

REDUCE

TP: Rs 1,950 | ▲ 3%

V-MART RETAIL

Retail

05 August 2019

Margins continue to disappoint

V-Mart Retail's (VMART) Q1FY20 revenue growth was in line at 26% YoY, with SSSg of 5.2%. Operating margins (ex-Ind-AS 116 impact) slid 330bps YoY to 8.7%, resulting in EBITDA/PBT dropping 9%/11%. Management retained guidance of ~25% area addition in FY20 with 9% margins (earlier 9-9.5%). We cut FY20/FY21 PAT by ~9% each and pare our target P/E from 32x to 30x on tough market conditions and rising competition. Rolling over, we have a Jun'20 TP of Rs 1,950 (vs. Rs 2,155). Upgrade to REDUCE post stock correction.

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Strong revenue growth aided by area addition: VMART reported revenue growth of 25.5% YoY to Rs 4.5bn with same-store sales growth (SSSg) of 5.2% (volume SSSg of 6%). Revenue growth was aided by area addition of 27% YoY in Q1. Management maintained its guidance of adding 25% more area in FY20.

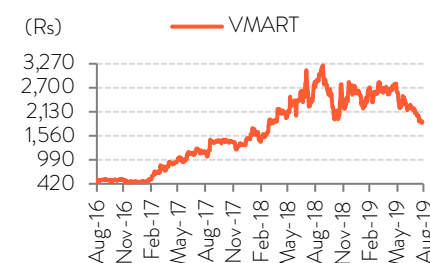
Operating margins shrink: Adjusted for Ind-AS 116, operating margins slipped 330bps YoY to 8.7% due to higher raw material prices (+295bps) and employee cost (+41bps), inducing a 9%/11% YoY drop in EBITDA/PBT. Aggressive discounting to clear old inventory, higher promotions as well as early end-of-season sales diluted gross margins, whereas employee and other costs increased due to the addition of 13 stores in Q1. Management is now targeting ~9% operating margins in FY20 but expects headwinds from tepid demand.

Upgrade to REDUCE from SELL: We like VMART for its strong growth potential, but see near-term risks to SSSg and margins from stiffer competition. Given the below-expected Q1, we scale back PAT estimates for FY20/FY21 by ~9% each. Rolling valuations forward, we have a new Jun'20 TP of Rs 1,950, set at 30x one-year forward P/E. We raise our rating a notch from SELL to REDUCE post the 30% fall in stock price since our [downgrade in Feb'19](#).

Ticker/Price	VMART IN/Rs 1,893
Market cap	US\$ 493.6mn
Shares o/s	18mn
3M ADV	US\$ 0.3mn
52wk high/low	Rs 3,299/Rs 1,809
Promoter/FPI/DII	53%/31%/16%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Adj. net profit (Rs mn)	768	724	894	1,111	1,373
Adj. EPS (Rs)	42.4	39.9	49.3	61.3	75.7
Adj. EPS growth (%)	101.0	(5.8)	23.5	24.3	23.6
Adj. ROAE (%)	24.9	19.1	19.8	20.3	20.7
Adj. P/E (x)	44.7	47.4	38.4	30.9	25.0
EV/EBITDA (x)	25.5	25.3	20.7	16.6	13.3

Source: Company, BOBCAPS Research | *Excluding Ind-AS 116 impact

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FIG 1 – QUARTERLY RESULTS (EXCLUDING IND-AS116 IMPACT)

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Total revenues	4,533	3,612	25.5	3,445	31.6
Total raw material consumed	3,142	2,397	31.1	2,447	28.4
% of sales	69.3	66.4	295bps	71.0	(169bps)
Employee expense	373	283	32.0	328	13.8
% of sales	8.2	7.8	41bps	9.5	(128bps)
Other expense	625	500	25.0	493	26.7
% of sales	13.8	13.8	(6bps)	14.3	(53bps)
Total expenditure	4140	3180	30.2	3268	26.7
% of sales	91.3	88.0	330bps	94.8	(351bps)
EBITDA	393	432	(9.1)	178	121
% of sales	8.7	12.0	(330bps)	5.2	351bps
Depreciation	79.6	65.5	21.6	72.3	10.0
Other income	20.8	8.9	133.3	22.6	(7.7)
Interest cost	1.5	2.0	(22.2)	3.5	(55.4)
PBT	333	374	(11.0)	125	167.0

Source: Company, BOBCAPS Research

FIG 2 – QUARTERLY PERFORMANCE (AS PER IND-AS116)

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Total revenues	4,530	3,612	25.4	3,445	31.5
Total raw material consumed	3,142	2,397	31.1	2,447	28.4
% of sales	69.3	66.4	295bps	71.0	(169bps)
Employee expense	373	283	32.0	328	13.8
% of sales	8.2	7.8	41bps	9.5	(128bps)
Other expense	437	500	(12.5)	493	(11.3)
% of sales	9.6	13.8	(419bps)	14.3	(467bps)
Total expenditure	3953	3180	24.3	3268	21.0
% of sales	87.2	88.0	(84bps)	94.8	(764bps)
EBITDA	578	432	33.7	178	225
% of sales	12.8	12.0	79bps	5.2	759bps
Depreciation	220.0	65.5	235.9	72.3	204.0
Other income	20.8	8.9	133.3	22.6	(7.7)
Interest cost	120.0	2.0	5960.4	3.5	3375.1
PBT	259	374	(30.7)	125	107.8
Taxes	83	125	(33.7)	60	37.9
Effective tax rate (%)	32.0	33.5	(145bps)	48.2	(1,622bps)
APAT	176	249	(29.2)	64	172.9

Source: Company, BOBCAPS Research

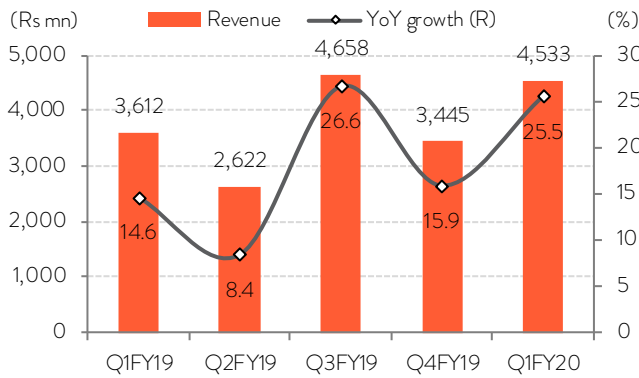
FIG 3 – IND-AS 116 IMPACT ON QUARTERLY FIGURES

Adjustment to increase/ decrease Net Profits (Rs mn)	Comparable basis (Ind-AS 17)	Changes due to Ind-AS 116	Reported numbers after Ind-AS changes
Other expenses	624.6	(187.3)	437.2
Finance Cost	1.5	118.5	120.0
Depreciation	79.6	140.3	220.0
Other operating income	(3.6)	2.3	(1.3)
Profit Before Tax	332.6	(73.7)	258.8

Source: Company, BOBCAPS Research

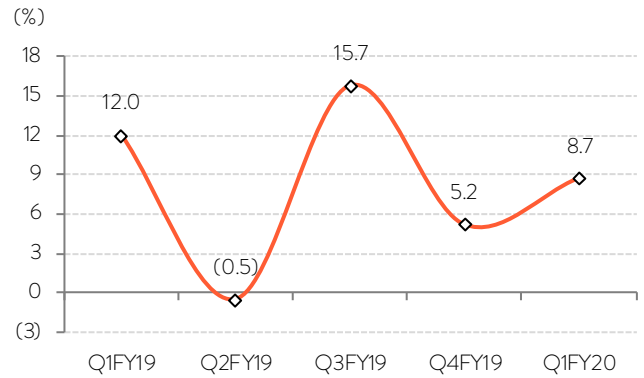
QUARTERLY TRENDS

FIG 4 – REVENUE & GROWTH



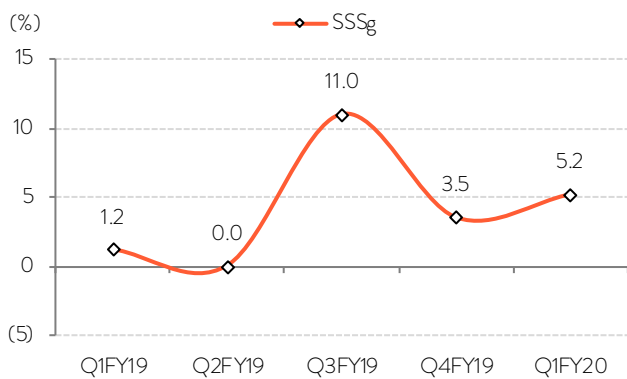
Source: Company, BOBCAPS Research

FIG 5 – OPERATING MARGINS



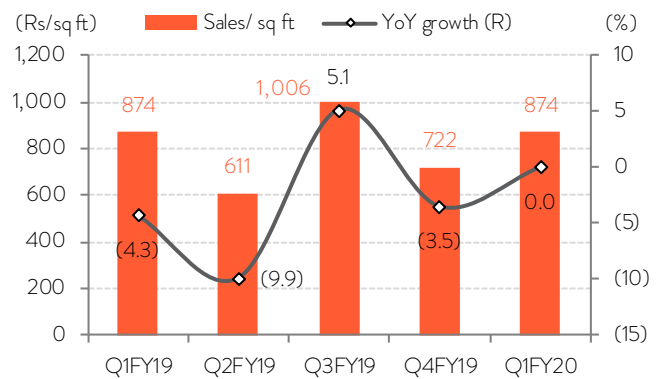
Source: Company, BOBCAPS Research

FIG 6 – SAME-STORE SALES GROWTH, YOY



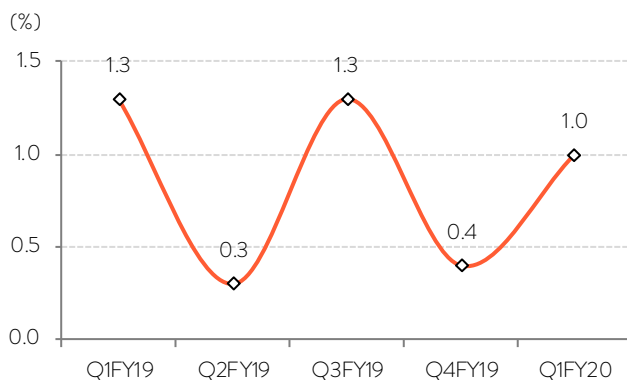
Source: Company, BOBCAPS Research

FIG 7 – REVENUE PER SQUARE FOOT/MONTH



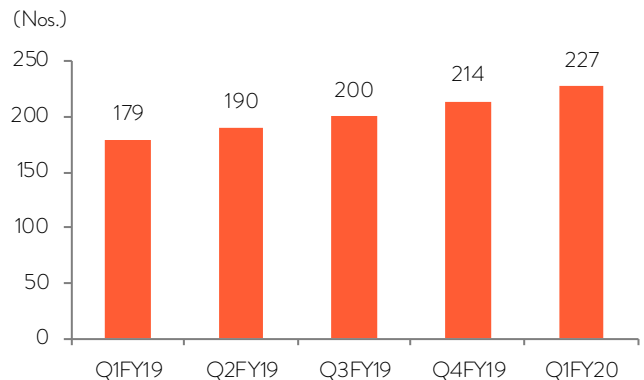
Source: Company, BOBCAPS Research

FIG 8 – INVENTORY SHRINKAGE



Source: Company, BOBCAPS Research

FIG 9 – NUMBER OF STORES



Source: Company, BOBCAPS Research

Earnings call highlights

- Per management, the demand climate remains tepid and consumer confidence is low, especially among the self-employed and farmers.
- End-of-season sales started early this year, in June, crimping margins. Also, higher promotions to attract more footfalls weighed on gross margins.
- VMART ran aggressive promotions during the quarter, especially during Eid season. This coupled with revamped merchandise aided robust topline growth.
- The company plans to add 25% more retail store area every year. At the same time, higher promotions to attract customers will result in some near-term margin pressure. Management is targeting 9% operating margins (excluding Ind-AS 116 impact), but cautioned that this may be difficult to achieve in the near term due to tough market conditions.
- VMART expects to maintain SSSg at historical levels of 7-8% in the medium term.
- Inventory shrinkage is likely to hold at 1.1-1.2% of sales on an annual basis. Inventory days during Q1 were brought down by 10 days YoY due to better sales, use of technology and higher stock clearance. Management anticipates some increase in Q2 due to onset of the festival season, with improvement thereafter as internal measures kick in.
- During the quarter, the men's category did well followed by the women's category. Private labels account for 66-67% of total sales; the company does not see this figure going beyond 75%.
- More national players have entered VMART's markets, though management views this as a positive development that will expand market opportunity.
- Ind-AS 116 will result in an ROCE decline of ~1.5% and ROE decline of 1% in FYxx. PBT could be affected depending on new lease addition.
- A new zonal head structure has been put in place at VMART, with the zonal head responsible for sales and profitability. The company plans to keep investing in technology and people to enable sustainable growth.

Valuation methodology

VMART is a play on the growing organised apparel retail market, high aspirational demand and rising purchasing power of middle-class India. We expect the company to benefit from a strong, efficient business model and an early-mover advantage in tier-2 and tier-3 cities. But with several organised players expanding their footprint in VMART's markets, the company could face near-term SSSg and margin headwinds.

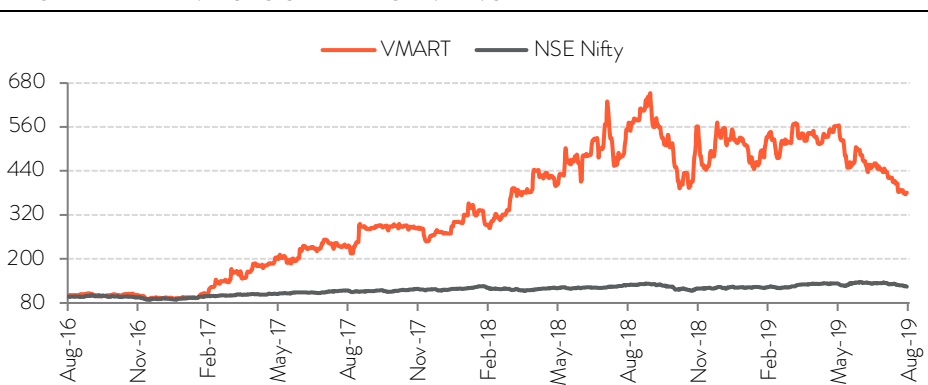
Amid a weaker-than-expected Q1FY20, tepid demand climate and rising competition, we cut PAT estimates by ~9% each for FY20/FY21 and also pare our target P/E multiple from 32x to 30x. Upon rolling valuations forward, we have a revised June'20 target price of Rs 1,950 (earlier Rs 2,155). The stock has corrected 30% since our [downgrade in Feb'19](#) and is currently trading at 30.9x FY21E EPS, leading us to raise our rating a notch from SELL to REDUCE.

FIG 10 – REVISED ESTIMATES

(Rs mn)	New		Old		Change (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	18,109	22,651	18,109	22,651	0.0	0.0
EBITDA	1,631	2,030	1,739	2,155	(6.2)	(5.8)
PAT	894	1,111	980	1,221	(8.8)	(9.0)

Source: Company, BOBCAPS Research

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Key upside risks to our estimates are:

- better-than-expected demand from the company's key states of Uttar Pradesh and Bihar, and
- inability of organised rivals to ramp up in tier-2/3 cities, thereby enabling VMART to deliver better growth.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Total revenue	12,224	14,337	18,109	22,651	28,264
EBITDA	1,332	1,336	1,631	2,030	2,529
EBIT	1,103	1,060	1,296	1,618	2,032
Net interest income/(expenses)	(15)	(16)	(23)	(33)	(41)
Other income/(expenses)	39	44	72	86	89
Exceptional items	0	0	0	0	0
EBT	1,127	1,088	1,344	1,671	2,081
Income taxes	(358)	(365)	(450)	(560)	(707)
Extraordinary items	9	(107)	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	777	616	894	1,111	1,373
Adjustments	(9)	107	0	0	0
Adjusted net profit	768	724	894	1,111	1,373

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Accounts payables	1,668	1,483	1,935	2,482	3,097
Other current liabilities	235	354	397	496	619
Provisions	116	169	181	227	283
Debt funds	6	219	300	400	500
Other liabilities	0	0	0	0	0
Equity capital	181	181	181	181	181
Reserves & surplus	3,293	3,911	4,757	5,810	7,114
Shareholders' fund	3,474	4,093	4,939	5,991	7,295
Total liabilities and equities	5,499	6,318	7,752	9,597	11,794
Cash and cash eq.	196	166	25	4	47
Accounts receivables	0	0	0	0	0
Inventories	3,071	3,290	4,019	5,027	6,272
Other current assets	317	443	550	691	857
Investments	340	607	900	1,000	1,100
Net fixed assets	1,447	1,655	2,100	2,716	3,359
CWIP	35	40	40	40	40
Intangible assets	0	0	0	0	0
Deferred tax assets, net	92	118	118	118	118
Other assets	0	0	0	0	0
Total assets	5,499	6,318	7,752	9,597	11,794

Source: Company, BOBCAPS Research | *Excluding Ind-AS 116 impact

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Net income + Depreciation	1,006	893	1,229	1,523	1,871
Interest expenses	15	16	23	33	41
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(400)	(356)	(330)	(457)	(617)
Other operating cash flows	(22)	(26)	0	0	0
Cash flow from operations	600	526	922	1,099	1,294
Capital expenditures	(397)	(489)	(780)	(1,028)	(1,140)
Change in investments	336	(266)	(293)	(100)	(100)
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(61)	(755)	(1,073)	(1,128)	(1,240)
Equities issued/Others	20	28	0	0	0
Debt raised/repaid	(351)	213	81	100	100
Interest expenses	(15)	(16)	(23)	(33)	(41)
Dividends paid	(27)	(44)	(48)	(59)	(70)
Other financing cash flows	2	18	0	0	0
Cash flow from financing	(372)	200	10	8	(10)
Changes in cash and cash eq.	167	(30)	(141)	(21)	44
Closing cash and cash eq.	196	166	25	4	47

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Reported EPS	42.9	34.0	49.3	61.3	75.7
Adjusted EPS	42.4	39.9	49.3	61.3	75.7
Dividend per share	2.0	1.7	2.2	2.7	3.2
Book value per share	191.6	225.7	272.4	330.5	402.4

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
EV/Sales	2.8	2.4	1.9	1.5	1.2
EV/EBITDA	25.5	25.3	20.7	16.6	13.3
Adjusted P/E	44.7	47.4	38.4	30.9	25.0
P/BV	9.9	8.4	7.0	5.7	4.7

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E*	FY21E*	FY22E*
Tax burden (Net profit/PBT)	68.2	66.5	66.5	66.5	66.0
Interest burden (PBT/EBIT)	102.1	102.7	103.7	103.3	102.4
EBIT margin (EBIT/Revenue)	9.0	7.4	7.2	7.1	7.2
Asset turnover (Revenue/Avg TA)	233.1	242.6	257.4	261.1	264.3
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.6	1.6	1.6
Adjusted ROAE	24.9	19.1	19.8	20.3	20.7

Source: Company, BOBCAPS Research | Note: TA = Total Assets | *Excluding Ind-AS 116 impact

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E*	FY21E*	FY22E*
YoY growth (%)					
Revenue	22.0	17.3	26.3	25.1	24.8
EBITDA	60.9	0.3	22.0	24.5	24.6
Adjusted EPS	101.0	(5.8)	23.5	24.3	23.6
Profitability & Return ratios (%)					
EBITDA margin	10.9	9.3	9.0	9.0	8.9
EBIT margin	9.0	7.4	7.2	7.1	7.2
Adjusted profit margin	6.3	5.0	4.9	4.9	4.9
Adjusted ROAE	24.9	19.1	19.8	20.3	20.7
ROCE	23.0	18.1	18.0	18.5	18.9
Working capital days (days)					
Receivables	0	0	0	0	0
Inventory	127	120	108	108	108
Payables	55	44	38	39	40
Ratios (x)					
Gross asset turnover	6.2	7.0	6.8	6.4	6.1
Current ratio	1.8	1.8	1.6	1.6	1.6
Net interest coverage ratio	72.1	65.7	55.5	49.2	50.2
Adjusted debt/equity	(0.1)	0.0	0.1	0.1	0.1

Source: Company, BOBCAPS Research | *Excluding Ind-AS 116 impact

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

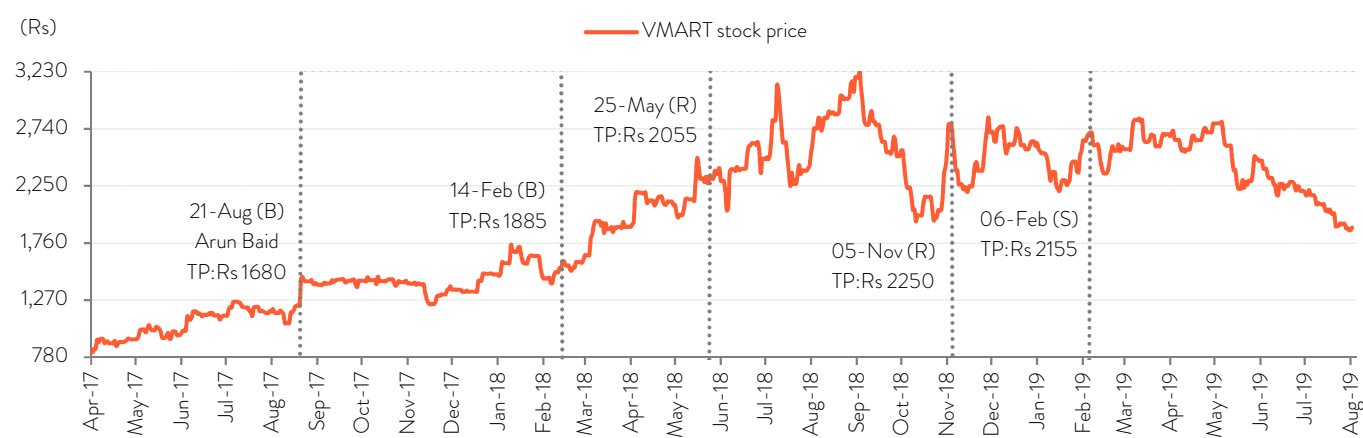
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: V-MART RETAIL (VMART IN)



B – Buy, A – Add, R – Reduce, S – Sell

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