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Institutional Equities

V-Mart Retail

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Reuters: VMAR.BO; Bloomberg: VMART IN

Management Meet Update

Sticking To The Basics; Growth Thrust Through Tier-4 Cities

We had a meeting with V-Mart Retail's (VRL) management recently to dig a little deeper into its growth strategy. It elaborated a bit more on some of the points made during the 4QFY18 results call (see our earlier report: Commendable SSG On A High Base). Some key elements include: (1) Trying to grow revenues by ~25% in the medium term with a high single-digit contribution from same-store sales growth (SSG). (2) Expanding in clusters after assessing viability of setting up a store – driving growth in overall store area by 15%-17% CAGR. Increasingly, this looks like expansion into Tier-4 towns rather than in Tier-3 towns as competitive intensity in the latter has increased significantly with expansion of both national and regional players. VRL's expansion would entail setting up ~35-40 stores in FY19 and in FY20. (3) Continuing to focus on ploughing back excess margins to customers by keeping the prices low so as to keep retain loyalty. VRL stated that it aims to keep gross margin at ~32% and EBITDA margin at 10.0%-10.5%. The management repeatedly emphasised on volume-led growth as it tries to cater to value-oriented customers in middle-India. (4) Goods and Services Tax or GST negative impact is wearing off. While immediately after GST introduction there was a bit of consumer sentiment setback as many of its customers in Tier-2 to Tier-4 cities are self employed, normalcy has returned. VRL was of the view that consumer sentiment is normal and not exuberant currently. After the meeting we have kept our estimates intact with revenue/EBITDA/PAT CAGR of 19%/18%/20%, respectively, over FY18-FY21E. We believe there could be some upside to our revenue projections, but prefer to wait for a quarter or two to see the execution. We continue to value VRL at 36xFY20E EPS and maintain our Accumulate rating on it. We believe the market opportunity for value retailing is immense in India and VRL has been executing well on its strategy to be the leader in geographies that it competes in with a great deal of success. While the near-term upside is limited, we believe it still remains a key long-term bet to play on consumption in the hinterland of India.

Market potential in Tier-4 towns: The foray into Tier-4 towns (where the competitive intensity is likely lower) has helped VRL to deliver better growth and margins, in our view, in FY18. The management indicated that both national and regional competitors seem to have plans to enter Tier-4 markets as they follow the success tasted by VRL. We believe this will happen with a lag of about 6-12 months. But the market in Tier-4 towns is fairly large. The management stated that there are nearly 5,000 towns where VRL's current business model can be replicated (currently it is present in 140 towns) and also stated that ~95% of the market share still belongs to the unorganised segment. It stated that the untapped potential within the states in which VRL has a presence (14 states) as well as in the states where the company is yet to set its footprint in is large, thereby providing huge headroom for growth. The management sounded optimistic on growth coming in from expansion which will most likely be led by store growth in the North East among other regions.

Access to information, aspiration and demand fulfillment in not too far-away towns or cities is driving growth for VRL: The company believes that demand for its value fashion is driven by aspirational youth in smaller towns of India as they are exposed to fashion through both television and mobile internet. The rising availability of such products in organised retail stores at not too far a distance from where they live is the other growth driver.

Customer analytics drives product trend: With VRL entering multiple Tier-4 and Tier-3 cities, being able to understand customer requirements and deliver on them is very critical. VRL depends on both store-level employee feedback as well as other customer analytics to be on top of customer trends in specific cities.

Private label apparel will grow, but there will be no focus on gaining higher profitability through it - at least for the next two years: Although private label apparel accounts for ~50% of VRL's apparel sales, the company is very clear that it does not want to push for higher margins on these products versus the normal clothing that it sells. VRL believes that its customers are not coming to its stores to buy brands, but to buy products. While it has created about 15-17 in-house brands (of which 4-5 are fairly prominent), it has not priced them higher to gain higher margin. The management believes that an attempt on this front can be made if it is able to provide a differentiated product or customer experience. It has been investing in a design team and also trying to enhance the quality of its private label products.

ACCUMULATE

Sector: Retail

CMP: Rs2,398

Target Price: Rs2,318

Downside: 3%

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Key Data

Current Shares O/S (mn)	18.1
Mkt Cap (Rsbn/US$mn)	43.4/638.4
52 Wk H / L (Rs)	2,516/1,015
Daily Vol. (3M NSE Avg.)	155,554

Price Performance (%)

	1 M	6 M	1 Yr
V-Mart Retail	3.8	77.5	112.0
Nifty Index	0.1	4.7	12.9

Source: Bloomberg

Private label products: As of now there is no difference in margins between private label and other labels. The management has consciously decided to keep it that way as it believes that there is no unique value proposition that VRL can provide for its private label clothing. VRL, being a honest price shop, does not want to charge a premium only because it keeps private label apparel. The management stated that it will take at least two years for VRL to be able to demand a differential pricing for its private label products. The management stated that VRL has already created 17 brands which it has been using since the past five years. Out of these 17 brands, there have been 4-5 brands which it has been using extensively namely Desi Mix, J White, Charcoal, etc. VRL has started showcasing such brands separately in its shops. The new stores have started having such brand stations whereas the older stores will have such brand stations as and when renovation happens at such stores.

Consumer sentiment in Tier-2, Tier-3 and Tier-4 cities: VRL's management stated that post GST the consumer sentiment could be broken down into three phases. Immediately after GST introduction, the consumers did not know what had just happened (state of shock), then came in the stabilisation phase and now it is all normal. It stated that there are still a lot of loopholes that the unorganised segment is exploiting. The management stated that youth in Tier-3 and Tier-4 cities have a sense of fashion and aspire for better clothing irrespective of their financial background. This has led to a rise in spending and comparatively lower savings. Better information and availability (more retail stores opening in nearby towns) is driving growth.

Penetration: The management stated that there is stiff competition. It has been experimenting with Tier-4 cities and if the model works well then it will aggressively penetrate these towns. The way the clustered approach works is that after it sets up a shop in a particular district, it plots 150km radius and then examines other opportunities. It stated that although competition could be a problem, the number of Tier-4 cities is very high which could prove to be a growth booster.

Example of Tier-2, Tier-3, Tier-4 cities in Uttar Pradesh or UP: Within UP, Kanpur is a Tier-2 city, Banda is Tier-3 city and Lal Ganj/Shukla Ganj is a Tier-4 city. The economics is not very different between Tier-3 and Tier-4 city stores. This is because the minimum wage and price of electricity per unit remain the same. However, rentals are marginally lower.

Loyalty programme: The management stated that it is close to around 11mn customers registered under this programme (started a year back) and 45%-48% of sales is repeat sales to these customers. The management stated that it is yet to start with the analytics part, but it has undertaken small programmes to understand the consumer pattern which will further help it to boost sales. The management stated that on the customer loyalty programme it had a higher average bill size per customer. The management believes the bill size will stabilise at the current level.

Others: (1) 70% of VRL's customers are dependent on agriculture. Hence, the demand environment is monsoon-dependent. (2) The management stated that, as a trend, there is always a jump in sales post elections because of availability of more cash in its concentration states.

New geographies: The management stated that Odisha is improving and West Bengal has become better. There are only six stores in West Bengal as of now and the management plans to accelerate store penetration there. As to the reason why there are only a few stores in Madhya Pradesh and Rajasthan, the management's view was that there it needs a certain density of population to drive cluster-based expansion. According to the management, these two states do not fit the bill adequately for that approach.

Financials

Exhibit 1 : Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	**10,017**	**12,224**	**14,962**	**17,830**	**20,703**
Growth (%)	*23.8*	*22.0*	*22.4*	*19.2*	*16.1*
Cost of Materials	2	-	-	-	-
Purchases of stock-in-trade	7,673	8,682	10,645	12,642	14,610
Change in inventories	(647)	(379)	(479)	(579)	(679)
Raw Materials	7,028	8,303	10,165	12,063	13,931
Gross Profit	**2,990**	**3,921**	**4,797**	**5,767**	**6,773**
Gross Margin (%)	***29.8***	***32.1***	***32.1***	***32.3***	***32.7***
Employee expenses	777	984	1,182	1,476	1,842
Other expenses	1,387	1,609	1,985	2,348	2,726
Prior period items	-	-	-	-	-
Total expenditure	9,191	10,896	13,333	15,886	18,499
EBITDA	**826**	**1,328**	**1,629**	**1,944**	**2,204**
Growth (%)	*33.6*	*60.8*	*22.7*	*19.3*	*13.4*
EBITDA Margin (%)	***8.2***	***10.9***	***10.9***	***10.9***	***10.6***
Other income	31	41	51	61	104
Interest costs	35	18	84	18	10
Depreciation	220	229	243	277	311
Exceptional Items	-	-	-	-	-
PBT	**601**	**1,122**	**1,354**	**1,710**	**1,986**
Tax	206	348	434	524	607
Effective tax rate (%)	*34.3*	*30.9*	*31.0*	*31.0*	*31.0*
PAT	**395**	**775**	**920**	**1,186**	**1,379**
Growth (%)	*43.0*	*96.6*	*24.2*	*20.7*	*15.9*
PAT Margin (%)	***3.9***	***6.4***	***6.5***	***6.5***	***6.5***
EPS (Rs)	**21.8**	**42.9**	**53.3**	**64.4**	**74.6**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity	181	181	181	181	181
Reserves	2,523	3,293	4,266	5,431	6,782
Net worth	2,703	3,474	4,447	5,612	6,963
Short-term Borrowings	349	1,668	350	350	350
Long-term Borrowings	6	3	3	3	3
Total Debt	355	1,671	353	353	353
Deferred tax liabilities	(70)	-	(84)	(101)	(117)
Other non-current liabilities	148	81	234	276	320
Total Liabilities	**3,135**	**5,226**	**4,950**	**6,140**	**7,519**
Gross Block	2,096	2,463	2,863	3,263	3,663
Accumulated depreciation	821	1,051	1,294	1,571	1,883
Net Block	1,275	1,412	1,569	1,692	1,780
Capital WIP	12	35	35	35	35
Long-term investments	58	63	63	63	63
Other non-current assets	201	302	481	527	655
Current Investments	619	277	430	180	1,650
Inventories	2,692	3,071	3,788	4,462	5,153
Cash & Bank	29	196	559	559	559
Other current assets	34	142	193	193	193
Total Current Assets	3,374	3,686	4,969	5,393	7,555
Creditors	1,599	153	1,950	1,322	2,290
Other current liabilities/provisions	186	120	218	248	280
Total current liabilities	1,785	273	2,167	1,570	2,570
Net current assets	1,589	3,414	2,802	3,824	4,985
Total Assets	**3,135**	**5,226**	**4,950**	**6,140**	**7,519**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
PBT	601	1,125	1,399	1,689	1,958
(Inc.)/Dec in working capital	(90)	(1,999)	1,127	(1,272)	309
Cash flow from operations	511	(875)	2,526	417	2,267
Other income	(30)	(41)	(51)	(61)	(104)
Other expenses	228	15	38	38	38
Depreciation	220	229	243	277	311
Tax paid	(243)	(348)	(434)	(524)	(607)
Net cash from operations	**687**	**(1,019)**	**2,323**	**149**	**1,907**
Capital expenditure	(416)	(389)	(400)	(400)	(400)
Net cash after capex	**272**	**(1,409)**	**1,923**	**(251)**	**1,507**
Other investing activites	(312)	213	(225)	322	(1,431)
Cash from financial activities	**49**	**1,305**	**(1,287)**	**(14)**	**(11)**
Opening cash	20	29	137	500	500
Closing cash	29	137	500	500	500
Change in cash	8	109	411	57	65

Source: Company, Nirmal Bang Institutional Equities Research

Note: Closing Cash represents Cash & Cash Equivalents

Exhibit 4: Key ratios

Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Per share (Rs)					
EPS	21.8	42.9	53.3	64.4	74.6
Book value	149	192	246	310	385
Valuation (x)					
P/E	109.8	55.8	45.0	37.2	32.1
P/sales	4.3	3.6	2.9	2.4	2.1
P/BV	16.1	12.5	9.8	7.7	6.2
EV/EBITDA	52.9	33.8	26.5	22.2	19.6
EV/sales	4.4	3.7	2.9	2.4	2.1
Return ratios (%)					
RoE	15.8	25.2	24.4	23.2	21.5
RoCE	21.5	26.8	27.9	31.0	28.5
Pre- Tax RoIC	15.4	23.5	24.6	25.2	25.3
Margins (%)					
Gross margin	29.8	32.1	32.1	32.3	32.7
EBITDA margin	8.2	10.9	10.9	10.9	10.6
EBIT margin	6.0	9.0	9.3	9.3	9.1
PBT margin	6.0	9.2	9.4	9.5	9.5
PAT margin	3.9	6.4	6.5	6.5	6.5
Turnover ratio					
Asset turnover ratio (x)	2.0	2.2	2.1	2.3	2.1
Avg inventory days	123	127	123	125	126
Avg payable days	82	45	46	59	55
Cash Conversion Cycle	41	81	77	66	71
Solvency ratios (x)					
Debt-equity	0.1	0.5	0.1	0.1	0.1
Growth (%)					
Sales	23.8	22.0	22.4	19.2	16.1
EBITDA	33.6	60.8	22.7	19.3	13.4
PAT	43.0	96.6	24.2	20.7	15.9

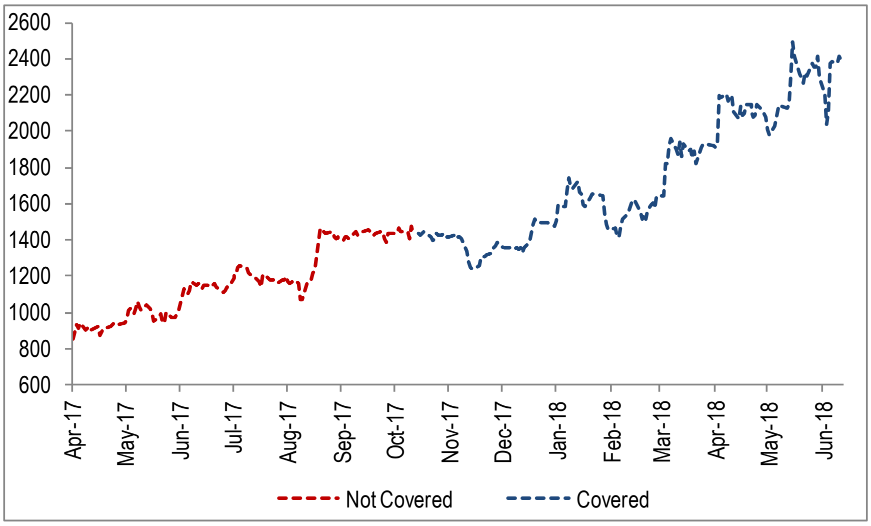
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
16 October 2017	Buy	1,435	1,797
13 November 2017	Buy	1,399	1,797
15 February 2018*	Buy	1,600	2,039
28 May 2018	Accumulate	2,314	2,318
18 June 2018	Accumulate	2,398	2,318

**Transfer of coverage to Girish Pai with effect from 15 February 2018*

Rating track graph



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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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