SPECIAL REPORT

22nd March, 2024

TECHNO FUNDA

BP WEALTH

AVENUE SUPERMARTS LTD

Buy

BP WEALTH

Diversified Retail

Technical View (Weekly Chart)

Source: TradingView

Technical View

⇒ DMART recorded a healthy 956% bull run since the listing day before it propelled into a multi-year consolidation.

⇒ The price action has retraced back into the accumulation phase of stage 1 after witnessing a steady growth in its former stage 2.

⇒ The pattern analysis on the weekly timeframe evinces that the price action has been trading in volatility contraction pattern.

⇒ The diminishing contraction of bases with respect to time and price depth along with lower highs and higher lows indicate that the smart hands are gradually capitalizing opportunities to absorb the available supply whilst the stock is trending sideways.

⇒ The constant absorption of supply has been restricting drawdowns thereby strengthening the price action.

⇒ The 50 week period volatility has been trading at lower levels thereby reducing the probability of any unruly moves.

⇒ Other than the relative strength compared to the 50-index, the EPS strength and buyers' demand in the stock has seen fair improvement as the pattern shows early signs to unfold. This is another positive sign.

⇒ The RSI across its daily and higher timeframe are trading well above their respective medians without showing any divergence against their prices. This indicates that price action poses momentum thrust to bolster the continuation of the primary trend.

⇒ **We reiterate a buy on DMART in the range of 4163-4052 for the target of 5607 against a protective stop at 3754.**

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Fundamental View

Avenue Supermarts Ltd. – Seizing the opportunity

Contrarian View on Avenue Supermarts: Recognizing the Potential for Substantial Growth Despite Current Correction

Company Overview

Avenue Supermarts Ltd., established in 2000, is the parent company of DMart, a well-known grocery retail chain in India. DMart has strategically expanded its presence through a cluster-based approach since its inception. It provides various everyday items with a balanced product mix across Foods, Non-foods, and General Merchandise and Apparel categories. DMart initiated its operations by launching its first store in 2002 in Mumbai, Maharashtra. Over the years, it has significantly expanded its footprint and currently operates 341 stores across various states in India. The retail business area of DMart stores is 14.2 million square feet, demonstrating the company's substantial physical presence. The geographical spread of DMart stores encompasses multiple states, including Maharashtra, Gujarat, Telangana, Andhra Pradesh, Karnataka, Madhya Pradesh, Tamil Nadu, Rajasthan, Punjab, NCR (National Capital Region), Chhattisgarh, and Daman. This widespread presence indicates DMart's commitment to catering to customers in diverse regions nationwide. DMart's business model is anchored on the principle of Everyday Low Cost/Everyday Low Price (EDLC/EDLP), emphasizing affordability and value for customers. The company aims to consistently offer high-quality products at competitive prices by adhering to this strategy.

Operational Performance

In Q3FY24, DMart's standalone sales demonstrated a YoY growth of 17.2%, reaching Rs. 132.47 billion. This growth was primarily attributed to a slight increase in discretionary spending, particularly during the extended festive season. The management of DMart observed an encouraging demand trend, particularly around festivals, which boosted the contribution from the General Merchandise/ Apparel segment, stabilizing it at around 24%. Despite this positive development, some margin pressures were evident in the financials. The gross margin for the period stood at 14.2%, representing a slight decrease of 9 bps YoY. This marginal decline in gross margin contributed to a decrease in EBITDA margin, which settled at 8.5%, down by 16 bps compared to the previous year. However, despite these challenges, the company grew in PAT by 14.9% to Rs. 7,368 million, driven by factors such as a better product mix and lower interest costs, which decreased by 8.0% YoY. Opex also grew at a faster clip at 36% than revenue growth. During Q3FY24, DMart opened five new stores. In 9MFY24, the company opened 17 stores, compared to 22 stores in the same period of the previous financial year. As a result, the total store count reached 341 outlets. In addition, the average size of the new stores increased YoY to 41.6 thousand square feet per store. This expansion demonstrates DMart's ongoing commitment to growing its physical footprint and reaching out to more customers across different regions. Despite the slightly slower pace of expansion compared to the previous financial year, DMart continues to focus on strategic store openings to capture market share and drive long-term growth.

Execution Data

Target (Rs)	5607
Stop loss (Rs)	3754
Buying Range (Rs)	CMP-4052
Last Close Price (Rs)	4163
% change Weekly	5.87%

Weekly Oscillator Direction

10 WMA	FLATTISH
20 WMA	UPWARD
50 WMA	FLATTISH
RSI	BUY MODE
MACD	BUY MODE

Sector Outlook — Neutral

Stock

BSE code	540376
NSE Symbol	DMART
Bloomberg	DMART IN
Reuters	AVEY.BO

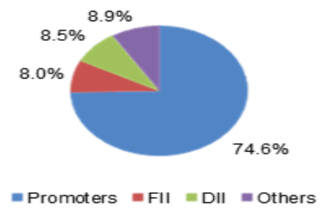
Key Data

Nifty	22,012
52WeekH/L(Rs)	4238 / 3300
O/s Shares (mn)	651
Market Cap (Rs bn)	2,710
Face Value (Rs)	10

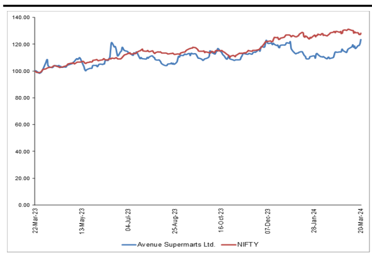
Average volume

3 months	3,44,450
6 months	3,84,970
1 year	3,59,720

Share Holding Pattern (%)



Relative Price Chart



Fundamental View

Investment Thesis

Promoter's Impeccable Track Record and Cash Management

Led by respected investor Mr. Radhakishan Damani, DMart understands the cyclical nature of businesses. With a focus on cash preservation during challenging times, DMart maintains a cash-rich position. This strategy enables it to purchase products competitively, reinforcing its reputation for offering value to customers and sustaining a competitive advantage. Inspired by Peter Lynch's wisdom on retail companies, DMart's adherence to increasing same-store sales, prudent debt management, and transparent communication with shareholders underscores its reliability as an investment choice.

Overcoming Near-Term Challenges with Steady Growth Prospects

Despite facing near-term challenges such as tepid General Merchandise and Apparel (GMA) sales and a slow pace of store expansion, DMart remains poised for growth. While these challenges persist, there are positive indicators such as Store throughput numbers are steadily improving, reflecting increasing efficiency in-store operations. This improvement suggests the potential for topline growth and operational effectiveness. We anticipate a significant improvement in GMA sales performance. The structural opportunity in both offline and online retail spaces remains strong. DMart is well-positioned to capitalize on these opportunities and further expand its market presence. Although apparel sales may face structural challenges, the company's diversification into emerging categories can mitigate this impact. By tapping into new product categories with growing demand, DMart aims to sustain overall revenue growth. DMart's competitive edge lies in its robust procurement capabilities, offering low-priced products while maintaining stringent cost control measures. These factors attract greater footfall to its stores. As a result, DMart achieves high inventory turnover and revenue per square foot, surpassing industry standards and establishing itself as a leader in retail store productivity. Avenue Supermarts operates in merely 10 out of 28 Indian states, signaling substantial room for expansion both within existing regions and into new states. Despite projecting sales of Rs. 50,000 crores in FY24, DMart faces a massive untapped market, with the unorganized sector estimated at Rs. 60 lakh crores. This discrepancy highlights an opportunity size nearly 100 times larger, underscoring the significant growth potential awaiting the company.

Potential Margin Recovery Through Product Mix Improvement

DMart’s Margins are expected to improve mainly on account of a strategic focus on a high-margin product mix. Despite YoY decline from 14.3% to 14.2% in gross margin due to Inflationary pressures that resulted in a reduced contribution from higher-margin segments, particularly the general merchandise and apparel (GM&A) business, thereby impacting margins. However, the company reports a stabilization in GM&A contribution post-Diwali, indicating encouraging trends. The expected recovery in the discretionary mix, supported by decreasing inflation, is anticipated to bolster margins in forthcoming quarters. Despite an anticipated lower gross margin in FY24 compared to FY23 due to the product mix deterioration, an improvement is expected in FY25. This improvement is expected to be supported by enhanced discretionary demand, driven by lower inflation rates.

Unlocking Value Through Rapid Growth with Dmart Ready

Dmart Ready, Avenue Supermarts' e-commerce platform, is witnessing rapid expansion without incurring losses. With a remarkable 50% CAGR, it achieved revenues of Rs. 2,200 crore in FY23. This impressive growth trajectory underscores the platform's potential, presenting an opportunity for a stake sale to unlock further value for the company.

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Poised for Walmart-like Growth

Drawing parallels with the trajectory of global retail giant Walmart, as elucidated by Peter Lynch in "Beating the Street," Avenue Supermarts showcases significant growth potential. While investors could have entered Walmart a decade after its public debut, witnessing a remarkable 20-fold gain, Avenue Supermarts mirrors a similar growth trajectory. With the potential to double its revenue every 3-4 years, fueled by India's burgeoning GDP and rising consumer aspirations, coupled with the transition from unorganized to organized retail, Avenue Supermarts presents an opportunity for substantial returns reminiscent of Walmart's historical performance.

Outlook

India's retail industry is projected to expand to $4.5 trillion by the end of the decade, according to Deloitte India and the Shopping Centre Association of India (SCAI). The shift from unorganized to organized retail is poised to accelerate, propelled by the middle class's growing preference for quality products at reasonable prices and the succession hurdles encountered by traditional kirana stores. This trend lays a robust foundation for Avenue Supermarts' sustained, long-term growth, as it continues to cater to evolving consumer demands and solidifies its position in the organized retail sector. DMart led by savvy promoters, offers essential products at compelling values. Targeting the vast Indian middle class, it positions itself as a high-quality franchise poised for substantial growth. DMart continues to uphold its reputation as a value-focused retailer, prioritizing affordability and quality for its customers. Additionally, DMart Ready, the company's online delivery service, stands out in terms of SKU (Stock Keeping Unit) availability compared to its competitors. It is demonstrating sequential improvement, indicating a commitment to enhancing its offerings and meeting customer needs efficiently. The recovery in the discretionary mix, particularly in General Merchandise and Apparel (GM&A), is expected to contribute to margin improvement going forward. Overall, while there were some margin pressures experienced by DMart in the reported period, the company's performance was supported by encouraging demand trends, improved product mix, and cost management initiatives.

The management's effort to address margin challenges, coupled with the recovery in the discretionary segment, is expected to drive future growth and profitability for the company. With a healthy balance sheet and a debt-free status, DMart is well-positioned to leverage its strengths in the under-penetrated organized retail grocery industry. With an anticipated significant transition from unorganized to organized retail, Avenue Supermarts is well-positioned to capitalize on this enduring trend. The company offers an appealing entry point amid market consolidation and corrections, presenting investors with the opportunity for sustained long-term growth. Therefore, our outlook on Dmart remains positive, driven by the factors discussed above. With its focus on value-oriented retailing, strong balance sheet, debt-free status, and operational leverage, DMart is well-positioned to capitalize on the opportunities within the organized retail industry.

With a market capitalization of Rs. 2.6 lakh crores and a robust cash profit of Rs. 880 crores in Q3FY24, Avenue Supermarts is anticipated to achieve an annualized cash profit of Rs. 4,500 to Rs. 5,000 crores in FY25 and FY26. Furthermore, the projected operating cash flow of Rs. 6,000 crores signals a formidable operating cash flow yield of 2.4%. Typically, businesses with substantial growth potential and a ROCE exceeding 20%, selling essential day-to-day goods, tend to bottom out at an operating cash flow yield of 3%. Given these fundamentals, it is believed that the stock is nearing its bottom. A single quarter with growth exceeding 22-23% and an increase in the number of store openings could potentially lead to a rerating of the stock upwards.

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Key Financials								
YE March (Rs. crores)	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**9MFY24**
Revenue	**11,898**	**15,033**	**20,005**	**24,870**	**24,143**	**30,976**	**42,840**	**38,062**
Revenue Growth (Y-oY)		*26.3%*	*33.1%*	*24.3%*	*(2.9%)*	*28.3%*	*38.3%*	
EBIDTA	**969**	**1,353**	**1,633**	**2,128**	**1,745**	**2,502**	**3,639**	**3,160**
EBIDTA Growth (Y-o-Y)		*39.6%*	*20.7%*	*30.3%*	*(18.0%)*	*43.4%*	*45.4%*	
Net Profit	**479**	**806**	**902**	**1,301**	**1,099**	**1,492**	**2,378**	**1,972**
Net Profit Growth (Y-o-Y)		*68.3%*	*11.9%*	*44.2%*	*(15.5%)*	*35.8%*	*59.4%*	
Diluted EPS	**7.7**	**12.9**	**14.5**	**20.1**	**17.0**	**23.0**	**36.7**	**30.3**
Diluted EPS Growth (Y-o-Y)		*68.4%*	*11.9%*	*38.9%*	*(15.5%)*	*35.8%*	*59.2%*	
Key Ratios								
EBIDTA margin (%)	**8.1%**	**9.0%**	**8.2%**	**8.6%**	**7.2%**	**8.1%**	**8.5%**	**8.3%**
NPM (%)	4.0%	5.4%	4.5%	5.2%	4.6%	4.8%	5.6%	5.2%
RoCE (%)	**21.0%**	**24.0%**	**26.0%**	**20.0%**	**13.0%**	**16.0%**	**20.0%**	**20.1%**
Valuation Ratios								
P/E (x)	**519.9x**	**308.7x**	**275.8x**	**198.5x**	**235.0x**	**173.1x**	**108.7x**	**133.9x**
Market Cap. / Sales (x)	22.2x	17.6x	13.2x	10.6x	10.9x	8.5x	6.2x	6.9x

Source: Company, BP Equities Research

Prepared By:

Kushal Gandhi
Technical Analyst
kushalgandhi@bpwealth.com

Shreyansh Shah
Fundamental Analyst
shreyansh@bpwealth.com

BP WEALTH

Research Desk Tel: +91 22 61596131

Institutional Sales Desk Tel: +91 22 61596132/36/38

Disclaimer Appendix

Analyst (s) holding in the Stock : Nil

Analyst (s) Certification:

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Corporate Office:
4th floor,
Rustom Bldg,
29, Veer Nariman Road, Fort,
Mumbai-400001
Phone- +91 22 6159 6464
Fax-+91 22 6159 6160
Website- www.bpwealth.com

Registered Office:
24/26, 1st Floor, Cama Building,
Dalal street, Fort,
Mumbai-400001

BP Equities Pvt. Ltd.
CIN No: U67120MH1997PTC107392