



18 July 2019

General Retailers



Source: Refinitiv

Market data

EPIC/TKR	KOOV
Price (p)	7.35
12m High (p)	24
12m Low (p)	6
Shares (m)	359
Mkt Cap (£m)	26
EV (£m)	23
Free Float*	40%
Market	AIM

*As defined by AIM Rule 26

Description

Koovs is an online retailer of fashion across India. It has an experienced management team, growing brand awareness and the highest Net Promoter Score (NPS) in its vertical.

Company information

CEO	Mary Turner
CFO	Rob Pursell
Chairman	Waheed Alli
	+44 20 7151 0170
	www.koovs.com

Key shareholders

Waheed Alli (Dir.)	11%
Future Lifestyle Fashion	26%
Hindustan Times Media	11%
Dragon Asia	7%
Michinoko	5%
Anant Nahata	3%

Diary

Sep'19	AGM
Dec'19	Interim results

Analyst

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KOOVS

New year started with a bang

The important information from Koovs' FY19 results is not the results for the year but the trading since the company secured its additional financing. With Gross Order Value (GOV) up 104% in 1Q20, Koovs is once more showing the sort of growth associated with online success. FY19 itself was a lost year, as the company conserved cash while it successfully sought new investors; they eventually arrived – not only with money but with important synergistic benefits too. The GOV data is a function of being able to finance growth again. The benefits of the Future Lifestyle (FLFL) tie-up are still to come in additional distribution and improved buying.

- **Strategy:** Koovs' plan to become the ASOS of India is back on track. The impact of the lack of resources in FY19 showed up in the low growth in reported revenue (+9%). With the tap turned back on, GOV has doubled in 1Q20 and web traffic is up 148% (and this not achieved at the expense of the trading margin: up to 21%).
- **Forecasts:** We have, effectively, shifted our forecasts one year later. The expected revenue in FY20 is roughly what we were anticipating for FY19, had the funding arrived straightaway. The base is slightly lower, but we would expect that the benefits from the FLFL tie-up should accelerate growth prospects.
- **Valuation:** Our valuation has changed – under the old estimates, the value should have risen, as the growth came through and the discount unwound. By delaying for a year, this has not happened, and there has been some dilution. Our central estimate of value suggests that Koovs is worth £300m today, or 74p per share.
- **Risks:** We see the two key risks as being slower uptake of e-commerce in India than we forecast, and damaging discounting by Koovs' direct and indirect competitors. Koovs also needs to manage the relationship with FLFL successfully to optimise its benefits. In addition, it will need further funding in FY21 to achieve its plans.
- **Investment summary:** With the money raised and the new partners on board, Koovs becomes an exciting way to play the last big world retail market to move online. The prize, if it gets it right, is a billion-pound company and more. It is likely to be a bumpy, exciting ride, but investors have the reassurance of a highly experienced management team in charge, and the backing of two major Indian corporations straddling both retail and media.

Financial summary and valuation

Year-end Mar (£m)	2018	2019	2020E	2021E	2022E	2023E
Visits (m)	66	76	100	160	260	340
Conversion	1.37%	1.14%	1.40%	1.70%	2.50%	3.00%
No. of orders (m)	0.91	0.86	1.40	2.72	6.50	10.20
AOV (£)	16.37	14.99	14.90	15.00	15.50	16.00
GOV (£m)	14.5	12.8	22.6	49.0	135.2	249.8
Net sales	9.6	8.5	13.8	30.4	85.9	159.9
Weighted margin	47%	49%	52%	57%	61%	62%
Trading profit	1.2	0.1	3.3	10.3	39.0	73.9
Trading margin	11%	1%	24%	34%	45%	46%
EBITDA	-14	-14	-18	-18	1	21
No. of shares (m)	175	313	359	359	359	359
EV/sales (x)	1.0	1.7	1.7	0.8	0.3	0.1

Source: Hardman & Co Research

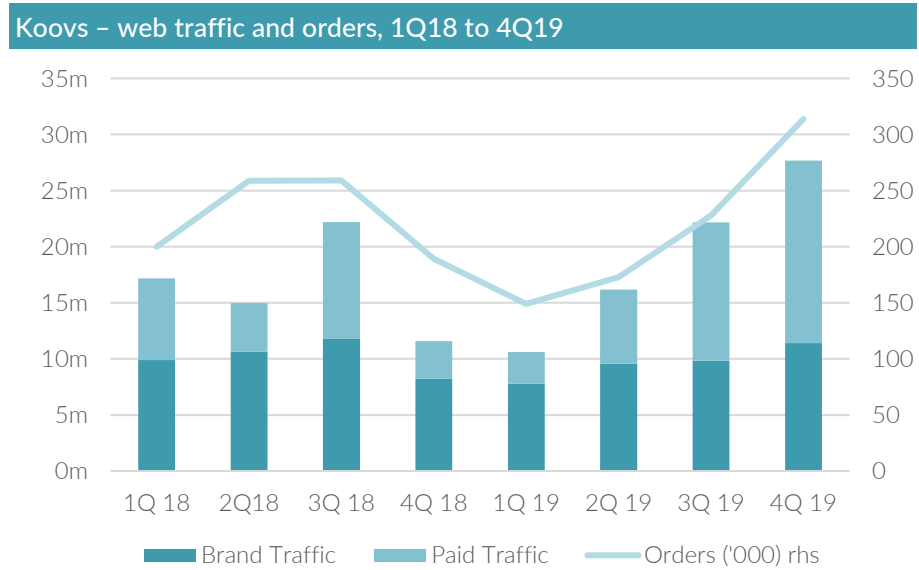
FY19 results

Summary of key takeaways

With the company suffering from lack of resources and the need to preserve cash, marketing spend and clothing ranges were severely restricted at the start of FY19. Revenue for the year was up 9% in Indian Rupee terms (flat in Sterling), but that was largely because of the increase in 3Q and 4Q once some of the money raised had come through.

- ▶ GOV reached £4.4m in 4Q19, up 63% YoY.
- ▶ The trading margin increased to 18% in FY19, from 14% in FY18.
- ▶ Web traffic reached 76m in FY19, from 66m in FY18, with 4Q up 139% YoY.

Koovs was careful to maintain its brand recognition with targeted social media programmes, but the turnaround is clear in the chart below, where the web traffic and orders both show a sharp pick-up from the low in the first quarter.

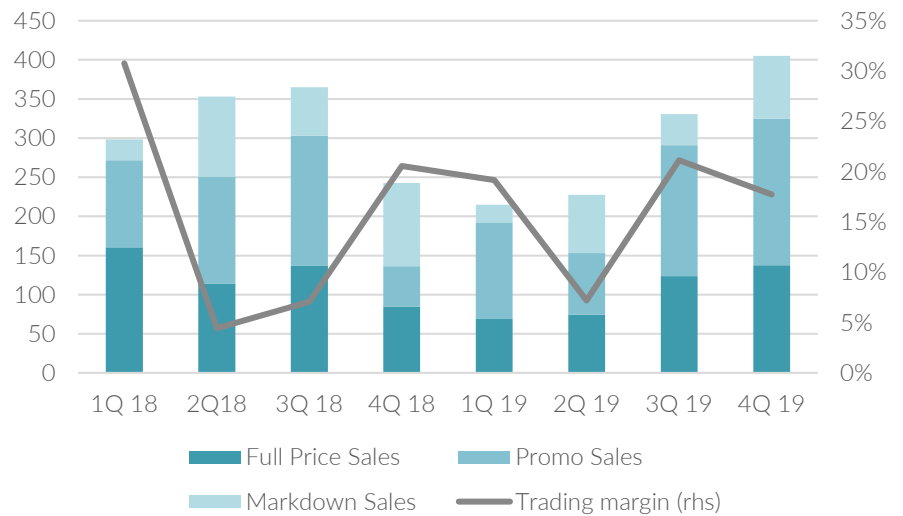


Source: Hardman & Co Research

Koovs has focused on its brand and customer service, even while funds were tight. It was named as the top retailer for customer experience in India by Forrester Research for the second consecutive year. Furthermore, its focus on online media has proved effective, with 2.6m social media followers, more than three times the level of engagement of its nearest competitor.

The growth in sales in the second half was not achieved through excessive discounting. Markdown sales fell from 24% of the mix in FY18 to 19% in FY19, as the trading margin rose from 14% to 18% in the year.

Koovs – sales mix (INR 000) and trading margin, 1Q18 to 4Q19



Source: Hardman & Co Research

Fundraising

In March 2018, Koovs announced its intention to raise £50m to accelerate growth. In June, it announced an agreement with HT Media, whereby Koovs would acquire four lots of £6m of media every six months, paid for 70% in new shares and 30% in cash. The price of the shares was determined at 10p for the first tranche and subsequently to be calculated as the lower of the three-month average share price or the price of the most recent funding round.

The HT Media deal was conditional on Koovs raising at least £6m of new equity. On 6 July 2018, Koovs announced that it had raised £12m at 15p per share, including a £1.5m subscription from the Chairman, Lord Alli. In between, it had also announced a tie-up with FLFL. FLFL agreed to subscribe for 58m shares at 10p. Then, in August, a further commitment by FLFL to take its holding up to 29.99% was announced by subscribing for a further 63.3m-69.85m shares at 15p each. The details subsequently changed, but the commitment remained the same.

In FY19, a total of £22.1m was raised, together with FLFL’s commitment of approximately £10.5m, of which £3.7m was received in May 2019.

Compulsory convertible

Koovs is issuing FLFL with a compulsory convertible. The instrument will convert into 24m shares at an implied price of 28.36p. This, together with the 46m shares issued at ca.8p, equates to 70m shares at 15p. The terms of the convertible allow FLFL to delay conversion until February 2021. From a Koovs perspective, it makes no difference, as the cash will already have been received, and since the conversion is compulsory, we assume all the shares will be issued when we make our fully-diluted calculation.

Future Lifestyle (FLFL)

The FLFL tie-up is still in its early stages. In addition to the cash injection, we see three benefits:

- ▶ marketing and customer engagement;
- ▶ manufacturing and sourcing synergies; and

- ▶ profitable provision of services to FLFL.

Koovs has already opened some concession in three FLFL stores in Delhi, and this will be rolled out in four other metro cities. The idea is not to become a bricks and mortar retailer of Koovs fashion, but simply to enhance the brand profile.

FLFL is a massive clothes retailer, and subsequently has relationships with suppliers of fabric and garment manufacturers. Koovs will be able to piggyback on these relationships, getting cheaper prices and access to a wider range of material.

Lastly, Koovs is already providing technical services to one of FLFL's divisions – Brand Factory. It is also providing its studio facilities to shoot catalogue images and videos. These agreements are profitable for Koovs but, perhaps more importantly, they are an endorsement of Koovs' technical ability. Koovs has been contracted to build and maintain Brand Factory's online retail platform.

Forecast changes

With the full-year figures, we have updated our forecasts, which had remained unchanged since last year. We have largely just pushed out progress by one year. We have revenue near-doubling, or more, each year (£11m, £25m, £76m, £145m), with a small gross profit in FY20E, rising sharply, so that Koovs makes a very small operating profit in FY22E and significant profit in FY23E.

The underlying assumption is that the Indian e-commerce market continues to grow at a rapid pace and that apparel outpaces the market growth and, within that, Koovs grows its market share.

These are optimistic assumptions, but they are no different from what has been seen many times in other more mature online retail markets.

On our forecasts, Koovs will require additional funding during FY21 to achieve its plans.

Valuation

We use the same methodology as explained in our Koovs initiation report, *Poised to clean up – the emerging ASOS of India, March 2018*. Essentially, we look out to FY23, where we are expecting EBITDA of £20.8m. We apply an EBITDA multiple of 35 (typical of what was applied to ASOS and Boohoo at that stage of their development) to derive a future value of £731m, which we then discount back to today at 25% – a high rate to encompass all the risks faced in growing a business to that scale. That derives a value of £300m, or 74p per share on a fully-diluted basis.

Financials

Income statement, 2018-23E						
Year-end Mar (£000)	2018	2019	2020E	2021E	2022E	2023E
Revenue	6,350	6,427	10,822	24,854	76,133	144,553
Cost of sales	-8,068	-6,959	-10,562	-20,112	-46,651	-86,546
Gross profit/loss	-1,718	-532	260	4,742	29,482	58,007
Operating expenses	-12,857	-13,431	-17,971	-23,415	-29,181	-37,111
Operating loss	-14,575	-13,963	-17,711	-18,672	301	20,896
Finance income	220	281	100	100	100	100
Finance expense	-982	-1,824	-100	-100	-100	-100
Profit/Loss before tax	-15,337	-15,506	-17,711	-18,672	301	20,896
Tax						
Profit/Loss	-15,337	-15,506	-17,711	-18,672	301	20,896
EBITDA	-14,443	-13,822	-17,531	-18,472	541	21,196
Equity holders	-15,337	-15,506	-17,711	-18,672	301	20,896
Loss per share (p)	-8.7	-5.3	-5.1	-5.2	0.1	5.8
No of shares						
Period end (m)	175	313	359	359	359	359
Weighted (m)	175	293	350	359	359	359
Potential dilution (m)			46	46	46	46
Revenue growth	-27%	1%	68%	130%	206%	90%
Gross margin	-27%	-8%	2%	19%	39%	40%
Operating margin	-230%	-217%	-164%	-75%	0%	14%

Source: Hardman & Co Research

Cashflow, 2018-23E						
Year-end Mar (£000)	2018	2019	2020E	2021E	2022E	2023E
Loss before tax	-15,337	-15,506	-17,711	-18,672	301	20,896
Depreciation and amortisation	132	141	180	200	240	300
Working capital changes	-257	-2,892	1,500	1,000	-3,000	-4,500
Net interest income/expense	762	1,543				
Other operating cashflows	778	985	500	500	500	500
Tax paid						
Net cashflow from operations	-13,922	-15,729	-15,531	-16,972	-1,959	17,196
Purchase/sale of assets	-233	-100	-200	-300	-400	-500
Interest income	176	281	100	100	100	100
Deposits	2,735	-2,349	4,754			
Net cashflow from investing	2,678	-2,168	4,654	-200	-300	-400
Share issues		20,818	10,500			
Convertible loan	9,507					
Repayment of debt		-271				
Interest and finance expense	22	-13	-10	-10	-10	-10
Net cashflow from financing	9,529	20,534	10,490	-10	-10	-10
Net change in cash	-1,715	2,637	-387	-17,182	-2,269	16,786
Cash at start	1,774	404	3,447	3,460	-13,323	-15,192
FX effects	345	406	400	400	400	400
Cash at end	404	3,447	3,460	-13,323	-15,192	1,994

Source: Hardman & Co Research

Balance sheet

Balance sheet, 2018-23E

@ 31 Mar (£000)	2018	2019	2020E	2021E	2022E	2023E
Intangible assets	6,866	6,950	6,950	6,950	6,950	6,950
PP&E	260	254	274	374	534	734
Non-current financial assets	75	88	88	88	88	88
Total non-current assets	7,201	7,292	7,312	7,412	7,572	7,772
Inventories	1,536	2,364	4,364	6,364	8,364	10,364
Receivables	6,922	11,506	12,506	13,506	14,506	15,506
Bank deposits	2,314	4,754				
Cash	949	3,750	3,460	-13,323	-15,192	1,994
Total current assets	11,721	22,374	20,330	6,547	7,678	27,864
Total assets	18,922	29,666	27,642	13,959	15,250	35,636
Trade payables	-2,680	-5,065	-6,592	-11,582	-12,572	-12,062
Borrowings	-572	-9,722	-9,722	-9,722	-9,722	-9,722
Total current liabilities	-3,252	-14,787	-16,314	-21,304	-22,294	-21,784
Long-term liabilities	-7,833	-103	-103	-103	-103	-103
Total non-current liabilities	-7,833	-103	-103	-103	-103	-103
Total liabilities	-11,085	-14,890	-16,417	-21,407	-22,397	-21,887
Net assets	7,837	14,776	11,225	-7,448	-7,147	13,749
Equity share capital	1,838	3,690	4,150	4,150	4,150	4,150
Share premium	67,799	88,127	91,327	91,327	91,327	91,327
Other reserves	2,098	3,546	14,046	14,046	14,046	14,046
Retained earnings	-63,898	-80,587	-98,298	-116,971	-116,670	-95,774
Minority interest						
Total equity	7,837	14,776	11,225	-7,448	-7,147	13,749

Source: Hardman & Co Research

Risks

- ▶ The Indian online market does not grow as predicted.
- ▶ The online growth does not turn into as many online shoppers as expected.
- ▶ The online shoppers do not spend as much as forecast.
- ▶ The shoppers do not buy their clothes from Koovs.
- ▶ Koovs has to spend more than it anticipates generating the traffic.
- ▶ Koovs has to discount more heavily than expected to generate sales.
- ▶ The competition is even fiercer in its discounting and marketing spend.
- ▶ Costs are higher (in particular, product returns may be higher).
- ▶ The Indian government introduces more disruptive measures.
- ▶ The benefits of the FLFL tie-up fail to materialise.
- ▶ Koovs fails to raise additional capital.

In addition, there are a number of other generic business risks.

There is no doubt that this is a highly risky venture. Koovs has achieved a lot in its short existence and, in particular, in the past two years, but it is still years from profitability, and many things can go wrong along the way.

We believe, with the single exception of its financing, that Koovs is in an excellent position to make the best of the enormous opportunity that online Indian clothes retailing represents.

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