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Street cautious on ABFRL amid weak value segment showing

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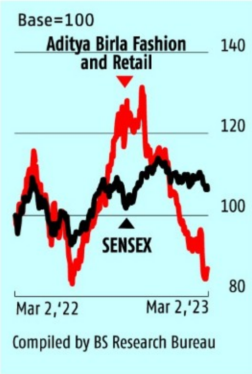
The stock of Aditya Birla Fashion Retail is down 10 per cent from its February high. Even as the revenue performance of the apparel retail major in the October-December quarter's for the 2022-23 financial year (Q3FY23) was better than expected, the company saw brokerage downgrades, given the weak operating performance and the pressure on margins. This the second consecutive quarter of margin miss despite strong traction on the sales front.



Compiled by BS Research Bureau

Ambit Capital downgraded the earnings per share estimates of the company for FY23 by a sharp 68 per cent. The revision was led by increase in marketing spends and losses in new businesses.

The operating profit at the consolidated level was down 25 per cent year-on-year (YoY) and 17 per cent lower than estimates of Emkay Research. Operating margin, at 12.1 per cent, was down a steep 730 basis points. The company cited negative operating leverage in Pantaloons, higher marketing expenses and investments in ethnic segment, Reebok and TMRW -- its direct-to-consumer outfit -- for the fall in profitability.

The company posted its highest ever quarterly revenues, led by lifestyle brands. Overall revenues were up 20 per cent as compared to the year ago quarter to ₹3,588 crore. Revenue performance was led by lifestyle brands which grew 18 per cent with 5 per cent like-to-like growth. The uptick in the segment was led by premiumisation across brands, coupled with rebound in occasion and workwear. The company expects the sales of core brands in this segment (Louis Philippe, Van Heusen, Peter England, Allen Solly) to double going ahead, with the segment growing at 12 per cent on a sustainable basis in the medium term.

The key disappointment for the Street in the quarter was the performance in the value (Pantaloons) segment which reported a revenue growth of 9 per cent and a like-for-like growth of 1.2 per cent. In addition to demand slowdown after Diwali, the company indicated that the substantial customer base located in Tier 2 and Tier 3 cities was impacted by inflationary pressures and weak consumer sentiment, leading to sluggish performance in these cities and towns.

JM Financial Research says that on a combined 2Q and 3Q basis, Pantaloons' sales per square feet were down 8 per cent vs pre-pandemic level even though store-count is 18 per cent higher since then. Say analysts led by Richard Liu of the brokerage, "Whichever way one slices it, the (Pantaloons) segment has done badly on all counts; it is perplexing how the company still doesn't appear to have a strong-enough grip on this business even after having owned it for a decade now."

Other businesses, including ethnic brands, Reebok, digital only segment saw a growth of 48 per cent YoY. Ethnic business reported a growth of 66 per cent to ₹190 crore with its operating profit at ₹8 crore as against loss of ₹47 crore in Q2FY23, aided by festive-related sales. Reebok accounted for ₹34 crore of consolidated revenue (first quarter under ABFRL) but had a loss of ₹13 crore. HDFC Securities believes that investments in new forays such as D2C business, ethnic wear and Reebok are likely to keep cost structures high and have therefore cut their operating profit estimates for FY24 by 3 per cent.

Given the pressures on the value segment and higher investments, investors should await steady improvement in growth and profitability before going for the stock.

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