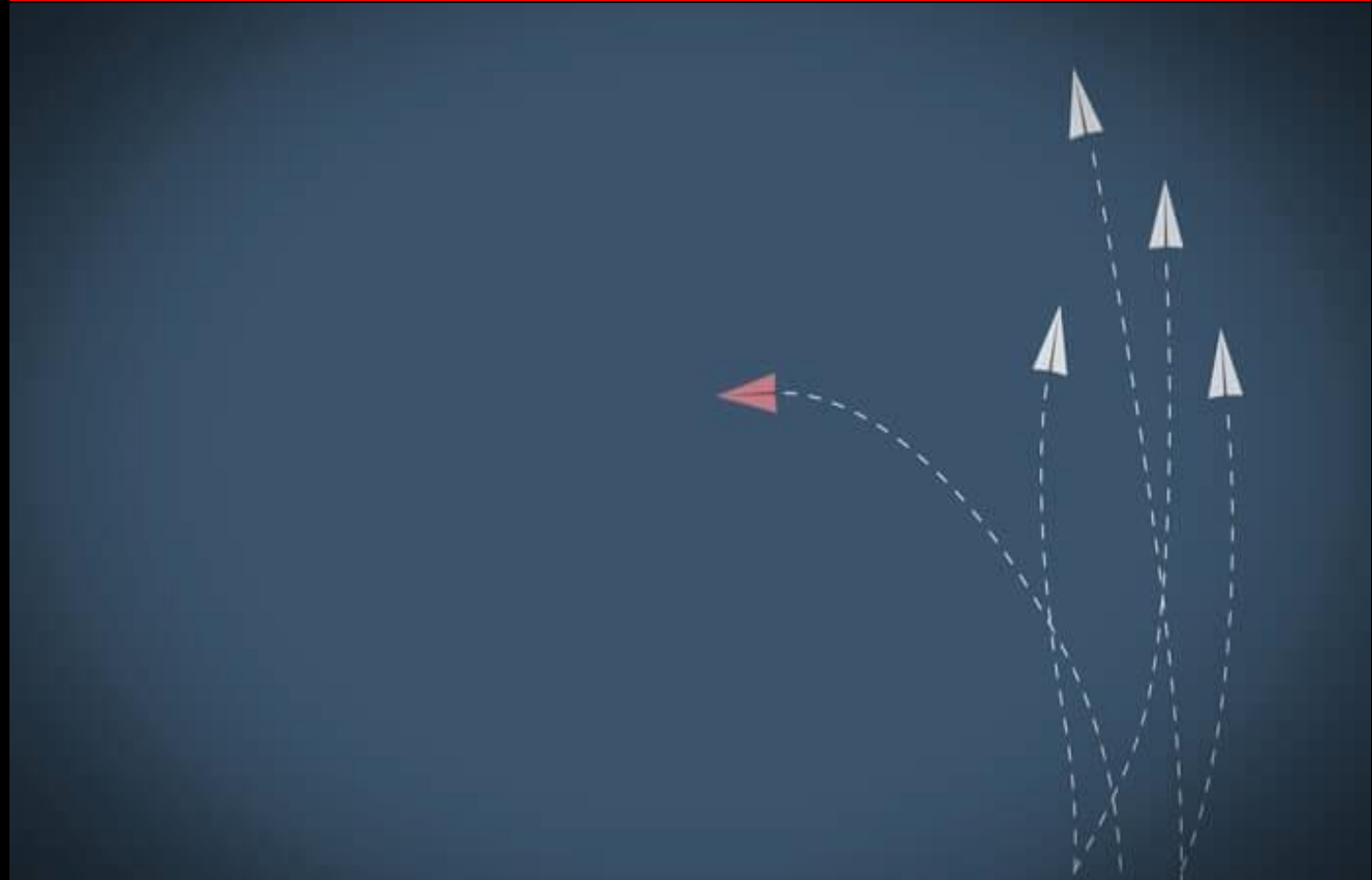


June 2020



AMBIT ASSET MANAGEMENT



Ambit Good & Clean Portfolio



Ambit Coffee Can Portfolio



Ambit Emerging Giants Portfolio

**EQUITY INVESTMENTS & PMS ARE SUBJECT TO MARKET RISKS,
READ ALL SCHEME RELATED DOCUMENTS CAREFULLY BEFORE INVESTING**

Disruption is inevitable: We are prepared

We at Ambit are constantly trying to stay ahead of the curve by drowning out the noise and looking ahead. In keeping with our long term investment thesis, we like to stay up to date with not just the present impediments faced by your portfolio companies but also long term disruptions which can hit these companies. Hence we will regularly come out with our thoughts on disruptions in your portfolio companies/sectors and for the fifth write up of this series we have chosen Avenue Supermart (Parent company of D-Mart).

A disruptive technology/ innovation is one that helps create a new market and value network, and eventually goes on to disrupt an existing market and value network (over a few years or decades), displacing conventional wisdom or technology. This note takes a closer look at Avenue Supermart with a focus on (1) How this simple yet legendary business was set up (2) What allows D-Mart to be the best and (3) Can it stay “un-disrupted” over the next decade

D-Mart: The Man amidst the Boys!

The Founder’s foundation

To better understand Avenue Supermart we must first understand the background and story of its fabled founder – Radhakishan Damani. He started his career in the ball bearings trade, however as fate would have it financial troubles and the untimely death of his father led him to join his brother in the stock broking business. After low success as a short term investor and a near encounter with bankruptcy-Radhakishanji reoriented his investment style to focus on long term investing post 1992. As a long term investor and stock picker his skill is said to be legendary. Following this strategy of long term investments he is said to have made phenomenal returns in companies like VST Industries, HDFC Bank, Gillette (India) and Sundaram Finance, to name a few!

The entrepreneurial foray!

In 1997, Radhakishanji forayed into the retail segment by taking up a franchisee of Apna Bazaar (a co-operative department store chain). The 2 years he spent running Apna Bazaar were as important a time as ever-it taught him the inner nuances of the business and taught him to avoid what wouldn’t work. Furthermore, to form a solid understanding of the target audience and business models that work, no stone was left unturned -strong advantages of global Industry leaders like Costco, Walmart and IKEA were studied in great detail by the founding team. Finally, on 15th May 2002 D-Mart opened its first store in Hirandani gardens, Powai and what a journey it has been ever since!

The idea was astonishingly simple –EDLC EDLP strategy – Every Day Low Cost, Every Day Low Price. In practice however it posed a formidable challenge to the 48-year old investor turned entrepreneur. They achieved this by focusing relentlessly on costs and effective processes and mastering these small steps each day, continuously. The model was such that the first 10 stores would fund the next 10 stores after four years of operation; then these 20 stores would collectively fund the next 20 after eight years of operation... and so on and so forth. This was vital it allowed the company to manage debt and growth through internal accrual. Despite an ownership model D-Mart has negligible debt and sizeable cash pile making it a negative net debt company

How D-mart has fared since then!

The D-Mart of today has mastered the grocery retail business in India in its nearly 18 years of history since inception and it has done so staying true to the value-investing principles of it’s founder. D-Mart does not believe in spending big on advertisements or promotions, it acquires customers mainly through word-of-mouth backed by the trust of cheapest price. This fundamental value (or moat) has been the core of D-marts operations and smoothly outcompeting “compelling” offers of peers such as Big Billion Day Sale, Republic Day sale-to name a few.

The idea was astonishingly simple –EDLC EDLP strategy – Every Day Low Cost Every Day Low Price!

D-mart today is the sole retailer (food/grocery) in the market with scale (214 stores in FY20), efficiency (~11% SSSG, 15% RoCE in FY20) and wide presence (12 states / UT). D-Mart store size is well-positioned between hyper market and convenience store (average store size: 36,000sqft) which allows keeping a mix of higher turn FMCG and higher margin general merchandising. The company’s sales/sqft of ~Rs36,000 is 2.5x vis-a-vis its competitor Big Bazaar led by better value proposition (cheaper by 6%/18% vis-a-vis modern/general trade).

D-Mart’s industry-best EBITDAM (8.6%) and post-tax RoCE (15%) are led by **(a)** mastering the art of assortment (wider categories but limited brands/SKUs in each), leading to better utilization of shelf space (2.7x asset turns) and **(b)** nailing cost rationalization (owning real estate, lower employee cost, contract workforce) **(Ref to Exhibit 4-6)**.

The Grocery “Titan”: What Titan is to jewellery, D-Mart is to grocery!

The success of Tanishq in gold retailing and that of its parent Titan Company in creating shareholder wealth is well known among consumers and investors, respectively. Tanishq has done in the jewellery retailing business what D-Mart aspires to do in F&G retail. Both are highly unorganized industries where many organized players have failed. Tanishq faced a lot of challenges – both, consumer centric as well as regulatory and every time it leveraged those to propel itself further ahead in the industry and establish its position as the leader.

In the early 2000s when consumer viewed it as an elite brand, it launched the ‘Impure to Pure’ scheme offering to exchange consumer’s 19-carat jewellery for Tanishq’s 22-carat Jewellery. This initiative helped change the brand image of Tanishq.

When growth slowed down from 2013-16, it innovated by reducing making charges from 13% to 9%, increasing new launches backed by product innovation and offering gold exchange schemes which nudged the consumers to up trade. We believe D-Mart similarly can leverage the disruptions in the Retail industry and turn them into innovations.

D mart: Super track record amid struggling peers! Still got miles to go...

The organized retail segment catering to grocery in India is more than two decades old but has hardly seen a successful grocery retail business **(Ref to Exhibit 1)** other than D-mart. This goes to further demonstrate how D-Mart’s dominance and how Modern trade is yet to evolve in India. Of the US\$616bn Indian retail market, only 9% is organized. Furthermore, the penetration of the organized market in the food and grocery segment (US\$413bn), which dominates the retail market, is even lower, at 3%. This implies significant scope not only for the market to evolve but also for D-Mart to grow.

Exhibit 1: Convenience stores like Easyday and More and online grocery players like Grofers and Big Basket have been struggling to get the format right. Even Reliance has shut down multiple Fresh stores

Company	Description
Easyday Stores	<ul style="list-style-type: none"> In order to cut costs, Future Group is shutting 140 Easyday stores (10% of total), reversing the chain’s rapid-expansion strategy. All 53 Easyday stores in the West — Mumbai, Pune, Ahmedabad — will be shut down in phases in this fiscal year.
More	<ul style="list-style-type: none"> Almost 11 years after setting up the 4th largest supermarket chain in the country, Aditya Birla Group sold Aditya Birla Retail Ltd (ABRL) to Amazon and PE fund Samara Capital, ending up with ~Rs70bn losses on an investment of Rs110bn.
Grofers	<ul style="list-style-type: none"> Online grocery company Grofers, too, met with failure with its initial model of partnering with kiranas. Its co-founder attributed this to the lack of inventory fit. Inability to fulfill the entire order (only 2Kg Detergent available instead of 5Kg ordered) from a single store led to losses.
Big Basket	<ul style="list-style-type: none"> Online grocery retailer, Big Basket had initially planned to use the kirana store as a last-mile delivery agent, but later decided to opt for the online cash-and-carry model sighting lack of adequate infrastructure at the retail store..
Nature’s Basket	<ul style="list-style-type: none"> Spencer’s Retail is aiming for profitability of its recently acquired F&G retail chain, Nature’s Basket, in two years by shutting down unviable stores, trimming costs and streamlining sourcing and supply-chain operations with itself.
Reliance Fresh	<ul style="list-style-type: none"> Over the last year, Reliance Retail has shut >60 loss-making Reliance Fresh stores which were due for lease renewal in order to reduce losses. Currently, there are 465 value format stores operational, including Reliance Fresh and Reliance Smart. In Mumbai, around nine Reliance Fresh stores have been shut in the last one year while only one Fresh store was added.

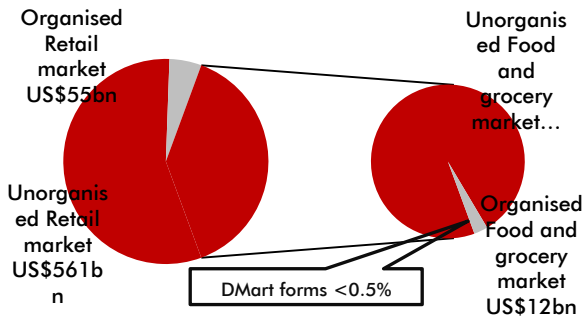
Source: Ambit Capital research

“There is no burden on us to achieve any target, we are not asked to try to sell more to a customer or convince them into buying something, Most of our time is spent on inventory management and making sure that every rack is adequately stocked with all the variety of brands we have in that category”

-A DMart employee

Highlights focus on inventory management and asset turns is key!

Exhibit 2: Modern trade is highly underpenetrated leaving a huge runway open for time tested champions



Source: DRHP, Ambit Capital research

Exhibit 3: Going a step ahead to demonstrate D-Mart's prowess. It stands out vs. leaders across sectors

	FY14-19 EPS CAGR	FY14-19 EBITDA CAGR	FY19 RoCE
Titan	13%	16%	19%
D-Mart	39%	37%	18%
Jubilant Foodworks	22%	19%	29%
Trent	19%	55%	9%
Asian Paints	12%	12%	26%
HUL	9%	13%	82%
Nestle	8%	6%	47%
GCPL	25%	12%	37%

Source: Ambit Asset Management

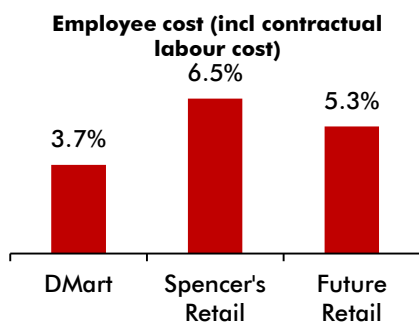
D-Mart: A simple approach but not an easy one!

1. Company ethos and organization structure

One of the key trait of D-Mart's success which is often invisible to outsiders is it's ethos and strong processes. The Japanese concept of Kaizen lays emphasis on small improvements, continuously, consistently, which results in immense end results. The company spent the first ten years mastering this scalable model. The Company lays emphasis on cost-control over revenues with a belief that revenues will come if the processes are right. In contrast to other retailers who built up high central costs, D-Mart focused on getting the front-end right and invested in supply chain.

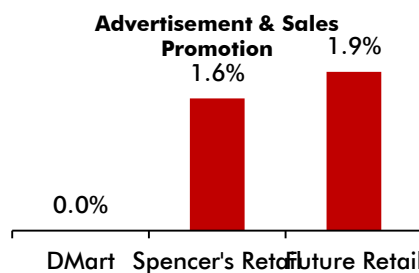
- a) **Unique hiring policy:** D-Mart is not a believer of hiring extremely pedigreed people and high-cost MBAs as the entitlement culture (pay/promotion by virtue of their academics) which they bring disturbs the organization's culture. The company instead focus on hiring hard working individuals who want to prove themselves and who can follow processes well. Talented individuals may find this business monotonous and boring-leading to higher attrition. **(Ref to Exhibit 4)**
- b) **Low margin is a strategy:** Do not let the low margins fool you! PAT Margins although slim have remained in the range on 3-5% consistently for the last 10 years vs loss making peers. This is because all the cost efficiencies that D-mart has built, right from the cash discount from vendors, higher focus on asset turns, lower employee costs and a strategy to own stores to name a few are passed on to customers through lower prices. These lower prices drive huge customer footfall and the growth continues thus. No peer is able to compete with D-Mart at such low prices consistently and profitably. **(Ref to Exhibit 5 & 6)**

Exhibit 4: Least employee cost...



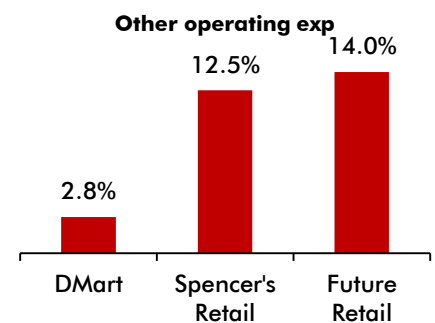
Source: Ambit Capital research, Company FY19 AR

Exhibit 5: ...as it doesn't spend on ads...



Source: Ambit Capital research, Company FY19 AR

Exhibit 6: ...and controls overheads



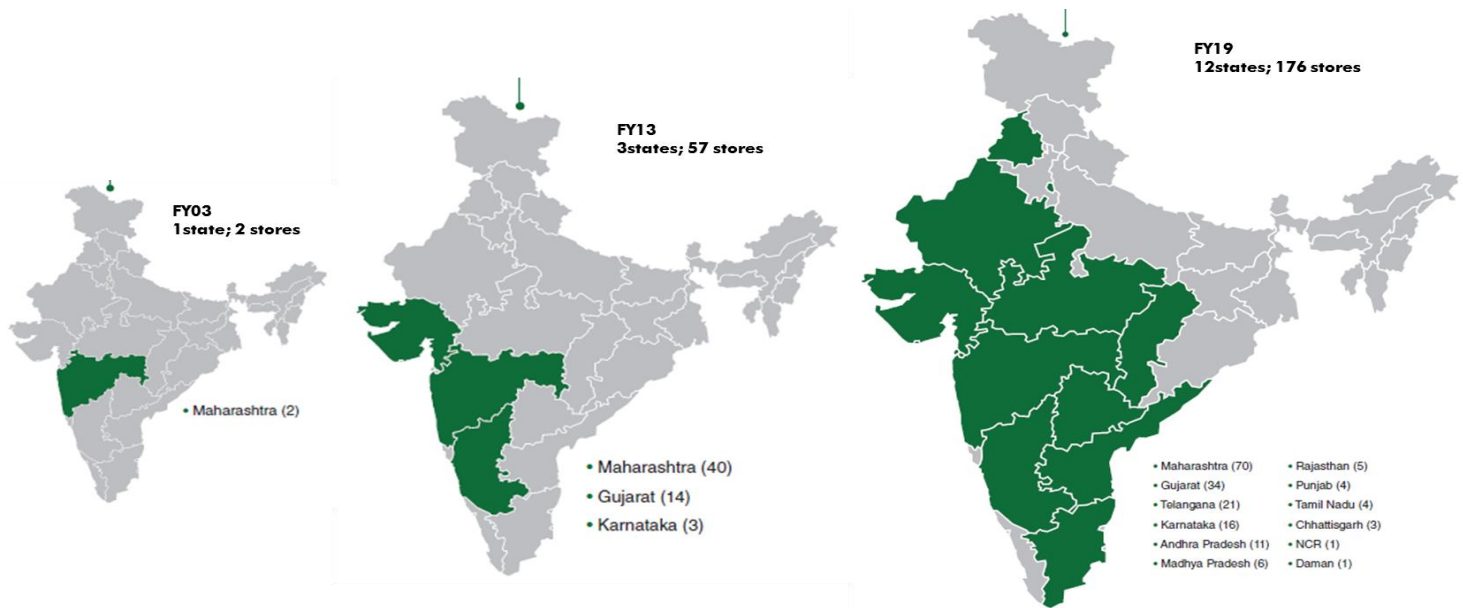
Source: Ambit Capital research, Company FY19 AR

2. The Secret sauce: Store cluster strategy and use of technology to grow

While opening new stores, D-Mart consciously follows a cluster-based approach. It prioritizes opening stores near existing stores and distribution centers, prior to expanding across newer regions. **(Ref to Exhibit 7)** This purposefully leads to:

- **Supply chain efficiencies:** Concentration of its business in a relatively small area and enables supply chain efficiencies. Once a store reaches full utilization, D-Mart launches a new one within 3-5 Km range.
- **1 + 1 = 3:** Helps reduce rush at mature stores which can now shop at the new store along with the newly attracted customers to the new store leading to higher overall footfall. (1+1=3) As a result, a mature store helps establish a new store in the vicinity which in turn will help establish another new store and the chain will continue.
- **Cost savings:** This cluster based approach also helps establish strong sourcing and vendor base leading to multiplier effect in terms of cost (freight / transportation), customers (popularity / mind share) and the company's ability to order and warehouse in bulk.
- **Use of Technology: Ref to Exhibit 8**

Exhibit 7: D-Mart state/city expansion has been based on cluster approach; starting in the west and creeping into neighboring states gradually



Source: Ambit Asset Management, Company

Exhibit 8: Early investments in an ERP platform and distribution center allowed the company to have a far more efficient supply chain than competition...

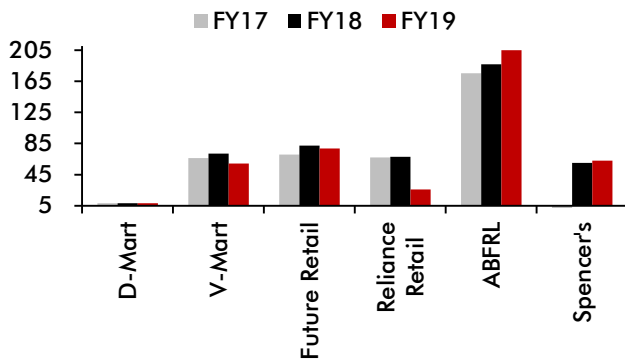
Key investments	Details
Early investments into ERP (2006)	DMart has been an early investor in technology for managing supply chain. For instance, in 2006, when DMart was just a seven-store operation, it implemented its first enterprise resource planning (ERP) platform.
Investments in ARS	It has also implemented an auto replenishment system, which allows them to track in real time how goods are moving across any store in the network.
Central procurement (2012)	8 years ago, except staples, everything was procured at that store. Slowly migrated to centralized procurement in a staggered manner, starting with few categories and then rapidly expanding in the last 36 months; 75-80% of the savings have been achieved due to centralized procurement.
Distribution Centre (2011)	DMart has set up multiple distribution centres across India. Unlike competition, it hadn't spread itself thin across India; instead, it had clustered its stores across Maharashtra and Gujarat.

Source: Company, Ambit Capital research, Media interviews

3. Simplicity of operations: Low price+ High inventory turnover: While competitors tried to follow latest fads and attract customers by ambience, wide assortments and private labels, D-Mart followed the Kaizen approach of simplicity offering what customers need the most (right assortments) at cheapest price possible and continuously built on this.

- D-Mart focuses on having maximum variety of products/categories but limited number of brands and SKUs. In short, they know what you need and what you would buy most frequently. **(Ref to Exhibit 10 & 12)**
- D-Mart doesn't shuffle its sections frequently accelerating customer shopping experience. Billing, which is the biggest capacity constraint in retail store is taken care of by having 20-30 counters ensuring quick hassle free experience.
- The retailer does not operate a loyalty programme and force their vendors to give clear offers rather than cash backs on wallets.
- D-Mart pays its vendors promptly within seven to eight days (competition takes 35-40 days). Firstly, this allows first access to items where the inventory is low in the market because the vendor knows he is paid quickest and secondly it enables cash discount benefits which are passed on to customers as lower prices. **(Ref to Exhibit 9)**

Exhibit 9: Early vendor settlement implies lower Creditor Days



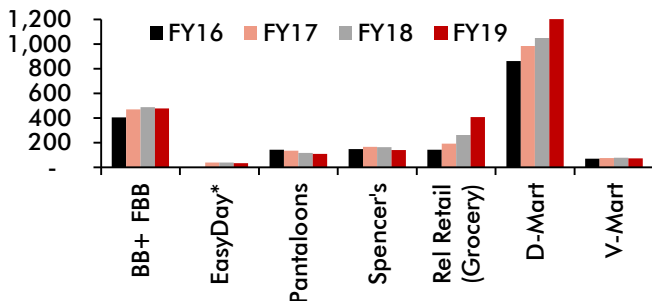
Source: Ambit Asset Management, Creditor Days is on Cost

Exhibit 10: Colour coding facilitates faster shopping



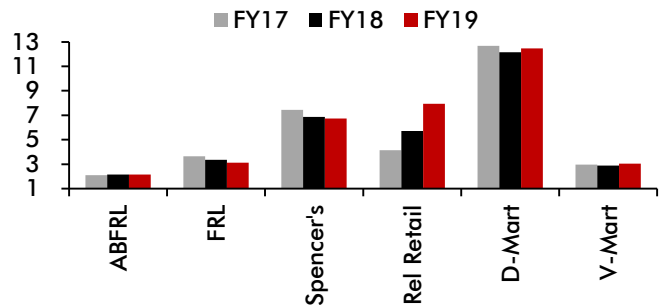
Source: Ambit Capital research

Exhibit 11: Highest per store sales among peers...



Source: Ambit Asset Management

Exhibit 12: ...courtesy high Inventory turns



Source: Ambit Asset Management, Inventory turns on Cost

What could disrupt a disruptor?

1. Consumer preferences and changing trends

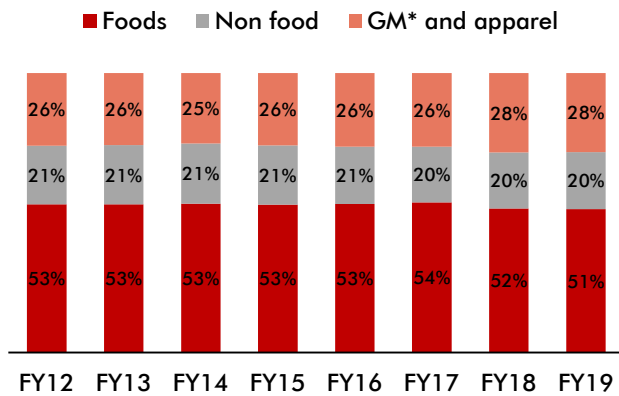
Consumer preferences keep changing and so it is important to be mindful of this constantly. While we remain comfortable with the pedigree of companies like D-mart which are well prepared to respond to changes as and when they come about, here are some potential changes to think about.

Change in preferences

Change in preferences can disrupt	Potential disruptors explained	How companies like D mart are already positioned to approach such problems:
a) Preference for products which are lower margin for the stores:	<ul style="list-style-type: none"> A preference for shopping more branded FMCG and Non-food products (Lurpak Butter, avocado, sauces, dips, etc) in stores would lead to deterioration in profitability for stores as margins on them may be less. 	<ul style="list-style-type: none"> Increased focus on higher margin general merchandise and apparel (Ref Exhibit 13 & 14) Ensures steps taken to give higher inventory turns of food and non- food products (Ref Exhibit 12)
b) Preference away from organised retail:	<ul style="list-style-type: none"> If purchase from local shops becomes more prevalent larger format stores like D-mart can be impacted by lower foot fall. D-mart does not provide a home delivery service over the telephone like local shops do. 	<ul style="list-style-type: none"> Presently trend is towards shopping in larger format organized retail stores and so the company is a current beneficiary here of the ongoing trend until or if it reverses (eg. Post an event such as covid)
c) Preference for convenience:	<ul style="list-style-type: none"> Lacks a sizeable e-commerce platform presence or tie up with delivery apps. D-mart Ready (online) orders need to be collected from stores or pay a small delivery fee. These steps enable cost control however change in customer preferences towards convenience may disrupt the business model. 	<ul style="list-style-type: none"> Investing in establishing D-mart Ready stores as a precursor to evaluate e-commerce as a financially viable future option Use of technology to increase in store convenience (scientifically placed product selection, lower number of brands, higher checkout kiosks/counters) Encouraging D-mart ready store visits by selling essentials (Bread, milk) at discount.

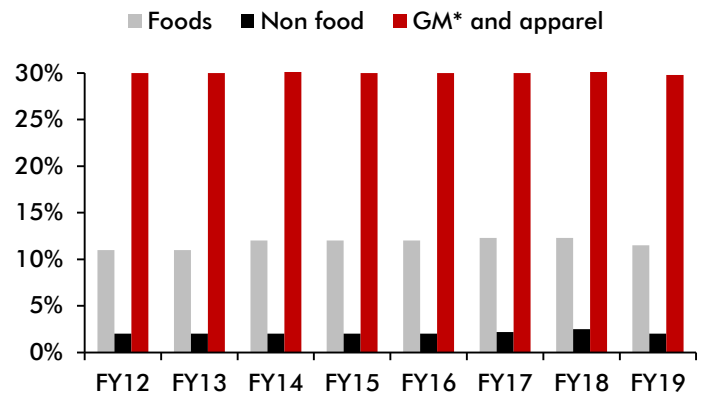
Source: Ambit Asset Management, Company

Exhibit 13: Increasing share of GM & apparel...



Source: Ambit Asset Management, Note: * GM – General Merchandise

Exhibit 14: ...which has the highest GM, would be a lever



Source: Ambit Asset Management, Note: * GM – General Merchandise

2. When Black Swan attack– GFC, DeMo and now COVID too

- We have faced our fair share of Black swans over the years. Few recent instances have been **the 2008 Global Financial Crisis and the 2016 De-Monetization crisis**. These are disruptors which are not known in advance and one cannot prepare for either.
- A similar Black Swan event which is upon us at present is the **COVID-19** pandemic. It has brought businesses, countries and even continents to a standstill in a matter of weeks. D-Mart itself may be impacted by **1) social distancing norms** leading to lower footfall at stores; and, **2) Changing consumer preferences and trends**. It also saw 50% of its store shut during this time. However, being a strong business franchise, D-Mart continues to look for ways to innovate and thus survive and thrive as they have done so time and again with consistency. The company took quick steps such as increasing scope for home delivery by operating D-Mart Ready app across 200 stores. D-Mart On Wheels (DOW) project was taken up where local store teams would set up a mini store with a small assortment of essential products in a large housing complex for 6-8 hours. Frontline employees who worked during the lockdown were given a hardship allowance and an additional COVID-19 leave policy was announced.
- In the past instances the company's robust processes helped it weather through the tough times unscathed (**Ref to Exhibit 15**) and we believe the company will emerge stronger post crisis this time as well. The company has consistently shown its ability to do well vs global peers as well through good years and bad. (**Ref to Exhibit 16**)

Exhibit 15: Performance during GFC and Demonetization

Metric	GFC		Demonetization	
	FY08	FY09	FY17	FY18
Revenue Growth	40%	71%	38%	26%
EBITDA Growth	11%	191%	47%	39%
CFO Growth	-52%	335%	6%	61%

Source: Ambit Asset Management

Exhibit 16: Performance has been consistently better than successful global peers too

Company	FY15	FY16	FY17	FY18	FY19
DMart					
EBITDA margin (%)	7.0%	7.6%	8.1%	8.9%	8.2%
Asset Turnover (x)	3.4	3.5	2.9	2.9	3.5
RoCE (%)	13%	15%	14%	15%	16%
Walmart					
EBITDA margin (%)	7.5%	7.0%	6.8%	6.2%	6.3%
Asset Turnover (x)	2.4	2.4	2.4	2.5	2.4
RoCE (%)	14%	13%	13%	10%	7%
Target					
EBITDA margin (%)	9.2%	10.5%	10.5%	9.5%	9.1%
Asset Turnover (x)	1.7	1.8	1.8	1.9	1.8
RoCE (%)	-4%	14%	14%	14%	13%

Source: Ambit Capital research

3. Geographical concentration, ownership model and avenues to raise touch points:

a) Concentrated presence across the country: One of the drawbacks of D-Mart’s cluster based approach is geographical concentration. As of FY19, 60% of its stores were located in the two western states of Gujarat and Maharashtra. While we believe that such concentration makes the company vulnerable to exogenous events like shutdowns due to flood, extreme temperatures and events like COVID-19 lockdown, the company is taking adequate measures to expand operations (Evident in its expansion from 4 states in FY12 to 12 in FY19).

Exhibit 17: Store count and store addition in FY19 was concentrated in top-5 states

State / UT	Stores	Concentration	New Store Addition
Maharashtra	70	40%	38%
Gujarat	34	19%	19%
Telangana	21	12%	10%
Karnataka	16	9%	19%
Andhra Pradesh	11	6%	5%

Source: Ambit Asset Management

b) Ownership model of store expansion: D-Mart prefers to own its store rather than lease them out, unlike its competitors. This has helped D-Mart build an asset base, reduce expenses (lower rent cost) thus providing operating leverage while still giving superior return ratios (**17% RoIC as seen in Exhibit 18**).

This model however slows down the pace of store expansion (**Ref to Exhibit 20**) considering that D-Mart is highly selective with locations which are sometimes even vetted by the CEO. However, the company is evolving with time and as per the management moving from **“extreme conservatism to controlled aggression”**. Going ahead, D-mart will be looking to open stores on long-term lease as well which will help increase the pace of store expansion.

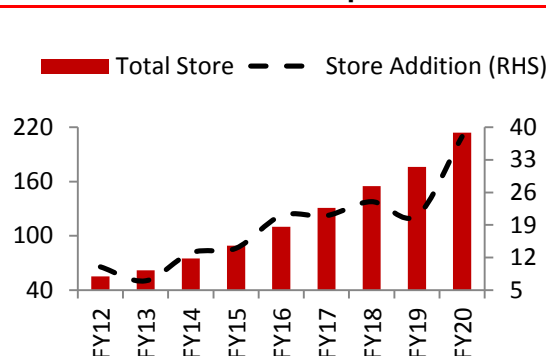
c) Think out of the box: D-Mart can also take a cue from other developed countries to expand stores. For instance the company can partner with OMC’s to open small stores at Petrol Pumps. Partnership with large housing societies to set up smaller grocery stores or use mobile truck stores as an option too. Such steps can certainly increase the touch points with consumers manifold but however can easily become a trap if not executed properly.

Exhibit 18: Despite ownership model, D-Mart generates high RoIC (17%)

Rs mn	Owned model	Rental model
Rent	656	5,737
EBITDA	16,422	11,341
Depreciation	1,988	687
EBIT	14,434	10,654
Capital employed	58,461	20,215
RoIC (post-tax)	17%	37%

Source: Ambit Capital research, Company

Exhibit 19: but slows store expansion...



Source: Ambit Asset Management, Company

Exhibit 20: especially vs competition

Company	FY19 Revenue (Rs bn)	Stores added in last 1 yr	Stores added in last 5 yrs
BB + FBB *	165.7	40	88
Pantaloons	31.9	33	201
Spencer's	21.9	29	28
Reliance Retail (Grocery)	234.1	74	-106
D-Mart	199.2	21	101
V-Mart	14.3	43	125

Source: Ambit Asset Management, Company, *- Last 3 years, BB- Big Bazaar, FBB-Fashion at Big Bazaar

4. Government regulations and policy changes: Changing government policies are a threat to any business, let alone D-Mart. We especially believe that the company may be vulnerable to the below mentioned 3 key government regulations.

Key Government regulations to look out for which may impact D-Mart

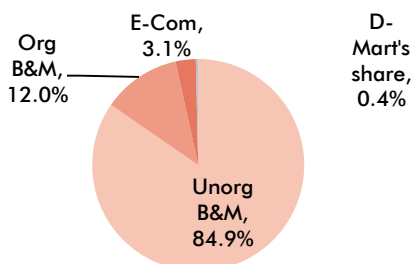
Regulation	Details
FDI Policy	<ul style="list-style-type: none"> Liberalization of FDI laws in multi-brand retail will give D-Mart’s competitors access to greater resources – both human and financial - enabling them to spend more aggressively and compete more effectively. As a result, other successful foreign players may enter Indian market whether it be organically (IKEA) or through acquisition (Walmart-Flipkart). D-Mart in it’s bid raised Rs41bn via a QIP earlier this year which has given it access to sufficient capital to grow profitably.
Minimum wage laws	<ul style="list-style-type: none"> D-Mart’s ability to offer low prices is a function of it’s ability to keep costs low. One of them being employee cost. Any increasing trend in manpower costs has a direct impact on margins. Further, any amendment to the minimum wage laws in India which may lead to upward revisions in the minimum wages payable will have a direct impact on the company’s margins
Region-wise curfew and lockdown	<ul style="list-style-type: none"> 50% of D-Mart stores were shut during the lockdown and the operating timing for the remaining varied. Most of it’s stores in the western region are concentrated in the states of Gujarat and Maharashtra which have seen high number of cases, most of them being in the RED Zone. Any increase in lockdown or implementation of a full curfew may impact store operability directly.

Source: Ambit Asset Management, DRHP, Company

5. E-commerce presence lacking so far...is it a future threat?

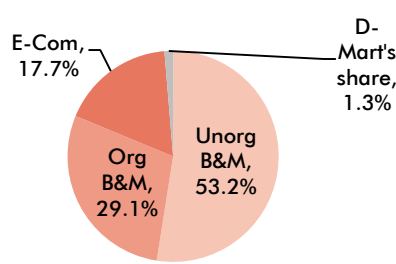
- E-Commerce is changing consumer preferences and buying habits, shifting the focus of young generation from ‘cost-based’ to ‘convenience-based’ buying. Why take the troubles to go out and shop for groceries when you can order it all on your phone while watching your favorite Netflix series? Over the next decade, convenience offered by e-commerce and home delivery will be key to attract new customers (like during COVID-19). Whether it can be done profitably or not is the question D-mart wants to answer first!
- D-Mart certainly does not seem to be in a hurry and is taking a slow & steady approach in e-commerce. D-Mart’s pilot project in hybrid e-commerce (order online and self-pick up) via D-Mart Ready has been so far limited to complementing physical stores - which continue to remain its core focus. D mart ready has attracted customers through: **a)** providing quick reach in areas where it doesn’t have presence through smaller stores; **b)** providing scale to its warehouse while diverting loyal customers to reduce pressure on mature stores and **c)** Also, there is keen focus on cross-selling. For instance general merchandise items like water bottles, tiffin box, stationery, bags, bulbs, etc. are sold at D-Mart Ready stores and Dairy items are offered at 3-5% discount which encourages higher footfall. This would help offer higher Gross Margin items to online customers and even attract new ones. Going ahead as well, focus for the company will be on physical stores.
- D-Mart Ready financials have improved (**Ref to Exhibit 23**) but the model was only identified for metro cities like Mumbai. We believe D-Mart’s competitive advantages, focus on technology and customer insights offer it the right to win in e-commerce too (like Brick & Mortar retail) but it needs to act. **Given its track record of responding to changes quickly we think when profitable opportunities present themselves D mart would be able to seek it!**

Exhibit 21: Indian Organized retail industry in FY20...



Source: Ambit Asset Management, Company

Exhibit 22: ... to grow at a swift pace by FY40



Source: Ambit Asset Management, Company

Exhibit 23: Avenue E-Commerce (DMart ready) is yet to break even

Rs mn	FY18	FY19
Revenue	441	1,436
Gross margin	7.4%	11.0%
EBITDA	(379)	(404)
EBITDA margin	-85.8%	-28.1%
Depreciation	106	111
EBIT	(485)	(514)

Source: Ambit Capital research

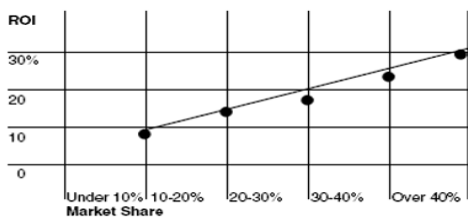
6. Highly fierce competition

- a) **Modern and General Trade:** D-Mart faces stiff competition from other modern trade competitors like Big Bazaar, Nature’s Basket, Easy Day. In General Trade the competition (Local Kirana store) has differentiated itself on instant home delivery and monthly credit model.
- b) **E-commerce & delivery platforms:** Severe price discounting from e-commerce players and entry of new players like Swiggy Genie and Zomato in instant delivery space will prove to be a challenge. However, as far as pricing is concerned, our analysis shows that D-Mart’s moat is intact (**Ref to Appendix**) We compared the prices of a basket of items across categories with offered by online retailers and found that D-Mart and D-Mart Ready offer the lowest price (**Ref to Appendix**), and they are able to do this while maintaining healthy margins.
- c) **Reliance Jio Mart:** Jio Mart is an Online to Offline e-commerce platform which aims to connect retail groceries to customers through partnership with local Kirana stores using Whatsapp’s business app. It helps retailers:

- Track inventory levels and stock them at a cheaper price by directly sourcing from the manufacturer
- Allows smaller retailers to start giving out higher discounts and perhaps impact D-Mart’s growth, at least in the tier-2/3 cities where it planned to expand.
- **Importantly however:** JioMart is at a very nascent stage and is available only in certain parts of Mumbai and Thane and yet to scale up. Moreover, we believe the overall Retail industry in India is too huge to be conquered by a select few players or formats (**Ref to Exhibit 21 & 22**), unlike in Telecom where you need to be a dominant market leader to make money (**Ref to Exhibit 25**), in retail there is ample opportunity for all organized players to grow and thrive by taking share from unorganized players rather than organized retailers.

Unlike Telecom where you need to dominate to be profitable (Explains Reliance Jio’s disruptive Telecom strategy), there is ample scope for all to grow profitably in organized retail! D-Mart is still under 0.5% of the organized grocery market

Exhibit 24: There is a theory that higher market share leads to higher profit



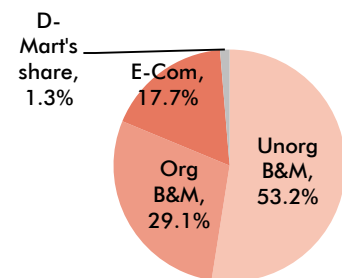
Source: Ambit Asset Management, Harvard Business Review [\(Source\)](#)

Exhibit 25: This applies to Telecom and that’s what Jio tried here

Company	2016	2017	2018	2019
Bharti	23.6%	24.9%	28.9%	28.4%
Vodafone Essar	18.2%	18.2%	18.2%	14.7%
Idea Cellular	15.5%	15.4%	17.4%	14.2%
R-Jio	6.4%	13.7%	23.8%	32.1%
Other Players	36.4%	27.8%	11.6%	10.6%

Source: Ambit Asset Management

Exhibit 26: However in retail there is enough scope for all players to grow profitably. Industry size by FY40E-



Source: Ambit Asset Management

- 7. Threat of capital guzzling moves by D-Mart:** The following initiatives we believe could drain considerable capital of the company, however, if implemented properly could prove to be game-changers.
- a) Private Label Strategy:** Building a profitable private label brand, especially in FMCG, is a difficult exercise. It can take 10-15 year to build a credible brand which customers can trust. Till now, D-Mart has tread this area cautiously and slowly by launching private labels in items with lower customer stickiness and higher price sensitivity like Handkerchief, Pulses, Toilet cleaner but future growth here can lead to higher profitably with the trade off from higher inventory costs, higher cannibalization and risk of lower footfalls from brand conscious customers.
- b) Possibilities for Diversification:**
- **Diversification into services-** Entry into F&B retailing via set up of fast food stalls, sale of financial products or other services like repair & maintenance.
 - **Diversification into newer products-** As the company looks to expand margins, entry into categories like electronic retail, pharmacy, footwear, furniture, books, etc can be rewarding (replicate the model of Tesco / Target)
 - **Diversification outside India-** Till now, not many Indian companies have been successful abroad. Titan in its earlier years tried to expand aggressively in Europe but failed. On the other hand Marico has been hugely successful in establishing its oil business in Bangladesh. Expansion by D-Mart into neighboring countries however risky could prove to be a disruptor if they replicate their EDLC EDLP strategy.
- c) Investment heavy decisions:** Asset heavy strategy by way of owning stores has worked so far for D-Mart. The tendency to copy the same and backward integrate the supply chain by owning warehouses, fleet and drivers may prove risky if not executed well. Opportunistic M&A to acquire rather than build in a bid to quickly expand stores are also future risks one can consider.

At Ambit we believe in wealth creation by long term equity investment and through the power of compounding. We constantly try and stay ahead of the curve on what may possibly impede the growth our portfolio companies. While Avenue Supermart has been a leader in Indian F&G Retailing, we do a long term scenario analysis on what could be the possible disruptions to the company and the industry. In our view: (1) Ability to keep offering lowest prices, (2) Pace of expansion, and (3) Execution of a profitable e-commerce strategy going ahead are things to watch out for in case of D-Mart over the next decade

Appendix

Store visits of D mart vs. peers during pre-lockdown

Particulars/Products	D-Mart	D-Mart Ready	Amazon	Big Basket	Reliance Smart	Flipkart Supermart	D-Mart price diff from competitors
Staples							
Aashirvaad Multigrain Flour (1 kg)	57	55	60	60	60	55	0%
Branded sugar (1 kg)	49	45	42	55	48	43	7%
Devaaya rice (5 kg) (Aged)	370	375	379	449	390	500	-2%
Fortune Sunflower Oil (5 ltr)	545	545	564	564	599	550	-1%
Toor dal - private label (1 kg)	101	109	105	105	114	123	-4%
Cashew nut - private label (500 gm)	488	535	545	534	429	602	14%
Cumin - private label (100 gm)	25	28	28	32	60	42	-11%
Packaged food							
Kellogg's Cornflakes - Original (1.2 Kg)	295	299	325	390	425	290	2%
Tropicana Orange Delit Juice (1 ltr)	79	86	120	110	110	94	-16%
Parle G Biscuits (800 gm)	63	63	65	65	70	70	-3%
Hide and Seek Biscuits (120 gm)	32	32	30	30	36	NA	8%
Britannia Bourbon (150 gm)	25	25	28	30		30	-11%
Dark Fantasy (75gm)	30	26	26		30	27	0%
Dairy							
Amul Butter (500 gm)	218	217	235	235	235	235	-8%
Amul Taaza Milk (1 ltr)	61	61	64	64	64	64	-5%
Beverages							
Brooke Bond Red Label (500 gm)	199	199	204	215	215	215	-2%
Nescafe Classic Coffee (50 gm jar)	139	137	141	150	150	150	-3%
HPC							
Shampoo							
Sunsilk thick and long (340 ml)	134	149	170	174	174	156	-14%
Pantene Smooth care (650 ml)	370	320	357	380	500	NA	-10%
Clinic Plus Strong & Long (650 ml)	345	310	231	308	385	262	34%
Soap							
Dettol Original (3x75 gm)	74	99	99	87	NA	NA	-14%
Pears Pure & Gentle (4x125 gm)	160	185	196	196	268	223	-18%
Lifebuoy Total (3x125 gm)	74	72	100	81	90	90	-11%
Detergents							
Rin detergent powder (1 kg)	72	71	74	NA	77	NA	-4%
Surf Excel Quick Wash (2 kg)	370	360	380	400	400	NA	-5%
Tide Plus (1 kg)	98	99	102	106	106	NA	-4%
Ariel Matic front load (1 kg)	211	209	249	218	230	206	1%
Toothpaste							
Colgate original (2x300 gm)	264	258	284	278	284	261	-1%
Sensodyne Repair & Protect (100 gm)	195	189	194	210	250	207	-3%
Pepsodent germicheck (2x150 gm)	115	105	105	156	190	110	0%

Source: Ambit Asset Management, Store visits pre lockdown

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