

Fsn E-commerce Ventures

The going seems to be getting tougher!

We recently met Nykaa's management (Mar-23) to primarily track our core thesis and what it holds. Hence, our REDUCE rating on Nykaa stands with a DCF-based TP of INR110/sh (implying 157x FY25 P/E). Our three-point thesis was (1) TAM seemed oversold; (2) ad revenue will be closely contended for; and (3) Nykaa seems more like an efficient pipe business than a platform. All three still hold! While management highlighted that BPC offers an upside from product cross-selling, purchase frequency and market share gains, its performance doesn't quite add up. AUTC growth < order growth < NSV growth i.e. it seems to be getting tougher to add new consumers. (2) BPC ad revenue—the single non-linear variable in the P&L stands at high-single digits of GMV as per management (HSIE: ~7%; down 50-100bps YoY). While Nykaa intends to improve on its ad tech stack, the jury is still out on its success in the backdrop of rising competition. Another point highlighted was most of the fulfilment efficiency gains seem behind (especially in BPC); there may be room in customer acquisition costs (CAC) and product margins, but these are more a function of the competitive landscape and Nykaa remains in customer recruitment mode. This makes the operating levers more linear vs. a platform.

Key takeaways/inferences from the management meeting:

- **Beauty & Personal Care—the core:** While management highlighted that BPC is a long-tail category that offers meaningful upside from product cross-selling, purchase frequency and market share gains, it doesn't quite add up in performance. Sure, purchase frequency and AoV are marginally up (HSIE: 3.4x in FY23 vs 3.2x in FY22; AoV: up 2% YoY); BPC growth rate is estimated to slip to 33% in FY23 vs 46% (FY22). Note: Despite the introduction of the "Pink Love" campaign in Q4, AUTC growth (~23%) < order growth (~30%) < NSV growth (~33%) for FY23E. i.e., it's getting tougher to add new consumers (at the margin). On BPC Margins, Nykaa intends to hit mid-double digit EBITDAM in BPC over 3-4 years, from 10-11% currently (factored in). It's important to note, however, that the focus in FY23 was to improve BPC efficiency, reflected in marginally improving AoV, order frequency and higher share of repeat consumers (75% vs 72% in 9MFY22). However, if Nykaa were to milk the TAM, new consumer sampling has to increase which could keep the planned margin expansion at risk (by virtue of higher CAC).
- **Fray in fashion doesn't seem convincing:** Management continues to focus on improving assortment breadth/relevance. However, fashion still remains WIP. The management intends to achieve EBITDA break-even in this segment over the next 2-3 years and an aspirational margin profile would be high-single digits (focus is to (a) improve private label salience and (2) reduce returns). We view this as a low-probability event as (1) most online peers are extremely aggressive on customer acquisition (Myntra/AJIO have significantly higher ad spend budgets) to drive traffic. We suspect (1) CAC for fashion is likely to remain high in the medium term, given the competitive landscape; (2) the ability to earn ad dollars in fashion is negligible, given the discovery-based nature of consumer purchase (Myntra is a case in point: <4% of sales); (3) cost of retailing (ex-ad spends) is also meaningfully lower for peers, given their scale advantage/warehouse density. Advantage Myntra/AJIO.

REDUCE

CMP (as on 25 Apr 2023)	INR 117
Target Price	INR 110
NIFTY	17,769

KEY CHANGES	OLD	NEW
Rating	REDUCE	REDUCE
Price Target	INR 115	INR 110
	FY24E	FY25E
EBITDA%	-	-

KEY STOCK DATA

Bloomberg code	NYKAA IN
No. of Shares (mn)	2,852
MCap (INR bn) / (\$ mn)	337/4,078
6m avg traded value (INR mn)	2,645
52 Week high / low	INR 304/115

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(9.5)	(36.9)	(58.4)
Relative (%)	(9.4)	(37.8)	(64.7)

SHAREHOLDING PATTERN (%)

	Dec-22	Mar-23
Promoters	52.34	52.28
FIs & Local MFs	4.06	5.14
FPIs	11.06	12.26
Public & Others	32.54	30.32
Locked-in Shares (%)	19.95	19.93

Source : BSE

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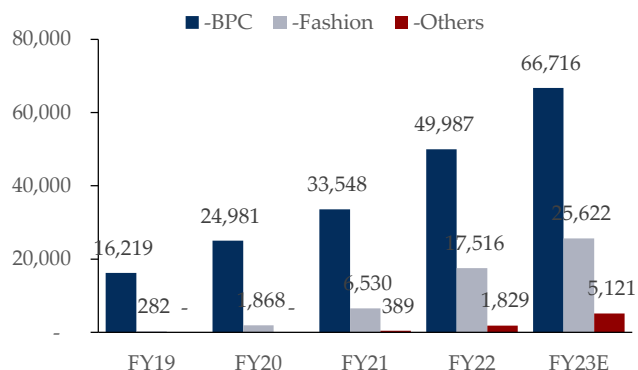
- **On the single non-linear variable—ad revenue:** Management highlighted that it intends to improve its ad tech stack by offering layered advertising spots (i.e., more ad inventory). This coupled with its preferred partner positioning could help gain a disproportionate share of digital ad spends, especially in an environment where advertisers are focused on 'return on ad spends' (RoAS). While no one disputes Nykaa's premier positioning in BPC, it is already over-indexed in terms of ad revenue it earns (in terms of % of revenue vs. other online deep-pocketed players). Also, with Myntra/RR's Tira/Tata Cliq Palette getting aggressive in the BPC space, ad dollars are likely to be closely contested. An inkling of this can be seen in the 50-100bps decline (YoY) in ad revenue for Nykaa in FY23 (HSIE: ~7/10% of GMV/revenue). Note: ad revenue is key for Nykaa's profitability as any decline puts added pressure on product margins to drive incremental unit economics.
- **On private labels and offline/omni-strategy:** While Nykaa continues to improve on its owned brand portfolio in both segments (BPC/fashion owned brands contribute 11.7/12.5% in 9MFY23 vs 10.1/7.1% in 9MFY22 respectively). The management intends to cap the contribution to the mid-teens at most. Management also highlighted that they see offline in BPC as a must-have channel and they've noticed that offline expansion leads to increased online sales in respective catchments as well. Our take on the omni-strategy is that while it may be necessary, especially for BPC, it does make Nykaa incrementally asset-heavy.
- **What's built in?** We expect Nykaa to clock 27/43/79% (overall: 31%) revenue CAGR for BPC/fashion/other segments (INR 73/8.9/6.6bn) over FY23-25 respectively. AUTC remains the anchor growth variable across segments. Building in a 170bp expansion in EBITDAM to 4.9% (Pre-IND AS 116) as (1) BPC product margins improve from -2.2% to 6% courtesy higher private labels, (2) scale-led operating efficiencies, (3) fashion losses are ebbing (building in a break-even in FY30). RoE/RoCE to improve to 12.4/9.5% by FY25 (from 3.5/4.5% respectively in FY23).
- **Valuation and outlook:** While Nykaa remains an efficient online business; especially on the BPC side, its success in part is also due to the absence of potent competitors (this is gradually changing). Ex-ad income, the lack of non-linearity in monetization capabilities restricts us from being constructive on the name. Hence, our REDUCE rating on Nykaa stands with a DCF-based TP of INR110/sh (earlier: 115.sh; implying 157x FY25 P/E).

Financial Summary	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	24,409	37,739	51,487	68,183	88,497
EBITDA	1,567	1,633	2,644	4,076	6,063
APAT	616	413	481	1,065	1,977
Dil. EPS (Rs/sh)	1.3	0.9	0.2	0.4	0.7
P/E (x)	96.5	144.1	742.1	335.3	180.5
EV/EBITDA (x)	228.3	219.0	135.2	87.7	59.0
ROE (%)	15.2	4.5	3.5	7.4	12.4
RoIC (%)	12.3	4.4	4.0	6.6	9.8
ROCE (%)	10.5	5.2	4.5	6.7	9.5

Focus Charts

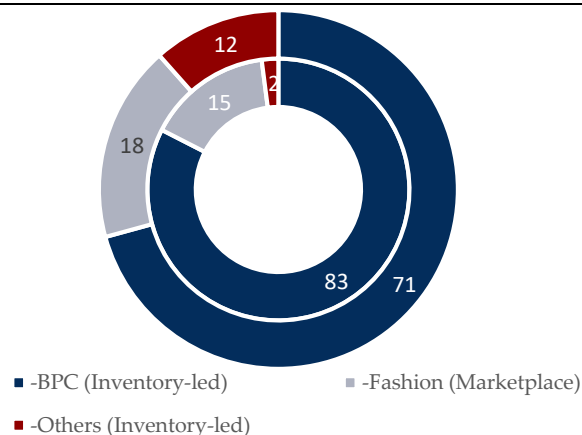
While Nykaa has scaled well...

Segment-wise GMV split (INR mn)



Source: Companies, HSIE Research

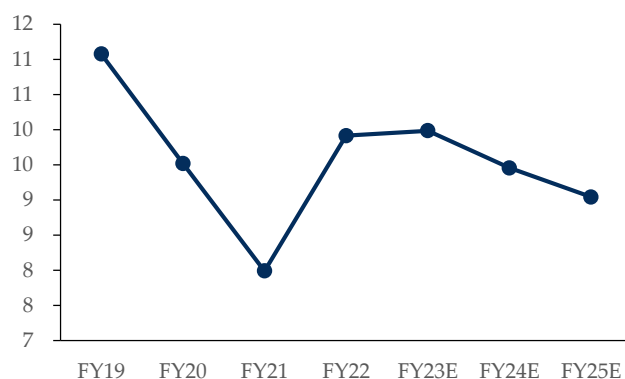
...it is likely to remain a predominantly inventory-led model for the foreseeable future



Source: Company, HSIE Research

While Nykaa's ad income contribution seems to be inching down (albeit gradually)

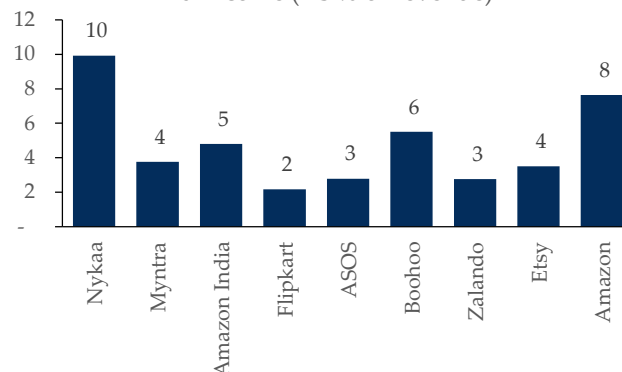
Ad/Shipping Income (As % of revenue)



Source: Companies, HSIE Research

Nykaa also seems most over-indexed across domestic/global e-tailers in terms of ad income

Ad income (As % of revenue)



Source: Company, HSIE Research

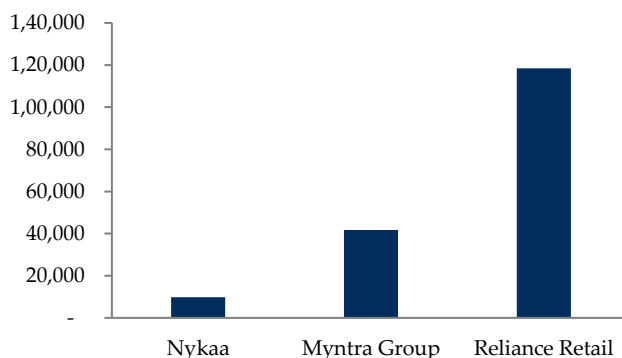
...Nykaa's unit economics remains ad income reliant currently (BPC Product margins has just hit profitability)

FY23 Indicative Unit Economics (Per Order, INR)		
	BPC	Fashion
AoV	1,864	3,967
NSV	1,160	1,152
Revenue (on product)	1,160	580
GM (on products)	35	73
A&P Expenses	121	355
FFC expenses	105	130
Ad/Shipping Income	125	92
Contribution	303	29
Employee Expenses	89	210
Other expenses	63	103
EBITDA	151	(284)
EBITDAM (% on NSV)	13.0	(24.7)
EBITDAM (on product)	26	(377)
Product EBITDAM (% on NSV)	2.2	(32.7)

Source: Companies, HSIE Research

...ad income could get split as peers scale up the tech stack for their respective lifestyle (BPC & Fashion) platforms

FY21-22 equity funds raised; INR mn)



Source: Company, HSIE Research; Note: Intangible asset under development (FY22) used as proxy to showcase investment aggression

Key Assumptions	FY21	FY22	FY23	FY24	FY25
Total GMV (INR mn)	40,467	69,332	97,459	1,31,823	1,75,595
YoY (%)	51	71	41	35	33
-BPC	33,548	49,987	66,716	85,776	1,08,734
-Fashion	6,530	17,516	25,622	35,804	48,937
-Others	389	1,829	5,121	10,242	17,924
Total NSV (INR mn)	23,380	37,118	50,326	67,327	88,284
YoY (%)	44	59	36	34	31
-BPC	20,941	30,632	40,706	52,336	66,343
-Fashion	2,308	5,728	7,443	10,741	14,681
-Others	131	758	2,177	4,251	7,259
Total Revenue (INR mn)	24,409	37,739	51,487	68,183	88,497
YoY (%)	38	55	36	32	30
-BPC	22,836	33,831	45,072	57,818	72,961
-Fashion	1,438	3,254	4,341	6,454	8,893
-Others	135	654	2,074	3,911	6,642
EBITDA (As % of NSV)					
-BPC	9.1	9.3	12.9	14.8	16.1
-Fashion	(11.3)	(11.9)	(16.7)	(14.1)	(10.6)
-Others	(56.6)	(60.3)	(63.6)	(51.1)	(41.9)
KPIs					
AUTC (mn)					
-BPC	5.6	8.4	10.3	12.7	15.5
-Fashion	0.6	1.8	2.5	3.4	4.6
Orders (mn)					
-BPC	17	27	35	44	54
-Fashion	2	5	6	9	12
AoV (INR)					
-BPC	1,963	1,864	1,901	1,958	2,017
-Fashion	2,739	3,420	3,967	4,047	4,127
FFC/Order					
-BPC	110	120	105	101	98
-Fashion	117	121	130	116	113
A&P/Order					
-BPC	73	108	121	115	113
-Fashion	169	302	355	327	301
Contribution/Order					
-BPC	314	277	303	326	344
-Fashion	136	68	29	95	133
EBITDA/Order					
-BPC	112	118	151	178	198
-Fashion	(86)	(131)	(284)	(256)	(220)

Financials

Income Statement

Year End (March)	FY21	FY22	FY23	FY24	FY25
Net Revenues	24,409	37,739	51,487	68,183	88,497
Growth (%)	38.1	54.6	36.4	32.4	29.8
Material Expenses	14,926	21,300	28,512	37,714	48,958
A&P Expense	1,695	4,781	7,311	9,272	11,724
Fulfilment expenses	2,177	3,956	4,769	5,959	7,480
Employee Expense	2,330	3,259	4,922	6,716	8,871
Rent Expenses	83	106	145	273	354
Other Expenses	1,632	2,704	3,184	4,173	5,046
EBITDA	1,567	1,633	2,644	4,076	6,063
EBITDA Growth (%)	93.3	4.2	62.0	54.2	48.7
EBITDA Margin (%)	6.4	4.3	5.1	6.0	6.9
Depreciation	716	964	1,660	2,233	2,692
EBIT	851	668	985	1,844	3,371
Other Income (Including EO Items)	118	270	342	386	307
Interest	307	465	725	865	1,077
PBT	661	473	601	1,365	2,602
Total Tax	45	60	120	300	624
PAT before share of associate earnings	616	413	481	1,065	1,977
Share of associate earnings	-	-	-	-	-
RPAT	616	413	481	1,065	1,977
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	616	413	481	1,065	1,977
APAT Growth (%)	(477.3)	(33.0)	16.5	121.3	85.7
Adjusted EPS (Rs)	1.3	0.9	0.2	0.4	0.7
EPS Growth (%)	(477.3)	(33.0)	(80.6)	121.3	85.7

Balance Sheet

Year End (March)	FY21	FY22	FY23	FY24	FY25
SOURCES OF FUNDS					
Share Capital - Equity	151	474	474	474	474
Reserves	4,749	12,925	13,406	14,471	16,448
Total Shareholders' Funds	4,899	13,399	13,880	14,945	16,922
Minority Interest	8	56	56	56	56
Long Term Debt	17	9	9	9	9
Short Term Debt	1,858	3,321	3,321	3,321	3,321
Total Debt	1,875	3,330	3,330	3,330	3,330
Lease Liabilities	1,452	2,596	4,450	6,304	8,159
Net Deferred Taxes	247	22	22	22	22
Other Non-current Liabilities & Provns	850	2,889	2,889	2,889	2,889
TOTAL SOURCES OF FUNDS	9,332	22,292	24,628	27,546	31,378
APPLICATION OF FUNDS					
Net Block	921	2,032	2,230	2,291	2,202
CWIP	20	98	98	98	98
Other Non-current Assets	2,274	4,342	6,108	7,875	9,641
Total Non-current Assets	3,215	6,471	8,436	10,263	11,941
Inventories	4,981	8,756	11,285	14,757	18,912
Debtors	766	945	1,572	1,876	2,435
Other Current Assets	1,568	7,617	4,843	5,442	5,803
Cash & Equivalents	2,490	2,670	4,926	3,634	3,103
Total Current Assets	9,805	19,989	22,626	25,710	30,253
Creditors	3,162	3,621	5,642	7,379	9,456
Other Current Liabilities & Provns	526	548	792	1,048	1,361
Total Current Liabilities	3,688	4,168	6,434	8,427	10,816
Net Current Assets	6,117	15,821	16,192	17,283	19,437
TOTAL APPLICATION OF FUNDS	9,332	22,292	24,628	27,546	31,378

Source: Company, HSIE Research

Cash flow statement

Year ending March	FY21	FY22	FY23	FY24	FY25
Reported PBT	753	473	601	1,365	2,602
Non-operating & EO Items	172	58	(342)	(386)	(307)
Interest Expenses	307	465	725	865	1,077
Depreciation	671	835	1,660	2,233	2,692
Working Capital Change	(273)	(4,649)	1,885	(2,383)	(2,684)
Tax Paid	(132)	(722)	(120)	(300)	(624)
OPERATING CASH FLOW (a)	1,498	(3,540)	4,409	1,393	2,754
Capex	(437)	(1,448)	(870)	(915)	(964)
Free Cash Flow (FCF)	1,062	(4,988)	3,539	478	1,790
Investments	(897)	(4,746)	-	-	-
Non-operating Income	36	166	342	386	307
INVESTING CASH FLOW (b)	(1,297)	(6,028)	(528)	(529)	(656)
Debt Issuance/(Repaid)	46	1,195	(725)	(865)	(1,077)
FCFE	1,107	(3,793)	2,814	(387)	713
Share Capital Issuance	6	8,727	-	-	0
Dividend	-	-	-	-	-
Others	(429)	(652)	-	-	-
FINANCING CASH FLOW (c)	(377)	9,270	(725)	(865)	(1,077)
NET CASH FLOW (a+b+c)	(176)	(297)	3,156	(1)	1,021
EO Items, Others	-	-	-	-	-
Closing Cash & Equivalents	2,477	2,670	4,926	3,634	3,103

KEY RATIOS

	FY21	FY22	FY23	FY24	FY25
PROFITABILITY (%)					
GPM	38.9	43.6	44.6	44.7	44.7
EBITDA Margin	6.4	4.3	5.1	6.0	6.9
EBIT Margin	3.5	1.8	1.9	2.7	3.8
APAT Margin	2.5	1.1	0.9	1.6	2.2
RoE	15.2	4.5	3.5	7.4	12.4
RoIC (or Core RoCE)	12.3	4.4	4.0	6.6	9.8
RoCE	10.5	5.2	4.5	6.7	9.5
EFFICIENCY					
Tax Rate (%)	6.8	12.7	20.0	22.0	24.0
Total Asset Turnover (x)	3.6	1.9	2.6	2.9	3.1
Fixed Asset Turnover (x)	22.0	19.6	18.4	18.4	18.9
Inventory (days)	74.5	84.7	80.0	79.0	78.0
Debtors (days)	11.5	9.1	11.1	10.0	10.0
Other Current Assets (days)	23.4	73.7	34.3	29.1	23.9
Payables (days)	47.3	35.0	40.0	39.5	39.0
Other Current Liab & Provns (days)	7.9	5.3	5.6	5.6	5.6
Cash Conversion Cycle (days)	54.2	127.2	79.9	73.1	67.4
Net D/E (x)	(0.1)	0.0	(0.1)	(0.0)	0.0
Interest Coverage (x)	2.8	1.4	1.4	2.1	3.1
PER SHARE DATA (Rs)					
EPS	1.3	0.9	0.2	0.4	0.7
CEPS	2.9	2.9	0.8	1.2	1.7
Dividend	-	-	-	-	-
Book Value	10.6	28.4	4.9	5.3	6.0
VALUATION					
P/E (x)	97	144	742	335	181
P/BV (x)	12	4	26	24	21
EV/EBITDA (x)	228.3	219.0	135.2	87.7	59.0
EV/Revenues (x)	14.6	9.4	6.9	5.2	4.0
OCF/EV (%)	0.4	(1.0)	1.2	0.4	0.8
FCF/EV (%)	0.3	(1.4)	1.0	0.1	0.5
FCFE/Mkt Cap (%)	0.3	(1.1)	0.8	(0.1)	0.2
Dividend Yield (%)	-	-	-	-	-

Source: Company, HSIE Research

1Yr Price History**Rating Criteria**

BUY: >+15% return potential
ADD: +5% to +15% return potential
REDUCE: -10% to +5% return potential
SELL: >10% Downside return potential

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