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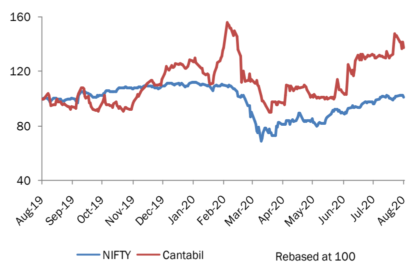
Cantabil Retail India Limited

19 August 2020

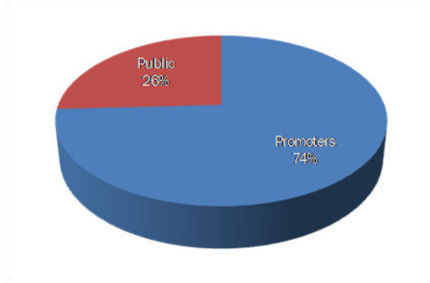
Capitalising on the emerging brand consciousness in smaller towns — BUY

Sector	: Retail
Target Price	: Rs 398
Current Market Price	: Rs 298
Market Cap	: Rs 486 crore
52-week High/Low	: Rs 358/193
Daily Avg Vol (12M)	: 58,763
Face Value	: Rs 10
Beta	: 0.79
Pledged Shares	: 0%
Year End	: March
BSE Scrip Code	: 533267
NSE Scrip Code	: CANTABIL
Bloomberg Code	: CANT IN
Reuters Code	: CRIL.NS
Nifty	: 11,385
BSE Sensex	: 38,528
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- A branded retail play in the vast mid-premium segment of the apparels market, Cantabil has developed a scalable business model and looks to capture the huge market opportunity by expanding aggressively.
- Cantabil's strategy of using a combination of own and outsourced facilities in manufacturing and retailing allows it to operate an asset-light model while expanding rapidly and effectively managing inventory.
- With a revamp of business model, aggressive target for average sales per store looks achievable while brand loyalty, increasing footfall conversion and higher average billing will boost sales going forward.
- Heavy expansion into underpenetrated Tier 2 and 3 markets with robust demand potential is a credible strategy for growth and cost reduction. Strong presence in smaller towns allowed opening up of stores early following the COVID-driven lockdown.
- Sizeable marketing budget has helped the company to build a large customer base with a high proportion of returning customers.
- Foray into online retailing is in tune with the times.
- Cantabil looks to bank on expansion through the franchise route instead of committing large capital investments in the current uncertain times.
- With overall demand environment remaining weak, we expect a fall in FY21 revenues, followed by a sharp recovery in FY22 aided by pent-up demand. Margins are also expected to recover following a decline due to a difficult operating environment in FY21 with incremental effect at the PAT level due to lower interest expense / debt, leading to solid gains in return ratios. Basis strong earnings growth forecast, the Cantabil stock trades at a very attractive forward P/E of 13.5x FY22E EPS. Valuing at 18.0x FY22E EPS, our target price of Rs 398 informs a BUY rating with an upside potential of 33%.

Key Financial Metrics

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Operating revenue	19,724	28,855	33,804	23,066	46,240
Growth		*46.3%*	*17.1%*	*-31.8%*	*100.5%*
EBITDA	1,982	2,961	4,637	2,560	5,919
EBITDA margin	*10.1%*	*10.3%*	*13.7%*	*11.1%*	*12.8%*
PAT	1,999	1,250	2,553	1,106	3,606
PAT margin	*10.1%*	*4.3%*	*7.6%*	*4.8%*	*7.8%*
Diluted EPS (Rs)	12.24	7.66	15.63	6.78	22.09

Note: FY20A and forecasts are on a pro forma basis and not based on Ind AS 116
Source: Company data; Khambatta Research

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Company Profile

Cantabil Retail India Limited (Cantabil) was established in February 1989 as a private limited company, dealing in wholesale of garments and accessories. Starting garment manufacturing and retailing in 2000, the first Cantabil-branded store opened in New Delhi in September 2000. The company further forayed into women's wear in 2007, and in 2010 it was listed on the stock exchanges. Subsequently, Cantabil launched its kidswear line in 2018.

Cantabil has 302 exclusive brand stores across India

Cantabil designs, manufactures, brands and retails apparel and accessories for men, women and children in the middle to high-income groups through a chain of retail stores under the brand names, “Cantabil”, “Crozo”, “Kaneston” and “Lil Potatoes”. It has a network of 302 exclusive brand outlets (EBOs) in 16 Indian states, up from 166 in FY17. In the lpast 5 years the company's operations expanded at a brisk CAGR of 20%. The stores are located in prominent locations including malls. The company primarily operates under two models – Company-owned & Company-operated (COCO) and Franchise-owned & Franchise-operated. As on 31 March 2020, Cantabil operated 222 COCO EBOs (covering an area of 2.49 lakh sqft) and while another 80 (with an area of approximately 76,000 sqft) were under the FOFO model across 16 states with the strongest growth coming from operations in Tier 2 and 3 cities.

Cantabil has a manufacturing plant with an area of 1.5 lakh sqft in Bahadurgarh, Haryana, and two centralised warehouses to ensure seamless and timely logistics. The production facility has fully-integrated infrastructure and systems with complete automation required for modern manufacturing and retailing operations. The Bahadurgarh plant is currently running at full capacity. Besides its own manufacturing capacity, the company outsources jobwork to two large dedicated fabricators and some smaller units. Canabil's annual overall manufacturing capacity is 1 million garments.

Over 80% of Cantabil's sales comes from men's wear

In FY20, 84% of Cantabil's revenues came from men's wear, 11% from women's wear, 3% from accessories and 2% from kidswear. The region-wise sales split was: North 65%, West 28%, East 3%, Central 3% and South 1%.

Peer Group

There are a number of listed retailers in India. Some of these companies operate across retail segments such as food/grocery, clothing, electronics and books while some others are more specialised. We have considered three listed peers for Cantabil, which operate predominantly or have a significant presence in the clothing retail market, and are broadly comparable in terms of market cap.

Shoppers Stop: Shoppers Stop is a retail company operating department stores across India. Besides the flagship Shoppers Stop department store chain, the company's other brands include the home furnishing chain Homestop and the book retail chain Crossword while it operates the international cosmetics brands of Estèe Lauder, MAC, Clinique (all part of the

Estèe Lauder Companies), and Bobbi Brown in India. Shoppers Stop operates 86 stores across 40 Indian cities.

TCNS Clothing Company: Besides its flagship brand W, women's clothing retailer TCNS's other brands include Aurelia, Wishful and Elleven. The Delhi-headquartered company operates stores in India, Mauritius, Sri Lanka and Nepal. TCNS has a wide distribution network across India including 595 exclusive brand outlets (EBOs), and presence in 1,114 multi-brand outlets (MBOs) and 1,944 large format stores (LFSs).

V2 Retail: V2 Retail is a clothing retail chain operating over 9 lakh sqft of retail space across 77 stores in 17 Indian states. The company has a strong presence in Tier 2 and 3 towns such as Patna, Varanasi, Sagar and Itanagar. Starting out in 2001 as Vishal Megamart Limited, the company hived off the Vishal brand/business to re-establish in its present form in 2011.

Peer Comparison: Key Financials Metrics, FY20

Rs crore	Cantabil Retail	Shoppers Stop*	TCNS Clothing	V2 Retail
Revenue	338.0	3,315.5	1,148.7	701.2
EBITDA	46.4	245.7	186.3	74.9
EBITDA margin	*13.7%*	*7.4%*	*16.2%*	*10.7%*
PAT	25.5	65.0	69.4	8.8
PAT margin	*7.6%*	*2.0%*	*6.0%*	*1.3%*
Diluted EPS (Rs)	15.63	7.38	11.29	2.57
ROCE	22.5%	18.2%	N/A	N/A
ROE	18.3%	7.1%	10.9%	3.1%
Market cap	486	1,452	2,122	194

**FY19 numbers as the company reported losses at the PAT level in FY20*
Source: Company data; Bloomberg; Khambatta Research

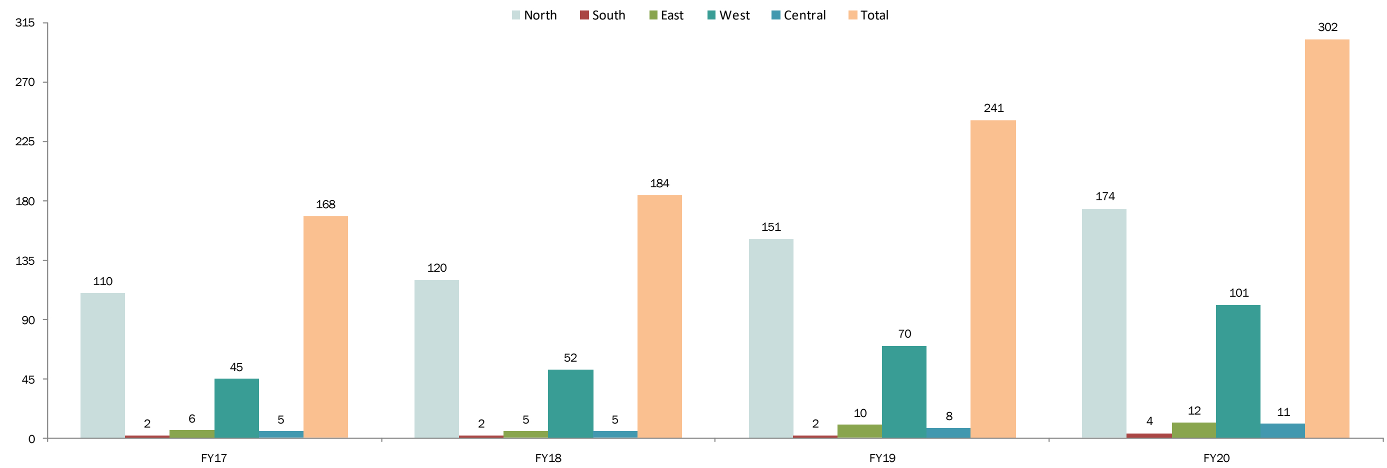
Investment Thesis

Cantabil's product range is priced between Rs 900 and Rs 2,500

A branded retail play in the vast mid-premium segment of the apparels market, Cantabil has developed a scalable business model. The prices of Cantabil's products range from Rs 900 to Rs 2,500, averaging approximately Rs 1,150, which suits every brand-conscious customer. For those who aspire to own a brand, Cantabil offers a wide range of choice to the aspirational consumer that desires to own branded clothing. The brand also serves regular users of premium brands who are looking for something new and different, especially at the higher end of its range. We believe Cantabil is well-placed to capture the vast and growing opportunity in India's middle-income demographic segment, aided by increasing disposable income, consumerism and expanding urbanisation.

Cantabil looks to capture the huge market opportunity by expanding aggressively. Cantabil has opened a substantial number of stores each year during the last five years. The closure rate of the brand's newly opened stores is also very low, which can be attributed to strict adherence to the various parameters for choosing a location, cost calculations, in-depth market studies, and the right product mix as per location. The company has set itself a target of opening 50 to 60 stores a year. In line with this, 57 stores were opened in FY19 while FY20 saw 61 new stores commencing operations.

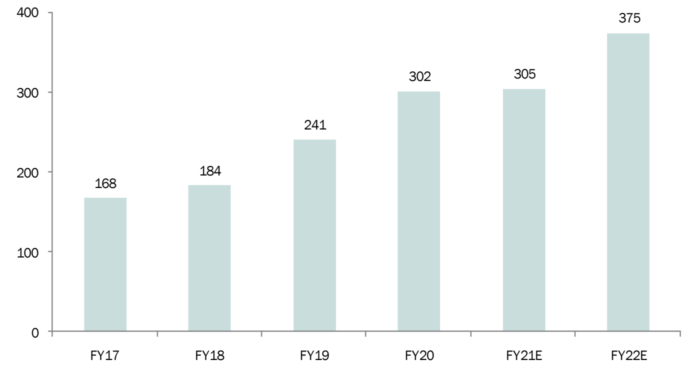
Geographical split of stores



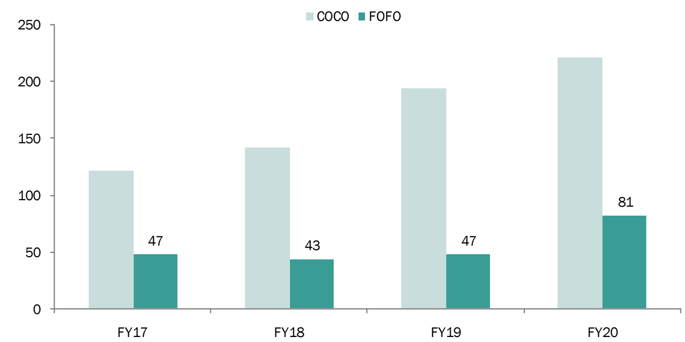
Source: Company data

Initially a North India-dominated retailer, where most of it outlets are located, Cantabil has been gradually expanding into other zones over the last 4 years. In FY20, 57% of its outlets were in North India, down from 65%. During this period, the number of outlets in Western India increased from 26% to 33%. Management expects FY21 to be subdued due to lower demand on account of the COVID outbreak while looking to resume new store additions from FY22 onwards to cater to the pent-up demand and renewal of demand growth.

Total number of stores



Stores mix



Source: Company data; Khambatta Research

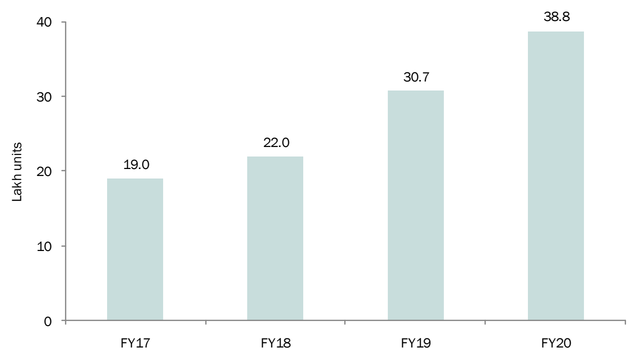
Cantabil looks to maintain the share of owned stores at 60%-70%

Cantabil's strategy of operating through a mix of owned and franchise stores enables it to effectively manage capex/opex, diversify risk and expand faster. Cantabil follows a strategy of carefully balancing between company-owned stores and franchises where it judiciously selects franchisees. This has resulted in a high success rate of franchisees staying with the company for long periods. Cantabil looks to maintain a 70:30 to 60:40 mix between company-owned and franchise stores. We see this as a credible strategy which enables the company to reduce its cost burden (both capex and opex) and diversify operational risk while being able to expand geographically at a faster pace.

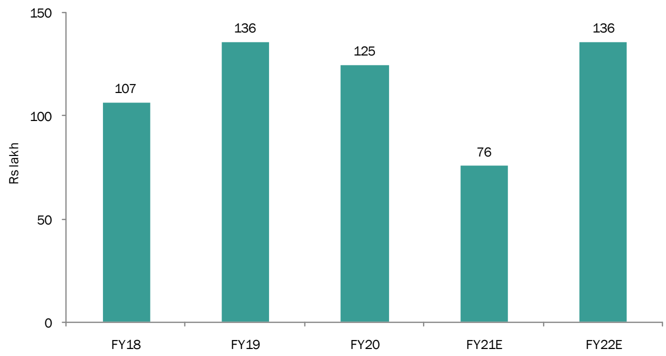
Cantabil's manufacturing unit near Delhi has an annual capacity of 11 lakh units

Production strategy involving a combination of in-house manufacturing and outsourcing helps in effectively managing inventory while operating on an asset-light model. Cantabil sold 38.8 lakh pieces of garment in FY20, out of which only about a third was manufactured in-house. With another one-thrid outsourced to dedicated fabricators and the remainder being contract manufactured, the company's asset-light production model enables it to save on capex. Cantabil's state-of-the-art manufacturing plant at Bahadurgarh near Delhi with an installed capacity of approximately 11 lakh pieces has expertise in suits, blazers, casual shirts and casual trousers. With the timely availability of inventory at stores being an extremely important element of any retail business model, the company's adoption of a diversified manufacturing model helps it to effectively manage production and inventory.

Sales volume (number of garments)



Average sales per store



Source: Company data; Khambatta Research

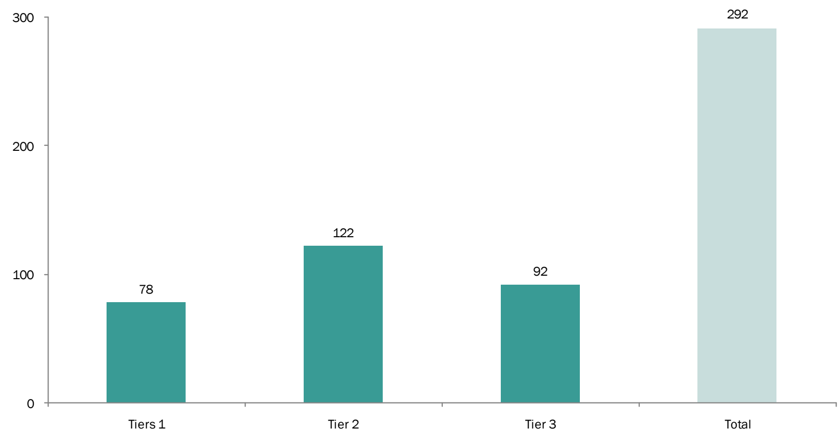
Sales volume expanded by a CAGR of 22% in the last 5 years

With the revamp of business model and strategy, management's aggressive target of increasing average sales per store looks achievable. With the revamp of its business model and adoption of industry best practices in product quality, competitive pricing, look and feel of outlets, and customer experience, Cantabil recorded robust growth in sales volume. The company registered a CAGR of 22% in the last five years with management confident of this trend continuing over the next 3-5 years, driven by opening of new stores and healthy same-store sales (SSG) growth. Cantabil's management lays a lot of emphasis on increasing efficiencies within its operating matrix. Since revamping its business strategy in 2017, the company's focus has been on increasing the average sales per store (ASPS). The ASPS increased from Rs 1.07 crore in FY18 to Rs 1.12 crore in FY20. Management has set a target of increasing ASPS to Rs 1.50 crore in the next 2 to 3 years by adopting branding strategies and through other means. With the right marketing strategy and product mix, we believe this is an achievable target.

Cantabil's average transaction size was approximately Rs 3,500 in FY20

Brand loyalty, increasing footfall conversion and higher average billing will boost sales going forward. Enhancing customer experience at its store is an important focus area for Cantabil. From value-for-money products to store ambience and regular renovations are key elements of the company's operations matrix, leading to greater footfall conversion. But the biggest asset for the company is its existing customer base. Of the brand's total billing, about 50% is generated from existing customers. The repeat customers are also the company's brand ambassadors as they refer many new customers. The brand's average transaction size (ATS) rose from Rs 3,300-3,400 in FY19 to Rs 3,400-3,500 in the last FY. This is an evidence of the growing acceptability of brand Cantabil, which, in turn, is a result of expansions in product categories, and increasing brand awareness and brand penetration in our opinion. We expect further rises in ATS and higher footfall/conversion will continue to be a key driver of ASPS and total sales going forward.

Stores' location by city tier (as on 31-Dec-19)



Source: Company data

Expanding heavily into Tier 2 and 3 cities has resulted in rental costs going down by 30%-40%

Management sees huge opportunities in Tier 2 and 3 cities. Cantabil has consciously adopted a strategy of moving into Tier 2 and 3 cities. The smaller cities and towns have a growing population of aspirational classes that wishes to associate with brands. However, most international and marquee brands usually do not consider smaller towns as a part of their primary target markets and consequently tend to reach there much later. Cantabil, on the other hand, has been expanding to these locations in the last two years with the experience being quite encouraging according to the company's management. This strategy has led to overall rental expenses declining by almost 30%-40% while the company has established early competitive edge from being the first mover in these markets. Further, the breakeven and payback in these locations are 10%-15% lower. In the unlock period, post-COVID lockdown, the Tier 2 and towns were the first ones to bounce back with utilisation levels at Cantabil's outlets in these locations already reaching 60%-70% of pre-COVID levels.

The company spends 2.5%-3.0% of its revenues on marketing

Cantabil's sizeable marketing budget has helped the company to build a large customer base with a high proportion of returning customers. Cantabil engages in advertising and promotion (A&P) across platforms including theatres, magazines, outdoor hoardings, social media, and direct marketing. The brand also organises fashion shows. Cantabil has active presence on popular social networking platforms and has entered into distribution agreements with leading digital commerce platforms. The company spent 1.2% of its revenues on marketing as it incurred Rs 2.68 crore in FY2018 and Rs 3.27 crore in FY2019 on A&P activities. The company's marketing initiatives have helped in building a 22 lakh-strong customer base with 40%-50% returning customers. Cantabil's plans of roping in a new brand ambassador in this FY have been temporarily delayed due to the pandemic.

Cantabil expects to generate 10%-15% of revenues from online sales by the next year

Cantabil has made a foray into online retailing through partnerships with leading online marketplace brands. Cantabil made its debut in e-commerce by entering into partnerships with Flipkart, Amazon, Snapdeal and Paytm. The move strengthens the company's omni-channel strategy further. Management stated that these partnerships are the first of a series of online retail initiatives with further announcements to be made next year as it expects 5%-10% of revenues from this channel by next year.

The average capex required to set up a Cantabil COCO store is Rs 1,700-1,800 per sqft

Faced with demand slowdown in the overall market, Cantabil looks to bank on expansion through the franchise route instead of committing large capital investments in these uncertain times. Cantabil incurred a capex of ~Rs.9 crore in FY20, of which Rs 7.7 crore was incurred on expanding COCO stores and complete renovation of some old stores while Rs 1.3 crore was spent on factory and headquarters. Considering the COVID-19 impact, the company plans to expand its asset-light FOFO model in FY21 and FY22. With an average capex of Rs 1,700-1,800 per sqft for COCO stores including branding and considering a slump in demand, we expect management to open few COCO stores in FY21 and remain conservative going into FY22. However, Cantabil's overall growth plan of opening 5-6 stores a month may resume from 2Q/3Q remain intact, given an improvement in the demand environment. In light of the prevailing situation, we expect the company to curtail its capex and expand through franchise route during FY21 and FY22. Consequently, we have modelled a modest capex of Rs 5 crore in FY21.

A half of Cantabil's stores had resumed operations by May-end after exiting the lockdown

Strong presence in smaller towns has allowed opening up of stores early following the COVID-driven lockdown but overall demand environment remains weak; a sharp recovery is expected in FY22 aided by pent-up demand. Retail sales were heavily impacted by the COVID-19 outbreak and the ensuing lockdown across the country. As a majority of Cantabil's stores are located in Tier 2 and 3 cities, most of which were classified as orange and green zones after the first set of relaxations, over 150 Cantabil stores became operational from end-May. Nevertheless, the demand environment is still weak with almost a half of the financial year gone, sales will be significantly hit for retailers during FY20. We expect a sharp recovery in FY22, driven by strong pent-up demand and improvement in overall economic environment.

Valuation

The Cantabil stock trades at a very attractive forward P/E of 13.5x FY22E EPS

At 18.0x FY22E EPS, we rate Cantabil a BUY with a target price of Rs 398 and an upside potential of 33%. We expect a decline in operating revenues in FY21 in the absence of new store openings and lower ASPS due to the prevailing demand slump as a result of the COVID outbreak. Subsequently in FY22, we anticipate a sharp recovery in demand, leading to doubling of revenues in FY22, driven by higher average billing and resumption of new store opening. The lower revenues and supply chain disruptions in FY20 will lead to a fall in margins, which is expected to recover during FY22 on resumption of demand and robust revenue growth. We expect incremental growth in PAT margin in FY22 as interest expense falls with declining debt levels. Consequently, return ratios are expected to see solid gains in FY22. Basis robust earnings growth forecast, the Cantabil stock trades at a very attractive forward P/E of 13.5x FY22E EPS. Valuing at a relatively conservative 18.0x FY22E EPS on account of downside risks associated with the COVID-driven economic downturn, our target price of Rs 398 informs a BUY rating with an upside potential of 33%.

Relative Valuation: Price-to-Earnings (FY16 to date)

	High	Low	Average	Current
Cantabil Retail	51.0	9.1	26.1	30.6
Shoppers Stop	82.1	9.2	38.0	27.7
TCNS Clothing Company	52.4	15.4	35.9	30.4
V2 Retail	48.4	5.6	23.1	21.0

Note: Shoppers Stop's multiples have been normalised to exclude extreme outliers; data for TCNS are since its listing in July 2018

Source: Bloomberg; Khambatta Research

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Profit & Loss Account

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Revenue from operations	**19,724**	**28,855**	**33,804**	**23,066**	**46,240**
Growth		*46.3%*	*17.1%*	*-31.8%*	*100.5%*
Cost of production and operations	17,741	25,895	29,167	20,506	40,321
EBITDA	**1,982**	**2,961**	**4,637**	**2,560**	**5,919**
EBITDA margin	*10.1%*	*10.3%*	*13.7%*	*11.1%*	*12.8%*
Depreciation & amortization	884	889	1,041	937	1,151
PBIT	1,429	2,471	4,002	2,016	5,230
Interest expense	666	852	692	537	410
PBT	763	1,619	3,310	1,479	4,820
Tax expense	(1,236)	369	758	372	1,213
PAT	**1,999**	**1,250**	**2,553**	**1,106**	**3,606**
PAT margin	*10.1%*	*4.3%*	*7.6%*	*4.8%*	*7.8%*
Diluted EPS (Rs)	**12.24**	**7.66**	**15.63**	**6.78**	**22.09**

Source: Company data; Khambatta Research

Abridged Balance Sheet

Rs lakh	FY18A	FY19A	FY20A	FY21E	FY22E
Total shareholders' equity	10,110	11,430	13,977	15,083	18,690
Total debt	4,548	4,152	3,783	2,533	2,293
Current liabilities	4,432	6,930	6,852	4,890	9,747
Total equity & liabilities	**19,089**	**22,513**	**24,612**	**22,507**	**30,730**
Property, plant & equipment	5,487	5,972	6,026	5,629	5,439
Inventory	8,106	9,690	12,805	11,053	16,691
Trade receivables	1,050	1,845	452	1,327	2,660
Cash & cash equivalents	259	249	478	728	402
Total assets	**19,089**	**22,513**	**24,612**	**22,507**	**30,730**

Source: Company data; Khambatta Research

Ratio Analysis

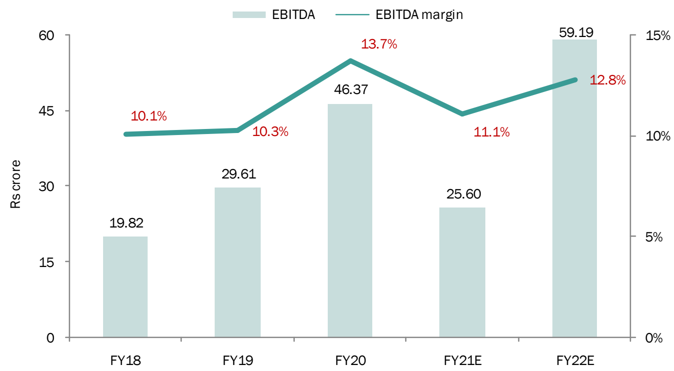
	FY18A	FY19A	FY20A	FY21E	FY22E
ROA	10.5%	5.6%	10.4%	4.9%	11.7%
ROCE	9.7%	15.9%	22.5%	11.4%	24.9%
ROE	19.8%	10.9%	18.3%	7.3%	19.3%
Debt-to-equity ratio	0.45x	0.36x	0.27x	0.17x	0.12x

Source: Company data; Khambatta Research

Note: FY20A and forecasts are on a pro forma basis and not based on Ind AS 116

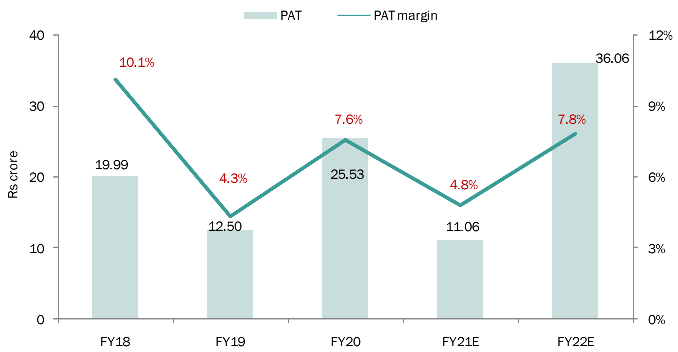
Operating revenue

Operating profitability

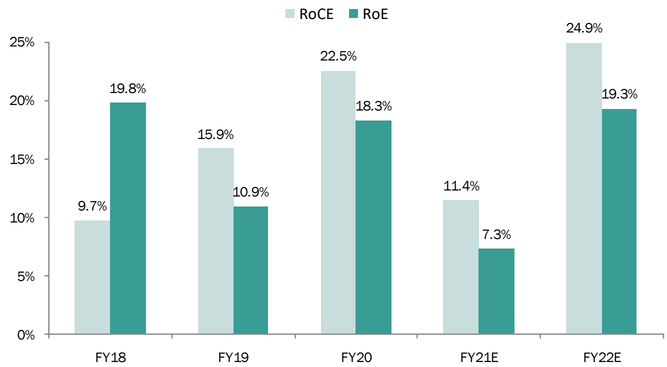


Source: Company data; Khambatta Research

PAT & PAT margin



Return ratios



Source: Company data; Khambatta Research

Key Risks

- The COVID-19 outbreak remaining around for an extended period of time and continuation/reinstatement of lockdown are likely to negatively impact our estimates.
- Supply chain disruptions can negatively affect Cantabil's business.
- Primarily catering to a relatively price-sensitive mid-premium market, the company may not be able to pass on sharp increases in raw material prices to its customers, leading to negative impact on its profitability.
- Intensification of competition from other brands, especially in Tier 2 and 3 markets may lead to an underperformance of our forecasts.

Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

Stock ratings

Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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