13 December 2023

Company Update | Sector: Retail

V-MART

BSE SENSEX	S&P CNX
69,585	20,926

CMP: INR1,750 **TP: INR1,800 (+3%)** **Neutral**

Winds of change

V-MART (VMART) has reported a weak earnings trajectory over the last few years, primarily due to factors such as weakness in the core business, sluggish performance/ recovery in the Unlimited format, and losses within Limeroad. However, we believe there are signs of gradual reversal in trend, with noticeable changes in the business. These changes are being driven by strong actions taken by the management, which may bring about a significant transformation. The key trends of visible changes are outlined below:

- **Improvement in the core business is expected from 3QFY24 onwards, driven by healthy same-store sales growth (SSSG) due to increased demand during festive periods. Although it is expected to be below the normalized level, this trend is now seen to have bottomed out.**
- **Unlimited, which is operating with suboptimal profitability (3-4% pre IND-AS 116 EBITDA margin) due to weak revenue productivity, is likely to close more than 15 stores in 4QF24. These stores have low productivity and high rental costs. This should help in recovering margins to reach levels of 6-7% from FY25 onwards. The newer stores opened with smaller footprints, better locations, and lower rentals are already experiencing higher productivity.**
- **Management is now looking to reduce investments in Limeroad, revisit the previous strategy of higher spending to expand the business and achieve operating leverage. This should help in curbing losses from INR600m to breakeven in FY25 (we estimate FY24 losses at INR900m).**

Weakness in core business bottoming out

The weak performance of the core segment is now seeing a recovery. We expect the festive period to see decent traction, with high single-digit SSSG. The wedding category is also expected to perform well during this time. However, while the Oct-Nov'23 period saw a strong traction with a high single-digit LTL growth led by the festive season compared to the previous year, the delayed onset of winter could potentially hurt demand in Dec'23. This situation is similar to what was experienced in 3QFY23. VMART's EBITDA margin for 3QFY24 could be affected by the inventory clean-up, low SSSG, and the decision to pass on the benefits of raw material (RM) pricing to stimulate growth (as competition remains stiff from regional players who operate at a 20% gross margin). The decrease in average selling prices (ASPs) is expected to be offset by increased demand, which will help revive volume growth.

Limeroad to curtail losses

The company's plan to accelerate growth and drive operating benefits within the Limeroad segment is now undergoing a change. The management is now focusing on reducing marketing expenses and prioritizing profitability over growth. As a result, losses within the segment could further decline ~40% QoQ to INR120m in 3QFY24 vs. INR198m in 2QFY24 (our estimate of INR220m in 3QFY24) and further drop by 50% (~INR50m) in 4QFY24). This will help meet the company's guidance of INR600m losses vs. our estimate of INR900m losses for FY24 (i.e. 20% of overall EBITDA and 2% margin impact). Subsequently, operating losses may reduce to INR150m in FY25, thereby resulting in a benefit of ~200bp on EBITDA. On the other hand, prioritizing profitability over growth may lead to a sequential decline in revenue at Limeroad. This, however, could be expected to remain inconsequential.

Stock Info

Bloomberg	VMART IN
Equity Shares (m)	20
M.Cap.(INRb)/(USDb)	34.6 / 0.4
52-Week Range (INR)	3110 / 1591
1, 6, 12 Rel. Per (%)	-5/-23/-51
12M Avg Val (INR M)	93
Free float (%)	55.7

Financials Snapshot (INR b)

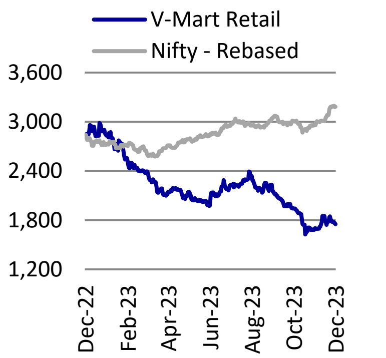
Y/E March	FY23	FY24E	FY25E
Sales	24.6	28.2	33.2
EBITDA	2.7	1.6	3.5
NP	-0.1	-1.1	0.3
EBITDA Margin (%)	10.9	5.5	10.5
Adj. EPS (INR)	-4.3	-60.9	15.5
EPS Gr. (%)	NM	NM	-125.5
BV/Sh. (INR)	469.1	408.2	423.7
Ratios			
Net D:E	1.5	1.8	1.7
RoE (%)	NM	NM	3.7
RoCE (%)	3.2	-0.7	5.9
Payout (%)	0.0	0.0	0.0
Valuations			
P/E (x)	NM	NM	108.6
EV/EBITDA (x)	17.3	29.9	13.4
EV/Sales (x)	1.4	1.2	1.1
Div. Yield (%)	0.0	0.0	0.0
FCF Yield (%)	-2.1	1.3	3.4

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	44.3	44.3	46.1
DII	32.6	31.0	31.5
FII	14.3	14.8	11.5
Others	8.7	9.9	10.9

FII Includes depository receipts

Stock Performance (1-year)



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Unlimited to shut down loss-making stores

In line with the company's strategy of aligning the Unlimited store economics with VMART and improving efficiency, the company plans to close a total of 20 stores from 4QFY24 onwards, with the majority of them being Unlimited stores (~15 stores). The segment's old stores, which were generating a revenue throughput of INR400-500/sqft (INR5,000-6,000/sqft annualized), were making operating losses of 2-3% mainly due to their premier market locations (resulting in weak footfalls) and larger store sizes (10,000 and 12,000 sqft) with a rent of INR100/sqft. The benefits of these closures are expected to take time to accrue, possibly in FY25, which would include inventory clean-up. However, the new Unlimited stores in South are doing well, with a revenue throughput of INR800/sqft and improved productivity. This can be attributed to factors such as: 1) smaller store sizes (7,500 sqft store size), 2) improved focus on strategic locations to attract more customers, and 3) lower rental costs, thereby improving store economics. The business has also reduced ASPs, which has helped achieve volume growth. The overall revenue growth, however, remains flat on LTL basis.

Valuation and view

- Improved growth trajectory within the core segment, a focus on enhanced productivity within the Unlimited segment, and reducing cash burn within the online segment are expected to drive growth for the company in the coming period. These could also potentially lead to a re-rating. We continue to monitor the developments closely.
- The stock is trading at a Price/Sales ratio of around 1x on FY25E, which is much lower than the 3-6x ratio for most retailers. With improvements in each of the above factors, earnings can recover to a 7% EBITDA margin and a 4% PAT margin, which implies an EV/EBITDA and P/E of 15x and 23x, respectively.
- Despite the recent weakness seen within the mass segment, the huge growth opportunity in the Value Fashion segment and VMART's strong execution capability remain key drivers of its success. This has the potential to generate sustainable double-digit revenue growth for a prolonged period, supported by new store additions. Low price points, cost leadership, strong liquidity, and prudent inventory management give VMART an edge over its competitors.
- With the onset of the festive period and the company's decision to lower ASPs to revive volume growth, it is expected that the company will experience a revenue recovery in 2HFY24. However, prolonged weakness in the macro environment and a delayed winter would remain the key monitorables.
- We are not modeling any recovery in numbers yet. We value the stock at 11x EV/EBITDA on FY26E basis with a TP of INR1,800. **Maintain Neutral.**

Exhibit 1: Valuation based on FY23E EBITDA

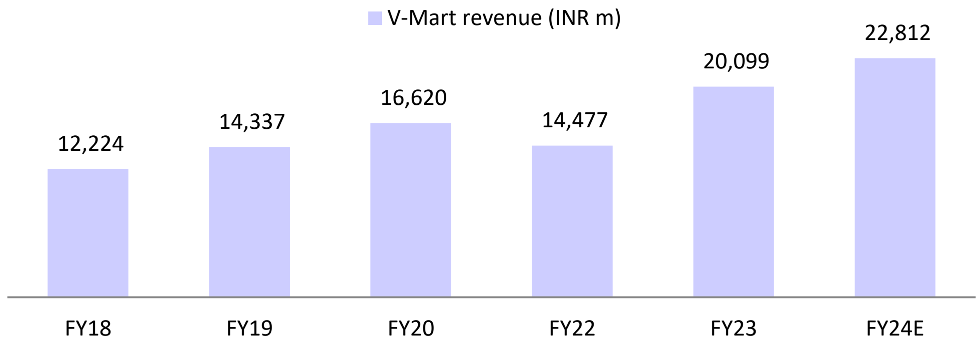
	Methodology	Driver (INR m)	Multiple (x)	Fair value (INR m)	Value/share (INR)
EBITDA	FY26 EV/EBITDA	4,531	11	48,574	2,459
Less: Net debt				13,030	659
Total Value				**35,544**	**1,800**
Shares o/s (m)				19.8	
CMP (INR)					1,750
Upside (%)					**3**

Source: MOFSL, Company

Reversal in demand trend within the core segment

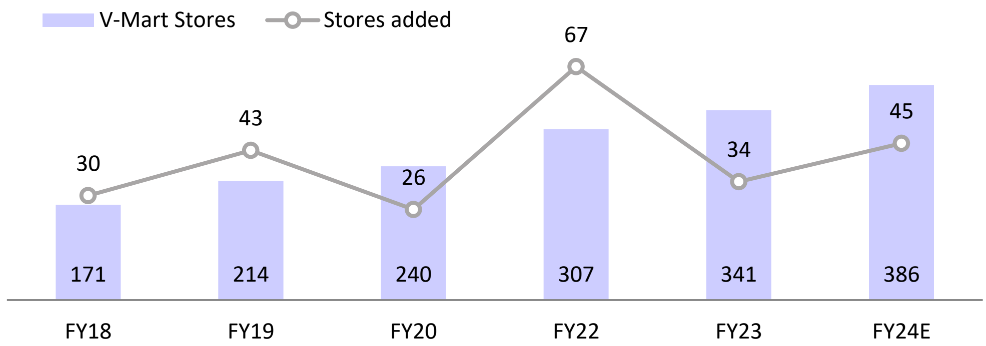
Revenue for the VMART (Core) segment as of FY23 stood at ~INR20.1b, reporting a 7% CAGR over FY20-23. This growth was primarily driven by footprint additions as revenue throughput continued to remain below pre-Covid levels. Demand for 1HFY24 too remained weak due to inflationary pressures and a shift in festive period. VMART (core)'s 2QFY24 revenue posted a growth of 5%, which was mainly propelled by store additions as revenue/sqft declined 4% to ~INR5,600 (annualized), which stood at INR8,800 before Covid-19.

Exhibit 2: Revenue growth for VMART remained moderate over FY20-23…



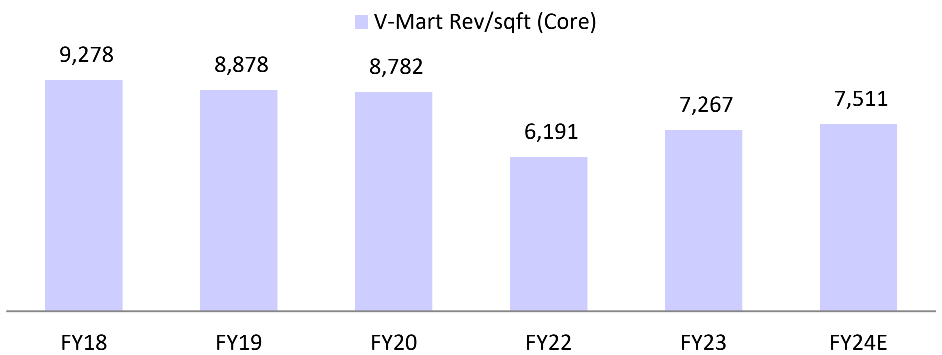
Source: MOFSL, Company

Exhibit 3: …mainly due to footprint additions



Source: MOFSL, Company

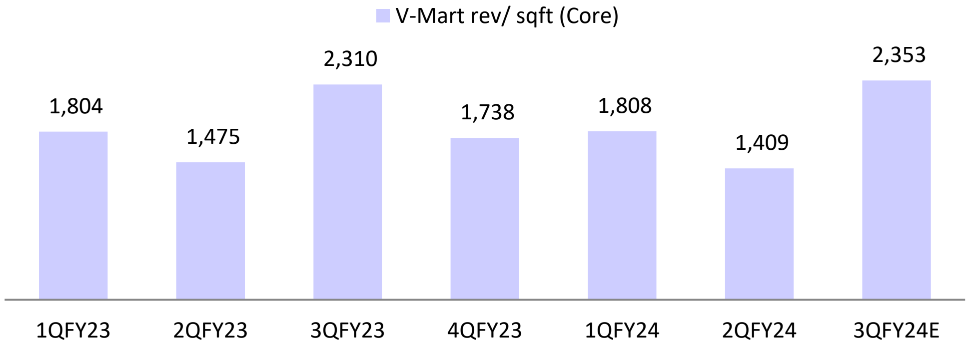
Exhibit 4: Revenue throughput, however, continued to remain below pre-Covid levels (INR)



Source: MOFSL, Company

However, we are expecting a reversal in the demand trend led by a festive push. While Oct-Nov'23 are expected to report single-digit LTL growth for the festive period, a delayed winter and a demand slowdown post-Diwali could drag revenue for Dec'23. In addition, the company could see further benefits from improved volumes as it plans to pass on the benefits of RM moderation to enhance its market share against regional players who are operating at 20% gross margin levels. The reduction in ASPs will be offset by improved volumes, which will contribute to the recovery of the growth momentum. On the profitability front, the operating margin for the segment could be hit by the clean-up in inventory and low SSSG.

Exhibit 5: Revenue productivity expected to improve from 3QFY24 onwards (INR)

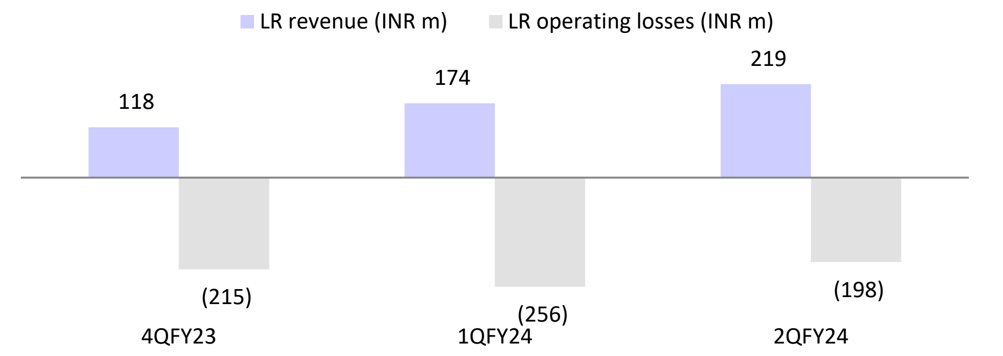


Source: MOFSL, Company

Realigning the online strategy; profitability in focus

The company acquired Limeroad in Oct'22 with the aim of enhancing its online and omnichannel strategies. With an initial focus on driving revenue growth for the segment, the company had guided for an annual investment of 15-20% of overall EBITDA within the segment. This implies a margin impact of 150bp, primarily towards marketing and back-end costs.

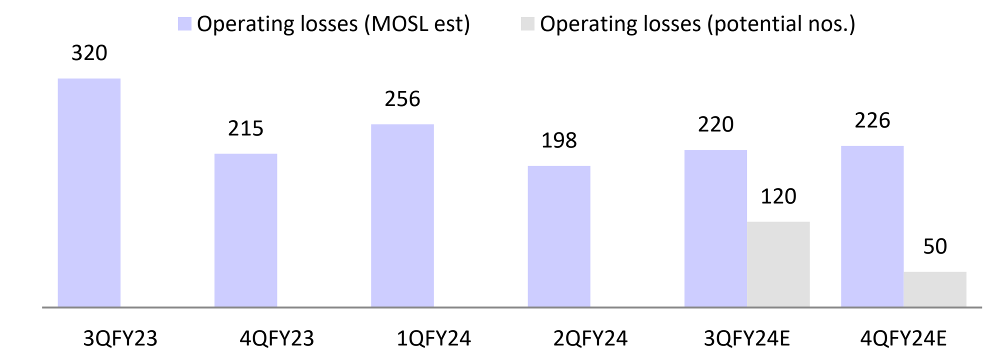
Exhibit 6: Aggressive focus on growth led to higher operating losses for the segment (INR m)



Source: MOFSL, Company

With significant costs associated with back-end integration now completed, we anticipate a shift in focus towards reducing losses in this business and improving profitability. Operating losses for the segment, which stood at ~INR200m in 2QFY24, are expected to narrow down to INR120m in 3QFY24 and INR50m in 4QFY24.

Exhibit 7: Shift in focus towards profitable growth to curtail losses in Limeroad (INR m)



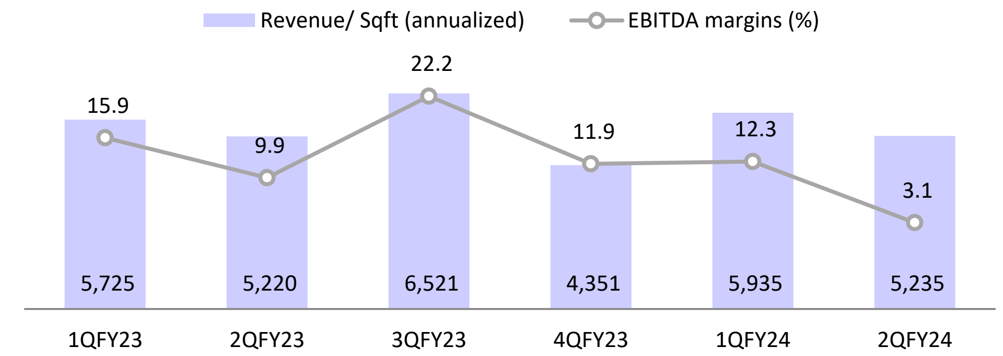
Source: MOFSL, Company

This shift in focus from accelerated growth and gaining scale will ensure that the company's losses from the segment will reduce to INR600m (vs. our estimates of INR900m) for FY24E and further narrow down to INR50m in FY25E. This will contribute to a margin improvement of 200bps on EBITDA level. However, focusing solely on profitability might hurt overall growth, potentially resulting in a moderation of sequential revenue growth for the segment, which remains inconsequential though.

Looking to improve efficiency within the Unlimited segment

In line with the company's recent strategy of focusing on the Southern India segment, the company has announced the closure of 20 stores, with the majority of them being under the Unlimited format. These larger stores (10,000-12,000 sqft) operated at suboptimal profitability with operating losses of 2-3%. This was attributed to lower store throughput of ~INR5,000/sqft. Further, these stores were located in Tier 1 localities that were not suitable for the company's target audience, resulting in lower foot traffic. Additionally, these stores operated at higher rental costs, with a monthly rent of INR100/sqft, which adversely impacted their productivity.

Exhibit 8: Revenue throughput remained moderate for Unlimited stores, which dragged the profitability (EBITDA post Ind AS 116)



Source: MOFSL, Company

On the other hand, the newer stores opened by the company are now operating at a monthly run rate of INR800/sqft (annualized at INR9,600/sqft). This is mainly aided by factors such as:

a) Opening of stores with smaller footprints (7,500sqft/store) vs. larger legacy stores
b) Identifying the correct catchment areas, which contribute to increased footfall and lower rental costs.

We expect the benefits of these steps to be realized starting in FY25, as we anticipate an increase in the share of newer stores and the completion of inventory clean-up. Additionally, the segment has also experienced rationalization in ASPs, which will support volume growth for the segment. We expect the revenue from the segment to grow 3% in FY24 and 15% in FY25 to reach INR5.2b with an EBITDA margin (Pre-Ind AS 116) of 6% in FY25E driven by improved productivity.

Financials and valuations – standalone

Consolidated - Income Statement								(INR m)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Total Income from Operations	**14,337**	**16,620**	**10,755**	**16,662**	**24,648**	**28,243**	**33,173**	**38,894**
Change (%)	17.3	15.9	-35.3	54.9	47.9	14.6	17.5	17.2
Raw Materials	9,703	11,263	7,236	10,911	15,971	18,640	21,894	25,670
Employees Cost	1,257	1,536	1,169	1,796	2,555	3,107	3,151	3,539
Other Expenses	996	396	1,038	1,821	3,178	4,688	4,389	4,898
Total Expenditure	**13,008**	**14,483**	**9,442**	**14,618**	**21,959**	**26,690**	**29,690**	**34,363**
% of Sales	90.7	87.1	87.8	87.7	89.1	94.5	89.5	88.4
EBITDA	**1,329**	**2,137**	**1,312**	**2,043**	**2,689**	**1,553**	**3,483**	**4,531**
Margin (%)	9.3	12.9	12.2	12.3	10.9	5.5	10.5	11.7
Depreciation	276	939	1,030	1,307	1,800	1,937	1,992	2,028
EBIT	**1,053**	**1,198**	**282**	**736**	**889**	**-384**	**1,491**	**2,503**
Int. and Finance Charges	16	548	589	772	1,169	1,297	1,326	1,414
Other Income	59	45	210	140	150	170	220	220
PBT Blf. EO Exp.	**1,096**	**695**	**-97**	**104**	**-130**	**-1,511**	**385**	**1,309**
EO Items	-98	0	0	0	0	0	0	0
PBT after EO Exp.	**998**	**695**	**-97**	**104**	**-130**	**-1,511**	**385**	**1,309**
Total Tax	382	202	-35	-12	-52	-408	104	354
Tax Rate (%)	38.3	29.0	35.8	-12.0	39.7	27.0	27.0	27.0
Minority Interest	0	0	0	0	0	0	0	0
Reported PAT	**616**	**493**	**-62**	**116**	**-78**	**-1,103**	**281**	**956**
Adjusted PAT	**715**	**493**	**-62**	**116**	**-78**	**-1,103**	**281**	**956**
Change (%)	-8.0	-31.0	-112.6	-287.7	-167.4	1,305.1	-125.5	240.3
Margin (%)	5.0	3.0	-0.6	0.7	-0.3	-3.9	0.8	2.5

Consolidated - Balance Sheet								(INR m)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
Equity Share Capital	181	182	197	197	198	198	198	198
Total Reserves	3,911	4,408	8,055	8,299	8,292	7,190	7,470	8,426
Net Worth	**4,093**	**4,589**	**8,252**	**8,496**	**8,490**	**7,387**	**7,668**	**8,624**
Minority Interest	0	0	0	0	0	0	0	0
Total Loans	0	11	0	0	1,478	2,000	2,400	2,400
Deferred Tax Liabilities	-118	-160	-253	-386	-531	-531	-531	-531
Other long term liabilities	111	5,218	5,751	9,131	11,964	11,521	11,156	10,867
Lease Liabilities		5,157	5,678	9,022	11,838	11,448	11,083	10,795
Capital Employed	**4,086**	**9,658**	**13,750**	**17,240**	**21,400**	**20,378**	**20,693**	**21,361**
Net Fixed Assets	**1,655**	**6,670**	**6,965**	**11,110**	**14,455**	**13,637**	**12,952**	**12,418**
Right to use assets		4,921	5,180	8,283	10,643	9,930	9,241	8,630
Capital WIP	40	25	22	64	1,092	22	22	22
Total Investments	**607**	**79**	**3,189**	**1,248**	**85**	**85**	**85**	**85**
Curr. Assets, Loans&Adv.	**3,898**	**5,302**	**5,836**	**8,186**	**11,261**	**12,749**	**14,817**	**17,257**
Inventory	3,290	4,779	4,283	6,682	8,706	9,672	11,361	13,320
Account Receivables	0	0	0	0	0	0	0	0
Cash and Bank Balance	166	50	275	351	202	380	289	224
Loans and Advances	443	473	1,278	1,153	2,353	2,697	3,167	3,713
Curr. Liability & Prov.	**2,114**	**2,418**	**2,261**	**3,368**	**5,493**	**6,116**	**7,183**	**8,422**
Account Payables	1,483	1,968	1,917	2,906	4,883	5,416	6,362	7,459
Other Current Liabilities	534	451	345	462	610	699	821	963
Provisions	97	0	0	0	0	0	0	0
Net Current Assets	**1,784**	**2,884**	**3,574**	**4,818**	**5,768**	**6,633**	**7,634**	**8,835**
Appl. of Funds	**4,086**	**9,657**	**13,750**	**17,240**	**21,400**	**20,378**	**20,693**	**21,360**

Financials and valuations – standalone

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)								
EPS	**39.5**	**27.3**	**-3.4**	**6.4**	**-4.3**	**-60.9**	**15.5**	**52.8**
Cash EPS	54.8	79.2	53.5	78.7	95.1	46.1	125.6	164.9
BV/Share	226.1	253.6	456.0	469.5	469.1	408.2	423.7	476.5
DPS	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	6.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)								
P/E	42.7	61.8	NM	262.0	NM	NM	108.6	31.9
Cash P/E	30.8	21.3	31.5	21.4	17.7	36.5	13.4	10.2
P/BV	7.5	6.6	3.7	3.6	3.6	4.1	4.0	3.5
EV/Sales	2.1	1.8	3.1	2.0	1.4	1.2	1.1	0.9
EV/EBITDA	22.8	16.7	29.4	20.5	17.3	29.9	13.4	10.2
Dividend Yield (%)	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	19.7	17.5	55.2	-81.3	-49.3	31.2	80.3	107.1
Return Ratios (%)								
RoE	18.9	11.4	NM	1.4	NM	NM	3.7	11.7
RoCE	18.1	12.7	2.7	6.2	3.2	-0.7	5.9	9.3
RoIC	21.2	13.3	1.8	6.4	3.0	-1.4	5.4	8.8
Working Capital Ratios								
Fixed Asset Turnover (x)	8.7	2.5	1.5	1.5	1.7	2.1	2.6	3.1
Asset Turnover (x)	3.5	1.7	0.8	1.0	1.2	1.4	1.6	1.8
Inventory (Days)	84	105	145	146	129	125	125	125
Debtor (Days)	0	0	0	0	0	0	0	0
Creditor (Days)	38	43	65	64	72	70	70	70
Leverage Ratio (x)								
Current Ratio	1.8	2.2	2.6	2.4	2.0	2.1	2.1	2.0
Interest Cover Ratio	65.3	2.2	0.5	1.0	0.8	-0.3	1.1	1.8
Net Debt/Equity	-0.2	0.0	-0.4	-0.2	0.1	0.2	0.3	0.2

Consolidated - Cash Flow Statement

(INR m)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) Before Tax	993	695	-97	104	-130	-1,511	385	1,309
Depreciation	268	939	1,030	1,307	1,800	1,937	1,992	2,028
Interest & Finance Charges	16	548	589	772	1,169	1,297	1,326	1,414
Direct Taxes Paid	-332	-241	-35	-118	-182	408	-104	-354
(Inc)/Dec in WC	-270	-1,091	182	-1,985	-857	-739	-1,092	-1,267
CF from Operations	**674**	**850**	**1,669**	**80**	**1,800**	**1,393**	**2,508**	**3,131**
Others	89	13	-176	-192	8	-170	-220	-220
CF from Operating incl EO	**763**	**863**	**1,493**	**-113**	**1,808**	**1,223**	**2,288**	**2,911**
(Inc)/Dec in FA	-407	-546	-406	-1,494	-2,783	-606	-699	-793
Free Cash Flow	**357**	**317**	**1,087**	**-1,606**	**-976**	**617**	**1,589**	**2,118**
(Pur)/Sale of Investments	-339	550	-3,092	2,676	1,192	0	0	0
Others	12	2	-690	54	5	170	220	220
CF from Investments	**-734**	**5**	**-4,188**	**1,237**	**-1,586**	**-436**	**-479**	**-573**
Issue of Shares	19	13	3,713	76	35	0	0	0
Inc/(Dec) in Debt	-3	8	-11	0	1,478	522	400	0
Interest Paid	-16	-933	-589	-772	-1,164	1,070	0	0
Dividend Paid	-44	-31	0	0	-15	0	0	0
Others	0	0	-244	-349	-708	-2,201	-2,299	-2,404
CF from Fin. Activity	**-44**	**-943**	**2,869**	**-1,045**	**-374**	**-609**	**-1,899**	**-2,404**
Inc/Dec of Cash	**-14**	**-75**	**174**	**80**	**-152**	**178**	**-91**	**-65**
Opening Balance (excluding bank bal.)	137	123	48	222	302	150	328	237
Closing Balance	**123**	**48**	**222**	**302**	**150**	**328**	**237**	**172**
Bank balance	43	1	53	49	52	52	52	52
Closing Balance (including bank balance)	**166**	**50**	**275**	**351**	**202**	**380**	**289**	**224**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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