

Avenue Supermarts (AVESUP)

CMP: ₹ 4300

Target: ₹ 4900 (14%)

Target Period: 12 months

HOLD

October 16, 2022

RoIC improvement hangs on recovery of GM & apparel

About the stock: Avenue Supermarts (ASL) operates supermarket chain under 'D-Mart' brand with a core focus on value retailing. D-Mart, through its proven business model, has been able to maintain consistent profitability and remains an exceptional performer in its peer group.

- D-Mart has progressively enhanced its return ratios (RoIC: 20%+) despite being capital intensive (follows ownership model)
- Robust store operating metrics (breakeven in 18-24 months of its operations and one of industry best revenue/sq ft: ₹ 30000+)

Q2FY23: D-Mart reported a subdued operational performance with profitability coming below our/consensus estimates in Q2FY23. Footfalls are yet to recover completely compared to the pre-Covid levels. This is causing a major hindrance for the recovery of its profitable segment (general merchandise & apparel).

- On tepid base, sales up 37% YoY to ₹ 10638 crore (three year CAGR: 21%)
- Discretionary product mix continues to be lower compared to pre-Covid levels leading to lower gross margins (up 20 bps YoY to 15.1%). Higher opex further impacted EBITDA margins, which were at 8.4% (I-direct: 9.4%)
- PAT for the quarter came in at ₹ 685.7 crore (up 64% YoY), aided by tax reversal in respect of earlier years (tax rate: 8.3%)
- Company added 8 new D-Mart outlets taking the total store count to 302 with total business area now at 12.4 million sq ft

What should investors do? ASL has been a consistent compounder with stock price increasing at 35% CAGR in the last five years. D-Mart continues to remain India's most profitable low cost retailer and a strong play on India's retail growth story and a key beneficiary of unorganised to organised segment shift. However, we believe current valuations captures most positives.

- Hence, we maintain **HOLD** recommendation on the stock

Target Price and Valuation: We value ASL at ₹ 4900 i.e. 6x FY24E EV/sales

Key triggers for future price performance:

- We anticipate store addition trajectory to accelerate and bake in 80 incremental store additions (addition of ~ 4.6 mn sq ft) in FY23-24E
- Robust liquidity position and healthy operating cashflows to provide impetus to store addition pace (H1FY23 cash & investments: ₹ 1200+ crore)
- We model revenue, earnings CAGR of 32%, 47%, respectively, in FY22-24E

Alternate Stock Idea: Apart from ASL, in our retail coverage we also like Trent.

- Inherent strength of brands (Westside, Zudio, Zara) and proven business model positions Trent as a key beneficiary of economy unlock theme
- We have a BUY rating with target price of ₹ 1665/share



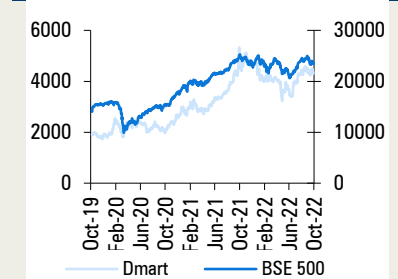
Particulars

Particulars	Amount
Market Capitalisation (₹ crore)	2,78,735.4
Total Debt (FY22) (₹ crore)	-
Cash & Investment (FY22) (₹ crore)	1,575.1
EV (₹ crore)	2,77,160.4
52 Week H / L	5900 / 3185
Equity Capital (₹ crore)	647.8
Face Value (₹)	10.0

Shareholding pattern

	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	75.0	75.0	75.0	75.0	75.0
FII	10.0	10.0	9.4	8.3	8.6
DII	6.7	6.7	6.7	6.8	6.9
Others	8.3	8.4	8.8	9.9	9.5

Price Chart



Recent event & key risks

- Eight new stores added in Q2FY23

Key Risk: (i) Slower ramp up of store network (ii) Faster than expected revenue growth in GM & apparel

Research Analyst

Bharat Chhoda
bharat.chhoda@icicisecurities.com

Cheragh Sidhwa
cheragh.sidhwa@icicisecurities.com

Key Financial Summary

Financials	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	20,004.5	24,870.2	24,143.1	30,976.3	21.1%	43,572.3	54,218.2	32.3%
EBITDA	1,633.3	2,128.3	1,743.1	2,498.5	20.6%	3,912.8	5,031.4	41.9%
PAT	902.4	1,301.0	1,099.4	1,492.4	25.5%	2,597.3	3,205.2	46.6%
P/E (x)	297.6	214.3	253.5	186.8		107.3	87.0	
EV/Sales (x)	13.4	11.1	11.4	8.9		6.4	5.1	
EV/EBITDA (x)	164.7	129.4	158.4	110.9		70.9	55.0	
RoCE (%)	23.4	16.4	12.5	15.5		20.9	22.4	
RoE (%)	16.2	11.7	9.0	10.9		16.0	16.5	

Key takeaways of Q2FY23 results

- As guided by the management in its pre-quarterly update, on a favourable base, Avenue Supermarts reported revenue growth of 36.6% YoY to ₹ 10638.3 crore (three-year CAGR: 21%). The company added eight new D-Mart outlets (18 in H1FY23) taking total store count to 302 with total business area of 12.4 million sq ft. We notice that the company has added relatively smaller sized stores (~average sq ft: 37500) in Q2FY23 unlike the previous quarters wherein it has been adding 60000+ sq. ft. size stores. D-Mart ready (online business) continues to perform well with revenue growth of 82% YoY to ₹ 253 crore
- Revenue per sq ft did witness a marginal improvement on a sequential basis by ~2% to ₹ 8580 but continues to remain below pre-Covid levels (Q2FY20: ₹ 9210). We believe the new larger stores added over the past two years have never got an opportunity to function in normal circumstances, which is leading to lower throughput per store. Also, the rationale behind opening of larger stores were to stock higher discretionary categories such as GM & apparel which yields better gross margins. However, Covid led disruptions materially impacted performance of this category, which, in turn, impacted gross margins and RoCE for the stores. Same store sales growth (SSSG) for stores which are older than five years have grown at a moderate pace of 6.5% annually (within which older stores with significantly higher throughputs have a weaker SSSG)
- The management highlighted that inflationary stress is more acute at lower price points in discretionary non-FMCG categories. Also, the FMCG and staples segment continue to outperform GM & apparel segment. With the discretionary product mix being impacted, gross margins for the quarter came in below our estimate at 15.1% (I-direct estimate: 15.6%). Share of GM & apparels stood at ~25% in H1FY23 (FY22: 23%, pre-Covid levels: 28%). Other expenses grew significantly by 51% YoY (17% QoQ) to ₹ 528 crore. Subsequently EBITDA margins declined 20 bps YoY to 8.4% (I-direct estimate: 9.4%). Absolute EBITDA grew by 32% YoY to ₹ 892 crore (I-direct estimate: ₹ 996.9 crore, three-year CAGR: 20%)
- Higher depreciation expenses (owing to addition of new rented stores, up 40% YoY) and finance cost (lease liability, up 43% YoY) further impacted profitability. Ensuing PBT was at ₹ 747.9 crore (I-direct estimate: ₹ 860 crore, up 32% YoY). Owing to tax reversal in respect of earlier years, the tax rate came in significantly lower at 8.3% (Q2FY22: 26%). Hence, PAT for the quarter was at ₹ 685.7 crore (up 64% YoY, I-direct estimate: ₹ 643.6 crore)
- On the balance sheet front, with steady working capital days and better profitability company generated healthy OCF worth ₹ 834 crore in H1FY23 (H1FY22: ₹ 241 crore). Capex for H1FY23 was at ₹ 970 crore vs. ₹ 1036 crore in H1FY22. Cash and cash equivalents were at ₹ 1200 crore as on H1FY23 (FY22: ₹ 1575 crore)
- **The company believes it would be able to provide better value to its customers by managing its cost better and providing value for money in an inflationary environment. With the upcoming festive season, Q3FY23 would be a critical quarter to watch out for. We expect RoIC to improve in the current financial year driven by dual triggers of enhanced margins and better store throughput. We build in average SSSG of 11% in FY20-24E with revenue per sq ft of ₹ 34000 in FY24E. We bake in revenue and earnings CAGR of 32% and 47%, respectively, in FY22-24E with healthy RoIC of 24%**

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	10,638.3	10,605.0	7,788.9	36.6	10,038.1	6.0	3-year CAGR: 21%. Revenue/sq. ft. at ₹ 8580 (~93% of pre-covid levels)
Raw Material Expense	9,029.2	8,950.6	6,625.0	36.3	8,397.6	7.5	
Gross Profit	1,609.1	1,654.4	1,164.0	38.2	1,640.5	-1.9	
Gross Profit Margin	15.1	15.6	14.9	18 bps	16.3	-122 bps	Gross margins came in below our estimates owing sustained pressure on GM & apparel segment
Employee exp	188.6	190.9	146.6	28.7	179.4	5.1	
Other Exp	528.5	466.6	348.8	51.5	452.9	16.7	
EBITDA	892.0	996.9	668.6	33.4	1,008.2	-11.5	Significantly higher other expenses further impacted profitability (3-year EBITDA CAGR: 20%)
EBITDA Margin (%)	8.4	9.4	8.6	-20 bps	10.0	-166 bps	
Depreciation	162.0	149.1	116.0	39.6	144.7	11.9	
Other Income	35.6	30.0	27.5	29.3	29.1	22.1	
Interest	17.7	17.4	12.4	42.9	17.2	2.7	
Exceptional Income	-	-	-	-	-	-	
PBT	748.0	860.4	567.7	31.8	875.4	-14.6	
Tax Outgo	62.2	216.8	149.9	-58.5	232.5	-73.2	Lower tax outgo owing to tax reversal of earlier years (₹ 140 crore)
PAT	685.7	643.6	417.8	64.1	642.9	6.7	

Source: Company, ICICI Direct Research

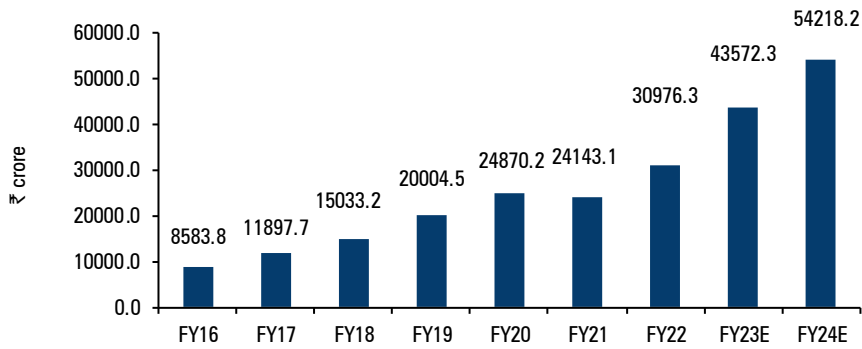
Exhibit 2: Change in estimates

(₹ Crore)	FY 22	FY 23E			FY 24E			Comment
	Actual	Old	New	% Change	Old	New	% Change	
Revenue	30,976.3	42,033.0	43,572.3	3.7	54,148.0	54,218.2	0.1	
EBITDA	2,498.5	3,858.0	3,912.8	1.4	5,133.0	5,031.4	-2.0	
EBITDA Margin (%)	8.1	9.2	9.0	-20 bps	9.5	9.3	-20 bps	
PAT	1,492.4	2,432.5	2,597.3	6.8	3,273.9	3,205.2	-2.1	FY23 PAT estimates up mainly owing to tax reversal in Q2FY23
EPS (₹)	23.0	37.6	40.1	6.8	50.5	49.5	-2.1	

Source: Company, ICICI Direct Research

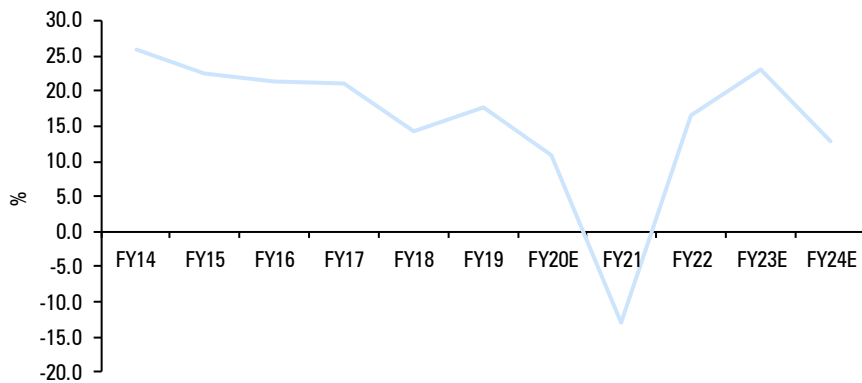
Financial story in charts

Exhibit 3: Revenue growth trend



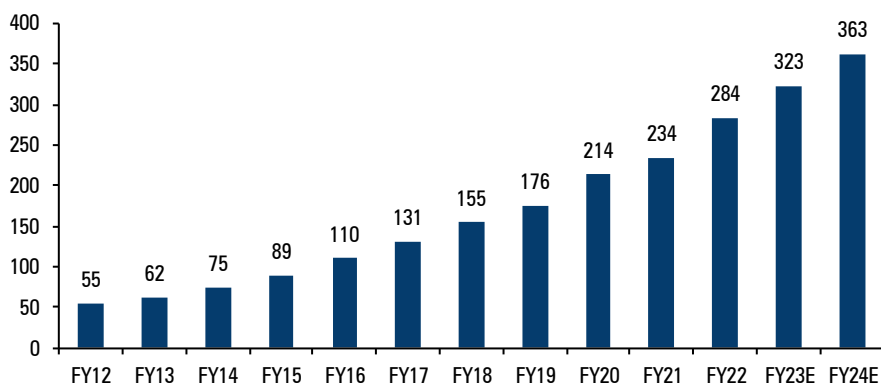
Source: Company, ICICI Direct Research

Exhibit 4: Same stores sales growth (SSSG) trend



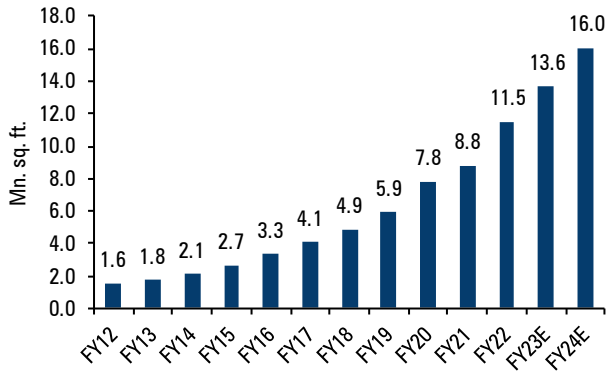
Source: Company, ICICI Direct Research

Exhibit 5: Store addition trend



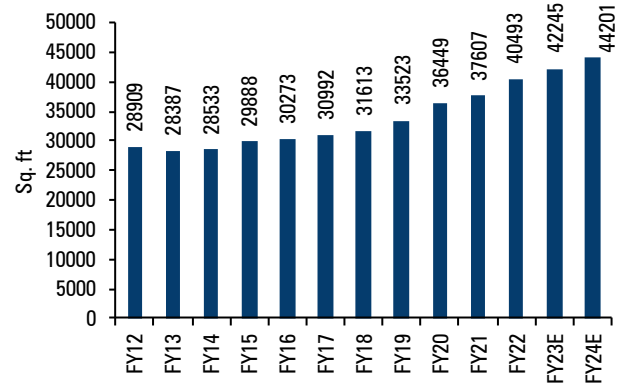
Source: Company, ICICI Direct Research.

Exhibit 6: Total carpet area grows at much faster clip...



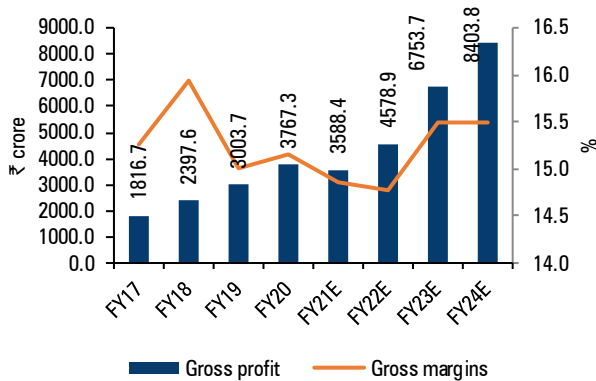
Source: Company, ICICI Direct Research

Exhibit 7: ...with gradual increase in average store size



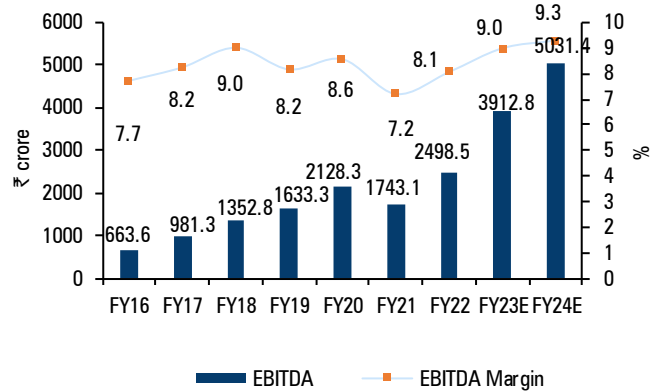
Source: Company, ICICI Direct Research

Exhibit 8: Gross margins trend



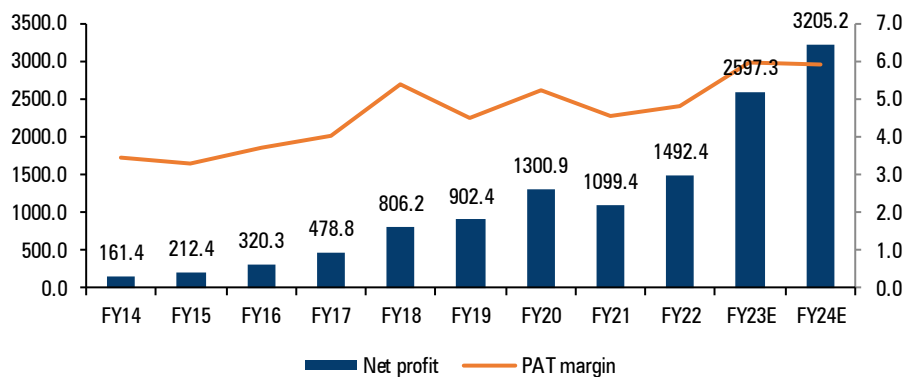
Source: Company, ICICI Direct Research

Exhibit 9: EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 10: Net profit trend



Source: Company, ICICI Direct Research.

Financial Summary

Exhibit 11: Profit and loss statement ₹ crore

(Year-end March)	FY21	FY22	FY23E	FY24E
Net Sales	24,143.1	30,976.3	43,572.3	54,218.2
Growth (%)	(2.9)	28.3	40.7	24.4
Total Raw Material Cost	20,554.7	26,397.4	36,818.6	45,814.3
Gross Margins (%)	14.9	14.8	15.5	15.5
Employee Expenses	536.6	616.2	784.3	921.7
Other Expenses	1,308.8	1,464.2	2,056.6	2,450.7
Total Operating Expenditure	22,400.0	28,477.8	39,659.5	49,186.7
EBITDA	1,743.1	2,498.5	3,912.8	5,031.4
EBITDA Margin	7.2	8.1	9.0	9.3
Interest	41.7	53.8	64.7	77.7
Depreciation	414.2	498.1	623.9	780.8
Other Income	196.2	117.5	105.7	112.1
Exceptional Expense	-	-	-	-
PBT	1,483.5	2,064.1	3,329.9	4,285.1
Total Tax	384.0	571.7	732.6	1,079.8
Profit After Tax	1,099.4	1,492.4	2,597.3	3,205.2

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement ₹ crore

(Year-end March)	FY21	FY22	FY23E	FY24E
Profit/(Loss) after taxation	1,099.4	1,492.4	2,597.3	3,205.2
Add: Depreciation	414.2	498.1	623.9	780.8
Net Increase in Current Assets	-551.5	-446.3	-1,045.7	-831.2
Net Increase in Current Liabilities:	378.8	55.9	247.3	205.0
CF from operating activities	1,340.9	1,600.0	2,422.8	3,359.8
(Inc)/dec in Investments	2,032.1	-155.9	381.5	133.5
(Inc)/dec in Fixed Assets	-2,029.0	-2,410.0	-2,343.2	-2,880.0
Others	91.0	-56.9	0.0	0.0
CF from investing activities	94.1	-2,622.8	-1,961.7	-2,746.5
Inc / (Dec) in Equity Capital	0.0	0.0	0.0	0.0
Inc / (Dec) in Loan	-3.7	0.0	0.0	0.0
Others	-93.6	-125.5	-152.8	-194.4
CF from financing activities	-97.4	-125.5	-152.8	-194.4
Net Cash flow	1,337.6	-1,148.2	308.3	419.0
Opening Cash	107.9	1,445.6	297.4	605.7
Closing Cash	1,445.5	297.4	605.7	1,024.7

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet ₹ crore

(Year-end March)	FY21	FY22	FY23E	FY24E
Equity Capital	647.8	647.8	647.8	647.8
Reserve and Surplus	11,535.9	13,028.3	15,625.7	18,830.9
Total Shareholders funds	12,183.7	13,676.1	16,273.4	19,478.7
Total Debt	-	-	-	-
Non Current Liabilities	444.7	712.0	712.0	712.0
Source of Funds	12,628.5	14,388.1	16,985.4	20,190.7
Gross block	7,048.4	9,256.4	11,778.9	14,658.9
Less: Accum depreciation	1,109.9	1,485.9	1,957.1	2,543.4
Net Fixed Assets	5,938.5	7,770.5	9,821.8	12,115.5
Capital WIP	1,019.6	1,129.3	950.0	950.0
Intangible assets	100.5	91.9	91.9	91.9
Investments	1,121.8	1,277.7	896.1	762.6
Inventory	2,248.3	2,742.7	3,700.7	4,456.3
Cash	1,445.6	297.4	605.7	1,024.7
Debtors	43.6	66.9	119.4	148.5
Loans & Advances & Other	320.7	328.8	345.2	352.1
Total Current Assets	4,058.2	3,435.7	4,771.0	5,981.6
Creditors	578.1	589.2	835.6	1,039.8
Provisions & Other CL	449.4	494.2	495.0	495.8
Total Current Liabilities	1,027.5	1,083.4	1,330.6	1,535.6
Net Current Assets	3,030.7	2,352.4	3,440.4	4,446.0
LT L& A, Other Assets	1,417.4	1,766.4	1,785.2	1,824.7
Other Assets	0.0	0.0	0.0	0.0
Application of Funds	12,628.5	14,388.1	16,985.4	20,190.6

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios

(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	17.0	23.0	40.1	49.5
Cash EPS	23.4	30.7	49.7	61.5
BV	188.1	211.1	251.2	300.7
Cash Per Share	22.3	4.6	9.4	15.8
Operating Ratios (%)				
EBITDA margins	7.2	8.1	9.0	9.3
PBT margins	6.1	6.7	7.6	7.9
Net Profit margins	4.6	4.8	6.0	5.9
Inventory days	34.0	32.3	31.0	30.0
Debtor days	0.7	0.8	1.0	1.0
Creditor days	8.7	6.9	7.0	7.0
Return Ratios (%)				
RoE	9.0	10.9	16.0	16.5
RoCE	12.5	15.5	20.9	22.4
RoIC	13.8	16.5	22.3	24.0
Valuation Ratios (x)				
P/E	253.5	186.8	107.3	87.0
EV / EBITDA	158.4	110.9	70.9	55.0
EV / Sales	11.4	8.9	6.4	5.1
Market Cap / Revenues	11.5	9.0	6.4	5.1
Price to Book Value	22.9	20.4	17.1	14.3
Solvency Ratios				
Debt / Equity	0.0	0.0	0.0	0.0
Debt/EBITDA	0.0	0.0	0.0	0.0
Current Ratio	2.5	2.9	3.1	3.2
Quick Ratio	0.4	0.4	0.3	0.3

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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