DMart needs a wardrobe upgrade

Vineetha Sampath & Pallavi Pengonda
vineetha.s@livemint.com

In recent times, Avenue Supermarts Ltd's earnings print has been a story of the same trends, quarter after quarter. Avenue runs the DMart supermarket retail chain. Standalone year-on-year revenue growth in the three months ended June (Q1FY24) has dropped for the fourth consecutive time. On a four-year compound annual growth rate basis, DMart clocked 19% revenue growth in Q1 to ₹11,584 crore. However, here too, the growth rate has been declining and Q1 marks the fifth consecutive instance of drop. On profit margins too, there is not much comfort.

So, who is the culprit? Primarily, lower sales contribution of general merchandise and apparel has weighed on gross margin, said DMart. Elevated inflation levels are impacting demand in the mass discretionary segment. The company clocked a gross margin of 14.6% in Q1, down by 125 basis points year-on-year. One basis point is 0.01%.

Investors are visibly upset. DMart's shares fell by more than 3% on Monday. Note that the stock performance has been muted post results in the previous three quarters as well. The silver lining, however, is that the general merchandise contribution is recovering and inching towards pre-pandemic levels, said DMart. General merchandise & apparel contribution stood at 28.3% in FY19 versus 23% in FY23. Of course, a recovery is helpful, particularly in the apparel category. "DMart needs to restructure its apparel business given new threat perception, which will take a few quarters for turnaround," analysts at Prabhudas Lilladher said in a 15 July report. The broking firm also notes that structural competitive pressures from mass market apparel companies such as Zudio and Reliance Trends weighed on Q1 margin performance. Zudio is Trent Ltd's value fashion concept. For now, given this backdrop, analysts have slashed their earnings estimates for DMart. For instance, ICICI Securities has cut earnings estimates by 6.5%/8.4% for FY24/25.

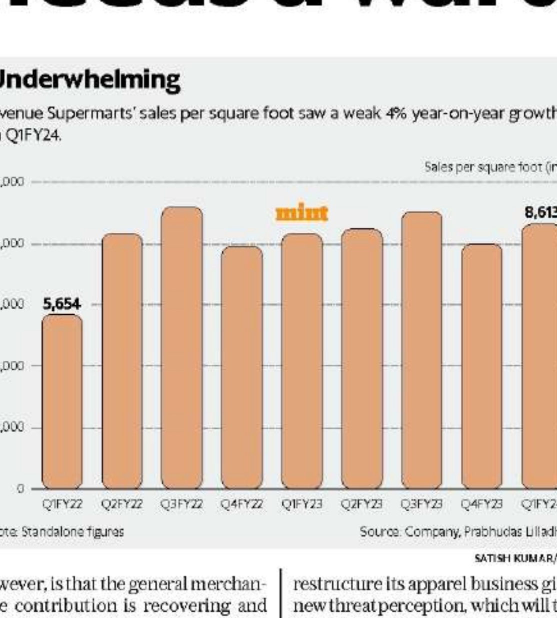
Apart from the muted financial performance, store addition in Q1 was lower than expected, too. It added three new stores last quarter, taking the total count to 327. For perspective, DMart had added 10 stores in Q1FY23. Here, it is worth noting that average area per new store is 33,333 sq. ft when compared to overall average of 41,284 sq. ft. ICICI Securities' analysts believe this is prudent given lower-than expected business economics of the large size stores that were added over the last 4-5 years.

In Q1, DMart's sales per square foot saw muted growth of 4% year-on-year. However, this is an improvement when compared to previous three quarters. The recently added stores are ramping up gradually, thus adding to the woes. According to JM Financial Institutional Securities' calculations, newer stores (about 30% of the network commenced operations in the last two years) are likely taking longer to achieve optimum level of efficiencies. To be sure, a pick-up in apparel business and faster recovery in general merchandise is crucial to aid investor sentiments. Some are optimistic. "A recovery in this part of the portfolio would help gross margin and also bring scale-efficiencies back into the business. We believe it's more a question of when and not if," said JM Financial's analysts.

As things stand, DMart's shares are down by over 19% from 52-week highs seen in September. Still, valuations are expensive. DMart's stock trades at 65 times its FY25 estimated earnings, showed Bloomberg data. Going ahead, store additions require closer tracking. Further, investors will closely follow if the change in mix is a structural one. In the near term, subdued demand and competition are expected to keep margins under pressure. Investors will wait to see how the recovery is panning out before allocating brownie points.

Underwhelming

Avenue Supermarts' sales per square foot saw a weak 4% year-on-year growth in Q1FY24.



Note: Standalone figures

Source: Company, Prabhudas Lilladher

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ROOM FOR CHANGE

LOWER sales contribution of general merchandise and apparel weighed on gross margin in Q1

A recovery in general merchandise and apparel could support margin improvement ahead