

CMP: ₹ 328

Target: ₹ 380 (16%)

Target Period: 12 months

BUY

November 7, 2022

Higher marketing spend subdues profitability

About the stock: ABFRL combines Madura's portfolio of leading power brands (Allen Solly, Van Heusen, Louis Philippe and Peter England) with Pantaloons' forte of largest value fashion retailer. The company has a robust distribution network with 3197 brand stores along with 396 Pantaloons stores.

- ABFRL has charted out growth strategies to become a ~US\$2.8 billion entity (₹ 21000 crore) by FY26E, translating to 15% CAGR in FY20-26E
- It has enhanced focus on ethnic wear (through its recent acquisitions)

Q2FY23 Results: ABFRL reported healthy revenue growth (in line with our estimates) but higher than anticipated marketing spends weighed on profitability. On the balance sheet front, net debt declined to ₹ 243 crore against ₹ 504 crore in FY22 (owing to capital infusion worth ₹ 770 crore by GIC).

- On a favourable base, revenue grew 50% YoY to ₹ 3074.6 crore (three year CAGR: 10%). Revenue grew 33% over pre-Covid levels
- Gross margins improved 170 bps YoY to 55.1% owing to better product mix and sharp markdown reductions. However, other expenses grew sharply by 60% YoY to ₹ 716.8 crore. Subsequently, EBITDA margins were at 12.9% (I-direct estimate: 14.6%, Q2FY22: 15.3%)
- Lower than anticipated EBITDA (miss by ~ ₹ 40 crore) resulted in PAT coming in at ₹ 29.4 crore (below our estimate of ₹ 69 crore)

What should investors do? The stock price of ABFRL has appreciated at a CAGR of ~18% over the last five years.

- ABFRL has strengthened its balance sheet through recent equity infusion with net debt declining sharply from ₹ 2500 crore (in FY20) to ~₹ 230 crore. We remain structurally positive and maintain **BUY** rating on the stock

Target Price and Valuation: We value ABFRL at ₹ 380 i.e. 2.5x FY24E EV/sales

Key triggers for future price performance:

- ABFRL has aggressive store addition plans for FY23E with 75+ Pantaloons store and 400+ (franchisee) lifestyle brand stores
- Multiple strategic initiatives like entry into footwear by acquiring Reebok's India operations, acquisition of majority stake in Masaba to foray into beauty category, launch of premium menswear ethnic brand Tasva and setting up a separate platform to build a portfolio of D2C brands to add value over the medium to long term
- Maintaining b/s strength coupled with aggressive expansion would be the focus of ABFRL, going forward (debt/EBITDA: 1-2x)

Alternate Stock Idea: Apart from ABFRL, in our retail coverage we also like Trent.

- Inherent strength of brands (Westside, Zudio) and proven business model position Trent as a preferred pick. BUY with a target price of ₹ 1665



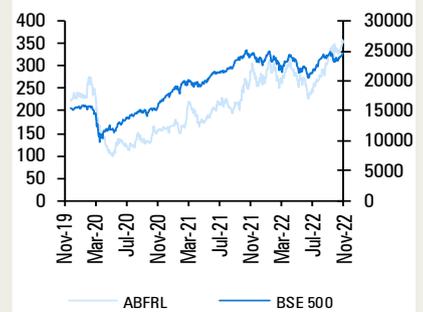
Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	31,110.5
Total Debt (Mar-22) (₹ Crore)	1,232.3
Cash (Mar-22) (₹ Crore)	121.1
EV (₹ Crore)	32,221.7
52 week H/L	359.4 / 221
Equity Capital (₹ Crore)	948.5
Face Value (₹)	10.0

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	56.1	56.1	56.1	56.1	56.1
FII	13.8	13.5	13.2	13.2	14.1
DII	18.2	19.2	19.9	20.0	19.4
Others	11.9	11.2	10.8	10.7	10.4

Price Chart



Key risks

- Higher investments in new initiatives (ethnic, innerwear) could lower margins
- Delay in expansion of store network.

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Key Financial Summary

Financials	FY19	FY20	FY21	FY22	5 year CAGR (FY17-FY22)	FY23E	FY24E	2 year CAGR (FY22-FY24E)
Net Sales	8,117.7	8,787.9	5,249.0	8,136.2	4.1%	12,413.9	14,638.2	34%
EBITDA	554.1	1,211.8	554.9	1,099.9		1,861.3	2,273.5	44%
PAT*	321.2	(163.0)	(673.1)	(108.7)		403.1	608.6	
EV/Sales (x)	3.3	3.2	6.0	3.9		2.5	2.2	
EV/EBITDA (x)	48.8	23.0	-	29.0		17.0	14.2	
RoCE (%)	10.7	10.2	(8.9)	5.1		13.7	17.1	
RoE (%)	22.5	-15.3	-25.5	-3.9		7.5	10.2	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Lifestyle brands:

- Lifestyle brands (Allen Solly, Van Heusen, Louis Philippe and Peter England) continued their strong growth momentum with revenues increasing 45% YoY to ₹ 1680 crore (three year CAGR: 10%). Retail channel (44% of sales) has been the fastest growing one with sales increasing at a three year CAGR of 22%, higher than the square feet addition (three year CAGR: 7%). This has translated into revenue/sq ft (annualised) increasing to ~ ₹ 9000/sq ft, vs. ₹ 6000 during pre-Covid levels. Retail SSSG was at an impressive 32% (over Q2FY20). On a high base, revenue from e-commerce grew by 18% YoY and 3x of pre-Covid levels
- While casual wear continued to perform well, there was also resurgence in demand for formal wear owing to opening of offices. During H1FY23, the company added 39 new stores taking the overall store count to 2561 (3.3 million sq ft). It continued to strengthen its presence in Tier III/IV cities through PE Red stores (~550). On the profitability front, EBITDA margins improved 70 bps YoY to 17.0% (Q2FY20: 17.4%). Change in channel mix (as wholesale channel is still below pre-Covid levels) has led to margins being lower than pre-Covid levels. We expect the company to continue its accelerated store expansion strategy especially in Tier III/IV cities and build in 600 new stores (~90% franchise led) during FY23-24. We expect lifestyle brands to register revenue CAGR of 26% in FY22-24E

Pantaloons:

- Pantaloons division reported revenue growth of 65% YoY to ₹ 1094 crore (three year CAGR: 6%). Revenue recovery for Pantaloons was lagging lifestyle brands owing to a larger share of mall stores (~ 58%) that had prolonged restrictions. Furthermore, inflationary pressure has been more acute on value fashion segment (wherein Pantaloons operates) than the premium-end of the market (lifestyle brands). We expect H2FY23 to be significantly better than H1FY23 (₹ 2121 crore) owing to strong festive season and accelerated store addition pace. Despite slower revenue growth, the division has displayed resilient show on the profitability front with EBITDA margins improving over pre-Covid levels. Sharp markdown reductions and enhanced product mix has led to enhanced margins for the division. It accelerated its store addition pace during the quarter with opening of new 21 outlets taking the overall count to 396 (5.2 million sq ft). It has reiterated its stance of adding 70-75 stores in FY23E (15-20% franchisee model). The management indicated that the company generates decent operating cash flow to fund its capex requirements. On a favourable base, we expect revenue to grow at CAGR of 41% in FY22-24E. The company would continue to strive for increasing the share of private labels which would enable to improve profitability over the longer term

Other segments

- Revenue from other segment (which included fast fashion, innerwear and super premium brands) reported healthy operational performance with growth of 31% YoY to ₹ 307 crore (three year CAGR: 14%). Among other business, Innerwear and athleisure continued to perform well as it recorded highest ever quarterly sales (27% YoY and 1.9x of pre-Covid levels). The innerwear segment is well on track to achieve ₹ 500 crore annual sales in FY23 with an aim to reach ₹ 1000+ crore in the next two to three years. It continues to expand its distribution reach with addition of ~1400 new touchpoints taking the total count to 30400 MBOs. The portfolio is now well balanced between innerwear and athleisure wear. It has also forayed into kid's innerwear category. Super premium brands segment (which includes The Collective) continues to be the fastest growing business for ABFRL as sales grew more than 35% YoY (130% of pre-Covid levels). EBITDA for other segment declined to ₹ 2 crore (Q2FY22: ₹ 24 crore) mainly owing to higher investments (marketing & others) in the innerwear space

Ethnic wear:

- In the ethnic space, all the business combined reported a revenue of ₹ 109 crore in Q2FY23 (up 8% QoQ), driven by network and category expansions. The company believes that ethnic wear has strong growth potential and hence would continue to invest in the business. The company significantly enhanced overall marketing spends by 2.5x YoY (60% over pre-Covid levels), with majority of the chunk being spent towards ethnic category. It has seven brands catering to different price point and segments with 60+ stores. Continued with aggressive store expansion plan for its newly launched 'Tasva' brand with the opening of nine stores (21 stores). ABFRL expects to scale up the brand to ₹ 200 crore by FY24E. Brand Sabyasachi grew 60% YoY and it continues to hold leadership position in celebrity weddings. *Jaypore* recorded 80% YoY sales growth led by retail expansion (expanded to 13 stores) and growth new business (home business grew 98% YoY). The management expects quarterly run-rate of ethnic segment revenues to increase ~50% (₹ 150 crore) in the coming quarters
- On the balance sheet front, the company has invested aggressively in inventory (up 44% from March 2022 levels), in anticipation healthy festive and wedding season. Post payment of lease liability and finance cost, company generated negative OCF worth ₹ 117 crore in H1FY23 (vs. (-) ₹ 487 crore). Furthermore, it significantly accelerated capex investments to ₹ 390 crore (including ₹ 80 crore towards acquisition of Masaba) in H1FY23 vs. ₹ 109 crore in H1FY22. The negative FCF worth ~₹ 500 crore was mainly funded through recent capital infusion by GIC worth ₹ 770 crore. Net debt declined to ₹ 243 crore vs. ₹ 504 crore in FY22. With the recent capital infusion and company generating positive FCF in FY24E, we do not expect gross debt levels to increase in the medium term
- **We believe ABFRL with lighter balance sheet and strong bouquet of brands is well placed to accelerate the pace of store addition and revenue growth. We reiterate our BUY rating with a target price of ₹ 380 (2.5x EV/sales FY24E, earlier TP: ₹ 370).**

Q2FY23 conference call highlights:

- The management highlighted that Q2FY23 was the best ever performance by the company in terms of revenue. Network and category expansion along with a strong End of Season sales performance enabled the company to report strong revenue growth. E-commerce revenues grew 41% and the current annual run rate of e-com revenues is trending close to ₹ 1300 crore
- The management highlighted that the premium products were growing at a faster clip with urban region stores performing well. Pantaloons revenue growth has been lower owing to the value segment customer being significantly impacted by the higher inflation and appear to have curtailed discretionary purchases. The management highlighted that Pantaloons could have grown faster, however the management was not just chasing revenue growth and wanted to maintain a profitable growth for the division
- During the quarter, the company added 34 new branded stores (including 13 Ethnic brand stores). Pantaloons store addition also picked up as in Q1FY23 only four stores were opened but during Q2FY23 the company added 21 new Pantaloons stores. ABFRL aspires to maintain a run-rate of around 70 Pantaloons store openings annually with 20% of stores expected to be opened on franchise basis and the rest expected to be company owned stores
- Pantaloons introduced new private label brands to cater to evolving consumer needs. The performance of the private label has been below expectation of the management and it expects the share of private labels to pick up going ahead

- Ethnic businesses grew ~ 90% YoY (9x over pre-COVID), driven by both network expansion and category extensions. The brand "Sabyasachi" opened its first-ever exclusive brand store in New York. Men's premium ethnic wear brand Tasva, which has 25 stores (20 stores are on company owned and company operated model) plans to continue its aggressive expansion targeting to end this year with ~70 stores by end of FY23. Majority of the store addition will be on COCO format and after perfecting the model the company will add franchise stores. The company is focusing on enhancing the brand presence for Tasva and has already launched an advertisement campaign for the brand
- On the D2C brands initiative, ABFRL would be spending around ₹ 400-500 crore. The company is evaluating 8-10 investment proposals which should be finalised by end of FY23. The company intends to buy a majority stake in small digital first brands and then gradually scale them up
- The company is testing a new format 'Style up', which focusses on the value segment and is expected to be launched in both large cities and smaller towns to capture the demand at value segment price points
- ABFRL has completed acquisition of Reebok India operations through signing of local asset transfer agreement on October 1, 2022. The management indicated that it would open a combination of company owned and franchise stores (15 store addition in H2FY23). The company would invest in the brand as it believes that the brand has good long term potential

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	3074.6	3013.7	2054.3	49.7	2874.76	7.0	On the base of Q2FY20, recovery rate stood at ~133% of pre-covid levels.
Raw Material Expense	1,380.3	1,380.3	956.5	44.3	1,269.5	8.7	Better product offerings and reduced markdowns led to gross margins improving ~170 bps YoY to 55.1%.
Employee Expenses	379.0	361.6	286.6	32.2	347.4	9.1	
Rent	201.8	232.1	50.4		208.9	-3.4	
Other Expenses	716.8	599.7	447.4	60.2	580.6	23.5	Other expenses grew sharply by 60% YoY to ₹ 716.8 crore mainly on account of 2.5x higher advertising spends (60% more than pre-covid levels and higher expenses towards new initiatives (ethnic & innerwear).
EBITDA	396.7	440.0	313.5	26.5	468.4	-15.3	
EBITDA Margin (%)	12.9	14.6	15.3	-236 bps	16.3	-339 bps	Higher than expected marketing spends impacted EBITDA margins
Depreciation	290.7	281.1	241.6	20.3	270.3	7.5	
Interest	103.6	99.1	87.6	18.3	94.4	9.7	
Other Income	22.0	32.1	25.2	-12.6	31.1	-29.3	
PBT before Exceptional item	24.5	91.8	9.6	155.8	134.8	-81.8	
Share of JV	-0.7	0.0	-0.8		0.6		
PBT	23.8	91.8	10.4		135.5		
Tax Outgo	-5.6	23.1	3.7		41.1		
PAT	29.4	68.7	5.1	478.0	94.4	-68.8	

Source: Company, ICICI Direct Research

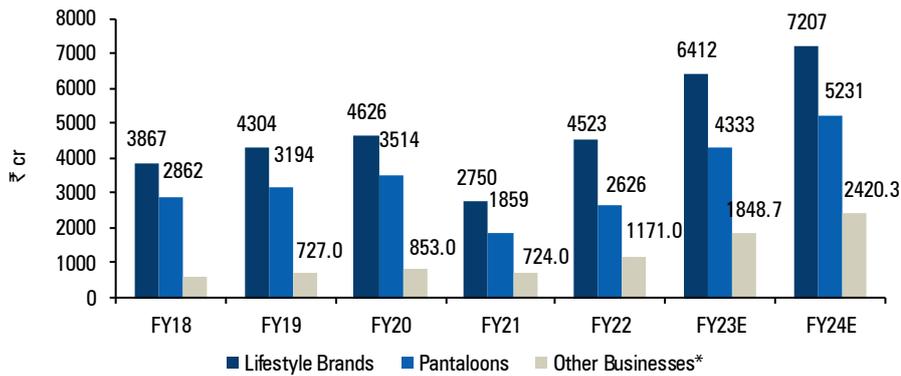
Exhibit 2: Change in estimates

(₹ Crore)	FY 23E			FY 24E		
	Old	New	% Change	Old	New	% Change
Revenue	12,158.7	12,413.9	2.1	14,269.7	14,638.2	2.6
EBITDA	1,927.7	1,861.3	-3.4	2,284.2	2,273.5	-0.5
EBITDA Margin (%)	15.9	15.0	-86 bps	16.0	15.5	-48 bps
PAT	441.0	403.1	-8.6	591.5	608.6	2.9
EPS (₹)	4.6	4.2	-8.4	5.8	6.0	2.9

Source: Company, ICICI Direct Research

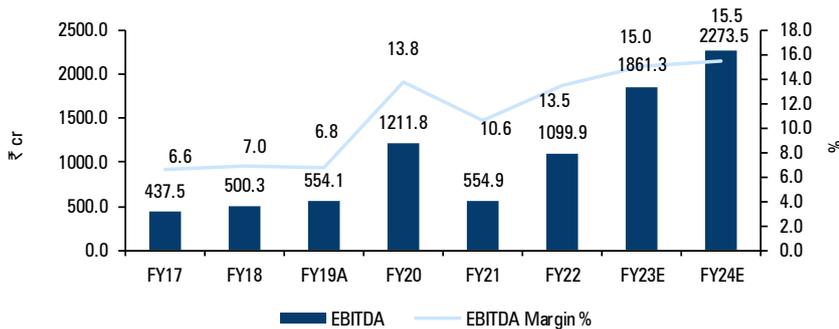
Financial story in charts

Exhibit 3: Revenue growth trend



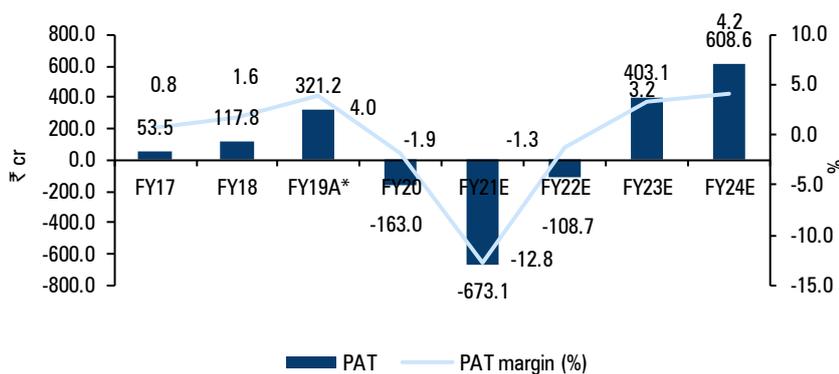
Source: Company, ICICI Direct Research. Other business includes ethnic segment and Reebok revenues

Exhibit 4: EBITDA and EBITDA margin trend (post Ind-AS 116)



Source: Company, ICICI Direct Research

Exhibit 5: Net profit trend



Source: Company, ICICI Direct Research. FY19 PAT includes deferred tax assets worth ₹ 193 crore

Exhibit 6: Valuation

Target EV/Sales multiple	2.5
2024E Sales	14,638.2
2023E EV	37,181.0
2023E Debt	1,000.0
2023E Cash	2,021.2
2023E Market Cap.	38,202.2
No. of shares	101.4
Target Price	380
CMP	328.0
Upside/(Downside)	16

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(Year-end March)	FY 21	FY 22	FY 23E	FY 24E
Gross Revenue	5,249.0	8,136.2	12,413.9	14,638.2
Growth (%)	(40.3)	55.0	52.6	17.9
Cost of Sales	2,563.0	3,720.2	5,691.8	6,714.6
Employee Costs	865.0	1,158.5	1,465.5	1,685.4
Administration & Other Exp	1,266.1	2,157.6	3,395.3	3,964.8
EBITDA	554.9	1,099.9	1,861.3	2,273.5
Growth (%)	(54.2)	98.2	69.2	22.1
Depreciation	963.0	997.0	1,093.0	1,223.2
EBIT	(408.1)	102.9	768.3	1,050.3
Interest	503.0	350.7	364.8	396.8
Other Income	73.0	100.5	120.6	144.7
PBT	(838.1)	(147.3)	524.1	798.2
Growth (%)	-	-	LP	52.3
Tax	(101.5)	(26.6)	131.0	199.5
Reported PAT	(736.6)	(120.7)	393.1	598.6
Minority Interest	(63.5)	(12.0)	(10.0)	(10.0)
Adjusted PAT	(673.1)	(108.7)	403.1	608.6
Growth (%)	-	-	LP	51.0
Reported EPS	(7.2)	(1.2)	4.2	6.0

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(Year-end March)	FY 21	FY 22	FY 23E	FY 24E
Profit after Tax	(673.1)	(108.7)	403.1	608.6
Add: Interest Expense	503.0	350.7	364.8	396.8
Add: Depreciation	963.0	997.0	1,093.0	1,223.2
Add: Others	-	-	-	-
Increase/(Decrease) in CL	452.8	1,408.4	1,012.0	793.2
(Increase)/Decrease in CA	(18.5)	(1,617.8)	(1,116.8)	(895.4)
CF from Operating Activities	1,227.2	1,029.5	1,756.1	2,126.4
(Add) / Dec in Fixed Assets	(162.0)	(315.9)	(700.0)	(750.0)
(Inc)/Dec in Investments	(710.0)	(266.1)	(68.6)	(75.5)
CF from Investing Activities	(872.0)	(582.1)	(768.6)	(825.5)
Inc/(Dec) in Loan Funds	(1,646.6)	96.0	(132.3)	(100.0)
Inc/(Dec) in Sh. Cap. & Res.	2,249.2	238.0	768.3	1,426.0
Others	(459.5)	(571.9)	(781.8)	(807.0)
Less: Interest Expense	(503.0)	(350.7)	(364.8)	(396.8)
CF from financing activities	(359.9)	(588.6)	(510.6)	122.2
Change in cash Eq.	(4.6)	(141.2)	476.9	1,423.1
Op. Cash and cash Eq.	266.9	262.3	121.1	598.0
Cl. Cash and cash Eq.	262.3	121.1	598.0	2,021.2

Source: Company, ICICI Direct Research

Exhibit 9: Balance Sheet				
	₹ crore			
(Year-end March)	FY 21	FY 22	FY 23E	FY 24E
Source of Funds				
Equity Capital	915.1	938.3	948.5	1,014.3
Others	-	-	1,898.8	-
Reserves & Surplus	1,729.0	1,835.0	2,522.4	4,965.1
Shareholder's Fund	2,644.1	2,773.3	5,369.7	5,979.4
Total Loan Funds	1,136.4	1,232.3	1,100.0	1,000.0
Other Non Current Liabilities	2,463.4	2,868.0	2,868.0	2,868.0
Minority Interest	32.8	15.2	15.5	15.8
Source of Funds	6,455.3	7,281.5	9,745.9	10,255.9
Application of Funds				
Gross Block	1,385.8	1,520.6	2,220.6	2,970.6
Less: Acc. Depreciation	(811.1)	(889.4)	(1,200.3)	(1,616.2)
Net Block	574.7	631.2	1,020.3	1,354.4
Capital WIP	37.6	102.6	102.6	102.6
Total Fixed Assets	612.3	733.8	1,122.9	1,457.0
Goodwill	2,696.7	2,903.6	2,903.6	2,903.6
Investments	419.8	686.0	754.5	830.0
Inventories	1,847.0	2,929.6	3,741.2	4,411.5
Debtors	730.5	756.4	1,020.3	1,203.1
Cash	262.3	121.1	598.0	2,021.2
Loan & Advance, Other CA	1,461.8	1,752.9	1,794.2	1,836.5
Total Current assets	4,301.5	5,560.1	7,153.7	9,472.3
Creditors	2,373.4	3,410.4	4,421.4	5,213.6
Provisions & Other CL	1,343.0	1,714.4	1,715.4	1,716.4
Total CL and Provisions	3,716.4	5,124.8	6,136.8	6,930.0
Net Working Capital	585.1	435.3	1,016.9	2,542.3
Other NCA	2,141.4	2,522.9	3,947.9	2,522.9
Application of Funds	6,455.3	7,281.5	9,745.9	10,255.9

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
(Year-end March)	FY 21	FY 22	FY 23E	FY 24E
Per share data (₹)				
Book Value	28.2	29.6	56.6	59.0
EPS	(7.2)	(1.2)	4.2	6.0
Cash EPS	3.1	9.5	15.8	18.1
DPS	-	-	-	-
Profitability & Operating Ratios				
EBITDA Margin (%)	10.6	13.5	15.0	15.5
PAT Margin (%)	(12.8)	(1.3)	3.2	4.2
Fixed Asset Turnover (x)	1.4	2.0	1.9	2.1
Inventory Turnover (Days)	128.4	131.4	110.0	110.0
Debtor (Days)	50.8	33.9	30.0	30.0
Current Liabilities (Days)	165.0	153.0	130.0	130.0
Return Ratios (%)				
RoE	(25.5)	(3.9)	7.5	10.2
RoCE	(8.9)	5.1	13.7	17.1
RoIC	(31.0)	6.3	35.0	38.8
Valuation Ratios (x)				
P/E	-	-	77.2	54.7
Price to Book Value	11.6	11.1	5.8	5.6
EV/EBITDA	-	29.0	17.0	14.2
EV/Sales	6.0	3.9	2.5	2.2
Leverage & Solvency Ratios				
Debt to equity (x)	0.4	0.4	0.2	0.2
Interest Coverage (x)	-	0.3	2.1	2.6
Debt to EBITDA (x)	2.0	1.1	0.6	0.4
Current Ratio	1.1	1.1	1.1	1.1
Quick ratio	0.6	0.5	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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