Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Aditya Birla Fashion and Retail Limited

Recovery on cards; focus on leaning balance sheet

Consumer Discretionary	Sharekhan code: ABFRL	Company Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 165**	
Price Target: **Rs. 191**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

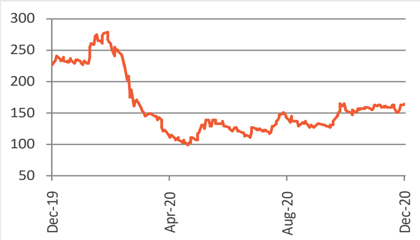
Company details

Market cap:	Rs. 12,770 cr
52-week high/low:	Rs. 281/96
NSE volume: (No of shares)	26.1 lakh
BSE code:	535755
NSE code:	ABFRL
Free float: (No of shares)	31.1 cr

Shareholding (%)

Promoters	59.8
FII	6.1
DII	22.3
Others	11.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.1	27.6	33.9	-26.2
Relative to Sensex	-2.8	2.2	-2.3	-40.7

Sharekhan Research, Bloomberg

Summary

- Aditya Birla Fashion & Retail Ltd (ABFRL) clocked a good recovery in the festive season with its core business Madura Fashion & Lifestyle and Pantaloon Retail saw business recovering to 75-80% (better than a 45% recovery witnessed in Q2FY2021).
- Company will reduce debt by Rs. 1,750 crore (to ~Rs. 900 crore) by FY21-end by raising Rs. 1500 crore from a stake sale to Flipkart and a Rs. 250 crore partial payment of rights issue.
- Recovery in footfalls, strong store expansion, focus on increasing private label contribution (67% currently) and scale-up of lifestyle business (innerwear) will be key growth drivers in the near to medium term.
- Focus on deleveraging balance sheet and improving growth prospects of core businesses augur well for the company in the near term. We maintain a Buy with an unchanged price target of Rs. 191.

We interacted with Rahul Desai - Head Treasury, M&A and Investor Relations, Aditya Birla Fashion & Retail (ABFRL) to understand the current business environment and growth prospects of the Lifestyle and Retail business. ABFRL witnessed good demand during the festive season in both Madura Fashion & Lifestyle (MFL) and Pantaloons which saw business recovering to 75-80% (95-96% of stores are currently operational). This was much better than a 45% recovery witnessed in Q2FY2021, when most stores were not operational. Footfalls in most metros are yet to see a full recovery but online sales gaining strong momentum. According to industry reports, North and South India have seen a good recovery with both regions have recovered to almost 90%, while West and East India are seeing a slower recovery. The recovery would be much faster once the covid-19 scare recedes significantly in key metros, according to the most top retailers. We expect ABFRL to post 100% recovery by Q1FY2022 and it would witness strong double digit growth in FY2022 festive season. This will also be supported by prudent store addition of around 500 lifestyle stores (95% will launched through franchisee route) and 70-75 pantaloon retail stores coupled with decent addition in MBOs. Rent negotiations and reduction in manpower helped the company save ~Rs. 837 crore in H1FY2021. Some savings on manpower costs will sustain in H2, while rental costs are expected to go up as sales rise. The company is focusing on increasing the contribution of private labels to 70% in the next two years (and 75% in the next five years) from 67% currently. Increase in contribution from private labels would add to gross margins in the coming years. The company eyes to reduce its debt by Rs. 1,750 crore (to ~Rs. 900 crore) by end of FY20 through fund-raising of Rs1500crore from stake sale to Flipkart and Rs. 250 crore in the form of a partial payment of the rights issue (both will be received by January 2021).

Our Call

View: Maintain Buy with price target of Rs. 191: Improvement in consumer sentiments and a recovery in footfalls would aid ABFRL clock strong performance in FY2022. A fall in debt will also substantially reduce interest costs in the coming years, which will ease pressure on the bottom-line. Focus on deleveraging balance sheet and improving the growth of prospects of core businesses augurs well for the company from near-term perspective. The stock is currently trading at 11.3x its FY2023E earnings. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 191.

Key Risks

Any sustained slowdown in the recovery due to localised lockdowns in the coming quarters would act as a risk to our estimates in the near term.

Valuations (standalone) - reported Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	8,118	8,743	5,325	7,915	9,140
OPM (%)	6.8	14.0	9.6	12.3	14.5
Adjusted PAT	127	-39	-488	0	260
Adjusted EPS (Rs.)	1.6	-0.5	-5.5	0.0	2.8
P/E (x)	100.3	-	-	-	59.6
P/B (x)	8.9	11.8	5.1	4.8	4.4
EV/EBIDTA (x)	26.1	14.4	29.7	16.0	11.3
RoNW (%)	10.1	-3.1	-24.4	0.0	7.7
RoCE (%)	10.8	8.8	-4.7	3.4	9.7

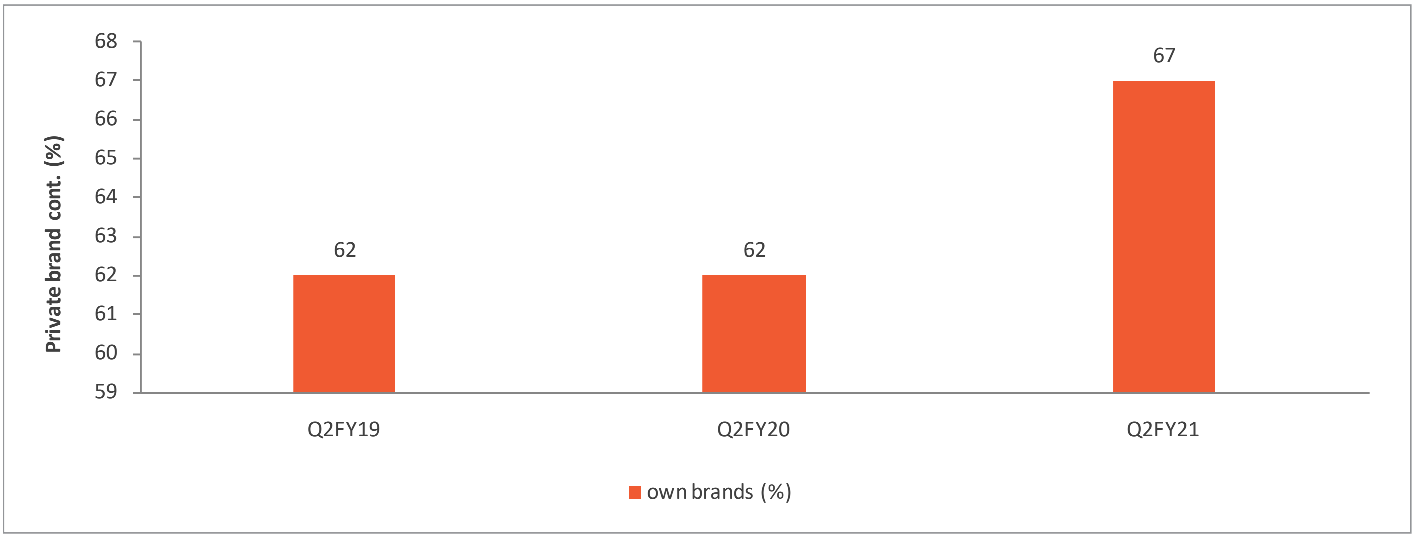
Source: Company; Sharekhan estimates

**estimates include the impact of Ind-AS 116 and equity dilution led by right issue and preferential allotment to flipkart*

Focus on improving the contribution from private labels

Contribution of private labels improved from to 67% in Q2FY2021 from 62% in Q2FY2020. The company is focusing on improving this further to 70% in the next two years and 75% by FY2025. The increase in contribution from private labels would definitely help improve gross margins in long run. ABFRL gross margins stood at close to 52% in FY2020. We expect gross margins to gradually inch up to 53% over the next two years. Further, an increase in contribution from online sales will pull down the gross margins slightly as online sales clock lower gross margins as compared to conventional retail channels. However, the online business OPM is much better than the retail business margins and hence the overall OPM is expected to see faster recovery in the coming years. We expect the OPM to reach to 14-14.5% by FY2023. This will also be supported by cost saving initiatives the company during the covid era and some of the cost savings are likely to sustain in the coming years. Manpower cost optimisation started in June and the benefit have started accruing from Q2FY2021. Reduction in other expenses such as advertising, travel and other discretionary costs is expected to sustain in the near term.

Private brand contribution increase to 67%

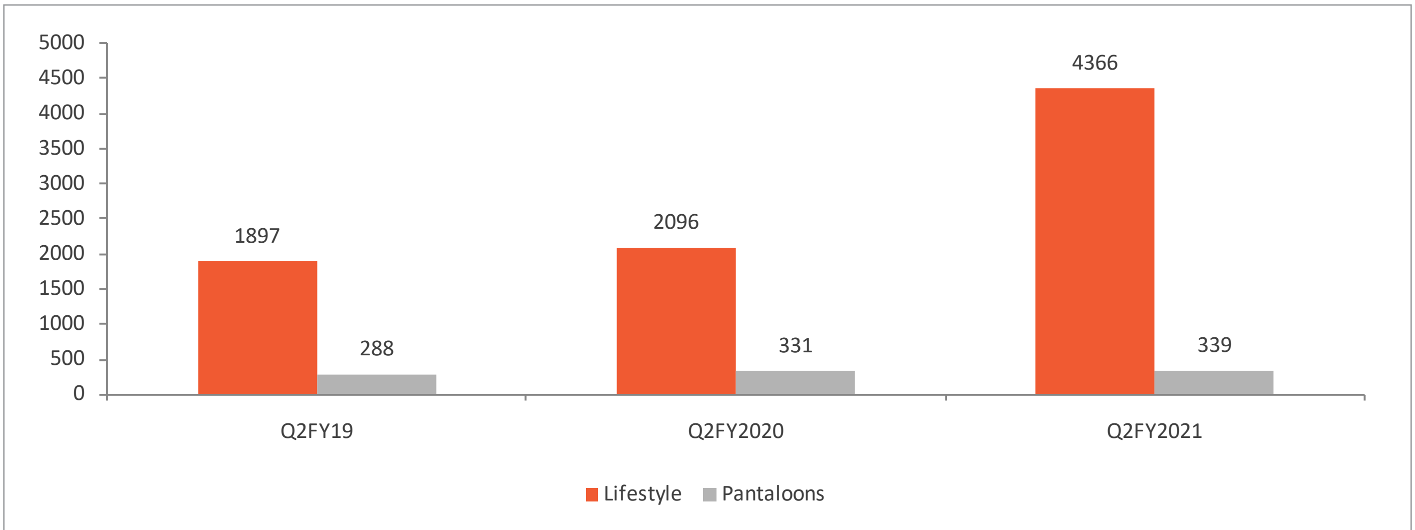


Source: Company, Sharekhan Research

Prudent store addition and capex funded by internal accruals

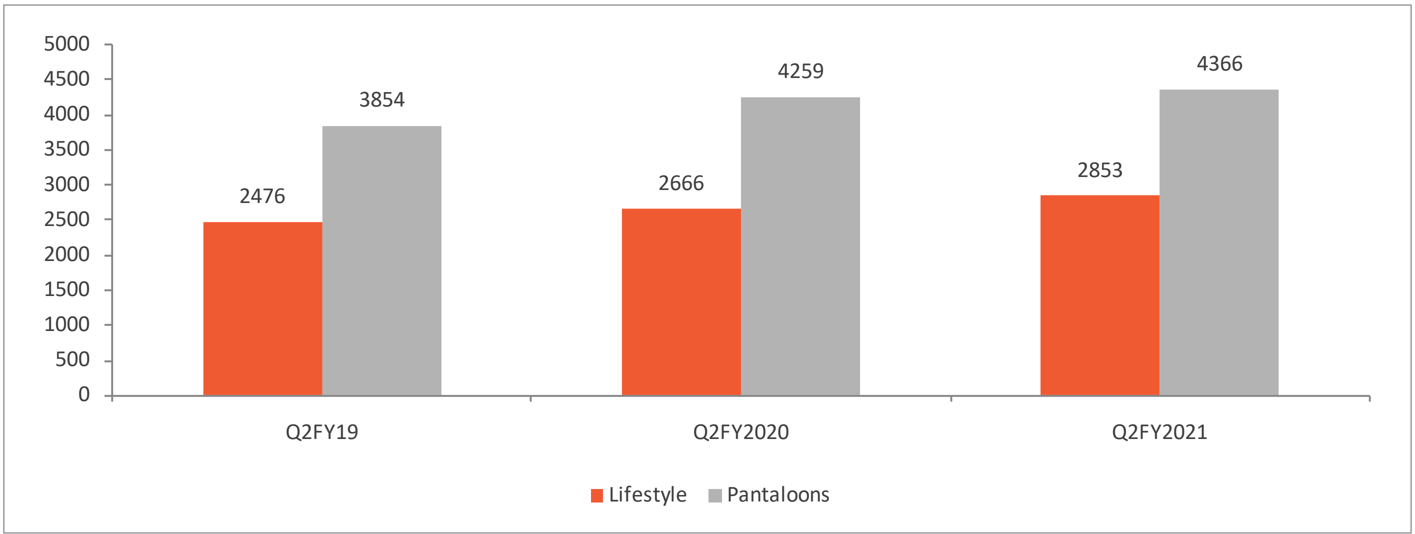
ABFRL plans to add 200 lifestyle stores and 50-55 Pantaloons stores by FY2021 (already added 100 stores in H1FY2021). The company will be undertaking a capital expenditure of Rs. 75-100 crore in FY2021. Further, it plans to add 500 lifestyle stores and 70-75 Pantaloons stores in FY2022 with capital expenditure of Rs. 300 crore that will be largely funded through internal accruals. About 95% of lifestyle stores will be added through franchisee and large part of capex is lined up for addition of Pantaloons stores.

Increase in number of stores



Source: Company, Sharekhan Research

Increase in retail space (area Sq.ft)



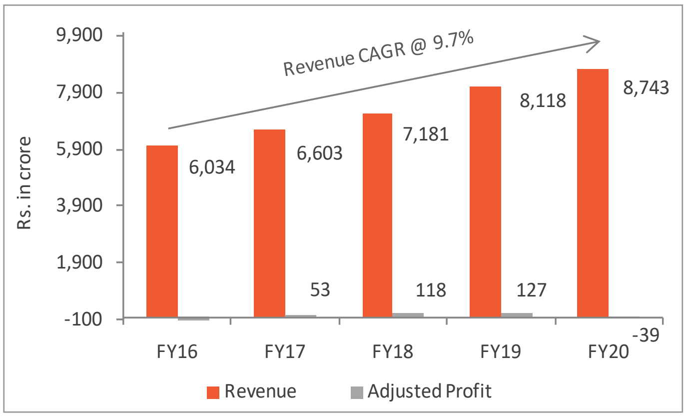
Source: Company, Sharekhan Research

Debt to reduce by Rs. 2000-2200 crore in FY2021

ABFRL's net debt stood at Rs. 3,157 crore as on Q2FY2021. The company has successfully completed its rights issue of Rs. 1,000 crore, of which ~Rs. 500 crore was received in July and ~Rs. 250 crore is expected in January 2021. Moreover, the company raised another Rs. 1,500 crore from the 7.8% stake sale to Flipkart (deal expected to be completed by January 2021). This will be utilised to reduce the debt on books. The company expects to end FY2021 with a net debt of ~Rs. 2,000-2,200 crore. This would result in substantial reduction in the interest cost in the coming years

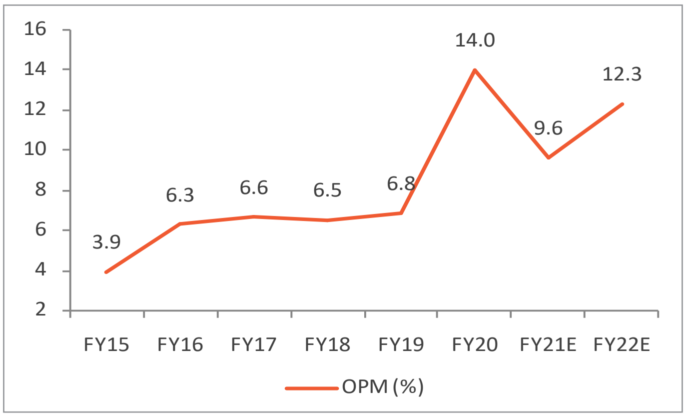
Financials in charts

Revenues grew at CAGR of ~10% over FY16-20



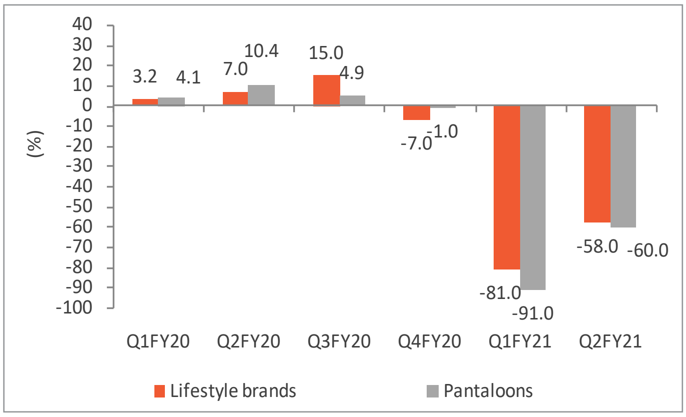
Source: Company, Sharekhan Research

Trend in OPM (%)



Source: Company, Sharekhan Research

Lifestyle and Pantaloons saw recovery in Q2

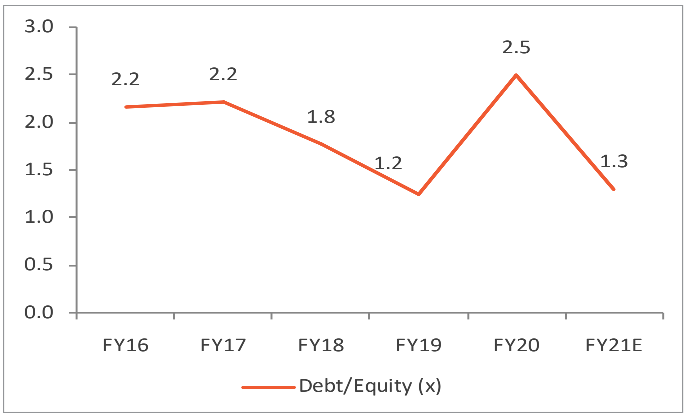


Source: Company, Sharekhan Research

Channel wise sales (Rs crore)

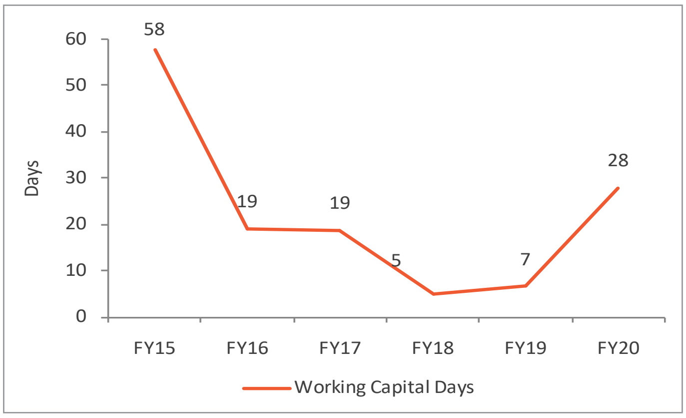
Source: Company, Sharekhan Research

Debt to reduce by end of current fiscal



Source: Company, Sharekhan Research

Working capital days grew in FY20 to higher inventory



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Gradually recovering to pre-COVID levels

Most retail companies have seen good recovery during the festive season with business inching close to pre-COVID levels. The retail sector across India posted a month-on-month recovery with sales in November 2020 being 13% short of sales in the corresponding month last year. Western and Eastern part of India witnessing a slow recovery with sales falling by 18% and 17% respectively. North India and South India are progressing well with sales down by just 9% each over pre-COVID. A full recovery of branded apparel, jewellery, and retail companies is expected by Q4FY2021/Q1FY2022. Profitability would be severely impacted in FY2021, while we expect it to come back on track in FY2022 (with a strong recovery in sales). However, the sector's long-term growth prospects are intact as companies focus on expanding their reach, banking on e-Commerce/ online channels to drive the next league of growth, improving store fundamentals, and driving efficiencies to see better margins.

■ Company outlook - Full recovery expected by Q4FY2021; cost reduction to reduce stress on profitability

ABFRL's business recovered to ~45% of pre-COVID sales in Q2FY2021. Around 96% of stores are currently operational and business has recovered to 75-80% during the festive season. The management expects business to gradually improve with a recovery in footfalls as scare of the Coronavirus eases. In Q1FY2022, revenues are likely to grow back to pre-COVID levels with both the business verticals, lifestyle brands and Pantaloons showing a significant recovery. Rental negotiations, employee cost savings and reduction in discretionary cost led to savings of Rs. 417 crore in Q2. Benefits of cost-saving measures (especially on man-power cost front) will continue in the coming quarters. A rights issue of Rs. 1,000 crore and strategic fund-raising of Rs. 1,500 crore along with stable working capital management would strengthen the balance sheet by end of the current fiscal.

■ Valuation - Recommend Buy with a PT of Rs. 191

Improvement in consumer sentiments and a recovery in footfalls would aid ABFRL clock strong performance in FY2022. A fall in debt will also substantially reduce interest costs in the coming years, which will ease pressure on the bottom-line. Focus on deleveraging balance sheet and improving the growth of prospects of core businesses augurs well for the company from near-term perspective. The stock is currently trading at 11.3x its FY2023E earnings. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 191.

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Trent	-	-	88.2	91.2	34.6	27.9	0.8	9.0	11.7
ABFRL	-	-	59.6	29.7	16.0	11.3	-4.7	3.4	9.7

Source: Company, Sharekhan estimates

About company

ABFRL is India's largest pure-play fashion and retail entity with an elegant bouquet of leading fashion brands and retail formats supported by a pan-India distribution network with a combined retail footprint of 8 million square feet across 750 cities, which includes 2,662 brand stores and 342 Pantaloons stores. The company comprises of two segments, Madura Fashion and Lifestyle (MFL) and Pantaloons. MFL includes lifestyle brands (Louis Philippe, Van Heusen, Allen Solly and Peter England), fast fashion brands (Forever 21) and other businesses such as the innerwear business. The company has also acquired stake in ethnic wear brands Jaypore and entered into a partnership with designers Shantanu and Nikhil with an aim of retail expansion.

Investment theme

ABFRL is one of the largest players in the branded apparel and retail space. With redefined strategies, ABFRL has seen consistent improvement in its performance over the last three years (revenues and operating profit grew at CAGR of 10.4% and 13.6%). The company has built an agile supply chain model to deliver continuous fresh fashion throughout the 12 months season, which will further reduce the working capital in the coming years. With the acquisition of Jaypore brand, ABFRL is focusing on tapping the ethnic and wedding segment, which has a large unorganised presence. FY2021 will be affected by COVID-19 but strong recovery is expected in FY2022 on the back of strong portfolio of brands and expanded reach.

Key Risks

- Any slowdown in the discretionary demand environment would impact SSSG, affecting revenue growth.
- Heightened competition, especially in the form of private labels by other branded players, would act as a threat to revenue growth.

Additional Data

Key management personnel

Ashish Dikshit	Managing Director
Himanshu Kapania	Vice-Chairman
Sangeeta Pendurkar	Chief Executive Officer - Pantaloons
Jagdish Bajaj	Chief Financial Officer
Geetika Anand	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Reliance Capital Trustee Co Ltd	6.1
2	UTI Asset Management Co Ltd	3.3
3	Franklin Resources Inc	2.5
4	Invesco Asset Management India Pvt Ltd	1.8
5	Mirae Asset Global Investments Co Ltd	1.6
6	Sundaram Asset Management Co Ltd	1.5
7	ICICI Prudential Life Insurance Co Ltd	1.3
8	India Opportunuties Growth Fund Ltd	1.1
9	Canara Robeco Asset Management Co Ltd	1.0
10	Vanguard Group Inc	0.8

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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