Sharekhan by BNP PARIBAS

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Stock Update

Company Update

Aditya Birla Fashion & Retail Ltd

Demerger – focused on creating value for shareholders

Consumer Discretionary	Sharekhan code: ABFRL

Reco/View: Buy ↑	CMP: Rs. 240	Price Target: Rs. 297 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↑	

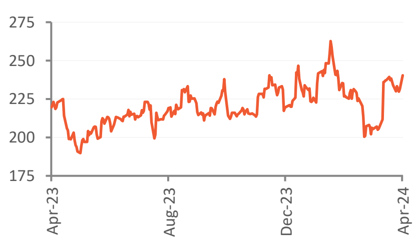
Company details

Market cap:	Rs. 24,396 cr
52-week high/low:	Rs. 266 / 184
NSE volume: (No of shares)	49.1 lakh
BSE code:	535755
NSE code:	ABFRL
Free float: (No of shares)	48.9 cr

Shareholding (%)

Promoters	51.9
FII	19.8
DII	15.1
Others	13.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.0	7.9	12.2	9.5
Relative to Sensex	15.9	3.3	-1.8	-14.0

Sharekhan Research, Bloomberg

Summary

- Aditya Birla Fashion and Retail's (ABFRL's) board approved the vertical demerger of Madhura Fashion (MFL) and Lifestyle business into separate listed entity – Aditya Birla Lifestyle Brands Ltd (ABLBL). Existing shareholders will receive shares of the new entity in the ratio of 1:1.
- ABFRL plans to raise Rs. 2,500 crore within 12 months of the demerger. A large part of the fundraising will be invested in improving growth prospects of ethnic and luxury businesses along with reduction in debt.
- ABLBL is a mature business with strong cash flow generation, which will take care of future growth prospects. Reebok will be key lever for improving growth trajectory ahead.
- Vertical demerger of MFL is a step towards creating independent growth engines with proper capital allocation plan, which will create value for shareholders. Current valuation of 15x/12x its FY2025E/26E EV/EBIDTA is at significant discount to close peers. With risk-reward favorable, we upgrade our rating on the stock to Buy with a revised SOTP-based price target of Rs. 297.

Aditya Birla Fashion and Retail Ltd's (ABFRL's) board has approved the proposal of vertical demerger of the Madura Fashion and Lifestyle business (MFL Business) from ABFRL into a newly incorporated company. The new entity, Aditya Birla Lifestyle Brands Ltd. (ABLBL), will be listed separately once the demerger is completed. Shareholders of ABFRL will get one share of ABLBL for every one share in ABFRL. Post demerger, ABFRL will be focused on high-growth segments (including value retailing & ethnic). The demerger will be completed over the next nine to twelve months. ABFRL plans to raise Rs. 2,500 crore within 12 months of the demerger supported by promoter participation. The funds will be largely utilized to fund the growth prospects of new businesses such as ethnic and luxury which has large scope of growth in the near to medium term. It will also be used to pair off some debt (~Rs. 2,000 crore on ABFRL's book). On the other hand, ABLBL is a mature business with strong cash flows and a good return profile. The strong cash flows generated by the business will be utilised for improving the growth trajectory of the business in the coming years.

- **Event – demerger of MFL into new listed entity:** ABFRL's Board has approved vertical demerger of Madura Fashion and Lifestyle business (MFL Business) from ABFRL into a newly incorporated company named as Aditya Birla Lifestyle Brands Ltd (ABLBL). Upon completion of the demerger, ABLBL will be listed separately and the shareholders of ABFRL will get one share of ABLBL for every one share in ABFRL, in addition to their existing shareholding in ABFRL. ABLBL will house the business consisting of - Lifestyle brands (Louis Phillippe, Van Heusen, Allen Solly & Peter England), casual wear brands (American Eagle and Forever 21), sportswear brand (Reebok) and Innerwear business under the Van Heusen brand, while the remaining businesses in ABFRL will be a portfolio of multiple growth platforms including value retail (Pantaloons & Style Up), ethnic portfolio (designer wear partnerships and recently acquired portfolio of TCNS brands), luxury portfolio (The Collective, Galleries Lafayette and select luxury brands) and digital brands (TMRW).
- **Rationale for demerger:** The proposed demerger is done to accelerate growth and value creation through two listed entities with distinct capital structures, independent growth trajectories and value creation opportunities. It will help bring in sharper focus through differentiated strategies aligned with individual business verticals. Within 12 months of completion of the demerger, ABFRL plans to raise ~Rs. 2,500 crore equity capital to strengthen its balance sheet and fund the growth of the remaining businesses. Large part of the fund raise will be used to improve growth prospects of ethnic and luxury business. The business assets and liabilities will be split between the two companies in accordance with the prescribed regulatory provisions. In-line with this, ~Rs. 1,000 crore debt will be transferred in the books of ABLBL while ~Rs. 2,000 crore debt will remain on the books of ABFRL.
- **Focus is to create value for shareholders:** Vertical demerger of MFL in separate entity (ABLBL) is positive from restructuring perspective with two separate entities striving for growth by implementing strategies under independent roof. The funds raised by ABFRL will be utilized for improving the growth prospects of ethnic and luxury businesses which have a large growth potential in the coming years. Further, funds raised will also be utilized to reduce debt on books and strengthen the balance sheet. On the other hand, ABLBL is a mature business with strong cash flows and a good return profile. The strong cash flows generated by the business will be utilised for improving the growth trajectory of the business in the coming years.

Our Call

View - Upgrade to Buy with a revised price target of Rs. 297: We believe vertical demerger of MFL into separate entity is the right strategy to simplify the company's structure. Separating entities under revamped organizational structure with appropriate capital allocation plan can create value for shareholders in the long run. ABFRL's stock price has underperformed in the last year and is trading at 15x/12x its FY2025E/26E EV/EBIDTA which is at a stark discount to closest peers such as Trent. With focus remaining on enhancing shareholders value through restructuring strategy, the risk-reward remains favorable at current valuations. Hence, we have upgraded our rating on the stock to Buy from Hold earlier with a revised SOTP-based price target of Rs. 297.

Key Risks

Any delayed recovery in the performance of key businesses despite revamped in the strategies will act as key risk to our rating on the stock.

Valuation (Consolidated) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Revenue	12,418	13,968	16,462	19,349
EBITDA Margin (%)	12.0	11.1	12.5	13.7
Adjusted PAT	-53	-469	-408	-202
Adjusted EPS (Rs.)	-0.6	-4.6	-4.0	-2.0
P/B (x)	6.1	5.1	5.6	5.9
EV/EBITDA (x)	19.0	19.8	15.4	11.8
RoCE (%)	4.1	0.5	1.5	3.0

Source: Company; Sharekhan estimates

Event: Board approves demerger of Madura business into a separate listed entity

ABFRL's board has approved the proposal of demerger of Madura Fashion and Lifestyle business (MFL Business) from ABFRL into a newly incorporated company named as Aditya Birla Lifestyle Brands Ltd. (ABLBL).

Rationale for demerger: To accelerate growth and value creation through two listed entities with distinct capital structures, independent growth trajectories and value creation opportunities.

Post demerger structure: ABLBL will house the business consisting of - Lifestyle brands (Louis Phillippe, Van Heusen, Allen Solly & Peter England), casual wear brands (American Eagle and Forever 21), sportswear brand (Reebok) and Innerwear business under Van Heusen brand, while the remaining businesses in ABFRL will be a portfolio of multiple growth platforms including value retail (Pantaloons & Style Up), ethnic portfolio (designer wear partnerships and recently acquired portfolio of TCNS brands), luxury portfolio (The Collective, Galleries Lafayette and select luxury brands) and digital brands (TMRW).

Entitlement ratio: Upon completion of the demerger, ALBL will be listed separately and the shareholders of ABFRL will get one share of ABLBL for every one share in ABFRL, in addition to their existing shareholding in ABFRL.

Split of assets and liabilities: As on March 31, 2024, ABFRL's total borrowing is estimated to be ~Rs. 3,000 crore, out of which debt of ~Rs. 1,000 crore is estimated to be transferred to ABLBL, while the balance (~Rs. 2,000 crore) will continue to stay with ABFRL.

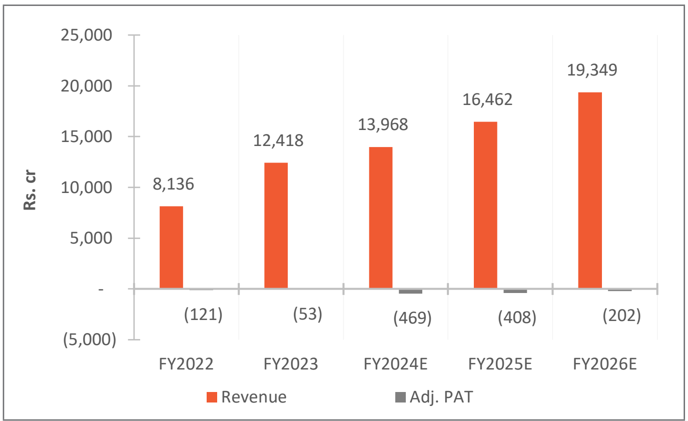
Fund-raising post demerger: ABFRL plans to raise ~Rs. 2,500 crore equity capital with promoter participation within 12 months after the completion of the demerger to strengthen its balance sheet and fund the growth of the remaining businesses.

Key concall highlights

- **Demerger rationale:** ABFRL needed to raise capital, so the company planned to separate the businesses depending on growth trajectory and need for capital. Further, the demerger will result in better and efficient control and management for the segregated businesses, operational rationalization, organization efficiency and optimum utilisation of various resources.
- **ABLBL:** The current run rate of this business is ~Rs. 8,000 crore on annualised basis. It is a mature business with a good return profile and strong cash flow which will take care of future growth prospects. According to the management, Reebok will be the key lever for improving growth trajectory ahead.
- **ABFRL:** Current run rate of this business is ~Rs. 7,000 crore on annualised basis. New businesses under ABFRL are in the investment mode and might take time to scale-up with appropriate capital back-up. The management has guided that going ahead, ABFRL will focus on high-growth segments (including value retailing and ethnic).
- **Timeline:** Demerger may take 9-12 months for implementation, which includes filing and approval of the scheme with the stock exchanges (likely to happen in the next week) and post that filing and approval of the scheme with NCLT. Management indicated that the proceedings of TCNS Clothing acquisition transaction (expected to be concluded in ~4 months) will precede the proceeding of this demerger transaction.
- **Fund raising:** ABFRL plans to raise Rs. 2,500 crore within 12 months of demerger, with a large part of the fundraising to be invested in ethnic and luxury businesses. Nature of fund raising and instrument is not yet decided. Fund raising will lead to further equity dilution for shareholders.
- **Debt:** Out of the existing ~Rs. 3,000 crore debt in the books of ABFRL, ~Rs. 1,000 crore debt will be transferred in the books of ABLBL while ~Rs. 2,000 crore will remain on books of ABFRL. Management stated that, with scale up of the new businesses, debt is expected to be significantly lower in the next 2-3 years.

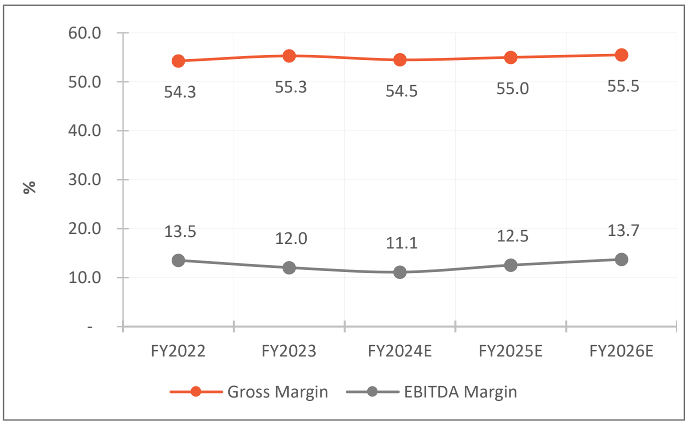
Financials in charts

Steady growth in revenue; loss to reduce in coming years



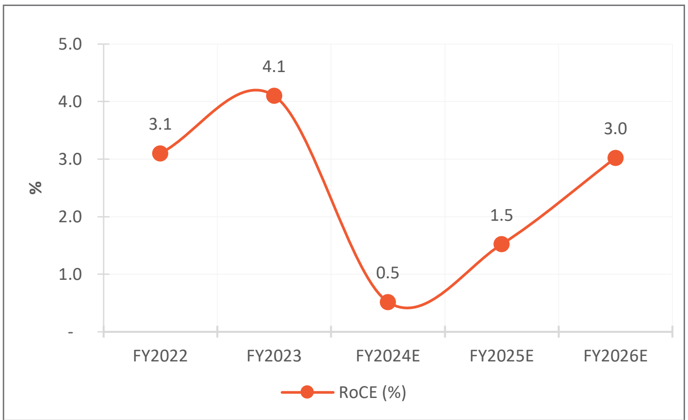
Source: Company, Sharekhan Research

Margins to improve going ahead



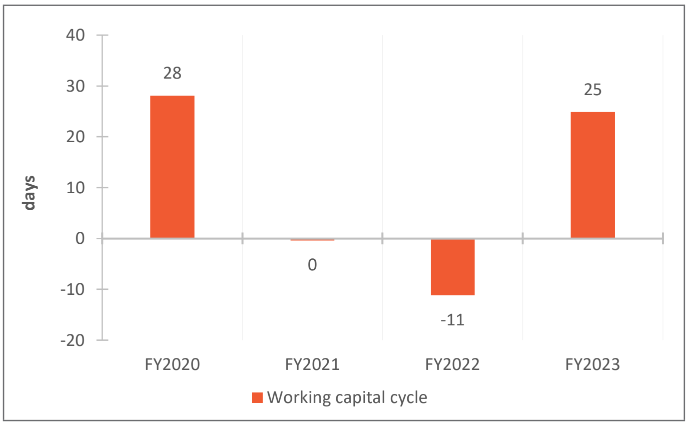
Source: Company, Sharekhan Research

RoCE to rise from current level



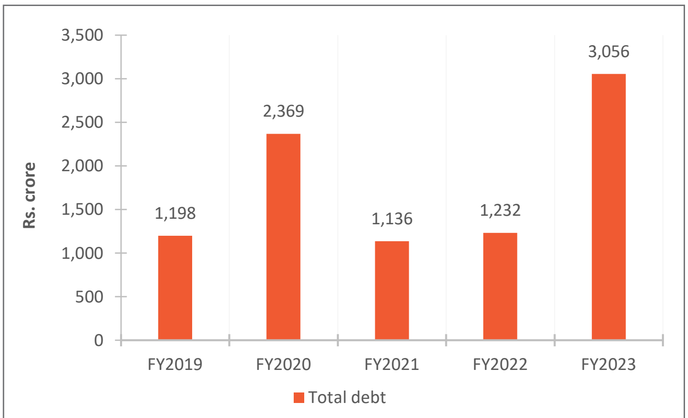
Source: Company, Sharekhan Research

Working capital days in the past few years



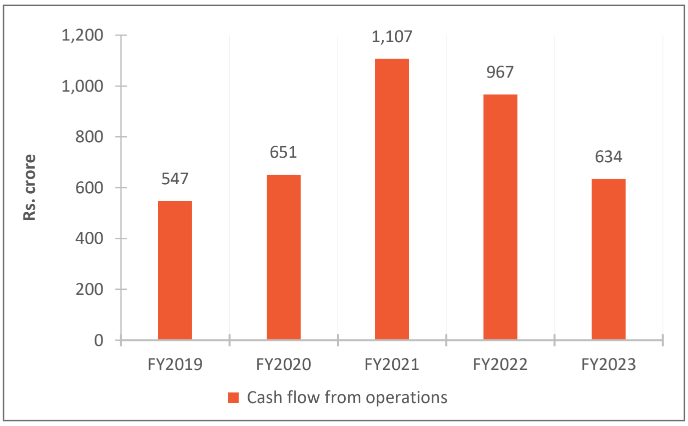
Source: Company, Sharekhan Research

Trend in total debt



Source: Company, Sharekhan Research

Trend in cash flow from operations



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Near term outlook bleak; long-term growth prospects intact

Q4FY2024 was yet another quarter of subdued performance for most retail players due to muted demand. We believe that retail companies will take some time to see revival in SSSGs. In the near term, revenue growth for the branded retail & apparel companies is expected to be largely driven by store expansion, steady demand for premium products and better consumer sentiments in urban markets/metros. In the medium to long term, market share gains, higher traction on the e-Commerce platform, a strong retail space expansion strategy, and sustained expansion of product portfolio will help branded apparel and retail companies to post consistent growth. Better operating leverage, greater efficiencies and an improved mix would help branded apparel & retail companies to post higher margins in the coming years.

Company Outlook – Near team environment weak; demerger to simplify structure

The management expects demand to remain soft in the near term will have operating performance in the near term. Further, net debt is expected to be higher at Rs. 2,800 crore to fund future capex, working capital requirement and acquire controlling stake in TCNS Clothing. The company remains focused on leveraging its strong brand portfolio, evolving the product profile in line with changing consumer preferences, and expanding its reach (especially in smaller towns and cities). The demerger of MFL into separate entity will result in better and efficient control and management for independent businesses, operational rationalization, organisational efficiency and optimum utilization of various resources. This will in improving the growth prospects of both the businesses in long run.

Valuation – Upgrade to Buy with a revised price target of Rs. 297

We believe vertical demerger of MFL into separate entity is the right strategy to simplify the company's structure. Separating entities under revamped organizational structure with appropriate capital allocation plan can create value for shareholders in the long run. ABFRL's stock price has underperformed in the last year and is trading at 15x/12x its FY2025E/26E EV/EBIDTA which is at a stark discount to closest peers such as Trent. With focus remaining on enhancing shareholders value through restructuring strategy, the risk-reward remains favorable at current valuations. Hence, we have upgraded our rating on the stock to Buy from Hold earlier with a revised SOTP-based price target of Rs. 297.

Peer Comparison

Companies	EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Trent	96.8	65.2	48.8	14.5	22.6	27.5
ABFRL	19.0	19.8	15.4	4.1	0.5	1.5

Source: Company; Sharekhan Research

About company

ABFRL is India's largest pure-play fashion and retail entity with a combined retail footprint of 12.2 million square feet, which includes 4,753 stores across ~37,106 multi-brand outlets with 9,781 point of sales in department stores across India. The company has leading brands under its umbrella, such as Louis Philippe, Van Heusen, Allen Solly, Peter England, and Pantaloons. The international brands' portfolio includes – The Collective, Simon Carter, and select brands such as Ralph Lauren, Hackett London, Ted Baker, Fred Perry, Forever 21, American Eagle, Reebok, and Galeries Lafayette. ABFRL's foray into the branded ethnic wear business includes Jaypore, Tasva, and Marigold Lane and strategic partnerships with designers Shantanu & Nikhil, Tarun Tahiliani, House of Masaba, and Sabyasachi. In addition, to cater to the needs of digitally native consumers, ABFRL is also building a portfolio of digital-first brands under its technology-led 'House of D2C Brands' venture, TMRW. In September 2023, ABFRL acquired majority stake in TCNS Clothing Co, thus acquiring brands like - W, Aurelia, Wishful, Elleven & Folksong.

Investment theme

ABFRL is one of the largest players in the branded apparel and retail space. The company has built an agile supply chain model to deliver continuous fresh fashion throughout the year with its 12-season model, which will aid in reducing working capital in the coming years. The company has entered into strategic partnerships with designers such as Shantanu & Nikhil, Tarun Tahiliani, Sabyasachi, and House of Masaba, to tap the ethnic and wedding segments, which has a large unorganised presence. Going ahead, the company's growth would be driven by capex across brands, marketing expenses incurred on brands, IT and digital enhancement, and strengthening the overall digital play through organic and inorganic routes. The company is confident of achieving its target of Rs. 21,000 crore revenue with EBITDA of over Rs. 2,350 crore by FY2027.

Key Risks

- Any slowdown in the discretionary demand environment would impact same store sales growth (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

Kumar Mangalam Birla	Chairman
Ashish Dikshit	Managing Director
Jagdish Bajaj	Chief Financial Officer
Anil Malik	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Caladium Investment PTE Ltd.	7.49
2	Flipkart Inv Pvt Ltd.	7.21
3	Nippon Life India AMC	3.89
4	SBI Life Insurance Co Ltd	2.05
5	Tata AMC	1.75
6	ICICI Prudential Life Insurance Co.	1.57
7	Vanguard Group Inc.	1.47
8	Aditya Birla AMC	1.19
9	UTI AMC	0.67
10	Blackrock Inc.	0.66

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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