COMPANY UPDATE

FUTURE RETAIL

HyperCity buy: Bolstering consolidation

India Equity Research| Retail

Future Retail (FRL) has bought HyperCity including Shoppers Stop's (SSL) stake (51.09%). We expect the deal to be a win-win proposition for both players. FRL will gain access to prime locations in metros (an issue due to slow mall development; incrementally negative for D-Mart) and HyperCity's private labels. The company can easily turn HyperCity (likely to be rebranded *Big Bazaar NXT*) profitable in the first year (-1.5% EBITDA margin in FY17) itself by enhancing apparel share (~35% gross margin), pruning headquarter cost and boosting synergy benefits. HyperCity's EV at INR9,110mn (0.78x FY17 EV/sales versus 2x for TESCO deal in CY14) is positive for FRL. The Future Group had earlier bought Bharti Retail, Heritage Retail (At Fresh), Big Apple and Nilgiri, consolidating its position in modern retail. Maintain 'BUY'.

HyperCity buy: A winning proposition

HyperCity's EV is pegged at INR9,110mn (0.78x FY17 EV/sales), of which consideration stood at INR6,550mn and debt at INR2,560mn. FRL will pay the consideration partly in cash (INR1,550mn) and partly via share issue (INR5,000mn @INR537 / share). The deal is expected to conclude in 3-5 months.

Scale benefits and fashion will be low hanging fruits

FRL will rebrand HyperCity stores as *Big Bazaar NXT* post the deal closure. The fashion component in HyperCity stood at 17% of revenue, which is now likely to improve to 35% (similar to Big Bazaar). Further, HyperCity's **headquarter cost of INR550mn in FY17** will ease off as FRL will harness its existing management. Also, HyperCity's sales and marketing costs at 1.87% of revenue in FY17 will be contained below 1% riding scale and synergy benefits. FRL expects the acquisition to be profitable in FY19.

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

On sustained strong SSG, improving margin and better inventory turns, we estimate ~690bps jump in RoE to 23.5% over FY17-19. We maintain **'BUY/SO'** and revise our target multiple to 30x FY19E EV/EBITDA (earlier 25x) and arrive at TP of INR619 (earlier INR516) aided by synergy benefits and increase in market share in prime location. At CMP, the stock trades at 25.6x FY19E EV/EBITDA.

Financials

Year to March	FY16	FY17	FY18E	FY19E
Revenues (INR mn)	68,451	1,70,751	2,01,727	2,55,443
Rev. growth (%)	*NA*	*149.4*	*18.1*	*26.6*
EBITDA (INR mn)	834	5,813	7,536	10,387
Adjusted Profit (INR mn)	151	3,683	5,974	8,546
Diluted EPS (INR)	3.5	7.8	12.2	17.1
EPS growth (%)	*NA*	*125.0*	*56.3*	*40.4*
Diluted P/E (x)	152.1	67.6	43.2	30.8
Enterprise Value / EBITDA (x)	38.1	44.4	35.1	25.6

EDELWEISS 4D RATINGS

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

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

CMP	: INR 528
Target Price	: INR 619
52-week range (INR)	: 593 / 115
Share in issue (mn)	: 489.8
M cap (INR bn/USD mn)	: 258 / 3,964
Avg. Daily Vol.BSE/NSE('000)	: 774.3

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	47.7	49.5	48.8
MF's, FI's & BK's	4.8	4.7	4.2
FII's	16.7	17.3	17.5
Others	30.8	28.5	29.5

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

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Retail Index
1 month	(9.1)	(0.3)	(0.1)
3 months	33.4	2.2	5.0
12 months	236.6	13.5	15.9

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October 6, 2017

Deal contours

- HyperCity's EV pegged at INR9,110mn.
- HyperCity's debt at INR2,560mn.
- Therefore, FRL bought HyperCity at INR6,550mn—part cash and part share consideration.
- FRL will issue shares worth INR5,000mn @ INR537 per share.
- Balance INR1,550mn consideration will be paid via cash.
- SSL owned 51.09% stake in HyperCity. Therefore, the company will receive the cash and shares of FRL proportionately.
- SSL will receive INR3,346mn partly in cash (INR792mn) and partly in form of FRL shares.
- The deal is expected to conclude in 3-5 months.

Table 1: HyperCity— Enterprise value break-up (INR mn)

Enterprise value: A	9,110
Debt: B	2,560
Consideration: C = A-B	6,550
Consideration break up	
FRL shares	5,000
Cash	1,550
Shoppers Stop	
Stake owned in HyperCity (%)	51.09
Consideration	3,346
FRL shares	2,555
Cash	792

Source: Edelweiss research

Table 2: HyperCity—Financials

Year to March	FY13	FY14	FY15	FY16	FY17
Net revenues	**7,802**	**9,112**	**10,590**	**9,787**	**11,794**
Cost of materials	6,063	6,896	7,385	7,441	8,693
Gross profit	1,739	2,216	3,205	2,346	3,101
Employee expenses	605	713	694	768	1,014
Rent expense	471	558	530	563	651
S G &A expenses	1,018	1,215	1,237	1,289	1,617
Total operating expenses	2,094	2,486	2,461	2,621	3,282
EBITDA	**(355)**	**(270)**	**744**	**(275)**	**(181)**
Depreciation & amortization	214	289	288	291	323
EBIT	(569)	(559)	456	(566)	(504)
Less: Interest Expense	328	338	385	442	465
Add: Other income	19	39	64	136	129
Profit before tax	**(877)**	**(858)**	**135**	**(872)**	**(840)**
Reported Profit	**(877)**	**(858)**	**135**	**(872)**	**(840)**
Adjusted Profit	**(877)**	**(858)**	**135**	**(872)**	**(840)**

Source: Edelweiss research

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

FRL, India's largest grocery retailer and No. 2 fashion retailer, has been clocking robust SSSG over the past 4 quarters. The strong run is expected to sustain led by changing consumer habits (helped by demonetisation), consolidation in distribution network (wholesale getting consolidated) and various initiatives to reduce inventory and assortment, etc. The company is expected to record gradual margin improvement led by better mix and turnaround in Easy Day business. Balance sheet improvement will be led by further improvement in inventory days.

Improvement in financial metrics apart, FRL has successfully realigned to have in place an asset-light model with better return ratios. Notably, the company is one of the few players to have successfully cracked this model along with being profitable (D-Mart being the bellwether) and with reach across the country (901 stores present in 240 cities in FY17).

We maintain **'BUY/SO'** and revise our target multiple to 30x FY19E EV/EBITDA (earlier 25x) and arrive at TP of INR619 (earlier INR516) aided by synergy benefits and increase in market share in prime location.

Company Description

Future Retail (FRL, housing Big Bazaar, FBB, Easy Day, ezone, Foodhall) is a pioneer of retail market in India with market leadership in the food and grocery retail market (market share of 13% in 2016). The company, which is the largest organised retailer in India, has total retail space of 13.8mn sq ft with presence in 26 states and 240 cities with a total store count of 901 stores at the end of FY17. A major realignment and consolidation exercise was undertaken to make FRL a asset light and a pure play retail company with strong presence in multiple formats – hypermarket and supermarket. In May 2015, the company acquired the supermarket format, Easy Day, from Bharti Group and enhanced its overall presence across the country. Recently it also acquired the retail operations of Heritage foods and expanded into Southern India.

Investment Theme

Brighter GDP growth prospects and changing consumer behaviour in favour of larger discretionary and organized spends has set the stage for a healthy growth in the retail space. Future retail with the largest store network will be the biggest beneficiary of the increasing change in consumer spending habits. Also in the current restructured form, Future Retail is asset light and generates free cash flow thereby giving investors a pure play retail company. Having cracked the Hypermarket model with Big Bazaar, the company is on the journey of store expansion and turnaround in the convenience store format, Easy Day. This along with increase in the private label mix will bolster margins.

Key Risks

Economic slowdown: A slowdown in economy and GDP growth rate can have significant impact on company's overall footfalls and SSSG.

Increase in inventory levels: Rise in inventory has been a concern for Future group investors. Though various measures have been taken to reduce inventory days and the same are bearing results, the risk of increase in inventory always lingers due to slowdown in SSSG.

Reckless diversification and expansion: This remains a key risk though the company has hived off non-retail portion of business. Diversification in non-related areas and aggressive acquisitions not only result in business risks, but can also increase debt that has been taken for any acquisition.

Failure of supermarket model: Future Group has a long experience in running the hypermarket format. However, they are new to super markets which has not been a successful format for most players in India.

Intensifying competition: Heightened competition from both brick and mortar and online players could impact overall SSSG of FRL. Competition from online delivery players, such as, bigbasket.com. grofers.com, Amazon etc., remains a key threat.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
Company				
No. of stores - BB	228.0	235.0	257.0	272.0
No. of stores - FBB	51.0	54.0	104.0	154.0
No. of stores - Easyday	320.0	538.0	763.0	988.0
No. of stores - Others	139.0	74.0	22.0	22.0
Retail Sp (mn sq.ft)- BB	9.8	10.2	11.1	11.7
Retail Space (mn sq. ft) - FBB	0.5	0.6	1.1	1.6
Retail Space (mn sq. ft) - Easyday	0.7	1.4	1.9	2.5
SSSG - Big Bazaar	-	14.0	14.0	12.0
SSSG - FBB	-	20.0	20.0	17.0
SSSG - Easyday	-	8.0	9.0	9.0
COGS as % of sales	74.0	75.2	75.0	74.7
Staff costs (% of rev)	4.8	4.7	4.6	4.7
Rent costs (% of rev)	8.8	8.0	7.9	7.7
Other expenses as % of sales	11.2	8.8	8.8	8.8
Capex (INR mn)	-	1,115	2,250	2,250
Debtor days	6	5	5	5
Inventory days	238	106	100	95
Payable days	159	79	80	80
Cash conversion cycle	85	32	25	20
Int rate on debt (%)	5.1	18.9	13.0	12.0
Dep. (% gross block)	-	7.2	7.5	7.5
Dividend payout	-	-	7.2	6.0

Income statement (INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Net revenue	68,451	170,751	201,727	255,443
Materials costs	50,651	128,344	151,266	190,879
Gross profit	17,800	42,407	50,461	64,563
Employee costs	3,285	8,034	9,340	12,007
Rent and lease expenses	6,043	13,595	15,898	19,588
Other Expenses	7,638	14,965	17,687	22,581
EBITDA	834	5,813	7,536	10,387
Depreciation	368	326	550	1,021
EBIT	466	5,487	6,986	9,366
Add: Other income	182.2	238.00	390.1	629.52
Less: Interest Expense	498	2,042	1,402	1,450
Profit Before Tax	151	3,683	5,974	8,546
Reported Profit	151	3,683	5,974	8,546
Adjusted Profit	151	3,683	5,974	8,546
Shares o /s (mn)	44	472	490	499
Adjusted Basic EPS	3.5	7.8	12.2	17.1
Diluted shares o/s (mn)	44	472	490	499
Adjusted Diluted EPS	3.5	7.8	12.2	17.1
Adjusted Cash EPS	11.9	8.5	13.3	19.2
Dividend per share (DPS)	-	-	0.7	0.9
Dividend Payout Ratio(%)	-	-	7.2	6.0

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Rent and lease expenses	8.8	8.0	7.9	7.7
Materials costs	74.0	75.2	75.0	74.7
Staff costs	4.8	4.7	4.6	4.7
Other expenses	11.2	8.8	8.8	8.8
Interest Expense	0.7	1.2	0.7	0.6
EBITDA margins	1.2	3.4	3.7	4.1
EBIT margins	0.7	3.2	3.5	3.7
Net Profit margins	0.2	2.2	3.0	3.3

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	-	149.4	18.1	26.6
EBITDA	-	597.2	29.6	37.8
PBT	-	2,340.6	62.2	43.0
Adjusted Profit	-	2,340.6	62.2	43.0
EPS	-	125.0	56.3	40.4

Balance sheet				(INR mn)
As on 31st March	**FY16**	**FY17**	**FY18E**	**FY19E**
Share capital	87	944	979	998
Reserves & Surplus	18,653	24,593	30,137	40,472
Shareholders' funds	18,740	25,537	31,116	41,470
Short term borrowings	9,682	10,776	10,000	10,000
Long term borrowings	-	8	-	2,560
Total Borrowings	9,682	10,784	10,000	12,560
Long Term Liabilities	1,661	1,896	1,896	1,896
Sources of funds	**30,083**	**38,217**	**43,013**	**55,926**
Gross Block	2,829	6,202	8,452	10,702
Net Block	2,609	5,656	7,357	10,559
Total Fixed Assets	2,609	5,656	7,357	10,559
Cash and Equivalents	895	1,560	3,436	9,707
Inventories	32,972	37,352	41,443	51,646
Sundry Debtors	1,149	2,281	2,763	4,783
Loans & Advances	12,448	17,074	19,074	21,074
Other Current Assets	5,781	5,452	5,452	5,898
Current Assets (ex cash)	52,350	62,159	68,733	83,400
Trade payable	22,085	27,800	33,154	43,188
Other Current Liab	3,686	3,358	3,358	4,553
Total Current Liab	25,771	31,158	36,513	47,740
Net Curr Assets-ex cash	26,579	31,000	32,220	35,660
Uses of funds	**30,083**	**38,217**	**43,013**	**55,926**
BVPS (INR)	430.8	54.1	63.5	83.1

Free cash flow				(INR mn)
Year to March	**FY16**	**FY17**	**FY18E**	**FY19E**
Reported Profit	151	3,683	5,974	8,546
Add: Depreciation	368	326	550	1,021
Interest (Net of Tax)	498	2,042	1,402	1,450
Others	-	(238)	(390)	(630)
Less: Changes in WC	27,314	4,186	1,220	1,543
Operating cash flow	(26,298)	1,627	6,316	8,844
Less: Capex	(2,178)	1,115	2,250	2,250
Free Cash Flow	**(24,120)**	**511**	**4,066**	**6,594**

Cash flow metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	(26,298)	1,627	6,316	8,844
Investing cash flow	(1,195)	(877)	(1,860)	(3,170)
Financing cash flow	8,703	(84)	(2,580)	597
Net cash Flow	(18,790)	666	1,876	6,271
Capex	(2,178)	1,115	2,250	2,250
Dividend paid	-	-	430	513

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	1.6	16.6	21.1	23.5
ROACE (%)	4.6	17.7	19.1	21.0
Inventory Days	238	106	100	95
Debtors Days	6	5	5	5
Payable Days	159	79	80	80
Cash Conversion Cycle	85	32	25	20
Current Ratio	2.1	2.0	2.0	2.0
Gross Debt/EBITDA	11.6	1.9	1.3	1.2
Gross Debt/Equity	0.5	0.4	0.3	0.3
Adjusted Debt/Equity	0.5	0.4	0.3	0.3
Net Debt/Equity	0.5	0.4	0.2	0.1
Interest Coverage Ratio	0.9	2.7	5.0	6.5

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	2.3	5.0	5.0	5.2
Fixed Asset Turnover	52.5	41.3	31.0	28.5
Equity Turnover	7.3	7.7	7.1	7.0

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	3.5	7.8	12.2	17.1
Y-o-Y growth (%)	-	*125.0*	*56.3*	*40.4*
Adjusted Cash EPS (INR)	11.9	8.5	13.3	19.2
Diluted P/E (x)	152.1	67.6	43.2	30.8
P/B (x)	1.2	9.7	8.3	6.3
EV / Sales (x)	0.5	1.5	1.3	1.0
EV / EBITDA (x)	38.1	44.4	35.1	25.6
Dividend Yield (%)	-	-	0.1	0.2

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
Name	**(USD mn)**	**FY18E**	**FY19E**	**FY18E**	**FY19E**	**FY18E**	**FY19E**
Future Retail	3,964	43.2	30.8	35.1	25.6	21.1	23.5
Aditya Birla Fashion and Retail Ltd	1,906	79.2	37.5	24.0	16.7	14.6	25.0
Jubilant Foodworks	1,501	71.2	53.6	26.3	21.4	15.9	18.7
Shoppers Stop	650	285.5	39.1	18.7	13.0	2.7	16.0
Titan Company	8,114	52.9	40.8	34.1	26.5	21.8	24.3
Wonderla Holidays	313	37.1	25.7	18.6	12.9	12.2	15.9
Median	-	62.0	38.3	25.1	19.1	15.2	21.1
AVERAGE	-	94.8	37.9	26.1	19.3	14.7	20.6

Source: Edelweiss research

Additional Data

Directors Data

Mr. Kishore Biyani	Chairman and Managing Director	Chairman and Managing Director	Joint Managing Director
Mr. Shailendra Bhandari	Independent Director	Ms. Sridevi Badiga	Independent Director
Mr. Rajan Bharti Mittal	Non Executive Director	Ms Gagan Singh	Independent Director
Mr. Ravindra Dhariwal	Independent Director		

Auditors - M/s. NGS & Co.

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Future corporate res	36.99	Pil industries ltd	9.01
Cedar support servic	8.88	Arisaig partners asi	6.46
Brand equity treatie	5.1	Bennett coleman & co	5
Verlinvest sa	2.19	Wgi em smaller co fu	2.08
Government pension f	1.48	Gargi business ven p	1.38

**in last one year*

Bulk Deals

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

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
06 Apr 2017	Gargi Business Ventures Private Limited	Buy	1684663.00
06 Apr 2017	Future Capital Investment Private Limited	Sell	531375.00
06 Apr 2017	Ryka Commerical Ventures Private Limited	Sell	1684663.00
06 Apr 2017	Gargi Business Ventures Private Limited	Buy	531375.00
06 Apr 2017	Future Corporate Resources Limited	Buy	1875000.00

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Aditya Birla Fashion and Retail Ltd	BUY	SO	L	Future Lifestyle Fashions Limited	BUY	SO	L
Future Retail	BUY	SO	H	Jubilant Foodworks	HOLD	SP	M
Shoppers Stop	BUY	SO	L	Titan Company	BUY	SO	L
Wonderla Holidays	BUY	SP	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss
Ideas create, values protect

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Coverage group(s) of stocks by primary analyst(s): Retail

Aditya Birla Fashion and Retail Ltd, Future Lifestyle Fashions Limited, Future Retail, Jubilant Foodworks, Shoppers Stop, Titan Company, Wonderla Holidays

Recent Research

Date	Company	Title	Price (INR)	Recos
06-Oct-17	**Shopper Stop**	HyperCity sale: The winning stroke; *Company Update*	508	Buy
25-Sep-17	**Shoppers Stop**	Win win deal for both Amazon and SSL; *Company Update*	418	Buy
12-Sep-17	**Future Lifestyle Fashions**	Same store sales surpass peers; *Result Update*	396	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

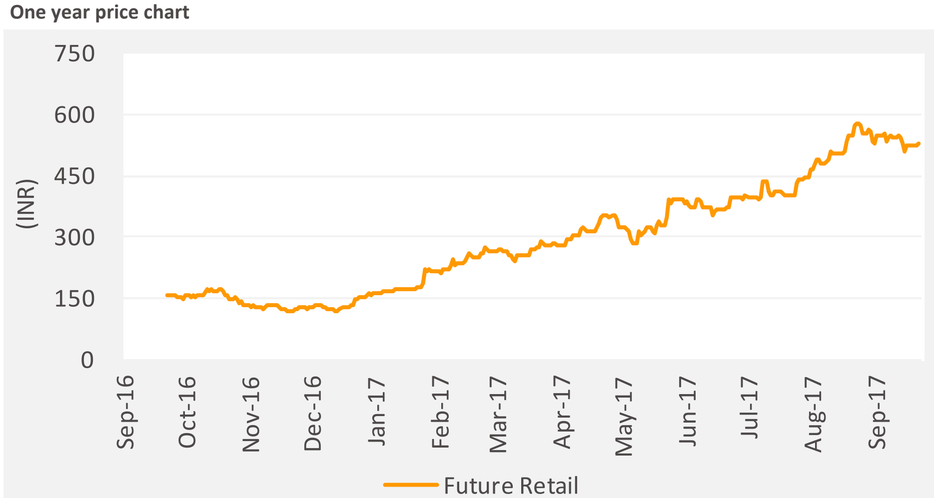
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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