2QFY19 Result Update

V-Mart Retail

9 November 2018

Reuters: VMAR.BO; Bloomberg: VMART IN

SSG Guidance Lowered To Mid-Single-digit Versus High Single-digit

V-Mart Retail or VRL's 2QFY19 results were below our expectations. 2Q has typically been the weakest quarter in recent years. We were anticipating that. We were also aware of the festivals (Durga Puja and Navratri) moving to 3QFY19 while they were there in the base quarter. VRL maintained that the results were in line with its own internal expectations and that most of the festival-related revenues will be recouped in 3QFY19. Early indications on 3Q - which is packed with festivals - are apparently encouraging. VRL also talked about the early onset of winter which helps push sales of winter wear. 2QFY19 same-store sales growth (SSG) in value terms of 0% with volume growth of 12% indicated a realisation decline on same-store basis of 12%. VRL stated that the key reasons for poor performance in revenue growth are: (1) Movement of key festivals of Navaratri and Durga Puja from 2QFY19 to 3QFY19, as per the religious calendar. These festivals drive sales in eastern part of India, where it has 35%-40% of its stores. (2) Higher competitive intensity from national and regional value retail players. EBITDA margin has been worse than expected because of: (1) ASP decline of ~10% YoY partly driven by the festival season shift (as most of its customers make big-ticket purchases only during festive occasion). (2) Some fairly aggressive discounting to pare down old inventory during the EOSS (end of season sales). (3) Rapid expansion leading to higher employee and rental costs. (4) Higher corporate office-related costs as it hires senior-level people in advance in various key functions to prepare the company for the next level of growth. Plus there were investments in systems, processes and infrastructure. There was also a write-off connected with an investment that the company had made into some debt paper of an NBFC (likely IL&FS). 2QFY19 revenue growth of ~8% (YoY) was driven by ~20% increase in retail area, ~10% decline in revenue per sq ft and fall in apparel sales. VRL pegged its SSG guidance at 6% (against 1% so far in 1HFY19, implying low-teen run-rate in 2HFY19). This is lowering from the high single-digit numbers that it has been talking about in the past. The management indicated that festivals usually drive up volume as well as ASP which are already showing a positive trajectory in October 2018. There is typically a great deal of seasonality 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 which has normally not 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. After a weaker-than-expected 2QFY19 performance, we have tweaked our numbers lower (see Exhibit 2 inside). We expect VRL to post sales/EBITDA/PAT CAGR of 18%/17%/18%, respectively, over FY18-FY21E. We continue to value the stock at 36x 12-month forward EPS and roll forward our valuation to September 2020E earnings with a revised target price of Rs2,369 and reiterate our Accumulate rating on it. 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.

Market scenario: The management stated that the market scenario remained quite stable in 3QFY19, except for the fact that the new stores opened recently may take more time to pick up in terms of sales and start realising profit. 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.

A fresh thrust on kirana sales: VRL indicated a new tilt towards a special kind of kirana sales which have more do with personal care and involve high gross margin items like deodorants, chocolates, hand sanitisers etc.

ACCUMULATE

Sector: Retail

CMP: Rs2,383

Target Price: Rs2,369

Downside: 0%

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Key Data

Current Shares O/S (mn)	18.1
Mkt Cap (Rsbn/US$mn)	45.5/625.1
52 Wk H / L (Rs)	3,299/1,192
Daily Vol. (3M NSE Avg.)	22,982

Price Performance (%)

	1 M	6 M	1 Yr
V-Mart Retail	22.8	17.1	77.4
Nifty Index	2.6	(1.0)	3.0

Source: Bloomberg

Y/E March (Rsmn)	2QFY18	1QFY19	2QFY19	YoY (%)	QoQ (%)	2QFY19E	Dev (%)
Net sales	2,419	3,612	2,622	8.4	(27.4)	2,758	(4.9)
Net raw material & purchases	1,713	2,397	1,858	8.5	(22.5)	1,903	(2.4)
% of sales	70.8	66.4	70.9	-	-	69.0	-
Gross Profit	**706**	**1,215**	**764**	8.2	(37.1)	**855**	(10.6)
Gross Margin (%)	29.2	33.6	29.1	-	-	31.0	-
Employee expenses	237	283	301	26.9	6.4	**290**	3.8
% of sales	9.8	7.8	11.5	-	-	10.5	-
Other expenses	384	500	503	31.0	0.6	**441**	13.9
% of sales	15.9	13.8	19.2	-	-	16.0	-
Total expenditure	2,333	3,180	2,661	14.0	(16.3)	**2634**	1.0
EBITDA	**86**	**432**	**(39.0)**	(145.3)	(109.0)	**124**	(131.3)
EBITDA (%)	3.5	12.0	(1.5)	-	-	4.5	-
Depreciation	50	65	67.0	33.4	1.9	**44**	51.2
EBIT	**36**	**367**	**(106.0)**	(395.0)	(128.8)	**80**	(232.0)
EBIT Margin (%)	1.5	10.2	(4.0)	-	-	2.9	-
Other income	8	9	10.0	25.5	16.7	**13**	(19.8)
Interest expense	6	2	2.0	(66.8)	(3.7)	**2**	(4.7)
PBT	**38**	**374**	**(97.0)**	(353.1)	(126.0)	**91**	(206.7)
Total tax expense	11	125	(57.0)	(621.3)	(145.4)	**25**	(322.6)
Effective tax rate (%)	28.4	33.5	58.4	-	-	28.0	-
PAT	**27**	**249**	**(40.0)**	(246.9)	(116.2)	**66**	(161.7)
PAT Margin (%)	1.1	6.9	(1.5)	-	-	2.4	-

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	14,387	17,310	20,294
YoY (%)	23.8	22.0	17.7	20.3	17.2
EBITDA	826	1,328	1,521	1,838	2,116
EBITDA (%)	8.2	10.9	10.6	10.6	10.4
Reported PAT	395	775	932	1,111	1,314
EPS (Rs)	21.8	42.9	49.9	61.2	72.4
YoY (%)	43.0	96.6	16.3	22.7	18.2
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)	109.1	55.5	44.1	36.5	31.5
EV/Sales (x)	4.3	3.5	3.0	2.5	2.1
EV/EBITDA (x)	52.6	32.4	28.3	23.4	20.3

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our earnings estimates

	New			Old			*Deviation (%)*		
Y/E March (Rsmn)	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	*FY19E*	*FY20E*	*FY21E*
Revenues	14,387	17,310	20,294	14,962	17,830	20703	*(3.8)*	*(2.9)*	*(2.0)*
EBITDA	1,521	1,838	2,116	1,629	1,944	2204	*(6.7)*	*(5.5)*	*(4.0)*
EBITDA margin (%)	*10.6*	*10.6*	*10.4*	*10.9*	*10.9*	*10.6*	-	-	-
PAT	932	1,111	1,314	999	1,186	1379	*(6.7)*	*(6.3)*	*(4.8)*
FDEPS (Rs)	49.9	61.2	72.4	53.3	64.4	74.6	*(6.4)*	*(4.9)*	*(3.0)*

Source: Nirmal Bang Institutional Equities Research

Result and Conference-call highlights

Key parameter analysis: VRL's revenues in 2QFY19 grew ~8.4% on YoY basis. 2Q has, for the past two years, been the weakest quarter. The growth was largely led by new store addition (190 vs. 157 in 2QFY18) as SSG in value terms was flat. 0% SSG was driven by volume growth of 12% with likely decline in realisation per store of the same amount. Sales/sqft/month declined ~9.9% on YoY basis and stood at Rs611. The management attributed the decline in sales/sqft to primarily the shift in festivals and aggressive store addition in Tier-IV cities which generally takes time to mature. Footfalls increased 12.7% on YoY basis, which is a positive sign and the conversion rate increased by ~80bps on YoY basis to 59.6% in 2QFY19. Retail space increased 20% on YoY basis driven by rapid expansion, especially in the east and north-east parts of the country and into Tier-4 towns in Uttar Pradesh and Bihar. Shrinkage at 0.3% was lower than historical standards as the company disposed off most its old inventory through aggressive discounting during the end-of-season sales.

Exhibit 3: Key parameters

Y/E Mar (Rsmn)	2QFY18	1QFY19	2QFY19	*YoY %*	*QoQ %*	FY17	FY18	*YoY %*
No. of stores	157	179	190	*21.0*	*6.1*	141	171	*21.3*
Retail space (mn sqft)	1.3	1.5	1.6	*20.3*	*3.6*	1.19	1.44	*21.0*
SSG (%) (fashion) - Value	*8.0*	*1.2*	*0*	-	-	*13.3*	*9.0*	-
SSG (%) (fashion) - Volume	*13.0*	*3.5*	*12*	-	-	*10.7*	*13.0*	-
Sales per sqft (Rs/month)	678	874	611	*(9.9)*	*(30.1)*	799	823	*3.0*
Average selling price (total)	182	187	164	*(9.9)*	*(12.3)*	208	207	*(0.5)*
Transaction size	644	718	613	*(4.8)*	*(14.6)*	713	750	*5.2*
Footfall (mn)	6.8	8.9	7.7	*12.7*	*(13.5)*	24.8	30.3	*22.2*
Conversion rate (%)	*58.8*	*60.0*	*59.6*	-	-	*59.6*	*57.0*	-
Shrinkage (%)	*1.2*	*1.3*	*0.3*	-	-	*1.4*	*1.3*	-

Source: Company, Nirmal Bang Institutional Equities Research

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 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 because 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. This has led to opening of more stores in Tier-IV and Tier-III towns where there is not much competition from bigger brands and rental/ employee costs are also less. VRL remains a strong player, despite rising competition. The ASP of large 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 as it believes in volume-led growth. 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. (2) 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. (3) The management stated that it is building capacity and expanding to unexplored states in order to avoid rising competition and cater to its core demography which is present in these towns in a higher number.

Building capacity: VRL focuses on building capacity by store addition in primarily the states of Bihar, Jharkhand, Odisha, Jammu & Kashmir or J&K, Assam and other states in the north-east region. In October 2018 itself, six to seven new stores were opened. As a result of this build-up in capacity, inventory level also increased (as of September-end). The company has now 197 stores across 16 states. According to the management, because of these numerous store openings, there has been an increase in expenses and the EBITDA loss that happened was foreseen by the management. This capacity build-up was pre-planned. As a result of this, employee costs also went up sharply (as a percentage of sales) from 7.8% in 1QFY19 to 11.5% in 2QFY19. The management indicated that this was because of rising investment in manpower for its future expansion plan and also decreased top-line.

Share of business segments: The share of kirana sales increased to 9% of revenues in 2QFY19 from 6% in 1QFY19. This was led by pushing the impulse products e.g. sanitisers, chocolates etc to the customers by making the products available at billing counters. According to the management, this was done keeping in mind customers' requirement during shopping and rising kirana sales is just a temporary trend.

Average selling price or ASP declines: The total ASP stood at Rs164 in 2QFY19 (~9% lower on a YoY basis).The management stated that this has been done keeping in mind the Tier-IV customer base, as the company is opening numerous stores in Tier-IV and Tier-III where the preference price point is lower. The ASP of fashion category also continued along its declining trend since 3QFY18, falling from Rs264 in 1QFY19 to Rs246 in 2QFY19.

Private labels: The management stated that private labels are introduced to create brand loyalty and not to drive up margins. The private label products are not manufactured by the company. They have been added to the portfolio to increase quality and variety. 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 62%.

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. Around 20 stores were refurbished in 2QFY19. The management stated that the cost of refurbishment is ~Rs3,00,000-Rs3,50,000 for each store.

Same-store sales growth or SSG: The management stated that SSG is showing positive trajectory since October 2018. It gave guidance of 6% SSG for FY19 which will be mostly driven by festive season revenues in 3QFY19 and 4QFY19.

Provision for investment made into debt paper of a financial institution: VRL apparently made an investment of Rs100mn in the CPs of an entity (we believe it was IL&FS). Interest connected with that investment was due, but there has been a default and hence VRL made an approximate provision of 25% on this investment.

Other main points:

- On the e-commerce front, the management stated that it is conscious of the rising competition from other players in the e-commerce market. Therefore, it has started an omni-channel effort which looks towards integrating various departments. The company indicated that it may have an online presence also at some point down the line.
- The management stated that the stores in Tier III and II towns give the maximum RoI, more than that in Tier-I cities. But still the company is venturing into Tier IV towns as it sees an opportunity over there. Tier IV towns still remain unexplored - a relatively blue ocean market - and the company can get some first-mover advantage.
- The company is dealing with logistics problems of opening stores in states like J&K and Assam where it has opened two and four stores, respectively, in FY19. It is working towards resolving these problems at the earliest.
- The management stated that its new stores enjoy lower margin whereas its old stores enjoy higher operating margin.
- The sales pick-up is lower initially in new stores, but has a decent pick-up in two to three months.
- Though attrition is a part and parcel of the retail industry, the management stated that it is under control and has in fact reduced in 2QFY19.
- Shrinkage stood at 0.3%in 2QFY19.

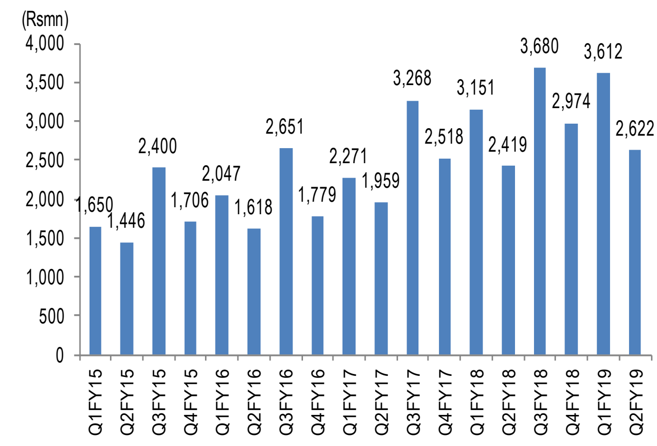
Our recent notes on VRL are given in the links below:

V-Mart Retail- Softer SSG Due To Geo Mix And Curtailed Marriage Season

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

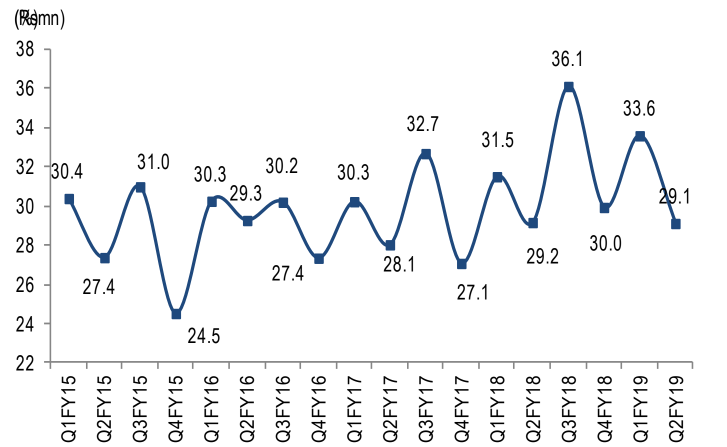
V-Mart Retail- Commendable SSG On A High Base

Exhibit 4: Quarterly revenues



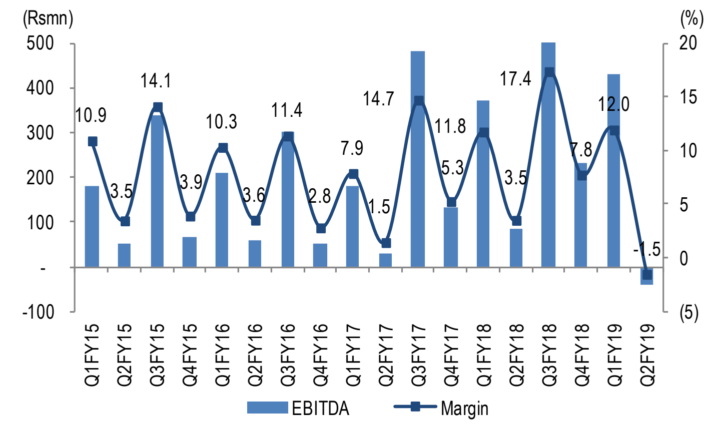
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Quarterly gross margin



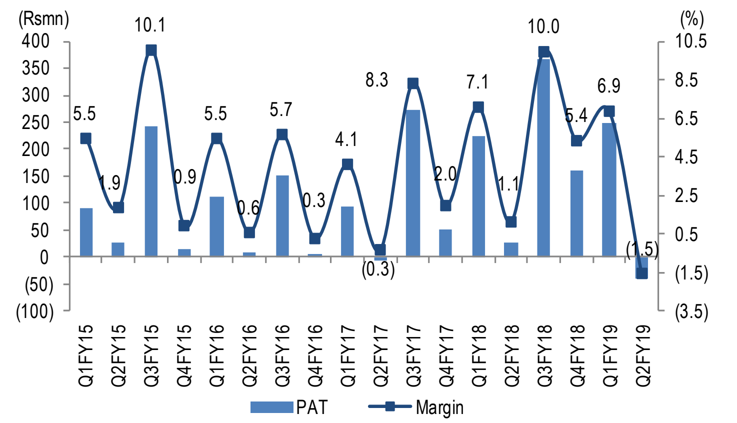
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Quarterly EBITDA & margin



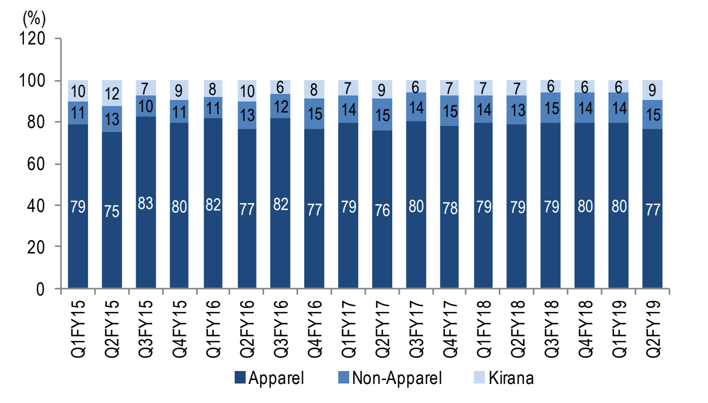
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Quarterly PAT & margin



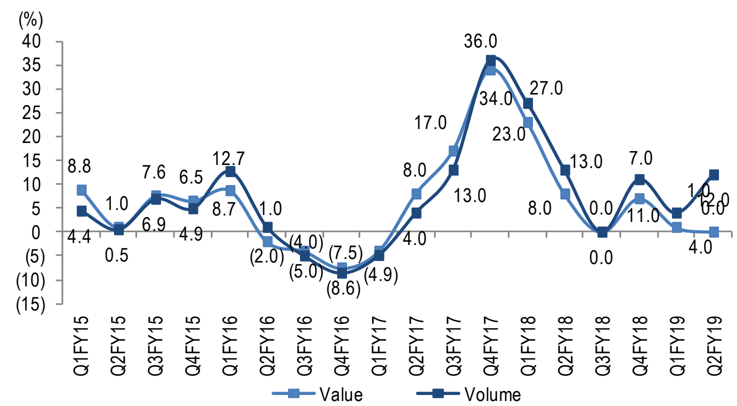
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Share of business segments



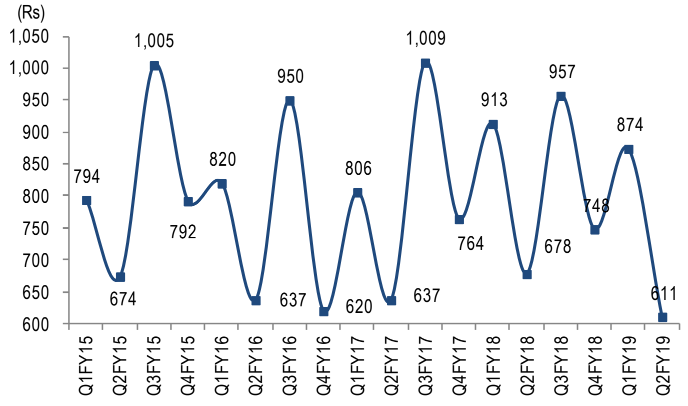
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: SSG trend (fashion)



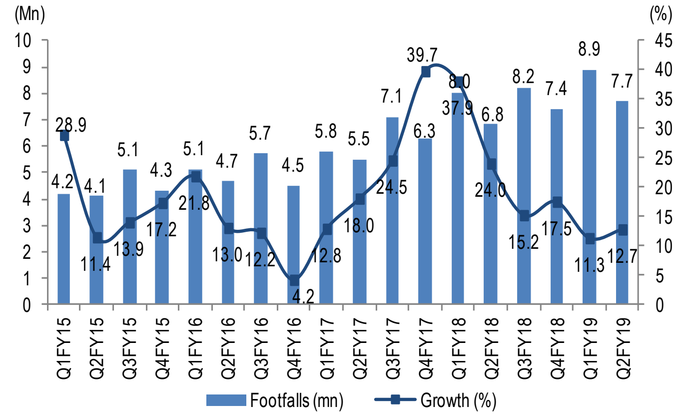
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Sales/sq.ft/month



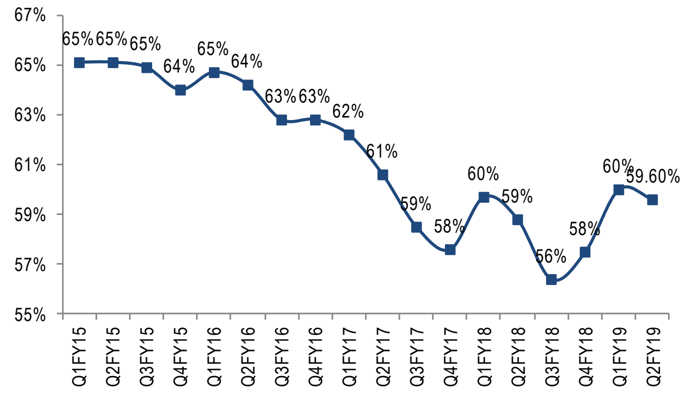
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Footfall trend



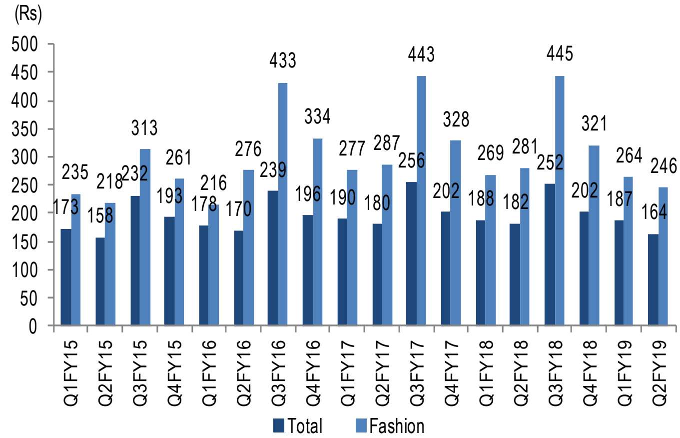
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Conversion rate



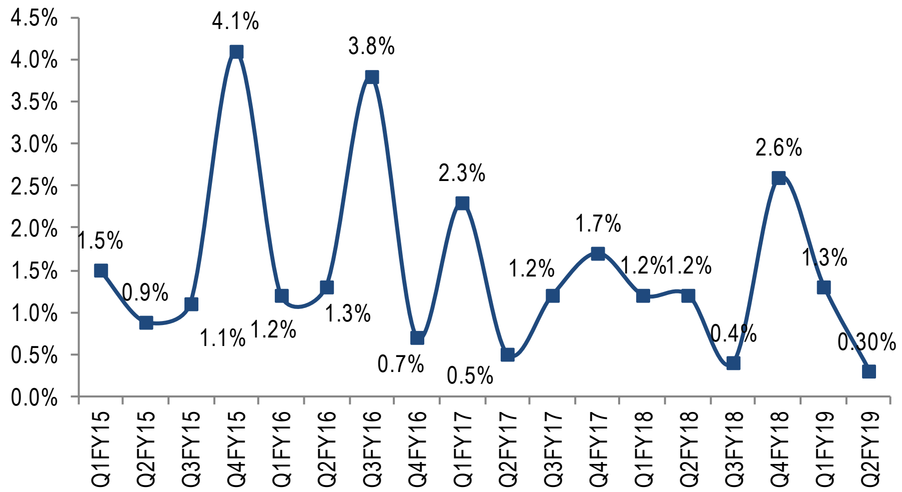
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: ASP trend



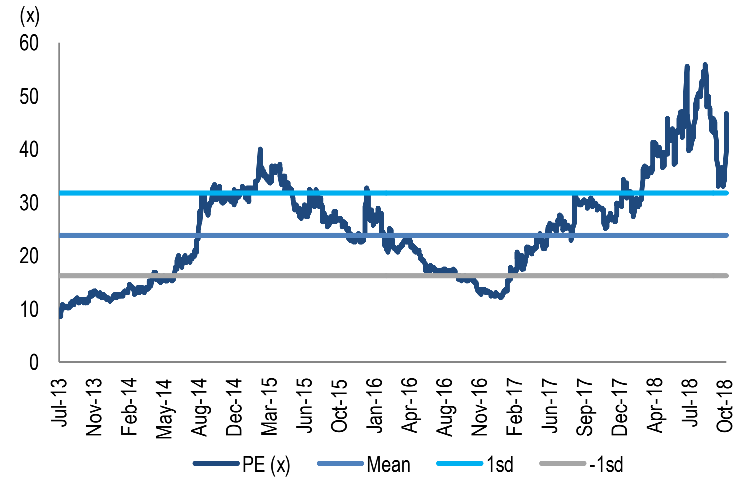
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Shrinkage level



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: P/E one-year forward trend



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 16: EV/EBITDA one-year forward trend

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Financials

Exhibit 17: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net Sales	**10,017**	**12,224**	**14,387**	**17,310**	**20,294**
Growth (%)	*23.8*	*22.0*	*17.7*	*20.3*	*17.2*
Cost of Materials	2	-	-	-	-
Purchases of stock-in-trade	7,673	8,682	10,235	12,273	14,313
Change in inventories	(647)	(379)	(479)	(579)	(679)
Raw Materials	7,028	8,303	9,756	11,694	13,634
Gross Profit	**2,990**	**3,921**	**4,631**	**5,616**	**6,660**
Gross Margin (%)	***29.8***	***32.1***	***32.2***	***32.4***	***32.8***
Employee expenses	777	984	1,201	1,499	1,872
Other expenses	1,387	1,609	1,909	2,279	2,672
Prior period items	-	-	-	-	-
Total expenditure	9,191	10,896	12,866	15,472	18,178
EBITDA	**826**	**1,328**	**1,521**	**1,838**	**2,116**
Growth (%)	*33.6*	*60.8*	*14.5*	*20.8*	*15.2*
EBITDA Margin (%)	***8.2***	***10.9***	***10.6***	***10.6***	***10.4***
Other income	31	41	51	61	104
Interest costs	35	18	10	35	35
Depreciation	220	229	243	277	311
Exceptional Items	-	-	-	-	-
PBT	**601**	**1,122**	**1,338**	**1,609**	**1,902**
Tax	206	348	406	498	589
Effective tax rate (%)	*34.3*	*3,090.9*	*31.0*	*31.0*	*31.0*
PAT	**395**	**775**	**932**	**1,111**	**1,314**
Growth (%)	*43.0*	*96.6*	*16.3*	*22.7*	*18.2*
PAT Margin (%)	***3.9***	***6.4***	***6.3***	***6.4***	***6.5***
EPS (Rs)	**21.8**	**42.9**	**49.9**	**61.2**	**72.4**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: 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	235	277	321
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	471	518	647
Current Investments	619	277	430	180	1,650
Inventories	2,692	3,071	3,635	4,325	5,043
Cash & Bank	29	196	559	559	559
Other current assets	34	142	193	193	193
Total Current Assets	3,374	3,686	4,817	5,257	7,445
Creditors	1,599	1,668	1,871	1,281	2,241
Other current liabilities/provisions	186	215	218	248	280
Total current liabilities	1,785	1,883	2,089	1,529	2,521
Net current assets	1,589	1,803	2,728	3,728	4,924
Total Assets	**3,135**	**3,616**	**4,867**	**6,036**	**7,450**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: 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 activities	(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 20: 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	109.1	55.5	44.1	36.5	31.5
P/sales	4.3	3.5	3.0	2.5	2.1
P/BV	16.0	12.4	9.6	7.6	6.1
EV/EBITDA	52.6	32.4	28.3	23.4	20.3
EV/sales	4.3	3.5	3.0	2.5	2.1
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	32.2	32.4	32.8
EBITDA margin	8.2	10.9	10.6	10.6	10.4
EBIT margin	6.0	9.0	8.9	9.0	8.9
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	125	124	125
Avg payable days	82	85	78	59	55
Cash Conversion Cycle	41	42	48	65	70
Solvency ratios (x)					
Debt-equity	0.1	0.0	0.1	0.1	0.1
Growth (%)					
Sales	23.8	22.0	17.7	20.3	17.2
EBITDA	33.6	60.8	14.5	20.8	15.2
PAT	43.0	96.6	24.2	20.7	15.9

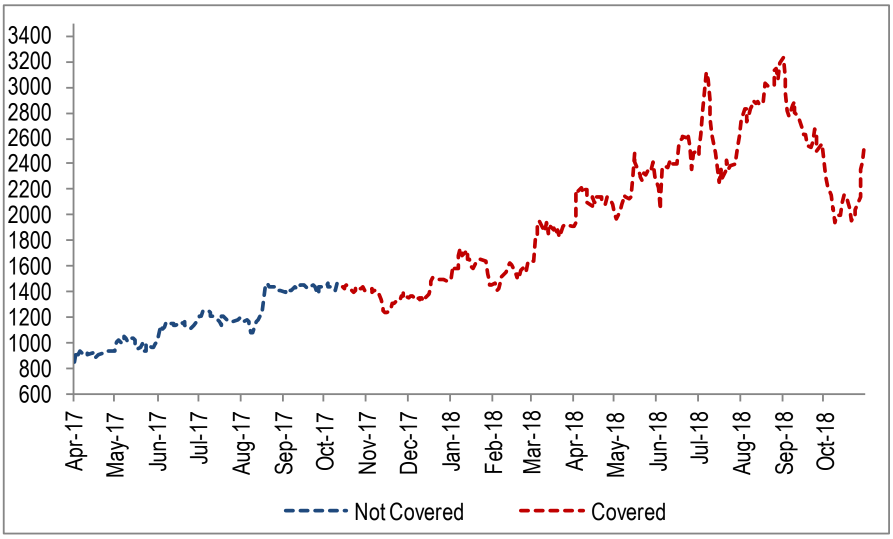
Source: Company, Nirmal Bang Institutional Equities Research

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
9 November 2018	Accumulate	2,383	2,369

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

Rating track graph



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SELL < -5%

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