

ANALYSTS
Bharat Chhoda

bharat.chhoda@icicidirect.com

Prerna Jhunjunwala

prerna.jhunjunwala@icicidirect.com

Rahul Malhotra

rahul.malhotra@icicidirect.com

Retail play deferred...

Our coverage universe of retail companies is expected to report 40.5% YoY revenue growth due to increased space under operations. However, the companies are expected to report less than proportionate growth of 32.5% YoY in operating profit due to slowing sales and higher costs of operation (cost of goods sold, rentals and power). Net profit is expected to decline by 3.28% due to slowing sales and higher debt taken for working capital requirements.

Highlights of the quarter

During the quarter, almost all retailers announced a slowing in their expansion plans. The retailers are closing their unviable stores and resizing the existing large stores to make them profitable. They also announced cost cutting strategies involving centralising of operations and renegotiating rentals with the mall developers. The retailers also started looking at revenue sharing agreements with mall developers, which will enable them to lower rental cost. Such an agreement increases the responsibility of mall developers to attract consumers to malls. Franchise agreement was the most preferred route on the part of a majority of the retailers due to the asset-light model nature of business.

Neutral on the sector due to economic uncertainty

Consumer behaviour is undergoing a drastic change wherein savings have become the first priority in the weak global economic scenario. Consumers are postponing their not-so-important requirements that are leading to a deferral in immediate purchases. As a result, the footfalls and conversion ratio have been lower, thereby affecting sales. We believe that in such a scenario, the declining rentals and the cost cutting drive by retailers will provide a cushion to margins.

India continues to be among the top retail destinations in the world. Value retail remains the preferred format for Indian consumers. We believe the investments in the sector will continue in the long-term. We are neutral on the sector due to the uncertain scenario in both domestic and global economy. We will revisit our stand when the global and domestic economy nears stabilisation and better footfalls and conversion is seen happening in the sector.

Result Summary

Exhibit 1: Coverage Universe (Consolidated)

Company	Sales (%) change			EBIDTA (%) change			PAT (%) change		
	OND08	Y-o-Y	Q-o-Q	OND08	Y-o-Y	Q-o-Q	OND08	Y-o-Y	Q-o-Q
Koutons Retail	285.45	64.91	1.08	52.89	76.35	9.68	22.07	80.16	12.72
Vishal Retail	381.59	26.46	6.49	41.32	0.55	-1.70	4.26	-71.55	4.37
Total	667.04	40.48	4.11	94.21	32.53	4.39	26.33	-3.28	11.28

Source: Company, ICICIdirect.com Research

Koutons Retail (KOURET)

Koutons Retail India, a speciality discount company, operates through "Koutons" and "Charlie Outlaw" outlets throughout the country. At the end of Q2FY09, the company had a network of 1398 outlets (including Koutons and Charlie Outlaw outlets) across the country. The company follows an asset-light business model wherein 94% of stores are under franchise agreement. It primarily caters to the men's apparel segment and is now increasing its offering to women and kids apparels, accessories and footwear segments.

- Considering weak consumer sentiments on spending in the current uncertain economic scenario and slowing pace of expansion, we have revised our annual estimates downwards. We are revising our FY09E and FY10E revenue downwards by 12.5% and 14.0%, respectively. Our revised EPS estimates are lower than earlier estimates by 16.7% and 23.3% for FY09E and FY10E, respectively.

Exhibit 2: Revised Estimates

Rs. Crore

	FY09E			FY10E		
	Revised	Earlier	% Chg	Revised	Earlier	% Chg
Sales	1228.85	1404.3	-12.49	1654.62	1924.7	-14.03
EBIDTA	220.65	253.48	-12.95	299.35	364.28	-17.82
PAT	97.16	116.66	-16.72	136.62	178.17	-23.32
EPS	31.75	38.12	-16.72	44.65	58.23	-23.32

Source: Company, ICICIdirect.com Research

- We expect revenues to increase by 64.9% to Rs 285.45 crore in Q3FY09 due to an increase in space. As a result, revenue per square feet (psf) is expected to increase due to the expected increase in contribution from the ladies and kids segment.
- Operating margins are expected to be better than the previous quarter due to sale of winter season products.
- We expect approximately 40% of annual FY09E revenues to be reported in Q4FY09 due to the concentration of stores in the north. In the fourth quarter, the company generates higher sales and better margins on account of sale of winter products, where the margins are high.
- At the CMP of Rs 516 per share, the stock is trading at a P/E of 11.55x its revised FY10E EPS of 44.65. We are positive on the asset-light model of the company and the value retail segment in which the company operates. We are lowering our target price to Rs 670 valuing the company at 15x (revised lower from 17x due to uncertain economic scenario) its revised FY10E earnings. We maintain our **OUTPERFORMER** rating.

Exhibit 3: Quarterly Estimates

Rs. Crore

	Q3FY09E	Q3FY08	Q2FY09	Y-o-Y (%)	Q-o-Q (%)	H1Y09	FY09E
Sales	285.45	173.10	282.39	64.91	1.08	440.23	1228.85
EBIDTA	52.89	29.99	48.22	76.35	9.68	79.59	220.65
EBIDTA margin	18.53	17.33	17.08			18.08	17.96
Profit	22.07	12.25	19.58	80.16	12.72	30.30	97.16
Profit margin	7.73	7.08	6.93			6.88	7.91
EPS	7.21	4.00	6.40	80.16	12.72	9.90	31.75

Source: Company, ICICIdirect.com Research

Vishal Retail (VISRET)

Vishal Retail Ltd (VRL), incorporated in 2001 by Ram Chandra Agarwal, is in the business of value retailing with a focus on Tier-II and Tier-III cities. The company operates 181 stores with a retail space of 2.9 mn sq ft across the country. VRL sells over 100,000 stock keeping units (SKUs) across categories of apparels (57% of sales in Q2FY09), non-apparels (19%) and FMCG (24%). In order to strengthen its operations, it has set up two manufacturing facilities with a total capacity of 5000 pieces per day. To ensure strong logistics support, the company established 29 warehouses in eight cities with a total space of 1.05 mn sq ft and a fleet of trucks for transportation.

- We expect Vishal Retail to report 26.46% YoY growth in revenues on account of increased space under operations. EBIDTA margins are expected to be under pressure due to expected lower realisation psf and declining footfalls.
- The company is consciously slowing down its expansion plans due to lack of funds. This will lead to a moderation in the growth rate of the company. Moreover, the current economic scenario where consumers are postponing their not-so-important needs may aggravate the negative impact.
- At the current market price of Rs 91, the stock is trading at 4.88x its FY10E earnings of Rs 18.64 per share. We believe the company is fairly valued at Rs. 93, which values the company at 5x its FY10E earnings. We advise investors to book profits and re-enter the stock in the range of Rs 60-70, where the company will be trading at 3.2x–3.8x FY10E earnings making the risk-reward ratio favourable.

Exhibit 4: Quarterly Estimates

Rs. Crore

	Q3FY09E	Q3FY08	Q2FY09	Y-o-Y (%)	Q-o-Q (%)	H1Y09	FY09E
Sales	381.59	301.74	358.34	26.46	6.49	734.89	1420.42
EBIDTA	41.32	41.09	42.03	0.55	-1.70	91.13	168.11
EBIDTA margin	10.83	13.62	11.73			12.40	11.84
Profit	4.26	14.97	4.08	-71.55	4.37	18.09	29.89
Profit margin	1.12	4.96	1.14			2.46	2.10
EPS	1.90	6.68	1.82	-71.55	4.37	8.08	13.34

Source: Company, ICICIdirect.com Research

Coverage Universe Valuation table

	CMP (Rs.)	TP	Rating	M Cap (Rs Cr.)	EPS (Rs.)			P/E (x)			EV/EBIDTA (x)			ROCE			ROE		
					FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E	FY08	FY09E	FY10E
Koutons Retail	516	670	OP	1,576.38	23.21	31.80	44.72	22.23	16.22	11.54	12.28	9.61	7.65	20.86%	20.49%	22.04%	21.29%	22.58%	24.11%
Vishal retail	91	93	H	203.84	18.15	13.34	18.64	5.01	6.82	4.88	5.64	5.70	5.55	12.57%	12.55%	12.46%	14.29%	9.93%	12.18%

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect endeavours to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer (OP): 20% or more;

Performer (P): Between 10% and 20%;

Hold (H): $\pm 10\%$ return;

Underperformer (UP): -10% or more;

Pankaj Pandey

Head – Research

pankaj.pandey@icicidirect.com

**ICICIdirect Research Desk,
ICICI Securities Limited,
Gr. Floor, Mafatlal House,
163, HT Parekh Marg,
Backbay Reclamation
Churchgate,
Mumbai – 400 020**

research@icicidirect.com

ANALYST CERTIFICATION

We /I Bharat Chhoda MBA (Finance), Prerna Jhunjunwala MBA (Finance), Rahul Malhotra MBA (Finance) research analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that Bharat Chhoda MBA (Finance), Prerna Jhunjunwala MBA (Finance), Rahul Malhotra MBA (Finance) research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its subsidiaries collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that Bharat Chhoda MBA (Finance), Prerna Jhunjunwala MBA (Finance), Rahul Malhotra MBA (Finance) analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.