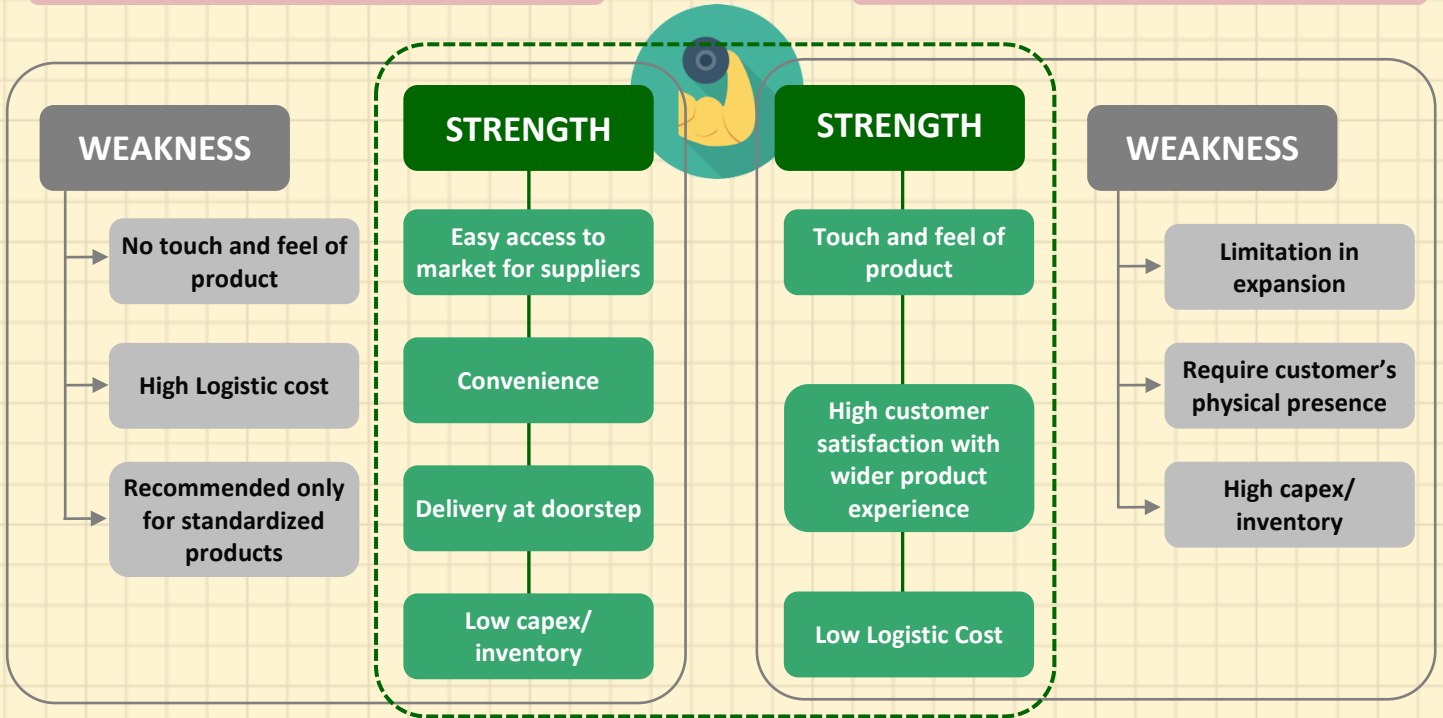
Expect high store adds over next few years



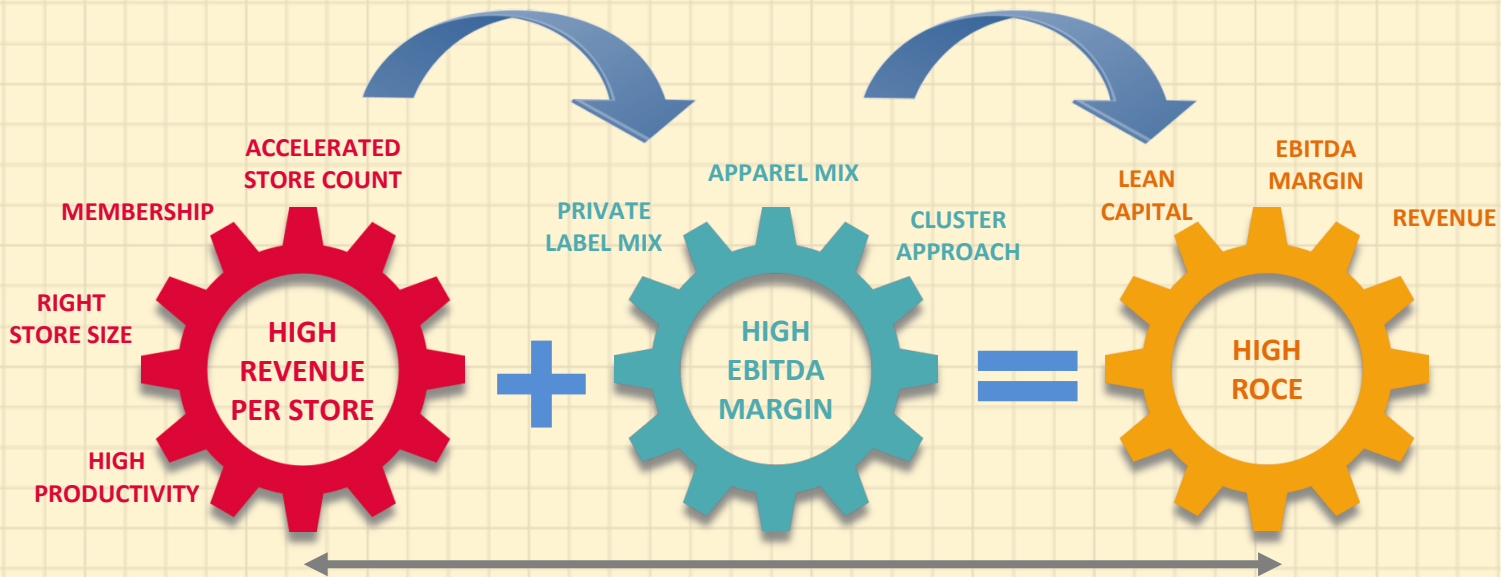
Ecommerce – Hybrid model evolving

PRO'S AND CON'S OF ONLINE RETAIL

PRO'S AND CON'S OF OFFLINE RETAIL



Balanced scorecard – what wins, who loses



Balanced scorecard

	FY18							
Formats	Store Productivity	Efficient store size	Pvt label mix	Apparel mix	Cluster approach	Accelerated store count	Membership programme	Result
Big Bazaar	●	●	●	●	●	●●	●	●
D-Mart	●●	●	●●	●	●●	●	●●	●
EasyDay	●	●	●	N.A.	●●	●●	●	●
Star bazaar	●●	●	●	●	●	●	●	
Spencer	●	●	●	●	●	●	●	●
Central	●	●	●	N.A.	●	●	●	
Shoppers Stop	●	●	●	N.A.	●	●	●	●
Westside	●	●	●●	N.A.	●	●	●	●
Brand Factory	●	●	●	N.A.	●	●	●	●
Pantaloons	●	●	●	N.A.	●	●	●●	●
V-Mart	●	●	●	N.A.	●●	●	●●	●

	FY21							
Formats	Store Productivity	Efficient store size	Pvt label mix	Apparel mix	Cluster approach	Accelerated store count	Membership programme	Result
Big Bazaar	●	●	●●	●	●	●●	●	●
D-Mart	●●	●	●●	●	●●	●	●●	●
EasyDay	●	●	●	N.A.	●●	●●	●●	●
Star bazaar	●	●	●	●	●	●	●	●
Spencer	●	●	●	●	●	●	●	●
Central	●	●	●	N.A.	●	●	●	●
Shoppers Stop	●●	●	●	N.A.	●	●	●	●
Westside	●●	●	●●	N.A.	●	●	●	●
Brand Factory	●	●	●	N.A.	●	●	●	●
Pantaloons	●	●	●	N.A.	●	●●	●●	●
V-Mart	●●	●	●	N.A.	●●	●	●●	●

IMPACT: Lowest ●● | Low ● | Average ● | High ● | Highest ●●

Burgeoning opportunity in organized retail market

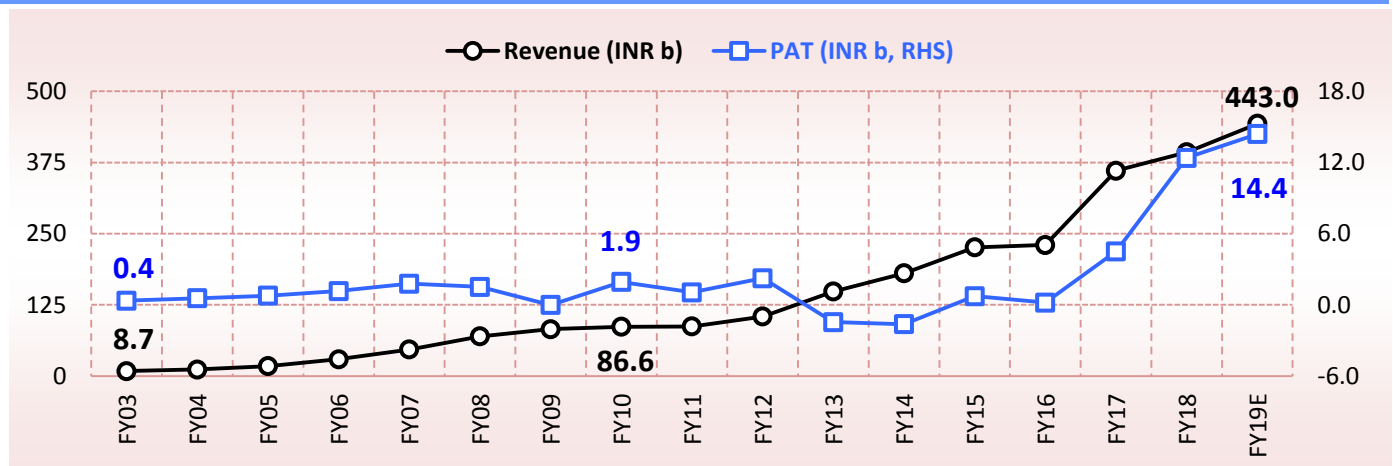
- The Indian organized retail market appears set for a stellar run, with its size likely to grow by nearly 3x by FY25.
- The sector remains in a sweet spot owing to favorable demographics and an attractive tier-2 opportunity. The target market to tap into is now bigger than ever.
- Measured growth with a focus on profitability and RoCE by players creates sustainable growth opportunity.

Prioritizing profitability over growth

Focus on measured growth

In the past, ambitious growth by retailers had severely dented profitability, given the wafer-thin EBITDA/PAT margins. Retailers aggressively added new stores to tap the huge opportunity in the organized retail market, and in the process, bit off more than they could chew. With aggressive capex, high inventory cycles and ballooning leverage position, most retailers had to reverse the trend by downsizing and rationalizing loss-making stores. However, retailers are now taking a measured approach to expansion, with a strong focus on a lean cost structure, low inventory days and an efficient operating structure. All this provides comfort on the sustenance of profitable growth. On the flip side, the retail industry offers a huge runway for growth. The organized retail industry is likely to grow at 21% over the next four years, supported by an accelerated shift from unorganized to organized trade.

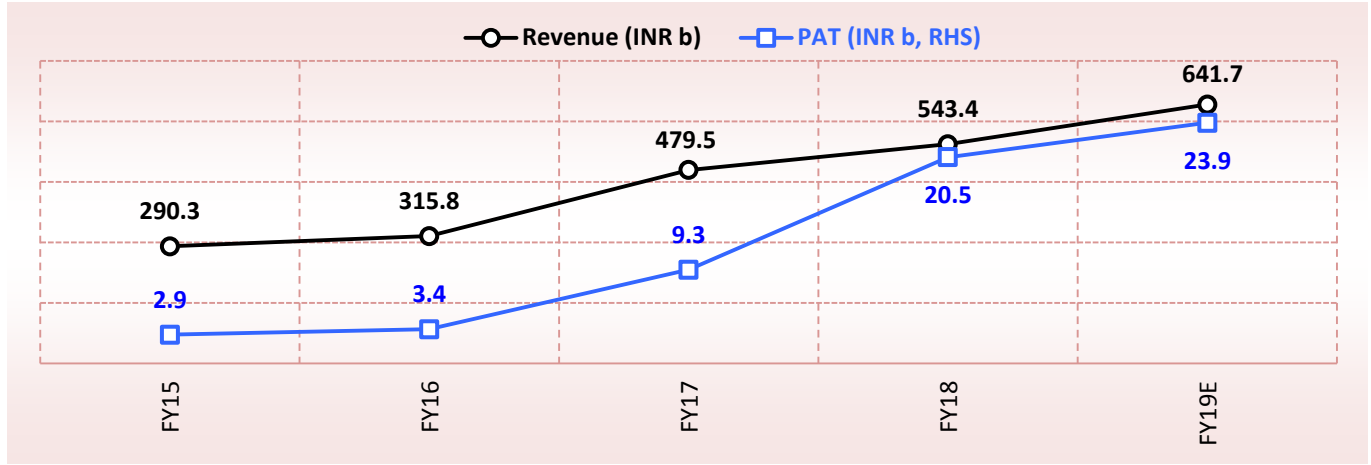
Exhibit 2: Focus on growth by unreasonable expansion impacted profitability for the sector in the past (ex-D-Mart)



Includes ABFRL, FEL, FLFL, FRETAIL, FCON, VMART, TRENT, SHOP, SPENCER from their listing date

Source: Bloomberg, MOFSL

Exhibit 3: Profitability has been on an uptrend over the past three years



Includes ABFRL, FLFL, FRETAIL, DMART, VMART, TRENT, SHOP, SPENCER from their listing date

Source: Bloomberg, Company, MOFSL

Organized retail CAGR of 19% over last five years

Expect organized retail CAGR of 21% over FY17-21...

India’s retail market size is pegged at ~USD710b (~INR46t), of which the organized segment accounts for USD66.6b (INR4.3t), 9.4% of the overall retail market as of CY17, according to Technopak. This share is expected to increase to 13% over the next four years (CY17-21), with the organized retail market registering a CAGR of 21% to reach a size of USD144b (INR9.4t). Notably, over the last five years (CY12-17), the organized retail market grew at 19%, with its penetration increasing from 7% to 9.4%.

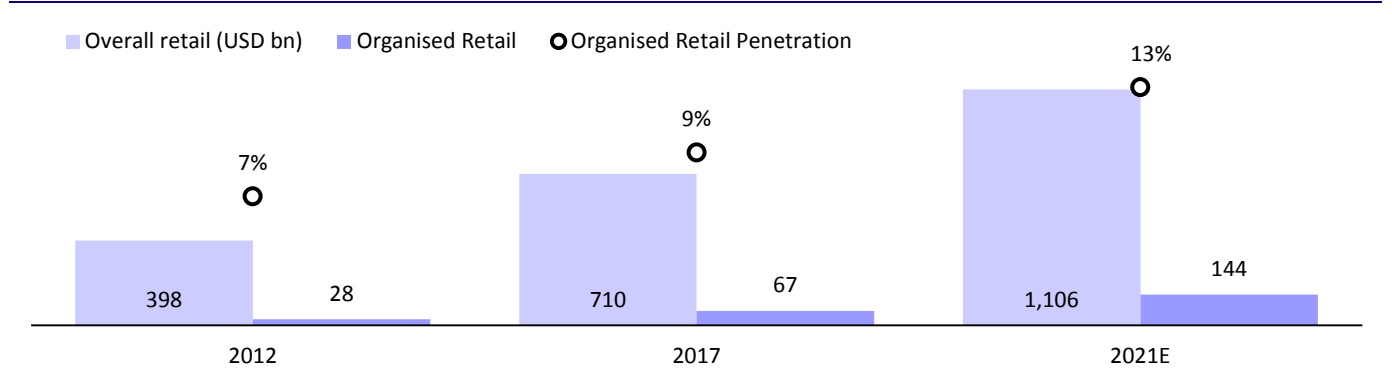
...as trade shifts away from unorganized segment

Within the overall retail market, the penetration of the organized segment has increased to mid-20s in four categories – Jewelry & Watches, Footwear, Consumer Electronics and Apparel. These together contribute 23% of the organized retail market. F&G is the least penetrated, with share of the organized segment at 3.4%. However, given the size of F&G, which is two thirds of the retail market, even with its miniscule share, F&G contributes 67% of the overall organized market at USD67b (INR4,422b).

F&G is projected to drive the share of organized retail within the total retail market over the next four years. In 2021, the F&G organized segment should witness robust 27% growth and reflect 6% organized retail penetration. In addition to the demand equation, investments across the entire ecosystem of food processing, cold storage, logistics & distribution and product development would lend significantly to driving the penetration of F&G in organized retail.

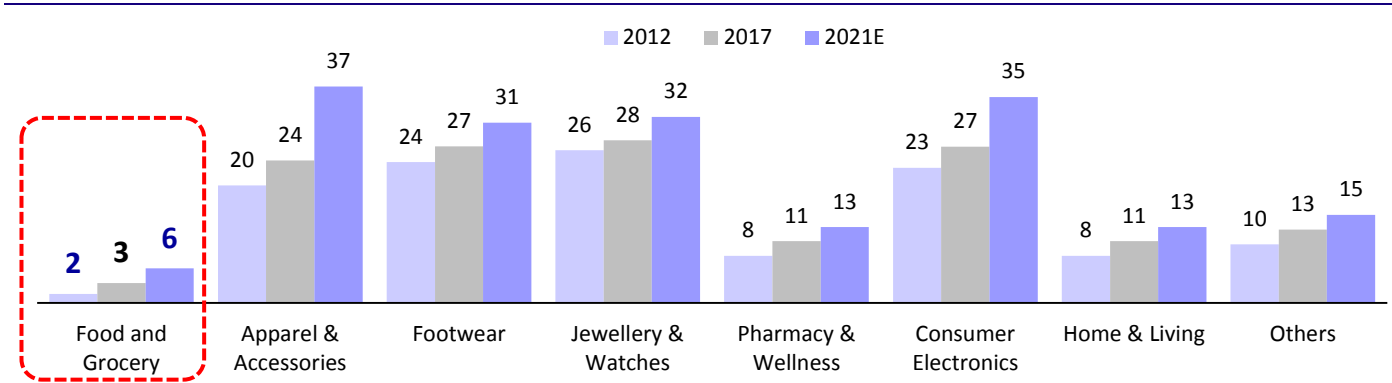
Increased focus from general merchandise players would also drive offtake of Apparel and Footwear in the value segment, resulting in further increase of organized penetration in the category. Together, the above factors should result in 13% organized retail penetration (USD144b) in CY21.

Exhibit 4: Organized retail penetration to increase to 13% by CY21



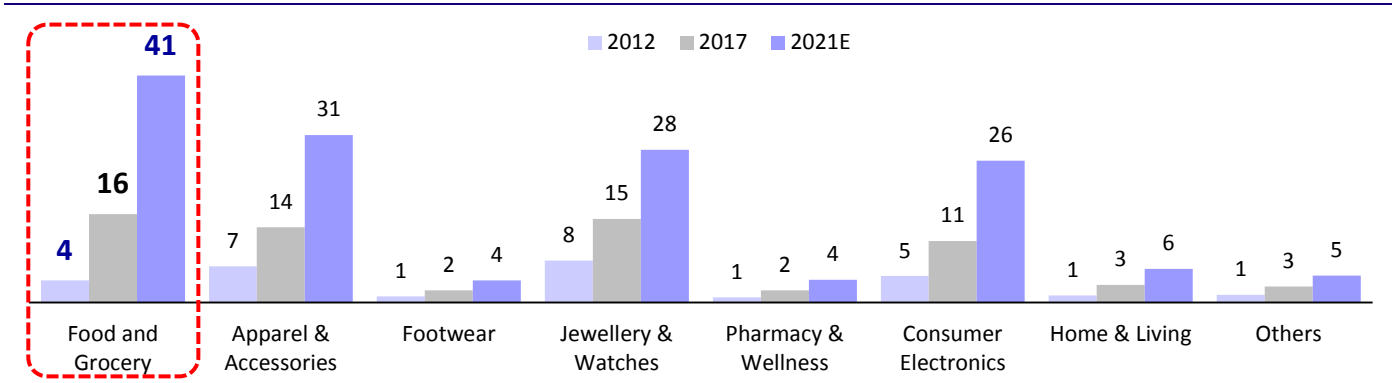
Source: Technopak Report 2017, MOFSL

Exhibit 5: Significant room for increasing penetration of F&G in organized retail consumption (%)



Source: Technopak Report 2017, MOFSL

Exhibit 6: F&G expected to grow fastest at 27% CAGR over CY17-21 (USD b)



Source: Technopak Report 2017, MOFSL

Exhibit 7: Key retailers across categories in organized retail (USD b)

Categories	Key Retailers
Food and Grocery	❖ Big Bazaar, Easy Day, Heritage, Nilgiris, DMart, Reliance Fresh, More
Apparel & Accessories	❖ Central, Brand Factory, FBB, Shoppers Stop, Lifestyle, Westside
Footwear	❖ Bata India, Metro Shoes, Adidas, Clarks
Jewellery & Watches	❖ Kalyan Jewellers, Tanishq, Malabar
Pharmacy & Wellness	❖ Apollo, MedPlus
Consumer Electronics	❖ eZone, Samsung, Vijay Sales, Croma, Reliance Digital
Home & Living	❖ Home Town, Home Centre, Home Stop

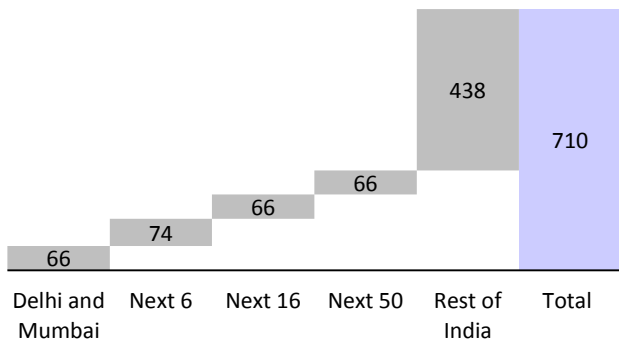
Source: Technopak Report 2017, MOFSL

Value retail gaining prominence, offering bridge between unorganized and branded apparel

Metros, tier-1 cities contribute highest share, but new clusters emerging in lower-tier towns

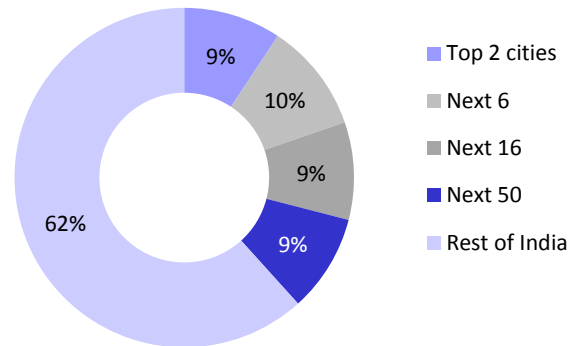
The top-24 cities (metros, mini-metros and tier-I cities) account for 29% of total retail spending, with the Delhi and Mumbai clusters contributing about 9%. Even the top-72 cities account for 38% of total retail consumer spending, which highlights the strength of rest of India that has 71% share. Major expansion in terms of retail consumer spending is expected to come from India’s tier-2 cities. This should benefit the value apparel category, which is a much attractive option for customers. Pricing difference between unbranded and branded apparel is ~4x, but value category products come with just 2x higher pricing. Thus, more apparel players are increasingly expanding into tier-2 cities to tap this opportunity.

Exhibit 8: Share of retail consumer spending in cities (USD b, 2017)



Source: Technopak Report 2017, MOFSL

Exhibit 9: Top-74 cities account for ~38% of total retail consumer spending (%)

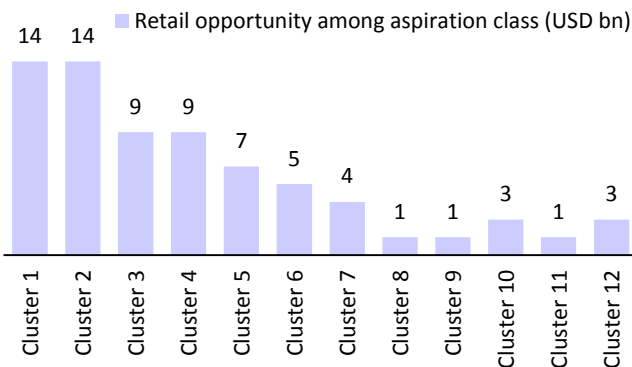


Source: Technopak Report 2017, MOFSL

Next 6 Cities: Bangalore, Chennai, Hyderabad, Ahmedabad, Pune, Kolkata

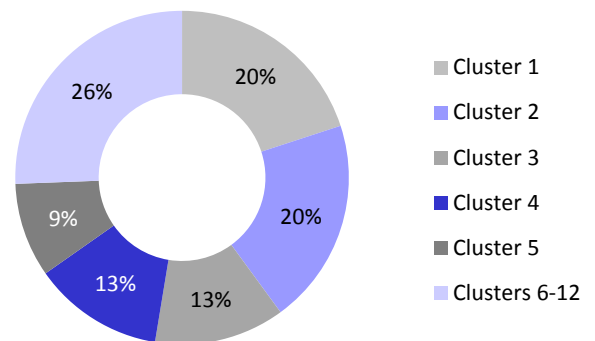
Next 16 Cities: Surat, Jaipur, Lucknow, Nagpur, Patna, Indore, Coimbatore, Vadodara, Ludhiana, Bhopal. Kochi, Vishakapatnam, Madurai, Nashik, Jamshedpur, Guwahati

Exhibit 10: Size of retail spending in key clusters (USD b, 2017)



Source: Technopak Report 2017, MOFSL

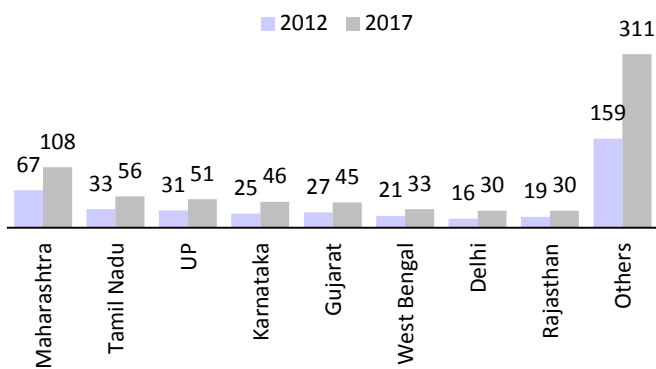
Exhibit 11: Top-5 clusters account for ~75% of the total 12 clusters’ retail spend (% , 2017)



Source: Technopak Report 2017, MOFSL

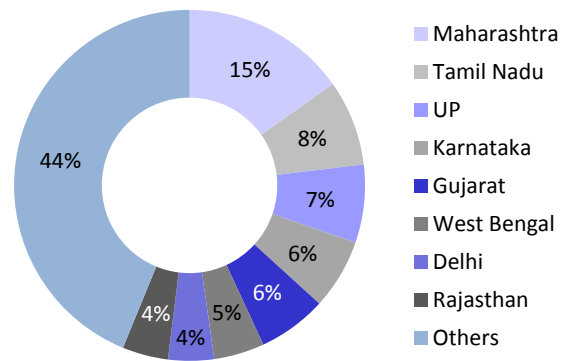
CLUSTER 1:	Greater Mumbai, Pune, Nashik, Solapur, Aurangabad, Bhiwandi
CLUSTER 2:	Delhi, Gurgaon, Noida, Faridabad, Ghaziabad
CLUSTER 3:	Kolkata, Asansol, Guwahati, Bhubaneswar, Cuttack
CLUSTER 4:	Bangalore, Chennai, Mysore, Hubli-Dharwad, Mangalore, Belgaum, Pondicherry
CLUSTER 5:	Hyderabad, Visakhapatnam, Vijayawada, Warangal, Guntur
CLUSTER 6:	Ahmedabad, Surat, Vadodara, Rajkot, Jamnagar, Bhavnagar
CLUSTER 7:	Kanpur, Lucknow, Varanasi, Agra, Meerut, Bareilly, Aligarh, Moradabad, Dehradun, Gorakhpur
CLUSTER 8:	Jaipur, Jodhpur, Kota, Bikaner
CLUSTER 9:	Ludhiana, Amritsar, Chandigarh, Jalandhar
CLUSTER 10:	Kochi, Coimbatore, Madurai, Trivandrum, Kozhikode, Tiruchirapp, Tiruppur
CLUSTER 11:	Ranchi, Jamshedpur, Dhanbad, Patna
CLUSTER 12:	Gwalior, Indore, Bhopal, Jabalpur, Durg-Bhilai, Raipur, Amravati

Exhibit 12: Size of retail spending of SEC-A and SEC-B across states (USD b)



SEC - Socio-economic classification Source: Technopak Report 2017, MOFSL

Exhibit 13: 8 states account for ~55% of total retail spend (2017, %)



Source: Technopak Report 2017, MOFSL

Levers of organized retail growth

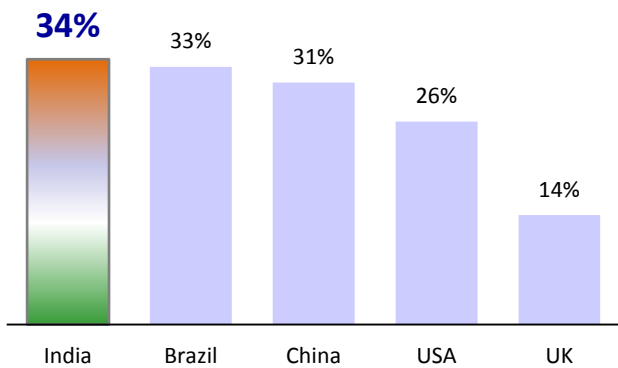
- Millennial population driving attractive target market
- Growing middle class and rising disposable income
- Increasing urbanization
- Growing nuclearization
- GST supporting organized market growth

#1 Millennial population driving attractive target market

Over 440m millennials –
34% of the population

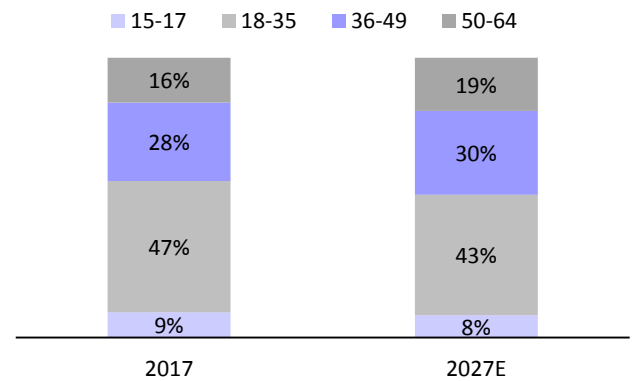
In absolute terms, India is blessed with the largest millennial population (age bracket of 18-35 years) globally. With a population of over 440m, the group constitutes ~34% of the country’s total population. Further, with a median age of ~26 years, India is one of the youngest major economies and is expected to stay so in the foreseeable future. This is in contrast to other countries such as the US, large European countries, China, etc, where the median age of population is higher and an imminent situation of declining working-age population looms the markets.

Exhibit 14: Millennial population as a % of country’s total population



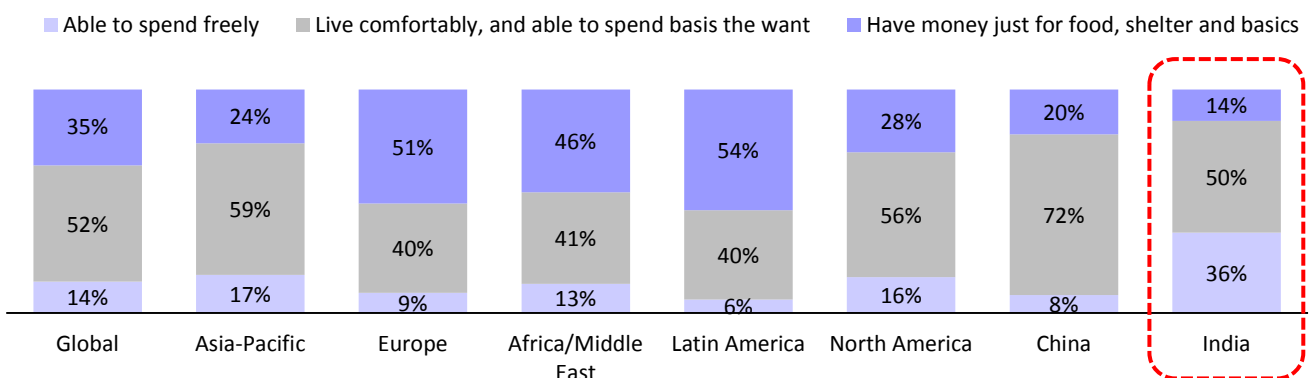
Source: Trend-setting millennial report 2018, MOFSL

Exhibit 15: Millennials account for nearly half of the working age population for India



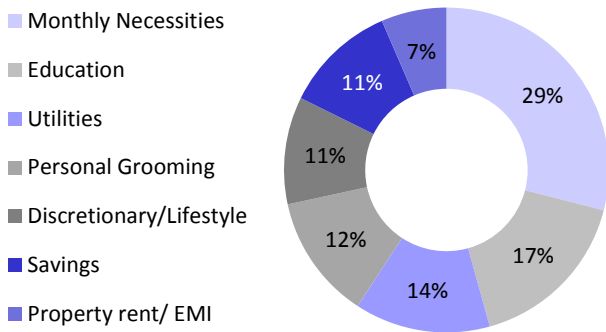
Source: Trend-setting millennial report 2018, MOFSL

Exhibit 16: Perceived financial spending ability



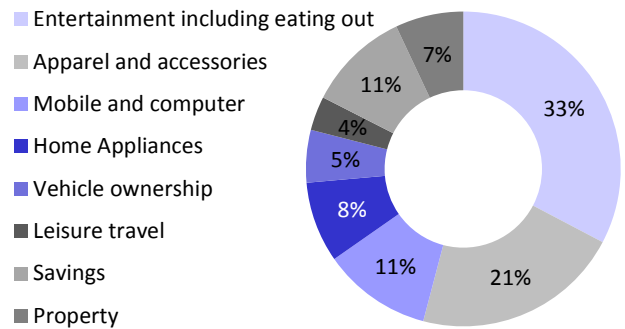
Source: Trend-setting millennial report 2018, MOFSL

Exhibit 17: Monthly expenses for millennial (%)



Source: Trend-setting millennial report 2018, MOFSL

Exhibit 18: Expenses from incremental income for millennial (%)



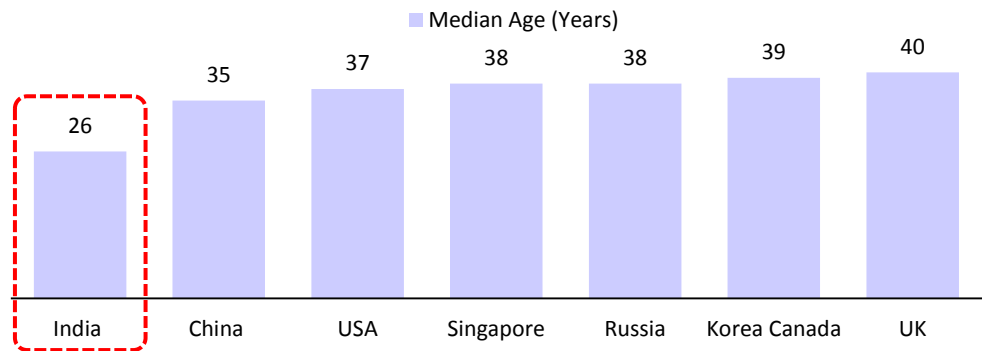
Source: Trend-setting millennial report 2018, MOFSL

Millennials spend heavily on entertainment, apparels and electronics

Millennials driving consumption

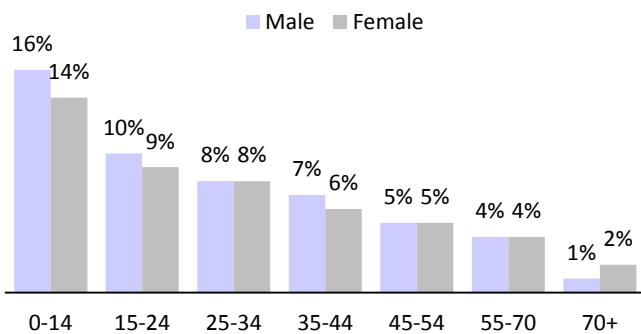
The Indian millennials stand out from the rest of the population in terms of better education, lifestyle choices, consumption pattern, significant need for convenience, and brand preferences. Millennials spend a high proportion of their incremental income towards eating out and entertainment (32.7%), apparel and accessories (21.4%), and electronics (11.2%) among others. Savings account for ~10% of the income. This indicates a shift towards a consumption economy rather than a savings economy, which was a predominant feature of the preceding demography. Millennials, with their low inclination towards savings and increasing spending capacity, provide brands with vast growth opportunities. With a high and growing millennial population, modern retail, organized apparel sector should get a push.

Exhibit 19: Median age: Key emerging and developed economies (2012)



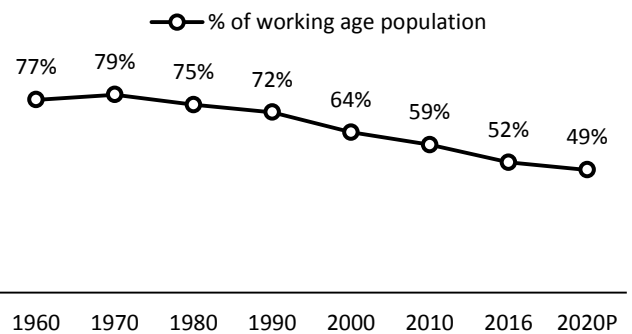
Source: Technopak Report 2017, MOFSL

Exhibit 20: Age-wise breakup of population in India (2011)



Source: Technopak Report 2017, MOFSL

Exhibit 21: Dependency ratio in India



Source: Technopak Report 2017, MOFSL

#2 Growing middle class and rising disposable income

India's per capita crossed USD2,000, triggering high discretionary spends

Households with annual earnings of USD5,000-10,000 have grown at a CAGR of 17% over FY11-16 and are projected to grow at a CAGR of 12% to reach 109m in FY20. Households with annual earnings of USD10,000-50,000 have also grown at a CAGR of 20% over the last five years. Increase in the number of households with annual earnings of USD10,000-50,000 will lead to an increase in indulgence spending by the group. This will lead to an increase in expenditure on consumption categories such as Food, Fashion, Luxury Products, and Consumer Durables. It is estimated that 23% of the global middle class will be from India by FY30.

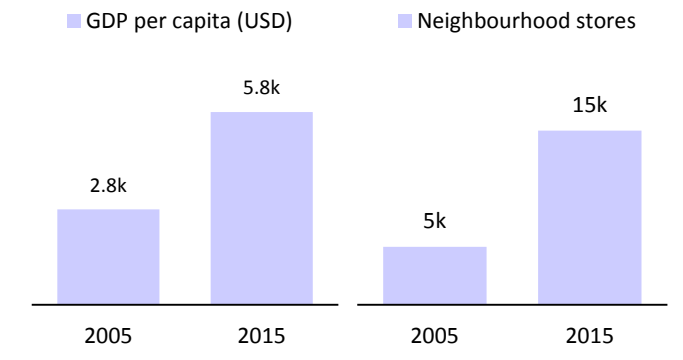
Exhibit 22: As GDP/capita crosses USD2000, retail sales grow 2-4x



Source: Future Retail, MOFSL

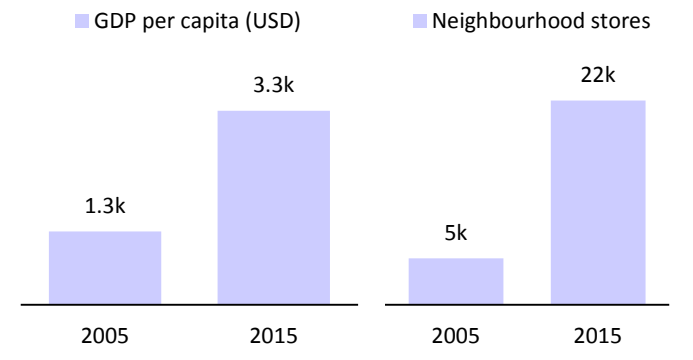
India's average per capita income has crossed USD2,000. Global examples highlight that as per capita income crosses USD2,000, retail sales magnify, driven by higher share of discretionary spends towards better lifestyle and upgrade in quality of living.

Exhibit 23: Thailand: As GDP per capita grew ~2x, neighborhood stores grew ~3x



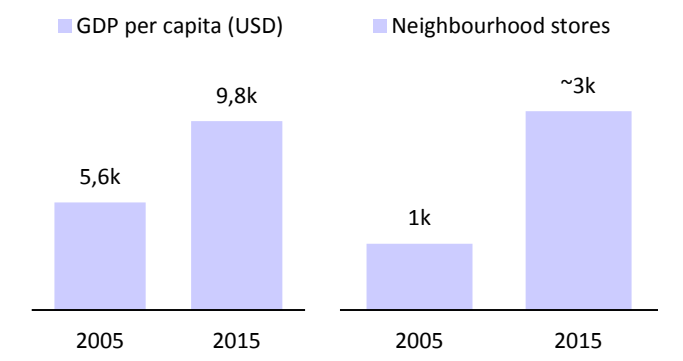
Source: Future Retail, MOFSL

Exhibit 24: Indonesia: As GDP per capita grew ~2.6x, neighborhood stores grew ~4.4x



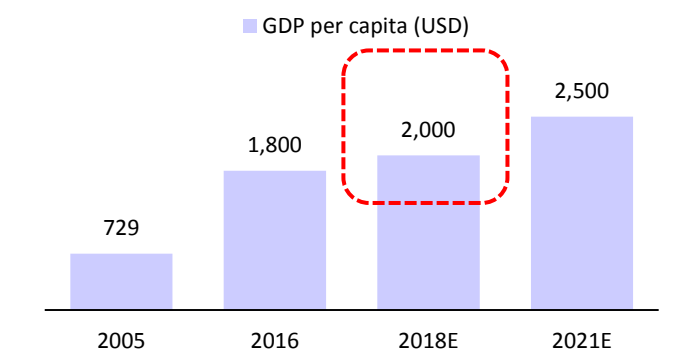
Source: Future Retail, MOFSL

Exhibit 25: Malaysia: As GDP per capita grew ~1.7x, neighborhood stores grew ~3x



Source: Future Retail, MOFSL

Exhibit 26: India: GDP per capita at an inflection point



Source: Future Retail, MOFSL

Exhibit 27: As country's per capita GDP nears ~USD2,000, its fashion industry sees exponential growth

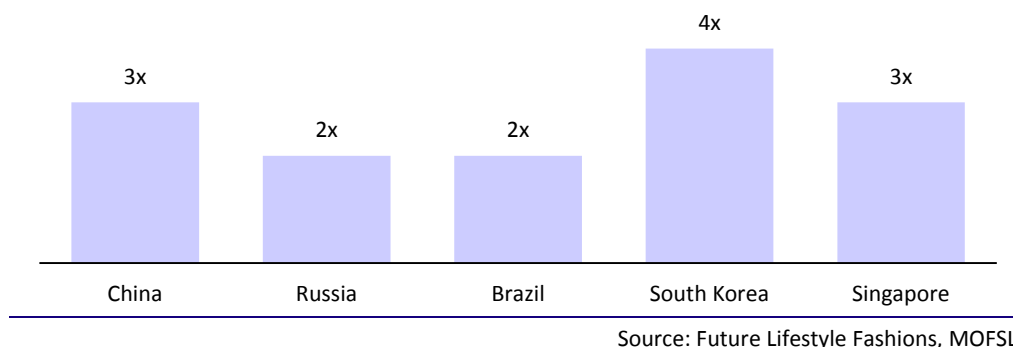
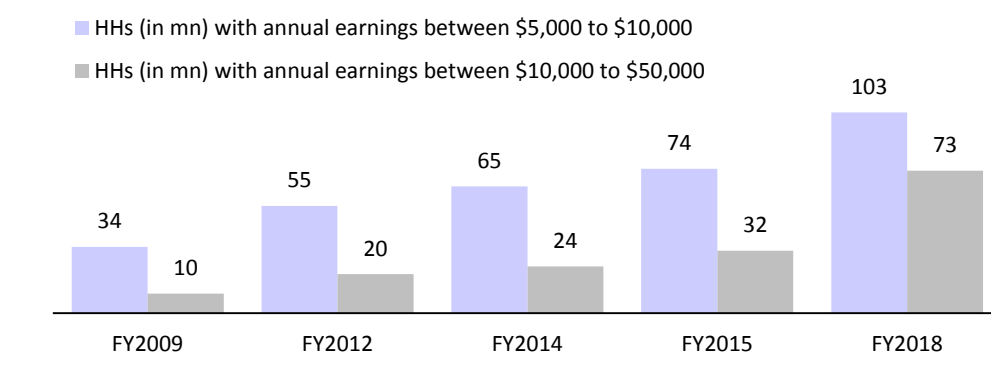


Exhibit 28: India's consumption opportunity is well-distributed

Per Capita Income	Below \$1,300	\$1,300 - \$2,000	\$2,000 – \$2,500	More than \$2,500
No of States / UT	8	7	8	8
States	Assam, Bihar, Jharkhand, MP, Manipur, Meghalaya, Odisha, UP	AP, Chattisgarh, J&K, Nagaland, Rajasthan, Tripura, WB	Arunachal Pradesh, Gujarat, HP, Karnataka, Mizoram, Punjab, TN, Telangana	Goa, Haryana, Kerala, Maharashtra, Sikkim, Uttarakhand, Delhi, Chandigarh
State GDP: FY17(\$bn)	500	460	752	674
Contribution to National GDP	21%	19%	32%	28%
Growth rate (5Y Historical)	12.0%	13.2%	12.7%	12.0%
India represents a well dispersed opportunity				
No. of Districts	278	135	192	107
Urban Population (mn)	97	74	108	98

Source: Future Retail, MOFSL

Exhibit 29: Increase in number of households with higher annual earnings should lead to higher spending (in m)



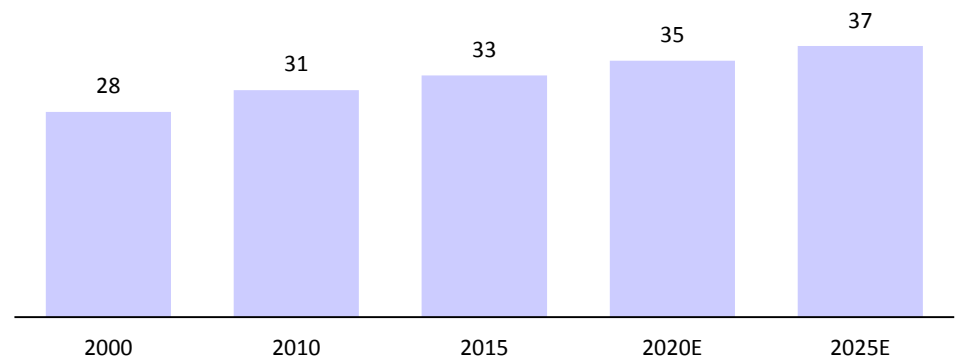
Source: Technopak Report 2017, MOFSL

#3 Increasing urbanization

Every sixth person getting urbanized globally is an Indian

India has the 2nd largest urban community in the world after China, with an urban population of about 435m in FY16. However, at 33%, India’s urban population as a share of total population is still lower than the global average of 54%, highlighting the potential growth opportunity. According to a McKinsey Study, urbanization in India is happening at fast pace, with every sixth person getting urbanized globally being an Indian. It is estimated that by FY20, 35% of India’s population will be living in urban centers, contributing 70-75% of India’s GDP. The urbanization trend is expected to continue, and by FY50, half of India’s total population is likely to stay in urban areas, accounting for well over 80% of GDP. Government initiatives like smart cities to create new ‘urban clusters’ will also expedite urban development / urbanization in India. This indicates that India’s retail growth has a long runway – higher income, more working women in urban centers, and better standards of living should fuel growth for better quality products.

Exhibit 30: Urban population is expected to reach 37% of the total population by 2025 (%)

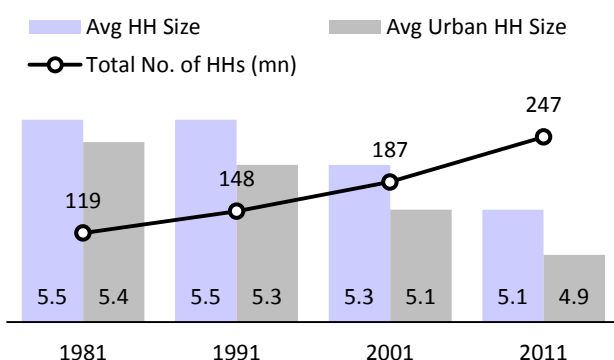


Source: Technopak Report 2017, MOFSL

#4 Growing nuclearization

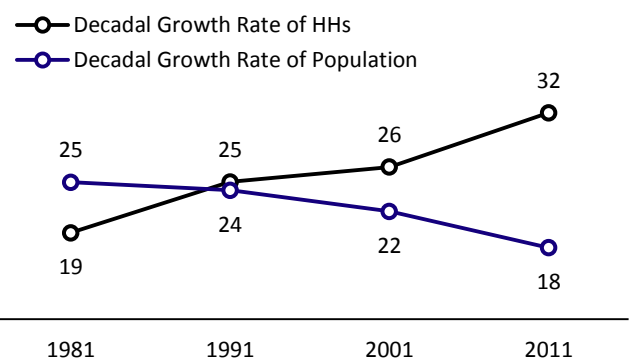
Fall in the average household size coupled with rising disposable income is likely to lead to higher percentage of discretionary spending. About 74% of urban households have five or fewer members according to the census data in 2011 compared to 65% in 2001.

Exhibit 31: Age-wise breakup of population in India



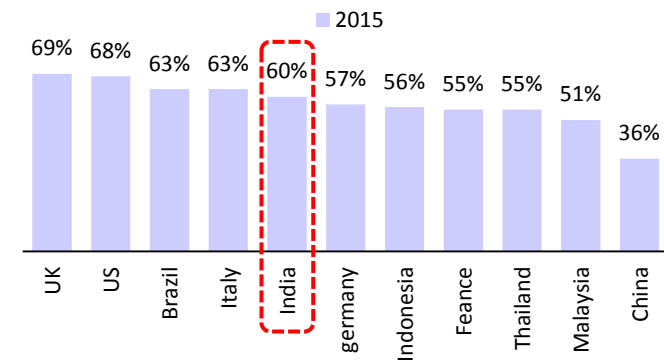
Source: Technopak Report 2017, MOFSL

Exhibit 32: Dependency ratio in India (%)



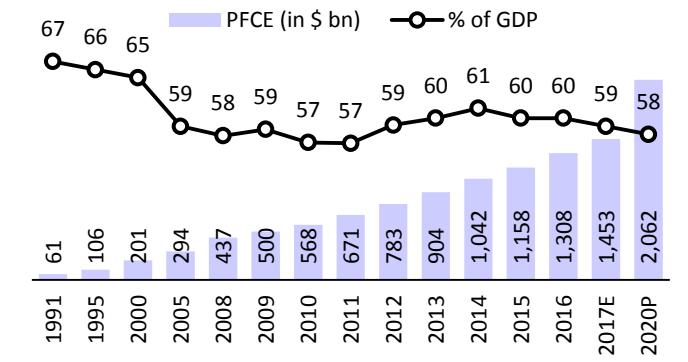
Source: Technopak Report 2017, MOFSL

Exhibit 33: Global comparison of private final consumption expenditure (2015, USD b)



Source: Technopak Report 2017, MOFSL

Exhibit 34: Trend in total private final consumption expenditure for India (USD b)



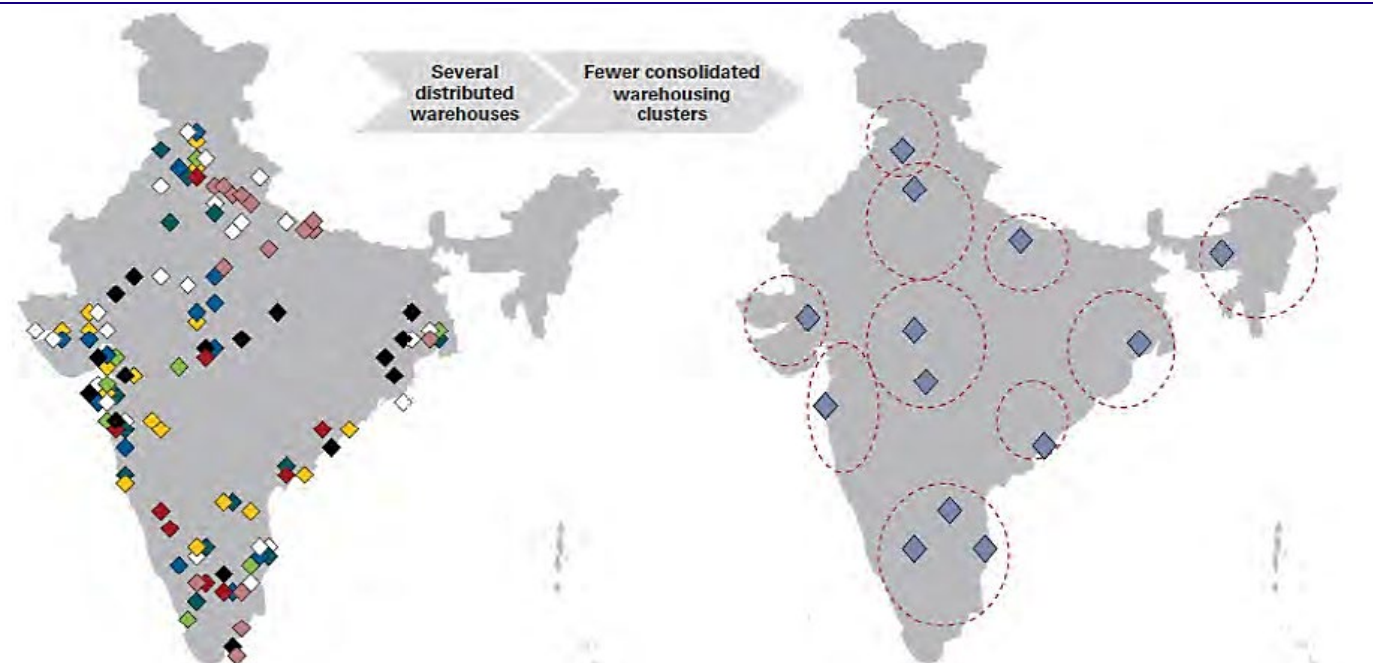
Source: Technopak Report 2017, MOFSL

#5 GST supporting organized market growth

No more warehouses needed in every state – this reduces cost

GST has allowed business owners to start their business faster through a centralized registration process in which they do not have to worry about individual state requirements. With the implementation of GST, the movement of goods across states is becoming easier due to a standardized set of rules in place. Warehouses are not needed in every state and this will help companies reduce costs. Organized players with an all-India presence should benefit and inflows to the formal economy should increase. Digitization should allow businesses access to a larger market.

Exhibit 35: GST will promote the hub-and-spoke model, leading to higher outsourcing and thereby benefit logistics companies



Source: KPMG, MOSL

Ecommerce – more a friend than foe

- Ecommerce has grown at a rapid pace, threatening to derail growth in offline retail.
- However, ecommerce has grown largely in standardized products and yet to gain traction in groceries and apparels.
- A new policy is now in place which seeks to ensure that ecommerce platforms are impartial marketplaces. The policy is a major support to offline retail as it restricts online players from offering deep discounts, cash backs and exclusive product sale.
- Moreover, ecommerce has plateaued in top cities and obstructed by high logistics cost in smaller cities. Thus, there is a strong need for omni presence – i.e. a hybrid (online + offline) model.

Bringing parity between
online and offline playing
field

New ecommerce policy to support offline retail

- Some of the key highlights of the new ecommerce policy are: (a) it does not allow cash back, exclusive product sale or any form of influencing sale price directly or indirectly, (b) it does not allow ecommerce companies to own inventory or purchase more than 25% of any vendor's inventory and (c) it puts accountability on the sellers for products sold in the marketplace and requires companies to furnish RBI compliance annually.
- Offline players – which had come under threat because of rampant discounts, cash back and exclusive product sale by online players – may now have a level-playing field. Also, ecommerce companies may neither be able to control inventory or promote in-house products.
- However, it is yet unclear about how the government will be able to force online players to comply with norms related to discounts and inventory, which could be housed in other entities.

No to steep discounting, exclusive offerings

According to the new guidelines for foreign direct investment in the e-commerce sector, platforms such as Flipkart and Amazon will no longer be allowed to influence the sale price of goods or service, directly or indirectly. Cash back provided by group companies of the marketplace entity to buyers shall be fair and non-discriminatory. Provision of services to any vendor on such terms which are not available to other vendors in similar circumstances will be deemed unfair and discriminatory. Moreover, ecommerce marketplace cannot mandate any seller to sell any product exclusively on its platform only.

No control over inventory

Ecommerce marketplaces cannot own or control inventory (i.e. goods purported to be sold). Such an ownership or control over inventory including any equity participation will render the business into an inventory based model (FDI is not allowed in the inventory model). Inventory of the vendor will be deemed to be controlled by ecommerce marketplace entity if more than 25% of purchases of such vendors are from the marketplace entity or its group companies.

Accountability to sellers

Sellers will be accountable for warrantee/ guarantee of products sold via the ecommerce marketplace. It has become mandatory for marketplace to provide name, address and other contact details of the seller to the customer. All post-sale activities will be the responsibility of sellers – right from delivery of goods to the customers and customer satisfaction.

RBI compliance

Ecommerce companies will be required to furnish a certificate along with a report of statutory auditor to the RBI, confirming compliance of guidelines by 30th September of every year for the preceding financial year.

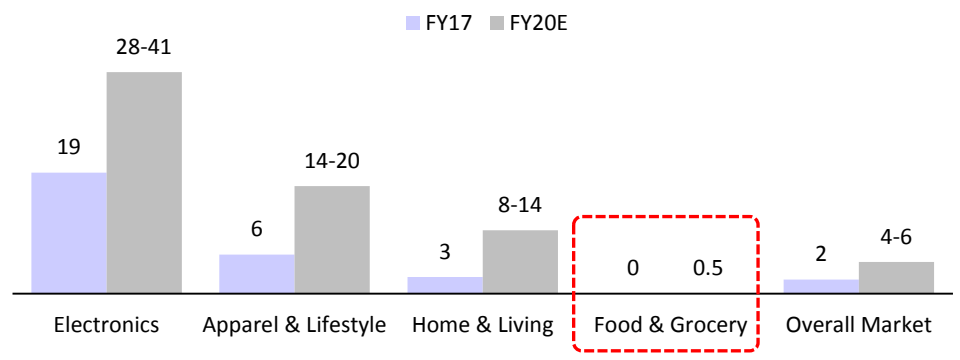
Payments

E-commerce marketplaces can initiate payments for sale in conformity with the guidelines of the RBI.

Online retail market gaining scale

Currently, the e-tail market in India is 2.3% (USD16b) of the overall retail market and is projected to be 4-6% of the overall retail market (USD40b-60b) by CY20, according to Technopak – a CAGR of 46% over FY17-20.

Exhibit 36: E-tail penetration in food & grocery is near zero (%)



Source: Technopak Report 2017, MOFSL

Standardized categories seeing shift to online

Consumer Electronics constitute the major portion of e-tail in India, being a highly standardized category. This is followed by Apparel and Lifestyle. These two categories will continue to lead the online space even in CY20; however, the share of electronics may decline and newer categories like Home and F&G are likely to gain penetration. In CY12, the e-tail pie was only USD0.6b, with the key categories of Electronics, Books, Stationery, and Music catering to ~50% of the pie.

Electronics market has seen biggest damage due to online

Exhibit 37: E-tailing in India – category dynamics

	Description	Eg. Of categories	Rationale
High Impact	E-tail will drive significant Indian urban incremental demand in the next 5 years	Books & DVD's	❖ Greater standardisation
		Small Electronics	❖ Low value, low involvement
		Fashion & Lifestyle	❖ Discretionary/range-brands
Medium impact	E-tail will complement the sales through the existing channels of commerce	Home improvement	❖ Low standardisation and High involvement categories
		White goods	❖ Longer product life/low frequency of purchase
		Kids, Jeweller, eyewear	❖ High ticket price and experience factor
Low impact	E-tail will have limited impact in the next 5 years	Food & grocery	❖ Need based
		Home improvement (eg. Large furniture)	❖ In-adept logistics capabilities
		High value jewellery	❖ Quality consistency

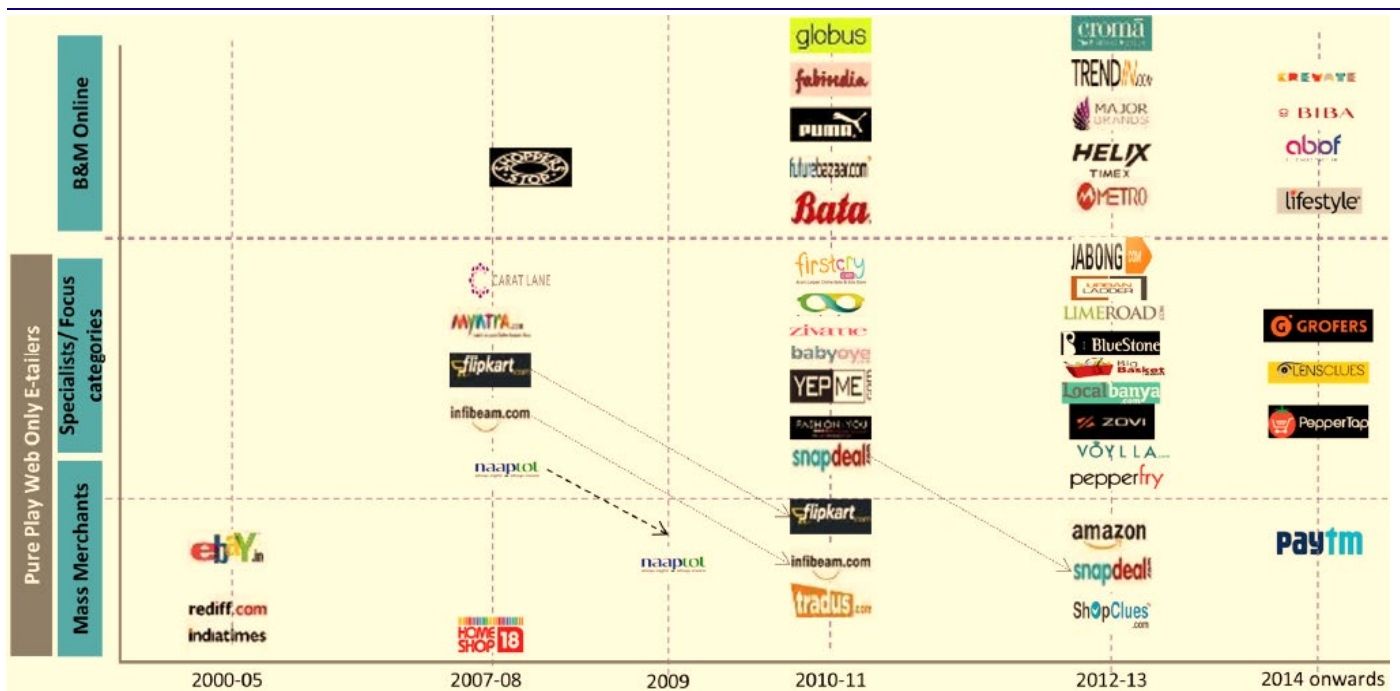
Source: Technopak Report 2017, MOFSL

Some of the key issues in ecommerce market are

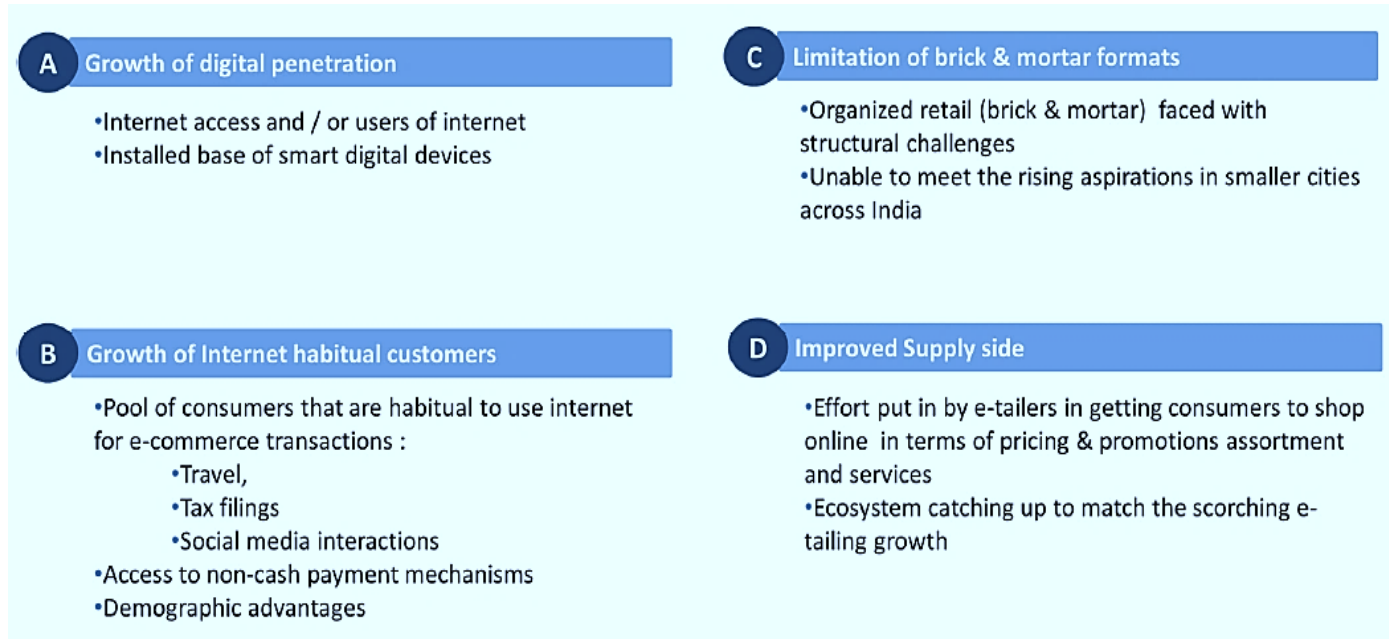
- Supply chain & logistics
- Perishability
- Cyclicity
- Installation
- Service support
- Customization

Among the above factors, ecommerce players have addressed issues like installation, service support and supply chain/logistics, which has led to higher penetration in electronics, lifestyle and home products. The growth in F&G has so far remained lackluster and will depend on how ecommerce players manage supply chain and perishability issues.

Exhibit 38: Evolution of e-tailers



Source: Technopak Report 2017, MOFSL

Exhibit 39: Growth drivers of e-tailing in India

Source: Technopak Report 2017, MOFSL

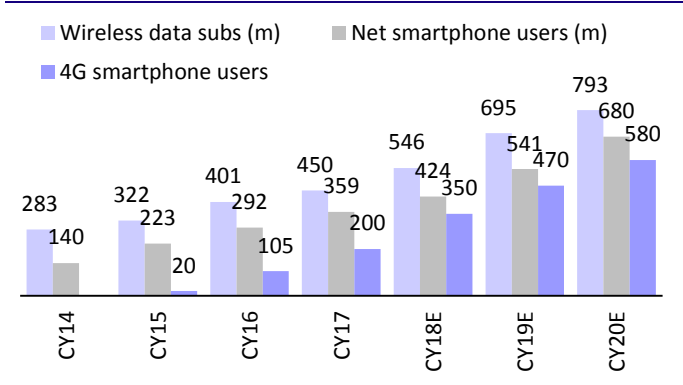
Data ecosystem driving online consumption**Millennials driving online consumption**

In the last 5-7 years, the internet ecosystem in India has improved drastically, driving up data usage exponentially. This is backed by (a) availability of smartphones with high configuration at low price, (b) improvement of data network coverage and speeds, and (c) reduction in data pricing. Being a young country, India has seen strong data penetration among younger people – the millennials. Over the next few years, millennials are expected to redefine the consumer story owing to their deeply-tied mobility and connectivity practices. Based on a survey of urban millennials across India by Deloitte, almost all millennials own a smartphone with nearly 84% 3G/4G penetration, implying mobile phones being the primary devices used to access the internet. Further, the traffic towards ecommerce websites, banking transactions and online purchases too has seen strong growth. This attractive target market should continue driving up penetration of ecommerce in India.

To attract millennials, companies are:

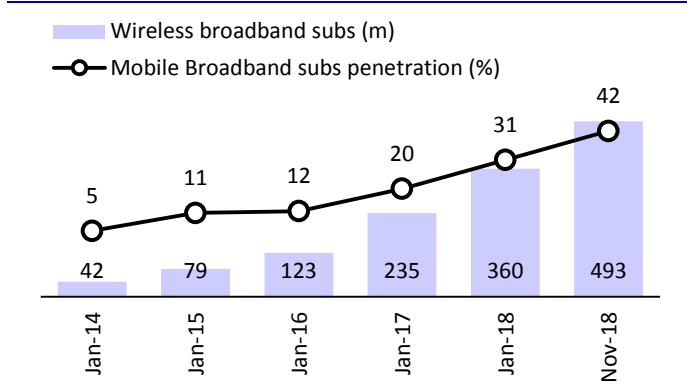
- Investing in Omni Channel to fill a key distribution gap used by millennials.
- Emphasizing on greater mix of value for money products like Value apparels segment which fills the gap between Branded apparel and unorganized products.
- Focus on social media including product launch campaigns to reach out to millennials.

Exhibit 40: Smartphone base likely to grow 1.9x in three years



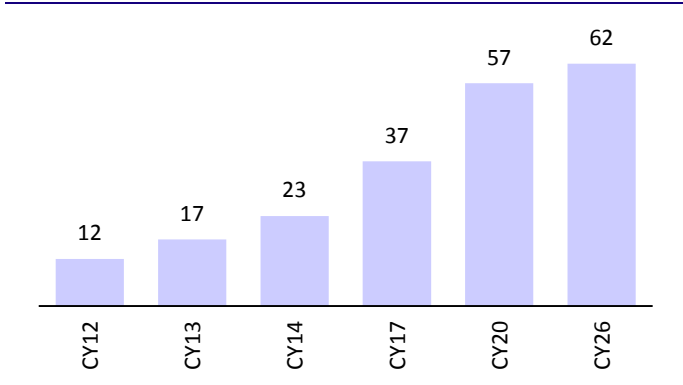
Source: Industry estimates, MOFSL

Exhibit 41: Penetration of mobile broadband subscribers has been on an uptrend



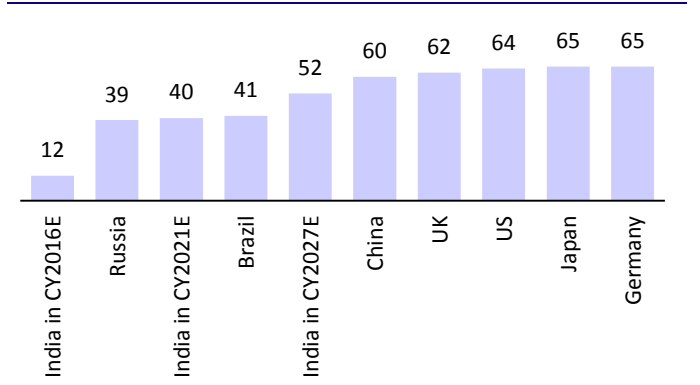
Source: TRAI, MOFSL

Exhibit 42: Significant shift expected in India's internet penetration (%)



Source: Industry estimates, MOFSL

Exhibit 43: Expect shopper penetration growth in next 5-10 years (%)



Source: Industry estimates, MOFSL

Exhibit 44: Indian online retail market to reach 12% of total market by CY27

Particulars	CY17	CY27
Total internet users (m)	432	915
Internet penetration (%)	33	62
Total online shoppers (m)	60	475
Online shoppers as a % of total internet users	14	52
Total online retail market size including food delivery (USD b)	15	200
Total online retail as % of total retail (%)	2	12

Source: Industry estimates, MOFSL

Exhibit 45: Comparison of operating and financial metrics of e-commerce players

Metrics	Amazon	Flipkart	Paytm Mall
Registered Users (mn)	115	>100	80
Active Users (mn)	N/A	54	N/A
Monthly Unique Visitors (mn)	154	110	22
Sellers ('000)	~300	>100	~75
GMV (US\$ mn)	(FY17) ~4,800	(FY18) ~7,500	(Annualized FY18) ~3,000
Product listed (mn)	168	80	N/A
Warehousing Space (mn cubic feet)	13.5	12	N/A
Key Categories	Smartphones/Electronics, Fashion, FMCG	Mobile/Electronics, Fashion, Large appliances	Electronics, Grocery, Fashion
Captive Payment Options	Amazon Pay	Phone Pe	Paytm

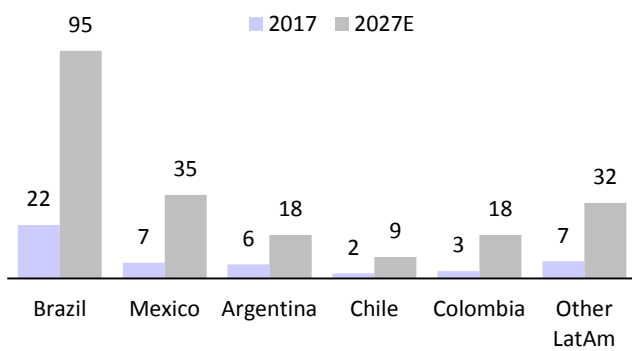
Source: Industry estimates, MOFSL

Exhibit 46: UPI payment ecosystem

	Phone pe	Tez	Paytm	WhatsApp	Amazon Pay
Key Stakeholders	Flipkart, Walmart, Tiger Global, Naspers, Microsoft, Tencent, Steadview Accel India	Alphabet	Softbank, Alibaba Group, SAIF partners, Silicon Valley bank	Facebook	Amazon Pay
UPI launch date	Aug-16	Sep-17	Nov-17	Feb-18	Feb-18
Users/Engagement	75m	16m	330m	250m	160m
Digital wallet	Yes	No	Yes	No	Yes
Payment service provider	Yes Bank	ICICI Bank, Axis Bank, SBI, HDFC bank	Paytm payments bank	ICICI Bank, Axis Bank, SBI, HDFC bank	N/A
Merchant partners	0.06m	0.5m	7m	N/A	0.3m

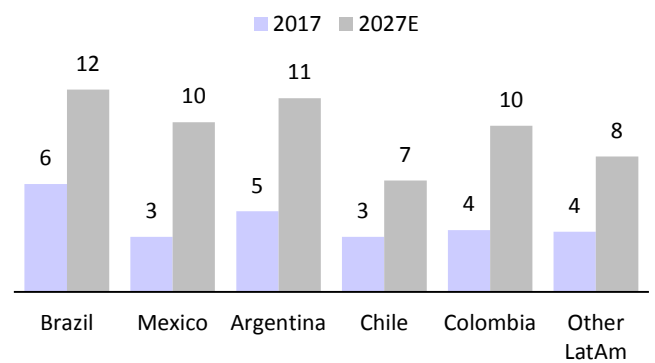
Source: Industry estimates, MOFSL

Exhibit 47: Overview of online spends in Latin America (USD b)



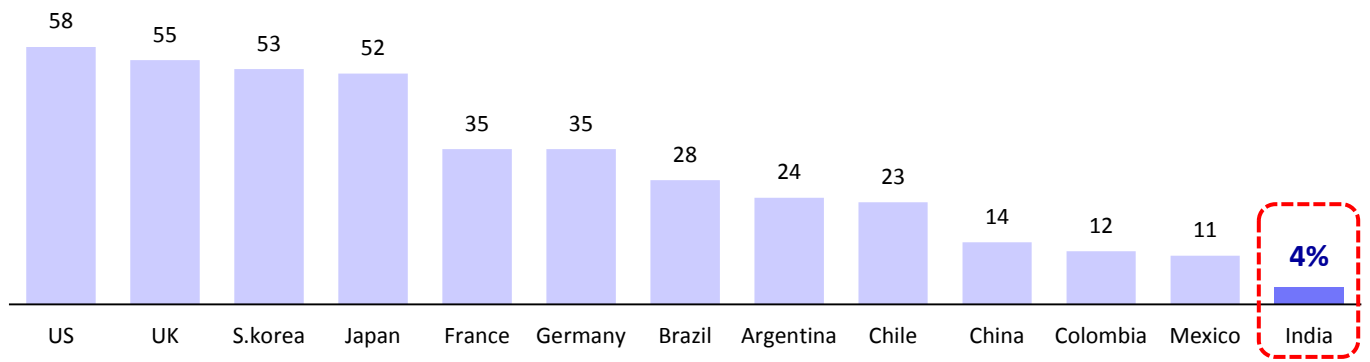
Source: Industry estimates, MOFSL

Exhibit 48: Overview of online retail penetration in Latin America (%)



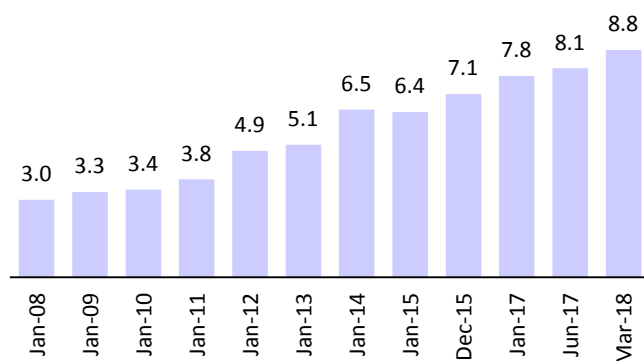
Source: Industry estimates, MOFSL

Exhibit 49: Global credit card penetration (%)



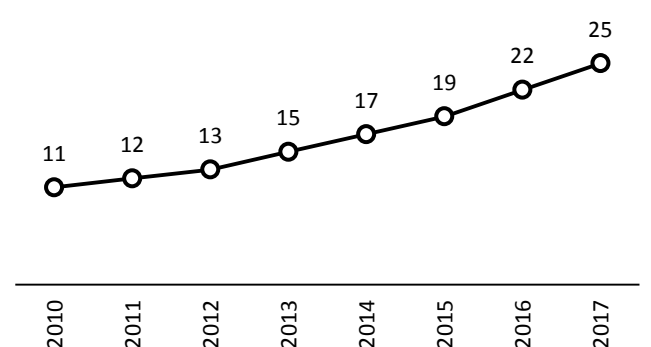
Source: Industry estimates, MOFSL

Exhibit 50: Australia – online sales as % of total retail sales



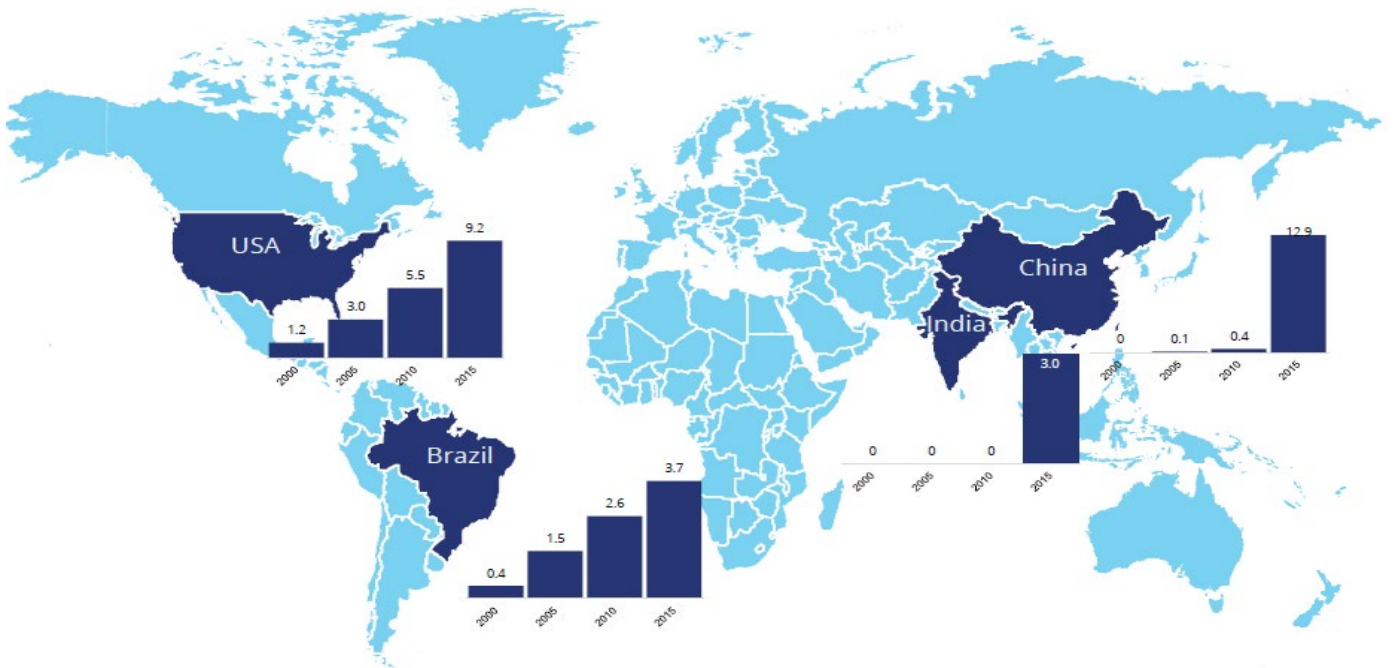
Source: Industry estimates, MOFSL

Exhibit 51: Korea – online retail penetration (%)



Source: Industry estimates, MOFSL

Exhibit 52: Online retail as a % of country's total retail



Source: Trend-setting millennial report 2018, MOFSL

Operating models: E-tailing in India

Currently, there are broadly three operating models followed by e-tailers.

- **Inventory-led:** The e-tailer stocks products and sells directly to the consumer. This again could be an outright purchase model, where the e-tailer owns the stocks, or a consignment model, where the e-tailer does not own the stock, but simply warehouses the inventory and returns unsold inventory.
- **Managed marketplace:** The e-tailer is a listing platform for the seller, but the logistics, product quality and packaging are managed/controlled by the e-tailer to maintain quality and delivery standards.
- **Pure marketplace:** The e-tailer is only a listing platform for sellers. The logistics are managed by the sellers.

Consolidation in online marketplace

The e-tailing landscape in India is presently dominated by web-only e-tailers, particularly by marketplace players. The top players – Flipkart, Amazon, Paytm and Snapdeal – have >80% of the total market. Several other marketplace players such as Shopclues, E-bay, Indiatimes, Home Shop 18, etc, have 10% of the total e-tailing market. The niche players focusing on specific categories are estimated to be contributing to around 10% of the e-tailing market and should consolidate as the marketplace players expand their wings in similar product categories.

Exhibit 53: Big players account for >80% of the market

Players	Market share (%)
Flipkart, Amazon, Paytm and Snapdeal	More than 80
Shopclues, E-bay, Indiatimes, Home Shop 18, etc	~10
Others	Less than 10

Source: MOFSL, Company

Exhibit 54: E-tail models operating in India

		Current Operating Models		
		1 Inventory led	2 Managed Marketplace	3 Pure Marketplace
Defn.		The e-tailer outright purchases/stocks products from the vendor and sells it directly to the consumer. In consignment model e-tailer does not own the stock	The e-tailer is a listing platform for the seller but the logistics/product quality/packaging is managed/controlled by the e-tailer	The e-tailer is only a listing platform for sellers. The logistics is managed by the seller
PROS		<ul style="list-style-type: none"> • Visibility into the stock levels • Higher fulfillment rate & faster dispatch time • Better brand credibility & customer confidence • Higher margins than other options • Can enable curation 	<ul style="list-style-type: none"> • No capital tied up in inventory • Lesser space tied up in inventory since only few days stocking (or no stocking) for key products done • Higher control over quality of the product • Government policies favor marketplace 	<ul style="list-style-type: none"> • No Inventory storing & handling costs • Wider product offering • Government policies favor marketplace
CONS		<ul style="list-style-type: none"> • Capital tie-up in case of outright purchase • Increased inventory mark-down risk • Risk of building non selling products • Limits range which can be offered 	<ul style="list-style-type: none"> • Longer delivery cycles (for Back to back model) • Seller ecosystem is not evolved hence training and control needed • System integration with seller required • Lower margins than inventory led 	<ul style="list-style-type: none"> • Non standardized customer service • Multiple listing of the same product • Poor vendor service resulting in poor customer experience • System integration with vendor required

Source: Technopak Report 2017, MOFSL

Ecommerce sales plateauing in top cities

Geographically, online shopping activity has not been broad-based. The top 10-15 cities still account for over 75% of total sales. Even in the large cities, to drive growth and customer stickiness, e-tailers are using cashback offers, fast delivery, flexible return policy, and low delivery charges through subscription model to drive growth. Growth will slow down in the top cities, as they are already highly penetrated and players need to move to the next level of tier-II and tier-III cities to sustain growth. Presently, smaller ticket size and logistical complexity have restricted growth of e-tailers in tier-II, tier-III cities and beyond.

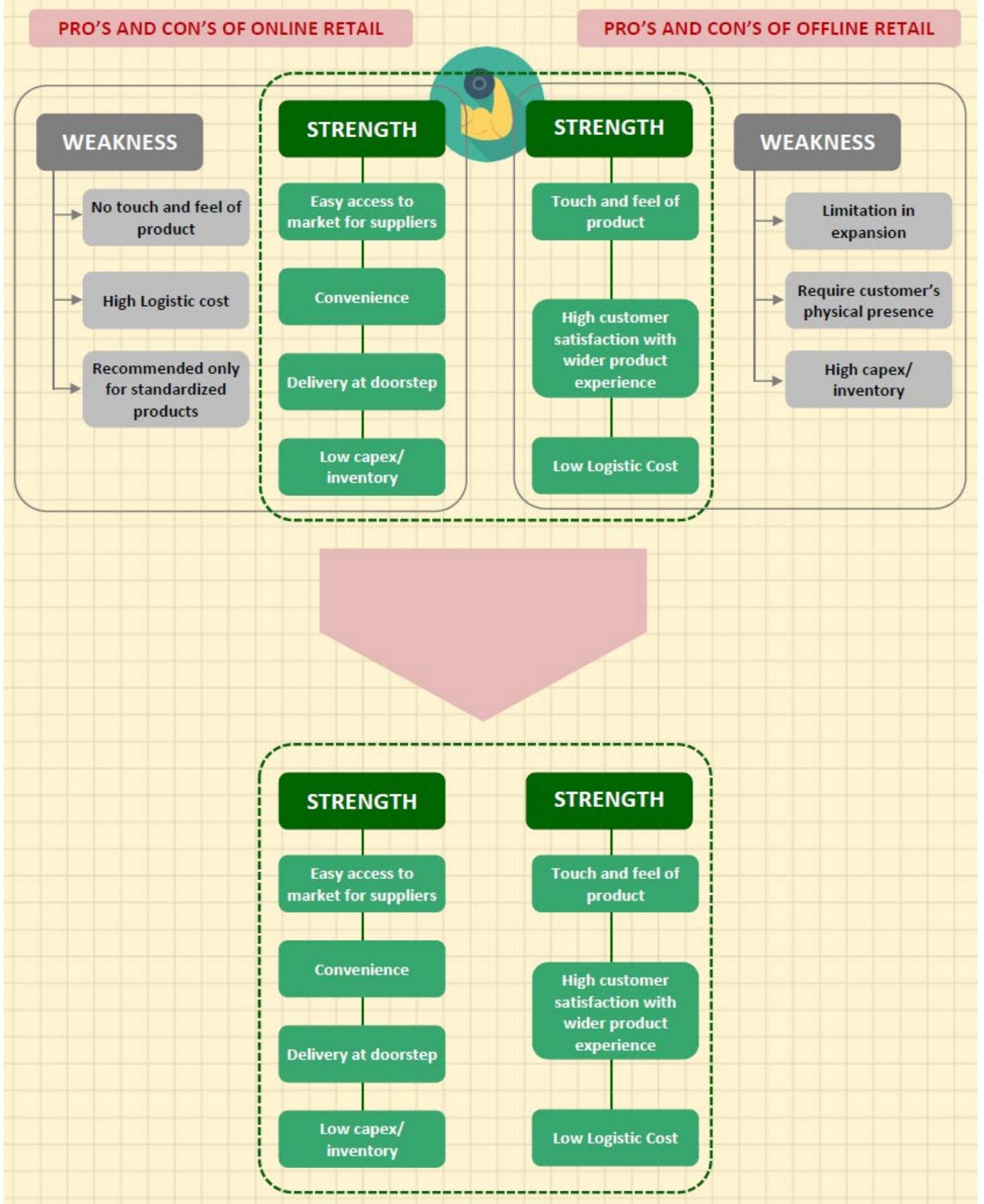
High logistics cost of online players pushing convergence with offline

Advent of Multichannel – Omni Presence

On the one hand, ecommerce players need to increase depth of coverage. On the other, brick and mortar players are looking to tap online distribution to bridge the gap of offline and online demands.

Presently, ecommerce sales of brick and mortar companies contribute 1-2% of the ecommerce market. This space makes logical sense for brick and mortar chains, as their existing stores can work as fulfilment centers, giving them advantage of both hyper-local and inventory-led models, reducing the logistics cost, which remains the biggest cost burden for e-tailers. Additionally, they can tap consumers preferring to shop from the comfort of their homes. In the last one year, we have seen multiple instances of e-tailers initiating physical presence, and of brick and mortar retailers expanding online presence.

Exhibit 55: ECOMMERCE – HYBRID MODEL EVOLVING



Source: MOFSL

- Reliance Fresh has piloted its online grocery business in Mumbai and is looking to scale up to other large cities
- Spencer’s Retail has acquired Meragrocer.com for its online foray
- Godrej’s Nature’s Basket has acquired EkStop to enter online grocery
- Amazon has tied up with Shoppers Stop; media reports indicate Amazon is in talks with other retail groups for similar tie-ups
- The Tata group has started Tata Cliq with minority investment from Trent
- Some regional players like SRS Grocery with a strong presence in the National Capital Region have also forayed into the e-commerce space

As consumer demand grows for both online and offline distribution, we believe more online and offline players will either merge or expand reach progressively through both mediums, reducing the difference between each type of player.

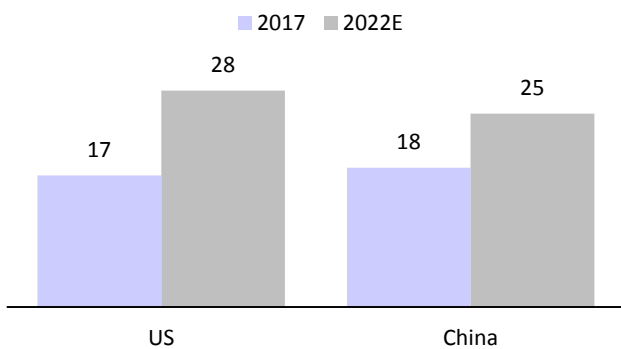
US/China online user spend nearly 3-4x v/s India

Taking cues from US and China market

US and China’s ecommerce market penetration is at 17% and 18%, respectively. In US/China, 30%/70% of the market is covered by Amazon/Alibaba, which has primarily driven the growth in respective markets. However, both US and China have a strong online user ecosystem, with online population base of 251m and 720m, respectively, that is, a strong 77% and 54% penetration rate.

On an average, a US online user spends USD1,777 annually, while a Chinese online user spends USD1,316 annually on retail. This is significantly higher than Indian online users, spending ~USD500 annually, with an annual market size of USD16b – 2-3% of US/China’s online market. As internet users accelerate on a healthy data ecosystem, the retail industry in India should also grow in line with US and China.

Exhibit 56: Ecommerce penetration is rising in US & China, %



Source: Industry estimates, MOFSL

Exhibit 57: China’s retail & online spends are expected to grow faster than US

	US		China	
	2017	2022	2017	2022
Population online (m)	251	268	720	802
Retail spend (USD b)	2,654	2,845	5,323	8,403
Retail spend per capita (USD)	8,135	8,011	3,973	5,994
Online spend (USD b)	446	796	947	2,112

Source: Industry estimates, MOFSL

Exhibit 58: Increasing footprint of Amazon in India

Period	Particulars
Jun-13	❖ Launched Amazon market place
2014	❖ Pledged USD2b investment
2016	❖ Increased the pledged investment to USD5b
July-16	❖ Launched Amazon prime
Dec-16	❖ Launched Amazon video
	❖ Built 60+ sortation and fulfilment centres
	❖ Prime, Video, producing local content
	❖ Partner with offline retailers (over 6k stores)

Source: Industry estimates, MOFSL

Exhibit 59: Increasing footprint of Alibaba in India

Period	Particulars
Aug-15	❖ USD200m investment in Snapdeal
Mar-17	❖ USD177m investment in Paytm
Feb-18	❖ USD146m investment in Bigbasket
	❖ Expanding Paytm into eCommerce w/ Paytm Mall

Source: Industry estimates, MOFSL

Penetration of online food & grocery segment stands at >1%

Next step: Food and Grocery foray of e-tailers

The online grocery segment, which had a handful of players two years ago, has lately seen an uptick in the number of players as well as investor interest. In the overall food retail industry, the penetration of online food and grocery (F&G) segment stands at a miniscule ~0.1%, indicating significant growth potential. Major players such as Big Basket and Grofers, as well as new entrants such as Amazon, Flipkart, and Reliance are sharpening focus, resulting in an increase in investments in the high-volume, low-margin segment by over 7x from ~INR3b in FY17 to ~INR20b in 9MFY18.

Exhibit 60: New players raising the heat

Players	Description
Amazon	❖ Received FDI approval in 2017 to invest around Rs 35 billion into food and grocery business over the next five years
Flipkart	❖ Did a soft launch of online grocery delivery service Supermart in Bengaluru in 2017
Reliance Jio	❖ The company is undertaking an online-to-offline pilot study to create an operational model that will allow consumers to buy at neighbourhood shops using digital coupons through its Jio Money platform or text messages
Starquik	❖ Launched in December 2017, this is an omni-channel foray by the Tata Group
D-Mart	❖ Apart from offline, the company is also offering groceries online

Source: CRISIL report, MOFSL

Juggling between inventory and hyperlocal model

Food & Grocery e-tailing yet to determine a sustainable model

F&G is the largest category in retail (commanding ~2/3rd share). Also, online penetration in the F&G category is small at <1%, given that it is a more recent and challenging category than others in the online space.

The Indian grocery e-tailing story started in 2011-12, when players like Big Basket, EkStop, Zopnow and LocalBanya entered the market with different operating models. The segment gained traction with the entry of hyperlocal players, Grofers and Peppertap in 2013-14, as well as heightened investor interest. At the same time, several others have shut / scaled down operations or got acquired. E-tailing bigwigs like Amazon, Flipkart and Paytm also entered in the market in 2015.

Inherent structural and operational challenges in selling grocery online

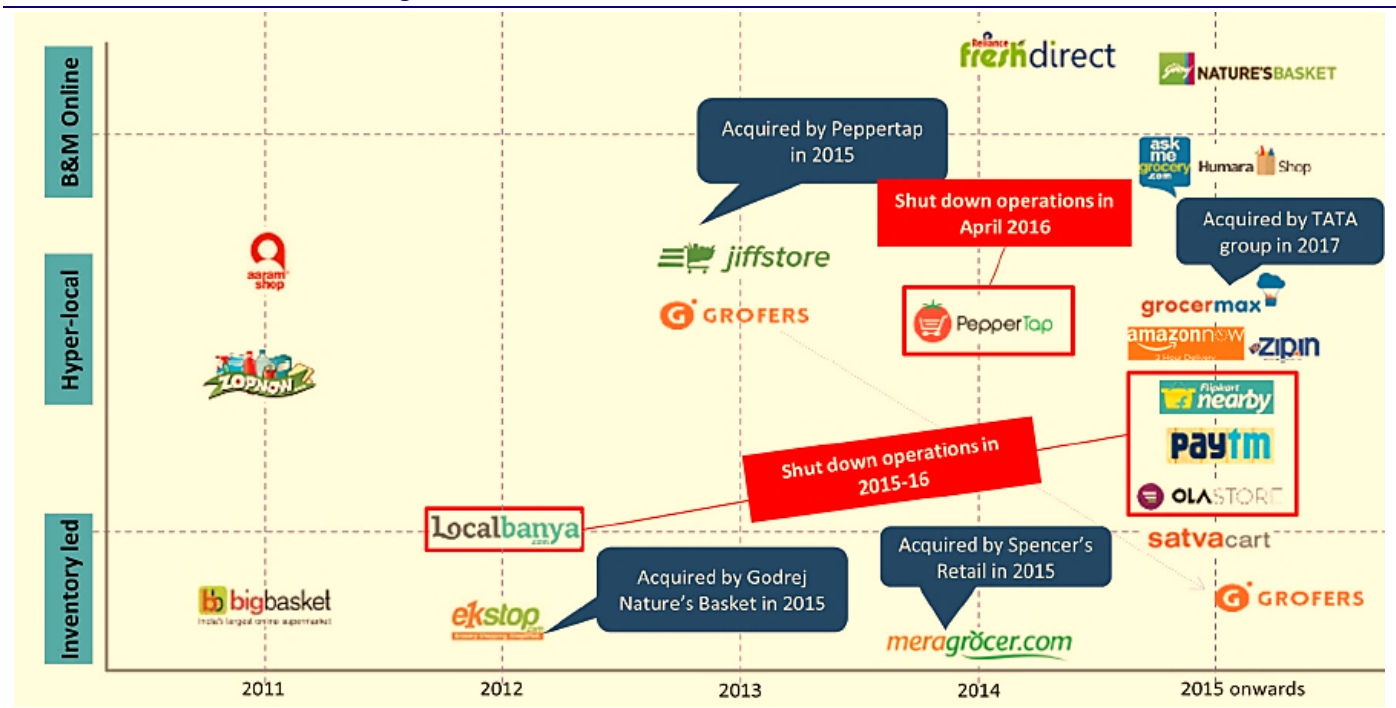
- Low demand in smaller cities
- Wider SKU offerings, albeit at low margin: City-specific, local, multiple categories and brands

- Ubiquitous neighborhood formats
- Sub-optimal logistics
- Handling perishables
- High volume game
- High quality and delivery targets
- Manpower: High attrition increasing minimum wages

The category has evolved to get segmented into players with distinct business models:

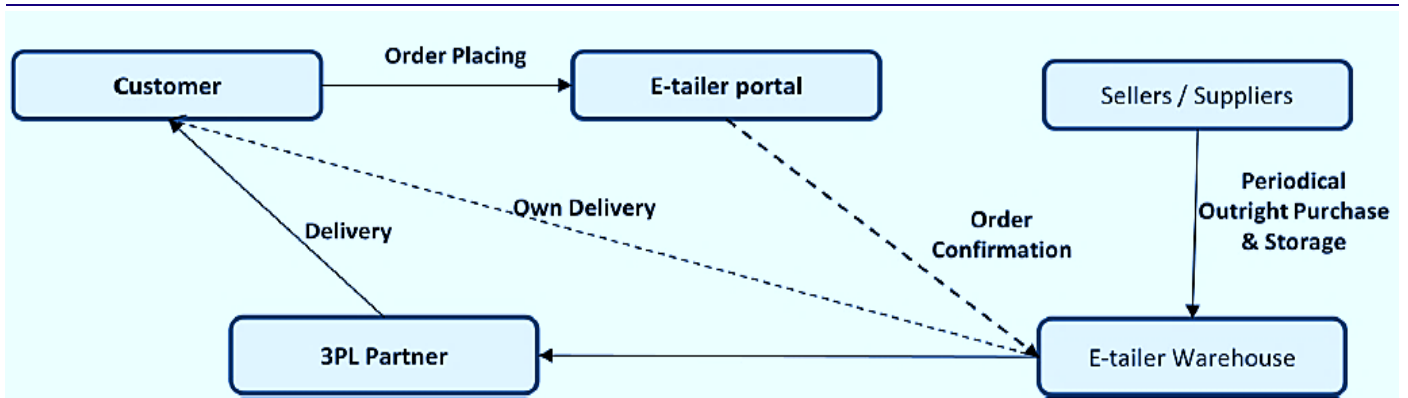
- Inventory-led
- Hyper-local
- B&M online

Exhibit 61: Evolution of F&G e-tailing in India



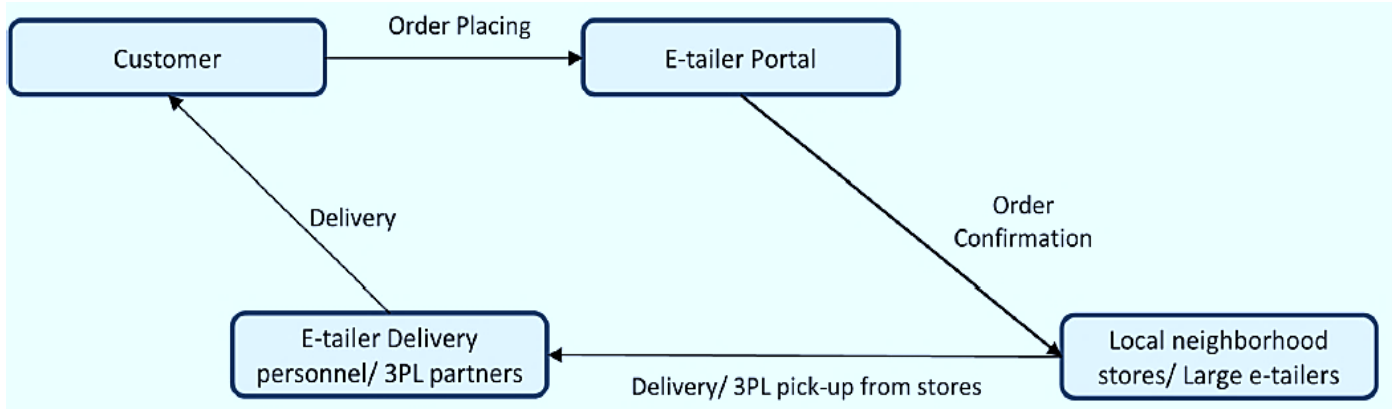
Source: Technopak Report 2017, MOFSL

Exhibit 62: Inventory-led model



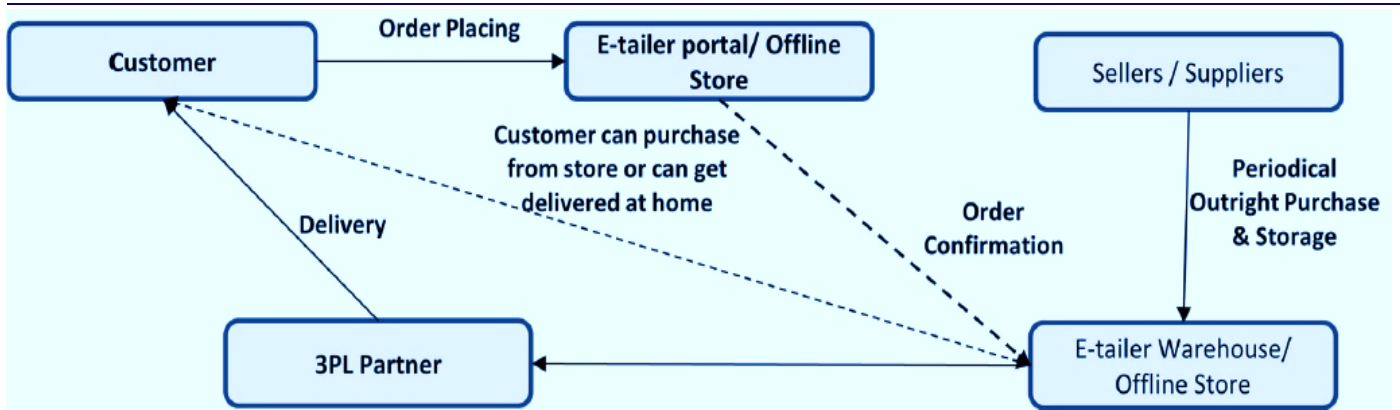
Source: Technopak Report 2017, MOFSL

Exhibit 63: Hyper-local model



Source: Technopak Report 2017, MOFSL

Exhibit 64: Multi-channel model



Source: Technopak Report 2017, MOFSL

Exhibit 65: Comparison between business models in food & grocery e-tail

	Inventory led	Hyper local	Multi-channel
Inventory storage	Inventory heavy model as it involves outright purchase of inventory	Inventory light model as it involves only providing infra & logistics support	Hybrid model combining features of inventory led and hyper local model
Capital requirement	Capital intensive	Capital light	Moderate capital
SKU's	High	Low	Moderate
Lead Time	High	Low	Moderate
Margin potential	High	Low	Moderate

Source: Technopak Report 2017, MOFSL

Changing business model in food e-tailing

Most players that experimented with the inventory model either shut down got acquired or shifted to other models. While the inventory model allows stringent quality checks and faster delivery timelines, it is difficult to sustain, given the perishable nature of the product and vast number of SKUs. Some of the players that shut down or scaled down operations after testing inventory models are EkStop, LocalBanya, Zopnow, and Grofers.

Low margin, high logistics cost key obstruction for online players

Hyper-local model could be difficult

The hyper-local model may not be an answer to F&G due to low margin and quality adherence/delivery. A combination of inventory-led dark store and multi-channel model may eventually succeed; this model may lead to a firm handle on inventory as well as relatively higher margins to sustain the business. We believe the future e-tail market is likely to see growth from omni-channel players, as the interlink of brick-and-mortar with online present becomes prominent.

Omni presence a good solution for F&G

F&G online is being chased by players like Amazon and Big Basket. However, logistics management, particularly due to high number of SKUs and perishable product portfolio makes it a difficult business to manage. Further, the F&G market in India is influenced by regional preferences.

We believe F&G online may have a complementary existence to organized brick-and-mortar players. Organized F&G players may explore a play of multi-channel distribution. This may solve issues related to logistics, perishability and regional preferences. Having physical presence close to the delivery location could reduce logistics cost and also allow fresh produce, particularly of food products, which have low shelf life. There is also scope for private label players to enhance margins.

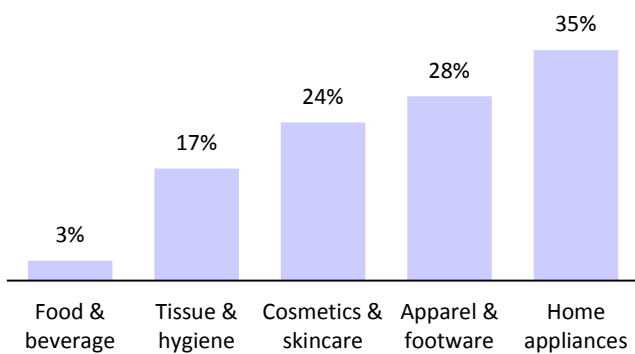
We believe online players could adopt any of the following options: (a) acquire existing retail stores, (b) operate a mix of designated and dark stores/distribution centers, or (b) open own retail outlets for food and use private brand play (single brand) for non-food retail, which could have low scalability or turnaround time.

Globally, F&G has seen limited online success

Globally, search for sustainable model for F&G continues

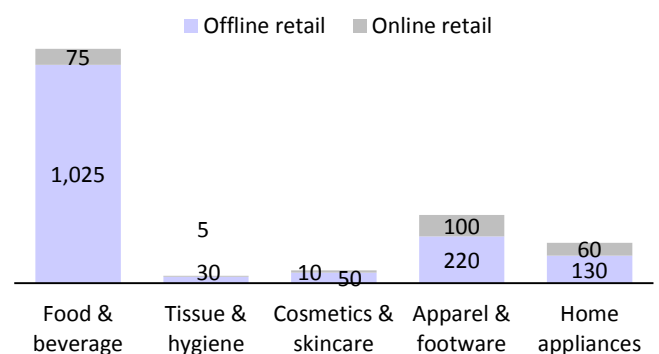
Ecommerce, the world over and in India, continues to work on the sustainable model for Food and Grocery (F&G). In 2016, F&G comprised less than 4% of the total share of the world’s ecommerce size. In India as well, the share of F&G in ecommerce is ~2.5%. Online penetration of the F&G category is <1% and is expected to remain below 1% even in 2020. Globally, in UK, US and other Asian countries like China, Japan, the penetration of online F&G remains in single digit despite strong penetration of the overall online retail market.

Exhibit 66: China – B2C ecommerce penetration (2017, %)



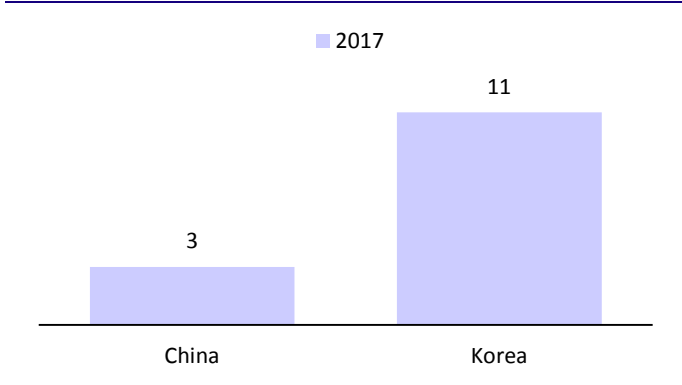
Source: Industry estimates, MOFSL

Exhibit 67: China – online v/s offline sales across categories (USD b)



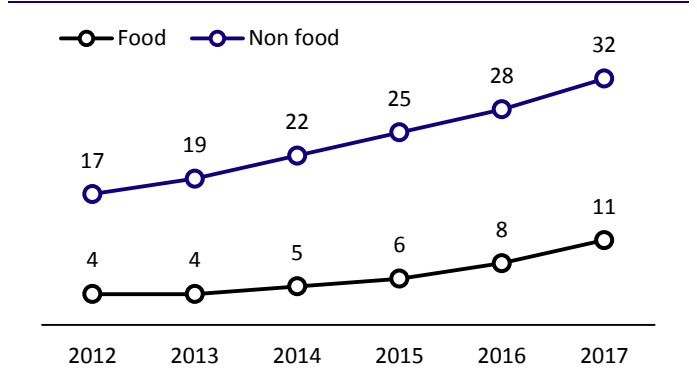
Source: Industry estimates, MOFSL

Exhibit 68: Comparison of online penetration for food category (%)



Source Industry estimates, MOFSL

Exhibit 69: Korea: Online penetration only 11% for food category (%)



Source: Industry estimates, MOFSL

High last mile cost a big hindrance

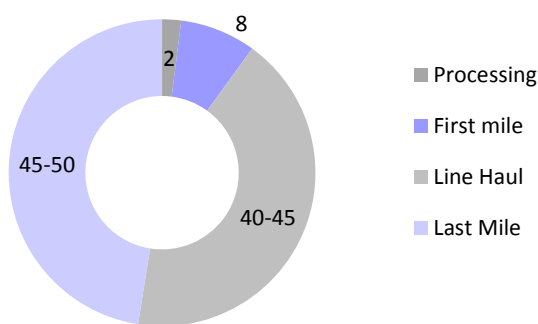
Logistics cost - a big burden

Transportation cost remains the major factor in ecommerce logistics cost

The ecommerce business incurs logistics cost primarily towards four segments: transportation, warehousing, freight forwarding, and value-added logistics. Transportation alone holds 60% share of the logistics cost and the rest 40% is contributed by warehousing, freight forwarding, and value-added logistics among others. In-house logistics arms of large e-retailers execute over 70% of the deliveries. Within the transportation cost, the two segments that cater to the majority of the cost are:

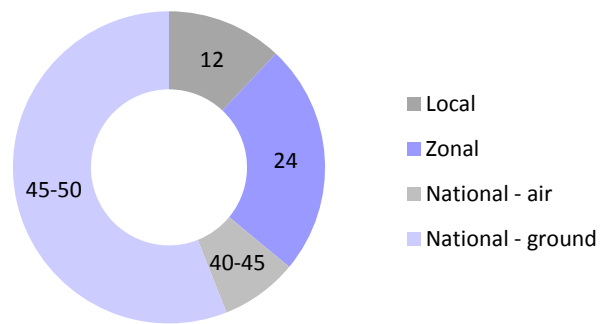
- a. Line haul, supporting the movement of freight between distant cities (by land, air or waterways), contributes a sizeable 40-45% of the transportation cost. ~40% of line haul is by air due to time sensitivity and service commitments. This is unsustainable in the long run and a shift to rail/road is inevitable.
- b. Last mile, supporting movement of goods from transportation hub to the final delivery destination, contributes the balance 45-50% in India. This compares with 25-30% in the developed economies.

Exhibit 70: Ecommerce retail transportation cost split (%)



Source: E-commerce-retail-logistics - May-18, MOFSL

Exhibit 71: E-tail logistics shipments split by zone (2018,%)



Source: E-commerce-retail-logistics - May-18, MOFSL

Low order value increases logistic cost burden

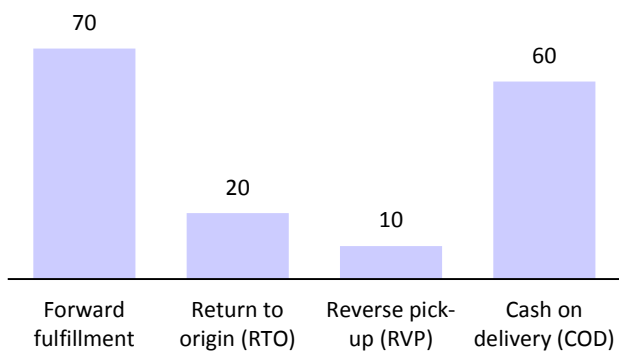
Forward logistics cost remains 10%, about 3x that in China

In India, e-commerce forward logistics cost constitutes 10% of the average order value (AOV), which is ~USD2/order. This should be less than 5% for sustainability. The comparable logistics cost per order in China is USD2.2/order, but with 3x higher AOV, that is, USD2.2/order for an AOV of USD60, 3-4% cost/delivery.

Delivery failures, returns and COD pushes logistics cost

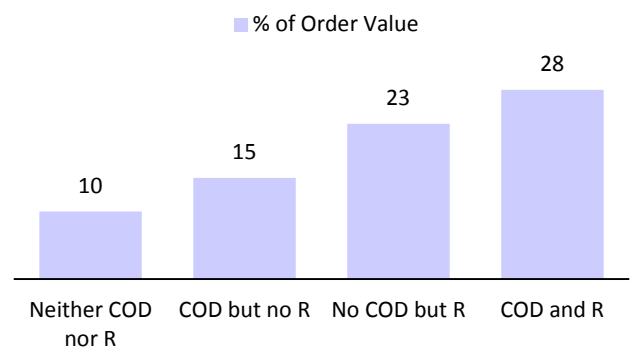
If we include the cost of reverse pick (R) and cash on delivery (COD), the overall cost/order rises to 28%. On a portfolio basis, including (a) returns, (b) non-delivered products, and (c) cash on delivery sales, transportation commands 22% of the total order value. This makes it unviable, especially in the retail business, which operates on low gross margins. Addition of warehousing, freight forwarding and other value-added logistics could stretch the overall logistics cost/order to 30-35%. Typically, of the overall online orders, 30% are returned due to (a) return by the consumer – 10% of sales, and (b) not reaching the destination – 20% of the portfolio. COD constitutes 50-55% of the orders and this costs 150% above the forward fulfillment cost.

Exhibit 72: Share in total volume of shipments (%)



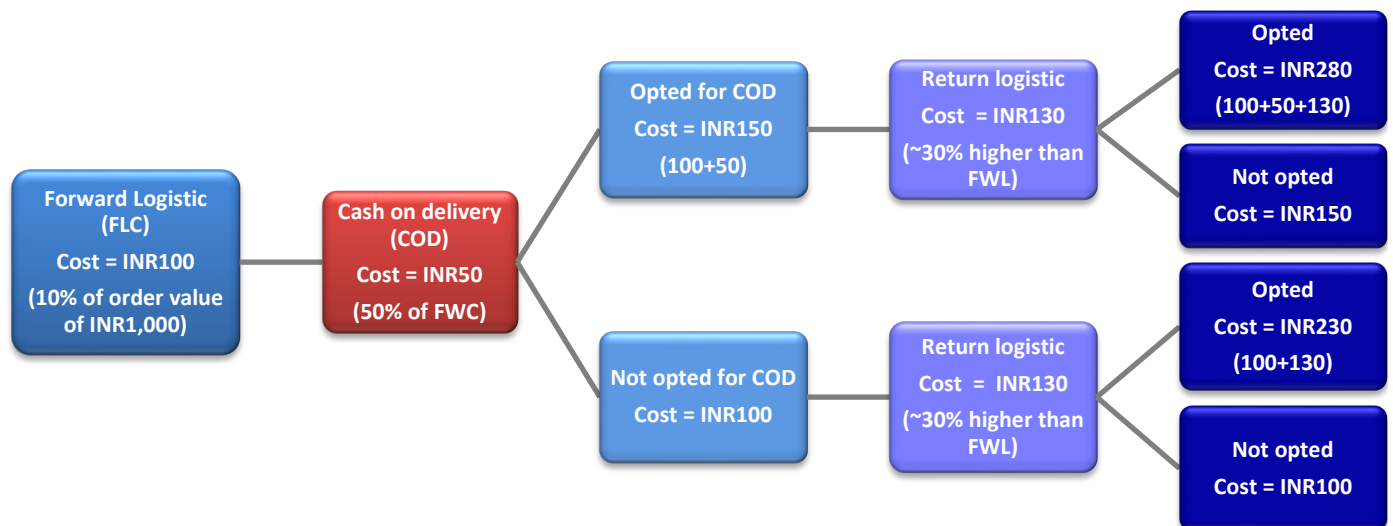
Source: E-commerce-retail-logistics - May-18, MOFSL

Exhibit 73: Summary logistics cost working (%)



Source: E-commerce-retail-logistics - May-18, MOFSL

Exhibit 74: Detailed logistics cost working



Source: E-commerce-retail-logistics - May-18, MOFSL

First attempt delivery strike rate remains a dismal 75%. The average number of delivery attempts per shipment is estimated to be as high as 1.4x, contributing to the inefficiencies. COD, on the other hand, increases the settlement period, lengthens the cash conversion cycle, and also increases the risk of rejection and returns. These challenges associated with COD have added to the complexities.

Trend is reversing – cutting cost on line haul, COD and returns

Ecommerce players are shifting line haul from air to road transport, helping cut costs by almost half. Also, with the implementation of GST, e-tailers are spreading their footprint of fulfillment centers (FCs) pan-India, reducing travel time and distance, and saving costs. Traditionally, e-tailers established FCs in locations where they enjoyed tax benefits, resulting in larger number of national shipments. This is not required any more, as they get input tax credits. They are making significant efforts to reduce COD and returns to cut transportation cost to 6-7%, which will make the ecommerce model more viable.

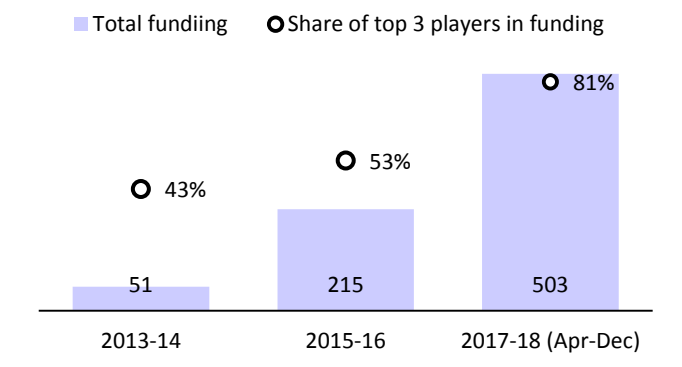
Reversal of era of ‘heavy loss funding’ driving e-tail market

With an eye on profitability, only a handful getting incremental funding

In the last few years, frenzied discounting on retail websites ended badly for many investors, who saw their equity getting wiped out. About 26 prominent start-ups have shut down in the past two years. Investors are now putting money into just a handful of players holding dominant market share and showing sustainability of business. Overall funding increased by more than INR250b in 9MFY18 as compared to entire fiscal 2017, but the number of players funded reduced by ~30%, underscoring the caution and sharper focus after the losses. As per CRISIL Research, of the total amount invested over FY14-16 in 11 major e-tailers, almost 45% of >INR400b was wiped off due to losses.

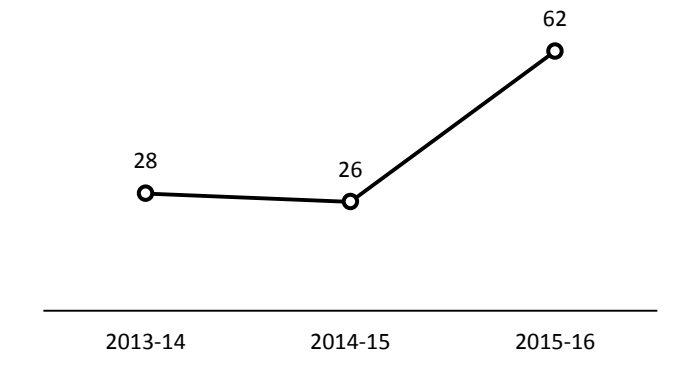
Funding for the top-3 players has increased from 40-45% of overall investments in FY14 to 75-80% in 9MFY18 out of 30 e-tailers, as per CRISIL Research.

Exhibit 75: Thriving three pull money (INR b)



Source: Industry estimates, MOFSL

Exhibit 76: How they bled (losses/funding, %)



Source: Industry estimates, MOFSL

With an eye on profitability, the industry, which is now 8-10 years old, is moving from the initial start-up phase to a more consolidated phase. We believe, going forward, funding will only get more concentrated with big ticket players getting the bulk of the pie. Players in niche segments will get limited funding.

Instead of aggressive discounting to drive up GMV, this funding will be used to explore new segments to enter, apart from growing existing business. We expect a level playing field to evolve in the retail market between brick & mortar and online players.

Modern retail has huge potential

- Over the next eight years, 3,900 new stores are required to cater to growth in the organized retail market, highlighting the huge opportunities for all retailers to tap into.
- To meet operational efficiency requirements in smaller cities, bigger formats like hypermarkets are rationalizing their store size by 10-20% to 20,000-30,000sf.

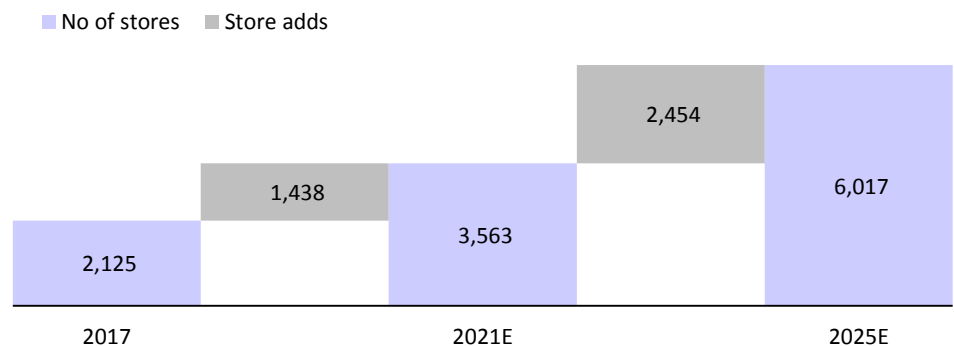
Organized retail – Huge runway of growth

1,000 new stores required over next three years to cater to organized retail growth in India

Presently, the organized general merchandise players in India occupy 40-45msf area of retail space as per Technopak. This is estimated to grow to 60-65msf by CY20, that is, 14% CAGR over CY17-20 to cater to 21% organized retail growth, indicating 7% SSSG. Assuming a blended store size of 20,000, overall 1,000 new stores will be required over the next three years to cater to the growth in the organized retail market.

One of the key positives of the retail market growth is that it offers a strong and long runway for growth. With a high single-digit GDP growth, the retail space should continue to grow at 14% until FY25. This is assuming (a) overall retail market grows at 12%, at a pace of 1x nominal GDP growth, (b) organized segment continues to grow at 1x overall retail growth, and (c) SSSG is 6%. At 20,000sf blended store size, over the next eight years, to cater to the growth in the organized retail market, 3,900 new stores are required, highlighting the huge scope of growth for all retailers. This implies organized retail penetration of a meager 17% in 2025, highlighting the huge demand in the organized retail market.

Exhibit 77: Expect high store adds over next few years



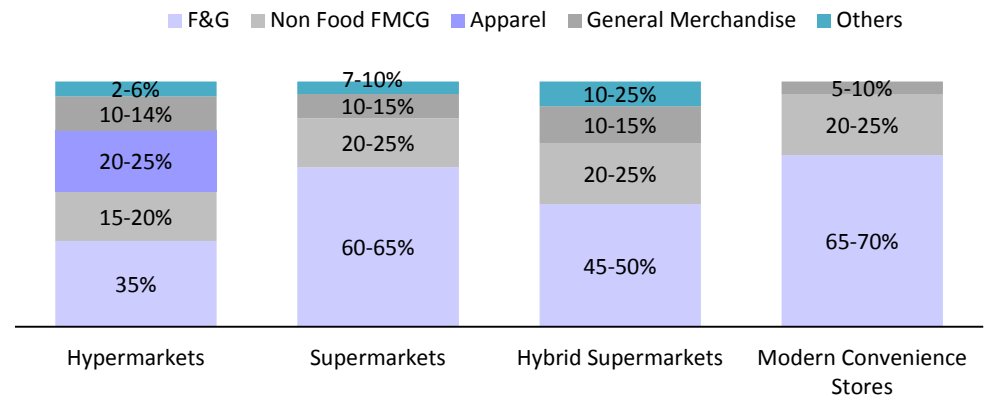
Source: MOFSL

Key formats across modern retail

Key formats in the organized market on the basis of store size and category mix are

- Hypermarket
- Supermarket
- Hybrid supermarket
- Modern convenience stores

Exhibit 78: Comparison of revenue mix across key formats



Source: Technopak Report 2017, MOFSL

Exhibit 79: Key formats in organized general merchandise play

Format	Hypermarkets	Supermarkets	Hybrid Supermarkets	Modern Convenience Stores
Average Store Size	30,000-60,000 Sq. Ft.	3,000-6,000 Sq. Ft.	20,000-30,000 Sq. Ft.	1,500-3,000 Sq. Ft.
Focus Category Mix	F&G: 30-35% Non Food FMCG: 15-20% General Merchandise: 10-14% Apparel: 20-25% Furniture & Furnishing: 2-6%	F&G: 60-65% Non Food FMCG: 20-25% General Merchandise: 10-15% Others: 7-10%	F&G: 45-50% Non Food FMCG: 20-25% General Merchandise: 10-15% Others: 10-25%	F&G: 65-70% Non Food FMCG: 20-25% General Merchandise: ~10%
Key Differentiating Factors	Destination format for planned visits ➤ Emphasis on shopping experience and wide variety of products ➤ Destination format for planned visits ➤ Emphasis on shopping experience and wide variety of products	➤ Situated near a residential area in order to be convenient to consumers ➤ Emphasis on smart efficiencies with shopping experience and relatively low price points	➤ Hybrid between hypermarkets and supermarkets in terms of retail space and category mix	➤ Similar to supermarkets but the focus is more on fast moving products with emphasis on neighbourhood requirements ➤ Have low inventory levels as compared to supermarkets
Key Players	Big Bazaar, Spencer's etc.	Spencer's etc.	D'Mart, Q'Mart etc.	Easy Day, Heritage, Nilgiris, M.K. Retail, Ratandeep and other regional players

Source: Technopak Report 2017, MOFSL

Exhibit 80: Player-wise comparison of growth in store count and average store size

Group	Brands	Stores		Area ('000 sqft)	
		2012	2017	2012	2017
Future Group	Big Bazaar	160	235	45-50	42
	Easy Day	188	538	NA	3
	Nilgiris	NA	170	NA	3
Reliance Retail	Reliance Smart	NA	77	NA	7-20
	Reliance Fresh	453	465	3-5	1.5-3
Aditya Birla Retail	More Megastore	13	20	70-80	40-45
	More	489	503	2-5	2-2.5
Tata group/Trent	Star Bazaar		10	55-60	50
	Star Market	15	12	NA	NA
	Star Daily		19	NA	4
CESC Ltd	Spencer's Hyper	NA	39	40-50	23
	Spencer's Super	NA	17	3.5-4.5	8
	Spencer's Daily	NA	68	NA	2
K Raheja Corp	Hypercity	10	19	90-100	71
Avenue Supermarkets	D'Mart	55	131	28-32	31

Source: Technopak Report 2017, MOFSL

Right store size holds key to profitability

Star, DMart, Spencer restricting store size to 20k-30ksf to drive profitability

Format forte

Hypermarkets and supermarkets driving organized retail growth

Growing consumption and availability of retail area will be instrumental in the growth of hypermarkets and supermarkets. Technopak projects that the share of these formats will rise from 47% in 2016 to 51% by 2020. Currently, dailies with typical store size of ~2,000sf comprise nearly half of the organized pie, with hypermarkets taking 7% and supermarkets the balance 40% in terms of store count. However, convenience stores have seen limited profitability, and therefore, most players are focusing on larger store size.

Hypermarkets garner high gross margins

Though revenue/sf of hypermarkets is lower than supermarkets, gross margin is higher. The higher gross margin is a factor of category mix, which is a healthy combination of F&G, fashion & apparel, non-food FMCG, accessories, etc. Moreover, the average ticket value is higher for hypermarkets compared to supermarkets, as the former give customers an option to purchase a larger selection of margin-accretive non-food & grocery items. This is evident from Big Bazaar - 40-50% of the revenue mix from non-F&G products, offering 2x gross margin earned from F&G category.

Smaller stores drive productivity but cater to low margin products

Among the formats focusing on food and general merchandise, supermarkets tend to garner higher levels of productivity. The store productivity of a supermarket is typically 20-25% higher than that of a hypermarket, given the high frequency of F&G purchases (F&G occupies a higher share in the supermarket format). Though efficiencies are higher for supermarkets, margins are lower due to high presence of F&G (margins in F&G are lower). The productivity of daily stores like Easy Day is higher than hypermarket stores.

Hybrid supermarkets gaining prominence in cities

To meet the operational efficiency requirements in smaller cities, bigger formats like hypermarkets are rationalizing store size by 10-20% to 20,000-30,000sf. This rationalization is giving rise to a new format in retailing – hybrid supermarket. Players like D-mart, Star Market and Spencer's reducing store size or are opening smaller stores to improve store productivity and cut wastages.

Premium niche retailer

To satisfy customers' growing need for premium products, some retailers have launched specialty stores, for example: Food Hall and Nature's Basket. Moreover, retailers are also stocking a higher number of organic / gourmet products to provide customers a larger selection of premium products.

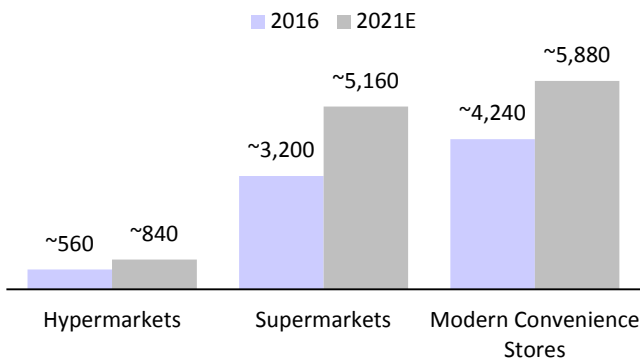
Increasing number of consumers prefer modern retail over traditional grocery

Modern retail eating into the share of traditional grocers

Clearly, modern retail has been gaining share from the traditional grocer in the last few years, which is evident from the growth in organized retail. In 2017, modern retail has seen an increase in both the frequency of shopping and the amount spent compared to the traditional grocery stores, which have seen a dip in spending compared to 2016. In a recent survey done by Spencer's, in 2017, out of the total sample size, about 63% of the shoppers visited a modern retail store in 2017 v/s 50% in 2016. Also, in terms of the amount spent, 37% of the shoppers mentioned that majority of their grocery spending was through modern retail v/s 30% in 2016. Within modern retail, the hypermarket format saw a strong improvement in the frequency of shopping by consumers (31% of the consumers v/s 16% in 2016 mentioned that they shopped at a hypermarket during the last four weeks). This led to an increase in the percentage of shoppers who did most of their spending in hypermarkets from 4% in 2016 to 10% in 2017.

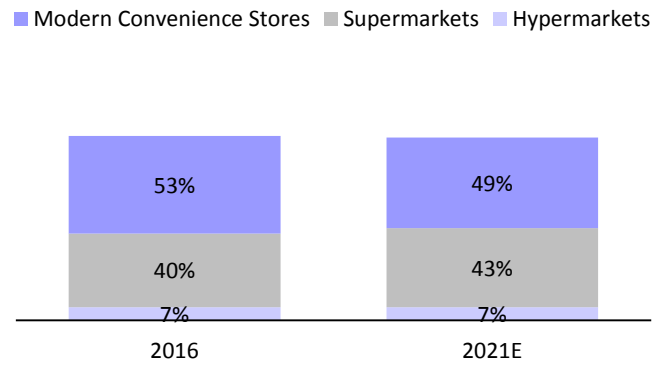
Modern retail continues to be predominantly chosen for stocking up regular grocery. This is evident from a recent survey by Spencer's, highlighting regular grocery stock-up as the top shopping mission of modern retail shoppers (at 30%) in 2016. However, it has fallen from 34% in 2015. The other three factors that have gained share in driving shopping in modern retail are (a) daily shopping (non-meal preparation), (b) shopping to take advantage of promotional offers, and (c) shopping on occasions. 18%/11%/9% of modern retail shoppers mentioned these as the key reason for their visit compared to 13%/7%/4% in 2015.

Exhibit 81: Supermarket stores to reach 5k count by 2021



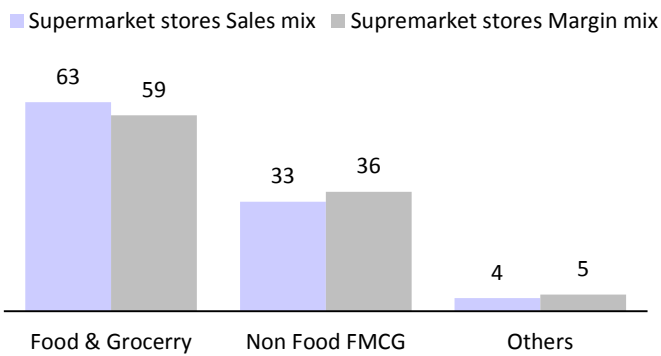
Source: Technopak Report 2017, MOFSL

Exhibit 82: Share of supermarkets expected to increase



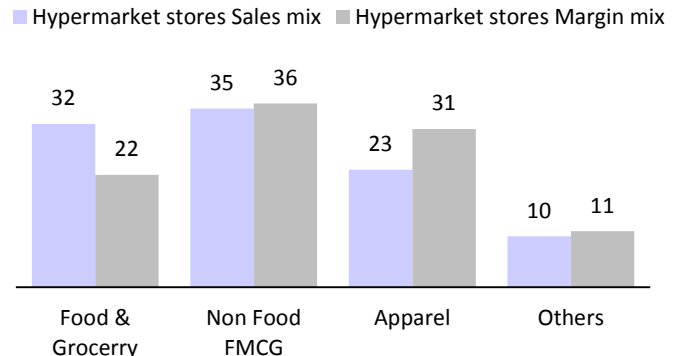
Source: Technopak Report 2017, MOFSL

Exhibit 83: F&G accounts for ~2/3rd of revenue and margin mix for supermarket stores (%)



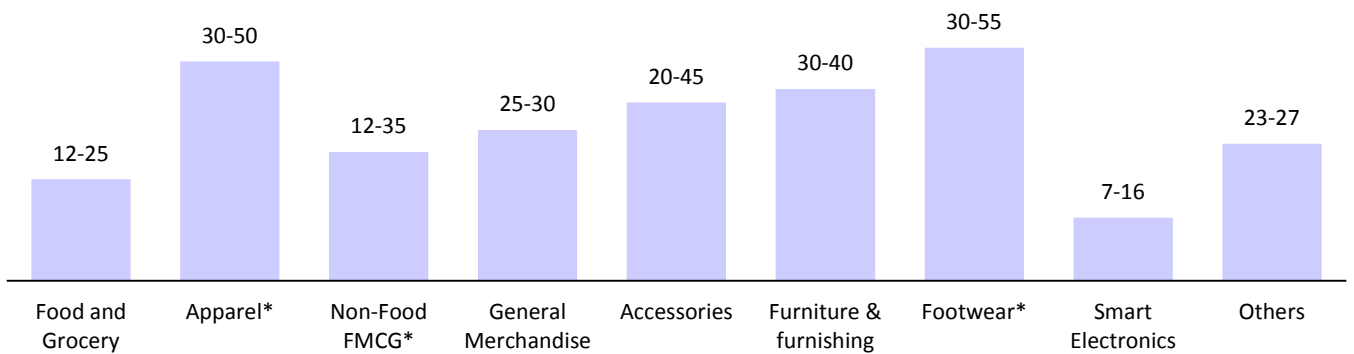
Source: Technopak Report 2017, MOFSL

Exhibit 84: Apparel the key margin driver in hypermarket stores (%)



Source: Technopak Report 2017, MOFSL

Exhibit 85: Average gross margins for retailers across different categories (%)



* Gross margin range depicts both the brand and private level mix in the product offering.

Source: Technopak Report 2017, MOFSL

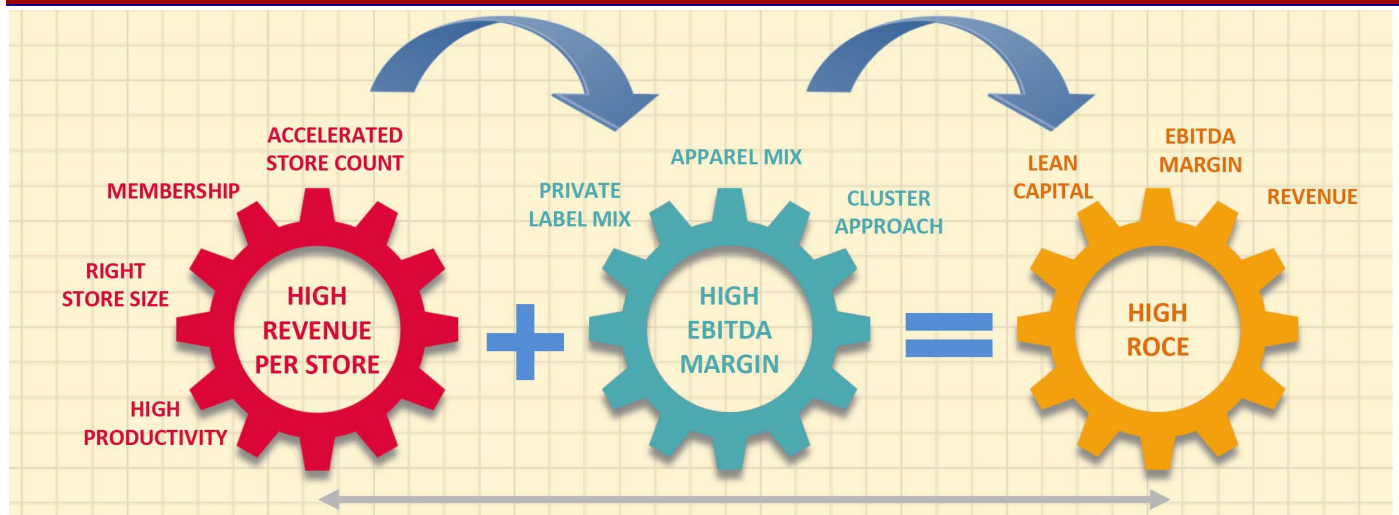
Balanced scorecard – what wins, who loses

Focus on high store throughput and efficiency to drive profitable growth

- Our balance scorecard metrics assess each player’s efforts to improve store throughputs, efficiency and product mix to achieve profitable growth.
- Right store size is seen as a key factor by most players to achieve healthy store throughput.
- In order to improve gross margins, retailers are increasing the mix of private label products and apparels.
- Players operating in hypermarket or apparel formats are venturing into value format category, which is seen as the next growth driver in the apparel space, as it bridges the 2-3x pricing gap between premium brands and unorganized market products.
- Typically, our workings indicate that players that add store footprint of 15-20% are able to ensure low leverage and sustainable growth.
- Retailers are increasingly venturing in the omni-channel formats, leveraging their deep network to reduce delivery time and logistics cost – a key burden for e-commerce players.

Given the high growth potential in the organized retail market, retailers are looking to increase footprint. However, the wafer-thin margins and high inventory levels required leave limited room for error. Currently, the EBITDA margin for retailers is in the range of 3-8%. To enhance growth and margins, retailers are looking at streamlining their business in terms of store size, product mix to bring operational efficiencies and edge in the market. We compare retailers on the basis of key parameters that should determine the sustainability of pace and quality of future growth and profitability.

Exhibit 86: KEY PARAMETER THAT DETERMINE SUSTAINABILITY OF PACE AND QUALITY OF FUTURE GROWTH



Source: MOFSL, Company

1) Productivity, efficient store size

Most players are looking to restrict unused space to improve store productivity. In F&G value retail, 20,000-30,000sf is seen as the most productive store size. D-mart (store size: 30,000sf; revenue/sf: INR37k) and Star Market (store size: 17,500sf; revenue/sf: INR25k) are among the most productive stores. In fashion apparel, Westside (store size: 17,500sf; revenue/sf: INR10k) has the most productive stores. Central, with store size of 100,000sf, offers a good shopping experience at 15%

lower productivity than Westside, but its productivity still remains at par with other value fashion apparel stores like VMart, Shoppers Stop, and Brand Factory and garners healthy profitability.

Efficient store size garners better productivity

Exhibit 87: D-Mart outperforms Big Bazaar in productivity (FY19E)

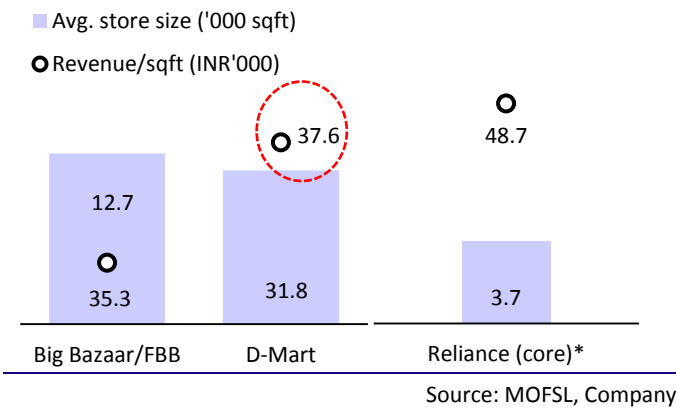


Exhibit 88: Star leads in neighbourhood stores category in terms of productivity (FY19E)

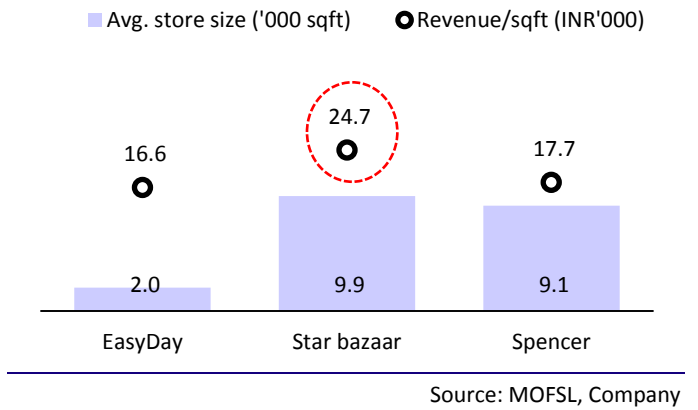


Exhibit 89: Westside outperforms peers in productivity (FY19E)

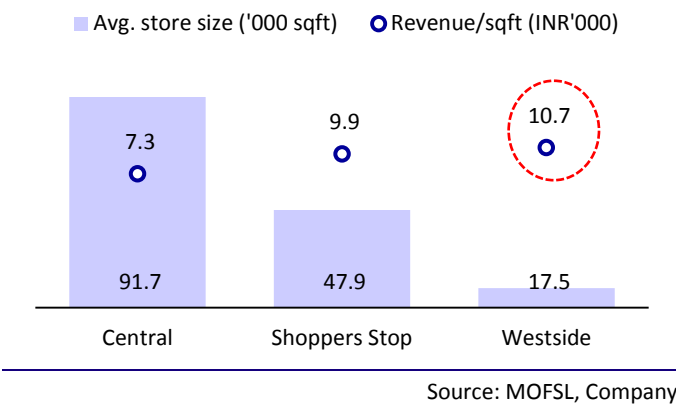
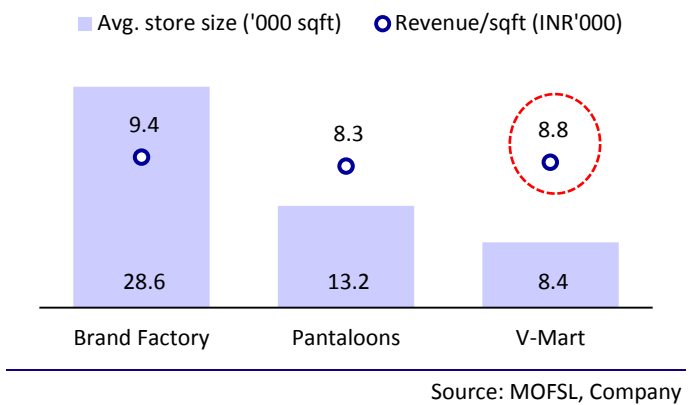


Exhibit 90: Value retailers garner better productivity on the back of smaller store size (FY19E)



...Thus, players are judiciously reducing avg. store size

Exhibit 91: Big Bazaar's average store size is expected to come down

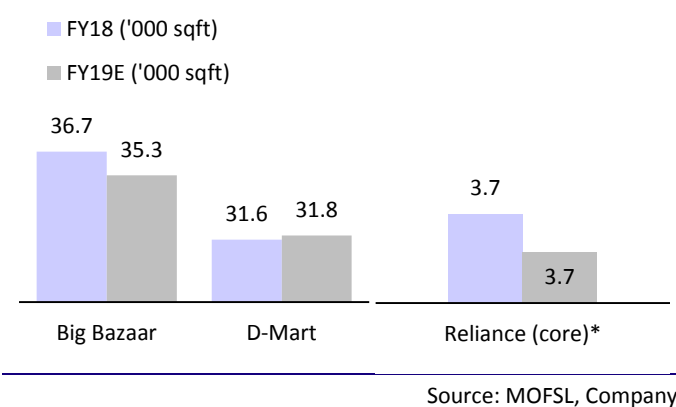


Exhibit 92: Star is rationalizing average store size to garner better productivity

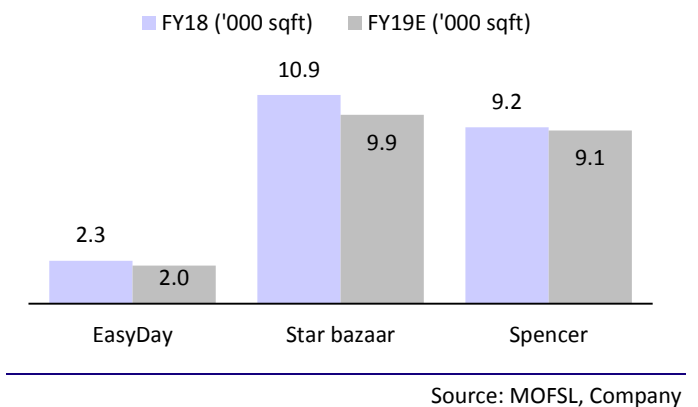
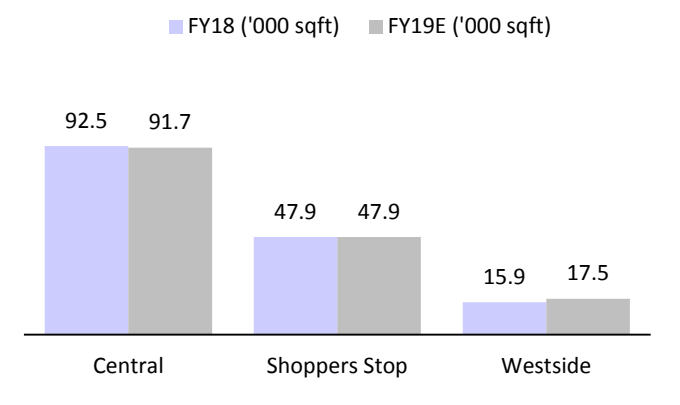
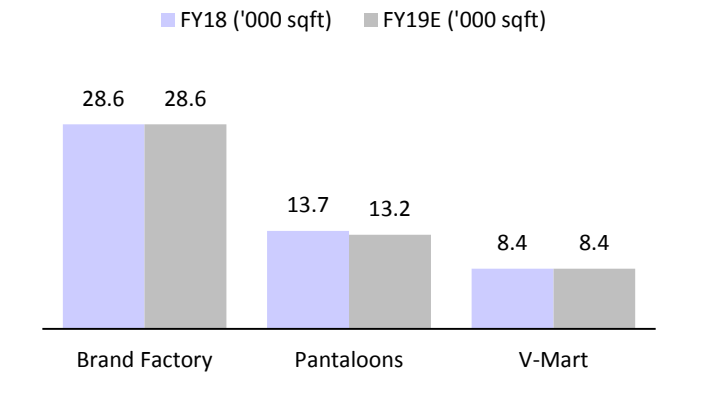


Exhibit 93: Central is reducing average store size to garner better productivity



Source: MOFSL, Company

Exhibit 94: Value apparel players planning to reduce average store size for higher productivity



Source: MOFSL, Company

2) Private labels

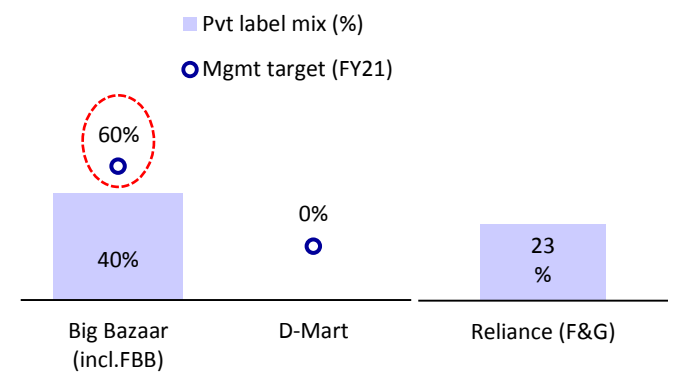
Private labels and apparel mix improve store margin

With 5-10% lower pricing than branded products, private labels allows gross margin improvement by 100-200bp. This also aids better working capital management, as retailers are able to squeeze producers with relatively higher creditor days. In the F&G space, Future Retail-led Big Bazaar has the best portfolio of private labels with 40% contribution, supporting pricing in a cutthroat competitive market and yet aiding margin expansion.

In the apparel space, Westside is by far the best player, with 96% private labels, earning a healthy 10% EBITDA margin. VMart, Central and Brand Factory, with a healthy blend of 40-50% private labels, attract customers looking for branded as well as private label products and are also gaining margin leverage.

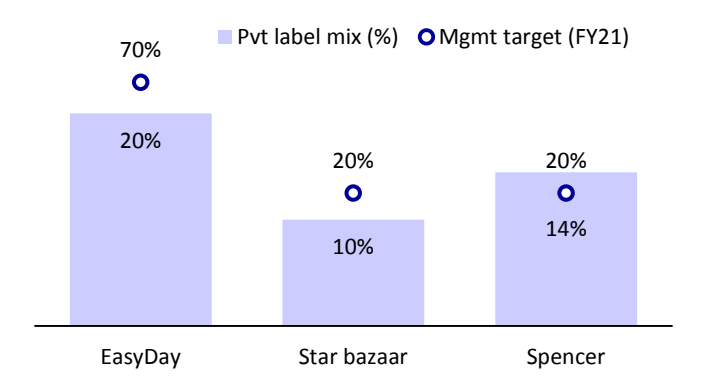
Private labels act as key catalyst for higher gross margin

Exhibit 95: Private label mix for Big Bazaar stands at 40%



Source: MOFSL, Company

Exhibit 96: Private label mix for Easy day stands at 70%



Source: MOFSL, Company

Exhibit 97: Westside leads peers in private label mix

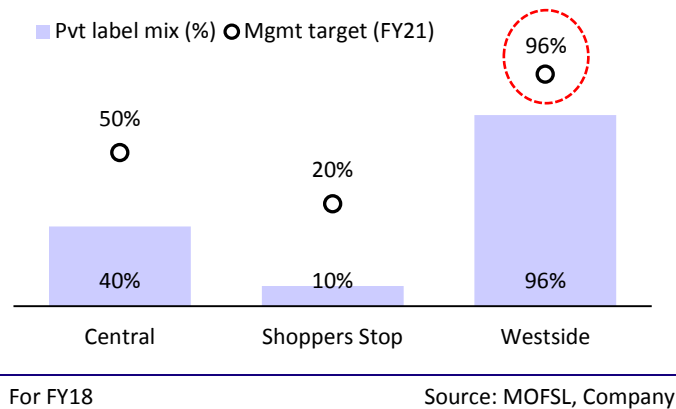
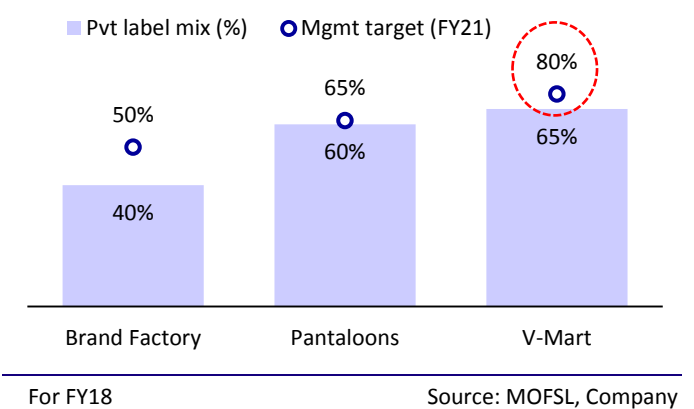


Exhibit 98: Private label mix across value retailers at healthy 40-60%



Bridging the gap between branded apparel and unorganized market

3) Value apparel

The key value proposition is that value apparel bridges the 2-3x price gap between premium brands and the unorganized market products, accelerating the shift from consumption of low-quality unorganized market products to organized market products. Value apparel is a category that has been strongly attracting customers in the last 3-5 years. Value apparel retailers like FBB, Pantaloons and Trends in the urban markets and VMart in the semi-urban markets are witnessing aggressive growth.

To increase wallet share and bill size, and improve store profitability, all F&G value retailers are expanding their product portfolio, with a higher mix of apparel. Apparel garners ~40% gross margin compared with 20-25% for F&G. Big Bazaar has the healthiest apparel mix of 35%, higher than Star Bazaar, Spencer’s, and other players. This has allowed it to garner better EBITDA margin than peers.

Apparel assist in garnering better gross margin v/s pure play F&G

Exhibit 99: Apparel mix for Big Bazaar stands at healthy 35% (FY19E)

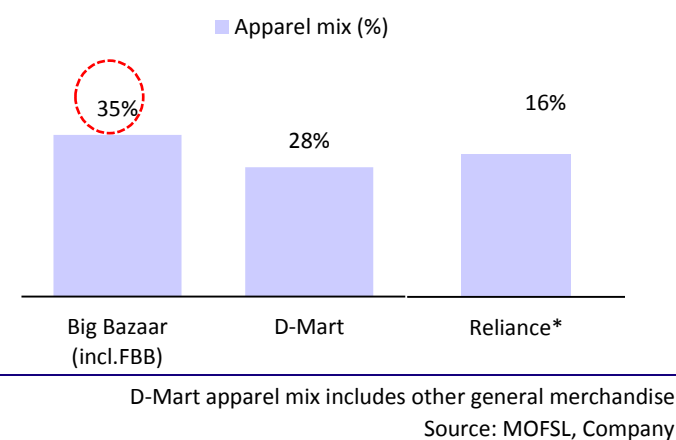


Exhibit 100: Super markets stores have meager apparel mix (FY19E)

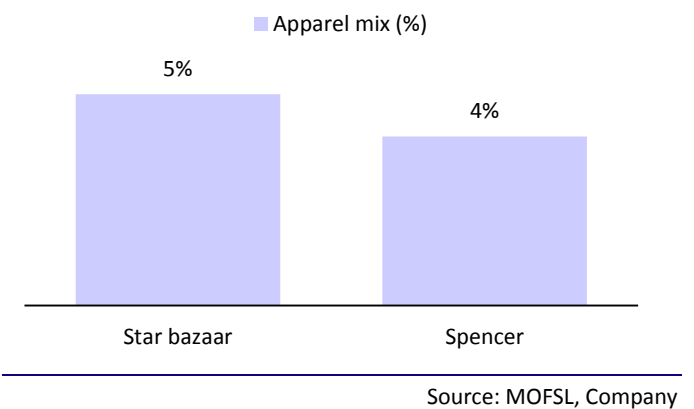
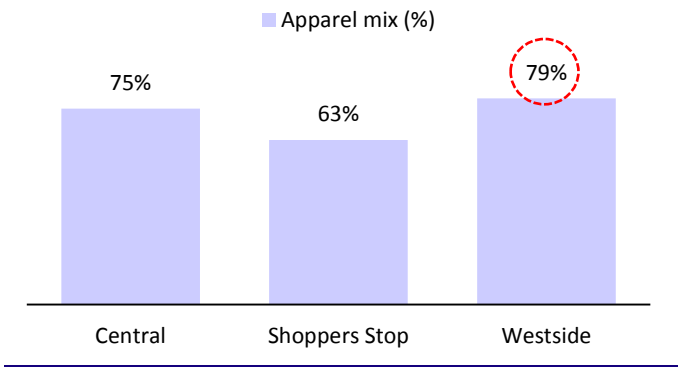
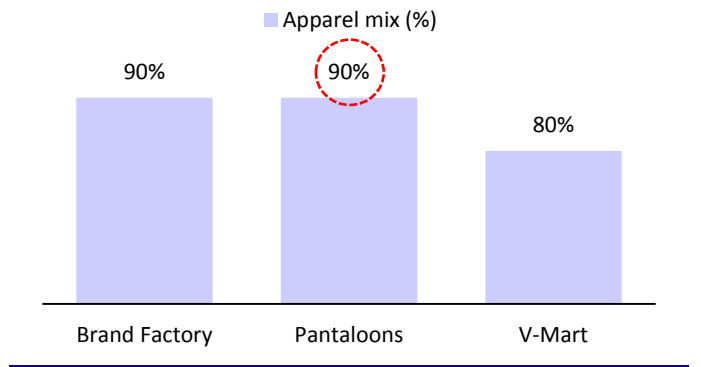


Exhibit 101: Apparel mix for Westside stands at strong ~80% (FY19E)



Source: MOFSL, Company

Exhibit 102: Apparel mix for value retailers stands at healthy 80-90% (FY19E)



Source: MOFSL, Company

4) Cluster approach

Most F&G retailers are now focusing on expanding through the cluster approach, as it helps to (a) reduce backend cost (logistics, warehousing), (b) optimize marketing cost, and (c) leverage store footprint and customer loyalty. D-mart has strongly followed the cluster approach, which has allowed it to optimize cost and enhance customer loyalty. Future Retail’s Easy Day, Spencer’s, Star Market and VMart’s growth targets too are focused on the cluster approach to enhance profitability.

Exhibit 103: Cluster approach visible in store network

Format	Strategy of cluster approach
D-Mart	❖ Maharashtra and Gujarat account for ~60% of total store network
Easy Day	❖ Four markets (Ludhiana, NCR, Hyderabad and Lucknow) account for ~68% of total store network
V-Mart	❖ UP and Bihar account for ~63% of total store network
Spencer	❖ Concentrated mainly in Eastern and South-Eastern India

Source: MOFSL, Company

5) Accelerated store count

In the last decade, we saw many players chasing growth with aggressive store rollouts, in the bargain adding up (a) huge operating costs, (b) loss-making stores, and (c) debt. However, in the last 3-5 years, most players have taken a measured approach to growth. Their intent has been to capture the huge opportunity in the organized retail space while at the same time ensuring that high growth does not take away the focus from store economics, especially in a market characterized by wafer-thin margins. Most retail chains have added 15-20% new area, annually. This ensures that the retailers’ new store growth is maintained. At the same time, on the back of a healthy 40-50% of the portfolio being 3-4 years old, SSSG also remains upbeat. Star, Shopper’s Stop, and Spencer’s have seen patchy growth in the last few years, as they consolidated their position and pared loss-making stores. We expect healthy growth momentum, going forward.

Adding 15-20% new footprint ensures low leverage and sustainable growth

Players are ramping up store additions

Exhibit 104: Reliance retail leads the pack in store adds

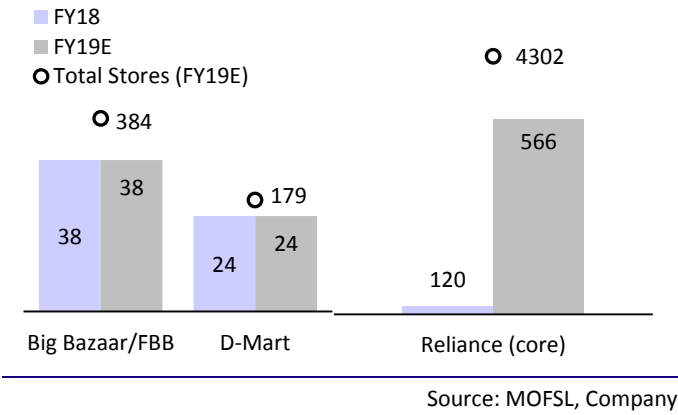


Exhibit 105: Easyday's store additions on a spree

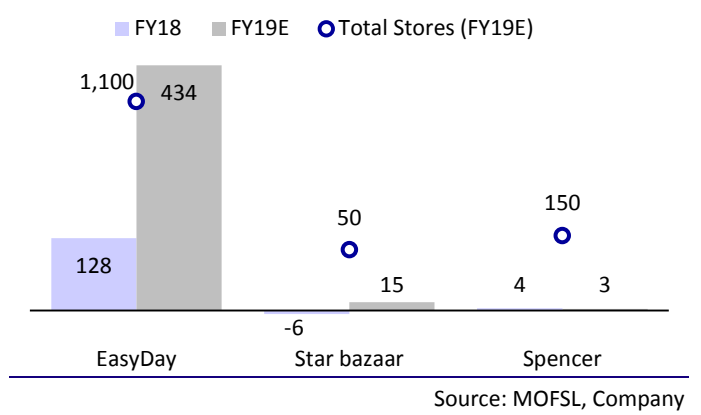


Exhibit 106: Westside adding healthy 18-20 new stores

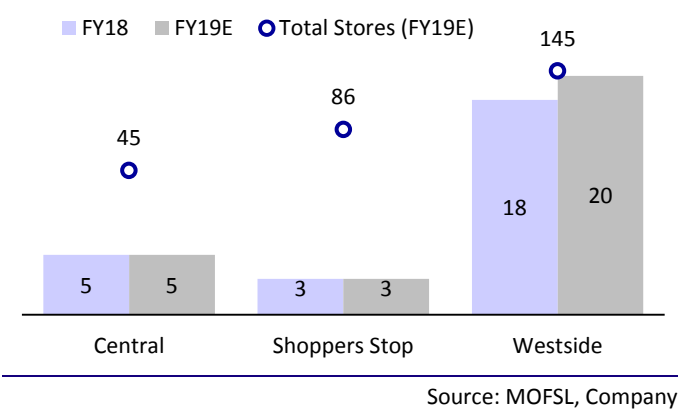
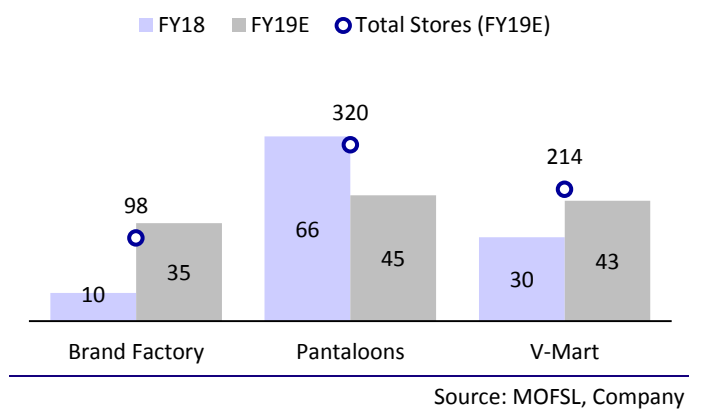


Exhibit 107: Pantaloons to outperform peers in store adds



So as to drive same store sales growth (SSSG, %)

Exhibit 108: DMART to outperform Big Bazaar in SSSG front (%)

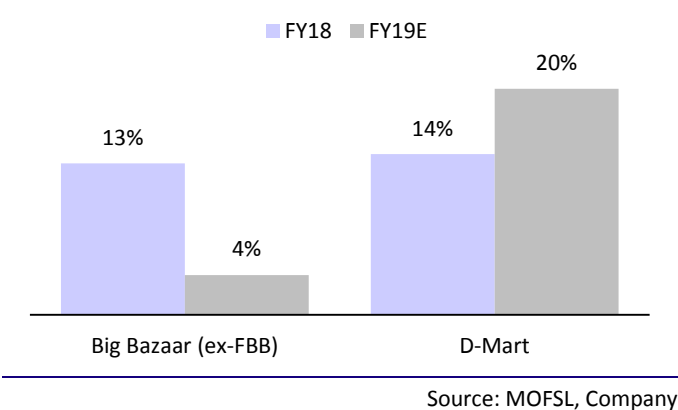


Exhibit 109: Expect Star to outperform on SSSG front (%)

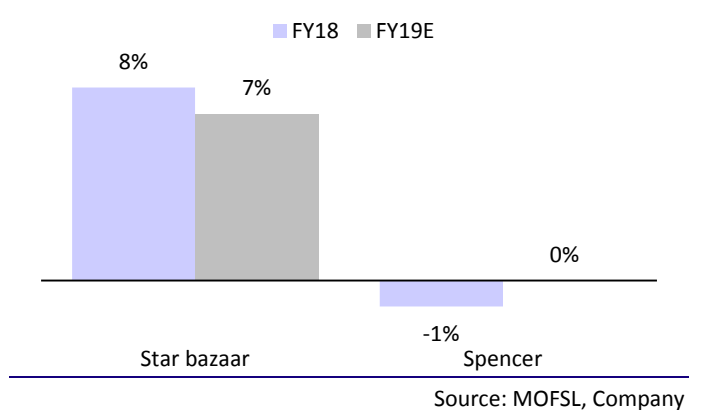
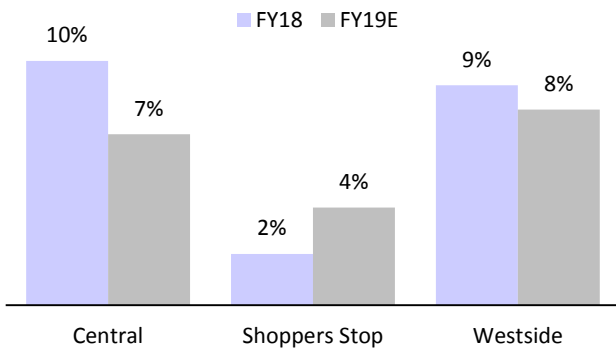
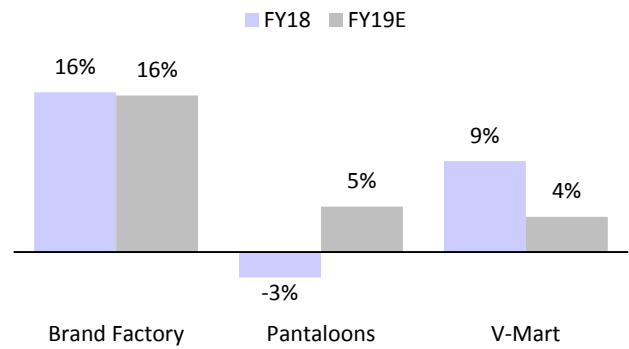


Exhibit 110: Central/Westside to garner 7-8% SSSG (%)



Source: MOFSL, Company

Exhibit 111: Brand Factory to lead the value retail format pack in terms of SSSG (%)



Source: MOFSL, Company

6) Membership program

Membership programs are a good medium to create sticky customers, especially in an industry with single-digit profit margins. Such programs allow retail chains to (a) reduce customer acquisition cost, (b) create loyal customers, which improves bill size, store economics, (c) support customer analytics, which in turn allows the retail chains to improve store offerings, inventory management, sales velocity, and profit margins. In the hypermarket format, Big Bazaar and Spencer’s have been the most focused on membership programs. In the apparel segment, Shopper’s Stop has a strong member program, with 75% revenue share coming from it. Future Retail’s aggressive rollout plans in the neighborhood store format, Easyday are focused on membership-led growth to attract loyal kirana store customers.

7) Omni channel

In contrast to the period of hyper-competition from ecommerce companies, most companies (ecommerce, retailers) are revisiting their strategy towards omni-channel presence. Amazon’s tie-up with Shoppers Stop and Wal-Mart’s acquisition of Flipkart are recent large investments on the same lines. Most retailers now understand that their wide retail network can be used as a key strength to bridge the biggest concern for ecommerce – logistics cost. Retailers can use outlets as storage and delivery hubs, reducing delivery time and logistics cost, and creating a strong value proposition in comparison to pure play ecommerce companies. Shopper’s Stop, with its collaboration with Amazon, and most other hypermarket players are taking advantage of this unique strength and planning to expand in the ecommerce segment. It can also attract less tech savvy offline consumers.

Using network strength to reduce delivery time and logistics cost

Exhibit 112: PANTALOONS SHOPPERS STOP, BIG BAZAAR LIKELY TO MAKE STRONG IMPROVEMENTS

FY18								
Formats	Store Productivity	Efficient store size	Pvt label mix	Apparel mix	Cluster approach	Accelerated store count	Membership programme	Result
Big Bazaar	●	●	●	●	●	●●	●	●
D-Mart	●●	●	●●	●	●●	●	●●	●
EasyDay	●	●	●	N.A.	●●	●●	●	●
Star bazaar	●●	●	●	●	●	●	●	
Spencer	●	●	●	●	●	●	●	●
Central	●	●	●	N.A.	●	●	●	
Shoppers Stop	●	●	●	N.A.	●	●	●	●
Westside	●	●	●●	N.A.	●	●	●	●
Brand Factory	●	●	●	N.A.	●	●	●	●
Pantaloons	●	●	●	N.A.	●	●	●●	●
V-Mart	●	●	●	N.A.	●●	●	●●	●

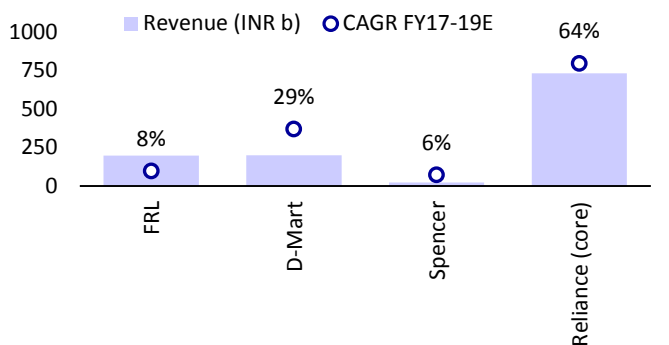
FY21								
Formats	Store Productivity	Efficient store size	Pvt label mix	Apparel mix	Cluster approach	Accelerated store count	Membership programme	Result
Big Bazaar	●	●	●●	●	●	●●	●	●
D-Mart	●●	●	●●	●	●●	●	●●	●
EasyDay	●	●	●	N.A.	●●	●●	●●	●
Star bazaar	●	●	●	●	●	●	●	●
Spencer	●	●	●	●	●	●	●	●
Central	●	●	●	N.A.	●	●	●	●
Shoppers Stop	●●	●	●	N.A.	●	●	●	●
Westside	●●	●	●●	N.A.	●	●	●	●
Brand Factory	●	●	●	N.A.	●	●	●	●
Pantaloons	●	●	●	N.A.	●	●●	●●	●
V-Mart	●●	●	●	N.A.	●●	●	●●	●

IMPACT: Lowest ●● | Low ● | Average ● | High ● | Highest ●●

Source: MOFSL, Company

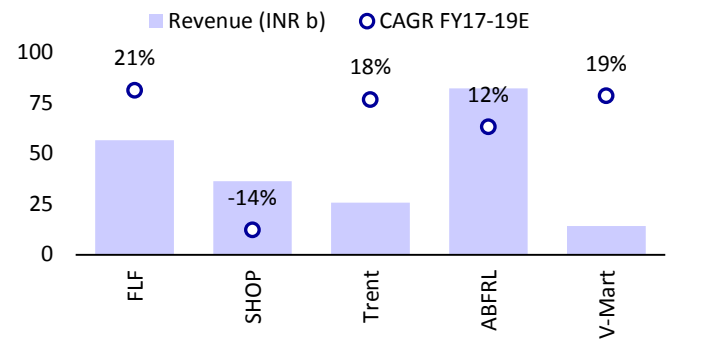
High store adds drive revenue growth

Exhibit 113: Reliance Retail has grown at a robust pace over FY17-19E



Source: MOFSL, Company

Exhibit 114: FLF has outperformed peers on revenue growth



Source: MOFSL, Company

Apparel companies garner higher gross margin

Exhibit 115: Higher F&G revenue mix drags gross margin for DMART (FY19E)

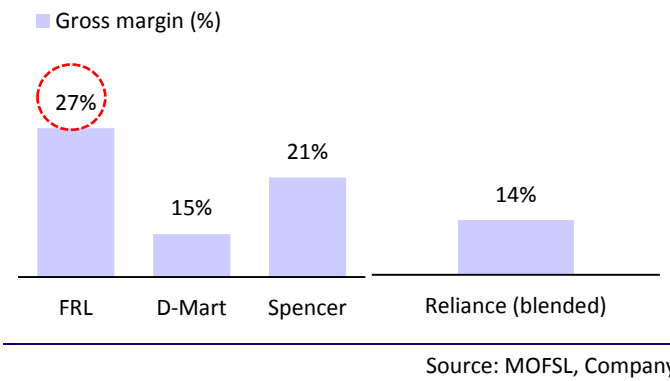
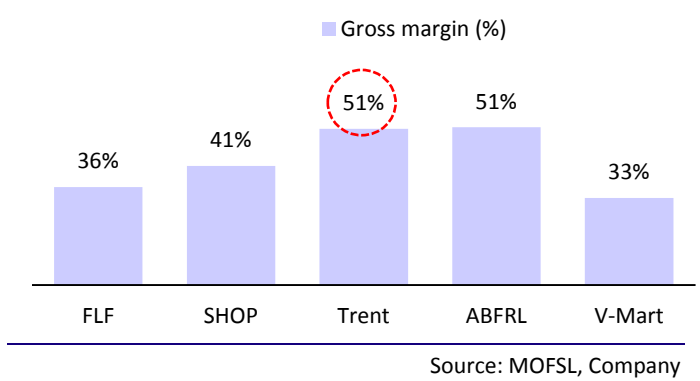


Exhibit 116: Apparel players command higher gross margin than F&G players (FY19E)



...and thus higher EBITDA margins as well

Exhibit 117: DMART leads the pack on EBITDA margin (FY19E)

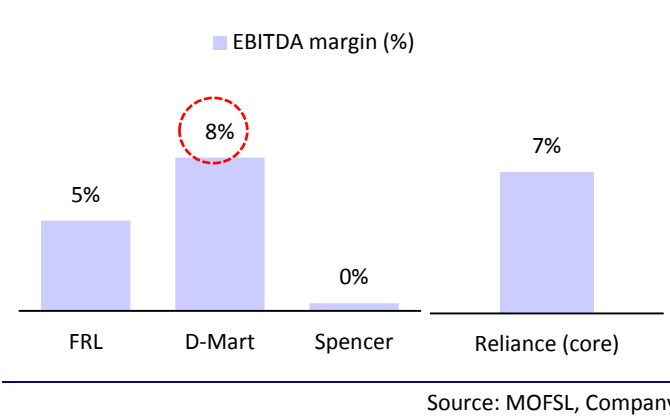
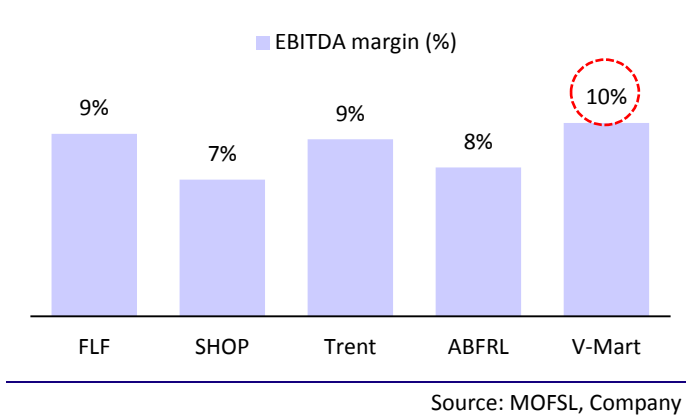


Exhibit 118: V-Mart leading the pack on EBITDA margin (FY19E)



Player-wise comparison of Inventory days (FY19E)

Exhibit 119: Inventory days for F&G players are lower...

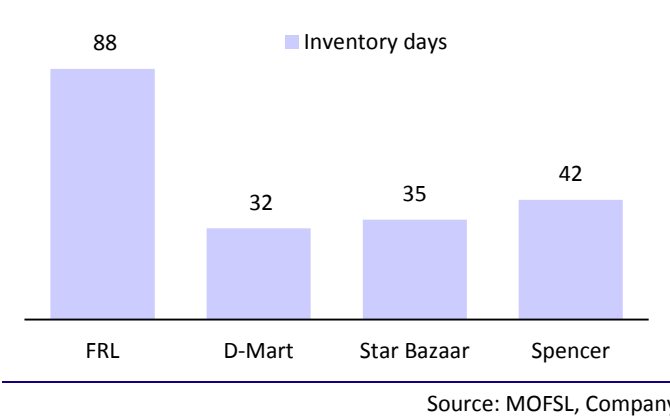


Exhibit 120: ...compared to that of apparel players (FY19E)

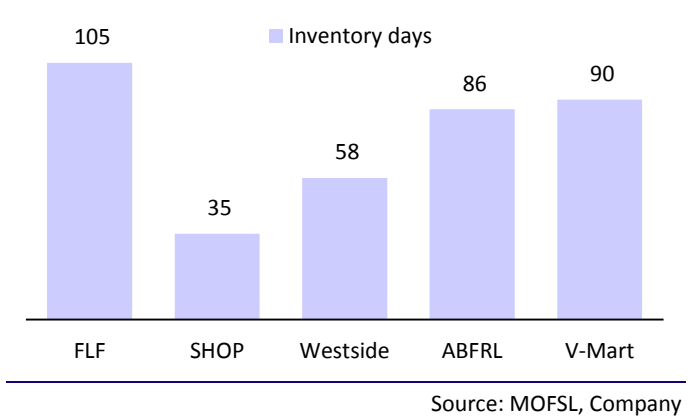
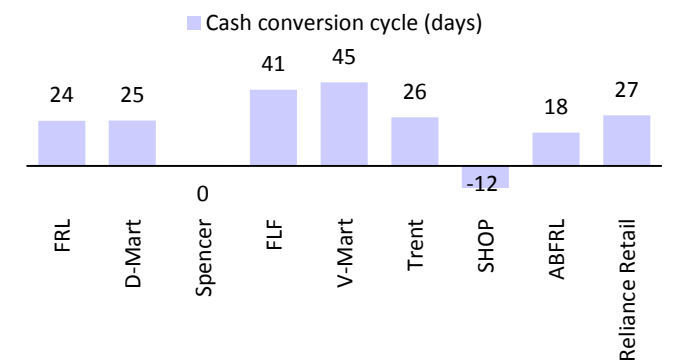
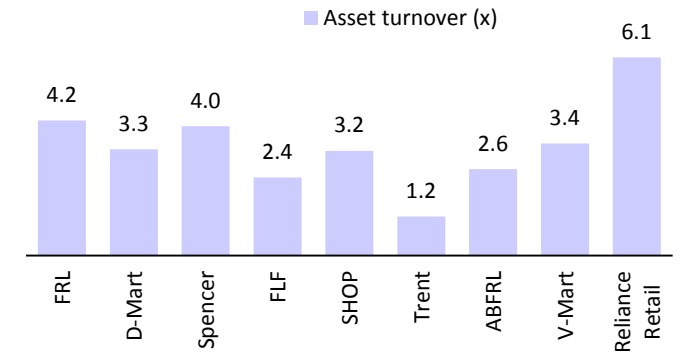


Exhibit 121: Player-wise comparison of cash conversion cycle (FY19E)



Source: MOFSL, Company

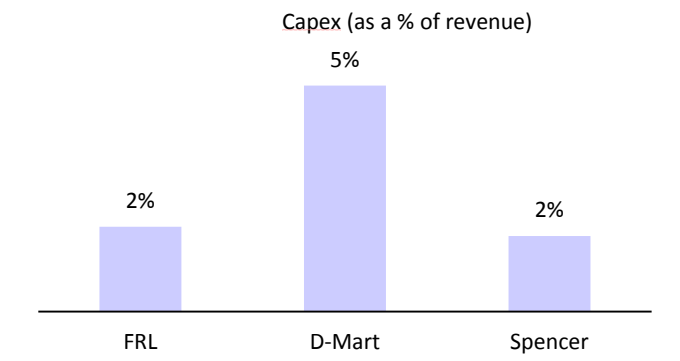
Exhibit 122: Player-wise comparison of asset turnover (FY19E)



Source: MOFSL, Company

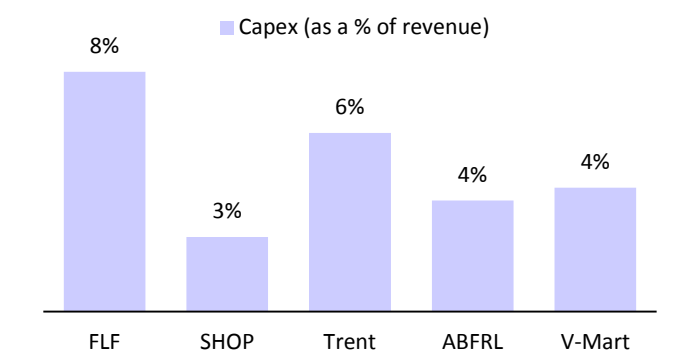
Player-wise comparison of capex (as a % of revenue) (FY19E)

Exhibit 123: Capex as a % of revenue for F&G players (FY19E)



Source: MOFSL, Company

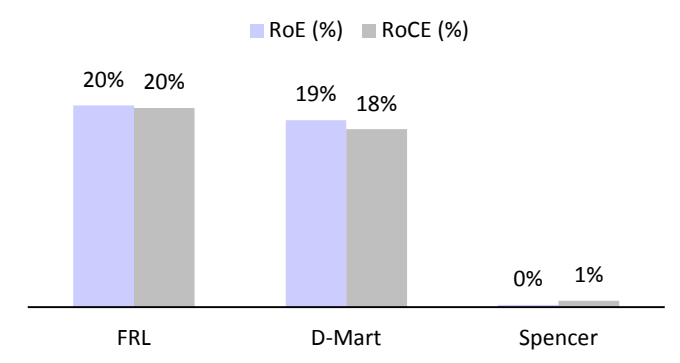
Exhibit 124: Capex as a % of revenue for apparel players (FY19E)



Source: MOFSL, Company

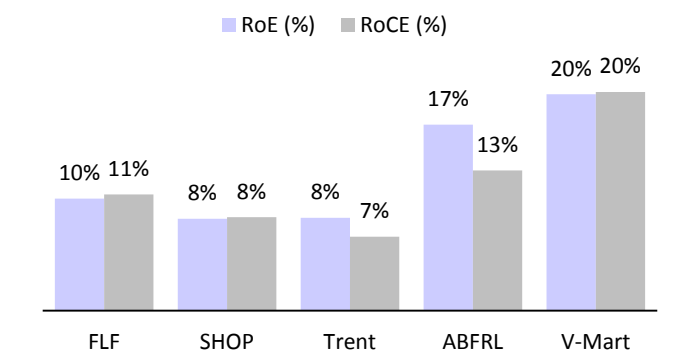
Return ratios yet to move up (FY19E)

Exhibit 125: Return ratios for F&G players (FY19E)



Source: MOFSL, Company

Exhibit 126: Return ratios for F&G players (FY19E)



Source: MOFSL, Company

Exhibit 127: Store-wise payback and RoCE comparison

	Big Bazaar/ FBB	D-Mart	Easyday	Central	Brand Factory	V-mart	Shoppers Stop	Westside	Pantaloons
Capex	0	248	0	324	57	12	77	44	27
Net Working Capital	21	57	-2	61	33	8	-13	13	3
Total	21	305	-2	385	90	20	64	56	31
Payback (in years)	0.7	3.2	2.0	4.4	4.2	2.4	2.3	4.2	4.3
Revenue	499	1,051	39	833	286	78	462	171	118
Gross margin	125	168	6	325	83	25	177	92	57
Gross margin (%)	25.0	15.9	15.5	39.0	29.2	32.1	38.4	53.6	48.0
Other operating cost	94	73	7	236	62	17	150	76	50
EBITDA	30	95	-1	88	21	9	27	16	7
EBITDA margin (%)	6.1	9.0	-3.0	10.6	7.5	10.9	5.9	9.7	6.0
Depreciation	0	11	0	51	9	1	8	3	6
Depreciation rate (%)	6	5	6	16	16	12	10	5.9	5
EBIT	30	83	-1	38	12	7	20	14	1
RoCE (Tax - 30%)	99.8	19.1	NM	6.5	9.3	24.4	21.4	16.8	3.0

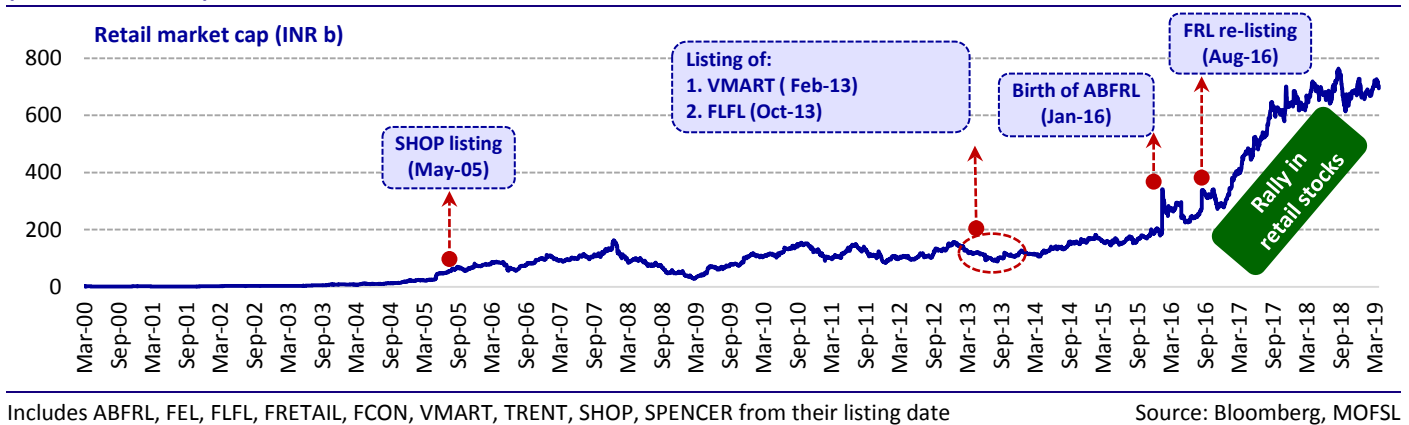
Source: MOFSL, Company

Valuation summary

Healthy profit growth driving stocks

Retail stocks in India have outperformed the overall market over the last 2-3 years, with their market cap increasing by a significant 50%+. Investors are seen flocking toward retail stocks, as evident from the huge success of IPOs, particularly Avenue Supermart (and the stock post listing). This is not surprising given the improving profitability of the retail companies.

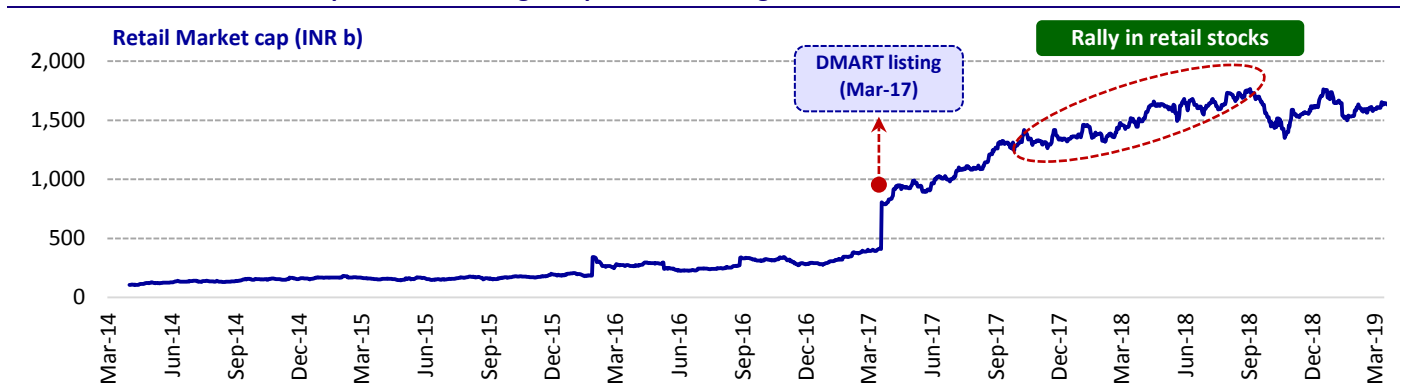
Exhibit 128: Revised focus on store economics/profitability has led to stupendous growth in sector market cap (ex-D-Mart, INR b)



Includes ABFRL, FEL, FLFL, FRETAIL, FCON, VMART, TRENT, SHOP, SPENCER from their listing date

Source: Bloomberg, MOFSL

Exhibit 129: Sector market cap witnessed a huge fillip with the listing of D-Mart



Includes ABFRL, FLFL, FRETAIL, DMART, VMART, TRENT, SHOP, SPENCER from their listing date Source: Source: Bloomberg, Company, MOFSL

Rich valuations on account of huge runway of growth

Until strong growth is sustained, premium valuations would persist

The organized retail market is expected to grow at over 20% for a consistently long period of 8-10 years, backed by 6-7% SSSG and expansion of footprint. This provides a strong runway for growth. With sector growth potential already in place, companies that have shown consistent earnings growth, improving return profile, and limited leverage are commanding rich valuations. However, in some cases, the market might have factored earnings of the next 2-3 years in advance, given the strong earnings visibility in the respective companies. This might leave limited incremental upside. Yet, until the companies sustain the strong growth, we believe the premium valuations would persist.

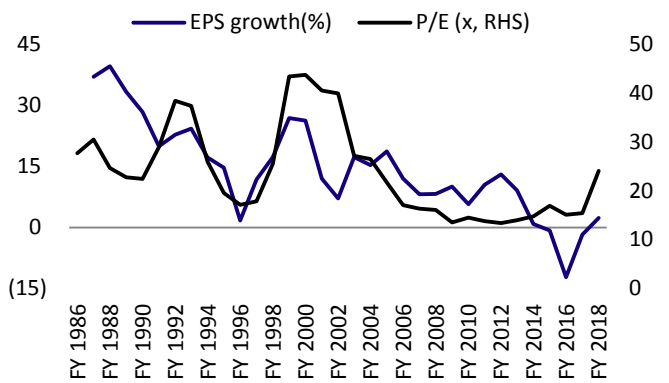
US players in the high-growth period of late 1990s-early 2000s were rewarded with ~2x higher valuation multiples v/s last 20-year cycle

Drawing parallels with global players in high growth period

In the 1990s, the US retail market witnessed strong earnings growth – consistently by players like Walmart and Home Depot, and inconsistently by players like Target. Subsequently, Walmart and Home Depot were rewarded with far higher valuation multiples during the period with average EV/EBITDA and P/E of 2x during the peak cycle than in the last 20 years. The average PEG ratio still remained 1.1x for Walmart over FY85-95 and 1x for Home Depot over FY85-00, which highlights the key point that the rich P/E was supported by robust earnings growth.

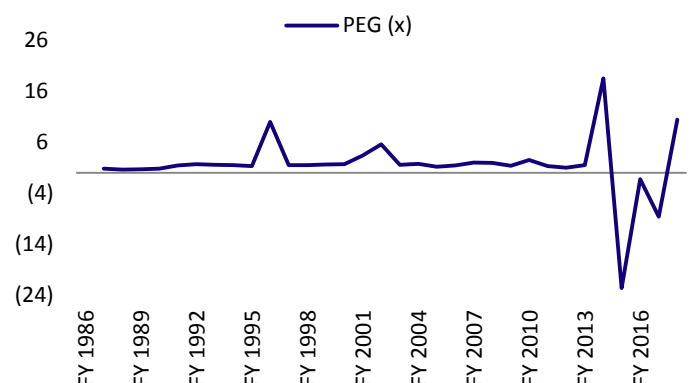
In India too, we believe companies that deliver healthy EBITDA/EPS growth of over 20% consistently for the next 10 years could garner about 2x EV/EBITDA and P/E multiples compared to the average valuations. Given the sustainability of earnings growth in India’s retail market, rich valuations could be justified.

Exhibit 130: P/E trend of Walmart Inc chasing EPS growth...



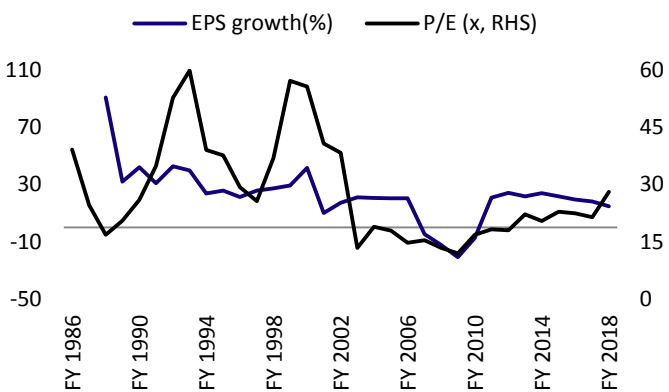
Source: MOFSL, Bloomberg

Exhibit 131: ...with average PEG remaining closer to 1-1.5x



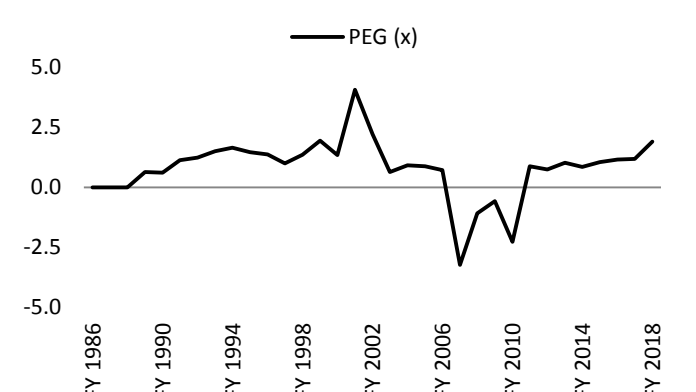
Source: MOFSL, Bloomberg

Exhibit 132: P/E trend of The Home Depot Inc chasing EPS growth



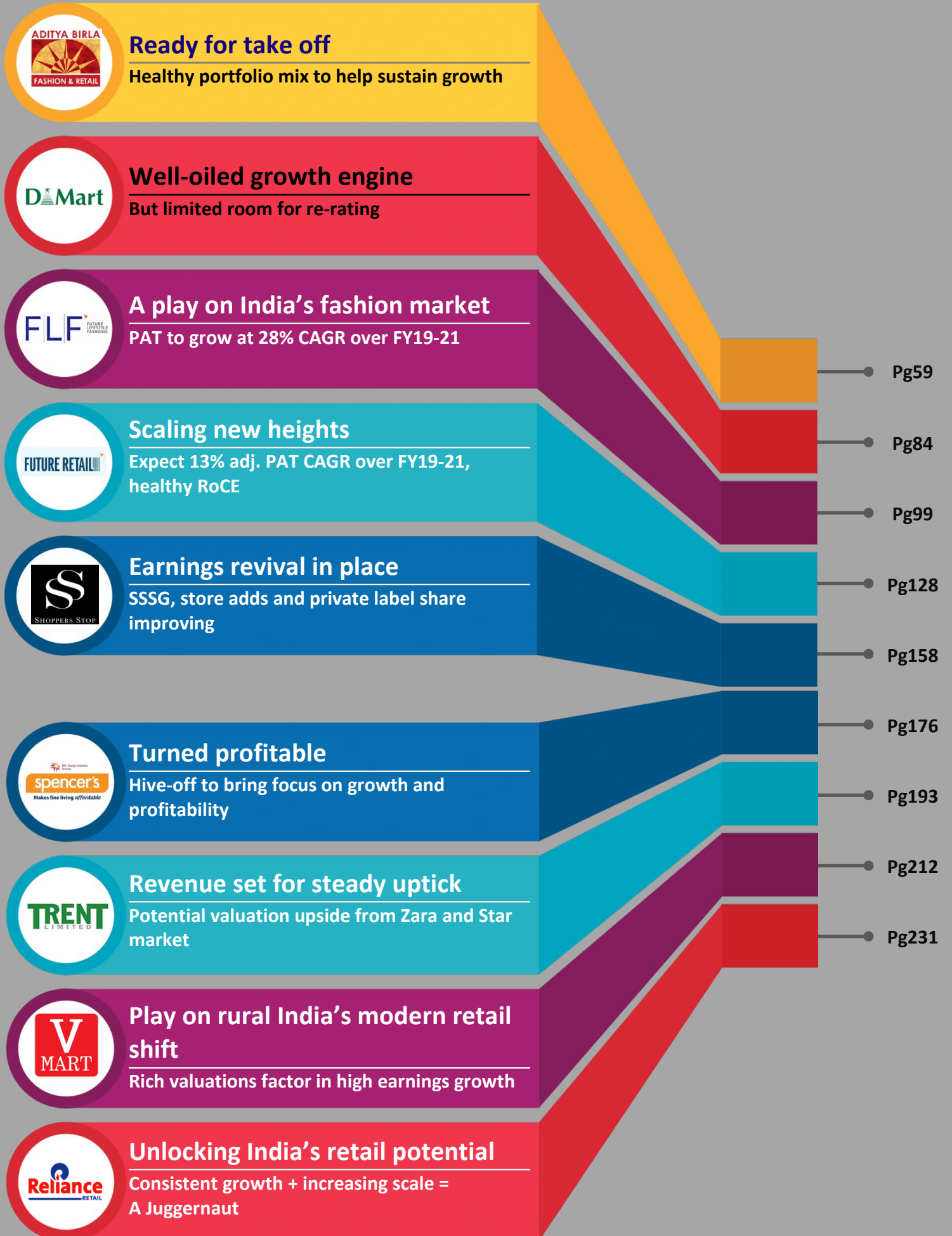
Source: MOFSL, Bloomberg

Exhibit 133: ...with average PEG remaining closer to 1x



Source: MOFSL, Bloomberg

Retail: The Land of Opportunities



Aditya Birla Fashion and Retail

BSE SENSEX
38,862S&P CNX
11,666

CMP: INR219

TP: INR260 (+19%)

Buy



Stock Info

	ABFRL IN
Bloomberg	ABFRL IN
Equity Shares (m)	772
M.Cap.(INRb)/(USDb)	169.1 / 2.4
52-Week Range (INR)	236 / 132
1, 6, 12 Rel. Per (%)	-9/9/31
12M Avg Val (INR M)	233
Free float (%)	40.8

Financials Snapshot (INR b)

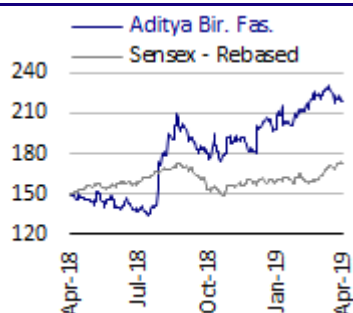
Y/E MARCH	FY19E	FY20E	FY21E
Sales	82.3	93.4	106.5
EBITDA	6.2	7.6	9.3
NP	2.0	3.1	4.5
EPS (INR)	2.6	4.0	5.8
EPS Gr. (%)	70.3	54.7	44.0
BV/Sh (INR)	16.8	20.8	26.6
P/E (x)	84.1	54.4	37.8
P/BV (x)	13.0	10.5	8.2
EV/EBITDA (x)	30.2	24.3	19.4
EV/Sales (x)	2.3	2.0	1.7
RoE (%)	16.8	21.4	24.5
RoCE (%)	12.7	15.2	18.0

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	59.2	59.2	59.2
DII	18.9	19.0	14.2
FII	9.5	9.5	11.6
Others	12.3	12.2	14.9

FII Includes depository receipts

Stock Performance (1-year)



Ready for take off

Healthy portfolio mix to help sustain growth

- ABFRL holds a healthy and diversified portfolio mix consisting four leading menswear brands, Pantaloons in the value-fashion retail format, men/women's innerwear through Van Heusen's brand extension, and women's fast-fashion venture – Forever 21.
- Pantaloons has undergone revamp over the years post its acquisition. The strategy has been to tap the lucrative value-fashion format with small store size. Accordingly, 213 new Pantaloons stores were added over FY14-19. We find comfort in these efforts, and thus, expect earnings to revive with revenue/EBITDA CAGR of 17%/24% over FY19-21.
- The recently launched men's innerwear segment under the well-known Van Heusen brand should see robust ~2x revenue growth and EBITDA breakeven by FY21, driven by ramp-up in distribution. The lifestyle segment consisting of four marquee brands and product extensions should achieve moderate 11%/11% revenue/EBITDA CAGR over FY19-21.
- We expect overall revenue/EBITDA CAGR of 14%/23% over FY19-21. EBITDA margin should expand ~120bp to 8.7% by FY21 on the back of (a) break-even in the innerwear and fast-fashion businesses, (b) steady uptick in Pantaloons' private label mix (60%) and (c) the company's strategy of franchisee-led store additions, which should provide an impetus to RoCE.
- We initiate coverage on ABFRL with a Buy rating and an SOTP-based target price of INR260. We ascribe (a) 23x FY21E EBITDA of INR6.7b for the lifestyle segment, given its strong brand value, (b) 18x FY21E EBITDA of INR3.9b to Pantaloons, given its strong earnings potential and (c) 1x FY21E sales of INR10.2b for the fast-fashion and other businesses. This implies an EV of 23x on FY21E EBITDA, ~15% discount to its three-year average.

Fine-tuning its portfolio mix

With a strong two-decade old dominance in the menswear category with deep distribution across multiple formats, ABFRL is now leveraging its capabilities by widening its portfolio across other market categories. It has recently ventured into innerwear, fast-fashion and youth-oriented casuals. We expect ABFRL to see a strong revival in growth due to (a) a favorable business environment in the aftermath of demonetization and GST, (b) consolidation of ecommerce websites and the subsequent discounting draw down, (c) company initiatives like rationalizing both the lifestyle segment and Pantaloons' store network by maintaining healthy store adds and a re-jiggle of Pantaloons' product price equation reviving SSSG. The strong traction witnessed in Van Heusen innerwear may further contribute to growth. Subsequently, we expect a robust 14%/23%/49% revenue/EBITDA/PAT CAGR for ABFRL over FY19-21.

Lifestyle segment back on a stable growth path

ABFRL owns four leading menswear brands (Louis Philippe, Peter England, Van Heusen, Allen Solly) which together generate ~INR38.7b revenue. This showcases its lifestyle segment's strong brand pull. EBITDA margins, after being impacted by

macro factors like demonetization/GST/ aggressive discounting by ecommerce companies, have now improved to 12.5% in FY19E. With most of the clean-up behind, we expect 11% revenue CAGR over FY19-21 to be fueled by (a) reach expansion - 250 net annual store adds over next 2-3 years, (b) increase in mix of casual and premium products, and (c) increase in ecommerce contribution, which is currently at 7% and growing at a steady pace. We believe EBITDA margins on a high base of 12.5% (FY19E) have little room for improvement. Accelerated growth fueled by the revival in SSSG and growth through the e-commerce channel should drive 11% EBITDA CAGR over FY19-21; expect margin to remain steady at 12.6%.

Revamped Pantaloons set to drive earnings

Typically, branded apparel is 4x costlier than products of unorganized local counterparts. Under the value-fashion retail format, branded apparels are cheaper (priced at 2x v/s unorganized local apparel), and therefore, have gained prominence over the last few years. To target this category, Pantaloons (post acquisition from the Future Group) was completely revamped from a lifestyle apparel retail chain to the value fashion format. This was done by (a) curtailing the size of larger (17-18k sq. ft.) stores as well as new stores to ~10-15k sq. ft., (b) reducing product price equation from premium product pricing to affordable apparels starting at just INR699, and (c) increasing proportion of private labels that are attractively priced and margin accretive (~60%), with a target to further increase it to 70%. With (a) completion of store restructuring and sizeable new store adds (213 over FY14-19E) and (b) expectation of adding 60-65 stores annually, Pantaloons is well poised to witness strong 17%/24% revenue/EBITDA CAGR over FY19-21.

Fast-fashion and innerwear to emerge as future growth engines

The fast-fashion apparel market, particularly the women's category, is seeing good traction with the launch of H&M and Zara. The launch of Forever 21, a strong US-based licensed brand targeting women's fashion, has enabled ABFRL to expand its predominantly menswear portfolio of brands to include women's fashion. However, since Forever 21's launch three years ago, ABFRL's fast-fashion segment has seen limited traction with revenue/EBITDA of INR3.6b/-INR0.3b (FY19E). We believe management's strategy to test smaller sized stores with limited 8-10 stores and linear cost structures should allow ABFRL to maneuver operating models and build a base for strong future growth.

On the other hand, revenues of its innerwear segment under the Van Heusen brand have zoomed to INR1.9b in the last two years, thanks to strong distribution and marketing push. While the scale is yet small, we expect revenue to reach INR3.4b over the next two years. Also, the company plans to expand into other similar products across its stable of brands. We expect fast-fashion, innerwear and its other brands/formats to witness a turnaround, with revenue/EBITDA of INR10.2b/-INR0.3b in FY21 from INR7.4b/-INR1.1b in FY19 on the back of accelerated growth in the innerwear segment and Forever 21 achieving break-even.

Healthy balance sheet, growing cash flow

ABFRL sells its menswear brands' inventory on an outright basis (rare) instead of Sale or Return (SoR) basis, thus garnering healthy inventory of 86 days and lean net working capital of merely 18 days. Its lifestyle business predominantly following a leased exclusive brand outlet (EBO) model allows it to garner about 30% RoCE. However, store rollout in fast-fashion and other smaller segments, coupled with EBITDA losses, dragged Madura Fashion's (Lifestyle +Fast-Fashion + Innerwear + Other businesses) RoCE to ~15%. We believe that rationalization of stores as well as turnaround of fast-fashion and other businesses should improve RoCE. Due to Pantaloon's aggressive store expansion and modest EBIT, RoCE came in at a meager 1% in FY18. We believe better asset monetization driven by improving asset turns and EBITDA CAGR of 24% over FY19-21 should improve Pantaloon's RoCE to double-digits over the next two years. Subsequently, we expect overall ABFRL's RoCE to improve to 18% in FY21. Free cash flows (post interest cost), too, should turn positive with superior earnings generating OCF CAGR of 21% and stable INR3.3b overall capex.

Valuation

We believe ABFRL offers secular growth potential with a unique portfolio of established and leading industry brands and high growth categories of value-fashion retail chains. Its strong platform of established brands, deep distribution and management capability allows it to launch multiple products across apparel categories like innerwear, women's fast-fashion, casual-wear and luxury retail chains, which can continue to fuel growth and drive valuations. Further, it is among the few apparel companies to have garnered a healthy return profile (lifestyle segment ~30%). We have valued ABFRL on an SOTP basis to arrive at a TP of INR260, with 19% upside and recommend a **Buy**. We have assigned the lifestyle segment 23x EV/EBITDA of FY21E EBITDA, given its strong brand value. We have assigned 18x EV/EBITDA to Pantaloon's FY21E EBITDA as we believe there is a strong foundation laid for robust future growth; on delivering strong earnings in the next 1-2 years, valuations too should improve. The other businesses including fast-fashion and innerwear are still loss-making as a portfolio, and we thus assign it 1x of FY21E sales. This implies an EV of 23x on FY21 EBITDA – a ~10% premium to the target EV/EBITDA multiple for our apparel coverage, but ~15% discount to the three-year average. Despite the sharp rally over the last six months, we believe it has not fully captured the secular growth potential, healthy improvement in return ratios and cash flows.

Fine-tuning its portfolio mix

Expect 14%/23% overall revenue/EBITDA CAGR over FY19-21

- Strong brand pull of its lifestyle segment's four leading brands, good hold in the value-fashion format coupled with robust distribution reach [~4k from large format stores (LFS), ~5k from multi-brand outlets (MBOs) and 2.1k from exclusive brand outlets (EBOs)] gives ABFRL a competitive edge over its peers.
- ABFRL has strong economic moats that act as a catalyst to up its ante in categories such as brand extensions, fast-fashion and its recent foray into innerwear, thus enabling it to tap the burgeoning opportunity in the branded apparel market.
- We expect overall revenue/EBITDA to grow at 14%/23% CAGR over FY19-21 and EBITDA margins to expand 120bp, reaching ~8.7% by FY21.

Healthy mix of brands and retail across categories

Post the merger of Pantaloons with Madura Fashion & Lifestyle (FY16), ABFRL with its leading fashion brands and deep distribution across multiple formats became India's largest lifestyle and fashion conglomerate. It owns (a) four leading menswear brands in India through its lifestyle segment, (b) a large retail chain- Pantaloons in the value-fashion format, (c) Forever 21, a strong US-based licensed brand targeting women's fashion and (d) Van Heusen innerwear for men and women, among others.

The lifestyle segment operates on a brand-driven business model, targeting the premium and sub-premium branded apparel market through its four key brands – Louis Phillip, Van Heusen, Peter England and Allen Solly. In FY19, the lifestyle brands operated through 2.1k EBOs with a deep network of LFS and MBO, contributing ~52% of ABFRL's total revenues and a healthy 12.5% EBITDA margin, garnering ~30% ROCE. Pantaloons contributed ~40% of the overall revenue, operating in the value fashion format with good 320 stores, providing a healthy mix of brands and retail.

Exhibit 134: Four leading brands under Lifestyle segment (Madura Division)



Source: Company, MOFSL

Exhibit 135: ABFRL: Division-wise operational and financial metrics (FY19E)

ADITYA BIRLA FASHION AND RETAIL		
	MADURA F&L	pantaloons IN ♥ WITH FASHION
REVENUE (INR B)	50.4	32.9
REVENUE CONTRIBUTION (%)	61%	39%
EBITDA MARGIN (%)	8.5%	7.7%
NO OF STORES	2,440	320
AREA (M SQFT)	3.9	4.2
AVG. REVENUE/SQ.FT (INR'000)	14.1	8.3

Source: MOFSL, Company

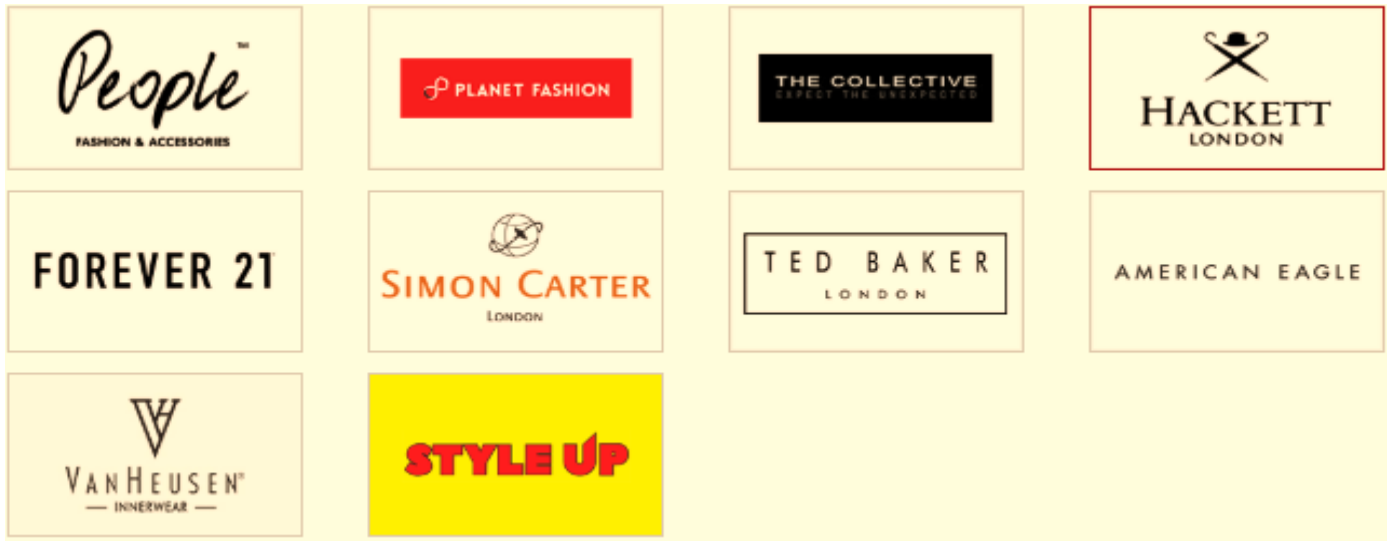
Fueling growth in established businesses

We expect ABFRL to see a strong revival in growth due to (a) a favorable business environment in the aftermath of demonetization and GST, consolidation of ecommerce websites and the subsequent drop in discounting, and (b) company initiatives like rationalization of both the Lifestyle segment and Pantaloons' store network in the last two years, maintaining healthy store adds and a rejig of Pantaloons' product price equation, which should revive SSSG.

A good platform to launch new growth drivers

The company can now leverage its capability to widen its portfolio across other market categories as is evident from its venture into innerwear, fast-fashion and youth-oriented casuals among others. ABFRL's stable of brands include pure-play fashion brands (Forever 21, People), casual wear brand American Eagle, innerwear brand Van Heusen and luxury brands like The Collective, Hackett, Ted Baker, and Simon Carter, which should provide accelerated growth opportunities over the next five years, but some brands are likely to see tapering growth (10-12%) even as they achieve a high revenue scale.

Exhibit 136: Emerging brands under the Madura division

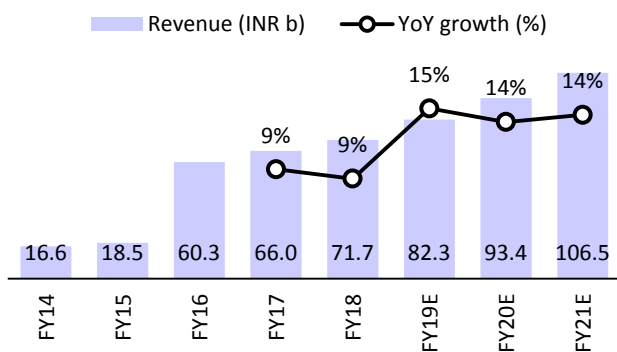


Source: Company, MOFSL

In some of these categories, brands like US Polo, Lee Cooper, Levi’s, Jack & Jones (casual wear) and Zara (fast-fashion) are the industry leaders (generating ~INR10b+ revenue). Two key determinants for ABFRL to bridge this gap are (1) building distribution reach, and (2) creating a strong brand profile through aggressive advertisement and marketing promotions.

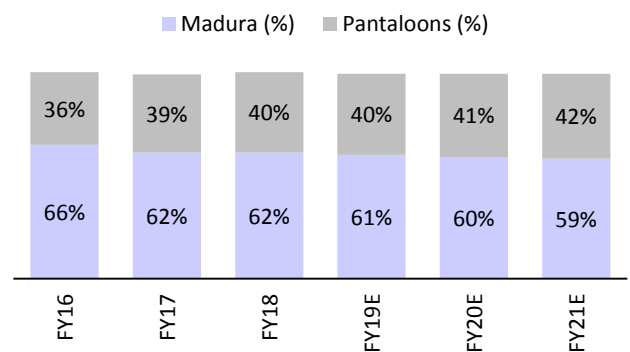
Reach should be partly supported by ABFRL’s existing business with ~4k LFS’ and ~5k MBOs. The rollout of EBOs may also be supported by management’s execution capability of operating across ~2k EBOs, which are predominantly franchisee-led. Subsequently, we expect a robust 14%/23%/49% CAGR of revenue/EBITDA/PAT for ABFRL over FY19-21.

Exhibit 137: Overall revenue to grow at 14% CAGR over FY19-21



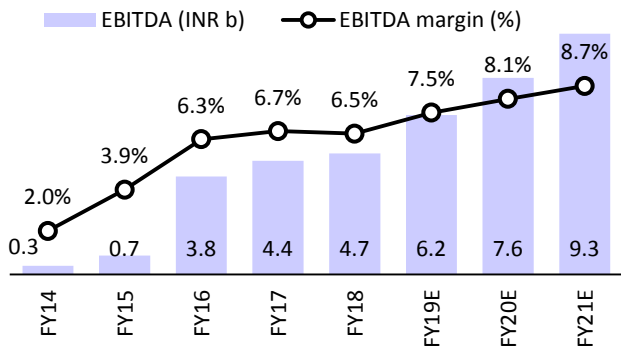
Source: MOFSL, Company

Exhibit 138: Pantaloon’s revenue contribution to reach ~42% by FY21 (as a % to gross revenue)



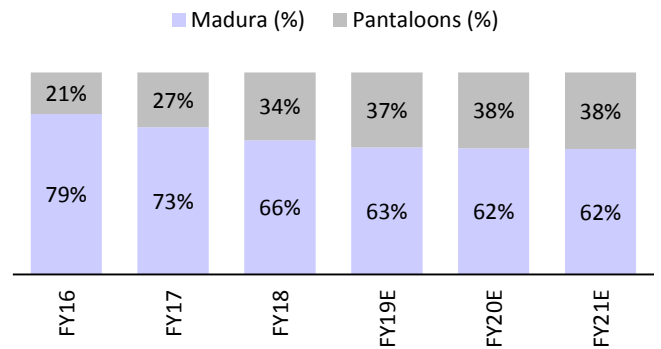
Source: MOFSL, Company

Exhibit 139: EBITDA margins to expand ~120bp over FY19-21



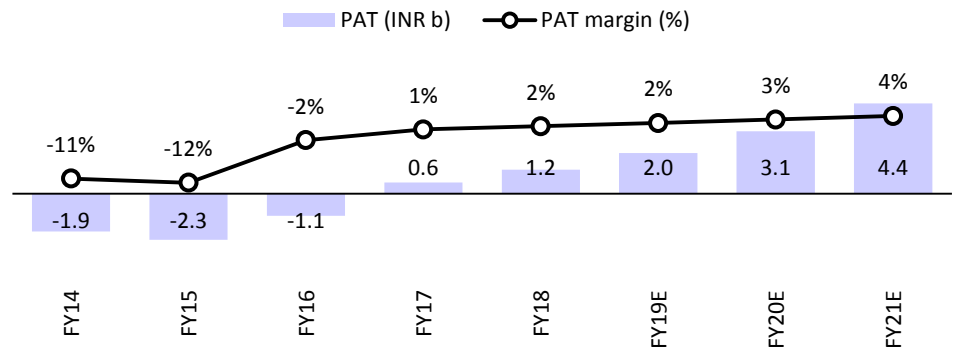
Source: MOFSL, Company

Exhibit 140: Pantaloon's EBITDA contribution to reach ~38% by FY21 (as a % to gross EBITDA)



Source: MOFSL, Company

Exhibit 141: PAT to grow at 49% CAGR over FY19-21



Source: MOFSL, Company

Exhibit 142: Geographical spread of ABFRL (Dec-18)



*includes VH innerwear outlets
Source: MOFSL, Company

Lifestyle segment back on a stable growth path

Casuals and store addition to act as key catalysts

- Madura's Lifestyle division, which was marred by macroeconomic factors (demonetization and GST), ecommerce driven discounted pricing and network rationalization in the past two years, is well poised to regain its lost momentum, in our view.
- We expect revenue to grow at a CAGR of 11% over FY19-21 mainly on the back of (a) (franchisee-led) robust store addition of around 250 EBOs annually over FY19-21E, (b) increasing mix of brand extensions, and (c) premiumization of its product offerings.
- This coupled with healthy 6% SSSG and increasing contribution from the online channel (expected to reach 10% by FY21) should lead to steady EBITDA margin (on a high base of 12.5%), reaching 12.6% by FY21. We expect EBITDA CAGR of 11% over FY19-21.

Improving consumer sentiment to revive SSSG

The past few years (FY15-18) were painful as management was focused on network rationalization - involving closure of ~150 loss-making stores leading to net addition of 78 stores. This was on account of a weak macro-economic environment led by demonetization and GST implementation coupled with a hyper competitive market driven by ecommerce sales. However, with headwinds now behind, we believe Madura EBO's should register 6% SSSG driven by (a) burgeoning demand for branded apparels, (b) solid traction for its four key (lifestyle) brands, and (c) judicious network expansion. Store rationalization led by leaner store size, rental negotiation, employee rationalization and shut down of loss-making stores has created a strong base for store additions. Management plans to add net 250 EBOs (predominantly franchisee-led), thus, limiting capex requirements. Further, uptick in revenues from ecommerce distribution channel - mainly Flipkart, Amazon and own website - should also continue its accelerated growth.

Lifestyle segment generating INR38.7b revenue driven by four established menswear brands:



1) Louis Philippe (LP) – LP's range earlier included formal menswear. Tapping the premium INR2k+ price point, LP's offering now extends to semi-formals and other extension categories such as LP footwear and accessories. The non-formal category now contributes ~50% to the overall INR10b+ revenue generated during FY18, making LP the largest and most profitable brand in the industry. It competes with Raymond, Arrow and Zodiac, which garners about ~INR3-5b revenue.



2) Peter England (PE) – Similar to LP, PE is a brand focused on menswear with revenue of INR10b+. However, its attractive price point of INR1-1.2k differentiates PE from LP.

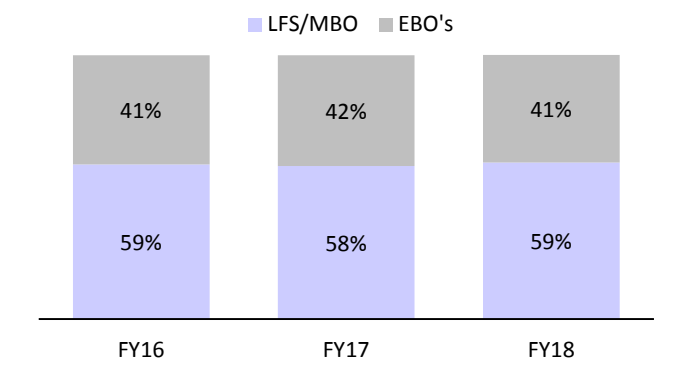


3) Van Heusen (VH) and Allen Solly (AS) – Both VH and AS are targeted towards the INR1.5-2k price point categories and generate revenues of INR10b+ and INR7.5b+, respectively. Unlike LP, which is focused on menswear, these brands also cater to women's wear (formals, casuals, party wear, etc.). Of the two, VH is largely focused on corporate attire while AS capitalizes on 'Friday Dressing'.

Healthy franchisee-led EBO expansion

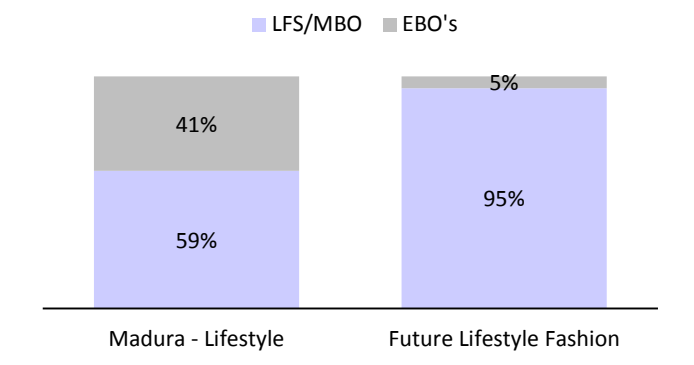
ABFRL has a strong network of 2.4k EBOs (FY19E), which contribute ~40% to the Lifestyle segment’s revenues and ~20% to the overall company’s revenue. The balance is contributed by LFS and MBOs. This is in contrast to the Future Lifestyle Fashion’s business model, which garnered ~95% of its revenue from LFS and MBOs, with a meager 4-5% contribution from (229) EBOs (FY18). ABFRL’s strong brand pull allows it to operate a franchisee-led deep EBO distribution model, which allows ABFRL to showcase its complete wardrobe solution.

Exhibit 143: EBOs contribute a healthy 41% to Madura’s Lifestyle revenue... (as a % of revenue)



Source: MOFSL, Company

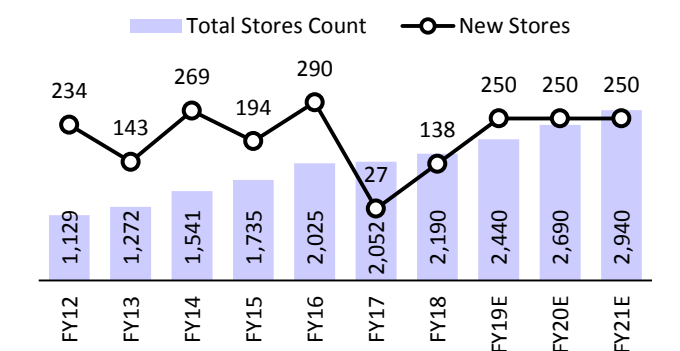
Exhibit 144: ...compared to a miniscule 5% of Future Lifestyle Fashion (as a % of revenue)



Source: MOFSL, Company

Though network rationalization over FY15-18 led to the closure of ~150 stores, its judicious operating strategy provides ABFRL a runway for quicker network expansion and increases traction for its brands in the markets. We expect the company to add ~250 new EBOs (mainly franchisee-led) over FY20/21, providing impetus to SSSG.

Exhibit 145: Overall store count under Madura division to witness a fillip on the back of franchisee-led expansion



Source: MOFSL, Company

Exhibit 146: Expect the EBO network to grow strong on the back of franchisee-led expansion



Source: MOFSL, Company

Brand extensions to support growth

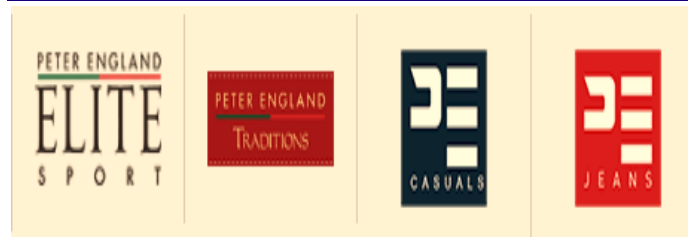
ABFRL is wisely leveraging the goodwill of its brands to monetize untapped opportunities from brand extensions, a category it recently forayed into. This includes casuals, footwear – sports and formal, and other accessories of the (four) lifestyle brands. Brand extensions acted as a key catalyst to FY18 growth, contributing ~45-50% to the overall brand revenue; however, it is subtle v/s the fast growing revenue of the lifestyle brands. We believe that the latent demand for extensions should provide a fillip to the overall growth.

Exhibit 147: Louis Philippe – brand extensions



Source: MOFSL, Company

Exhibit 148: Peter England – brand extensions



Source: MOFSL, Company

Exhibit 149: Van Heusen – brand extensions



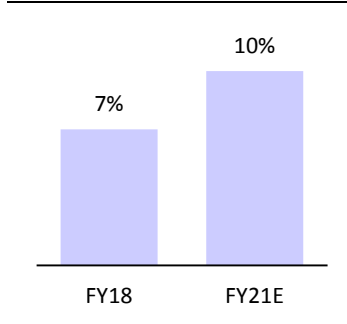
Source: MOFSL, Company

Exhibit 150: Allen Solly – brand extensions



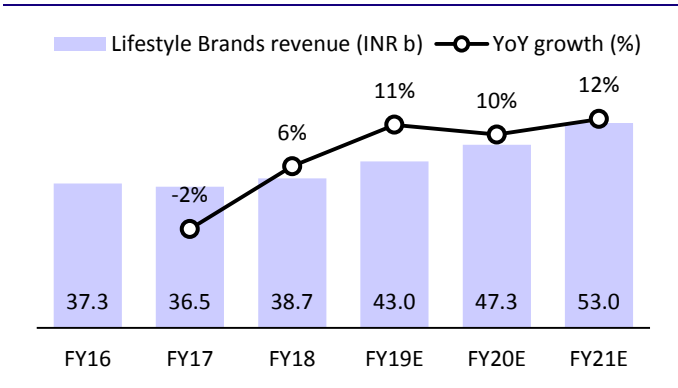
Source: MOFSL, Company

Share of online revenue to reach 10% by FY21E



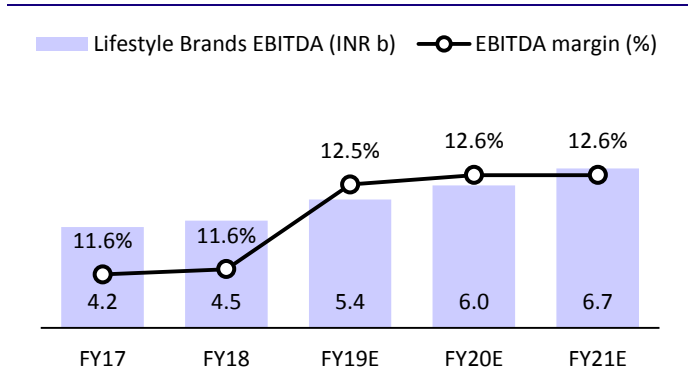
We expect revenue for the Lifestyle segment to grow at a strong 11% CAGR reaching INR53b over FY19-21. SSSG is expected at 6% driven by (a) improving macro-economic conditions and competitive environment in the market, which pulled down sales in the last 2-3 years, (b) increasing share of brand extensions like casual wear and accessories, and (c) premiumization of products through higher price SKUs. Increase in online revenue share (from the current 7% to 10% over the next three years) and accelerated store expansion by addition of 250 net EBOs annually should drive the Lifestyle segment growth.

Exhibit 151: Revenue to grow at 11% CAGR over FY19-21E



Source: MOFSL, Company

Exhibit 152: EBITDA margin to gradually inch up reaching 13% by FY21E



Source: MOFSL, Company



Revamped Pantaloon's set to drive earnings

Expect 100bp margin expansion over FY19-21

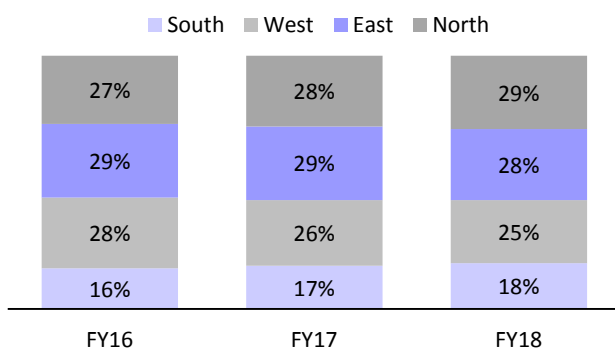
- Pantaloon's stands at an inflection point with aggressive store expansion tapping the prospective value fashion format.
- ABFRL undertook a series of restructuring measures to transform Pantaloon's from a premium retail format to a value-fashion format, which included reducing (1) store size (from ~17-18k sqft to 10-15k sqft), and (2) product pricing (starting from INR699).
- We expect the Pantaloon's division to register strong 17% revenue CAGR over FY19-21 on healthy 5% SSSG and a strong addition of around 65 stores annually.
- Uptick in the private label mix (expected to reach 70-75% by FY21), healthy SSSGs and scale benefits should drive 100bp margin expansion, reaching 9% by FY21.

Tapping the fastest growing value fashion segment

Branded apparels being 4x costlier than unorganized local products, has led to the value-fashion retail format gaining prominence in the last few years as it is priced at 2x v/s local apparel products. In order to target this category, Pantaloon's (post its acquisition from Future Group), has been completely revamped from a lifestyle apparel retail chain to value fashion format.

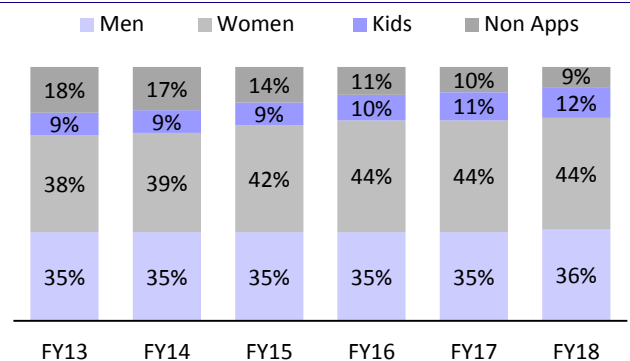
Pantaloon's contributed ~40% to the overall revenues of ABFRL (FY19E). Competing with, FBB, Reliance Trends and Max at the lower end and Westside at the higher end, it is largely spread across tier-1 and 2 cities with an average selling price of ~INR699. With burgeoning demand, the branded apparel market is expected to grow at 14% CAGR over CY15-21 and therefore immense growth opportunities exist for each player in the value fashion category. This is evident from the fact that Pantaloon's/Brand Factory grew at a healthy 16%/28% CAGR over FY15-18 while the premium and sub-premium formats of Central/Shoppers' Stop grew at a modest 9%/6% CAGR over the same period.

Exhibit 153: Pantaloon's - Healthy revenue mix across all four regions



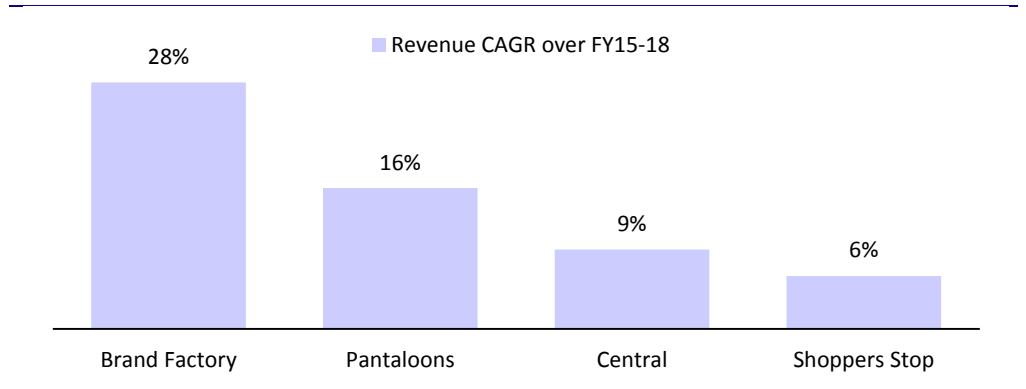
Source: MOFSL, Company

Exhibit 154: Pantaloon's - Revenue mix across women's category is witnessing an uptrend



Source: MOFSL, Company

Exhibit 155: Revenue growth for value fashion formats have outpaced the premium formats



Source: MOFSL, Company

Key women-centric brands under Pantaloons’ umbrella include Izabel London, Anabelle, Candie’s New York, Honey, Akkritim, Rang Manch and Trishaa; menswear brands include SF Jeans, Richard Parker, Byford, Alto Moda and Ajile.

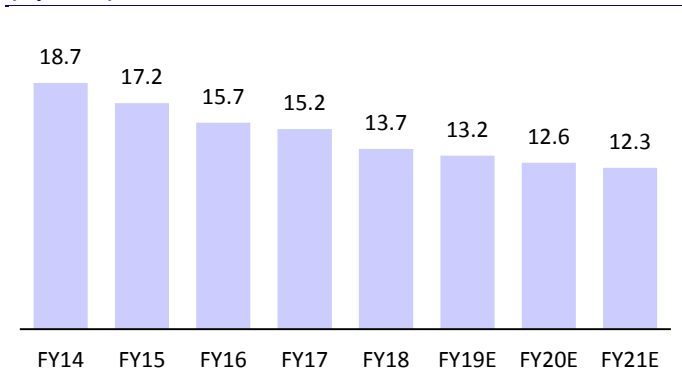
Last three years of restructuring complete

Post its acquisition in FY13, various restructuring programs were undertaken for Pantaloons. This involved (a) rationalizing store size for improving productivity; average size of Pantaloons’ store trimmed to ~13k sqft in FY19E (from 17k sqft in FY15), and (b) turning Pantaloons into a value-fashion proposition (from a premium brand under the Future Group). Consequently, the company voluntarily took price reduction and increased its private label mix (from 40% to 60%), in order to improve product-price equation, turning it into a value-fashion store.

Improving private label mix

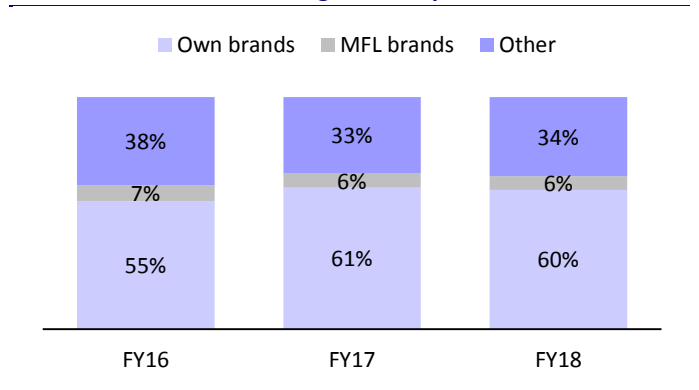
Private label mix for Pantaloons currently stands at 60% (FY18) driven by new launches and refreshed products. At the time of its acquisition from the Future Group, private label mix was 40% and management is targeting to further increase this mix to 70-75% in the next two years.

Exhibit 156: Pantaloons – Rationalization of avg. store size (sqft’000)...



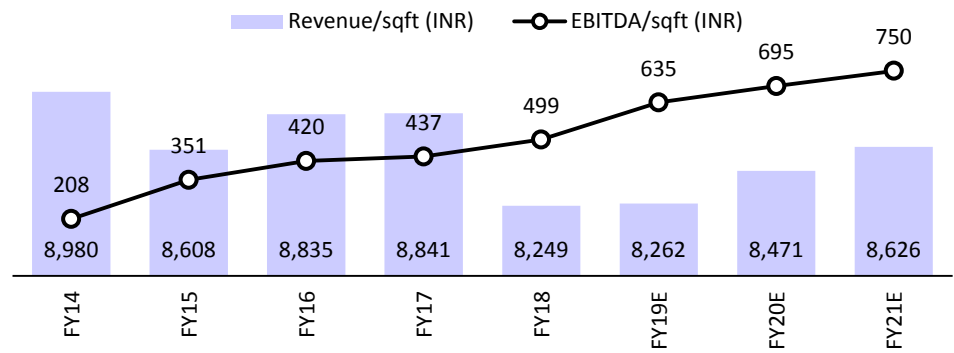
Source: MOFSL, Company

Exhibit 157: ...and increasing share of private labels...



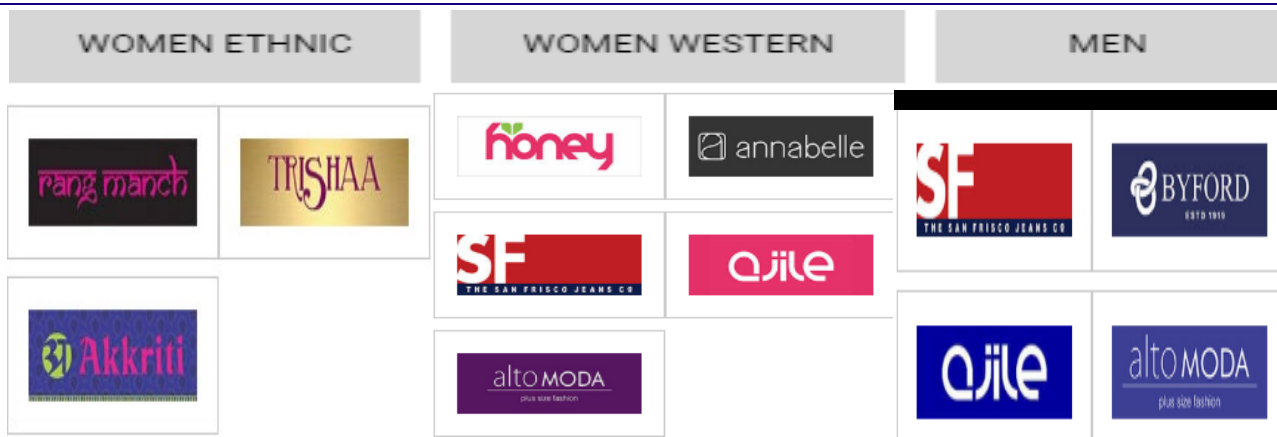
Source: MOFSL, Company

Exhibit 158: ...provided impetus to profitability/sqft



Source: MOFSL, Company

Exhibit 159: Private label brands under Pantaloons division



Source: MOFSL, Company

www.pantaloons.com

Launch of pantaloons.com to boost ecommerce business

The company has launched Pantaloons.com – the online platform for Pantaloons offerings – to quickly boost its presence in the online medium. It is also tying up with the two online giants – Amazon and Flipkart – to step up the traction for its private label brands. Since the strategy is similar to that of Madura, management is bullish about the revenue potential (Madura currently garners ~7% revenues from the online channel).

Growth levers in place

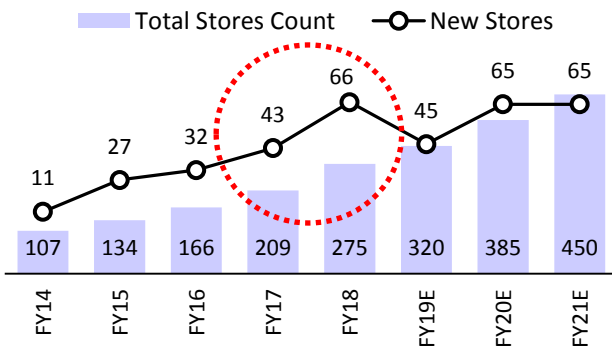
We expect revenue for the Pantaloons division to grow at 17% CAGR reaching INR44.7b over FY19-21, mainly on the back of healthy 5% SSSG and steady addition of 65 new stores.

1) Expect 5% SSSG over FY19-21 led by:

- a) Focus on customer loyalty program with ~10m loyal customers contributing ~90% to the total revenue. Higher wallet share from these sticky customers should further augment growth.
- b) Healthy mix of 130 new stores (including franchisee stores) i.e. 40% of the overall 320 stores (FY19E).
- c) Increasing share of private labels from current 60% to 70%.
- d) Increasing revenue share from ecommerce channel led by the launch of pantaloons.com and sale through online medium - Flipkart and Amazon.

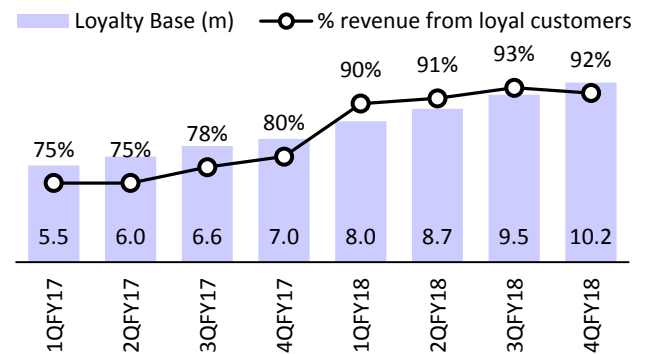
2) Store adds run-rate to continue: We expect 65 store adds annually, with a combination of 20% franchise stores.

Exhibit 160: Pantaloons – healthy 109 store adds...



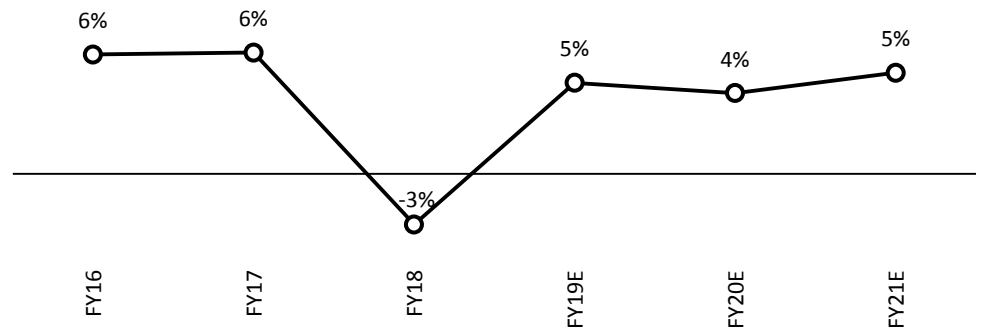
Source: MOFSL, Company

Exhibit 161: ...and increasing stickiness of customers...



Source: MOFSL, Company

Exhibit 162: ...is expected to drive SSSG (%)



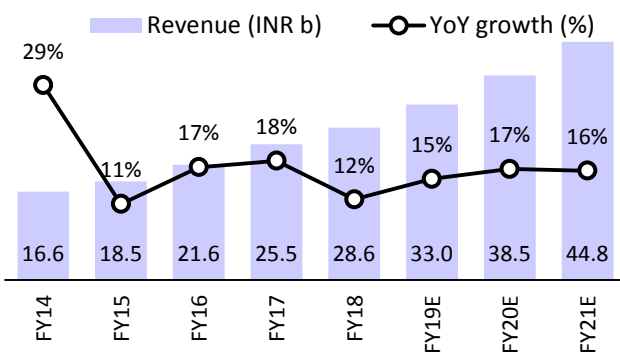
Source: MOFSL, Company

Expect 100bp margin improvement in two years

EBITDA margin should improve by 100bp over FY19-21E, reaching ~9% by FY21; subsequently we expect 24% EBITDA CAGR over the same period. This is on the back of

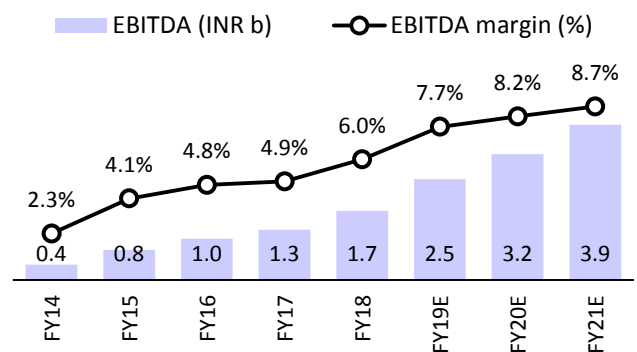
- a) **Revival of healthy SSG growth.**
- b) **Improvement in Private labels contribution**, which garners nearly 55-60% gross margin v/s ~48% for overall Pantaloons segment.
- c) **Scale benefits** as Pantaloons’ revenue is likely to grow at 17% CAGR over FY19-21E driving operating leverage for non-store cost.
- d) **Recent rationalization of Pantaloons’ store cost** including rental, employee and other costs.

Exhibit 163: Revenue to grow at 17% CAGR over FY19-21E



Source: MOFSL, Company

Exhibit 164: EBITDA margin to expand 100bp, reaching ~9% by FY21E



Source: MOFSL, Company

Innerwear and Fast fashion – New growth engines

Expect segmental EBITDA to break-even fast, driving overall margins

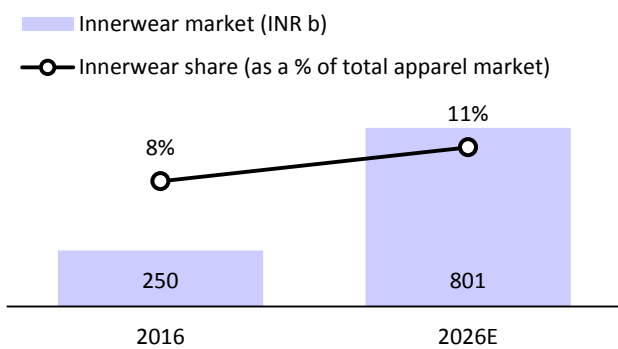
- With just two years since its foray into the innerwear category, revenue from Van Heusen innerwear has reached INR1.9b (FY19E) led by strong brand pull and distribution network with 12k channels.
- We believe innerwear business thrust on ramping up the distribution reach to 30-40k channels would not only drive 35% revenue CAGR for ‘Other biz’ segment over FY19-21 but also lead to fast EBITDA breakeven (INR800m loss FY19E).
- Fast Fashion EBITDA loss of INR300m (FY19E) should reach break-even by FY21 led by renewed focus on rationalizing the store economics through reducing Forever 21 store size and operating on leaner cost structures.

Innerwear fuelling growth

Branded market remains shallow

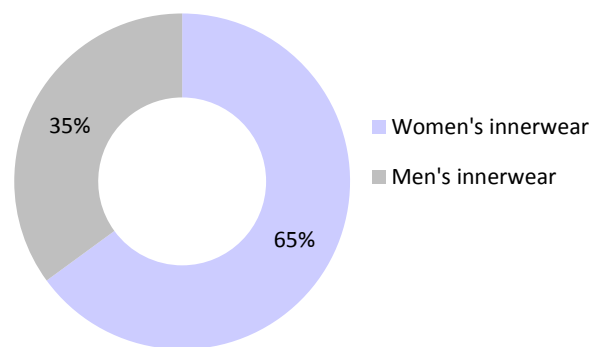
In India, the innerwear market stood at a meager 8% (INR250b) of the overall apparel market in CY16. This is expected to grow at 12% CAGR over CY16-26. The innerwear segment is mainly categorized into men and women wear - Men’s innerwear accounts for INR80b (35% of the total innerwear market), while women’s innerwear category stood at INR163b (~65%); kids’ innerwear market remains largely unorganized.

Exhibit 165: Innerwear market is expected to grow at 10% CAGR over CY16-26



Source: Page Industries, MOFSL

Exhibit 166: Men’s innerwear accounts for 35% of the total innerwear market (%)

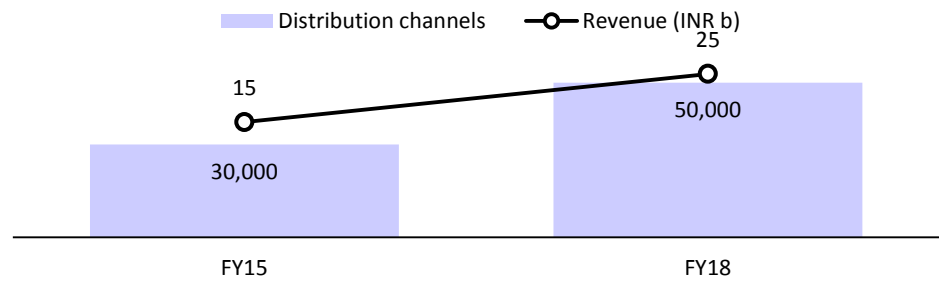


Source: Page Industries, MOFSL

Of the massive INR250b industry size, branded (men + women) innerwear market is miniscule. Though many (international) players like Levi’s, Calvin Klein have forayed into this category, Jockey continues to rule the market with an annual turnover of about INR30b (FY19E), out of which ~50% is men’s innerwear. Two key determinants for Jockey’s monopoly are reach and pricing:

- 1) Reach:** With a robust distribution network of 50k+ outlets across 1,400+ cities, Jockey’s offerings are sold predominantly through MBOs, but are also available across channels of LFS as well as EBOs.
- 2) Price points:** Jockey offerings are available at attractive price points of ~INR140 in contrast to the premium offerings of Levi’s and Calvin Klein. Thus, the traction for Jockey’s products continues to increase over the years, which turned ‘Jockey’ into a juggernaut in the innerwear category.

Exhibit 167: Spurt in distribution reach led to 19% CAGR in Jockey’s revenue over FY15-18



Source: Page Industries, MOFSL



Reaping benefits of strong brand pull

The innerwear market is massive and largely untapped, and ABFRL forayed into this category with Van Heusen’s men’s innerwear. With just two years into the sub-premium category, revenue from the launch of Van Heusen’s men innerwear reached INR1.9b mark (FY19E). Though the strong 12k distribution channel reach assisted in generating revenue, the strong brand recall of Van Heusen can’t be ignored, which is a mainstay for ABFRL with all its brands.

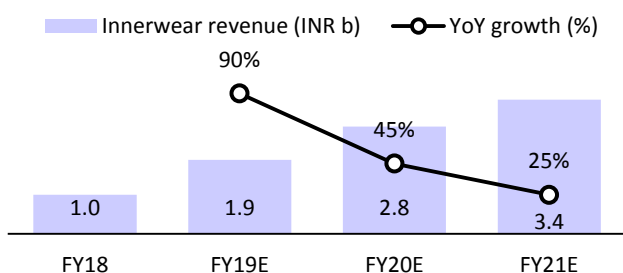
Widening distribution

The company is focused on ramping up its innerwear distribution network to 30-40k (from the current 12k) channels in the next three to five years in order to compete with the market leader. Consequently, it is investing heavily in building the distribution channels offering higher margins to retailers vis-à-vis those provided by Jockey. Once the ~40k channel network gets ready, we believe that it can introduce the innerwear category across its other brands too – Louis Philippe, Peter England and Allen Solly – to leverage the distribution network and strong brand recall. Management targets to reach INR5b in three years. Overall, we expect the other segment businesses including Van Heusen innerwear to reach INR6b, 25% CAGR over FY19-21.

Scale to drive EBITDA growth

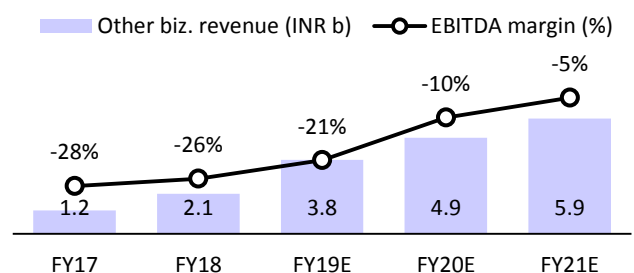
Despite the opex heavy investments in the near term, spurt in the revenue from the category would offset the incremental investments, limiting the EBITDA loss at ~INR0.8b (FY19E). Further, given the strong brand recall for these brands and the burgeoning demand for branded innerwear category, as the revenue scales up from the Van Heusen innerwear offerings, it would only aid in margin expansion. Subsequently, we expect FY19 EBITDA loss of INR800m to come down to INR300m by FY21.

Exhibit 168: Expect innerwear revenue for ABFRL to grow ~2x over FY19-21E



Source: MOFSL, Company

Exhibit 169: Expect EBITDA margin for other business segment to improve from -21% in FY19 to -5% by FY21



Source: MOFSL, Company

Fast-Fashion in WIP

Strong brand pull

Fast Fashion includes 'Forever 21' and 'People' brands contributing ~5% of overall revenue.

FOREVER 21

a) Forever 21:

- US-based Forever 21 is a strong fast fashion brand. It was licensed by ABFRL for 30 years in Jul'16 and is largely run through ecommerce and EBO model. Globally, Forever 21's trendy offerings cater to both men and women's wear, while in India ABFRL has acquired (offline and online) license exclusively for women's wear offerings.
- With estimated revenue of ~INR2.5b+ in FY19E, Forever 21 is operated through 25 EBOs (Mar'19E), with presence across 18 cities (mainly Metro and Tier I). Though its on-ground presence seems miniscule, Forever 21 has a strong brand pull in the US, which has driven healthy online demand, generating ~1/3rd (INR1b) revenue. It operates in the premium price point of INR800+, competing with Zara (INR12b revenue FY18), among others.

b) People:

- With an estimated annual turnover of ~INR1b (FY19), 'People' is a fast fashion brand, targeted towards the youth. It is a homegrown brand with a network of 98 stores across 48 cities.



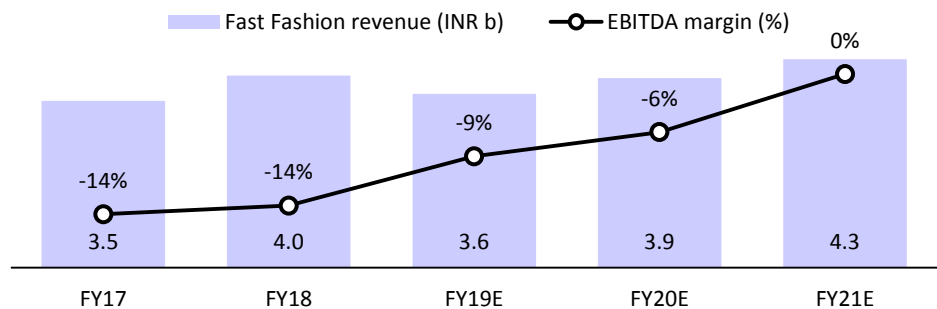
Getting the retail model right

Although per store revenue for Forever 21 EBOs was on an uptrend, its profitability remained muted due to larger-than-required store size and higher operating costs. Consequently, during 3QFY18, the company kicked off the store rationalization program for the legacy Forever 21 stores, thus prioritizing the store profitability by (a) reducing the store size from earlier 10-15k sqft to 6-8k sqft, and (b) closure of the loss-making stores. Thus, management is focused on getting the per store economics right, before eyeing business takeoff.

Moderate store expansion

We believe the company will witness modest annual store adds of sub-10 for Forever 21 and 10 for 'People' brand over FY20/21. This coupled with high single-digit SSSG should drive 9% revenue CAGR over FY19-21. Furthermore, thrust on per store economics should result in restricting EBITDA losses and potentially break-even by FY21E from an EBITDA loss of ~INR300m in FY19E.

Exhibit 170: Expect fast fashion segment to turn EBITDA breakeven by FY21



Source: MOFSL, Company

Healthy balance sheet, growing cashflow

Franchisee-led store adds to keep balance sheet asset-light

- Overall return ratios remained depressed during the past two years due to (a) profitability of Madura's Lifestyle business getting partly offset by the loss-making fast fashion and other categories and (b) ramp-up in store adds impacting Pantaloon's returns.
- Company's capex requirement remains moderate at ~INR3.3b annually over FY19-21E driven by Lifestyle's franchisee model. This should provide impetus to overall FCF, expected to reach INR4.1b by FY21 v/s INR2b in FY19.
- With strong revenue/EBITDA growth and steady capex requirements, we believe the company is ready to witness a fillip in overall return ratios; expect RoCE to reach 18% by FY21 (13% FY19E).

Healthy WC terms, asset-light distribution and improving profitability to garner healthy ROCE

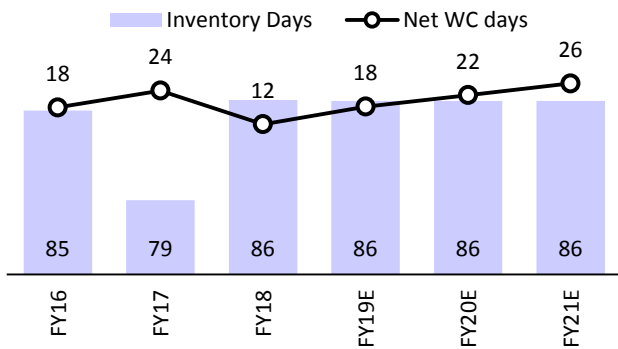
Typically, LFS operates on a Sale or Return basis, thus keeping the inventory on the books of the brand owner. However, ABFRL due to its revenue scale of INR44.6b, which is easily 4-5x of other brands, is able to negotiate a sale on an outright basis instead of an SOR basis. This has allowed it to garner healthy inventory of 86 days. With account payable of 98 days, the net working capital is merely 18 days, thus allowing ABFRL a lean working capital.

The lifestyle business being predominantly a lease EBO model allows it to garner about 30% ROCE. However, the store rollout in fast fashion and other smaller segments coupled with EBITDA losses pulled down Madura's (Lifestyle + Fast Fashion + Innerwear + Other business) ROCE to ~15%. We believe rationalization of stores as well as turnaround of Fast Fashion and other businesses should improve ROCE. Further, Pantaloon's due to its aggressive store expansion and modest EBIT has posted meager 1% ROCE in FY18. We believe this should improve to double-digits in the next two years on better asset monetization driven by improving asset turns and EBITDA CAGR of 24% in FY19-21E.

FCF generation to improve

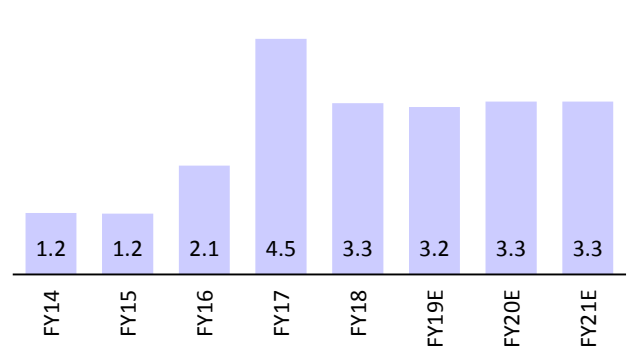
Free cash flows (post interest cost) too should turn positive with superior earnings generating OCF CAGR of 21% and stable overall capex of INR3b. Despite aggressive targets of 250 EBO adds under Lifestyle and 65 Pantaloon's store adds, we believe growth capex requirements should be maintained at INR3b (INR1b/ INR1.5b/ INR500m for Lifestyle/ Pantaloon's/ Other segments, respectively). Lifestyle segment's franchisee-led model given its strong brand pull requires limited maintenance capex. Furthermore, other segment capex of a meager INR500m driven by about 10-store adds each for Forever 21 and People, and investment in innerwear would keep the total capex requirements steady at ~INR3b, thus, limiting the balance sheet from excessive bloating. Thus, strong revenue growth and uptick in margins coupled with stable capex requirements should result in healthy FCF. We expect the company to generate INR4.2b FCF by FY21 (INR1.9b FY19).

Exhibit 171: Low working capital despite being a brand owner



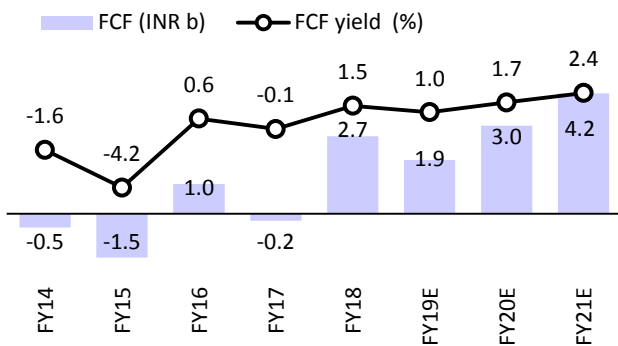
Source: MOFSL, Company

Exhibit 172: Franchisee-led store expansion should limit capex (INR b)



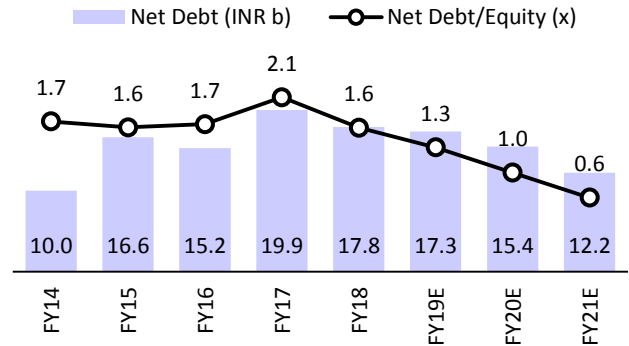
Source: MOFSL, Company

Exhibit 173: Increase in FCF...



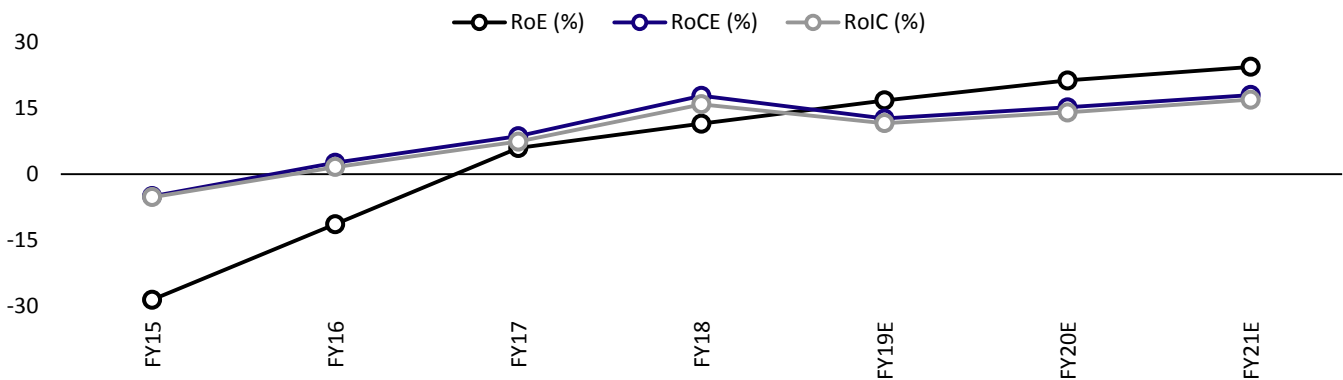
Source: MOFSL, Company

Exhibit 174: ...should lead to a plunge in debt



Source: MOFSL, Company

Exhibit 175: Return ratios to surge



Source: MOFSL, Company

Franchisee-led model garners higher RoCE

Lifestyle brands

Franchisee-led store model remains the mainstay for network expansion under the Madura division. Consequently, majority of the capex and opex requirements get shifted to the franchisee, thus, amplifying the return ratios – mainly for the Lifestyle segment's EBOs. Thus, for an investment of INR4m per store (capex - INR3m per store (INR2000/sqft) and opex - INR1m per store), store level RoCE for EBOs is ~66%. Strong brand pull for the four signature brands under the Lifestyle segment coupled with an attractive ~1.5k sqft average store size acts as a key catalyst driving productivity - INR17.4k per sqft/INR26m per store. Besides, premium pricing of brands and lower discounts assist in garnering higher (60%+) gross and (~12%) EBITDA margins.

Pantaloons

Pantaloons' stores currently operate on an average store size of ~13k sqft (new stores at 10k sqft), with an average investment of INR31m/store (capex – INR27m per store (INR2000/sqft) and opex – INR3m per store). Driven by the value-fashion business model, each store generates healthy average revenue of INR118m with a 4x asset turn. This provides impetus to higher gross profits of INR57m (48% gross margin) and EBITDA of INR7m (EBITDA margin of 6%). As the proportion of franchisee-led store mix increases (currently ~17% of the total stores) and the incremental capex requirement subsides, these margins would further inch up. Assuming a depreciation of INR6m, the EBIT/store stands at INR1m, garnering post tax ROCE of about 3%. Over the next two years, as EBITDA margins improve to 9%, ROCE (post tax) should improve to about ~14%.

Exhibit 176: Per store analysis for payback and RoCE (INR m)

Particulars (FY18)	Lifestyle		Pantaloons	
	Per Store	Per Sq.ft	Per Store	Per Sq.ft
Capex/store	3	2,000	27	2,000
WC/store	1	593	3	242
Total	3	2,593	31	2,242
Breakeven (in years)	1.1	1.3	4.3	4.5
Revenue	26	17,367	118	8,249
Gross profit	16	10,420	57	3,959
Gross margin (%)	60.0%	60.0%	48.0%	48.0%
Other operating cost	13	8,403	50	3,461
EBITDA	3	2,017	7	499
EBITDA margin (%)	11.6%	11.6%	6.0%	6.0%
Depreciation	1	514	6	434
as a % of revenue	3.0%	3.0%	5.3%	5.3%
EBIT	2	1,503	1	64
RoCE (Tax - 0%)	66%	58%	3.0%	2.9%

Source: MOFSL, Company

10% SSSG can drive more than 100bp margin expansion

During the last two years, network rationalization coupled with macro factors had impacted growth. However, with headwinds now behind, a modest 10% SSSG for a Lifestyle/Pantaloons store should drive 132bp/114bp EBITDA margin expansion on a per store basis, led by the inherent fixed cost business model. As the revenue per store starts scaling up, the operating leverage starts playing out with ~30% of the cost remaining fixed.

Exhibit 177: Scenario analysis on per store basis (INR m)

Particulars (FY18)	Lifestyle		Pantaloons	
	Per Store	Per Sq.ft	Per Store	Per Sq.ft
Revenue increases by	10%	20%	10%	20%
Revenue	29	31	130	142
Gross profit	17	19	62	68
Gross margin (%)	60.0%	60.0%	48.0%	48.0%
Other Operating Cost				
Fixed (%)	30%	30%	30%	30%
Fixed	4	4	15	15
Variable (%)	70%	70%	70%	70%
Variable	10	11	38	42
Other Operating Cost	13	14	53	57
EBITDA	4	4	9	12
EBITDA margin (%)	12.9%	14.0%	7.2%	8.1%
Change in bps	132	242	114	210
EBIT	3	4	3	5
Breakeven (in years)	0.9	0.8	3.3	2.7
RoCE (Tax - 0%)	85.5%	105.3%	10.2%	17.4%

Source: MOFSL, Company

Valuation and view

Recommend Buy with TP of INR260

- We initiate coverage on ABFRL with a Buy rating and an SOTP-based TP of INR260. We ascribe 23x to Lifestyle segment FY21E EBITDA of INR6.7b (given its strong brand value), 18x to Pantaloons FY21E EBITDA of INR3.9b (expected to drive earnings growth) and 1x FY21E EV/sales for the fast fashion and other business.
- At CMP, the stock is trading at 38x/19x FY21E P/E and EV/EBITDA. We have ascribed ~10% premium to the target EV/EBITDA multiple for our apparel coverage, but ~15% discount to three-year average, which should reduce with a better performance in Pantaloons and an uptick in the return ratios.

SOTP of INR260, Buy

ABFRL offers secular growth potential with a unique portfolio of established industry leading brands and high growth categories like value-fashion retail chain. Its strong platform of established brands, deep distribution and management capability allow it to launch multiple products across apparel categories like its recent inroads in the innerwear segment, women's fast fashion, casual wear and luxury retail chain which can continue to fuel growth and drive valuations. Further, it is among the few apparel companies that have garnered a healthy return profile (Lifestyle ~30%).

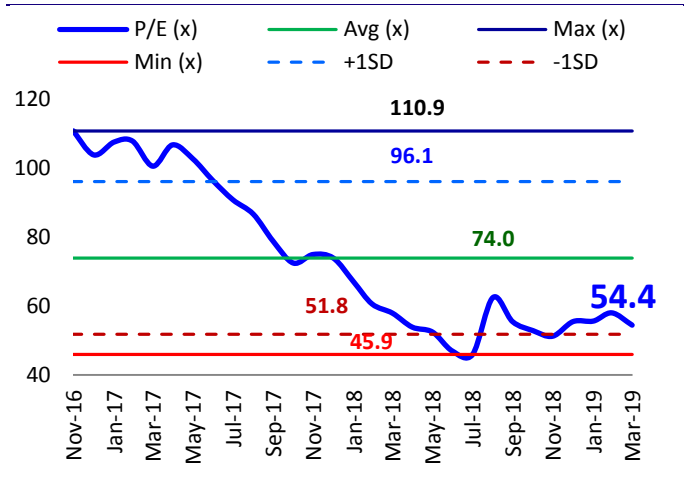
We have valued ABFRL on SOTP basis arriving at a TP of INR260, 19% upside, recommending **Buy**. We have assigned the Lifestyle segment 23x EV/EBITDA of FY21E EBITDA of INR6.7b, given its strong brand value. We have assigned 18x EV/EBITDA to Pantaloons FY21E EBITDA of INR3.9b as we believe there exists a strong foundation for robust future growth; as it delivers strong earnings in the next 1-2 years, valuation should improve. Further, the other business including fast fashion and innerwear among others is yet loss-making as a portfolio and we therefore assign 1x EV/sales to FY21E sales. We have ascribed ~10% premium to target EV/EBITDA multiple for our apparel coverage (ABFRL, FLF, VMART, Trent, Shoppers Stop), but ~15% discount to three-year average conservatively. Despite the sharp rally over the last two quarters, this gap can further reduce as Pantaloons delivers better margins, driving a healthy improvement in return ratios and cash flows over the next two years.

Exhibit 178: FY21 SOTP-based valuation

Particulars	EBITDA/Sales (INR b)	Multiple (x)	Value (INR b)
Lifestyle Brands (gross EBITDA)	6.7	23	154
Pantaloons (gross EBITDA)	3.9	18	70
Others (gross sales)	10.2	1	10
Total EV (net)			212
Less: Net debt			12
Equity Value			200
No of Shares (m)			769
Target Price (INR)			260
CMP (INR)			219
Upside (%)			19%

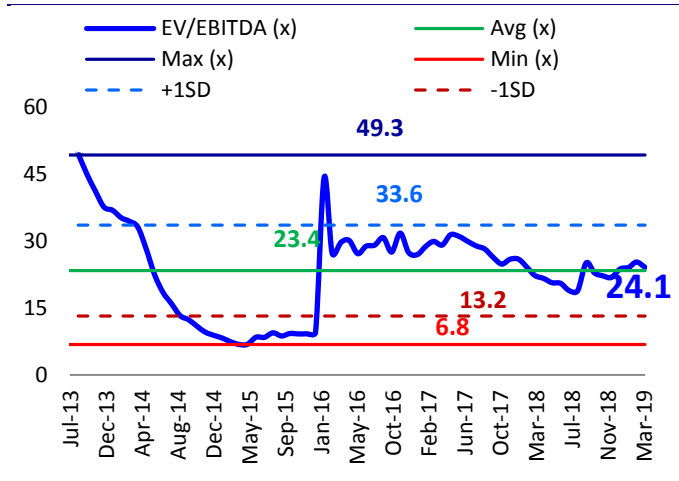
Source: MOFSL, Company

Exhibit 179: ABFRL: 1-year forward P/E band



Source: Bloomberg, MOFSL

Exhibit 180: ABFRL: 1-year forward EV/EBITDA band



Source: Bloomberg, MOFSL

Financials and valuations

Standalone - Income Statement

(INR m)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	16,612	18,507	60,339	66,029	71,721	82,251	93,359	1,06,545
Change (%)	NA	11.4	226.0	9.4	8.6	14.7	13.5	14.1
Raw Materials	9,523	10,004	27,518	30,070	33,901	40,094	44,756	51,202
Employees Cost	1,497	1,837	6,205	7,058	7,723	8,965	10,083	11,507
Rent	2,503	2,825	9,032	10,871	10,429	11,280	12,712	14,268
Other Expenses	2,755	3,114	13,801	13,638	14,985	15,743	18,209	20,253
Total Expenditure	16,278	17,780	56,555	61,637	67,038	76,082	85,759	97,230
% of Sales	98.0	96.1	93.7	93.3	93.5	92.5	91.9	91.3
EBITDA	334	727	3,784	4,392	4,683	6,169	7,600	9,315
Margin (%)	2.0	3.9	6.3	6.7	6.5	7.5	8.1	8.7
Depreciation	1,090	1,835	3,381	2,425	2,805	2,835	3,319	3,946
EBIT	-756	-1,108	403	1,967	1,878	3,334	4,281	5,369
Int. and Finance Charges	1,173	1,202	1,765	1,797	1,716	1,836	1,711	1,461
Other Income	51	28	264	382	328	509	534	561
PBT bef. EO Exp.	-1,877	-2,281	-1,098	552	490	2,006	3,103	4,468
EO Items	0	0	0	0	0	0	0	0
PBT after EO Exp.	-1,877	-2,281	-1,098	552	490	2,006	3,103	4,468
Total Tax	0	0	0	0	-688	0	0	0
Tax Rate (%)	0.0	0.0	0.0	0.0	-140.5	0.0	0.0	0.0
Reported PAT	-1,877	-2,281	-1,098	552	1,178	2,006	3,103	4,468
Adjusted PAT	-1,877	-2,281	-1,098	552	1,178	2,006	3,103	4,468
Change (%)	NA	21.5	-51.9	-150.3	113.4	70.3	54.7	44.0
Margin (%)	-11.3	-12.3	-1.8	0.8	1.6	2.4	3.3	4.2

Standalone - Balance Sheet

(INR m)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	933	928	7,688	7,705	7,717	7,717	7,717	7,717
Total Reserves	4,862	9,211	1,367	1,876	3,214	5,220	8,324	12,792
Net Worth	5,795	10,139	9,055	9,582	10,931	12,937	16,040	20,509
Total Loans	10,155	16,864	15,436	20,446	18,615	18,115	16,115	13,115
Deferred Tax Liabilities	0	0	0	0	-688	0	0	0
Capital Employed	15,949	27,003	24,491	30,028	28,857	31,052	32,155	33,623
Gross Block	19,905	29,868	24,943	27,575	30,667	33,767	37,067	40,367
Less: Accum. Deprn.	3,504	5,187	1,711	2,704	4,844	7,679	10,998	14,945
Net Fixed Assets	16,401	24,681	23,232	24,871	25,823	26,088	26,069	25,422
Capital WIP	179	157	254	250	459	459	459	459
Total Investments	60	0	0	0	42	0	0	0
Curr. Assets, Loans & Adv.	4,892	19,796	22,338	25,238	30,326	34,926	38,878	43,938
Inventory	3,584	11,503	14,105	14,313	16,912	19,380	21,997	25,104
Account Receivables	170	4,085	3,124	4,522	5,518	6,760	7,673	8,757
Cash and Bank Balance	108	270	192	497	728	899	767	1,028
Loans and Advances	1,031	3,938	4,917	5,907	7,168	7,887	8,441	9,049
Curr. Liability & Prov.	5,583	17,631	21,334	20,331	27,793	30,422	33,251	36,196
Account Payables	3,756	12,415	14,298	14,578	20,093	22,084	24,043	26,271
Other Current Liabilities	1,673	4,621	6,290	3,823	5,780	6,084	6,650	7,006
Provisions	154	595	746	1,929	1,920	2,253	2,558	2,919
Net Current Assets	-691	2,165	1,005	4,907	2,533	4,505	5,627	7,742
Appl. of Funds	15,949	27,003	24,491	30,028	28,858	31,051	32,155	33,623

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	-2.4	-3.0	-1.4	0.7	1.5	2.6	4.0	5.8
Cash EPS	-1.0	-0.6	3.0	3.9	5.2	6.3	8.3	10.9
BV/Share	7.5	13.2	11.8	12.4	14.2	16.8	20.8	26.6
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				305.8	143.3	84.1	54.4	37.8
Cash P/E				56.7	42.4	34.9	26.3	20.1
P/BV				17.6	15.4	13.0	10.5	8.2
EV/Sales				2.9	2.6	2.3	2.0	1.7
EV/EBITDA				43.0	39.9	30.2	24.3	19.4
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-5.1	-16.4	1.3	-0.3	3.5	2.5	3.9	5.4
Return Ratios (%)								
RoE	-32.4	-28.6	-11.4	5.9	11.5	16.8	21.4	24.5
RoCE	NA	-5.0	2.6	8.6	17.8	12.7	15.2	18.0
RoIC	NA	-5.3	1.6	7.4	15.9	11.6	14.1	17.0
Working Capital Ratios								
Fixed Asset Turnover (x)	0.8	0.6	2.4	2.4	2.3	2.4	2.5	2.6
Asset Turnover (x)	1.0	0.7	2.5	2.2	2.5	2.6	2.9	3.2
Inventory (Days)	79	227	85	79	86	86	86	86
Debtor (Days)	4	81	19	25	28	30	30	30
Creditor (Days)	83	245	86	81	102	98	94	90
Leverage Ratio (x)								
Current Ratio	0.9	1.1	1.0	1.2	1.1	1.1	1.2	1.2
Interest Cover Ratio	-0.6	-0.9	0.2	1.1	1.1	1.8	2.5	3.7
Net Debt/Equity	1.7	1.6	1.7	2.1	1.6	1.3	1.0	0.6

Standalone - Cash Flow Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
(INR m)								
OP/(Loss) before Tax	-1,877	-2,281	-1,098	535	490	2,006	3,103	4,468
Depreciation	1,090	1,835	3,381	2,425	2,805	2,835	3,319	3,946
Interest & Finance Charges	1,173	1,202	1,765	1,761	1,669	1,836	1,711	1,461
Direct Taxes Paid	-29	-15	-19	-30	-10	0	0	0
(Inc)/Dec in WC	408	-1,096	-741	-573	760	-1,112	-1,254	-1,854
CF from Operations	763	-357	3,288	4,118	5,714	5,566	6,880	8,022
Others	-62	-3	-179	134	237	-509	-534	-561
CF from Operating incl EO	701	-359	3,109	4,252	5,951	5,057	6,346	7,461
(Inc)/Dec in FA	-1,175	-1,163	-2,076	-4,499	-3,271	-3,100	-3,300	-3,300
Free Cash Flow	-473	-1,522	1,033	-247	2,680	1,957	3,046	4,161
(Pur)/Sale of Investments	7,968	75	0	4	-36	42	0	0
Others	20	198	219	40	58	511	536	563
CF from Investments	6,813	-889	-1,857	-4,455	-3,250	-2,547	-2,764	-2,737
Issue of Shares	0	0	-16	11	12	0	0	0
Inc/(Dec) in Debt	-6,802	2,602	508	1,948	-1,832	-500	-2,000	-3,000
Interest Paid	-857	-1,191	-1,821	-1,450	-649	-1,836	-1,711	-1,461
Dividend Paid	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Fin. Activity	-7,659	1,411	-1,330	509	-2,469	-2,336	-3,711	-4,461
Inc/Dec of Cash	-144	162	-78	306	233	174	-130	263
Opening Balance	253	108	270	190	495	725	897	765
Closing Balance	108	271	192	496	727	899	767	1,028

Avenue Supermarkets

BSE SENSEX 38,862 S&P CNX 11,666

CMP: INR1,446 TP: INR1,300 (-10%) Sell



Stock Info

	DMART IN
Bloomberg	DMART IN
Equity Shares (m)	624
M.Cap.(INRb)/(USDb)	902.5 / 13
52-Week Range (INR)	1696 / 1127
1, 6, 12 Rel. Per (%)	-8/-4/-12
12M Avg Val (INR M)	1195
Free float (%)	18.8

Financials Snapshot (INR b)

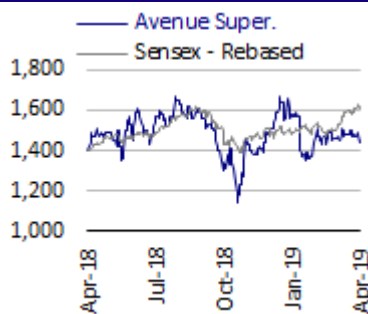
Y/E MARCH	FY19E	FY20E	FY21E
Sales	199.5	245.4	309.8
EBITDA	16.8	21.0	27.1
NP	9.6	12.3	16.3
EPS (INR)	15.3	19.7	26.1
EPS Gr. (%)	18.6	28.5	32.7
BV/Sh (INR)	90.1	109.8	136.0
P/E (x)	94.4	73.4	55.3
P/BV (x)	16.0	13.2	10.6
EV/EBITDA (x)	53.7	42.8	32.9
EV/Sales (x)	4.6	3.7	2.9
RoE (%)	18.6	19.7	21.3
RoCE (%)	17.7	18.8	20.5

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	81.2	81.2	82.2
DII	3.1	3.0	3.6
FII	5.9	5.5	3.6
Others	9.8	10.3	10.7

FII Includes depository receipts

Stock Performance (1-year)



Well-oiled growth engine

But limited room for re-rating

- DMART has consistently outperformed its peers, with strong 20% SSSG and 8.4% EBITDA margin (FY19). Its EDLC-EDLP strategy has been the key catalyst for its success. Better assortment, scale and vendor mix, supply chain efficiencies, and rent savings provide a competitive edge to DMART.
- We expect revenue CAGR of 25% over FY19-21, driven by 22% SSSG and healthy 26 store additions annually. As around one third of its 179 stores (FY19E) that are in early growth phase move up in their lifecycle, productivity should inch up. This, coupled with judicious store location (targeting under-served regions), bodes well for SSSG.
- ~15% gross margin, coupled with operating leverage, should lead to modest 30bp EBITDA margin expansion to ~9% over FY19-21. We expect 27% EBITDA CAGR and 31% PAT CAGR over FY19-21.
- At CMP, the stock is expensively valued at 43x/33x FY20/21E EV/EBITDA and 73x/55x FY20/21E P/E. At such rich valuations, we believe there is limited room for a re-rating. We, thus, maintain our Sell rating with a target price of INR1,300, ascribing 30x (~40% discount to two-year average multiple of 45x, since IPO) EV/EBITDA to FY21E EBITDA of INR27b.

King of value retail

DMART's well-oiled business model with a strong focus on low procurement and operating cost has created a deep moat around it. Its optimal product assortment, strong supplier network and low payable days ensure low procurement cost and enable it to squeeze cash discounts from creditors. Its store ownership model, right store size (~30,000sf) and low supply chain cost with auto replenishments help it maintain low operating cost to achieve the key pillar of its success – everyday low cost (EDLC) and everyday low price (EDLP). In a predominantly food and grocery business (52% revenue contribution) with wafer-thin margins (15% gross margin), DMART is able to offer everyday low pricing, unlike peers that offer discounts on select days in a week or month, creating a competitive edge.

Proven recipe for high SSSG

DMART's high SSSG of over 20% has been a pivotal link in delivering 8.4% EBITDA margin (FY19E), as against peers' mid-single-digit EBITDA margins (5-7%). DMART's performance is aided by (a) high sales velocity, triggered by a virtuous cycle of low-cost offerings and high inventory churn, (b) accelerated store adds, with ~30% of the stores less than two years old and in high growth phase and (c) strategic store locations – targets stores in virgin locations with low competition, giving it first-mover advantage and an opportunity to create loyal customers by delivering value.

Winning against the tide

Unlike the leased store model adopted globally to achieve scale, DMART has chosen the owned store model. Though owned stores have a longer payback

period of about nine years, DMART has achieved healthy scale without severe pressure on the balance sheet. This model has enabled it to (a) keep operating cost low, allowing high sales velocity and store productivity, (b) de-risk itself from store churn due to lease model, allowing it to take advantage of a store's best years of profitability (RoCE of ~30% from the fifth year), and (c) open stores in clusters, resulting in scale-related supply chain and marketing cost benefits, as well as higher brand recall. Though it is difficult to gauge the indirect impact of the lease model on DMART's EDLC strategy, and subsequently, on inventory churn and store productivity, simple math indicates that the lease model may impact store EBIT margin by 170bp but improve RoCE from 19% to over 35% and improve scalability, both in terms of investment requirement and execution capability.

The question is: If the company continues its ownership model, what would be the store addition potential? We believe DMART's cash flows, along with IPO proceeds, provide a runway to add stores (capex of ~INR400m/store) for the next two years without any requirement from external sources. This will help garner cumulative FCF of INR8.1b over FY19-21 and expand the profit base from new stores – enough to trigger an engine of profit growth that should sustain healthy store addition for the next 3-5 years. Yet, in the long term, growth through the ownership model without meaningful reliance on external capital could be challenging.

Earnings growth to sustain over FY19-21

DMART's spectacular average SSSG of over 20% in the last five years (except FY18) has been a hallmark of success in an industry where peers have hardly managed to achieve SSSG of 8-10% consistently. The recent IPO has filled its fuel tank for steady store additions, which should help sustain growth in the conceivable future. We expect addition of 26 stores and 22% SSSG in each of the next two years (FY20, and FY21), driving 25% revenue CAGR over FY19-21. DMART's stellar EBITDA margin of 8.4% in FY19E already factors in high efficiency gain. We believe management's focus on competitive pricing over margin improvement would offset the scale-related opex benefits. Consequently, we expect EBITDA margin to expand by modest 30bp to ~9% (FY21). Further, IPO-driven debt repayment should also save interest cost. We expect CAGR of 27% in EBITDA and 31% in PAT over FY19-21. DMART's well-oiled working capital cycle and asset turns should continue improving RoCE from 18% in FY19E to ~21% by FY21.

Rich valuations to sustain, but little left on the table

DMART's remarkable consistency in achieving industry leading growth, margins and RoCE despite a relatively asset-heavy model is captured in the stock valuation. At FY21E EV/EBITDA of ~33x and P/E of ~55x, it commands a healthy 2x premium to FRL. Over the last two years, DMART's 2-3x revenue growth, ~150bp higher EBITDA margin v/s industry players due to its ownership model and better competitive position (seen in product pricing, growth, margins, RoCE) helped it to command better valuations. We expect the valuation premium to continue until DMART is able to maintain its earnings growth lead. Yet, at EV/EBITDA of 33x and P/E of 55x, there is hardly any upside potential even on FY21. Our TP stands at INR1,300 – 30x (~40% discount to two-year average multiple of 45x, since IPO) FY21E EV/EBITDA. We recommend **Sell**.

King of value retail

EDLC-EDLP the mantra

- Thriving on the business mantra of EDLC-EDLP, DMART has evolved as a low cost value retailer, deriving ~52% of its revenue from food and grocery.
- Optimal product assortment, scale, vendor mix and historically low creditor days have consistently backed DMART’s low procurement cost, while its store ownership model, cluster-based expansion and ~32ksf store size (offering wide range of SKUs) have reduced opex, providing impetus to offer lower prices to customers (on daily basis).
- This gives DMART an economic moat, helping it to garner strong SSSG and healthy EBITDA margins relative to peers.

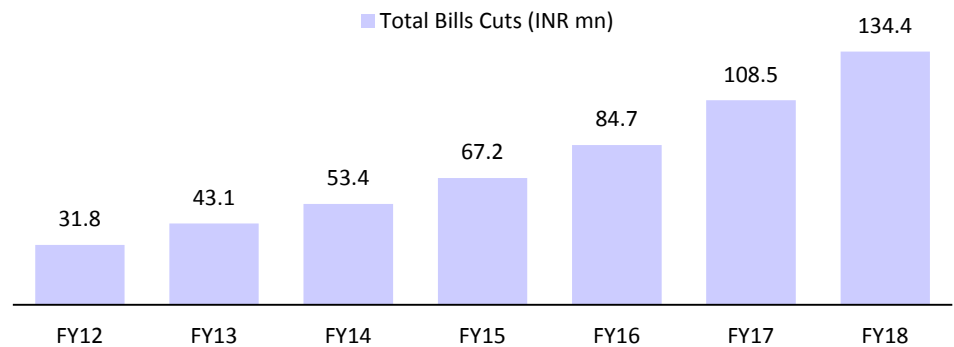
DMART operates a virtuous cycle of low cost procurement and operating cost, which allows it to offer a value retail proposition to customers at significantly lower prices than peers. This increases sales velocity and drives store productivity, enhancing profit generation.



EDLC-EDLP strategy – a key catalyst

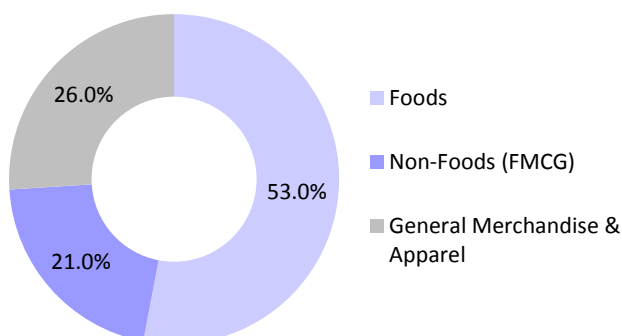
Despite operating predominantly in the food and grocery business (52% of revenue), with wafer thin margins (8.4% EBITDA margin), DMART is able to provide the lowest cost offerings to customers consistently, creating strong customer loyalty. Its value retailing format operates on everyday low cost - everyday low price (EDLC-EDLP) strategy. It offers low prices daily rather than as a special promotion limited to certain products or to a particular day, week or any other specific period in the year. It is able to do so by achieving low procurement and operations cost.

Exhibit 181: Total billings on a steep rise (m)



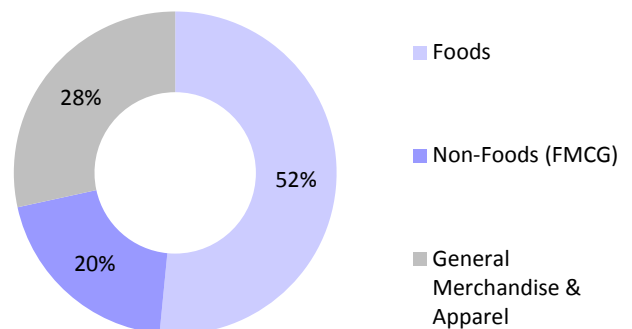
Source: MOFSL, Company

Exhibit 182: Revenue mix remains skewed (FY12)...



Source: Company, MOFSL

Exhibit 183: ...towards Foods category (FY18)



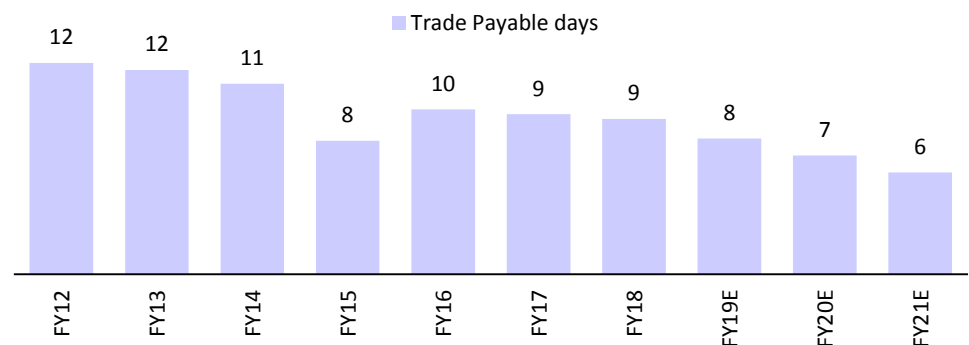
Source: Company, MOFSL

The EDLC-EDLP strategy requires minimization of (a) cost of procurement, and (b) cost of operations to achieve low prices on a daily basis. DMART minimizes operating costs in several ways: (1) it owns underlying real estate or enters into long-term lease arrangements for most of its stores to minimize rental costs, (2) procures goods directly from vendors and manufacturers, (3) employs an efficient logistics and distribution system, and (4) maintains strong focus on product assortment to minimize inventory build-up, supported by efficient store operations. The following are the key drivers of DMART's EDLC-EDLP strategy:

Optimal product assortment and low procurement cost: DMART's key strategy is to ensure strong sales velocity to create high store productivity, leading to higher store profitability. This is achieved by (a) customizing the product assortment in each store keeping in mind local demands, (b) locating the best product sources in relation to both quality and price, and (c) sourcing products from regions where the product is widely available or manufactured to minimize procurement costs.

Low creditor days: One of the key factors driving low cost operations is DMART's efficient working capital cycle, with single-digit creditor days. DMART operates on the philosophy that if creditors are paid on time, they can be squeezed to pass on the working capital cost savings. This allows it to reduce cost of procurement. Besides, increased churn triggered by lower pricing allows higher turnover ratio, thus improving earnings.

Exhibit 184: Creditor days consistently low for years

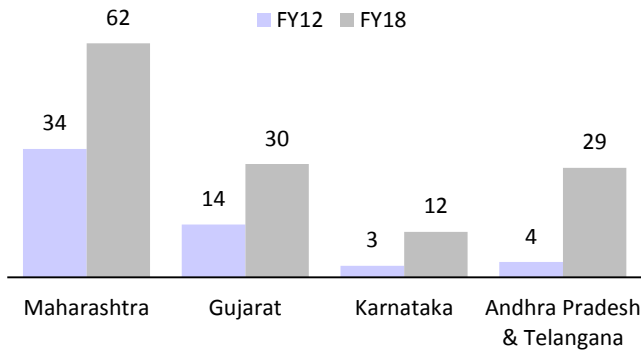


Source: Company, MOFSL

No rental cost: Unlike the conventional lease model used globally in the retail business, DMART has adopted the capex-heavy ownership model and used it in its favor, reducing operating cost and subsequently driving low cost business growth. The store ownership model helps DMART to control fixed costs per store and to execute its EDLC-EDLP strategy effectively. The rent savings outweigh the capital servicing costs and provide a significant competitive advantage.

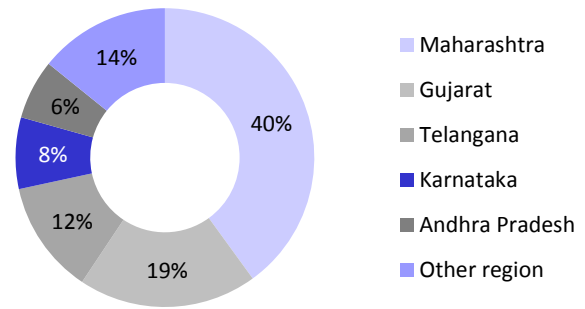
Cluster-based approach – reducing supply chain cost: DMART's expansion has predominantly covered Maharashtra, Gujarat, Telangana and Andhra Pradesh using a cluster-based approach. Strengthened store and distribution center presence within a radius of a few kilometers has ensured (a) better understanding of local needs and preferences, and tailoring offerings accordingly, (b) higher cost efficiency due to economies of scale achieved in supply chain and inventory management, and (c) greater and concentrated brand visibility due to focused implementation of marketing and advertising initiatives.

Exhibit 185: Expanding presence through cluster approach... (store count)



Source: Company, MOFSL

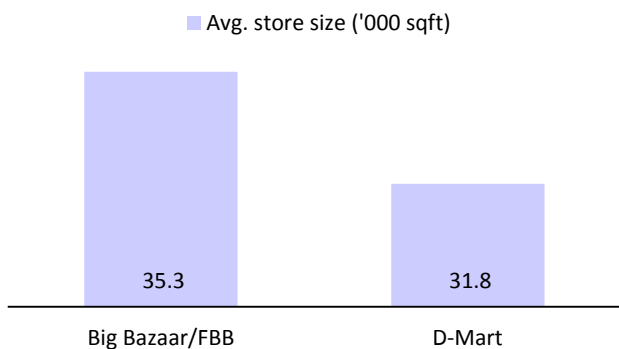
Exhibit 186: ...with four key markets accounting for 86% of total store network (FY18)



Source: Company, MOFSL

Right store size – offering wide range of SKUs: With an average size of ~32ksf each, DMART stores are nearly 15% smaller than peers’ stores. Given the limited space, DMART stores restrict inventory to only higher-selling SKUs, thus improving store productivity. This is reflected in DMART’s productivity – at ~INR38k/sf, the productivity of DMART stores is nearly double that of its peers.

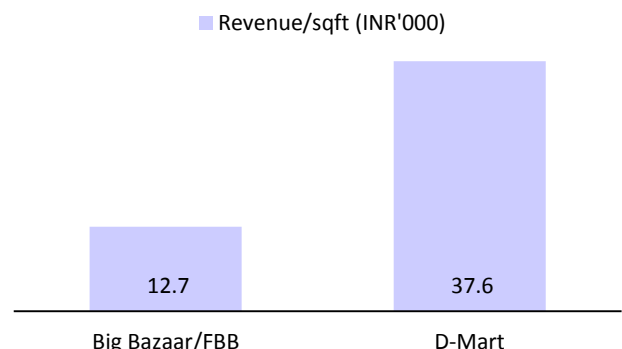
Exhibit 187: Average store size of ~32ksf for DMART (FY19E)



Big Bazaar includes FBB

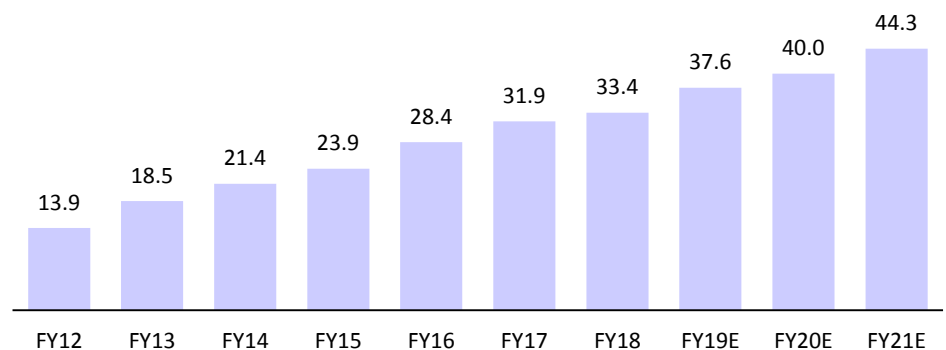
Source: Company, MOFSL

Exhibit 188: DMART garners ~38k revenue/sf (FY19E)



Source: Company, MOFSL

Exhibit 189: Overall productivity to grow at ~8% CAGR over FY19-21E (INR k)



Source: MOFSL, Company

Proven recipe for high SSSG

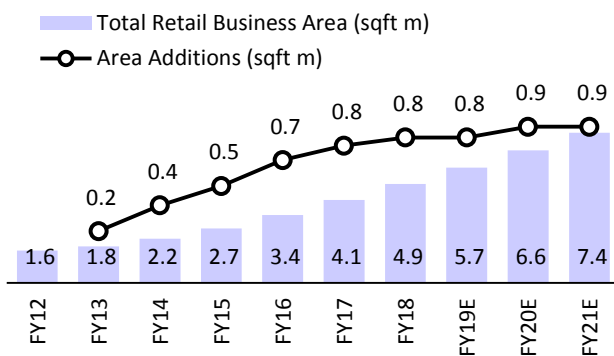
Expect 22% over FY19-21

- We expect DMART to add ~26 stores per year, taking total store count to ~231 by FY21. Also, about a third of its current 179 stores (FY19E) are less than two years old. As these stores move up in their lifecycle, productivity should rise, driving SSSG.
- This coupled with (1) judicious store location – targeting under-served regions, and (2) EDLP mantra – value offerings catering to low-to-upper-middle class should drive high inventory churns, driving strong SSSG.
- We expect DMART to continue its strong SSSG momentum, with an average 22% SSSG over FY19-21, driven by robust store adds, judicious locations, and the EDLP mantra.

Accelerated store additions

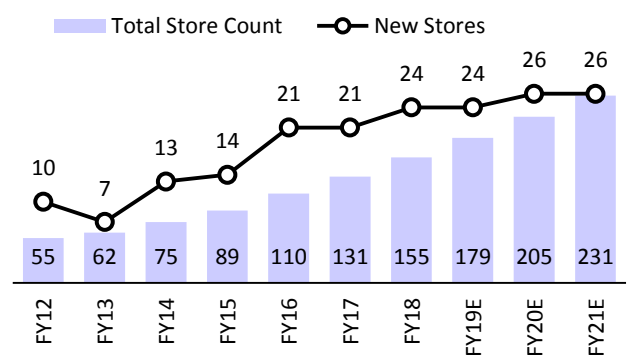
Despite operating on ownership model, DMART’s store count has more than doubled from 75 in FY14 to 179 in FY19E. Retail business area too grew 160% to 5.7msf, highlighting that the ownership model has had limited impact on its pace of growth. With a large proportion of stores in early stage of growth, DMART’s average SSSG has continued to hover at >20%, far higher than the average industry SSSG of 8-10%.

Exhibit 190: Retail business area to grow at ~14% over FY19-21



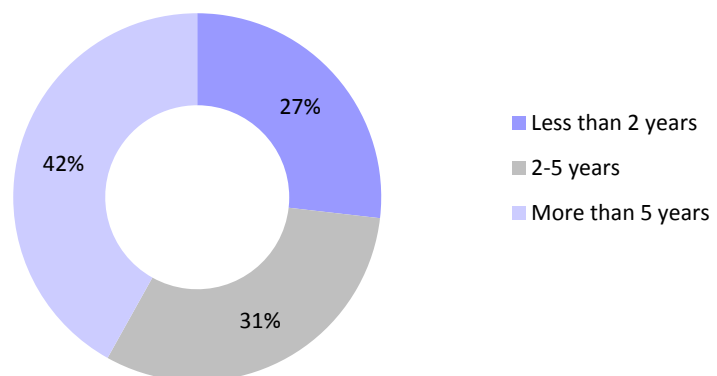
Source: Company, MOFSL

Exhibit 191: Store count has more than doubled over FY14-19E



Source: Company, MOFSL

Exhibit 192: ~1/3rd of stores less than two years old (%)

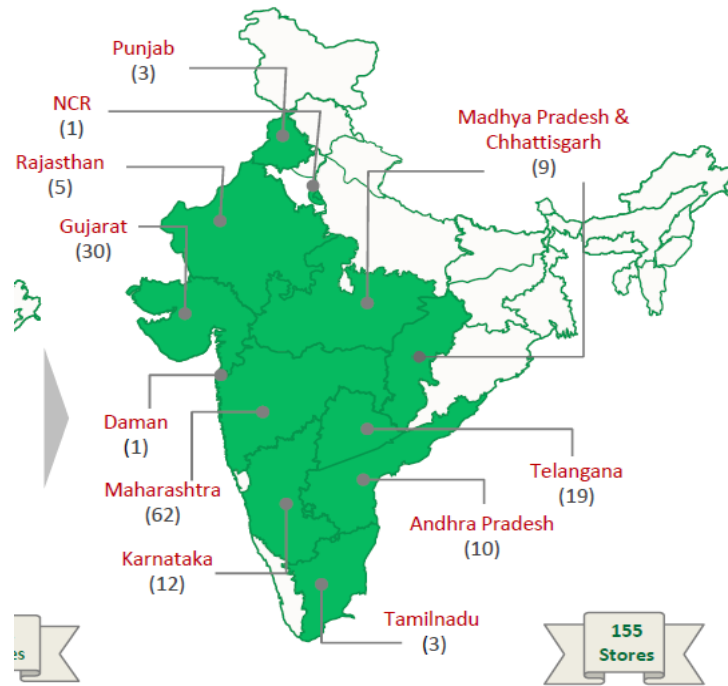


Source: Company, MOFSL

Strategic locations with cluster-based approach

DMART’s selection of suitable locations for stores has been critical to its steady growth. It aims to be an early mover in its target markets to take advantage of the opportunities offered by these under-served regions. It takes the cluster approach, targeting densely-populated neighborhoods and residential areas inhabited by lower-middle, middle and aspiring upper-middle class consumers. This enables DMART stores to achieve high footfalls and healthy revenue growth.

Exhibit 193: DMART’s geographical footprint (FY18)

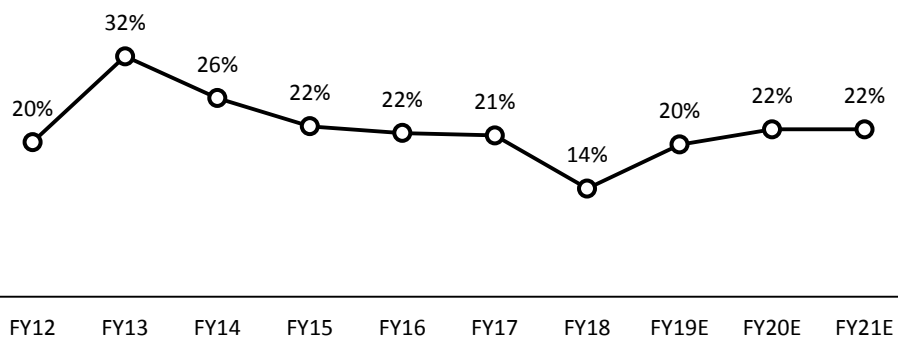


Source: Company, MOFSL

EDLP strategy enabling high volume growth

DMART’s EDLP strategy allows it to grow above industry growth rate. Even its mature stores are able to grow at 8-10%. The combination of high growth in new stores and industry-leading growth in mature stores provides a good mix of growth engines for elevated SSSG.

Exhibit 194: Expect strong 22% SSSG over FY19-21 (24 months, %)



Source: Company, MOFSL

Winning against the tide

Store ownership model a test in the longer term

- Though the store ownership model provides ~170bp higher EBIT margin than the lease model, the latter knocks down the former in terms of RoCE. Yet, lower costs enable the ownership model to offer low pricing in a low margin business.
- We believe its cash flows along with IPO proceeds should meet its FY20-21 capex requirements of ~INR21.1b. Yet in the long term, the current pace of growth through ownership model will be difficult without external funding.

DMART predominantly operates on an ownership model (including long-term lease arrangements – the land is leased for at least 30 years and the building is owned by DMART). Despite adopting a capex-heavy approach, DMART's balance sheet and leverage position remain comfortable. It enjoys industry-leading RoCE of ~18%. We try to dissect the reasons.

Payback of less than nine years

DMART's store investment is nearly 4x (Gross Block of INR8,500/sqft) required under the lease model. This is because it invests in land/building; in the lease model, the investment is only in store fit-outs. However, assuming a rent of INR68/sf/month for DMART's owned properties (20% discount to FRL due to its sub-premium locations), it might require about nine years to recover the investment through rental cost savings.

Ownership model saves 170bp on EBIT

While it is difficult to gauge the indirect impact of the lease model on DMART's EDLC strategy (and subsequently, on inventory churn and store productivity), simple math indicates that the lease model may impact store EBITDA margin by about 250bp due to rental cost, but net of depreciation cost (80bp), the impact on EBIT margin would be ~170bp. Despite its asset-heavy store ownership model, DMART garners ~20% RoCE. Looking at a typical 10-year lifecycle for a DMART store, we find that in year-5, the store starts generating EBITDA margin of 10% and RoCE of over 30%, and therefore, benefits from limited risk of store churn. In the leased store model, the risk of store churn is significant, given the periodic rental rate renegotiations.

Exhibit 195: DMART: Ownership v/s Lease model (FY18, INR m)

Particulars	Own Model	Lease Model
Revenue	1,50,332	1,50,332
Revenue/store	1,051	1,051
Revenue/sqft (INR)	33,407	33,407
Rental expense	0	3,799
as a % of sales	0%	3%
Rentals/sqft (INR)	0	65
EBITDA	13,528	9,729
Margin (%)	9.0%	6.5%
Depreciation	1,590	397
as a % of rev	1.1%	0.3%
EBIT	11,938	9,331
Margin (%)	7.9%	6.2%
ROCE (%)	19%	37%
Payback (years)	2.7	1.0
Capex recovery via rent (years)		9.7

Source: MOFSL, Company

Lease model RoCE superior, but competitive advantage could be compromised

Using simple math, we find that DMART's current RoCE of 19% could shoot up over 35% if it were following the leased store model – the steep capex requirement more than offsets the savings in rental costs. This could also improve DMART's scalability proposition, both in terms of investment requirement and execution capability. However, the high operating cost pushed up by rentals could deter the pricing edge hurting profitability indirectly.

Growth rate to sustain for five years

If DMART continues its ownership model, what would be the store add potential? We believe its cash flows along with IPO proceeds provide runway for stores addition (capex of INR400m/store for the next two years without any requirement from internal sources). This in turn will garner a cumulative FCF of INR8.1b over FY19-21E and expand profit base from new stores enough to trigger an engine of profit growth that may sustain healthy store addition for the next 3-5 years. However, in the long term, we believe, the ownership model would be tested.

Exhibit 196: RoCE generation over the store lifecycle

Year of Operation	1	2	3	4	5	6	7	8	9	10
Sales Capacity (new store Trajectory)	40%	60%	80%	100%	110%	113%	118%	124%	131%	138%
Sales	388	582	776	970	1,067	1,096	1,144	1,203	1,271	1,338
Gross Margins %	14%	14%	14%	15%	16%	16%	16%	16%	16%	16%
Gross Profit	53	81	111	147	170	177	185	196	208	220
Operating Costs	54	56	58	61	63	66	68	71	74	77
Growth in Op expenses		4%	4%	4%	4%	4%	4%	4%	4%	4%
EBITDA (excl. rent)	(1)	25	53	86	107	111	117	125	134	144
EBITDA margin (%)	0%	4%	7%	9%	10%	10%	10%	10%	11%	11%
Pre Tax Cash RoCE %	0%	7%	15%	24%	30%	31%	33%	35%	37%	40%

Source: MOFSL, Company

Stellar performance should continue

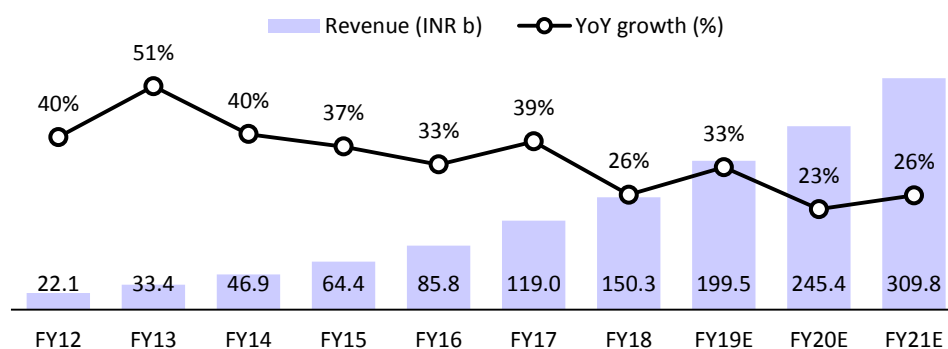
Expect 31% PAT CAGR over FY19-21

- We expect revenue to grow at a robust 25% CAGR over FY19-21, led by 22% SSSG and 26 new store additions. Management's focus on competitive pricing over margin improvement would offset the scale-related opex benefits; expect EBITDA margin to expand by modest 30bp to ~9% (FY21). EBITDA should grow at 27% CAGR over FY19-21.
- Further, strong cash flows along with unutilized IPO proceed help trim gearing (and finance cost), driving 31% PAT CAGR over FY19-21.
- We expect RoCE to reach ~21% by FY21, up from 18% in FY19E.

Robust revenue growth to continue

DMART's spectacular growth has been a hallmark of success in an industry where peers have hardly managed to achieve SSSG of 8-10% consistently. Its recent IPO has filled its fuel tank for steady store additions, and thus, sustained SSSG. We expect DMART to add 26 stores per year and achieve 22% SSSG in the next two years, driving 25% revenue CAGR over FY19-21.

Exhibit 197: Revenue to witness robust 25% CAGR over FY19-21



Source: MOFSL, Company

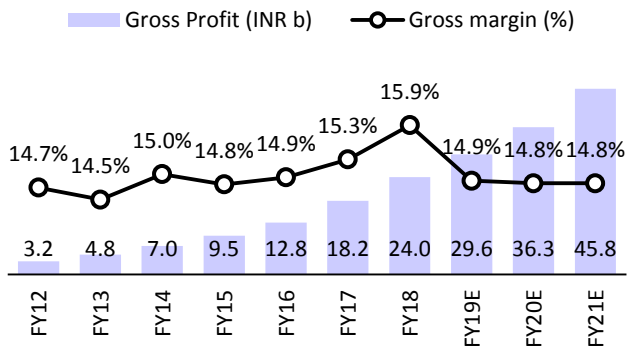
Focusing on penetrating existing clusters and farming new ones

DMART plans to further deepen its footprint in Maharashtra, Gujarat, Andhra Pradesh, and Telangana by expanding its store network in these states. It also intends to farm new catchment areas in Madhya Pradesh, Karnataka, Chhattisgarh, Tamil Nadu, and in North India, where it has limited presence. With over a decade of experience and proven success, DMART is well-positioned to make the most of the growth opportunities in many western, southern, central and northern states.

EBITDA margin to still witness an uptick

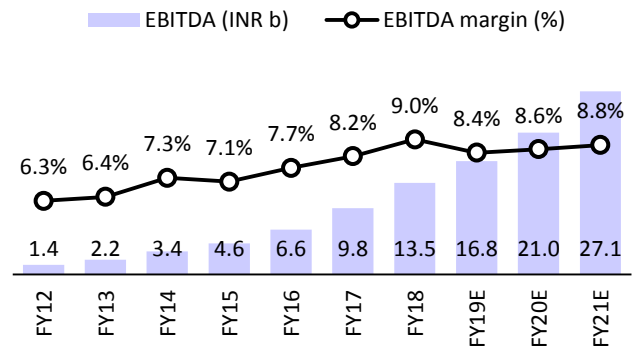
DMART's stellar EBITDA margin of 8.4% in FY19E already factors high efficiency gain. Management's focus on competitive pricing over margin improvement would offset the scale-related opex benefits; expect EBITDA margin to expand by modest 30bp to ~9% (FY21). Further, IPO-driven debt repayment should also save interest cost. We expect 27% EBITDA CAGR and 31% PAT CAGR over FY19-21.

Exhibit 198: Gross margin to remain steady over FY19-21E



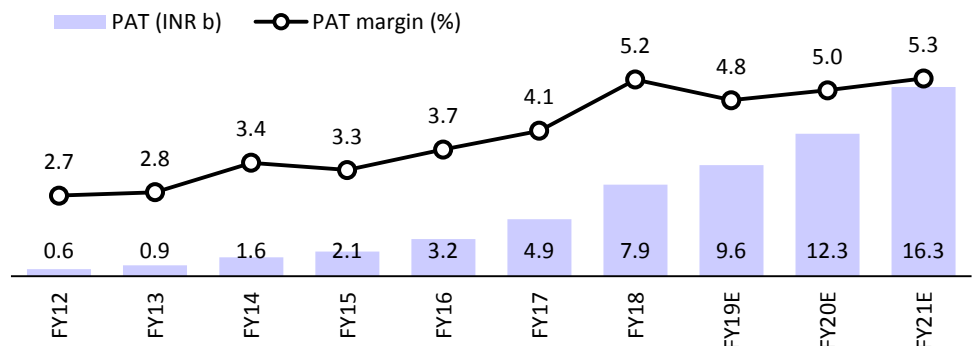
Source: MOFSL, Company

Exhibit 199: EBITDA margin to inch up gradually over FY19-21E



Source: MOFSL, Company

Exhibit 200: PAT to grow at 31% CAGR over FY19-21E

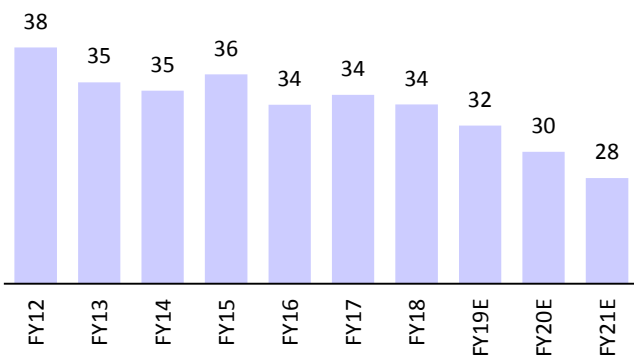


Source: MOFSL, Company

RoCE to grow despite asset-heavy business model

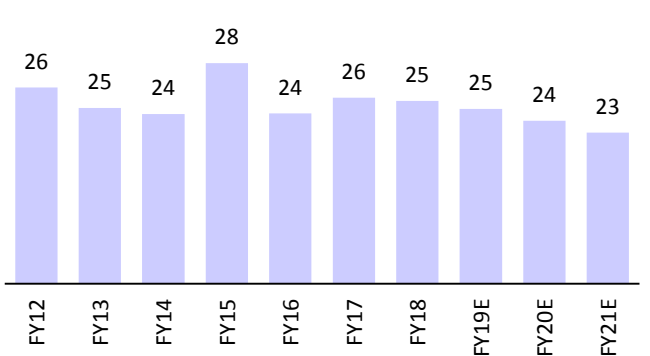
DMART’s well-oiled working capital cycle and asset turns despite the asset-heavy model highlight its efficient operations. We expect RoCE to improve from 16% in FY18 to 21% by FY21 on the back of improving asset turns and EBITDA margins. Further, its healthy cash flows along with IPO proceed should support capex requirements and maintain low gearing.

Exhibit 201: Inventory days to remain steady at 30-35 days



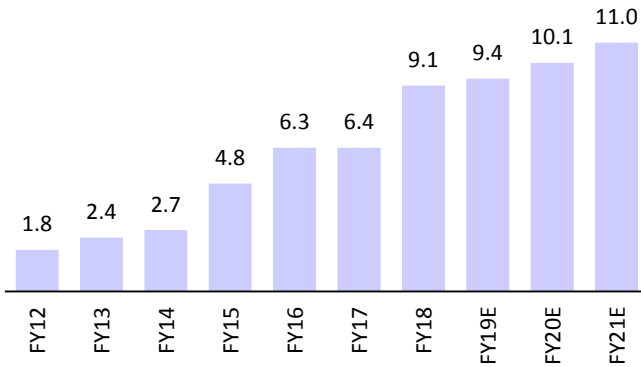
Source: MOFSL, Company

Exhibit 202: Net WC days to remain steady near 25 days



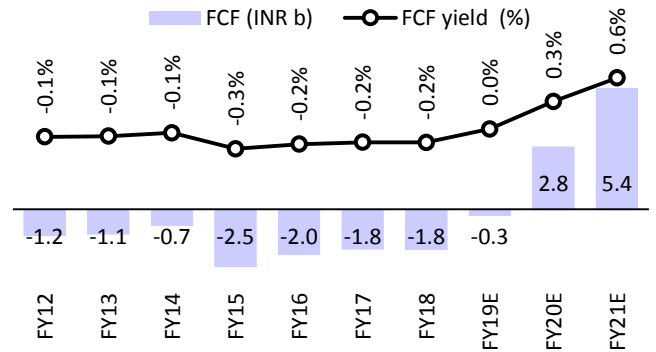
Source: MOFSL, Company

Exhibit 203: Capex to remain elevated due to robust store adds... (INR b)



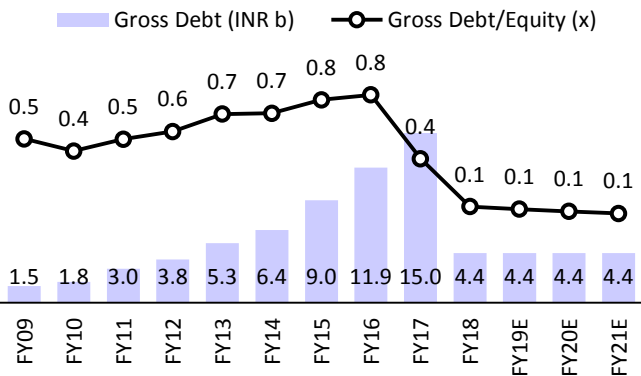
Source: MOFSL, Company

Exhibit 204: ... yet, healthy growth should drive FCF...



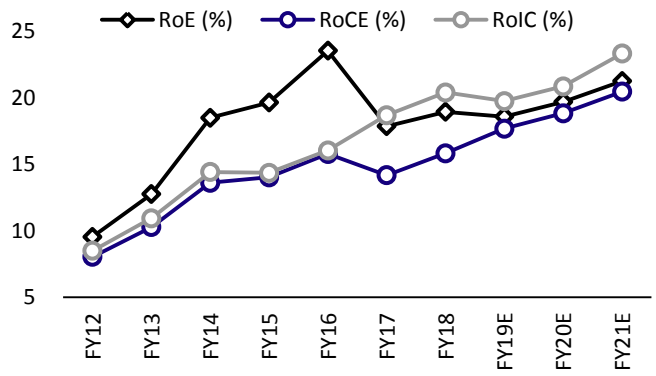
Source: MOFSL, Company

Exhibit 205: ...providing impetus to lower gearing



Source: MOFSL, Company

Exhibit 206: Return ratios to witness an uptick



Source: MOFSL, Company

Valuation and view

Recommend Sell with TP of INR1,300

- At CMP, stock is expensively valued at 43x/33x FY20/21E EV/EBITDA and 73x/55x FY20/21E P/E. We believe there is limited room for rerating given the strong grasp of D-mart, capitalizing the industry.
- Maintain Sell, with a target price of INR1,300 ascribing 30x EV/EBITDA to FY21E EBITDA of INR27b.

Strong competitive position warrants premium valuations...

DMART’s remarkable consistency in achieving industry-leading growth, margins and RoCE despite a relatively asset-heavy model is captured in the stock valuation. . At FY21E EV/EBITDA of 33x and P/E of 55x, it commands a healthy 2x premium to FRL. Over the last two years, DMART’s 2-3x revenue growth, ~150bp higher EBITDA margin v/s industry players (due to its ownership model) and better competitive position (seen in product pricing, growth, margins, RoCE) helped it command better valuations. We expect the valuation premium to continue until DMART is able to maintain its earnings growth lead. Yet, at EV/EBITDA of 33x and P/E of 55x, there is hardly any upside potential even on FY21E. Our target price is INR1,300, ascribing 30x FY21E (~40% discount to two-year average multiple of 45x, since IPO) EV/EBITDA. We recommend **Sell**.

...but premium valuations hardly leave any room for error

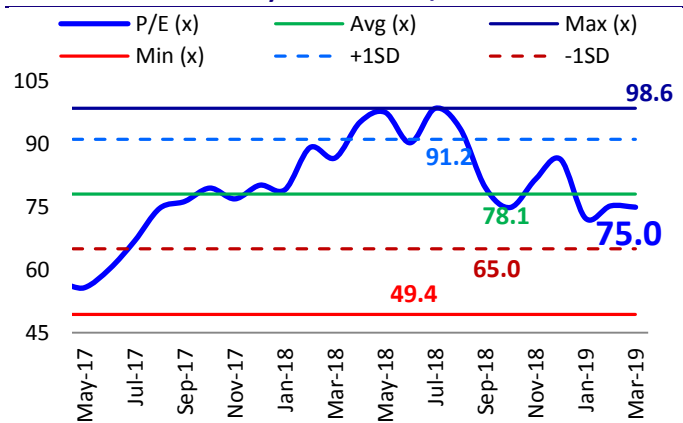
We believe the premium valuations leave little room for error. Any deceleration in growth due to (a) macroeconomic factors, (b) inability to find attractively-priced real estate for new stores, (c) delay in turnaround of stores on acquired land, and (d) changes in consumption patterns could severely impact valuations.

Exhibit 207: Valuation based on FY21E EBITDA

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR b)	Value/share (INR)
EBITDA	FY21 EV/EBITDA	27	30	800	1,282
Less Net debt				-11	-18
Total Value				811	1,300
Shares o/s (m)				624	
CMP (INR)					1,446
Upside (%)					-10

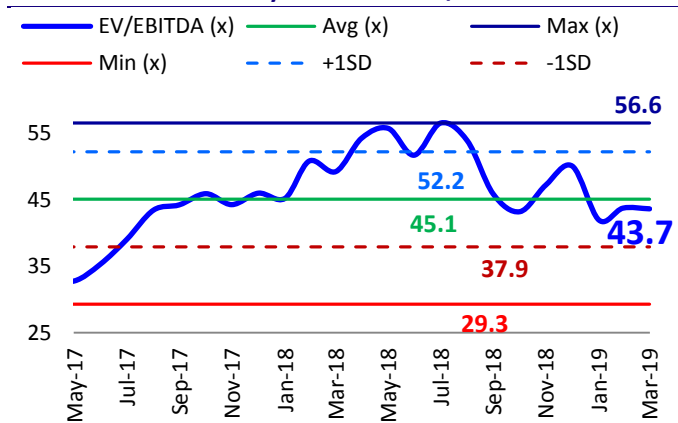
Source: MOFSL, Company

Exhibit 208: DMART: 1-year forward P/E



Source: Bloomberg, MOFSL

Exhibit 209: DMART: 1-year forward EV/EBITDA



Source: Bloomberg, MOFSL

Financials and valuations

Consolidated - Income Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	46,865	64,394	85,838	1,18,977	1,50,332	1,99,465	2,45,412	3,09,769
Change (%)	40.3	37.4	33.3	38.6	26.4	32.7	23.0	26.2
Raw Materials	39,845	54,879	73,035	1,00,810	1,26,356	1,69,844	2,09,091	2,63,923
Gross Margins	7,020	9,515	12,802	18,167	23,976	29,621	36,321	45,846
Margin (%)	15.0	14.8	14.9	15.3	15.9	14.9	14.8	14.8
Employees Cost	873	1,341	1,490	1,925	2,826	3,371	4,025	4,801
Other Expenses	2,729	3,592	4,676	6,429	7,622	9,475	11,289	13,940
Total Expenditure	43,448	59,811	79,201	1,09,165	1,36,804	1,82,690	2,24,405	2,82,664
% of Sales	92.7	92.9	92.3	91.8	91.0	91.6	91.4	91.3
EBITDA	3,417	4,583	6,636	9,812	13,528	16,775	21,007	27,105
Margin (%)	7.3	7.1	7.7	8.2	9.0	8.4	8.6	8.8
Depreciation	570	815	984	1,278	1,590	2,042	2,520	3,030
EBIT	2,847	3,768	5,652	8,534	11,938	14,733	18,487	24,074
Int. and Finance Charges	557	724	913	1,220	595	483	439	439
Other Income	158	183	179	286	693	466	716	1,260
PBT bef. EO Exp.	2,449	3,226	4,918	7,600	12,036	14,716	18,764	24,895
EO Items	0	0	0	0	0	0	0	0
PBT after EO Exp.	2,449	3,226	4,918	7,600	12,036	14,716	18,764	24,895
Total Tax	835	1,109	1,715	2,683	4,158	5,151	6,474	8,589
Tax Rate (%)	34.1	34.4	34.9	35.3	34.5	35.0	34.5	34.5
Minority Interest	0	0	1	129	-185	0	0	0
Reported PAT	1,614	2,117	3,202	4,788	8,063	9,565	12,290	16,306
Adjusted PAT	1,614	2,117	3,202	4,788	8,063	9,565	12,290	16,306
Change (%)	71.9	31.2	51.3	49.5	68.4	18.6	28.5	32.7
Margin (%)	3.4	3.3	3.7	4.0	5.4	4.8	5.0	5.3

Consolidated - Balance Sheet

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	5,468	5,615	5,615	6,241	6,241	6,241	6,241	6,241
Total Reserves	4,088	6,377	9,589	32,177	40,450	50,015	62,305	78,611
Net Worth	9,556	11,992	15,204	38,418	46,691	56,256	68,546	84,852
Total Loans	6,408	9,043	11,923	14,973	4,393	4,393	4,393	4,393
Deferred Tax Liabilities	265	305	399	505	452	452	452	452
Capital Employed	16,229	21,340	27,527	53,898	51,541	61,107	73,397	89,703
Gross Block	13,969	18,321	21,918	27,764	37,041	46,318	56,538	67,149
Less: Accum. Deprn.	2,252	3,041	983	2,260	3,987	6,029	8,549	11,580
Net Fixed Assets	11,717	15,281	20,935	25,504	33,054	40,289	47,989	55,569
Capital WIP	888	981	817	1,529	1,471	1,596	1,472	1,859
Total Investments	155	152	293	531	845	845	845	845
Curr. Assets, Loans & Adv.	5,316	7,134	8,970	30,629	20,330	23,510	29,016	38,392
Inventory	3,783	5,396	6,717	9,479	11,634	14,890	17,186	20,246
Account Receivables	95	71	84	210	335	328	403	509
Cash and Bank Balance	554	380	351	18,843	5,602	5,299	8,359	14,539
Loans and Advances	884	1,287	1,818	2,097	2,758	2,992	3,068	3,098
Curr. Liability & Prov.	1,847	2,208	3,488	4,295	4,942	5,917	6,710	7,746
Account Payables	1,226	1,185	1,944	2,607	3,173	3,723	4,010	4,338
Other Current Liabilities	533	843	1,487	1,605	1,642	1,995	2,454	3,098
Provisions	89	179	56	84	127	199	245	310
Net Current Assets	3,469	4,926	5,482	26,334	15,387	17,593	22,306	30,646
Deferred Tax assets	0	0	0	0	1	1	1	1
Appl. of Funds	16,229	21,340	27,527	53,897	51,541	61,107	73,397	89,703

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS (diluted from FY17)	3.0	3.8	5.7	7.7	12.9	15.3	19.7	26.1
Cash EPS (diluted from FY17)	3.9	5.2	7.5	9.7	15.5	18.6	23.7	31.0
BV/Share (diluted from FY17)	17.5	21.4	27.1	61.6	74.8	90.1	109.8	136.0
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				188.5	111.9	94.4	73.4	55.3
Cash P/E				148.8	93.5	77.8	60.9	46.7
P/BV				23.5	19.3	16.0	13.2	10.6
EV/Sales				7.6	6.0	4.5	3.7	2.9
EV/EBITDA				91.6	66.6	53.7	42.8	32.9
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-1.2	-4.1	-3.2	-2.8	-2.9	-0.5	4.5	8.6
Return Ratios (%)								
RoE	18.5	19.6	23.6	17.9	18.9	18.6	19.7	21.3
RoCE	13.6	14.0	15.8	14.2	15.8	17.7	18.8	20.5
RoIC	14.4	14.3	16.0	18.7	20.4	19.7	20.9	23.3
Working Capital Ratios								
Fixed Asset Turnover (x)	3.4	3.5	3.9	4.3	4.1	4.3	4.3	4.6
Asset Turnover (x)	2.9	3.0	3.1	2.2	2.9	3.3	3.3	3.5
Inventory (Days)	35	36	34	34	34	32	30	28
Debtor (Days)	1	0	0	1	1	1	1	1
Creditor (Days)	11	8	10	9	9	8	7	6
Leverage Ratio (x)								
Current Ratio	2.9	3.2	2.6	7.1	4.1	4.0	4.3	5.0
Interest Cover Ratio	5.1	5.2	6.2	7.0	20.0	30.5	42.1	54.8
Net Debt/Equity	0.6	0.7	0.7	-0.1	0.0	0.0	-0.1	-0.1

Consolidated - Cash Flow Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	2,449	3,226	4,918	7,600	12,036	14,716	18,764	24,895
Depreciation	570	815	984	1,278	1,590	2,042	2,520	3,030
Interest & Finance Charges	557	724	913	1,220	595	483	439	439
Direct Taxes Paid	-750	-1,000	-1,642	-2,586	-4,027	-5,151	-6,474	-8,589
(Inc)/Dec in WC	-827	-1,520	-685	-2,697	-2,427	-2,508	-1,654	-2,160
CF from Operations	1,998	2,245	4,489	4,815	7,767	9,583	13,596	17,616
Others	-17	-25	-154	-237	-467	-466	-716	-1,260
CF from Operating incl EO	1,981	2,220	4,335	4,578	7,300	9,116	12,880	16,356
(Inc)/Dec in FA	-2,706	-4,770	-6,350	-6,354	-9,087	-9,402	-10,097	-10,996
Free Cash Flow	-724	-2,549	-2,015	-1,775	-1,787	-285	2,783	5,360
(Pur)/Sale of Investments	7	31	-151	-229	-247	0	0	0
Others	5	8	181	244	383	466	716	1,260
CF from Investments	-2,694	-4,731	-6,320	-6,339	-8,951	-8,936	-9,381	-9,737
Issue of Shares	46	326	0	18,406	0	0	0	0
Inc/(Dec) in Debt	1,148	2,634	2,898	3,050	-10,791	0	0	0
Interest Paid	-552	-621	-934	-1,203	-800	-483	-439	-439
Dividend Paid	0	0	0	0	0	0	0	0
Others	11	5	0	0	0	0	0	0
CF from Fin. Activity	652	2,345	1,964	20,253	-11,591	-483	-439	-439
Inc/Dec of Cash	-60	-166	-21	18,492	-13,241	-302	3,060	6,180
Opening Balance	614	546	370	351	18,843	5,601	5,299	8,359
Closing Balance	554	380	349	18,843	5,601	5,299	8,359	14,539

Future Lifestyle Fashions

BSE SENSEX 38,862 S&P CNX 11,666

CMP: INR478

TP: INR585 (+22%)

Buy



Stock Info

Bloomberg	FLFL IN
Equity Shares (m)	195
M.Cap.(INRb)/(USD\$b)	92.9 / 1.3
52-Week Range (INR)	502 / 359
1, 6, 12 Rel. Per (%)	4/10/-7
12M Avg Val (INR M)	76
Free float (%)	46.5

Financials Snapshot (INR b)

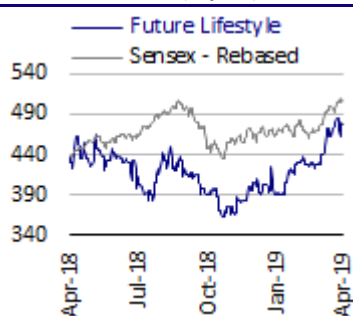
Y/E MARCH	FY19E	FY20E	FY21E
Sales	56.7	67.5	79.2
EBITDA	5.2	6.3	7.6
NP	1.6	2.0	2.7
EPS (Rs)	8.6	10.6	14.1
EPS Gr. (%)	28.4	24.2	32.2
BV/Sh (INR)	88.9	99.5	113.6
P/E (x)	55.7	44.9	34.0
P/BV (x)	5.4	4.8	4.2
EV/EBITDA (x)	18.7	15.1	12.2
EV/Sales (x)	1.7	1.4	1.2
RoE (%)	10.1	11.3	13.2
RoCE (%)	10.5	11.3	12.9

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	53.5	53.5	60.5
DII	16.5	16.2	17.4
FII	15.2	15.2	5.5
Others	14.9	15.1	16.6

FII Includes depository receipts

Stock Performance (1-year)



A play on India's fashion market

PAT to grow at 28% CAGR over FY19-21

- **FLF's unique business model – a combination of Branded Apparel and Large-Format Retailing – gives it a competitive edge over fashion retailers/brand owners. It earns 200-300bp higher EBITDA margin than the pure retail or pure brand formats.**
- **We expect strong 18% CAGR in consolidated revenue over FY19-21, driven by robust growth in both Central and Brand Factory. While Central should grow at a CAGR of 11%, backed by 7% SSSG and annual addition of five stores, Brand Factory is likely to post 27% CAGR, led by 8% SSSG and average annual addition of 30 stores.**
- **Increasing revenue share of own brands, with thrust on power brands, and burgeoning demand for fashion should provide impetus to gross and EBITDA margins. We expect 21% EBITDA CAGR and 28% PAT CAGR over FY19-21.**
- **We recommend Buy with a target price of INR585, ascribing 15x (~20% premium to three-year average) EV/EBITDA. At CMP, FLF is valued at EV/EBITDA of 12x and P/E of 34x (on FY21E). We believe the valuation gap compared to peers should reduce, as Future Lifestyle Fashion (FLF) has all its growth levers in place.**

Integrated play on Brand and Retail

In FY12, the Future Group carved out its fashion retail chain and apparel brands into Future Lifestyle Fashion (FLF), an integrated play on India's Fashion Retail segment. FLF operates two large-format retail chains, Central and Brand Factory, coupled with its robust portfolio of 15 brands. ~40% of its retail revenue comes from own brands, while 70% of its in-house brands are sold via own stores. This gives it a robust growth opportunity, with a healthy margin profile – it earns 200-300bp higher EBITDA margins than conventional models. Central's mini mall-like experience (2x conventional store size) and Brand Factory's 365-day discount stores (inventory destocking platform for brands) offer a unique value proposition.

Growth momentum to continue; healthy scope to improve EBITDA margin

FLF has grown at a 21% CAGR over FY17-19E, backed by healthy double-digit SSSG growth and new store adds. We expect FLF to continue its accelerated revenue growth at 18% over FY19-21, led by (a) healthy SSSG of avg. 7%/8% for Central/Brand Factory and (b) average annual store additions of 5/30 for Central/Brand Factory. FLF's EBITDA margin has contracted from a peak of 10.5% in FY15 to 9.2% in FY19E due to Ind-AS impact and business mix change toward Brand Factory. We expect EBITDA margin to expand 40bp to 9.6% by FY21 (on a high base), with a focus on raising the share of in-house brands in own store sales to over 60% and on increasing the scale of non-FLF channel sales. We expect 28% PAT CAGR over FY19-21.

Brands to act as a key catalyst for growth

We expect power brands revenue to grow at a 25% CAGR over FY19-21 (contributing ~63% of the FLF brands revenue), tapping the burgeoning demand for branded fashion apparel (14% CAGR over CY15-21E). Further, the growth potential of these brands also provides FLF a value unlocking opportunity by way of spin-off. FLF also has an average stake of ~30% in its 10 investee brands – Clarks and Turtle are the key brands among them (turnover of INR1.5b-2b; potential of reaching INR4b/3b), while Cover Story has potential for INR2b annual revenue. Exits from these remain latent, giving FLF significant upside potential.

Healthy balance sheet to support growth

FLF has a healthy leverage position with 0.3x net-debt-to-equity, which should further reduce in 2-3 years, with cumulative FCF generation of INR5.6b over FY19-21. Net working capital too remains healthy at 41 days (FY19E). Healthy growth driven largely through internal capital should be a key positive in maintaining balance sheet strength. RoE stands at 10%, but we believe increasing productivity should drive better asset turnover and improve margin profile. FLF has the potential to improve RoE to 13% by FY21.

Valuations discount to peers, Buy with TP of INR585

FLF is valued at EV/EBITDA of 12x (FY21E) and P/E of 34x (FY21E). Strong earnings growth, coupled with healthy balance sheet and RoE improvement, should support valuations. We have valued FLF at 15x EV/EBITDA to arrive at a TP of INR585. This is at ~20% premium to the three-year average due to the strong performance over the last two years, but still ~25% discount to the target EV/EBITDA multiple for our apparel coverage, indicating an opportunity for value appreciation. We recommend **Buy**. Our target price implies a P/E of 42x and a PEG of 1.5x. Valuation gap compared to peers should reduce on the back of strong 28% PAT CAGR over FY19-21 and RoCE improving to 13% by FY21.

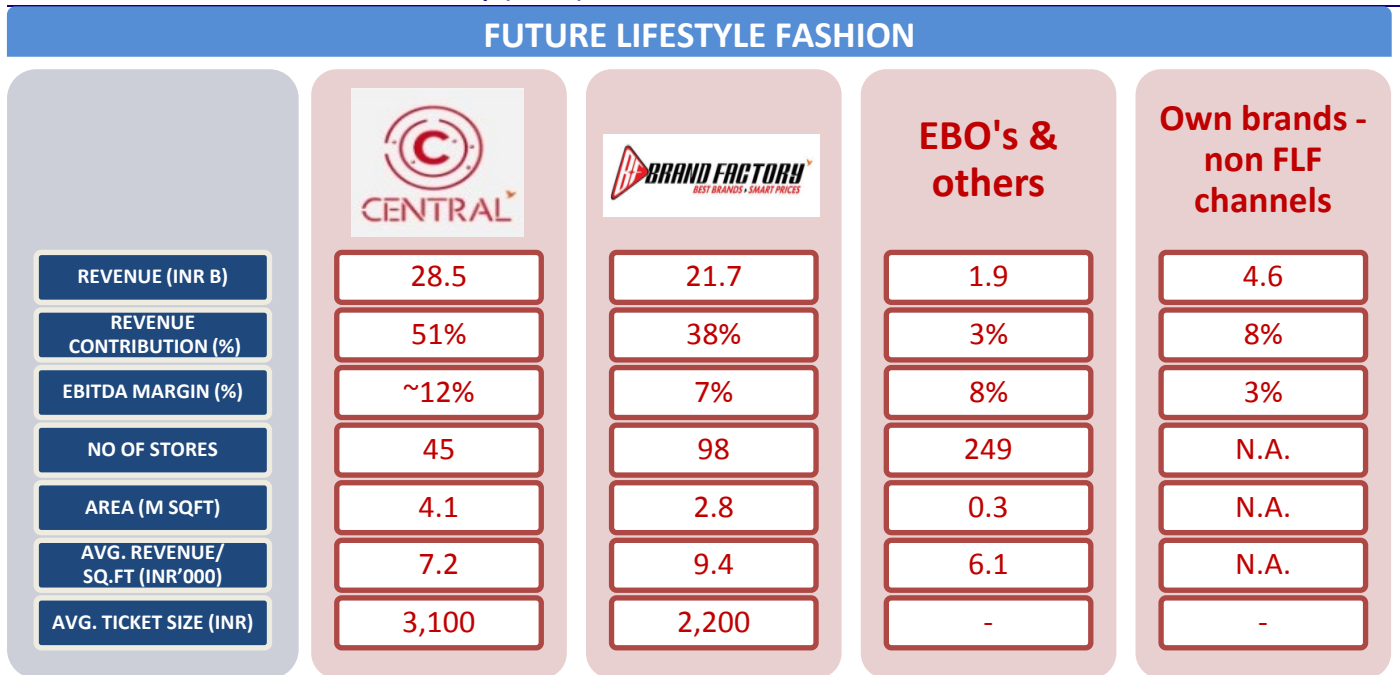
Unique business model

Gaining competitive edge over peers

- We believe FLF’s distinct business model – a mix of Brand and Retail – gives it an economic moat, enabling it to earn 200-300bp higher EBITDA margins, led by lower COGS (compared to Retail) and SGA expenses (compared to Brand).
- The hybrid format allows FLF brands to scale up quickly, as (1) they gain wider visibility (through in-house large format stores), and (2) capex and opex are lower compared to exclusive brand outlets.
- Central’s ‘mini-mall’-like experience (2x conventional store size) and Brand Factory’s 365-day discount store (inventory destocking platform for brands) offer a unique value proposition to the consumer.

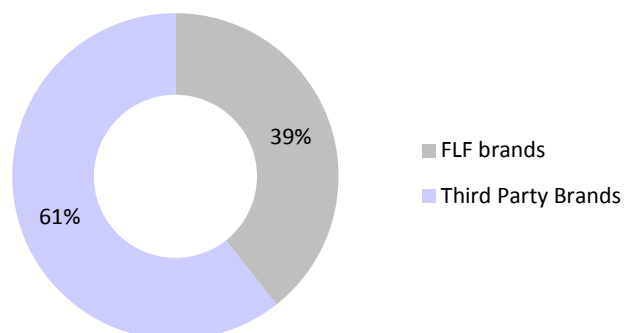
FLF is an integrated play on the Brand and Retail businesses. FLF provides a branded play in a modern large retail format – Central and Brand Factory, which contribute ~88% FLF’s revenue, offer a wide range of over 500 apparel brands under one roof.

Exhibit 210: FLF: Retail format-wise breakup (FY19E)

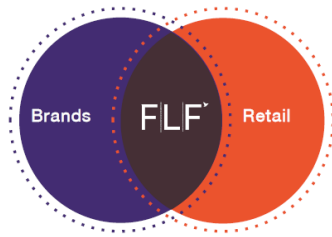


Source: MOFSL

Exhibit 211: FLF: Brand format-wise breakup (FY19E)



Source: MOFSL, Company



Brand + Retail margin > Brand or Retail margin

Operating a retail model with in-house brands accounting for ~40% of total FLF revenue yields the following benefits: (a) from a retail business perspective, it reduces COGS, which is typically 60% of revenue, and (b) from a branded apparel business perspective, since 60% of revenue comes from in-house large-format stores (LFSs), it reduces the cost towards retail margin, usually shared with the LFS / multi-brand outlet (MBO). This is vindicated in FLF’s net margin of 9%, which is higher than the single-digit margin for a typical brand or retail company.

Typically, branded apparel (B) companies enjoy higher gross margins, but selling and marketing costs remain high, as they need to promote brands in case of exclusive brand outlets (EBOs) or share 35-40% of their margins with external LFSs. Pure retail (R) apparel companies save on SG&A (brand owner’s responsibility), but their gross margins are restricted by lack of in-house brands. FLF’s B+R mix allows higher EBITDA margin, as it thrives on low COGS (compared to retail) and low SGA expenses (compared to brand). Own brands further support margins.

Exhibit 212: Retail-format-wise economics

	Brand (LFS)	Brand (EBO)	Retail	Brand+Retail
MRP	100	100	100	100
Discount @ 20%	20	20	20	20
Sales value	80	80	80	80
GST @ 5%	4	4	4	4
Net Sales value	76	76	76	76
COGS	30	30	50	40
Gross Margin	46	46	26	36
Selling expenses	3	30	20	15
Share to retail	24	0	0	0
EBITDA	19	16	6	21
Corporate overhead	10	10	0	10
Net Margin	9	6	6	11

Source: MOFSL, Company

Large format stores have an edge over EBOs

Unlike an EBO, where the apparel range is restricted to a specific brand, an LFS offers a wide range of brands. It remains the key distribution driver for FLF.

FLF brands gain from its wide retail footprint

For a new brand to scale up, it needs to (a) set up a chain of EBOs, involving high capex, and (b) spend heavily on marketing to get visibility and footfalls. FLF’s positioning of private labels as strong independent brands with superior product quality albeit at a discount to popular brands allows it to garner healthy traction. FLF gains from its in-house retail network, witnessing higher footfalls than EBOs. This gives FLF brands quicker visibility to expand. Further, unlike the traditional retail formats wherein display for small/emerging brands and private labels is restricted, limiting brand visibility, FLF’s Central and Brand Factory offer healthy brand promotion to FLF brands.

Exhibit 213: Average age of Central and Brand Factory stores (FY18)

Age of Store	Central	Brand Factory	EBO's	Total
Greater than 5 years	14	11	82	107
3-5 years	9	19	63	91
Less than 2 years	17	33	84	134
Total Store Count	40	63	229	332
Less than 5 years mix (%)	65%	83%	64%	68%

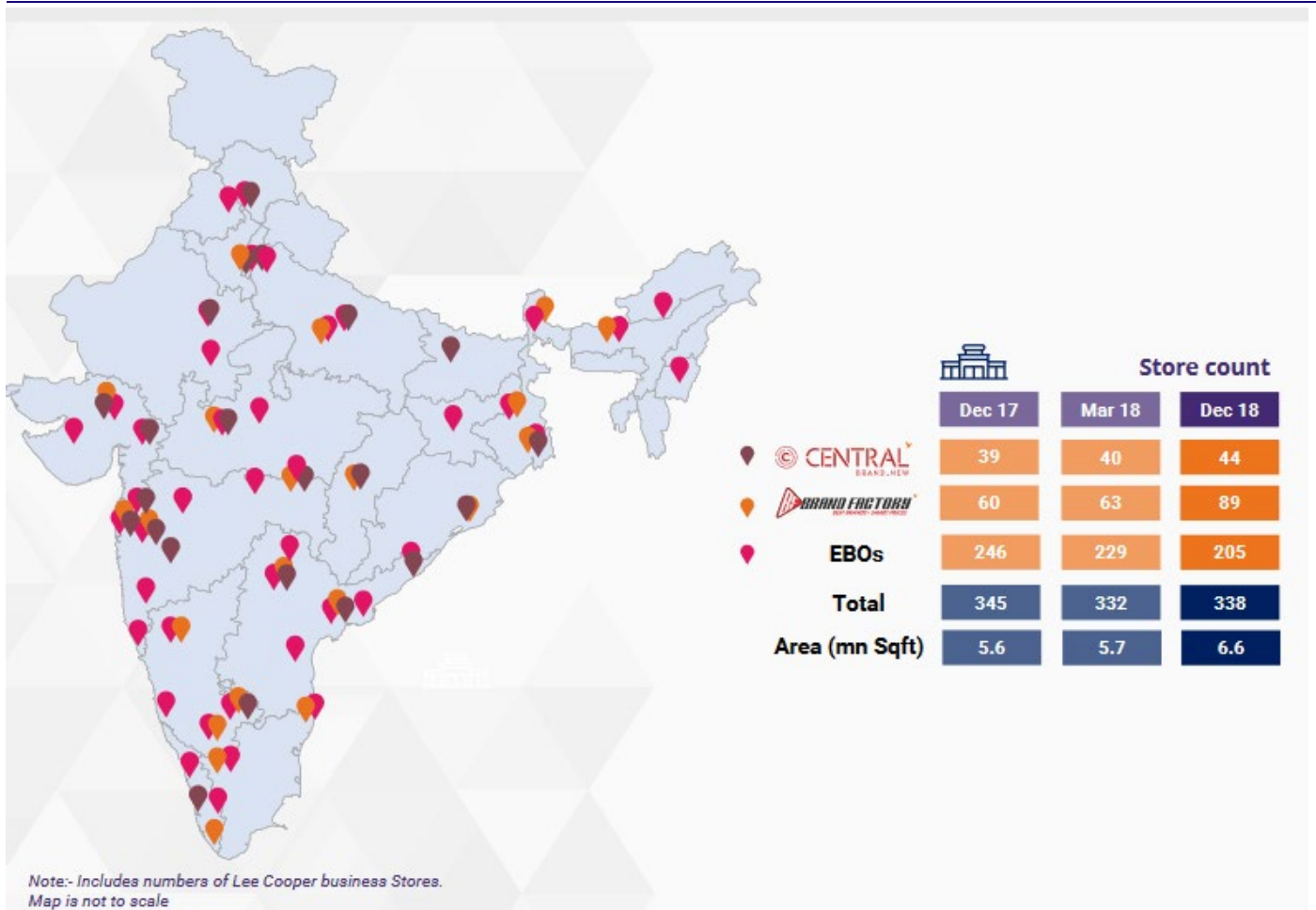
Source: Company, MOFSL

Exhibit 214: Indicative journey of Central and Brand Factory stores

Particulars					
Central	Y1-Y2	Y3-Y4	Y4-Y5	Y6 Onwards	
Store Maturity Cycle	Cash Break Even	Scale up	Pay Back	Matured & High RoCE	
Brand Factory	Y1	Y2-Y3	Y4	Y5 onwards	
Store Maturity Cycle	Cash Break Even	Scale up	Pay Back	Matured & High RoCE	

Source: Company, MOFSL

Exhibit 215: FLF's geographical reach (Dec-18)



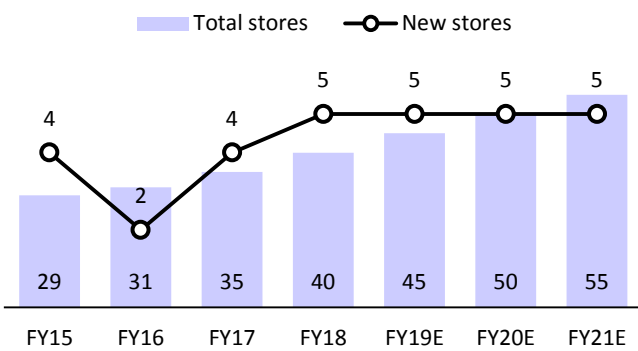
Source: MOFSL, Company



Central – a mini mall

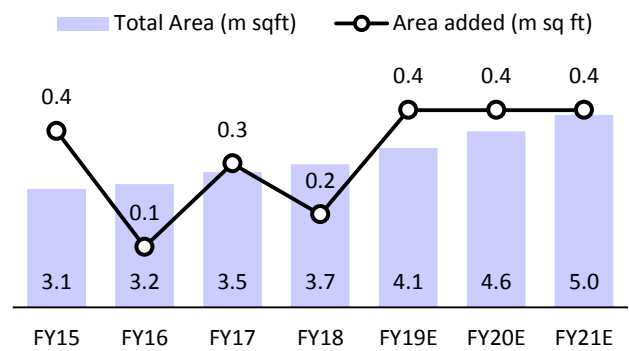
FLF’s flagship store, Central offers 500+ brands. The average store size is ~100ksf compared to 30-50ksf for most LFSs. Central has large stores in a mall-like format, which caters to all apparel categories across men, women and kids. Menswear brands contribute nearly half of Central’s revenue, followed by women’s apparel brands (35%); others (including kidswear, sports equipment, home care products, etc.) contribute ~18% of revenue. Operating in a shop-in-shop format, with dedicated floor space for each brand, Central offers the widest range of SKUs within each brand. Central stores include food courts, couches, and refreshment areas – the idea is to prolong shopping duration. This allows Central to garner healthy average ticket size of ~INR3.1k.

Exhibit 216: Healthy store adds to increase overall footprint (number of stores)



Source: MOFSL, Company

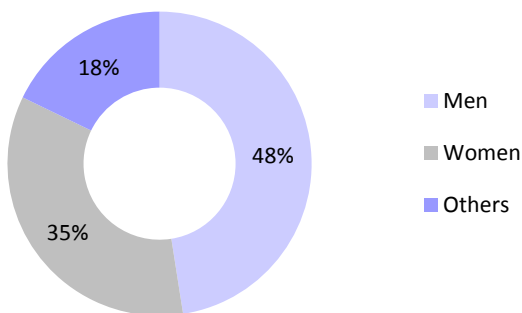
Exhibit 217: Total area under Central format (msf)



Source: MOFSL, Company

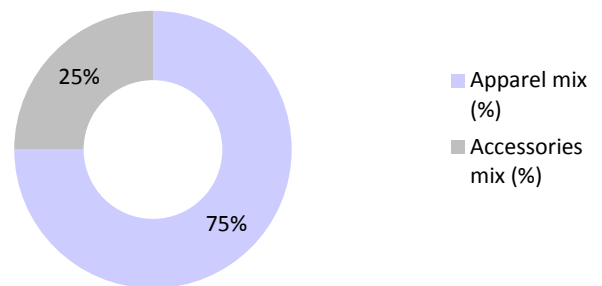
Central contributes ~50% of FLF’s total revenue. It has been consistently clocking double-digit SSSG and revenue per square foot is currently ~INR7.3k (FY19E). It operates through 45 stores (total store area of 4.1msf) across 25 cities and attracts footfalls of ~34m. Apparel constitutes ~75% of Central’s revenue, while accessories constitute the balance 25%.

Exhibit 218: Menswear brands form half the revenue mix



Source: MOFSL, Company

Exhibit 219: Apparel constitutes ~3/4th of the revenue mix



Source: MOFSL, Company

HD shopping – taking customer experience to the next level

Central has recently started HD shopping, wherein it provides (1) product reservation, (2) fashion stylists by appointment, (3) fashion attendants, (4) valet parking, (5) golf cart pickup and drop services, and (6) WhatsApp shopping to enhance customize experience, create higher footfalls, and improve ticket size.



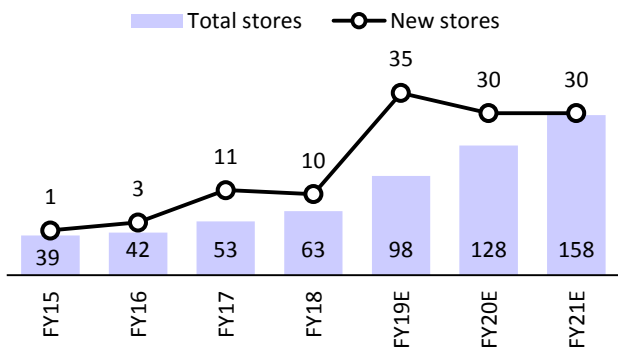
Brand Factory – inventory destocking platform; compelling value

Brand Factory targets consumers interested in buying branded products at the price of unbranded products. While on the one hand, it caters to value buyers looking for brands at discounted prices, on the other, it operates as a post-season inventory destocking platform for brands. The discounted pricing, which ranges from 20% to 70%, runs all 365 days a year and this is Brand Factory’s biggest USP. Unlike Central, the products sold at Brand Factory are one to two seasons old.

Extensive reach and vast offerings augur well

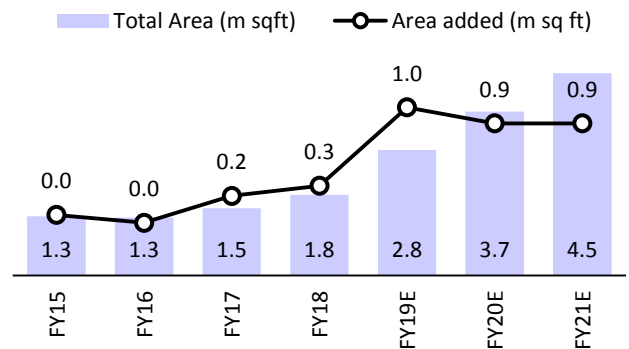
Brand Factory subsumes 200+ brands and has a geographical reach across 25 cities through 98 stores. With an average store size of ~29ksf (total store area of 2.8msf) and footfalls of ~20m, it garners revenue of INR9.4k/sf and has been witnessing double-digit SSSG consistently for the last two years. Average ticket size is healthy at ~INR2.3k. While ~90% of its revenue comes from apparel, the rest is from accessories. Menswear brands constitute ~74% of revenue, followed by women’s apparel (15%); others (kidswear, sports equipment, home care, etc) account for 11% of revenue. Brand Factory contributes ~38% of FLF’s revenue.

Exhibit 220: Aggressive store adds to increase overall footprint (number of stores)



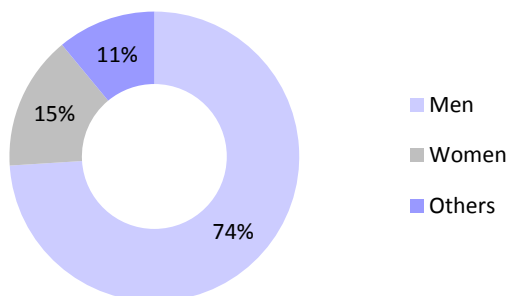
Source: MOFSL, Company

Exhibit 221: Total area under Brand Factory format (msf)



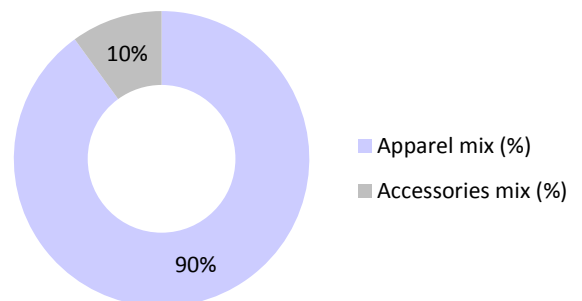
Source: MOFSL, Company

Exhibit 222: Menswear constitutes ~3/4th of the revenue mix

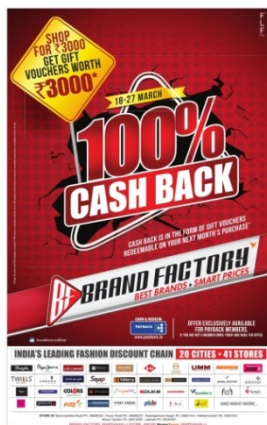


Source: MOFSL, Company

Exhibit 223: Apparel forms the major chunk of the revenue mix



Source: MOFSL, Company



Singles day – a disrupter in fashion industry

Brand Factory conducts an annual event, Singles Day, wherein consumers are offered a 45-60% discount on products, with the opportunity to buy products worth INR5k effectively for free (see exhibit 15). In FY18, Brand Factory sold ~700k passes and plans to increase this, going forward. Brand Factory is the answer to discounted online sales. It registers consumers online for the event and sells products offline.

Exhibit 224: Singles Day offer

Particulars	INR
Shop worth	5,000
Less: Discount @ 60%	3,000
Amt. to be paid upfront	2,000
Less: Voucher	1,000
Less: Gift worth	1,000
Amt. actually paid	-

Source: MOFSL, Company

Brand Factory 2.0

Similar to the Central's HD format, FLF has also launched premium services through its Brand Factory format. Critical store touch points like billing counter/CSD desk/entry and exit points have been given a new look.

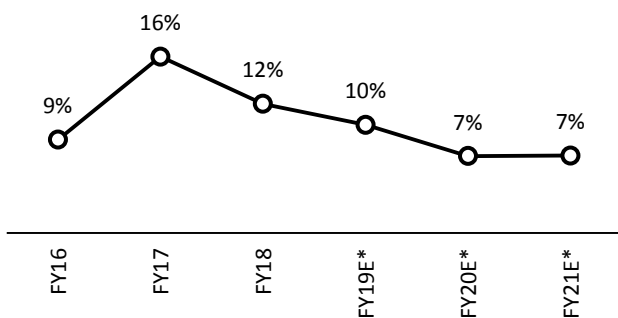
Growth momentum to remain solid

EBITDA margin to expand 40bp to ~10% by FY21 (on a high base)

- We expect consolidated revenue to grow at a CAGR of 18% over FY19-21, led by 11% CAGR in Central and 27% CAGR in Brand Factory. Growth would mainly be driven by:
 - SSSG of avg. 7% in Central and 8% in Brand Factory (BF): Over 40%/50% of the Central/BF stores are less than two years old (that is, still in cash breakeven phase). As these stores move up their life cycle, coupled with the burgeoning demand for fashion, their average productivity should increase.
 - Uptick in new store adds: Historically, FLF has added 2-4 Central stores and 10-15 BF stores per year. Now, we expect it to add of 5 Central stores and 30 BF stores per year. This should provide further impetus to overall revenue growth.
- Thrust on increasing the share of private labels to ~50% by FY21 (~40% in FY18) together with its B+R model should help it to garner higher gross and EBITDA margins. We expect 21% EBITDA CAGR and 28% PAT CAGR over FY19-21.

We expect FLF’s revenue to grow at a CAGR of 18% over FY19-21, led by (a) healthy SSSG across Central and Brand Factory, (b) new store additions, and (c) rising share of private labels.

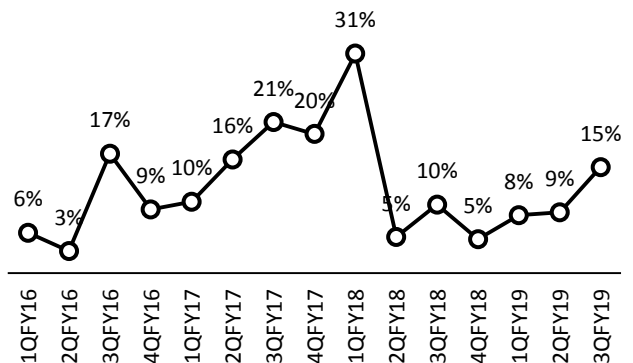
Exhibit 225: Healthy 8-10% overall SSSG (%)



*Central + Brand Factory

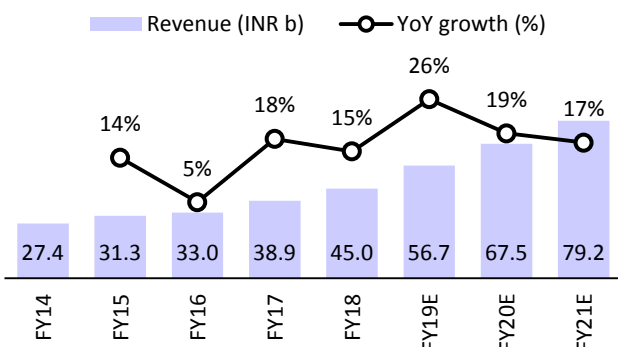
Source: MOFSL, Company

Exhibit 226: Healthy trend in overall quarterly SSSG (%)



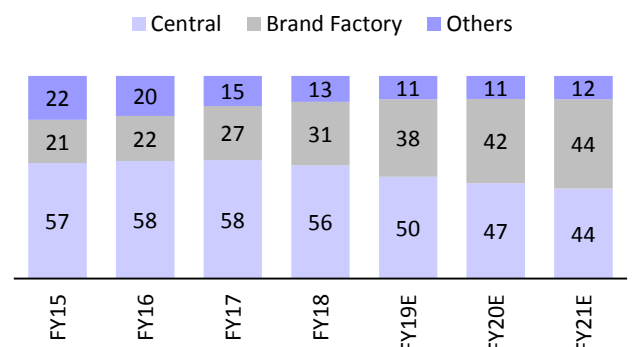
Source: MOFSL, Company

Exhibit 227: Total revenue to grow at 18% CAGR over FY19-21 (INR b)



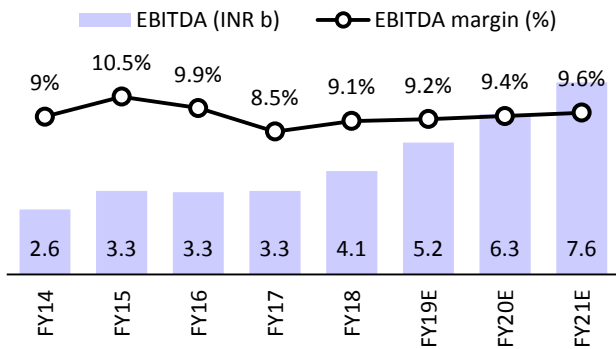
Source: MOFSL, Company

Exhibit 228: Revenue contribution from Brand Factory increasing (%)



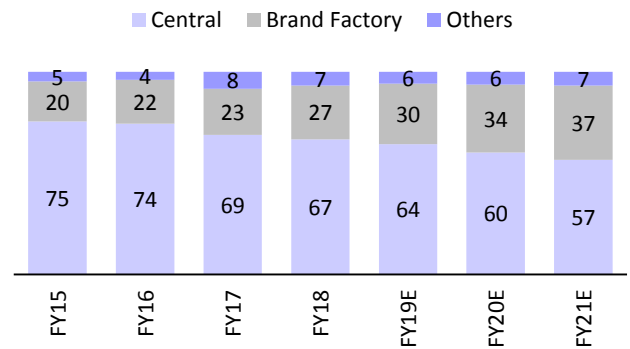
Source: MOFSL, Company

Exhibit 229: Expect total EBITDA to grow at a CAGR of 21% over FY19-21 (INR b)*



FY14/15/16 are pre Ind-AS adjustments Source: MOFSL, Company

Exhibit 230: EBITDA contribution of Brand Factory increasing (%)



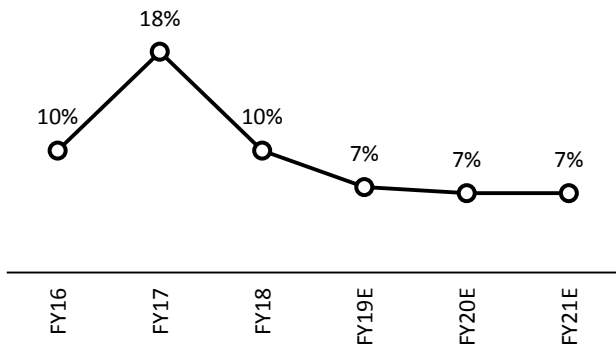
Source: MOFSL, Company

**Ind-AS impact: Under the previous GAAP, interest-free lease security deposits are recorded at their transaction value. Under Ind-AS, the company has measured security deposits at fair value, thereby showing lower EBITDA margin.*

Central: Expect 11% revenue CAGR over FY19-21

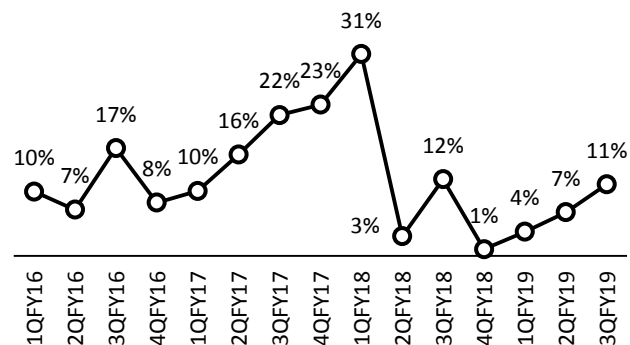
Central has been achieving double-digit SSSG in the last 2-3 years. About 40% of its 40 stores (FY18) are less than two years old and have a productivity of ~INR7k/sf. As these stores mature, they should gradually inch up to an average revenue/sf of ~INR7.3k. This coupled with increased demand for branded apparel and modern-retail-driven shopping should help drive 7% SSSG over FY19-21 for Central. We expect 11% revenue CAGR over FY19-21.

Exhibit 231: Expect healthy 7% SSSG for Central over FY19-21 (%)



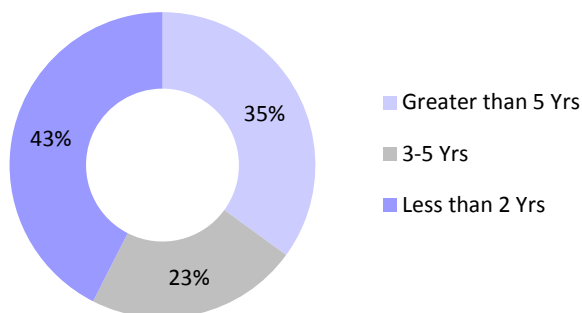
Source: MOFSL, Company

Exhibit 232: Strong trend in Central's quarterly SSSG (%)



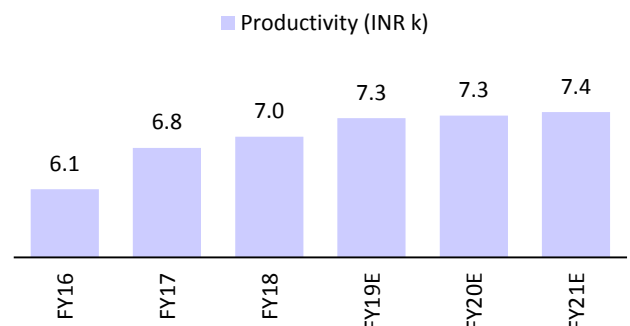
Source: MOFSL, Company

Exhibit 233: Over 40% of Central's stores less than two years old...



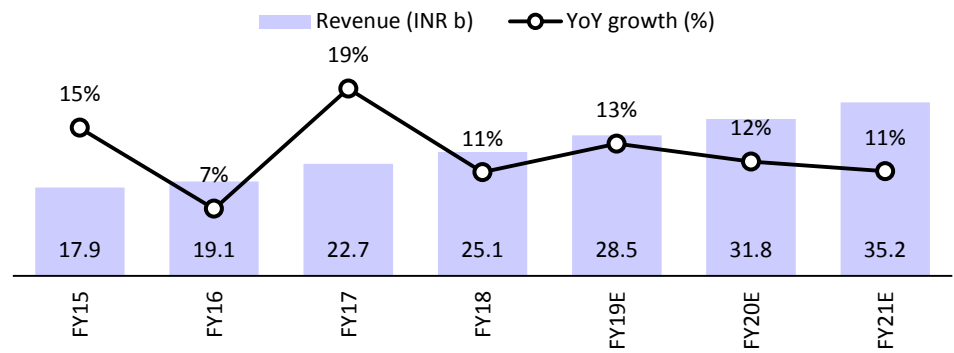
Source: MOFSL, Company

Exhibit 234: As the stores mature, productivity should remain steady (INR/sf)



Source: MOFSL, Company

Exhibit 235: Central's revenue to grow at 11% CAGR over FY19-21

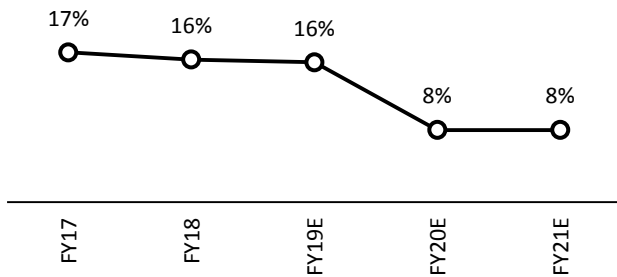


Source: MOFSL, Company

Brand Factory: Expect 27% revenue CAGR over FY19-21

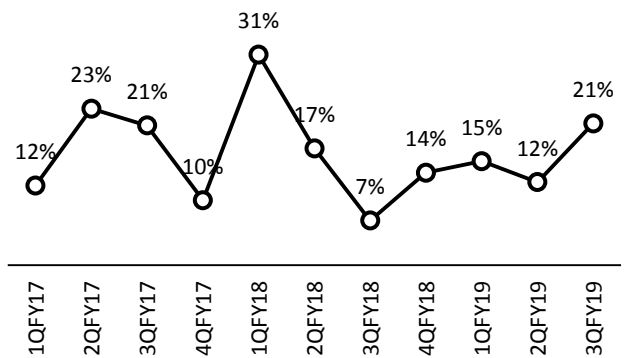
Brand Factory offers a strong value proposition for customers – branded apparel at unbranded apparel prices. With limited competition in the all-season discount sales market, it should continue to see healthy growth. Currently, about 50% of its 60 stores are about two years old, that is, still in their early growth phase. As these stores mature, productivity of ~INR8.5k/sf should translate into a healthy 8% SSSG over FY19-21. Further, it is focusing on increasing the number of brands and categories offered. Brand Factory should also gain from women’s apparel and non-apparel products. We expect revenue to witness a fillip, with 27% CAGR over FY19-21.

Exhibit 236: Expect strong 18% SSSG for Brand Factory over FY19-21 (%)



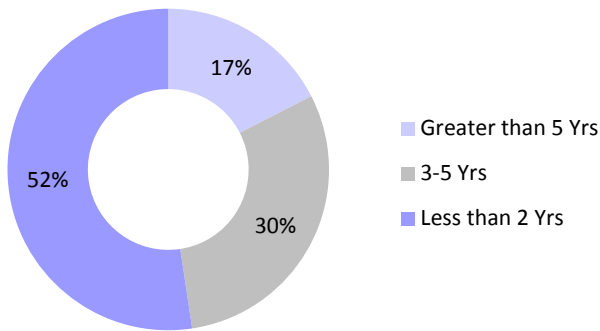
Source: MOFSL, Company

Exhibit 237: Strong trend in Brand Factory's quarterly SSSG (%)



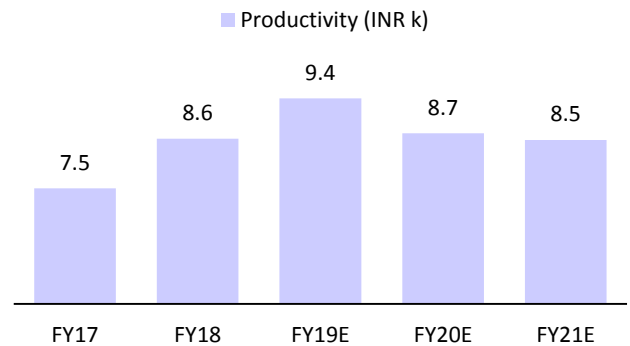
Source: MOFSL, Company

Exhibit 238: Brand Factory: Over 50% of stores less than two years old



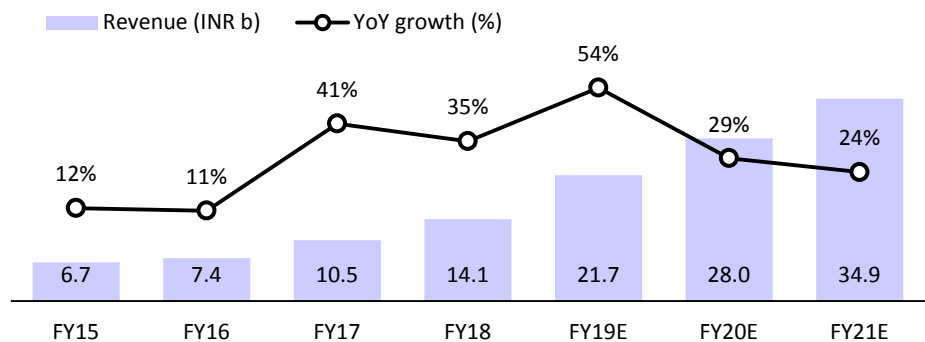
Source: MOFSL, Company

Exhibit 239: Expect revenue/sqft of INR8.5k by FY21 (INR/sf)



Source: MOFSL, Company

Exhibit 240: Brand Factory's revenue to grow at 27% CAGR over FY19-21

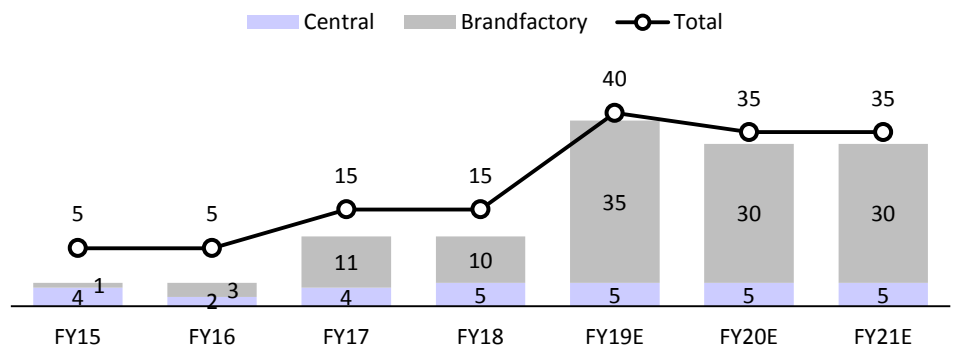


Source: MOFSL, Company

Healthy new stores adds – a key growth driver

FLF has added 4-5 Central stores and 10-15 Brand Factory stores in the last couple of years. We expect it to add 5 Central stores each in FY20/21, taking the total to 55 stores by FY21, and add 30/30 Brand Factory stores in FY20/21, taking the total to 158 stores. The new stores should help FLF achieve 18% revenue CAGR over FY19-21.

Exhibit 241: New store adds to drive growth



Source: MOFSL, Company

Higher own brand share to propel growth

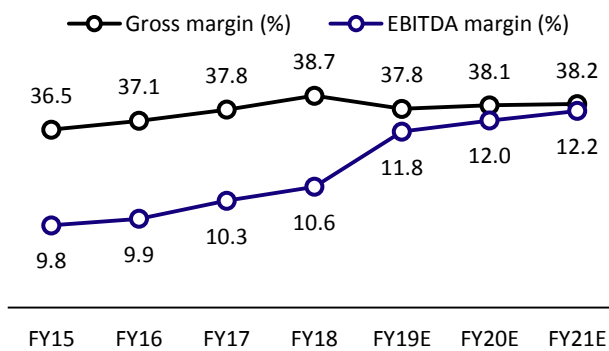
A key catalyst driving revenue growth for FLF in the next 2-3 years would be increasing share of FLF brands. Currently, these brands contribute 40% of overall revenue (compared to Shoppers Stop's ~10%). With its continued focus on

promoting own brands, we believe the share of private labels should improve to ~50%. Besides, own channels (Central, Brand Factory) account for ~70% of own brand sales. FLF is able to earn superior gross and EBITDA margins, led by lower COGS and savings in selling and marketing expenses.

Please also refer to the discussion, [Brand + Retail margin > Brand or Retail margin](#) on page 103.

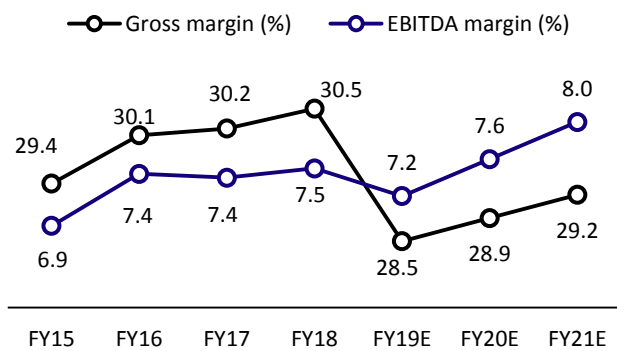
We expect Central's/Brand Factory's gross margin to expand by 30-70bp from 37.8%/28.5% in FY19E to 38.2%/29.2% by FY21. This coupled with inherent operating leverage should aid EBITDA margin expansion of 45-80bp. We expect Central's/Brand Factory's EBITDA margin to reach 12%/8% by FY21, up from 11.8%/7.2% in FY19E. We expect overall EBITDA CAGR of 21% over FY19-21, with EBITDA margin to inch up gradually to 9.6% by FY21 (9.2% in FY19E).

Exhibit 242: Central's EBITDA margin to expand ~45bp over FY19-21



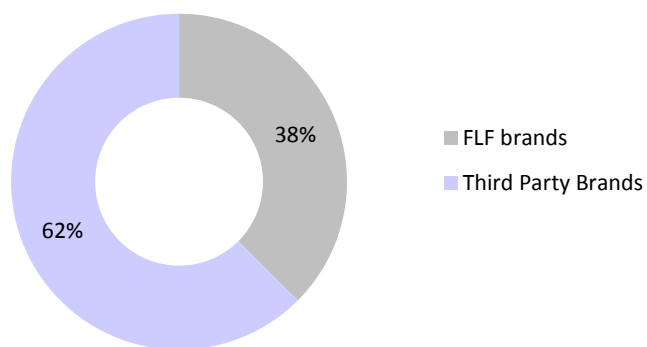
Source: MOFSL

Exhibit 243: Brand Factory's EBITDA margin to expand ~80bp over FY19-21



Source: MOFSL

Exhibit 244: Contribution from FLF brands increased to ~38% of branded sales in FY18 (from ~36% in FY14)



Source: MOFSL, Company

Own brands – a key catalyst driving growth

All set to tap burgeoning demand

- FLF has a strong brand portfolio, which draws ~30% (INR7b) revenue from third-party stores, highlighting the brand pull. Its seven power brands differentiate it from peers and contribute ~63% (INR14.6b) of its total own brands revenue. As Central and BF act as key distribution channels, the increasing share of these brands (a) aids EBITDA margin expansion, and (b) drives strong value unlocking potential.
- We expect power brands revenue to grow at a CAGR of 25% over FY19-21 (contributing about 63% of FLF brands revenue), tapping the burgeoning demand for branded fashion (14% CAGR over CY15-21E). Further, the growth potential of these brands also provides FLF a value unlocking opportunity by way of spin-off.
- On an average, FLF has ~30% stake in its 10 investee brands, Clarks and Turtle (current annual turnover of INR1.5b-2b; potential to reach INR3b-4b) being the key ones, and Cover Story (potential of INR2b annual revenue) fast emerging. Exit from these brands remains latent, giving FLF significant upside potential.

Power brands to drive value unlocking

The branded apparel market is expected to grow at a CAGR of 14% over CY15-21 (higher than the overall fashion market CAGR of 10%), reaching USD30b by CY21. The share of branded apparel is likely to increase from 25% of the overall market in CY11 to 34% by CY21. Growth would be driven by rising disposable income coupled with increasing desire to be fashion-relevant, which has led to an increase in the shopping cycles of an Indian consumer from 1-2x per year earlier to 10-12x now.

Exhibit 245: Share of branded apparel market is expected to grow at 14% CAGR

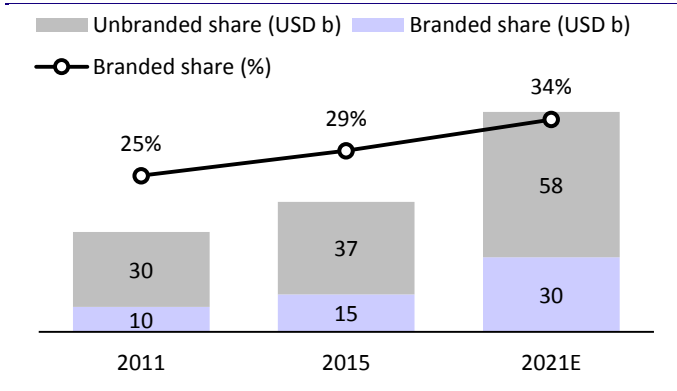
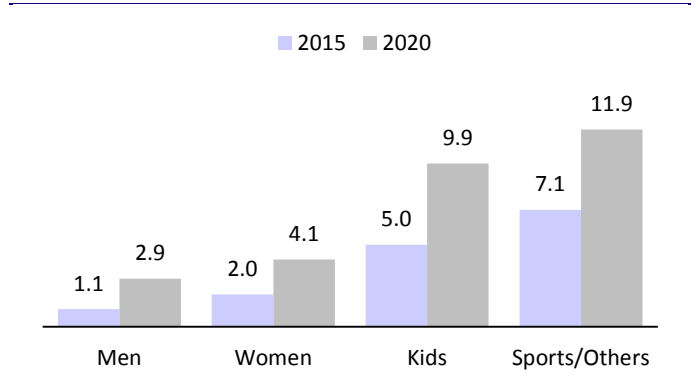


Exhibit 246: Category-wise share of the branded apparel market (%)



FLF’s brands cater to men/women, with offerings across formalwear, casualwear, sportswear and leisurewear. Of its 15 brands, seven are power brands: Lee Cooper, John Miller, Scullers, Indigo Nation, Jealous21, aLL, and Bear. These contribute ~63% of FLF’s brands revenue. These brands are more focused on casual wear than on core merchandise (for example, simple white shirts). Riding on the back of burgeoning demand for branded fashion, we believe these brands would support private label share over FY19-21. The power brands have reached a healthy scale of INR14.5b in revenue and contribute ~25% of total sales.

Its branded apparel portfolio supports FLF in three ways:

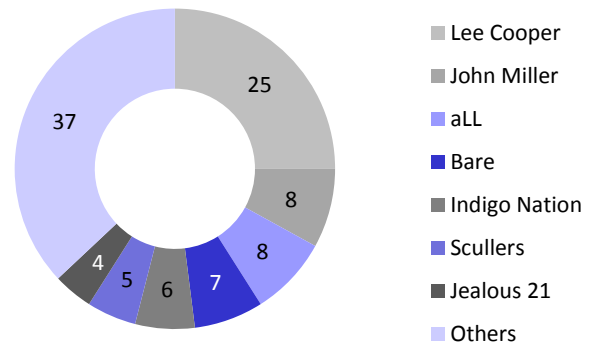
1. There is a strong pull factor for these brands, driving footfalls and revenue for Central and Brand Factory.
2. FLF has increased the size of the branded portfolio beyond some of the large brands in India, thus creating the potential for value unlocking.
3. The higher share of in-house brands has improved overall EBITDA margin, which continues to move up.

Exhibit 247: FLF's power brands...



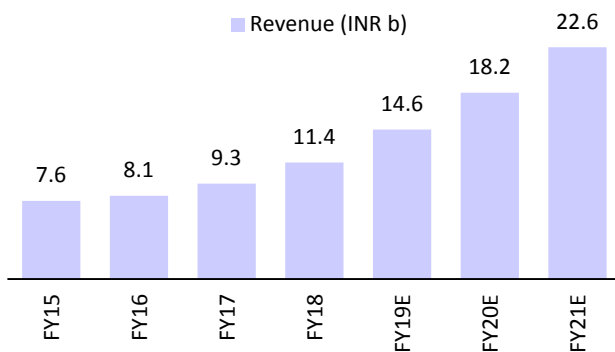
Source: MOFSL, Company

Exhibit 248: ...constitute ~63% of its brand sales



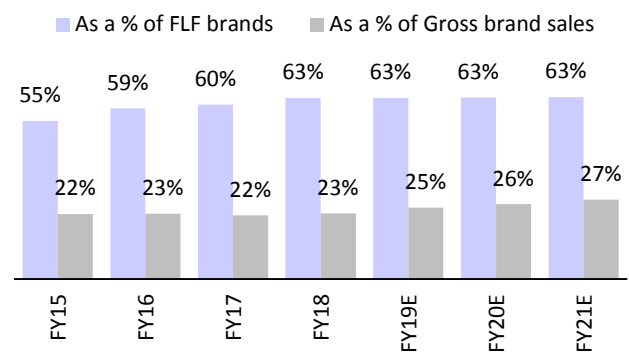
Source: MOFSL, Company

Exhibit 249: Momentum of power brands revenue to continue to grow strong (INR b)



Source: MOFSL, Company

Exhibit 250: Revenue contribution of total power brands segment

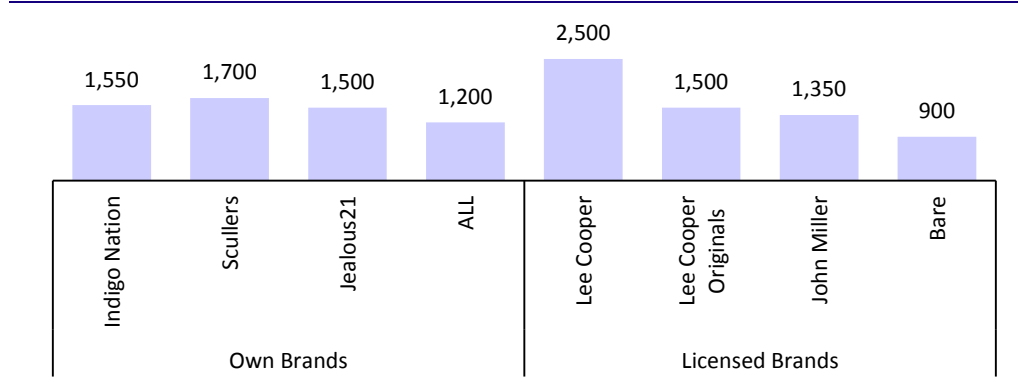


Source: MOFSL, Company

Exhibit 251: FLF brands across categories

Branded Market Opportunity	FLF Brands
Men's wear Size: USD 7bn Growth: 10% CAGR	INDIGO NATION, JOHN MILLER, DANIEL HECHTER, URBANA
Unisex Brands	Lee Cooper, SCULLERS, all, BARE, RIG, UMM
Women's wear Size: USD 5bn Growth: 15% CAGR	JERLOUS 21, NAVRAS, ATEESA, Hey!, Morpankft, PRIMADIVA
Sports / Leisure wear	CONVERSE, Champion, URBAN YOGA, umbro
Footwear / Others	CERIZ

Source: MOFSL, Company

Exhibit 252: Brand-wise price points (INR)

Source: MOFSL, Company

Lee Cooper is a licensed brand, offering denims, casualwear and footwear, with annual revenue of INR4.5b. It targets young men and women, with price points of INR1,500 for Lee Cooper Originals and INR2,500 for Lee Cooper. It is sold through all formats of FLF and non-FLF distribution channels. Large-format stores (LFSs) contribute about 65% of revenue, of which 70% is derived from own stores (Central, Brand Factory), while the rest is derived from third-party LFSs. About 30% of revenue is generated through traditional multi-brand outlets (MBOs), and 5% is derived from online sales and independent exclusive brand outlets (EBOs). Management believes, given its strong brand pull, Lee Cooper does not require significant independent EBOs. This also restricts marketing, branding cost. We expect Lee Cooper to continue garnering 25% revenue CAGR over FY19-21 to reach a revenue base of INR9.2b.

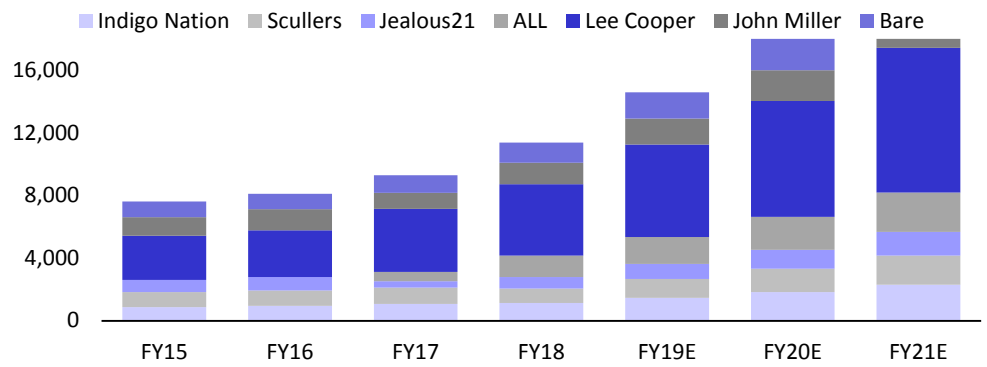
Apart from the license for Lee Cooper's apparel business, FLF also has sought license for its footwear business from mid-FY19. This was earlier with M&B Footwear Private Ltd.; business had an annual turnover of INR2.4b (FY18). Given the strong traction for the brand, foray into the footwear category should further propel growth.

aLL specifically focuses on plus-size clothing (~15% of the Indian apparel market), which is expected to double to an INR110b market by 2020. It provides a range of products from western to ethnic wear (including accessories). At present, aLL is an INR1.7b brand, with an average price point of INR1,200. Distribution is nearly 80% through EBOs, while the rest is sold through Central and the online channel.

The rest of the five power brands have annual revenue ranging from INR1b to INR2b (as of FY19E). **John Miller** (semi-casuals), **Indigo Nation** and **Scullers** are the larger ones, with ~INR2b annual revenue. **Bare** (casualwear) garners INR1.7b revenue and **Jealous** (casuals and denims for young women) generates ~INR1b per year.

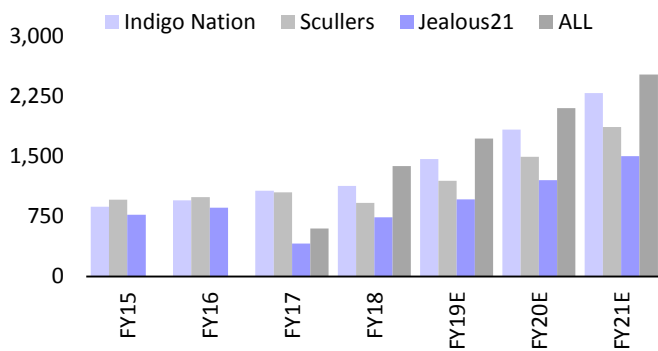
Given that FLF derives a sizeable proportion of its revenue from in-house Central and Brand Factory outlets, these brands should steadily grow in line with the growth of FLF's retail format. As these brands reach annual revenue generation of INR3b-5b, they could lead to significant value unlocking for FLF.

Exhibit 253: Power brands revenue (INR m)



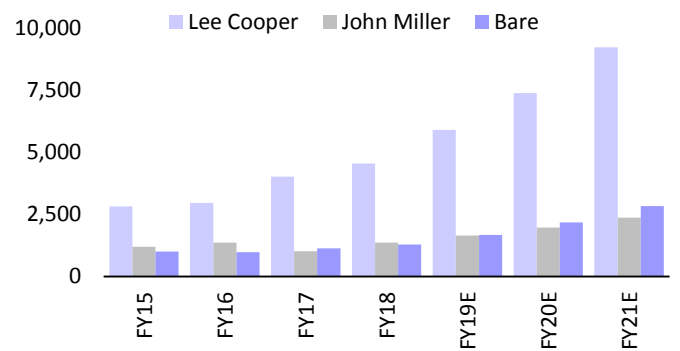
Source: MOFSL, Company

Exhibit 254: Annual revenue trend of own brands (INR m)



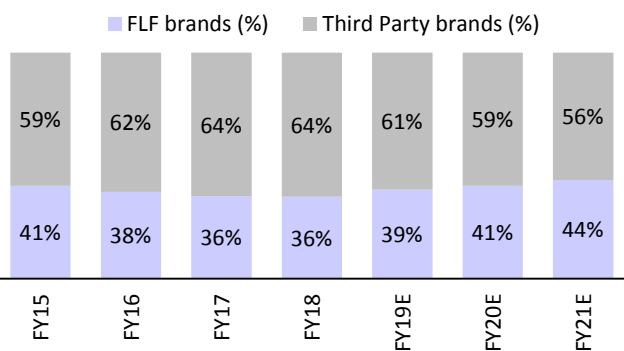
Source: MOFSL, Company

Exhibit 255: Annual revenue trend of licensed brands (INR m)



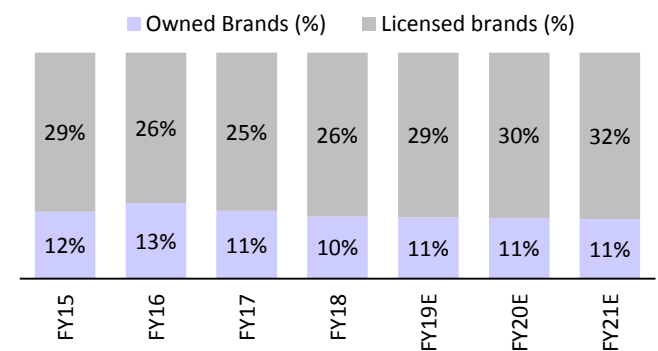
Source: MOFSL, Company

Exhibit 256: Share of FLF brands to increase... (%)



Source: MOFSL, Company

Exhibit 257: ...mainly led by higher share of licensed brands (as a % of total brand revenue)



Source: MOFSL, Company

Key investee brands offer value unlocking potential

Besides the brands and distribution business, FLF is also involved in the investment business. It invests in early fashion start-ups (investee brands), nurtures them through its distribution channels (mainly Central), and then exits at the opportune moment after the brands reach a sizeable value. FLF has investments in 10 such brands, with an average stake of 33%. These brands include Cover Story, Clarks, Turtle, Tresmode, Giovani, Mineral, Holii, Spunk, Celio, and Mother Earth.

Exhibit 258: FLF brands across categories



Source: MOFSL, Company

Current investments provide latent upside potential

Exhibit 259: Key investee brands

	Cover Story	Clarks	Turtle
Stake (%)	90%	50%	26%
Revenue (INR m)	500	1,300	1,750
Price Point (INR)	1,800	4,500	1,800
Distribution	Central & EBO's	Central, EBO's, 3rd party MBO's, E-com	Central, Brand Factory, EBO's, E-com, 3rd party MBO

Source: MOFSL, Company

FLF owns 90% stake in **Cover Story**, a fast fashion-wear brand for women (particularly for the 20-40 year age group), which has an annual turnover of ~INR500m. With an average price point of INR1,800, it targets to bridge the gap between INR1k and INR5k price points, and competes with H&M. Central and EBOs are the main distribution channels for Cover Story.

FLF holds 50% stake in **Clarks**, a premium footwear brand. Targeted towards both men and women, it has annual sales of ~INR1.5b, with an average price point of INR4.5k. It is distributed through all FLF platforms and non-FLF channels (Central, EBOs, third-party MBOs, and online), except Brand Factory (value proposition platform of FLF). It competes with Hush Puppies, Woodland, Aldo, Charles & Keith.

In the next 3-5 years, Cover Story could turn into an INR2b brand, Clarks into an INR4b brand, and Turtle into an INR3b brand. These brands hold significant value unlocking potential for FLF.

Past investment exits had enabled high value unlocking

FLF has a healthy track record of unlocking value in investee companies. Investment exits by FLF include BIBA, in which it had bought stake at INR50m and exited at INR1,800m. In Anita, it had bought stake at INR60m and sold at INR1,900m.

Exhibit 260: Significant value unlocked from investee brands (INR m)

	BIBA	AND
Purchase value	50	60
Sale value	1,800	1,900

Source: MOFSL, Company

Healthy balance sheet to support growth

Return ratios ready to witness an uptick

- We expect FLF to generate a cumulative FCF of INR5.6b over FY19-21, primarily on robust EBITDA growth, partly offset by internally-funded expansion. Net debt should decline from INR4.3b in FY19E to INR-0.4b by FY21.
- High asset turnover coupled with leaner balance sheet should boost return ratios. We expect RoE/RoCE of ~13% by FY21 (~10% in FY19E).

Large store size pulls productivity, cash payback period

Capex for Central's LFSs (average size: 85ksf-100ksf) is ~INR325m/store, and including working capital, total investment/store works out to INR385m. Large store size offers superior customer experience compared to a typical 30ksf-50ksf store; Central's matured store productivity would be ~INR9.0k/sf. We expect the healthy SSSG to continue improving productivity. Central's average store-level margins (gross margin: ~39%; EBITDA margin: ~10.5%) are superior to peers' (EBITDA margin: 6-7%). However, due to larger store size, overall RoCE remains at ~6.5%, with cash payback of 4-5 years.

For Brand Factory, the overall store investment stands at INR90m (capex: ~INR60m; working capital: 30m) for a store size of ~28.6ksf. For a matured store, productivity stands at ~INR10.0k/sf. EBITDA margin remains healthy at 7.5%, garnering RoCE of ~9%, with cash breakeven of ~4 years.

Exhibit 261: Per store analysis for payback and RoCE (INR m)

	Central		Brand Factory	
	Per Store	Per Sq.ft	Per Store	Per Sq.ft
Capex	324	3,500	57	2,000
WC	61	660	33	1,144
Total	385	4,160	90	3,144
Breakeven (in years)	4.4	4.4	4.2	4.2
Revenue	833	9,000*	286	10,000*
Gross margin	325	3,510	83	2,920
Gross margin (%)	39.0%	39.0%	29.2%	29.2%
Other operating cost	236	2,556	62	2,170
EBITDA	88	954	21	750
EBITDA margin (%)	10.6%	10.6%	7.5%	7.5%
Depreciation	51	547	9	313
Depreciation rate (%)	16%	16%	16%	16%
EBIT	38	407	12	437
RoCE (Tax - 33%)	6.5%	6.5%	9.3%	9.3%

*Productivity for a matured store (more than 5 years old)

Source: MOFSL, Company

10% SSSG can lead to 60-80bp EBITDA margin expansion

While store RoCE and payback remain moderate, we see two key levers for sharp EBITDA margin expansion: (1) productivity-driven operating leverage, and (2) rising contribution from branded apparel.

FLF has consistently commanded double-digit SSSG. One-third of its costs (30% of revenue) remain fixed; our workings indicate that even if two-third of the costs are controlled, EBITDA margin for Central/Brand Factory can improve by 80bp/60bp, leading to higher RoCE. Also, higher share of branded apparel in own as well as third-party channels should support margin expansion and improve asset turnover, thus enhancing RoCE. We expect FLF's RoCE to improve to 13% by FY21.

Exhibit 262: Scenario analysis on per store basis (INR m)

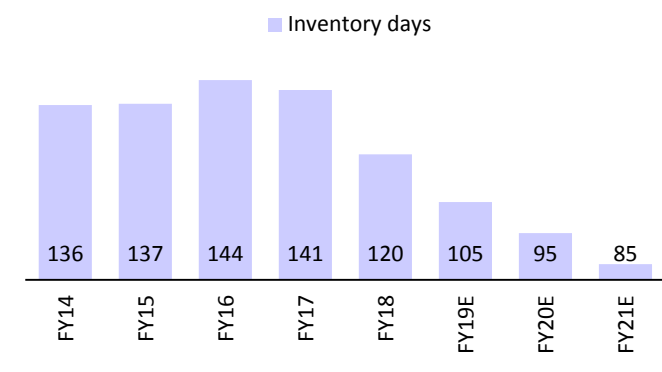
	Central		Brand Factory	
	Per Store	Per Sq.ft	Per Store	Per Sq.ft
Revenue increases by	10%	20%	10%	20%
Revenue	916	999	314	343
Gross margin	357	390	92	100
Gross margin (%)	39.0%	39.0%	29.2%	29.2%
Fixed (%)	30%	30%	30%	30%
Fixed	71	71	19	19
Variable (%)	70%	70%	70%	70%
Variable	182	199	48	52
Other Operating Cost	253	270	66	71
EBITDA	104	120	25	29
EBITDA margin (%)	11.4%	12.0%	8.1%	8.6%
Change in bps	77	142	59	108
EBIT	54	69	16	20
Breakeven (in years)	3.7	3.2	3.5	3.1
RoCE	9.3%	12.1%	12.3%	15.3%

Source: MOFSL, Company

Working capital cycle remains low

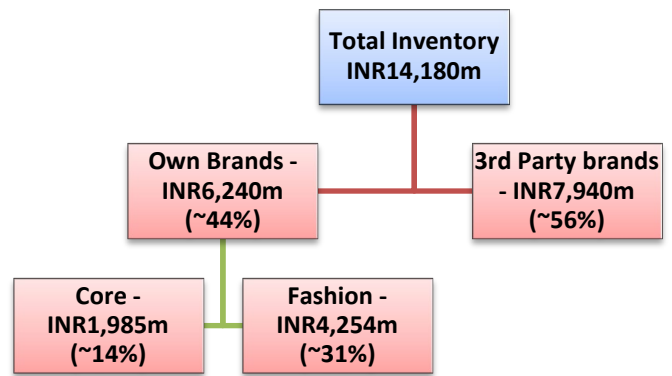
The mix of retail and brand business reduces FLF's overall working capital. FLF has reduced its WC days from a peak of over 71 days (FY15) to 57 days (FY18). At INR14b, inventory is high (120 days), but 56% is on sales or return (SOR) basis, which is backed by payables of about 90 days. Thus, the overall working capital cycle is reduced to 57 days. The balance 40-45% inventory (INR6b) comes from own brands, of which one-third is seasonal inventory, having a high inventory cycle of 150 days, but the inventory cycle for the rest of the core non-seasonal inventory is less than two months.

Exhibit 263: Inventory days to remain at 85-100 days



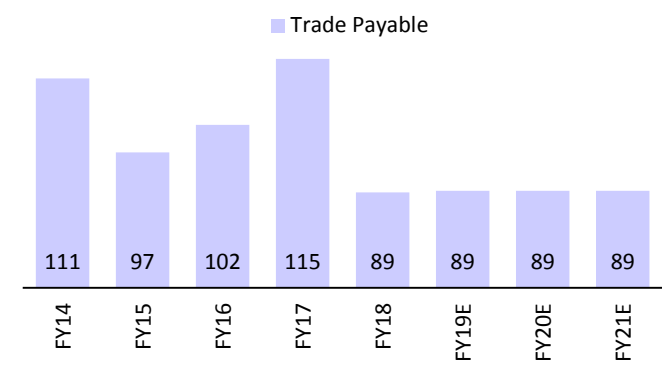
Source: Company, MOFSL

Exhibit 264: Inventory breakup (FY18)



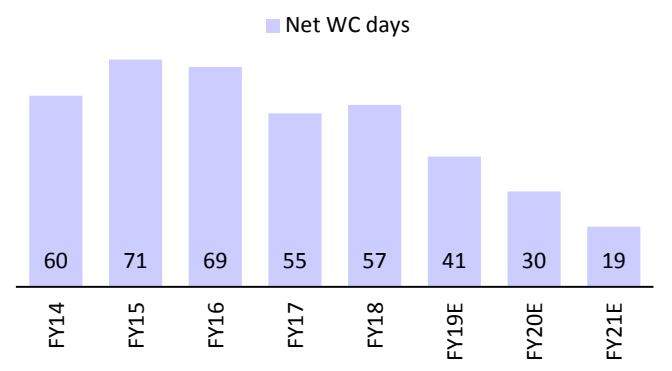
Source: Company, MOFSL

Exhibit 265: Creditor days to remain at 80-90 days



Source: Company, MOFSL

Exhibit 266: Net WC days have reduced

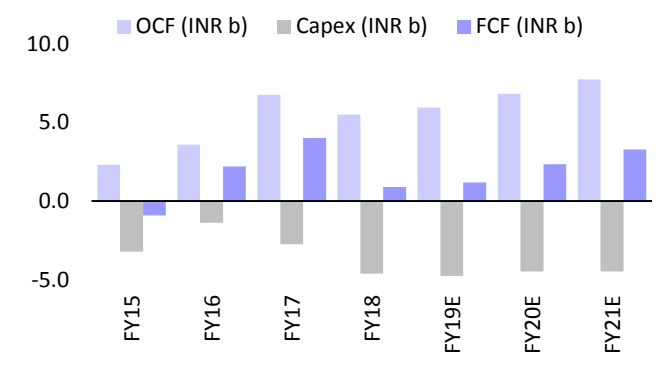


Source: Company, MOFSL

Healthy FCF to help lower leverage

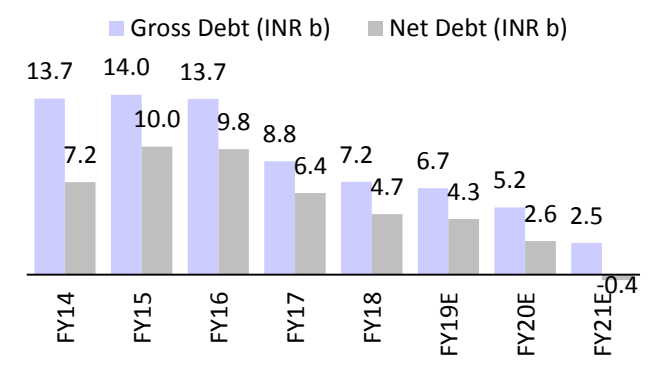
In FY19E, FLF will generate ~INR6.3b of OCF. The planned annual addition of 5 Central stores, 30 Brand Factory outlets and 20 EBOs should require capex of about INR4b, which can be funded by internal accruals. With huge opportunity to grow in the organized retail space, eagerness to grow at an accelerated pace can often create a stretched balance sheet. However, as at the end of FY19E, FLF’s net debt-to-equity stood at 0.3x and interest coverage was ~2.7x.

Exhibit 267: FCF to grow gradually, as expansion gets funded from internal accruals...



Source: Company, MOFSL

Exhibit 268: ... and support lower gearing (INR b)

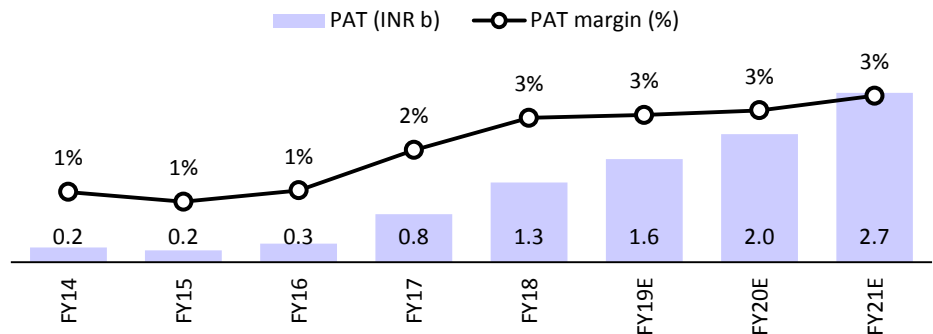


Source: Company, MOFSL

Expect strong 28% PAT CAGR over FY19-21

With the shift from unorganized to organized retail driving strong industry growth, we see (a) FLF expanding its store network, and (b) healthy growth in same-store sales. We expect 18% revenue CAGR over FY19-21, led by healthy SSSG and new store sales growth. We expect EBITDA margin to inch up gradually to 10%. However, below-EBITDA healthy operating leverage due to the flow through of high SSSG and deleveraging should drive strong 28% PAT CAGR.

Exhibit 269: PAT to grow at 28% CAGR over FY19-21

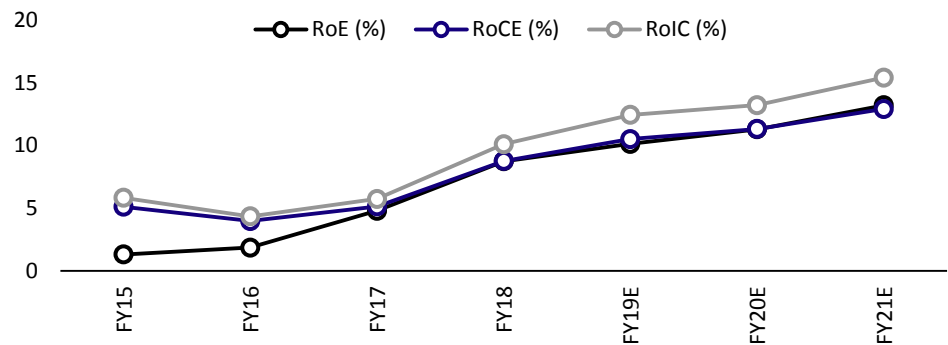


Source: MOFSL, Company

Expect healthy 13% RoCE in next two years

Being in a steady expansion phase, FLF has a large proportion of stores in the 0-3 year age group, which reflects in its single-digit RoCE. However, with a healthy 8-10% SSSG, we expect steady PAT growth, driving RoCE in next two years.

Exhibit 270: Return ratios to surge in near term (%)



Source: MOFSL, Company

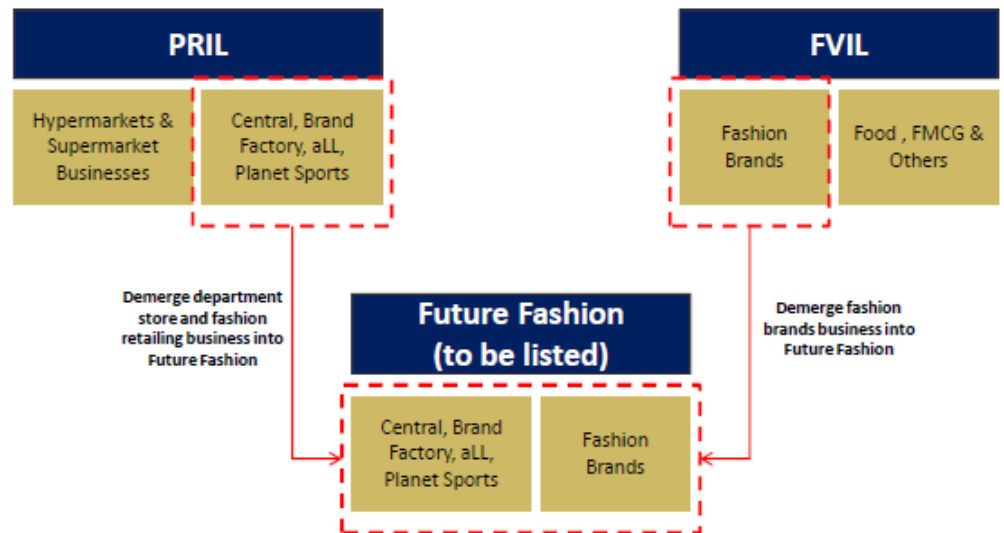
Interparty competition in apparel space

FLF’s group company – FRL operates Fashion at Big Bazaar (FBB) (both under Future Group). Both FLF and FRL have a sizeable private label/own brand presence. Both are catering to the aspiring consumer segment – FBB through the value format and Brand Factory through the discount store format. Given that FLF was carved out as a separate fashion venture of Future Group and houses all the fashion brands, we are unclear as to whether FRL’s apparel business will be eventually spun off into FLF or both the competing businesses will continue operating as separate entities of the same promoter group. This conflicting business in the same promoter group could be a key concern for minority investors.

FLF – restructured Future Group’s fashion business under one umbrella

FLF was carved out as a fashion company by hiving off the retail chain (Central, Brand Factory, aLL and Planet Sports) from PRIL and the Fashion brands from Future Ventures. This makes it a rare business model, combining a large format store (LFS) chain and the apparel brands.

Exhibit 271: FLF carved out from PRIL and FVIL



PRIL – Pantaloons Retail India Ltd, FVIL – Future Ventures India Ltd

Source: MOFSL, Company

Valuation and view

Recommend Buy with TP of INR585

- We recommend Buy, with a target price of INR585, ascribing 15x (~20% premium to three-year average) to FY21E EBITDA of INR7.6b. At CMP, FLF is valued at 34x FY21E EPS and an EV of 12x FY21E EBITDA.
- We believe the valuation gap compared to peers should reduce, as FLF has all its growth levers in place.

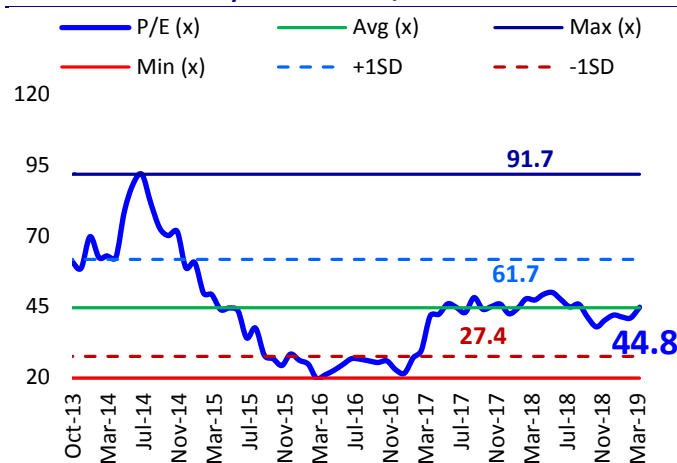
At the current market price, FLF is valued at 34x FY21E EPS and an EV of 12x FY21E EBITDA. We value FLF at 15x EV/EBITDA, arriving at a target price of INR585. This is ~20% premium to three-year average due to the strong performance over the last two years, but still ~25% below the target EV/EBITDA multiple for our apparel coverage, indicating an opportunity for value appreciation. We recommend **Buy**. Our target price implies a P/E of 42x and a PEG of 1.5x.

Exhibit 272: Valuation based on FY21E EBITDA

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR b)	Value/share (INR)
EBITDA	FY21 EV/EBITDA	7.6	15	114	598
Less Net debt				3	14
Total Value				111	585
Shares o/s (m)				190	
CMP (INR)					478
Upside (%)					22

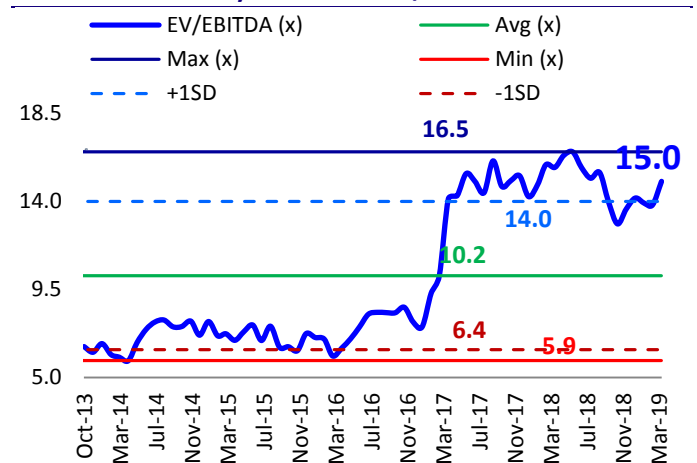
Source: MOFSL, Company

Exhibit 273: FLFL: 1-year forward P/E



Source: Bloomberg, MOFSL

Exhibit 274: FLFL: 1-year forward EV/EBITDA



Source: Bloomberg, MOFSL

Valuation gap versus peers to reduce

We believe with steady EBITDA margin (on a high base) over FY19-21, FLF should see strong 28% PAT CAGR, attracting healthy valuations and bridging the gap with peers.

Strong earnings growth, healthy balance sheet to support rich valuations

FLF's strong earnings growth coupled with healthy balance sheet and RoE improvement should support rich valuations. It has a debt of INR6.7b and working capital cycle of just 41 days (FY19E). However, with cumulative OCF of ~INR14.5b over FY19-21 and an annual capex requirement of about INR4.5b, leverage should decline further. Rational growth, driven largely through internal capital, should be a key positive in maintaining balance sheet strength. We expect RoE to increase to 13% by FY21, driven by an improvement in asset turnover and EBITDA margin, supporting rich valuations.

Financials and valuations

Consolidated - Income Statement								(INR m)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	27,440	31,341	33,002	38,947	44,982	56,669	67,509	79,152
Change (%)	NA	14.2	5.3	18.0	15.5	26.0	19.1	17.2
Raw Materials	16,970	19,194	20,455	24,721	28,468	36,478	43,476	50,974
Employees Cost	1,291	1,692	1,886	2,139	2,649	3,250	3,737	4,298
Rent	2,919	3,462	3,727	4,410	4,528	5,411	6,704	7,984
Other Expenses	3,696	3,691	3,683	4,383	5,250	6,319	7,257	8,311
Total Expenditure	24,876	28,039	29,750	35,653	40,895	51,457	61,175	71,567
% of Sales	90.7	89.5	90.1	91.5	90.9	90.8	90.6	90.4
EBITDA	2,563	3,302	3,252	3,294	4,087	5,212	6,335	7,585
Margin (%)	9.3	10.5	9.9	8.5	9.1	9.2	9.4	9.6
Depreciation	3,852	1,701	1,614	890	1,539	1,957	2,682	3,331
EBIT	-1,289	1,601	1,637	2,404	2,548	3,255	3,652	4,253
Int. and Finance Charges	1,630	1,583	1,353	1,232	1,033	1,186	1,016	655
Other Income	3,317	217	165	242	341	365	386	398
PBT bef. EO Exp.	399	235	450	1,414	1,856	2,434	3,022	3,997
EO Items	-57	0	0	689	0	0	0	0
PBT after EO Exp.	342	235	450	2,103	1,856	2,434	3,022	3,997
Total Tax	110	49	155	1,033	586	803	997	1,319
Tax Rate (%)	32.0	21.0	34.5	49.1	31.6	33.0	33.0	33.0
Reported PAT	233	185	295	1,070	1,271	1,631	2,025	2,678
Adjusted PAT	271	185	295	719	1,271	1,631	2,025	2,678
Change (%)	NA	-31.7	58.9	144.1	76.6	28.4	24.2	32.2
Margin (%)	1.0	0.6	0.9	1.8	2.8	2.9	3.0	3.4

Consolidated - Balance Sheet								(INR m)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	309	372	379	380	381	381	381	381
Total Reserves	12,604	15,325	15,853	13,450	14,915	16,546	18,571	21,249
Net Worth	12,913	15,697	16,232	13,830	15,296	16,927	18,952	21,630
Total Loans	13,696	13,994	13,655	8,818	7,225	6,725	5,225	2,475
Deferred Tax Liabilities	645	650	709	-473	-392	0	0	0
Capital Employed	27,255	30,341	30,597	22,175	22,129	23,652	24,177	24,105
Gross Block	15,524	16,269	16,814	8,182	11,495	16,259	20,737	25,215
Less: Accum. Deprn.	4,025	3,250	4,386	784	2,251	4,207	6,889	10,221
Net Fixed Assets	11,499	13,019	12,428	7,398	9,245	12,052	13,847	14,994
Capital WIP	1,895	1,721	1,862	1,898	2,905	2,905	2,905	2,905
Total Investments	3,785	3,437	3,754	2,164	2,171	2,171	2,171	2,171
Curr. Assets, Loans & Adv.	22,224	21,312	21,771	24,147	23,272	25,073	27,039	29,298
Inventory	10,240	11,732	13,050	15,058	14,829	16,302	17,571	18,433
Account Receivables	2,632	2,692	2,419	3,028	3,155	3,881	4,439	4,988
Cash and Bank Balance	2,711	597	146	299	330	207	433	707
Loans and Advances	6,642	6,291	6,157	5,763	4,959	4,683	4,596	5,170
Curr. Liability & Prov.	12,149	9,148	9,219	13,432	15,463	18,548	21,785	25,262
Account Payables	8,348	8,288	9,216	12,256	10,932	13,818	16,461	19,300
Other Current Liabilities	3,663	686	-191	709	3,565	3,764	4,358	4,996
Provisions	137	175	195	467	966	966	966	966
Net Current Assets	10,075	12,164	12,552	10,715	7,809	6,525	5,254	4,035
Appl. of Funds	27,255	30,341	30,597	22,175	22,129	23,652	24,177	24,105

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	1.4	1.0	1.6	3.8	6.7	8.6	10.6	14.1
Cash EPS	21.7	9.9	10.0	8.5	14.8	18.8	24.7	31.6
BV/Share	68.0	82.6	85.4	72.6	80.3	88.9	99.5	113.6
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				126.4	71.6	55.7	44.9	34.0
Cash P/E				56.5	32.4	25.3	19.3	15.1
P/BV				6.6	5.9	5.4	4.8	4.2
EV/Sales				2.6	2.2	1.7	1.4	1.2
EV/EBITDA				30.2	23.9	18.7	15.1	12.2
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-122.6	-4.8	11.6	21.1	4.7	6.3	12.4	17.2
Return Ratios (%)								
RoE	2.1	1.3	1.8	4.8	8.7	10.1	11.3	13.2
RoCE	NA	5.1	4.0	5.1	8.8	10.5	11.3	12.9
RoIC	NA	5.8	4.3	5.7	10.1	12.4	13.2	15.4
Working Capital Ratios								
Fixed Asset Turnover (x)	1.8	1.9	2.0	4.8	3.9	3.5	3.3	3.1
Asset Turnover (x)	1.0	1.0	1.1	1.8	2.0	2.4	2.8	3.3
Inventory (Days)	136	137	144	141	120	105	95	85
Debtor (Days)	35	31	27	28	26	25	24	23
Creditor (Days)	111	97	102	115	89	89	89	89
Leverage Ratio (x)								
Current Ratio	1.8	2.3	2.4	1.8	1.5	1.4	1.2	1.2
Interest Cover Ratio	-0.8	1.0	1.2	2.0	2.5	2.7	3.6	6.5
Net Debt/Equity	0.6	0.6	0.6	0.5	0.3	0.3	0.1	0.0

Consolidated - Cash Flow Statement

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
(INR m)								
OP/(Loss) before Tax	342	235	450	1,795	1,847	2,434	3,022	3,997
Depreciation	3,852	1,701	1,614	890	1,539	1,957	2,682	3,331
Interest & Finance Charges	1,630	1,583	1,353	1,232	1,033	1,186	1,016	655
Direct Taxes Paid	-125	-47	-98	-116	-456	-803	-997	-1,319
(Inc)/Dec in WC	-8,468	-1,194	152	2,711	1,453	1,553	1,497	1,492
CF from Operations	-2,769	2,278	3,471	6,512	5,416	6,327	7,220	8,156
Others	-3,160	30	113	249	101	-365	-386	-398
CF from Operating incl EO	-5,930	2,308	3,584	6,761	5,517	5,962	6,835	7,758
(Inc)/Dec in FA	-17,364	-3,215	-1,384	-2,737	-4,614	-4,764	-4,478	-4,478
Free Cash Flow	-23,293	-907	2,200	4,024	903	1,198	2,357	3,280
(Pur)/Sale of Investments	-490	484	-210	340	-10	0	0	0
Others	12,702	65	41	93	-161	365	386	398
CF from Investments	-5,151	-2,666	-1,553	-2,303	-4,785	-4,399	-4,092	-4,080
Issue of Shares	0	2,721	1	4	4	0	0	0
Inc/(Dec) in Debt	15,419	-2,814	-1,039	-2,964	658	-500	-1,500	-2,750
Interest Paid	-1,630	-1,583	-1,353	-1,232	-1,033	-1,186	-1,016	-655
Dividend Paid	0	-80	-91	-91	-183	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Fin. Activity	13,790	-1,756	-2,481	-4,283	-555	-1,686	-2,516	-3,405
Inc/Dec of Cash	2,709	-2,114	-450	174	178	-123	226	274
Opening Balance	2	2,711	597	125	152	329	207	433
Closing Balance	2,711	597	146	300	329	207	433	707

Annexure

Exhibit 275: Key milestones



Source: MOFSL, Company

Future Retail

BSE SENSEX 38,862 S&P CNX 11,666

CMP: INR447

TP: INR580 (+30%)

Buy



Stock Info

	FRETAIL IN
Bloomberg	FRETAIL IN
Equity Shares (m)	503
M.Cap.(INRb)/(USDb)	224.7 / 3.2
52-Week Range (INR)	639 / 402
1, 6, 12 Rel. Per (%)	-4/-11/-32
12M Avg Val (INR M)	485
Free float (%)	53.5

Financials Snapshot (INR b)

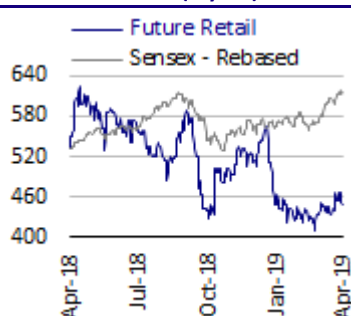
Y/E MARCH	FY19E	FY20E	FY21E
Sales	198.3	223.1	254.0
EBITDA	9.8	12.0	14.6
NP	6.9	7.8	8.8
EPS (Rs)	13.7	15.4	17.5
EPS Gr. (%)	12.2	12.4	13.5
BV/Sh (INR)	75.4	90.9	108.4
P/E (x)	32.5	28.9	25.5
P/BV (x)	5.9	4.9	4.1
EV/EBITDA (x)	23.6	19.1	15.4
EV/Sales (x)	1.2	1.0	0.9
RoE (%)	20.0	18.6	17.6
RoCE (%)	19.8	17.5	17.0

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	46.5	46.5	46.6
DII	15.5	13.3	5.1
FII	14.9	16.6	17.0
Others	23.2	23.6	31.3

FII Includes depository receipts

Stock Performance (1-year)



Scaling new heights

Expect 13% PAT CAGR over FY19-21, healthy RoCE

- FRL, a multi-format retailer, has a balanced product category portfolio across food and grocery, apparel and others, driving healthy SSSG and margin improvements.
- We expect revenue CAGR of 13% over FY19-21, driven by:
 - 10% CAGR at large formats: Led by increased consumption spends and higher mix of apparel revenue garnering an average 9% SSSG.
 - 30% CAGR for small format: Led by robust (~400) store additions and 10% growth in members/store to 1,120, which may drive sticky revenue stream.
- EBITDA margin should expand ~80bp to 5.7% on the back of multiple levers of (1) increasing share of private labels, (2) favorable mix of margin-accretive non-food (apparel) category, (3) operating leverage and (4) fast breakeven of Hypercity and Easyday stores.
- FRL recently announced INR20b promoter warrants, which should be utilized in releasing FRL assets from FEL, a move that will clean FRL's asset ownership structure, turn EPS accretive, and garner 12% RoCE with further improvement potential.
- We have a Buy rating on FRL with a target price of INR580 – EV/EBITDA of 20x (at three-year average) FY21E EBITDA of INR15b. At CMP, the stock is valued at EV/EBITDA and P/E of 15x and 26x, respectively, on FY21. This is at ~50% discount to D-Mart. With growth levers in place and return ratios set to take off, we believe the valuation gap should reduce.

Balanced portfolio across formats and categories

Future Retail (FRL) has created a strong pan-India presence with its hypermarket format – Big Bazaar/FBB/Hypercity (384 stores, FY19E), and neighborhood store format – Easyday (1,100 stores, FY19E). It has achieved strong same-store sales growth (SSSG) of ~9% over FY16-19E. FRL has a balanced portfolio: (a) targeting different formats – hypermarket stores in large cities and cluster-based neighborhood stores closer to homes and (b) targeting different categories – ~35% groceries, 15% HPC products, 35% apparel and 15% other segment (including home articles and general merchandise). This allows it to optimize productivity through membership-based grocery sales as well as enhance margin profile by improving margin-accretive private label and apparel mix.

Healthy revenue growth momentum to continue

We expect overall revenue/PAT CAGR of 13%/13% over FY19-21. Large format stores should witness 10% revenue CAGR over FY19-21, driven by healthy 9% SSSG and ~25 store additions, better assortment, higher share of fashion goods, and higher consumption spends. Small format stores, backed by Easyday's robust membership program expansion, should see 30% revenue CAGR over FY19-21.

Multiple margin levers in place

We expect FRL's EBITDA margin to expand 80bp to 5.7% over FY19-21. EBITDA margin for large format stores should improve from current 7.1% (FY19E) to 7.4% by FY21, led by a favorable mix of margin-accretive private label apparel and a steady improvement in productivity. Besides, Hypercity's -2% EBITDA margin (FY19E) could reach 4% by FY21, with cuts in corporate overheads, lower distribution center (DC) cost, sourcing benefits, and higher share of private labels and fashion products in the sales mix. Small format store's current -3% EBITDA margin should improve, with growing scale and better productivity.

Clean-up of inter-group arrangements – key positive

FRL operates on an asset-light model, leasing premises from the land lord/developer and fit-outs from sister concern, Future Enterprise (FEL). FEL has a steady flow of lease income and asset monetization plans to source funds. Yet in order to clean up the asset ownership structure, FRL recently announced INR20b warrant issues to the promoter group, which should be utilized to release INR40-45b FRL assets from FEL. With 15% yield cost at current asset base, the move should be 25% EPS accretive on FY19 adjusted basis and yet garner 12% RoCE with further improvement potential.

Recommend Buy with TP of INR580; deep discount to peers

FRL is valued at 26x FY21E EPS and an EV of 15x FY21E EBITDA. The market values FRL at ~50% discount to DMART, which trades at 55x FY21E EPS and an EV of 33x FY21E EBITDA, despite similar PAT growth estimates. This discount should shrink due to (a) steady 13% PAT CAGR expected over FY19-21 and (b) strong track record of SSSG and margin improvement in the past 3-4 years. Recent promoter warrant issue and steps to acquire its fixed assets from FEL, reversing the lease model with Group Company, should provide a transparent operating structure, and comfort to minority shareholders, thus reducing valuation gap with peers. We recommend **Buy**. We value FRL at an EV of 20x (at three-year average, ~30% discount to DMART's target multiple) FY21E EBITDA of INR15.0b, arriving at a TP of INR580 (implying 30% upside). At our TP, the implied P/E is 33x and the implied PEG is about 2.6x.

Covering the complete value chain

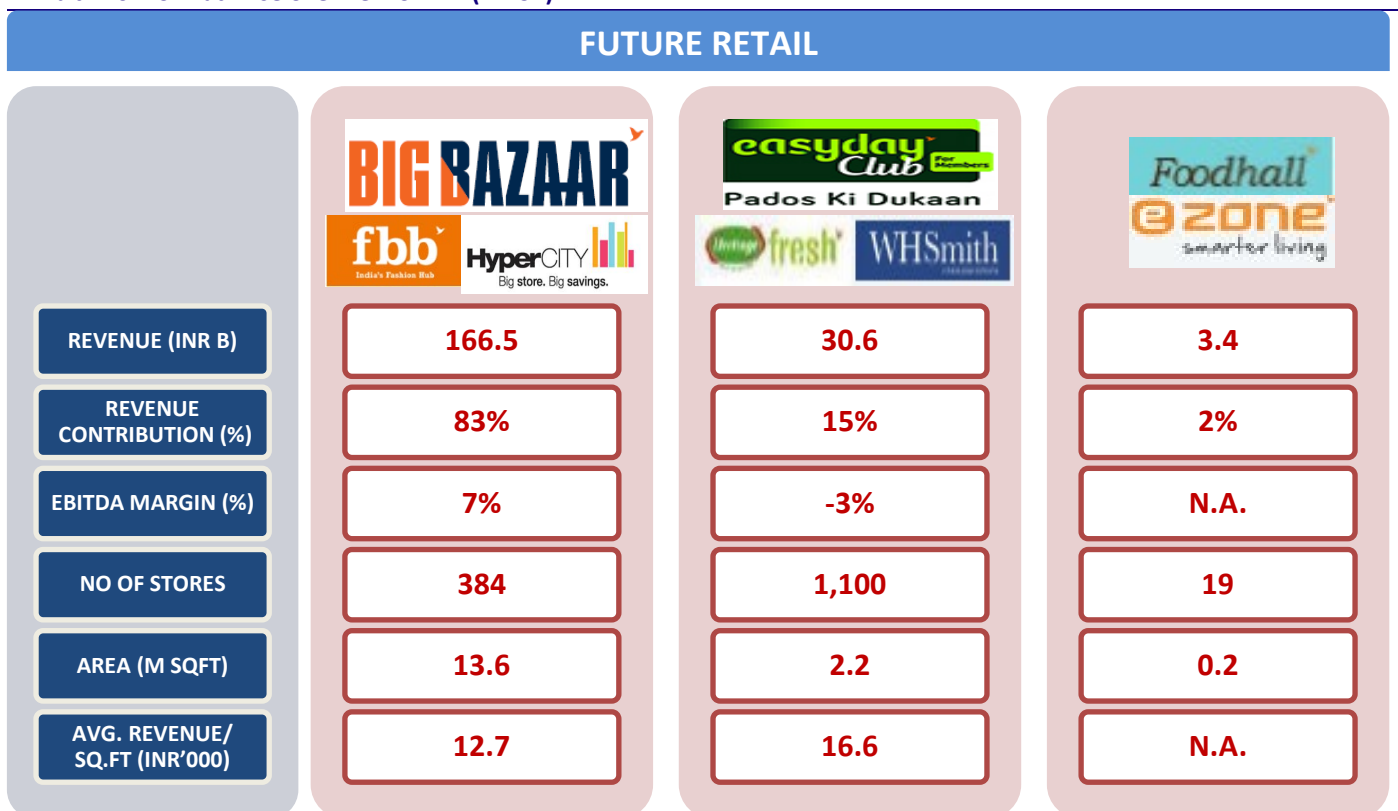
Revenue contribution skewed towards food segment

- FRL has a diversified portfolio. It is present across the entire consumption chain via 1) Store format - large and small format and 2) Product mix - food & grocery, fashion and general merchandise (including home improvements).
- It has a wide network of 384 large format stores and 1,100 small format stores (FY19E).

FRL’s unique proposition is its presence across multiple categories of consumption including food, fashion & apparel, and home improvement through both large as well as small formats – Big Bazaar/FBB/Hypercity, Easyday, Foodhall and E-zone. This is unlike other players that are predominantly present in specific categories (food and grocery, or apparel) or formats (hypermarkets or neighborhood stores). This should allow FRL to achieve secular growth.

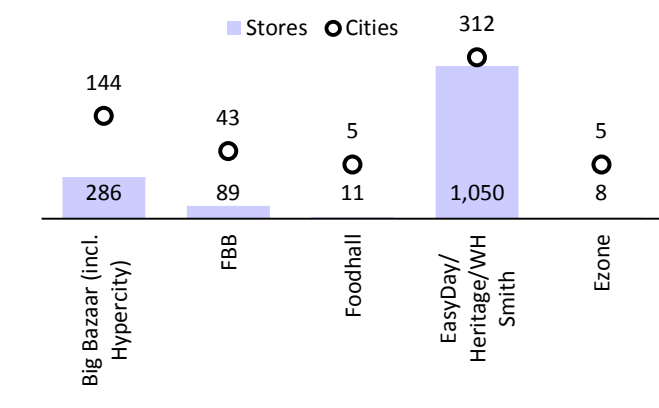
FRL has a good balance of (a) high turnover, low margin business in Food and Grocery, and (b) margin-accretive and relatively low turnover business in Apparel. Format-wise, (a) in the top-tier cities, it caters to the organized retail opportunity through its hypermarket format, Big Bazaar, and (b) in smaller towns, it meets demand through its neighborhood format, Easyday.

Exhibit 276: Format-wise overview of FRL (FY19E)



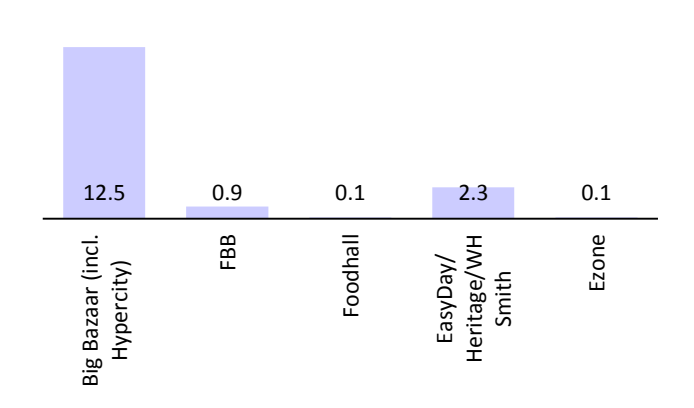
Source: MOFSL, Company

Exhibit 277: Format-wise store network (Dec-18)



Source: MOFSL, Company

Exhibit 278: Format-wise total area (Dec-18, msf)



Source: MOFSL, Company

Diversified revenue mix across segments

FRL derives ~35% of its revenue from food and grocery. The penetration of organized retail is the lowest for this category at just 3%, despite 34% CAGR over 2012-17. Grocery is the third-fastest growing category after apparel and consumer electronics. It is expected to grow at 29%, providing a healthy growth opportunity for FRL. Apparel segment driven by FBB, value fashion format is another strong growth category.

Ecommerce is least penetrated in grocery business

The penetration of e-commerce is merely 0.1% in the grocery category as against 2.3% in the overall retail market and 19.1% in electronics. Since FRL derives a healthy share of its revenue from grocery, it is relatively insulated from aggressive competition from e-commerce.

Flagship Big Bazaar and FBB – mainstay for growth

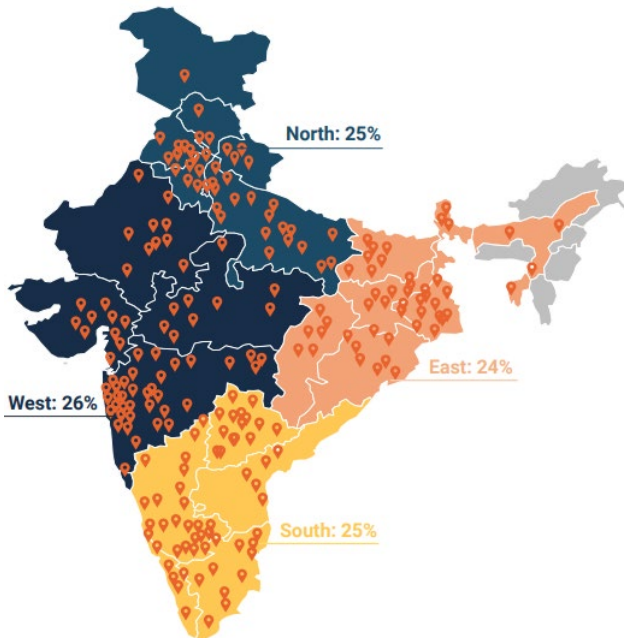
Expect 10% revenue CAGR over FY19-21

- We expect large format stores revenue to grow at 10% CAGR over FY19-21 mainly driven by 9% SSG as well as healthy new store adds (an average of 25 stores annually).
- Higher contribution from fashion category led by thrust on FBB, increased consumption spends and strong traction for memberships should provide impetus to 5% growth in revenue/sq. ft. to INR14k by FY21.
- We expect EBITDA margins to expand ~30bps (FY19-21) on a high base of 100bp improvement in FY19, reaching 7.4% by FY21. This is led by improving share of margin accretive private labels and apparels, as well as fast breakeven at Hypercity stores.



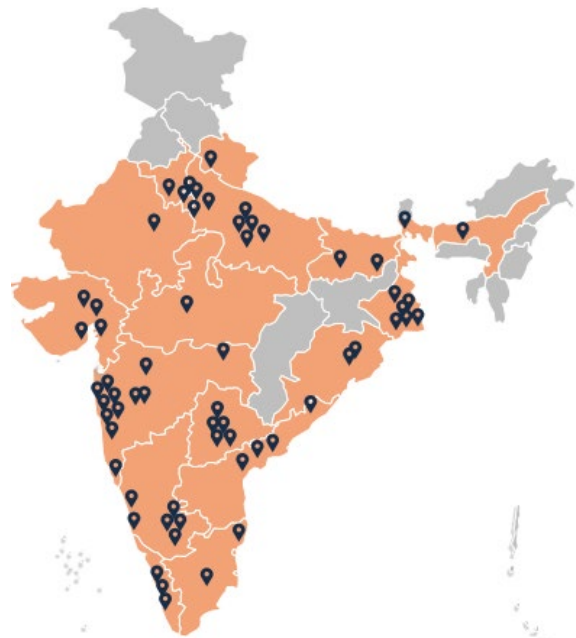
FRL’s largest contributing retail platform, Big Bazaar/FBB caters to complete household requirements – food & grocery, fashion & apparel, and home improvement. Large format stores, which contribute ~83% (INR167b FY19E) of FRL’s total revenue, have a pan-India geographical presence. FRL has 288 Big Bazaar (incl. Hypercity) stores (FY19E), with an average size of ~43ksf (total of 12.6msf). Besides the Big Bazaar stores, which have FBB subsumed, FRL also operates 96 (FY19E) standalone FBB stores. Having an average size of 10ksf (aggregating to 1.0msf), FBB stores offer range of in-house private labels for men, women and children. Food & grocery contributes over 35% of Big Bazaar’s revenue, fashion & apparel contributes about 35%, HPC contributes ~15% and home improvement contributes ~15%.

Exhibit 279: Geographical reach of Big Bazaar



For FY18, % represents revenue share from regions
Source: MOFSL, Company

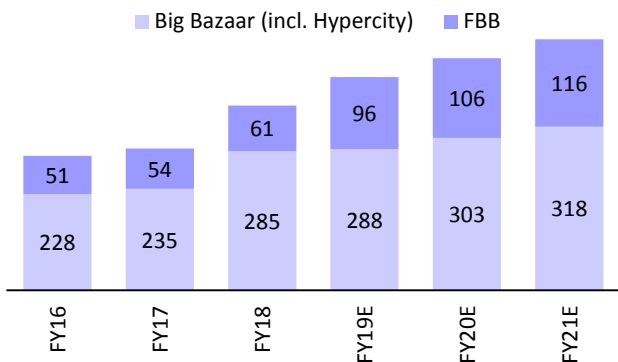
Exhibit 280: Geographical reach of FBB



For FY18

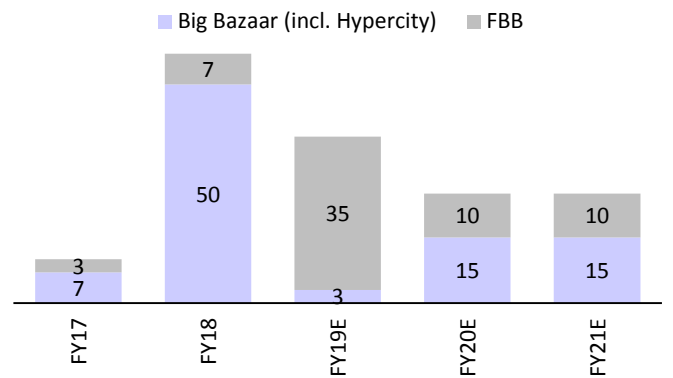
Source: MOFSL, Company

Exhibit 281: Aggressively increasing footprint (store count)...



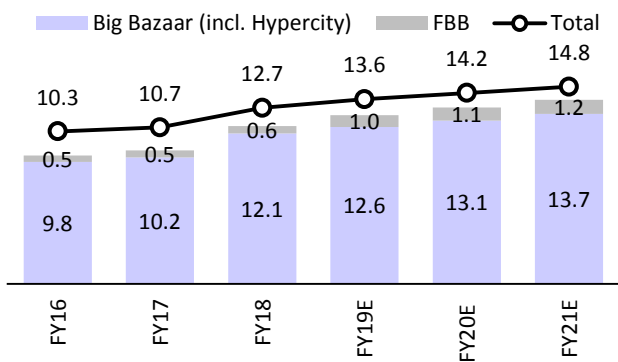
FBB refers to FBB standalone stores Source: MOFSL, Company

Exhibit 282: ...through robust store additions



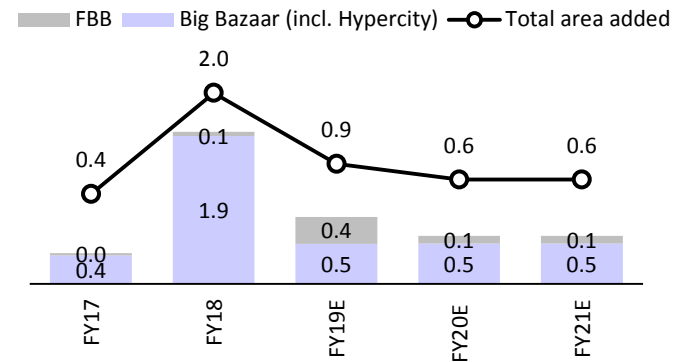
Source: MOFSL, Company

Exhibit 283: Total area under hypermarket format (msf)



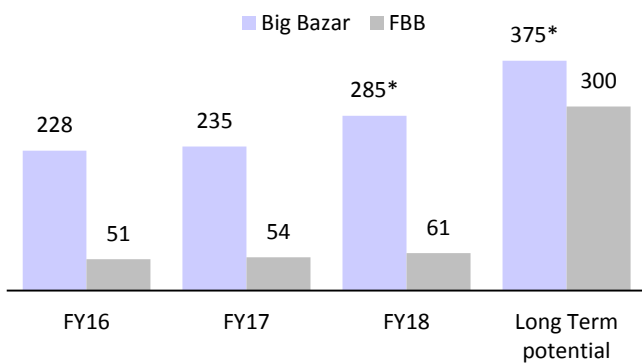
FBB refers to FBB standalone stores Source: MOFSL, Company

Exhibit 284: Area added under hypermarket format (msf)



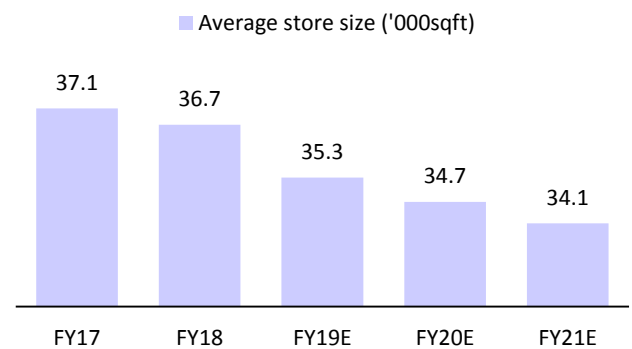
Source: MOFSL, Company

Exhibit 285: Management targets aggressive store expansion for BB/FBB, taking the total count to 350/500



*Includes Hypercity Source: MOFSL, Company
** Next 2-4 years for Big Bazaar

Exhibit 286: Reducing new store's size for large format stores to improve productivity



Includes Hypercity Source: MOFSL, Company

Store productivity to improve consistently led by: 9% same-store sales growth

Large format stores have an average revenue of ~INR12.7k/sf including 30-35% backend store area and ~INR22k/sf excluding the backend area, lower than D-mart’s INR30k/sf (with predominantly higher food and grocery contribution). The management targets to increase revenue/sf including the backend area to INR30k in 3-4 years. Our estimates build 9% same-store sales CAGR over FY19-21 driven by higher growth in grocery and high-margin non-food categories, rising consumption, and improving membership program penetration.

High contribution from apparel and other segments

Food & grocery, where margins are lower, contributes ~35% of revenue. Apparel contributes ~35% of revenue. Given the higher margins in apparel and strong demand for private labels, the management plans to improve contribution by adding SKUs and better marketing of FBB brands. Home products, which contribute ~30% of revenue, yield 20-25% gross margin. Thus, increasing mix of the Apparel & other segment in the overall revenue pie should improve productivity.

Increasing consumption spends

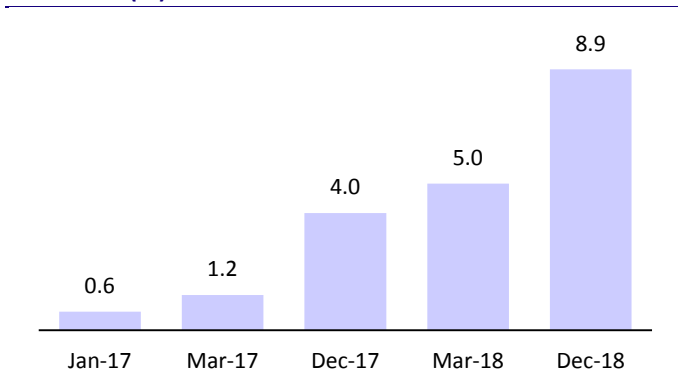
A favorable macro environment supporting per capita GDP growth coupled with a shift from the unorganized to the organized segment is expected to improve footfalls and wallet share. Increasing consumption spends should improve store productivity.



Big Bazaar/FBB membership program

Profit Club: The consumer pays INR10k once and shops for INR12k during the year (maximum of INR1k per month). This proposition has gained traction from ~600k members, who spend an average of INR25k per year.

Exhibit 287: Future Pay membership has grown more than 2x in CY18 (m)



Source: MOFSL, Company

Exhibit 288: Big Bazaar/FBB membership programs comparison (INR)

	Profit club
Membership ('000)	600
Value of Shopping	12,000
Amount to be paid	10,000
Discount	2,000
Avg. ticket size	2,000

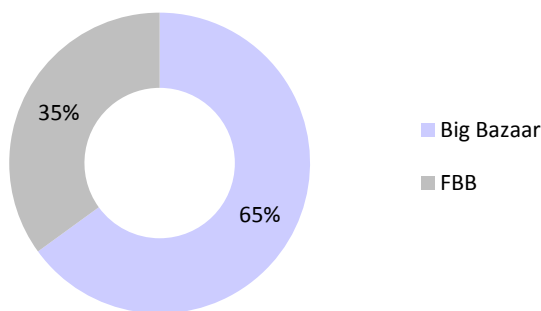
Source: MOFSL, Company



FBB to turn big – potential value unlocking of large private labels

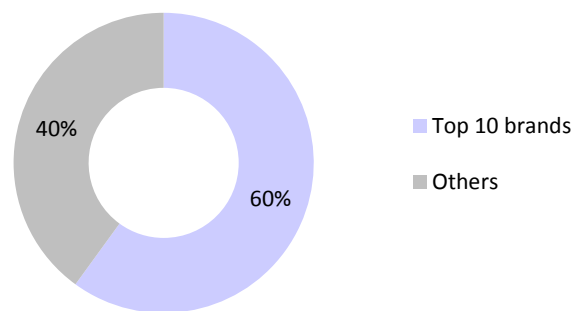
Fashion at Big Bazaar (FBB), with ~35% share (INR58b) of the total hypermarket revenue, remains sizeable relative to other top branded apparel players. FBB derives 90% of its revenue from private labels. The top 10 brands, which include Shrishti, (pegged at ~INR10b), Pink and Blue, Akriti, Buffalo, and DJ&C, contribute 50-60% (INR25b-30b) of revenue. We believe these brands offer a strong value proposition, given their size and lower price points. They cater to mass market consumers looking to move from the unorganized segment to value segment private labels. The top 5-10 brands yield annual revenue of INR5b-10b, and offer strong value unlocking potential whenever the management takes these brands to third-party stores.

Exhibit 289: FBB contributes ~35% of total hypermarket format revenue



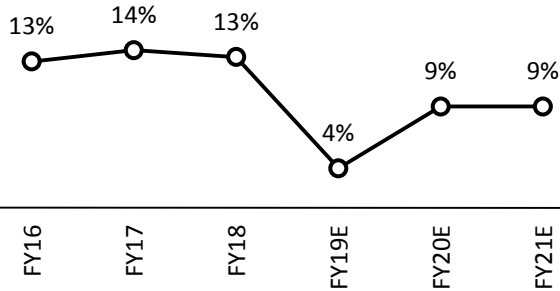
Source: MOFSL, Company

Exhibit 290: Top-10 brands contribute ~60% of FBB revenue



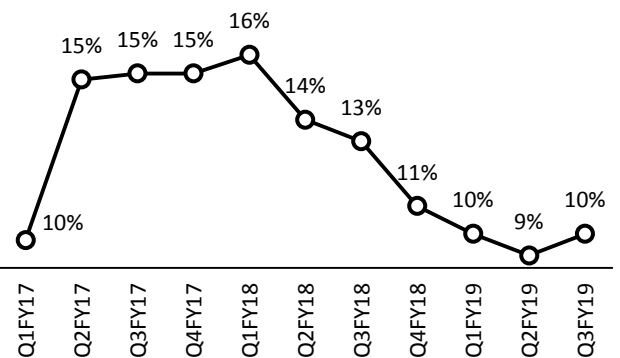
Source: MOFSL, Company

Exhibit 291: Big Bazaar’s healthy 9% SSSG (%)...



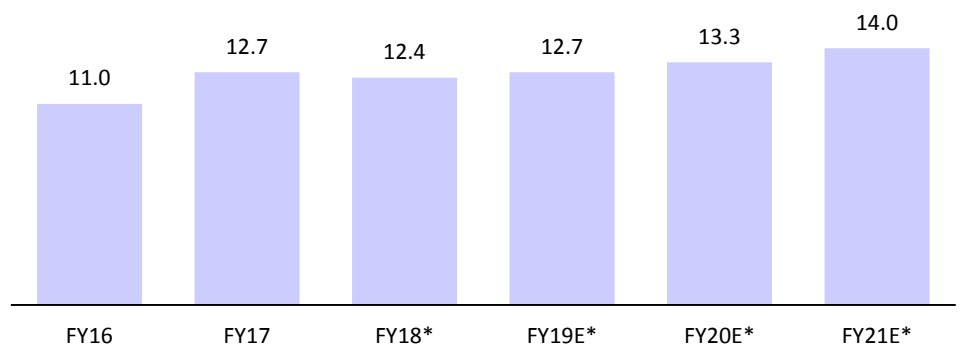
Source: MOFSL, Company

Exhibit 292: ...trend in Big Bazaar’s quarterly SSSG (%)...



Source: MOFSL, Company

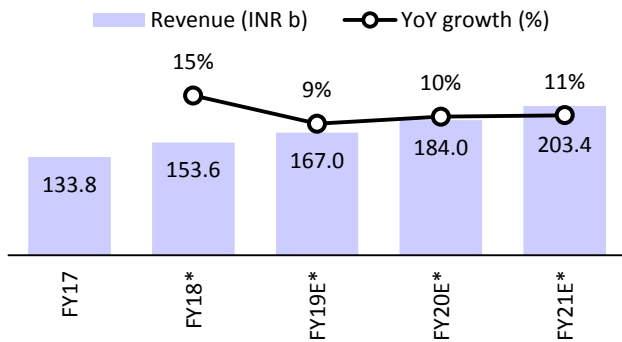
Exhibit 293: ...should drive productivity for large format stores (INR’000/sf)



*Includes Hypercity

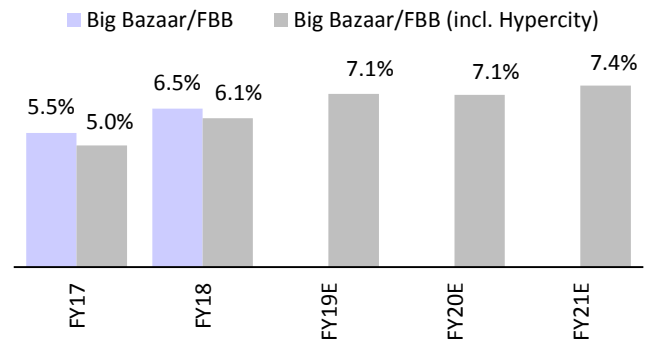
Source: MOFSL, Company

Exhibit 294: Total revenue for large format stores to grow at 10% CAGR over FY19-21 (INR b)



*Includes Hypercity (FY18 includes 4 months consolidation)
Source: MOFSL, Company

Exhibit 295: EBITDA margins for large format stores to expand 30bp over FY19-21 (%)



Source: MOFSL, Company



Gen Nxt Big Bazaar – A vibrant touch

With fast changing dynamics of the environment, FRL has introduced Big Bazaar as ‘Big Bazaar Gen Nxt’ to give consumers a futuristic shopping experience in terms of store look and feel. These Gen Nxt stores, spanning ~55ksf (against 42-45ksf for existing BB stores), designed to give customers a vibrant touch for which it has different flooring together with dynamic digital walls. There is a dedicated area to fashion, separating beauty and health. The Food Zone, unlike the traditional format, has an open kitchen. Most importantly, the store has a sit-down billing facility, the first of its kind.

Thus, a wider assortment coupled with much better shopping experience, should garner higher footfalls.



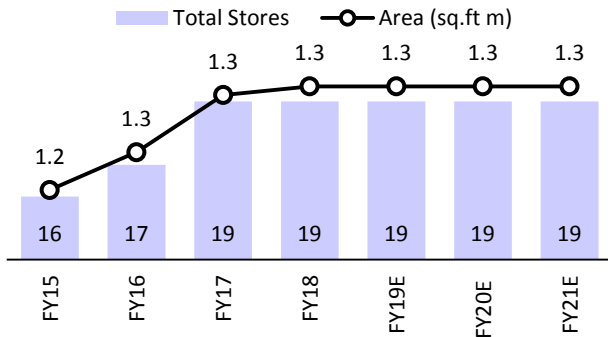
Hypercity - A good fit

- We expect Hypercity to remain profitable at store level, and garner 2%/4% margins in FY20/FY21 v/s -2% in FY19, primarily on the back of (1) higher contribution from fashion and (2) pruning of overheads cost (including DC cost, SGA and other cost).
- Acquired at an EV of INR9b (0.8x EV/sales), the 19 stores have a productivity of ~INR8k. Rebranding them Big Bazaar augurs well for FRL.

FRL’s acquisition of Hypercity, a loss-making business, from Shoppers Stop should complement its existing large format stores – Big Bazaar. Hypercity has turned EBITDA positive with 3.6% margin in 3QFY19 as against -20.2% in 4QFY18. However, operating at -2% EBITDA margin (FY19E), the turnaround should be significant by FY21, contributing 2% of overall EBITDA. We see significant cost-optimization potential, which should allow FRL to turn it to EBITDA breakeven for the full year FY20. This should come from three avenues: (a) increasing contribution of high-margin fashion products from 15% to Big Bazaar’s 35%, (b) reduction in corporate overheads – distribution center (DC) cost pulled down Hypercity’s store-level 1% EBITDA margin to 4% EBITDA loss at company level, and (c) sourcing benefits as well as high private label mix. Management targets 5-6% EBITDA margin in three years. We expect initial synergy gains, including a cut in DC cost and corporate overheads,

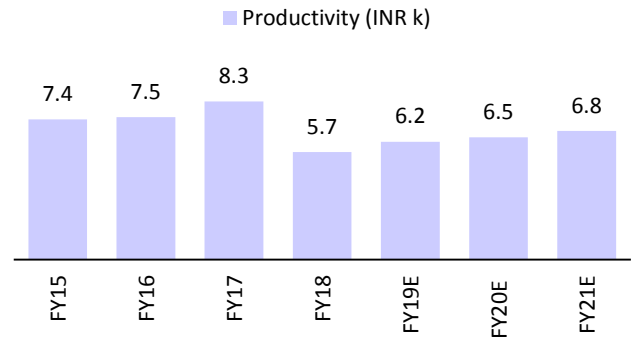
to allow improve the EBITDA margin from -15% in FY18 to -2% in FY19 and +4% by FY21.

Exhibit 296: Store network of Hypercity



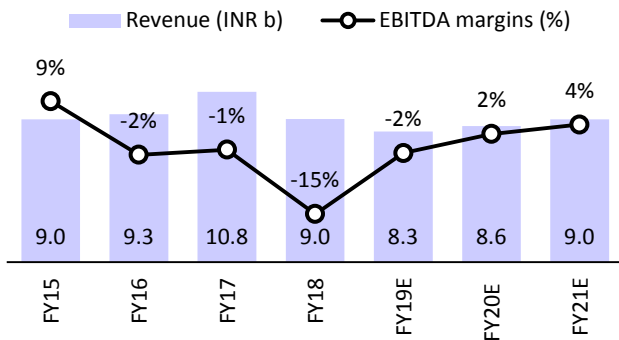
Source: MOFSL, Company

Exhibit 297: Hypercity 's productivity of should inch up gradually



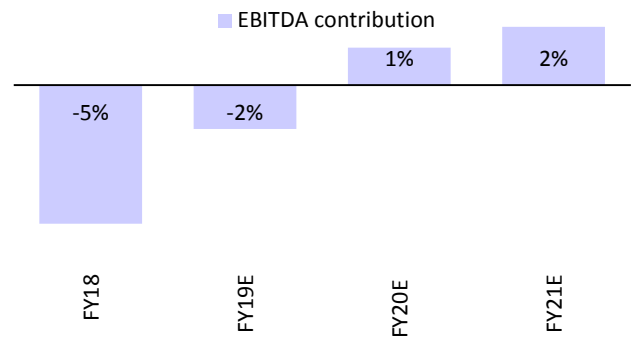
Annualized 4QFY18 productivity for FY18 Source: MOFSL, Company

Exhibit 298: Expect higher EBITDA margin for Hypercity... (%)



Source: MOFSL, Company

Exhibit 299: ...to increase its contribution in FRL's EBITDA (%)



Source: MOFSL, Company

Acquisition done at luring valuation

FRL acquired Hypercity at an EV of INR9b (equity of INR5b + debt of INR2.5b + cash of INR1.6b) or EV/sales of ~0.8x, issuing 9.3m shares @ INR537 (aggregating to INR5b). Adding an area of ~10% (1.4msf) to Big Bazaar's current retail space, we see FRL's acquisition of Hypercity as a good fit to its existing portfolio of hypermarket stores.

Exhibit 300: Enterprise value (EV) for Hypercity

Particulars	INR b
Equity (9.3m shares @ INR537)	5.0
Debt	2.6
Cash consideration	1.6
Enterprise value	9.1
Revenue (FY17)	10.8
EV/Sales (x)	0.8

Source: MOFSL, Company



EasyDay – Ready to take wheels

Robust store adds to propel growth

- Impeccable membership model and aggressive store addition plan (management plans to reach 4,000 store count in next 3-5 years) should drive 30% revenue CAGR over FY19-21E.
- Cluster based expansion plan should drive better store productivity, faster scalability and cost optimization.
- Expect EBITDA breakeven in FY20E, on the back of scale benefits and cost efficiencies. EBITDA margins should reach 2% by FY21 v/s -3% in FY19E.

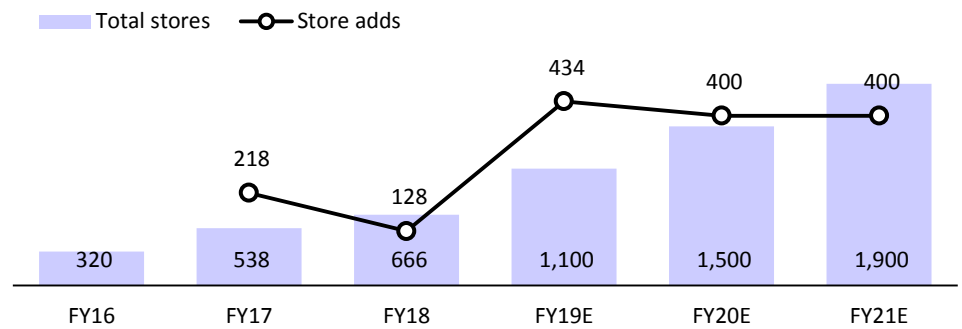
Acquired from Bharti Retail in FY16, Easyday, a small store (supermarket) format, contributes ~15% of FRL's total revenue (FY19E). It caters to the daily food and grocery needs of households. Thriving on the mantra of 'Pados ki Dukaan' (neighborhood store), it addresses consumers' need to get all their daily needs under one roof (rather than different local stores), particularly in locations where Big Bazaar's hypermarket store size may not be viable. FRL has 1,100 Easyday stores (FY19E) having an average size of ~2ksf (totaling 2.2msf), with a major presence in tier-I and tier-II cities. Easyday stores earn revenue of INR16.5k/sf.

Easyday – Going against the wind

Most retailers have given up on neighborhood stores model a.) Star is curtailing its Daily stores due to its weak store profitability b.) Spencer is restricting Daily stores in a cluster of its large stores to ensure low logistics and marketing costs. c.) FRL acquired Easyday (small format stores) from Bharti which failed to turn it around.

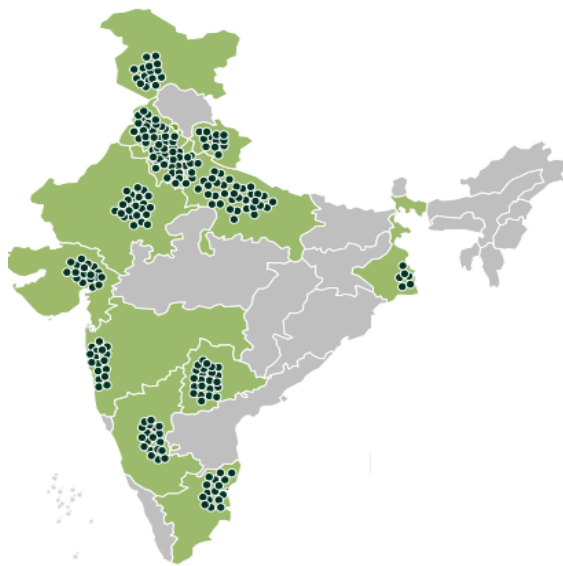
Low revenue traction as neighborhood mom and pop – *Kirana* stores have sticky consumers of delivery, trust, right pricing, quality of products. In order to penetrate the market Easyday plans to operate in clusters to reduce logistics cost, offer attractive pricing through membership program to get sticky customers, use analytics to restrict inventory days and offer flexibility of delivery/close proximity of stores. This should be possible only at a healthy scale to drive operating leverage. In the last three years, since its acquisition Easyday has added ~780 stores, generating revenue of INR31b and expected to grow at 30% CAGR over FY19-21E. We believe healthy scale along with its cluster-based approach and lucrative membership model should allow it to turn profitable in FY20 and garner 2% EBITDA margin in FY21.

Exhibit 301: Expect 1,900 small format stores by FY21



Source: MOFSL, Company

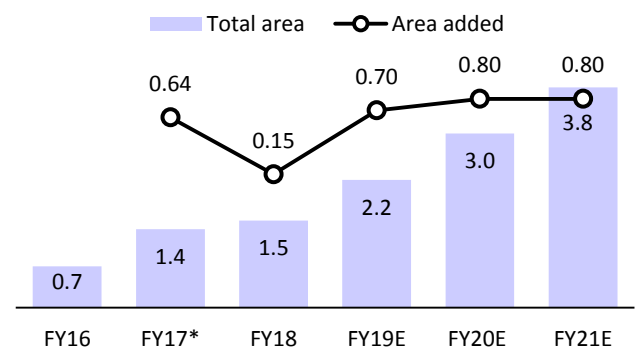
Exhibit 302: Geographical reach of Easyday



For FY18

Source: MOFSL, Company

Exhibit 303: Total area and area added under small format stores (msf)



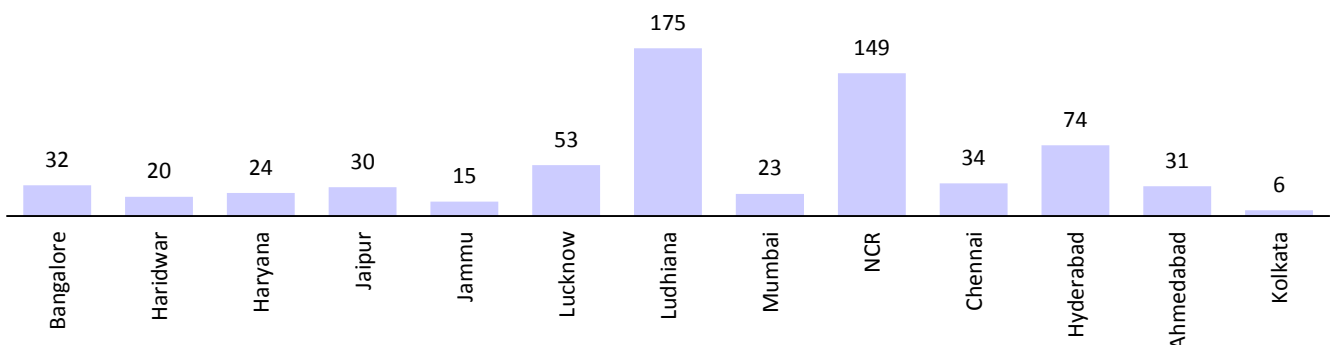
*Includes 136 stores of Heritage

Source: MOFSL, Company

Robust store additions with cluster approach

Operating in clusters of 150-200km radius allows higher store productivity, and optimization of inventory management and sales & distribution cost. Store replenishments get fulfilled within 2-3 days from a single warehouse, thus containing inventory days. This allows faster and smoother scalability of stores within a cluster. The cluster-based approach also allows customized offerings suited to the region. High store visibility across the cluster gets better customer loyalty.

Exhibit 304: Cluster-wise count of stores (FY18)

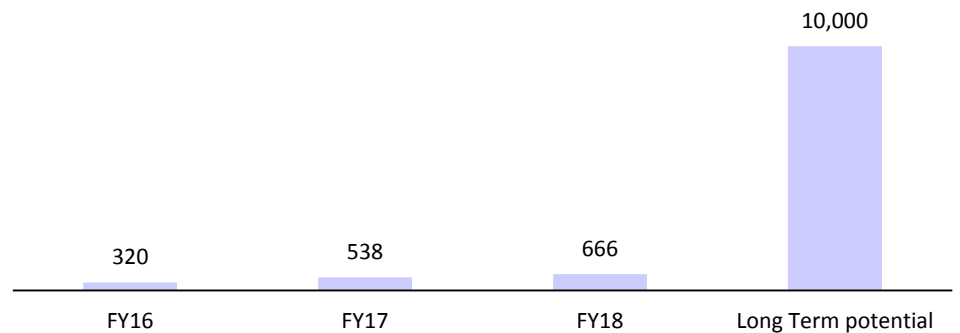


Source: MOFSL, Company

Aggressive growth targets

Small format stores have expanded from 320 stores in FY16 to 1,100 stores in FY19E through aggressive cluster-based addition and acquisition of Heritage’s 136 stores in AP. The management plans to expand aggressively in five years in a manner that stores are ~2km apart. Small format stores typically target areas with ~10k households. With less than ~INR2m capex/store, we believe the store count can be scaled up quickly without any major hurdle.

Exhibit 305: Management plans to reach 4,000 stores in 3-5 years and 10,000 in longer term



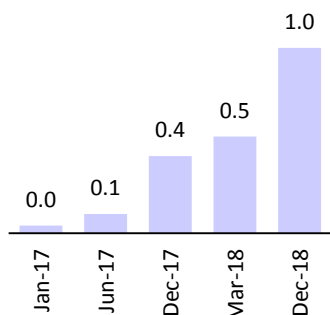
Source: MOFSL, Company



Membership-driven business model

Easyday stores operate on a robust membership model that contributes ~40% of the store revenue. Thriving on a membership-driven business model, Easyday Savings Club gives 10% discount on purchases up to INR50,000 annually at a membership charge of INR999. It also provides home delivery services and assured product quality in a category where quality adherence is weak.

Easyday Savings Club membership has multiplied ~2x in CY18 (m)



Source: MOFSL, Company

In 2019E, Easyday has an average of 920 members per store, up from ~750 members per store in one year. Assuming an average mid-income group household has consumption spends of INR40,000, each store should achieve INR36m revenue (900 members x INR40k). Besides, non-members could also contribute to the revenue. The management targets INR100m revenue/store, with at least 2,500 members spending INR40,000/sf on a 2,000sf store size. Increase in membership would be the key driver of high sales/sf and also gross margin.

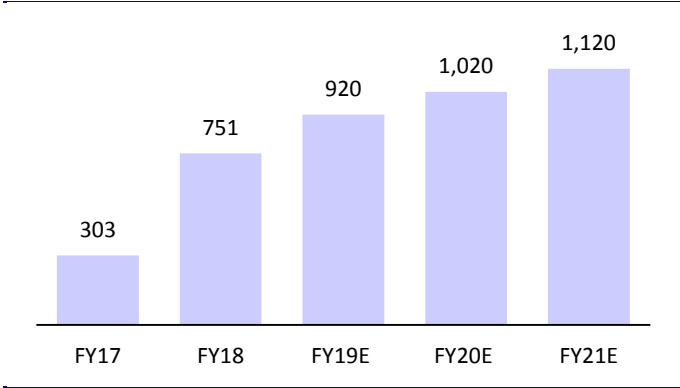
The membership model also provides customer data for analytics. This can be used to (a) understand product assortment and shelf space requirements, and (b) reduce supply chain time and cut costs through better procurement and sales strategy.

Exhibit 306: Per store economics as membership increases

Members	500	1,000	2,000	2,500
Sales/sf (INR)	14,000	28,000	57,000	71,000
Sales from members	10,000	20,000	40,000	50,000

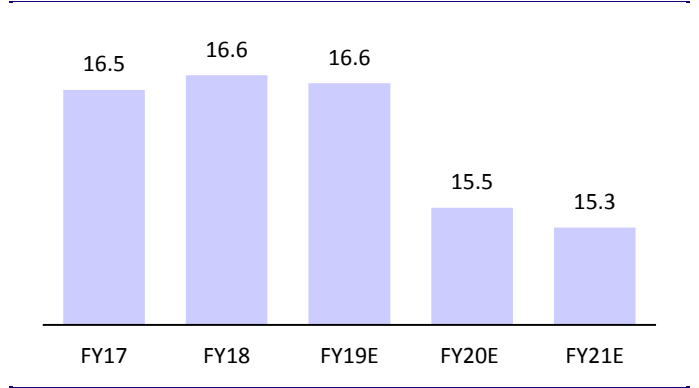
Source: MOFSL, Company

Exhibit 307: Expect healthy growth in avg. membership per store



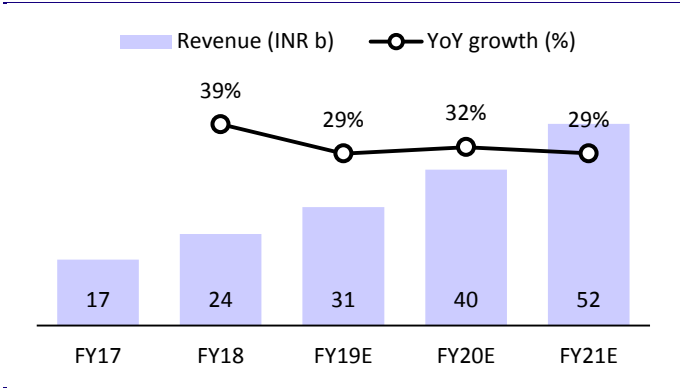
Source: MOFSL, Company

Exhibit 308: Robust area adds would mathematically result in lower productivity (INR'000/sf)



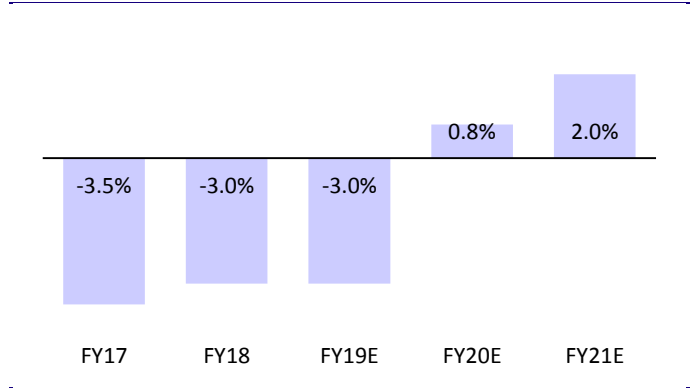
Source: MOFSL, Company

Exhibit 309: Expect 30% CAGR in small format stores revenue over FY19-21 (INR b)...



Source: MOFSL, Company

Exhibit 310: ...leading to spurt in EBITDA margin (%)



Source: MOFSL, Company

Ready to fire on all cylinders

Expect strong 13% revenue CAGR over FY19-21

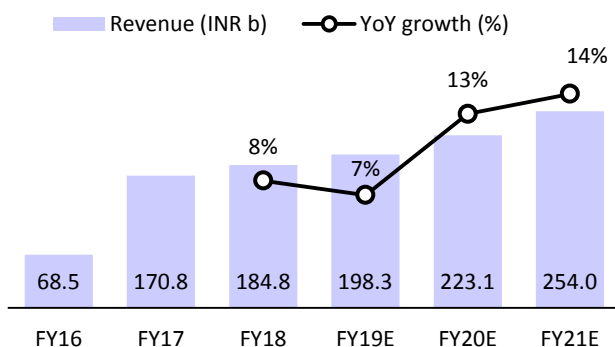
- We expect overall revenue to witness 13% CAGR over FY19-21 driven by healthy 9% SSSG (at large format stores) coupled with healthy 10% growth in membership per store (at small format stores) and robust new store addition plans.
- Increased share of private labels and fast break-even of EBITDA margins at Hypercity and Easyday stores should provide a fillip to the overall EBITDA margins. We expect EBITDA margins to expand ~80bp to 5.7% by FY21.

Robust revenue growth led by healthy SSSG and store adds

SSSG: We expect large format stores to grow at a CAGR of 11% over FY19-21, contributing 79% of total revenue, on the back of 9% SSSG and 25 new store additions. We expect a tapering off after strong SSSG of 13%/14%/13% in FY16/17/18. Small format stores should grow at a robust CAGR of 30%, its contribution increasing from the current ~15% to 20%. This is driven by a strong membership model, members/store expected to grow from ~920 to 1,120, which should result in INR15.3k revenue/sqft and INR31 revenue/store. We expect to contribute 4% EBITDA margin by FY21.

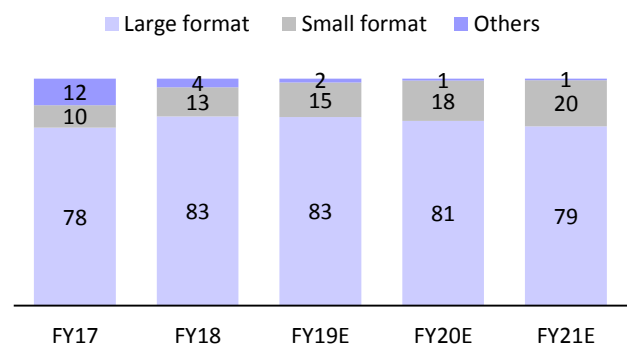
New store adds: The management targets to add about 1.3msf of store space annually, adding ~0.6m store area each for Hypermarket format – Big Bazaar and its small format – Easy Day. We expect addition of 15 Big Bazaar stores of an average size of ~40,000. Small format stores should add about 0.8m area at an average store size of 2,000sf, leading to about 400 store adds annually. So far the capex was done by FEL on lease basis, however, now with management endeavor to clean up the operating structure, the capex should be done by FRL. We have budgeted annual capex INR3.5b which should be easily manageable with estimated FCF of over INR4.8b annually.

Exhibit 311: Revenue to grow at 13% CAGR over FY19-21 (INR b)



Source: MOFSL, Company

Exhibit 312: Revenue contribution from small format stores to increase (%)



Source: MOFSL, Company

EBITDA margin to improve

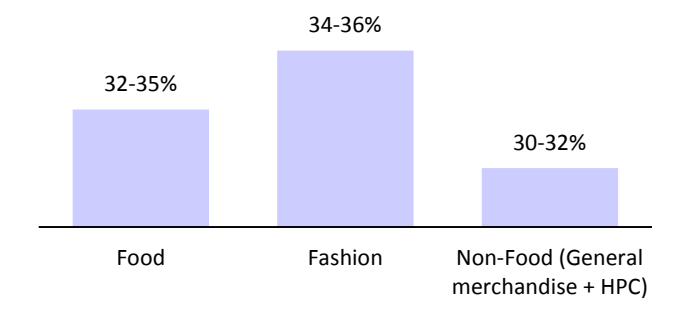
We expect overall EBITDA margin to expand ~80bp over FY19-21 to 5.7%, driven by improving margin contribution from Big Bazaar/FBB coupled with turnaround in

Easy day and Hypercity EBITDA margins. Consequently, we expect 22% EBITDA and 13% PAT CAGR over FY19-21.

Higher share of own brands – a key catalyst for margins

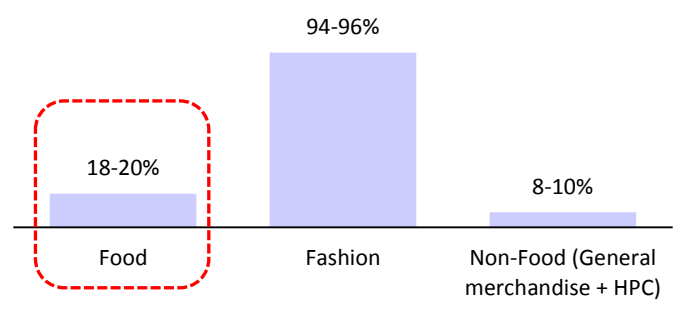
For a retail format, own brands remain a key catalyst for margins. Private labels help FRL garner 5-7% higher margins (overall for all categories). Private labels account for ~95% of its total fashion sales, the benefit of which is reflected in gross margins (40-42%). In food and groceries, private labels contribute only 18-20% while in general merchandise category, it accounts for meager 8-10%. FRL’s shelves constitute ~70% of Future Consumer’s channel mix (58% BB and 10-12% Easyday). Management targets to increase this share which should drive overall margins.

Exhibit 313: Food constituting one third of the revenue mix ... (%)



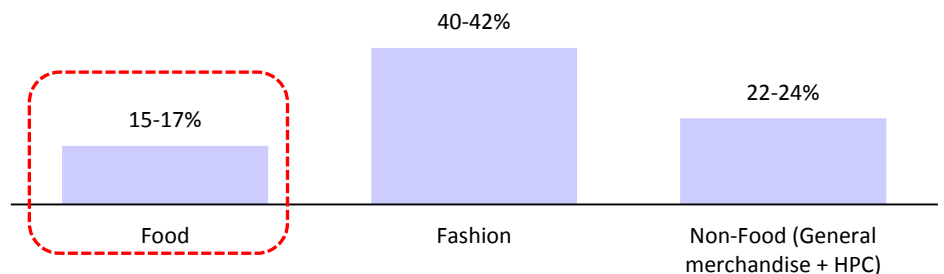
Source: MOFSL, Company

Exhibit 314: ...significant room for increasing share of pvt. labels in food and grocery (%)...



Source: MOFSL, Company

Exhibit 315: ...should help drive gross margins (%)



Source: MOFSL, Company

Favorable apparel mix, private labels and superior store productivity to improve BB/FBB margins

Presently, large format stores operate at ~26% gross margin and ~7.1% EBITDA margin (FY19E). Its EBITDA margin should improve, driven by (a) improving mix of apparel products, which enjoy 40% gross margin against 15% gross margin for food and grocery, (b) healthy SSSG growth, driving store productivity, and (c) higher contribution from private labels. The 20% gap between gross and EBITDA margin should shrink, with higher store productivity driving operating leverage.

Small format stores to gain from scale

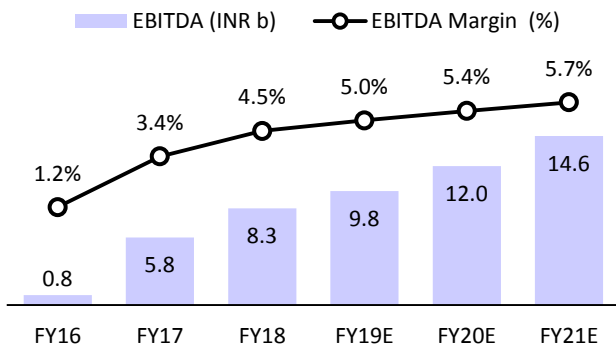
Currently, small format stores operate at sub-optimal level of INR35m revenue/store. Given its membership program’s strong value proposition and healthy growth, we expect small format stores revenue to grow at 30% CAGR over FY19-21. Its gross margin has expanded 70-80bp to ~16% and EBITDA margin has improved from -3.5% in FY17 to -3% (FY19E) on the back of improving productivity.

- **Cluster approach:** Easyday’s cluster approach should allow it to optimize SG&A and logistics cost, which should support margins.

Hypercity – a good fit

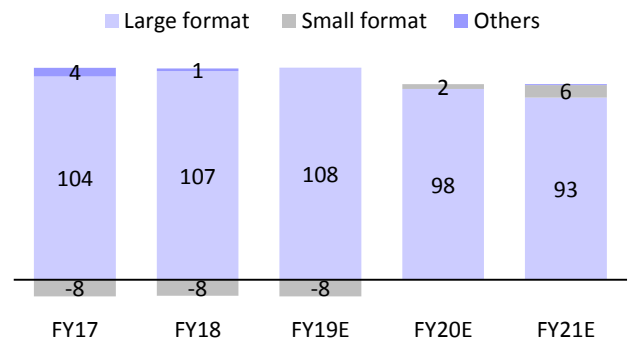
We expect Hypercity to garner 4% EBITDA margin by FY21 (v/s -2% FY19E), which should support overall EBITDA growth.

Exhibit 316: Overall EBITDA and margin to surge



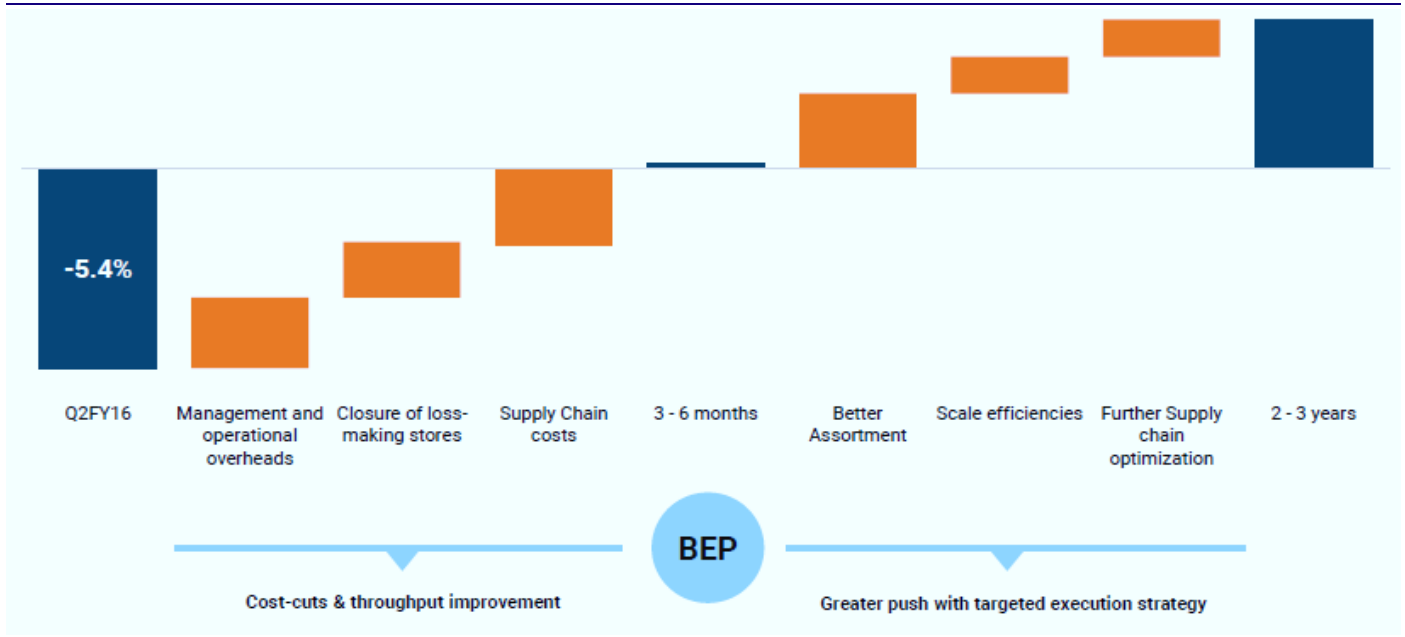
Source: MOFSL, Company

Exhibit 317: EBITDA contribution from small format stores to rise (%)



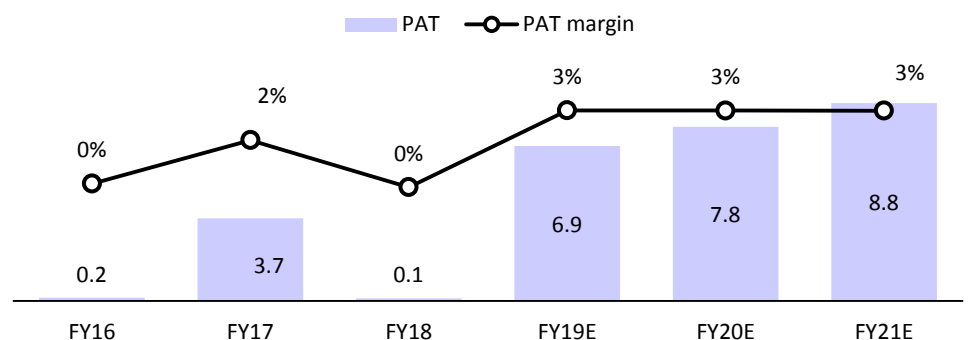
Source: MOFSL, Company

Exhibit 318: Easyday: Management’s closer to EBITDA break-even



Source: MOFSL, Company

Exhibit 319: PAT to witness 13% CAGR over FY19-21 (INR b)



Source: MOFSL, Company

Asset ownership structure under transition

FRL fixed assets sitting in FEL balance sheet to be reversed aided by promoter warrant issue

- FRL so far operated on lease based asset model with capex done by group company FEL, optimizing returns. However, it created an opaque asset structure.
- It now plans to reverse the structure through buy back of fixed assets worth INR40-45b from FEL, with the help of promoter warrant issue of INR20b.
- While this could put burden on return profile, it will clean up the asset ownership structure and yet garner over 13% ROCE and should further improve in the next 2-3 years.
- Strong EBITDA growth should lead to cumulative FCF of over INR6.5-7b annually over FY19-21, aiding to further prune down the gearing.
- Better assortment and vendor rationalization has assisted in trimming down the inventory days (on revenue basis) to ~88days (from the highs of 176 in FY16). We expect the inventory days to gradually come down to ~80 days over FY19-21.

Healthy store level profitability

Large format stores operate at an average 36,000sf size (BB: 45,000sf; FBB: 10,000sf). Total store-level investment is INR21m towards inventory, while capex is nil, as property as well as fit-outs are leased. With an average revenue of ~INR500m/store, it garners gross profit of INR125m/store (gross margin: 25%) and EBITDA of INR30m/store (gross margin: 6.1%) due to a healthy 35% contribution from apparel. Easyday, on the other hand, has an average store size of 2,000sf, with revenue of ~INR40m/store and gross profit of INR6m/store (15.5% gross margin). However, it has yet not turned EBITDA breakeven.

Factoring FRL's fixed assets sitting in the balance sheet of FEL, our workings indicate 12% ROCE as explained in exhibit 327.

Exhibit 320: Per store analysis for payback and RoCE (INR m)

	Large format store		Small format store	
	Per Store	Per Sq.ft	Per Store	Per Sq.ft
Capex	0	0	0	0
WC	21	608	-2	-535
Total	21	608	-2	-535
Breakeven (in years)	0.7	0.8	2.0	1.1
Revenue	499	12,414	39	16,632
Gross margin	125	3,099	6	2,578
Gross margin (%)	25.0%	25.0%	15.5%	15.5%
Other operating cost	94	2,341	7	3,077
EBITDA	30	758	-1	-499
EBITDA margin (%)	6.1%	6.1%	-3.0%	-3.0%
Depreciation	0	0	0	0
Depreciation rate (%)	6%	6%	6%	6%
EBIT	30	758	-1	-499
RoCE (Tax - 30%)	99.8%	87.2%	NM	NM

Source: MOFSL, Company

10% SSSG can drive 50bp margin improvement

With inherent high fixed cost, the retail business has strong operating leverage potential. This is evident from FRL's healthy gross margin of 26%, but low EBITDA margin of 6-8%, leaving a gap of 20% between gross and EBITDA margin. At present, ~20% of the total large format stores and ~50% of the total small format stores are less than two years old. Typically, the store takes 2-3 years to reach stable revenue and cost structure. We expect overall store productivity to improve, resulting in higher EBITDA margins. Typically, a 10% SSSG can drive ~50bp margin expansion in large format stores and small format stores, assuming 70% of the operating cost below gross profit remains fixed. FRL is well poised to witness a spurt in EBITDA margin, riding on the back of SSSG growth.

Exhibit 321: Scenario analysis on per store basis (INR m)

	Large format store		Small format store	
Revenue increases by	10%	20%	10%	20%
Revenue	549	599	43	47
Gross margin	137	149	7	7
Gross margin (%)	25.0%	25.0%	15.5%	15.5%
Fixed (%)	30%	30%	30%	30%
Fixed	28	28	2	2
Variable (%)	70%	70%	70%	70%
Variable	72	79	6	6
Other Operating Cost	101	107	8	8
EBITDA	36	42	-1	-1
EBITDA margin (%)	6.6%	7.0%	-2.5%	-2.1%
Change in bps	51	94	50	93
EBIT	36	42	-1	-1
Breakeven (in years)	0.6	0.5	2.2	2.4
RoCE	119.0%	138.2%	32.1	29.1%

Source: MOFSL, Company

Auto replenishment systems to improve supply chain

FRL has seen a strong improvement in inventory cycle over the last couple of years. In FY19, vendor rationalization and better assortment have kept inventory days stable at 88 days. FRL has put in place a real-time replenishment system, which generates replenishment supply orders based on customer purchases, enabling real-time auto procurement. This system optimizes the supply chain cycle and product assortment mix, steadily improving overall inventory days.

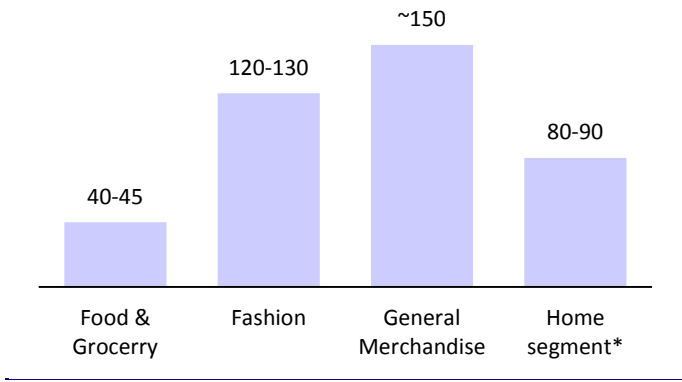
Inventory levels to come down further

Our workings indicate that FRL's product-wise inventory is as follows:

- Food and grocery: 40-45 days (9-10x churn)
- Fashion: 120-130 days (3x inventory churn)
- Home: 150 days
- General merchandise: 80-90 days

In the next 2-3 years, the management targets to reduce overall inventory days to 60-70 from the current 88, largely driven by reduction in fashion apparel inventory to 75-80 days.

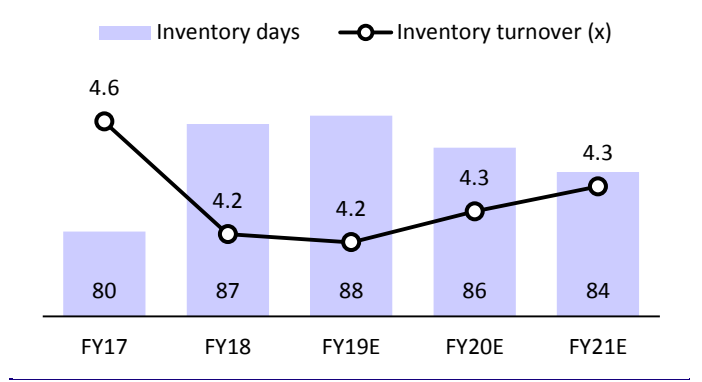
Exhibit 322: Segment-wise inventory (days)



*Now demerged

Source: MOFSL, Company

Exhibit 323: Inventory days to remain stable (days)



On Revenue basis

Source: MOFSL, Company

Intend to reverse FRL-FEL assets ownership structure

FRL leases store fit-out at 12.5% from group company, FEL

FRL has an asset-light business model – it leases the premises for its large and small format stores from the landlords/developers, and in-store fit-outs from its group company, Future Enterprises (FEL). FEL owns the store infrastructure, for which it receives lease rental income of ~INR7b (FY19E) from FRL. In FY19E, FRL’s total lease rental expenses were INR15b; while 50% were paid to FEL, we believe the balance 50% would have been paid to the landlords. For FEL, the rental yield works out to ~12.5% (assuming 90% of net block for infra lease), ~200bp over the market interest rate, which we believe is fair.

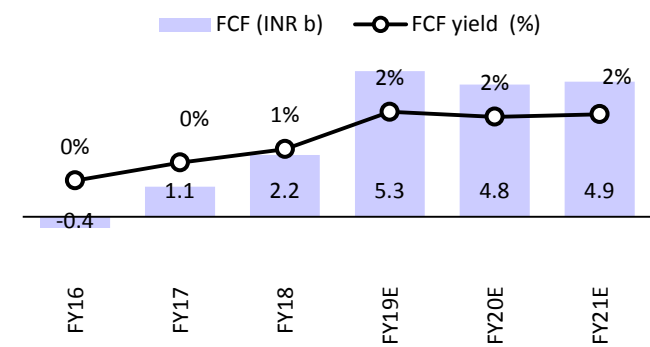
FEL in steady state to fund FRL’s capex

FRL plans to add store area of about 1.4msf annually for large and small format stores put together, which may require capex of about INR3.5b annually. FEL has annual internal cash flows after interest cost of INR4.5b (in FY17), which suffice for FRL’s capex. FEL has debt of INR52.9b, with net-debt-to-EBITDA of 5.2x, but it also holds stake in multiple Future Group companies, whose market value could be over INR40b presently and could reach over INR100b in the next three years. It targets to monetize these investments in the next few years. This should allow FEL to service its high debt without derailing FRL’s store addition plans.

Healthy RoIC and low debt to rerate the stock

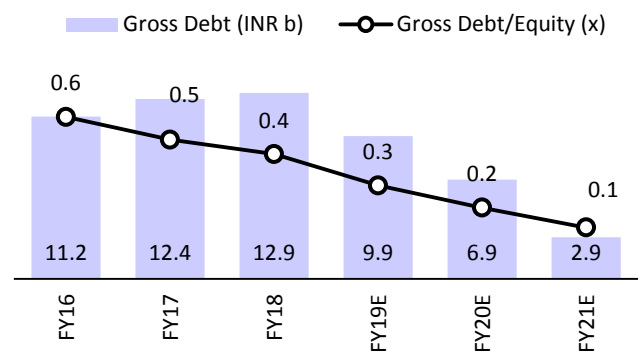
FRL’s steady revenue growth coupled margin improvement should enable it to grow its PAT at a CAGR of 13% over FY19-21. We expect RoE/RoCE to remain stable at 18%/17% and RoIC at 18% by FY21.

Exhibit 324: Increase in FCF...



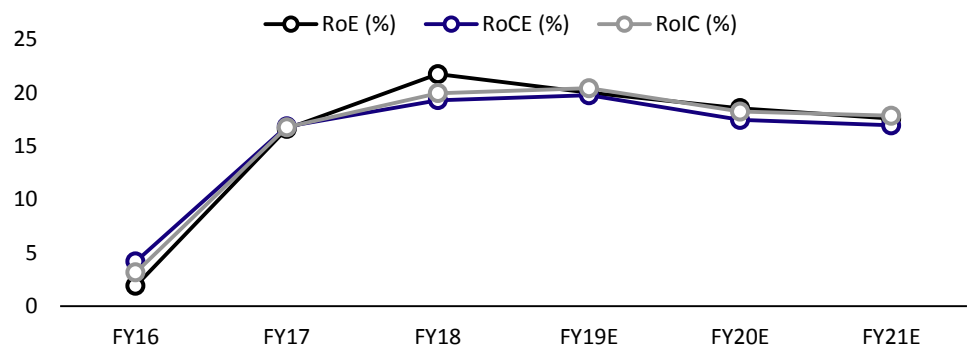
Source: MOFSL, Company

Exhibit 325: ...should lead to plunge in debt



Source: MOFSL, Company

Exhibit 326: Return ratios to surge



Source: MOFSL, Company

FRL’s interparty arrangements for competing businesses in group entities

FRL and FLF (Future Group companies) have similar and competing businesses within the group. FRL has multiple interparty arrangements with other promoter group companies i.e. FLF and Future Consumer Ltd (FCL) and Future Enterprise Ltd (FEL), and Future Supply Chain Ltd (FSCL).

This is evident from: (a) FRL’s 20-25% revenue in Food category (35% of BB revenue) comes from in-house brands including ‘Tasty Treat’ which is owned by Future Consumer Ltd – a promoter group company. (b) The arrangement is reverse in the case of FLF, to whom FRL sells private label brands like John Miller. (c) Both FRL and FLF compete in the apparel space - FRL targets the value fashion market through FBB, competing with FLF’s Central retail chain at the higher end and Brand Factory at the lower end. (d) FRL leases store fit-outs for Big Bazaar and Easyday outlets from group company FEL which owns the investment. (e) FRL engages with FSCL for its logistics and supply chain management.

We understand that most of the arrangements are at arm’s length. However, the multiple interparty arrangements and the nature of competing business in multiple promoter group companies have been a cause of concern for minority investors.

Recent promoter warrants issue to clean up FRL-FEL intercompany arrangements

FRL recently announced INR20b warrant issue to the promoter group. Management indicated that it will support in acquiring back FRL assets sitting in FEL balance sheet. We estimate that FRL has ~INR40-45b worth of assets sitting in FEL books on which it pays lease rentals of ~INR6.5b.

Apart from the INR20b warrant issue, we believe that FRL should be able to raise about INR20b from four other sources – (1) Claw back gains from the FRL share sale by Bharti received against the sale of Easyday should help garner ~INR9.8b. Out of the total 46.3m shares, 30.3m shares are already sold generating INR6.4b, while the rest 10.3m could garner additional INR3.4b. (2) Potential claw back gains from FRL share sale given for Heritage Foods acquisition could fetch INR2.6b. (3) FEL also holds advances of INR5.6b against the FRL assets held, which could be nullified. (4) FRL holds cash of INR2b which should also grow by about INR5-7b in the next four quarters. This should provide FRL with enough wherewithal to complete the release of intercompany holdings with FEL.

Exhibit 327: Sources of funds for FRL

Particulars	INR b
Cash/Bank balance as on Sept-18	2.0
Equity Infusion by promoters	20.0
Advances pending to be received from FEL	5.6
Gains to FRL from shares sold by BRL	6.4
Potential gains from unsold shares with BRL	3.4
Potential gains from unsold shares with Heritage	2.6
Total balance	40.0

Source: MOFSL, Company

Transaction is EPS accretive with healthy return profile

The move to acquire assets sitting in FEL balance sheet should reduce ROCE optically, as FRL's asset base will increase. However, we believe that (a) this should be EPS accretive with FY19 adjusted EPS (diluted) about 25% higher at INR17.1 as FRL will save INR6.5b lease yield (15% lease yield). This is higher than management's indication of 12-13% yield as the value of assets has reduced due to the annual depreciation charge, (b) adjusted ROCE of 12% after clearing the intercompany holdings is better than 20% without the same, as it creates a transparent business structure mapping assets against earnings (even investors focus on business ROCE instead of company level ROCE generated merely by shifting assets to other entities).

Exhibit 328: Working for adj. RoCE (INR m)

Particulars	FY18	FY19E	FY20E	FY21E
Revenue	1,84,780	1,98,252	2,23,098	2,53,963
COGS	1,37,407	1,45,120	1,63,308	1,85,393
Gross Profit	47,373	53,132	59,790	68,570
Gross Margin (%)	26%	27%	27%	27%
Employee cost	9,300	10,805	12,270	13,968
Adj. Rental expenses	7,553	7,898	8,538	9,929
Other expenses	15,697	17,585	19,410	21,841
Adj. EBITDA	14,823	16,844	19,573	22,832
Adj. EBITDA margin (%)	8%	8%	9%	9%
Adj. Depreciation	4,784	5,591	6,295	7,048
Adj. EBIT	10,039	11,253	13,278	15,784
Adj. EBIT margin (%)	5%	6%	6%	6%
Net Interest cost/(income)	1,637	1,984	1,080	555
Tax rate	0%	0%	20%	30%
Tax	-	-	1,939	3,772
Adj PAT	8,402	9,269	10,260	11,457
Current PAT	6,152	6,899	7,755	8,802
No of diluted shares	502	542	542	542
Adj diluted EPS	16.7	17.1	18.9	21.1
EPS	0.23	13.7	15.43	17.51
Adj. RoCE	11%	12%	11%	10%
Current RoCE	19%	20%	17%	17%

Source: MOFSL, Company

Limited synergies led to Home Town's exit

Home Town offers home-making solutions under one roof. These include furniture, furnishings, home improvement products, tableware/kitchenware, and décor-related products. As at the end of FY17, it had 37 standalone stores across 22 cities. However, given its specialty business model vis-à-vis pure retail business models of BB/FBB and Easyday coupled with differing fundamentals of supply chain, logistics, and warehouses, there were limited similarities. Also, inventory days for Home Town stood at ~150, stretching overall working capital. The management decided to demerge the business from FRL in August 2017. It intends to consolidate the home retail business' offline (FRL) and online (BSPL) segments under a new entity, PHRPL. The demerger of Home Town would help rationalize FRL's overall working capital.

Valuation and View

Recommend Buy with TP of INR580

- We recommend Buy on FRL with a target price of INR580, valuing the stock at 20x (at three-year average) FY21E EBITDA of INR15b.
- At CMP, the stock is valued at EV/EBITDA and P/E of 15x and 26x on FY21E. This is ~50% discount to D-Mart. We believe, with growth levers in place and return ratios set to take off, the valuation gap should reduce.

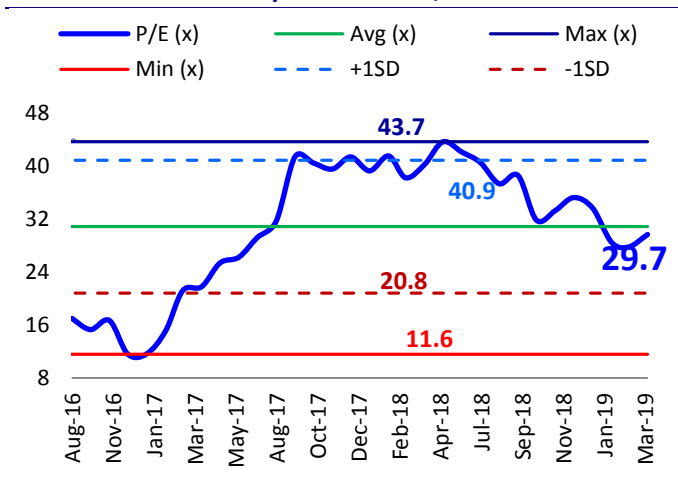
FRL is valued at 26x FY21E EPS and at an EV of 15x FY21E EBITDA. We have valued FRL at 20x (at three-year average, ~30% discount to DMART’s target multiple) on FY21E EBITDA of INR15b, deriving an EV of INR291b. Subsequently, we arrive at a TP of INR580, recommending **Buy** with 30% upside. This values the stock at implied P/E of 33x and PEG of about 2.6x.

Exhibit 329: Valuation based on FY21E EBITDA

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR b)	Value/share (INR)
EBITDA	FY21 EV/EBITDA	15	20	295	588
Less Net debt				4	8
Total Value				291	580
Shares o/s (m)				502	
CMP (INR)					447
Upside (%)					30

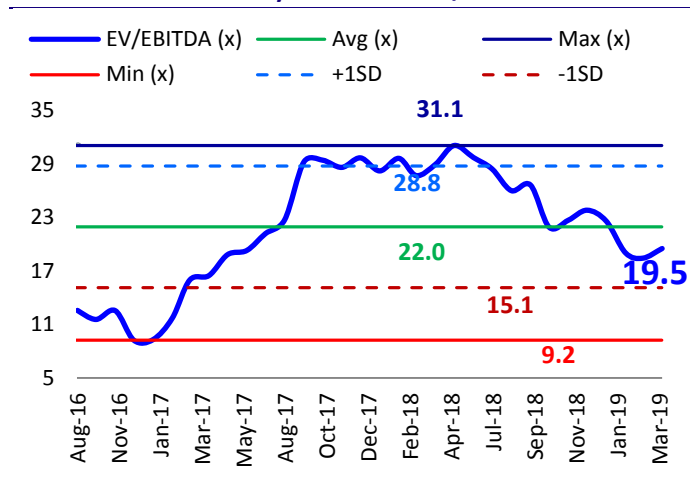
Source: MOFSL, Company

Exhibit 330: FRETAIL: 1-year forward P/E band



Source: Bloomberg, MOFSL

Exhibit 331: FRETAIL: 1-year forward EV/EBITDA band



Source: Bloomberg, MOFSL

Valued at ~50% discount to D-Mart

FRL continues to trade at ~50% discount to D-mart even as FRL is expected to deliver PAT CAGR of 13% over FY19-21. Given FRL’s healthy earnings growth, strong balance sheet, and return ratios of ~18%, we believe the valuation gap between D-Mart and FRL should reduce over time.

High earnings growth, improving margins and growing FCF to support valuations

FRL should command healthy valuation multiples, given the robust revenue/PAT CAGR potential of 13%/13% over FY19-21. The company has a strong track record of ~9% overall SSSG over the last 3-4 years; we have factored an average of 7% for the next two years. FRL plans to add 1.4-1.5msf annually, which should be easily achieved and provide a healthy 10% growth in store area. EBITDA margin should expand 80bp over FY19-21, backed by favorable mix of apparel and private labels, turnaround of Easyday, and scale benefits, driving EBITDA CAGR of 22%.

FRL should garner healthy RoCE/RoE of over 12% consistently, even assuming buyback of FEL assets. With FCF generation of INR5.3b in FY19E, FRL should continue to grow FCF on the back of healthy operating cash flow and low capex requirements.

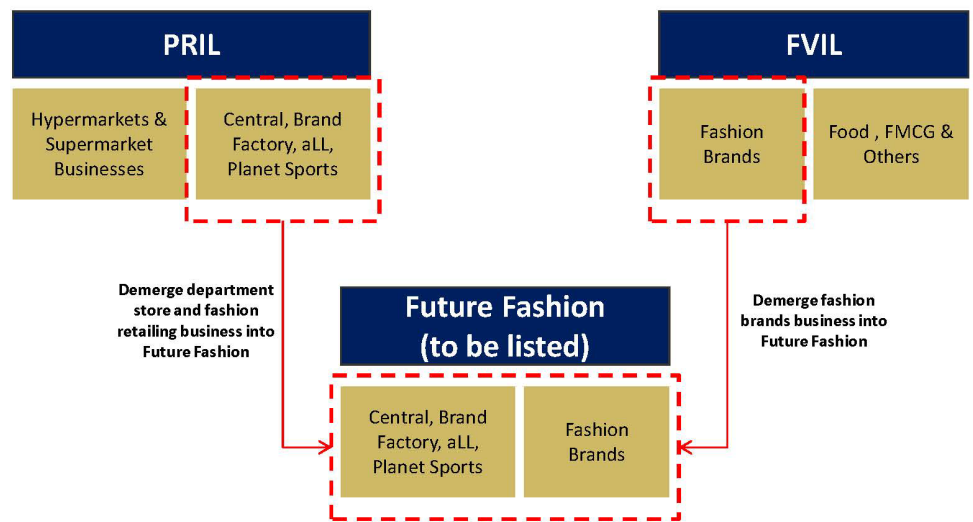
Previous concerns of aggressive growth through high leverage have been mitigated with its measured growth approach, limiting the risk of a bloated asset base and high leverage.

Pantaloons Retail restructured

In the last five years, to streamline its business operations of food, fashion and infrastructure, the Future Group has carried out a number of restructuring and M&A transactions. We outline the entire rejig into three phases:

Phase 1: Demerger of Pantaloons Retail India and Future Ventures’ fashion segment

Exhibit 332: PRIL & FVIL demerging fashion segment into Future Lifestyle Fashion



Source: MOFSL, Company

Pantaloons Retail India (PRIL) operated in two segments: (1) retail segment through Big Bazaar, etc., and (2) fashion segment via Central, Brand Factory, etc. Future Ventures India (FVIL) was involved in: (1) manufacturing of food and FMCG products through various brands such as Tasty Treat, etc., and (2) fashion apparel brands including Lee Cooper, Scullers, Indigo Nation, etc. To bring the fashion business under one roof, the management demerged the fashion segment from both PRIL and FVIL into a new entity, Future Fashion (FLF) with a share swap ratio of 1:3 for every share holder of PRIL and 1:31 for FVIL.

Post restructuring, PRIL (including FBB and operating only in the retail segment) was renamed Future Retail. FVIL (operating only in the food and FMCG products segment) is now Future Consumer. FLF operates in fashion (brands + retail).

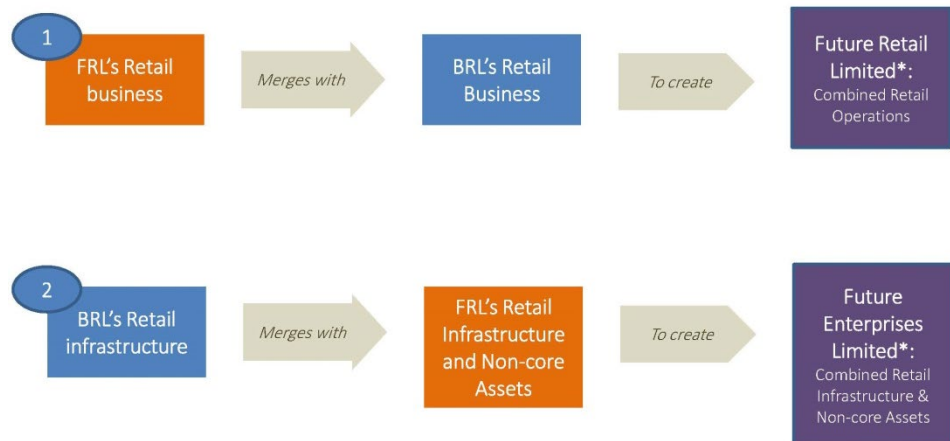
Exhibit 333: Company-wise business post transaction

PRIL (Listed)	FVIL (Listed)	Future Fashion (New Entity to be Listed)
Value Retail (Core Business)	Food & FMCG Brands	Fashion Retail Formats
Big Bazaar	Tasty Treat, Fresh n Pure, Premium Harvest, Cleanmate, Caremate, Sach, Poonya, Sangi's Kitchen, Think Skin & Ekta	Central
Fashion@ Big Bazaar		Brand Factory
Food Bazaar & Food Hall		Planet Sports
Other Formats	Distribution	aLL
Home Town	KB's Fair Price	Brands
eZone	Big Apple	Indus League (John Miller, Indigo Nation, Scullers, Urban Yoga, Urbana, Jealous 21, Lee Cooper, Manchester United, Daniel Hechter, Privileged Club)
Other Investments	Aadhaar	Sourcing & Distribution Business
Future Supply Chain, Future Agrovet, Future Ecommerce, Future Generali Insurance (Life & Non Life), Staples, Goldmohur & Apollo NTC Mills JV	Other Investments	Other Investments
	Capital Foods (Ching's Secrets, Smith & Jones, Raji)	Celio, Holii, Indus Tree, Clarks, Turtle, AND, BIBA
	Integrated Food Park	
	Amar Chitra Katha, Star & Sitara	

Source: MOFSL, Company

Phase 2: Merger of Bharti Retail and Future Retail

Exhibit 334: Retail segments of BRL and FRL get housed under Future Retail (erstwhile BRL)...

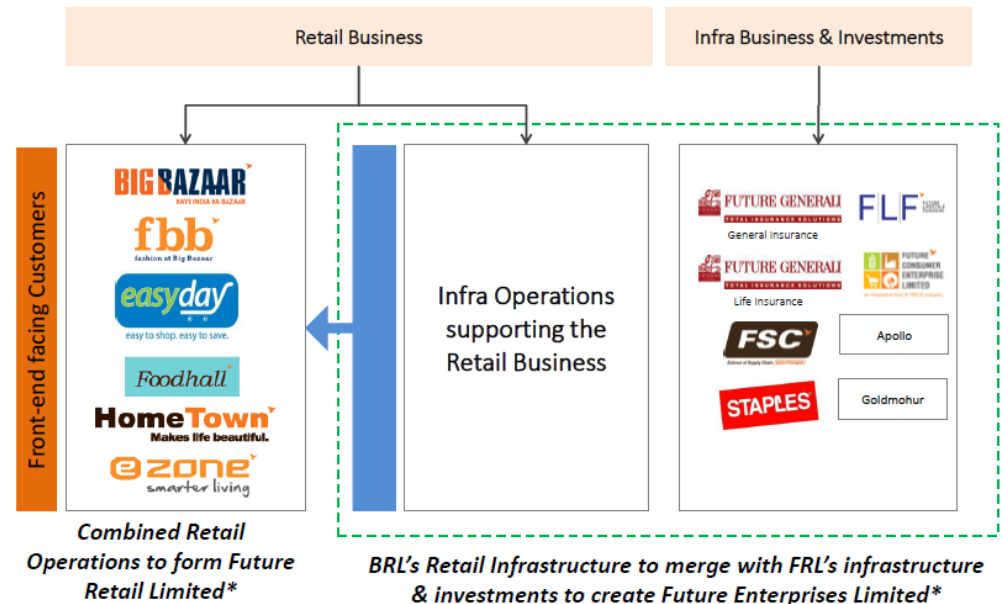


Source: MOFSL, Company

In a bid to expand its retail presence and form a pure play retail organization, in 2015, Future Retail (operating Big Bazaar, Food Bazaar, etc) acquired Bharti Retail (operating Easyday). The transaction was structured as follows: (a) FRL moved its retail business into Bharti Retail (BRL), and simultaneously, (b) BRL moved its retail infrastructure business into FRL. BRL turned into a pure play retail organization, which was later renamed as FRL, whereas the erstwhile FRL (retail infrastructure and non-core assets) was renamed as Future Enterprise (FEL). Post this leg, FRL acquired 16 hypermarket stores (re-branded as Big Bazaar) and ~187 small stores (Easyday).

With a share swap ratio of 1:1, Bharti retained 9.2% holding in both FRL and received 9.2% shareholding in FEL with 43.4m shares. BRL (now FRL) was valued at an EV/Sales ratio of 0.4x.

Exhibit 335: ...while retail infrastructure segments of BRL and FRL get housed under Future Enterprise (erstwhile FRL)



Source: MOFSL, Company

However, the key thing to note in the contours was the agreed claw back provision by the erstwhile BRL shareholders (along with the OCD holders), which should generate total INR10b for FRL and FEL, out of which FRL should retain over INR9.5b on the basis of its market cap weightage.

Exhibit 336: Contours of claw-back provision

Sale Proceeds	Sharing Ratio	FRL's share
INR9.5 – 14.5b	50% of the amount above INR 9.5b	50% of INR5b = INR2.5b
INR14.5 – 19.5b	60% of the amount above INR 14.5b	60% of INR5b = INR 3b
Above INR19.5b	75% of the amount above INR 19.5b	75% of INR6b = INR4.5b

Source: MOFSL, Company

Phase 3: M&A of Heritage foods and Hypercity

Acquired in 2016 for a consideration of 17.8m shares, the retail business of Heritage Foods was valued at an EV of ~INR3b. FRL got 136 Heritage Foods stores (rebranded as Easyday) and a wider footprint in southern India. However, similar to the previous (Bharti-FRL) merger, this deal too had the following clawback provision:

Exhibit 337: Contours of clawback provision

Sale Proceeds	Sharing Ratio
INR4–5b	50% of the amount above INR4b
Above INR5b	75% of the amount above INR5b in addition to above

Source: MOFSL, Company

Financials and valuations

Standalone - Income Statement

(INR M)

Y/E March	FY16	FY17	FY18	FY19E*	FY20E*	FY21E*
Total Income from Operations	68,451	1,70,751	1,84,780	1,98,252	2,23,098	2,53,963
Change (%)	262.1	149.4	8.2	7.3	12.5	13.8
Raw Materials	50,651	1,28,344	1,37,407	1,45,120	1,63,308	1,85,393
Employees Cost	3,285	8,034	9,300	10,805	12,270	13,968
Rent expenses	6,043	13,595	14,053	14,918	16,143	18,184
Other Expenses	7,638	14,965	15,697	17,585	19,410	21,841
Total Expenditure	67,618	1,64,938	1,76,457	1,88,428	2,11,130	2,39,386
% of Sales	98.8	96.6	95.5	95.0	94.6	94.3
EBITDA	834	5,813	8,323	9,824	11,968	14,577
Margin (%)	1.2	3.4	4.5	5.0	5.4	5.7
Depreciation	368	326	534	941	1,195	1,448
EBIT	466	5,487	7,789	8,883	10,773	13,129
Int. and Finance Charges	498	2,042	1,754	2,159	1,255	730
Other Income	182	238	117	175	175	175
PBT bef. EO Exp.	151	3,683	6,152	6,899	9,694	12,574
EO Items	0	0	-6,039	0	0	0
PBT after EO Exp.	151	3,683	113	6,899	9,694	12,574
Total Tax	0	0	0	0	1,939	3,772
Tax Rate (%)	0.0	0.0	0.0	0.0	20.0	30.0
Minority Interest	0	0	0	0	0	0
Reported PAT	151	3,683	113	6,899	7,755	8,802
Adjusted PAT	151	3,683	6,152	6,899	7,755	8,802
Change (%)	-104.0	2,340.6	67.0	12.2	12.4	13.5
Margin (%)	0.2	2.2	3.3	3.5	3.5	3.5

Standalone - Balance Sheet

(INR M)

Y/E March	FY16	FY17	FY18	FY19E*	FY20E*	FY21E*
Equity Share Capital	87	944	1,004	1,004	1,004	1,004
Eq. Share Warrants & App. Money	0	0	0	0	0	0
Total Reserves	18,653	24,593	29,959	36,858	44,613	53,415
Net Worth	18,740	25,537	30,963	37,862	45,617	54,419
Total Loans	11,224	12,441	12,864	9,864	6,864	2,864
Deferred Tax Liabilities	0	0	0	0	0	0
Capital Employed	29,964	37,978	43,827	47,726	52,481	57,283
Gross Block	2,791	6,045	11,227	14,727	18,227	21,727
Less: Accum. Deprn.	181	507	1,041	1,982	3,177	4,625
Net Fixed Assets	2,609	5,538	10,186	12,745	15,050	17,102
Capital WIP	0	119	336	336	336	336
Total Investments	0	0	0	0	0	0
Curr. Assets, Loans & Adv.	53,245	63,719	71,423	75,953	83,380	92,325
Inventory	32,972	37,352	44,174	47,711	52,348	58,412
Account Receivables	1,149	2,281	2,701	2,716	3,056	3,479
Cash and Bank Balance	895	1,560	1,832	2,171	2,915	3,298
Loans and Advances	18,229	22,526	22,716	23,356	25,060	27,136
Curr. Liability & Prov.	25,891	31,397	38,118	41,308	46,285	52,479
Account Payables	22,085	27,800	34,242	37,169	41,648	47,221
Other Current Liabilities	3,737	3,541	3,836	4,096	4,590	5,204
Provisions	69	57	40	42	48	54
Net Current Assets	27,354	32,322	33,305	34,646	37,095	39,845
Appl. of Funds	29,964	37,978	43,827	47,726	52,481	57,283

*Consolidated; E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY16	FY17	FY18	FY19E*	FY20E*	FY21E*
Basic (INR)						
EPS	0.3	7.3	12.3	13.7	15.4	17.5
Cash EPS	1.0	8.0	13.3	15.6	17.8	20.4
BV/Share	37.3	50.9	61.7	75.4	90.9	108.4
DPS	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)						
P/E		61.0	36.5	32.5	28.9	25.5
Cash P/E		56.0	33.6	28.6	25.1	21.9
P/BV		8.8	7.2	5.9	4.9	4.1
EV/Sales		1.4	1.3	1.2	1.0	0.9
EV/EBITDA		40.5	28.3	23.6	19.1	15.4
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-0.8	2.2	4.5	10.6	9.6	9.8
Return Ratios (%)						
RoE	1.9	16.6	21.8	20.0	18.6	17.6
RoCE	4.2	16.9	19.3	19.8	17.5	17.0
RoIC	3.2	16.8	20.0	20.5	18.3	17.9
Working Capital Ratios						
Fixed Asset Turnover (x)	24.5	28.2	16.5	13.5	12.2	11.7
Asset Turnover (x)	2.3	4.5	4.2	4.2	4.3	4.4
Inventory (Days)	176	80	87	88	86	84
Debtor (Days)	6	5	5	5	5	5
Creditor (Days)	118	59	68	68	68	68
Leverage Ratio (x)						
Current Ratio	2.1	2.0	1.9	1.8	1.8	1.8
Interest Cover Ratio	0.9	2.7	4.4	4.1	8.6	18.0
Net Debt/Equity	0.6	0.4	0.4	0.2	0.1	0.0

Standalone - Cash Flow Statement

(INR M)

Y/E March	FY16	FY17	FY18	FY19E*	FY20E*	FY21E*
OP/(Loss) before Tax	151	3,683	113	6,899	9,694	12,574
Depreciation	368	326	534	941	1,195	1,448
Interest & Finance Charges	498	2,042	1,754	2,159	1,255	730
Direct Taxes Paid	-46	-81	-154	0	-1,939	-3,772
(Inc)/Dec in WC	1,680	-3,998	-2,265	-1,001	-1,705	-2,367
CF from Operations	2,650	1,973	-18	8,998	8,499	8,612
Others	-30	-3	6,023	-175	-175	-175
CF from Operating incl EO	2,620	1,970	6,006	8,823	8,324	8,437
(Inc)/Dec in FA	-3,032	-870	-3,759	-3,500	-3,500	-3,500
Free Cash Flow	-412	1,100	2,247	5,323	4,824	4,937
(Pur)/Sale of Investments	0	0	-1,039	0	0	0
Others	1,337	450	644	571	571	571
CF from Investments	-1,695	-421	-4,153	-2,928	-2,929	-2,929
Issue of Shares	1,881	64	1,484	0	0	0
Inc/(Dec) in Debt	-1,497	1,094	-1,035	-3,000	-3,000	-4,000
Interest Paid	-498	-2,042	-1,754	-2,159	-1,255	-730
Dividend Paid	0	0	0	0	0	0
Others	0	0	0	0	0	0
CF from Fin. Activity	-113	-884	-1,305	-5,159	-4,255	-4,730
Inc/Dec of Cash	812	666	548	735	1,141	779
Opening Balance	83	895	1,285	1,436	1,775	2,519
Closing Balance	895	1,560	1,832	2,171	2,915	3,298

*Consolidated; E: MOSL Estimates

Shoppers Stop

BSE SENSEX
38,862S&P CNX
11,666

CMP: INR458

TP: INR520 (+13%)

Neutral

SHOPPERS STOP

Stock Info

Bloomberg	SHOP IN
Equity Shares (m)	88
M.Cap.(INRb)/(USDb)	40.9 / 0.6
52-Week Range (INR)	690 / 450
1, 6, 12 Rel. Per (%)	-12/-20/-25
12M Avg Val (INR M)	43
Free float (%)	36.3

Financials Snapshot (INR b)

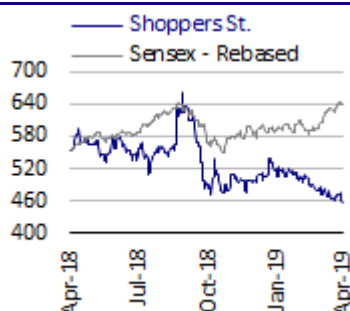
Y/E	MARCH	FY19E	FY20E	FY21E
Sales	36.4	39.9	43.6	
EBITDA	2.4	2.9	3.4	
NP	0.8	1.1	1.4	
EPS (INR)	9.9	13.3	16.6	
EPS Gr. (%)	-19.1	34.6	24.7	
BV/Sh. (INR)	118.2	131.5	148.1	
P/E (x)	46.4	34.5	27.6	
P/BV (x)	3.9	3.5	3.1	
EV/EBITDA (x)	16.7	13.9	11.4	
EV/Sales (x)	1.1	1.0	0.9	
RoE (%)	8.7	10.7	11.9	
RoCE (%)	8.6	10.3	11.6	

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	63.7	63.7	63.7
DII	12.9	12.5	14.8
FII	11.8	11.9	8.0
Others	11.7	12.0	13.5

FII Includes depository receipts

Stock Performance (1-year)



Earnings revival in place

SSSG, store adds and private label share improving

- Shoppers Stop witnessed muted SSSG and earnings growth over FY16-18 owing to slow pace of new store adds, a drop in the share of private labels and loss-making non-core business. However, rationalization of stores, thrust on core business and rejig of private label brands should revive growth trajectory, going forward.
- Management targets 20 store adds (Shoppers stop + beauty) annually, high-single-digit SSSG and 100bp margin improvement from hive-off of loss-making biz, increasing private label share (albeit slow) and operating leverage from SSSG.
- We have modeled 6% SSSG and 100bp EBITDA margin expansion over FY19-21 from modest four Shoppers Stop stores adds per year, estimating consolidated revenue/EBITDA/PAT growth of 9%/18%/30% over FY19-21.
- Yet we believe, branded apparel retailers are facing pressure from ecommerce, evident from modest 5% annual footprint add and plateauing footfalls. Thus, we value Shoppers Stop at 13x (~40% discount to target EV/EBITDA multiple of our apparel coverage) FY21E EV/EBITDA and Crosswords at 1x FY21 EV/sales.
- We recommend Neutral with an SOTP-based TP of INR520, implying EV of 13x on FY21 EBITDA, at 20% discount to three-year average.

Focus reverting to growth

Over the last three years, Shoppers Stop posted weak growth, with meager SSSG and store adds, as it was (a) consolidating stores which were added aggressively over FY11-14, (b) lowering leverage and (c) witnessing slow pace of mall development. We expect growth to revive, as these issues are now behind. We expect four Shoppers Stop store adds and 15 Beauty store adds annually in FY20/21 (management target of cumulative 20 store adds annually). This should also help revive SSSG, which had tapered due to a large proportion of mature stores, demonetization/GST issues, and loss of revenue due to store/mall renovations. We expect 6% SSSG for Shoppers Stop stores (management target of high-single-digit) in FY20/21, as growth recovers and contribution from newly-opened stores rises. We expect 9% CAGR in consol. revenue over FY19-21.

Private label rejig to improve margins

SHOP's private label, STOP is among the oldest. Yet, we believe it has not leveraged its value. Over the last six years, the share of private label has been 14-15% and dropped to 10% in FY18/19 compared to over 40% for peers. This is due to design and pricing issues. Management has now addressed these issues, re-pricing STOP to value pricing and rejigging product designs to target the value segment. It plans to increase the share of private brands to ~15%, with significant further room, as top retail chains have over 40% share of private brands.

Private labels garner 45-50% gross margin v/s ~30% for third-party brands. This can be increased further with better management of inventory. Management targets to further scale it up to 50% in 2-3 years, driven by lower inventory write-offs, improving full-price sales, and rejigging product mix. We expect consol. EBITDA margin to expand ~50bp each in FY20/21, led by a rising share of private labels and contribution from scale-related operating efficiency.

Serious inroads in omni-presence rollout

Amazon recently invested INR1.8b for a 5% stake in the company. Given the scale of Amazon's India operations, this is a small investment. However, as Amazon has made limited inroads in the apparel category, we believe this is a strategic investment and adds credence to Shoppers Stop's omni-channel focus. In the first leg of the tie-up with Amazon, Shoppers Stop products feature at the top of the list for specific category searches. Also, apart from its own site, Amazon operates a microsite of SHOP's products on Amazon. The second leg of the collaboration with Amazon includes (a) engaging in customer analytics through exchange of Amazon Prime and First Citizen membership data, which could help understand customer needs better and (b) leasing store space to Amazon. SHOP plans to increase the current 2% revenue contribution from the online sales to ~10% in three years. However, recent new guidelines for Foreign Direct Investment on e-commerce sector have caused Shoppers Stop to withdraw its sales from Amazon website, but company is working on plans to revive the same.

Lean balance sheet to provide impetus for growth

SHOP has reduced its net debt from INR8.8b in FY17 to INR0.1b in FY19. This should support healthy PAT and OCF growth. Management plans INR1.2b capex toward rollout of new stores, renovation of old stores and rejig of IT/backend infrastructure. We expect SHOP's capex to be fueled by annual FCF, with further support from potential improvement in the EBITDA margin and negative working capital. Besides, potential sale of FRL shares (~INR2b) should increase cash position, opening avenues for growth investments.

Valuation and view

SHOP is trading at 11x FY21E EV/EBITDA and 28x FY21E P/E. Sale of the loss-making Hypercity business, which was a misfit to SHOP's apparel retailing business, has restricted the EBITDA loss. We believe SHOP's earnings should recover over the next two years on the back of (a) reviving SSSG, (b) increasing store footprints and (c) improving share of private labels. We expect 18% EBITDA CAGR and 30% PAT CAGR over FY19-21. Branded apparel retailers are facing pressure from ecommerce, as evident from modest 5% annual footprint add and plateauing footfall. Thus, we value Shoppers Stop at 13x (~40% discount to the target EV/EBITDA multiple of apparel coverage) FY21E EV/EBITDA and Crosswords at 1x FY21 EV/sales. We recommend **Neutral** with an SOTP-based TP of INR520, implying EV of 13x on FY21 EBITDA, at a 20% discount to three-year average.

Focus reverting to growth

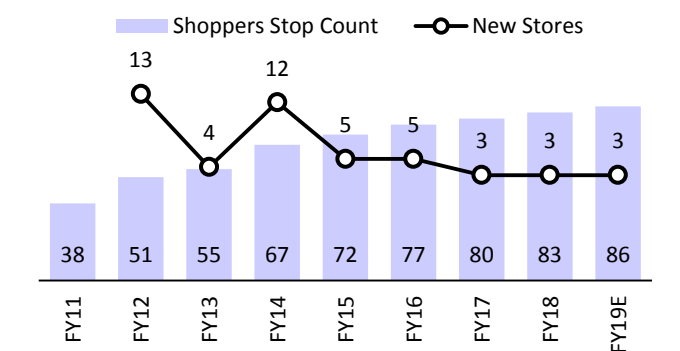
Expect 9% revenue CAGR over FY19-21

- In the last three years, Shoppers Stop business has lagged peers with meager ~3% SSSG over FY16-19. This was mainly due to consolidation of the aggressive (29 Shoppers Stop) store additions over FY11-14.
- This, coupled with the slow pace of mall development (forming 80% of the overall stores) and focus to lower the gearing, led to muted 3 Shoppers Stop store adds over FY16-19E, acting as a hurdle to SSSG.
- However, with all headwinds behind and focus back from non-core (sale of Hypercity, Timezone and Nuance biz.) to the core (Shoppers Stop) biz., SSL is well poised to witness an uptick in SSSG.
- We expect an average 6% Shoppers Stop biz. SSSG and steady four annual stores adds over FY19-21. This should propel 9% consol. revenue CAGR over FY19-21.

Lagged growth in last three years

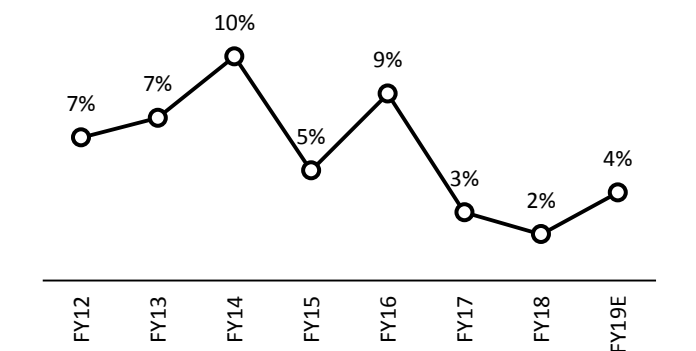
In the last three years, Shoppers Stop has posted weak growth, with meager SSSG and store additions. Over FY11-14, Shoppers Stop was on a store addition spree, adding 20-22 overall stores annually (of which ~10 were Shoppers Stop departmental stores). Management then decided to stabilize the new stores before adding more. Also, the pace of mall openings slowed, impacting store openings. SHOP's leverage too had risen and the management had taken a conscious call to reduce debt before adding more stores. The industry saw aggressive new store additions in the last 3-5 years, particularly in the private label-driven value retail segment (10,000-15,000sf store size). Shoppers Stop, which has larger stores, catering to the premium segment with brand-focused product portfolio, lagged industry growth.

Exhibit 338: Uneven aggressive store adds over FY11-15 led to muted store adds over FY16-19E...



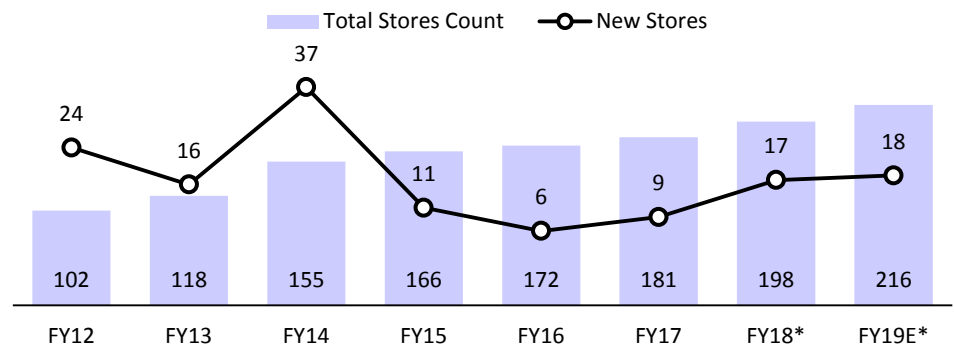
Source: MOFSL, Company

Exhibit 339: ...impacting SSSG over FY16-19E (%)



Source: MOFSL, Company

Exhibit 340: Trend in overall stores count (includes Shoppers Stop and specialty stores)



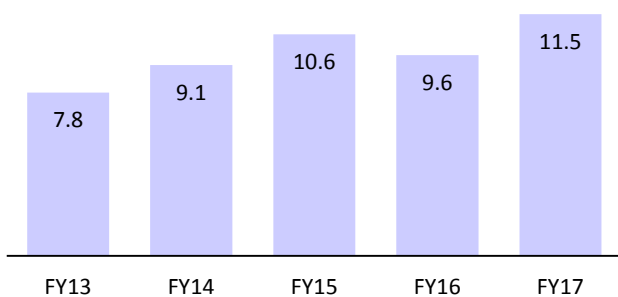
* Includes 33 SIS stores

Source: MOFSL, Company

Exit from non-core business to streamline overall business

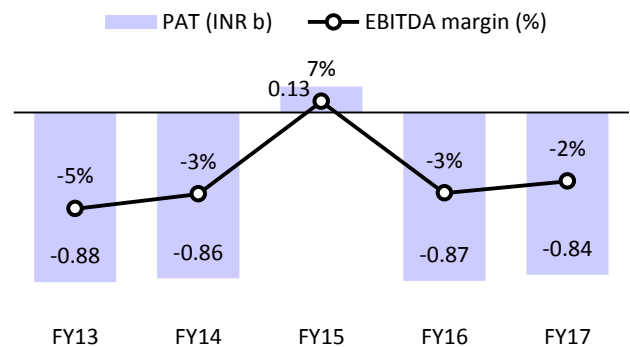
The sale of loss-making and cash-guzzling Hypercity, Time Zone and Nuance for overall EV of INR9.2b in FY18 is a key positive, as it has improved profitability, improved cash flow, and released management bandwidth to focus on the core Shoppers Stop business. Operating at PAT loss of about INR840m, we believe Hypercity lacked scale, hurting overall profitability.

Exhibit 341: Hypercity: 10% revenue CAGR over FY13-17... (INR b)

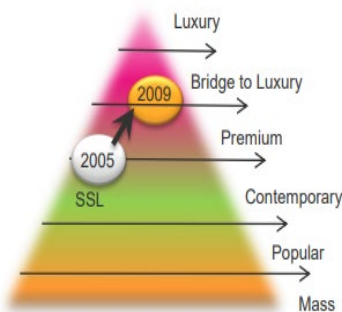


Source: MOFSL, Company

Exhibit 342: ...yet, the business remained loss-making



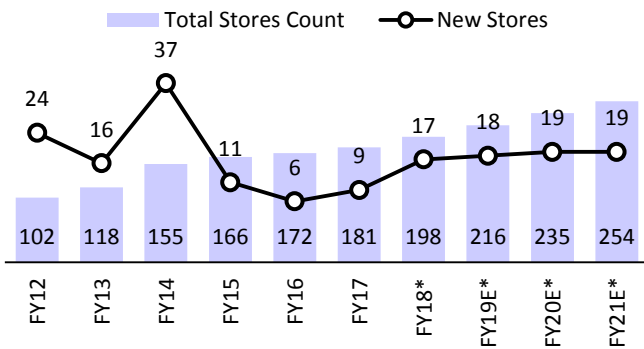
Source: MOFSL, Company



Renewed focus on growth augurs well

Management targets to steadily add ~20 stores annually on the current base of 216 stores (FY19E) over the next 3-5 years. Shoppers Stop, which has 86 stores (FY19), is likely to add five stores annually. Further, it targets to add 10-15 beauty stores annually. We expect four Shoppers Stop store adds and 15 Beauty store adds annually in FY20/21. Shoppers Stop targets the Premium and Bridge to Premium categories, with 90% revenue contribution from brands. This restricts its geographic coverage to tier-1 cities. The management believes there is sufficient growth opportunity in the existing 38 cities and plans to expand to 51 cities. It has completed the location identification process and has a clear growth roadmap for the next five years. Also it can add additional 50 more stores, targeted to open in the next 5-8 years.

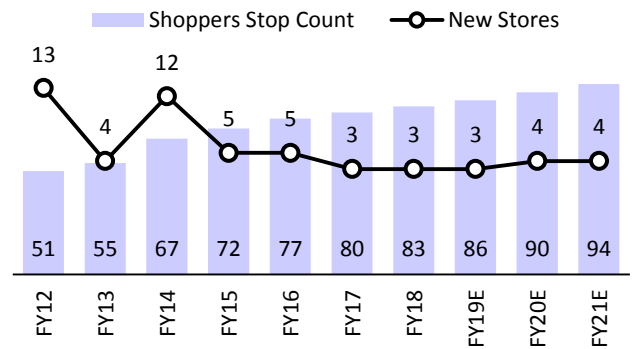
Exhibit 343: Healthy overall 19 store adds to drive growth



*Includes 33 SIS stores

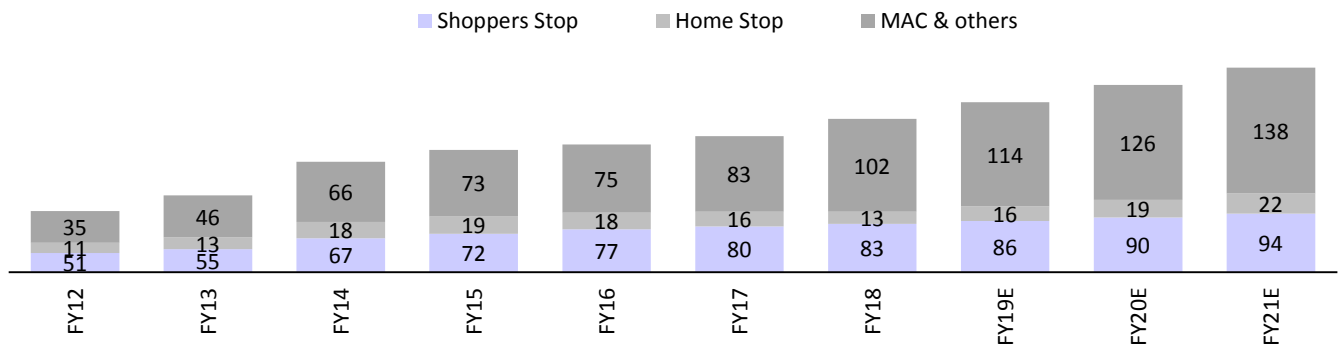
Source: MOFSL, Company

Exhibit 344: Steady 4 Shoppers Stop store adds annually bodes well



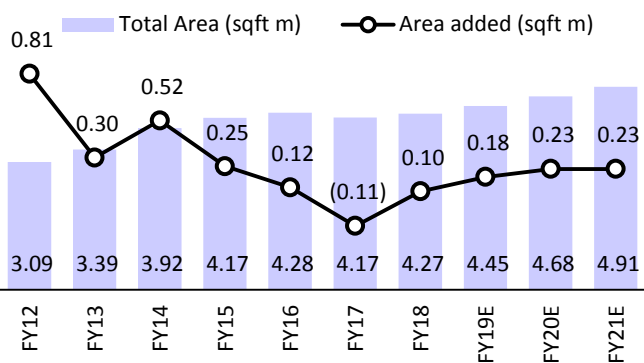
Source: MOFSL, Company

Exhibit 345: Trend in business-wise store count



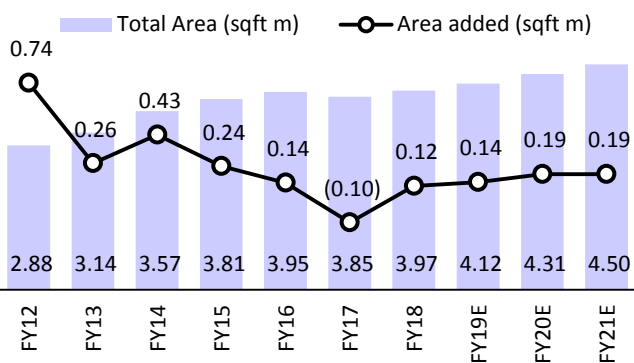
Source: MOFSL, Company

Exhibit 346: Total area under network across Shoppers Stop and specialty formats



Source: MOFSL, Company

Exhibit 347: Shoppers Stop stores constitute over 90% of the total area under network



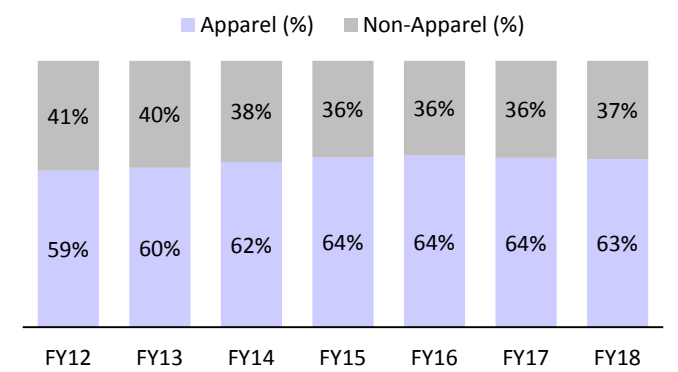
Source: MOFSL, Company

Apparel constitutes ~63% of the portfolio. Shoppers Stop’s key strength is its membership program, which has grown at 13% CAGR over FY12-18. Shoppers Stop’s membership program is among the most well penetrated, contributing ~75% of sales against 25-66% for other retailers. However, despite the growing number of members, the contribution of the membership program to sales has not increased significantly in the last 4-5 years, indicating inactive members or dropouts.

Value unlocking for private brands

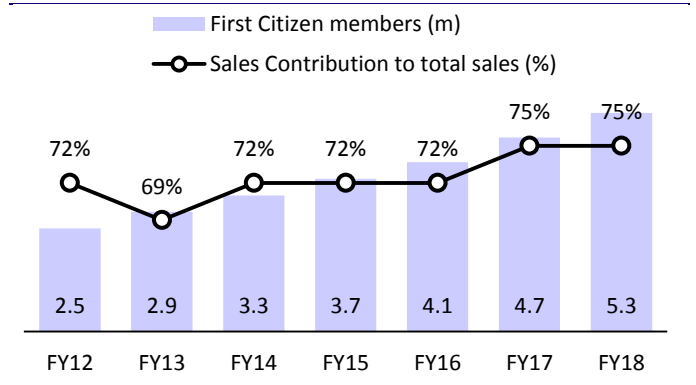
Presently, of the total private label share of 10%, nearly 50% would be contributed by STOP (~INR1b revenue size). Private brands' scale has reduced in the last one year; as the company endeavors to improve the contribution of brands through design and pricing rejig, the revenue scale could reach ~INR2b in the next three years. This is a sizeable value and the company could plan to unlock value by taking the brand offerings outside Shoppers Stop stores by opening STOP EBOs. This should provide strong impetus to the growth in private labels.

Exhibit 348: Apparel mix has remained steady at 60-65%



Source: MOFSL, Company

Exhibit 349: Sales contribution from membership program steady at 70-75%



Source: MOFSL, Company

Exhibit 350: Product portfolio at Shoppers Stop



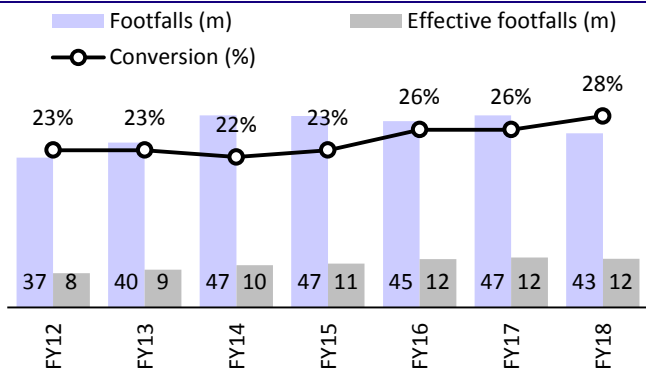
Source: MOFSL, Company

Expect 9% revenue CAGR over FY19-21

The accelerated pace of store addition should also revive SSSG, which had tapered due to a large proportion of old mature stores, demonetization/GST issues, and loss of revenue due to store/mall renovations. Increasing mix of new stores augurs well as the new stores should grow at an accelerated pace in the early growth period.

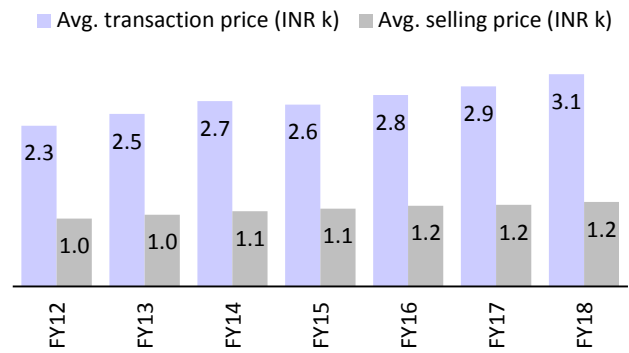
This coupled with 6% SSSG for Shoppers Stop stores in FY20/21 should drive 9% consol. revenue CAGR over FY19-21.

Exhibit 351: Effective footfalls steady at 12m



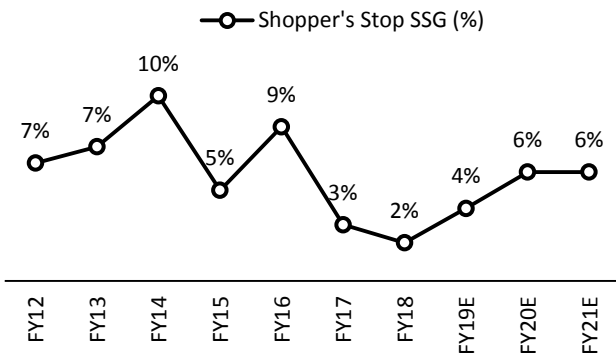
Source: MOFSL, Company

Exhibit 352: Average transaction and selling prices rising



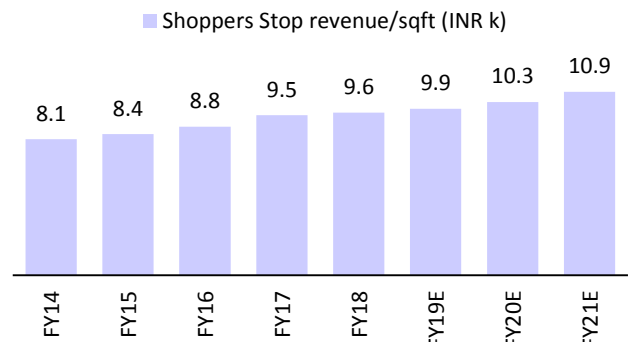
Source: MOFSL, Company

Exhibit 353: Shoppers Stop business SSSG to revive...



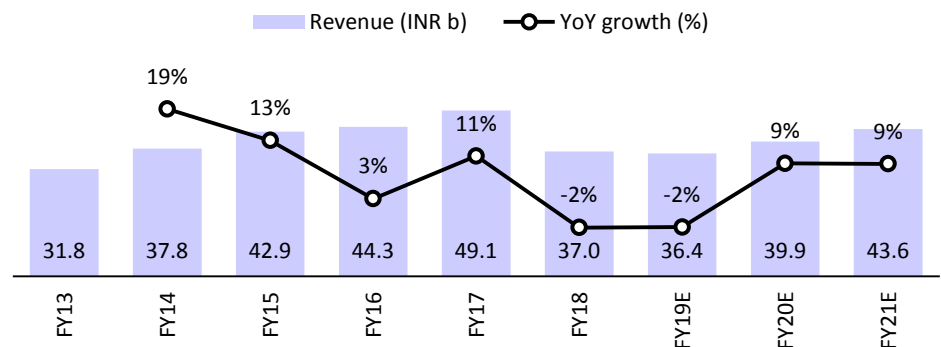
Source: MOFSL, Company

Exhibit 354: ...led by 5% average growth in productivity over FY19-21



Source: MOFSL, Company

Exhibit 355: Consolidated revenue to witness modest 9% CAGR over FY19-21



Figures up to FY17 include Hypercity, Timezone and Nuance performance; FY18 growth is calculated based on FY17 (ex-Hypercity) revenue

Source: MOFSL, Company

Private label rejig to spur margins

Expect 100bp margin expansion over FY19-21

- Marred by the unattractive product portfolio and elevated pricing, the contribution of STOP, Shoppers Stop’s private label, dipped to 10% (FY19E). This is in contrast to the peers witnessing a continuous uptrend in the share of private labels.
- The management’s thrust on regaining lost share, led by rejig on both the designing and pricing front with a new team in place and its target of 45-50% private label gross margins should lead to a fillip in overall EBITDA margin.
- We expect consol. EBITDA margin to expand 100bp over FY19-21 (v/s management target of 100bp annually), led by higher private label mix, inherent operating leverage, and hive-off of loss-making non-core businesses. Consolidated EBITDA/adjusted PAT should grow at a CAGR of 18%/30% over FY19-21.

Private label rejig – a key catalyst driving margin

Shoppers Stop’s private label, STOP is among the oldest. Yet, we believe it has not leveraged its value. Over FY14-16, the share of private label has been 14-15%, which dropped to ~10% in FY18/19E, compared to over 40% for peers. This is due to design and pricing issues. STOP’s pricing was benchmarked in line with premium brands and also the unattractive designs increased the dead stock. The management has now addressed these issues, re-pricing STOP to value pricing and rejigging product designs to target the value segment. It plans to increase the share of private brands to ~15%, with significant further room, as top retail chains have 30-40% share of private brands.

Exhibit 356: Private labels and exclusive brands together contributed 14% of total sales

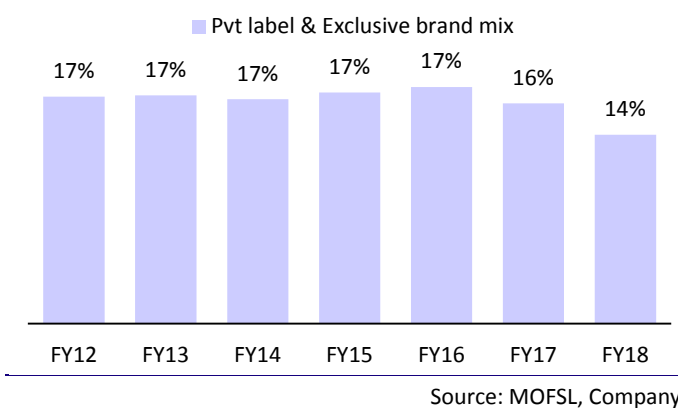
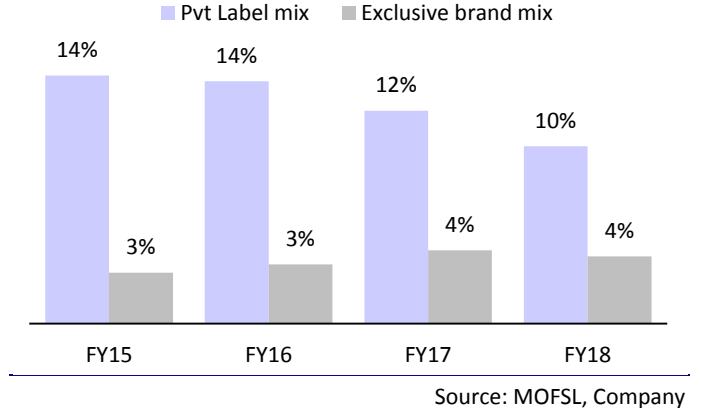


Exhibit 357: Share of private labels witnessed a steep decline to 10% in FY18



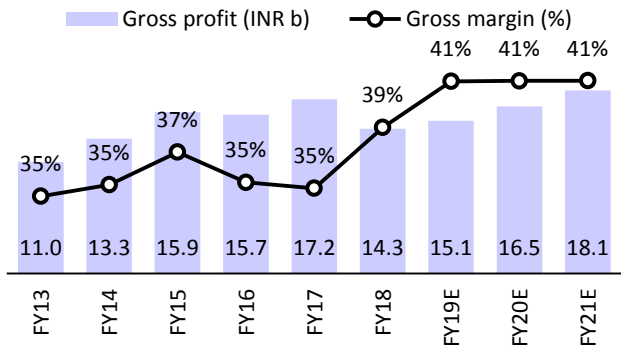
Expect 100bp EBITDA margin expansion over FY19-21

Private labels garner ~40% gross margin v/s 30% for third-party brands. This can be increased further with better management of inventory. The management targets to scale up private label gross margin to 45% in FY19 and to 50% in 2-3 years, driven by lower inventory write-offs, improving full-price sales, and rejigging product mix. This should help improve gross margin.

We expect overall EBITDA margin to expand ~50bp each in FY20/21 led by rising share of private labels and contribution from scale-related operating efficiency.

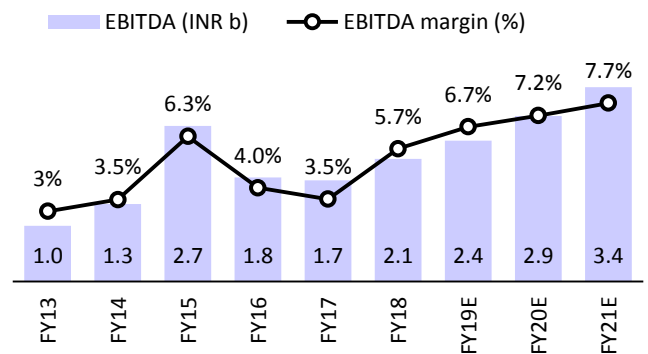
Subsequently, we expect 18% EBITDA CAGR and 30% adjusted PAT CAGR over FY19-21.

Exhibit 358: Consolidated gross margin to reach ~41% over FY19-21



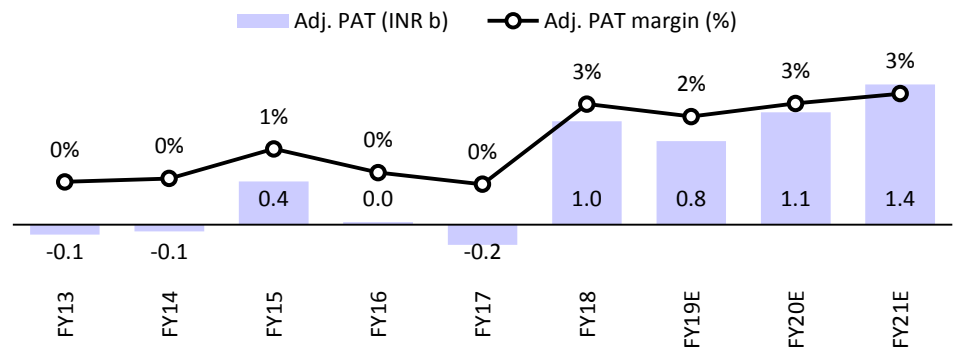
Source: MOFSL, Company

Exhibit 359: Consolidated EBITDA margin to expand 100bp over FY19-21...



Source: MOFSL, Company

Exhibit 360: ...driving 30% CAGR in consolidated adjusted PAT over FY19-21



Source: MOFSL, Company

Serious inroads in omni-presence rollout

Targeting 10% revenue from digital channel by FY21

- SHOP’s digital revenue should reach high-single-digits from meager 2% currently, as it plans to stock 100% of the inventory on Amazon’s website (from 65-70% currently) (apart from SHOP’s own website) and exchange customer analytics with Amazon to drive online consumption.
- New guidelines for Foreign Direct Investment on e-commerce sector have caused Shoppers Stop to withdraw its sales from Amazon website. However, company is working on plans to revive the same.

Amazon investment could be a key enabler

Amazon recently invested INR1.79b for a 5% stake in SHOP. Given the scale of Amazon’s India operations, this is a small investment. Management has reiterated that Amazon’s acquisition of 5% stake remains a financial investment and does not integrate with the business. However, we think, Amazon, has so far had limited inroads in apparel category, thus it would use this platform to ramp up apparel sales. This should add credence to Shoppers Stops’ Omni channel focus.

Omni-channel inroads

Shoppers Stop’s entire store inventory was available on its own website as well as Amazon India website until Jan’19. However, the new guidelines for FDI in the ecommerce sector have caused Shoppers Stop to withdraw its sales from Amazon website. However, the company is working on plans to revive the same.

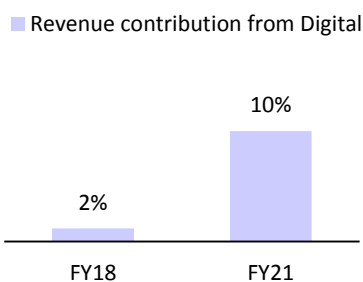
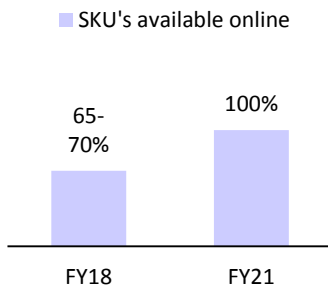
In the first leg of the tie-up with Amazon, Shoppers Stop products featured at the top of the list for specific category searches. Apart from its own site, Amazon also operates a microsite of Shoppers Stop products on Amazon. The second leg of the collaboration with Amazon should include engagement of customer analytics through exchange of Amazon Prime and First Citizen membership.

Experience Zone – brick and mortar format for Amazon-exclusive products

SHOP and Amazon are also working on a lease model, where Amazon will be provided 50-100sf of space in Shoppers Stop stores on lease dedicated for Amazon-exclusive products like Kindle, Echo, Alexa, Amazon Prime, and Kindle, among others. SHOP may benefit by way of rentals and margin sharing, while Amazon should ramp up store footprint and target market for Amazon-exclusive products.

Targeting 10% revenue from digital channel in three years

SHOP’s current revenue contribution from the digital channel is 2%. It plans to raise this to high-single-digit by FY21. The sales tie-up with Amazon and inventory stocking on digital platform are positive steps in this direction. Amazon’s investment in SHOP and the prospective analytics tie-up could improve SHOP’s digital revenue contribution. However, seamless delivery model, managing logistics cost (particularly returns), and aggressive marketing of digital channels may be pivotal for accelerated growth.



Lean balance sheet to boost return ratios

Expect ROCE to reach 12% by FY21

- Hive-off of non-core businesses (Hypercity, Timezone, and Nuance) and 5% stake sale to Amazon had helped to lower leverage from ~INR9b in FY17 to INR0.1b in FY19.
- Besides, increasing share of consignment sales (leading to lower inventory), INR4.4b cumulative OCF over FY19-21 (easily funding capex requirements), and monetization of investment in Future Retail bode well.
- With all growth levers in place, return ratios should surge. We expect RoCE/RoIC to reach 12%/17% by FY21 (9%/12% in FY19E).

RoCE pulled down by high store investment and low EBITDA margin

Shoppers Stop stores, with an average size of 47ksf, require a capex of ~INR1.6k/sf (INR77m per store) v/s INR2k-2.5k/sf for peers. However, over 60% of its total inventory is on consignment (Sale On Return) basis, giving Shoppers Stop stores an edge over peers by way of negative working capital. Each Shoppers Stop store garners revenue of INR462m (INR9.6k/sf), with gross margin of ~40%. This is primarily led by focus on apparel, which contributes 60-65% of total sales. EBITDA margin of ~6% (or INR27m per store) translates into a payback of ~2.5 years.

Exhibit 361: Store payback of 2.5 years(INR m)

	Per Store	Per Sq.ft
Capex	77	1,600
Net Working Capital	-13	-21,905
Total capital	64	-20,305
Breakeven (in years)	2.3	
Revenue	462	9,630
Gross margin	177	3,695
Gross margin (%)	38.4%	38.4%
Other operating cost	150	3,128
EBITDA	27	567
EBITDA margin (%)	5.9%	5.9%
Depreciation	8	160
Depreciation rate (%)	10%	10.0%
EBIT	20	407
RoCE (Tax - 30%)	21.4%	NM

Source: MOFSL, Company

10% SSSG should drive ~90bp EBITDA margin expansion

With ~30% of the total other operating cost being fixed for a Shoppers Stop store, a 10% SSSG and similar increase in variable cost would drive ~90bp EBITDA margin improvement per store. This would help trim down payback period to less than two years and also leads to an uptick in RoCE per store to 29%.

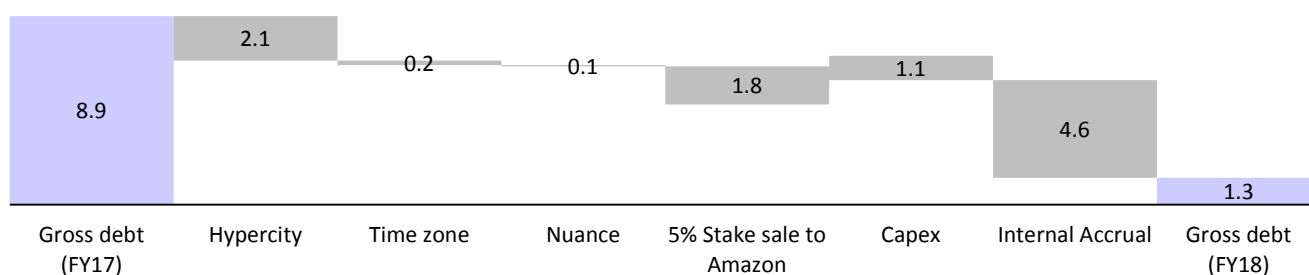
Exhibit 362: Per store scenario analysis (INR m)

Revenue increases by	10%	20%
Revenue	508	555
Gross Margin	195	213
Gross Margin %	38.4%	38.4%
Fixed Portion	30%	30%
Total fixed cost	45	45
Variable Portion	70%	70%
Total variable cost	116	126
Total Operating Costs	161	171
EBITDA	34	42
EBITDA margin (%)	6.8%	7.5%
Change in bps	89	162
EBIT	27	34
Break-Even (in Years)	1.9	1.5
RoCE	29.3%	37.3%

Source: MOFSL, Company

Sale of Hypercity and other non-core business support deleveraging plans

In the last three years, the management's focus was to reduce leverage. SHOP achieved this through (a) sale of non-performing businesses – Hypercity, Timezone, and Nuance, and (b) sale of 5% stake to Amazon. The sale of Hypercity released INR2.1b (51% of (INR1.6b cash + INR2.6b debt)), the sale of Time Zone released INR227m, and the sale of Nuance released INR60m. SHOP's 5% stake sale to Amazon provided a further INR1.8b. This allowed the company to reduce its net debt from INR8.8b in FY17 to just INR1b in FY18 and close to net cash by FY19E. This should support healthy PAT and OCF growth.

Exhibit 363: Deleveraging led by exit from non-core businesses and stake sale (INR b)

Source: MOFSL, Company

**Hypercity sale bodes well**

In 3QFY17, SHOP sold Hypercity to Future Retail (FRL) at an EV of INR9b, valuing the business at EV/Sales of 0.9x (1HFY18 annualized). FRL acquired Hypercity's debt of INR2.6b and paid cash of INR1.6b. It paid the balance consideration in the form of equity shares at a price of INR537, amounting to INR5b. Based on Shopper's Stop's 51% shareholding, it received 4.75m shares with lock-in period of one year until December 2018 and presently valued at INR2.1b. This should provide further impetus to its balance sheet and enhance its net cash position. The sale of Hypercity would reduce the drag on balance sheet as well as earnings. Additionally, being predominantly in food and grocery retailing, unlike SHOP's branded apparel retailing business, it offered limited synergy gains.

Exhibit 364: Enterprise value for Hypercity

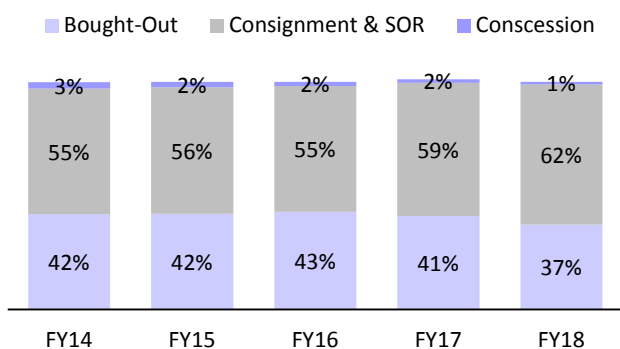
Particulars	INR b
Equity (9.3m shares @ INR537)	5.0
Debt	2.6
Cash	1.6
Enterprise value	9.2
Sales - (1HFY18 annualised)	10.6
EBITDA - (1HFY18 annualised)	-0.4
EV/Sales (x)	0.9

Source: MOFSL, Company

Low inventory to support scaling up of operations

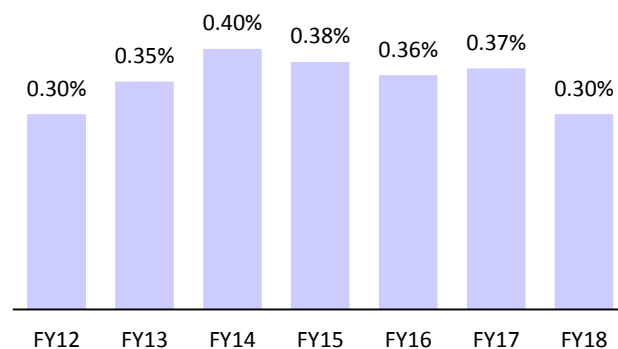
SHOP purchases ~62% of its inventory on consignment (sale or return) basis. This allows it to operate on a negative working capital cycle. This unique value proposition of negative working capital allows it to scale up operations with limited cash concerns. In the last few years, SHOP has increased the proportion of sales on consignment basis from 27% to 62%. Consequently, net working capital has reduced to –INR0.9b in FY19E. This is despite the chargeable area increasing from 2.3msf (FY11) to 4.4msf (FY19E).

Exhibit 365: 62% of inventory on SOR basis...



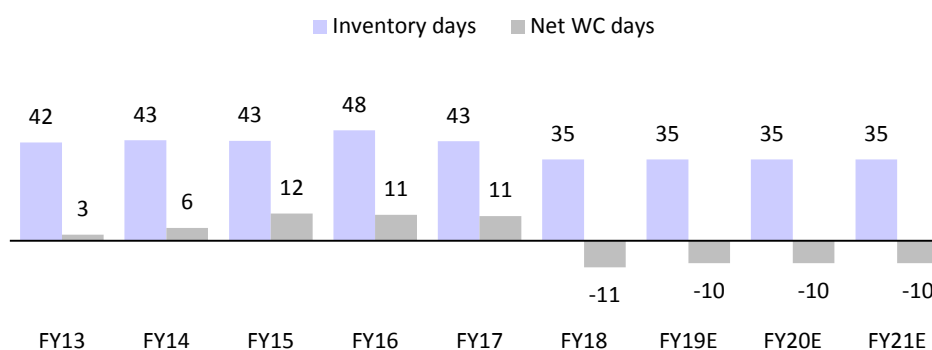
Source: MOFSL, Company

Exhibit 366: ...and low shrinkage...



Source: MOFSL, Company

Exhibit 367: ...leading to low inventory and negative WC days

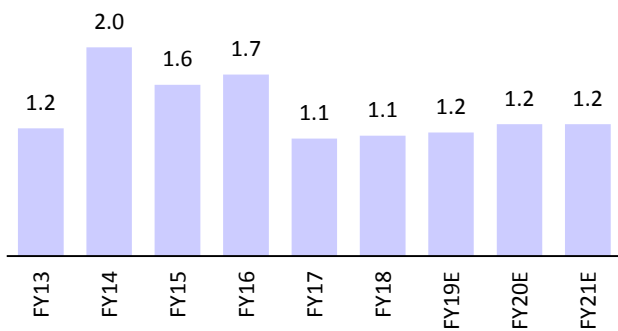


Source: MOFSL, Company

Capex to get internally funded despite accelerated store adds

The management plans INR1.1b capex towards rollout of new stores, renovation of old stores, and rejig of IT/backend infrastructure. It intends to add 5-7 Shoppers Stop stores and 10-15 Beauty stores, which should cost about INR400m. Additionally, it plans to spend about INR300m towards store renovation and INR300m towards streamlining IT/backend infrastructure. We expect SHOP’s capex to be fueled by annual FCF, with further support from potential improvement in EBITDA margin and negative working capital. Besides, proceeds from the potential sale of FRL shares (current value: INR2.1b), lock-in period for which ended in December 2018, should increase cash position, opening avenues for growth investments.

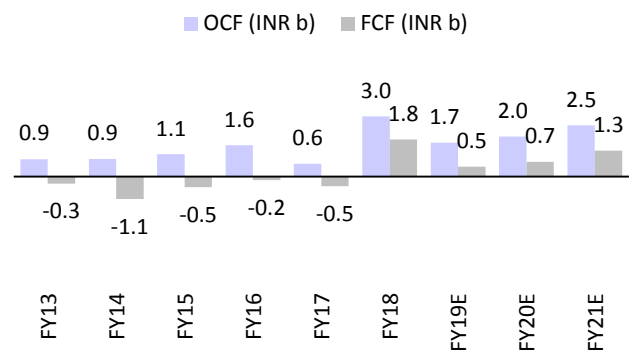
Exhibit 368: Capex requirements of INR1.2b...



*Includes Hypercity sale

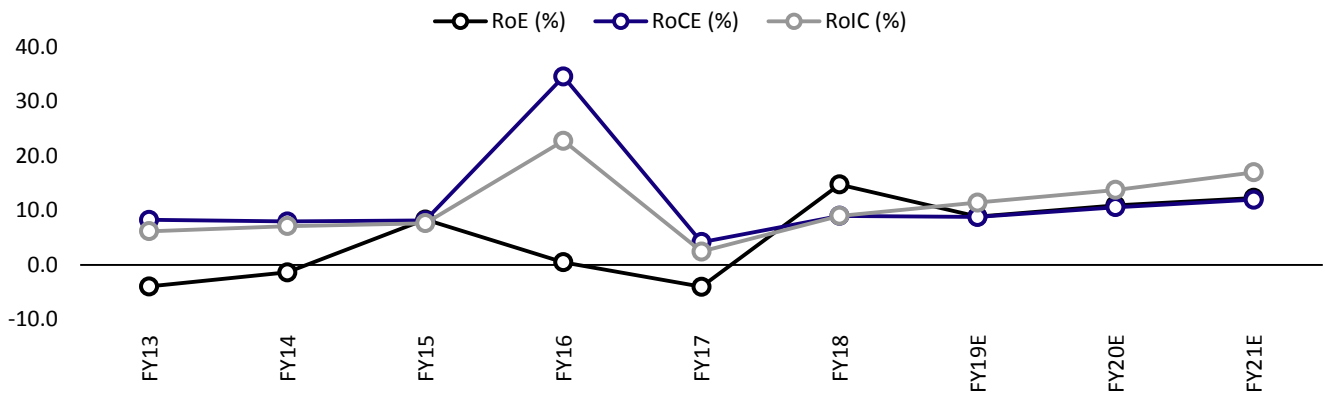
Source: MOFSL, Company

Exhibit 369: ...to be funded by increasing OCF



Source: MOFSL, Company

Exhibit 370: Return ratios to witness an uptick



Source: Company, MOFSL

Valuation and view

Recommend Neutral with TP of INR520

- Branded apparel retailers are facing pressure from ecommerce, evident from plateauing footfalls, low SSSG and modest 5% annual footprint add.
- Thus, we value Shoppers Stop at 13x (~40% discount to the target EV/EBITDA multiple of our apparel coverage) FY21E EV/EBITDA and Crosswords at 1x FY21 EV/sales.
- We recommend Neutral with an SOTP-based TP of INR520, implying EV of 13x on FY21 EBITDA – ~20% discount to three-year average.
- Recovery of SSSG, accelerated store adds and higher margin improvement could be key lever of rerating.

Healthy earnings growth; RoCE improving

Sale of the loss-making Hypercity business, which was a misfit to SHOP's apparel retailing business, has restricted EBITDA loss. The management targets about 5% footprint addition and high SSSG revival. However, we are building modest 6% SSSG. We believe SHOP's earnings should recover over the next three years on the back of (a) four Shoppers Stop store additions, and (b) modest yet improving share of private labels. We expect 18% EBITDA CAGR and 30% PAT CAGR over FY19-21. RoIC should reach 17% v/s 12% in FY19E.

Recommend Neutral with a TP of INR520

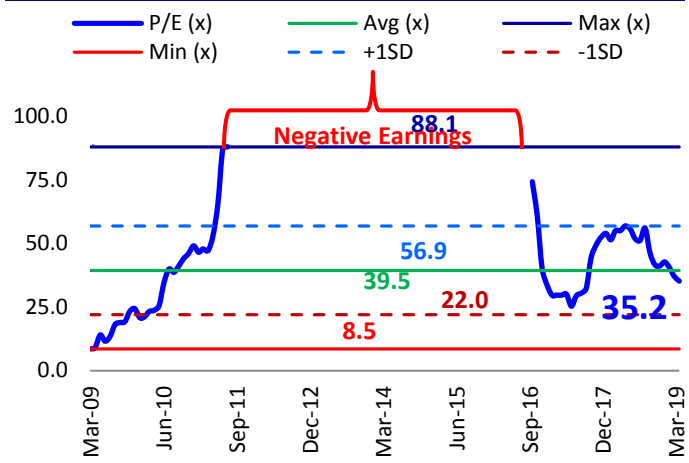
SHOP is trading at 11x FY21E EV/EBITDA and 28x FY21E earnings. We have valued the stock on an SOTP basis – Shoppers Stop at 13x (~40% discount to the target EV/EBITDA multiple of our apparel coverage) FY21E EV/EBITDA and Crosswords at 1x FY21E EV/sales, given its low profitability, arriving at a target price of INR520 (implying EV of 13x on FY21E EBITDA – ~20% discount to three-year average). Recommend **Neutral**. Recovery of SSSG, accelerated store adds and higher margin improvement could be key lever of rerating.

Exhibit 371: Valuation on SOTP basis

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR m)	Value/share (INR)
Standalone (Shoppers Stop)	FY21E EV/EBITDA	3	13	42	478
Crossword	FY21E EV/Sales	1	1	1	17
Total Enterprise Value				44	495
Less Net debt				-2	-25
Equity Value				46	520
Shares o/s (m)				88.0	
CMP (INR)					458
Upside (%)					13

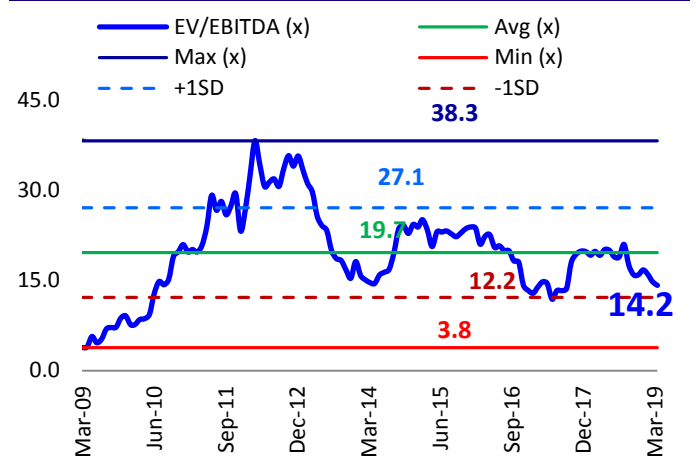
Source: MOFSL, Company

Exhibit 372: SHOP: 1 year forward P/E band



Source: Bloomberg, MOFSL

Exhibit 373: SHOP: 1 year forward EV/EBITDA band



Source: Bloomberg, MOFSL

Financials and valuations

Consolidated - Income Statement								(INR M)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	37,783	42,869	44,320	49,101	36,967	36,408	39,866	43,619
Change (%)	18.9	13.5	3.4	10.8	-24.7	-1.5	9.5	9.4
Raw Materials	24,464	26,925	28,632	31,892	22,679	21,339	23,357	25,552
Employees Cost	2,918	3,157	3,330	3,886	3,157	3,277	3,506	3,746
Lease Rentals	0	0	0	0	4,188	4,493	4,818	5,160
Other Expenses	9,068	10,107	10,566	11,581	4,828	4,871	5,332	5,806
Total Expenditure	36,449	40,189	42,529	47,359	34,852	33,979	37,013	40,265
% of Sales	96.5	93.7	96.0	96.5	94.3	93.3	92.8	92.3
EBITDA	1,334	2,680	1,791	1,743	2,115	2,428	2,852	3,354
Margin (%)	3.5	6.3	4.0	3.5	5.7	6.7	7.2	7.7
Depreciation	981	1,253	1,297	1,510	1,149	1,226	1,366	1,519
EBIT	353	1,427	494	233	966	1,202	1,487	1,835
Int. and Finance Charges	653	781	848	874	377	128	49	18
Other Income	62	133	285	188	180	157	219	249
PBT bef. EO Exp.	-239	778	-69	-453	769	1,231	1,657	2,066
EO Items	-7	0	0	-128	2,160	0	0	0
PBT after EO Exp.	-245	778	-69	-581	2,929	1,231	1,657	2,066
Total Tax	257	288	334	203	176	406	547	682
Tax Rate (%)	-104.7	37.0	-482.1	-34.9	6.0	33.0	33.0	33.0
Minority Interest	-420	66	-427	-411	-297	0	0	0
Loss from discontinued operations	-0.9	0.1	0.1	-0.1	-608.2	0.0	0.0	0.0
Reported PAT	-83	424	24	-373	2,442	825	1,110	1,384
Adjusted PAT	-68	424	24	-200	1,020	825	1,110	1,384
Change (%)	-31.6	-723.7	-94.3	-925.4	-610.6	-19.1	34.6	24.7
Margin (%)	-0.2	1.0	0.1	-0.4	2.8	2.3	2.8	3.2

Consolidated - Balance Sheet								(INR M)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	416	417	417	418	440	440	440	440
Total Reserves	4,489	4,867	4,734	4,375	8,605	9,430	10,540	11,924
Net Worth	4,905	5,284	5,151	4,792	9,044	9,869	10,980	12,364
Minority Interest	15	261	-12	52	0	0	0	0
Total Loans	6,449	7,512	8,290	8,851	1,253	903	403	403
Deferred Tax Liabilities	100	96	-36	-43	-198	-198	-198	-198
Capital Employed	11,468	13,153	13,393	13,652	10,100	10,575	11,185	12,569
Gross Block	11,716	13,162	8,954	9,749	8,687	9,718	10,976	12,234
Less: Accum. Deprn.	4,139	5,151	861	1,501	2,057	3,292	4,667	6,195
Net Fixed Assets	7,577	8,012	8,093	8,248	6,630	6,426	6,309	6,039
Goodwill on Consolidation	1,019	1,019	976	976	97	97	97	97
Capital WIP	367	276	333	200	182	182	182	182
Total Investments	0	0	390	199	2,825	2,825	2,825	2,825
Curr. Assets, Loans & Adv.	8,808	10,509	10,489	10,898	7,946	8,297	9,397	11,656
Inventory	4,490	5,063	5,792	5,776	3,563	3,497	3,835	4,204
Account Receivables	480	1,015	519	568	477	431	473	518
Cash and Bank Balance	279	199	103	76	60	587	941	2,389
Loans and Advances	3,559	4,231	4,075	4,478	3,845	3,782	4,148	4,546
Curr. Liability & Prov.	6,302	6,661	6,889	6,869	7,578	7,250	7,624	8,229
Account Payables	4,387	4,688	4,944	4,908	5,191	4,884	5,353	5,863
Other Current Liabilities	1,795	1,844	1,863	1,861	2,305	2,284	2,188	2,283
Provisions	120	130	81	100	82	83	83	83
Net Current Assets	2,505	3,847	3,601	4,029	367	1,046	1,773	3,427
Appl. of Funds	11,468	13,153	13,393	13,653	10,100	10,575	11,185	12,569

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	-0.8	5.1	0.3	-2.4	12.2	9.9	13.3	16.6
Cash EPS	10.9	20.1	15.8	15.7	26.0	24.6	29.7	34.8
BV/Share	58.7	63.3	61.7	57.4	108.3	118.2	131.5	148.1
DPS	0.7	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	-88.3	17.7	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				NM	37.5	46.4	34.5	27.6
Cash P/E				29.2	17.6	18.7	15.5	13.2
P/BV				8.0	4.2	3.9	3.5	3.1
EV/Sales				1.0	1.1	1.1	1.0	0.9
EV/EBITDA				27.0	19.6	16.7	13.9	11.4
Dividend Yield (%)	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-13.1	-6.2	-2.0	-5.7	20.9	9.8	7.9	14.0
Return Ratios (%)								
RoE	-1.4	8.3	0.5	-4.0	14.7	8.7	10.7	11.9
RoCE	8.0	8.1	34.6	4.2	9.0	8.6	10.3	11.6
RoIC	7.1	7.6	22.8	2.4	9.0	11.5	14.0	17.1
Working Capital Ratios								
Fixed Asset Turnover (x)	3.2	3.3	4.9	5.0	4.3	3.7	3.6	3.6
Asset Turnover (x)	3.3	3.3	3.3	3.6	3.7	3.4	3.6	3.5
Inventory (Days)	43	43	48	43	35	35	35	35
Debtor (Days)	5	9	4	4	5	4	4	4
Creditor (Days)	42	40	41	36	51	49	49	49
Leverage Ratio (x)								
Current Ratio	1.4	1.6	1.5	1.6	1.0	1.1	1.2	1.4
Interest Cover Ratio	0.5	1.8	0.6	0.3	2.6	9.4	30.4	103.8
Net Debt/Equity	1.3	1.4	1.5	1.8	-0.2	-0.3	-0.3	-0.4

Consol. Cash Flow Statement

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	-240	778	-95	-390	2,320	1,231	1,657	2,066
Depreciation	981	1,253	1,297	1,510	1,149	1,226	1,366	1,519
Interest & Finance Charges	653	781	848	874	377	128	49	18
Direct Taxes Paid	-248	-231	-425	-241	-356	-406	-547	-682
(Inc)/Dec in WC	-400	-1,499	-69	-463	1,749	-152	-373	-206
CF from Operations	747	1,083	1,556	1,290	5,239	2,026	2,152	2,715
Others	138	24	-3	15	-2,258	-142	-205	-234
CF from Operating incl EO	884	1,107	1,554	1,304	2,981	1,884	1,947	2,481
(Inc)/Dec in FA	-1,979	-1,624	-1,722	-1,505	-1,141	-1,022	-1,249	-1,249
Free Cash Flow	-1,095	-517	-169	-201	1,840	862	698	1,232
(Pur)/Sale of Investments	-111	0	0	0	644	0	0	0
Others	76	49	35	29	536	532	595	624
CF from Investments	-2,014	-1,576	-1,687	-1,476	39	-490	-654	-625
Issue of Shares	51	41	25	9	1,814	0	0	0
Inc/(Dec) in Debt	1,463	1,079	874	561	-3,178	-350	-500	0
Interest Paid	-649	-774	-850	-871	-416	-128	-49	-18
Dividend Paid	-73	-73	-151	0	-75	0	0	0
Others	390	182	207	476	145	0	0	0
CF from Fin. Activity	1,182	455	105	176	-1,710	-478	-549	-18
Inc/Dec of Cash	52	-14	-28	4	1,310	917	744	1,838
Opening Balance	227	210	132	72	-1,250	-330	197	551
Closing Balance	279	196	104	76	60	587	941	2,389

Spencer Retail

BSE SENSEX 38,862 S&P CNX 11,666

CMP: INR164

TP: INR200 (+22%)

Buy



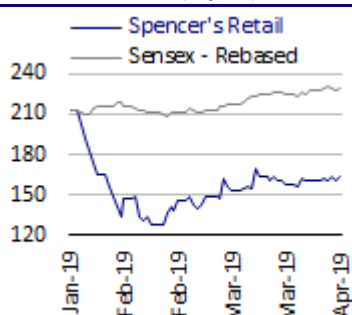
Stock Info

Bloomberg	SPENCER IN
Equity Shares (m)	79.5
M.Cap.(INRb)/(USDb)	13.1 / 0.2
52-Week Range (INR)	230 / 121
1, 6, 12 Rel. Per (%)	10/-/-
12M Avg Val (INR M)	158
Free float (%)	100.0

Financials Snapshot (INR b)

Y/E MARCH	FY19E	FY20E	FY21E
Sales	22.5	25.7	29.5
EBITDA	0.1	0.3	0.5
NP	0.0	0.1	0.3
EPS (INR)	0.0	0.4	0.9
EPS Gr. (%)	-104.0	879.3	136.3
BV/Sh. (INR)	18.5	18.9	19.8
P/E (x)	NM	424.1	179.5
P/BV (x)	8.9	8.7	8.3
EV/EBITDA (x)	484.5	167.6	85.4
EV/Sales (x)	2.1	1.8	1.6
RoE (%)	0.2	2.1	4.7
RoCE (%)	0.6	3.0	5.6

Stock Performance (1-year)



Turned profitable

Hive-off to bring focus on growth and profitability

- Spencer's predominantly operates as a food retailer. Food & Grocery contributes 80% of its revenue. A loss-making entity for several years, it has turned EBITDA breakeven in FY18, closing 118 loss-making dailies.
- After a phase of weak SSSG due to GST rollout, liquor ban and store renovation, Spencer's is now expected to clock healthy 14% revenue CAGR over FY19-21, on avg. 7% SSSG, 15 hypermarket store additions annually, and increasing apparel mix. Further, management targets an ambitious uptick in online sales.
- This, coupled with (a) thrust on increasing private labels share, (b) closure of loss-making dailies and rationalization of store size and (c) inherent operating leverage should drive 140bp EBITDA margin expansion over FY19-21.
- We recommend Buy, valuing Spencer's at INR200/share, ascribing 0.5x to FY21E sales as the business is yet to attain scale in profits. However, we believe the recent turnaround in business and measured growth targets with right store size bode well.

Predominantly a food retailer

Spencer's has predominantly operated as a food retailer, with a tall 80% of revenue coming from Food & Grocery, including categories like liquor and non-vegetarian foods. In the last nine years (FY10-19E), when most retailers have expanded footprint rapidly, Spencer's has continued to rationalize its store footprint, shutting down 118 loss-making dailies, even as its hypermarket and supermarket stores continued to grow (overall area grew ~52% over FY10-19E). Net store additions have eventually turned positive, with 20 net store additions in FY19. As a result, Spencer's turned EBITDA-positive in FY19E. We believe its hive off from CESC will provide much-needed focus on the retail business. Spencer's plans to fuel growth through accelerated store additions and improved store productivity by focusing on smaller store size and non-food product offerings.

Reenergizing growth

After downsizing its loss-making dailies and turning EBITDA positive, Spencer's has realized that the hypermarket format is the most efficient. It targets to add ~15% store area (cumulatively ~0.44msf over FY19-21E), adding 15 stores p.a. To improve store productivity, it plans to curb store size to 15,000-18,000sf. Following a cluster-based approach, it plans to add new stores in existing four clusters (a) West Bengal, (b) NCR and Eastern UP, (c) AP and Telangana and (d) Kerala and Tamil Nadu – to improve supply chain and other marketing cost efficiencies. To increase bill size, store productivity as well as gross margin profile of the store, Spencer's plans to increase the apparel mix with the recently launched value fashion brand 2Bme in 39 hypermarket stores. It plans to take the revenue share of apparel to 10% in three years from the current 4-5%. Value fashion remains a robust growth market but may have initial 2-3 years gestation of branding, marketing and discounting. We expect 14% revenue CAGR over FY19-21 on the back of 7% SSSG and 15 new store additions annually.

Margin on the uptrend

Spencer's targets to improve EBITDA margin by (a) focusing on margin-accretive private labels, (b) growing the revenue share of non-food items, primarily apparel, (c) reducing average store size and (d) realizing scale benefits. Further to improve store productivity, Spencer's plans to open new hypermarket stores in existing clusters and reduce average store size to 15,000-18,000sf from 23,000-25,000sf. We expect EBITDA margin to expand 140bp over FY19-21 to ~2% on the back of gross margin expansion of 50bp and opex efficiency of 90bp.

Early inroads to omni channel a big positive

Combining data analytics with online operations, Spencer's intends to increase consumption spends through its omni-channel presence. With ~65% revenue from loyal customers and online spends at typically 1.2-1.5x v/s store purchases, Spencers plans to leverage its loyalty program and online revenue mix to 8-10% by FY21 from negligible presently. It has restricted itself to existing clusters to keep logistics/warehousing costs under check. Spencer's serves ~50,000 orders monthly and is expected to turn profitable at ~75,000 orders.

Leaner balance sheet; enough cash to fund next 2-3 years

We expect 15% total area (sq. ft.) addition across store formats each in FY20/21. At INR40m for a 18,000sf store, Spencer's would require capex of INR400m-500m annually. With net cash of ~INR2.5b (FY19E) along with cumulative OCF of INR0.7b over FY19-21, this could be well funded internally. No incremental gearing despite ramp-up in expansion would enable Spencer's to continue as a debt-free company post demerger.

Valuation and view

Spencer's is presently operating at low EBITDA margin and is yet to attain a stable state business model garnering healthy SSSG, margins. However, with the backing of a strong business group, operating history of over two decades, huge growth opportunity and recent EBITDA turnaround, we see good investment potential in Spencer's. Given its recovery phase and presently low EBITDA margin, we have valued Spencer's on an EV/sales basis, ascribing 0.5x on FY21E sales of INR29.5b, to arrive at a TP of INR200/share; recommend **Buy**.

Predominantly a food retailer

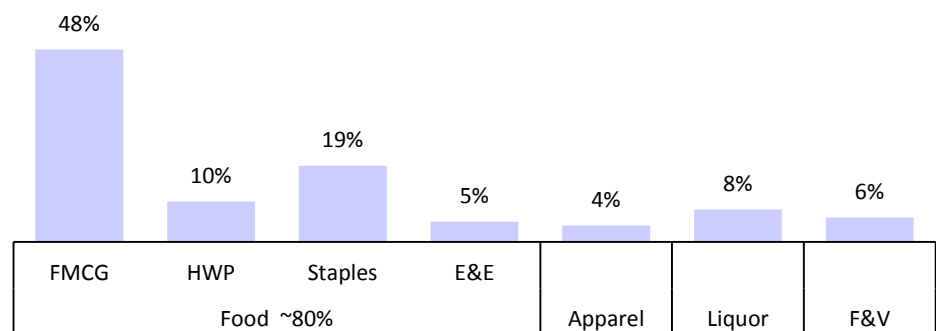
Rationalization of 'daily' stores reaping benefits

- Spencer's has predominantly operated as a food retailer, with ~80% of its revenue coming from Food & Grocery, thus operating at low ~20% gross margin.
- Closure of 118 loss-making 'daily' stores over FY10-19E and shift of focus to hypermarkets and large stores (ramping up store count to 58 (v/s 18 in FY10) and 21 (v/s 9 in FY10), respectively over the same period) has enabled it to turn EBITDA breakeven.

Specialized in Food retailing

Spencer's has predominantly operated as a food retailer, with ~80% of its revenue coming from Food & Grocery, including categories like liquor and non-vegetarian food, which get limited shelf space in most retail formats. It also caters to the Gourmet segment, with live bakery offerings, and a segment named Epicuisine, which includes ready to consume global cuisines. Most retailers restrict food and grocery offerings to staples and FMCG products, which typically account for about 60% of revenue. As food & grocery is a high turnover and low margin category, Spencer's generates revenue of ~INR17.7k/sf, but its gross margin is just about 20%.

Exhibit 374: Food constitutes ~80% of Spencer's revenue

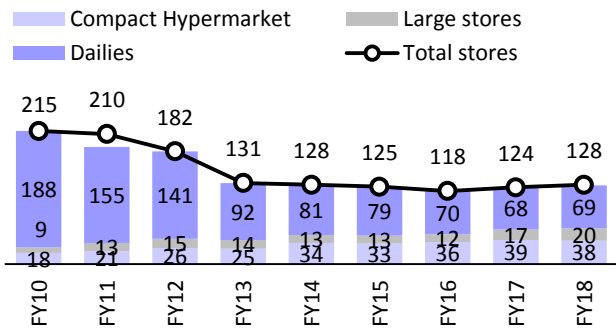


Source: MOFSL, Company

Streamlining different formats

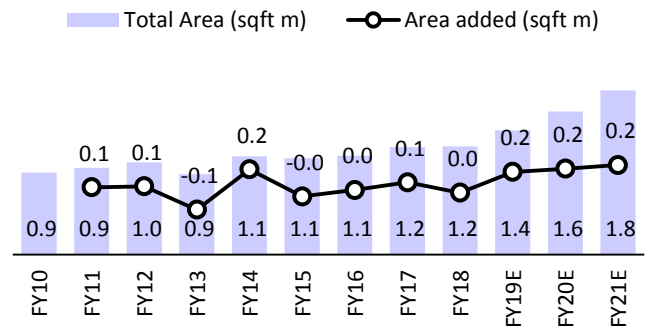
In the last nine years (FY10-19E), when most retailers rapidly expanded footprint, Spencer's continued to rationalize store footprint, shutting down 118 loss-making dailies. Dailies have seen limited success in India. Other players like Star (Tata-Tesco JV) and Easy Day too have struggled to turn in profitable. Spencer's 58 hypermarkets stores count however, trebled over the same period (18 in FY10) while supermarkets store network rose to 21 (v/s 9 in FY10). Spencer's has completed its dailies rationalization. It is now focusing predominantly on hypermarkets and supermarkets, with 20 net store additions in FY19E. This has allowed it to turn EBITDA breakeven in FY18.

Exhibit 375: ~60% of the dailies have been closed down (store count) since FY10



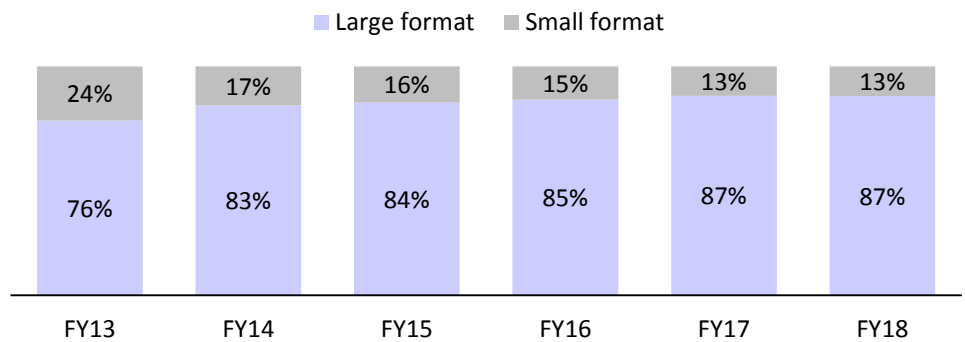
Source: MOFSL, Company

Exhibit 376: Overall area increased ~52% over FY10-19E



Source: MOFSL, Company

Exhibit 377: Area under large formats



Source: MOFSL, Company

Exhibit 378: Spencer's geographical presence



Source: MOFSL, Company

Reenergizing growth

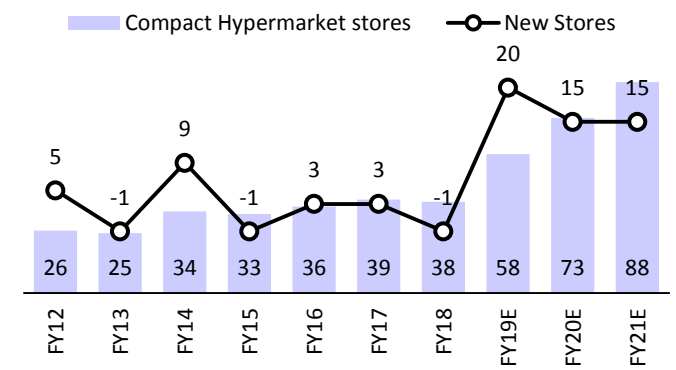
Expect 14% revenue CAGR over FY19-21

- We expect Spencer’s to register healthy 14% revenue CAGR over FY19-21, primarily on 7% SSSG and addition of 15 hypermarket stores/year.
- Thrust on increasing the revenue share of apparel to 10% by FY21 (led by traction for newly launched value fashion brand 2Bme) and focus on higher-productivity hypermarket should support SSSG.
- This coupled with the waning headwinds from GST rollout, renovation of key store in South City, Kolkata, and liquor ban on highways (which impacted revenue previously) bode well for overall growth.

Hypermarket store adds to fuel growth

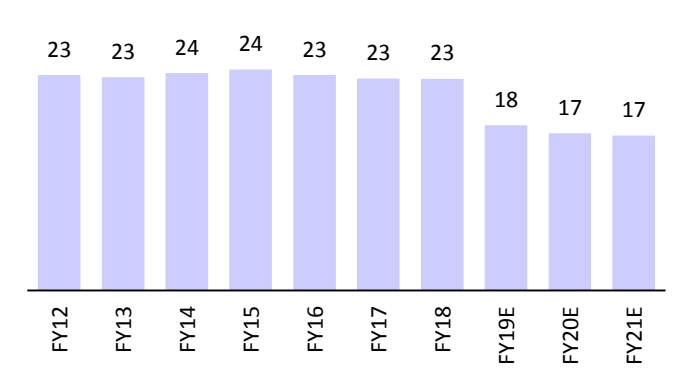
After downsizing its loss-making dailies and turning EBITDA positive, Spencer’s has realized that the hypermarket format is the most efficient. It targets to add ~15% store area (cumulatively ~0.44msf over FY19-21E), adding 15 stores p.a. To improve store productivity, it plans to curb store size to 15,000-18,000sf. Following a cluster-based approach, it plans to add new stores in four clusters – (a) West Bengal, (b) NCR and Eastern UP, (c) AP and Telangana and (d) Kerala and Tamil Nadu – to improve supply chain and other marketing cost efficiencies. Spencer’s continues to run dailies, albeit at a lower scale and largely to supplement its hypermarket stores. Subsequently, the management plans to add dailies selectively in Kolkata, Gurgaon and Lucknow, where it has a healthy hypermarket presence.

Exhibit 379: Expect 15 new compact hypermarket stores/year



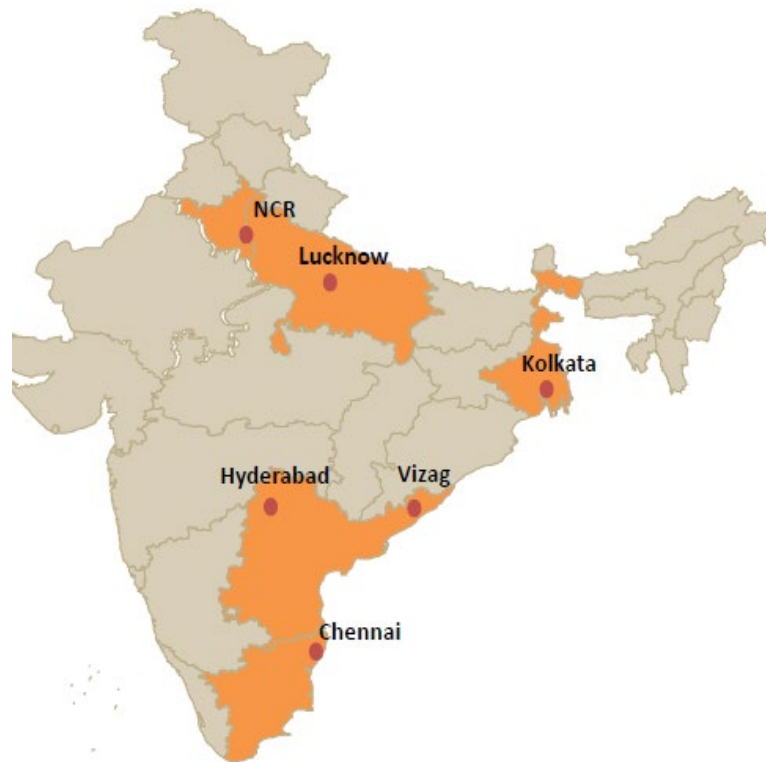
Source: MOFSL, Company

Exhibit 380: Average size of compact hypermarket stores to decline (sqft'000)



Source: MOFSL, Company

Exhibit 381: Spencer's key geographies



Source: MOFSL, Company



Launch of value fashion apparel brand '2Bme' to drive growth

To increase bill size and store productivity, Spencer's plans to increase non-food revenue mix and focus primarily on apparel. The value fashion apparel space remains an upcoming potential market, as improving standards of living are shifting consumption from unorganized local apparel to private labels. In line with the industry trend, Spencer's launched its private label, 2Bme about three quarters ago, targeting the value fashion segment (products under INR999) and infused complete range of inventory (menswear, womens' wear and kidswear) in 58 hypermarket stores (FY19E). It plans to take the revenue share of apparel to 10% in three years from the current 4-5%. Given the low brand recall for 2Bme, the initial one year may remain challenging, with heavy branding, marketing and discounting even with a strong product profile. However, despite the flux of inventory across retailers, value fashion remains a robust growth market.

Recovery in sight

FY18 was a weak year, with declining revenue, primarily due to negative SSSG pulled down by GST rollout issues, renovation of its largest store in South City, Kolkata, and the ban on sale of liquor along highways. However, GST implementation issues are getting ironed out and the South City store has resumed operations. The declassification of liquor-selling highway locations from national highways too has mitigated the impact on liquor sales. With each of these issues behind, growth revival is in sight. Increasing share of new stores should further support growth with improving productivity. We expect 14% revenue CAGR over FY19-21 on the back of 7% SSSG and 15 new store additions annually.

Targets to increase the share of private label to 10% by FY21

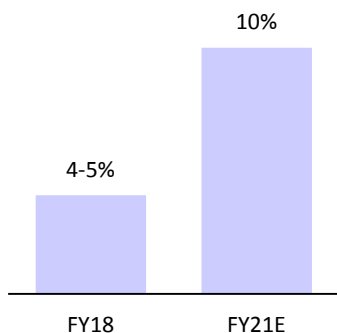
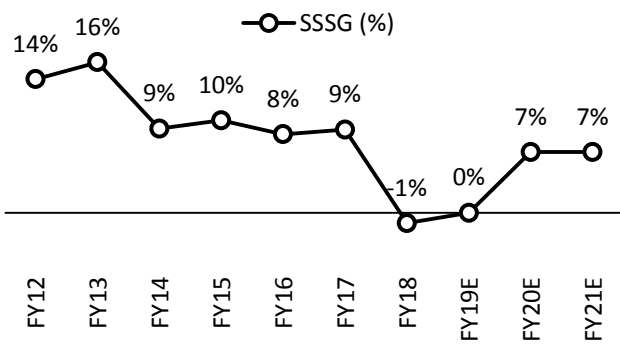
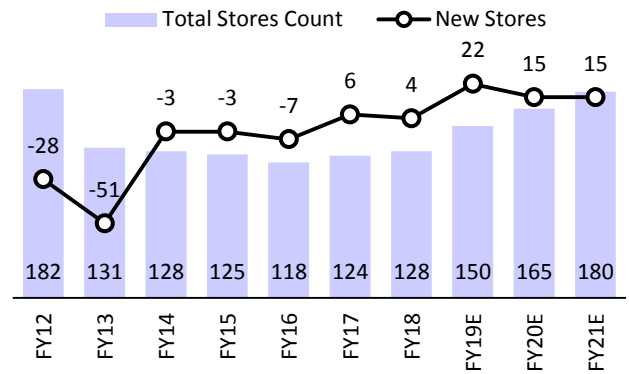


Exhibit 382: SSSG to inch up to 7% over FY19-21



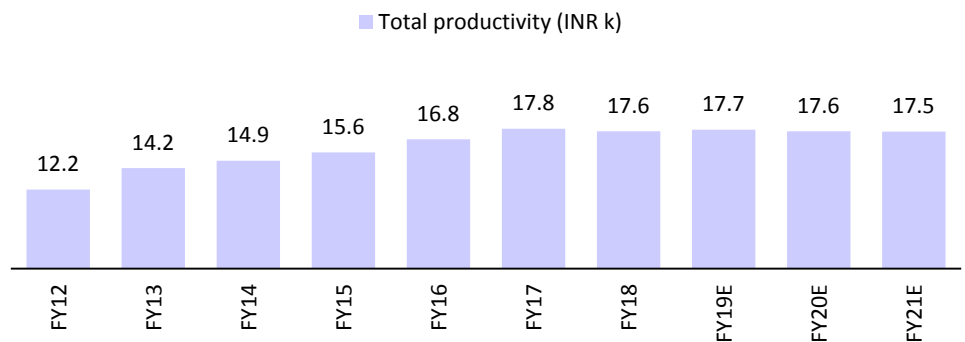
Source: MOFSL, Company

Exhibit 383: Expect 15 net store additions/year in FY20/21



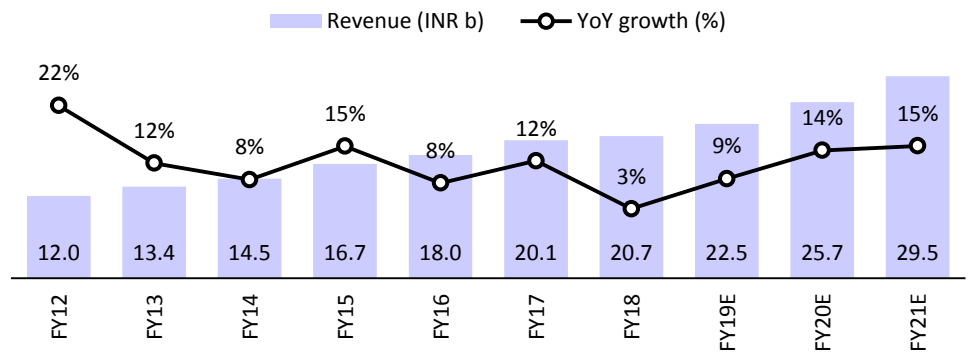
Source: MOFSL, Company

Exhibit 384: Productivity to remain steady on a high base over FY19-21



Source: MOFSL, Company

Exhibit 385: Revenue to grow at 14% CAGR over FY19-21



Source: MOFSL, Company

EBITDA margin on the uptrend

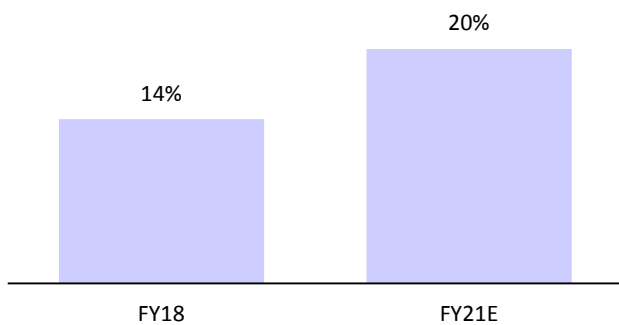
Expect 140bp expansion to ~2% by FY21

- Focus on increasing the share of margin accretive private labels (to 20% by FY21) and non-food categories (primarily apparel – 10% by FY21) and rationalizing average store size should drive gross margin expansion of 50bp over FY19-21.
- This coupled with inherent operating leverage should act as a catalyst for EBITDA margin expansion.
- We expect EBITDA margin to expand 140bp to ~2% by FY21.

Focus on private label bodes well

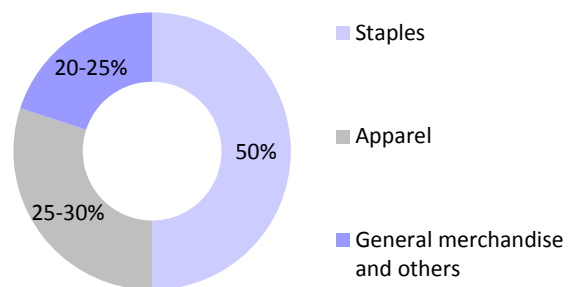
Spencer’s private labels (INR3b portfolio presently) contribute ~14% of revenue. Of this, 50% is from labeled staples and 25-30% is from labeled apparel. Typically, private labels offer ~ 5% higher gross margins than third-party brands. The management targets to increase the share of private labels to 20% in 2-3 years. Most retailers strive for high share of private labels in terms of shelf space and revenue mix. If products are attractively priced and quality is maintained, there could be a healthy shift towards private labels in staples.

Exhibit 386: Management targets to increase the overall share of private labels to 20% by FY21



Source: MOFSL, Company

Exhibit 387: Break-up of private labels (FY18)



Source: MOFSL, Company

Exhibit 388: Spencer’s private label brands



Source: MOFSL, Company

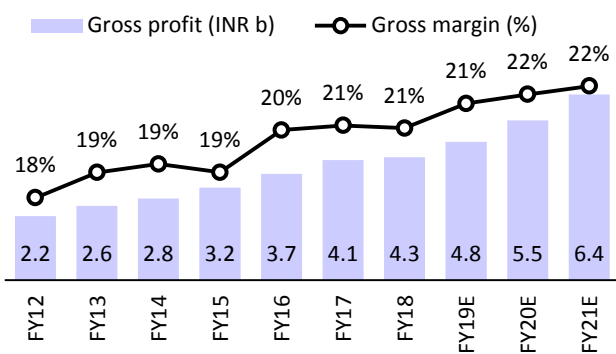
Focus on margin-accretive non-food items, including apparel

Driven by the launch of 2Bme in the apparel category, the management targets to increase the revenue share of private label apparel. Against overall gross margin of ~20%, apparel garners ~35% gross margin. This should also allow the company to improve customer bill size and drive store productivity, providing better operating leverage for store fixed cost. Spencer’s targets to increase the revenue share of apparel to 7-8% in two years and to 10% in three years from the current 4-5%.

Reducing store size, healthy SSSG to drive operating leverage

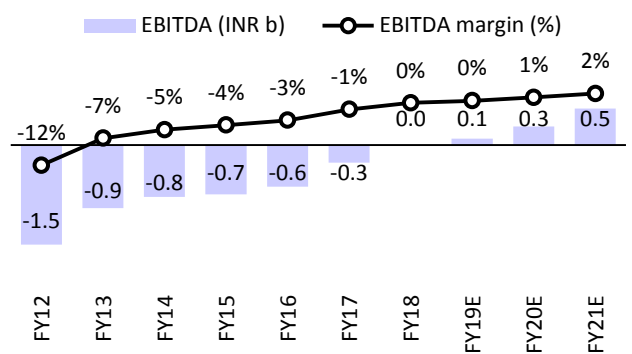
To improve store productivity, Spencer’s plans to open new hypermarket stores in existing clusters, reduce average store size to ~15,000-18,000sf from 23,000-25,000sf. Further, we believe higher proportion of new stores and increasing share of apparel should support healthy SSSG. We expect per store fixed cost to reduce and the company to realize scale benefits. EBITDA margin should expand 140bp over FY19-21 to ~2% on the back of 50bp gross margin expansion and opex efficiency of 90bp.

Exhibit 389: Gross margin to expand 50bp over FY19-21



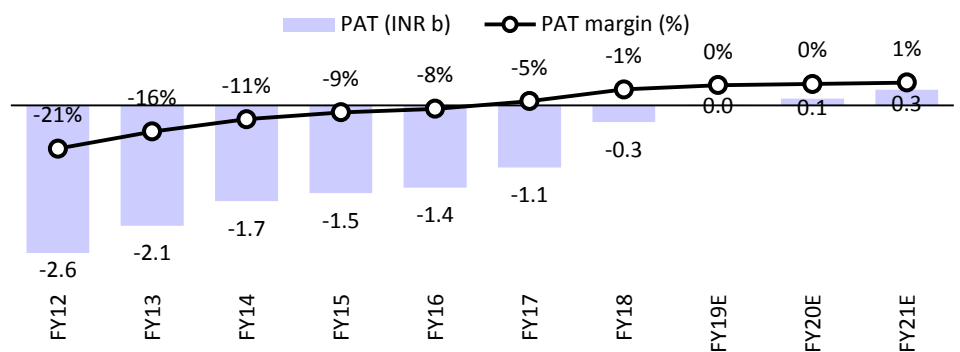
Source: MOFSL, Company

Exhibit 390: EBITDA margin to expand 140bp over FY19-21



Source: MOFSL, Company

Exhibit 391: PAT margin to turn around and reach 1% by FY21



Source: MOFSL, Company

Early inroads to omni channel a big positive

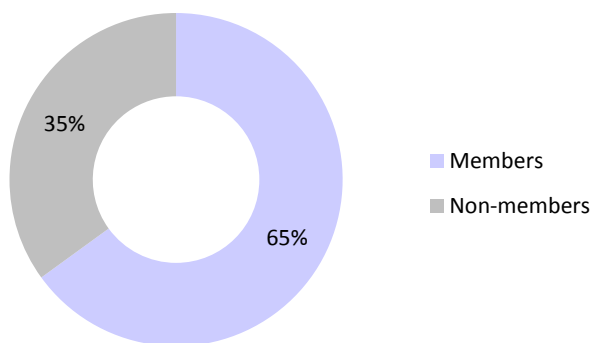
Target to increase share of online sales to 8-10%

- The management targets to increase the revenue share from online sales to 8-10% by FY21, thus increasing the productivity per store. This is on the back of (a) higher spends (1.2-1.5x offline spends) due to ease in shopping, and (b) deep customer data analytics program.
- Though inherent logistics and warehousing costs are a key hurdle to ecommerce, operating in close proximity to stores would help reduce costs and allow Spencer's to offer complementary service offerings.

To increase wallet share through convenience, analytics

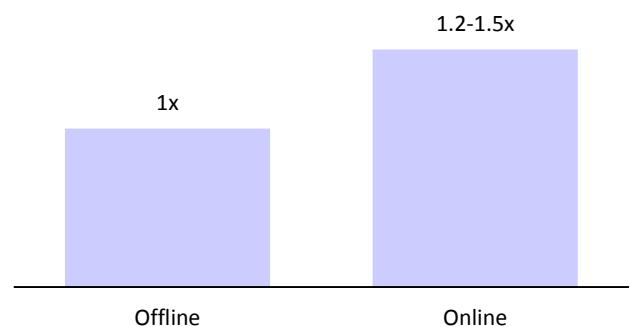
Through its omni-channel presence, Spencer's targets to increase consumption spend. According to an AC Nielsen report, average Indian consumer shops 12x a month for groceries, of which visits to hypermarkets are restricted to 1.8x a month. Spencer targets to increase the average consumer's monthly purchases from hypermarkets either by increasing store visits or offering the convenience of ordering online. Combining data analytics with online operations, Spencer's offers customers preferential pricing through its loyalty program, creating a sticky customer base. With 65% revenue from loyal customers, it further links customers' consumption patterns with store offers and maps online requests to nearby stores, providing consumers the comfort to find store products/offers online. Typically, online purchases drive 1.2-1.5x spends v/s store purchases due to the convenience factor. Omni-channel presence helps target a wider customer base, thus improving store productivity.

Exhibit 392: ~65% of total revenues generated from members



Source: MOFSL, Company

Exhibit 393: Ease of online shopping leads to 1.2-1.5x higher consumption spends

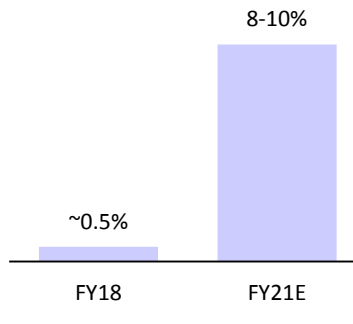


Source: MOFSL, Company

Targeting existing regions

Spencer's has begun offering omni-channel services in a limited region. At the moment, it has restricted itself to 20 cities in its two dominating clusters – a) NCR/East UP and b) West Bengal. It plans to scale its omni-channel presence across regions where it has a healthy hypermarket presence.

Targets to increase revenue share from online business to 8-10% by FY21



Solving key hurdles – logistics and warehousing costs

Given that it has restricted itself to existing clusters, Spencer’s omni-channel model keeps logistics/warehousing costs under check. Proximity to stores reduces (a) variable cost attributed to product delivery, (b) warehousing costs, as the store houses all products, (c) wastage of perishable items due to the store’s inventory churn. Targeting a radius of 5km around the store, delivery cost works out to about INR60/order for an average INR1,100 ticket size, including fuel and manpower cost, which translates into 5-6% of revenue.

Spencer’s presently serves ~50,000 orders monthly and is expected to turn profitable at ~75,000 orders. The online industry’s business model remains fluid, as the consumer’s purchasing patterns and cost structure are not yet streamlined. Further expanding online business across regions will keep variable and fixed costs high. The management targets to increase the online revenue mix to 8-10% by FY21 from negligible presently. We factor limited upside from the online category.

Leaner balance sheet; enough to fund next 2-3 years

Cash of INR2.5b to fund INR400-500m annual capex

- Healthy growth and turnaround in margins augur well for healthy OCF generation.
- Net cash of over INR2.5b (FY19E) coupled with cumulative OCF of INR0.8b over FY19-21 should support capex requirements of INR400m-500m, without the need for incremental gearing.
- Low margin to keep RoCE/RoIC in single digit at 6% by FY21.

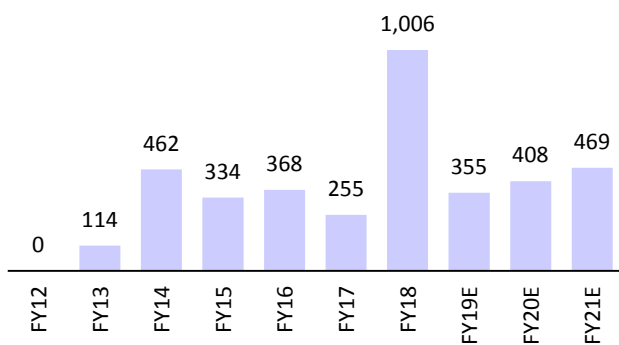
Internal cash flows to support store additions

We expect 15% total area (sqft) addition across store formats in FY20/21. At INR40m for an 18,000sf store, Spencer’s would require capex of 1400m-500m annually. This could be largely funded internally, given net cash of INR2.5b (FY19E) coupled with cumulative OCF of INR0.8b over FY19-21, assuming ~2% EBITDA margin. Spencer’s should remain debt-free, with no incremental gearing, despite ramp-up in expansion post demerger. We expect RoCE/RoIC to remain in single digit at 6% by FY21 given the low EBITDA margin expectation.

CESC hive-off a welcome positive

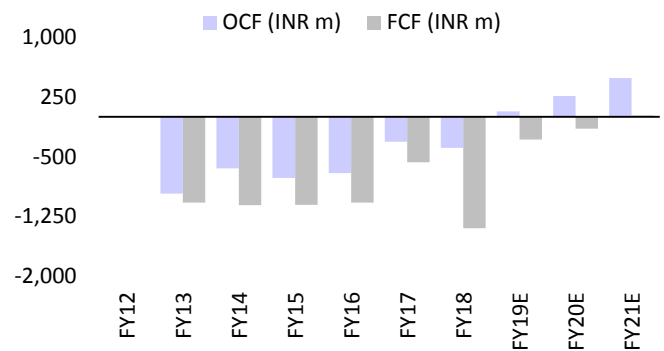
Hive-off from CESC should provide much-needed focus to the retail business. Leaner debt-free balance sheet and steady OCF should allow Spencer’s to accelerate store additions and improve store productivity by focusing on lower store size and non-food product offerings.

Exhibit 394: Capex to be INR400b-500m per year over FY19-21



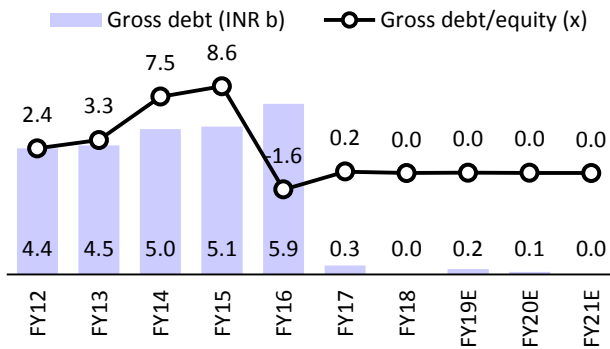
Source: MOFSL, Company

Exhibit 395: Healthy EBITDA growth should lead to quick improvement in OCF and FCF generation over FY19-21



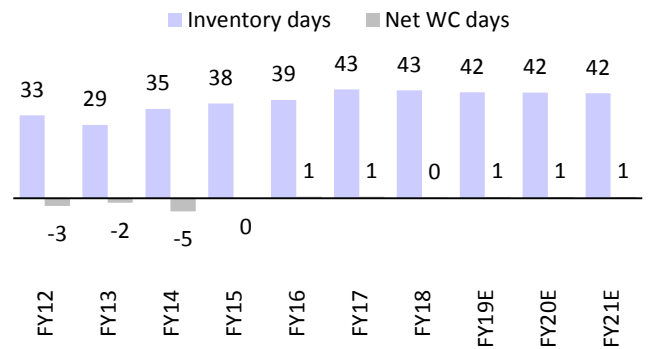
Source: MOFSL, Company

Exhibit 396: To remain debt-free, as capex gets funded internally



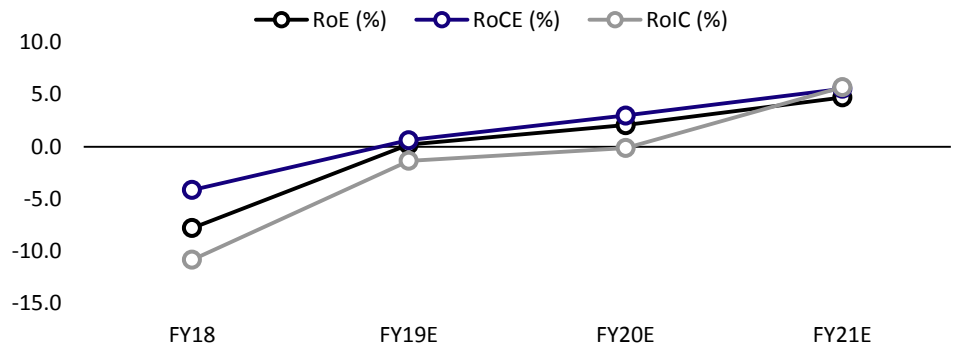
Source: MOFSL, Company

Exhibit 397: Inventory days to remain steady at 40 days



Source: MOFSL, Company

Exhibit 398: Return ratios to witness a turnaround from FY20



Source: Company, MOFSL

Valuation and view

CESC's hived off retail venture – Spencer's valued at INR200

- Though the retail business is yet to attain a steady state, we believe strong group backing and growth horizon insight bode well for Spencer's.
- We recommend Buy, valuing Spencer's Retail at INR200/share, ascribing 0.5x to FY21E sales.

Spencer's is presently operating at low EBITDA margin and is yet to attain a stable state business profitability garnering healthy SSSG, margins and RoCE. However, with the backing of a strong business group, presence of over two decades, huge growth opportunity, and recent EBITDA turnaround, we see good investment potential. Given its recovery phase and presently low EBITDA margin, we have valued it on EV/Sales basis with 0.5x on FY21E sales of INR29.5b, valuing Spencer's at INR200/share; recommend **Buy**.

Exhibit 399: Valuation based on FY21E sales

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR b)	Value/sh (INR)
Total Enterprise Value	EV/Sales	29.5	0.5	13.6	170
Less Net debt				-2.5	-31
Equity Value				16.0	200
Shares o/s (m)				80.0	
CMP (INR)					164
Upside (%)					22

Source: MOFSL, Company

Financials and valuations

Consolidated - Income Statement

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	14,513	16,657	17,965	20,124	20,730	22,524	25,676	29,479
Change (%)	8.5	14.8	7.9	12.0	3.0	8.7	14.0	14.8
Raw Materials	11,692	13,460	14,292	15,982	16,480	17,742	20,155	23,068
Employees Cost	1,140	1,310	1,366	1,452	1,470	1,572	1,823	2,064
Rent	772	826	940	1,063	1,112	1,317	1,560	1,847
Other Expenses	1,678	1,794	1,983	1,887	1,668	1,797	1,861	1,960
Total Expenditure	15,281	17,390	18,582	20,384	20,730	22,428	25,399	28,939
% of Sales	105.3	104.4	103.4	101.3	100.0	99.6	98.9	98.2
EBITDA	-768	-733	-617	-260	0	96	276	540
Margin (%)	-5.3	-4.4	-3.4	-1.3	0.0	0.4	1.1	1.8
Depreciation	319	369	367	332	340	253	280	311
EBIT	-1,088	-1,102	-984	-592	-340	-158	-4	229
Int. and Finance Charges	434	476	530	573	130	77	69	62
Other Income	67	62	89	89	180	272	217	174
PBT bef. EO Exp.	-1,454	-1,516	-1,425	-1,076	-290	37	144	341
EO Items	-204	0	0	0	0	0	0	0
PBT after EO Exp.	-1,658	-1,516	-1,425	-1,076	-290	37	144	341
Total Tax	0	0	0	0	0	26	30	70
Tax Rate (%)	0.0	0.0	0.0	0.0	0.0	68.6	20.5	20.5
Minority Interest	0	0	0	0	0	0	0	0
Reported PAT	-1,658	-1,516	-1,425	-1,076	-290	12	115	271
Adjusted PAT	-1,454	-1,516	-1,425	-1,076	-290	12	115	271
Change (%)	NM	NM	NM	NM	NM	LP	879.3	136.3
Margin (%)	-10.0	-9.1	-7.9	-5.3	-1.4	0.1	0.4	0.9

Consolidated - Balance Sheet

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	1,734	2,428	2,968	2,968	398	398	398	398
Total Reserves	-1,070	-1,833	-6,584	-978	5,074	5,085	5,200	5,471
Net Worth	665	595	-3,617	1,990	5,471	5,483	5,598	5,869
Minority Interest	0	0	0	0	0	0	0	0
Total Loans	5,016	5,110	5,896	307	0	182	82	0
Deferred Tax Liabilities	-3,105	-3,105	0	0	0	0	0	0
Capital Employed	2,575	2,600	2,279	2,297	5,471	5,665	5,680	5,869
Net Fixed Assets	1,952	1,741	1,707	1,694	2,387	2,489	2,616	2,775
Capital WIP	6	139	81	29	2	2	2	2
Total Investments	320	720	199	298	69	69	69	69
Curr. Assets, Loans & Adv.	2,707	2,896	3,248	3,810	6,278	6,516	6,856	7,434
Inventory	1,406	1,712	1,917	2,378	2,425	2,585	2,937	3,362
Account Receivables	209	212	279	273	402	366	418	480
Cash and Bank Balance	61	39	62	74	1,000	2,588	2,488	2,535
Loans and Advances	1,030	933	990	1,085	2,451	976	1,013	1,058
Curr. Liability & Prov.	2,409	2,897	2,955	3,534	3,264	3,409	3,863	4,409
Account Payables	1,819	1,935	2,160	2,615	2,802	2,916	3,313	3,791
Other Current Liabilities	414	773	577	685	229	248	282	323
Provisions	176	188	218	234	232	245	268	295
Net Current Assets	298	0	293	276	3,014	3,106	2,993	3,024
Appl. of Funds	2,575	2,600	2,279	2,297	5,471	5,665	5,680	5,869

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	-4.9	-5.1	-4.8	-3.6	-1.0	0.0	0.4	0.9
Cash EPS	-3.8	-3.9	-3.6	-2.5	0.2	0.9	1.3	2.0
BV/Share	2.2	2.0	-12.2	6.7	18.4	18.5	18.9	19.8
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				NM	NM	NM	413.0	174.8
Cash P/E				NM	948.4	178.8	120.0	81.4
P/BV				23.8	8.7	8.6	8.5	8.1
EV/Sales				2.4	2.2	2.0	1.8	1.5
EV/EBITDA				NM	NM	471.2	163.0	83.1
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-2.5	-3.7	-3.6	-1.9	-4.7	-1.0	-0.5	0.1
Return Ratios (%)								
RoE	-143.4	-240.7	94.3	132.3	-7.8	0.2	2.1	4.7
RoCE	-17.7	-18.3	-22.4	-22.0	-4.1	0.6	3.0	5.6
RoIC	-49.1	-56.6	-54.1	-30.9	-10.8	-1.3	-0.1	5.7
Working Capital Ratios								
Fixed Asset Turnover (x)	7.4	9.6	10.5	11.9	8.7	9.1	9.8	10.6
Asset Turnover (x)	5.6	6.4	7.9	8.8	3.8	4.0	4.5	5.0
Inventory (Days)	35	38	39	43	43	42	42	42
Debtor (Days)	5	5	6	5	7	6	6	6
Creditor (Days)	46	42	44	47	49	47	47	47
Leverage Ratio (x)								
Current Ratio	1.1	1.0	1.1	1.1	1.9	1.9	1.8	1.7
Interest Cover Ratio	-2.5	-2.3	-1.9	-1.0	-2.6	-2.1	-0.1	3.7
Net Debt/Equity	7.0	7.3	-1.6	0.0	-0.2	-0.5	-0.4	-0.4

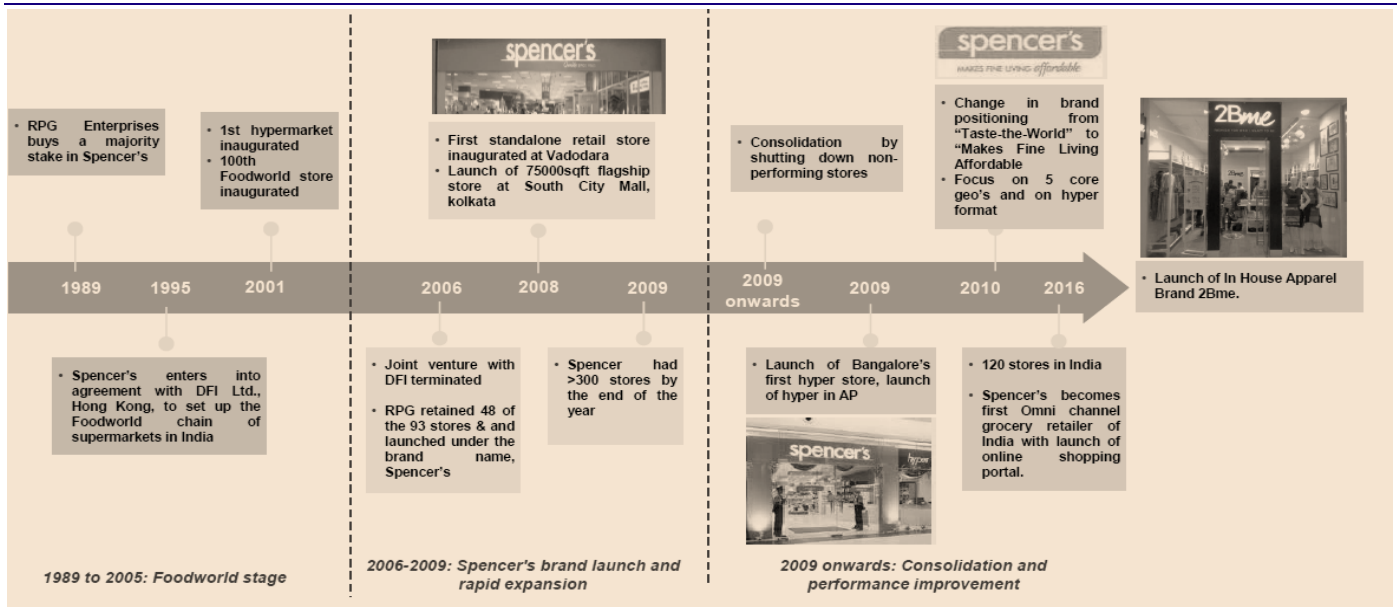
Consolidated - Cash Flow Statement

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
EBITDA	-768	-733	-617	-260	0	96	276	540
Direct Taxes Paid	0	0	0	0	0	-26	-30	-70
(Inc)/Dec in WC	0	0	0	60	-386	0	13	16
CF from Operations	-768	-733	-617	-200	-386	70	260	487
Others	490	-38	-90	-113	0	0	0	0
CF from Operating incl EO	-278	-771	-707	-313	-386	70	260	487
(Inc)/Dec in FA	-462	-334	-368	-255	-1,006	-355	-408	-469
Free Cash Flow	-740	-1,105	-1,075	-568	-1,392	-285	-148	17
(Pur)/Sale of Investments	-393	-517	-419	-345	229	0	0	0
Others	368	360	152	28	-1,246	1,767	217	174
CF from Investments	-487	-491	-635	-572	-2,023	1,412	-191	-295
Issue of Shares	1,298	1,486	1,130	6,900	3,772	0	0	0
Inc/(Dec) in Debt	338	160	616	-5,566	-307	182	-100	-82
Interest Paid	-337	-351	-366	-417	-130	-77	-69	-62
Dividend Paid	0	0	0	0	0	0	0	0
Others	-117	0	0	0	0	0	0	0
CF from Fin. Activity	1,181	1,295	1,380	917	3,335	105	-169	-144
Inc/Dec of Cash	416	33	39	32	926	1,588	-100	47
Opening Balance	58	51	39	42	74	1,000	2,588	2,488
Closing Balance	474	84	78	74	1,000	2,588	2,488	2,535

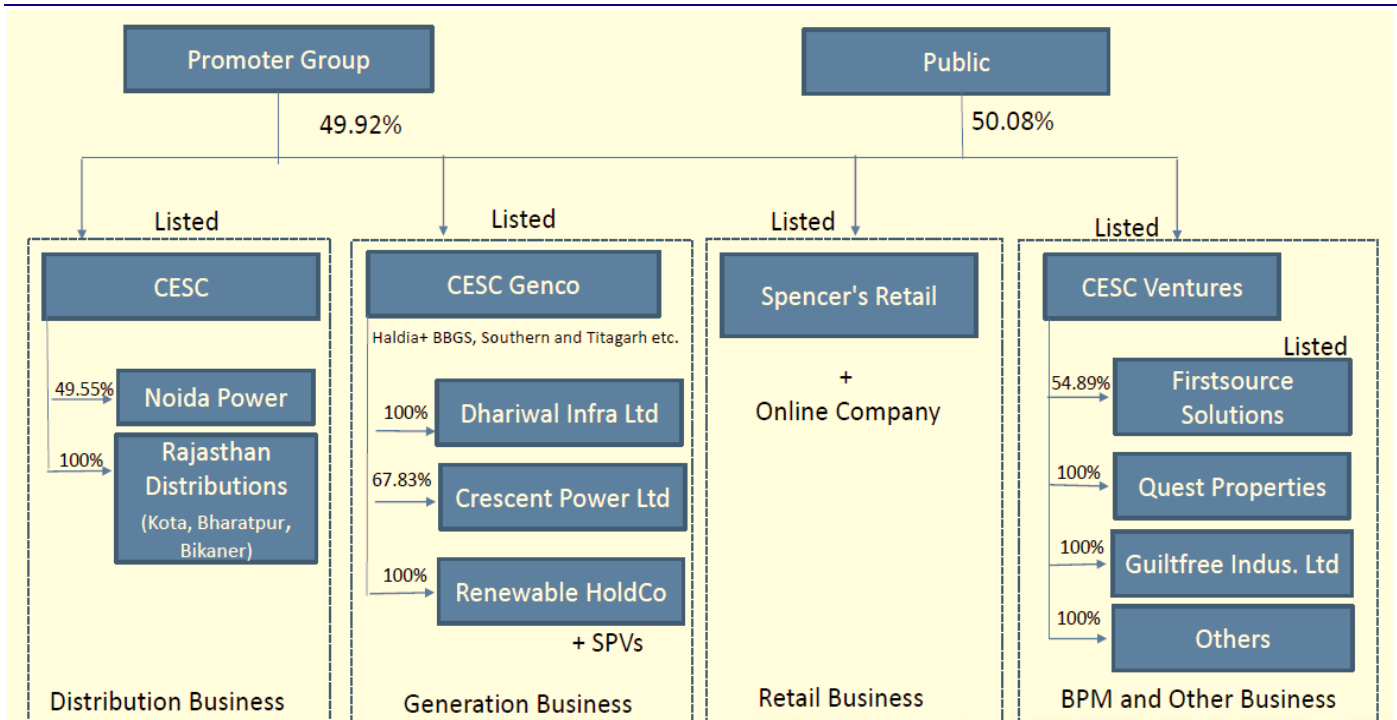
ANNEXURE

Exhibit 400: Spencer's evolution



Source: MOFSL, Company

Exhibit 401: Spencer's restructuring



Source: MOFSL, Company

Trent

BSE SENSEX 38,862 S&P CNX 11,666

CMP: INR353

TP: INR440 (+25%)

Buy



Stock Info

Bloomberg	TRENT IN
Equity Shares (m)	332
M.Cap.(INRb)/(USDb)	117.3 / 1.7
52-Week Range (INR)	397 / 295
1, 6, 12 Rel. Per (%)	-5/-10/-14
12M Avg Val (INR M)	52
Free float (%)	67.4

Financials Snapshot (INR b)

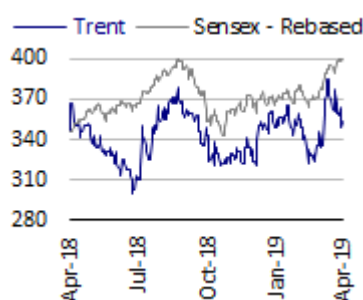
Y/E	March	FY19E	FY20E	FY21E
Sales	25.7	30.8	36.2	
EBITDA	2.3	2.9	3.6	
NP	1.4	2.0	2.6	
EPS (Rs)	4.2	5.9	7.8	
EPS Gr. (%)	60.8	40.5	32.2	
BV/Sh. (INR)	52.2	58.1	66.0	
P/E (x)	83.8	59.7	45.1	
P/BV (x)	6.8	6.1	5.4	
EV/EBITDA (x)	52.8	41.3	33.1	
EV/Sales (x)	4.7	3.9	3.3	
RoE (%)	8.4	10.7	12.6	
RoCE (%)	6.7	7.7	8.6	

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	32.6	32.6	32.6
DII	15.8	15.1	13.1
FII	23.1	23.7	25.3
Others	28.5	28.6	29.0

FII Includes depository receipts

Stock Performance (1-year)



Revenue set for steady uptick

Potential valuation upside from Zara and Star market

- With its thrust on women-centric fashion and private labels, Westside has created a strong brand. It should witness robust 17% revenue CAGR over FY19-21.
- Also, rejig in the operational strategy of Star Bazaar and Zudio stores puts THPL at an inflection point. We expect EBITDA margin to improve from -7% in FY19 to 4% by FY21, led by 18% revenue CAGR and increasing share of private labels.
- We expect consolidated revenue CAGR of 19% over FY19-21, primarily driven by Westside. This, coupled with operating leverage and healthy private label mix, should lead to 100bp margin expansion to 10% by FY21.
- The stock has been range bound in the last 12 months despite consistent growth.
- We recommend Buy with an SOTP-based TP of INR440, ascribing Westside and Zara 25x FY21E EBITDA (~20% premium to the target EV/EBITDA multiple of our apparel coverage), and THPL (Star branded grocery chain) 1x FY21E sales.

Westside – Cracked the growth recipe

Operating in the mid-premium to premium category, Westside has all the ingredients of a productive store: (a) high private label share, (b) right store size, (c) in-house designing and apparel sourcing and (d) high share of women's apparel. This has helped it to achieve estimated EBITDA margin of ~11% (FY19). Shrinkage has reduced from 0.5% in FY13 to just 0.12% in FY18. Consistently growing club membership, coupled with secular 8% CAGR in average bill size, has led to steady 9% SSSG over FY16-19E. Given its healthy balance sheet and strong execution capability, we expect average addition of 23 stores per year in FY20/21. This, coupled with 9% SSSG, should drive 17% revenue CAGR over FY19-21.

Star – work in progress

TRENT's 50% retail venture, Trent Hypermarket (THPL), which runs the *Star* brand stores, was among the first to enter the food and grocery retail business. However, it is yet to become profitable – negative 7% EBITDA margin (FY19E). After operating in three different formats – Star Daily (~2,500sf store size), Star Market (~8,000sf), and Star Bazaar (~20,000sf), it is now focusing on the Star Market format. It has closed the loss-making Star Daily format and is tightening the SKU list for Star Market to improve store productivity. The launch of gross margin-accretive apparel line-up, Zudio, in all 12 Star Bazaar stores should further improve store turnover and profitability. We have built in 15 Star Market store adds annually over FY19-21 (company targets 20-25 store adds annually). This, coupled with 7% SSSG, should help THPL grow at 18% over FY19-21. The closure of loss-making Star Daily stores, the launch of Zudio and the focus on the profitable Star Market format should reduce EBITDA loss to 4% by FY21, enabling THPL to reach closer to breakeven.

Zara – value-unlocking potential

Trent holds 49% stake in its JV - Inditex Trent Retail India Private Limited (Inditex-Trent). However, the operations of Zara and Massimo Dutti are controlled by Inditex (in entirety), whereas Trent has primarily been a financial investor. After the revival of margin in FY18 from the impact of countervailing duty, we expect healthy 20% revenue CAGR and 16% EBITDA margin over FY19-21. With FY21E EBITDA of INR3.5b, Zara could garner healthy enterprise value of INR42b at 25x EV/EBITDA, ~33% of TRENT's overall value. Over the next 5-7 years, this could increase to 35-40%, considering the fast evolving market for premium fast fashion products and Zara's strong product portfolio.

Revenue and margins ready for a fillip

We expect TRENT's consol. revenue CAGR of 19% over FY19-21 on (a) Westside's 17% revenue CAGR, backed by 9% SSSG and addition of average 23 stores per year, and (b) Zudio's 58% standalone revenue CAGR (on a low base), led by 10 independent store adds annually. THPL's (Star branded grocery chain) revenue should grow at 18% CAGR over FY19-21 led by 7% SSSG and 15 annual store adds. TRENT's consol. EBITDA margin has improved to 9% (FY19E) and incremental margin expansion will be subject to the pace of SSSG. We believe consolidated EBITDA margin could improve 100bp over FY19-21 on operating leverage from Westside's steady 9% SSSG and healthy store adds. RoIC should improve from 11% in FY19E to 14% in FY21, with improving earnings and asset turns, and efficient working capital cycle of about 25 days. FCF should remain steady despite aggressive store adds; we expect cumulative FCF of INR1.3b over FY19-21.

Valuation and view

The stock has seen time correction of 12-15 months despite consistent growth. We have valued each business separately on an SOTP basis – Westside/Zara on EV/EBITDA of 25x on an FY21E basis (~20% premium to the target EV/EBITDA multiple of our apparel coverage, given its strong track record and dominance in the lifestyle apparel category) and THPL (Star branded grocery chain) on 1x EV/sales on FY21E as it is incurring losses. Thus, we arrive at a TP of INR440 - 25% upside. This implies EV/EBITDA of 25x on FY21E EBITDA, including EBITDA share of JVs – Inditex and THPL; at par with three-year average. Also, a faster-than-expected recovery in THPL and accelerated SSG in Westside could offer further upside. Recommend **Buy**.

Exhibit 402: Retail format-wise breakup (FY19E)

TRENT						
	STANDALONE			JOINT VENTURE		
	WESTSIDE	landmark FOR THE CHILD IN ALL OF US	zudio	star EXTRA HYPER MARKET DAILY <small>A TATA and TESCO Enterprise</small>	ZARA Massimo Dutti	
REVENUE (INR B)	23.0	0.4	1.3	10.8	15.3	
REVENUE CONTRIBUTION (%)	93%	2%	5%	N.A.	N.A.	
EBITDA MARGIN (%)	~11%	N.A.	N.A.	-7%	16%	
NO OF STORES	145	5	25	50	25	
AREA (M SQFT)	2.3	N.A.	N.A.	~0.5	N.A.	
AVG. REVENUE/SQ.FT (INR'000)	10.7	N.A.	N.A.	24.7	N.A.	

Source: MOFSL, Company



Westside – Cracked the growth recipe

Expect strong 17% revenue CAGR over FY19-21

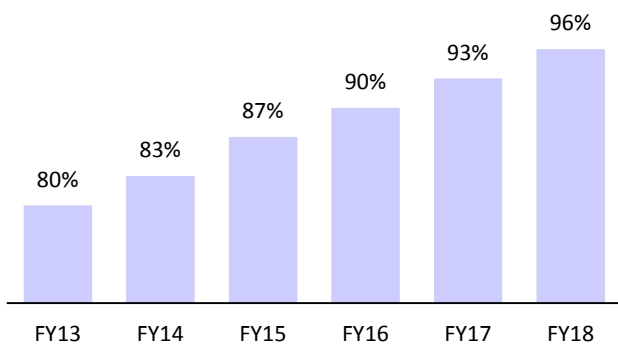
- Continuous rise in the private label mix (>96%) and thrust on women’s outfits (contributing more than half of revenue) should continue to drive SSSG.
- We expect revenue to grow at a strong 17% CAGR over FY19-21, primarily led by healthy 9% SSSG and an average 23 new store adds annually to 191 by FY21 (145 in FY19E).
- Right mix of an average 17.5k store size and dominance in the most difficult ethnic/fast fashion women apparel wear allow it to garner store productivity of ~INR10.7k/sq. ft.

Under its flagship format, Westside, TRENT operates 145 apparel stores (FY19E). These stores offer products for men, women and kids. There are two things that set Westside apart:

High share of private labels

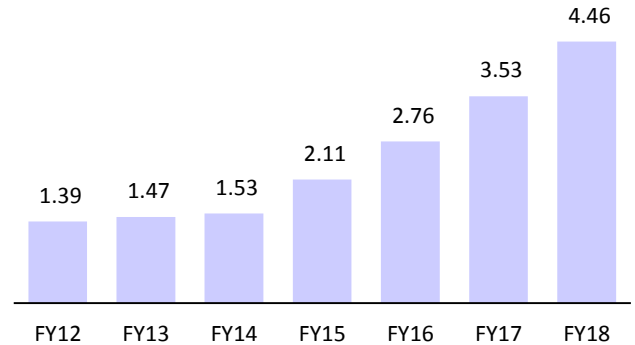
Strong brand loyalty for in-house private labels is the key to an efficient and profitable apparel store. For Westside, the revenue share of private labels has not only been high but has also been increasing further – up from 80% in FY13 to more than 96% in FY18. It procures products on outright basis, controls the sourcing, and manages the inventory cycle, resulting in shrinkage of just 0.12%. Westside’s discounted sales account for 10-15% of its total revenue, far below 20-25% for other brands in the industry, enabling it to earn higher margins.

Exhibit 403: High and rising share of private labels (%)



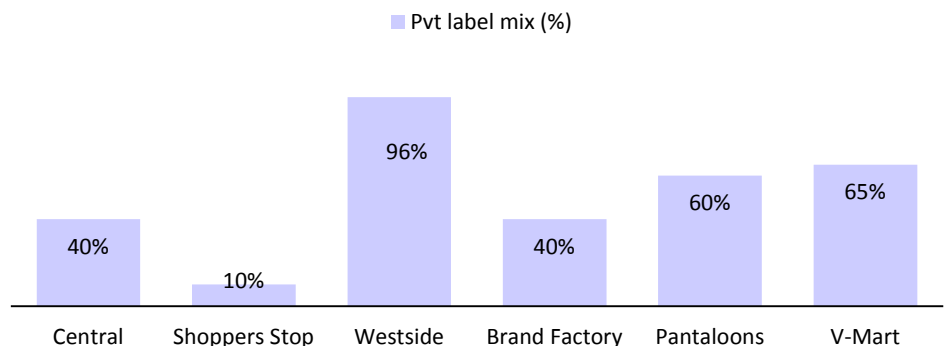
Source: MOFSL, Company

Exhibit 404: Growing Club-West membership (m)



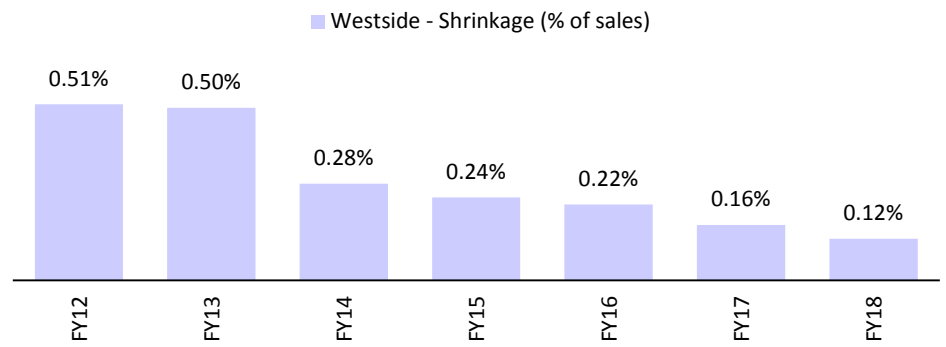
Source: MOFSL, Company

Exhibit 405: Highest private labels in the industry



FY18 basis; Source: MOFSL, Company

Exhibit 406: Shrinkage at all-time low levels of 0.12%



FY18 basis; Source: MOFSL, Company



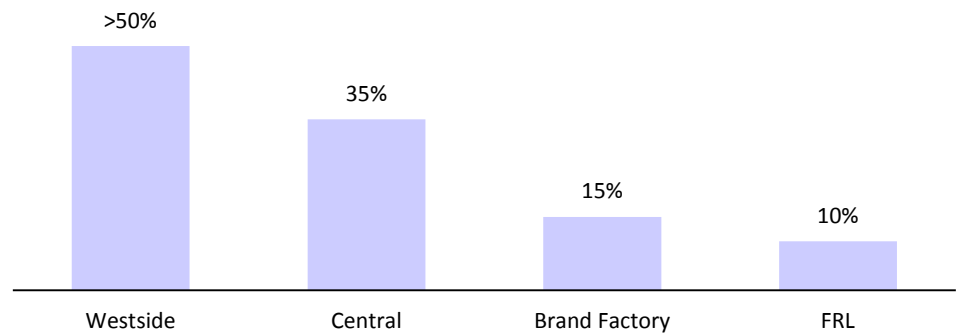
Westside frequently revamps brands as well as product styles. In the last one year, Westside has launched five new brands – Studiofit (fitness), Utsa (women’s ethnic apparel), Vark (traditional salwar kameez), Luna Blu (women’s footwear), and Soleplay (men’s footwear). The management believes the private label model allows it to control the product portfolio, pricing and cost structure, resulting in higher margins and RoCE. Westside enjoys healthy EBITDA margin of ~11% (FY19E).



Predominantly focused on women’s apparel

Women’s apparel contributes more than half of Westside’s apparel revenue. Unlike most other women’s apparel brands in India, Westside focuses not only on traditional Indian apparel but also on fast fashion western apparel. To attract the complete family to an apparel store, the management believes it is most important to attract women through its own brands. This increases footfalls and shopping time, eventually resulting in higher bill size.

Exhibit 407: Highest mix of women’s apparel in the industry (%)



Source: MOFSL, Company

MARKETPLACE



Omni-channel presence to deepen penetration

TRENT has a 10% stake in Tata Group’s e-commerce venture, www.tatacliq.com, which is 90% owned by Tata Group entities. The website is a marketplace that offers multiple product categories, including apparel, electronics, and jewelry. For TRENT, it provides an omni-channel presence for its Westside offerings.

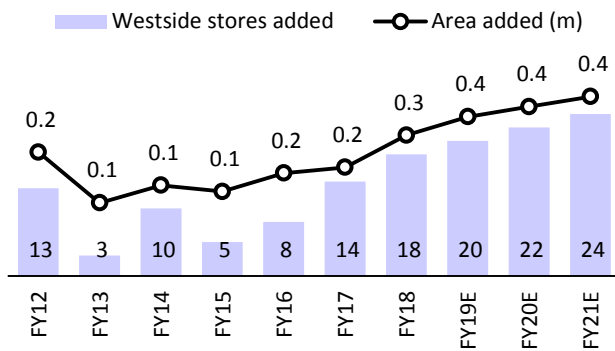
Tata cliq has a central inventory position with merchandise range synchronized with the in-store offer. It emphasizes on leveraging the Westside store network and strong digitally enabled product delivery engine across the value chain, creating an efficient logistics cost structure.

It also has exclusivity of arrangement with brands, allowing it to better compete with the discounts on other marketplace websites. In FY18, Westside online revenues were up over three-fold YoY and the channel is now profitable. Management targets revenues of ~INR1b through this channel in FY19.

Nailed the store size to garner better productivity

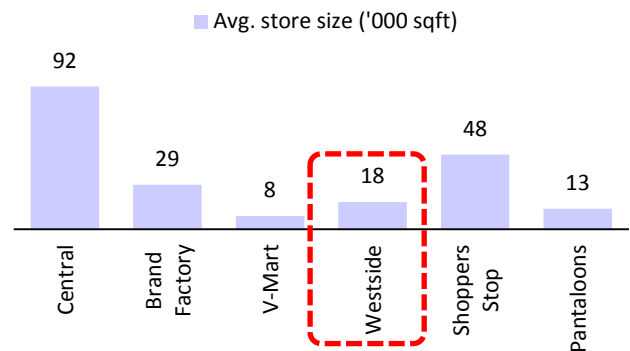
Westside stores have an average store size of ~17,500sf. The management believes this store size allows for an ideal store layout, enabling it to offer ample SKUs and achieve superior productivity. Lean store size has allowed it to improve store efficiency.

Exhibit 408: Steadily rising area under network



Source: MOFSL, Company

Exhibit 409: 17.5ksf store size well suited to offer wide range of SKUs



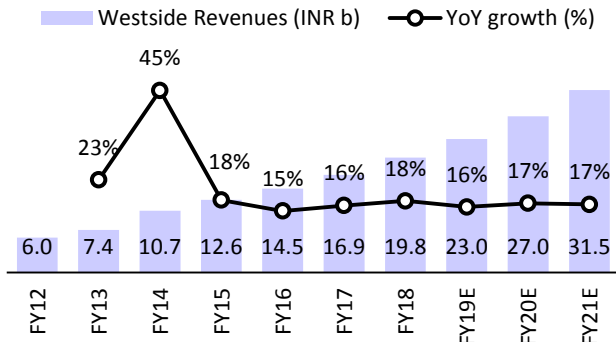
Source: MOFSL, Company

Healthy 9% SSSG to fuel growth

After adding an average of 8-10 stores in the last five years until FY16, Westside added 14/18/20 stores in FY17/18/19E. We expect addition of 23 stores per year over FY19-21 to 191 stores by FY21 (145 in FY19E). The management targets double-digit SSSG, outpacing the inflation rate, led by increasing bill size. It has been modernizing its stores; nearly 15 (~10%) stores have been revamped in the last two years and the company targets to revamp 7-9 stores in the next one year. Typically, store revamps result in 10-15% increase in productivity. In the last three years (FY16-19E), Westside has witnessed an average of 9% SSSG. Its store productivity has reached ~INR10.6k/sf (FY19E), among the highest in the apparel category. Westside’s consistent product refreshment and target to increase customer wallet share should hold in good stead.

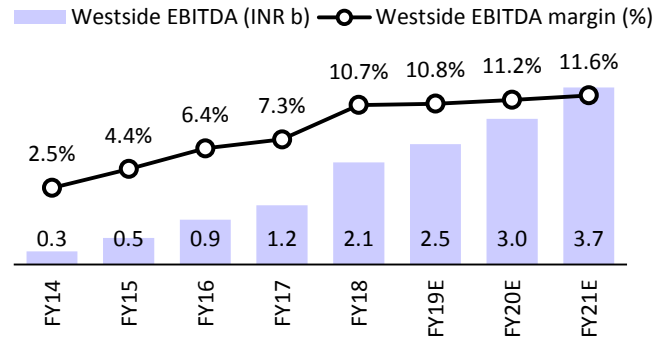
We expect Westside’s revenue to grow at a robust 17% CAGR over FY19-21, led by an increase in productivity at existing stores driving 9% SSSG, coupled with healthy new store adds. We expect EBITDA margin to expand 80bp to 11.6% by FY21.

Exhibit 410: Westside revenue to grow at strong 17% CAGR over FY19-21...



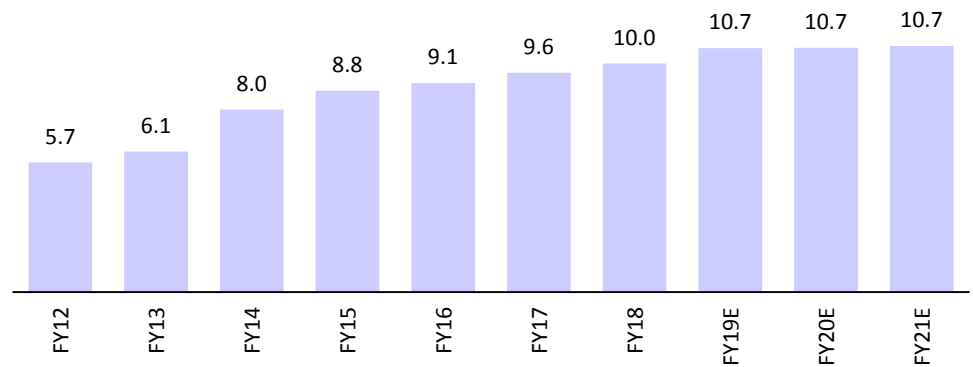
Source: MOFSL, Company

Exhibit 411: ...with EBITDA margin gradually inching up on high base



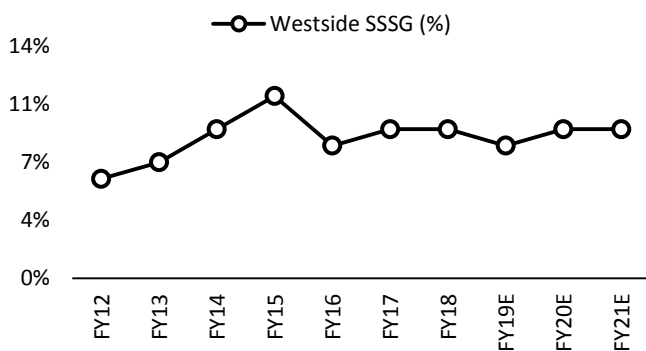
Note: Assuming INR100m EBITDA loss for Zudio and EBITDA breakeven for Landmark in FY18
Source: MOFSL, Company

Exhibit 412: Productivity per square foot to gradually inch up... (INR k)



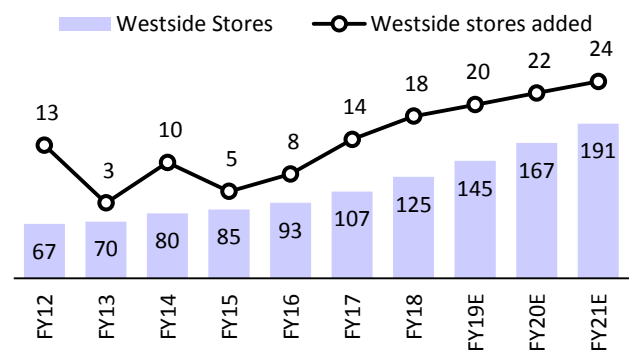
Source: MOFSL, Company

Exhibit 413: ...strong 9% SSSG over FY19-21 and...



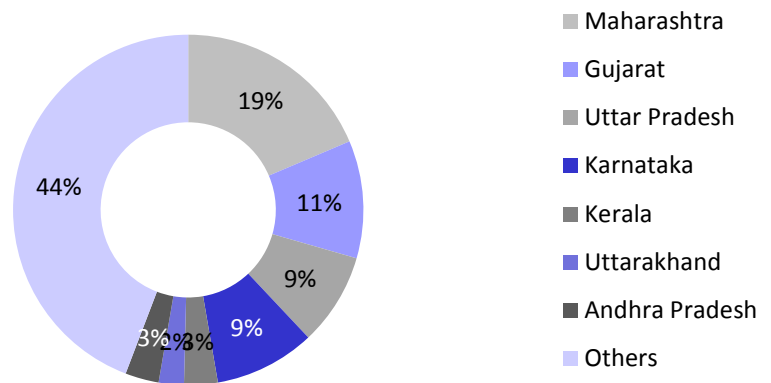
Source: MOFSL, Company

Exhibit 414: ...healthy 23 store additions per year



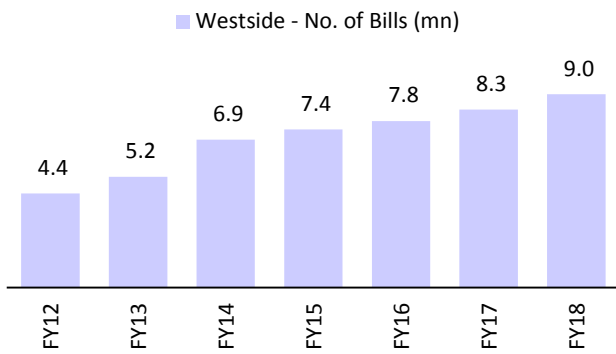
Source: MOFSL, Company

Exhibit 415: Geography-wise store concentration (FY18, %)



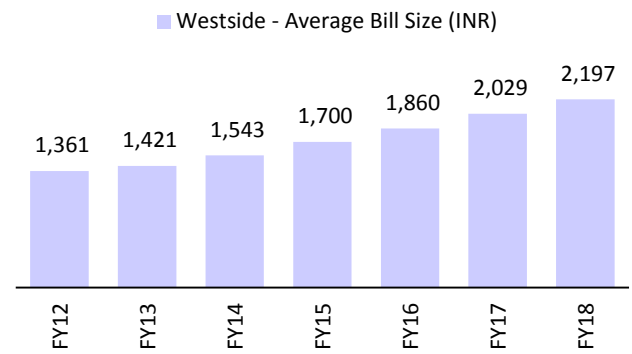
Source: MOFSL, Company

Exhibit 416: Steady growth in number of bills (m) and...



Source: MOFSL, Company

Exhibit 417: ...an uptick in bill size to support SSSG (INR)

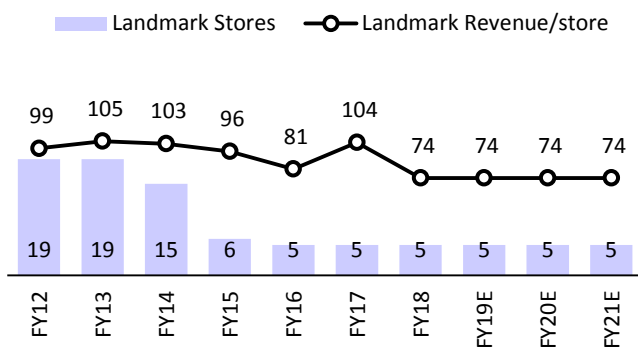


Source: MOFSL, Company

Landmark – expect single-digit growth

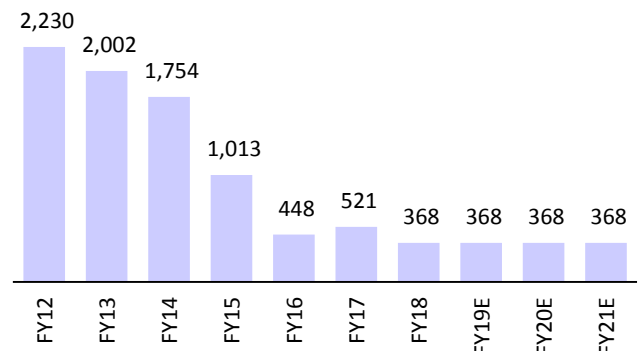
Landmark, which provides family entertainment offerings like toys, books and sports merchandize, earns annual revenue of just INR500m-600m (3% contribution) and has achieved EBITDA breakeven. It operates through five independent stores and select retail Westside outlets. The strategy is to focus on sports retailing, which has strong potential. However, there are no major store rollout or product extension plans. Earnings are likely to grow at a modest single-digit rate.

Exhibit 418: Revenue per store to remain steady



Source: MOFSL, Company

Exhibit 419: Revenue to remain stable at ~INR370m (INR m)



*For FY18, we assume ~2% of standalone revenue
Source: MOFSL, Company

A TATA and TESCO Enterprise



Star – at an inflection point

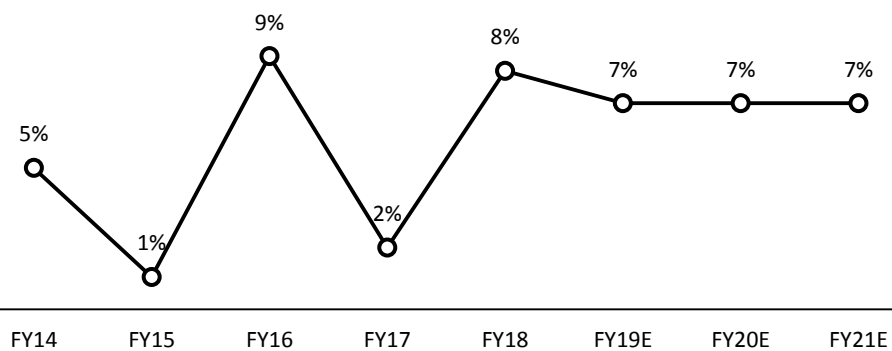
Expect negative EBITDA margins to trim down

- Despite being early mover, Star is yet to crack the code for a profitable retail venture. After multiple trials, management now has a clear growth strategy in terms of:
 - Store format: Focus shifted to Star market formats (avg. store size of 8-10k sqft) targeted towards food and grocery v/s other smaller and larger format stores. Managements target of aggressive 20-25 Star market stores additions annually with cluster based approach bode well.
 - Thrust on Zudio: A value proposition fashion brand (INR1.4b), present in 15 Star locations and 7 standalone stores, has a lucrative revenue/sq. ft. of INR10.4k. It plans to scale up the network significantly and also drive Star’s store throughput.
 - We expect revenue to grow at 18% CAGR over FY19-21 led by 7% SSSG over FY19-21.
- Company’s target to increase the mix of private labels to 20% in FMCG (currently 10%) and closure of the loss making Star Dailies, should aid in garnering better productivity and margins. We expect the current -7% (FY19E) EBITDA margins to trim down to -4% by FY21.

An early mover in the multi-brand food and grocery retail segment, Star is yet to turn profitable. It is focusing on four key things to reduce losses, improve productivity and enhance margins:

1. Strong food and grocery portfolio anchored by USP of fresh food
2. Leaner format size to improve productivity
3. Emphasis on own brands across categories to improve gross margin
4. Cluster presence in select states/cities to reduce supply chain cost

Exhibit 420: Expect modest 7% SSSG over FY19-21



Source: MOFSL, Company



Known for fresh food

Star’s fresh food product range – it offers fresh vegetables and meat at value prices – has become the lead footfall driver. It sources 70% of the vegetables directly from over 200 farmers through a network of collection and distribution centers. It competes with smaller vegetable vendors that operate on low inventory size, attractive pricing, proximity to residential areas, and direct quality management. Yet, it has effectively managed multiple issues like quality, inventory (enabling consistent availability), waste, and cost, and is seen as offering value.

Revising format size to turn profitable

An early mover in the multi-brand food and grocery retail segment, Star is yet to turn profitable. With wafer-thin gross margin of 20% in the segment, it is critical to get the format size and product mix right. Having tried three formats – Star Daily (~2,000sf), Star Market (8,000-10,000sf), and Star Bazaar (17,500sf), it is now primarily focusing on Star Market. It has closed most of its loss-making Star Daily stores and plans to continue existing Star Bazaar stores without significant new additions. Star Market’s lean store size will compel it to focus on sharper product portfolio, as it targets superior productivity. Further, the closure of 10 loss-making Star Daily stores should curtail losses. The company targets about 100 Star Market stores by FY21, opening 20-25 stores annually.

Exhibit 421: Star Market the way forward (msf)

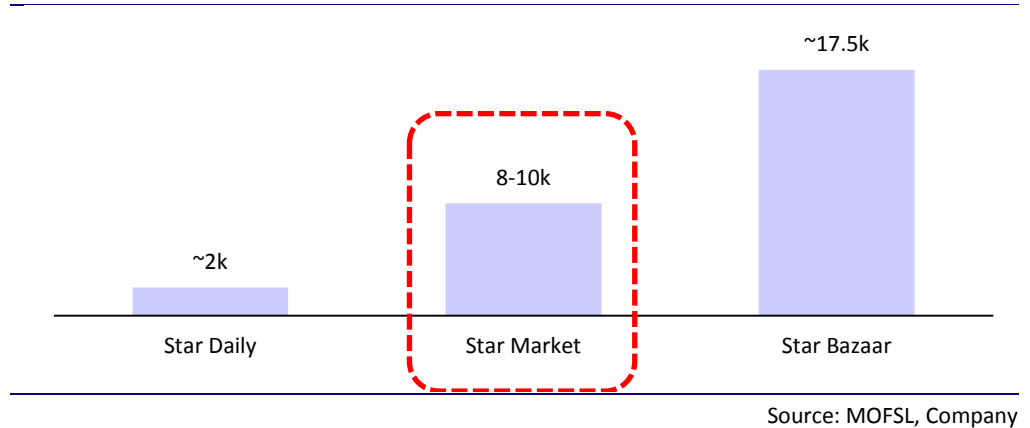


Exhibit 422: Ramp-up in Star Market store count...

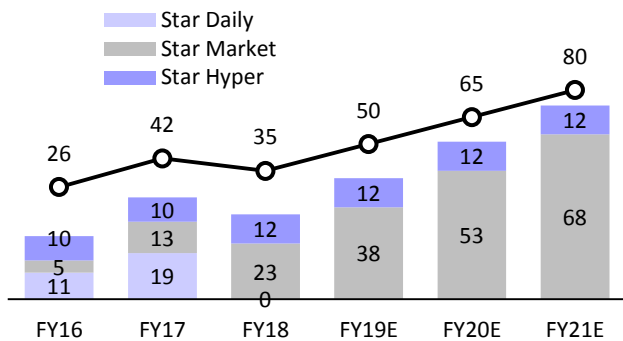
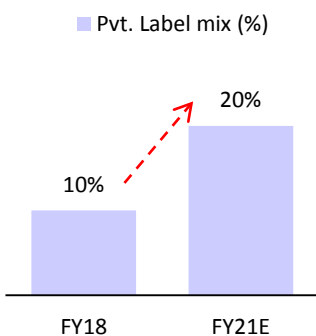
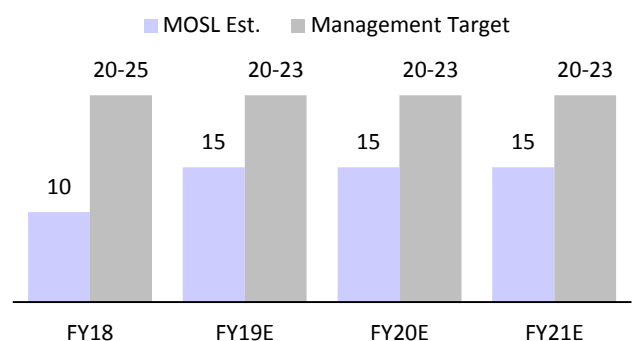


Exhibit 423: ...led by 15 store adds per year



Revamping product categories to support EBITDA recovery

THPL plans to increase the share of private labels in its overall sales mix, as it typically reduces costs by ~5%, thus improving gross margins. In the last one year, it has added over 200 SKUs across staples, beverages, cleaning aids, ready foods, and health and beauty. The intent is to offer more of Tata-branded private labels. It has launched ‘KLIA’ for cleaning products, ‘FABSTA’ for FMCG products, and ‘SKYE’ for personal care. It targets to double the share of private label sales in the FMCG space from 10% to 20%. This should support margin expansion.

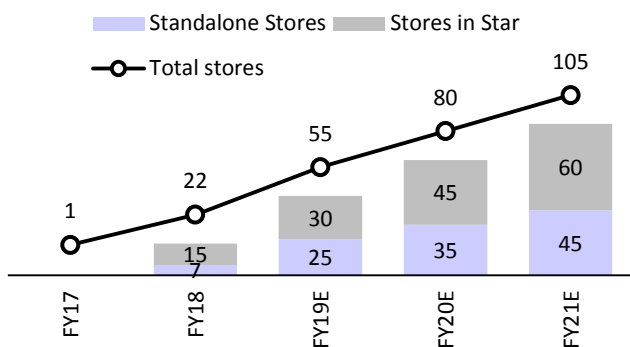
Zudio – focus on apparel to improve margins, wallet share

Zudio, a value fashion brand is a new venture. Until FY17 it was part of THPL and only present in Star Bazaar but the company carved out the venture from its JV in FY18 and is now part of TRENT’s standalone vertical.

Zudio’s apparel line-up is also housed in Star Bazaar, in line with most retailers’ strategy to increase store productivity through apparel offerings. This allows Star to fill the gap of apparel offers provided by all peers in the retail industry. In its first leg of expansion, it has covered all the 15 larger format stores – Star Bazaar houses Zudio’s complete range including apparel for men, women and kids. Typically, apparel enjoys 40% gross margin compared to 15-17% for food. Hence, a rising share of apparel sales should improve profitability, though turnover may be lower. Further, in-house sourcing and quality control capability in Westside should allow TRENT to provide a better product portfolio at healthy margins. This should improve Star’s overall profitability. However, value fashion is a highly competitive market, with most retailers building scale to improve store productivity and profitability, and may require investment in branding and marketing to enhance brand recall.

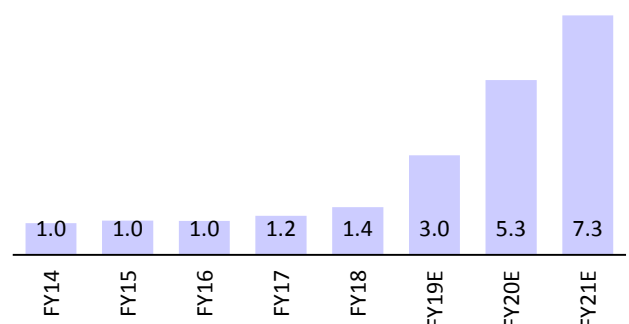
Expect 10 stores adds annually: Management has an aggressive target to reach 50 stores by the next few months. We expect 10 independent stores adds annually reaching 45 stores by FY21. This should require capex of INR150-160m annually, assuming capex of INR2,500/sq.ft. Store expansion should provide impetus to revenue growth. We expect Zudio’s standalone revenue CAGR of 58% over FY19-21 on a low base, contributing 9% of TRENT’s standalone revenue by FY21 (up from 2% in FY18).

Exhibit 424: Uptick in standalone/Star located store count should lead to...



Source: MOFSL, Company

Exhibit 425: ...a fillip in Zudio’s total revenue (INR b)



Includes revenue from Star, Zudio standalone stores and Tatacliq
Source: MOFSL, Company

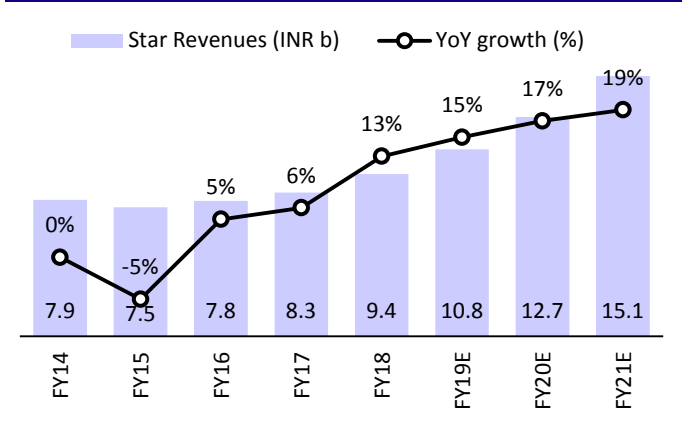
Cluster approach expansion bodes well

To create local scale and supply chain advantage, THPL continues its cluster-based approach with stores in Maharashtra, Karnataka and Telangana. This is even more relevant, given the focus on fresh food, which has low shelf life, and therefore, less turnaround time to make it available from the farm to the selling counter.

Expect EBITDA margin to shrink to -4% by FY21

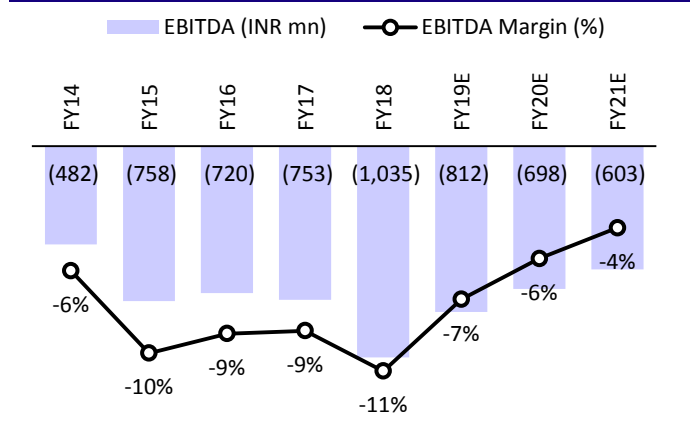
THPL operates at EBITDA margin of -7%, with a revenue scale of INR10.8b (FY19E). We expect EBITDA margin to improve to -4%, and EBITDA loss to reduce to about INR600m by FY21. This would be driven by (a) productivity improvement derived from a wider product category including apparels, (b) lower cost through aggressive private label push, (c) greater focus on margin-accretive apparel segment, and (d) closure of loss-making Star Daily stores.

Exhibit 426: Revenue to grow at 18% CAGR over FY19-21...



Source: MOFSL, Company

Exhibit 427: ...narrowing EBITDA loss



Source: MOFSL, Company

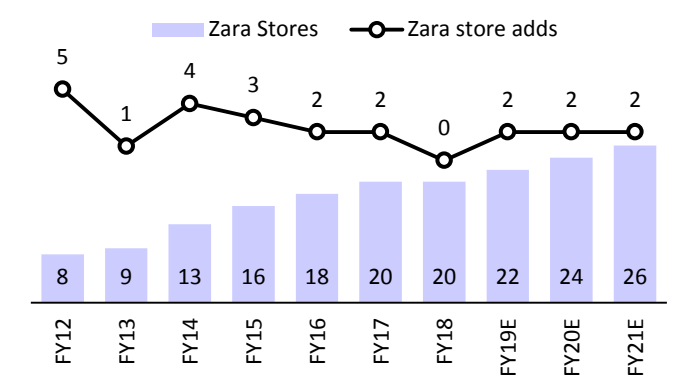
Zara - Value unlocking potential

EBITDA margins at the cusp of revival

- Strong traction for the fast growing apparel branded apparel market should aid Zara revenues grow at 20% CAGR over FY19-21. Besides, the resurgence in EBITDA margins to 16% (from the 9% in FY17) bodes well.
- This should provide impetus to higher earnings from JV, and thereby increase its contribution to the overall EV of Trent. Ascribing 22x to FY21 EBITDA, the JV forms constitutes 1/3rd of the total Trent's current market cap.

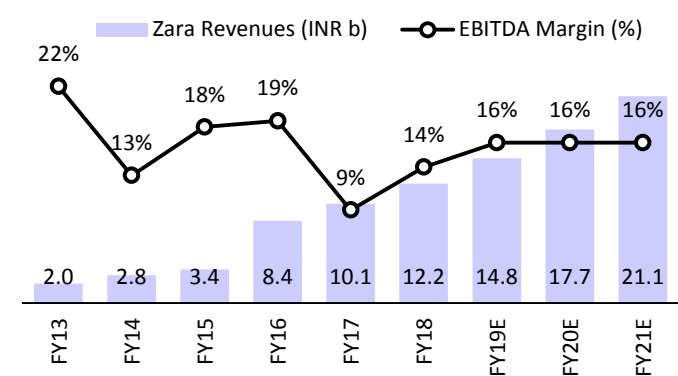
TRENT has a 49% JV with Inditex, Inditex Trent Retail India Private Limited (Inditex-Trent), to retail Zara's apparel products in India. The backend product sourcing as well as the front-end retailing, marketing and branding are managed by Inditex, the 51% JV partner, leaving limited operational scope for TRENT. The venture is a pure-play investment for TRENT and could create strong equity value for the company.

Exhibit 428: Store adds to remain steady



Source: MOFSL, Company

Exhibit 429: EBITDA margin to revive



Source: MOFSL, Company

Could be valued at one-third of TRENT's market cap by FY21

Inditex-Trent has consistently grown at over 20% to INR12b in annual revenue in FY18. After increasing to 19% in FY16, EBITDA margin dropped sharply to 9% in FY17 due to countervailing duty, which has been addressed; FY18 EBITDA margin at 14%. We expect EBITDA of INR3.5b and PAT of INR2.1b in FY21 on healthy volume growth and stable margins. At 22x EV/EBITDA, equity value would be INR37b, over one-third of TRENT's current market cap, with implied P/E of 19x.

Exhibit 430: Zara contributing ~1/3rd to Trent's market cap

Particulars	INR b
FY21 EBITDA	3.5
TRENT's share @ 49%	1.7
EV/EBITDA (x)	22
Enterprise Value/Market cap	37
Trent's current market cap	118
Contribution (%)	32

Source: MOFSL, Company

Revenue and margins ready for a fillip

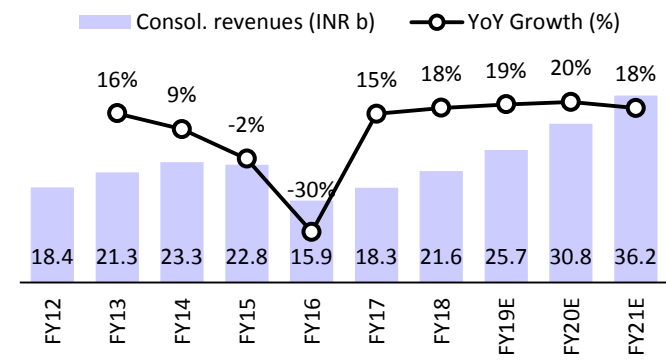
Expect robust 36% PAT CAGR over FY19-21

- We expect consol. revenue to grow at robust 19% CAGR over FY19-21 primarily led by strong 17% CAGR of Westside revenue.
- Besides, the inherent operating leverage from the Westside stores should provide impetus to ~100bp improvement in EBITDA margins. Subsequently, we expect 26%/36% consol. EBITDA/PAT CAGR over FY19-21.
- This coupled with moderate capex should drive RoIC, reaching 14% by FY21E.

We expect consolidated revenue to grow at 19% over FY19-21, backed by healthy SSSG and addition of Westside stores. EBITDA margin should expand ~100bp, supporting 26% EBITDA CAGR and 36% PAT CAGR. Westside, Star and Zudio are the key drivers for TRENT’s earnings growth. The robust revenue outlook is on the back of 9% SSSG and addition of 23 stores/year for Westside and 7% SSSG and addition of 15 stores/year for Star.

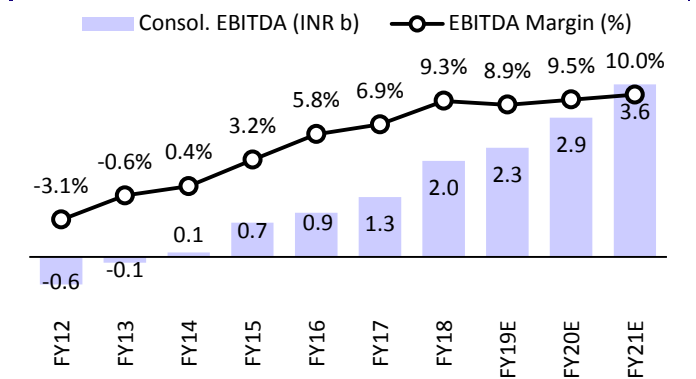
EBITDA margin should expand ~100bp over FY19-21 to 10%, primarily on an uptick in Westside’s EBITDA margin. Operating leverage from healthy SSSG and favorable private label/apparel mix should drive Westside’s margins.

Exhibit 431: Consolidated revenue to grow at robust 19% CAGR over FY19-21...



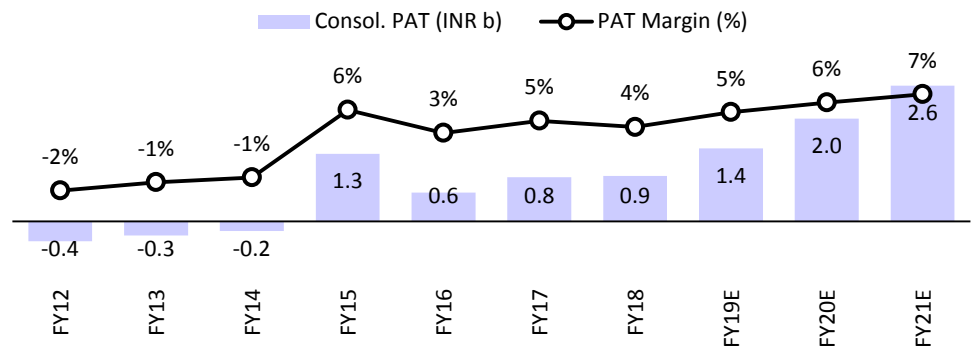
Source: MOFSL, Company

Exhibit 432: ...with EBITDA margin expanding 100bp to reach 10% by FY21



Source: MOFSL, Company

Exhibit 433: Consolidated PAT to witness 36% CAGR over FY19-21

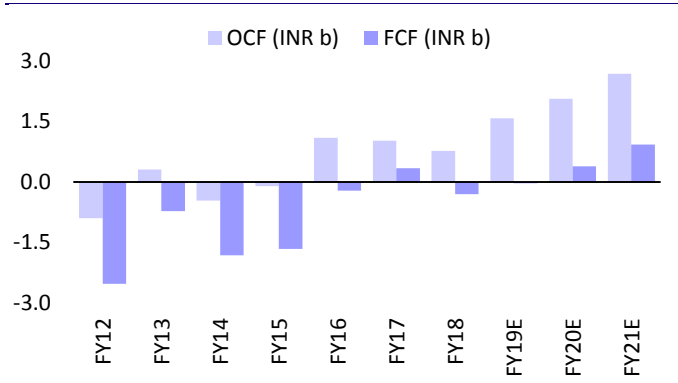


Source: MOFSL, Company

Capex to be easily funded

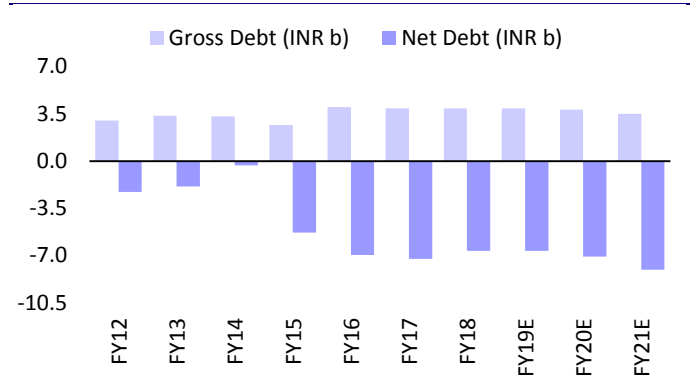
TRENT has consistently remained a net cash company (INR6.6b FY19E). It has steadily added stores, but without external capital. Going forward too, while we expect store addition to accelerate, overall capex should be within the operating cash flow. We expect cumulative OCF of INR4.7b over the next two years, which should suffice for annual capex requirement of INR1.7b. Excluding cash, RoIC stands at 11% (FY19E). In the next two years, we expect high asset turns backed by better store productivity and higher EBITDA margin to support healthy RoIC (14% by FY21E).

Exhibit 434: Increasing OCF with steady capex should drive cumulative FCF of INR1.3b over FY19-21...



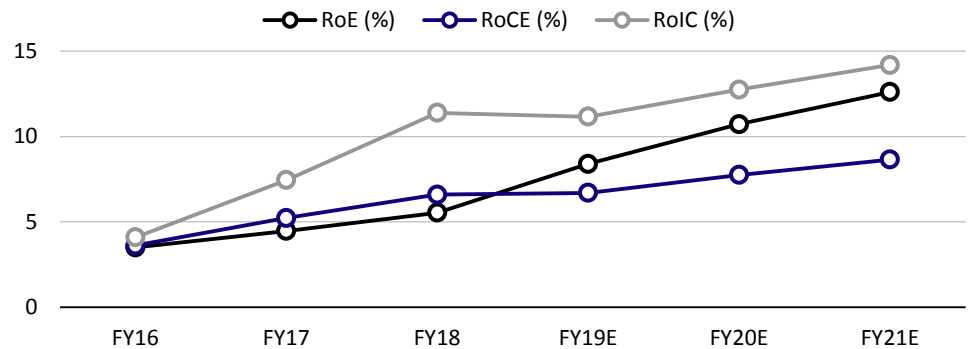
Source: MOFSL, Company

Exhibit 435: ...providing impetus to net cash



Source: MOFSL, Company

Exhibit 436: Return ratios set to grow



Source: MOFSL, Company

Healthy store payback

An average 17.5ksf Westside store requires a total investment of ~INR56m (INR3.3k/sf). Of this, INR44m (INR2,500/sqft) goes towards capex while the balance is towards working capital. Being margin-accretive fashion stores, with over 90% private labels mix, Westside stores garner strong 54% gross margin (INR76m/store) on average revenue of INR171m/store. This coupled with inherent operating leverage enables the stores to achieve 10% EBITDA margin and EBITDA of INR16m/store – a payback of four years.

An average Star Bazaar store requires capex of INR10m and total investment of ~INR22m (including working capital). Operating in the low gross margin food and

grocery category, these stores garner INR54m gross profit (20% gross margin) on revenue of INR247m, but still remain EBITDA loss-making.

Exhibit 437: Per store analysis (INR m)

	Westside	Star Bazar
Capex	44	10
WC	13	12
Total	56	22
Breakeven (in years)	4.2	NA
Revenue	171	247
Gross profit	92	49
Gross margin (%)	54%	20%
Other operating cost	76	79
EBITDA	16	-30
EBITDA margin (%)	10%	-11%
Depreciation	3	1
Depreciation rate (%)	6%	8%
EBIT	14	-30
RoCE (Tax - 30%)	17%	NA

Source: MOFSL, Company

10% SSSG can drive ~200bp margin improvement for Westside

Considering ~30% of the other operating cost per store as fixed, a 10% SSSG and ~6% rise in variable cost for Westside and Star Bazaar stores would result in ~200bp EBITDA margin expansion at Westside stores and ~75bp expansion at Star stores, driven by inherent operating leverage.

Exhibit 438: Scenario analysis on per store basis

	Westside		Star Bazar	
	10%	20%	10%	20%
Revenue increases by	10%	20%	10%	20%
Revenue	188	205	272	297
Gross profit	101	110	54	59
Gross margin (%)	54%	54%	20%	20%
Fixed (%)	30%	30%	30%	30%
Fixed	23	23	24	24
Variable (%)	70%	70%	70%	70%
Variable	56	56	59	59
Other Operating Cost	79	79	82	82
EBITDA	22	31	(28)	(23)
EBITDA margin (%)	12%	15%	-10%	-8%
Change in bps	200	549	74	326
EBIT	20	29	(29)	(24)
Breakeven (in years)	2.9	2.0	NA	NA
RoCE	24%	36%	NA	NA

Source: MOFSL, Company

Valuation and view

Recommend Buy with a TP of INR440

- The stock has seen time correction of 12-15 months despite consistent growth.
- We have valued each business separately on an SOTP basis, valuing Westside/Zara on EV/EBITDA of 25x on FY21E basis (~20% premium to target EV/EBITDA multiple of our apparel coverage), while THPL (Star branded grocery chain) being loss making is valued at 1x EV/sales on FY21E. Thus, we arrive at a TP of INR440 - 25% upside.
- This implies EV/EBITDA of 25x on FY21E EBITDA, including EBITDA share of JVs Inditex and THPL – at par with three-year average.
- Further, faster-than-expected recovery in THPL and accelerated SSSG in Westside would offer further upside. Recommend Buy.

Over FY19-21, we expect 26% CAGR in consolidated EBITDA and 36% CAGR in PAT. RoIC should improve from 11% to 18%. The stock trades at 60x FY20E and 45x FY21E EPS, and at an EV of 41x FY20E and 33x FY21E EBITDA.

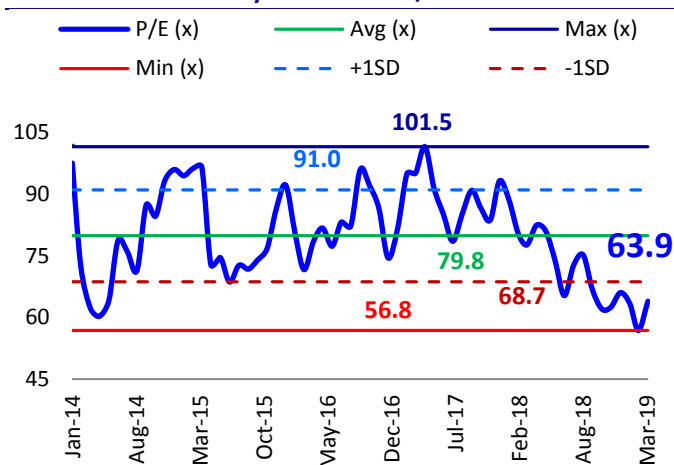
We value the stock based on SOTP. Given Westside and Zara’s strong product portfolio and earnings growth, we have valued both at 25x FY21E EV/EBITDA (~20% premium to target EV/EBITDA multiple of our apparel coverage, given its strong track record and dominance in the lifestyle apparel category). THPL being loss-making, we have valued it at 1x FY21E EV/Sales. Our SOTP-based target price works out to INR440. Faster-than-expected recovery in THPL, and accelerated SSSG in Westside and THPL might result in an upside. Recommend **Buy**.

Exhibit 439: Valuation based on SOTP

Particulars	Financial metric	Multiple (x)	EBITDA/Sales (INR b)	Value (INR b)
Westside	FY21 EBITDA	25	4	89
Star	FY21 Sales	1	8	8
Zara	FY21 EBITDA	25	2	42
Total Enterprise Value				138
Net Debt				-8
Equity Value				146
Shares (m)				332
Target Price (INR)				440
CMP (INR)				353
Upside (%)				25%

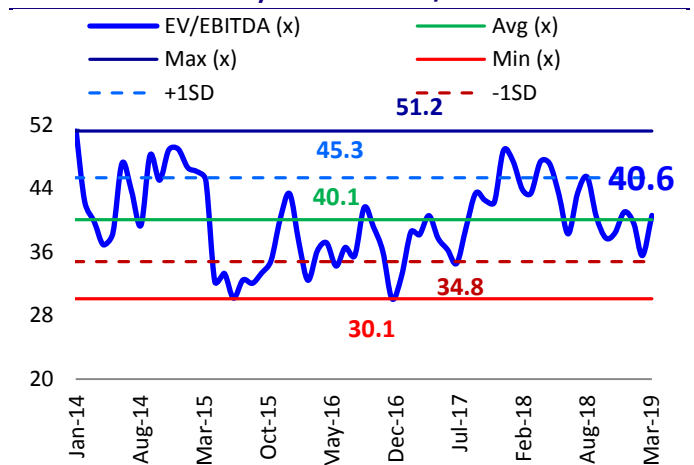
Source: MOFSL, Company

Exhibit 440: TRENT: 1 year forward P/E band



Source: Bloomberg, MOFSL

Exhibit 441: TRENT: 1 year forward EV/EBITDA band



Source: Bloomberg, MOFSL

Financials and valuations

Consolidated - Income Statement								(INR m)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	23,330	22,843	15,893	18,339	21,575	25,673	30,803	36,232
Change (%)	9.4	-2.1	-30.4	15.4	17.6	19.0	20.0	17.6
Raw Materials	14,531	13,290	7,956	9,028	10,315	12,612	15,116	17,755
Employees Cost	1,980	2,079	1,638	1,925	2,305	2,820	3,353	3,925
Rent and lease expenses	1,328	1,156	1,924	2,317	2,725	3,236	3,782	4,384
Advertising & Sales Promotion	520	475	440	481	418	490	588	691
Other Expenses	4,876	5,122	3,007	3,331	3,800	4,228	5,051	5,867
Total Expenditure	23,236	22,121	14,966	17,082	19,563	23,386	27,890	32,622
% of Sales	99.6	96.8	94.2	93.1	90.7	91.1	90.5	90.0
EBITDA	94	722	928	1,257	2,012	2,288	2,913	3,610
Margin (%)	0.4	3.2	5.8	6.9	9.3	8.9	9.5	10.0
Depreciation	536	743	386	413	455	527	625	720
EBIT	-442	-21	542	844	1,557	1,761	2,288	2,890
Int. and Finance Charges	131	107	376	338	306	352	343	316
Other Income	614	972	573	605	442	388	377	357
PBT bef. EO Exp.	41	843	739	1,112	1,693	1,796	2,322	2,931
EO Items	-26	1,152	79	258	0	0	0	0
PBT after EO Exp.	15	1,995	818	1,370	1,693	1,796	2,322	2,931
Total Tax	202	701	347	431	596	645	824	1,036
Tax Rate (%)	1357.0	35.1	42.4	31.4	35.2	35.9	35.5	35.4
Minority Interest	-2	1	-79	90	227	-247	-468	-704
Reported PAT	-185	1,293	550	850	870	1,399	1,965	2,599
Adjusted PAT	-511	546	505	672	870	1,399	1,965	2,599
Change (%)	869.0	-206.9	-7.5	33.2	29.5	60.8	40.5	32.2
Margin (%)	-2.2	2.4	3.2	3.7	4.0	5.4	6.4	7.2

Consolidated - Balance Sheet								(INR m)
Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	332	332	332	332	332	332	332	332
Total Reserves	9,576	13,887	14,312	15,145	15,621	17,020	18,985	21,584
Net Worth	9,908	14,220	14,644	15,477	15,954	17,352	19,317	21,917
Minority Interest	26	26	103	8	8	8	8	8
Total Loans	3,316	2,669	3,998	3,917	3,914	3,914	3,814	3,514
Deferred Tax Liabilities	-153	-21	-26	90	193	193	193	193
Capital Employed	13,097	16,893	18,719	19,491	20,068	21,467	23,332	25,631
Gross Block	9,460	9,506	6,535	7,492	8,341	9,949	11,619	13,376
Less: Accum. Deprn.	2,258	2,822	2,024	2,266	2,478	3,004	3,630	4,350
Net Fixed Assets	7,201	6,685	4,511	5,226	5,864	6,945	7,989	9,027
Goodwill on Consolidation	0	0	261	262	261	261	261	261
Capital WIP	1,376	921	537	55	96	96	96	96
Total Investments	3,003	7,397	10,670	10,800	10,229	10,229	10,229	10,229
Curr. Assets, Loans&Adv.	7,629	7,042	5,554	5,823	6,904	7,682	9,098	10,869
Inventory	3,565	3,299	2,792	3,054	3,448	3,970	4,687	5,420
Account Receivables	176	177	130	59	151	156	183	212
Cash and Bank Balance	619	555	269	343	328	333	659	1,327
Loans and Advances	3,269	3,011	2,363	2,367	2,977	3,223	3,569	3,910
Curr. Liability & Prov.	6,113	5,151	2,821	2,673	3,286	3,746	4,341	4,851
Account Payables	3,308	2,213	1,662	1,422	2,084	2,383	2,771	3,062
Other Current Liabilities	1,103	1,181	997	1,056	997	1,159	1,366	1,584
Provisions	1,701	1,758	162	195	205	205	205	205
Net Current Assets	1,516	1,890	2,733	3,150	3,618	3,936	4,757	6,018
Appl. of Funds	13,097	16,893	18,719	19,491	20,068	21,467	23,332	25,631

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	-1.5	1.6	1.5	2.0	2.6	4.2	5.9	7.8
Cash EPS	0.1	3.9	2.7	3.3	4.0	5.8	7.8	10.0
BV/Share	29.8	42.8	44.1	46.6	48.0	52.2	58.1	66.0
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				174.6	134.8	83.8	59.7	45.1
Cash P/E				108.1	88.5	60.9	45.3	35.3
P/BV				7.6	7.3	6.8	6.1	5.4
EV/Sales				6.6	5.6	4.7	3.9	3.3
EV/EBITDA				96.1	60.1	52.8	41.3	33.1
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-5.5	-5.0	-0.6	1.0	-0.9	-0.1	1.2	2.8
Return Ratios (%)								
RoE	-4.6	4.5	3.5	4.5	5.5	8.4	10.7	12.6
RoCE	-14.9	4.1	3.6	5.2	6.6	6.7	7.7	8.6
RoIC	64.0	-0.2	4.1	7.5	11.4	11.2	12.7	14.2
Working Capital Ratios								
Fixed Asset Turnover (x)	2.5	2.4	2.4	2.4	2.6	2.6	2.7	2.7
Asset Turnover (x)	1.8	1.4	0.8	0.9	1.1	1.2	1.3	1.4
Inventory (Days)	56	53	64	61	58	56	56	55
Debtor (Days)	3	3	3	1	3	2	2	2
Creditor (Days)	52	35	38	28	35	34	33	31
Leverage Ratio (x)								
Current Ratio	1.2	1.4	2.0	2.2	2.1	2.1	2.1	2.2
Interest Cover Ratio	-3.4	-0.2	1.4	2.5	5.1	5.0	6.7	9.1
Net Debt/Equity	0.0	-0.4	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4

Consolidated - Cash Flow Statement

(INR m)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	41	843	785	1,354	1,467	1,796	2,322	2,931
Depreciation	536	743	387	413	455	527	625	720
Interest & Finance Charges	-85	-100	174	128	88	352	343	316
Direct Taxes Paid	-234	-134	-199	-384	-501	-645	-824	-1,036
(Inc)/Dec in WC	-544	-613	313	-244	-643	-313	-495	-594
CF from Operations	-285	740	1,460	1,268	866	1,718	1,972	2,337
Others	-171	-841	-366	-244	-98	-141	90	347
CF from Operating incl EO	-456	-101	1,094	1,024	769	1,577	2,062	2,684
(Inc)/Dec in FA	-1,357	-1,555	-1,307	-686	-1,068	-1,608	-1,670	-1,757
Free Cash Flow	-1,813	-1,656	-213	339	-300	-31	392	927
(Pur)/Sale of Investments	212	-2,177	-60	146	928	0	0	0
Others	660	671	383	103	100	388	377	357
CF from Investments	-485	-3,062	-984	-437	-40	-1,220	-1,292	-1,400
Issue of Shares	-70	3,500	840	-2,002	-1,024	0	0	0
Inc/(Dec) in Debt	-40	-9	-4	1,864	1,000	0	-100	-300
Interest Paid	-123	-110	-213	-365	-317	-352	-343	-316
Dividend Paid	-272	-272	-756	-11	-403	0	0	0
Others	0	-11	0	0	0	0	0	0
CF from Fin. Activity	-505	3,099	-133	-514	-743	-352	-443	-616
Inc/Dec of Cash	-1,446	-64	-23	74	-15	5	326	668
Opening Balance	2,065	619	292	269	343	328	333	659
Closing Balance	619	555	269	343	328	333	659	1,327

V-Mart

BSE SENSEX
38,862S&P CNX
11,666

CMP: INR2,653

TP: INR2,880 (+9%)

Neutral



Stock Info

Bloomberg	VMART IN
Equity Shares (m)	18
M.Cap.(INRb)/(USDb)	48.1 / 0.7
52-Week Range (INR)	3298 / 1874
1, 6, 12 Rel. Per (%)	-3/6/5
12M Avg Val (INR M)	145
Free float (%)	46.1

Financials Snapshot (INR b)

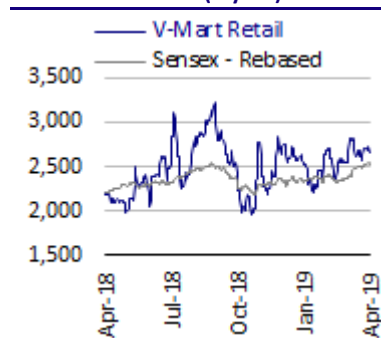
Y/E	MARCH	FY19E	FY20E	FY21E
Sales	14.3	16.7	19.6	
EBITDA	1.4	1.7	2.0	
NP	0.8	0.9	1.1	
EPS (INR)	41.6	49.0	60.2	
EPS Gr. (%)	-3.0	17.7	22.9	
BV/Sh. (INR)	233.6	282.6	342.9	
P/E (x)	63.7	54.1	44.0	
P/BV (x)	11.4	9.4	7.7	
EV/EBITDA (x)	34.5	28.8	23.2	
EV/Sales (x)	3.4	2.9	2.4	
RoE (%)	19.6	19.0	19.3	
RoCE (%)	19.8	19.2	19.4	

Shareholding pattern (%)

As On	Dec-18	Sep-18	Dec-17
Promoter	54.0	54.0	54.4
DII	4.7	3.8	2.4
FII	30.0	30.4	30.8
Others	11.4	11.8	12.4

FII Includes depository receipts

Stock Performance (1-year)



Play on rural India's modern retail shift

Rich valuations factor in high earnings growth

- Capitalizing on the shift from the unorganized to the organized segment in apparel retailing, VMART has consciously targeted tier-2 and tier-3 cities (~76% presence) of India, offering 25-30% lower prices than most national/regional apparel chains.
- VMART's small (~8.4ksf) store size and high 65% private label share have enabled healthy productivity growth to ~INR8.8k/sq. ft. and healthy EBITDA margin of ~10% (FY19E). We expect 17% revenue CAGR over FY19-21, led by 6% SSSG and addition of average 40 new stores per annum.
- We expect EBITDA/PAT CAGR of 21%/20% over FY19-21, led by healthy revenue growth and 70bp EBITDA margin expansion on a high base of 9.7% (FY19E).
- Healthy RoIC of 22% by FY21 and strong earnings growth favor rich valuations, but we believe large part of the upside is already captured in the stock price.
- We ascribe 25x (~40% premium to three-year average) to FY21E EBITDA of INR2b, arriving at a TP of 2,880 – 9% upside. Recommend Neutral.

Value retailer catering to small tier cities

VMART is a play on rural India's shift to modern retail. It operates predominantly in smaller towns (87% of its stores are in non-tier 1 cities), with smaller store size (~8.4ksf), targeting aspiring consumers. With 30-40% lower pricing than national/regional apparel chains, the company's philosophy is to remain a value retailer. VMART's strengths are low prices, innovative design sourcing, and 65% sales from private labels and about one-third from exclusive products. This keeps VMART ahead of the traditional network in terms of value proposition.

Robust earnings growth to continue

VMART's revenue has grown at a strong 20% CAGR over FY14-19E, backed by an average of 6% SSSG and 19% new store addition. Despite operating at low gross margin of 33% (v/s 40+% for peers), the company garners industry leading EBITDA margin of ~10%. We expect VMART to continue generating healthy SSSG of 6% over FY19-21 and add 17% store area, leading to 17% revenue CAGR. With EBITDA margin of 9.7% in FY19E, further room for margin expansion might be limited. We expect EBITDA/PAT CAGR of 21%/20% over FY19-21.

Lean balance sheet; healthy returns profile

VMART's entire growth in the last five years has been funded from internal accruals, with net cash of INR0.5b (FY19E). Its net working capital remains steady at 45 days, despite acquiring inventory outright to gain cost advantage. Its cumulative OCF generation of INR1.7b over FY19-21 and improving annual FCF from –INR66m in FY19E to INR250m in FY21 should support 40 annual store additions. VMART's healthy ROICs of over 20% are likely to remain steady, backed by superior asset turns and EBITDA margin profile.

Valuations rich; recommend Neutral

The stock is valued at an EV/EBITDA of 23x (FY21E) and at a P/E of 44x (FY21E). Though superior EBITDA margin and strong competitive position favor premium valuations, we believe large part of the upside is captured in the stock price. We ascribe 25x (~40% premium to three-year average; 20% premium to target EV/EBITDA multiple of our apparel coverage, given its unique value proposition and consistent profitable growth) to FY21E EBITDA of INR2b, arriving at a TP of INR2,880 – 9% upside. Our target price implies a P/E of 48x and a PEG of 2.4x. Recommend **Neutral**.

A value retailer

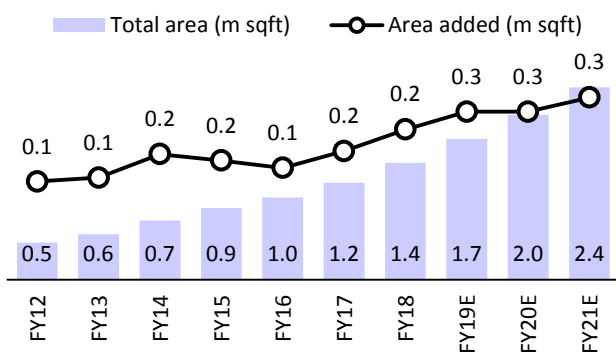
Targeting tier-2 and tier-3 cities

- Capitalizing on the shift from the unorganized to the organized segment in apparel retailing, VMART has consciously targeted tier-2 and tier-3 cities (~76% presence) of India, offering 30-40% lower prices than most national / regional apparel chains.
- VMART's small store size (8,000-8,500sf), high private label share (65%), exclusive product offerings, and expertise in low cost product sourcing allows it to drive cost efficiency and retain its value retailer tag.

Play on rural India's shift to modern retail

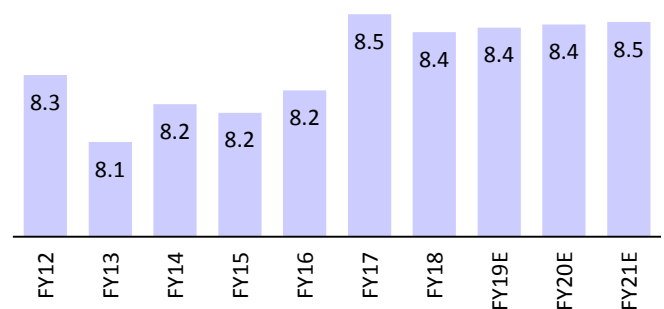
VMART has grown at 20% CAGR over FY14-19E, with 125 new store adds to 214 stores (FY19E) and clocking an average 6% SSSG. The company predominantly operates in smaller towns (87% non-tier 1 cities). It targets the aspiring middle class in smaller tier towns, and is benefiting from the shift towards the organized segment. Unlike conventional modern retail stores that have an average size of 30,000sf, VMART stores have an average size of 8,000sf, making them among the most productive. VMART is a play on semi urban/rural India shift to modern retail.

Exhibit 442: Steadily rising area under network



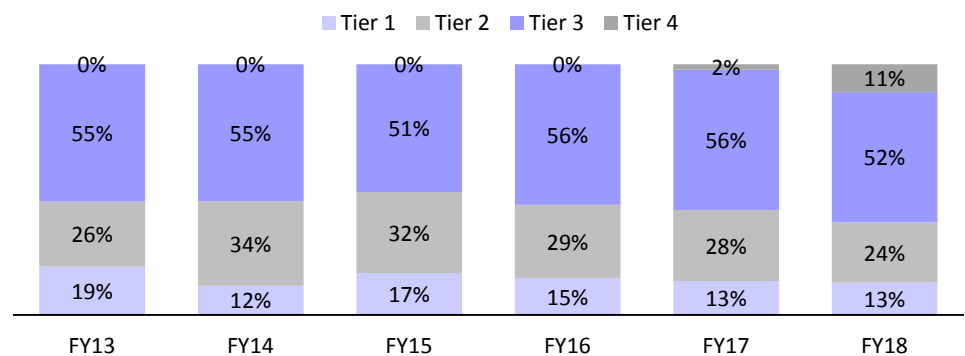
Source: MOFSL, Company

Exhibit 443: Low area per store at 8,000-8,500 sqft ('000 sqft)



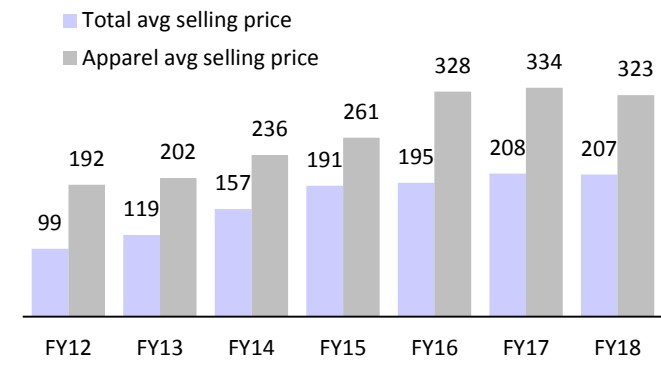
Source: MOFSL, Company

Exhibit 444: 87% of total store presence in non-tier 1 cities (FY18)



Source: MOFSL, Company

Exhibit 445: Average selling price improving (INR)



Source: MOFSL, Company

Exhibit 446: Consistently increasing ticket size (INR)



Source: MOFSL, Company

Focus on private label and exclusive apparel

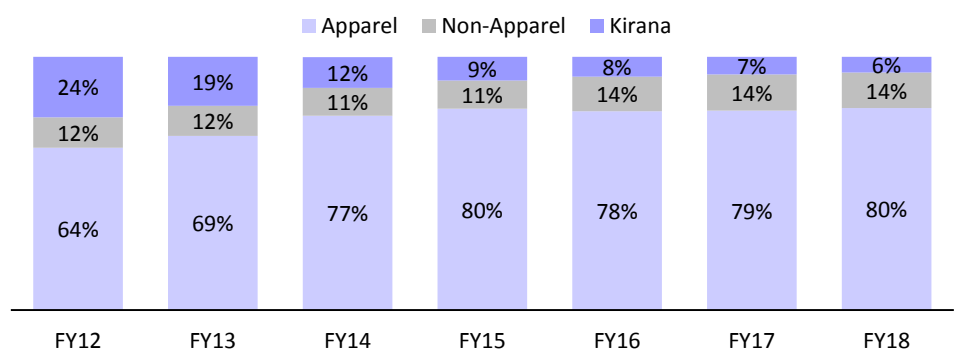
VMART targets to increase the share of private labels from the current 65% to 80%. Its focus on private labels helps to reduce costs as well as to bring product exclusivity. VMART passes on the cost benefits to consumers while keeping its margins intact. At the same time, it attempts to provide exclusive designs to consumers, retaining the image of a value retailer.

Exhibit 447: VMART’s product offerings skewed towards fashion

Fashion	Kirana
Apparels - Men’s, Women’s, Boys’, Girls’, Toddler’s, Accessories	FMCG products Packaged food items and Staple products
General Merchandise - Footwear, Home furnishings, Kitchenware, Toys and games, Bags and luggage and Crockery	Home care Beauty and personal - care

Source: MOFSL, Company

Exhibit 448: Apparel mix on a continuous rise

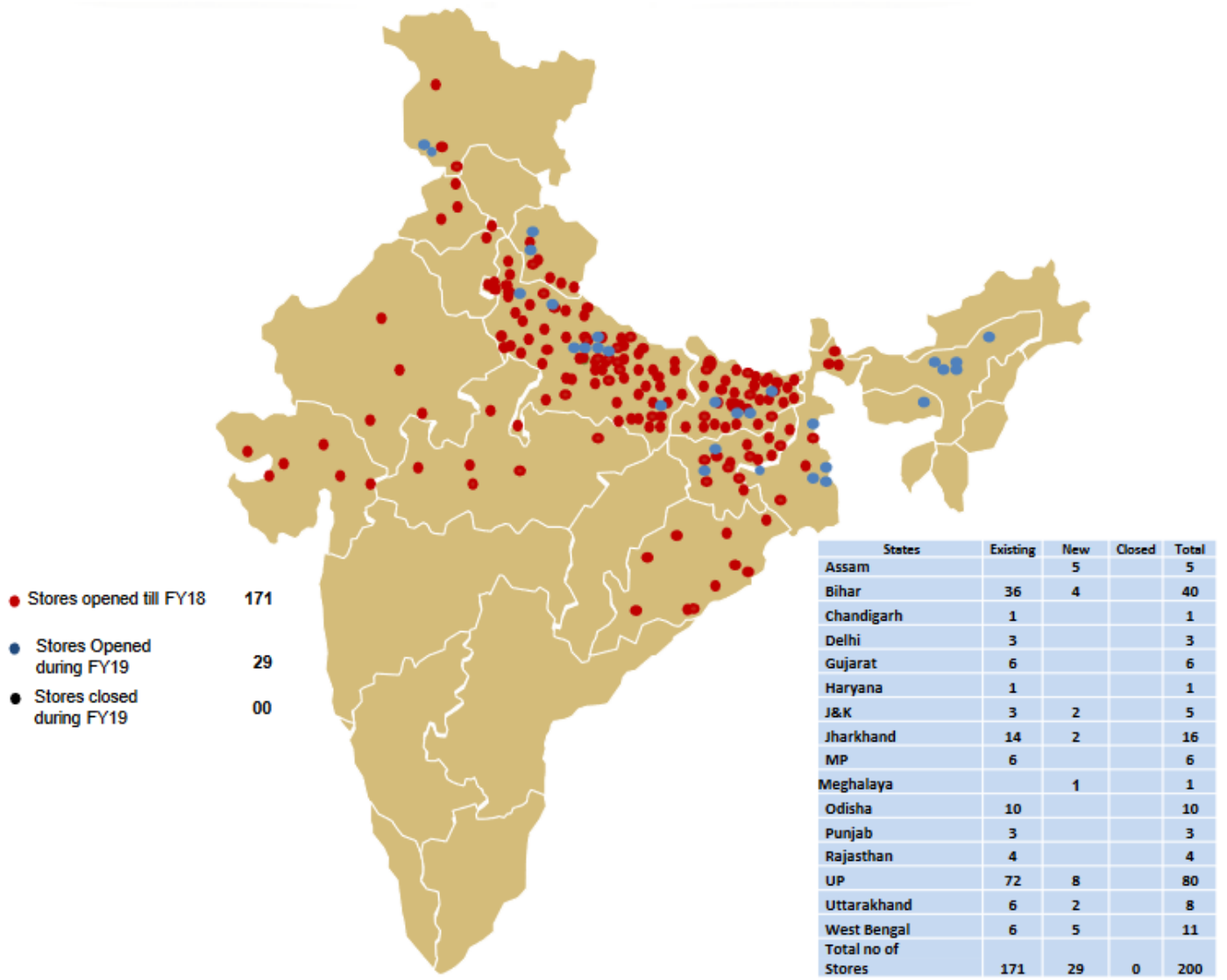


Source: MOFSL, Company

Cluster-based approach

VMART’s cluster-based store addition (adds new stores within 50-150km radius of existing stores) has allowed it to improve economies of scale. This approach helps to improve supply chain management and turnaround time for inventory stocking, and to minimize marketing, advertisement and other fixed costs. It also helps to better understand regional consumption patterns and accordingly create a customized inventory. Its stores are largely concentrated in the states of Bihar (40 stores) and Uttar Pradesh (80 stores).

Exhibit 449: VMART’s footprint focused on North and East markets; 200 stores as on Dec-18



Source: MOFSL, Company

Strong revenue momentum should continue

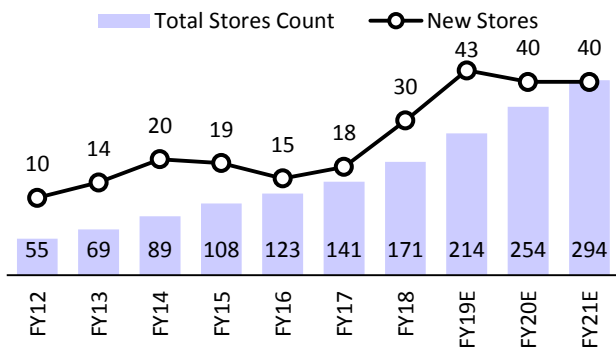
Yet, EBITDA margin to remain steady at ~10%

- We expect 17% revenue CAGR over FY19-21, driven by (1) healthy 6% SSSG: ~60% of its stores are still in the early part of their life cycle, and as these stores mature, their productivity should increase and (2) addition of 40 stores/year.
- VMART earns higher EBITDA margins than its peers, aided by (a) increasing share of higher-margin apparel sales, (b) increasing mix of private labels, (c) relatively low rentals, and (d) strong sourcing power.
- Being a value retailer, the company passes on most of its cost benefits to customers. Hence, we expect modest 70bp EBITDA margin expansion to 10.4% (FY21). We estimate 21% EBITDA CAGR and 20% PAT CAGR over the same period.

Healthy 6% SSSG, an average 40 new stores/year to fuel growth

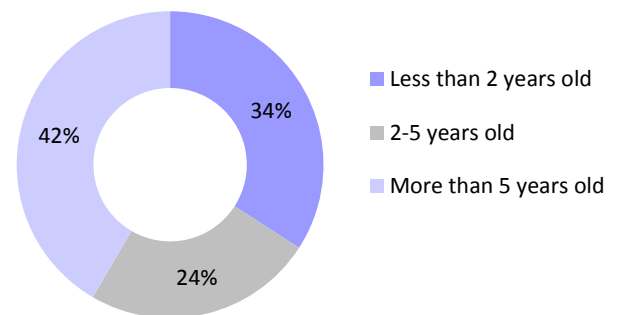
The management targets to maintain 8-10% SSSG. We have factored 6% SSSG, which is likely to be driven primarily by rising contribution from new stores. Nearly 60% of its stores are less than five years old. It takes 5-7 years for a store to reach full potential; VMART has consistently grown its footprint at 20%. The management is conscious of not growing beyond its appetite and restricts the use of borrowed capital for growth. It plans to add about 18-20% retail area annually; we see this number rising further, as EBITDA improves.

Exhibit 450: Store adds to witness an uptick



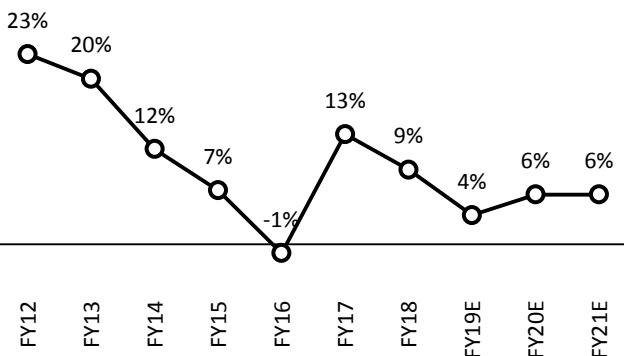
Source: MOFSL, Company

Exhibit 451: ~57% of stores are less than five years old



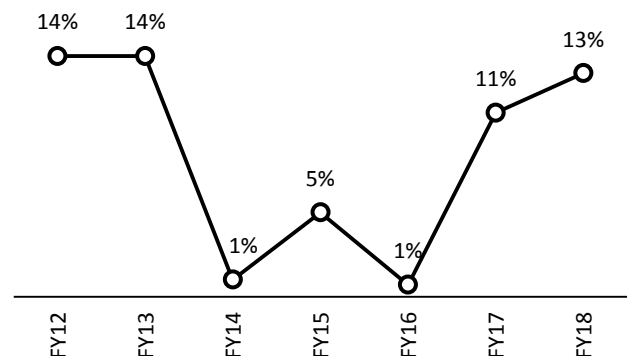
Source: MOFSL, Company

Exhibit 452: Apparel value SSSG to remain healthy (%)



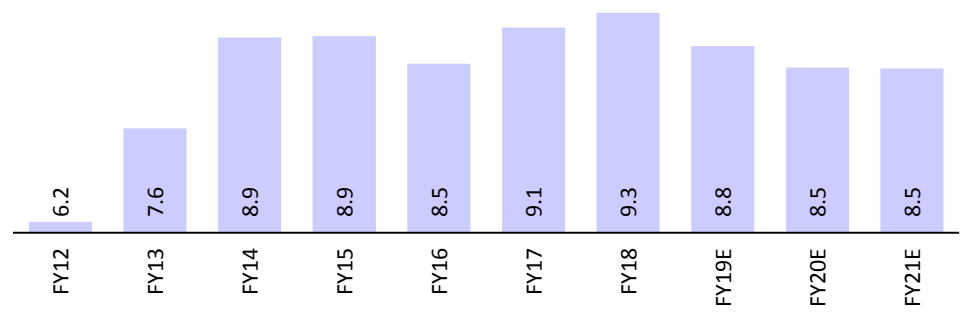
Source: MOFSL, Company

Exhibit 453: Annual trend in apparel volume SSSG (%)



Source: MOFSL, Company

Exhibit 454: Fast pace of area addition to limit productivity growth (INR'000)



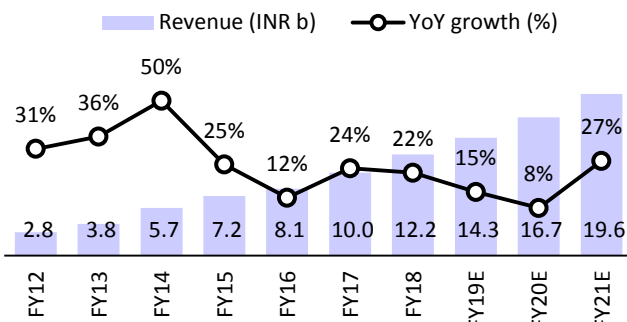
Source: MOFSL, Company

However, passing on of benefits could limit margin expansion

In the last three years FY16-19E, VMART has expanded its EBITDA margin by 200bp to 9.7% on higher gross margin driven by increasing private label mix and healthy SSSG. While the management has maintained that it will pass on cost benefits resulting from rising share of private labels to consumers, which is evident from estimated 120bp EBITDA margin contraction in FY19E, yet we see levers for strong EBITDA margin. Management’s focus to increase share of private labels, operating leverage from increased store throughput should provide room for some margin gains even if it passes on most of the gains to consumers.

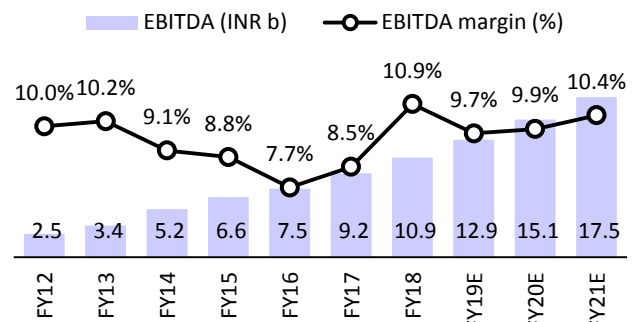
We expect healthy 6% SSSG and an average 40 new store adds/year over the next two years, which should allow revenue CAGR of 17% and EBITDA CAGR of 21% over FY19-21. EBITDA margin to expand 70bp, reaching 10.4% by FY21.

Exhibit 455: Revenue to grow at 17% CAGR over FY19-21



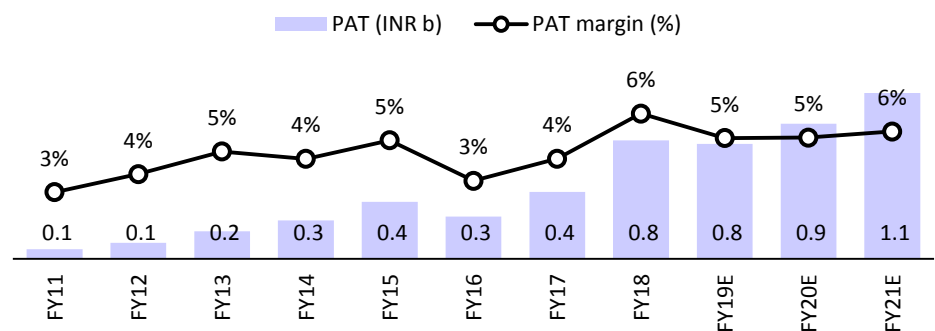
Source: MOFSL, Company

Exhibit 456: EBITDA margin to remain steady at 10% in near term



Source: MOFSL, Company

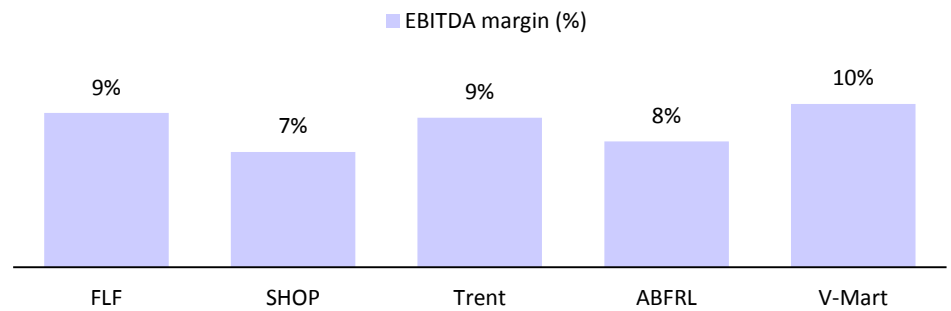
Exhibit 457: PAT to grow at 20% CAGR over FY19-21E



Source: MOFSL, Company

Key factors driving higher than peers' EBITDA margin

Exhibit 458: VMART garners higher EBITDA margin than most apparel peers (FY19E, %)



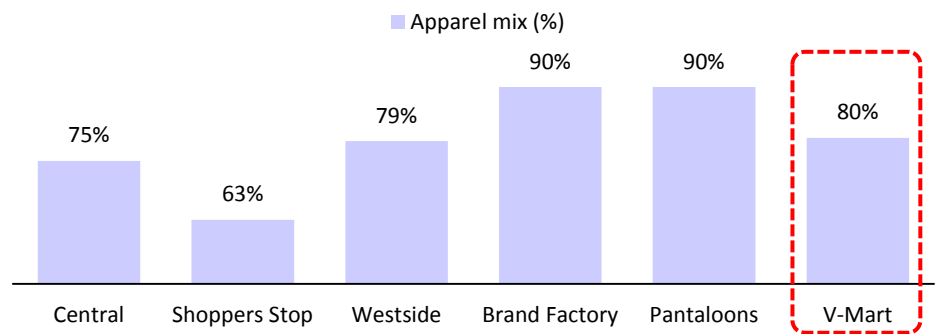
Source: MOFSL, Company

VMART's EBITDA margin is 100-300bp higher than peers' due to the following:

1) Higher share of apparel sales

Apparel sales, which garner higher gross margin, account for ~80% of VMART's sales. The share of apparel could rise further, as VMART reduces grocery products in new stores.

Exhibit 459: VMART's stores are apparel-heavy

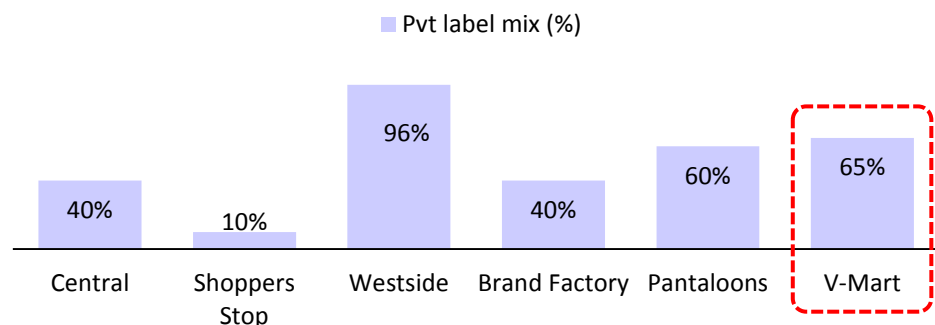


FY18; Source: MOFSL, Company

2) High share of private labels

Private labels, which earn higher margins, contribute ~65% of VMART's sales. The management plans to increase this to ~80%. However, it plans to pass on most of the resultant cost benefits to consumers.

Exhibit 460: Player-wise private label mix in apparels



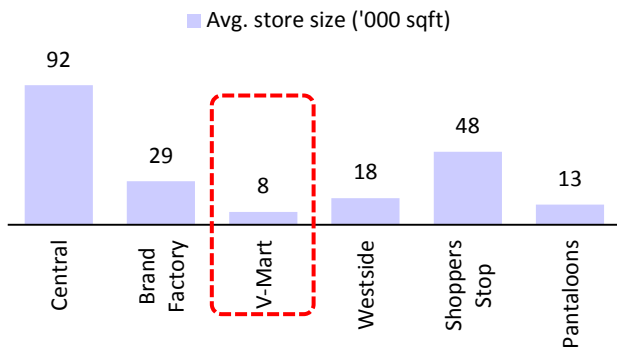
65% private label mix for V-Mart is as on Dec-18; rest FY18

Source: MOFSL, Company

3) Lower rentals, healthy revenue/sf

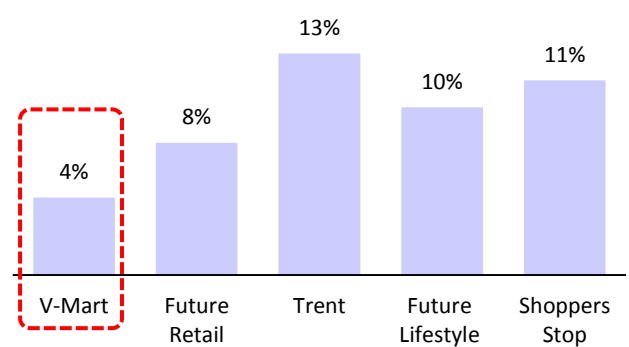
VMART’s rentals remain the lowest in the industry at ~4% compared to peers’ 8-9%, given its large presence in smaller tier towns, where rentals are relatively modest. Further, VMART operates small 8,000sf stores, incurring lower capex and operating cost. This is unlike other retailers that typically operate large format stores of 30,000-100,000sf, incurring higher capex as well as operating cost. This allows it to garner better productivity – revenue/sf and EBITDA margin.

Exhibit 461: VMART operates smaller stores ('000sf; FY19E)



Source: MOFSL, Company

Exhibit 462: Player-wise rentals as a % of revenue (FY19E)



Source: MOFSL, Company

4) Strong sourcing advantage in regional market

VMART’s key strength is its strong sourcing expertise, with the senior management’s involvement. It sources from over 800 vendors across the country as per seasonal requirement, with average ticket size of just INR100k-200k. These small suppliers have limited bargaining power and VMART acts as a price maker instead of a price taker.

5) Healthy store productivity and SSSG

VMART has consistently clocked healthy store productivity of about INR9k/sqft high SSSG, driving strong operating leverage, despite adding over 20% area annually over the last seven years. Except in FY15/16, VMART’s SSSG has been in double digits, ensuring healthy store productivity.

Lean balance sheet to support healthy return profile

Expect 23% ROIC by FY21

- Strong revenue/EBITDA growth should drive cumulative OCF of INR1.7b over FY19-21. This should help fund ~INR700m capex for the targeted 40 new stores per year. VMART has not preferred debt for expansion.
- We expect return ratios to remain healthy at over 20% during FY19-21.

Spending INR20m/store, with less than three years payback

VMART's ~8.4ksf store requires capex of ~INR12m (at INR1,425/sf) and working capital of INR8m. It garners healthy revenue of ~INR9k/sf or INR78m store, translating into 3.6x asset turn. Inventory/store remains at INR18m, but with ~INR10m trade payables, net working capital/store remains a meager INR8m. It operates at a gross margin of ~32%, with about 80% apparel mix. VMART's 32% gross margin is lower than the typical 40-45% in the apparels category, as it focuses on value offering and prices products 20-25% below peers. Yet, high volumes enable it to earn strong EBITDA of INR9m/store (~11% margin). This translates to a payback of 2.4 years, with post tax RoCE of 24% – better than peers in the apparel space.

Exhibit 463: Store payback of ~2.5 years (INR m)

	Per Store	Per sqft
Capex	12	1,425
WC	8	975
Total Capital	20	2,400
Breakeven (in years)	2.4	2.4
Revenue	78	9,278
Gross margin	25	2,976
Gross margin %	32%	32%
Other operating cost	17	1,801
EBITDA	9	1,008
EBITDA margin (%)	10.9%	10.9%
Depreciation	1	174
Depreciation rate (%)	12%	12%
EBIT	7	834
RoCE (Tax-30%)	24%	24%

Source: MOFSL, Company

10% SSSG should drive ~60bp margin expansion

VMART has ~30% fixed cost, which provides strong operating leverage. If this 30% of the fixed cost is controlled, VMART's 10% SSSG could drive 60bp margin improvement despite ~10% increase in other variable cost.

Exhibit 464: Per store scenario analysis (INR m)

Revenue increases by	10%	20%
Revenue	86	94
Gross Margin	28	30
Gross Margin %	32%	32%
Fixed Portion	30%	30%
Total fixed cost	5	5
Variable Portion	70%	70%
Total variable cost	13	14
Total Operating Costs	18	19
EBITDA	10	11
EBITDA margin (%)	11%	12%
Change in bps	58	106
EBIT	8	10
Break-Even (in Years)	2.4	2.1
RoCE	29%	34%

Source: MOFSL, Company

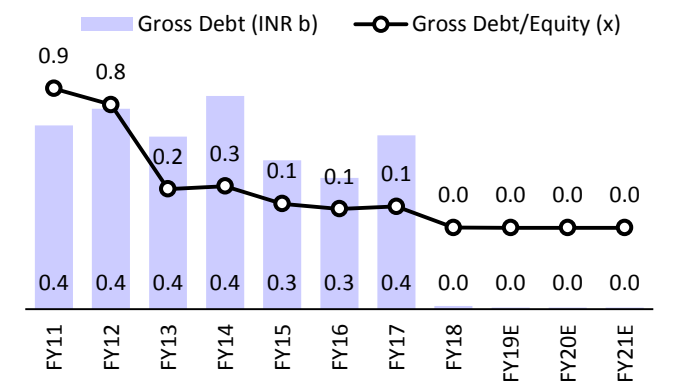
Controlled growth strategy...

VMART has grown its footprint by over 20% annually over the last five years (FY14-19E) – it has added 125 stores to reach 214 stores. It has calibrated growth by restricting itself to internal accruals for store addition and relying on borrowings only for working capital. Its measured growth and low leverage are key positives, in our view. The management plans to add 18-20% increase in footprint annually. We expect store addition to accelerate to maintain its growth rate.

...with capex being sourced internally

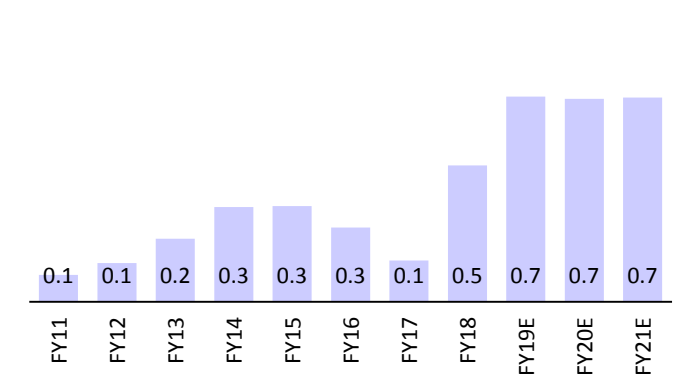
VMART has guided for 18-20% area addition and refurbishment of 20-25 stores annually. Store properties are largely on long-term lease, with average annual escalation of 3-4%. Assuming INR1,425/sf capex, it incurs about INR12m capex/store. With a cumulative OCF of INR1.7b over the next two years, we expect VMART to add 40 stores in FY20/21, growing store area at 17% CAGR over FY19-21. We build in capex of ~INR700m for FY20/21, which should be largely funded through internal accruals.

Exhibit 465: Low gearing coupled with...



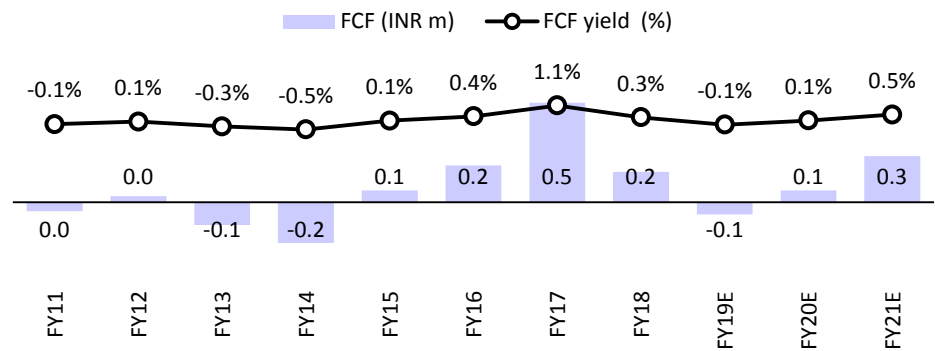
Source: MOFSL, Company

Exhibit 466: ...low capex... (INR b)



Source: MOFSL, Company

Exhibit 467: ...should provide impetus to FCF and FCF yield



Source: MOFSL, Company

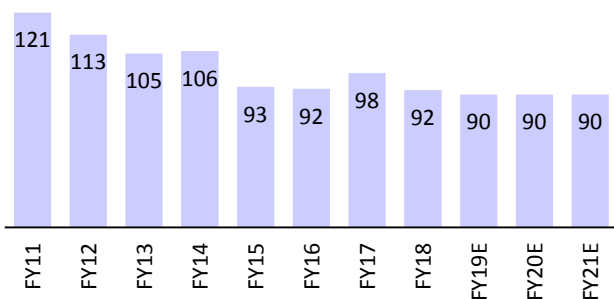
Efficient working capital cycle

VMART’s net working capital is at a healthy 45 days and has consistently improved from 65 days in the last five years. Unlike most apparel players that buy on consignment basis, VMART procures its products outright to gain in terms of pricing and product designs. Despite holding the complete inventory on its books, it has managed to control inventory at ~90 days. It controls its apparel inventory by maintaining a lower share of seasonal inventory.

Garners healthy RoIC of over 20%

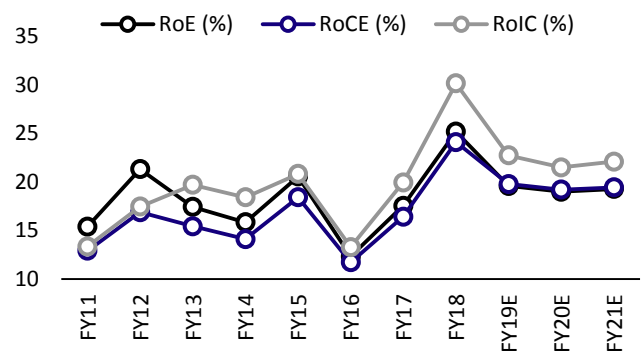
During FY16/17, weak SSSG and low EBITDA margin had pulled down RoIC to low double digits. However, it revived to over 20% in FY19E. With healthy SSSG and store productivity, we expect RoIC to remain steady at over 20%.

Exhibit 468: Inventory days at well managed levels (revenue days)



Source: MOFSL, Company

Exhibit 469: Return ratios to witness a fillip (%)



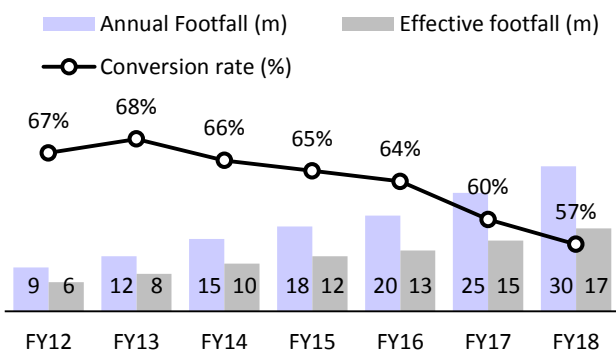
Source: MOFSL, Company

Holding turf against national/regional retailers in tier-2/3 towns

Management recently highlighted that it is facing competition from national/regional retailers in about ~30% of its total stores. Several large retailers are expanding footprint in tier-2 and tier-3 towns, which are largely unorganized markets and predominantly catered to by traditional distribution channels, providing a different buying experience through modern retail formats. To mitigate the risk from these large peers, VMART is doing the following:

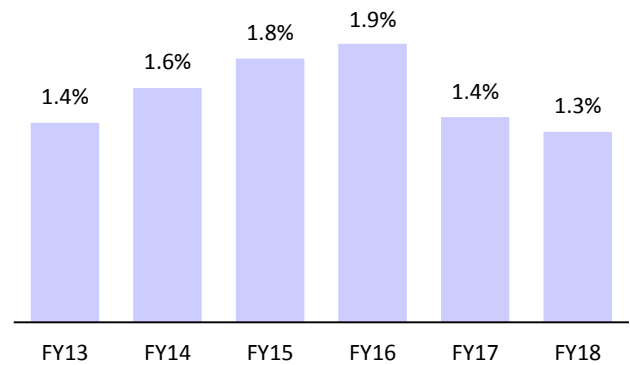
- Targeting the low band of the value market, with products priced significantly lower than larger peers. VMART sells private label apparel at INR600-700 v/s ~INR2,000 for branded apparel.
- As consumers move up in terms of consumption value, VMART is moving further down, targeting the next lower strata of the consumer segment with lower value products. This is evident from its value SSSG being lower than its volume SSSG. Also, the management has indicated that it will continue to pass on margin gains from higher private label contribution, making its products more compelling to value-seeking consumers.
- With average store size of 8,000sf, VMART is targeting store openings at places where the population size is 100k-200k. Large retailers operating 30,000sf stores may find it difficult to get healthy productivity at such locations.
- Unlike large peers that have a mix of urban and rural stores, VMART’s predominantly lower-tier footprint allows it to completely focus its value proposition to such consumers.
- VMART’s low marketing/advertising spend provides a leaner cost structure, allowing it to sustain better productivity.

Exhibit 470: Despite conversion rate declining, effective footfalls remain high



Source: MOFSL, Company

Exhibit 471: Reducing shrinkage (as a % of sales)



Source: MOFSL, Company

Valuation and view

Recommend Neutral with TP of INR2,880

- The stock is richly valued at an EV/EBITDA of 23x (FY21E) and at a P/E of 44x (FY21E).
- Superior EBITDA margin and strong competitive position favor premium valuations, but we believe large part of the upside is already captured in the stock price.
- We ascribe 25x (~40% premium to three-year average) to FY21E EBITDA of INR2b, arriving at a TP of INR2,880 – 9% upside. Recommend **Neutral**.

High growth and RoE profile

VMART boasts of healthy earnings growth, superior return profile, and a strong competitive position in the market. Over FY14-19E, revenue/PAT has grown at a robust CAGR of 20%/25% on the back of strong SSSG and organic growth. It garners a healthy 23% RoIC. We expect healthy SSSG to continue, as one-third of its stores are less than two years old and yet to reach maturity. Further, healthy OCF should drive new store rollout, driving overall revenue CAGR of 17% over FY19-21.

However, we see limited room for margin expansion – VMART has already seen 200bp improvement in the last three years. The management intends to pass on the margin benefit to customers to enhance its value offerings. We expect 17% revenue CAGR and 20% PAT CAGR over FY19-21. RoE/RoIC should continue to remain at about 20-22% on the back of healthy asset turnover.

Valuations rich; recommend neutral

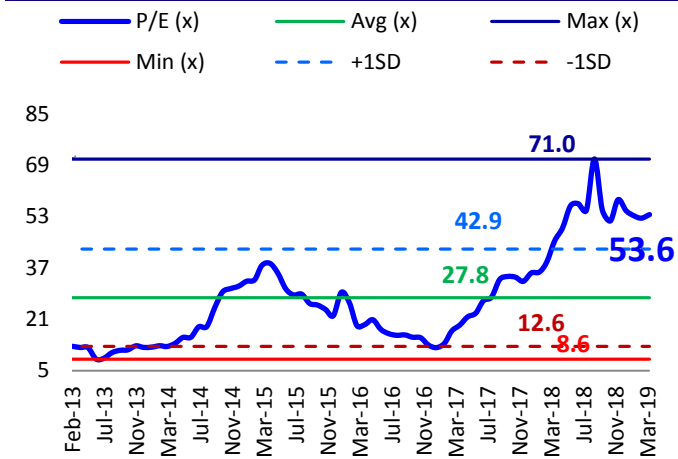
The stock is richly valued at an EV/EBITDA of 23x and P/E of 44x on FY21E basis. Though superior EBITDA margin and strong competitive position favor premium valuations, we believe large part of the upside is already captured in the stock price. We ascribe 25x (~40% premium to three-year average; ~20% premium to target EV/EBITDA multiple of our apparel coverage, given its unique value proposition and consistent profitable growth) to FY21E EBITDA of INR2b, arriving at a TP of INR2,880 – 9% upside. Recommend **Neutral**.

Exhibit 472: Valuation based on FY21E EBITDA

	Methodology	Driver (INR b)	Multiple (x)	Fair Value (INR b)	Value/share (INR)
EBITDA	FY21 EV/EBITDA	2.0	25	51.2	2,830
Less Net debt				-1.0	-51
Total Value				52.1	2,880
Shares o/s (m)				18.1	
CMP (INR)					2,653
Upside (%)					9

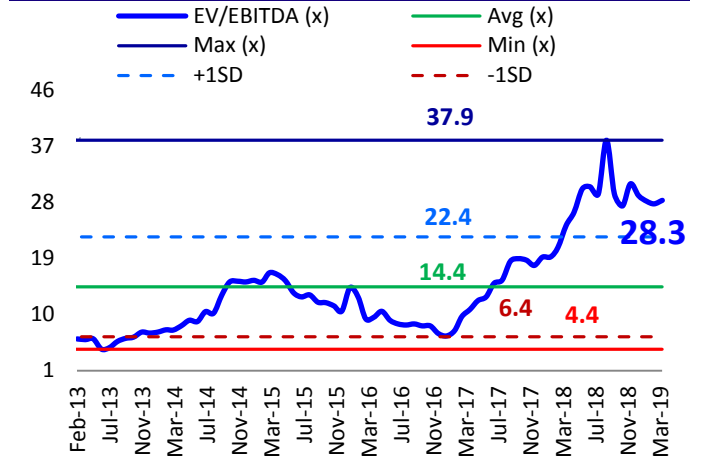
Source: MOFSL, Company

Exhibit 473: VMART: 1-year forward P/E



Source: Bloomberg, MOFSL

Exhibit 474: VMART: 1-year forward EV/EBITDA



Source: Bloomberg, MOFSL

Financials and valuations

Standalone - Income Statement

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Income from Operations	5,750	7,202	8,093	10,017	12,224	14,250	16,720	19,569
Change (%)	49.9	25.3	12.4	23.8	22.0	16.6	17.3	17.0
Raw Materials	4,041	5,143	5,712	7,028	8,303	9,580	11,329	13,265
Employees Cost	383	489	623	777	984	1,290	1,471	1,683
Rent and lease expenses	249	328	400	479	526	653	792	935
Advertising & Sales Promotion	136	148	191	226	0	314	351	391
Other Expenses	418	457	547	682	1,083	1,026	1,120	1,252
Total Expenditure	5,227	6,566	7,472	9,191	10,896	12,862	15,063	17,527
% of Sales	90.9	91.2	92.3	91.8	89.1	90.3	90.1	89.6
EBITDA	522	636	620	826	1,328	1,388	1,657	2,042
Margin (%)	9.1	8.8	7.7	8.2	10.9	9.7	9.9	10.4
Depreciation	109	46	190	220	229	285	369	459
EBIT	414	590	430	606	1,099	1,103	1,288	1,583
Int. and Finance Charges	42	42	31	35	15	13	15	15
Other Income	7	22	12	31	41	50	60	70
PBT bef. EO Exp.	378	571	411	601	1,125	1,140	1,333	1,638
EO Items	0	-17	12	0	0	0	0	0
PBT after EO Exp.	378	553	423	601	1,125	1,140	1,333	1,638
Total Tax	127	180	147	206	348	387	446	548
Tax Rate (%)	33.5	32.5	34.7	34.3	30.9	33.9	33.5	33.5
Minority Interest	0	0	0	0	0	0	0	0
Reported PAT	252	374	276	395	777	754	887	1,090
Adjusted PAT	252	385	268	395	777	754	887	1,090
Change (%)	43.2	53.2	-30.4	47.4	77.0	-3.0	17.7	22.9
Margin (%)	4.4	5.4	3.3	3.9	6.4	5.3	5.3	5.6

Standalone - Balance Sheet

(INR M)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	180	180	181	181	181	181	181	181
Total Reserves	1,522	1,869	2,127	2,523	3,293	4,047	4,934	6,024
Net Worth	1,702	2,049	2,307	2,703	3,474	4,228	5,115	6,205
Minority Interest	0	0	0	0	0	0	0	0
Total Loans	438	306	270	357	6	3	3	3
Deferred Tax Liabilities	-22	-6	-42	-70	-92	-92	-92	-92
Capital Employed	2,117	2,349	2,535	2,990	3,388	4,139	5,026	6,116
Net Fixed Assets	700	981	1,103	1,303	1,447	1,882	2,225	2,482
Capital WIP	10	7	23	12	35	35	35	35
Total Investments	342	218	324	676	340	340	340	340
Curr. Assets, Loans & Adv.	1,862	2,077	2,340	2,929	3,584	4,047	4,829	5,911
Inventory	1,677	1,832	2,044	2,692	3,071	3,514	4,123	4,825
Account Receivables	0	0	0	0	0	0	0	0
Cash and Bank Balance	23	34	43	29	196	164	273	578
Loans and Advances	162	212	253	208	317	370	434	508
Curr. Liability & Prov.	797	935	1,255	1,930	2,019	2,166	2,404	2,653
Account Payables	647	752	956	1,599	1,668	1,757	1,924	2,091
Other Current Liabilities	92	115	217	256	309	360	422	494
Provisions	58	68	82	75	42	49	57	67
Net Current Assets	1,065	1,143	1,085	999	1,565	1,881	2,426	3,259
Appl. of Funds	2,117	2,349	2,535	2,990	3,388	4,139	5,026	6,116

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	13.9	21.3	14.8	24.3	42.9	41.6	49.0	60.2
Cash EPS	20.0	23.9	25.4	34.5	55.6	57.4	69.4	85.6
BV/Share	94.2	113.4	127.7	149.2	192.0	233.6	282.6	342.9
DPS	1.3	1.5	1.3	0.0	0.0	0.0	0.0	0.0
Payout (%)	10.6	8.7	9.9	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E				109.4	61.8	63.7	54.1	44.0
Cash P/E				76.9	47.7	46.2	38.2	31.0
P/BV				17.8	13.8	11.4	9.4	7.7
EV/Sales				4.8	3.9	3.4	2.9	2.4
EV/EBITDA				57.0	36.0	34.5	28.8	23.2
Dividend Yield (%)	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
FCF per share	-12.3	3.5	11.1	30.0	9.2	-3.6	3.5	13.8
Return Ratios (%)								
RoE	15.8	20.6	12.3	17.5	25.2	19.6	19.0	19.3
RoCE	14.1	18.4	11.7	16.4	24.1	19.8	19.2	19.4
RoIC	18.4	20.8	13.3	19.9	30.1	22.7	21.5	22.1
Working Capital Ratios								
Fixed Asset Turnover (x)	8.2	7.3	7.3	8.5	8.4	7.6	7.5	7.9
Asset Turnover (x)	2.7	3.1	3.2	3.4	3.6	3.4	3.3	3.2
Inventory (Days)	106	93	92	98	92	90	90	90
Debtor (Days)	0	0	0	0	0	0	0	0
Creditor (Days)	41	38	43	58	50	45	42	39
Leverage Ratio (x)								
Current Ratio	2.3	2.2	1.9	1.6	1.8	1.9	2.0	2.2
Interest Cover Ratio	9.7	14.2	13.8	18.8	71.9	85.0	85.8	105.5
Net Debt/Equity	0.0	0.0	0.0	-0.1	-0.2	-0.1	-0.1	-0.1

Standalone - Cash Flow Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	378	553	423	668	1,125	1,140	1,333	1,638
Depreciation	109	46	190	179	222	285	369	459
Interest & Finance Charges	0	0	0	35	15	13	15	15
Direct Taxes Paid	-120	-167	-149	-243	-381	-387	-446	-548
(Inc)/Dec in WC	-389	-227	-207	69	-346	-348	-435	-528
CF from Operations	-21	205	257	709	635	703	836	1,036
Others	132	195	204	-22	8	-50	-60	-70
CF from Operating incl EO	110	399	461	687	643	653	776	966
(Inc)/Dec in FA	-332	-335	-260	-145	-478	-719	-712	-716
Free Cash Flow	-222	64	201	542	166	-66	64	250
(Pur)/Sale of Investments	62	145	-101	-337	395	0	0	0
Others	6	7	12	-245	-10	109	119	129
CF from Investments	-264	-183	-349	-727	-92	-611	-594	-588
Issue of Shares	0	9	8	0	9	0	0	0
Inc/(Dec) in Debt	83	-150	-20	87	-351	-3	0	0
Interest Paid	-42	-40	-35	-37	-15	-13	-15	-15
Dividend Paid	-18	-18	-48	-2	-27	0	0	0
Others	0	0	0	0	0	0	0	0
CF from Fin. Activity	23	-199	-96	49	-384	-16	-15	-15
Inc/Dec of Cash	-130	17	16	9	167	26	168	364
Opening Balance	153	16	26	20	29	137	105	214
Closing Balance	23	34	43	29	196	164	273	578

ANNEXURE

V-Mart store visit takeaways

Bhagal store – Noida

- With a size of 8.6k sqft (located at ground floor), Bhagal store commenced its operations in March'17. The store has about 27 employees.
- Annual revenue stands at INR60m (INR5m monthly) with a productivity of INR6.9k (INR581/month).
- Store has a revenue target of INR80m for FY19.
- Average monthly footfalls are in the range of 8k-9k with a conversion rate of 60%. Thus, the effective footfall stands at 5k-5.5k.
- Average ticket size is INR1k while average product price is INR250.
- Of the total sales, 40-50% products are private label (of which ~50% are exclusive). Most of the brands are completely unknown compared to other known peer brands.
- Store has an inventory of around 2-3 months and re-stocking is done once a week (at night).
- Apparel category constitutes ~80% of the total store inventory. House-ware category form 17-18% while balance 1-2% is packaged food.
- Within Apparel, ~32% of the inventory pertain to men-wear while women-wear and kids-wear form 30%/25% respectively.
- Competitor stores in the vicinity include 1) V2-Mart with 10,600sqft store size and 2) City Life. Both stores are being owned by promoter relatives.
- Company provides stay and food for top 3 employees of the store like store manager etc.

Exhibit 475: Bhagal store – Monthly proforma P/L

	INR m
Sales	5-5.5
Gross Profit	1.8
Gross margin (%)	32-34%
Avg. fixed cost	1-1.2
--Rental cost (8.6 sqft @ INR50/sqft)	0.4
--Other cost	0.4-0.5
Profit	0.4-0.5
Profit margin	9-10%

Source: MOFSL, Company

Lajpat Nagar store - Delhi

- With a size of 7.2k-7.6k sqft, the Lajpat Nagar store is ~14 years old.
- Annual revenue stands at INR60m (INR5-6m monthly) with a productivity of INR7.8k (INR650-700/month). The store has about 27 employees
- Store has a revenue target of 10-15% growth for FY19.
- Average monthly footfall is ~30k with a conversion rate of 60%.
- Average ticket size is INR1k while average product price is INR250.

- Apparel products (at V-mart) are very low priced – Jeans in the range of INR600-800, formal shirts - INR400-600, casual T-shirts – INR200-300 and sherwani's at INR1,600-1,700. This is ~30-50% discount compared to the large format stores.
- Monthly rental cost stands at INR600k (INR90/sqft.) as the store is situated at prime location. The store needs some renovation and also there is possibility of increase in rental.
- Besides, there is also a local apparel market nearby.
- Unlike avg. apparel category's gross margin of ~45%, V-Mart garners only 30% gross margin. This is because, V-mart prices its products very attractively to promote store productivity and increase asset turnover.
- Store has an inventory of around 2 months and re-stocking is done once a week (at night).

Exhibit 476: Lajpat Nagar store – Monthly proforma P/L

	INR m
Sales	5-5.5
Gross Profit	1.7-1.8
Gross margin (%)	32-34%
Avg. fixed cost	1-1.2
--Rental cost (7.2 sqft @ INR90/sqft)	0.6
--Other cost	0.5
Profit	0.4-0.5
Profit margin	9-10%

Source: MOFSL, Company

Reliance Retail

BSE SENSEX

38,862

S&P CNX

11,666

NA



Financials Snapshot (INR b)

Y/E MARCH	FY19E	FY20E	FY21E
Sales	977.7	1,312.2	1,585.8
EBITDA	56.7	80.9	99.5
NP	32.2	47.7	60.1
EPS (INR)	6.5	9.6	12.0
EPS Gr.%	159.1	48.2	25.9
BV/Sh. (INR)	24.6	34.2	46.2
RoE (%)	30.2	32.5	30.0
RoCE (%)	23.4	26.2	25.5

Unlocking India's retail potential

Consistent growth + increasing scale = A Juggernaut

- Reliance Retail has the largest organized food & grocery (F&G) and fashion business in India, with a widespread core network of ~4,300 stores (FY19E). Over the last three years, the company has aggressively expanded across verticals.
- Rapid expansion and consequent healthy growth have brought scale benefits, with the core EBITDA margin likely to expand 260bp YoY to 6.9% over FY16-19E.
- We expect core (ex-petro/connectivity) revenue/EBITDA CAGR of 28%/34% over FY19-21, driven by its expanding footprint across businesses.
- It is also undertaking various omni-channel initiatives, (a) aggressively digitizing small retailers through merchant POS to support last mile connectivity and cash & carry stores, (b) launching fashion and F&G portal, (c) building kiosks in fashion stores.
- We, thus, believe that Reliance Retail is well positioned to tap India's large expanding retail market, given its (a) vast physical presence, (b) strength of Jio's platforms and subscriber base, (c) payment banks venture and (d) deep-pocketed promoter group.

Largest retail player across formats, product categories

Reliance Retail – one of the largest players in the organized retail market – has a diversified presence across products/formats, including F&G (conducted via small neighborhood stores, super markets and hypermarkets), apparel (Reliance Trends), electronics (Reliance Digital), connectivity (5,705 Jio points) and petro retail (510+ outlets). The company has ~4,300 core stores and ~15.8m sq.ft core area under network (FY19E). Cross-selling opportunities across formats are also immense.

Focus on core segments yielding results

Reliance Retail has placed massive emphasis on growing its core segments (F&G, apparel and electronics) to capitalize on opportunities in these fastest growing segments of the Indian retail market. Over the past three years, the company has added ~1.1k core stores across formats, including 120+ Reliance Smart stores (F&G). Trends (apparel) now operate over 500 stores, significantly higher than FBB – the only other large player in the value fashion segment. Consequently, the grocery and value fashion formats have registered an impressive CAGR of 38% and 36% over FY16-19, with their contribution to core sales now at 31% and 14%, respectively. The electronic segment, too, has received fillip from the success of Jiophone. Given the accelerated store adds and strong productivity, we expect core revenue/footprint CAGR of 28%/7% over FY19-21 to reach ~INR1,202b/18m sq. ft.

Scale benefits provide comfort on margins

Reliance Retail's core business EBITDA margin has now reached 6.9% (FY19E) from 2.5% in FY14. However, given its scale, there is still huge room for an improvement in the overall EBITDA margin profile. We believe that the fashion business should deliver low-double-digit EBITDA margin on a net basis, while the grocery and

electronics segments should achieve low-to-mid single-digit margin. We, thus, expect overall core margin to improve by 60bp to 7.5% over FY19-21.

Building a strong omni-channel presence

Reliance Retail is set to build a strong omni-channel retail business with its diverse physical presence, huge subscriber base through Jio, a wide app ecosystem on Jio's digital platform, and foray in payment banking. The company is aggressively digitizing small retailers, targeting to set up over 15m merchant POS overtime, which will support last mile customer connectivity and drive cash & carry business. It is also integrating over 100 Trends stores and over 100 partner brand stores for fulfillment of online orders/returns placed on AJIO.com and operationalizing kiosks across 465 Trends stores to browse online inventory. It has also launched Reliancesmart.in, an online platform in select cities.

Valuation and view

We have valued the business on an SOTP basis –20x EV/EBITDA to core EBITDA of INR73b (FY21) and 5x EV/EBITDA to the commoditized petro and connectivity EBITDA of INR14b (FY21). We, thus, arrive at an equity value of INR1,424b and value per share of INR225.

Fast network expansion...

Reliance Retail has placed massive emphasis on growing its core segments (F&G, apparel and electronics) to capitalize on opportunities in these fastest growing segments of the Indian retail market. To cater to the increasing retail needs of consumers, the company has increased its core store count (across all formats) from 2,621 in FY15 to ~4,300 (spread across ~15.8m sq. ft.) in FY19E.

Given the accelerated store add and strong productivity, we expect core revenue/footprint CAGR of 28%/7% over FY19-21 to reach ~INR1,202b/18m sq. ft. The total count of stores including Jio points stand at ~10k (FY19E), out of which core stores (excluding Jio Points and petro outlets) stand at 4302 (FY19E). We expect 300 store additions annually in FY20/21, about 6-7% footprint addition annually.

...across formats...

It operates via numerous store models. In F&G, the company operates via neighborhood stores (Reliance Fresh) and the supermarket format (Reliance Smart). Further, it operates a wholesale format (Reliance Market) catering to the needs of various kirana stores and institutional customers. Reliance Trends, Reliance Footprint and Reliance Jewels are the fashion & lifestyle segment arms, while Reliance Digital, Reliance Digital Express Mini stores cater to the consumer electronics and digital categories.

...translating into healthy revenue growth

Reliance Retail's revenue has increased strikingly at 84% CAGR (to INR1,314b) over FY16-19E, While much of this growth can be attributed to RJio, we also note of the impressive CAGR of 38% and 36% in the F&G and fashion & lifestyle segments, respectively. The fast-growing organized retail market and the traction in online F&G and fashion categories offer immense benefits to players such as Reliance Retail.

Scale to provide crucial margins support

Robust revenue growth has translated into a strong 5x core EBITDA growth (to INR50.5b) over the FY16-19E. However, the core EBITDA margin remains at sub-7% levels. This, in our view, could be possibly due to new initiatives across numerous formats for both F&G and fashion & lifestyle (e.g. Trends Women, Trends Express despite well-evolved Reliance Trends) segments and aggressive network expansion, which is limiting store profitability. However, we believe that scale-related benefits in the form of reduced logistic and SG&A cost and improving store economics from maturing (older than 3 years) stores could improve margin by over 60bp to 7.5% over the next two years.

1) Food & Grocery (including HPC and general merchandise)

F&G contributes 31% of the company's core revenue (~20% of total revenue). Reliance Retail operates in F&G via a three-tier model – Reliance Fresh, Reliance Smart and Reliance Mart.

Reliance Fresh: Reliance Retail forayed into this business with the launch of Reliance Fresh stores catering to everyday needs (neighborhood store concept). This includes fruits & vegetables, dairy products, cereals and spices, processed food and

beverages, and HPC products, among others. Reliance Fresh stores have an estimated average store size of ~2k sq. ft.

Reliance Smart: The Company has 120+ Reliance Smart stores spread across 73 cities (mainly in the catchment areas). These supermarket stores have an estimated average size of 35-40k sq. ft. Most of the Reliance Smart format caters to F&G/HPC, general merchandise products, and also houses Reliance Trends (fashion and lifestyle segment) and Reliance Digital (electronics segment) formats.

Reliance Market: Operating on a B2B (wholesale) model, Reliance Market is targeted toward various kirana stores, hotels/restaurants/caterers (HoReCa), and institutional customers, among others. 'Buy for less' and 'Sell for less' are the key principles of this model. The company operates more than 40 Reliance Market stores (estimated average store size of 35-40k sq. ft.). The company has tied up with a large number of farmers and small vendors to directly source the 'fresh' F&G products to reduce wastage and improve gross margins.

Private Label: Operating in the low-margin F&G category, private label remains the mainstay for a company to build an economic moat. Consequently, Reliance Retail has developed a wide portfolio of private label brands under the F&G, HPC and general merchandise categories (includes brands such as Best Farms, Good Life, Rel Glow, etc.).

2) Fashion and Lifestyle segment

The fashion & lifestyle segment arms of Reliance Retail include Reliance Trends (value fashion format), AJIO, Marks & Spencers, Project Eve (targeting the mid-segment price points) and International Partner Brands (tapping the premium and luxury fashion assortments). This segment contributes ~14% of core revenue (~10% of total revenue).

Reliance Trends: With over 500 stores across 245 cities, Reliance Trends is the largest segment in the apparel business, a value-fashion destination arm of Reliance Retail. The estimated average store size ranges from 8k-24k sq. ft. catering to men, women and kids wear. It encompasses a healthy private label portfolio, including Rio, Avaasa, Fusion, DNMX and Netplay. To improve store productivity and accelerate store additions of its Trends format, the company had launched a new (smaller) concept 'Trends Express' in 4QFY18.

AJIO: Launched in Apr-16, AJIO.com is the fashion & lifestyle e-commerce platform of Reliance Retail. It offers private labels, national and international brands.

3) Consumer electronics segment

Reliance Digital: The consumer electronics arm of Reliance Retail – Reliance Digital stores – offers a complete range of white and brown goods, including handsets. Electronics contributes ~55% of overall core revenue (delivered 87% CAGR over FY16-19E).

Aggressive ramp-up of omni channel presence

Reliance Retail is set to build a strong omni-channel retail business with its diverse physical presence, huge subscriber base through Jio, a wide app ecosystem on Jio's digital platform, and foray in payment banking. It is also integrating over 100 Trends stores and over 100 partner brand stores for fulfillment of online orders/returns placed on AJIO.com.

1.) Digitizing small traders

The company is aggressively digitizing small retailers through deployment of merchant POS. Targeted towards packaged and grocery products, it helps to digitize billing, scanning, inventory management, order replenishment and create loyalty/other customer centric program. Traders can seamlessly order from Reliance market – the cash and carry store for order replenishments and fulfillment. This will help Reliance retail to a.) Provide last mile connectivity to consumers for omni-channel offerings and use the data for customer analytics, b.) Secure growth opportunity for its existing 50 cash and carry stores and upcoming new ones through inventory replenishments of small traders. Roughly there are 30-32m small retailers in the country, out of which Reliance retail plans to target at least half through the merchant POS system.

2.) Online portals for F&G and Apparel business

The B2C ecommerce is currently being operated through individual websites from each category – Ajio.com for up market fashion, reliancesmart.com for grocery and others merchandise. Retail may linked the websites to My Jio and also to non jio customers, but not currently working on an integrated multi category website.

3.) Integrating Trends online and offline channel

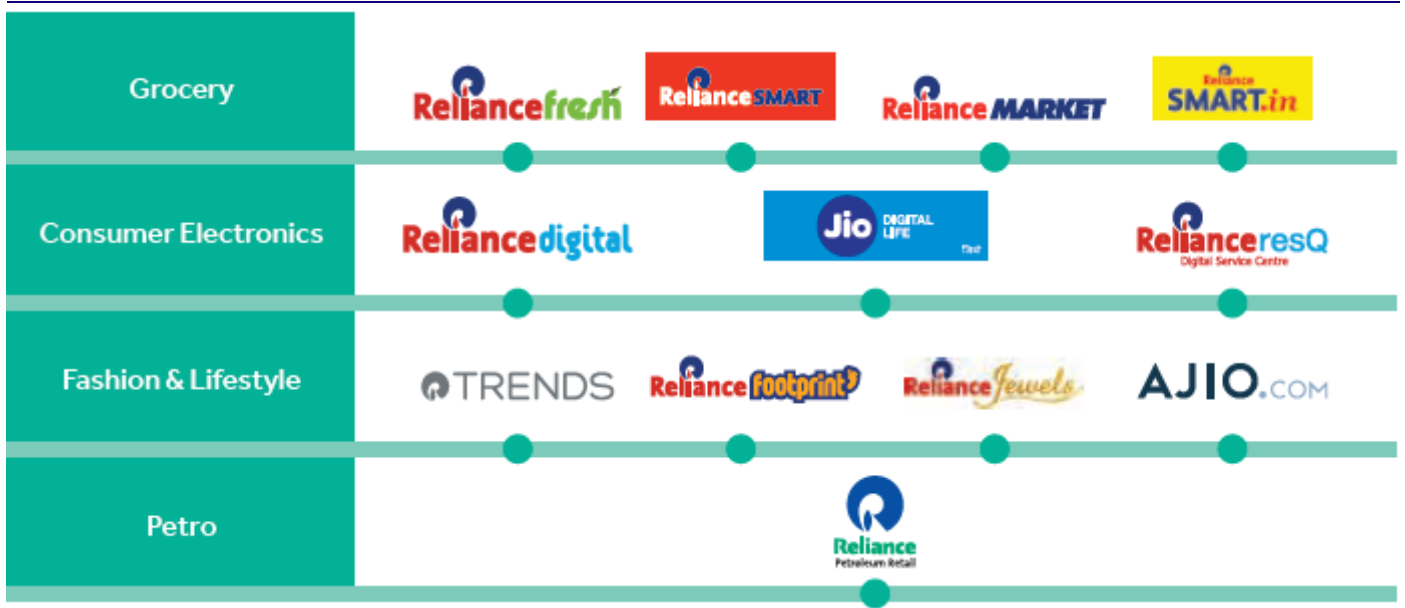
Reliance Retail has integrating over 100 Trends stores and over 100 partner brand stores for fulfillment of online orders/returns placed on AJIO.com. It has also operationalizing kiosks across 465 Trends stores to browse online inventory.

Exhibit 477: Valuation based on SOTP basis

	EBITDA (INR b)	Multiple (x)	EV (INR b)
Core Revenue	73	20	1,456
Petro and Connectivity	14	5	68.7
Total			1,524
Less Net Debt			100
Equity Value			1,424
No of Shares (in b)			6.3
TP			225

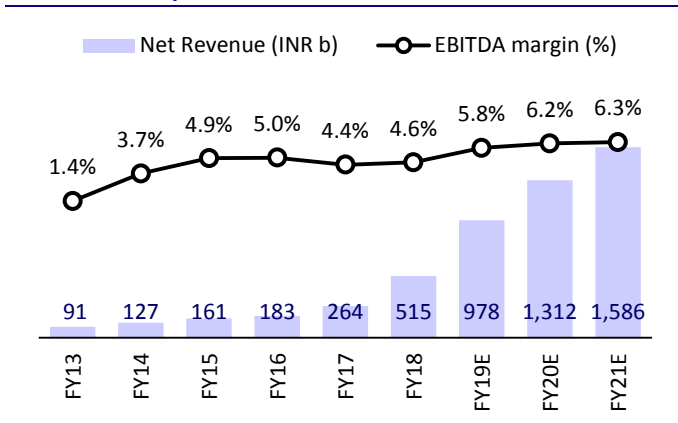
Source: MOFSL, Company

Exhibit 478: Numerous formats across categories



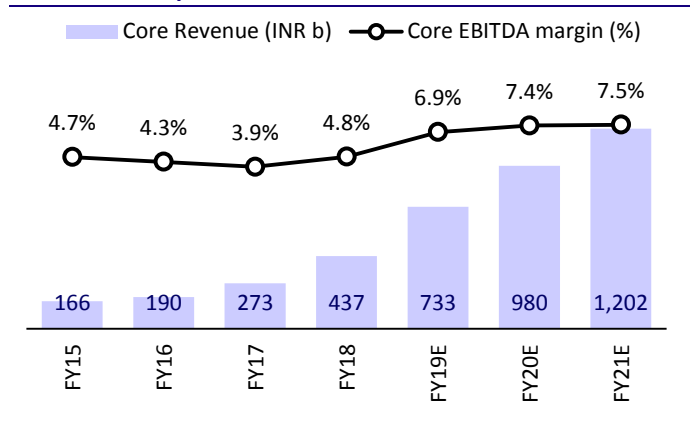
Source: Company, MOFSL

Exhibit 479: Expect total revenue CAGR of 27% over FY19-21



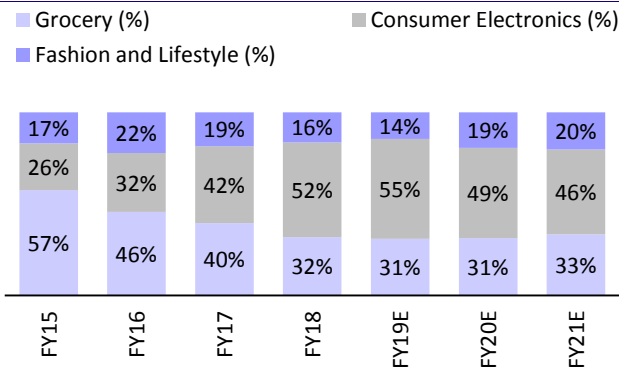
Source: MOFSL, Company

Exhibit 480: Expect core revenue CAGR of 32% over FY19-21



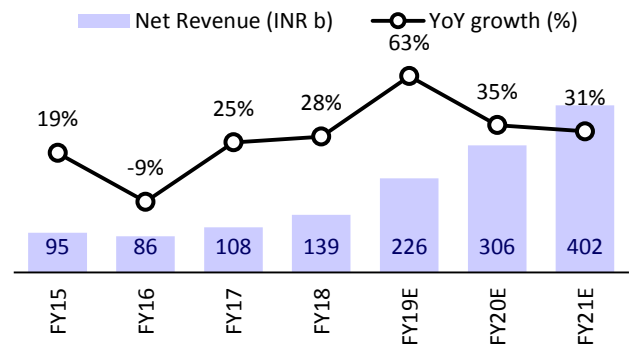
Source: MOFSL, Company

Exhibit 481: Consumer electronics share (as % of core revenue) is higher in FY18/FY19 due to Jiophone sales



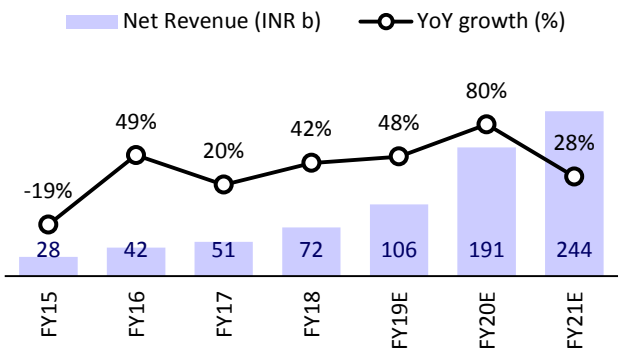
Source: MOFSL, Company

Exhibit 482: F&G segmental revenue to grow at 33% CAGR over FY19-21



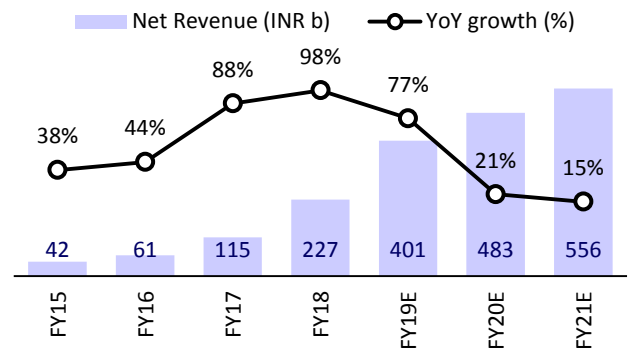
Source: MOFSL, Company

Exhibit 483: Fashion & Lifestyle segmental revenue to grow at 52% CAGR over FY19-21



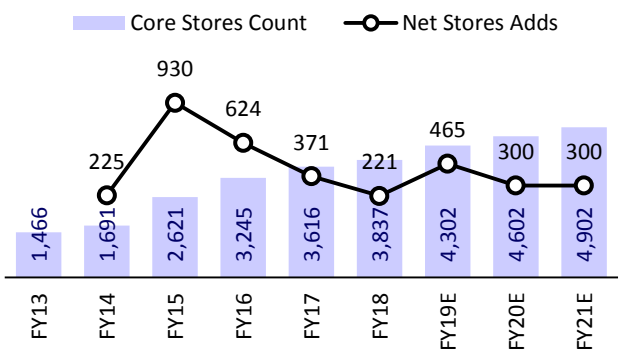
Source: MOFSL, Company

Exhibit 484: Consumer electronics segmental revenue to grow at 18% CAGR over FY19-21



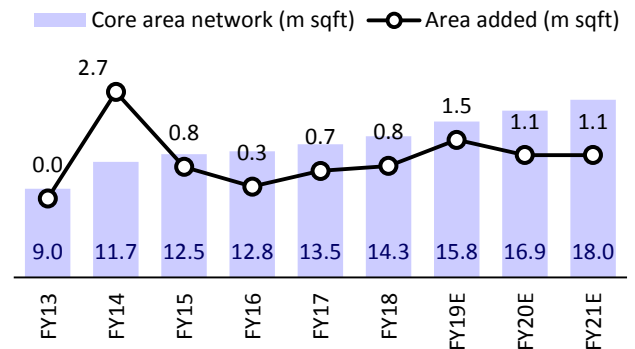
Source: MOFSL, Company

Exhibit 485: Expect core store adds to remain healthy



Source: MOFSL, Company

Exhibit 486: Expect core area network CAGR of 7% over FY19-21 on a high base



Source: MOFSL, Company

Exhibit 487: Segmental breakup of gross revenue (INR b)

	FY17	FY18	FY19E	FY20E	FY21E
Grocery	108	139	226	306	402
YoY growth (%)	25%	28%	63%	35%	31%
as a % of Core Revenues	40%	32%	31%	31%	33%
Consumer Electronics	115	227	401	483	556
YoY growth (%)	88%	98%	77%	21%	15%
as a % of Core Revenues	42%	52%	55%	49%	46%
Fashion and Lifestyle	51	72	106	191	244
YoY growth (%)	20%	42%	48%	80%	28%
as a % of Core Revenues	19%	16%	14%	19%	20%
Core Revenue	273	437	733	980	1,202
YoY growth (%)	44%	60%	68%	34%	23%
as a % of Total Revenues	81%	63%	56%	56%	56%
Connectivity	0	152	451	628	743
YoY growth (%)			196%	39%	18%
as a % of Total Revenues	0%	22%	34%	36%	35%
Petro Retail	64	103	131	157	188
YoY growth (%)			27%	20%	20%
as a % of Total Revenues	0%	15%	10%	9%	9%
Gross Revenue	338	692	1,315	1,765	2,133
YoY growth (%)	60%	105%	90%	34%	21%

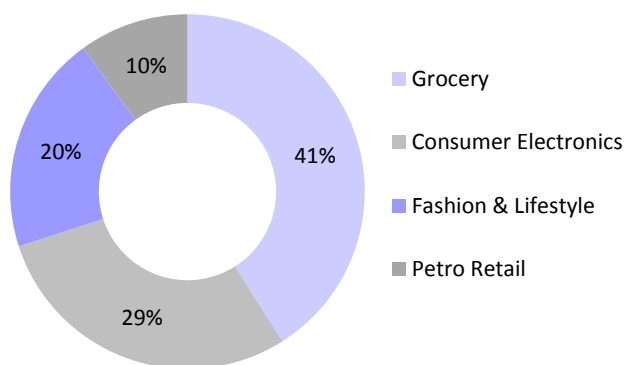
Source: MOFSL, Company

Exhibit 488: Segmental breakup of gross EBITDA (INR b)

	FY17	FY18	FY19E	FY20E	FY21E
Core EBITDA	11	21	50	73	90
YoY growth (%)	30%	95%	142%	44%	24%
Core EBITDA margin	4%	5%	7%	7%	8%
as a % of Total EBITDA	90%	82%	83%	84%	85%
Connectivity EBITDA	0	3	8	11	13
YoY growth (%)			196%	39%	18%
Connectivity EBITDA margin	2%	2%	2%	2%	2%
as a % of total EBITDA	0%	11%	13%	13%	12%
Petro Retail EBITDA	1	2	2	3	3
YoY growth (%)	204%	60%	27%	20%	20%
Petro retail EBITDA margin	2%	2%	2%	2%	2%
as a % of total EBITDA	10%	7%	4%	3%	3%
Gross EBITDA	12	25	61	87	106
Gross EBITDA margin	3%	4%	5%	5%	5%

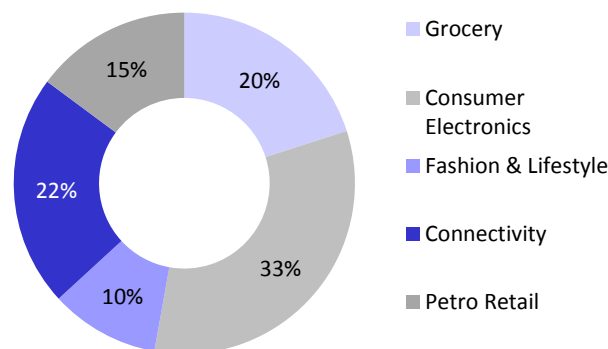
Source: MOFSL

Exhibit 489: Gross revenue mix in FY16 was skewed toward F&G category... (%)



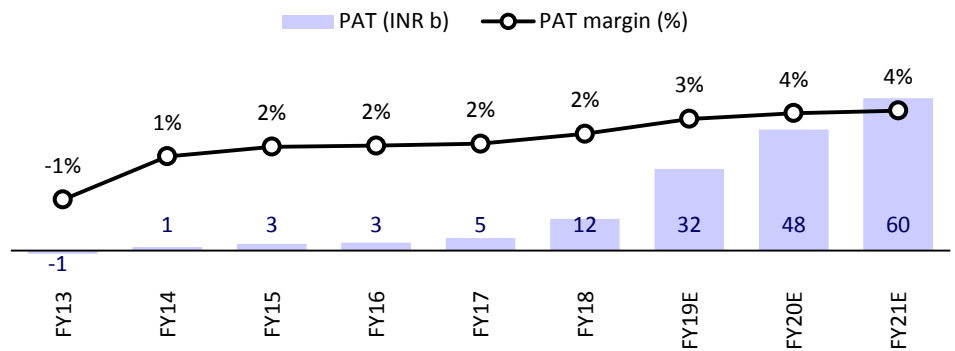
Source: MOFSL, Company

Exhibit 490: ...which diversified in FY18 due to connectivity segment (%)



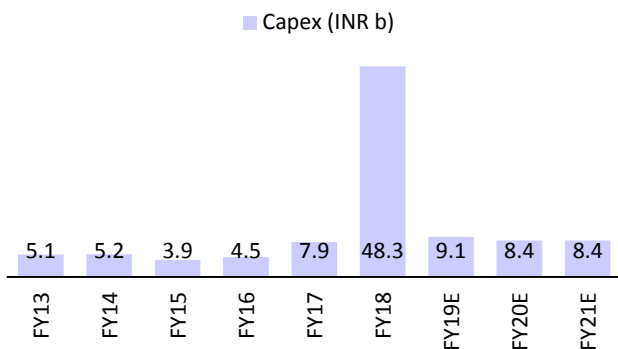
Source: MOFSL, Company

Exhibit 491: Expect PAT margin to reach 4% by FY21



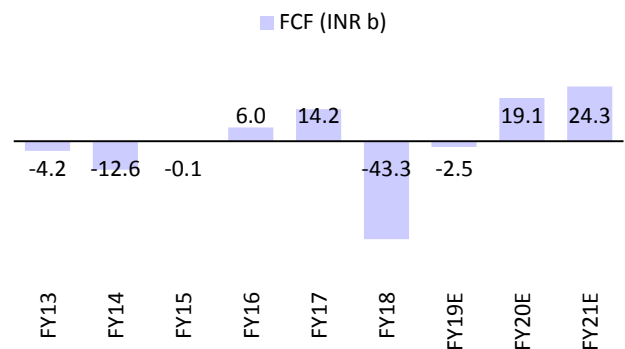
Source: MOFSL, Company

Exhibit 492: Capex to stabilize at INR8-9b...



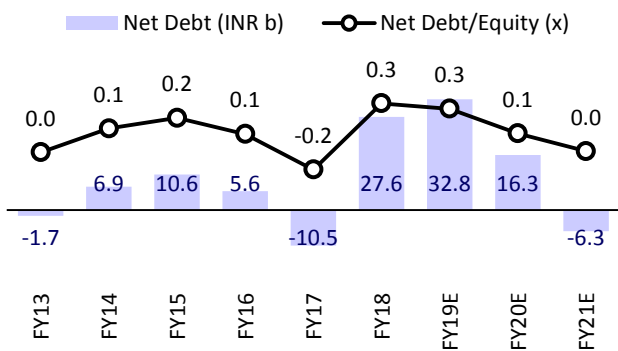
Source: MOFSL, Company

Exhibit 493: ...leading to higher FCF over FY19-21



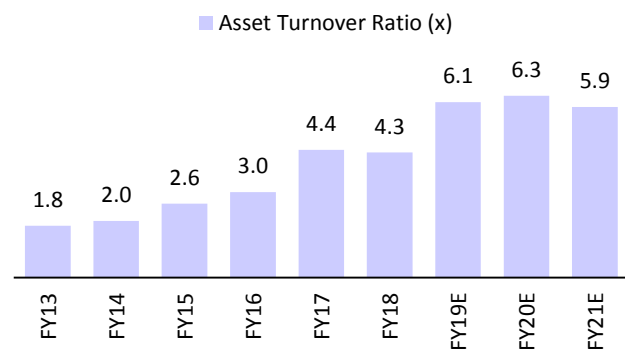
Source: MOFSL, Company

Exhibit 494: Net debt to gradually come down over FY19-21



Source: MOFSL, Company

Exhibit 495: Strong growth across categories to drive asset turns (x)



Source: MOFSL, Company

Financials and valuations

Standalone - Income Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Revenue from Operations	1,26,945	1,61,116	1,83,300	2,64,376	5,14,562	9,77,715	13,12,201	15,85,774
Change (%)	39.1	26.9	13.8	44.2	94.6	NA	NA	NA
Total Expenditure	1,22,297	1,53,165	1,74,180	2,52,744	4,90,919	9,21,033	12,31,311	14,86,281
% of Sales	96.3	95.1	95.0	95.6	95.4	94.2	93.8	93.7
EBITDA	4,648	7,951	9,120	11,632	23,643	56,682	80,891	99,493
Margin (%)	3.7	4.9	5.0	4.4	4.6	5.8	6.2	6.3
Depreciation	1,866	3,031	3,243	3,686	4,342	5,179	5,966	6,718
EBIT	2,782	4,920	5,877	7,946	19,301	51,504	74,925	92,775
Int. and Finance Charges	698	1,500	1,177	773	1,010	3,158	3,558	3,558
Other Income	1,874	574	191	355	456	454	946	1,853
PBT bef. EO Exp.	3,958	3,994	4,891	7,528	18,747	48,799	72,312	91,070
EO Items	1,352	81	-81	-411	0	0	0	0
PBT after EO Exp.	5,310	4,075	4,810	7,117	18,747	48,799	72,312	91,070
Total Tax	1,238	1,268	1,836	3,103	6,315	16,592	24,586	30,964
Tax Rate (%)	23.3	31.1	38.2	43.6	33.7	34.0	34.0	34.0
Reported PAT	4,072	2,807	2,974	4,014	12,431	32,207	47,726	60,106
Adjusted PAT	3,035	2,751	3,024	4,246	12,431	32,207	47,726	60,106
Change (%)	-315.1	-9.4	9.9	40.4	192.8	NA	NA	NA
Margin (%)	2.4	1.7	1.6	1.6	2.4	3.3	3.6	3.8

Standalone - Balance Sheet

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Equity Share Capital	49,895	49,895	49,895	49,895	49,895	49,895	49,895	49,895
Total Reserves	2,638	1,988	11,345	18,300	40,769	72,977	1,20,703	1,80,809
Net Worth	52,533	51,883	61,240	68,195	90,665	1,22,872	1,70,598	2,30,704
Total Loans	19,207	16,766	10,901	277	34,478	44,478	44,478	44,478
Deferred Tax Liabilities	-6,796	-5,633	-10,014	-8,519	-6,204	-6,204	-6,204	-6,204
Capital Employed	64,944	63,016	62,127	59,953	1,18,939	1,61,146	2,08,873	2,68,978
Gross Block	29,501	33,474	34,742	39,973	52,976	62,108	70,467	78,826
Less: Accum. Deprn.	9,863	12,932	14,447	17,456	21,387	26,566	32,532	39,250
Net Fixed Assets	19,638	20,542	20,295	22,517	31,590	35,542	37,935	39,576
Capital WIP	3,877	4,232	5,328	7,290	41,464	41,464	41,464	41,464
Total Investments	8,478	4,701	4,848	8,263	5,344	5,344	5,344	5,344
Curr. Assets, Loans & Adv.	47,781	50,547	64,347	70,134	1,56,243	2,46,259	3,48,883	4,64,056
Inventory	32,637	38,817	52,495	50,965	1,04,653	1,36,659	1,79,336	2,26,576
Account Receivables	1,569	2,108	2,179	7,301	22,157	42,516	65,213	93,586
Cash and Bank Balance	3,856	1,505	476	2,523	1,561	6,347	22,818	45,384
Loans and Advances	9,719	8,117	9,197	9,345	27,872	60,737	81,516	98,511
Curr. Liability & Prov.	14,830	17,007	32,691	48,252	1,15,702	1,67,463	2,24,754	2,81,462
Account Payables	11,244	12,714	27,682	39,267	82,319	1,06,290	1,42,654	1,82,246
Other Current Liabilities	3,572	4,282	4,990	8,728	33,154	60,737	81,516	98,511
Provisions	14	11	19	257	229	435	584	705
Net Current Assets	32,951	33,540	31,656	21,883	40,542	78,796	1,24,129	1,82,594
Appl. of Funds	64,944	63,015	62,127	59,953	1,18,939	1,61,146	2,08,873	2,68,978

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)								
EPS	0.6	0.6	0.6	0.9	2.5	6.5	9.6	12.0
Cash EPS	1.0	1.2	1.3	1.6	3.4	7.5	10.8	13.4
BV/Share	10.5	10.4	12.3	13.7	18.2	24.6	34.2	46.2
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Return Ratios (%)								
RoE	5.9	5.3	5.3	6.6	15.7	30.2	32.5	30.0
RoCE	5.5	5.4	5.3	6.7	13.5	23.4	26.2	25.5
RoIC	5.0	6.7	7.0	9.6	22.8	38.1	40.0	38.7
Working Capital Ratios								
Fixed Asset Turnover (x)	4.3	4.8	5.3	6.6	9.7	15.7	18.6	20.1
Asset Turnover (x)	2.0	2.6	3.0	4.4	4.3	6.1	6.3	5.9
Inventory (Days)	94	88	105	70	74	51	50	52
Debtor (Days)	5	5	4	10	16	16	18	22
Creditor (Days)	32	29	55	54	58	40	40	42
Leverage Ratio (x)								
Current Ratio	3.2	3.0	2.0	1.5	1.4	1.5	1.6	1.6
Interest Cover Ratio	4.0	3.3	5.0	10.3	19.1	16.3	21.1	26.1
Net Debt/Equity	0.1	0.2	0.1	-0.2	0.3	0.3	0.1	0.0

Standalone - Cash Flow Statement

(INR Million)

Y/E March	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(Loss) before Tax	3,959	3,993	4,891	7,528	18,747	48,799	72,312	91,070
Depreciation	1,866	3,031	3,243	3,686	4,342	5,179	5,966	6,718
Interest & Finance Charges	698	1,411	1,107	509	751	3,158	3,558	3,558
Direct Taxes Paid	-332	-508	-1,286	-648	-4,596	-16,592	-24,586	-30,964
(Inc)/Dec in WC	-12,151	-4,076	2,429	10,533	-15,173	-33,470	-28,862	-35,898
CF from Operations	-5,960	3,851	10,384	21,608	4,072	7,075	28,389	34,484
Others	-1,490	-120	160	502	910	-454	-946	-1,853
CF from Operating incl EO	-7,450	3,731	10,544	22,110	4,981	6,621	27,443	32,631
(Inc)/Dec in FA	-5,186	-3,851	-4,498	-7,940	-48,312	-9,131	-8,359	-8,359
Free Cash Flow	-12,636	-120	6,046	14,170	-43,330	-2,510	19,084	24,272
(Pur)/Sale of Investments	3,412	1,088	-26	-3,324	3,040	0	0	0
Others	752	1,371	-11	36	-3,854	454	946	1,853
CF from Investments	-1,022	-1,392	-4,535	-11,228	-49,125	-8,677	-7,413	-6,506
Issue of Shares	0	0	0	0	10,000	0	0	0
Inc/(Dec) in Debt	20,691	23,458	-5,833	-8,044	34,203	10,000	0	0
Interest Paid	-684	-1,580	-1,184	-776	-1,010	-3,158	-3,558	-3,558
Dividend Paid	0	0	0	0	0	0	0	0
Others	-10,776	-25,141	-22	-15	-11	0	0	0
CF from Fin. Activity	9,231	-3,263	-7,039	-8,835	43,182	6,842	-3,558	-3,558
Inc/Dec of Cash	759	-924	-1,030	2,047	-962	4,785	16,471	22,566
Opening Balance	895	1,724	1,505	476	2,523	1,561	6,347	22,818
Closing Balance	3,857	1,505	475	2,523	1,561	6,347	22,818	45,384

NOTES

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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