Future Retail Ltd.

TP: INR 410 - ACCUMULATE

8 May 2017

Retail

Initiating Coverage

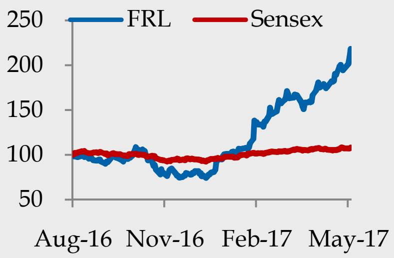
Key Statistics

CMP (INR)	349
Upside/downside (%)	17.3
Market Cap (INR/USD bn)	164.7 | 2.6
Shares outstanding (mn)	471.3
3 months avg volume	479,261
Dividend Yield (FY16, %)	0
52 Wk high/low	360 | 116.1
Sensex/Nifty	29,926/9,314
Bloomberg Code	FRETAIL IN

Performance (%)	1M	3M	Since listing
Absolute (%)	23.9	61.6	117.5
Rel. to Sensex (%)	23.2	55.8	110.2

Sh. Pattern, % (as Mar-2017)	
Promoter	49.5
FII	17.3
DII	4.7
Other	28.5
Total	**100.0**

Stock Price Performance*



* Rebased to 100 | Based on daily closing prices

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Market leader in the fast growing modern retail space

Future Retail Ltd (FRL) is the retailing arm of the Future Group, selling products ranging from food, apparels, appliances to general merchandise through large and small store formats including Big Bazaar (BB), Easyday (ED), Foodhall, Fashion at Big Bazaar (FBB), and ezone. As of 31 December 2016, FRL had retail space of ~ 13 mn square feet (sq ft) with BB forming ~75% of the total space; ED~ 6%; HomeTown~10% and FBB (standalone stores) and ezone contributed equally to the balance. We like FRL's leadership position in the fast growing modern retail space; focus on improving profitability; and the strong expansion plans within the retail space. We expect FRL to grow its sales at a CAGR of ~ 49% over FY16 to FY19 led largely by the expansion in number of stores and EBITDA margins to improve from 1.2% in FY16 to 4.3% in FY19. We initiate coverage on FRL with ACCUMULATE and a TP of INR 410.

- ✓ **Market leader in the fast growing space:** With modern retail (MT) gaining prominence in India, its share in the overall retail industry is on the rise. As per Technopak, the organized brick and mortar retail industry had a share of ~9% of total retail consumption in FY16, which is expected to rise to 12% by FY20. This would allow for faster growth of organized players, taking the market size to ~USD 115 bn by 2020. This translates to a CAGR of about 21-22% going ahead as compared to the 19-20% rates seen in the 4 years leading up to FY16. With a market share of ~ 13% in 2016 *(Source: Technopak)*, FRL is the market leader within MT space.
- ✓ **Small store expansion drive:** FRL has set an ambitious target to operate 3,000 small stores (ED) and 350 large stores (BB+FBB) by 2021. As of 31st December 2016, the company had 231 BB stores (average size of ~42,500 sq ft) and 379 ED stores (average size of ~2,200 sq feet). Going forward, we expect the large to small retail space ratio (barring ezone and Home Town stores) to change to ~82:18, as compared to the current ratio of ~85:15. We expect FRL to grow its sales at a CAGR of ~ 49% over FY16 to FY19 led by the expansion of stores.
- ✓ **Profitability improvement on the cards:** FRL is looking to improve profitability through various factors including better optimization of products to help increase off take (through the help of IT and data analytics) as well as increasing efficiencies arising out of large scale operations. The company is also looking to significantly increase the proportion of private labels. Further, the company is looking to scale down operations of its specialty stores (ezone) and demerge its home furnishing business (Home Town) into a separate unit. We expect FRL to expand its EBITDA margins by ~300 bps from FY16 to FY19 on the back of these efforts.
- ✓ **Initiate with ACCUMULATE rating and TP of INR 410:** Given FRL's dominance in the retail space, coupled with strong growth and improving earnings profile expectations, we are comfortable assigning it a 50% discount to the valuation the most efficient player in the retail space is garnering. At current levels, the stock trades at 32.2x/21.5x our FY18E/FY19E profit estimates. We initiate coverage on FRL with a Accumulate rating and a TP of INR 410 based on a multiple of 25x FY19E profits.

Year End (31 Mar)	FY15	FY16	FY17E	FY18E	FY19E
Revenues (INR mn)	17,794	68,450	168,386	191,450	226,096
Growth (%)	NA	284.7	146.0	13.7	18.1
EBITDA (INR mn)	(3,849)	856	5,338	7,178	9,620
EBITDA Margin (%)	(21.6)	1.2	3.2	3.7	4.3
Adjt. PAT (INR mn)	(3,792)	146	3,222	5,117	7,660
Adjt. PAT Margin (%)	(21.3)	0.2	1.9	2.7	3.4
Adj. EPS (INR)	(8.0)	0.3	6.8	10.9	16.3
Growth (%)	-	NM	2,114.5	58.8	49.7
ROE (%)	NM	1.8	15.8	20.9	24.8
P/E (x)	NM	1,131.9	51.1	32.2	21.5
EV/EBITDA (x)	NM	202.8	32.7	24.2	17.9
P/BV (x)	NM	8.8	7.5	6.1	4.7

Source: Company, YSL estimates; Note: Valuations as on 08th May 2017

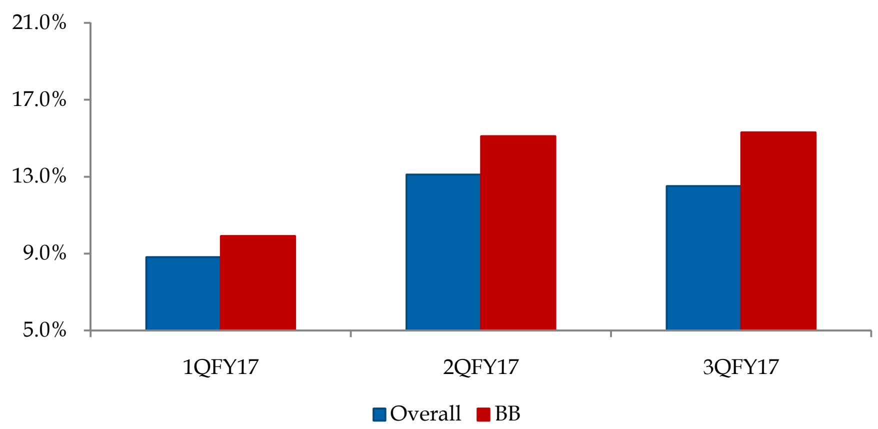
Re(new)ed aggression will help consolidate leadership position

Future Group underwent a massive restructuring that led to a renewed focus on Future Retail Ltd. that emerged as the Group's pure retail play, a business within the management's core competency. While the company has done well in the large store format (through BB stores) in the past, the key factors to look out for are the developments that take place in its neighbourhood/convenience store segment (through ED outlets) in terms of both growth as well as profitability.

For FRL to maintain its dominant position in the retail space, its move into the convenience store segment becomes imperative. The rationale behind this is increased presence across categories in the brick and mortar store space. While the bigger format stores are aimed at catering to the fortnightly and monthly household purchase requirements, the daily/weekly requirements are met through convenience stores. And thus, this is a segment FRL is looking to focus on to consolidate its position in the retail space.

✓ **Aggressive growth plans in place, with a close watch on profitability:** FRL's same store sales growth (SSG) numbers have been trending upwards in recent times.

Exhibit 1: Same store sales growth (YoY)



Source: Company, YSL

In part, this was helped by the tailwind related to demonetization and the government's drive to go cashless. Further, FRL has identified the following growth drivers:

1. **Retail space expansion**: FRL's goal is to operate 3,000 small (average store size ~2,000 sq ft) stores in key cities by the year 2021. These will largely be operated under the ED brand and will include formats such as Heritage. As for BB (including standalone FBB stores), the aim is to reach ~350 stores by 2021. As at end of December 2016, the company had 379 ED stores and 231 BB stores.

   Post the restructuring at the group level, all of the retail infrastructure has been moved to the sister concern – Future Enterprise Limited (FEL). As such, capex requirements for store expansions will be funded through FEL. FRL in turn will operate on a lease basis (it would have the option of taking up this model with third parties as well), thereby allowing it to operate an asset light model. As a result, gross block on the books of FRL stood at INR 2.8 bn (at the end of March 2016), which was mainly investment in software.

2. **Profitability improvement plans**: FRL's category mix is 50% food and home & personal care products, 35% fashion and 15% general merchandise. As per the company's management, this category mix is not expected to change drastically going forward. Category wise gross margins are as follows:

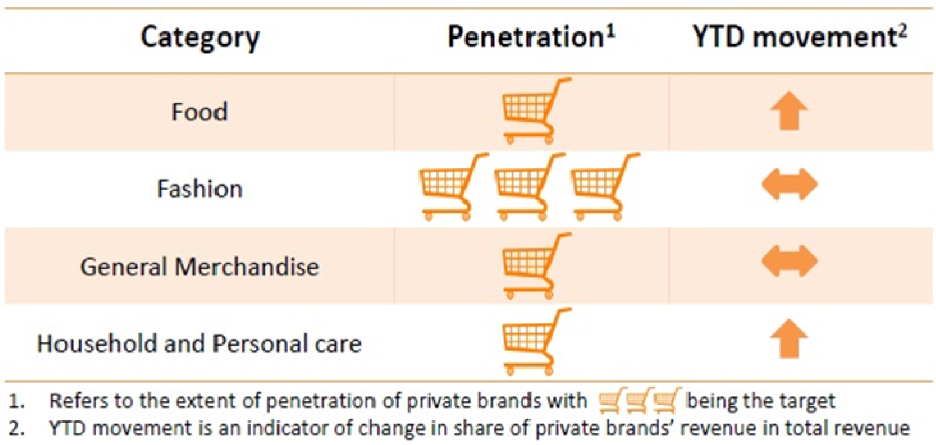
    - ~40% (for fashion),
    - ~20 to 25% (for general merchandise)
    - ~18% (for foods).

    In 9mFY17, FRL's gross margins stood at 24.8%, while EBITDA margins were lower at ~3.2%. Other expenses formed 8.9% of sales, while rental expenses formed ~8% of sales and employee costs ~4.7% of sales. Going ahead, rental expenses are expected to fall as incremental rent would be lower for the smaller stores as compared to the relatively large format BB stores. FRL is also open to buying properties, however the share of the same will not be meaningful anytime soon as the management believes renting properties allows for more flexibility in operations.

    Furthermore, FRL is working on other factors to improve margins. These include:

- **Increased penetration of group brands**: Group brand penetration is one aspect that the company is banking on to drive up margins, as it is able to earn 4-5% better margins on such products. Within the fashion business, ~95% of the business is derived through its own brands. In foods and general merchandise, this share stands at ~30% and ~5-10% respectively. The target for 2021 is to have as much as 70% of the food revenues coming from private labels. While this may seem like a very ambitious target, the fact is that group company Future Consumer Ltd. (FCL) has been getting aggressive in terms of product launch and brand building. With minimal penetration of private labels in the convenience stores business, this is one aspect that is expected to help the company improve upon its margins going forward.

Exhibit 2: Group brand penetration status as of 31 December 2016



Source: FRL's 3QFY17 investor presentation

- Change in product mix in the favor of higher margin products
- Improved margins for the neighborhood store segment
- Cost optimization: The management is expecting improvements on supply chain costs and improved efficiencies by taking up a cluster based store expansion approach – all of which are efforts aimed to provide better synergies and rationalize costs in the process.

Not to mention that FRL is also looking to rationalize the loss making stores and formats (will be merging most existing ezone stores into BB) and curb losses in the process.

3. **Focus on technology**: As per the company, technology-led networks has helped reach out to more consumers in an efficient way. As such, FRL will continue to create more digital interfaces - inside stores, on the web and on mobiles.

   Further, the company is banking on its customer loyalty and data science capabilities towards increasing consumer engagement in a fast and efficient manner. This move is likely to help the company better understand consumer buying patterns, and in the process allow for a better sell through.

4. **Improvement in working capital cycle:** Another key aspect the company is looking to improve upon is its inventory cycle and thus, better sales velocity and productivity resulting in improved cash flows. This we believe is possible through better product assortment, which is a key aspect the company is looking to work upon; this would be possible by leveraging on its IT infrastructure and better customer understanding.

   FRL's total inventory days stood at ~100 days as of 1HFY17. Inventory days for the food segment stood at ~35 days, while that for fashion was ~120 days. For its home furniture division, the same stood at ~150+ days. With the home furnishing business being demerged, inventory days are expected to improve. We expect total inventory days to gradually reduce on the back of improved product cycle as a result of better merchandise planning, procurement and supply chain coupled with enhanced terms / supplier financing.

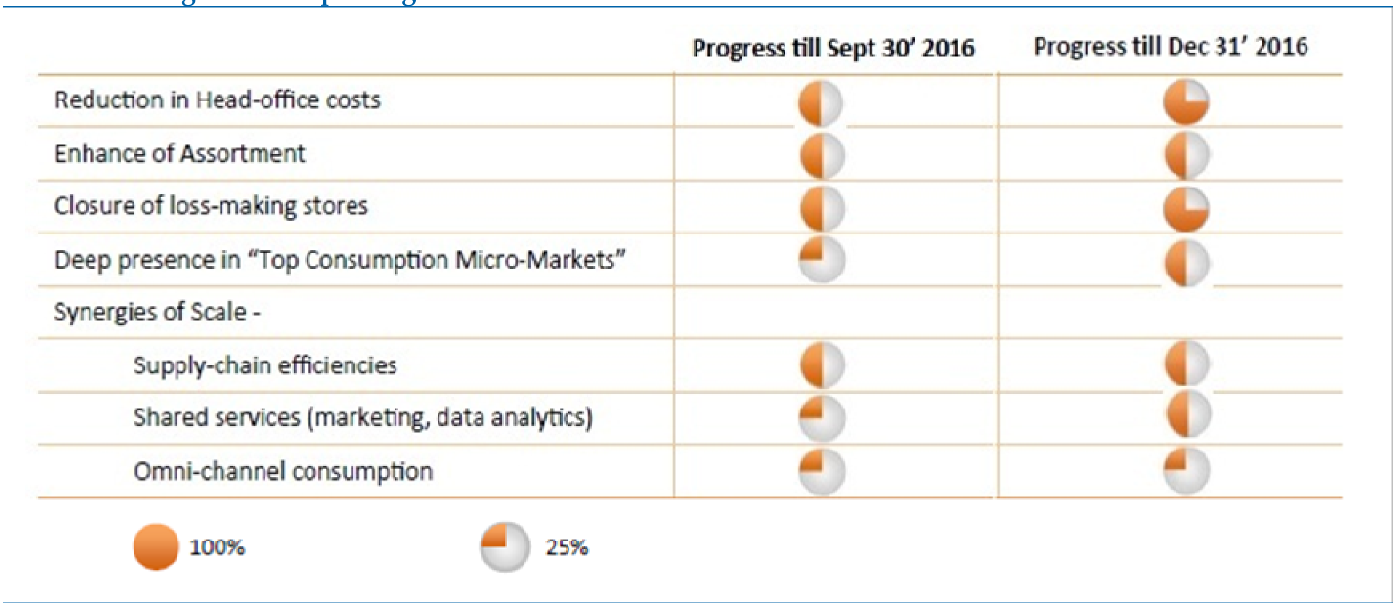
✓ **Restructuring and demerger of home furnishing business to improve focus:** Post the restructuring at the group level, all of the retail infrastructure has been moved to the sister concern – FEL. As such, capex requirements for store expansions will be funded through FEL. FRL in turn will operate on a lease basis (it would have the option of taking up this model with third parties as well), thereby allowing it to operate an asset light model. As a result, gross block on the books of FRL stood at INR 2.8 bn at the end of March 2016, which was mainly investment in software.

Furthermore, FRL will merge its home furnishing business (operated through Home Town stores) into Praxis Home Retail Private Limited (PHRPL) by a way of demerger. PHRPL will issue 1 fully paid up share of Rs 5 to equity shareholder of FRL for every 20 full paid up shares of Rs 2 each. Its foray into the e-commerce space (fabfurnish.com) will be part of this venture as well. As per the company, Home Town clocked revenues of ~INR 4.8 billion in FY16.

All these efforts allow for better utilization of resources and sharper focus on the pure food and fashion retailing businesses.

- ✓ **Strategy in place for improving EasyDay's financials:** FRL is focusing on turning around its convenience store operations and is targeting EBITDA breakeven within two to three quarters. To do so, it has charted out plans on aspects that need improvement that include reduction in head office costs, assortment enhancements, closure of loss-making stores, deep presence in 'top consumption micro-markets, supply chain efficiencies, etc.

Exhibit 3: Progress on improving efficiencies in the small store business



Source: Company; YSL

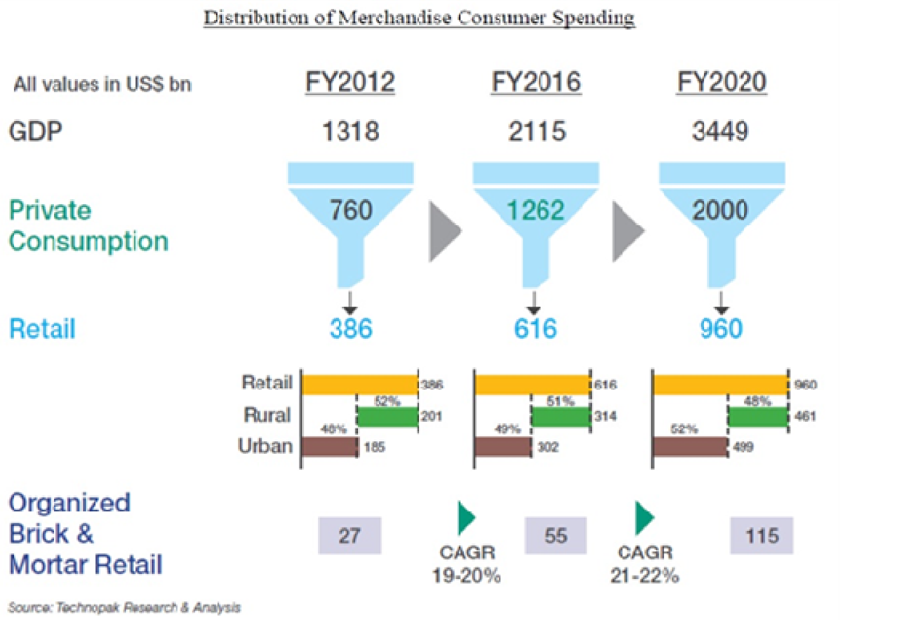
When it comes to expansion, the broader aim is to focus on markets where the company has a good presence with backend supply chain in place (distribution centres, etc). Some of the clusters that the company is currently focusing on include NCR (Delhi, Faridabad, Ghaziabad, Gurgaon, Noida), Bangalore, and Ludhiana.

- ✓ **Macro trends indicate favorable times for organized retail:** Private consumption expenditure (PCE) forms ~60% of India's GDP. India's GDP touched the USD 2 bn mark in 2014 and is expected to cross USD 3.5 bn by 2020 (CAGR ~9.8%). At 60% of GDP, PCE is expected to cross USD 2 trillion by 2020 from USD 1.125 bn in 2015. Factors driving consumption in India include favorable demographics; steady growth of urbanization; growing young & working population; increasing penetration of mobile technology and internet infrastructure; rising aspirations & affordability; the government's focus on skill development, job creation, infrastructure, manufacturing, and investments; factors such as financial inclusion initiatives and direct transfer of subsidies.

As per Technopak Research & Analysis, retail formed a little less than half of the PCE in 2016. Extrapolating this to expectations for 2020, the number is expected to cross USD 960 bn {~58% (PCE) x USD 3.5 trillion (GDP in 2020) x ~48% (retail spend)}.

The organized brick and mortar retail sector formed ~9% of total retail in FY16 and is expected to increase to 12% by FY20. This would provide faster growth for the organized players and in the process increase the market opportunity to about USD 115 bn by 2020; translating to a CAGR of about 21-22%, a figure higher than the 19-20% growth seen in the four years leading up to FY16.

Exhibit 4: Share of organized retail expected to rise at a faster pace



Source: Avenue Supermart RHP

The implementation of GST will have its role to play in enhancing the share of organized players as well. Besides reducing average tax payout through input credit and supply chain benefits, it will also help in shifting demand from the unorganized players towards the organized players. All these factors will help drive growth for organized retail going forward. And within the space, FRL holds the highest market share.

Exhibit 5: Market share of key players in 2012

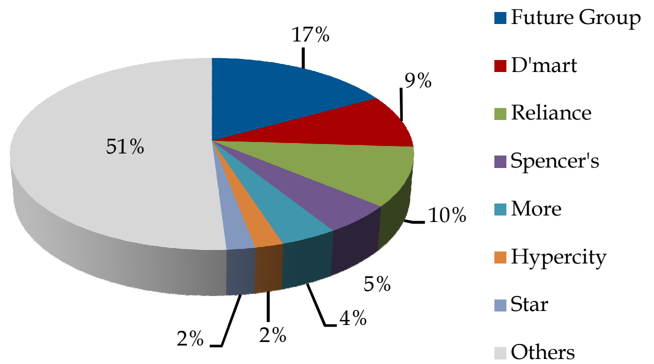
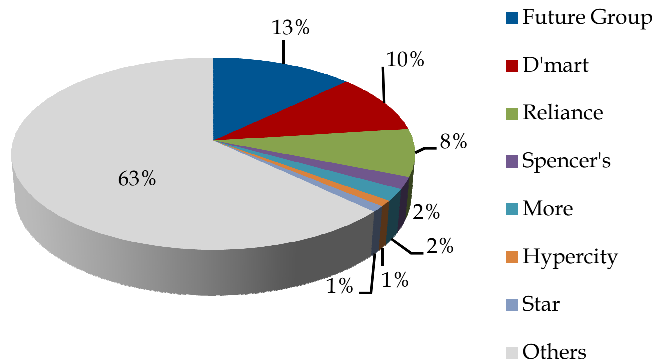


Exhibit 6: Market share of key players in 2016



Source: : Technopak Research & Analysis, YSL research

✓ New initiatives to play their part in driving growth:

- Tie up with Procter & Gamble (P&G): Future Group has tied up with P&G for joint sales forecasting and planning as well as exclusive product releases, including aspects such as supply chain efficiencies, planning strategies and managing shelf space. In addition, both the companies will place officials at the headquarters and be part of supply chain initiatives. As per the management this will help it grow sales for FRL and also help P&G increase its market share.

- Future Group launched Future Pay, a digital loyalty wallet comprising the Price Match feature that compares the price of items on the customer's bill with the competitor's advertised prices. As of December 2016, the company had over 1 mn users with about a fifth of the customers using the price comparison feature.

- Loyalty programs: FRL launched a customer loyalty program for ED called Easyday Savings Club. In this, customers are required to pay INR 999, post which they get 10% off on every bill for the year (barring certain items such as milk, edible oils). This way, the customers receive guaranteed savings. After a successful pilot project, this program has been extended in more than 340 stores (as of December 2016).

Exhibit 7: EasyDay Savings Club advertisement

Source: Company

- The company also tied-up with Paytm to offer seamless shopping for BB merchandise on Paytm marketplace for delivery to doorsteps.
- Future Group and Bajaj Finance launched India's first retail EMI card. This effort is aimed at driving loyalty of customers towards Future Group. The credit facility available to customers on a minimum invoice amount is INR 5,000 stretching up to a maximum of INR 3 lakhs. The tenure of loan would be three months to two years.

✓ **Aggressive plans for FBB:** As of December 2016, FRL had 54 standalone FBB outlets in addition to those present in many of the BB stores. FRL has identified the following factors to drive FBB's growth:

1) Introducing fresh and fashion-led merchandize in categories such as women's ethnic wear and men's & women's casual wear.
2) Driving incremental footfalls through a leadership position in denims, men's chinos and through end of season sales.
3) Establishing price leadership in kids' wear, women's sleepwear and suits & blazers.
4) Building new categories like summer looks (dresses, shorts, footwear) or introducing Athleisure as a fashion concept or new products like linens or men's casual shorts.

The company has also invested towards differentiating the brand through its advertising and social media campaigns. Efforts include appointing brand ambassadors like Katrina Kaif and Varun Dhawan; tying up with related events such as beauty pageants (Miss India) as well as other music events (Sunburn) and other events that will help the company connect with the youth from urban and non-urban parts of the country. What is interesting to note is that ~95% of the sales in the fashion business come from in-house brands.

✓ **Heritage to help get a foothold in southern markets:** In November 2016, FRL announced its intent to acquire 124 retail stores of Heritage Foods. This deal comprises of grocery & food retail business, agri (sourcing, processing & marketing) and bakery business. These stores had a total area of 0.43 mn sq ft (averaging to about ~3,467 sq ft per store). 70 stores were located in Hyderabad, while about 54 stores were located in Bangalore and Chennai. The acquisition is made through a share sale of 17.8 mn shares in FRL or ~3.65% stake in the company. There is an upside share clause for the same:

- If sale consideration from shares is in excess of INR 4 bn but upto INR 5 bn then 50% of the amount in excess above INR 4 bn would be shared with FRL.
- 75% of amount in excess of INR 5 bn in addition to above would be shared with the company.

The rationale behind this acquisition is to get access to the key southern markets. From a product perspective too, the acquisition would be a strategic fit as the key categories that Heritage retails include household items, FMCG products, staples, fresh fruits, and vegetables. All of these complement FRL's operations, thereby allowing for enhancement of assortment and benefits arising from supply chain efficiencies. This would also allow the company to get better insights into the southern markets. As per FRL, the retail business earns 16% gross margins with about 70 stores being EBITDA positive. On an overall basis, the company is targeting to reach breakeven within two quarters.

Valuation

✓ **Initiate with target price of INR 410; ACCUMULATE rating**

Given FRL's dominance in the retail space, coupled with the focus on the aggressive store expansion, we believe the company is well poised to report strong growth. To add to this, the asset light model will allow it to considerably improve upon its earnings quality; we expect RoEs to be ~25% two years forward. While it may take a few quarters for the company to stabilize operations of its smaller stores (ED and Heritage particularly), we expect the performance to improve substantially thereafter; especially considering that FRL is working on multiple factors to improve its financial metrics.

At current levels, the stock trades at 32.2x/21.5x our FY18E/FY19E earnings estimates. (It is important to note that our estimates are based on the outstanding shares as of March 2017. This is before the dilution of 3.6% which will happen once the Heritage acquisition is completed). This is at a significant discount to other players in the industry which trade at an average forward multiple of ~67x/42x their FY18E/FY19E profits. FRL's closest listed competitor is Avenue Supermart (ASL), which is trading at ~66x/50x its FY18E/FY19E profits (Bloomberg estimates). While FRL has the ability to narrow the gap in financial performance as compared to that of ASL's, nonetheless, we believe the business does deserve a discount of at least 50% to the multiple ASL is garnering. **We**

initiate coverage on FRL with a Accumulate rating and a TP of INR 410 based on a multiple of 25x FY19E profits.

Exhibit 8: Peer Comparison

Company Name	Ticker	Market Cap (INR mn)	CMP (INR)	PE (x)		EBITDA Margins		Return on Equity	
				FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
TRENT LTD	TRENT IN	84,924	256	42.2	31.0	8.8%	9.2%	12.8%	15.4%
SHOPPERS STOP LTD	SHOP IN	30,099	360	85.8	40.8	4.8%	5.5%	5.4%	12.5%
AVENUE SUPERMARTS LTD	DMART IN	486,880	780	65.7	50.0	8.6%	8.7%	17.6%	19.2%
FUTURE RETAIL LTD*	**FRETAIL IN**	**164,685**	**349**	**32.2**	**21.5**	**3.7%**	**4.3%**	**20.9%**	**24.8%**

Source: Bloomberg, *YSL estimates

Valuations based on closing price as on 08th May 2017.

✓ Risks to our estimates

(i) **Cash flow improvement dependent on inventory levels being brought down:** The inability of the company to lower its inventory levels despite leveraging on the information technology and data analytics will impact the company's cash flows.

(ii) **Margin expansion/ execution does not go as planned:** Apart from increasing the share of private labels, other factors such as better assortment mix coupled with lower rentals (as a result of increasing share of smaller stores) as well as better efficiencies arising out of improved efficiencies all need to play out for the company to improve upon its profitability. Failure to improve these, as well as execution related issues, may not result in margin expansion as estimated.

(iii) **Dilution risks:** Any acquisition or major capex plans may require FRL to raise capital / dilute stake to fund the same.

(iv) **FCL's ability to create brands and demand:** With FRL looking to increase the share of private labels – products from FCL's stable – a lot will depend on FCL's branding capabilities, product innovation, manufacturing capabilities and marketing & distribution efforts to drive growth and improve offtake from its stores. FCL's inability to deliver on these aspects will not allow for higher contribution from private labels and thus would defer the targeted profit margin goals.

Company background

FRL is the pure retail play from the Future Group stable. The company is broadly present in two categories – food and fashion – operating through select formats.

- Big Bazaar (BB): BB is a very well known brand in the organized brick & mortar (B&M) retail space in India. It is a hypermarket with average store size of ~40,000 sq ft. This format offers food, fashion, accessories, footwear, general merchandise, consumer durables and electronics, amongst others at affordable rates. Fashion at Big Bazaar (FBB) is also an in store concept at many BB outlets. In addition, the company has 54 standalone FBB outlets, through which it sells apparels and accessories for all age groups.
- Easyday: A convenience store brand aimed at meeting the everyday requirements (such as groceries, personal care) of households. All of the legacy convenience /neighbourhood stores (KB's Conveniently Yours and KB's Fairprice) have been folded into the Easyday umbrella.
- Foodhall: A premium food store, having live counter facilities, aimed at catering to the affluent households.
- ezone: Through ezone, FRL caters to the home appliance, personal & entertainment product requirements of households. However, FRL is looking to make this into an in store concept rather than a standalone store format.

Exhibit 9: FRL's retail formats/ brands*

Source: Company; *FRL's board has agreed to spinoff its home furniture business which operates under the brand Home Town in April 2017

Exhibit 10: FRL Store Count Summary

	No. of Stores	States	Cities	Retail space*
Big Bazaar	231	25	124	9.81
FBB	54	18	32	0.54
Easyday	379	10	128	0.83
Foodhall	6	4	4	0.08
ezone	87	17	29	0.49
Hometown	37	12	21	1.28
Cumulative	**794**	**25**	**238**	**13.03**

Source: Company, YSL | *As of 31 December 2016

Details related to FRL's restructuring:

Prior to the restructuring, Future Enterprise (FEL) had two key business segments – retail and other investments. Bharti Retail (BRL) operated Easyday stores. In May 2015, the two companies went through a scheme of arrangement. This led to:

- A change in BRL's paid up share capital

- Demerger of erstwhile FRL's retail operations into BRL (which was renamed as FRL).
- Demerger of BRL's retail infrastructure operations into FRL (now FEL).

With this, FEL now owns the retail infrastructure along with the other business and investments. FRL, thus became a pure retail company, operating the various formats of retail stores mentioned above.

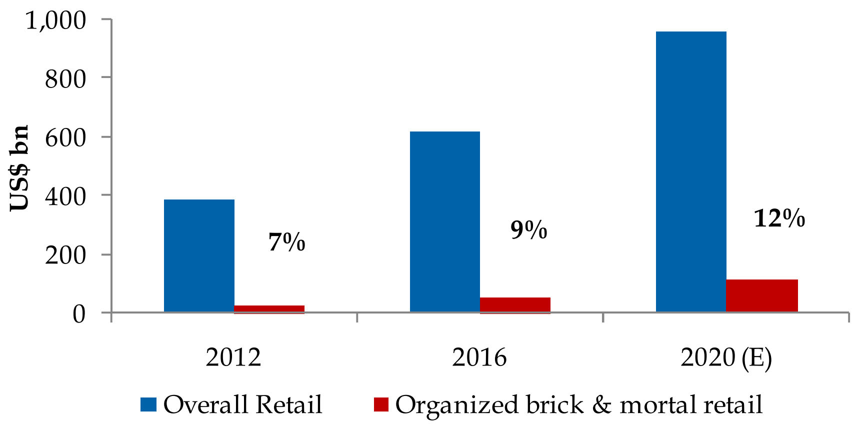
Other recent developments:

✓ On 19th April 2017, the company's board approved increase in the investment limited of registered foreign portfolio investors (including FIIs) in equity share capital of the company to 49% of total paid up capital of the company from 24% earlier.

RETAIL – AN INDUSTRY PERSPECTIVE

India's retail market was estimated to be USD 616 mn in 2016 and is expected to grow to USD 960 mn by 2020 *(Source: Technopak Research & Analysis)*. Within this, organized brick & mortal (B&M) retail contributes ~9% as of 2016 from 7% in 2012. It is expected to contribute 12% of total retail by 2020.

Exhibit 11 : Contribution of organized retail (brick & mortar) to overall retail still low in India

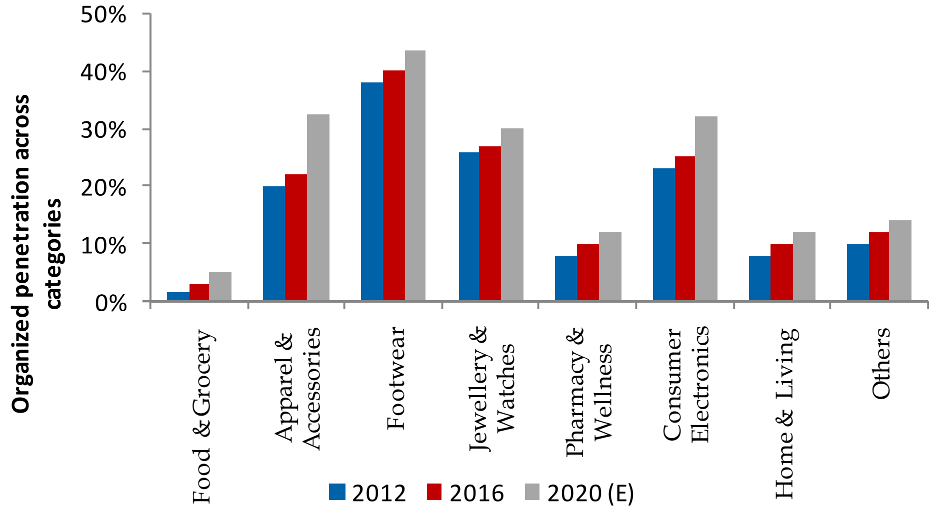


Source: Technopak Research & Analysis

Factors driving growth for organized retail in India include favorable demographics; rapid rate of urbanization; growing work force. In addition to this increasing time to travel in metros and Tier-1 cities has led to an increase in a preference for organized retail formats due to their convenience for shopping.

Food & grocery and general merchandise categories are expected to drive growth of organized retail within the total retail market in the coming years. This is despite a low 3% penetration of organized retail in this category.

Exhibit 12 : Contribution of organized retail (brick & mortar) to overall retail still low in India



Source: Technopak Research & Analysis

Formats & players in Organized B&M retail space:

Based on store size and product categories, organized B&M retail can be classified as:

- **Hypermarkets:** These are large stores with average store size ranging from 30,000 to 60,000 sq. ft. The product categories are divided as – food & grocery ~ 30-35%, non-food FMCG ~ 15-20% and others forming ~ 45-55%. The key differentiating factors for hypermarkets is the wide variety of products and shopping experience.

- **Hybrid Supermarkets:** The average store size is around 20,000 to 30,000 sq. ft. The product categories are divided as – food & grocery ~ 45-50%, non-food FMCG ~ 20-25% and others forming ~ 25-35%. The key focus is on competitive pricing due to efficiencies of scale.

- **Supermarkets:** The average store size ranges from 3,000 to 6,000 sq. ft. and the category assortment is dominated by the food & grocery segment. The product categories are divided as – food & grocery ~ 60-65%, non-food FMCG ~ 20-25% and others forming ~ 10-20%. These are typically situated in residential areas to provide a convenient outlet for local consumers.

- **Modern Convenience Stores:** These are the smallest format with an average store size 1,500 to 2,500 sq. ft. Similar to supermarkets; they have a greater focus on fast moving products, especially in line with specific neighborhood demands. The product categories are divided as – food & grocery ~ 65-70%, non-food FMCG ~ 20-25% and others forming ~ 5-15%.

Exhibit 13: Average store size of key players

Hypermarkets			Supermarkets			Regional Players		
Player	Average Area per Store (Sq. ft.) 2012	Average Area per Store (Sq. ft.) 2016	Player	Average Area per Store (Sq. ft.) 2012	Average Area per Store (Sq. ft.) 2016	Player	Average Area per Store (Sq. ft.) 2012	Average Area per Store (Sq. ft.) 2016

Reliance Mart	70,000-100,000	40,000-45,000	D'Mart	28,000-32,000	28,000-32,000	Regional Players	2,000-3,000	2,000-3,000
Star Bazaar	55,000-65,000	45,000-55,000	Reliance Fresh	3,000-5,000	3,000-4,000			
Big Bazaar	45,000-50,000	43,000-45,000	Food Bazaar	16,000-18,000	16,000-17,000			
Spencer Hypermarket	40,000-50,000	22,000-25,000	Spencer Supermarket	3,500-4,500	2,750-3,000			
More Megastore	70,000-80,000	40,000-45,000	More	2,000-5,000	2,000-2,500			
Hypercity	90,000-100,000	75,000-85,000						

Source: Technopak, Avenue Supermarts RHP, YSL research

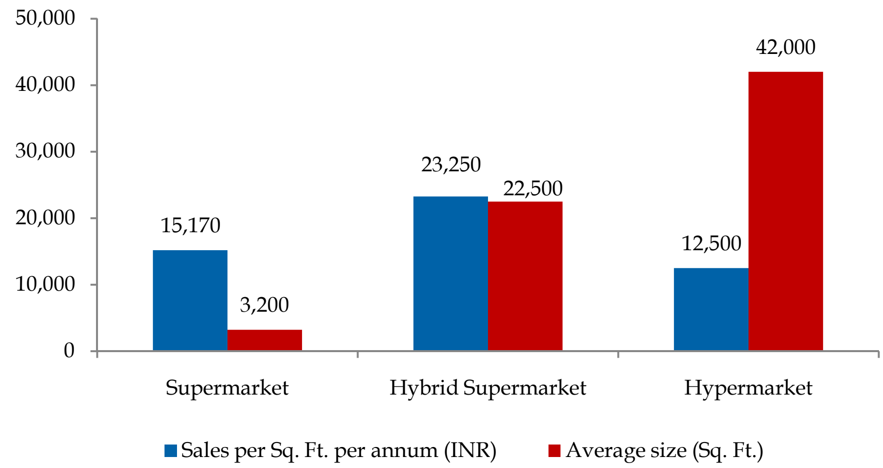
Within the categories, supermarkets have the highest productivity. As per Technopak, supermarket store productivity is 20-25% higher than that of a hypermarket. However due to the concentration on relatively lower margin food & grocery category, gross margins for supermarkets are typically lower than that of hypermarkets. Typically players operating in hybrid supermarket space with average store size of 20,000 to 30,000 sq. ft. have been able to achieve greater productivity as compared to hypermarkets and provide more variety to the consumers as compared to supermarkets.

Exhibit 14: Average sales per sq ft of key players

Hypermarkets			Supermarkets			Regional Players		
Player	**Sales per Sq. Ft./Annum (INR)-2012**	**Sales per Sq. Ft./Annum (INR)-2016**	**Player**	**Sales per Sq. Ft./Annum (INR)-2012**	**Sales per Sq. Ft./Annum (INR)-2016**	**Player**	**Sales per Sq. Ft./Annum (INR)-2012**	**Sales per Sq. Ft./Annum (INR)-2016**
Reliance Mart	5,000-6,000	8,500-9,500	D'Mart	12,000-12,500	28,000-30,000	Regional Players	8,500-9,500	17,000-17,500
Star Bazaar	6,500-7,500	11,000-13,000	Reliance Fresh	9,000-10,000	17,500-18,500			
Big Bazaar	5,500-6,500	9,500-10,500	Food Bazar	7,500-8,500	15,000-16,500			
Spencer Hypermarket	6,000-7,000	16,000-17,000	Spencer Supermarket	7,000-8,000	17,500-18,500			
More Megastore	4,500-5,500	8,500-9,500	More	5,000-6,000	8,000-9,000			
Hypercity	5,000-6,000	7,000-8,000	EasyDay	7,500-8,500	15,000-16,000			

Source: Technopak Research & Analysis, Avenue Supermarts RHP

Exhibit 15: Productivity of smaller format stores higher than that of hypermarkets



Source: Industry sources, YSL research

- **Organized B&M retail to grow at a fast pace:** Private consumption expenditure (PCE) forms ~60% of India's GDP. India's GDP touched the USD 2 bn mark in 2014 and is expected to cross USD 3.5 bn by 2020 (CAGR ~9.8%). At 60% of GDP, PCE is expected to cross USD 2 trillion by 2020 from USD 1.125 bn in 2015. Factors driving consumption in India include favorable demographics; steady growth of urbanization; growing young & working population; increasing penetration of mobile technology and internet infrastructure; rising aspirations & affordability; the government's focus on skill development, job creation, infrastructure, manufacturing, and investments; factors such as financial inclusion initiatives and direct transfer of subsidies.

  As per Technopak Research & Analysis, retail formed a little less than half of the PCE in 2016. Extrapolating this to expectations for 2020, the number is expected to cross USD 960 bn {~58% (PCE) x USD 3.5 trillion (GDP in 2020) x ~48% (retail spend)}. The organized brick and mortar retail sector formed ~9% of total retail in FY16 and is expected to gradually increase to 12% by FY20. This would provide faster growth for the organized players and in the process increase the market opportunity to about USD 115 bn by 2020; translating to a CAGR of about 21-22%, a figure higher than the 19-20% growth seen in the four years leading up to FY16.

INCOME STATEMENT

(INR Millions)

Year ending March	FY15	FY16	FY17E	FY18E	FY19E
Total operating revenues	17,794	68,450	168,386	191,450	226,096
Growth (%)		284.7	146.0	13.7	18.1
EBITDA	(3,849)	856	5,338	7,178	9,620
EBITDA margin (%)	(21.6)	1.2	3.2	3.7	4.3
Growth (%)	NM	NM	524.0	34.5	34.0
Depreciation & amortization	441	368	355	399	443
EBIT	(4,290)	488	4,983	6,779	9,177
EBIT margin (%)	(24.1)	0.7	3.0	3.5	4.1
Interest	202	498	2,011	1,962	1,867
Other income	700	155	250	300	350
Profit before tax	(3,792)	146	3,222	5,117	7,660
Tax	-	-	-	-	-
Minority Interest	-	-	-	-	-
Profit/loss of associate company	-	-	-	-	-
Adjusted net profit	(3,792)	146	3,222	5,117	7,660
Adjusted net margin (%)	(21.3)	0.2	1.9	2.7	3.4
Reported net profit	(3,792)	146	3,222	5,117	7,660
Reported net margin (%)	(21.3)	0.2	1.9	2.7	3.4
Adjusted EPS (INR)	(8.0)	0.3	6.8	10.9	16.3
Growth (%)	NM	NM	2,115	59	50

CASH FLOW STATEMENT

(INR Millions)

Year ending March	FY15	FY16	FY17E	FY18E	FY19E
Net profit before tax	(3,792)	146	3,222	5,117	7,660
Depreciation & amortization	441	368	355	399	443
Change in working cap Inc/dec	4,323	(28,268)	(9,723)	(11,688)	(15,407)
Others	(3,814)	1,457	7,099	8,840	11,137
Operating cash flow	**(2,843)**	**(26,298)**	**953**	**2,667**	**3,833**
Capex	(505)	(1,198)	(400)	(400)	(400)
Free cash flow (FCF)	**(3,348)**	**(27,496)**	**553**	**2,267**	**3,433**
Investments	1	-	-	-	-
Others	1	3	250	300	350
Cash flow from investing	**(503)**	**(1,195)**	**(150)**	**(100)**	**(50)**
Equity issue	-	1,881	0	-	-
Debt issue (net)	2,074	7,320	7,821	(849)	(807)
Dividend & tax thereon	-	-	-	-	-
Other financing cash flows	1,130	19,104	(2,011)	(1,962)	(1,867)
Cash flow from financing	**3,204**	**28,305**	**5,810**	**(2,812)**	**(2,674)**
NET CASH FLOWS	(142)	812	6,613	(244)	1,109
Opening cash	225	83	914	7,527	7,283
Closing cash	83	895	7,527	7,283	8,392

BALANCE SHEET

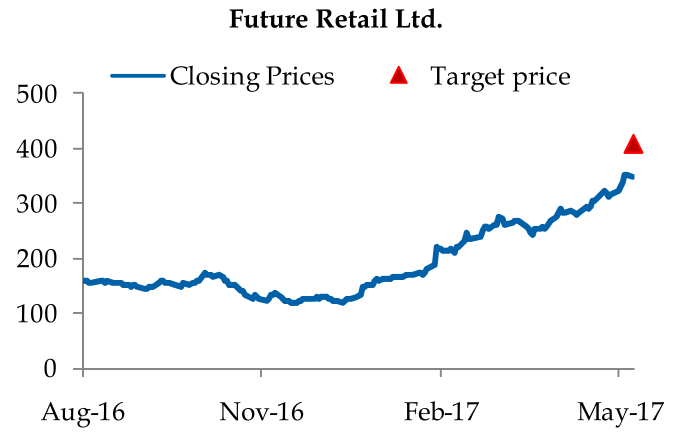
(INR Millions)

Year ending March	FY15	FY16	FY17E	FY18E	FY19E
SOURCE OF FUNDS					
Share capital	13,987	87	943	943	943
Reserve & Surplus	(18,203)	17,799	21,021	26,138	33,798
Other shareholder's equity	1330	855.7	0	0	0
Total shareholder's funds	**(2,886)**	**18,742**	**21,964**	**27,081**	**34,740**
Minority Interest	-	1,542	1,558	1,558	1,558
Debt	3,904	9,682	17,487	16,638	15,831
Other long term liabilities/provisions	1,202	1,661	3,873	4,403	5,200
TOTAL	**2,220**	**31,627**	**44,882**	**49,680**	**57,329**
APPLICATION OF FUNDS					
Gross block	2,864	2,829	3,229	3,629	4,029
Less: Accumulated depreciation	1,519	220	575	974	1,417
Net block	1,345	2,609	2,654	2,655	2,612
Goodwill on consolidation	-	-	-	-	-
Capital WIP	434	-	-	-	-
Investments	-	-	-	-	-
Other non-current assets	-	-	-	-	-
Total current assets	2,804	53,247	69,030	76,306	89,116
Inventories	2,162	32,972	36,427	40,519	47,071
Debtors	4	1,275	3,136	3,566	4,211
Cash & cash equivalents	98	914	7,527	7,283	8,392
Loans & advances	539	18,036	21,890	24,888	29,392
Other current assets	1	50	50	50	50
Total current liabilities	2,363	24,229	26,802	29,282	34,399
Net current assets	440	29,018	42,228	47,025	54,718
Net deferred tax (asset)	-	-	-	-	-
TOTAL	**2,220**	**31,627**	**44,882**	**49,680**	**57,329**

KEY RATIOS

Year ending March	FY15	FY16	FY17E	FY18E	FY19E
PROFITABILITY RATIOS					
EBITDA Margin (%)	(21.6)	1.2	3.2	3.7	4.3
Adjusted net margin (%)	(21.3)	0.2	1.9	2.7	3.4
Return on capital employed (%)	NM	2.9	13.0	14.3	17.2
Return on equity (%)	NM	1.8	15.8	20.9	24.8
EFFICIENCY RATIOS					
Asset Turnover	0.6	2.3	2.6	2.5	2.6
Debt to equity	(1.4)	0.5	0.8	0.6	0.5
Net debt to equity	(1.3)	0.5	0.5	0.3	0.2
Interest coverage	(21.2)	1.0	2.5	3.5	4.9
Debtor days	0	7	7	7	7
Inventory days	50	238	105	103	102
PER SHARE DATA					
Adjusted EPS (INR)	-8.0	0.3	6.8	10.9	16.3
Book value per share (INR)	-6.1	39.8	46.6	57.5	73.7
DPS (INR)	0	0	0	0	0
VALUATION RATIOS					
P/E	NM	1,131.9	51.1	32.2	21.5
P/BV	NM	8.8	7.5	6.1	4.7
EV/EBITDA	NM	202.8	32.7	24.2	17.9
Dividend Yield (%)	-	-	-	-	-

Recommendation History



Date	Rating	Target Price	Closing Price
08-May-17	ACCUMULATE	410	349

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Analysts assign ratings to the stocks according to the expected upside/downside relative to the current market price and the estimated target price. Depending on the expected returns, the recommendations are categorized as mentioned below. The performance horizon is 12 to 18 months unless specified and the target price is defined as the analysts' valuation for a stock. No benchmark is applicable to the ratings mentioned in this report.

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NEUTRAL: Expected point to point returns in the range of -10% and +15%

REDUCE: Expected point to point decline of 10% or more

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SUSPENDED: The rating as well as the target price has been suspended temporarily. This could be due to events that made coverage impracticable or to comply with applicable regulations and/or company policies.

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