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India Retail

Govt allows FDI in multi-brand retail

The Cabinet committee on Economic Affairs has approved upto 51% FDI in multi-brand retail. However given the statewise approvals required, we believe foreign retailers would go slow in terms of entering India. Though we remain negative on PF given the weak operating metrics, it would be the key beneficiary given its market leadership position. Other key listed retailers could also benefit by tying up in their nascent hypermarket business.

- **Govt approves FDI in multi-brand retail:** The Cabinet committee on Economic Affairs has approved upto 51% FDI in multi-brand retail (earlier approved by the Cabinet in November 2011, but rolled back due to stiff opposition). This paves the way for allowing foreign players to enter in multi-brand retail in India.

- **State approval remains the key rider:** Individual states will decide on the implementation of FDI in retail in their respective states which remains the key rider. Currently 9 states have approved the decision, whereas 6 states have expressed their reservations on the same. Given the statewise approvals required, we believe foreign retailers would go slow in terms of entering India. Most of the other conditions are similar to the ones which were approved by the cabinet earlier.

- **Positive for producers and consumers, higher competition for mom-and-pop stores:** Given the scale-up potential and capital intensity of the business, India could expect a steady inflow of FDI over a period, albeit the quantum would be small to begin with. Investments into supply chains (cold storage, logistics etc) would help build infrastructure back-end in India Potential lowering of prices as companies' source from farmers and remove distribution inefficiencies present today which would be positive for consumers. It would also entail more choices for the consumers. However this would lead to higher competition for mom-and-pop retailers (Currently India has ~12 mn unorganised retail network employing ~44 mn people).

- **Positive for listed retail plays**: **Pantaloon Retail (PF IN, SELL rated)** could be the key beneficiary given the market leadership in their *Big Bazaar* format which would make them an ideal partner for a foreign player to get scale in India straight away. Though there could be short-term bounce given sharp underperformance (down 45% in 1 year), we remain negative on the stock given weak operating metrics (SSS growth, inventory) and leveraged balance sheet. **Trent Ltd (TRENT IN, Not rated) and Shoppers Stop (SHOP IN, HOLD rated)** are the other key listed retailers which could benefit. Though we dont expect significant increase in competition or stake sale in their departmental store businesses, there is a potential to tie-up with foreign retailers in their nascent hypermarket businesses.

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COMPANY	TICKER	CMP (Rs)	TP (Rs)	REC
Pantaloon Retail	PF IN	157	145	SELL
Shoppers Stop	SHOP IN	360	380	HOLD

Event:

The Cabinet committee on Economic Affairs has approved upto 51% FDI in multi-brand retail (earlier approved by the Cabinet in November, but rolled back due to stiff opposition from UPA allies and the opposition). This finally paves the way for allowing foreign players to enter in multi-brand retail in India.

Riders:

Proposals to permit FDI in multi-brand retail trading in all products, in a calibrated manner, are likely to be subject to the following conditions:

- FDI in multi-brand retail may be permitted to the extent of 51 per cent with government approval. The government has said that individual states will decide on the implementation of the move. Hence if opposition states are not in favour of FDI then, they need not implement the same in their states. No clarity exists on whether a particular govt in a state allows FDI, then the subsequent govt (if from an opposition party) won't be allowed to roll back the decision.

- The Chief Ministers of Delhi, Assam, Maharashtra, Andhra Pradesh, Rajasthan, Uttarakhand, Haryana and Governments of the State of Manipur and the Union Territory of Daman & Diu and Dadra and Nagar Haveli, have expressed support for the policy in writing. The Chief Minister of Jammu & Kashmir, through his press statements, has publicly endorsed the policy and asked for its implementation. The State Governments of Bihar, Karnataka, Kerala, Madhya Pradesh, Tripura and Odisha have expressed reservations on the proposal. There are 16 cities with a population of 1 mn+ from the list of approved states.

- Minimum amount to be brought in as FDI by a foreign investor would be around $100 million. At least 50 per cent of the total FDI brought in shall be invested in back-end infrastructure. Back-end infrastructure will entail capital expenditure on all activities, excluding that on front-end units. For instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce, infrastructure, etc

- At least 30 per cent of the procurement of manufactured processed products shall be sourced from small industries, in the country, that have total investment in plant and machinery not exceeding $100 million. This valuation refers to the value at the time of installation without providing for depreciation.

- The government will have the first right to procurement of agriculture products.

- Retail sales locations may be set up only in cities with a population of more than 10 lakh (1 million) as per 2011 Census and may also cover an area of 10 km around municipal urban agglomeration limits of such cities. Retail locations will be restricted to areas as per the master zonal plans of the cities concerned and provisions will be made for requisite facilities such as transport connectivity and parking. On the other hand, States/ Union Terrritories, which do not have any city with a population exceeding 10 lakhs, but are desirous of implementing the policy, would have the flexibility to do so.

- Other conditions/safeguards, approved by the Cabinet on 24.11.2012, would remain unchanged.

Impact on sector:

We believe this would lead to gradual influx of foreign players into India and one should expect investments to follow the same. However given the statewise approvals required, we believe foreign retailers would go slow in terms of entering India. Out of India's total retail of $ 590 bn, only ~5% is organised. We expect this to gradually improve and modern retail which is currently ~$30 bn to grow faster going ahead given access to foreign capital and entry of multiple players.

Key points of impact:

- Given the scale-up potential and capital intensity of the business, India could expect a steady inflow of FDI over a period, albeit the quantum would be small to begin with.
- Investments into supply chains (cold storage, logistics etc) would help build infrastructure back-end in India
- Potential lowering of prices as companies source from farmers and remove distribution inefficiencies present today.
- Higher competition for mom-and-pop retailers. Currently India has ~12 mn unorganised retail network employing ~44 mn people.
- More choices for consumers.

Impact on stocks:

Pantaloon Retail (PF IN, SELL rated) could be the key beneficiary given the market leadership in their *Big Bazaar* format which would make them an ideal partner for a foreign player to get scale in India straight away. Though there could be short-term bounce given sharp underperformance (down 45% in 1 year), we remain negative on the stock given weak operating metrics (SSS growth, inventory) and leveraged balance sheet.

Trent Ltd (TRENT IN, Not rated) and Shoppers Stop (SHOP IN, HOLD rated) are the other key listed retailers which could benefit. Though we dont expect significant increase in competition or stake sale in their departmental store businesses, there is a potential to tie-up with foreign retailers in their nascent hypermarket businesses.

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