Avenue Supermarts (AVESUP)

ICICI direct Research

CMP: ₹ 2160	Target: ₹ 2360 (9%)	Target Period: 12 Months	HOLD

August 5, 2020

Resilient business model to weather new challenges

We attended the annual conference call on Avenue Supermarts (D-Mart) to get an insight into the outlook and challenges lying ahead owing to the Covid-19 pandemic. Majority of the questions (as anticipated) were pertaining to future plans regarding its e-commerce play ('DMart Ready') and views on intensified competition from new entrants with deep pockets. The management reiterated its stance of not aggressively foraying into e-commerce play and rather focusing on further consolidating its position to be an eminent player in the brick & mortar format. Over the years, D-Mart, through its proven business model, has been able to maintain consistent profitability and remains an exceptional performer in its peer group. Currently, ~95% of stores are operational, with stores seeing 80% of pre-Covid sales.

Key highlights

Store expansion strategy

- On the store opening front, the company has reasonable inventory of store acquisitions. However, store openings can be muted in FY21E due to a delay in construction owing to limited construction activity (since it takes two to three years to set up a store). The company plans to make up for the same by opening higher stores in FY22E. We bake in ~51 stores in FY21-22E
- Overall carpet area is expected to grow at a much faster clip as the company will continue its strategy of opening larger stores (50000+ vs. average of 35000 sq ft.). The benefit of opening a large store is that the incremental capex is lower and also the company has more space to display high margin general merchandise
- The management indicated that rates of properties have not declined substantially. However, deals are fructifying at a much faster pace compared to pre-Covid times

D-Mart Ready

- The company has enhanced the presence of D-Mart Ready stores from 50 to 220 stores, mainly in Mumbai, Thane and Navi Mumbai. Revenues have more than doubled to ₹ 354 crore as on FY20, with loss of ₹ 79.9 crore. The scale of the format is currently not big enough to provide significant operating leverage
- In recent times, the company has witnessed a significant spike in demand from D-Mart Ready stores (5x increase). However, due to various constraints (manpower & logistics), the company has been unable to service the same
- The management does not expect D-Mart Ready to become a substantial revenue contributor in the short-term but remains committed to the concept from a long term perspective

Valuation & Outlook

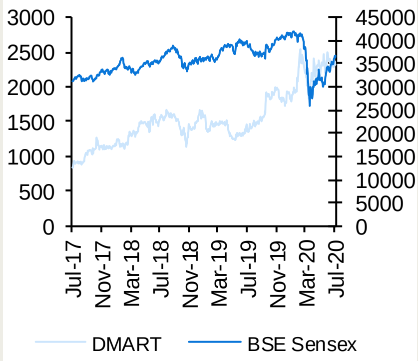
The near term outlook remains challenging given the uncertain scenario and various limitations on store operations due to strict lockdowns enforced by local authorities (that would impact footfalls). The company continues to have a healthy liquidity position (~₹ 3000 crore) with a strong balance sheet. D-Mart has proven to be a resilient business model generating superior RoIC of 23% and healthy fixed asset turnover ratio of 4.1x. We build in revenue and earnings CAGR of 21% and 29%, respectively, in FY20-22E. We reiterate our **HOLD** rating with a target price of ₹ 2360 (45x FY22E EV/EBITDA).

DMart

Particulars

Particulars	Amount
Market Capitalisation (₹crore)	139,918.3
Total Debt (FY 20) (₹crore)	3.7
Cash & Investment (FY 20) (₹crore)	3,261.8
EV (₹crore)	136,660.3
52 Week H / L	2559 / 1282
Equity Capital (₹crore)	647.8
Face Value (₹	10.0

Price Chart



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Company Update

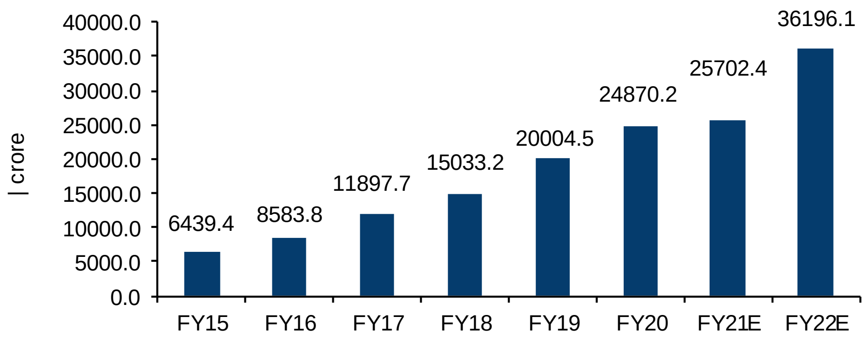
ICICI Securities – Retail Equity Research

Other key highlights….

- Going forward, the management will continue to add 70-80% of new stores in existing clusters. The company is open to leasing stores if the same are available for a longer period of 20-30 years. The current leasing rentals have become softer and the company is evaluating the opportunity. However, D-Mart is unlikely to go beyond 20-30% of stores on a lease basis in the longer term
- Benefit of opening a large format store accrues only after three to four years with scale picking up as initial operating costs are significantly high
- Q1FY21 margins were negatively impacted owing to restrictions on sale of general merchandise (which have higher margin). Also, the company had to incur additional cost as it provided incentives to frontline staff to keep working during April and May during the initial period of the pandemic
- Currently, 90%+ stores are allowed to sell general merchandise & apparels. However, revenues are still below its pre-Covid levels (<27% of revenues)
- The company is witnessing a change in profile of consumers who are shopping at D-Mart stores. A lot of new customers are from the lower middle class to middle class segment. There is also a visible trend of lower premiumisation
- D-Mart is expected to continue its sharp product assortment policy and provide limited SKUs to customers
- On the gross margin front, the management indicated they would like to maintain a gross margin in the range of 15-16%. Any efficiency benefits would be passed on to consumers in terms of lower pricing
- Given the current situation, the company’s plan to foray into the cash & carry business model has been temporarily put on hold
- The company has started selling general merchandise and apparels in select D-Mart Ready stores
- On the threat of consumers shifting to the e-commerce channel and enhanced competition by deep pocket players, the management said it believes the market is too large with humongous growth opportunity for all players with unique product and market positioning

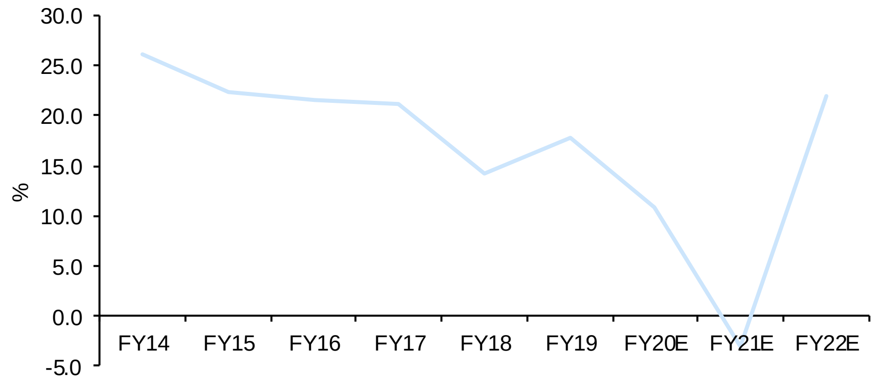
Financial story in charts….

Exhibit 1: We model revenue CAGR of 21% in FY20-22E



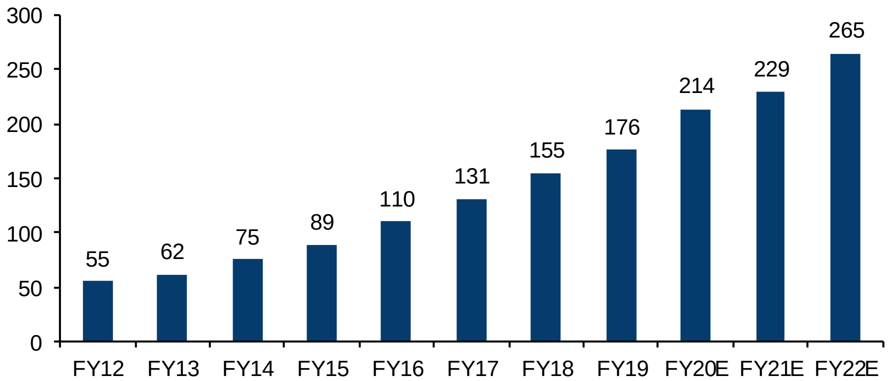
Source: Company, ICICI Direct Research

Exhibit 2: Same store sales growth (SSSG) trend



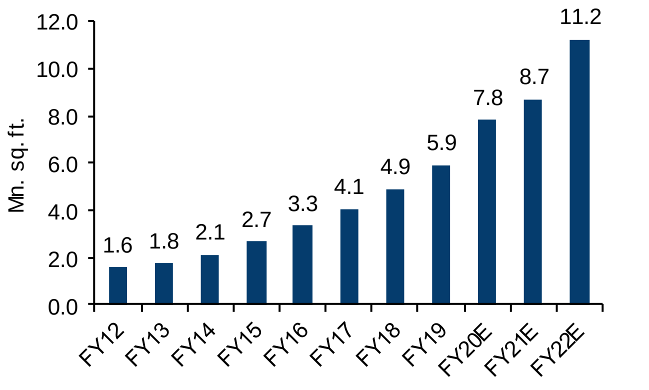
Source: Company, ICICI Direct Research

Exhibit 3: Store addition trend



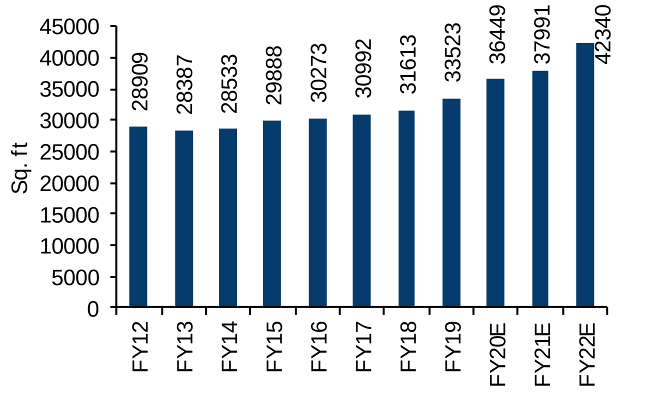
Source: Company, ICICI Direct Research

Exhibit 4: Total carpet area grows at much faster clip…



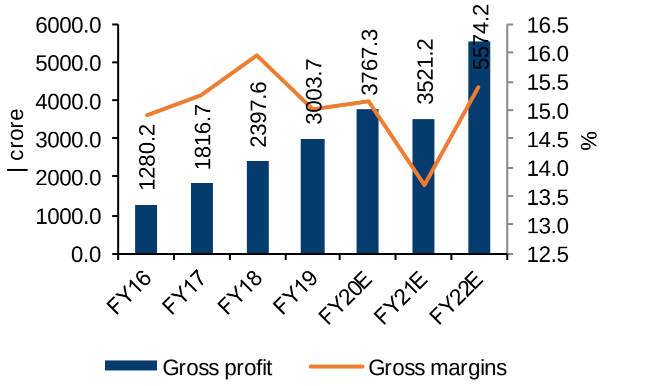
Source: Company, ICICI Direct Research

Exhibit 5: …with gradual increase in average store size



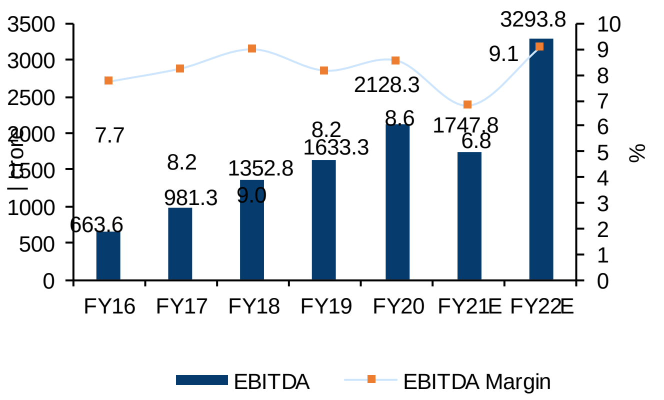
Source: Company, ICICI Direct Research

Exhibit 6: Gross margins expected to decelerate in FY21E owing to unfavourable product mix



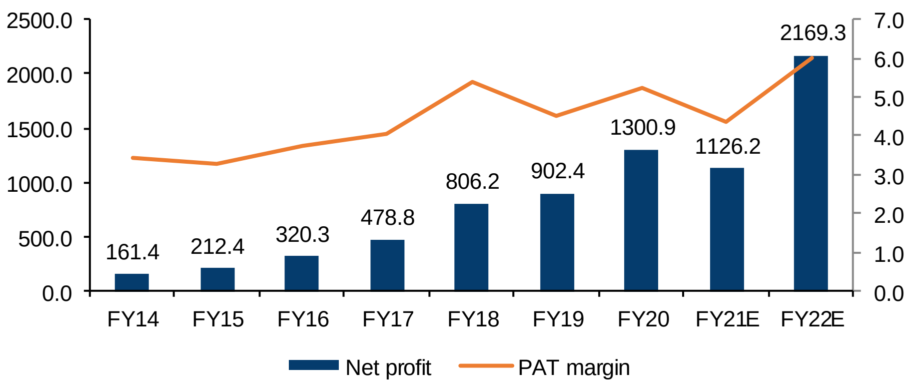
Source: Company, ICICI Direct Research

Exhibit 7: Weak SSSG, higher operating expense to impact margins in FY21E



Source: Company, ICICI Direct Research

Exhibit 8: Expect PAT to grow at 29% CAGR in FY20-22E aided by higher other income



Source: Company, ICICI Direct Research

Financial summary

Exhibit 9: Profit & loss statement

(Year-end March)	FY19	FY20A	FY21E	FY22E
Net Sales	**20,004.5**	**24,870.2**	**25,702.4**	**36,196.1**
Growth (%)	33.1	24.3	3.3	40.8
Total Raw Material Cost	17,000.8	21,102.9	22,181.2	30,621.9
Gross Margins (%)	15.0	15.1	13.7	15.4
Employee Expenses	355.4	456.1	539.8	687.7
Other Expenses	1,015.0	1,182.9	1,233.7	1,592.6
Total Operating Expenditure	18,371.3	22,741.9	23,954.6	32,902.2
EBITDA	**1,633.3**	**2,128.3**	**1,747.8**	**3,293.8**
EBITDA Margin	8.2	8.6	6.8	9.1
Interest	47.2	69.1	34.1	41.5
Depreciation	212.5	374.4	397.3	513.6
Other Income	48.4	60.0	189.3	161.3
Exceptional Expense	-	-	-	-
PBT	1,421.9	1,744.8	1,505.7	2,900.1
Total Tax	519.5	443.8	379.4	730.8
Profit After Tax	**902.4**	**1,301.0**	**1,126.2**	**2,169.3**

Source: Company, ICICI Direct Research

Exhibit 10: Cash flow statement

(Year-end March)	FY19	FY20A	FY21E	FY22E
Profit/(Loss) after taxation	902.4	1,301.0	1,126.2	2,169.3
Add: Depreciation	212.5	374.4	397.3	513.6
Net Increase in Current Assets	-520.0	-525.4	-485.1	-752.1
Net Increase in Current Liabilities	160.0	-4.8	-10.6	172.8
CF from operating activities	**755.0**	**1,145.2**	**1,027.7**	**2,103.6**
(Inc)/dec in Investments	49.9	-3,119.3	0.0	470.9
(Inc)/dec in Fixed Assets	-1,440.9	-1,700.0	-855.0	-2,441.9
Others	0.0	84.2	0.0	0.0
CF from investing activities	**-1,391.0**	**-4,735.0**	**-855.0**	**-1,971.0**
Inc / (Dec) in Equity Capital	0.0	23.7	0.0	0.0
Inc / (Dec) in Loan	260.9	-696.4	46.3	0.0
Others	34.0	4,151.4	-100.4	-110.5
CF from financing activities	**294.9**	**3,478.6**	**-54.2**	**-110.5**
Net Cash flow	-341.1	-111.1	118.6	22.1
Opening Cash	560.2	219.1	107.9	226.5
Closing Cash	**219.1**	**107.9**	**226.5**	**248.5**

Source: Company, ICICI Direct Research

Exhibit 11: Balance Sheet

(Year-end March)	FY19	FY20A	FY21E	FY22E
Equity Capital	624.1	647.8	647.8	647.8
Reserve and Surplus	4,963.4	10,432.0	11,558.2	13,727.4
Total Shareholders funds	5,587.5	11,079.7	12,206.0	14,375.2
Total Debt	700.2	3.7	50.0	50.0
Non Current Liabilties	64.6	343.8	343.8	343.8
Source of Funds	**6,352.2**	**11,427.2**	**12,599.7**	**14,769.0**
Gross block	4,857.6	5,969.5	6,824.5	9,266.3
Less: Accum depreciation	583.5	862.1	1,159.0	1,562.0
Net Fixed Assets	4,274.0	5,107.4	5,665.5	7,704.3
Capital WIP	376.8	364.4	364.4	364.4
Intangible assets	108.2	106.8	106.8	106.8
Investments	34.6	3,153.9	3,153.9	2,683.0
Inventory	1,608.7	1,947.4	2,323.8	2,975.0
Cash	219.1	107.9	226.5	248.5
Debtors	64.4	19.6	70.4	99.2
Loans & Advances & Other C	174.0	257.7	230.0	265.0
Total Current Assets	2,066.1	2,332.5	2,850.7	3,587.7
Creditors	463.3	433.5	422.5	595.0
Provisions & Other CL	190.2	215.3	215.6	215.9
Total Current Liabilities	653.5	648.7	638.1	810.9
Net Current Assets	1,412.6	1,683.8	2,212.6	2,776.8
LT L& A, Other Assets	145.9	1,011.0	1,096.6	1,133.6
Other Assets	0.0	0.0	0.0	0.0
Application of Funds	**6,352.2**	**11,427.2**	**12,599.7**	**14,769.0**

Source: Company, ICICI Direct Research

Exhibit 12: Key ratios

(Year-end March)	FY19	FY20A	FY21E	FY22E
Per share data (₹)				
EPS	14.5	20.1	17.4	33.5
Cash EPS	17.9	25.9	23.5	41.4
BV	89.5	171.0	188.4	221.9
Cash Per Share	3.5	1.7	3.5	3.8
Operating Ratios (%)				
EBITDA margins	8.2	8.6	6.8	9.1
PBT margins	7.1	7.0	5.9	8.0
Net Profit margins	4.5	5.2	4.4	6.0
Inventory days	29.4	28.6	33.0	30.0
Debtor days	1.2	0.3	1.0	1.0
Creditor days	8.5	6.4	6.0	6.0
Return Ratios (%)				
RoE	16.2	11.7	9.2	15.1
RoCE	23.4	16.4	12.6	20.4
RoIC	24.3	23.2	17.3	25.6
Valuation Ratios (x)				
P/E	149.4	107.6	124.3	64.5
EV / EBITDA	82.8	64.2	78.2	41.6
EV / Sales	6.8	5.5	5.3	3.8
Market Cap / Revenues	6.7	5.6	5.4	3.9
Price to Book Value	24.1	12.6	11.5	9.7
Solvency Ratios				
Debt / Equity	0.1	0.0	0.0	0.0
Debt/EBITDA	0.4	0.0	0.0	0.0
Current Ratio	2.8	3.4	4.1	4.1
Quick Ratio	0.4	0.4	0.5	0.4

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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