June 26, 2022

Sector Update

ICICI Securities – Retail Equity Research

On cusp of accelerating revenue, earnings growth

Despite various headwinds, fashion retailers displayed a resilient show with demand picking up pace in the latter part of H2FY22. Revenue recovery rate for most apparel and footwear players surpassed pre-Covid levels (100-105%) from Q3FY22 onwards, with Trent continuing to be the outperformer. Our retail coverage universe reported revenue growth of 36% YoY in FY22 (118% of pre-Covid levels), tad better than anticipated. Store addition trajectory improved significantly in Q4FY22 while companies have a healthy store addition pipeline for FY23E. Retail sector appears to be on the cusp of delivering strong sustained revenue growth driven by improved consumer sentiment, wardrobe refresh and increased spend on discretionary purchases as consumer wallet share on non-essentials had remained subdued for the last two years. Apparel players have been able to pass on the cost inflation (price hikes of 15-20%) with minimal impact of volumes. Multiple levers like business scenario normalisation and improvement in consumer sentiments are expected to buoy demand despite inflationary challenges in the near term.

Robust show despite second/third wave; momentum to sustain

Retail sector being a consumer facing industry was among most impacted sectors during pandemic peak. However, the sector showed significant improvement in recovery rate as it imbibed learnings from the first Covid wave and orchestrated better execution of strategies that led to higher recovery rate during the second and third wave. The sector saw strong bounce back post second wave with revenue recovery rate for most retailers surpassing pre-Covid levels (exhibit: 2). As per Retailers Association of India (RAI), sales momentum has continued to sustain with 23% and 24% revenue growth in April and May, respectively (vs. 2019 levels). We expect apparel and footwear retailers to demonstrate strong traction in revenue and earnings growth in the ensuing quarters driven by improved consumer sentiment and enhanced demand scenario for discretionary products.

Accelerated store addition to drive revenue growth

After a lull on store addition front in FY21, retail sector accelerated store expansion from H2FY22 onwards. Companies have restructured their existing store networks and aggressively enhanced footprint on pan India basis with emphasis on penetrating deeper in Tier 3-5 cities to capture potential demand pockets. **More than 16.5 million space addition is expected in FY21-24E vs. 8 million added in FY18-21 (~2x). Highest store addition to be led by ABFRL, Avenue Supermarts and Trent (exhibit: 3).**

Building inventory to capture potential demand

Another key parameter that is signifying improved demand expectation is built up of higher inventory by retailers after two consecutive years of below par Q1 revenue performance due to Covid waves during the period. **On an average, inventory days for fiscal ending FY22 increased 1.5x YoY (exhibit: 4).** We expect working capital days to normalise by H2FY22 resulting in positive operating cash flows.

Strong growth + valuation moderation = attractive entry point

We expect revenue of companies in our coverage universe to grow at a CAGR of 26% over FY22-24E (CAGR of ~17% from pre-Covid market in FY20) driven by healthy space addition pipeline coupled with higher focus on omni-channel play (physical + online). **Recent stock price correction offers good entry point to accumulate companies having healthy b/s, pan India presence and sustained long term revenue and earnings growth prospects. Key top picks: ABFRL, VIP, Titan and Trent.**

Sector Top picks

Company	Target Price	Upside (%)
ABFRL (ADIFAS)	340.0	41.7
Titan (TITIND)	2725.0	32.9
Trent (TRENT)	1470.0	38.7
VIP (VIPIND)	770.0	21.8

Key Risks

(i) Re-imposition of lockdown can negatively impact the revenue growth

(ii) Significant increase in raw material cost can subdue the margins

(iii) Lower than expected store addition can negatively impact the expected revenue growth

Research Analyst

Bharat Chhoda
bharat.chhoda@icicisecurities.com

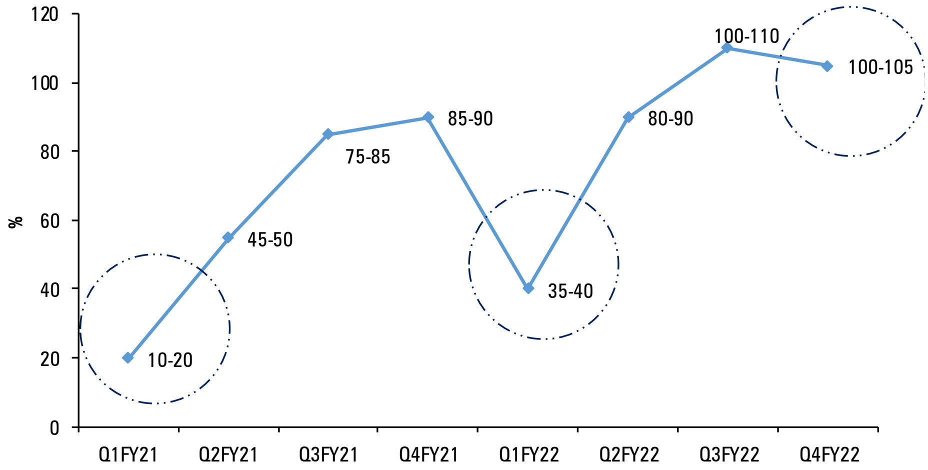
Cheragh Sidhwa
cheragh.sidhwa@icicisecurities.com

Exhibit 1: Top Retail Sector picks

Company	Comments	Valuation	CMP	Target Price	Upside (%)
ABFRL	ABFRL combines Madura's portfolio of leading power brands (Allen Solly, Van Heusen, Louis Philippe and Peter England) with Pantaloons' forte of largest value fashion retailer. Overall revenue recovery rate reached 93% of pre-covid levels in FY22 mainly driven by strong show in lifestyle brands. New category launches in active wear and casual wear and robust store additions (140+) fuelled growth. Demand trends continue to be strong with major drivers being strong wedding season and revival of formal portfolio with opening up of offices. Ethnic space continues to be the next growth engine for ABFRL with the business currently operating at an annual run rate of ₹ 400 crore. ABFRL has aggressive store addition plans for FY23E with 75+ Pantaloons store and 400+ (franchisee) lifestyle brand stores. The recent announcement of fund raise worth ₹ 2195 crore (equity+warrants) to GIC, would enable ABFRL to meet its long term capital needs and improve its competitive positioning	Stock price of ABFRL has appreciated at a CAGR of ~7% over the last five years. ABFRL has strengthened its balance sheet through recent equity infusion with net debt declining sharply from ₹ 2500 crore (in FY20) to ~₹ 504 crore. We believe ABFRL with lighter balance sheet and strong bouquet of brands is well placed to accelerate the pace of store addition and revenue growth. We reiterate our BUY rating with a target price of ₹ 340 (2.5x EV/sales FY24E)	240.0	340.0	41.7
Trent	Zudio remains the fastest growing value fashion brand in India with revenues surpassing ₹ 1000+ crore in FY22 (72% revenue CAGR in FY19-22). It's been Trent's new growth engine over the past couple of years. Westside format (75% of sales) too has demonstrated a strong recovery with like-for-like sales surpassing pre Covid levels in Q3FY22 (109%). The growth got further accentuated in Q4FY22 (despite omicron challenges) with robust LFL sales growth of 16%. Westside continues to be one of the most capital efficient fashion brand generating 25%+ RoCE (100% private label brands). We pencil in 215 new store additions between Westside and Zudio for FY23-24E. In the long run, the company aims to grow its revenue at a CAGR of 25%+	Trent has been an exceptional performer with the stock price appreciating at ~35% CAGR in the last five years. Robust performance during challenging times and industry leading performance will continue to warrant premium valuations for Trent. Hence, we maintain our BUY rating on the stock and value Trent at ₹ 1470 based on SOTP valuations	1060.0	1470.0	38.7
Titan	Titan has, over the years, withstood challenges and emerged as a resilient player. Despite covid related challenges, Titan's jewellery division (85% of revenues) has recorded an impressive 17% revenue CAGR during FY18-22, whereas overall industry during the same period has shown zero to marginal growth. Sustained market share gains without compromising on the balance sheet strength (FY22: RoCE 33% , cash & investments: ₹ 1500+ crore) has led to P/E multiple expansion over the last couple of years. The company has charted out aspiration to grow jewellery revenues by 2.5x by FY27 (implied CAGR: 20%). It has huge headroom for growth with current market share <6% in ₹ 4 lakh crore market. Estimated revenue and earnings CAGR of 20%/30% in FY22-24E, coupled with healthy RoCE (33%+), makes Titan one of the best compounding stories	The stock has witnessed steep correction since the last three months (~23%). Titan has been a consistent compounder with the stock price increasing at 31% CAGR in the last five years. Titan is a structural growth story and appears to be a key beneficiary of the unorganised to organised shift in the Indian jewellery market. We value Titan at ₹ 2725 i.e. 66x FY24E EPS	2050.0	2725.0	32.9
VIP	On the back of improved travel and tourism scenario in India and improving domestic airline passenger traffic, VIP industries witnessed a healthy recovery in FY22 with revenues increasing 2x YoY to ₹ 1289.5 crore. Recovery rate was at ~75% in FY22. While luggage segment has recovered 85%, backpacks reached 42% of pre-Covid levels. VIP is well geared up with inventory and ramping up the same to meet the demand, which could arise owing to strong demand revival in Q1FY23. April 2022 has been the best ever April in terms of revenue and expects Q1FY23 to surpass pre-covid levels after two years. We expect the company to reach pre-Covid levels by FY23E and model in revenue CAGR of 30% in FY22-24E (on a favourable base). Re-engineered fixed overheads and increased proportion of in-house manufacturing both from India and Bangladesh to translate into better margins, going forward.	VIP's share price has grown by ~3x over the past five years (from ~₹ 180 in June 2017 to ~₹ 600 levels in June 2022). Luggage being a proxy play to the travel & tourism industry was among the worst impacted sectors owing to pandemic in FY21/22. With demand green shoots visible, we expect VIP Industries to be a key beneficiary of increased movement of leisure and business tourist both domestically and internationally. We maintain BUY recommendation on the stock and value VIP at ₹ 770 (48x FY24E EPS)	632.0	770.0	21.8

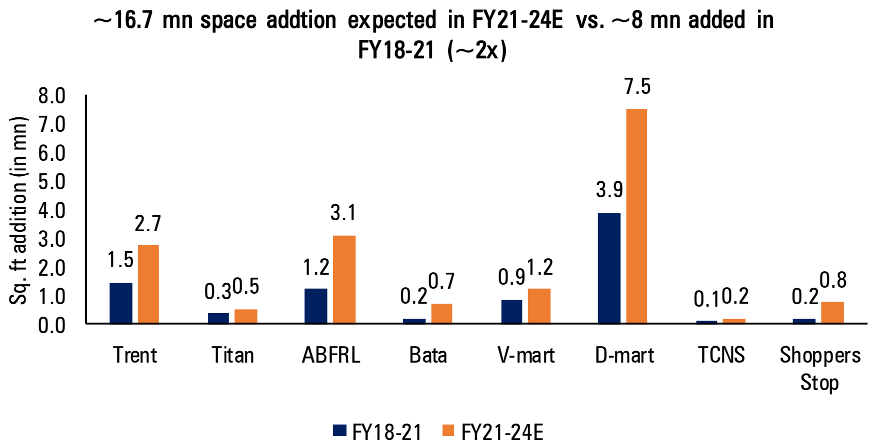
Source: Company, ICICI Direct Research

Exhibit 2: Revenue recovery rate surpasses pre-Covid levels from Q3FY22 onwards



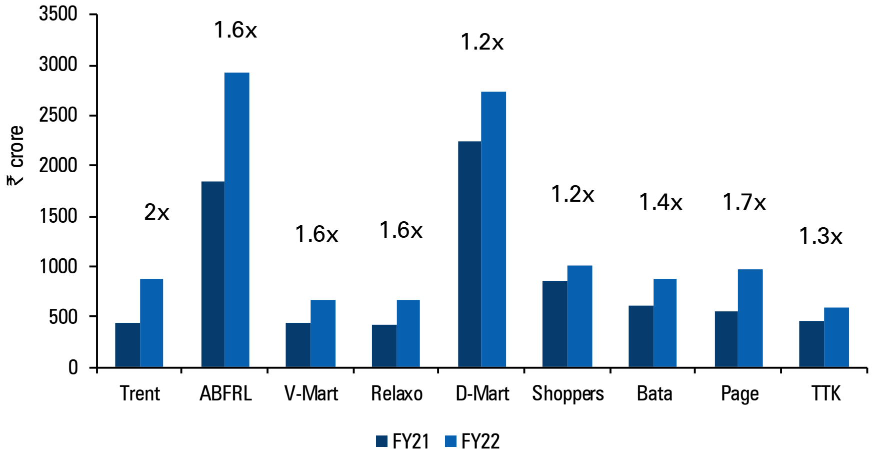
Source: Company, ICICI Direct Research

Exhibit 3: Square feet addition trend



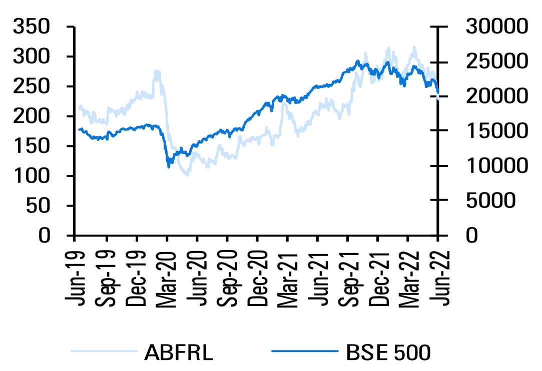
Source: Company, ICICI Direct Research

Exhibit 4: Trend in inventory levels and YoY increase

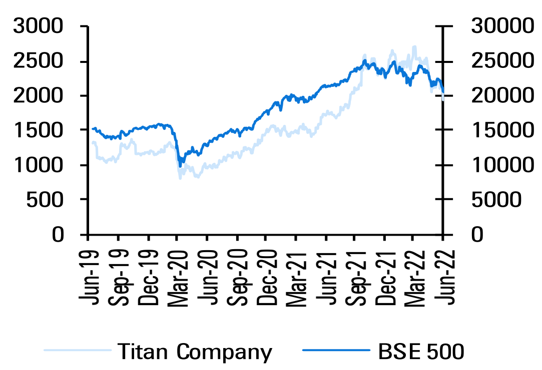


Source: Company, ICICI Direct Research

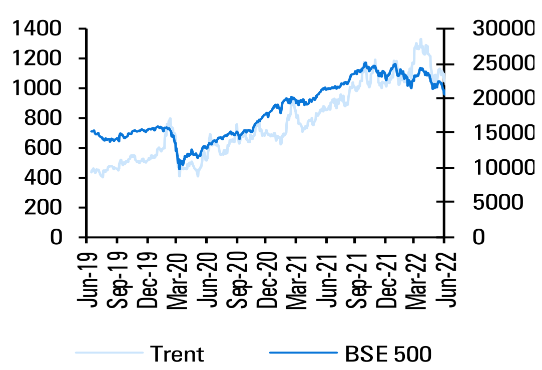
Price Chart: ABFRL



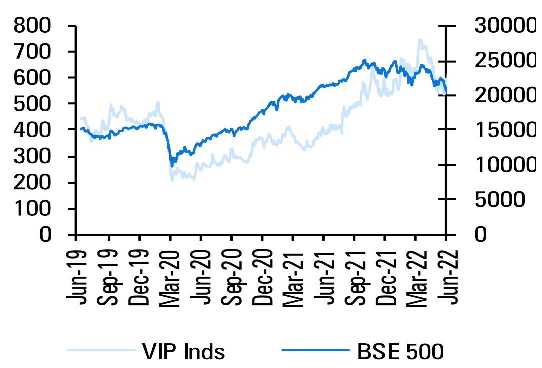
Price Chart: Titan



Price Chart: Trent



Price Chart: VIP



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Pankaj Pandey | Head – Research | pankaj.pandey@icicisecurities.com

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

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