Avenue Supermarts (AVESUP)

January 16, 2023

Delay in recovery of GM, apparel subdued margins...

About the stock: Avenue Supermarts (ASL) operates supermarket chain under the ‘D-Mart’ brand with 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 (break-even in 18-24 months of its operations and one industry best revenue/sq ft: ₹ 30000+).

Q3FY23: D-Mart reported a weak operational performance with profitability coming below our/consensus estimates. Discretionary non-FMCG business (general merchandise & apparel), which yields better margins, continued to perform below expectations and led to a moderation of profitability.

- Sales grew 25% YoY to ₹ 11504 crore (three year CAGR: 19%).
- Discretionary product mix continues to be lower vs. pre-Covid levels leading to lower gross margins (down 60 bps YoY to 14.8%). Higher opex further impacted EBITDA margins, which were at 8.3% (I-direct estimate: 8.8%).
- PAT for the quarter came in at ₹ 589.6 crore (up mere 7% YoY).
- The company added four new D-Mart outlets taking the total store count to 306 with total business area now at 12.6 million sq ft.

What should investors do? ASL has been a consistent compounder with the stock price increasing at 27% CAGR in the last five years. However, since the last one year, the stock has delivered negative returns (~12%) owing to revenue trajectory tapering down a bit to 19-20% (vs. 25-30%) and product mix change leading to lower than expected margins. D-Mart continues to remain India’s most profitable low cost retailer, a strong play on India’s retail growth story and a key beneficiary of unorganised to organised segment shift. We introduce FY25E estimates and bake in earnings CAGR of 22% in FY23-25E (vs. CAGR of 24% witnessed in FY20-23E).

- We maintain HOLD recommendation on the stock.

Target Price and Valuation: We value ASL at ₹ 4000 i.e. 4x FY25E EV/Sales.

Key triggers for future price performance:
- We anticipate store addition trajectory will accelerate and bake in 115 incremental store additions (addition of ~ 6.2 mn sq. ft.) in FY23-25E.
- Robust liquidity position and healthy operating cashflows to provide impetus to store addition pace (H1FY23 cash & investments: ₹ 1200+ crore).
- Recovery in GM & apparel segment (~25% of revenues) to shore up margins with subsequent improvement in RoIC: 24% (up 260 bps).

Alternate Stock Idea: Apart from ASL, in our retail coverage, we also like Trent
- We have a BUY rating with target price of ₹ 1730/share.

Key Financial Summary

<table>
<thead>
<tr>
<th>Financials</th>
<th>FY19</th>
<th>FY20</th>
<th>FY21</th>
<th>FY22</th>
<th>FY23E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales</td>
<td>20,004.5</td>
<td>24,870.2</td>
<td>24,143.1</td>
<td>30,976.3</td>
<td>43,230.1</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,633.3</td>
<td>2,128.3</td>
<td>1,743.1</td>
<td>2,498.5</td>
<td>3,778.3</td>
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<tr>
<td>PAT</td>
<td>902.4</td>
<td>1,301.0</td>
<td>1,099.4</td>
<td>1,492.4</td>
<td>2,483.7</td>
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<tr>
<td>P/E (x)</td>
<td>255.2</td>
<td>183.7</td>
<td>217.4</td>
<td>160.2</td>
<td>96.2</td>
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<tr>
<td>EV/Sales (x)</td>
<td>11.5</td>
<td>9.5</td>
<td>9.8</td>
<td>7.7</td>
<td>5.5</td>
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<tr>
<td>EV/EBITDA (x)</td>
<td>141.3</td>
<td>110.8</td>
<td>135.7</td>
<td>95.0</td>
<td>62.8</td>
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<tr>
<td>RoCE (%)</td>
<td>23.4</td>
<td>16.4</td>
<td>12.5</td>
<td>15.5</td>
<td>20.1</td>
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<tr>
<td>RoE (%)</td>
<td>16.2</td>
<td>11.7</td>
<td>9.0</td>
<td>10.9</td>
<td>15.4</td>
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4 year CAGR
(FY19-23E) | FY24E | FY25E | 2 year CAGR
(FY23-25E)
---|---|---|---
21.2% | 52,933.7 | 64,303.4 | 22.0% |
23.3% | 4,753.4 | 5,915.3 | 25.1% |
28.8% | 3,003.8 | 3,715.6 | 22.3% |

Market Capitalisation (₹ crore) | 2,39,027.1 |
Total Debt (FY22) (₹ crore) | - |
Cash & Investment (FY22) (₹ crore) | 1,575.1 |
EV (₹ crore) | 2,37,452.1 |
52 Week H / L | 4609 / 3185 |
Equity Capital (₹ crore) | 524.8 |
Face Value (₹) | 10.0 |

Particulars

<table>
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<tr>
<th>Particulars</th>
<th>Amount</th>
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<td>Promoter</td>
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<td>FII</td>
<td>9.4</td>
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<tr>
<td>DII</td>
<td>6.7</td>
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<tr>
<td>Others</td>
<td>8.8</td>
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</tbody>
</table>

Price Chart

Recent event & key risks:
- Added four new stores in Q3

Key Risk: (i) Slower ramp up of store network (ii) Faster recovery in GM & apparel to aid margin improvement

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Source: Company, ICICI Direct Research
Key takeaways of Q3FY23 results

- As guided by the management in its pre-quarterly update, Avenue Supermarts reported revenue growth of 25.5% YoY to ₹11,569.1 crore (three-year CAGR: 19%). The company added four new D-Mart outlets (22 in 9MFY23) taking the total store count to 306 with total business area of 12.6 million sq ft. Average square feet of new stores added is around 50000 (vs. FY22 average of ~41000). D-Mart ready (online business) continues to perform well with revenue growth of 72% YoY to ₹264 crore.

- Revenue per sq ft did witness a marginal improvement on a YoY basis (~3% YoY) to ₹9182. However, it continued to remain below pre-Covid levels (Q3FY20: ₹9,768). We believe 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 larger stores was to stock higher discretionary categories such as GM & apparel, which yields better gross margins. However, Covid led disruptions materially impacted the performance of this category, which, in turn, impacted gross margins and RoCE for the stores.

- The management highlighted FMCG and staples continued to outperform general merchandise and apparel segment. With the discretionary product mix being impacted, gross margins for the quarter came in below our estimate at 14.8% (l-direct estimate: 15.2%, Q3FY22: 15.4%, Q3FY20: 15.3%). On the back of festive purchases in the GM & apparel segment, Q3 generally tends to yield gross margins in excess of 15%. However, multi-year low margins recorded in Q3FY23 reflects some grave challenges, which could possibly be on account of heightened competitive intensity over the past two years and inflationary stress still pertaining in the discretionary value segment.

- Opex also grew at a faster clip (~36%) than revenue growth (25%). Subsequently, EBITDA margins declined by 110 bps YoY to 8.8% (l-direct estimate: 8.8%). Absolute EBITDA grew 11% YoY to ₹965 crore (l-direct estimate: ₹1,012 crore, three-year CAGR: 17%). Higher depreciation expenses (owing to addition of new rented stores, up 31% YoY) and finance cost (lease liability, up 22% YoY) further impacted profitability. Ensuing PBT was at ₹811.8 crore (l-direct estimate: ₹864 crore, up 8% YoY). Consequently, PAT for the quarter came in at ₹589.6 crore (up 7% YoY, l-direct estimate: ₹646.5 crore).

- Over the last three years, the company has expanded its square feet addition by an impressive three-year CAGR of ~ 22% with average size of new stores being bigger (~60000 + vs. average 35000 sq ft). However, the revenue trajectory has grown at a slower pace (~20%) resulting in lower sales per store. We expect the company to exit FY23E with RoIC of 22% (up 500 bps YoY but still ~500 bps below FY19 levels). We anticipate RoIC will improve, going forward, driven by dual triggers of enhanced margins (bake in 50 bps improvement in FY23-25E) and better store throughput (asset turn at 3.6x). We build in average SSSG of 11% in FY20-24E with revenue per sq ft of ₹36,000 in FY25E (FY23: ₹32,500).
### Exhibit 1: Variance Analysis

<table>
<thead>
<tr>
<th></th>
<th>Q3FY23</th>
<th>Q3FY23E</th>
<th>Q3FY22</th>
<th>YoY (%)</th>
<th>QoQ (%)</th>
<th>Comments</th>
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<tr>
<td>Revenue</td>
<td>11,569.1</td>
<td>11,504.0</td>
<td>9,217.8</td>
<td>25.5</td>
<td>8.7</td>
<td>3-year CAGR: 19%. Revenue/sq. ft. at ₹ 9180 (~93% of pre-covid levels)</td>
</tr>
<tr>
<td>Raw Material Expense</td>
<td>9,851.3</td>
<td>9,755.4</td>
<td>7,796.6</td>
<td>26.4</td>
<td>9.1</td>
<td></td>
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<tr>
<td>Gross Profit</td>
<td>1,717.7</td>
<td>1,748.6</td>
<td>1,421.2</td>
<td>20.9</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>14.8</td>
<td>15.2</td>
<td>15.4</td>
<td>-57 bps</td>
<td>-28 bps</td>
<td>Gross margins came in below our estimates owing to sustained pressure on GM &amp; apparel segment</td>
</tr>
<tr>
<td>Employee exp</td>
<td>192.3</td>
<td>195.6</td>
<td>161.8</td>
<td>18.9</td>
<td>2.0</td>
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<tr>
<td>Other Exp</td>
<td>560.2</td>
<td>540.7</td>
<td>392.9</td>
<td>42.6</td>
<td>6.0</td>
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<tr>
<td>EBITDA</td>
<td>965.3</td>
<td>1,012.4</td>
<td>866.5</td>
<td>11.4</td>
<td>8.2</td>
<td>Significantly higher other expenses further impacted profitability (3-year EBITDA CAGR: 17%)</td>
</tr>
<tr>
<td>EBITDA Margin (%)</td>
<td>8.3</td>
<td>8.8</td>
<td>9.4</td>
<td>-106 bps</td>
<td>8.4</td>
<td>-4 bps</td>
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<td>Depreciation</td>
<td>168.1</td>
<td>166.8</td>
<td>128.3</td>
<td>31.0</td>
<td>3.8</td>
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<tr>
<td>Other Income</td>
<td>31.6</td>
<td>36.6</td>
<td>26.0</td>
<td>21.6</td>
<td>-11.3</td>
<td></td>
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<tr>
<td>Interest</td>
<td>17.0</td>
<td>17.9</td>
<td>14.0</td>
<td>21.7</td>
<td>17.7</td>
<td>-4.0</td>
</tr>
<tr>
<td>Exceptional Income</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
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<tr>
<td>PBT</td>
<td>611.8</td>
<td>864.3</td>
<td>750.2</td>
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<td>Tax Outgo</td>
<td>222.1</td>
<td>217.8</td>
<td>197.6</td>
<td>12.4</td>
<td>62.2</td>
<td>256.9</td>
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<tr>
<td>PAT</td>
<td>589.6</td>
<td>646.5</td>
<td>552.5</td>
<td>6.7</td>
<td>685.7</td>
<td>-14.0</td>
</tr>
</tbody>
</table>

Source: Company, ICICI Direct Research

### Exhibit 2: Change in estimates

<table>
<thead>
<tr>
<th></th>
<th>FY 23E</th>
<th>FY 24E</th>
<th>FY 25E</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Old</td>
<td>New</td>
<td>% Change</td>
</tr>
<tr>
<td>Revenue</td>
<td>43,572.1</td>
<td>43,230.1</td>
<td>-0.8</td>
</tr>
<tr>
<td>EBITDA</td>
<td>3,912.8</td>
<td>3,778.3</td>
<td>-3.4</td>
</tr>
<tr>
<td>EBITDA Margin (%)</td>
<td>9.0</td>
<td>8.7</td>
<td>-24 bps</td>
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<tr>
<td>PAT</td>
<td>2,597.3</td>
<td>2,483.7</td>
<td>-4.4</td>
</tr>
<tr>
<td>EPS (`)</td>
<td>40.1</td>
<td>38.3</td>
<td>-4.4</td>
</tr>
</tbody>
</table>

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...

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

Exhibit 8: Gross margins trend

Exhibit 9: EBITDA margin trend

Exhibit 10: Net profit trend
Exhibit 11: Profit and loss statement (Year-end March) FY22 FY23E FY24E FY25E
Net Sales 30,976.3 43,230.1 52,933.7 64,303.4
Growth (%) 28.3 39.6 22.4 21.5
Total Raw Material Cost 26,397.4 36,615.9 44,781.9 54,336.3
Gross Margins (%) 14.6 15.3 15.4 15.5
Employee Expenses 616.2 752.2 899.9 1,157.5
Other Expenses 1,464.2 2,083.7 2,498.5 2,894.3
Total Operating Expenditure 28,477.8 39,451.8 48,180.2 58,388.1
EBITDA 2,488.5 3,773.3 4,753.4 5,915.3
EBITDA Margin 8.1 8.7 9.0 9.2
Interest 53.0 64.7 77.7 89.3
Depreciation 408.1 539.8 777.0 952.2
Other Income 117.5 110.4 117.1 93.7
Exceptional Expense - - - -
PBT 2,064.1 3,184.3 4,015.8 4,967.3
Total Tax 571.7 700.5 1,012.0 1,251.8
Profit After Tax 1,492.4 2,483.7 3,003.8 3,715.6

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement (Year-end March) FY22 FY23E FY24E FY25E
Profit/(Loss) after taxation 1,492.4 2,483.7 3,003.8 3,715.6
Add: Depreciation 488.1 639.8 777.0 952.2
Net Increase in Current Assets -446.3 -1,015.7 -752.1 -1,016.1
Net Increase in Current Liabilities 55.9 240.7 186.9 218.9
CF from operating activities 1,600.0 2,348.5 3,215.7 3,670.6
(Inc)/dec in Investments -155.9 381.5 133.5 113.5
(Inc)/dec in Fixed Assets -2,410.0 -2,159.7 -2,970.0 -2,970.0
Others -56.9 0.0 0.0 0.0
CF from investing activities -2,622.8 -1,778.2 -2,836.5 -2,856.5
Inc / (Dec) in Equity Capital 0.0 0.0 0.0 0.0
Inc / (Dec) in Loan 0.0 0.0 0.0 0.0
Others -125.5 -152.8 -194.4 -233.3
CF from financing activities -125.5 -152.8 -194.4 -233.3
Net Cash flow -1,148.2 417.5 184.8 780.8
Opening Cash 1,445.6 297.4 714.9 899.7
Closing Cash 297.4 714.9 899.7 1,680.5

Source: Company, ICICI Direct Research

Exhibit 13: Balance Sheet (Year-end March) FY22 FY23E FY24E FY25E
Equity Capital 647.8 647.8 647.8 647.8
Reserve and Surplus 13,028.3 15,512.1 18,515.9 22,231.5
Total Shareholders funds 13,676.1 16,519.8 19,163.7 22,879.2
Total Debt - - - -
Non Current Liabilities 712.0 712.0 712.0 712.0
Source of Funds 14,388.1 18,871.8 19,875.6 23,591.2

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios (Year-end March) FY22 FY23E FY24E FY25E
Per share data (₹)
EPS 23.0 38.3 46.4 57.4
Cash EPS 30.7 48.2 58.4 72.1
BV 211.1 249.5 295.8 353.2
Cash Per Share 4.6 11.0 13.9 25.9

Operating Ratios (%)
EBITDA margins 8.1 8.7 9.0 9.2
PBT margins 6.7 7.4 7.6 7.7
Net Profit margins 4.8 5.7 5.7 5.8
Inventory days 32.3 31.0 30.0 30.0
Debtor days 0.8 1.0 1.0 1.0
Creditor days 6.9 7.0 7.0 7.0
Return Ratios (%)
RoE 10.9 15.4 15.7 16.2
RoCE 15.5 20.1 21.4 22.1
RoIC 16.5 21.6 22.7 24.2

Valuation Ratios (x)
P/E 160.2 96.2 79.6 64.3
EV / EBITDA 95.0 62.8 49.9 40.0
EV / Sales 7.7 5.5 4.5 3.7
Market Cap / Revenues 7.7 5.5 4.5 3.7
Price to Book Value 17.5 14.8 12.5 10.4

Solvency Ratios
Debt / Equity 0.0 0.0 0.0 0.0
Debt/EBITDA 0.0 0.0 0.0 0.0
Current Ratio 2.9 3.1 3.2 3.4
Quick Ratio 0.4 0.4 0.3 0.3

Source: Company, ICICI Direct Research
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Buy: >15%
Hold: -5% to 15%;
Reduce: -15% to -5%;
Sell: <15%

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