V-Mart Retail

26 July 2018

1QFY19 Result Update

Reuters: VMAR.BO; Bloomberg: VMART IN

Softer SSG Due To Geo Mix And Curtailed Marriage Season

V-Mart Retail or VRL's 1QFY19 results were below expectations as 1% same-store sales growth (SSG) was below our expectation of high single-digit growth. The management stated that because of the religious calendar, almost one month during the quarter was considered inauspicious for marriages and that impacted sales adversely. VRL is taking time to understand customer needs in Tier-4 towns and that has also contributed to slower SSG. 1% SSG in value terms and 4% in volume terms, however, came on a very high base of 23% in value terms and 27% in volume terms in 1QFY18. Revenue growth of ~15% (YoY) was driven by a 19% increase in retail area and a 4% decline in revenue per sq ft. The management attributed the decline in sales/sqft to new stores, many of which have come up in Tier-4 cities. Gross margin improved by 210bps to 33.6% in 1QFY19 on the back of lower promotional spending and upfront discounts from vendors for better payment terms. VRL maintained its guidance of increasing SSG by high single digits and store area by 15%-17%. It is also sticking to gross margin of ~32% and EBITDA margin of 10.0%-10.5% and passing on the incremental gains to end-consumers. There is typically a great deal of seasonality in the business with 3QFY19 being the most important quarter because of the festive season. It was indicated by VRL that many more festivals are bunched up in 3QFY19 than has normally been the case before. Thus the consumer sentiment in that quarter is highly critical to deliver the full-year growth number. The management repeatedly emphasised volume-led growth as it tries to address value-oriented customers in middle-India. Post 1QFY19, while there has been some disappointment in its performance, we maintain our full-year estimate driven by better-than-expected execution by the company, especially in respect of store opening, margins, initiatives that it has taken to drive better customer experience, product design and better inventory as well as warehousing management. However, a lot depends on what happens to the monsoon in Uttar Pradesh or UP and Bihar and the implementation of minimum support price or MSP for food grains. If the two deliver, we believe there is little downside risk to our FY19 numbers. However, this is something that needs to be closely watched. Also, the competitive intensity in the value retail space in Tier-2 and Tier-3 towns has been increasing in recent times because of national and regional players. This is another factor that needs to be watched closely. We expect VRL to post sales/EBITDA/PAT CAGR of 19%/18%/20%, respectively, over FY18-FY21E. We continue to value the stock at 36xFY20E EPS with a target price of Rs2,318 and an Accumulate rating. We believe the market opportunity for value retailing is immense in India and VRL has been executing on its strategy to be a leader in geographic markets 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 scenario: The management stated that the market scenario remained quite stable in 1QFY19, except for the fact that it witnessed lower demand in Odisha, Jharkhand and Bihar. The demand in UP was flat. The management attributed the slackness in demand because of 'Adhikmass' which reduced the number of auspicious days during the quarter..The management stated that demand in FY19 will be driven by: (1) Adequacy of rainfall. (2) Minimum support price for food grains. (3) Elections, which will lead to distribution of money and other benefits, among the target audience.

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ACCUMULATE

Sector: Retail

CMP: Rs2,351

Target Price: Rs2,318

Downside: 1%

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Key Data

Current Shares O/S (mn)	18.1
Mkt Cap (Rsbn/US$mn)	42.7/620.5
52 Wk H / L (Rs)	3,294/1,015
Daily Vol. (3M NSE Avg.)	59,002

Price Performance (%)

	1 M	6 M	1 Yr
V-Mart Retail	(9.6)	42.6	99.6
Nifty Index	3.4	0.6	11.7

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	4QFY18	1QFY19	YoY (%)	QoQ (%)	1QFY19E	Dev (%)
Net sales	3,151	2,974	3,612	**14.6**	**21.5**	3,892	**(7.2)**
Net raw material & purchases	3,993	4,432	4,480	**12.2**	**1.1**	4,729	**(5.3)**
% of sales	*126.7*	*149.1*	*124.0*	-	-	*121.5*	-
Gross Profit	**994**	**891**	**1,215**	**22.2**	**36.3**	**1,245**	**(2.5)**
Gross Margin (%)	*31.5*	*30.0*	*33.6*	-	-	*32.0*	-
Employee expenses	231	251	283	**22.6**	**12.8**	**311**	**(9.2)**
% of sales	*7.3*	*8.4*	*7.8*	-	-	*8.0*	-
Other expenses	392	410	500	**27.5**	**22.0**	**467**	**7.0**
% of sales	*12.4*	*13.8*	*13.8*	-	-	*12.0*	-
Total expenditure	2,780	2,743	3,180	**14.4**	**15.9**	**3,425**	**(7.2)**
EBITDA	**371**	**231**	**432**	**16.5**	**87.2**	**467**	**(7.5)**
EBITDA (%)	*11.8*	*7.8*	*12.0*	-	-	*12.0*	-
Depreciation	54	67	65	**21.7**	**(2.1)**	**62**	**5.2**
EBIT	**317**	**164**	**367**	**15.6**	**123.7**	**405**	**(9.4)**
EBIT Margin (%)	*10.1*	*5.5*	*10.2*	-	-	*10.4*	-
Other income	11	12	9	**(19.4)**	**(27.4)**	**12**	**(25.6)**
Interest expense	5	2	2	**(60.0)**	**28.2**	**21**	**(90.6)**
PBT	**323**	**175**	**374**	**15.5**	**113.9**	**396**	**(5.6)**
Total tax expense	100	16	125	**25.2**	**705.4**	**113**	**10.7**
Effective tax rate (%)	*30.9*	*8.9*	*33.5*	-	-	*28.5*	--
PAT	**224**	**159**	**249**	**11.2**	**56.2**	**283**	**(12.1)**
PAT Margin (%)	*7.1*	*5.4*	*6.9*	-	-	*7.3*	

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Revenues	10,017	12,224	14,962	17,830	20,703
YoY (%)	*23.8*	*22.0*	*22.4*	*19.2*	*16.1*
EBITDA	826	1,328	1,629	1,944	2,204
EBITDA (%)	*8.2*	*10.9*	*10.9*	*10.9*	*10.6*
Reported PAT	395	775	999	1,186	1,379
EPS (Rs)	21.8	42.9	53.3	64.4	74.6
YoY (%)	*43.0*	*96.6*	*24.2*	*20.7*	*15.9*
RoE (%)	*15.8*	*25.2*	*24.4*	*23.2*	*21.5*
RoCE (%)	*21.5*	*33.1*	*33.1*	*31.0*	*28.5*
RoIC (%)	*15.4*	*23.5*	*24.6*	*25.2*	*25.3*
P/E (x)	107.6	54.8	44.1	36.5	31.5
EV/Sales (x)	4.3	3.5	2.8	2.4	2.0
EV/EBITDA (x)	51.9	32.0	26.0	21.8	19.2

Source: Company, Nirmal Bang Institutional Equities Research

Conference-call highlights

Key parameter analysis: VRL's revenues in 1QFY19 grew ~14.6% on YoY basis. The growth was led by both new store addition (179 vs. 149 in 1QFY18) as well as SSG, 1% in value terms and 4% in volume terms, which came on a very high base of SSG of 23% in value terms and 27% in volume terms in 1QFY18. Sales/sqft/month declined ~4.3% on YoY basis and stood at Rs874. The management attributed the decline in sales/sqft to new store addition which generally takes time to mature. Footfalls increased 11.3% on YoY basis and the conversion rate increased by ~30bps on YoY basis. Gross margin improved by 210bps from 31.5% in 1QFY18 to 33.6% in 1QFY19, despite a reduction in ASP by ~0.5% overall and ~1.9% in apparel on YoY basis. EBITDA margin improved ~20bps on YoY basis from 11.8% in 1QFY18 to 12.0% in 1QFY19. PAT margin declined 20bps on YoY basis from 7.1% in 1QFY18 to 6.9% in 1QFY19.

Exhibit 2: Key parameters

Y/E March (Rsmn)	1QFY18	4QFY18	1QFY19	*YoY %*	*QoQ %*	FY17	FY18	*YoY %*
No of stores	149	157	179	*20.1*	*14.0*	141	171	*21.3*
Retail space (mn sqft)	1.3	1.4	1.5	*18.8*	*7.3*	1.19	1.44	*21.0*
SSG (%) (fashion) - Value	*23.1*	*7.0*	*1.2*	-	-	*13.3*	*9.0*	-
SSG (%) (fashion) - Volume	*27.4*	*11.0*	*3.5*	-	-	*10.7*	*13.0*	-
Sales per sqft (Rs/month)	913	748	874	*(4.3)*	*16.8*	799	823	*3.0*
Average selling price (total)	188	206	187	*(0.5)*	*(9.2)*	208	207	*(0.5)*
Transaction size	699	745	718	*2.7*	*(3.6)*	713	750	*5.2*
Footfall (mn)	8.0	7.4	8.9	*11.3*	*20.3*	24.8	30.3	*22.2*
Conversion rate (%)	*59.7*	*57.5*	*60.0*	-	-	*59.6*	*57.0*	-
Shrinkage (%)	*1.2*	*2.6*	*1.3*	-	-	*1.4*	*1.3*	-

Source: Company, Nirmal Bang Institutional Equities Research

Improved margins: Gross margin of VRL improved 210bps from 31.5% in 1QFY18 to 33.6% in 1QFY19, despite the reduction in ASP by ~0.5% on YoY basis. Also, EBITDA margin improved ~20bps on YoY basis from 11.8% in 1QFY18 to 12.0% in 1QFY19. We believe the improvement in margin is on account of: (1) Higher full price sell-through on account of no-sale period and reduced incentive as well as promotion schemes. (2) Reduction in procurement cost on account of the rise in cash purchases. (3) Reduction in logistics and inventory costs. The management stated that it is further trying to reduce the cost of manufacturing and also procurement. In 4QFY18 conference call, the management had stated that it aims to keep gross margin at ~32% and EBITDA margin at ~10.0% to 10.5% and any improvement in margins from these levels will be passed on to end-consumers. The management repeatedly emphasised on volume-led growth rather than value-led growth.

Competition: The management, in its earlier interactions, had stated that VRL is witnessing a rise in competition in the value retail segment as competitors have started to understand the size of the opportunity in this space. It stated that there is generally an initial drop in footfalls in the first one to three months of competitors setting up stores, but it is observed that the customers generally come back within a period of three to six months. The heightened competition has resulted in some pressure on pricing and margins which the company has set off by running operations tightly. There is also apparently some extra pressure on real estate costs due to the presence of enhanced demand for space.The value retail play is all about how one caters to customers' needs. VRL has been operating in this space for the past 15 years and has a deep understanding of customers' purchasing pattern and preferences. VRL remains a strong player, despite rising competition. The ASP of larger competitors is still 30%-35% higher than that of VRL's. This may take away a few top customers of VRL on account of competitors' better visibility at the national level, but it did not have a big impact till now. VRL tackles competition at the store level by aligning its merchandise, advertisement and promotion with that of competing stores. 30% of cities in which VRL operates have the presence of other organised segment retailers.

Strategy & focus: (1) The management stated that it will continue its focus on increasing volume at the cost of marginally reduced ASP. The idea is to procure resources at a lower cost and pass on the benefit to the customers, thereby reducing the ASP while maintaining margins and attracting higher average bill size. As regards the two business segments VRL operates in, the management stated that its primary focus is to increase the share of apparel business and gradually discontinue the 'kirana' business. (2) VRL has also recently tied up with a consulting organisation to improve its operational efficiency.

Shift from unorganised to organised segment is yet to happen in a material way: One of the expectations post implementation of Goods and Services Tax or GST was that of formalisation of the retailing sector, especially in Tier-2 and Tier-3 towns. It was indicated that the unorganised segment players continue to operate outside the ambit of GST and also continue to have a reasonable market share (~95%). VRL states that this could change as efforts to prevent GST evasion like implementation of the e-way bill have been introduced. It stated that e-way bill and GST will improve overall market dynamics from the stand point of customers as well as producers in monetary terms as well as non-monetary terms like seamless flow of products, better documentation, time savings because of better logistics etc .However, the magnitude of change depends on the intensity with which the government implements the above reforms which, in the opinion of the management, will be muted as FY19 is an election year.

Store-level economics: The management stated that capital expenditure per store per sqft amounts to ~Rs1,400. The average store size is ~8,000sqft, taking the total capital expenditure per store to Rs~12mn. The amount blocked in inventory at the store-level comes to Rs10mn, taking the total investment per store to Rs22mn.It stated that the payback period of investment per store was ~2-2.5 years. ROCE at peak throughput is in the range of 25%-30%. EBITDA margin for the first year is in the range of 12%-15%.As regards cost inflation, the rent expenses are expected to move up in the range of 3%-4% p.a and manpower expenses in the range of 10%-20% p.a. Overall, the total expenses are likely to move up by 7%-10% on YoY basis.

Average Selling Price or ASP declines: The ASP on a total basis stood at Rs187 in 1QFY19 vis-a-vis Rs188 in 1QFY18 (a decline of Rs1). The same for apparel stood at Rs264 in 1QFY19 against Rs269 in 1QFY18 (a decline of Rs5). The management attributed this decline to introduction of new products across lower price points to suit the demand of Tier-4 towns. However, the management also stated that such low price products were margin-lucrative. As regards Tier-4 towns, the management stated that it did not witness any SSG and attributed the same to consumer psychology in such towns. The management stated that the customers take time to get confidence in a particular retailer and once that confidence is achieved, loyalty starts to kick in.

Private labels: The management stated that private labels are introduced to create brand loyalty and not to drive up margins. The products are uniquely designed and are available only in VRL outlets. If the customers have a good experience in using the product, they come back demanding the same label which in turn creates brand loyalty. The management stated that it strives to increase private label contribution in the sales mix, which is currently at 52%.

Refurbishment of stores: The management stated that it refurbishes its stores once in four to five years. However, the refurbishment decision also depends on competitive intensity. It stated that sales tend to make a come-back after refurbishment of the stores. The management stated that the refurbishment cost per sq.ft amounts to Rs500.

Discounting: The management stated that it reduced discounts because of the brand-building exercise which it undertook in 1QFY19. There was no sale period and incentive schemes & promotions were avoided to a great extent.

Same-store sales growth or SSG: The SSG for YTD19 stood at 1.2%. The management stated that stores with a maturity of more than three years performed better and had a higher SSG (3%-4%) as against stores with a maturity less than three years which had negative SSG. Stores with a maturity of less than three years were mostly located in Tier-4 towns. Mature stores, though more profitable, face a higher level of competition.

Others main points:

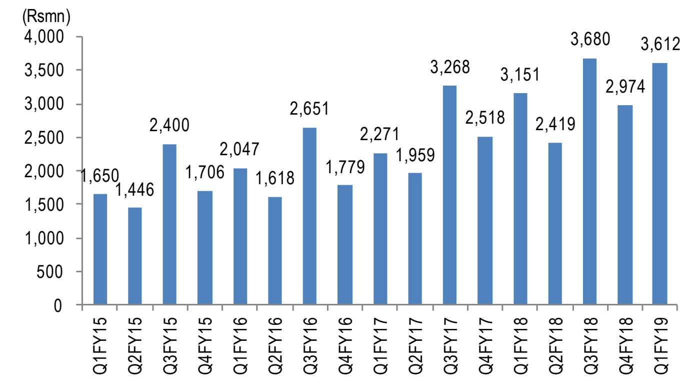
- On the e-commerce front, the management stated that it saw it as an opportunity more than a threat and it will come out with concrete plans pertaining to activation of its e-commerce site in a couple of quarters.
- The management stated that GST rate cut for footwear products which was announced on 21 July 2018 was positive for its business as it will make footwear available to its consumers at a reduced price.
- The management stated that cash accounted for 75% of customer payments and the rest 25% came from plastic money. Within plastic money, 80% was debit card payment and the balance 20% came in through credit cards. The management also stated that electronic wallets are gaining share when cash-back incentives are offered. Before demonetisation the cash component was as high as 90% which had reduced to 50% immediately post the event. It appears that cash has come made a comeback to some extent.
- Shrinkage stood at 1.3%in 1QFY19 which includes provision made for inventory write-off.
- The management stated that it had witnessed SSG of 8%-9% p.a. over the past five years, which was also the internal target for FY19.
- The management stated that it was working on expanding in the north-east markets and will announce store openings in this region in 2QFY19.
- The management stated that its new stores enjoyed lower margin whereas its old stores enjoyed higher operating margin.
- For FY19, the tax rate is expected to be in the range of 32%-33%.

Our recent notes on VRL are given in the links below

V-Mart Retail- Management Meet Update- Sticking To The Basics- Growth Thrust Through Tier-4 Cities

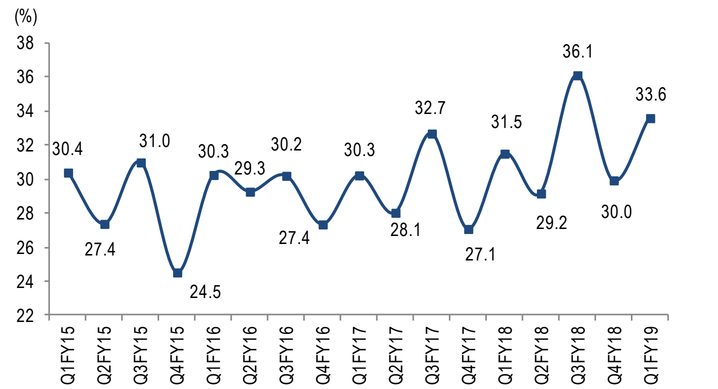
V-Mart Retail- Commendable SSG On A High Base

Exhibit 3: Quarterly revenues



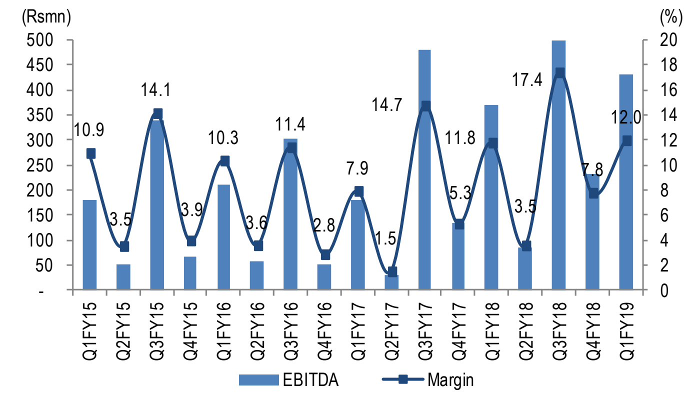
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Quarterly gross margin



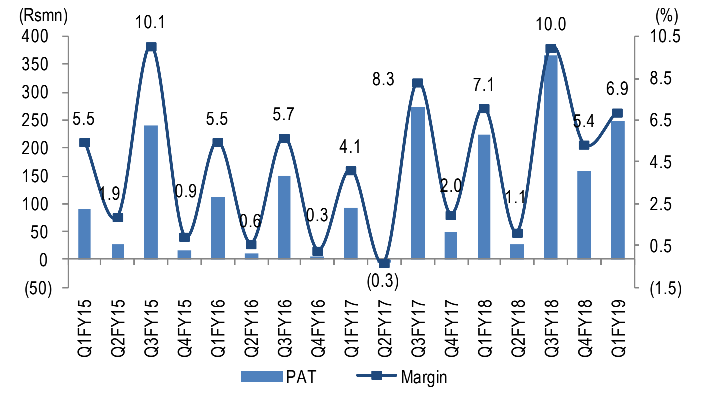
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Quarterly EBITDA & margin



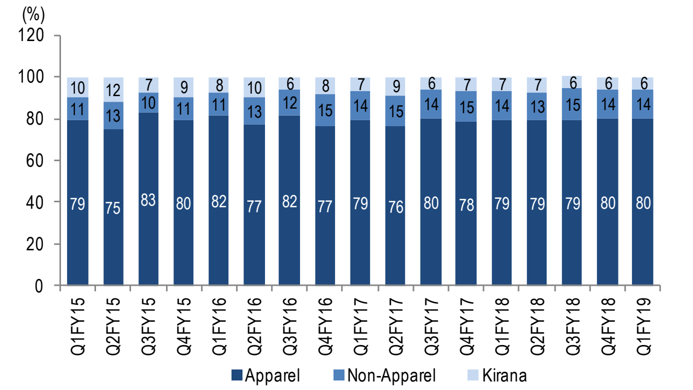
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Quarterly PAT & margin



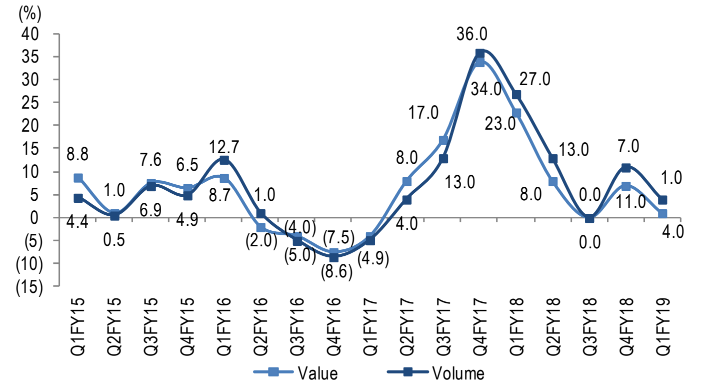
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Share of business segments



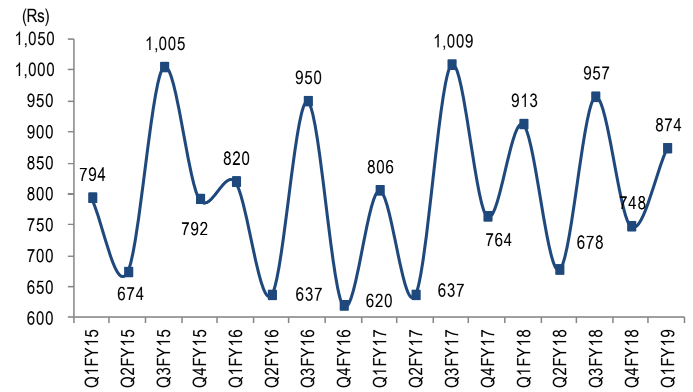
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: SSG trend (fashion)



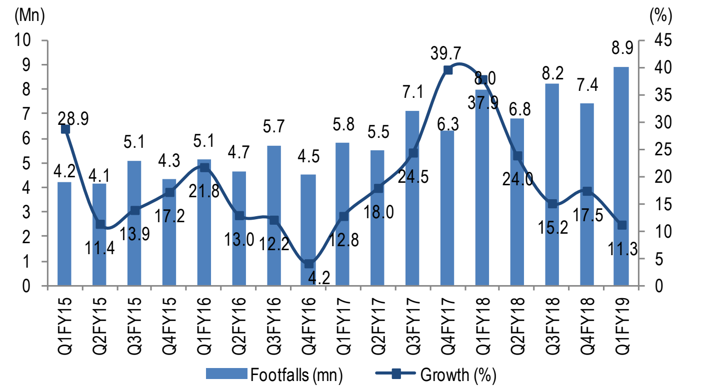
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Sales/sq.ft/month



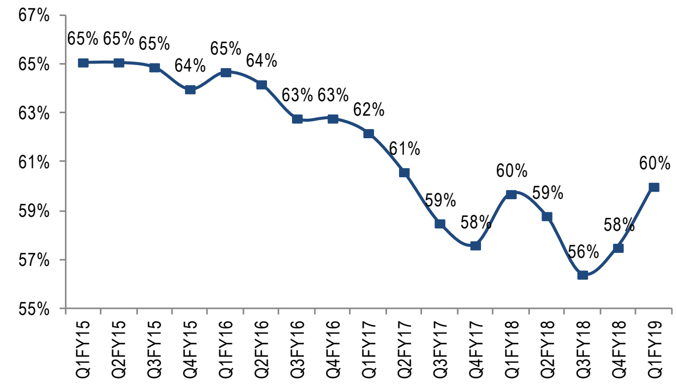
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Footfall trend



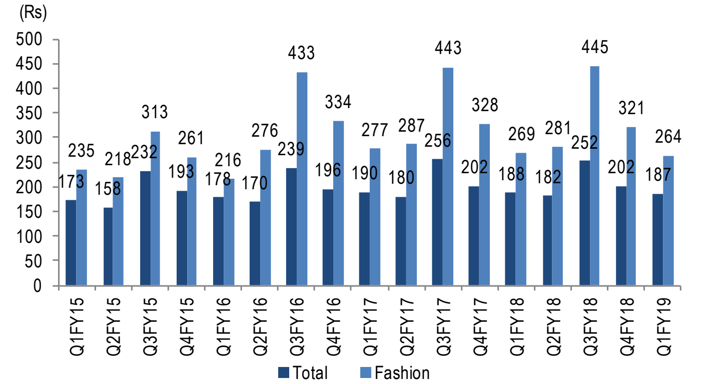
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Conversion rate



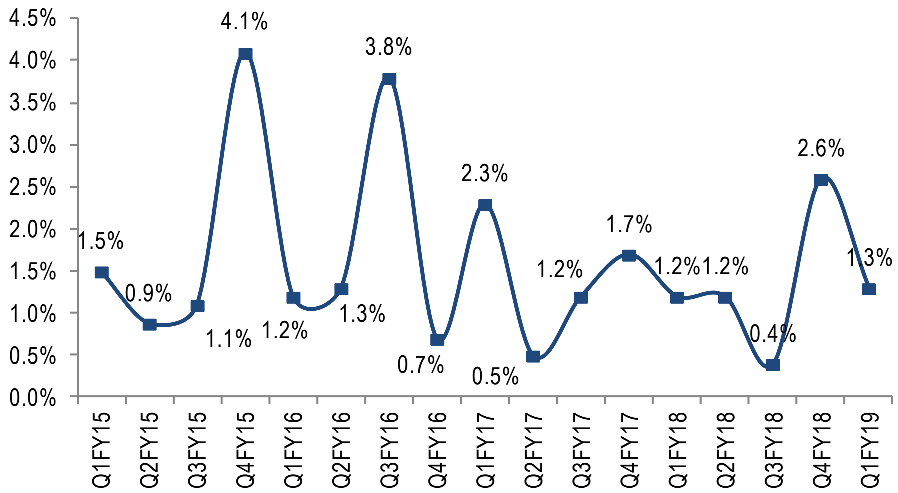
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: ASP trend



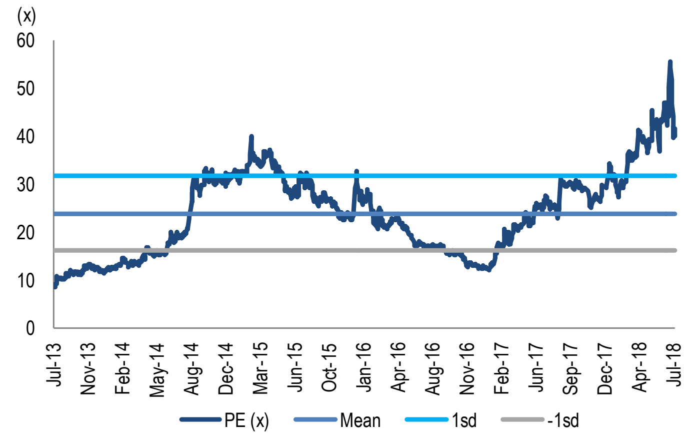
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Shrinkage level



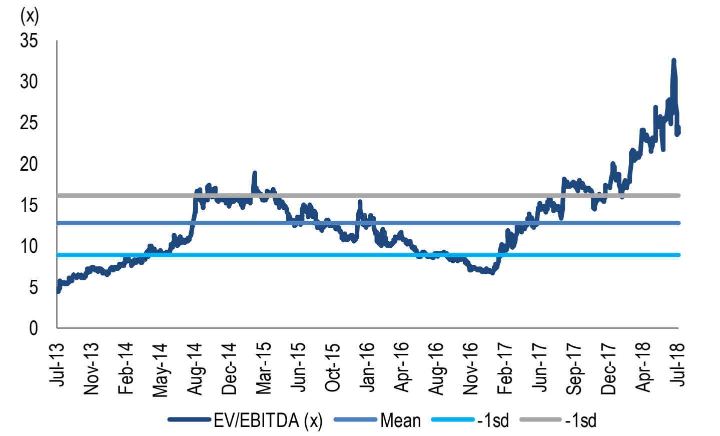
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: P/E one-year forward trend



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 15: EV/EBITDA one-year forward trend



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Financials

Exhibit 16: 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	5	18	10
Depreciation	220	229	243	277	311
Exceptional Items	-	-	-	-	-
PBT	**601**	**1,122**	**1,433**	**1,710**	**1,986**
Tax	206	348	434	524	607
Effective tax rate (%)	*34.3*	*3,090.9*	*31.0*	*31.0*	*31.0*
PAT	**395**	**775**	**999**	**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 18: 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	93	350	350	350
Long-term Borrowings	6	3	3	3	3
Total Debt	355	96	353	353	353
Deferred tax liabilities	(70)	-	(84)	(101)	(117)
Other non-current liabilities	148	81	234	276	320
Total Liabilities	**3,135**	**3,651**	**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	1,668	1,950	1,322	2,290
Other current liabilities/provisions	186	215	218	248	280
Total current liabilities	1,785	1,883	2,167	1,570	2,570
Net current assets	1,589	1,803	2,802	3,824	4,985
Total Assets	**3,135**	**3,616**	**4,950**	**6,140**	**7,519**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: 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)	(389)	(483)	(1,272)	309
Cash flow from operations	511	735	916	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**	**591**	**713**	**149**	**1,907**
Capital expenditure	(416)	(389)	(400)	(400)	(400)
Net cash after capex	**272**	**202**	**313**	**(251)**	**1,507**
Other investing activites	(312)	213	(225)	322	(1,431)
Cash from financial activities	**49**	**(270)**	**288**	**(14)**	**(11)**
Opening cash	20	29	137	500	500
Closing cash	29	137	500	500	500
Change in cash	8	144	376	57	65

Source: Company, Nirmal Bang Institutional Equities Research

Note: Closing cash represents cash & cash equivalents

Exhibit 19: 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	107.6	54.8	44.1	36.5	31.5
P/sales	4.3	3.5	2.8	2.4	2.1
P/BV	15.7	12.2	9.6	7.6	6.1
EV/EBITDA	51.9	32.0	26.0	21.8	19.2
EV/sales	4.3	3.5	2.8	2.4	2.0
Return ratios (%)					
RoE	15.8	25.2	24.4	23.2	21.5
RoCE	21.5	33.1	33.1	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	85	80	59	55
Cash Conversion Cycle	41	42	44	66	71
Solvency ratios (x)					
Debt-equity	0.1	0.0	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

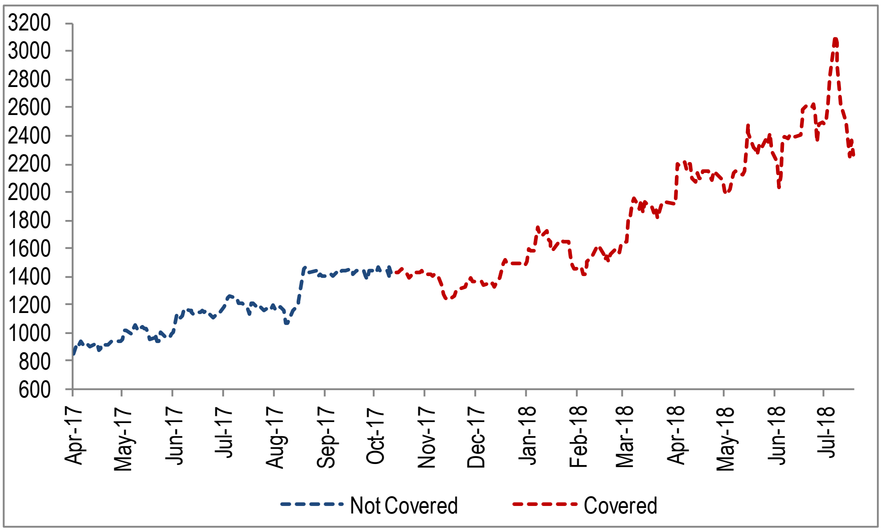
Source: Company, Nirmal Bang Institutional Equities Research

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
26 July 2018	Accumulate	2,351	2,318

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

Rating track graph



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