Sharekhan by BNP PARIBAS

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Stock Update

Trent Limited

Strong sequential recovery, expansion pace continues

Consumer Discretionary	Sharekhan code: TRENT	Result Update

Summary

- Q2 revenues recovered 55% as all stores became fully operational after easing of lockdowns. Recovery rate improved from 38% in July to ~70% in October.
- Company prioritised cost cuts by slashing employee expenses, discretionary spends and renegotiating rentals. This is likely to sustain and support profitability to some extent in the near term.
- As 100% of Westside merchandise being manufactured in-house, we expect Trent would bounce back faster. Product innovation, aggressive store expansions and leveraging digital presence will be near-term growth drivers.
- We recommend a Buy on Trent with a price target (PT) of Rs. 800. Trent is among India's strong branded retail players with robust balance sheet, stable cash flows and among the highest utilisation rates per store.

Q2FY2021 revenues recovered to ~55% of pre-COVID levels as all of Trent's stores resumed operations. Revenue declined by ~45% y-o-y to Rs. 452.1 crore, much better than our expectation of Rs. 327.2 crore. Operating profit stood at Rs. 6.4 crore, while pre-tax loss stood at Rs. 73.3 crore and reported loss came in at Rs. 48.1 crore. The company prioritised cost reductions by slashing employee costs, cutting discretionary spends and renegotiating rental expenses which resulted in positive operating profit in Q2 as against a steep loss in Q1. With Trent achieving large part of rent reduction already achieved in H1, operating costs might go up slightly in H2 though some of the savings are structural and likely to continue. Higher traction was seen in digital platforms with online channels registering an over 50% growth as after easing of lockdowns. The company is also focusing on enhancing growth by leveraging its association with Tata Cliq and its website Westside.com. The company maintained its pace of store expansions despite a tough H1FY2021 and has opened 11 stores (2 Westside, 8 Zudio & 1 Landmark store). The company has indicated that store expansions shall not be affected by near-term headwinds. The company has prioritised cash conservation, by focusing on reducing costs, especially on the discretionary front with a continued emphasis on maintaining adequate liquidity and minimal borrowings.

Key positives

- Strong growth in online channels registering over 50% growth.
- Trent has prioritised cost reduction by cutting discretionary spends and reducing rental costs (benefit of Rs. 58 crore in H1).
- Company has indicated that it will maintain its pace of store expansions.

Key negatives

- Gross margins slumped by 695 bps to 40.9% in Q2FY2021.

Our Call

View: Recommend Buy with PT of Rs. 800: We expect footfalls to recover once the pandemic situation normalises. With 100% of Westside merchandise being manufactured in-house, we expect recovery to be much faster for Trent in a normal business environment. Innovation in product portfolio, scaling-up of supply chain, aggressive store expansions and leveraging of digital presence will be the near-term growth drivers. Trent is among India's strong branded retail plays with a robust balance sheet, stable cash flows, and one of the highest utilisation rates per store. 100% own brand contribution, strong Balance Sheet and higher margins than peers would keep valuations at premium as compared to other branded apparel/retail companies. The stock is trading at 28.2x its FY2023E EV/EBITDA. We recommend Buy on the stock with a PT of Rs. 800. (based on sum-of-the parts valuation).

Key risk

If the lockdown sustains going ahead, it will further impact Q2FY2021 earnings due to sustenance of store closures resulting in an overall earnings disruption for FY2021.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	2,532	3,178	2,162	3,265	4,011
OPM (%)	9.5	17.6	4.7	16.0	17.5
Adjusted PAT	128	155	-134	158	271
Adjusted diluted EPS (Rs.)	3.6	4.3	-	4.4	7.6
P/E (x)	189.1	156.5	-	-	89.3
P/B (x)	13.3	9.7	10.4	10.0	9.2
EV/EBIDTA (x)	88.3	36.1	92.2	35.0	28.2
RoNW (%)	7.7	7.4	-	6.7	10.8
RoCE (%)	11.0	13.8	0.8	9.0	11.7

Source: Company; Sharekhan estimates *estimates include the impact of Ind-AS 116

Note: We now convert Trent Limited into a Stock Update; It was earlier a 'Viewpoint' under our coverage.

3R MATRIX

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 681**	
Price Target: **Rs. 800**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

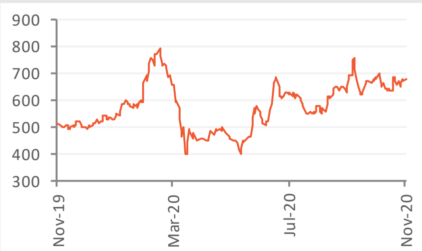
Company details

Market cap:	Rs. 24,196 cr
52-week high/low:	Rs. 804/368
NSE volume: (No of shares)	2.9 lakh
BSE code:	500251
NSE code:	TRENT
Free float: (No of shares)	22.4 cr

Shareholding (%)

Promoters	37.0
FII	23.1
DII	14.6
Others	25.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.3	17.0	51.1	33.3
Relative to Sensex	-4.9	5.5	16.1	27.7

Sharekhan Research, Bloomberg

Revenues recover to 55%, cost-saving initiatives resulted in positive operating profit: Revenue declined by ~45% y-o-y to Rs. 452.1 crore, much better than our expectation of Rs. 327.2 crore in Q2FY2021 from Rs. 818 crore in Q2FY2020. However, all of the company's stores have become operational and revenue has recovered to 70% of the corresponding quarter in October from 38% in July 2020. Gross margins declined significantly by 695 bps to 40.9% due to lower inventory levels and conservative company policies on ageing of products. Operating profit came in at just Rs. 6.4 crore in Q2FY2021 as against Rs. 132.8 crore in Q2FY2020 due to lower operating leverage. Rental costs fell significantly (savings of Rs. 23 crore in Q2 and Rs. 58 crore in H1), employee costs and other expenses. Other income declined by 15.9% y-o-y from Rs. 43.3 crore to Rs. 36.9 crore due to rent concessions of Rs. 23 crore. Loss before tax stood at Rs. 73.3 crore and reported loss came in at Rs. 48.1 crore as against a profit of Rs. 38.3 crore in Q2FY2020. The net impact of Ind-AS 116 on PBT was at Rs. 21 crore for Q2FY2021.

Key Conference call takeaways

- The company added two Westside stores, 8 Zudio stores and 1 Landmark store in H1FY2021. Total number of Westside stores currently stands at 166 across 88 cities.
- Zudio stores have seen good traction with opening of 41 new stores in FY2020. The number of Zudio stores now stands at 88 across 44 cities.
- The Star Foods business (50:50 joint venture) saw strong traction from customers in the post-lockdown period driven by higher demand for food products.
- The company has indicated that the pace of store expansion shall not be affected by near-term headwinds. The panic buying has normalised now, but average ticket size has increased.
- Trent will continue to straddle the retail space with unique brands to address multiple customer segments and value positioning by enhancing its portfolio with differentiated products.
- The company is also focusing on enhancing its presence through online channels by leveraging on its association with Tata Cliq and its website - Westside.com.
- No major issues were witnessed in terms of vendor liquidity.
- The company has availed of a majority of its rent concessions. Most new stores are on a variable basis and the company is expecting to get more stores under the variable model.
- Net impact of change in accounting standards stood at Rs. 44 crore for H1FY2021.
- The company, along with its JV/subsidiaries, does not have any major debt repayment due over the next one year while the current liquid resources materially exceed aggregate outstanding debt.

Results (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Net revenue	452.1	818.0	-44.7	96.3	-
Cost of goods sold	267.3	426.7	-37.4	83.5	-
Gross profit	184.8	391.3	-52.8	12.8	-
Staff cost	57.4	82.6	-30.5	60.8	-5.6
Other expenses	121.0	175.8	-31.2	71.1	70.2
Operating profit	6.4	132.8	-95.2	-119.1	-
Other income	36.4	43.3	-15.9	52.9	-31.2
Interest	58.3	59.8	-2.6	57.4	1.5
Depreciation	57.8	58.5	-1.1	58.5	-1.2
Profit before tax	-73.3	57.8	-	-182.2	-
Tax	-25.2	19.5	-	-42.8	-
Reported PAT	-48.1	38.3	-	-139.5	-
EPS (Rs.)	-1.4	1.1	-	-3.9	-
			bps		**bps**
GPM (%)	40.9	47.8	-695	13.3	-
OPM (%)	1.4	16.2	-	-123.7	-

Source: Company; Sharekhan Research

Result snapshot (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Net revenue	585.4	854.9	-31.5	248.4	-
Operating profit	0.4	129.3	-99.7	-123.8	-
Reported PAT	-78.6	17.3	-	-184.0	-
			bps		**bps**
GPM (%)	33.6	46.4	-	9.9	-
OPM (%)	0.1	15.1	-	-49.8	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Discretionary consumption to gradually recover

Stores of retail companies are opening up in most cities post the easing of lockdown norms, resulting in a gradual recovery in revenue for most companies. With inter-city travel resuming and increased out-of-home consumption products (such as apparels and watches), retail companies will also post good recovery in Q3. With malls reopening and better festive/wedding demand, we will see branded apparel companies performing better in H2FY2021. A full recovery of branded apparel, jewellery, and retail companies is expected by Q4FY2021. Profitability would be severely impacted in FY2021, while we expect it to come back on track in FY2022 (with 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 – Strong recovery in FY2022; cost reduction to reduce stress on profitability

Trent's business has recovered to ~55% of pre-COVID sales in Q2FY2021. All stores have become operational in October with a recovery rate of ~70%. The management expects business to gradually improve with a recovery in footfalls as the scare of virus eases. We expect strong recovery in H2 to be led by the festive season and End-of-Season Sales (EOSS). Rental negotiations, employee cost savings and reduction in discretionary cost will lead to some structural cost savings would boost the company's profitability. The company has indicated that its pace of store expansions shall not be affected by near-term headwinds. The company has prioritised cash conservation, by focusing on reducing costs, especially on discretionary front with a continued emphasis on maintaining adequate liquidity and minimal borrowings, which will help support profitability to some extent. Strong recovery is expected in FY2022.

■ Valuation – Recommend Buy with a PT of Rs. 800

We expect footfalls to recover once the pandemic situation normalises. With 100% of Westside merchandise being manufactured in-house, we expect recovery to be much faster for Trent in a normal business environment. Innovation in product portfolio, scaling-up of supply chain, aggressive store expansions and leveraging of digital presence will be the near-term growth drivers. Trent is among India's strong branded retail plays with a robust balance sheet, stable cash flows, and one of the highest utilisation rates per store. 100% own brand contribution, strong Balance Sheet and higher margins than peers would keep valuations at premium as compared to other branded apparel/retail companies. The stock is trading at 28.2x its FY2023E EV/EBITDA. We recommend Buy on the stock with a PT of Rs. 800. (based on sum-of-the parts valuation).

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
ABFRL	-	-	-	13.5	59.1	15.3	8.8	-	2.3
Trent	-	-	-	36.1	92.2	35.0	13.8	0.8	9.0

Source: Company, Sharekhan estimates

About company

Trent is a leading branded retail company that operates Westside, a chain of departmental stores retailing apparel, footwear and other accessories, with over 99% contribution from own brands. Westside has presence of over 150 stores across 76 cities in India. It also operates value fashion chain Zudio, having 40 stores and books and music retail chain Landmark with five stores. Trent has a 50:50 JV with Tesco PLC UK to operate Star stores through Trent Hypermarket Private Limited. In addition, Trent has also two separate associations of 49% each with the Inditex Group of Spain to operate Zara and Massimo Dutti stores in India through Inditex Trent Retail India Private Limited.

Retail format	JV/Association
Westside	Owned by Trent
Zudio	Owned by Trent
Star	50:50 JV with Tesco PLC UK
Zara	49% association with Inditex group
Massimo Dutti	49% association with Inditex group

Investment theme

Trent is the only branded retail player with close to 100% share of private brands with pan-India presence. Trent offers a strong set of brands catering to all categories of consumers, which has helped the company report the highest average revenue per square foot compared to other branded players. Trent has maintained its SSSG momentum over the years as well as the profitability is seen increasing y-o-y. Aggressive store expansion, better store fundamentals, higher contribution from private brands and innovative product offering in the premium and value fashion space would be key growth drivers for the company going ahead.

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.
- Any significant increase in key raw-material prices such as cotton would affect the company's profitability.

Additional Data

Key management personnel

Noel Tata	Chairman
Philip N Auld	Managing Director
P Venkatesalu	Executive Director & CFO
Mehernosh Surti	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Arisaig India Fund Limited	6.6
2	HDFC Asset Management Co Ltd	3.7
3	Franklin Resources Inc	1.8
4	L&T Mutual Fund Trustee Ltd	1.7
5	Sundaram Asset Management Co Ltd	1.7
6	SBI Life Insurance Co Ltd	1.5
7	HDFC Life Insurance Co Ltd	1.5
8	Emirate of Abu Dhabi UAE	1
9	Reliance Capital Trustee Co Ltd	0.9
10	Axis Asset Management Company	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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