

CMP: Rs. 150 Weight: 4%



STOCK DATA-

Market Cap (Rs. Cr)	1190
EPS	NA
P/E	NA
Promoters Holding (%)	52.76%
52 week high/low	230/121
Shares outstanding (Cr)	7.95

KEY FINANCIALS – Pro Forma (Rs. in cr)

Y/E	2015	2016	2017	2018
Revenue	1665.7	1796.5	2021.4	2091
EBIDTA	-67.1	-52.8	-17.1	17
PAT	-151.6	-142.5	-107.6	-30
Total Debt	458	469.2	16	0

VALUATION

Spencer Retail at Market cap of 1190 crores and has 250 Crores of cash on its book i.e. its Trading at an Enterprise value of 930 Crores. Future Retail is trading at 1.3x Enterprise Value to sales, whereas spencer is expected to do 2300 Crores of Sales for FY2019 & is trading at P/S 0.4x EV/Sales. Spencer is a mediocre business model at a cheap valuation with very less downside risk though all we are doing here is following a pattern of Investing in a debt free demerger with the promoter & there are a few unknowns here. A Small delta in Earnings with New management can re-rate the stock easily.

Spencer Retail- A Special Situation Bet

Thesis –At Stallion Asset we have a consistent investment philosophy of buying companies that can:

- 1) Growth more than 25%
- 2) Huge Opportunity Size
- 3) High Return on Equity
- 4) Smart and Ethical Management

Spencer's Retail Limited isn't like a typical growth stock that we at stallion backed. The company recently got demerged from Group Company CESC Ltd and is a multi-format retailer providing a wide range of products across categories such as food, personal care, fashion etc.

Our Coverage of Spencer Retail is deeply influenced by Joel Greenbaltt book "You can be a stock market genius" written in the year 1998. The Thesis of this book is that due to several reasons the demerged entity trades at an Undervalued price including Institutional selling, less history about the business, no prospectus like an IPO etc but within 1 year of listing as per a Study of Penn university in 1988 for 25 years, demerged entities gave 10% Excess returns over S&P.

This was later confirmed in the year 2014, Deloitte released a report on global spin off's which said "From year 2000-2012, Demerged companies have given on average 23% returns over their index 12 months after listing"

SBI Securities in its report on "Indian demergers" which was published in June 2017 used 154 demergers from & their analysis shows that demergers in India during 2002-2016 generated average excess returns (over the Sensex) of 36% in 12 months.

Why Spencer Retail?

- Big Opportunity Size
- Change in Management
- Promoter Buying
- Attractive Valuation

When is big money made on a Demerger trade according to Joel Greenblatt?

- Point 1** – Institutions don't want it as the demerged entity is small (Mutual Fund are selling their Stock in Spencer)
- Point 2** – The Insiders is buying the Stock (Promoters has picked up 3% Stake in Spencer)
- Point 3** – There is a change in Management or Independent management (COO of Walmart India is now CEO)
- Point 4** - There is a hidden asset that would be get discovered by the market after the demerger (Nothing like that in Spencer probably that's there in CESC Ventures- Too Yum)

The Spencer demerger fits in 3 out of 4 criteria's of an amazing demerger according to Joel Greenblatt.

We at Stallion add one more criteria for the Indian Markets here & that the demerged entity company should be debt free. Buying debt free demerged companies in our Backtesting virtually assures you massive outperformance in 1 year whereas Highly Leveraged demerger companies have failed to perform.

Retail Opportunity in India

As we have highlighted before in our Avenue SuperMart report that Retail is very big opportunity in India & the way to win in FMCG retail is to manage your cost really well. Globally, FMCG retail industry is dominated by cost leaders & the one who has lowest operating costs dominate markets for example Wal-mart in US, Tesco in UK and D-mart in India. Globally, size of retail industry is very huge around USD 28 Trillion, whereas in India, size of retail industry is around USD 1 Trillion (70 Lakh Crores). Globally, in retail industry, Hyper and supermarkets dominate sector with 35% market share. In India share of organised is around 10%, we expect share of organised retail to go up in future.

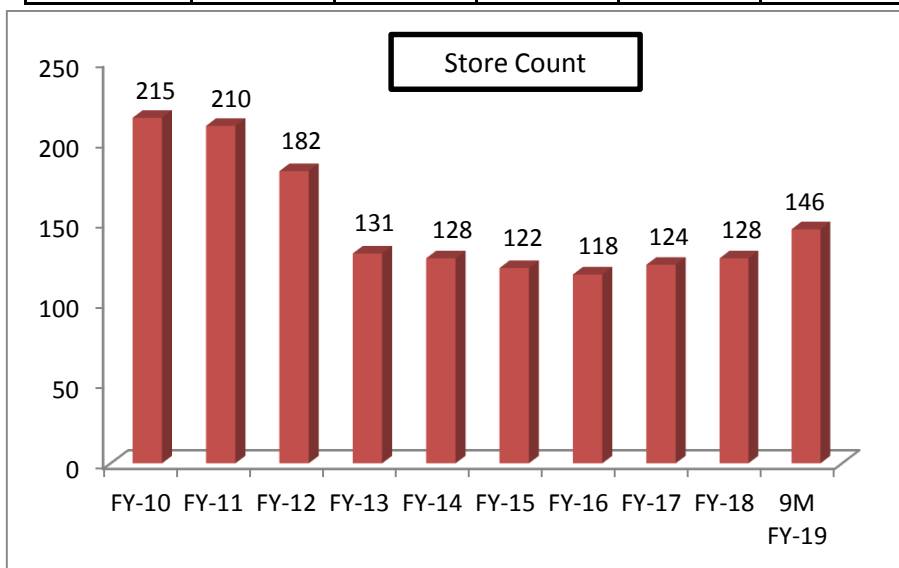
Spencer Retail India – Evolution

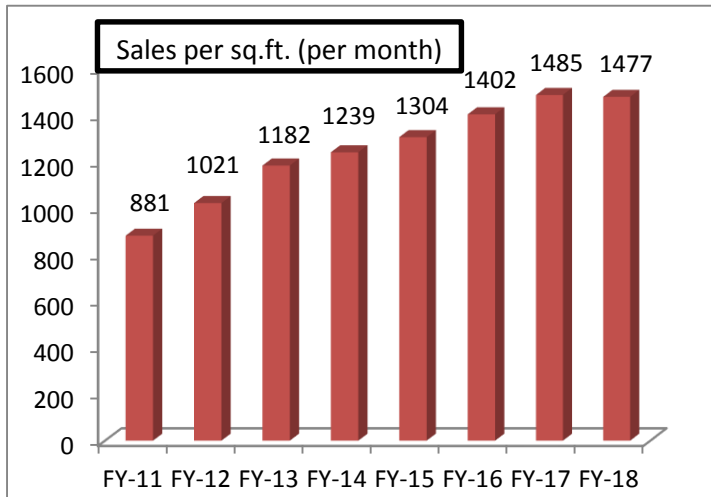
(cr)	2013-14	2014-15	2015-16	2016-17	2017-18
Revenue	1451	1666	1797	2021	2091
EBIDTA	-70	-67	-53	-17	17
EBIDTA (%)	-4.8%	-4.0%	-2.9%	-0.9%	0.8%
PAT	-166	-152	-143	-108	-30
PAT (%)	-11.4%	-9.1%	-7.9%	-5.3%	-1.4%

Spencer understood in FY2010 that retail isn't about scale, it's about cost. They started a massive journey of cutting their cost by closing non profitable stores which resulted in EBITDA Margin improving from -4.8% to +0.8% in FY2018.

Spencer has started adding stores count again & they have guided to increase store count at 10% going forward.

They now have a new management in place, we will have to see the strategy of the new management regards growth of stores as well as margins.



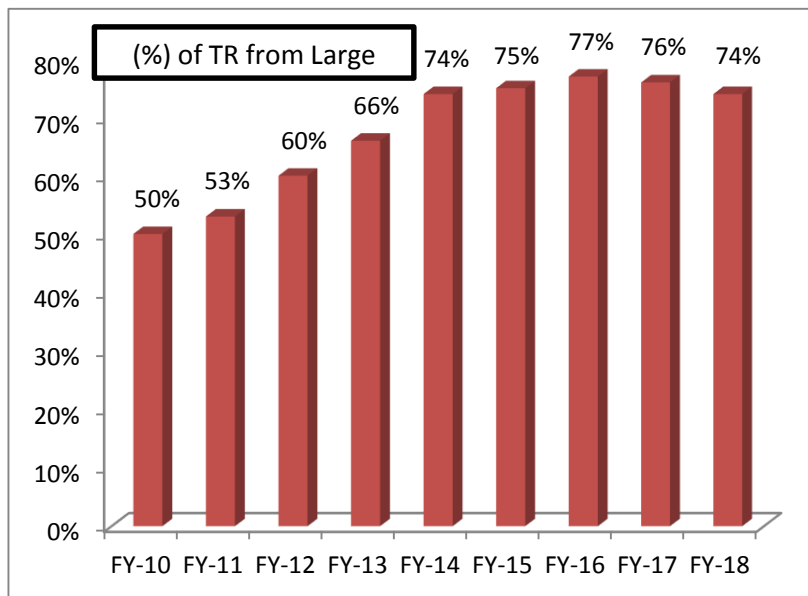


The strategy of shutting non profitable stores has worked very well for the company as they have been increasing sales per sq.ft. Revenue & has improved from 881/sq.ft per month in FY2011 to about 1477 this year.

The market leader Dmart does 2667 Per square feet per month sales whereas Future Retail does 1150/Sq Ft Per month.

Spencer is superior to future group in this matrix though Dmart the leader is ofcourse far better

1) Focusing more on Large store size



Spencer is shutting down/closed Mid-small store from 107 stores in FY-13 to 79 stores in FY-18 and increased large format stores from 24 stores in FY-13 to 67 stores in FY-18. Profitability in small stores in not easy, except seven eleven nobody has been globally successful in this strategy including the likes of Walmart, Tesco, Aldi etc though everyone has tried though Small stores strategy typically works in a niche like Godrej Nature basket in India.

The reason for focusing more on large format size is because in these outlets gross margin is higher compared to mid-small format store. In large format stores focus is more on non-FMCG product category (apparel, Electronics) in these products gross margins are higher than FMCG category.

	FY-13	FY-14	FY-15	FY-16	FY-17	FY-18
Large Format Stores	24	34	34	36	39	67
Mid-Small format store	107	94	88	82	85	79

Controlling cost

Spencer Retail					
Fig. in (cr)	2013-14	2014-15	2015-16	2016-17	2017-18
Revenue	1451	1666	1796	2021	2091
Employee Exp.	114	131	137	145	143
(%) of Rev.	7.9%	7.9%	7.6%	7.2%	6.9%
Other Exp.	245	262	292	295	303
(%) of Rev.	16.9%	15.7%	16.3%	14.6%	14.5%
Total Cost	24.7%	23.6%	23.9%	21.8%	21.4%

Operating cost % of Sales	
Dmart	8%
Future	21%
Spencer	22%
HyperCity	30%
Star Bazaar	33%

Spencer operating cost as a Percentage of sales has been declining from 25% in 2013 to 21.4% in 2018. Dmart's operating cost as a % of sales is 8% & a large reason for that is that it doesn't pay any rent. Spencer is better in this matrix compared to Start Bazaar & Hypercity though there is a scope of further improvement.

Change in Management:

Sanjiv Goenka has recently appointed Mr Devendra Chawla, as CEO and Managing Director of Spencer Retail Ltd. Mr.Devendra Chawla has vast experience of working with consumer & retail with Wal-mart India as chief operating office, prior to Wal-mart India, he was CEO of Future consumer and before Future consumer he was director at Coca Cola India. Spencer didn't have a CEO for last 1.5-2 Years & this hiring is great news. This kind of shows intention of management, what they want to do with the business. Ofcourse his strategy remains unknown us but he seems to be a smart guy.

In Aug.-14 Sanjiv Goenka hired Mr.Vikram Mehra from Tata Sky as their MD in, after change in management the performance of company has changed & the stock is up 6x; Vikram Mehra entered into new business segments and launched new products.(Launched Caravaan in April 2018, selling 1million + units till date)

Mutual Fund Selling:

Spencer Retail limited got demerged from CESC Ltd., all shareholders of CESC Ltd were allotted shares of demerged entity (spencer Retail). On listing in Jan-19, Spencer Retail got listed at M.cap of 1700, at that time many mutual funds were holding shares of demerged entity of Spence Retail, as per new Mutual fund classification norms, funds are restricted to invest in small market capitalisation companies.

Promoter has bought 23 lakh shares or 2.9% stake in the company in last 2 month which ofcourse is a massive positive here.

Name to Person	Category of Person *	Securities held pre Transaction	Type of Securities **	Number	Value	Transaction Type	Securities held post Transaction	Period ##	Mode of Acquisition #
RAINBOW INVESTMENTS LIMITED	Promoter	36632979 (46.06)	Equity Shares	1000000	143412655.00	Acquisition	37632979 (47.32)	01/03/2019 01/03/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	35477979 (44.61)	Equity Shares	600000	83434584.00	Acquisition	36077979 (45.36)	19/02/2019 19/02/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	36077979 (45.36)	Equity Shares	100000	13990148.00	Acquisition	36177979 (45.49)	19/02/2019 19/02/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	36177979 (45.49)	Equity Shares	330000	46460579.00	Acquisition	36507979 (45.90)	20/02/2019 20/02/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	36507979 (45.90)	Equity Shares	125000	17612822.00	Acquisition	36632979 (46.06)	20/02/2019 20/02/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	35277979 (44.36)	Equity Shares	100000	12807142.00	Acquisition	35377979 (44.48)	18/02/2019 18/02/2019	Market Purchase
RAINBOW INVESTMENTS LIMITED	Promoter	35377979 (44.48)	Equity Shares	100000	12736411.00	Acquisition	35477979 (44.61)	18/02/2019 18/02/2019	Market Purchase

Comparison with Industry

Fig. (in Cr) FY2018	D-mart	Future Retail	Spencer
No. of Stores	155	1035	146
Area (Mn sq.ft.)	4.9	14.5	1.3
Revenue	15009	18478	2091
EBIDTA	1337	844	17
EBIDTA (%)	8.90%	4.60%	0.80%
Rev. (per sq. ft)	32719	12743	18336
Mcap	90991	22436	1190
Mcap/Sales	6.1	1.2	0.6
Employee Exp.	283	930	143.2
Employee Exp. (%)	1.90%	5.00%	6.80%
Rent Exp.	0	949	108.7
Rental Exp. (%) of sales	Less than 0.5%	5.10%	5.20%
Inventory Turnover	14.4	3.4	8.6

If we look at data above, we can clearly see D-mart is leader in retail on all parameters, like revenue per sq.ft., employee expenses as % of Total revenue etc though Spencer is a better asset compared to future retail in most parameters.

Risk:

Competitive Market

Retail is very competitive business in country like India, at one side you are competing with big organised giants like D-mart, Big Bazar, on the other side competing with small mom and pop shops presence in every locality. The Game is not going to be easy after amazon and Flipkart has entered into grocery business. It will be very interesting to see which type of business gets success here.

Unclear Strategy – Since it's a new company in the market, its tough understand the exact strategy of the New management.

Recent Deal in Indian Retail Space

Last year, one big deal happened in Indian Retail, Aditya Birla Group sold its supermarket chain More to Witzig Advisory Services, owned by Samara Alternative Investment Fund, in a deal that will eventually see Amazon picking up a 49% stake.

Deal was valued at 4200 cr approx.

(cr)	2014	2015	2016	2017	2018
Revenue					
Aditya Birla Retail (more)	2510	2893	3509	4193	4400
Spencer	1451	1666	1796	2021	2091
EBIDTA					
Aditya Birla Retail (more)	-233	-164	-168	-99	positive
Spencer	-70	-67	-53	-17	17
EBIDTA (%)					
Aditya Birla Retail (more)	-9.28%	-5.67%	-4.79%	-2.36%	positive
Spencer	-4.83%	-4.03%	-2.94%	-0.85%	0.8%
Total Debt					
Aditya Birla Retail (more)					4000
Spencer					0

Comparing financials of More with Spencer Retail, Aditya Birla More is very big player compared to Spencer Retail when it comes to sales but if we compare on profitability parameters, Spencer Retail is performing better. Both More and Spencer have improved their EBIDTA profile. But if we look at debt levels, Aditya Birla More debt has gone up to 4000 cr whereas Spencer Retail has come down due to promoter equity infusion and as on FY-18, Spencer Retail has cash on book 250 cr.

Valuations and Conclusion

Spencer Retail at Market cap of 1190 crores and has 250 Crores of cash on its book i.e. its Trading at an Enterprise value of 930 Crores. Future Retail is trading at 1.3x Enterprise Value to sales, whereas Spencer is expected to do 2300 Crores of Sales for FY2019 & is trading at P/S 0.4x EV/Sales. Spencer is a mediocre business model at a cheap valuation with very less downside risk though all we are doing here is following a pattern of Investing in a debt free demerger with the promoter buying & there are a few unknowns here. A Small delta in Earnings with New management can re-rate the stock easily.

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