Retail

Shopping goes hyper

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Edelweiss
Ideas create, values protect

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Executive Summary

The Indian retail landscape is evolving with interplay of several demographic and economic factors. A strong 9% GDP growth, backed by changing consumer behaviour in favour of larger discretionary spend, has set the stage for a healthy 8.6% growth in the retail space over FY07-11E.

Key highlights

- The big opportunity lies in the growing share of organised retail in a space otherwise dominated by traditional retail forms. The growing trend of consumers to allocate a larger share of income to consumption and gradual improvement in lifestyle has opened up an opportunity in the form of under-penetration of organised retail. **We expect organised retail to grow at 42% CAGR, to reach USD 70 bn by FY11E, accounting for 15% of total retail as against 4.1% currently**.

- Favourable demographics, changing consumer preferences, desire for a superior experience, easy availability of credit, development of real estate, and large investments in improving supply chain efficiencies in the country are set to give a fillip to consumption.

- A major portion of the opportunity thrown up by organised retail will be concentrated in metros and tier I cities, given that the **top 784 towns constitute 35% of the retail market. Of these, metros and tier I cities account for more than 60%.**

- **Food and grocery, with organised retail penetration of less than 1%, present the most attractive opportunity.** Other opportunity segments are the emerging spending avenues like beauty care, home improvement, jewellery, books, and music.

- To make the most of the expanding consumer disposable income, retailers are targeting multiple formats and value propositions to capture maximum share of the consumer's wallet. In this bid, **we expect the first leg of growth to be driven by hypermarkets and supermarkets.**

- **We expect retailers to pump in over USD 25 bn into the sector over the next four years to scale up their retailing operations and strengthen back-end systems.**

- **We are extremely positive on the domestic retailers who enjoy early entrant advantages at key retailing locations and are looking to gain a pan-India presence.** We believe that by the time foreign competition is allowed to enter, the early entry into the most lucrative markets will give domestic retailers a competitive edge.

- However, we expect margins of retailers to remain under pressure in the near term due to spiraling rentals, employee costs, and shrinking catchments due to increasing competition in the most lucrative catchments. Over the next three years, we, however, expect these cost pressures to ease with the expansion plans bringing in economies of scale and the planned investments acting as margin levers.

- Our pick among the domestic retailers are Pantaloon Retail and Shoppers' Stop. We like Pantaloon Retail for its focus on pace of expansion and broad based presence in the value space across the consumption basket. We also like Shoppers' Stop which is a niche play with strong brand position in the lifestyles space. We initiate coverage on Pantaloon Retail with a **'BUY'** and on Shoppers' Stop with an **'ACCUMULATE'.**

Table of Contents

Page No.

AT A GLANCE

Retail — At a glance

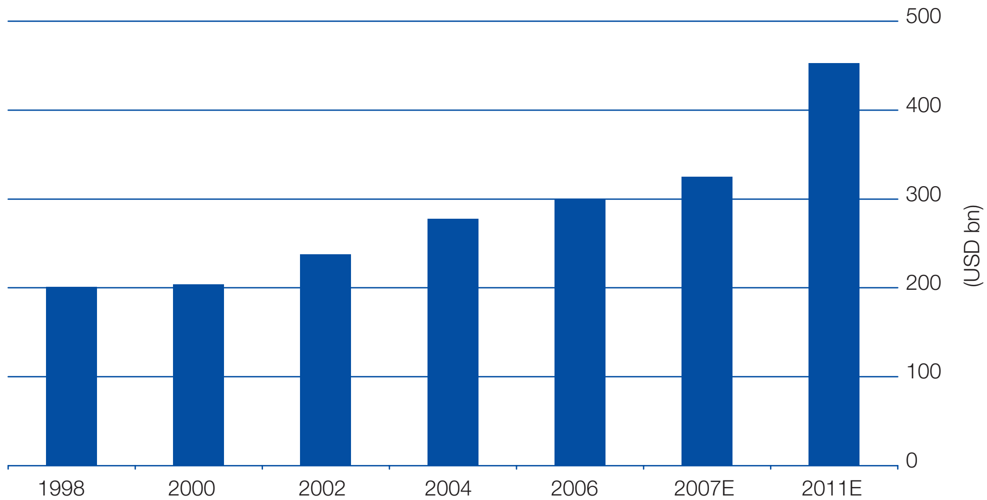
Company	Price (INR)	No. of Shares (mn nos)	Mkt cap (INR mn)	Reco		Financials (INR mn) Revenue	EBITDA	PAT	EPS	Growth (%) Revenue	EBITDA	PAT	Valuation (x) P/E	EV/ EBITDA	Mcap/ Rev.
Pantaloon Retail	557	151	83,996	BUY	FY07	32,367	2,156	609	4.1	73.2	47.0	(3.9)	85.8	29.5	2.6
					FY08E	57,558	3,862	976	6.5	77.8	79.1	60.3	55.0	20.5	1.5
					FY09E	89,602	5,863	1,513	10.0	55.7	51.8	55.0	35.5	13.5	0.9
					FY10E	136,608	9,214	2,591	15.2	52.5	57.1	71.3	23.5	8.6	0.6
Shoppers' Stop	398	35	13,850	ACCUMULATE	FY07	8,739	684	247	7.0	28.3	40.4	1.9	52.3	19.0	1.6
					FY08E	10,910	622	99	2.8	24.8	(9.1)	(60.1)	128.8	23.0	1.3
					FY09E	15,110	919	125	3.6	38.5	47.7	26.7	101.7	15.5	0.9
					FY10E	22,475	1,553	265	7.6	48.7	68.9	111.9	48.0	9.2	0.6

Retail Opportunity is Huge

Retail to grow at 8.6% CAGR to USD 453 bn, driven by 9% GDP growth over 2007-11E

The size of the Indian retail industry was pegged at~USD 300 bn in 2006, accounting for nearly 39% of GDP and almost 62% of private final consumption expenditure (PFCE). The retail landscape in India is gradually evolving with interplay of several factors ranging from demographic to economic ones. We expect the retail industry to reach a size of USD 453 bn by FY11E, fuelled by the Government of India's (GoI's) increasing focus on achieving 9-10% growth in GDP, and the growing consumer income level and aspirations.

Chart 1: Retail growth at 8.6% CAGR (2007-11E) to USD 453 bn



Source: A T Kearney, Edelweiss research

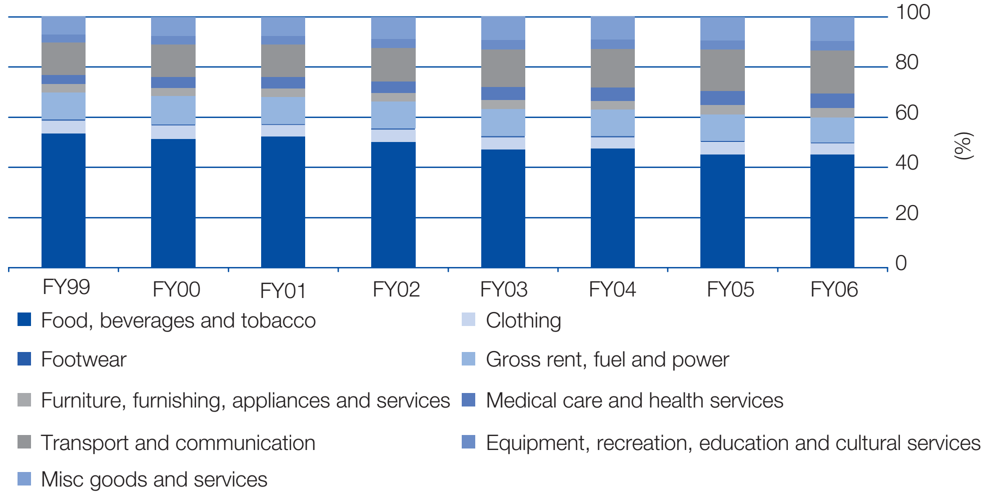
Strong growth in PFCE and shift in favour of discretionary spend set to drive retail spend

Over FY02-05 PFCE (accounting for close to 60% of GDP) has seen an average growth of over 8.5% compared with an 8% average GDP growth in the same period. Further, PFCE is expected to grow at a CAGR of 9.2% over the next 5-6 years on the back of strong economic growth and a stable savings rates.

The share of PFCE to GDP in India (62%) is similar to countries like Japan (57%) and the US (70%), as against China that derives only 40% from PFCE. This high share of PFCE bodes well for India, as the growing income levels are likely to drive consumption, which in turn, will fuel business opportunities, leading to GDP expansion eventually.

An analysis of the break-up of PFCE reveals a shift in the consumption pattern of the consumers. The share of necessities in the consumption basket is gradually falling whereas spend on other discretionary products like apparel, recreation and entertainment, and personal care is slowly growing share. This is an indicator of the improvement in the lifestyle of the population, and is likely to drive the growth of retail spend in discretionary avenues like beauty, health care, catering services, and entertainment.

Chart 2: Share of essentials declining



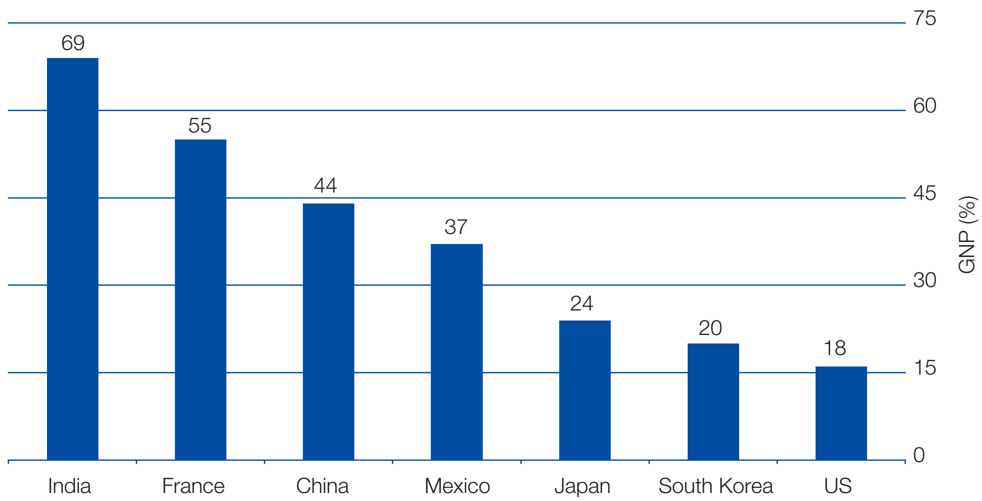
Source: CSO, Edelweiss research

✻ Steadying savings rate to drive consumption

In India, the household savings rate has traditionally been very high at ~69% as against 44% in China and 16% in the US, leading to slower consumption growth in the economy, as seen in the past. A primary cause of high saving rate in the country is the absence of any form of social security scheme. At a country level, the savings rate in India stands at 32.4%, and household savings account for ~70% of this amount.

With increased accessibility of organised credit forms and their penetration into the remote areas of the country, the household savings rate is however expected to stabilise at the current levels. This implies that the incremental income will comprise lower savings, and hence, drive consumption and further aid the retail growth.

Chart 3: Household savings rate in India higher than other countries



Source: Mckinsey Global Institute

Organised Retail at an Inflexion Point

✻ Rising share of organised retail - A growing opportunity

Though retail accounts for 39% of GDP, the share of organised retail in the overall segment is miniscule. In 2006, the organised retail stood at ~USD 11.8 bn, implying a share of ~4.1%. In comparison, the penetration in developed economies stands at 75-85% and at 20-40% in other emerging markets.

Chart 4: India lags other countries in organised retail share

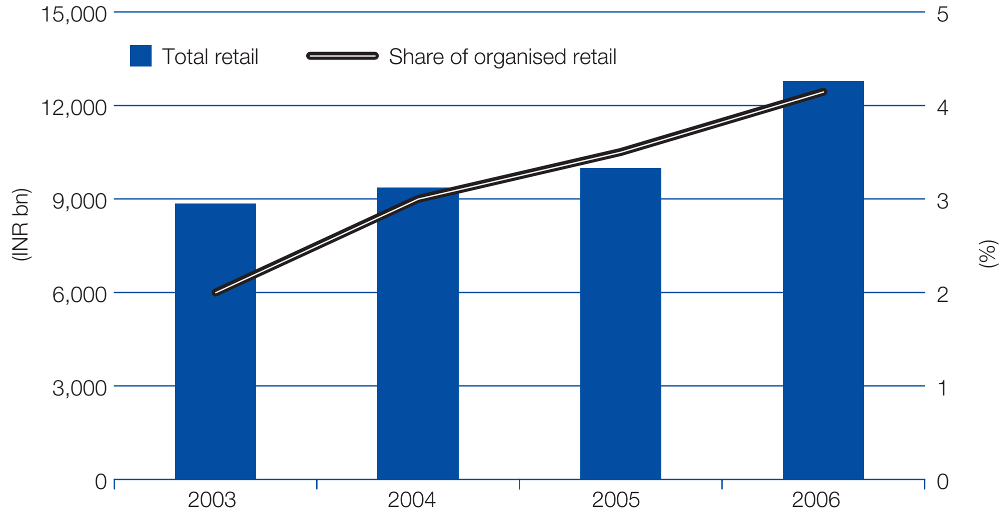
Source: CII-A T Kearney

In Thailand, there has been an explosion in the growth of organised retail, with over 40% of the trade moving to modern formats within 10 years. The easy entry of foreign retailers and geographic concentration of the retail industry has facilitated this growth. In Poland, where modern retail has captured 20% of the market in the past nine years, easy access to real estate, a level playing field between modern and traditional retailers, and early entry for foreign retailers contributed to the growth.

✻ Penetration has improved significantly to 4.1% in 2006 from 0.5% in 1999

Over the last decade, the share of modern retail has been gradually improving from below 1% in 1999 to 4.1% currently. The growth has been more rapid 2004 onwards. Growth in consumption, coupled with the growing prosperity of the new age consumers, is driving this acceptance of modern retail.

Chart 5: Share of organised retail on the rise



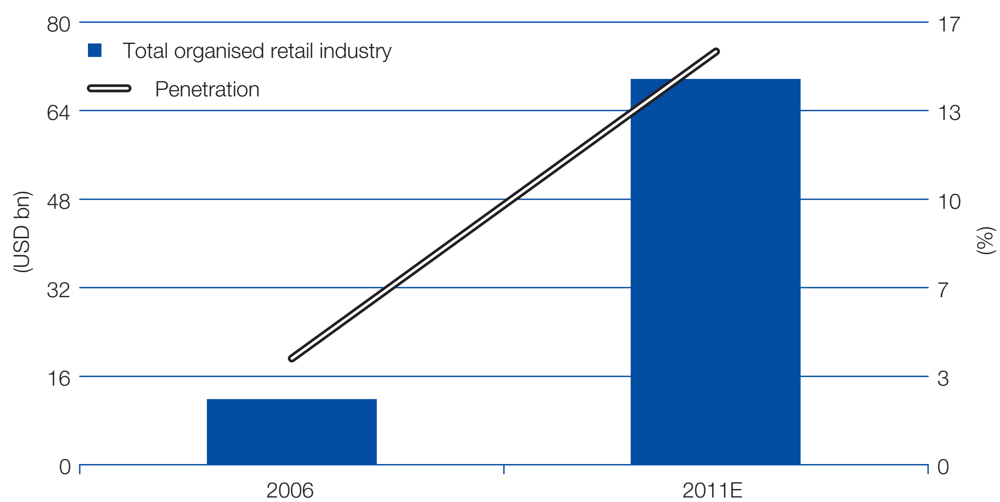
Source: CrisInfac

Organised retailing poised to grow at 42% CAGR over FY07-11E

In the backdrop of low penetration, favourable demographics, steady economic growth, easy availability of credit, and large scale real estate developments, the organised retail sector is in a sweet spot. From here, it is poised to grow robustly at a 42% CAGR over FY07-11E, to reach a size of USD 70 bn; its share in total retail is likely to improve from 4.1% currently to 15% by FY11E.

This growth is mainly on the back of changing customer aspirations and improving retail real estate infrastructure in the country. The growth could be even higher, if the Indian consumers have to leapfrog evolution cycles, as they did for the mobile phones in the past.

Chart 6: Organised retail to reach USD 70 bn by 2011E



Source: Technopak, Edelweiss research

India Most Attractive Retail Destination - Time Ripe for Entry

India is the most attractive retail destination

India has been rated as the most attractive retail destination in the world by AT Kearney for the third year in a row; the company's annual Global Retail Development Index (GRDI) ranks 30 emerging countries, selected from a universe of 185 countries, on a 100 point scale (based on country risk, population size, and wealth) to find out the relative attractiveness of these markets.

Table 1: Window of opportunity analysis (based on GRDI rankings for 1995-2007)

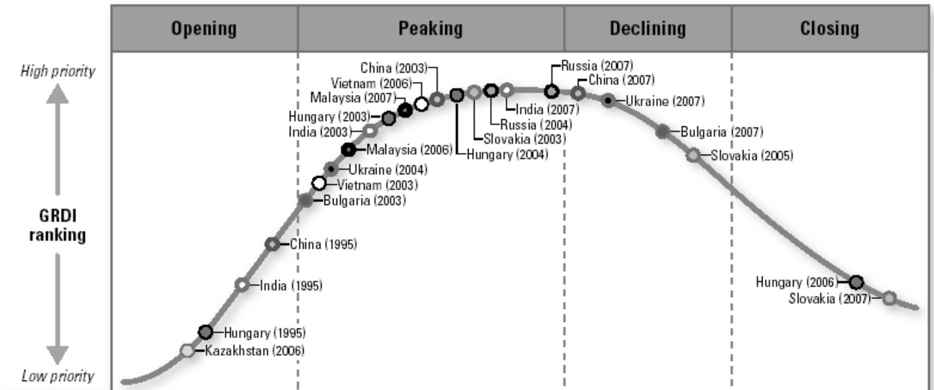
Country	Country risk 25%	Market attractiveness 25%	Market saturation 30%	Time pressure 20%	GRDI score	Rank 2007	Rank 2006
India	67	42	80	74	92	1	1
Russia	62	52	53	90	89	2	2
China	75	46	46	84	86	3	5
Vietnam	57	34	76	59	74	4	3
Ukraine	41	43	44	88	69	5	4
Malaysia	70	44	46	54	68	8	14
Mexico	83	58	33	33	64	9	19
Saudi Arabia	65	40	66	35	64	10	17
Turkey	52	50	57	43	62	13	10
Egypt	43	37	85	35	61	14	20
Thailand	71	39	30	55	59	16	12
Brazil	53	61	59	18	56	20	27

Source: A T Kearney

Perfect time for action

Retailing in India is currently at an inflexion point. The main factor announcing the significance for the retailers is the current optimal stage of readiness for retail and the entry of retailers into India. AT Kearney classifies retail markets worldwide and their study shows that retail markets progress through four stages as they evolve from an emerging to a mature market, usually over 5-10 years. These stages are opening, peaking, declining, and closing. India is currently very attractively placed in the peaking stage.

Fig. 1: Window of opportunity for entry- GRDI rankings 1995-2007



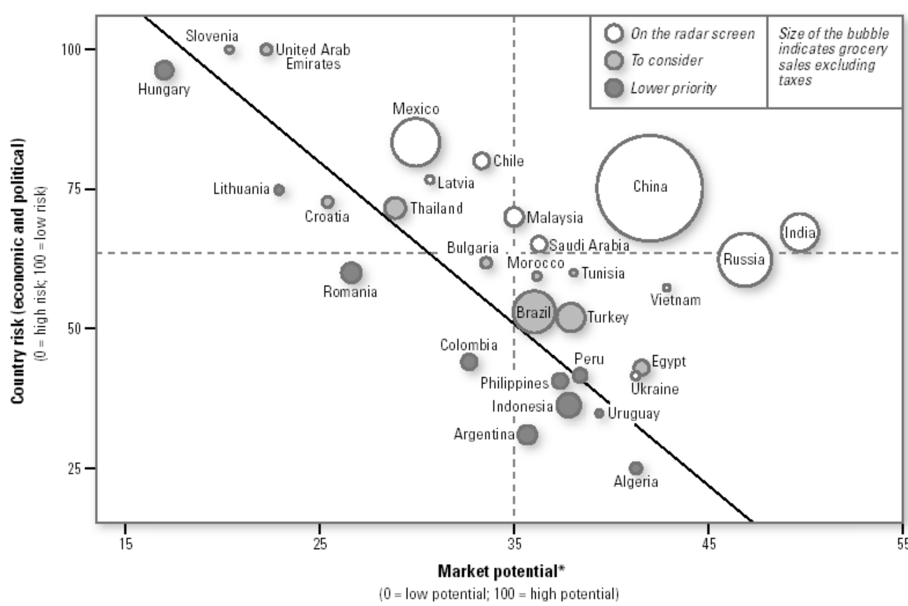
	Opening	Peaking	Declining	Closing
Action	Monitor market	Open local office (sourcing, research), test the market and learn	Expedite implementation	No pattern identified
Format of entry	Not applicable	Consider cash-and-carry or convenience formats apart from supermarket	Introduce discount and hypermarkets	Tailor formats to meet specific consumer needs at work
Labor strategy	Not required	Hire and send expatriate employees to location	Scale up operations, increase local hiring, participate in community	No pattern identified

Source: A.T. Kearney

✻ The window of opportunity right for India

Key Asian economies like Vietnam and India are peaking (developing quickly and ready for modern retail), while China has just tipped into the declining phase (big and growing, but with tighter space for the new entrants). India, in 2007, is what China was in 2003. This means that the next 3-4 years are best for foreign retailers and other Indian corporates to enter the Indian retail fray; it is also the perfect time for the existing players to expand operations in a big way.

Fig. 2: GRDI 2007 market share attractiveness



* *Based on weighted score of market attractiveness, market saturation and time pressure*

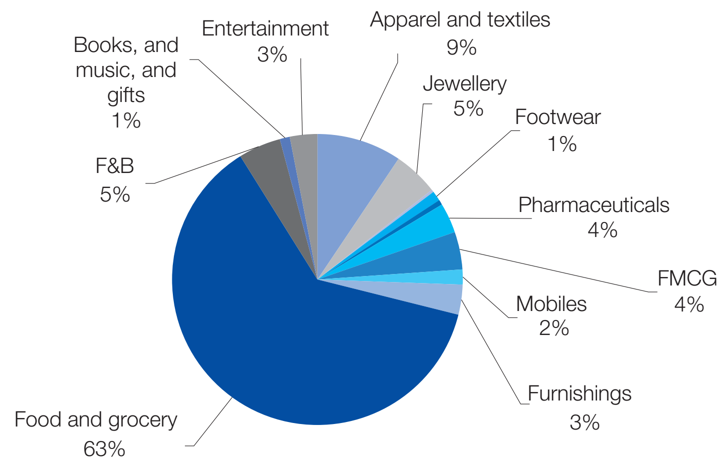
Source: A.T. Kearney

Food and Grocery Segment - Opportunity Ripe

Food and grocery constituted 63% of the retail pie

The total Indian retail market, pegged at USD 300 bn in 2006, is dominated by spend on food and grocery that comprises 63% of total retail spend. Though this has been the case historically, the segment's share is declining Y-o-Y with growing maturity and awareness of the Indian consumer, and his increasing propensity to consume discretionary products.

Chart 7: Food and grocery dominates total retail spend with 63% share

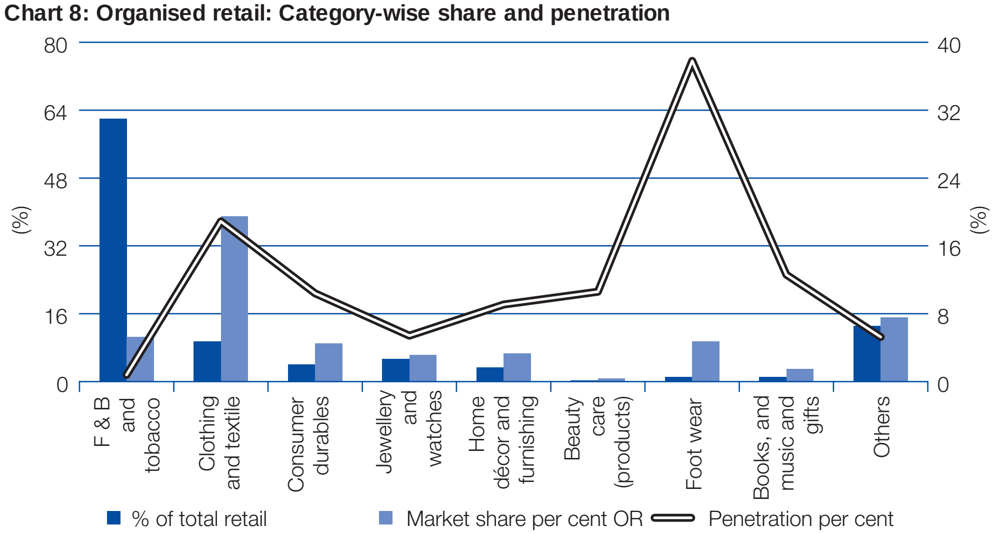


Source: Images India Retail Report 2007

Penetration of organised retail in food and grocery at a meager 1%

Despite food and grocery dominating the retail segment in India, the share of organised players in this space is the lowest among all segments. In 2006, the organised sales accounted for only 1% of total food and grocery spend. The category has shown considerable improvement with organised spend posting a 48% CAGR over (2002-05), but the relative share still remains the lowest.

Chart 8: Organised retail: Category-wise share and penetration

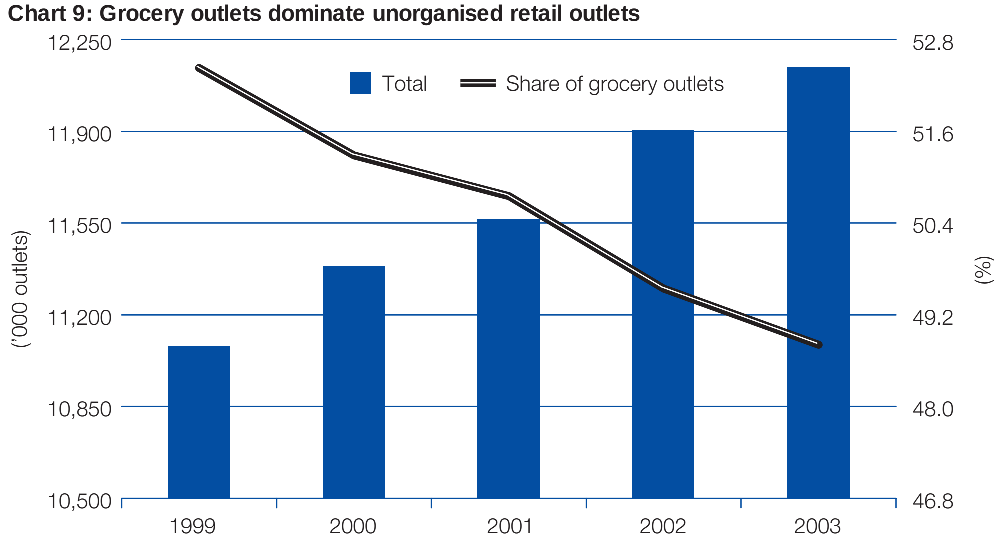


Source: Images India Retail Report 2007

50% of 12 mn retail outlets are food and grocery stores, resulting in fragmentation

Retail in India is highly fragmented consisting predominantly of independent and owner-managed shops. As per 1999-2003 Euromonitor from the Central Statistical Organisation, there were more than 12 mn retail outlets in India in 2003. Of these, about 78% were small family businesses, utilising only household labour. Nearly 50% of the retail outlets were specialised retailers selling food and grocery, beverages, and tobacco. This has led to the space staying largely out of the purview of organised retail.

Chart 9: Grocery outlets dominate unorganised retail outlets



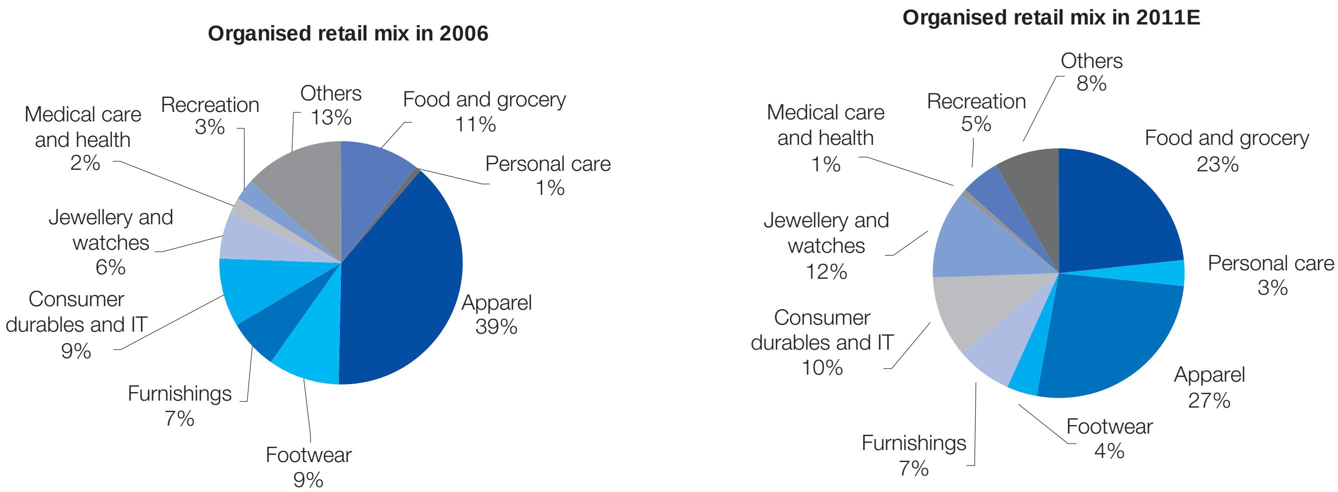
Source: CrisInfac, Edelweiss research

Organised food and grocery to grow at over 67% CAGR during FY06-11E

In light of low share of modern retail in large consumption baskets and the growing consumer acceptance of organised retail, retailers are working quickly to establish their presence and grab market share. The most promising space, we believe, will be the food and grocery, as this is the least penetrated. This segments also allows retailers to reap benefits of investments in supply chain.

Other bright segments will be wellness, books and music, and jewellery. These segments have only recently caught the fancy of Indian consumers, who (with their increasing disposable incomes) are moving to discretionary products, while allocating a small share of their incomes to necessities. We expect the total food and grocery space to grow at a CAGR of 6% over FY06-11E, with the organised share likely to increase from less than 1% currently to ~6-6.5%. This will translate into approximately 23% share for organised retail in 2011E.

Chart 10: Changing mix of organised retail from 2006-2011E



Source: Technopak, Edelweiss research

✻ Beauty care, home improvement, jewellery, and books and music - Other growth avenues

Apart from the food and grocery space, some other high-opportunity areas are segments such as home improvement, beauty and health care, books and music, and jewellery. These segments will be direct beneficiaries of the consumers' increasing discretionary spends and their improving lifestyle. Hence, with the shift in the consumers' spend, we expect categories like food and grocery, beauty and health care, home décor and improvement, and book and music to gain share of total organised spend from categories like clothing and apparel, footwear, and consumer durables.

Table 2: Share of organised retail to increase across categories

	Share of OR in 2006 (%)	Share of OR in 2011E (%)
Food and grocery	1	7
Personal care	1	20
Apparel	16	40
Footwear	34	50
Furnishings	8	25
Consumer durables and IT	9	30
Jewellery and watches	3	20
Medical care and health	24	30
Recreation	2	10
Others	17	30

Source: Technopak, Edelweiss research

Initial Battle in Top 784 Towns Constituting 35% of Retail Market

Urban market, outside 784 towns scattered and less attractive

The retail opportunity, in its initial stages, has restricted itself largely to the urban areas that account for 45% of total retail spend and 35% of the total populace. Within the urban expanse, the 8 tier I cities alone accounted for 39% of the total urban disposable income, while the tier I and II cities together accounted for about 52%. Hence, it is natural that these catchments have been at the midst of all the retail action. However, with the competition intensifying and the growing number of middle-class households outside these cities, the retailers will increasingly look to tap the opportunity in feasible tier III and IV cities.

Table 3: 35% of retail opportunity in top 784 towns

Urban and rural population	% of total population	Cumulative share	Share of total (%)	Total market cumulative
Urban India				
Top 4	6	6	9	9
Top 9	3	8	4	13
Top 62	7	15	9	22
Top 141	3	18	5	27
Top 338	3	22	4	31
Top 530	2	24	2	33
Top 784	2	26	2	35
Others	9	35	10	45
Total	35		45	
Rural India				
Top 100,000	33	33	33	33
Next 527,000	33	65	22	55
Total	65		55	

Source: Images Retail, Edelweiss research

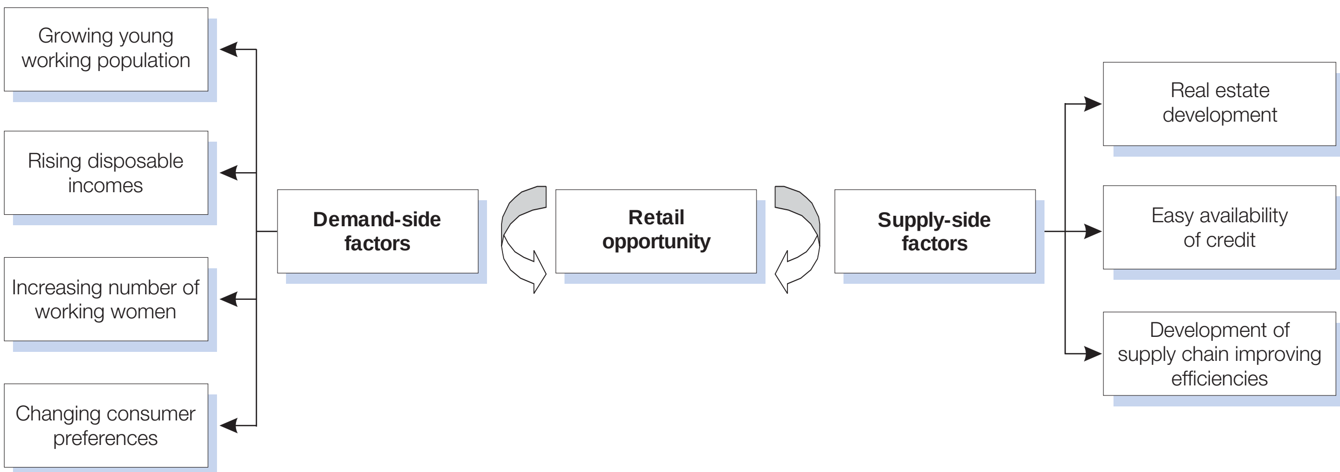
Metros and tier I towns account for the lion's share of modern retail

The top eight cities (four metros, Pune, Ahmedabad, Hyderabad, and Bangalore) account for a large part of the organised retail in the country and are expected to contribute almost 85-90% to the total organised retail, going forward. This explains the focus of all the major retailers to establish their presence in the best catchments in these prime locations. The share of modern retail in these top eight cities is much above the country average, at about 14-16%. Going forward, the tier II and tier III cities, and towns are poised to form a significant part of the growth plans of most retailers.

Growth Drivers for Organised Retail

Indian retail is witnessing a confluence of several favourable factors such as steady economic growth, favourable demographics, easy availability of credit, investments in infrastructure creation, and supply of real estate and malls. This, coupled with low penetration, creates a base for the next big leap of growth for the organised retailing industry.

Fig. 3: Confluence of favourable factors

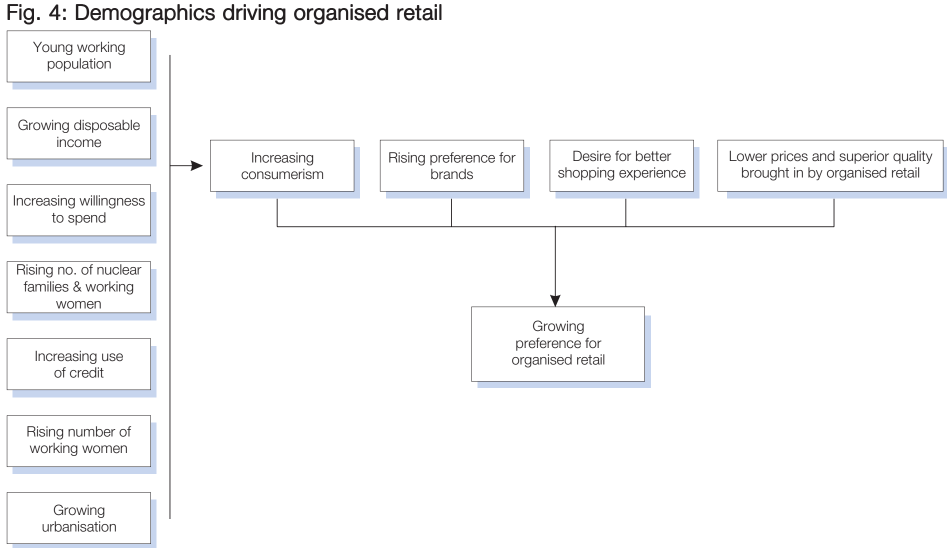


Source: Edelweiss research

Favourable Demographics Giving a Fillip to Demand

The organised retail in India is at the helm of action with robust growth in the economy trickling down to every segment in the country. The direct beneficiary is the consumer. In the last few years, the country has seen the evolution of a large and growing consumer group, with tastes and preferences vastly different from the older set of consumers. The new consumer group is across the country and is well-equipped to lap up modern retailing trends. Aiding the robust demand scenario, created by the attractive consumer set, is the investment in supply chain and real estate that will take organised retail across the country. A combination of the demand and supply side factors is the key driver of a 42% CAGR in organised retail over FY07-11E.

Fig. 4: Demographics driving organised retail

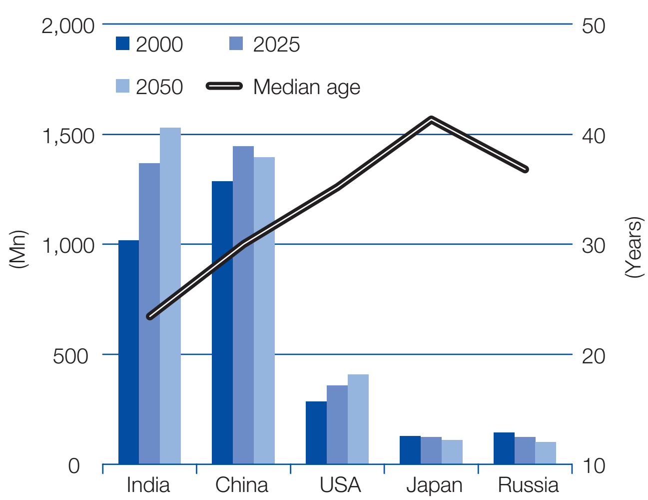


Source: Edelweiss research

✻ Young working population with no guilt of consumption

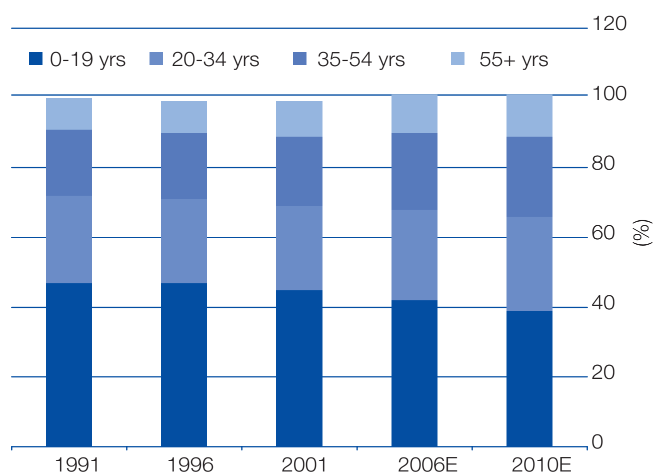
The median age of the Indian population is around 24 years, making it one of the youngest countries in the world compared with the US, China, and Japan with median ages of 35, 30, and 41 years, respectively. In addition, over 65% of the Indian population is below 35 years and 54% below 25 years. By 2010E, about 65% of the population will be under 35 years of age.

Chart 11: Comparison of population and median age



Source: UN, Edelweiss research

Chart 12: Youth dominate population mix



Source: NCAER, CrisInfac

India also has the largest share of the working population globally, with increasing economic prosperity and greater number of jobs in the service sector, especially in IT/ITES. This has given rise to a new genre of working youth called 'middle youth'. Aged between 22-28 years, this young population spends generously on lifestyle products without any guilt of indulgence.

Swelling consumer class across rural and urban areas to aid consumption

The consuming class, defined as population with annual income higher than INR 90,000, has risen from 20% of total households in 1995-96 to 35% in 2005-06. This is expected to increase to 48% of total households by 2010. The deprived section, which does not contribute to the consumption, will fall steadily and decline at a CAGR of 2% over 2006-10E. This upward movement of the population to the higher income level is one of the key drivers of organised retail.

Table 4: Growing middle class

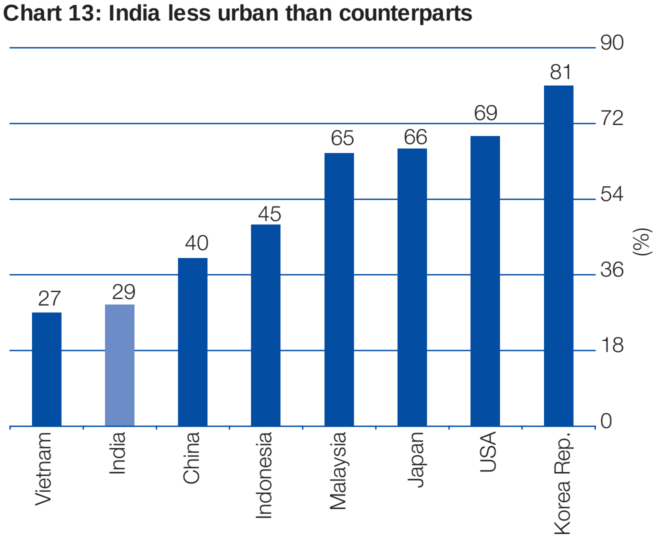
Classification	Income class INR '000 p.a.	1995-96	2001-02	2005-06f	2009-10f	4 yr. CAGR 02-06f	4 yr. CAGR 06-10f
Deprived	<90	131,176	135,378	132,250	114,394	(1)	(4)
Aspirers	90-200	28,901	41,262	53,276	75,304	7	9
Seekers	200-500	3,881	9,034	13,813	22,268	11	13
Strivers	500-1000	651	1,712	3,212	6,173	17	18
Near rich	1000-2000	189	546	1,122	2,373	20	21
Clear rich	2000-5000	63	201	454	1,037	23	23
Sheer rich	5000-10000	11	40	103	255	27	25
Super rich	>10000	5	20	53	141	28	28
Total	164,877	188,193	204,283	221,945			

Source: NCAER *Households in '000* ** INR/$ @43.5*

Rising urbanisation to fuel modern retail and development outside top cities

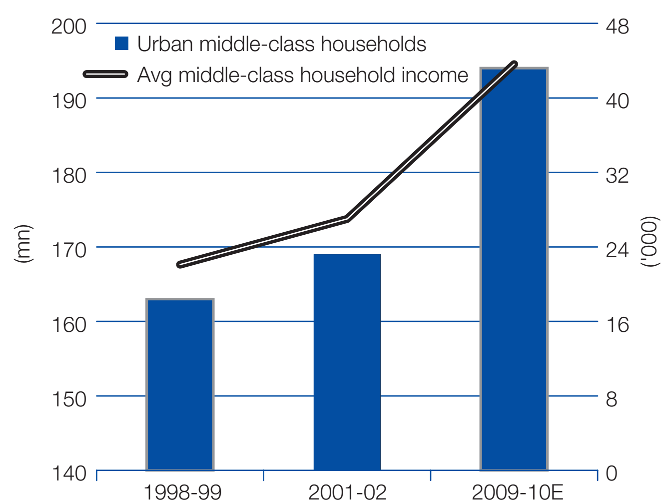
In India, urban population accounts for close to 30% of the population, and further is expected to increase in future. In comparison with other Asian nations, India appears to be less urban. By 2025, due to migration and population growth, the urban population is estimated to account for 37% of the total population. The higher the level of urbanisation, the higher is the growth in modern retail, as both income levels and accessibility improve. Additionally, increasing urbanisation leads to development outside the top tier cities and development in infrastructure.

Chart 13: India less urban than counterparts



Source: Mckinsey Global Institute, CrisInfac

Chart 14: Urban households better off

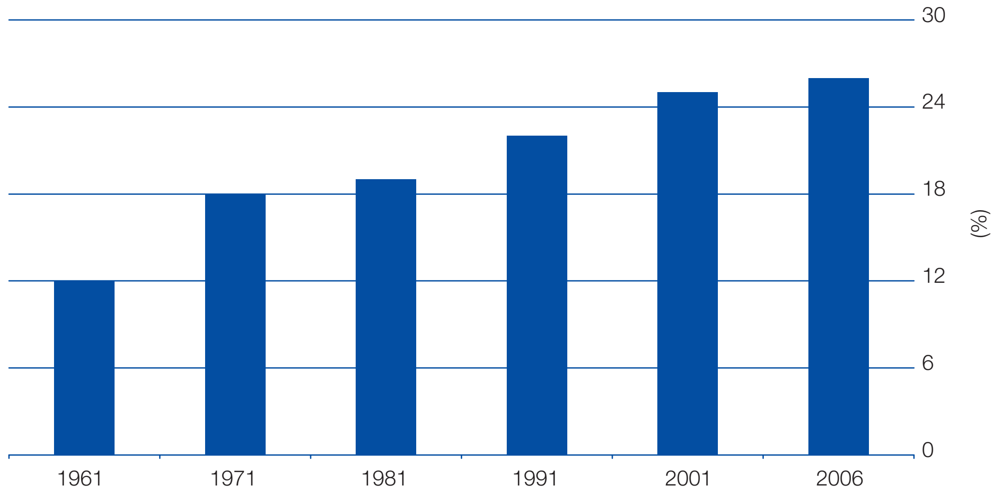


Source: NCAER

✻ Increasing proportion of working women resulting in higher discretionary spend

The number of working women, as a percentage of the total female population, has risen from ~12% in 1961 to close to 25% in 2005. This has resulted in growing disposable income, which in turn, leads to increasing retail spend. It is estimated that the propensity to spend in case of working women is higher 1.3 times compared with the housewives. Also, the buying behaviour of a working woman differs from that of a housewife. The rising income level of the female population has opened a whole new genre of retailing formats and products, catering exclusively to women.

Chart 15: Share of working women on the rise



Source: CrisInfac, Edelweiss research

Table 5: Working women spend much more than non-working women

	Monthly spending by women (INR)		
	Working	Non-working	Difference (%)
Home loan EMI	9,068	5,269	72
Domestic help	880	663	33
Educational services	2,341	1,789	31
Personal care/ beauty	237	193	23
Transportation	2,119	1,739	22
Packaged food	341	286	19
Mobile charges	875	755	16
Leisure and entertainment	1,097	956	15
Apparel, footwear etc	2,239	1,963	14
Others children related	441	395	12

Source: Pantaloon Retail, Edelweiss research

✻ Rising number of nuclear families altering consumption in favour of convenience

The average size of Indian households has fallen to 5.36 in 2001 from 5.57 in 1991 and is expected to reduce further to 5.02 by 2011. The consumption pattern of a nuclear household is very different from that of a joint family. In a nuclear set up, the demands of children and time crunch of a working woman dominate the shopping pattern. With this kind of a set up, the concept of weekend outings and eating out has become very popular. Eating out accounts for 10% of consumers' total annual spend.

Changing Consumer Preferences and Desire for a Superior Experience to Encourage Organised Retail

Over the years, consumer awareness about quality and price of products/services has increased due to increasing level of literacy in the country and growing exposure to the developed nations via satellite television or overseas work experience. Consumers are more vocal about the quality of products/services that they expect from the market. This awareness has made the consumer seek more reliable sources for purchases, and hence, the logical shift to buying from organised retail chains with established corporate backgrounds and pronounced accountability. The consumer also prefers to buy from a place where his/her feedback is more valued.

- **Higher spend on discretionary items**

  Nowadays, Indians are more confident and optimistic of their future, and therefore, do not mind saving less and spending more on retail goods and services. This explains why savings and investments constituted only 4% of the Indian consumer's wallet in 2003, down from 14% in 1999. The Indian consumers are seen spending more and more on discretionary heads than the necessities.

- **Growing preference for brands to boost modern retail**

  In the last 4-5 years, the Indian markets have witnessed a strong shift towards branded products. Indian consumers have now begun to believe that branded goods signify better quality and offer greater value for money, and are not just for the elite class.

  This trend is also driven by an increased exposure of the country to the ways of the developed nations. This shift in perception of branded goods has been the highest in the case of apparel. Most of the leading world brands like *Levis, Pepe, Lee, Arrow, Espirit, Nike, Reebok, Hugo Boss, Ray Ban,* and *Parker* are now available in India; brands like *Louis Vittion* and others are flocking to India to set shops. Currently, global brands in many segments like fast food, cosmetics, office stationary, and accessories are flocking into the country to pamper Indian consumers.

- **Better quality at best value proposition to woo consumers towards organised retail**

  The Indian consumers' mindset is a paradox of value and lifestyle. For modern retail to succeed, it has to effectively cater to both these mindsets effectively. Though, with rising disposable incomes, the consumer will adapt modern retail willingly, his stickiness to it will depend on how well his needs of service, quality, and value perception are met. Hence, modern retailers are undertaking investments in logistics, and supplier networks, to ensure they can get products at the best possible prices (by eliminating wastage and middlemen) and in the best packaged forms, to attract the 'value buyer'. They are offering the best possible brands, best quality, and best service, either individually or through joint ventures, to attract the lifestyle buyers.

- **Superior shopping experience and better services to drive shift to organised retail**

  Change in consumer lifestyle with a steep rise in the value of time, change in the Indian family structure from large joint families to nuclear ones, and an increasing level of quality awareness have made the case for organised retailing stronger. The traditional retailing format has been largely limited to meeting the changing requirements of the consumers. Nowadays, the consumers, however, want value, convenience and a wide variety of offerings, coupled with a pleasant shopping experience. This has created an opportunity for modern retailing formats to emerge and plug the existing gaps.

Table 6: Superior shopping experience attracting consumers to organised retail

Expectations	Offerings from modern retail
Touch and feel	Consumer friendly layout to enable easy access
	Allows consumer to pick products
Choice	Stock multiple brands
	Private lables introduced to complement brand offering
	Stock various price ranges
Service	Trained store personnel specific to formats
	Uniform communication and adherence of value proposition
	Allow for speedy transcations
	After sales services like alteration, exchange, repairs
	Recent introduction home delivery
	Effective packaging
Superior experience	Air conditioned environment
	Easy location
	Helpful personnel for ease of shopping
	Modern facilities like escalators, trollies
	Best bargains
Entertainment	Kids play area
	Video game parlour
	Food courts
	Share locales with multiplexes

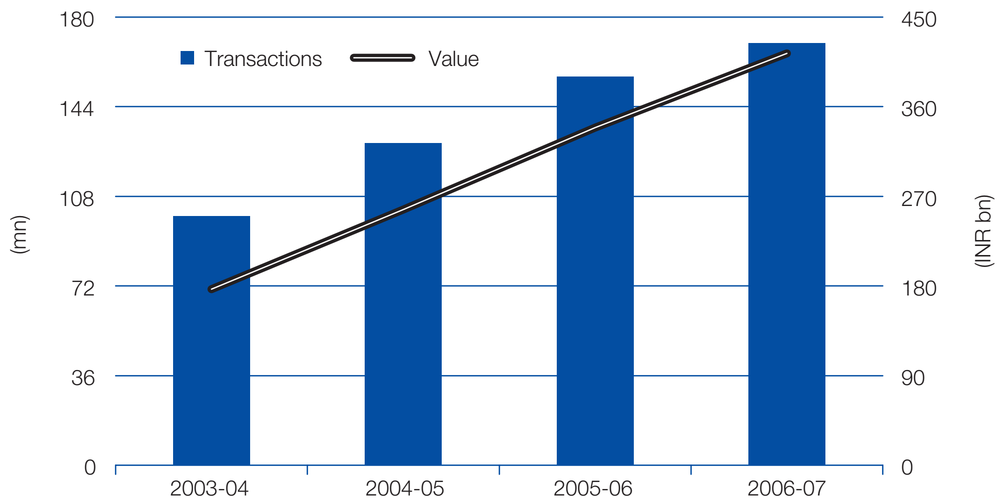
Source: Edelweiss research

Easy Availability of Credit Driving Consumption, Especially in Organised Form

✻ Credit, convenience, and rewards driving use of credit cards, aiding retail spends

The Indian consumers are gradually accepting plastic money. Indians spend just 1% of their total purchases through credit cards, while the Koreans make one-fifth of their total purchases through credit cards. The world average hovers around 9%. From a mere 3.2 mn in 2000, the number of credit cards has grown to 22.6 mn in 2007. This increase boosts retail spend, as it enables impulse buying and big ticket purchases.

Chart 16: Credit use on the rise



Source: RBI

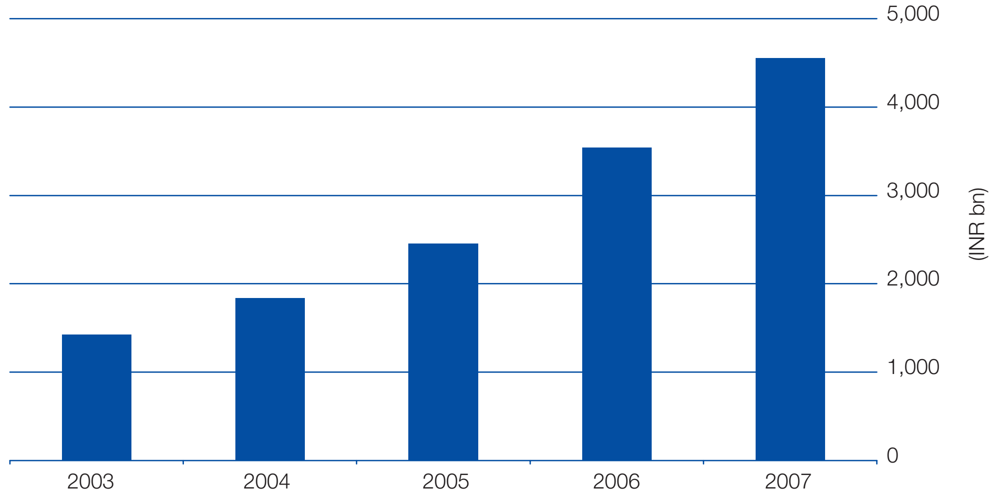
Various industry data sources reveal that travel and hotel bills, along with dining, account for ~25-35% of the total value of purchases through credit cards. Purchase of jewellery accounts for 10-11%, apparel 8-10%, and consumer durables nearly 6-7% of the purchases through plastic money.

A majority of these cardholders fall in the age group of 25-45 years. There is yet a lot of scope to exploit this market as shown by a recent study by NCAER, which says that there are currently 81 mn people who have the potential to become credit cardholders.

Easy availability of loans is putting money in people's hands, driving consumption

To capture the growing consumption, banks and lending institutions have designed and customised loans to suit the requirements of consumers. Personal loans have become the order of the day and the competition in the space has only made it better for the consumer. Attractive rates and convenient repayment options have put a lot of money in the hands of people, which is driving consumption.

Chart 17: Strong growth in personal loans



Source: RBI

Real Estate Development Facilitating Growth by Providing Access to Quality Retail Space

Location- The key success factor

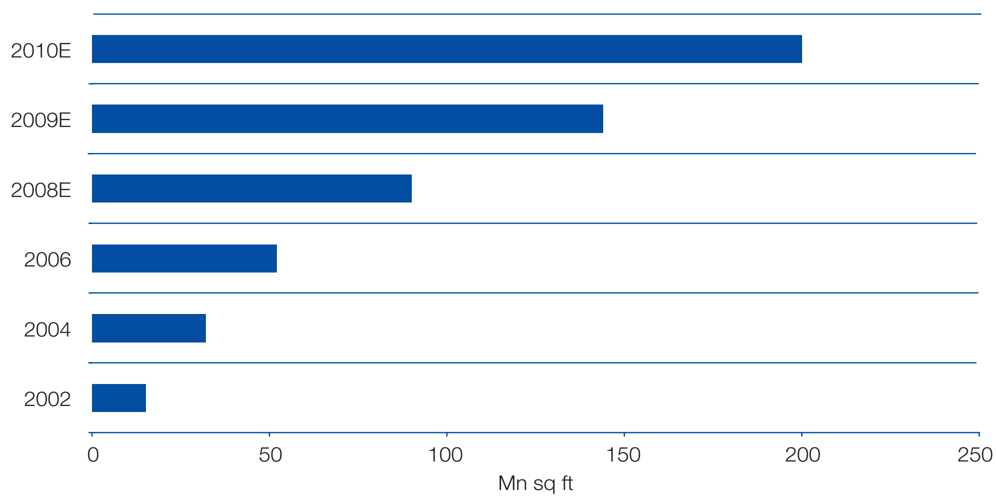
Real estate availability is a key factor influencing the choice of the right location. Real estate costs for the Indian organised retailers are 8-20% of sales compared with 3-4% for retailers in other countries. Choice of the right real estate is crucial for the success of modern retail, as there are significant strategic and financial implications involved. Location in most cases is the value proposition for many modern retailers. This is the key reason for the mad rush among retailers to get the best location in the same catchment or city.

Retail space to increase from 66 mn sq ft to over 300 mn sq ft by 2011E

We expect the 315 mn sq ft of retail space to come up by FY11E, taking modern retail to USD 70 bn. In the next 4-5 years, the country will have over 1,000 hypermarkets and 3,000 supermarkets. Real estate players have already announced big plans for development of close to 300-600 malls and shopping complexes all over the country.

An estimated investment of USD 25-30 bn (industry estimates) is expected to be made in development of retail space by the large real estate players to bridge this shortfall of space. In addition to the real estate players, some retailers have also entered the land development space.

Chart 18: Expected retail space



Source: Images retail, Edelweiss research

More than 50% of space to be concentrated in lucrative metros and tier I cities

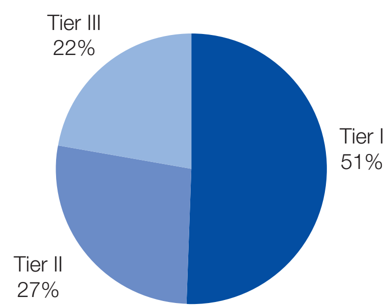
India requires nearly 315 mn sq ft of retail development. Such a development, however, ought not to be just in tier I cities, but also across more than 1,000 towns and major rural hubs. However, of the 100 mn sq ft that is expected to be developed by 2009, close to 50% is concentrated in the metros and tier I cities. This will result in clustered spaces, all fighting for the same catchments; consequently, the untapped markets, though ready, will not have the requisite space.

However, with the retailers showing more interest in capturing tier II and III markets, prominent real estate developers have started seeing advantages like cheaper cost of land and access to best sites, to tilt the scales in favour of tier II or tier III cities, away from the established tier I cities of the country.

Tier II and III cities catching up slowly

According to a study done by Cushman & Wakefield, the country's smaller towns and cities would catch up with the "mall culture" prevalent in urban centers with the benefits of economic development that has already created a booming consuming class. According to the report, roughly 300 mn sq ft of additional retail space would be generated for retail development by 2011, of which, close to 50% will be met by shopping malls. Of the new mall space coming up, 35-40% will be in smaller towns and cities.

Chart 19: Mall distribution in the country



Source: CrisInfac, Knight Frank

This will be in line with the retail market growth trickling down the tier I and II cities across the country. According to Knight Frank, the emerging avenues for retail are cities such as Chandigarh, Ludhiana, Lucknow, and Goa, where the retail real estate is in the developing stages currently.

Growing retailer interest in space development to gain control over best locations

Given the crucial role of location in the success of retail operations, a large number of retailers are setting up subsidiaries or group companies to develop retail space. This gives the retailers the twin advantages of having greater control over the delivery schedules (to plan roll-outs more efficiently) and gaining better access to key locations. Many like the Tatas and Rahejas are established players in mall development. Pantaloon Retail, through a subsidiary, has interests in mall development through its Kshitij- and Horizon funds. Provogue also has a subsidiary Prozone that is looking at mall development in the tier II cities.

Table 7: Real estate linkages

Company	Asset management
Pantaloon Retail	Kshitij and Horizon
Shoppers' Stop	Raheja group
Trent	Infinity
Provogue	Prozone
Bharti	Bharti Realty

Source: Edelweiss research

* Change in Urban Land Ceiling Act and development of mill lands to bode positive

The Urban Land Ceiling Act (ULCRA) prohibited landowners from developing more than 500 sq mt of land without the necessary approvals from the state government; also, the developer was necessitated to share some land parcel with the government. This led to holding of land without any development, causing shortage of land for commercial usage, thereby increasing rentals. However, this Act was recently repealed to promote industrialisation.

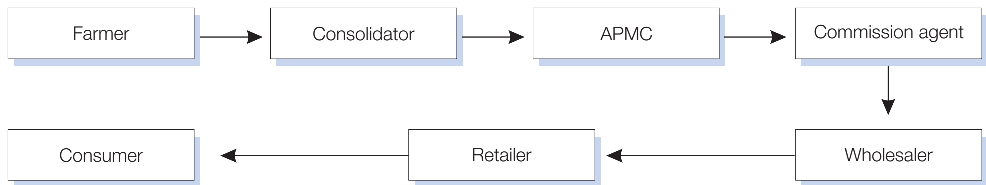
In June 2005, GoI cleared the SEZ Act to promote industrialisation and develop more cities. Though currently it is a topic of intense debate among various stakeholders, the Act would go a long way in developing real estate and organised retail in future. Lastly, development of mill lands, like that of the National Textile Corporation, has ensured availability of suitable locations for organised retail. All these factors bode well for the sector.

Supply Chain Efficiencies to enable Lower Prices, Driving Consumers to Modern Retail

* Traditional supply chain has too many intermediaries

The existing traditional supply chain in India has a minimum of five intermediaries between the producer and the end consumer. At every level of intermediation, wastage occurs, adding to the cost of the product.

Fig. 5: Traditional supply chain



Source: CrisInfac *APMC - Agricultural Produce Marketing Committee*

Obviously, each intermediary tries to make profits on the goods sold, which ultimately increases the price of the product. The illustration of potatoes (see below) indicates that the retail price increases from INR 7.2 per kg almost one and half times to INR 18 per kg. This is a result of the 24% cumulative wastage that occurs and the margin of the intermediaries.

Table 8: Potato- Unorganised chain

	Cost of procurement/ production (INR/kg)	Selling price (INR/kg)	Margin (%)
Farmer	6.8	7.2	
Consolidator	7.2	7.9	8
Commission agent	7.9	10.5	6
Wholesaler	10.5	13.2	12
Organised retailer	13.2	18	22
Consumer	18		

Source: CrisInfac, Edelweiss research

Table 9: Wastage for vegetables

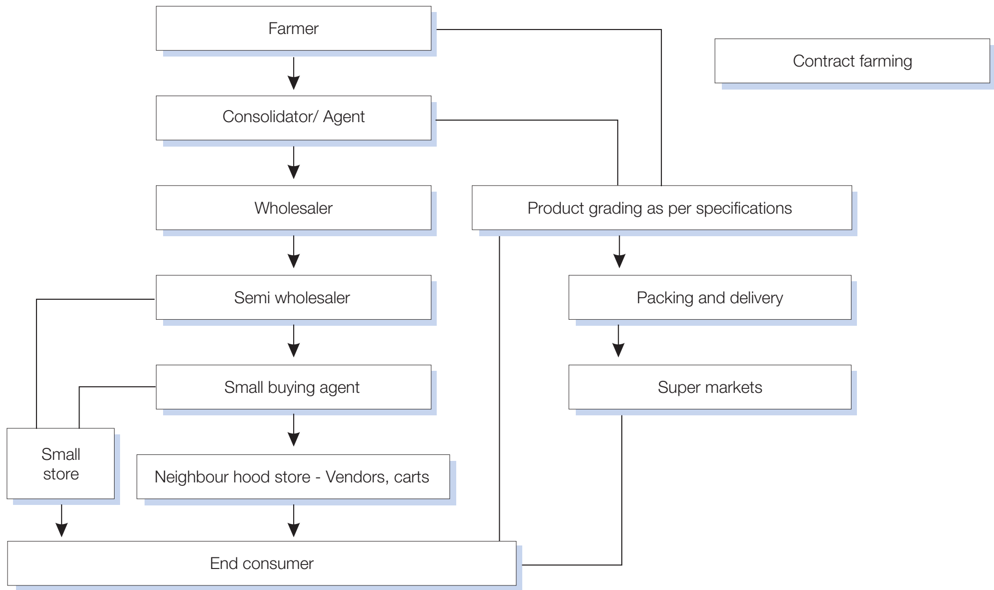
	Cumulative wastage (%)
Potato	24
Cauliflower	24
Banana	30
Cabbage	36
Tomato	40

Source: CrisInfac, Edelweiss research

* Modern retail reduces middlemen, leading to better efficiencies and superior prices

Under the modern supply chain channel, retailers reduce the number of intermediaries to a maximum of three (minimum five in the traditional format) by extending their presence and control to the wholesale operations and establishing direct linkages with the producers. Many retailers also source from Agriculture Produce Marketing Committee (APMC) markets, which also helps reducing 1-2 intermediaries.

Fig. 6: Shortening the traditional chain



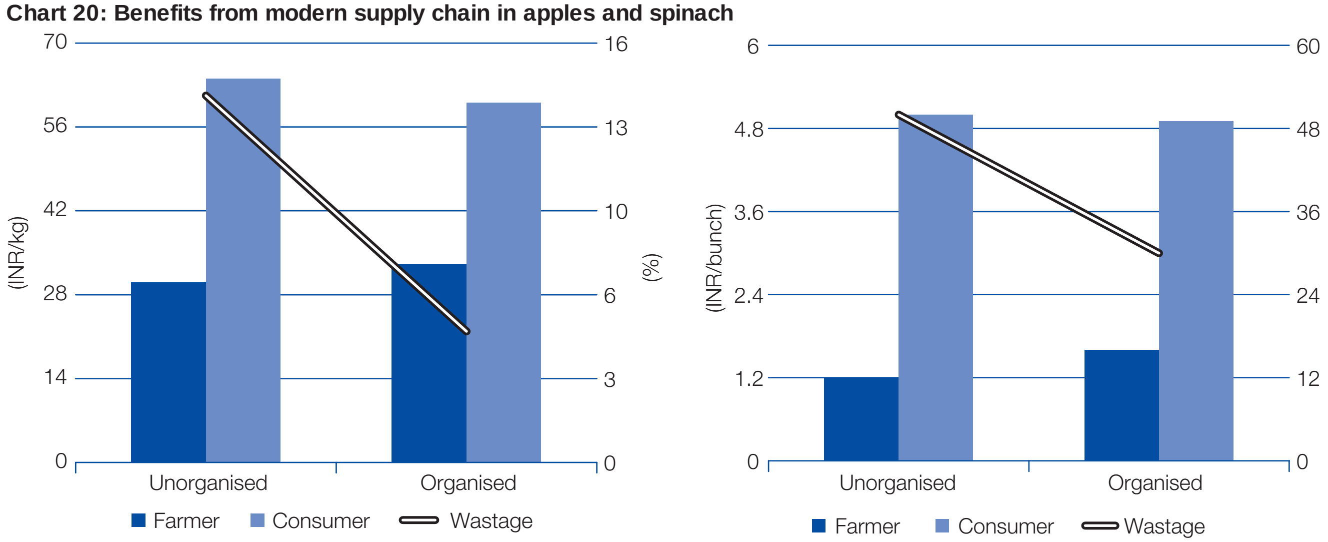
Source: CrisInfac, Edelweiss research

These initiatives not only result in reduced wastage and lower prices, but also allow the retailer a greater control over the quality of the final product, which is a key value proposition for the ultimate consumer. Increasingly, retailers are also exploring contract farming. This is undertaken in rare and high-value products to ensure captive and continued supply.

* Significant benefit to farmers, especially in case of fresh foods

The initiatives of retailers to shorten the supply chain have yielded significant gains that have accrued to the farmers as well. With the elimination of middlemen, the farmers now have access to many more buyers and can therefore make the best of the demand for their products.

Chart 20: Benefits from modern supply chain in apples and spinach



Source: CrisInfac, Edelweiss research

Table 10: Improvement in supply chain

	Benefits to end comsumers Price (INR/kg) paid by end consumer				
	Tomato	Potato	Cabbage	Cauliflower	Banana
Traditional distribution system	8.2	12.0	9.0	9.5	12.0
Modern distribution system	6.5	11.0	8.2	8.5	10.5
Improvement (%)	20.7	8.3	8.9	10.5	12.5

	Benefits to farmers Realisation (in INR) by farmer for 100kgs of produce				
	Tomato	Potato	Cabbage	Cauliflower	Banana
Traditional distribution system	79.2	561.6	426.0	390.0	342.0
Modern distribution system	98.8	583.4	430.1	474.4	353.4
Improvement (%)	24.8	3.9	1.0	21.6	3.3

Source: Industry, Edelweiss research

Large players queuing up significant back-end investments

Large players like Reliance Retail, Pantaloon Retail, and Bharti-Walmart are planning large-scale investments in the back-end processes. These investments are likely to boost efficiency for their wholesale cash-n-carry businesses and also allow better margins in the front-end retail businesses. Reliance Retail is investing nearly INR 80 bn in backward integration, market development, and location sourcing. It has entered into an exclusive arrangement with Blue Star, a major in central air conditioning and commercial refrigeration, for supply of refrigeration and cold room systems for its 'Reliance Fresh' outlets. Pantaloon Retail has set up a dedicated subsidiary for this purpose. We expect a third of the total investments planned in retail to flow into the development of supply chain.

100% FDI in cash-n-carry, driving investments in supply chain and distribution

In India, the current FDI policies allow 100% foreign investment only in wholesale cash-n-carry (wholesale retail) operations. This policy, in its current form, has attracted global retailers like Metro (Germany) and Shoprite (South Africa) into the cash-n-carry trade. These players have brought in their global expertise in effective sourcing to the country, which will help improve the existing system. The global retail major Walmart has also entered the cash-n-carry fray with a JV agreement with Bharti. Pantaloon Retail and Reliance have also announced their entry into this space with a view to derive maximum benefit of their investments in supply chain. This will improve the overall supply chain system, enabling significant cost savings for retailers as well as consumers. RK Foods is one of the few third party logistics players, providing back-end support in food and grocery services.

Most players following a "hub-and-spoke" model

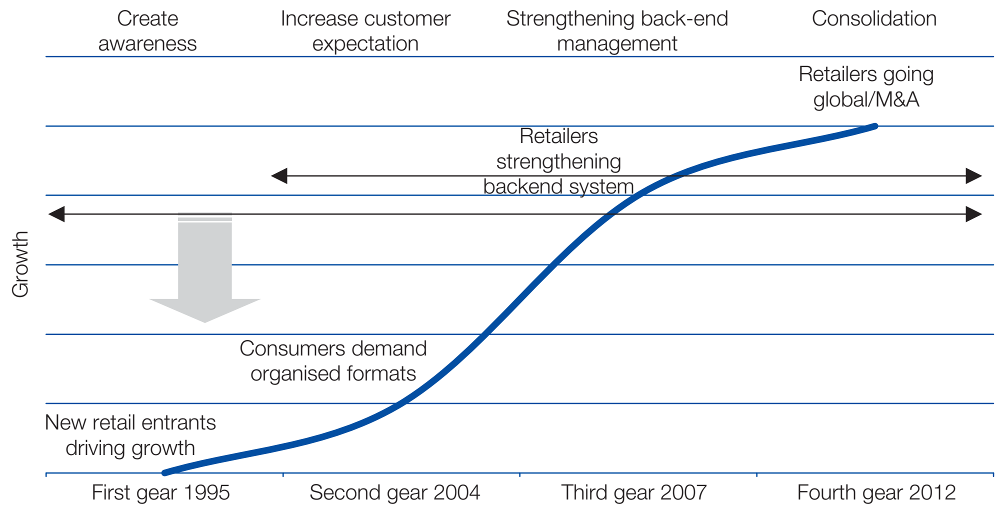
This model is being increasingly used by retailers to penetrate into the fragmented markets and capture smaller catchments in the vicinity of a single large catchment. Retailers are setting up smaller stores in-an-around one large store that serves as a hub. This model allows the retailer to operate smaller stores in the more distant catchments and use the larger store to keep them adequately stocked. Such stores increase the penetration levels of organised retailing beyond the larger catchments. A well developed supply chain is key to the success of this "hub-and-spoke" model.

Existing Scenario and Outlook - Key Trends in Organised Retail

Retail moving into third gear

Retail in India is currently evolving and is gradually moving from the second gear of development to the third. The retailers in the country are currently looking at establishing themselves in this high-growth space as early as possible to ensure that they capture as much market share in terms of retail space and consumer spend.

Chart 21: Different stages in growth of organised retail in India



Source: CrisInfac, Edelweiss research

Emergence of multiple modern retailing formats providing different value proposition

Nowadays, consumers prefer value convenience and a wide variety of offerings, coupled with a pleasant shopping experience, which the traditional retailing format has failed to meet. This has created an opportunity for modern retailing formats to emerge and plug the existing gaps. A number of these have sprung up, each offering a distinct value proposition to the consumer. Some of the modern retail formats and their value positions are given below:

Table 11: Value proposition of modern retail formats

Format	Definition	Value position
Supermarket/Convenience stores	Food and household products	Convenience
Department stores	Multiple product categories, usually lifestyle-driven, with apparel accessories predominating	Service and choice
Hypermarkets/Discount stores	Large stores big box format, with volume-based discounted prices	Price and choice
Speciality stores/Category killers	Extensive range of products under a single category	Service

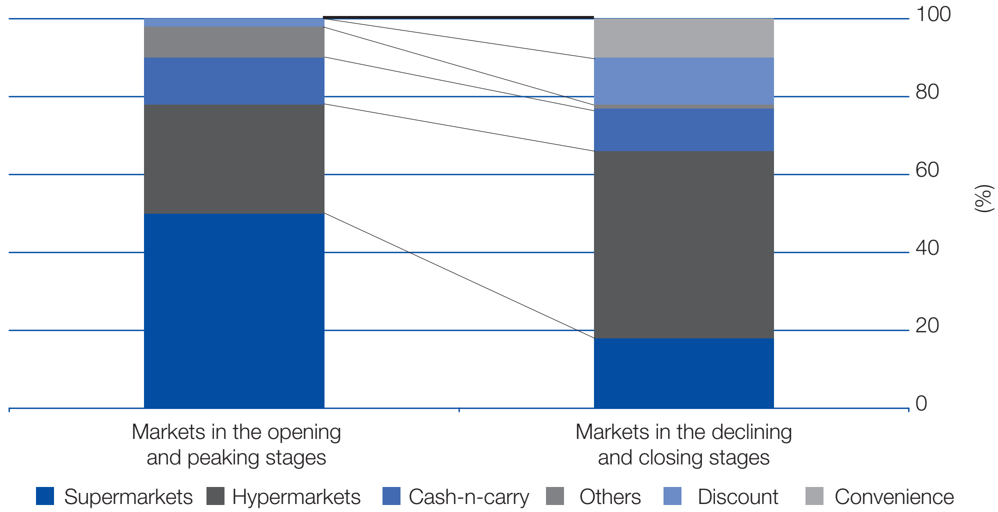
Source: Edelweiss research

Players targeting multiple formats to capture maximum share of consumer's wallet

In the past, Indian consumers have shown their ability to leapfrog cycles of market evolution and the same can be expected in the retail space too. Additionally, the experience gained from analysis of the retail market evolution in other Asian markets will also work to India's advantage. It is unlikely that in the current rapid growth scenario, any retailer will have too much time to establish, consolidate, and then mature. Hence, retailers are working to capture as many segments as possible with multiple formats.

The development of retail in other countries and industry research indicate that in the opening and peaking stage of retail development, the retail space is dominated by supermarkets and hypermarkets. These typically account for 75-80% of all formats, in line with the rush to set up hypermarkets witnessed in the Indian scenario.

Chart 22: Format and timing patterns based on countries under A T Kearney's GRDI



Source: A T Kearney

The following table broadly summarises the formats targeted by the leading domestic retailers. It is evident from the table that almost all the players are targeting the hypermarket and supermarket formats. Even the players who in the past did not have presence in the value retail space like Shoppers Stop and Trent have extended their businesses into the hypermarkets space to capture the retail opportunity from the swelling middle class.

Table 12: Format-wise presence of domestic retailers

Company	Hypermarket	Department stores	Supermarket/ Convenience	Specialty	Catalogue/ Kiosk retailing	Online retail
Pantaloon Retail	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Shoppers' Stop	✓✓	✓✓	✓✓	✓✓	✓✓	
Reliance	✓✓		✓✓	✓✓		
Vishal Retail	✓✓		✓✓	✓✓		
Trent	✓✓	✓✓				
Subhiksha			✓✓			✓✓
Spencers	✓✓		✓✓	✓✓		
Piramyd		✓✓	✓✓			
Wadhwan			✓✓		✓✓	
AV Birla			✓✓			

Source: Edelweiss research

Fig. 7: Players presence across formats

Format offerings

Supermarkets/ Convenience stores	Hypermarkets	Departmental stores	Speciality stores
Food Bazaar	Big Bazaar	Ebony	Croma
Foodland Fresh	HyperCity	Globus	Crossword
Hypercity-Express	Reliance Mart	Lifestyle	Koutons
KB Fair Price	Shoprite	Pantaloons	MAC
More	Spencers Hyper	Piramyd Megastore	McDonald
Nature Fresh	Star India Bazaar	Shoppers' Stop	Mothercare
Nilgiris	Vishal Megamart		Odyssey
Reliance Fresh			Provogue
Spencer Express			Raymond
Spencer Daily			Tanishq
Spinach			Titan
Subhiksha			Vijay Sales
Trinethra			Zodiac EBO
Trumart			

Source: Edelweiss research

First leg of growth being driven by hypermarkets and supermarkets

Currently, India has ~150-200 hypermarkets (dominated by Pantaloon Retail's Big Bazaar stores, and Vishal Retail) and close to 1,000 supermarkets (dominated by regional players like Nilgiris, Trinethra, and few national players like Subhiksha and Spencer's Retail). This is expected to grow to over 1,000 hypermarkets and 3,000 supermarkets by FY11E. Euromonitor estimates peg the growth in hypermarkets over 2006-11E at ~50% CAGR, while the convenience stores are expected to see a growth of ~30% in the same period.

This trend is similar to what has been seen in China, where the first leg of modern retail expansion was spearheaded by expansion in hypermarkets that were almost non-existent in 1999, but currently account for more than 3% of total retail markets sales growing at a CAGR of 28%.

- Value on bulk purchase - A key attribute to attract the emerging middle class, that form the largest chunk of consumers.
- Cater to wide range of merchandise and capture a larger wallet share.
- Effective anchors in malls, as they attract maximum footfalls to the mall as a whole.
- Anchor tenants can bargain for low rentals that can be 60-100% lower than the rentals for other tenants.
- Lead to development of catchment around the tier II and III cities.
- Cater to the weekly or fortnightly spend on food and grocery.

Table 13: Hypermarket players in the country

Format/ Store	No. of cities			No. of outlets			Retail space ('000) sq ft		
Hypermarkets	FY05	FY06	FY07	FY05	FY06	FY07	FY05	FY06	FY07
Big Bazaar (Pantaloon)	14	20	35	19	29	45	842	1,250	1,800
Fabcity (Trinethra)			1			1		50	
Hypercity (Shopper's Stop)			1			1			120
Jumbo Saver (Jubilant Org)			1			2			
Magnet		2	4		3	7		152	400
Metro Cash & Carry	1	1	2	2	2	3	200	200	300
Shoprite	1	1	1	1	1	1	55	55	55
Star India Bazaar	1	1	1	1	1	1			
Vishal Mega Mart	11	21	43	16	26	50	164	480	1,500

Source: Images India Retail Report, 2007

Supermarkets

Until recently, the supermarket format was dominated by players with a regional presence, as most of the players had established themselves in the regional markets. Players like Subhiksha, Nilgiris, and Trinethra, were known regionally. However, they are now expanding to strengthen their hold in their existing areas of operations and also tap other states. The new players on the block, namely Reliance, Birla, and Bharti-Wal-Mart, have either begun or are planning to begin their retail operations in this segment.

This segment is seeing acquisition of the smaller regional players by the bigger ones. Trinethra has been acquired by the Birla group. Spinach has acquired Sangam Direct, the home delivery retail business of FMCG giant Hindustan Liver (HLL).

The key selling proposition in this format is the convenience and value proposition. Players like Subhiksha have a large number of outlets, though small, in easily accessible locations, so that the consumer can access the stores at regular intervals. The merchandise comprises a wide range of daily use products with significant brand choice among the same.

Table 14: Different players in the supermarket category

Format/ Store	No. of cities			No. of outlets			Retail space ('000) sq ft		
Convenience	FY05	FY06	FY07	FY05	FY06	FY07	FY05	FY06	FY07
Arambagh Food Mart	1	2	3	19	19	24	10	10	13
Big Apple			1		1	3			
C3	1	1	1	2	3	6	6	10	22
Fabmall (Trinethra)	2	3	6	93	114	198	225	286	526
Food Bazaar (Pantaloon)	14	20	22	28	43	45	263	450	480
Foodworld	3	4	4	79	100	31	119	250	71
Fresh @ (Heritage Food)			1			1			4
Monday 2 Sunday	1	1	1	2	2	2	13	13	13
Namdhari's Fresh	1	1	2	3	6	13	5	9	20
Nature's Basket	1	1	1	1	3	3			
Nilgiri's	9	9		31	31	44	140	150	200
Reliance Fresh			1			22			66
SPAR	1	1	1	1	1	1	27	27	27
Spencer's (RPG Group)			17			68			181
Spinach		1	3		2	60		5	154
Subhiksha		4	6		195	315			
Tai	1	1	1	2	4	4	17	29	29
Trumart	3	5	7	4	12	42	16	48	168

Source: Images India Retail Report, 2007

Department stores

Organised retailing began in India through players catering to the lifestyle segment via various department stores that largely focused on branded apparel merchandise. Shoppers' Stop and Pantaloon Retail that began operations in 1991 and 1997, respectively, were the first players to look at a pan-India presence. The segment now has several well-established players with aggressive growth plans. Going forward, we see these departmental stores (mainly restricted to the metros currently) increasingly trickling down to the smaller cities. Shoppers' Stop, Westside, Lifestyle, and Globus lead the pack of departmental store retailer segment currently. We expect this format to gain prominence in the next leg of growth, as value retail becomes more competitive. We believe that Shoppers' Stop has the best brand recall and positioning in this pace.

Department stores now are broadening their merchandise mix to include accessories, cosmetics and jewellery, gift items, and home furnishings and accessories, in addition to a wider range of branded and unbranded apparel. Department stores follow the lifestyle and service proposition and also the choice proposition. As a result, they attempt to provide the customers a variety of well-known brands under one roof, targeted at the upper middle class and the rich segments of the population. Even their private labels are suited to lifestyle tastes and hence draw superior margins.

Table 15: Different players in the department store category

Format/ Store	No. of cities			No. of outlets			Retail space ('000) sq ft		
Department stores	FY05	FY06	FY07	FY05	FY06	FY07	FY05	FY06	FY07
Globus	5	8	14	7	12	20	14	195	290
Lifestyle	5	5	9	7	10	19	268	342	746
Pantaloons	9	15	22	12	21	40	288	485	760
Pyramid	3	6	8	3	7	11	180	420	660
Shoppers' Stop	9	10	12	16	20	26	753	951	1,507
Westside (Trent)	10	11	14	16	16	23	220	320	550

Source: Images India Retail Report, 2007

Specialty retail formats

Specialty stores are fast catching the fancy of Indian retailers. Such a format caters to specific merchandise and focuses on a single category, offering a large range of selection within a single merchandise category. Prominent examples of such stores in India include chains like Planet M, Music World - catering to music, Crossword, Odyssey, and Landmark - catering to books and music, Tanishq - catering to jewellery, and Spaces, @home - catering to home improvement. These stores enjoy strong customer loyalty with interesting loyalty programmes. A recent trend in the segment is the development of specialty malls like Gurgaon's Gold Souk and Bangalore's EVA mall.

Table 16: Jewellery retailers

	No. of cities			No. of outlets			Retail space ('000) sq ft		
Format/ Store	FY05	FY06	FY07	FY05	FY06	FY07	FY05	FY06	FY07
Anjali Jewellers	1	1	1		4	5	4	5	7
Damas						21			
Davanam	1	1	1	1	3	6		20	
Khazana	2	4	5	2	4	6			1
Kiah	3	10		4	14				
Kirtilal Kalidas & Co			6			6			13
MP Jewellers			7	5	6	10			18
PC Chandra			3			12			
Tanishq	55	61	65	69	83	92	101	117	124
TBZ	3	3	3	7	7	7			5

Source: Images India Retail Report, 2007

Table 17: Books and music, and gift retailers

	No. of cities			No. of outlets			Retail space ('000) sq ft		
Format/ Store	FY05	FY06	FY07	FY05	FY06	FY07	FY05	FY06	FY07
Archies	139	145	160	44	61	125	48	67	137
Book Café	10	16	25	12	22	36	7	9	16
Crossword	8	10	10	22	31	45	114	154	242
Fountainhead	2	2	2	2	2	2	13	13	13
Landmark	3	4	9	6	7	12	110	180	225
Music World	12	30	45	203	235	320	44		
Odyssey	6	6		12	13	30	60	60	291
Oxford	5	5	6	5	5	16	27	42	80
Planet M	25	31	36	114	124	145	100	115	140

Source: Images India Retail Report, 2007

Table 18: Home improvement

	No. of cities		No. of outlets		Retail space ('000) sq ft	
Format/ Store	FY06	FY07	FY06	FY07	FY06	FY07
@ Home	6	7	6	12		140
Atmosphere		10		11		
Bombay Dyeing		300		450		
Carmicheal House				100		
Godrej Interio & Lifespace				192		
Home Centre	1	4	1	4	25	96
Home Stop	1	2	1	2		
Home Store		8		14		105
Home Town		1		1		120
Pergo						29
Portico	40	50	300	400		12
Seasons Furnishings	36	40	39	47	15	32
Style Spa		40		70		
TTK Prestige	47	100	86	200		80
Welspun stores	17	21	43	82	84	200

Source: Images India Retail Report, 2007

Players using multiple formats to capture consumption - Pantaloon Retail leads the pack

Pantaloon Retail leads the retail pack in terms of presence across the consumption basket and enjoys the most diversified presence amongst all. Its recent addition in the form of catalogue retailing has established its presence across the major formats. This has resulted in the company successfully targeting a large share of the consumer wallet. Players like Spencer's and Shoppers Stop also have diversified presence, but lack the scale and multitude of format that Pantaloon Retail as a company has managed to scale up to. Reliance is aggressively entering the scene and is working to target all the segments through its target of operating 100 mn sq ft of retail space. Thus, players are spreading their operations across the consumption avenues with presence across many formats. We like this strategy of Indian retailers as this gives them the flexibility to cater to a broad-based buying basket of the consumer and also manage competition better in the near term.

Table 19: Players attempting to capture consumption basket

Consumption avenues	Food and grocery 17%	Personal care 1%	Apparel 37%	Footwear 9%	Furnishings 6%	Consumer durables & furniture 9%	Jewellery and watches 6%	Medical care and health 2%	Recreation 3%	Others 11%
Pantaloon	Food Bazaar Big Bazaar	Star and Sitara	Pantaloon, Brand Factory, Big Bazaar	Shoe Factory	Home Town	Home Town, Collection I Electronic Bazaar, E-zone Big Bazaar	Big Bazaar	Tulsi	F123	Big Bazaar, Depot
Shoppers' Stop	Hypercity	MAC, Clinique	Shoppers' Stop	Shoppers' Stop	Home Town	HyperCity	Arceila Shoppers' Stop		Time Zone F&B	Crossword
Trent	Star India Bazaar		Westside			Star India Bazaar	Westside			Landmark
Subhiksha	Subhiksha					Subhiksha Mobiles		Subhiksha		
RPG	Spencers Daily, Express, Hyper		Spencers Hyper			Spencer Hyper			Music World	
Piramyd Retail	Trumart		Megamart				Megamart			
Vishal Retail	Vishal Megamart		Vishal Megamart			Vishal Megamart				
Reliance	Reliance Fresh	Reliance hyper market	Reliance hyper market	Reliance hyper market	Reliance hyper market	Reliance hyper market	Reliance hyper market			Reliance hyper market
AV Birla	More									
Titan							Titan, Tanishq			

Source: Edelweiss research

✻ Value retail has outpaced lifestyle retail in growth- Trend to continue for a while

Over the last five years, the modern retailers have posted tremendous growth numbers with Vishal Retail and Pantaloon Retail leading the pack with 112% and 63% CAGR respectively. The growth in revenues has largely been driven by increase in retail presence for these two players, as is seen from the 90% and 61% growth in retail space posted over the same period.

Players focusing on value retail have grown much faster than those focused on lifestyle; value retail has been driven by space addition and lifestyle by better growth in the existing stores.

Table 20: Value retailers lead growth

	FY02 revenue (INR mn)	Space mn sq ft/ stores	FY07 revenue (INR mn)	Space mn sq ft	CAGR 5 year revenue (%)	Space (%)
Pantaloon Retail	2,853	0.53	32,367	5.73	63	61
Shoppers' Stop	2,462	0.56	8,895	1.17	29	16
Trent	811	0.12	6,006	0.50	49	33
Piramyd Retail	325	0.01	1,561	0.7	37	134
Titan	6,745	NA	21,359	NA	26	NA
Vishal Retail	141	0.05	6,027	1.25	112	90
Subhiksha*	NA	150	8,030	800	NA	52

Source: Edelweiss rsearch ** no. of stores not area in sq ft*

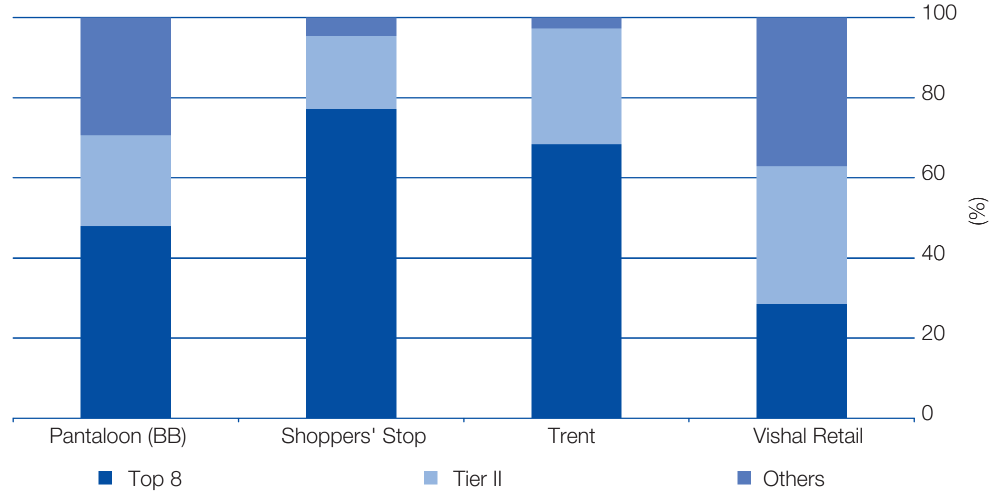
We expect this trend to continue for the next four years, given that hypermarkets are the format of choice and almost all the large players are planning large investments in setting up hypermarkets.

✻ Metros and tier I - towns account for the lion's share of modern retail

The top eight cities (metros and Pune, Ahmedabad, Hyderabad, and Bangalore) account for a large part of the organised retail in the country. These cities are expected to contribute almost 85-90% to the total organised retail in the country. This explains the focus of all the major retailers to establish their presence in the best catchments in these prime locations. The share of modern retail in these top eight cities is much above the country average at about 14-16%.

Large retailers like Pantaloon Retail have already begun tapping this opportunity, making the most of it by enjoying the first movers' advantage. Players like Vishal Retail have focused their operations largely on tier II and III towns. However, these markets will be much less profitable than the top 37. This will be largely on account of lower disposable incomes, smaller catchments, slower scale up of PSFPAs, lesser proportion of higher value merchandise, and slow acceptance of modern retail.

Chart 23: Store location break-up



Source: Edelweiss research

✻ Aggressive expansion plans – Inflow of USD 25 bn over next five years

If the expansion in the past has been fast-paced, the future has much more in store. Players have set out plans to invest close to USD 25 bn over the next four years. The opportunity in the sector has brought into the arena many large corporations like Reliance, AV Birla, Bharti, Munjals, and Mahindra among the domestic players, and the best names in the global retailing industry such as Walmart, Carrefour, Metro, and Shoprite. There are more foreign players waiting in the sidelines such as Tesco, Cotsco, and Marks and Spencer's, looking for Indian partners and evaluating the best mode of entry.

Table 21: Planned investments

New entrant investments	USD bn
Pantaloon Retail	1.8
Shoppers' Stop	0.5
Trent	0.3
Vishal Retail	0.2
Subhiksha	0.2
RPG	0.6
Reliance Retail	6.0
AV Birla	3.0
Bharti- Walmart	3.0
Others	9.4
Total investment	**25.0**

Source: Edelweiss research

✻ Scale players to gain in future - Execution crucial

India is the most coveted retail, and hence, the rush to capture a sizeable chunk of the pie has brought in some of the best known foreign retailers and a large number of domestic names in the fray. However, given that foreign players are not allowed to enter the country in a full-fledged manner as of now, domestic players remain the best placed, particularly the ones who attain scale early. Timely execution of the expansion plans remains the key success factor. In this regard, we like strategies of players like Pantaloon Retail, Vishal Retail, Subhiksha, and Koutons Retail, who are attempting to cover maximum ground before the foreign players enter.

✻ Control over prime retailing locations

Spiraling real estate prices and thus increasing rentals are hampering the profitability of many retailers. To manage this, many retailers are working to gain better control of the real estate space. They are entering into long-term leases (ranging from 6-12 years) and also tying up with developers to ensure access to the best retailing locations at reasonable rentals.

There is growing retailer interest in space development. Many companies have set up group companies or subsidiaries to develop quality retail space delivery within predetermined timelines. Pantaloon Retail, through its subsidiary Future Capital has an asset management business that is developing retail space; Bharti, Shoppers' Stop, and Trent also have group companies involved in real estate development. We prefer players with greater control over the retail space, as this is a key variable that can impact profitability and growth plans of the retailers. Players like Pantaloon Retail, Shoppers' Stop, RPG, who have tied in a large part of their planned retail expansions, are better placed than the others.

Table 22: Area locked in by large retailers

Company	Space tied up (mn sq ft)
Pantaloon Retail	30.0
Shoppers' Stop	6.0
Vishal Retail	1.0
Piramyd	1.0
RPG	2.0

Source: Edelweiss research

✻ Foreign players using the cash-n-carry mode of entry

GoI allowed FDI in retail until 1997 and those companies that had entered India prior to that year were allowed to continue with their existing foreign equity components. Some of the players who entered then were Mc Donalds and Dairy Farm International through a JV with RPG. However, the rules were altered later on; to secure jobs in the country, the current government policy allows 100% foreign investment in wholesale cash-n-carry, but prohibits FDI in retail trading, except in single brand retail, provided the following conditions are met:

- Maximum 51% foreign equity
- Prior FIPB/DIPP approval
- Products are sold under single brand only
- Products, target at international market, are sold under the same brand
- Products are branded during manufacturing
- Fresh government approval for any additional products sold

This was in itself a landmark step for the Indian government. However, any further liberalisation measure seem bleak due to protests from various sections in the country; political parties, small scale retailers, and even large domestic retailers feel that the entry of foreign retailers in a big way will hamper the growth of the Indian players and displace many jobs due to excessive automation.

Cash-n-carry that can receive 100% FDI is the easiest mode of entry for foreign retailers into India. Players like Metro and Shoprite have already started operating in this format and are awaiting FDI law relaxation to extend presence into multi brand front-end retail. Players like Walmart, Carrefour, and Tesco, who have successfully established themselves in the Chinese markets, are now trying to grab a share of the attractive Indian retail opportunity.

As of now, only Walmart (among the foreign retailers) has forged an alliance with Bharti, with Walmart investing in the cash-n-carry model and Bharti concentrating on the front-end retail. Others like Carrefour and Tesco are also entering through the cash-n-carry route. Many Indian players too are contemplating investments in cash-n-carry.

✻ Foreign brands keen on partnering

Many foreign brands are now tying up with leading Indian retailers like Pantaloon Retail and Shoppers' Stop, either as joint ventures, or exclusive franchisees to set shops in India. They are keen to enter the market right way, to tap the swelling middle as well as luxury classes in the country. Going forward, a large part of the middle class is expected to move upwards into the rich segment. Currently, industry estimates peg the number of high net worth individuals with financial assets outside fixed assets of USD 1 mn and above at 83,000. The luxury segment in India is worth USD 444 mn and is growing at well above 30-35%. Another data point available is that the number of luxury households in India is 1.6 mn currently, which is expected to cross 3 mn by 2010.

Table 23: Foreign brands present in the country

Staples - Office stationary	Burger King - F&B
Mother care - Baby and mother care	Starbucks - F&B
MAC - Cosmetics and beauty care	French retailer ETAM
Argos - Catalogue retailing	Marks and Spencer's - UK retailers
Alpha and Nuance - Airport retailing	

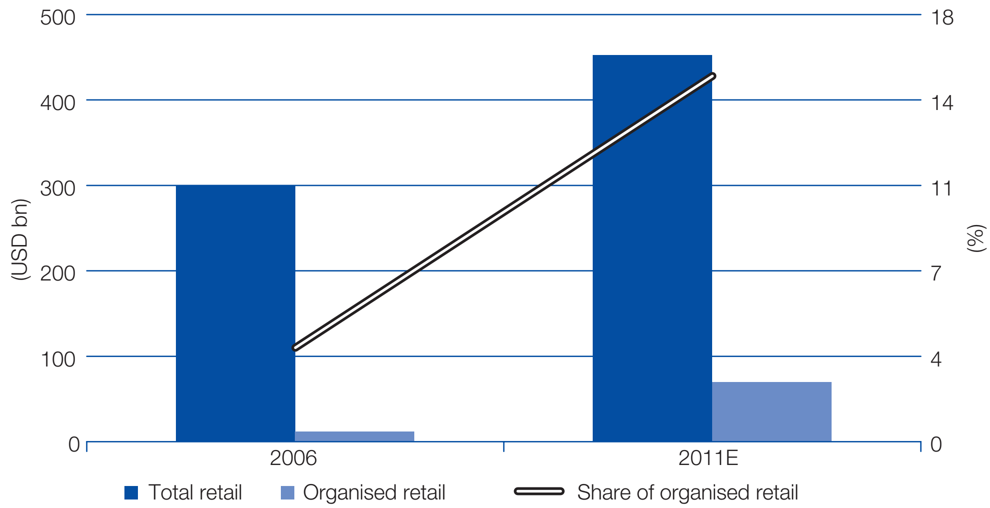
Source: Edelweiss research

Our Expectations

✻ Organised retail to grow at 42% CAGR to reach USD 70 bn by FY11E

We expect the retail space to undergo constant change over the next four years as the existing players and the new entrants battle it out with each other. We expect the planned USD 25 bn investments to take the industry from the current USD 12 bn to USD 70 bn by FY11E. This will translate into the organised retail growing at a 42% CAGR over the next five years on the back of an 8% growth in the total retail pie and increasing share of modern retail to 15% from 4.1% currently

Chart 24: Improving retail landscape

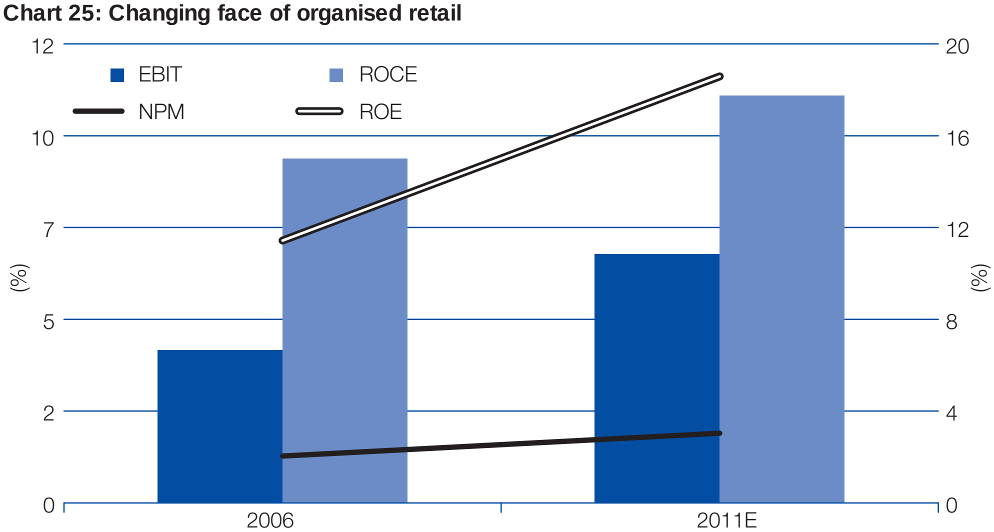


Source: Edelweiss research

✻ Return ratios to expand and operating metrics to improve

We expect a significant share of this investment to flow into strengthening the back-end and supply chain, which will improve operating efficiencies in the sector as a whole. Further, with a host of foreign players setting up cash-n-carry operations, focused investment will flow into the logistics and supply chain networks in the country. We expect this and the maturing of the retail operations to result in improvement of the return ratios. The domestic players' RoCEs currently stand at less than 10%, which we expect to improve steadily to 14-15%, in line with those of the global players.

Chart 25: Changing face of organised retail



Source: Edelweiss research

* Market share of large retailers to account for larger share of modern retail in future

The larger domestic retailers currently account for only ~16% of organised retail and 9% in retail terms, implying their low market share. However, we expect this metric to change drastically with the entry of large players like Reliance, Bharti, and AV Birla into the scene. Given the scale of their plans and their track record of effective execution in other business verticals, we see few large retailers dominating the retail scenario over the next five years. Among the listed players we expect Pantaloon Retail to figure among these.

We believe that this concentration of a large part of the retail space in the hands of the large domestic retailers is a key reason why the domestic retailers command such high valuations. Given that the current FDI regulations restrict foreign retailers entry, as and when they are allowed to enter, they will have a much tougher peer group to compte with who will be well-equipped with the best retail space and ability to dominate excellent catchments.

Incumbent Players Well-Placed to Retain Upper Hand

In the growing organised retail market in India, we believe that the present domestic retailers have an upper hand by virtue of their established presence. These players will be better placed than the foreign players or even other domestic players who will enter the market subsequently. This head-start, driven largely by the FDI restriction, has placed the domestic retailers at an advantageous position. They will have access to the best markets at the perfect time to establish themselves and gear-up for the competition.

- Early entry into the most lucrative catchments
- Benefits of early entrant in terms of best retail locations and rentals
- Cushion of lucrative markets to aid expansion into tier II and IV cities
- Better brand recall
- Bulk sourcing benefits and economies of scale
- Investments in IT infrastructure and supply chain viable due to scale
- Creation of entry barriers for subsequent entrants
- Ability to handle competition better

✻ Protection to domestic retailers – Make hay while the sun shines!

The current FDI policies restrict foreign retailers from operating in the multi-brand retail and allow them to participate to the extent of 51% in single-brand retail. However, 100% FDI is allowed in cash-n-carry wholesale operations. This protects the domestic retailers from foreign retailers, who with their experience in the developed markets, capital strength, and logistics capabilities, can prove to be very tough competitors.

However, the above advantage cannot last for long and we expect the Indian markets to open gates for the global players over the next two years. The domestic retailers must therefore use time to their advantage and make efforts to establish and fortify themselves in their respective segments. Over a period of time, only those players with abilities to effectively invest (in getting their businesses right and capture as much retail presence as possible) will be able to sustain.

After the FDI curb is eliminated, the foreign players will be forced to battle the established domestic retailers in the top 37 cities that are most profitable, while the domestic retailers will be further expanding presence in the untapped tier III and IV markets, as well as the rural markets. Thus, having already captured the best locations in the top 37 cities, it will be more profitable for the existing domestic players to cater to the scattered rural markets with the cushion of the cheap rentals in the other markets as against foreign players who will enter in the midst of high competition.

Table 24: Retail space distribution in favour of larger players

Space distribution	Space (mn sq ft) 2007	2011E
Bharti	0.0	30.0
Birla	0.3	30.0
Globus	0.7	3.0
Pantaloon Retail	5.7	26.9
Piramyd	0.8	2.0
Reliance	0.4	60.0
RPG	1.1	6.5
Shoppers' Stop	1.1	5.1
Subhiksha	0.8	4.0
Trent	0.9	4.0
Vishal Retail	1.1	4.5
Rest	53.2	139.9
Total	**66.0**	**316.0**

Source: Edelweiss research

Control of the prime retailing locations

By virtue of being early entrants in the prime retailing catchments in the tier I and some tier II cities, the domestic retailers would have under their operations the best retailing locations and at the lowest rentals. Since these lease agreements are mostly long term, ranging from 6-10 years, they lock-in a particular space for a long period, keeping the domestic players at advantage.

Table 25: Area locked-in by large retailers

Company	Space tied up (mn sq ft)
Pantaloon Retail	30
Shoppers' Stop	6
Vishal Retail	1
Piramyd	1
RPG	2

Source: Edelweiss research

Early entry into lucrative markets helps manage longer gestation in tier III and rural markets

Most of the organised retail action is likely to be concentrated in the top 37 urban locations over the next 3-5 years. These coveted locations will be largely captured by the domestic retailers by the time the foreign retailers are allowed to enter the country. The domestic players, having broken-even and working with high PSFPAs, will then have the cushion to expand into the tier III, IV, and rural markets that present huge opportunities, albeit with longer gestation periods. The foreign players, to first get their systems and processes in place, will concentrate on the top 37 cities, where despite competition stores are likely to mature faster than in the rural areas and tier II and IV cities due to the conducive consumer habits and acceptance of organised retail.

Early entrants get the best rentals - A key cost factor

Rental, currently accounting for 7-8% of a retailer's revenues, is the key cost factor that can either make or break the dynamics of the retailer. Anchor tenants usually enjoy rates which are 50-80% lower than rates for other retailers. Thus, if a retailer operates multiple formats, and enters as an anchor early, he will be in a better position to bargain with the developers and get best rates for any additional space requirement, as anchor tenants largely drive the footfalls in a mall.

Better equipped to cater to regional tastes and preferences

The Indian consumers are a diverse lot. The consumption patterns of consumers vary from region to region. This variance, to a certain extent, depends on the overall income levels and prosperity of the region and, to a large extent, on subjective variables like customs, culture, and food habits.

A key challenge for any retailer is to get the merchandise and positioning right to cater best to these diverse tastes and preferences. The right supply chain also needs to be put in place, which will include both national level and regional level chains. The domestic players are better-placed to understand these differences and include a variety of national and local brands to best cater to the consumers because of their proximity to the markets; this is precisely why the brands and merchandise-mix vary from store to store in most large retail chains. The domestic players have also used the private labels strategy effectively to meet the consumer needs. For instance, regional players like Nilgiris and Trinethra have been more successful in the south with their range of private labels.

Cushion to experiment and establish themselves across multiple formats

Another advantage that the domestic players will have is the flexibility to experiment with various formats and also establish themselves across multiple formats. Pantaloon Retail currently operates over 13 formats across the value and lifestyle spaces. There have been instances of some formats not scaling up to expected levels and the company closing down formats like *Fashion Station* to put the space to better use under other formats. This flexibility will however not be available to a global retailer entering a market with established domestic retailers, who after experimenting with different models, will obviously be ahead on the learning curve.

Consolidation among domestic players to speed up expansion

To speed up the scaling up process, we expect some of the larger domestic players to look at acquiring the smaller regional or even national level players, which will enhance their offerings or give them entry into new markets. We view this strategy as very viable, as this not only allows the company to grow much faster than it would have through a greenfield expansion, but also enables it to channelise resources on more productive expansion without battling the competition.

Table 26: Takeovers in retail

Year	Acquiree/ JV Company/ Target	Acquirer	Nature of business	Stake (%)	Consideration (USD mn)
2005	Liberty Shoes	Pantaloon Industries	Footwear	51	3
2005	Indus-League Clothing	Pantaloon Industries	Clothing	68	5
2005	Crossword	Shoppers' Stop	Books and music	100	9
2006	Adani Retail	Reliance Retail	Department store	100	22-33
2006	Trinethra	Aditya Birla Retail	Supermarket	90	76
2007	Nilgiris Dairy Farm*	Aditya Birla Retail	Supermarket	NA	111
2007	Landmark	Trent	Books	76	23

Source: Edelweiss research ** Deal not formally announced*

Attractive takeover candidates to increase presence or reduce competition

The domestic players will be attractive acquisition and merger targets for the foreign players, who with their financial strength, could look at acquiring a local player instead of going for a greenfield expansion. This strategy has been seen in China, where new entrants like Carrefour and Wal-Mart have acquired domestic firms to rapidly expand their stores base across catchments. Here, the gainers will be the domestic retailers who will give the foreign retailer maximum benefits from the acquisition either in the form of better reach into new attractive catchments or reduced competition in the catchments they are already present in.

Risks and Challenges

There is no doubt that the organised retail industry is on a high growth trajectory. Favourable demographics, steady economic growth (improving prosperity), higher disposable incomes, and easy availability of credit are providing the necessary impetus to the growth of modern retailing formats. However, there are several challenges that continue to stifle this growth. There is agreement among most players in the industry that the growth of organised retailing can be faster than projected 35%, if some of these issues are addressed proactively.

Real estate – Availability and high rental costs

The real estate costs for the Indian organised retailers are 8-20% of sales compared to 3-4% for the retailers in other countries. This adversely affects the economics of organised retailers, especially the relatively smaller retailers. This is a result of a combination of several factors including the following:

Most Indian cities suffer from poor city planning that has not provided for enough commercial space, resulting in high speculative real estate prices.

The stamp duty rates in India (5-14%) are among the highest in the world. For example, stamp duty rates in the UK range from 0-4%.

Archaic laws like the Urban Land Control Ceiling and Regulation Act and the Rent Control Act complicate the usage of land and reduce transparency in transactions.

Over the last year, rentals in the key catchment areas have increased 80-100% due to the mismatch between supply and demand for real estate; overall, rentals have increased ~40-50%.

The last budget has proposed levying 12% service tax on rental payments, which is likely to adversely affect the retailers who are already battling escalating rentals. This proposal is being disputed and the hearing on the same is expected soon.

Improperly developed malls

Several industry players who attended the National Retail Summit were of the view that quite a large percentage of malls, already developed or under construction, are not designed keeping in mind the requirements of modern retail formats.

Quite a few of the malls are developed with the idea of selling off the retail space, rather than managing it on a long-term basis. In most cases, the space is sold to the highest bidder without paying much heed to the mix of retailers who will occupy the mall. As a result, there is a fair possibility that such malls may not become destinations of choice because of poor retailer mix.

With the passage of time, there is a good chance that the customer tastes and preferences also change. However, since the ownership of retail space in such malls is with several parties, changing the retailer mix to suit customers' requirements becomes a difficult task. As a result, such malls can fall out of favour with the customers.

In several developed markets, the developer leases the mall space on long-term contracts rather than selling the space upfront. At regular intervals, the developer reviews the tenancy mix to weed out retailers that are not able to attract good footfalls. This helps the long-term sustainability of the mall. The scenario, as discussed above, is however quite different in India with the concept of mall management not having caught up.

Most of the mall developers do not follow a scientific method of selecting the retailer mix before the construction begins. As a result, the level of utilities available in such malls may be far lower than what is required by the traffic generated by the retailers in these malls, resulting in severe pressure on the mall infrastructure.

On the basis of the above-mentioned factors, several industry observers are of the view that quite a few of the malls being developed will come up for re-development in 5-6 years, as they may not be able to keep up with the changing consumer tastes and preferences.

Underdeveloped supply chain

Efficiencies in supply chain will determine which retailers will succeed in the long term; in view of this, it looks like that the bigger companies that have more financial muscle to make significant investments will have a distinct competitive edge. The supply chain infrastructure in India is however still quite underdeveloped.

There has been a lack of any meaningful investments by the existing retailers in developing robust and scalable supply chain. Retailers of food and groceries have not yet invested enough in setting up a cold chain system; hence, there is enormous wastage. Moreover, there is a very low level of automation in the supply chain and point of sale systems. There is little real-time link between suppliers, warehouses, and retail stores. This results in cost inefficiencies in the system, leading to increased delays and shortages.

The other reason for underdeveloped supply chain is the inconsistency in tax regime among states. Non-uniform VAT regime, multiple points of taxation, and taxes like octroi, and entry tax in some states prevent development of optimal supply chain models, acting as deterrents for organised retailing.

Policy and taxation hurdles

India suffers from several policy and taxation hurdles. If these issues are addressed effectively, modern retailing could grow significantly.

The government has still not granted industry status to retail. This makes financing from banks difficult, resulting in high interest rates, which ultimately pushes up capital costs.

Approximately 37-45 licenses are required to start a retail operation. This causes considerable delay in starting a new store operation.

Inconsistent agriculture and fertilizer subsidies by states lead to price anomalies and variation for the same product, thereby leading to supply chain inefficiencies.

The government has only allowed 51% FDI in retail and that too in single brand retail. Further, talks to bring in FDI in multi-brand retail have met with severe opposition. These factors have restricted the entry of foreign retailers into the country, who could have otherwise significantly contributed in improving the supply chain and level of technology usage in the sector.

Inadequate human resources

The retail industry is manpower intensive. Countries with high penetration of modern retail employ 10-12% of their workforce in retailing. Given India's large working population, the issue is not shortage of manpower, but competency gaps that exist because of absence of vocational training facilities for the organised retail sector. Most industry players feel that there is a significant shortfall of resources trained in retail specific skills sets, including supply chain management, merchandising, vendor management, facilities management, customer relations, and branding. This has resulted in high attrition rates and rising people expenses, hindering aggressive ramp-up of most retailers.

Protests against organised retailers

In the past few months, there have been protests in Uttar Pradesh, and the communist-ruled Kerala and West Bengal, including violent demonstrations last September that forced Reliance Fresh, the food stores arm of Reliance Retail, to shut their shops and lay off staff.

Thousands of traders, hawkers, farmers, and workers are protesting against the entry of large domestic corporations like Reliance, Spencer's, and foreign players like Wal-Mart into the retailing space. These protests are on the back of the belief that the entry of the corporations into the retail sector will negatively impact the livelihood of the intermediaries and the traders, who form a large share of the society currently. These protestors are demanding a national policy that is agreeable to all the stakeholders including small traders, shopkeepers, wholesalers, and vendors be put in place, since retail is the second-largest employer in the country and the livelihoods of 40 mn people are likely to be affected if the entry of big players is allowed at such an alarming pace.

On the back of these protests, the government has deferred the proposal to allow FDI in multi-brand retail till a study is made to ascertain the impact on traditional retailers by the growth of organised retail. In case of any adverse decision on this front, the growth plans of organised retailers will be severely hampered. The impact will be pronounced in the food and grocery space, as most of the players are targeting this segment.

PANTALOON RETAIL INDIA

INR 557

Big getting bigger

BUY

Edelweiss
Ideas create, values protect

February 15, 2008

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India's leading retailer with proven execution track record

Pantaloon Retail India (PRIL) is India's largest retailer with over 6.5 mn sq ft of retail space under a range of formats. Over the past five years, the company's retail space has expanded 14x and revenues have grown at a CAGR of 63%.

Presence across consumption categories captures larger wallet share

PRIL has established strong presence across multiple consumption categories in a bid to capture maximum consumer wallet share. It has widened its format offerings from a single format *Pantaloons* to over 15 formats which capture almost 75% of the consumption basket.

Aggressive expansion plan to drive growth; 56% CAGR in retail space

We expect the company to operate 8.6 mn sq ft of retail space by FY08E, 12.5 mn sq ft by FY09E, and 18.8 mn sq ft by FY10E at a standalone level. We expect this space addition to drive revenue CAGR of 62% over FY07-10E.

Successfully leveraging retail platform to diversify into ancillary businesses

PRIL has successfully incubated allied businesses derived from the retail business or support the core business. It has incorporated subsidiaries like Future Media, Future Logistics, Future Bazaar, Future Capital Holding (FCH), Future Ventures, and Future Knowledge Services, whose business models are designed to capitalize on the 30 mn sq ft of retail space that PRIL will have by FY12E.

Outlook and valuations: 26.5% upside at SOTP of INR 704; initiating with `BUY'

We have valued PRIL on an SOTP basis at INR 120.5 bn to capture value from its subsidiaries. We have valued the retailing businesses using DCF to even out the near term cost escalations and space delays. To value the unlisted subsidiaries, we have used stake sale benchmarks in absence of data regarding their business and growth plans. Future Capital has been valued at current market price of INR 842 with a 30% holding company discount. We believe, PRIL has the ability to create significant value with its large scale of operations and proven execution track record. Adjusting the CMP of INR 557 for the value of subsidiaries, the standalone retailing business trades at 55.0x FY08E EPS of INR 6.5, 35.5x FY09E EPS of INR 10.0, and 23.5x FY10E EPS of INR 15.2. We initiate coverage with a **`BUY'** recommendation.

Reuters	:	PFAS.BO
Bloomberg	:	PF IN

Market Data

52-week range (INR)	:	875 / 365
Share in issue (mn)	:	150.8
M cap (INR bn/USD mn)	:	84.0 / 2,110.8
Avg. Daily Vol. BSE/NSE ('000)	:	229.8

Share Holding Pattern (%)

Promoters	:	43.5
MFs, FIs & Banks	:	12.0
FIIs	:	25.2
Others	:	19.3

Financials

Year to June	FY07	FY08E	FY09E	FY10E
Net revenues (INR mn)	32,367	57,558	89,602	136,608
Growth (%)	*73.2*	*77.8*	*55.7*	*52.5*
EBITDA (INR mn)	2,156	3,862	5,863	9,214
Net profit (INR mn)	1,204	976	1,513	2,591
Shares outstanding (mn)	147	151	151	171
EPS (INR)	4.1	6.5	10.0	15.2
EPS growth (%)	*(13.5)*	*56.0*	*55.0*	*51.0*
P/E (x)	85.8	55.0	35.5	23.5
EV/EBITDA (x)	29.5	20.5	13.5	8.6

Investment Rationale

✻ India's leading retailer with proven execution track record

PRIL is India's largest retailer with over 6.5 mn sq ft of retail space under a range of formats. Over the past five years, the company's retail space has expanded 14x and revenues have grown at a CAGR of 63%. PRIL has made the best of the burgeoning retail opportunity to mark its presence across the length and breadth of the nation, with presence in 48 cities, leading the pack of large domestic retailers. This early entrant strategy has given it a strategic advantage vis-à-vis competition.

Table 1: PRIL has outpaced peers historically in growth

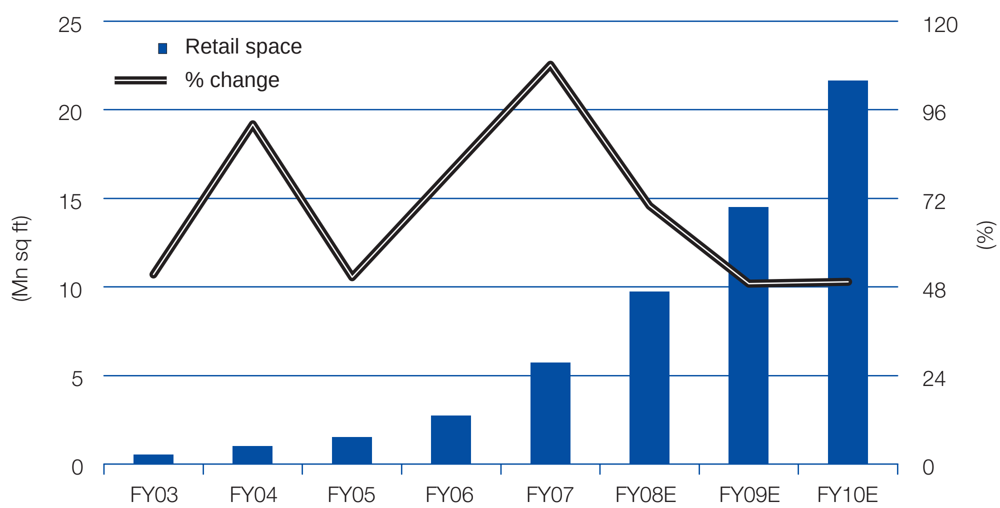
(INR mn)	FY02 revenue	FY07 revenue	5 year CAGR (%)
Pantaloon Retail	2,853	32,367	62.5
Shoppers' Stop	2,462	8,895	29.3
Trent	811	6,006	49.3
Piramyd Retail	325	1,561	36.9
Titan	6,745	21,359	25.9

Source: Edelweiss research

✻ Focus on pace is key success factor

PRIL has always focused on expanding at a fast pace. It has been proactive, both in terms of tying up retail space and rolling out stores, despite developer delays. We reinstate that in the near term, domestic players who capture as much retail space and as much wallet share as possible before the markets are thrown open to global competition will be the biggest beneficiaries.

Chart 1: Fast paced growth likely to drive 53% CAGR in retail space



Source: Edelweiss research

✻ Presence across consumption categories captures larger wallet share

PRIL has established strong presence across multiple consumption categories in a bid to capture maximum consumer wallet share. It has widened its format offerings from the single department store format *Pantaloons* to over 15 formats currently catering to both the value and lifestyle demands of consumers. The company, with its gamut of formats, is well represented in almost 75% of the consumption basket. These formats have been successful and have been instrumental in taking organized retail to the masses.

Table 2: Formats capture close to 75% of consumption basket

Consumption avenues share of organised retail	Food and grocery 17%	Personal care 1%	Apparel 37%	Footwear 9%	Furnishings 6%	Consumer durables 9%	Jewellery & watches 6%	Medical care & health 2%	Recreation 3%	Others 11%
FORMATS	Food Bazaar	Star & Sitara	Pantaloon	Shoe Factory	Collection I	E-zone	Blue Sky	Tulsi	F123	Depot
	Big Bazaar	Star Salon & Sitara	Brand Factory	Pairs	Furniture Bazaar	Electronics Bazaar	Navras		Chamosa	Staples
	Talwalkar's Fit and Active	aLL			Home Town	Home Town			Blue Foods	Marks & Spencers
		Central				Converge M		Sports Bar	GUESS Express	
		Big Bazaar				M Bazaar			Planet Sports	
		Marks & Spencers GUESS								

Source: Company, Edelweiss research

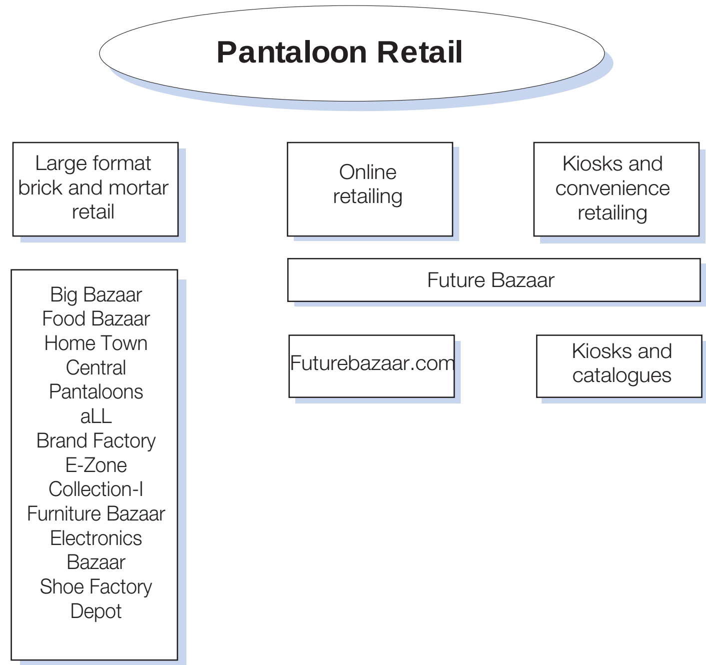
In 2001, PRIL launched *Big Bazaar*, a hypermarket chain, followed by *Food Bazaar*, a supermarket chain, which ushered in the hypermarket culture in India. It subsequently introduced several other formats including *Central* (seamless malls located in city centers), *Collection* I (home improvement products), *Home Town* (complete home decoration and furnishing), *E-Zone* (consumer electronics), *Depot* (books, music, gifts, and stationery), *aLL* (fashion apparel for plus-size individuals), *Shoe Factory* (footwear), and *Blue Sky* (fashion accessories).

Moving beyond brick and mortar to web platform

PRIL has recently launched its e-tailing venture, *futurebazaar.com*. According to industry estimates, the Indian online shopping business is likely to grow by 150% and touch INR 55 bn in FY08 from INR 23 bn in FY07. *futurebazaar.com* has been designed to capture the lion's share of this fast growing market by combining the expertise and wherewithal of PRIL's existing retail businesses with a strong technology backbone for the online platform.

Combining the online portal with catalogue retailing through kiosks located in malls and shopping centers, the format attracted a new set of customers yet untouched by internet access. The format derived close to 60% of its revenue from top six cities and the remaining 40% of the portal's topline was met by nearly 300 cities and towns like Guwahati, Asansol, Rajahmundry, Bhatinda, and Ludhiana.

Fig. 1: PRIL's presence across formats and buying platforms



Source: Company reports, Edelweiss research

✻ Firming up plans for convenience stores; reaching out to the last mile

PRIL is now focusing on rolling out a chain of small discount stores, which will be neighbourhood stores called *KB's Fair Price*, with limited variety and services. The low margins of the stores will be offset by economies of scale and lower costs.

Initially, around 12 of these will open in Delhi. PRIL is also exploring possibilities of joint ventures with foreign partners. Through these discount stores, PRIL could grab business from small stores and retailers, and also take on existing players such as *Subhiksha* and *Reliance Fresh*. These stores will target daily staple buyers, unlike *Big Bazaar/Food Bazaar*, which focus on monthly/weekly and bulk purchases.

✻ 'Kb Wholesale Markets' to capture rural opportunity and establish sourcing model

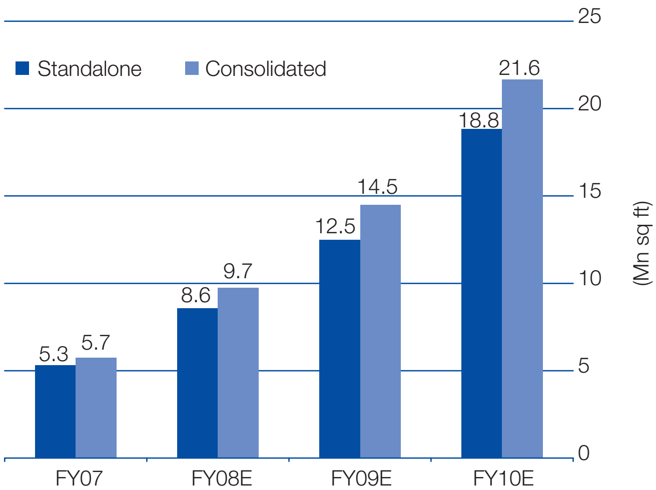
PRIL is considering setting up *KB's Wholesale Markets* in rural areas, to sell a range of items, including fresh fruits and vegetables, to get a foothold in the untapped rural markets. Another advantage of this venture will be the opportunity to source directly from rural areas, which the company has not yet done.

The stores are to be launched by FY08E end and first of these wholesale markets will come up in Burdwan in West Bengal and Mathura in Uttar Pradesh.

✻ Aggressive expansion plan to drive growth; 53% CAGR in retail space

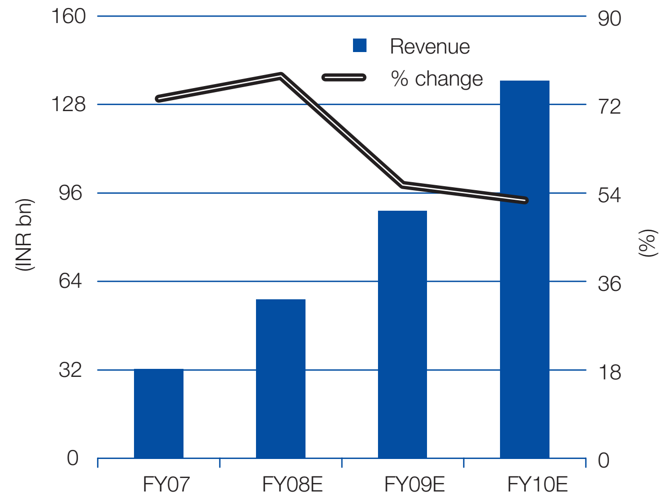
The company has set out an aggressive expansion plan to increase its retail space to 30 mn sq ft by 2010E. Developer delays have led to significant delays to this plan. We expect the company to operate 8.6 mn sq ft of retail space by FY08E, 12.5 mn sq ft by FY09E, and 18.8 mn sq ft by FY10E at a standalone level. The standalone retail business will comprise around 90% of the total retail space added. We expect this space addition to drive revenue CAGR at the standalone level of 62% over FY07-10E.

Chart 2: Strong retail space addition



Source: Edelweiss research

Chart 3: Strong revenue growth at 62% CAGR



Source: Edelweiss research

A large part of this expansion will be dominated by the hypermarket format. We expect the number of *Big Bazaars* to increase from 75 at present to 167 by FY10E and the space under the format to increase from 3.67 mn sq ft to more than 8.7 mn sq ft. *Big Bazaar* will account for close to 42% of PRIL's total standalone retail space in FY10E.

Chart 4: Home Solutions Retail catching up

Source: Edelweiss research

The company also has aggressive plans for its home solutions retail subsidiary. We expect it to operate around 14 *Home Towns* by FY10E amounting to more than 1.1 mn sq ft of retail space. The total area under Home Solutions Retail will increase from 0.4 mn sq ft at present to 2.4 mn sq ft in FY10E.

Strategic advantage: 25 mn sq ft of quality space locked in

PRIL had the foresight to gain control over retail space, one of the key variables which can make or break a company's expansion plan. It has locked in more than 25 mn sq ft of retail space at an average rental of INR 45-50 per sq ft. This is a big advantage for PRIL given that rentals are increasing by over 50% in key retailing locations and by locking in space, the company has secured prime locations in most places. Rentals have a significant bearing on the company's profitability and PRIL enjoys the benefit of lower rentals compared to other retail players. We have, however, assumed some impact of the service tax on rentals. In comparison, Shoppers' Stop's rentals are much higher.

✻ Early entry into nascent markets has created entry barriers for others

PRIL is present at over 48 locations in the country and has made inroads into a number of tier II and II cities where no other retailer has gone. Currently, 52% of its hypermarkets are outside the top 8 cities, giving it a head start in expanding across the country and creating strong brand recall for its format. Going forward, the company plans to take its count of *Big Bazaars* to over 200 from the current 80 and close to 50% of the new stores will be in tier II and III cities.

Benefits of early entry

- Access to best retail locations
- Dominance in the best catchment areas by virtue of early entry
- Best rentals
- More time to understand regional tastes and preferences and hence, serve them better than competition
- Superior tie ups with local suppliers
- Flexibility to launch private labels and nurture them to become national level brands

These advantages have worked as entry barriers for future entrants. In many cities that PRIL has entered early, it has been largely instrumental in developing the shift to organized retail.

Table 3: Wide presence across length and breadth of country

East	North	West	South
Kolkata	Gurgaon	Mumbai	Hyderabad
Bhubaneshwar	Ghaziabad	Pune	Bangalore
Durgapur	Delhi	Nagpur	Secunderabd
Guwahati	Chandigarh	Ahmedabad	Mangalore
Haldia	Ambala	Nashik	Chennai
Vizag	Noida	Sangli	Mysore
Darjeeling	Jaipur	Kolhapur	Coimbatoor
	Panipat	Indore	Palakkad
	Meerut	Rajkot	Thrissur
	Agra	Vadodara	Kochi
	Kanpur	Surat	Trivandrum
	Lucknow	Alwar	Vijayawada
	Allahabad	Anand	Belgaum
		Aurangabad	Hubli

Source: Company

✻ Using JV model to speed up growth and spread risk

PRIL has used the JV route effectively to explore niche and promising consumption segments. We like this strategy and believe it will further add pace to the company's expansion and shorten the learning curve with the venture partner' s expertise in the segment complementing PRIL's execution skills. This model has worked well for the company so far in its ventures with *Liberty, Alpha, Talwalkars, Generali Insurance Company, Staples, Lee Cooper, and Etam*.

Key benefits of JV model

- Opportunity to partner with foreign players as permitted under FDI regulations in retail
- Venture partner's expertise or brand name helps quicker scale up and acceptance
- Reduced learning curve
- Reduced risk of entering a new untested format or segment
- Quicker ramp up with lower capital investment

Table 4: Joint ventures in various segments speeding up growth

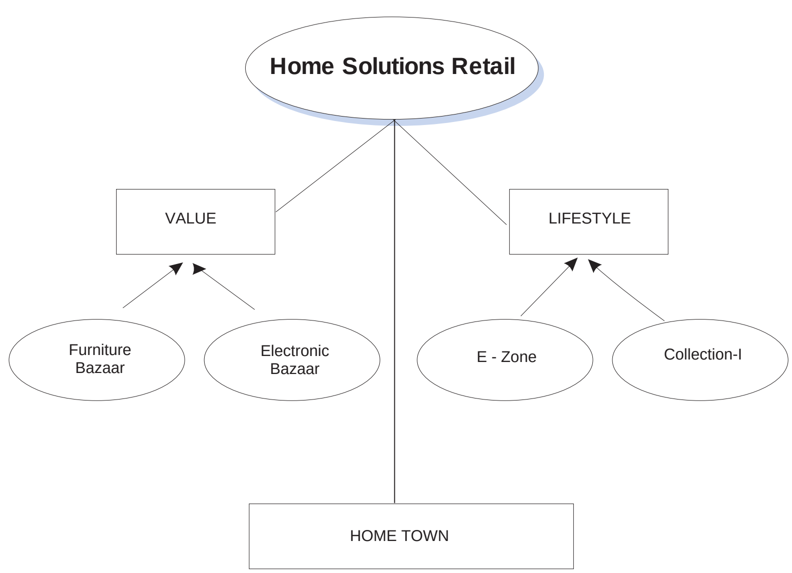
Joint Ventures	Stake (%)	Segment
CIG Infrastructure	51	Public-private participation projects real estate
Footmart Retail	51	Footwear (alliance with Liberty)
Talwalkars	50	Fitness
Pan India Food Solutions	50	Restaurants and out of home dining
Capital Land	50	Retail management services
Galaxy Entertainment	16	Leisure and entertainment: Sports Bar, The Bowling Company
Gupta Infrastructure	19	Infrastructure and mall development
Future Generali India Insurance Company	50	Non-life insurance
Future Generali India Life Insurance Company	50	Life insurance
Alpha Airports	50	Retailing at airports
Staples Future Office products	38	Office equipment and stationery
Axiom Telecom	50	Wholesale distribution of mobile handsets and accessories
Lee Cooper India	50	Market Lee Cooper's demin apparel products and accessories

Source: Company

Home Solutions Retail: Positioned to capture home improvement opportunity

The retail spend on home improvement is expected to grow at 15% CAGR over the next four years, while organized spend on this segment is expected to grow at a CAGR of 44% and account for close to 7% of total organized retail spend. PRIL has presence in the home improvement space through its 80% subsidiary Home Solutions Retail. The subsidiary operates formats like *Home Town, Collection I, e-Zone, Furniture Bazaar, Electronics Bazaar, and Got IT.*

Fig. 2: Formats under Home Solutions Retail



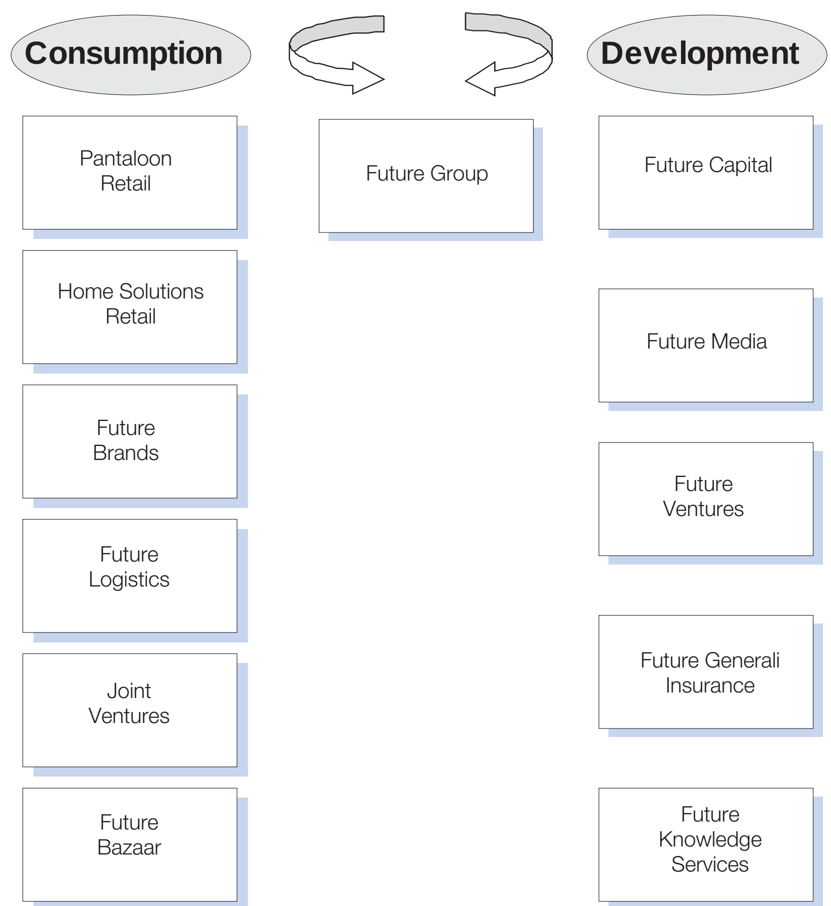
Source: Company, Edelweiss research

Leveraging retail platform to develop attractive gamut of ancillary businesses

With its multiple format model and growing retail space, PRIL is one of the best placed retailers in the country. To capitalize on this advantage, the company has started incubating allied businesses which either derive their origin from the retail business or support the core business. It has incorporated subsidiaries like Future Media, Future Logistics, Future Bazaar, Future Capital Holding (FCH), Future Ventures, and Future Knowledge Services, whose business models are designed to capitalize on the 30 mn sq ft of retail space that PRIL will have by FY12E.

We like PRIL's strategy as it allows the company to effectively leverage its retail platform to diversify into related businesses, which, in the long term, will generate value for shareholders. It will also help the company play a role in driving consumption by supplying capital, brands, visibility, and convenience of shopping.

Fig. 3: The gamut of attractive ancillary businesses



Source: Company, Edelweiss research

We consider the company's effort to develop a gamut of retail and retail-related businesses as a positive and believe these allied businesses will eventually add significant value to the core retailing business by periodic stake sales by the company. This is similar to the strategy of global players like Tesco.

We also view positively the company's efforts to enter allied businesses through its subsidiaries. This structure allows the company the flexibility to raise resources by parting with its stake to strategic investors and also benefit from the expertise of investors.

Subsidiaries to provide value unlocking

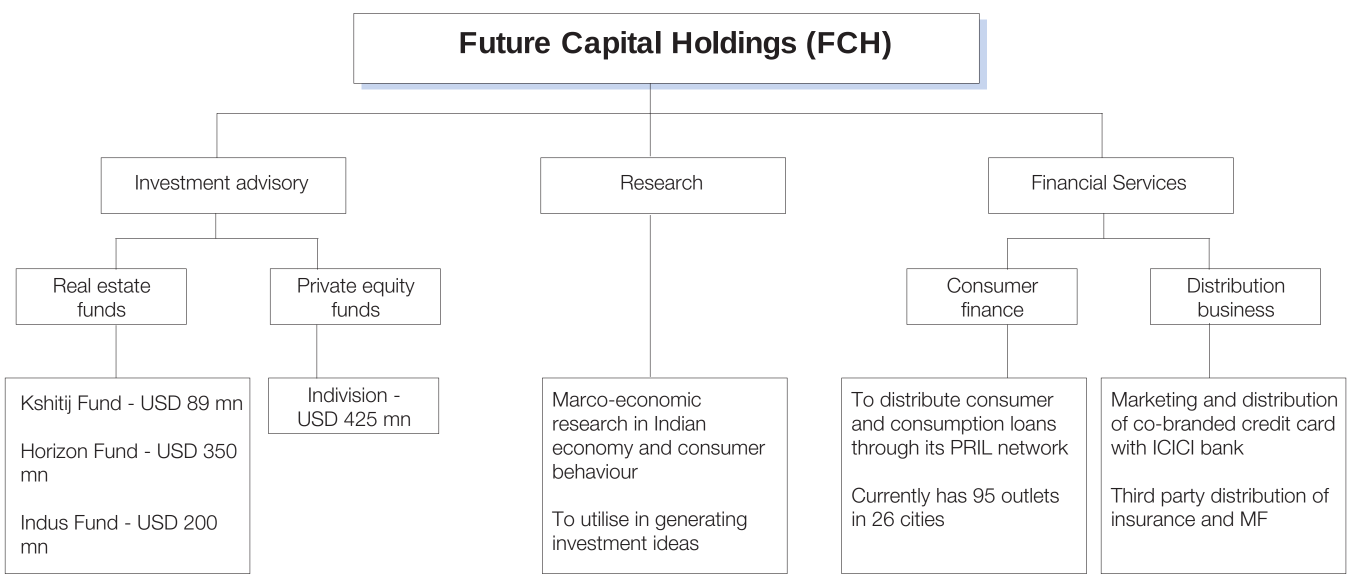
We believe that investments in some key subsidiaries like Future Media, Future Logistics, Future Bazaar, Future Capital, Future Ventures and the retail subsidiary Home Solutions Retail add significant value to PRIL. The company has sold part stake in Future Media, Future Bazaar, and Home Solutions Retail and is looking to list all its subsidiaries eventually, which will result in value unlocking for the company. We expect PRIL to dilute stake and raise capital in Future Ventures and Future Logistics in the near term. Future Capital has already become a listed entity.

We have valued the company's subsidiaries at INR 34 bn which amounts to 28% of the total SOTP value of INR 120 bn. The value of the retailing business including Home Solution Retail stands 95 bn. Hence, despite entry into other businesses, retailing continues to contribute a chunk of the value of the company.

Future Capital Holdings: A play on financial services sector

Future Capital Holdings (FCH), PRIL's financial subsidiary, is currently one of the fastest growing financial services companies in India with asset advisory, retail financial services, and proprietary research as its main lines of business. FCH provides fundamental research which assists the process of value creation for all PRIL businesses and investments.

Fig. 4: Future Capital Holdings structure



Source: Company

- **Asset advisory business manages assets of USD 1.5 bn**

  FCH currently manages over USD 1 bn in its asset management business under its real estate funds Kshitij, Horizon, Indus and private equity fund Indivision.

  Retail real estate funds Kshitij and Horizon

  Kshitij is a INR 3.5 bn fund launched in June 2005 to focus on investing in retail oriented real estate in India. The fund's prime objective is to invest in 'retail' oriented real estate in India and it will focus on developing malls primarily in tier II cities in India. It is expected that Future Group will be the anchor tenant in most Kshitij malls.

  Horizon Fund is a USD 350 mn real estate fund launched in December 2006, which will largely focus on building 'Market Cities' located within city limits. Mumbai, Chennai, and Bangalore have been identified as the main locations for market city developments.

Table 5: Funds advised by FCH

Fund	Launch/Size of the fund	Nature of operation
Real estate		
Kshitij	Launched in Jun 2005 Asset size - USD 89 mn	To develop malls predominantly in Tier II cities Fully committed its fund to develop 4.7 mn sq. ft of retail space - Chennai (1.8 mn), Ahmedabad (0.2 mn) Kolkata (0.4 mn), Kochi (0.4 mn), Vadodara (0.4 mn) Indore (0.3 mn), Jaipur (0.3 mn), Mysore (0.3 mn) Trivandrum (0.3 mn), and Lucknow (0.3 mn)
Horizon	Launched in Dec 2006 Asset size - USD 350 mn	To focus on building 'market cities' in the prime locations of Mumbai, Chennai, Pune, Bangalore, Hyderabad
Indus Hotel	Launched in 2007 Asset size - USD 200 mn	To develop three and four star hotels
Private equity fund		
Indivision	Launched in May 2006 Asset size - USD 425 mn	To invest in high growth companies in retail and consumption led sectors

Source: Company

Hotel sector fund

Indus Hotel Fund was launched in 2007 with the prime focus of investing in three and four star business class hotels. The current size of the fund is USD 200m.

Private equity opportunity

Indivision Fund was formed in May 2006 with the objective of investing in consumer and consumer related industries. The fund currently has USD 425 mn capital. Some of the investments made by the fund include, Capital Foods (manufactures and markets packaged food products, Lilliput Kidswear (marketer and retailer of children's wear, both apparel and footwear), B.E. Bilimoria, VLCC, among others.

Table 6: Investments made by Indivision

Company	% stake acquired	Investment (INR cr)	Nature of operation
Dish TV	4.9	250	India's first direct-to-home entertainment service provider
Lilliput Kidswear	25	~45	Marketing and retailing of children's wear
VLCC	22	~50	One of the leading fitness, beauty and health firms
Sula Wines	20	~50	India's leading premium wine company
BE Billimoria	26	75	Civil engineering construction company
Capital Foods	33	~25-30	Processed food products; Supplier to big retailer like Target
Global Hospitals	25	~125	Hyderabad based super-speciality corporate hospital
Interarch Building Products		~100	Manufacture metal building systems
Biba Apparel		~20	Retailing of ethnic womenswear
Tops Security	~7	~57	Provides security solutions
Faces Cosmetics	~70	~40	Retail outlets offering colour cosmetics and anti-ageing products

Source: Company, Edelweiss research

- **Retail financial services**

  To leverage Future Group's understanding of the retail and consumption-led sectors and PRIL's pan-India distribution network, FCH launched its retail finance offering—consumption loans and personal loans—under the brand *Future Money* in June 2007. The company strives to establish a unique customer-centric retail financing model (against product focused approach followed by banks and financial institutions) by financing its purchases at the site where consumption decisions are made. It will have 'shop-in-shops' outlets or kiosks installed within the present and future malls and retail stores of PRIL and its subsidiaries, accessing a network of 400 stores across more than 40 cities in India and one of the largest client base. It currently has 95 *Future Money* outlets located inside PRIL and subsidiaries in 26 cities across India. It will expand its branch network in other PRIL stores with the money raised through the IPO and plans to add independent stores and kiosks in the future.

Table 7: Loan composition

	Size (INR mn)	Average tenor
Consumption loans	20	12-18 months
Personal loans	40-45	30-36 months
Home equity loans	500-600	6-7 years

Source: Company, Edelweiss research

Launch of Future Money and Future Card

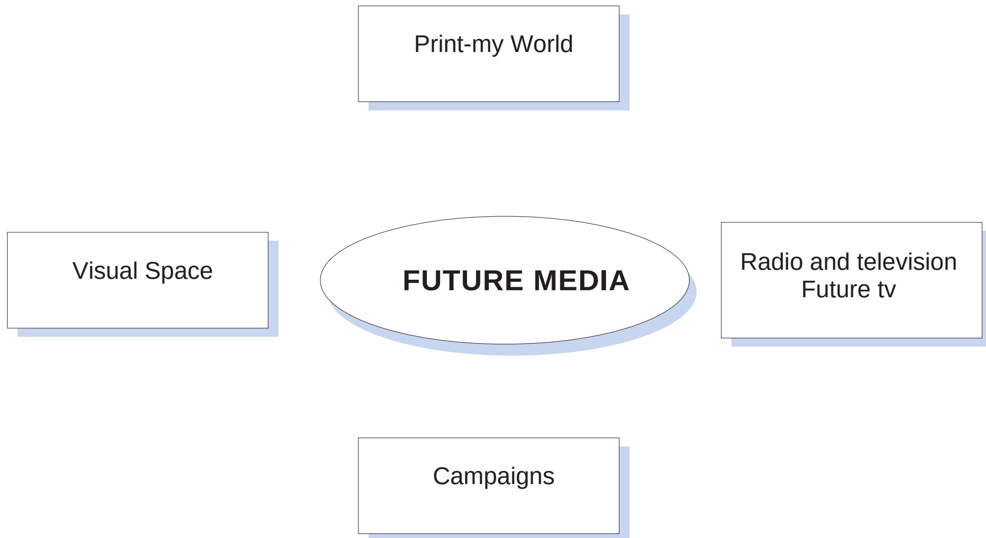
The company has also entered the credit card space through *Future Card* and has inked an agreement with ICICI Bank for marketing and distributing its credit card which offers loyalty points to customers.

Future Media: Positioned to capture value from in-store media space sale

Future Media's business is based on the tenet of being able to address the captive consuming class, while in the consumption frame of mind. Future Media aims to create media properties in the ambience of consumption, wherein the consumer seeks information via media, rather than the other way round.

At present, there are over 400 screens commissioned across *Home Town*, Kshitij Retail destinations, and *Big Bazaar* stores, with plans to install nearly 1,000 such screens in the next few months, across eight cities. The company holds 90% in the subsidiary with a liability to dilute to the extent of USD 20 mn on account of convertibles issued to private equity investors which will mature in 2011E. We estimates PRIL to hold 68% post this dilution.

Fig. 5: Future Media scope of operations



Source: Company, Edelweiss research

- **Visual spaces, print, television, and campaigns used to grab consumer attention**

  PRIL offers relevant engagement through its media properties like *Visual Spaces*, print, radio, television, and activation. *Visual Spaces* basically includes offering advertising space on shopping trolleys, carry bags, elevator doors, standees, danglers, trial rooms, counters, in-store signage, product displays, and facades. FMCG brands, industrial application companies, and leading auto companies are already heavy advertisers on the Future Media network.

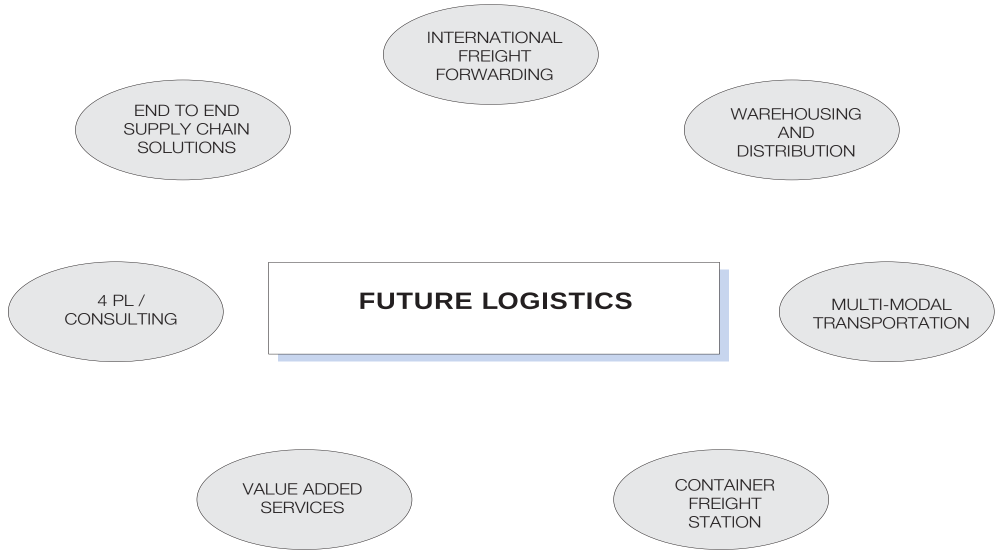
  The company has created media trends with innovative campaigns. Amongst print properties, Future Media offers *My World*, a monthly magazine to select *Big Bazaar* customers.

  Future Media has also launched Future TV, a television network across its retail space. It is the first retailer-owned channel in India, and aims at converting footfalls into eyeballs by engaging the consumer while in consumption mode. Presently aired in Mumbai, Delhi, and Bangalore across Future Group stores, Future TV aims to provide a completely unique audio visual experience in an in-store environment.

Future Logistics - integrating operations

Future Logistics Solutions (FLSL), a wholly owned subsidiary, has been formed to offer a more strategic, focused, and consolidated approach to meet the Group's large captive SCM requirements. Future Logistics begins with an inherent competitive advantage of being the only Indian company which has developed expertise in major consumer and consumption related categories.

Fig. 6: Building an integrated back-end support



Source: Company, Edelweiss research

- **Operations to scale up to 600 trucks from 200 by FY08E**

  The Future Logistics team currently oversees operations of an existing fleet of over 200 dedicated trucks, contracted from established regional and national transport carriers. The company is looking to increase the number of dedicated fleet to about 600 by FY08E. In terms of warehouse space, nearly 2 mn sq ft was operational as on June 30, 2007, consisting one master distribution centre and other regional DCs.

- **Plans to build four mega merchandising hubs and commission 23 warehouses**

  Future Logistics intends to build about four mega merchandising hubs (MMH) of about 250,000 sq ft each, located in each of the four zones over the next one year. Further, about 23 larger warehouses will be commissioned over the next couple of years, spread across nearly 20 locations across India. The total consolidated warehouse space the company intends to have operational by the end of FY08 is about 2.50 mn sq ft, increasing to nearly 7.50 mn sq ft by 2010-11E.

Valuation

We have valued PRIL on an SOTP basis at INR 120.5 bn to capture value from its subsidiaries. We have valued the retailing businesses using DCF to even out the near term cost escalations and space delays. To value the unlisted subsidiaries, we have used stake sale benchmarks in absence of data regarding their business and growth plans. We have valued the listed subsidiary Future Capital at current market price of INR 842 with a 30% holding company discount.

Table 8: Summary of valuation

Division	Value (INR mn)	Prop share (INR mn)	Holding (%)	Value per share (INR)	Method of valuation
Standalone retail	86,105	86,105	100	504	DCF
Home Solutions Retail	11,145	8,916	80	52	DCF
Future Capital	53,033	20,418	55	119	30% holding company discount to CMP of INR 842
Future Media	3,200	2,176	68	13	Stake sale benchmark
Future Bazaar	4,000	2,800	70	16	Stake sale benchmark
Total		**120,415**		**704**	

Source: Edelweiss research

✻ Retailing businesses valued on DCF

We have valued the standalone retailing business (which includes large formats like *Big Bazaar, Food Bazaar, Central, Pantaloons, aLL, Brand Factory*, and *Depot*), and the subsidiary Home Solutions Retail in which PRIL holds 80% (and houses formats like *Home Town, E-Zone, Collection-I, Electronics Bazaar, Furniture Bazaar)* using DCF.

We have used DCF to iron out the near term profitability impact due to the rapid expansion plans of these formats and the near term cost pressures on account of the mismatch between the supply and demand of retail space, labour and vendors coupled with the rush of new entrants. However, in line with the evolution of global markets and the easing out of supply side factors we expect the company to improve its margins and return ratios over the next three to four years. We expect to see a turning point from FY10E onwards with the benefits of investments coming in and margins improving.

Table 9: DCF assumptions

DCF assumptions (%)	PRIL	HSR
Risk free rate	8.0	8.0
Beta	0.9	0.9
Equity premium	5.5	5.5
Cost of equity	13.0	13.0
WACC	11.1	11.1
Terminal growth	4.0	4.0

Source: Edelweiss research

Table 10: Core retail value sensitivity

		Terminal growth				
	504	3.0%	3.5%	4.0%	4.5%	5.0%
WACC	**10.1%**	575	636	707	792	892
	10.6%	487	538	597	665	746
	11.1%	412	455	504	560	625
	11.6%	348	384	425	471	525
	12.1%	291	322	357	396	440

Source: Edelweiss research

Table 11: HSR value sensitivity

		Terminal growth				
	52	3.0%	3.5%	4.0%	4.5%	5.0%
WACC	**10.1%**	50	55	60	66	72
	10.6%	47	51	56	61	68
	11.1%	44	48	52	57	64
	11.6%	40	44	49	54	59
	12.1%	37	41	45	50	56

Source: Edelweiss research

We have used a three stage DCF model with explicit assumptions for the next three years, fading gradually for the next eight years and a terminal growth of 4% thereon from 2020E. Based on this, we have arrived at a value of INR 86.1bn for the standalone retail operations which translates into a per share value of INR 504 on fully diluted equity. At this value the core retail operations will trade at an EV/ sales ratio of 0.6 on FY10E basis and on a P/E basis at 33x FY10E earnings.

For Home Solutions Retail the value arrived at is INR 8.9 bn for PRIL's 80% share which translates into a per share value of INR 52 on fully diluted equity.

* Future Capital valued at CMP of INR 842

We have valued Future Capital at CMP of INR 842 per share which results in a total value of INR 53 bn. PRIL holds 55% in the company post its IPO and we have considered a 30% holding company discount on the same. Hence, PRIL's share in the company is valued at INR 20.4 bn which translates into a per share value of INR 119.

* Future Media and Future Bazaar valued at stake sale benchmarks

We have valued Future Media at INR 3.2 bn after taking into account an impending dilution on account of the conversion of USD 20 mn worth convertibles. We expect PRIL to hold 68% in the subsidiary post that conversion. This translates into a per share value of INR 13.

Future Bazaar, the company's online shopping portal, also has witnessed sale of stake of 30% which has valued the company at INR 4 bn. With a 70% share in the subsidiary, the value of PRIL's stake will stand at INR 16 per share.

* Upsides from stake sales in other subsidiaries

We have, however, not factored in value from some subsidiaries like Future Logistics, Future Generali, Future Ventures, Future Brands, and Future Knowledge, which have the potential to scale up significantly. Additionally, as more clarity emerges on businesses and the subsidiaries attain scale, future stake sales in Future Media and Future Bazaar (which we have now valued on the basis of previous stake sales) could see further upsides. These would offer upsides to our SOTP value.

* Outlook and valuations: 26.5% upside on SOTP: initiating with 'BUY'

We believe, PRIL has the ability to create significant value with its large scale of operations, proven execution track record, and its ability to create a successful ecosystem of allied retail businesses. This is a primary reason for the rich valuation commanded by the company. We have, hence, looked at FY10E numbers for PRIL and its domestic peers with a view to eliminate a large part of the near term cost and competitive pressures. We believe that FY10 will provide a better idea of how the retailing business will pan out.

Adjusting the CMP of INR 557 for the value of subsidiaries, the standalone retailing business trades at 55.0x FY08E EPS of INR 6.5, 35.5x FY09E EPS of INR 10.0, and 23.5x FY10E EPS of INR 15.2.

Key Risks

✻ Store rollout delays

A large number of retailers are facing delays in roll outs due to delays by developers. This is a significant risk and can lead to cost overruns. Additionally, the delays can also lead to capital crunch with a large number of stores bunching up.

✻ Pressure on margins due to competition and cost escalation

With increasing competition, catchment areas are shrinking and the PSFPA's are not scaling up as expected. This impact will be particularly severe in tier II and III cities which usually can accommodate only one large retailer. Coupled with this, the shortage of quality retail space leading to spiraling rentals, underdeveloped supply chain, and rising employee costs, could add to the cost and impact the company's margins.

✻ Slow down in same store sales

The company's same store sales as a whole have been falling steadily due to rising competition. Continued sharp decline in the same in the future will be a risk to the company's growth.

✻ Attrition and key change at managerial level

People are a crucial resource for a fast-paced company like PRIL. Hence, any loss of managerial talent or increase in attrition will be a hurdle in the company's growth plans.

✻ Change in inventory valuation policy may impact profits

PRIL values finished inventory at cost less markup, while other retailers usually value inventory at cost. Any change in the inventory valuation policy due to change in mark ups will impact margins.

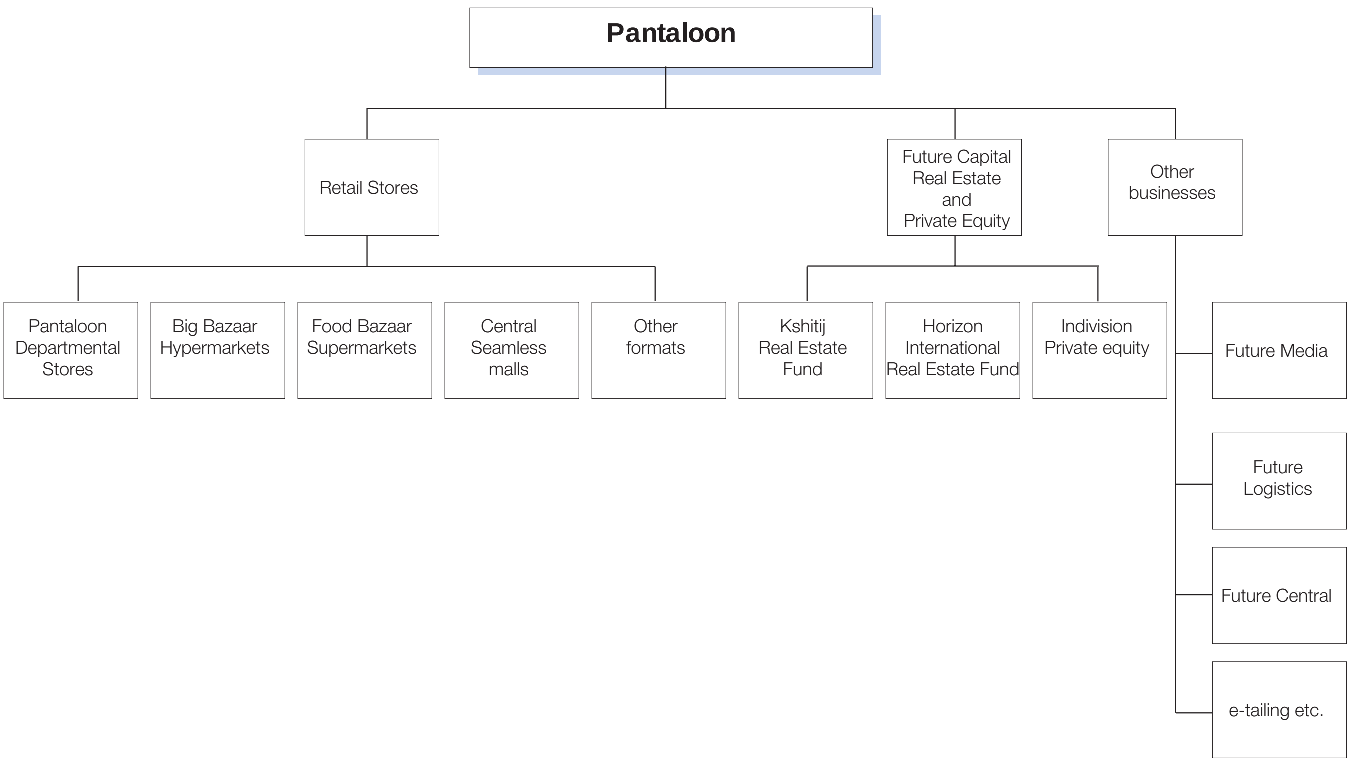
Company Description

PRIL is a leading Indian retail company with presence across most sectors of organized retail. The company, founded in 1987, entered modern retail in 1997 with the opening of its department store format *Pantaloons*.

In 2001, PRIL launched *Big Bazaar*, a hypermarket chain, followed by *Food Bazaar*, a supermarket chain. A five format company, two years back, it now operates over 20 formats which include *Central* (seamless malls located in city centers), *Collection I* (home improvement products), *E-Zone* (consumer electronics), *Depot* (books, music, gifts and stationeries), *aLL* (fashion apparel for plus-size individuals), *Shoe Factory* (footwear), and *Blue Sky* (fashion accessories). It has recently launched its e-tailing venture, *futurebazaar.com*.

The company, currently, operates over 15 formats across 6 mn sq ft of retail space and plans to take its total space under operation to over 30 mn sq ft.

Fig. 7: PRIL group structure



Source: Company , Edelweiss research

Pan-India presence with stores at 48 locations in India

PRIL has pan-India presence with stores in over 48 locations across the country. A key feature of the company's expansion plan is the two-pronged approach which focuses on consolidating its dominant position in the top 8 and tier I cities and simultaneously expanding into tier II and III cities where organized retail is at nascent levels. The company, in FY07, debuted in small towns and cities like Mangalore, Palakkad, in addition to other emerging centres like Surat, Indore, Kanpur, Haldia, Agra, Coimbatore, Jaipur, and Panipat. Currently, over 52% of its hypermarkets are outside the top 8 cities and going forward, the company intends to retain its dominance in tier II and III areas.

Loyalty programme

Green Card, Pantaloon's customer loyalty programme with exclusive privileges, rewards and benefits, had over 585,000 members by FY07 end. The company is working innovative schemes to cater to its loyal customer base. With a combination of the right fashion trend and the right communication through personalities, the company is constantly working at enhancing its loyalty base.

Strong management team driving growth

The key success factor driving the company's growth is its capable management team. The retail industry as a whole has been struggling with high attrition across managerial levels. However, PRIL has ensured that its growth is not deterred by any changes on the personnel front and has ensured that the best team is in place to take the company to the next level of growth. From time to time it has re-worked the company's structure and to ensure best results has now appointed separate CEOs for different formats like *Big Bazaar, Central, Food Bazaar,* etc., to ensure focused growth. The company, which began operations under Mr. Kishore Biyani, is now professionally managed by over eleven divisional CEOs. Mr. Biyani has now withdrawn from day to day management and is involved more at the strategic level.

Table 12: Management bandwidth

Name	Designation	Educational Qualifications	Previous Assignments
Rakesh Biyani	CEO - Retail	Advanced Management Prog.- Harvard Business School Boston, B.Com	On the Board of Pantaloon Retail (India)
Anshuman Singh	CEO - Value Fashion	MBA - Finance, B.E. (Mechanical)	Grasim Industries, H & R Johnson, Bombay Dyeing & Manufacturing,
Arvind Chaudhary	CEO - Food Business	Msc. Dairy Economics, B.Sc. Agriculture (Honours)	Radhakrishna Foodland, General Mills India, Cargill India, Smithkline Beecham Consumer,
Damodar Mall	CEO - Incubation & Innovation	PGDM - IIM Bangalore, B.Tech. - IIT Bombay	Hindustan Lever
Hans Udeshi	CEO - General Merchandising	B.Com. (Honours) DCM Ltd.	Landmark Group U.A.E., Pearl Global, Littlewoods
Hemchandra Javeri	CEO - Home Solutions Retail (India)	IIM - Kolkata	Madura Garments, Nike, Mcdowell and Wipro (Consumer Products)
Kailash Bhatia	CEO - Integrated Merchandising Group		Arvind Mills, Weekender, ColorPlus
Madhumati Lele	CEO - Services	M.Com - Banking and Finance, Sydenham	The Oberoi Group, The Times of India Group, The Taj Group, BPL Mobile and VSNL - India & International
Rajan Malhotra	CEO - Big Bazaar	MBA - Kurukshetra University	Niryat Sam Apparel, Design Connection, Raymonds
Sadashiv Nayak	CEO - Food Bazaar	PGDM - XLRI Jamshedpur, B.E. (E&C) - KREC Surathkal	Hindustan Lever, Asian Paints
Sanjeev Agrawal	CEO - Pantaloons	PGDM - IIM Lucknow, B.Tech. - BHU	Balsara Home Products, Modi Revlon, Procter & Gamble, Godrej Soaps, Hindustan Lever
Krishna Kant Rathi	CFO - Retail Businesses	ACA - ICAI, ACS - ICSI B.Com. - Rajasthan	H&R Johnson, KEC International, Universal Cans & Containers, Bihar Alloys & Steels, Macneil & Mayor
Kruben Moodliar	President- Operations (Value Retailing)	HAND - University of Sussex B.A. (Economics) - University of Capetown	Checkers Shoprite (South Africa), Game Discount World (South Africa), RPG Retail
Ushir Bhatt	Executive Board Member		CISCO, TESCO
Atul Takle	Head - Corporate Communications	M.M.M. (JBIMS)	Accenture, Tata Consultancy Services, RPG Enterprises, Jumbo Electronics Dubai, Indian Express
Prashant Desai	Head - Group IR & New Ventures (PE)	ACA - ICAI - Kolkata CWA - ICWAI - Kolkata	Rare Enterprises, Trisys Comm. United Credit Securities Ltd, C.K. Kothary & Co.

Source: Company

✻ Increasing focus on private labels to improve margins and merchandise mix

Each format of PRIL offers for sale its own range of private labels. The private label is designed considering the clientele and unique product offering of each segment. *Pantaloon* has a host of private labels such as *Bare Denim, Chalk, Honey,* and various others which contribute nearly 70% of its revenues. The company has always remained focused on developing private brands that complement its merchandise and also cater to the regional tastes and preferences of its consumers. This strategy has helped the company improve its gross margins and also manage the other cost pressures on account of rentals and employee expenses.

Table 13: List of private label brands

Categories	Private Labels
Apparel	John Miller, Honey, Bare, Chalk, Akkriti, Annabelle, Mix Match, RIG, Ajile, JM Sports T-2000
Home Appliances	Koryo, Sensei
Home Furnishings	Dreamline, Furnishings, IQIP
Food and Grocery	Farm& Fresh, Fresh & Pure, Premium Harvest, Tasty Treat, Caremate, Cleanmate

Source: Company, CrisInfac

✻ Creation of Future Brands to groom private labels in to national brands

Future Brands has been set up to create valuable brands based on understanding of the Indian consumer's needs. It will leverage the distribution reach and consumer connection forged by the existing retail formats of PRIL as well as enlarge its distribution footprint by reaching consumers across the country. In addition, it will provide cutting edge brand and consumer consulting services to clients outside the company.

Future Brands will be the licensor of select brands under apparel, home products, consumer durables, and food & beverages categories initially to PRIL and thereafter in select cases to other distribution formats outside the company. Future Brands will invest in advertising and brand building activities to enhance the selected brands' equities. To achieve this, its specialist brand teams will add value in areas of product design, merchandising, packaging, and advertising.

To begin with, the key brands in Future Brands' current portfolio include *Dreamline, DJ&C, Bare, John Miller, Buffalo, Lombard, RIG, Tasty Treat*, and *Fresh & Pure*. It aims to build sharp positioning differentiation for its brands.

✻ Creation of LoBs to focus on operational efficiencies

To augment its retail front-end team, the company has created LoBs in the most critical businesses—food, fashion, and general merchandise. These business units will focus on introducing operating efficiencies and ensure that back-end measures are taken care of and the right kind of merchandise reaches stores in the best possible time and at the right price.

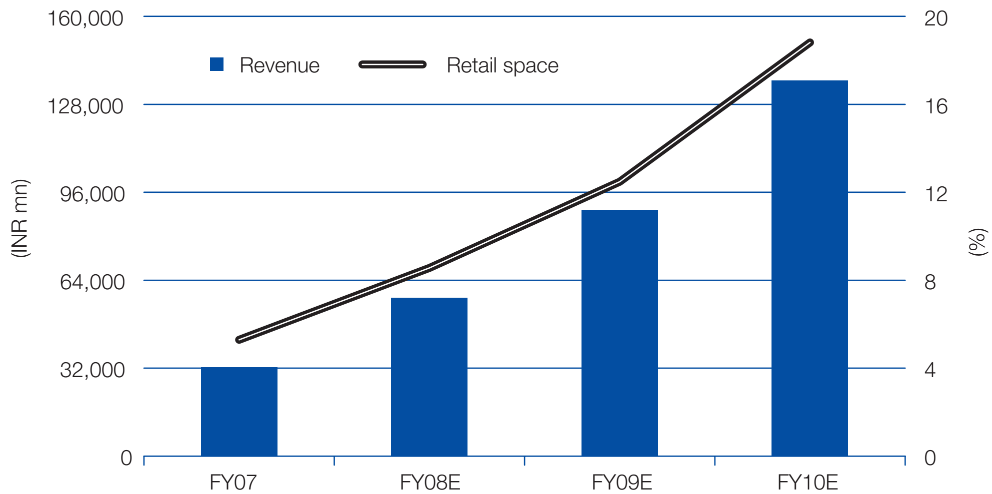
They will focus on product consolidation and suitability, margin improvement, and vendor rationalization, thereby ensuring sourcing benefits are made available to the front-end team.

Financial Outlook

Strong 62% revenue CAGR (FY07-10E) likely on back of space addition

We expect PRIL to post strong revenue CAGR of 62% (FY07-10E) to INR 137 bn in FY10E. This will be mainly driven by addition of over 13.5mn sq ft of retail space across its various formats. We expect the company to operate 8.6 mn sq ft of retail space in FY08E, 12.5 mn sq ft in FY09E, and 18.8 mn sq ft in FY10E at a standalone level. Accounting for developer delays, we have estimated the company's targeted 30 mn sq ft of retail space to come on stream by FY12.

Chart 5: Revenue growth driven by space addition

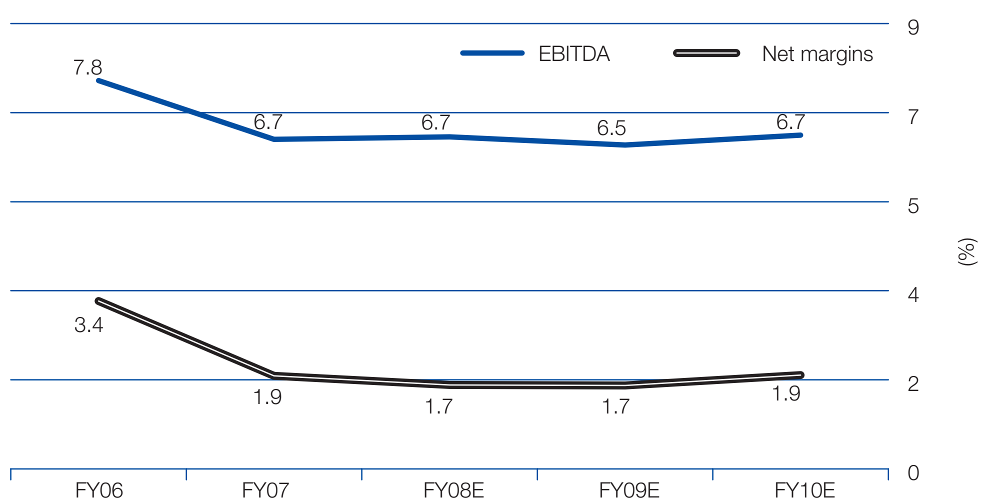


Source: Edelweiss research

Margin pressure likely to ease from FY10E

The company's margins have been under pressure for the past few years on account of mounting operating cost pressures. The key margin dampeners have been rentals, personnel costs, and advertising expenses. The cost of goods sold has also been increasing, which we believe is because increasing share of relatively lower margin goods like electronics and furniture in the product mix.

Chart 6: EBITDA and net margin improvement from FY10E



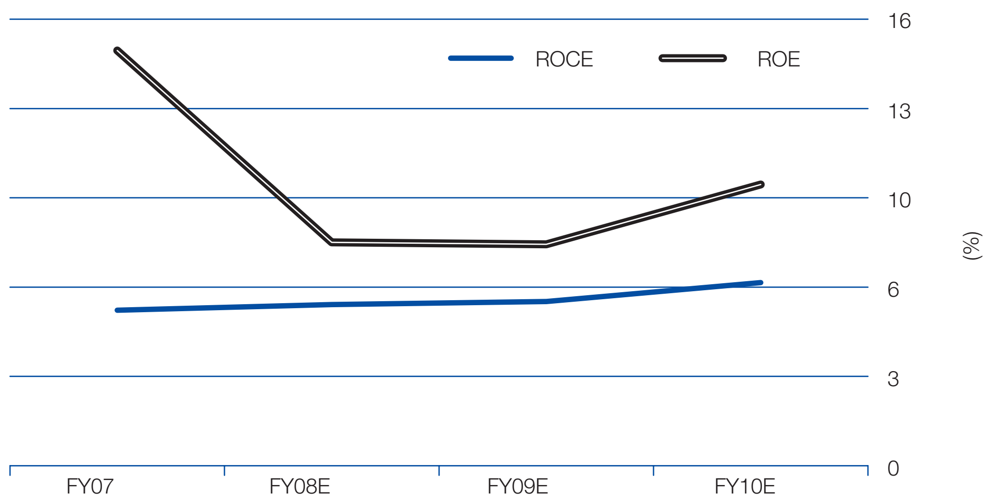
Source: Edelweiss research

The company's EBITDA margins have steadily declined from 8.6% in FY05 to 6.7% in FY07. We expect the pressure on margins to continue till FY09E, after which we expect it to ease due to benefits accruing from investments in systems, increased supply of space, investments in supply chain, and efficient supplier network. We expect margins to improve post FY09E. In the first half FY08 the company has posted healthy improvement in EBITDA margins at 8.1%, however, since space addition in the second half is significant and the second half typically has large discount sales we have been conservative in our margin assumption.

✻ Return ratios to improve in FY10E

PRIL's return ratios have been depressed on the back of falling margins and PSFPAs, fast-paced expansion, and equity dilutions. However, going forward, we expect margins to recover and coupled with improving PSFPAs they will drive the company's return ratios.

Chart 7: Return ratios to improve from FY10E



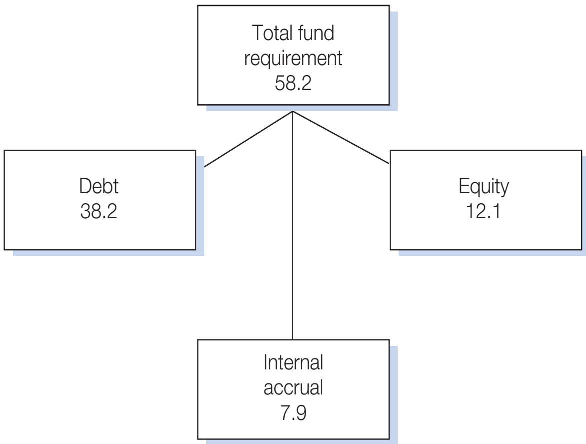
Source: Edelweiss research

✻ Total capex requirement of INR 58 bn over FY07-10E

We have estimated PRIL's total capex requirement to be around INR 58 bn with INR 21.6 bn towards fittings and furniture for setting up of stores, and INR 36.5 bn will be the working capital requirement. We have assumed a cost of INR 1,600 per sq ft for fittings and furniture and expect the company to maintain working capital at around INR 1,600 per sq ft going forward, against INR 1,400 in FY07 considering the possibility of inventory pile up due to slow ramp up in some of the new ventures.

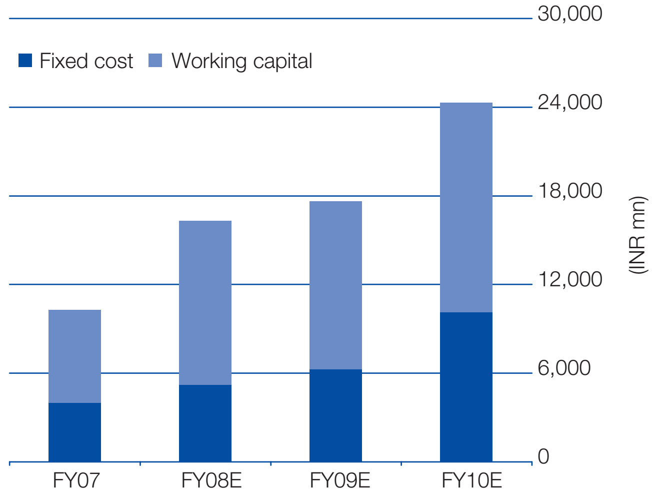
The company has recently issued 4 mn equity shares and 20.2 mn warrants to fund part of this expansion, which will bring in INR 12 bn.

Fig. 8: Expansion plan and funding requirements (INR bn)



Source: Edelweiss research

Chart 8: Capex requirement



Source: Edelweiss research

Financial Statements

Income statement (INR mn)

Year to June	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	18,690	32,367	57,558	89,602	136,608
Cost of goods sold	12,434	22,095	38,946	60,649	92,467
Rent and Lease expenses	1,145	2,070	3,741	5,914	9,016
Electricity Expenses	374	615	1,202	1,825	2,714
Advertising spend	510	931	1,899	2,867	4,371
Employee expenses	1,121	2,061	3,699	5,843	9,021
SG&A expenses	1,639	2,440	4,209	6,641	9,805
Total expenditure	17,223	30,212	53,696	83,739	127,395
EBITDA	1,467	2,156	3,862	5,863	9,214
Depreciation	208	369	669	1,043	1,576
EBIT	1,258	1,787	3,193	4,820	7,637
Interest	367	893	1,731	2,533	3,691
Other income	20	32	40	40	40
Profit before tax	911	926	1,501	2,328	3,986
Provision for taxation	277	317	526	815	1,395
Recurring profits	634	609	976	1,513	2,591
Extraordinary items	11	595	-	-	-
Profit after tax	645	1,204	976	1,513	2,591
EPS (INR) fully diluted	4.8	4.1	6.5	10.0	15.2
CEPS (INR) fully diluted	6.3	10.7	10.9	17.0	24.4
No. of shares	134.4	146.8	150.8	150.8	171.0
Dividend per share	2.5	2.5	2.5	2.5	2.5
Dividend payout ratio	53.0	60.3	38.6	24.9	16.5

Common size metrics as % of revenues

Year to June	FY06	FY07	FY08E	FY09E	FY10E
Cost of goods sold	66.5	68.3	67.7	67.7	67.7
Rent and Lease expenses	6.1	6.4	6.5	6.6	6.6
Electricity Expenses	2.0	1.9	2.1	2.0	2.0
Advertising spend	2.7	2.9	3.3	3.2	3.2
Employee expenses	6.0	6.4	6.4	6.5	6.6
SG&A expenses	8.8	7.5	7.3	7.4	7.2
EBITDA margin	7.8	6.7	6.7	6.5	6.7
Depreciation	1.1	1.1	1.2	1.2	1.2
Interest	2.0	2.8	3.0	2.8	2.7
Net profit margin	3.4	1.9	1.7	1.7	1.9

Growth metrics (%)

Year to June	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	77.5	73.2	77.8	55.7	52.5
EBITDA	61.4	47.0	79.1	51.8	57.1
EBIT	62.3	42.0	78.7	51.0	58.4
Net profit	64.3	(3.9)	60.3	55.0	71.3
EPS	36.7	(13.5)	56.0	55.0	51.0

** consolidated*

Balance sheet (INR mn)

As on 30th June	FY06	FY07	FY08E	FY09E	FY10E
Share capital	269	294	302	342	342
Reserves	5,000	10,628	13,172	24,321	26,431
Shareholders funds	5,269	10,922	13,474	24,663	26,773
Loan funds	6,014	12,996	25,476	30,804	51,210
Deferred tax	279	558	558	558	558
Sources of funds	**11,562**	**24,476**	**39,508**	**56,025**	**78,541**
Gross assets	3,660	7,671	12,899	19,167	29,295
Less: depreciation	566	925	1,594	2,637	4,213
Net fixed assets	3,094	6,746	11,305	16,530	25,081
Capital WIP	861	1,311	2,194	2,026	2,026
Investments	1,406	2,520	2,520	2,520	2,520
Current assets	8,824	17,495	27,757	41,596	59,048
Debtors	170	652	1,104	1,718	2,620
Inventory	5,070	8,860	14,974	23,471	35,853
Cash & bank balance	218	1,630	153	264	68
Advances	3,355	6,339	11,512	16,128	20,491
Other current assets	11	15	15	15	15
Current liabilities	2,623	3,596	4,268	6,646	10,133
Creditors	2,298	3,439	4,268	6,646	10,133
Provisions	325	157	-	-	-
Working capital	6,201	13,899	23,489	34,950	48,914
Uses of funds	**11,562**	**24,476**	**39,508**	**56,025**	**78,541**
BV (INR)	39.8	74.4	89.4	163.6	156.6

Cash flow statement (INR mn)

Year to June	FY06	FY07	FY08E	FY09E	FY10E
Cash flow from operations	1,476	2,181	3,862	5,863	9,214
Cash for working capital	(2,349)	(4,900)	(11,593)	(12,165)	(15,555)
Net operating cash flow (A)	(873)	(2,719)	(7,731)	(6,301)	(6,342)
Net purchase of fixed assets	(2,078)	(4,679)	(6,111)	(6,100)	(10,128)
Net purchase of investments	(2,266)	(1,738)	40	40	40
Net cash flow from investing (B)	(4,345)	(6,417)	(6,071)	(6,060)	(10,088)
Proceeds from LTB/STB	2,784	6,084	10,749	2,795	16,715
Proceeds from issue of share capital	2,498	4,540	2,000	10,100	-
Dividend payments	(63)	(77)	(424)	(424)	(481)
Net cash flow from financing	5,220	10,548	12,325	12,471	16,234
Free cash flow	**(5,217)**	**(9,136)**	**(13,801)**	**(12,361)**	**(16,430)**

Ratios

Year to June	FY06	FY07	FY08E	FY09E	FY10E
ROE (%)	17.2	14.9	8.0	7.9	10.1
ROCE (%)	8.4	5.6	5.8	5.9	6.6
Debtor days	3	7	7	7	7
Inventory days	149	146	140	141	136
Fixed assets t/o (x)	4.7	4.0	4.3	4.8	5.0
Net debt/Equity	1.2	1.1	1.9	1.3	1.9
Interest coverage (x)	3.4	2.0	1.8	1.9	2.1

Valuation parameters

Year to June	FY06	FY07	FY08E	FY09E	FY10E
EPS (diluted) (INR)	4.8	4.1	6.5	10.0	15.2
Y-o-Y growth (%)	*36.7*	*(13.5)*	*56.0*	*55.0*	*51.0*
CEPS (INR)	6.3	10.7	10.9	17.0	24.4
Y-o-Y growth (%)	*34.4*	*68.8*	*1.8*	*55.4*	*43.8*
P/E (x)	75.5	85.8	55.0	35.5	23.5
EV/Sales (x)	4.3	2.0	1.4	0.9	0.6
EV/EBITDA (x)	55.0	29.5	20.5	13.5	8.6

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SHOPPERS' STOP

INR 398

Edelweiss
Ideas create, values protect

Beginner's edge

ACCUMULATE

February 15, 2008

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Leading focused department store retailer in India

Shoppers' Stop (SSL), since inception, has focused on the luxury segment and has assiduously positioned itself as a retailer of superior quality products and services, offering an international shopping experience. This strong positioning and brand recall gives the company a strategic advantage in the light of increasing competition.

Presence in high opportunity segments through its bouquet of specialty stores

SSL has presence in high opportunity segments like home improvement through *Home Stop,* infant and mothers to be care through *Mothercare; (a franchise with Mother care PLC),* cosmetics and beauty care through *MAC and Clinique (a retail agreement with Estee Lauder), and Arcelia,* the books and music space through *Crossword,* fast food through *Cafe Bistro* and *Desi café* and in airport retailing through a JV with Nuance from Switzerland.

Embedded value in option of picking up 51% stake in HyperCity

SSL has the option to acquire 51% in HyperCity, a hypermarket venture promoted by a group company, by December 31, 2008, at an agreed amount of cost +10% or market value, whichever is lower. SSL has already acquired 19% in HyperCity for a consideration of INR 2 mn towards share capital. HyperCity has announced plans to set up 20 hypermarkets over the next three to four years.

Expansion plan to take total area under operations to over 3.4 mn sq ft

We expect SSL to operate 1.5 mn sq ft by FY08E, 2.0 mn sq ft by FY09E, and 2.9 mn sq ft by FY10E on a standalone basis. At a consolidated level (including 51% of HyperCity) the sq ft under operations will stand at 1.6 mn in FY08E, 2.2mn in FY09E, and 3.4 mn in FY10E. We expect the space addition to drive revenue CAGR of 37% over FY07-10E.

Outlook and valuations: 17% upside on SOTP; initiating with 'ACCUMULATE'

We have valued SSL on sum-of-the-parts (SOTP) basis to capture the value from its option to buy 51% stake in HyperCity. We have valued the retailing businesses of both SSL and HyperCity on a DCF basis to arrive at a total value of INR 16.2 bn, which translates into a value of INR 466per share. We view positively SSL's focus on systems and processes and its constant focus on operating efficiencies despite delay in store rollout. We initiate coverage on the company with an **'ACCUMULATE'** recommendation.

Reuters	:	SHOP.BO
Bloomberg	:	SHOP IN

Market Data

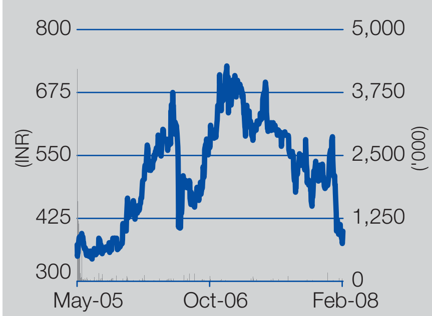
52-week range (INR)	:	703 / 350
Share in issue (mn)	:	34.9
M cap (INR bn/USD mn)	:	13.9 / 348.6
Avg. Daily Vol. BSE/NSE ('000)	:	13.0

Share Holding Pattern (%)

Promoters	:	66.2
MFs, FIs & Banks	:	8.6
FIIs	:	14.9
Others	:	10.3

Financials

Year to March	FY07	FY08E	FY09E	FY10E
Net revenues (INR mn)	8,739	10,910	15,110	22,475
Growth (%)	*28.3*	*24.8*	*38.5*	*48.7*
EBITDA (INR mn)	684	622	919	1,553
Net profit (INR mn)	247	99	125	265
Shares outstanding (mn)	35	35	35	35
EPS (INR)	7.0	2.8	3.6	7.6
EPS growth (%)	*(1.0)*	*(59.4)*	*26.7*	*111.9*
P/E (x)	52.3	128.8	101.7	48.0
EV/EBITDA (x)	19.0	23.0	15.5	9.2



Investment Rationale

✻ Leading focused department store retailer in India

SSL pioneered the departmental store concept in India. Its store count has grown from nine in 2000 to 23 at present and its retail space has expanded from 0.56 mn sq ft to 1.37 mn sq ft. Since inception, SSL has retained its focus on the luxury segment and has assiduously positioned itself to become synonymous with superior quality products, services, and an international shopping experience.

Though many hold the view that this focused approach has significantly slowed down the company's growth, we believe this strong positioning and brand recall gives SSL a strategic advantage in the light of increasing competition.

✻ Judicious mix of private labels and brands provide margin buffer

SSL is positioned as a national lifestyle brand retailer, stocking a wide range of national and international brands. However, it has also developed a host of successful private labels like *Stop, Kashish, Vettorio Fratini, Push and Shove, Life,* and *Elliza Donatein* to complement its merchandise offerings and ensure it has products at varying price points. *Stop* and *Life* are two of its most profitable private labels.

Table 1: Attractive range of national and international brands

Nike	Louis Philippe	Arrow	Corel
Reebok	Levi's	Dockers	Lego
Magppie	Pepe	BIBA	Mattel
Calvein Klein	Carbon	Gini & Jony	Fcuk

Source: CrisInfac, Edelweiss research

Table 2: Well positioned private labels

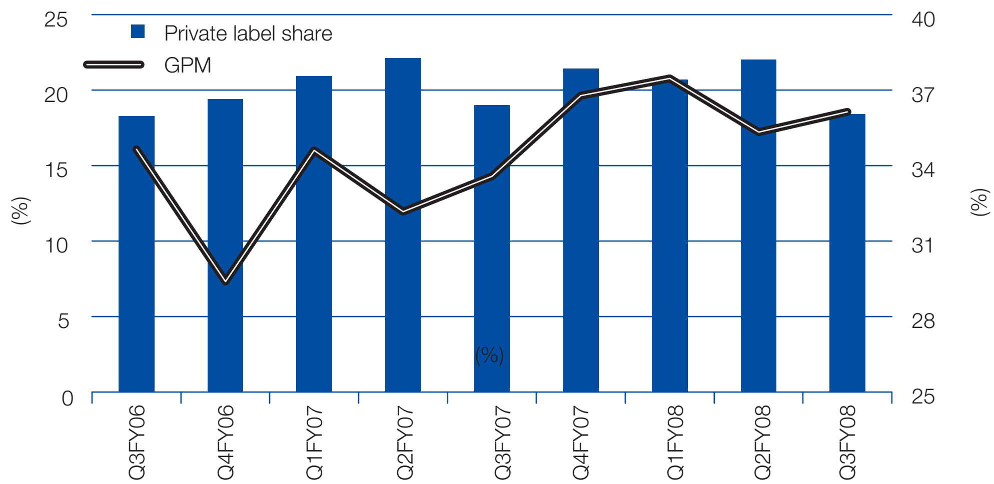
Kashish	Vettorio Fratini
Stop	Push and Shove
Elliza Donatein	Life
Haute Curry	Acropolis
Indi- Visual	I Jeans Wear
Mario Zegnoti	Insense

Source: CrisInfac, Edelweiss research

✻ Well positioned private labels complement merchandise and boost margins

Private labels, additionally, offer a margin buffer to SSL which earns gross margins on these labels in the 40-45% range. This lever can be used effectively to further include lower margin items in the apparel and non-apparel categories without impacting overall margins. During FY07, the contribution of private label has increased to 21% of sales from 19% in the previous year and the company expects their contribution to reach 25% by FY09E. This share is in line with its positioning as a national brand retailer and also its conservative inventory policy as the inventory of private labels will be taken on SSL's books.

Chart 1: Growing share of private labels offering gross margin cushion

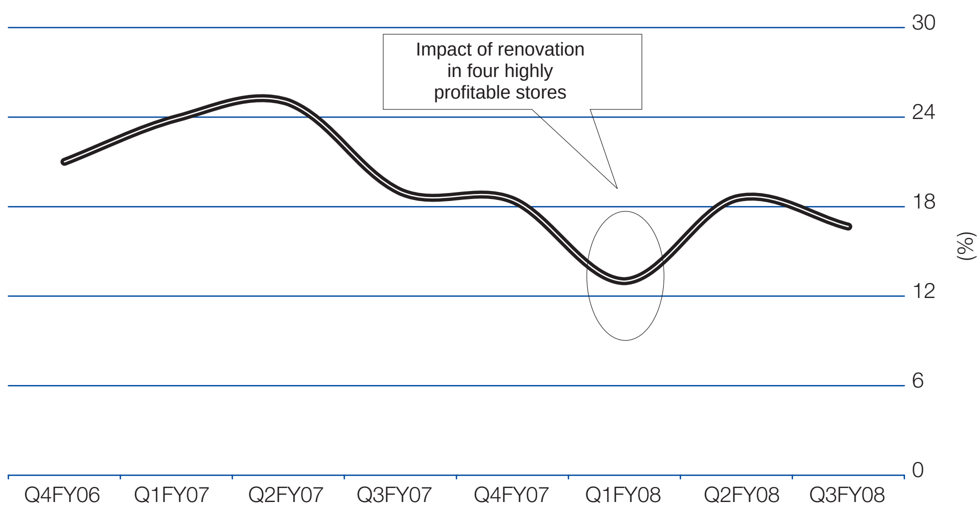


Source: Company, Edelweiss research

Continued double digit same store sales growth a sign of strength and acceptance

SSL has been consistently posting strong same store sales despite increasing competition. We attribute this to the strong positioning of stores, the right merchandise mix, and right selection of catchments. The company is refurbishing its old stores, which caused a slight dip in same store sales in Q1FY08, but the number has recovered in the following quarter. We believe this metric is an important indicator of the company's ability to ensure that its older stores continue to grow. SSL's same store sales stood at 17% in FY06 and have steadily improved every quarter to 21% in FY07 and 20% in H1FY08.

Chart 2: Healthy same store sales

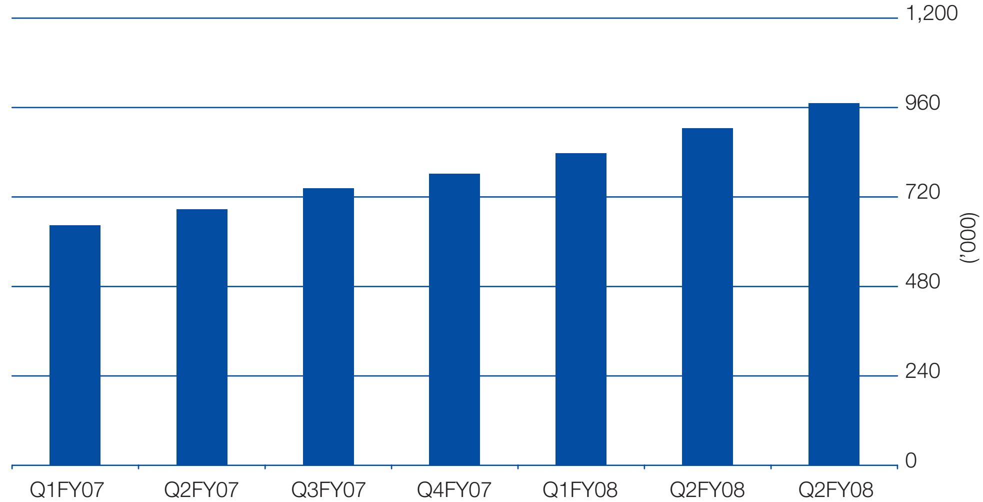


Source: Company, Edelweiss research

Strong loyalty programme

The company pioneered India's first retail loyalty programme *First Citizens,* the member base of which has increased from 632,000 at the beginning of FY07 to 744,000 by December 2006. During FY06, these members contributed 60% of the company's annual sales. Members are offered various benefits such as reward points on their purchases, exclusive schemes, home delivery of altered merchandise, and also access to an exclusive *First Citizens* lounge at select stores to rest after shopping. SSL, in association with Citibank, offers its *First Citizens* an option to add on a credit card to their existing loyalty cards.

Chart 3: Captive set of customers on the rise



Source: Company

This growing number of members is a huge positive for the company as it ensures a secure customer base. Also, on a cash basis, a *First Citizen* customer is more profitable compared to a regular customer as his memo size, on an average, is ~3-4x larger.

Specialty bouquet complements departmental store format

SSL has added a range of specialty stores to its format, offering to broaden its presence in the lifestyle space. These formats attract customers with a pre-defined buying mindset which often leads to impulse sales. Specialty formats are well placed to benefit from spend in niche and underpenetrated segments like accessories, mother and infant care, and high opportunity segments like home improvement, catering, and beauty care.

Table 3: The specialty bouquet

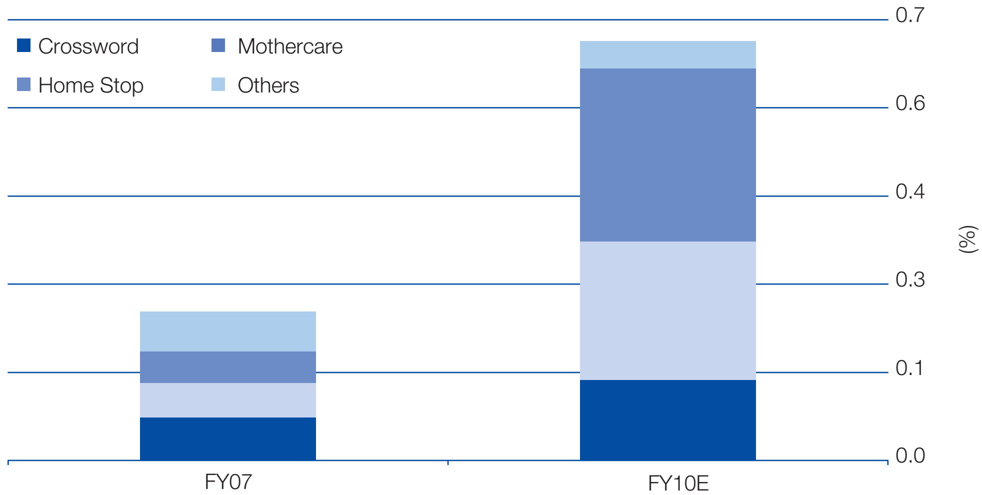
Format	Category catered
Mothercare	Catering to mothers to be, infants, children in the age group of 0-10
M.A.C Clinique	High value cosmetics and skin care
Crossword	Books, music and gifts
Arcelia	Jewellery fashion accesorries, cosmetics, jewellery
Home Stop	Home concept store
Time Zone	Family entertainment
Stop & Go	Domestic airport retailing

Source: Company , Edelweiss research

We like this strategy based on evidence from other markets like China as these stores make better margins in the longer run and are well suited to complement the departmental store model.

SSL has used this format to venture into high opportunity segments like home solutions through *Home Stop,* infant and mothers to be care through *Mothercare,* cosmetics and beauty care through *MAC Clinique and Arcelia,* books and music space through *Crossword,* and the food and beverages space though *Cafe Bistro* and *Desi café.* The company plans to take the space under specialty retail to close to 0.8 mn sq ft from the current 0.2 mn sq ft.

Chart 4: Speciality formats on growth path



Source: Edelweiss research

- **Retail agreements with Estee Lauder and Mothercare**

  SSL, through an exclusive franchise, operates *Mothercare* stores in India under franchise from Mothercare PLC, UK, which is the leading specialist retailer for the mother-to-be and the parents of young children. Over 70% of products sold in India are sourced from global vendors in over 13 countries to ensure consistency of quality with global standards. Currently, SSL operates 11 *Mothercare* stores in leading metros.

  The company has entered into a retail agreement with world-renowned cosmetics major Estee Lauder to open *M.A.C* stores in India. *M.A.C.* is the first brand under the Estee Lauder portfolio to enter the Indian retail market. The first store was opened in 2005 in Mumbai. On the back of the success of the first venture SSL introduced *Clinique* and *Estee Lauder* brands in India this year.

- ***Crossword:* Presence in growing books and music space**

  To enter the growing books and music segment which accounts for 3% of organized retail spend, SSL acquired *Crossword*, a well established player in the books and music space, from ICICI Trusteeship Services. The format currently has over 43 stores across the country with 23 stores operated by SSL as a franchisee and 20 by other franchisees.

  Crosswords has turned profitable in the current year and has presence in about nine cities across the country. It has, over the years, by virtue of early entry and focused brand building, developed good brand recall and currently has over 1,17,000 *Crossword Book Reward* members who contribute to 42% of *Crossword's* business.

- ***Home Stop:* Targeted at attractive home improvement market**

  SSL has launched *Home Stop*, a complete home solution store which offers designs and style, quality, and convenience. It houses some of the most reputed national and international brands under one roof. The home improvement space is expected to see very strong growth over the next few years which will be largely driven by increasing disposable incomes, construction boom, and a conducive interest rate scenario which are promoting ownership of homes. This has led to the home improvement and furnishings space becoming an attractive option for organized retailers.

The retail spend on this segment is expected to grow at 15% over the next four years, while organized spend on this segment is expected to grow at a CAGR of close to 44% and account for close to 7% of total organized retail spend.

- ***Café Brio, Desi Café,*** **and** ***Timezone:*** **A slice of hospitality and recreation**

  The organzied food and beverage space is growing at 30.8%. Coffee retailing, multi-cuisine outlets, and fast food formats are catching the interest of the emerging young consuming population. Coupled with this, the entertainment space is also seeing over 30% growth and the gaming industry in particular has bright prospects.

  SSL ventured into the food & beverages and entertainment spaces with *Brio*—a strategic alliance with Mumbai-based Blue Foods—and by acquiring 45% stake in Timezone Entertainment, which is in the business of operating family entertainment centres (FECs).

  Brio-the Café Bistro has been designed to be a warm and friendly place to relax, revive, and reflect. It has a classic yet sophisticated ambience, friendly service, and excellent food. It has 16 outlets in select cities. The company is also currently running an Indian fast food concept in Mumbai *Desi Café.* It currently operates two Desi café outlets in Mumbai.

  Timezone is a leading fun family interactive entertainment centre offering up to date and the latest range of attractive and popular interactive games. It is a joint venture with Leisure & Allied Industries (LAI) of Australia. As on March 31, 2007, *Timezone* operated five gaming centres spread across over 35,000 sq ft in Mumbai, Ahmedabad, Kolkata, and Hyderabad with retail space of over 35,000 sq ft.

Entry into airport retailing through JV with Nuance Group

SSL has identified airport retailing as another niche but high opportunity segment. To enter this nascent segment of duty free stores at Indian airports, the company entered into a JV with Nuance from Switzerland. The JV has won the bid for duty free retailing at greenfield airports at Hyderabad (fifth largest airport in India which handled 5.5 mn passengers on an annual basis, out of which just over 1.1 mn travelled internationally), and Bangalore(fourth largest airport in India which handled 7 mn passengers, out of which 1 mn travelled internationally). The JV will operate stores at the international airport and SSL will operate duty paid stores at domestic terminals.

We expect the first stores from this venture to come in by FY09. The company expects USD 150 mn revenues form the Bangalore airport over five years and will operate a total of five stores, covering approximately 20,000 sq ft, including a 4,500 sq ft arrival store. SSL expects USD 170 mn revenue from the Hyderabad airport over seven years covering approximately 25,000 sq ft

Embedded value in option of picking up 51% stake in HyperCity

SSL has the option to acquire 51% in HyperCity by December 31, 2008, at an agreed amount of cost +10% or market value, whichever is lower. The venture has been promoted by a group company and SSL has already acquired 19% in it for a consideration of INR 2 mn towards share capital.

HyperCity recorded revenues of INR 376 mn in FY07 with eleven months of operation and for the first half of the current year has posted revenue of INR 725 mn. The PSFPA is fairly consistent at INR 13,500 per sq ft. and the store has broken even in the first year of operations. We expect that the management to take the total number of HyperCity stores to 12 by FY12E.

The company has put in place exclusive supply agreements with Waitrose, a top supermarket chain in the UK, and Raleigh Cycles for India. As the number of stores grows, we expect the number of tie ups also to grow. We expect HyperCity to become a major growth driver for SSL given the immense scope for the hypermarket segment in India. We have valued HyperCity separately and have ascribed a value 44 per share to every SSL at 51% stake in the venture.

Table 4: *HyperCity*

	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
No. of stores (nos)	1	2	3	6	9	12
Total sq ft (mn)	0.1	0.3	0.4	0.8	1.1	1.5
PSFPA (INR)	10,800	12,000	12,240	12,485	12,734	12,989
Revenue (INR mn)	1,350	2,250	3,825	7,023	11,939	17,048

Source: Edelweiss research

Reaching out to the last mile with convenience stores: Express City

To enhance the scalability of the hypermarket model and cater to the day to day requirements of consumers, SSL is setting up *Express Cities*—convenience stores. It plans to develop a hub and spoke model around its HyperCity stores by setting up E*xpress Cities* which will be fed by the HyperCity. This strategy, we believe, will help SSL capture top-up daily fresh food and necessities shopping of consumers which its big box formats will not be able to capture. The company plans to open *Express Cities* and sell vegetables, fruits, and food items, in more than 50 cities by 2010E.

Entry into catalogue retailing through JV with Argos

In addition to the large sized brick and mortar formats, SSL is entering catalogue retailing to capture larger share of the consumer spend on staples. SSL, along with HyperCity Retail (India) has signed an MoU with The Home Retail Group Plc, UK, to open Argos format stores of catalogue and internet retailing. This venture will have large format stores (display stores with size of 10,000 sq ft) and also smaller stores. This format is likely to scale up by FY09E as HyperCity stores scale up.

An attractive bouquet of formats across consumption categories

SSL's efforts to bring the best global and national brands to the country through formats best placed to cater to the demands of the upper segment of the population have created an attractive bouquet of formats across consumption categories. It has used various avenues available for foreign brands to enter the country like JVs, franchisee agreements, exclusive tie ups effectively and associated with well known global names like *Mothercare, Argos, Nuance, Estee Lauder* to capture the growing opportunity in the niche segments of consumption.

Fig. 1: Attractive bouquet of formats across consumption basket

Categories	Market size (INR bn)	Share (%) 2006	SSL presence
Food and beverages	7,439	62.1	
Personal care	281	2.3	
Apparel	1,135	9.5	
Footwear	138	1.1	
Furnishings & furniture	406	3.4	
Consumer durables & IT*	697	5.8	
Jewellery & watches	1,002	8.3	
Medical care & health services	423	3.5	No presence
Recreation	372	3.1	
Books, music & gifts	107	0.9	
Total	**12,000**	**100**	

Source: India Retail Report 2007, Edelweiss research ** include home appliances & mobiles*

Robust systems and processes resulting in superior operating metrics

In the retail segment, it is important to have the right supplier base and optimal inventory level. SSL has developed strong systems and processes which have helped it grow at a robust pace while maintaining operational efficiency. It made significant investments in building a scalable IT infrastructure, which enables it to efficiently manage the flow of inventory to stores, track sales trends, manage pricing, and provide prompt replenishments.

It implemented an ERP system (JDA Warehouse and Merchandise Management System) way back in 1999, which many of its competitors are in the process of implementing only now.

Key features

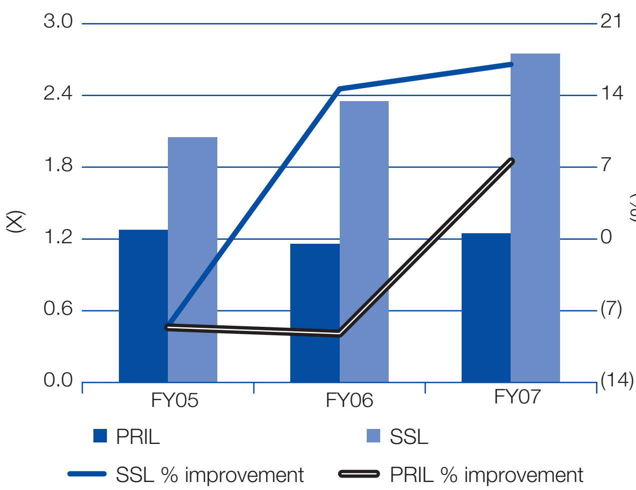
- Auto Purchase order upon drop in predetermined minimum levels
- Auto Replenishment
- Arthur Planning (for forecasting)
- Warehouse Management System
- Perpetual Inventory Control System

It has also put in place a B Connect B with vendors with over 150 partners connected online. To take it a step forward, SSL has also invested in B Connect C online retailing solution from Novator–Canada to collect information from stores to improve their operation and merchandise.

Improving GMROI and GMROF and falling shrinkage

SSL's investments in IT and systems have resulted in superior operating metrics for the company. It performs much better than its peer Pantaloon on key metrics of GMROI and GMROF. It also had one of the lowest shrinkage levels in the industry at 0.5% in FY07.

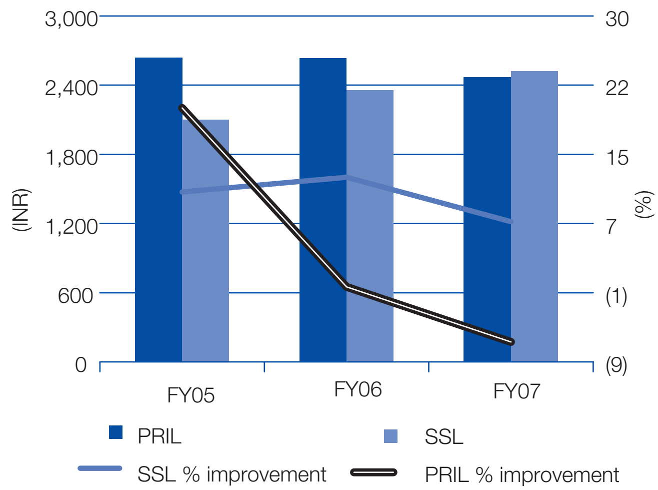
Chart 5: GMROI - Superior to PRIL



Source: Company, Edelweiss research

GMROI: Gross margin return on inventory

Chart 6: GMROF - Higher than peers



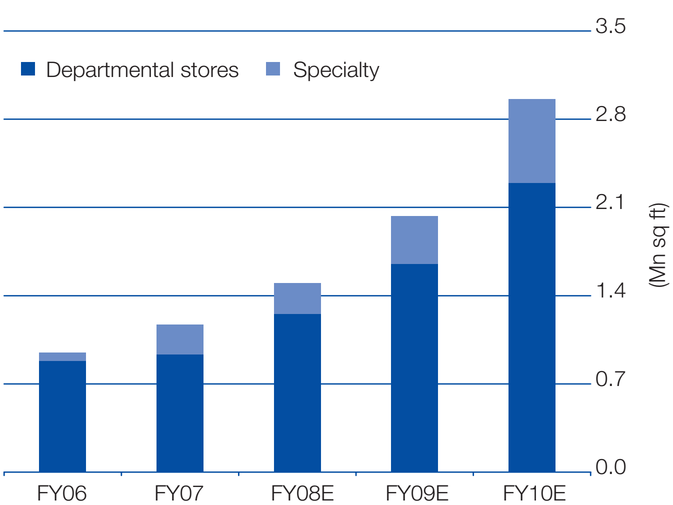
Source: Company, Edelweiss research

GMROF: Gross margin return on square feet

Expansion plan to take total area under operation to over 4 mn sq ft

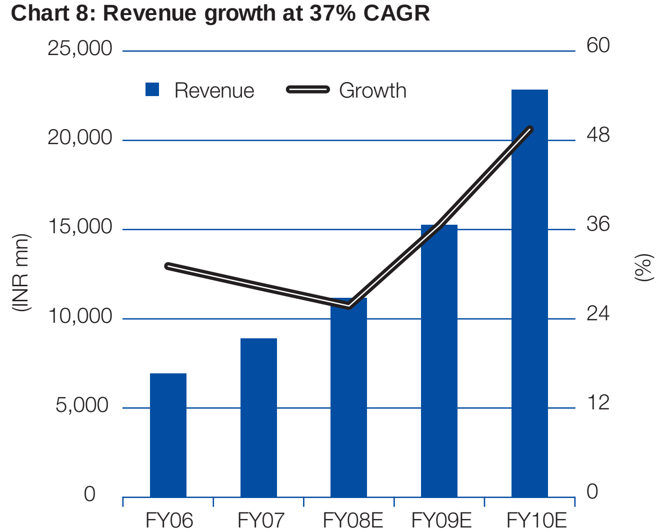
We expect SSL to operate 1.5 mn sq ft by FY08E, 2 mn sq ft by FY09E, and 2.9 mn sq ft by FY10E on a standalone basis. At a consolidated level (including 51% of HyperCity) the sq ft under operations will stand at 1.6 mn in FY08E, 2.2 mn in FY09E, and 3.4 mn in FY10E. We expect the space addition to drive revenue CAGR of 37% over FY07-10E. In the coming two years, we expect store openings to get bunched up due to delay in store openings in the past.

Chart 7: Addition of 1.8 mn sq ft to drive 37% revenue CAGR



Source: Edelweiss research

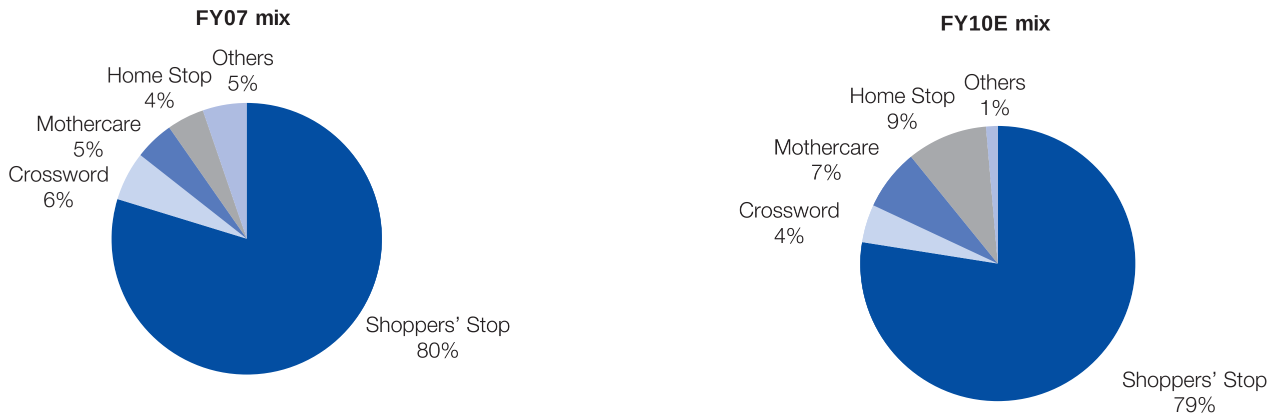
Chart 8: Revenue growth at 37% CAGR



Source: Edelweiss research

A large part of this expansion will be dominated by the department store format, with SSL stores accounting for 76% of the increase in retail space. We expect the number of department stores to increase from 23 at present to 37 by FY10E and the space under the format to increase from 1.2 mn sq ft to more than 2.3 mn sq ft.

Chart 9: Continued dominance of departmental stores



Source: Edelweiss research

Valuation

We have valued the company on SOTP basis at INR 16.2 bn to capture the value from its option to acquire 51% in HyperCity. We have valued both SSL and HyperCity using DCF methodology with appropriate retail space expansion assumptions till FY20E to even out the near term cost escalations and space delays.

Table 5: Summary of valuation

Division	Value (INR mn)	Proportionate share (INR mn)	Holding (%)	Value/share (INR)	Valuation method
Standalone retail	15,101	15,101	100	434	DCF
HyperCity	2,398	1,135	51	32	DCF
Total	**17,499**	**16,236**		**466**	

Source: Edelweiss research

SSL business valued at INR 16.2 bn translating into a value of INR 466 per share

We have valued SSL's retailing business comprising the departmental store format and the specialty stores using DCF methodology. This will work to iron out the near term profitability impact due to the rapid expansion plans of these formats and the near term cost pressures on account of the mismatch between the supply and demand of retail space, labour and vendors coupled with the rush of new entrants.

However, in line with the evolution of global markets and the easing out of supply side factors, we expect the company to improve margins and return ratios over the next three to four years. We expect a turning point from FY10E onwards with benefits of investments coming in and margins improving. We expect SSL's investments in IT and systems to bring in significant operating leverage once the company attains reasonable size over the next two to three years. The benefit of which is aptly captured in the DCF.

51% stake in HyperCity valued at INR 1.1 bn translates to INR 32 per share

We have been conservative in valuing HyperCity given that the venture still operates only one store and addition appears to be facing many delays. SSL has already acquired 19% stake in the company with infusion of INR 2 mn towards equity contribution and INR 90 mn towards loans paid. We expect the venture to operate 12 stores by FY12E

DCF assumptions

We have used a three stage DCF model with explicit assumptions for the next three years, fading gradually for the next eight years and a terminal growth of 3% thereon from 2020E. Based on this, we have arrived at a value of INR 15.1 bn for SSL, which translates into a per share value of INR 434. We have not considered the impact of the impending rights issue. At this value the retail operations of SSL will trade at an EV/sales ratio of 0.65x on FY10E basis.

Similary, for HyperCity we have arrived at a value of INR 1.1 bn for SSL's 51% stake after considering any incremental payment SSL will have to make to acquire the balance 31%. This translates into a value of INR 32 per share of SSL.

Table 6: DCF assumptions

DCF assumptions (%)	SSL	HyperCity
Risk free rate	8.0	8.0
Beta	0.9	0.9
Equity premium	5.5	5.5
Cost of equity	13.0	13.0
WACC	11.2	11.2
Terminal growth	3.0	4.0

Source: Edelweiss research

Table 7: Sensitivity of WACC and terminal growth of SSL

		Terminal growth				
	439	2.0%	2.5%	3.0%	3.5%	4.0%
WACC	10.2%	489	513	541	572	609
	10.7%	443	463	486	512	542
	11.2%	402	419	439	461	486
	11.7%	365	380	396	415	436
	12.2%	332	345	359	375	392

Source: Edelweiss research

Table 8: Sensitivity of WACC and terminal growth for HyperCity

		Terminal growth				
	33	3.0%	3.5%	4.0%	4.5%	5.0%
WACC	10.2%	39	44	49	55	63
	10.7%	32	36	40	45	51
	11.2%	26	29	33	37	42
	11.7%	20	23	26	30	34
	12.2%	16	18	21	24	27

Source: Edelweiss research

✻ Outlook and valuations: 17% upside on SOTP; initiating with 'ACCUMULATE'

SSL has built a strong brand in the department stores space, which we believe will give it a premium over its peers. Its conservative depreciation policy and inventory valuation policies are other comfort factors. We like SSL's focus on systems and processes and believe that it will be best placed to manage huge back ended store addition.

Going forward, we expect the pace of expansion to increase with close to 6 mn sq ft of space tied up and large number of delayed stores expected to come up for delivery by FY09E. We believe delays and near term cost escalation do not bring out the true picture of the company's business and hence, have looked at FY10E numbers. We have been conservative in accounting for further delays, but believe the cost pressure will ease by FY10E and the existing strong same store sales and phased expansion will drive growth.

The stock price has underperformed the benchmark index over the past year and we do not expect too much downside from current levels. Adjusting the CMP of INR 398for the value of HyperCity , SSL is ding at 128x FY08E EPS of INR 2.8, 101x FY09E EPS of INR 3.6, and 48x FY10E EPS of INR 7.6.

Key Risks

Delay in store rollout

A large number of retailers are facing delays in store roll outs due to delays by developers. This is a significant risk and can lead to cost overruns. Additionally, the delays can also lead to capital crunch with a large number of stores bunching up.

Pressure on margins due to competition and cost escalation

With increasing competition, the catchments are shrinking and PSFPA's are not scaling up as expected. This impact will be particularly severe in SSL's tier 1 catchments as more retailers are vying for the same pie and the company's new stores also are coming up in existing catchments. Moreover, shortage of quality retail space leading to spiraling rentals, underdeveloped supply chain, and rising employee costs also add to the cost and could impact the company's margins.

Slow down in same store sales

SSL is currently enjoying double digit same store sales, due to which, despite slow expansion, it has managed to retain margins and post reasonable growth. Any slowdown on this front could impact profitability and growth.

Service tax on rentals

In the last budget, rentals were proposed to be brought under the service tax purview. This is being contested by all retailers, but provisions for the same have been made. If it comes into force, rentals will escalate and further compress margins.

Increase in power costs

Due to power shortage, the state government of Maharashtra has increased power rates which have hit margins of retailers like SSL who have significant presence in Maharashtra. Any further increase will further compress margins.

Company Description

SSL is India's dominant player in the department store segment. It began operations in 1991 as a retailer of men's wear, through a single store in Mumbai. Within a year's time, it added several other product categories such as apparels for women and children and a non-apparels section. Between 1991 and 1999, SSL opened four more stores, taking the total number of stores to five. In the mean time, it had built a wide product offering and robust systems and processes by way of implementation of an ERP system. Post 2000, SSL grew rapidly, adding 14 more *Shoppers' Stop* stores and also added a host of specialty formats to enhance its product mix.

Table 9: Time line of evolution

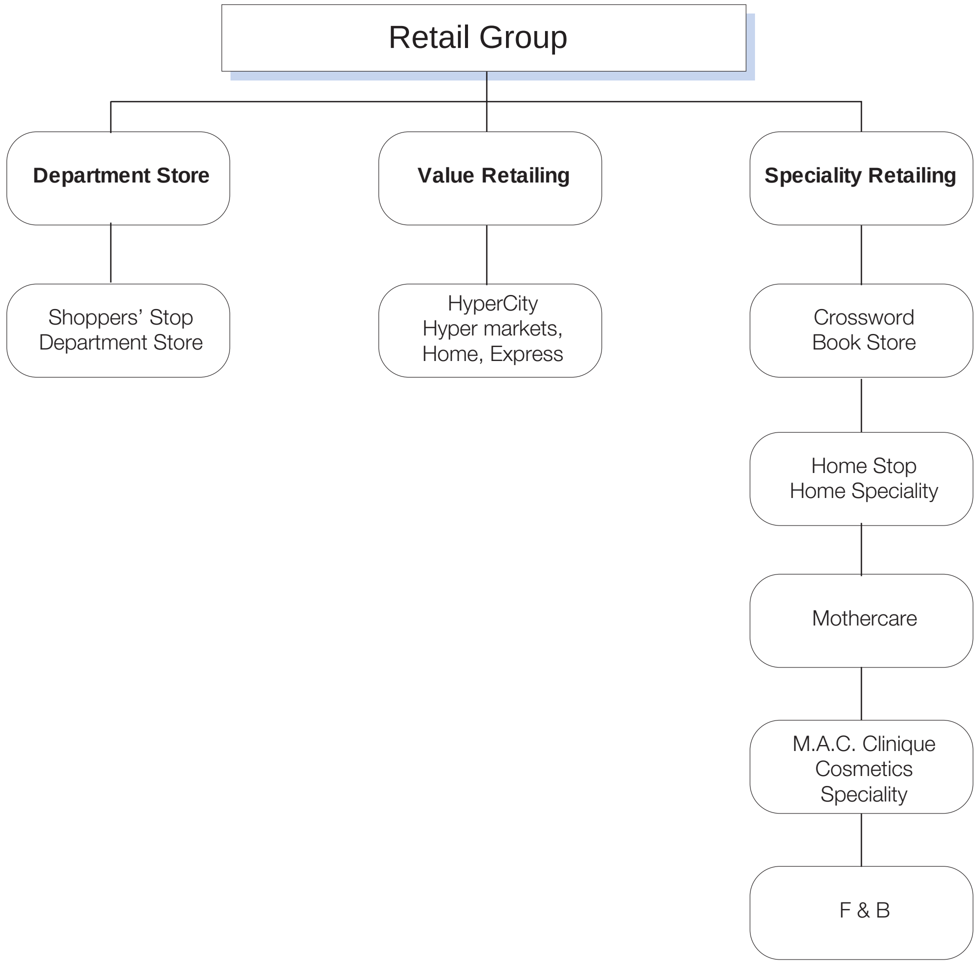
Year	Events
1991	Opened first store at Andheri, in Mumbai, selling only Menswear
1992	Ladieswear was introduced
1993	Added children & non apparels
1994	Loyalty program titled First Citizen was launched
1997	Launched co-branded credit cards for loyalty members in association with HSBC
1999	Implemented JDA Retail ERP (a global leader in retail ERP packages)
2000	Acquired Crossword – India's leading retail book chain
2005	Launched M.A.C & HomeStop – a home store
2006	Launched Mothercare in India and F & B outlets Brio & Desi Café. Bought 45% of Timezone India
2007	Signed a 50:50 joint venture with the Nuance Group for airport retailing signed an MOU with the Home Retail Group of UK to enter into a franchise arrangement for the Argos formats of catalogue & internet retailing

Source: Company

In 2000, the company, to diversify further, ventured into specialty retailing through the acquisition of 51% stake in *Crossword*. Subsequently, in 2005, it acquired the remaining 49% from ICICI Ventures and the company became a 100% subsidiary of SSL. Thereafter, SSL has ventured into several other specialty segments such as home solutions through *Home Stop,* infant care through *Mothercare,* cosmetics through *MAC Clinique,* and also hospitality through its two restaurants *Café Brio* and *Desi Café.* It also has the option to enter the value retailing segment by buying 51% stake in promoter held hypermarket chain, *HyperCity*, by December 2008.

As of FY07, it has 20 Shoppers' Stop stores, two *Home Stop* stores, 11 *Mothercare* stores, one M.A.C. store, 43 *Crossword* stores, 17 F&B outlets, and one hypermarket in the group company, occupying a total of 1.2 mn sq ft.

Fig. 2: Group structure



Source: Company

Management overview

SSL boasts of a strong management team which has led its growth since inception and has helped it build a robust business model. The team encompasses people from varied backgrounds who have brought rich experience from diverse fields such as FMCG, hospitality, textiles, international retailing, and IT. The managing director, Mr. B.S. Nagesh, has been at the helm from the beginning. Rahejas, promoters of SSL, have roots in real estate, construction, and hospitality businesses and they bring in expertise from areas that are closely associated with success of retailing.

Table 10: Management bandwidth

Name & Qualification	Designation/Nature of duties	Qualification
Mr. B S Nagesh	Managing Director	B.Sc., MBA
Mr. C B Navalkar	Group Chief Financial Officer	B.Com, C.A
Mr. C K Nair	Head - Home Division	B.Com., PGDMM
Mr. Devdas C	General Manager - Distribution & Logistics	B.Com
Mr. Dharmendar Jain	Business Head - Finance & Supply Chain	M.Com, A.I.C.W.A
Mr. Govind Shrikhnade	Executive Director & Chief Executive Officer	B.Tech., MBA
Mr. Jayakar Shettigar	Trading Manager	B.Com, PGDBM
Mr. Rajiv Nair	Head - Mothercare	B.Com, MBA
Mr. Salil Nair	Director - Buying & Merchandising	B.Sc, M.Sc
Mr. Sanjay Chakravarti	Sr. General Manager -Finance & Accounts	B.Com, A.C.A
Mr. Shamsundar Kamat	Regional Controller	B.E, MMS
Mr. Siddharthan M	Business Head - Human Resources	MBA
Mr. Vivek Mathur	Senior General Manager - Corporate Planning	B.Tech, MBA
Ms. Pooja Dhavan	Trading Manager	B.Com, MBA
Ms. Sheetal Choksi	Vice President - Marketing & Communications	B.Com, MMS
Dr. Tanaya Mishra	Head - Human Resources	PGMIR, LLB, P.H.D
Mr. Arun Gupta	Chief of Technology	B.Sc, PGCST
Ms. Harsimran Balbir Singh	Chief People Officer	B.A, DPMIR
Mr. Jeffrey Alan Mcanally	Chief of Speciality	B.A
Mr. Seshan Ranganathan	Chief of Operations	B.E, PGDBM
Mr. Ajit Joshi	Vice President - Retail Operations	B.Sc., MBA
Mr. Sanjay Badhe	Chief of Business Development	MBA
Mr. Unni Krishnan	Chief Technology Officer	MBA, MS
Mr. Vijay Kashyap	Vice President - Human Resources	B.A, PGDM

Source: Company

Attractive brand basket

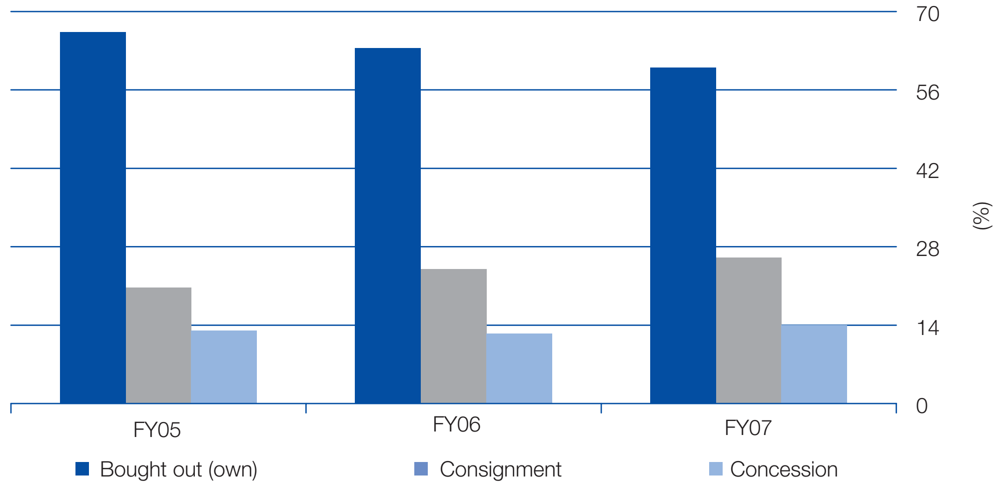
SSL stores offer a wide range of apparels, accessories, and home décor products. It retails various domestic and international brands such as *Allen Solly, Satya Paul, Zodiac, Wills Sports, Catwalk, Weekenders, Gini & Jony,* among others. SSL has acquired exclusive distribution rights with certain global brands like *Austin Reed*. It also has private labels like *Stop, Kashish,* and *Vettorio Fratini, which* account for nearly 22% of revenues. Within the home décor arena, it provides a variety of kitchen appliances and also bed, bath, and kitchen adornments under various domestic and international brands.

Judicious merchandise mix to manage inventory effectively

The company's merchandise mix comprises bought-out, consignment, and concessionaire goods. This model effectively derisks SSL's business and limits the inventory risk as the company bears the inventory risk only for bought-out products comprising largely of apparel.

We believe this policy of consignment and concession sales is viable as high value products like cosmetics and jewellery require marketing expertise of manufacturers or traders and also slow moving items could be a huge hit on the inventory as well.

Chart 10: Judicious mix of consignment and bought out goods to mitigate inventory risks

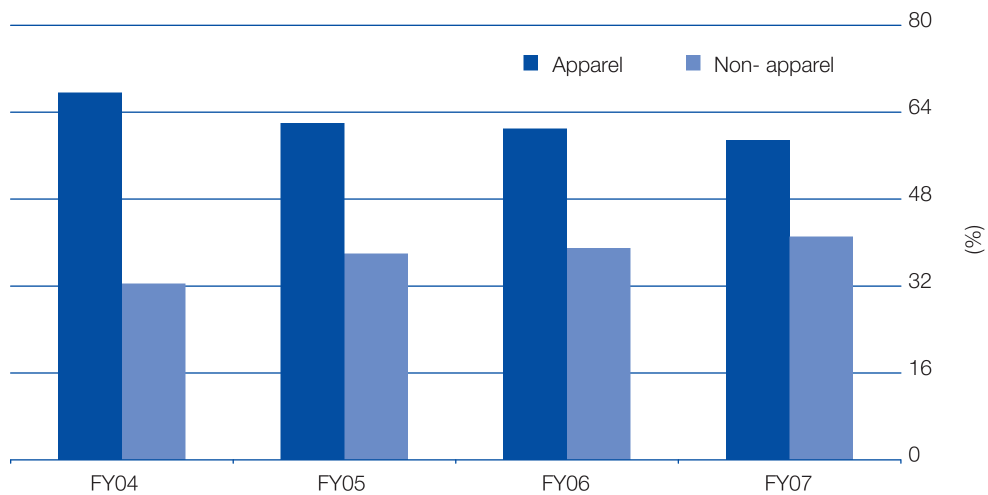


Source: Company

✻ Increasing share of non-apparels to broaden product mix

SSL's sales mix has been shifting away from apparel, which contributed 61% of the company's total sales in FY06, compared to 64% in FY05. This has become possible as the company has added more categories in the non-apparel segment including cosmetics, personal accessories, jewellery, leather goods, home ware, electronics, books, and music. With increasing scale, non-apparel, which is traditionally a lower gross margin space, is also drawing margins close to the levels of apparels.

Chart 11: Rising share of non-apparels improving merchandise mix

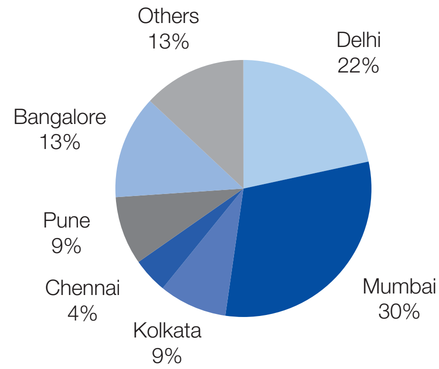


Source: Company, Edelweiss research

✻ Strong presence in six out of top eight Indian cities

SSL has set up its department stores *Shoppers' Stop* in 12 cities across the country and through its other formats in total has presence in around 14 key consuming locations. The company's focus on the luxury segment has strengthened its hold over the top 6-8 consuming cities which account for around 66% of total organized retail spend. Currently, 60% of urban global households live in the top eight cities (Delhi, Mumbai, Kolkata, Chennai, Bangalore, Hyderabad, Ahmedabad, and Pune).

Chart 12: Presence of stores in key cities



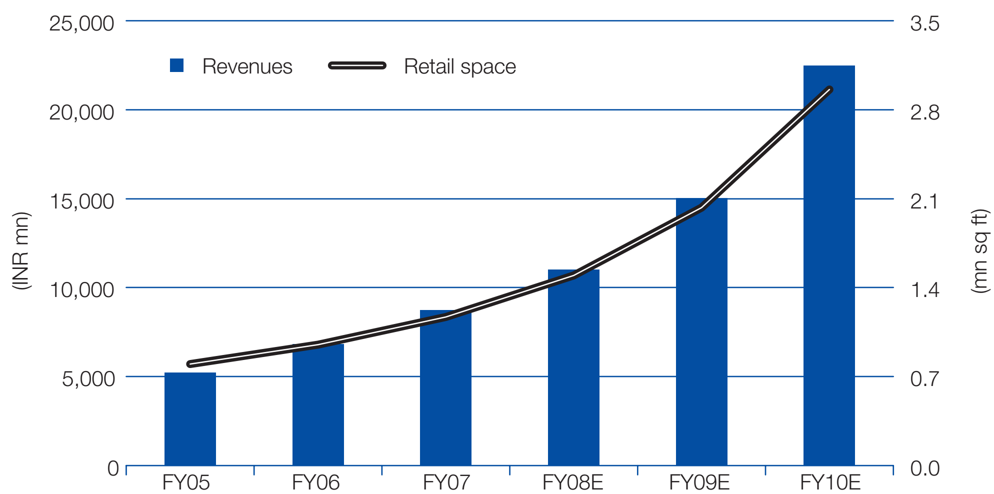
Source: Company, Edelweiss research

Financial Outlook

Revenues likely to grow at 37% CAGR over FY07-10E

Fuelled by increasing number of stores and strong like-to-like store sales, we estimate SSL's revenues to grow at a CAGR of 37% over FY07-10 to INR 23.5 bn in FY10. This increase will be on the back of the retail space growing from 1.1 mn sq ft to 2.9 mn sq ft in FY10E. We estimate the department store format to account for 2.3 mn sq ft of the total 3 mn sq ft.

Chart 13: Strong 37% revenue growth on back of space addition

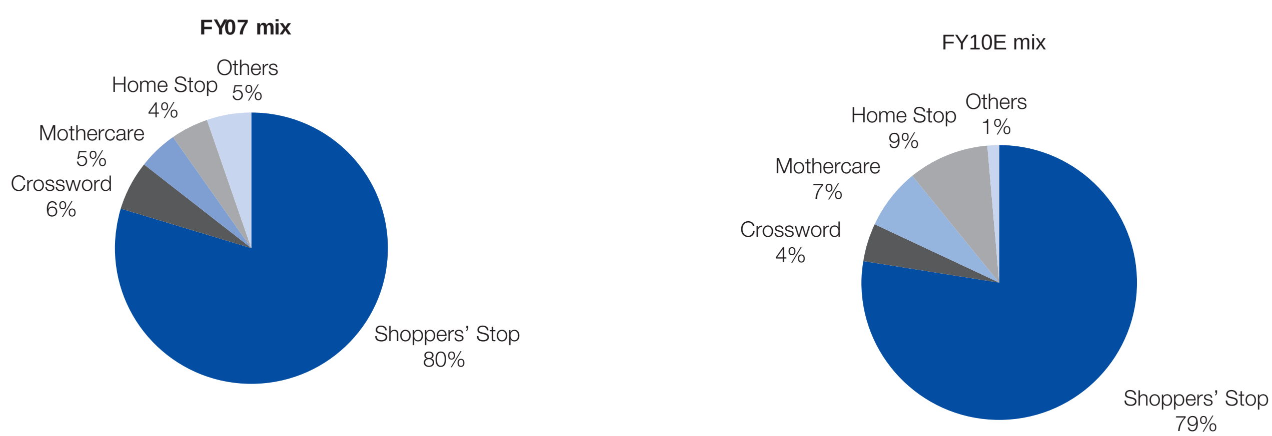


Source: Edelweiss research

Department store format to continue to dominate revenues

With 79% share of space we expect the department store format to retain dominance in the revenue mix with 82% share. But the notable feature is that most specialty formats, launched in the past two years, will scale up to account for close to 18% of revenue and in the future are more scalable than the department store model.

Chart 14: Continued dominance of department stores



Source: Edelweiss research

✻ Expansion in gross margin due to better product mix and scale benefits

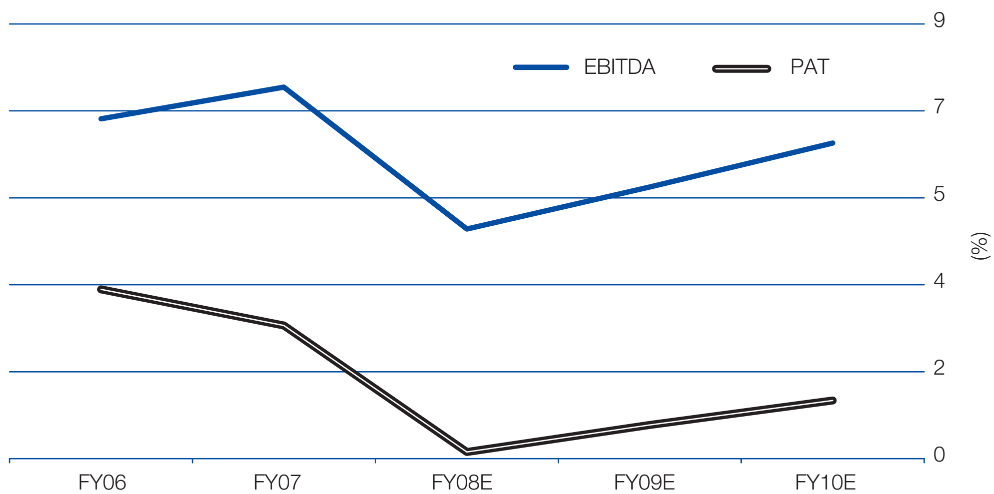
The company is constantly working on improving its product mix to best cater to consumers and also gain some margin expansion benefits through effective sourcing. The rising share of specialty formats to total revenue is positive as they enjoy higher gross margins than the core department store. The higher share of private labels will also work to improve gross margins. We have factored in 120bps improvement in gross margins over FY07-10E.

✻ EBITDA growth at 31% and PAT flat due to high depreciation

Recent cost pressures on rentals, employee, and power cost fronts have depressed the company's EBITDA margins. Change in the company's depreciation policy in FY07 resulted in a one-time charge of INR 101 mn, which depressed net margins in that year. Going forward we expect the cost pressure to continue for the next two years, but have assumed the situation will improve from FY10E onwards. However, the accelerated depreciation policy will continue to depress net margins.

We have estimated EBITDA margins to dip to 5.6% in FY08 and then recover to 6% in FY09 and 6.8% in FY10. Net margins, consequently, will improve from 0.9% in FY08E to 1.2% in FY10E. The company has an accelerated depreciation policy which, though beneficial in the long run will tend to depressed net margins for a while. We have assumed all the incremental expansion to be funded out of debt and not accounted for the rights issue. In that case, the interest will dip and net margin expansion will be higher.

Chart 15: Margins to improve



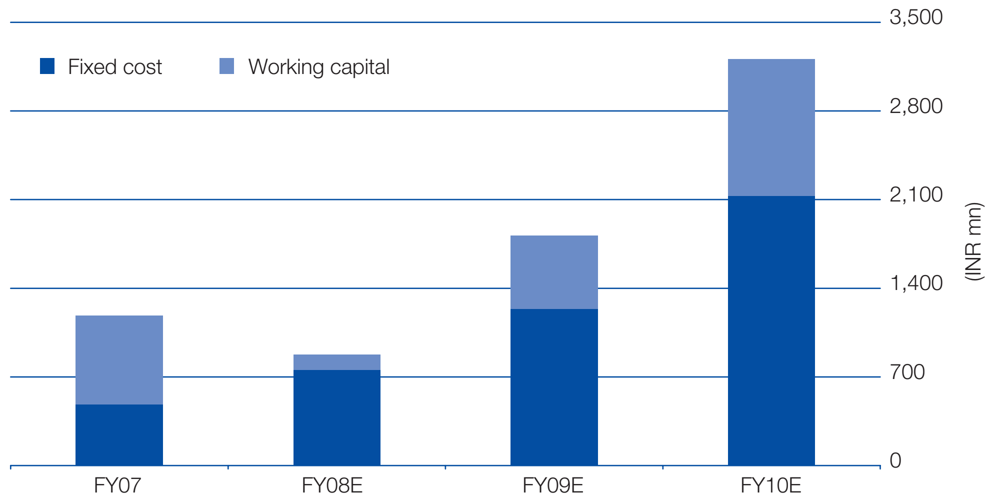
Source: Edelweiss research

✻ Total capex requirement of INR 5.9 bn over FY07-10E

We have estimated SSL's total capex requirement to be around INR 5.9 bn with INR 4.1 bn towards fittings and furniture for setting up of stores and INR 1.8 bn

will be the working capital requirement. This does not include the incremental investment required in HyperCity to buy the balance 31% and any further investment required in Timezone. We expect the investment in HyperCity at around INR 500 mn. We expect the per sq ft cost of fixtures and fittings to stay stable at around INR 2,000-2,100 per sq ft and the inventory per sq ft between INR 1,000 and 1,100 per sq ft.

Chart 16: Capex requirement



Source: Edelweiss research

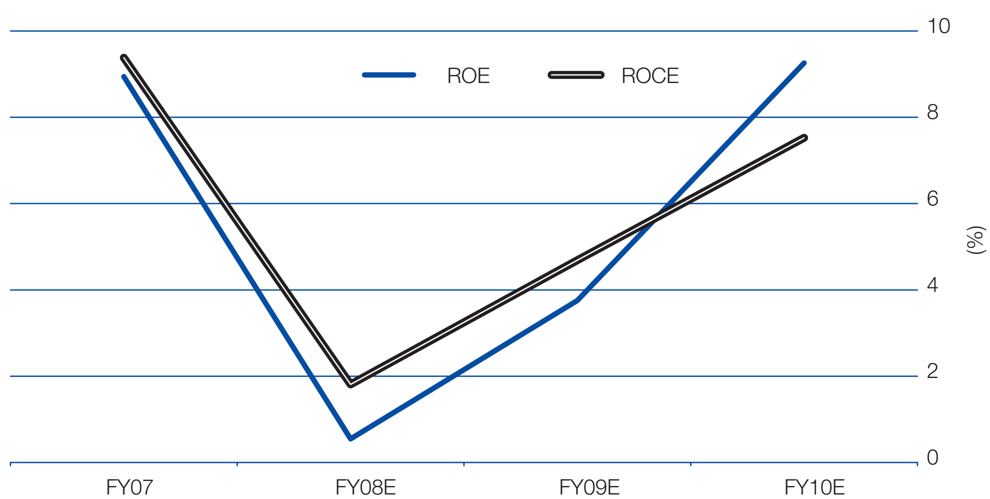
The company has announced plans to raise money through a rights issue in the next quarter to the extent of INR 5 bn. We have not incorporated the dilution on account of the rights issue and hence, have assumed the entire expansion will be through debt and internal accruals. We expect SSL to pay close to INR 500 mn to acquire the balance stake in HyperCity from the money raised. However, we have not included this in our fund estimation. Hence, the rights issue and the debt that can be taken on will be sufficient to fund the company's expansion till FY10E.

* Cost and margin pressures likely to ease in next two years

SSL currently is facing margin pressure due to key cost pressures in rentals and employee costs, and near doubling of power costs in Maharashtra. The specialty formats like *Home Stop, Mothercare, Crossword,* and *M.A.C.* have just turned profitable and hence, will take time to become margin accretive.

We believe this scenario is likely to improve by FY10E for all retailers as supply side drivers will be better placed with more retail space coming on stream, delays getting evened out and more people opting for retail as a profession of choice. Additionally, given that the company's systems are in place and its operating metrics are robust, the company will be able to get back to its high EBITDA levels in FY10E.

Chart 17: Return ratios likely to improve post FY10E



Source: Edelweiss research

Financial Statements

Income statement (INR mn)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	6,811	8,739	10,910	15,110	22,475
Other retail operating income	116	156	192	252	356
Total operating income	6,928	8,895	11,102	15,362	22,831
Cost of goods sold	4,617	5,843	7,276	10,000	14,724
Rent and Lease expenses	495	637	880	1,251	1,886
Employee expenses	436	600	841	1,189	1,772
SG&A expenses	892	1,131	1,483	2,002	2,897
Total expenditure	6,440	8,210	10,480	14,443	21,279
EBITDA	487	684	622	919	1,553
Depreciation	166	290	370	479	697
EBIT	322	394	253	440	856
Interest expenditure	28	50	165	297	495
Other income	78	127	51	51	52
Profit before tax	371	471	139	194	412
Provision for taxation	133	226	41	69	147
Profit after tax	243	247	99	125	265
EPS (INR) fully diluted	7.1	7.0	2.8	3.6	7.6
No. of shares	34.4	34.8	34.8	34.8	34.8
CEPS (INR) fully diluted	11.9	15.4	13.4	17.3	27.6
Dividend per share	1.5	1.5	1.5	1.5	1.5
Dividend payout ratio (%)	21.2	21.5	52.9	41.8	19.7

Common size metrics as % of revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Cost of goods sold	66.7	65.7	65.5	65.1	64.5
Rent and Lease expenss	7.1	7.2	7.9	8.1	8.3
Employee expenses	6.3	6.7	7.6	7.7	7.8
SG&A expenses	12.9	12.7	13.4	13.0	12.7
EBITDA margin	7.0	7.7	5.6	6.0	6.8
Depreciation	2.4	3.3	3.3	3.1	3.1
Interest expenditure	0.4	0.6	1.5	1.9	2.2
EBIT margin	4.6	4.4	2.3	2.9	3.7
Net profit margin	3.5	2.8	0.9	0.8	1.2

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	30.8	28.3	24.8	38.5	48.7
EBITDA	41.8	40.4	(9.1)	47.7	68.9
EBIT	38.6	22.6	(35.9)	74.3	94.2
Net profit	28.2	1.9	(60.1)	26.7	111.9
EPS	2.3	(1.0)	(59.4)	26.7	111.9

Balance sheet (INR mn)

As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Share capital	344	348	348	348	348
Reserves	2,285	2,510	2,549	2,614	2,819
Shareholders funds	2,629	2,859	2,897	2,962	3,167
Long term debt	635	1,304	2,158	3,781	6,110
Deferred tax	4	41	41	41	41
Sources of funds	**3,267**	**4,204**	**5,097**	**6,784**	**9,318**
Gross assets	1,866	2,350	3,106	4,344	6,472
Less: depreciation	565	846	1,216	1,694	2,392
Net fixed assets	1,302	1,504	1,890	2,649	4,080
Capital WIP	87	228	1,056	1,665	1,665
Goodwill	96	109	109	109	109
Current assets	2,733	3,767	3,686	4,570	6,640
Debtors	93	128	123	161	232
Cash & bank balance	1,138	1,015	585	301	338
Inventory	737	1,154	1,587	2,187	3,226
Advances	765	1,470	1,391	1,921	2,845
Current liabilities	950	1,405	1,644	2,209	3,176
Creditors	819	1,276	1,516	2,081	3,062
Other liabilities	72	67	67	67	53
Provisions	59	61	61	61	61
Working capital	1,783	2,362	2,042	2,361	3,464
Uses of funds	**3,267**	**4,204**	**5,097**	**6,784**	**9,318**
BV (INR)	76.5	82.1	83.2	85.1	90.9

Cash flow statement (INR mn)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Cash flow from operations	517	724	622	919	1,553
Cash for working capital	(189)	(889)	(150)	(673)	(1,213)
Net operating cash flow (A)	327	(164)	472	246	339
Net purchase of fixed assets	(335)	(639)	(1,583)	(1,847)	(2,128)
Net purchase of investments	58	76	51	51	52
Net cash flow from investing (B)	(278)	(563)	(1,532)	(1,795)	(2,077)
Proceeds from LTB/STB	(294)	619	690	1,325	1,834
Proceeds from issue of share capital	1,394	50	-	-	-
Dividend payments	(31)	(59)	(60)	(60)	(60)
Net cash flow from financing	1,069	611	630	1,265	1,774
Free cash flow	**49**	**(727)**	**(1,060)**	**(1,549)**	**(1,737)**

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROE (%)	13.8	8.9	3.4	4.3	8.6
ROCE (%)	8.2	9.4	5.0	6.5	9.2
Debtor days	5	5	4	4	4
Inventory days	38	46	51	51	50
Fixed assets t/o (x)	3.8	3.9	3.7	3.6	3.6
Debt/Equity	0.2	0.5	0.7	1.3	1.9
Interest coverage (x)	11.4	7.9	1.5	1.5	1.7

Valuation parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (diluted) (INR)	7.1	7.0	2.8	3.6	7.6
Y-o-Y growth (%)	*2.3*	*(1.0)*	*(59.4)*	*26.7*	*111.9*
CEPS (INR)	11.9	15.4	13.4	17.3	27.6
Y-o-Y growth (%)	*8.2*	*29.4*	*(12.5)*	*28.9*	*59.4*
P/E (x)	49.6	52.3	128.8	101.7	48.0
EV/Sales (x)	1.7	1.4	1.3	0.9	0.6
EV/EBITDA (x)	24.7	19.0	23.0	15.5	9.2

Aditya Birla Retail

MORE in the offing NOT RATED

February 15, 2008

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The Aditya Birla Group, a premier Indian business house, recently announced its venture into retail with an investment of USD 2.5-3 bn through a wholly-owned subsidiary, Aditya Birla Retail (ABRL). It is to be a multi-format policy, which will include hypermarkets, supermarkets, and convenience stores.

The model – Supermarket and hypermarkets with extensive focus on private labels

ABRL has outlined plans to open stores under the brand name of 'More'. It intends to operate supermarkets and hypermarkets and later include specialty formats in its bouquet. Its strategy is to offer budget and high-value private labels under 'More for you' and 'Select'. This is line with Tesco UK's successful model of having separate labels with separate quality and prices for the same product category. The company intends to differentiate itself by offering an apt product in a friendly and exciting environment at competitive prices. The stores have been designed by Fitch, the leading international retail design firm.

Trinethra acquisition provides 170 stores to begin with

ABRL is amongst the first few companies to use inorganic growth to expand retail presence. The company has picked up 90% in Trinethra for ~INR 3.4 bn from India Value Fund. Under the umbrella of Trinethra Super Retail are two brands, Trinethra and Fabmall. Trinethra and Fabmall run a total of 172 convenience stores, covering a total area of 34,000 sq mt, in Andhra, Tamil Nadu, Karnataka and Kerala, selling personal care, home products, food and grocery. The acquisition of Trinethra has provided the company with an employee base of 4,000 people. It plans to hire between 10,000 and 15,000 employees by 2012.

Acquisition of stake in Nilgiris – Strengthens southern foothold

Another acquisition reported is that of Nilgiris Dairy Farms for a reported investment of INR 500 cr. The Nilgiri group has been in operation for the last 100 years and is among the best known food brands in South India. Apart from its own dairy, it has dairy and bakery products, chocolates, and a variety of other local foods and snacks. It operates on a franchise model and its network has a strong foothold in Bangalore, Chennai, Coimbatore, and Erode markets. It has a total of 35 stores, spread across 64,500 sq ft.

✻ Putting the supply chain in place

As part of its sourcing strategy, the company has set-up a sourcing centre for fresh farm products such as fruits and vegetables, and has established direct linkages with farmers and suppliers. It is in the process of architecting a supply chain to connect households more directly to farmers, and towards this, invest appropriately in backend infrastructure.

The company has a tie-up with 200 local farmers to provide green groceries.

The chain is also covering categories such as groceries, processed foods, bakery products, and personal care products through its private labels - *More* and *Select*.

It has tied up with Apollo Hospitals to set up pharmacies within its supermarkets.

✻ Product mix

The product mix offers a wide range of product categories, including fruits and vegetables, staples, personal care, home care, household general merchandise, poultry, dairy products, a pharmacy, and a well-stocked bakery. The supermarkets will stock the daily and weekly household shopping needs and destination hypermarkets will cater to monthly and event-based shopping needs. The company is also contemplating including non-vegetarian products in its product range in the due course.

✻ Expansion plan

ABRL has a national roll-out plan for supermarkets and hypermarkets that envisages an expenditure of USD 2.5-3 bn over the next 3-5 years. It intends to lease space for the supermarkets- *More*, which in the first phase, is planning to set 200 stores. It has a roadmap to start 6,000 outlets by 2009.

The company is looking at expansion in its acquired ventures of Trinethra and Nilgiris as well. For the Trinethra brand, the company is undertaking a rebranding exercise to rebrand the existing stores as '*More*'. The company also has plans to expand into markets like Delhi, Mumbai, Pune, Bhubaneswar, and Bhopal.

For the Nilgiri chain, it is looking to increase the Nilgiris' private label presence to at least 40% of shelf space in all the stores to earn better margins. It is also looking at extending the geographical reach of the store to the western and northern regions of the country by setting up 90 stores and regional distribution hubs on a franchise basis over the next two years through the franchising model. It plans to set up 30-40 stores in the Delhi and Punjab, and another 50 in Mumbai, Nasik, and Pune.

BHARTI RETAIL

Gearing for the big entry

NOT RATED

February 15, 2008

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After changing the face of telecom in India, Bharti has now turned its attention to retail. It was looking at a foreign player to bring in the required expertise and best practices. The company has now zeroed its search on Wal-Mart as its JV partner. Bharti - with its deep knowledge of India's fast growing consumer market - and Wal-Mart - with its extensive global retail experience, would make a synergistic venture. Given that, in India, 100% FDI is currently allowed only in the cash-and-carry segment of retail, Bharti will manage the front-end and the US major would provide back-end and logistics support.

The JV agreement

The partnership is expected to be in the form of a 50:50 JV. As 100% FDI is not allowed in retail operations, the parties have broadly tied up for a master franchise agreement. Bharti is expected to pay a royalty between 2-3% of sales to Wal-Mart for using the latter's brand name. Bharti is entering the JV through a newly floated, wholly-owned subsidiary of Bharti Enterprises, christened Bharti Retail (Pvt) Ltd. Their arrangement will be in line with the FDI regulations in India, which currently permits 100% foreign investment in only cash-and-carry. Abiding with this, Wal-Mart will open such stores under its own brand name.

The business model

The duo will have stores in all formats right from hyper-markets (75-125,000 sq/ft), super markets (30-50,000 sq/ft), and convenience stores (2-5,000 sq/ft). The store roll-out is expected to begin during the first half of 2008. By 2015, Bharti has projected revenues of USD 5 bn from this new business. The product range will include all food and grocery categories, fresh fruits and vegetables, meat and poultry, dairy products, staples, FMCG and processed foods, electronics and appliances, clothing and footwear, furniture and furnishing, and other household articles. Certain reports indicate that this 50:50 JV will also be for setting up distribution centers, cold and ambient warehousing, and transportation of various perishable products.

Bharti Realty, the real estate arm of Bharti Group, will support the group's ambitious venture into organised retail as the front-end franchisee of Wal-Mart. The group's realty firm has projects of INR 1.3 bn, including some hi-tech buildings.

Product mix and store mix

Bharti Retail is planning the small-format convenience store, located within 1.5 km of customers' homes, a mid-level store 2-3 km distant, and a hypermarket within a 5-7 km drive. This is in sharp contrast with the Wal-Mart retail model in the US, which is dominated by large-format stores on the city outskirts. The small stores will mainly stock food, grocery, and household items, which have a high purchase frequency of 7-8 a month. The company plans to build a majority of the stores within this format under a model that will franchise existing mom-and-pop stores.

Bharti Retail hopes to have over 10 mn sq ft of retail space by 2015 and is also considering shop-in-shop formats (under which it would rent space to a jewellery or pharmacy chain), and a private label for food, grocery, and even consumer electronics.

✻ Backward integration

Bharti already has interest in the agri-retail through a JV with ELRo Holdings India, an investment company of the Rothschild family. The JV has established FieldFresh Foods, which looks at linking Indian fields to the world, by making India a global food basket. For this purpose, it exports premium quality fresh produce to the markets worldwide and promotes world-class standards for agricultural practices, progressive farming techniques, and identification and adoption of appropriate technologies

With an initial investment of USD 50 mn, FieldFresh Foods has acquired 300 acres of farm land in Punjab. It also has an understanding with one of the premier agricultural university's, the PAU at Ludhiana, Punjab to share the existing manpower resources, employ PAU graduates, and conduct periodic joint training and development programmes.

This provides the Bharti-Wal-Mart JV with a readymade base of quality agricultural produce. Also, the prices should be reasonably subsidised. It will be interesting to note how the JV makes use of FieldFresh Foods' facilities.

✻ Expansion plan

Bharti has outlined an investment of USD 2.5 bn on its retail network and intends to lease the retail space required. Bharti will have 200 large stores in the next seven years, developed through a mixture of internal accruals, debt, and equity. Further, it is looking at ~10 mn sq ft of retail space across India and would employ ~60,000 people in its retail outfit. The company expects its first store to come up in the first half of 2008. It hopes to earn around USD 5 bn by 2015 from its retail initiative.

KOUTONS RETAIL

INR 1,011

Fast and furious

NOT RATED

Edelweiss
Ideas create, values protect

February 15, 2008

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Koutons Retail (KRL) is an integrated apparel manufacturer and retail player based out of New Delhi. It is in the business of designing, manufacturing, and retailing apparel under the *Koutons* and *Charlie Outlaw* brands through a network of 1000+ exclusive brand outlets across the country.

✻ A play on the branded apparel space

KRL is a specialty apparel retailer-cum-manufacturer with its *Koutons* and *Charlie Outlaw* brands providing a complete range of men's apparel (casual and formal). Its brands are positioned as 'value for money, but high on fashion' and target the 22-45 age groups. The company currently operates over 0.9 mn sq ft of retail space through 1,150 retail outlets (both company and franchisee operated), which consists of 610 *Koutons* stores and 540 *Charlie Outlaw* stores.

✻ Franchisee model- Low on upfront capex and high on flexibility

The company operates its stores under three models:

COCO: Company owned or leased and company operated.

COFO: Franchise locations that are company owned/leased and franchisee operated.

FOFO: Franchise locations that are franchisee owned or leased and franchisee operated.

The franchisee model adopted by the company is the principal reason behind its rapid growth. KRL has seen limited churn among its franchisees over the past 3-4 years and only 10-12 franchisees (on a base of close to 858 FOFO stores) have left the company so far. At present, 86% of the stores operated are under the FOFO model. This unique model gives KRL the flexibility to expand with limited upfront capital expenditure. Under the model, the company has to incur an expenditure of ~INR 85-100 per sq ft, excluding inventory, at the beginning. This is much lower than the INR 1,500-1,600 per sq ft that has to be incurred for a company operated store.

✻ Integrated operations result in better gross margins

KRL has 18 in-house manufacturing/finishing units and 14 warehouses in and around Gurgaon. It sources raw materials through intermediaries, who in turn, procure that from domestic and international markets. The company has increased its finishing and manufacturing capacities from 3 mn and 6 mn pieces as of FY05, to 23 mn and 12.5 mn pieces, respectively.

Reuters	:	KRIL.BO
Bloomberg	:	KUTL IN

Market Data

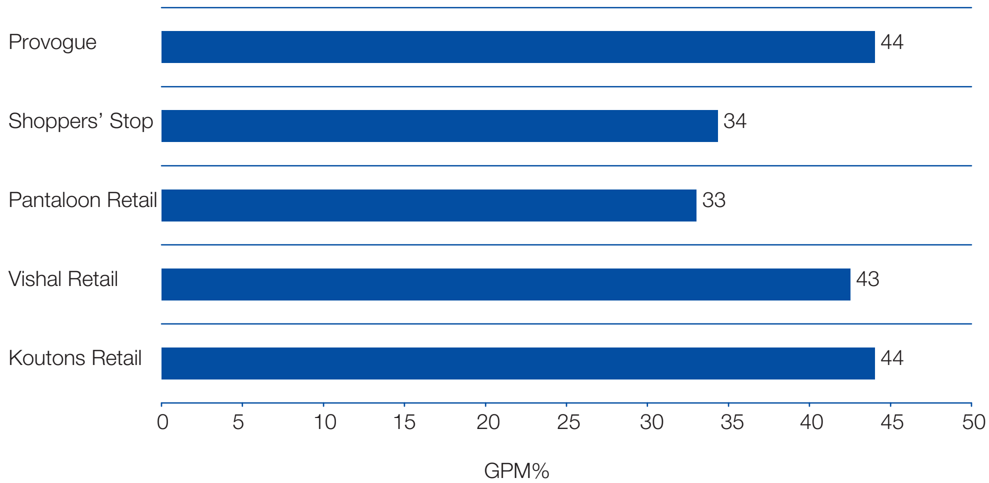
52-week range (INR)	:	1,070 / 515
Share in issue (mn)	:	30.6
M cap (INR bn/USD mn)	:	30.9 / 783.8
Avg. Daily Vol. BSE/NSE ('000)	:	407.5

Share Holding Pattern (%)

Promoters	:	66.6
MFs, FIs & Banks	:	9.7
FIIs	:	21.1
Others	:	2.6

To get its outsourcing operations in place, the company has further entered into fabricating agreements with various manufacturing units to outsource stitching of certain apparel like T-shirts and suits that are not manufactured in-house. This mix of in-house and outsourcing has given the company superior gross margins of ~44% vis-à-vis 30-35% for other pure retailers.

Chart 1: Gross margins better than peers



Source: Company, Edelweiss research *FY07 numbers*

✻ Scorching growth due to rapid store roll-out

KRL has posted revenue CAGR of 164% over FY05-07, driven by the massive roll-out of EBOs. This has increased its retail space 18x to 0.84 mn sq ft as of August 2007. The company is looking at 1,250 stores FY08-end, a large part of which will be on account of the franchisee model. Currently, less than 20% of the stores are owned and operated by the company.

✻ Steady improvement in profitability

The company has posted impressive revenue and profitability numbers in the past few years. Its revenues have grown at a CAGR of 164% over FY05-07 and EBITDA margins have expanded from 7.2% in FY05 to 17.5% in FY07 on the back of integrated operations, better sourcing, cost control, increasing expansion through franchisee stores, and investment in brands. For the nine months ending December 2008, the improvement has continued at the EBITDA level; EBITDA margins improved 200bps, but higher interest costs led to 60bps decline in the net margins.

✻ Expansion plans to maintain rapid growth and strengthen systems

Out of the IPO proceeds, KRL plans to expand its retail presence through EBOs, set up a new manufacturing facility, and purchase plant and machinery for the same. It also plans to invest in strengthening its IT infrastructure and internal controls. The company plans to utilise INR 412 mn for its retail expansion and open 140 exclusive retail outlets (EBOs) in tier-I and tier-II cities, out of which, it has already entered into agreements for 78 outlets. KRL also plans to spend INR 402 mn for setting up a new manufacturing facility to consolidate its manufacturing facilities and purchasing plant and machinery for the same.

✻ Inorganic boost to organic growth - 51% acquired in Upper Class Fashions

KRL has recently acquired 51% stake in Upper Class Fashions (UCF) through a 100% subsidiary, for INR 120 mn. UCF has a brand *Upper Class* that retails ladies fashion wear, which will help the company include ladies wear in its product mix.

UCF, was promoted by fashion designers Rajesh Sachdeva and his wife, Amita. It specialises in casual bottom wear for women. The company has been exporting apparel to leading brands in Europe such as *Armand Thiery, Class, F Ferra,* and *Alcorpe English* and is available in stores such as Splash and Lulu Center in the Middle East under its signature brand *Upper Class*. It has a strong foothold in the ladies apparel segment and is expected to compliment the existing men's wear portfolio of KRL.

Financials

For FY07, KRL posted revenues of INR 4.0 bn and net profits of INR 345 mn, a Y-o-Y growth of 154% and 161%, respectively. EBITDA margins have expanded 130bps, mainly on account of higher gross margins. The company's revenues and profits have been growing over the last three years at a CAGR of 135% and 239% respectively. For the nine months ended December 2008, the company posted revenues of INR 4.2 bn, EBITDA margins of 19.2%, and net margins of 8%. The company expects a large chunk of revenues to flow in the last quarter.

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Reliance Retail

A giant in the making NOT RATED

February 15, 2008

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Reliance Industries, through its subsidiary Reliance Retail (RRL), entered the organised retail business in FY07 and has outlined investment of USD 6 bn over the next five years to establish itself as a leading retail player in the country and expand its operations to cover 100 mn sq ft of retail space. The company is targeting revenues of USD 22 bn and a return on capital employed of around 15% by FY11.

✻ Integrated and scalable farm-to-fork business model

RRL is targeting fast paced growth across multiple formats and wants to capture as much of consumer's wallet and market share as possible. The company is developing a cost-efficient supply chain network through backward-integration, which involves direct sourcing from farmers, eliminating middlemen in the distribution process, thereby passing on savings to farmers, end-consumers, and shareholders.

✻ Entry into a variety of formats in second year of operations

RRL kicked off its operations with *Reliance Fresh* stores catering to the food and grocery space in November 2006, and has increased its pan-India store tally to 330 at FY07 end. It is also operating a bulk (cash-n-carry) retail format called *Ranger Farm* to supply fresh fruits, vegetables, and food in bulk to small shop keepers and push cart vendors.

It has also launched new formats like *Reliance Mart, Reliance mini mart, Reliance Digital, Reliance Trendz, Reliance Jewels, Reliance Footprint, Reliance Home,* and *Reliance Wellness* to broaden its bouquet of offerings and hedge its operations from large exposure to the fresh food and grocery space, expansion in which is facing protests by traders and smaller unorganised retailers.

✻ New ventures

According to media reports, the company is planning to set up *Reliance Town Centres* (RTC) in rural markets, a format which will cater to population below 3 lakh. These outlets will be spread across 60,000-200,000 sq ft, with the first outlet slated to open in North India. Thereafter, it plans to set up around 700 RTCs on a pan-India level by 2010.

Table 1: Rapid addition of formats to capture wallet share

	Reliance Fresh	Reliance Digital	Reliance Mart	Reliance Mini Mart	Reliance Trendz	Reliance Wellness	Reliance Home	Reliance Footprint	Reliance Jewels
Vertical	Food and grocery	Specialty-consumer durables	Hypermarket	Supermarket	Specialty-apparel	Specialty-wellness products	Specialty-home products	Specialty-footwear	Specialty-jewellery
Line of business	Value	Lifestyle	Value	Value	Lifestyle	Value	Lifestyle	Value	Lifestyle
Store size sq ft	3,000-5,000	15,000-30,000	50,000-2,50,000	10,000-50,000	30,000	1,500-3,500	40,000-60,000	8,000-10,000	2,000-20,000
Product offering	Fresh fruits, vegetables, and dairy products	Electronic goods and household appliances	Food and grocery, apparel, consumer durables, footwear	Food and grocery, apparel, footwear	Apparels and accessories	Pharma-ceuticals and medical services	Furniture and furnishings	Footwear	Jewellery
Private labels	Reliance Select	none	Reliance Select, Reliance Dairy Pure, First Class, Spirit, Contra, Hero, DNM-X, Cyber Gear, Buzz, Sparsh, Networks, Netplay, Panda	Reliance Select, Reliance Dairy Pure	Spirit, Contra, Hero, Cyber Gear, Buzz, Sparsh, Networks	n.a	n.a	Viviana, Tosca, Mancini, Monza, Hi-Attitude	none
No. of stores '07	330	1	3	1	3	1	5	2	1

Source: CrisInfac, Edelweiss research

✻ Developing private labels for better merchandise and margins

RRL has already started putting in place an effective network for the development and supply of private labels and exclusive brands for its formats. It has launched private labels like *Reliance Select* in rice, flour, dairy products, spices, pulses, leaf tea, and sugar. It is entering into exclusive agreements with textile companies such as Arvind Mills, Celebrity Fashions, and Indus League Clothing to develop exclusive brands for its retail outlets. It plans to maintain the share of private labels at 35-40%.

Table 2: Exclusive brands and private labels

Name	Category	Name	Manufacturer
Sparsh	Indian	Spirit	Indian Terrain
Networks	Formal	Contra	Indigo Nation
Netplay	Casual	Hero	Arvind Mills - Wrangler
Panda	Kid's wear	Cyber Gear	Vibe
Pogo	Kid's wear	Buzz	Blackberry

Source: Edelweiss research

✻ Inorganic initiatives likely to increase pace of growth

RRL has been one of the leaders in using inorganic growth to complement its expansion plan.

It acquired 100% stake in Gujarat-based Adani Retail for INR 10-11 bn in December 2006, which has resulted in it acquiring additional 54 stores. The company plans to restructure these stores into specialty stores retailing jewellery, medicines, home furnishing, telecom, and consumer durables.

It has also taken over managing the *Sahakari Bhandar* chain of 23 stores located at prime locations in Mumbai. It has upgraded eight stores by adding pharmacy, fresh vegetables, store-branded lentils, and electronic cash registers, but has not changed store names. It also plans to revive two more cooperative chains—*Super Bazaar* and *Kendriya Bhandar*.

✻ Backward integration initiatives to build robust supply chain

To provide fruits, vegetables, and groceries to consumers at reasonable prices, RRL is looking at putting in place a 'farm-to-fork' strategy.

Captive cargo services: RRL is launching captive cargo services by entering into a sales and buyback agreement of a '50 cargo aircraft' order with Boeing. This will facilitate transportation of fruits, flowers, and perishables to the company's warehouses.

State agri-distribution hubs: These hubs will act as collection centres in their respective states, routing the bulk produce to the central distribution hub in its SEZs, from where it can be exported as well as dispatched to various retail outlets across the country.

Farm-supply hubs: The company is setting up 1,600 farm-supply hubs across the country, which will facilitate the purchase of farm produce and sale and provision of farm supplies such as fertilisers, seeds, fuel, and credit to farmers. Farmers can also avail of the benefit of selling their produce in these hubs. These hubs will benefit the company by connecting farms and unorganised retail through a distribution system.

✻ Putting in place strategic alliances to improve efficiencies

RRL has signed an MoU with the government of Punjab for its agricultural and retail projects. It has committed an initial investment of INR 5 bn, which will be scaled up to INR 30 bn. This will be utilised for setting up rural hubs to procure vegetables, fruits, pulses, and other farm produce from various states. It is creating 50 such hubs with 250 franchisees.

The company is creating synergies in rural finance, contract farming, and co-branding of goods and services. It has tied up with Mahindra & Mahindra to obtain farm implements, tractors, spare parts, and extension services.

RRL is also planning to take over Himachal Pradesh Horticultural Produce Marketing and Processing Corporation (HPMC), where the company's business arrangement is based on vegetables and apples. It will be obtaining 30,000 tonnes of apples from HPMC for its retail project.

Table 3: RRL—Sourcing initiative

State	Government initiative	Company initiative
Tamil Nadu	Exemption to procure directly form the farmer	The company has 10 collection centres for fruits and vegetables in Chennai and is planning 10 more. The company is also providing the farmer with inputs and services such as insurance, vet care, and health care.
Maharashtra	Permitted direct marketing and allows single marketing licence system to retailers by ending the monopoly of the Act	The company has taken 1 lakh acre of land in Pune on a 50-year lease to grow vegetables and agro products. Alternatively, it is also planning to procure onions from Lasalgaon Agriculture Produce Market Committee in Nashik, for which it has been already granted a licence.
Kerala	Permitted direct marketing and single licensing by ending the monopoly of the Act	The company has commenced the procurement of fruits and vegetables from farmers. For instance, it has procured mangoes, ginger, and tender jack from Nadavayal in Wayanad district. Farmer groups have received INR 7 per kg for mangoes and ginger and INR 6 per kg for tender jack against the INR 3 and INR 2, respectively, rate prevailing in local markets.
Bengal	Amendments facing roadblocks, but the company adopts a different strategy	The company has undertaken the redevelopment of the Park Circus Civic Market, which will be partly managed by the Kolkata Municipal Corporation (KMC) and the company. KMC will retain land ownership, while Reliance will maintain the leasehold right.

Source: Media reports, CrisInfac

Managing real estate

Real estate could be one of the major speed breakers to RRL's ambitious plans, to counter which it has undertaken various progressive steps:

Tie ups: RRL has tied up with real estate majors DLF Universal and Ansal Properties and is also negotiating with Harsh Neotia of RDB Industries (Kolkata) and GTC (Mumbai) to buy retail space for its hypermarkets and convenience stores. Having already bought 74 plots for about INR 20 bn, RRL has so far invested around INR 30 bn (about 10% of the first phase planned outlay of INR 250-300 bn) on its retail initiative. It has acquired 1,260 properties for *Reliance Fresh* stores and 30 properties for *Reliance Mart* across the country.

SEZ route: The special economic zones (SEZs) created by the group will contribute immensely to its retail operations if RRL utilises them as distribution and stocking hubs to facilitate its retail business. This will lead to integration with an efficient supply chain, logistics, and information technology infrastructure.

RPG Retail - Spencers

Gearing up

NOT RATED

February 15, 2008

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The RPG Group is one of India's oldest retail players with multiple formats retailing food, apparel, fashion, electronics, lifestyle products, music, and books. Established in 1996, *Spencer's* has become a popular destination for shoppers with supermarkets, hypermarkets, and dailies spread over the country.

Strategy: Establish pan-India presence in food and select specialty segments

The company has multiple formats under which it operates close to 0.9 mn sq ft of retail space. RPG's strategy is to position itself as a foods-intensive retail company with cluster of 'destination' and convenience stores. It is also looking to set up retail chains in focused verticals like music, books, mobility solutions, apparel, footwear, luxury and life style brands, where it already has the domain knowledge or it can acquire the same through partnerships.

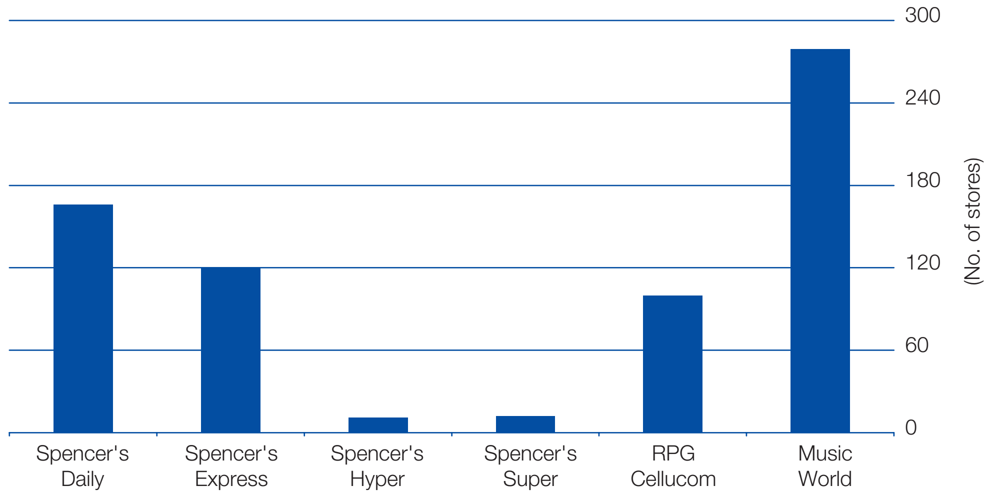
Multiple formats to capture larger share of consumer wallet

The company's retail business currently operates through the following three broad formats: *Spencer's Retail, Music World*, and *Books & Beyond*. *Spencer's Retail* houses the food and grocery part of the retail operation and operates formats like *Spencer's Hypermarkets, Spencer's Super, Spencer's Daily, Spencer's Fresh, Spencer's Express* to capture both the top up and frequent shopping of consumers and the longer duration weekly or fortnightly consumption. The company is also planning to enter the apparel segment by launching exclusive garment retail stores by mid-2008.

Broad presence with over 309 *Spencer* stores and close to 400 specialty stores

By virtue of being an early entrant in the business, it has established its presence across the country. Tamil Nadu accounts for a large chunk of its stores. It is looking to expand rapidly in the northern and western regions of India.

Chart 1: Varied formats



Source: Company, Edelweiss research

Table 1: Broad based presence across formats

	Spencer's Express	Spencer's Daily	Spencer's Super	Spencer's Hyper	RPG Cellucom	Books & Beyond	Music World
Business description	A convenience store format, stocking fresh produce.	A format larger than the Express store with similar product offerings at discounted prices	A supermarket format with a larger basket of product offerings	A hypermarket format offering products at low costs	Mobile and electronic goods store	Books, toys and stationery	Music store and personal audio gadgets
Line of business	Value	Value	Value	Value	Lifestyle	Lifestyle	Lifestyle
Product offering	Fresh produce, dairy and bakery products	Fresh produce, dairy and bakery products	Fresh produce, dairy-bakery products, FMCG, home care and personal products and frozen foods	Fresh produce, dairy-bakery products, FMCG, home care and personal products and frozen foods	Mobile phones, laptops, accessories and electronic gadgets	Books, as well as toys, gifts and stationery	CDs and cassettes, VCDs and DVDs, CD-ROMs and other music accessories, high-end personal audio gadgets such as Apple iPods, Neo Pods, and MP3 players
Avg store area (sq ft)	1,000	4,000-7,000	8,000-15,000	25,000	NA	100-10000	600-4000
Current no. of stores	66	231	11	12	100	2	279

Source: Company , Edelweiss research

✻ Merchandise mix: Looking to make the best of FDI policy

The retail group offers wide merchandise under its various formats and successfully captures a large chunk of the consumer spend. The group is also looking to include an international brand in its retail portfolio to make the best of the FDI being allowed in single brand retail.

Table 2: Product mix

Fresh fruits and vegetables	Office and home stationery
Groceries, grains, and cereals	Apparel and fashion accessories
Baked chilled and frozen foods	Electrical and electronics
Personal care and baby care products	Music, toys, and other entertainment
Home care products	Home video

Source: Company, Edelweiss research

✻ INR 35 bn expansion plan

The company has firm plans to take its retail space from the current 0.9 mn sq ft to over 4 mn sq ft by FY11E and its store count to over 4,000. Going forward, the RPG Group plans to invest INR 35 bn in its upcoming retail projects, for which it will tap the primary market by 2008-09E.

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Subhiksha Trading Services

Small and successful NOT RATED

Edelweiss
Ideas create, values protect

February 15, 2008

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Subhiksha Trading Services (STS) is a nation-wide chain of neighbourhood supermarkets. Incorporated by a first generation entrepreneur, Mr. R Subramanium, it began operations in 1997 with a single store in Chennai. In 1999, it began expanding outside the South. Today it is an 800+ stores strong chain, positioned as the neighbourhood low-priced *kirana* store with self-service and home delivery options. Subhiksha also has discount pharma and vegetable and fruits outlets.

The business model- Convenience retailing

Subhiksha is a convenience store, offering discounts in the range of 8-10% on almost all its merchandise. It follows a bulk sourcing strategy, coupled with low operating costs, to make discounts possible. On an average, Subhiksha stores span across 1,500-2,000 sq ft and operate as a 'no frills' neighbourhood supermarkets, competing directly with the local *kirana* stores. On entering a new market, they rapidly bombard it with their stores. This rapid expansion enables them to rationalise supply chain and media spend costs.

The product mix

The company operates in four areas: Fruits and vegetables, pharmacy, FMCG, and telecom through three formats - Subhiksha, Subhiksha Pharmacy, and the newly introduced Subhiksha Mobile respectively. Its stores sell a mix of FMCG, fruits and vegetables, pharmaceuticals, and telecom products and accessories. Its main focus however continues to be the untapped food and grocery segment. This segment contributed 95% to its revenues in 2006.

Building a supply chain

To facilitate a strong supply chain, the company has tied up with farmers to purchase their produce at current price levels under a preferred buying arrangement. It has set up a Centralised Processing Unit (CPU) at Nashik, as it sources 50% of fruits and vegetables under contract farming to meet the requirement of all its stores.

Aggressive expansion plans

From 132 stores in 2002, the company ended 2007 with over 1,000 stores across 10 states. It has completed its first phase of expansion involving an investment of INR 3 bn. In the next phase, it is likely to invest INR 2 bn for setting up 400 stores in Chandigarh, Punjab, Madhya Pradesh, Uttar Pradesh, Haryana, and West Bengal. Subhiksha is planning to offload 10% stake by raising INR 3,500 mn in an IPO at the beginning of 2008, to fund its expansion plans. Currently, promoters hold 65% of its equity, ICICI Venture 32%, and employees 3%.

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Vishal Retail

INR 790

Value for money

NOT RATED

Vishal Retail (VRL) began operations as a retailer of ready-made apparel in Kolkata in 2001. In 2003, it acquired the manufacturing facilities of Vishal Fashions and M/s Vishal Apparels, and thereon the company has focused on setting up a pan-India retail chain.

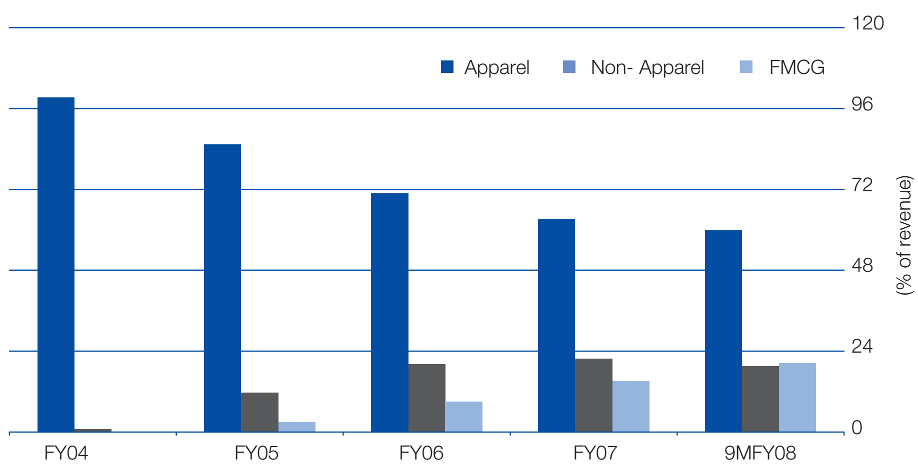
Value retailing: A viable business model

VRL's business is modeled on the 'value for money' retailing concept and has established a strong customer connect with the middle and lower-middle income consumer groups. Its key strategy is to offer quality products at the minimum possible cost, with a focus on private and quasi-private labels. Its discount store format is expected to be highly successful in the long run, as it provides the retailer quicker stock turns and economies of scale, and the consumer reaps the benefits of variety and convenience. The company's average selling price of INR 85 indicates that its merchandise targets the value-conscious consumer.

Profitable product mix, tier III locations, and private labels drive margins

VRL's product mix is dominated by apparel, which accounted for 63% of total revenues in FY07. It has a number of private apparel labels such as *Zepplin, Paranoia, Chlorine, Kitaan Studio, Famenne, Fleurier Women,* and *Roseau,* which are manufactured in house. In FY07, these accounted for around 10% of revenues. In addition to private labels, the company also houses many quasi-private labels. These are unbranded products, which unlike private labels, are not manufactured in house, but sourced from domestic and international destinations to avail cost benefits.

Chart 1: Product mix



Source: Company, Edelweiss research

On the back of its mix of private and quasi-private label-mix, the company enjoys high gross margins (38-40%). It is working on increasing the share of non-apparel and FMCG products in its product mix to de-risk its model and also ensure that a complete basket of customer requirement is met at its stores. The company also plans to introduce private labels in these categories to garner higher margins.

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February 15, 2008

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Reuters	:	VIRL.BO
Bloomberg	:	VISH IN

Market Data

52-week range (INR)	:	1,001 / 423
Share in issue (mn)	:	22.4
M cap (INR bn/USD mn)	:	17.7 / 448.9
Avg. Daily Vol. BSE/NSE ('000)	:	238.0

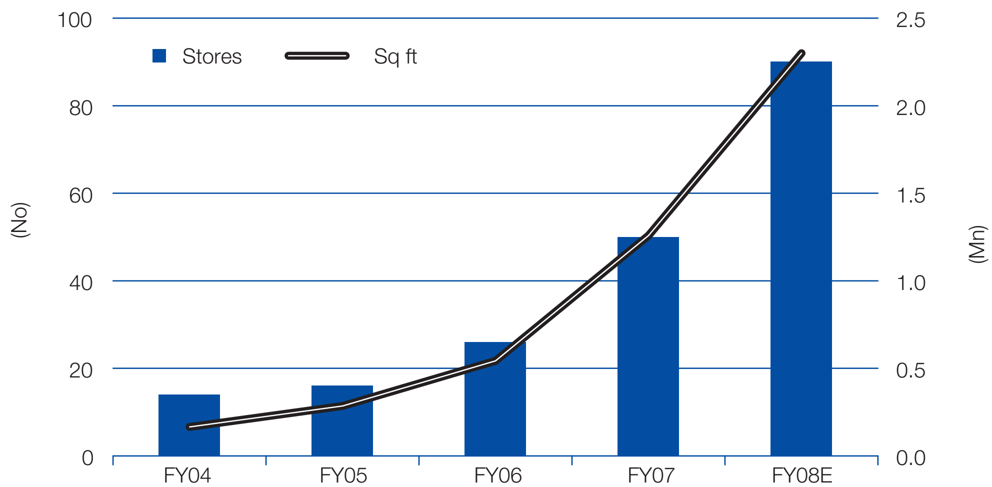
Share Holding Pattern (%)

Promoters	:	63.9
MFs, FIs & Banks	:	20.4
FIIs	:	9.2
Others	:	6.5

Aggressive expansion plans well on stream

VRL started off with plans to set up 32 stores in FY08E to take its store tally to 80 from the current 50. However, during the year, it has enhanced its expansion plan and is looking to take its store tally to close to 90 stores by end of FY08. The retail space with 90 stores will stand at around 2.3 mn sq ft. Given its consistent track record of rolling out stores and focus on tier II and III cities, the planned expansions look achievable. The company is also looking at entering other lucrative avenues like food and beverages and the fast food chain businesses. However, expansion plans on the same are not yet clear.

Chart 2: Fast-paced store roll out



Source: Company, Edelweiss research

Relatively lower rental costs due to focus on tier II and III cities

VRL has always focused on tier II and III cities and intends to maintain this strategy going forward; 43 of VRL's 50 existing stores are located in tier II and III cities. A big advantage of this strategy is that rentals in these cities are much lower than in tier I cities, at around INR 30-34 per sq ft, which has resulted in rental costs being much lower for VRL at 5.4% of revenues, against 6.4% for Pantaloon Retail. VRL has locked in most of its new properties at a rental of INR 32-34 per sq ft. At present, revenues from the North dominate, with a 62% share; however, this mix is likely to change soon, as most of its new stores are coming up in the West, East, and Central parts of India.

Table 1: Tier II and III locations dominate store distribution

	Existing	Planned	Total	(%) distribution
Tier I	7	3	10	12
Tier II	3	1	4	5
Tier III	40	28	68	83
Total	50	32	82	100

Source: Company, Edelweiss research

In house manufacturing, logistics, distribution network improve operating efficiency

To reduce costs and take advantage of economies of scale, the company has put in place a distribution set up comprising seven regional distribution centres located around Kolkata (West Bengal), Thane (Maharashtra), Jaipur (Rajasthan), Ghaziabad (Uttar Pradesh), Ludhiana (Punjab), Gurgaon (Haryana), and Delhi. It has its own fleet of 41 trucks, which helps transport and deliver products in a cost and time efficient manner, which has helped the company optimize its store inventory. VRL also has an in house apparel manufacturing capacity of 1 mn pieces per annum at Gurgaon. It is contemplating expansion of this existing capacity and setting up of a new apparel manufacturing facility at Dehra Dun.

Putting systems in place

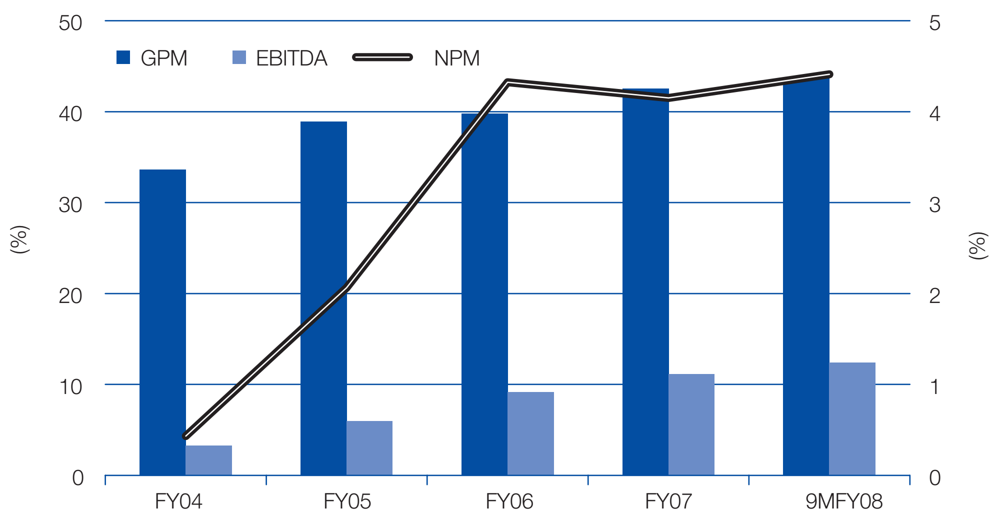
VRL focuses on acquisition and implementation of advanced information technology systems, processes, and business applications to handle its store operations, including inventory management and billing. The company is able to generate detailed daily reports covering various aspects of business such as division-wise sales per store, inventory movement, and position at stores and distribution centres and generation of purchase and delivery orders.

In August 2005, the company entered into a software end-user license agreement with SAP India. It has partly implemented the information technology set up and is currently in the midst of completing the process of upgrading its information technology set up and has entered into an agreement with TCS for providing ERP applications, rendering services inter alia for management of information system on reports related to stock management, receipt processing, picking and packing, project systems, merchandise assortment management, pricing and promotion, sales, controlling, and financial accounting.

Steady improvement in profitability

The company has been improving its operating metrics consistently along with growing its topline. Its EBITDA margins have expanded from 3.3% in FY04 to 11.1% in FY07 on the back of an improved product mix, integrated operations, investments in logistics and distribution, and investments in internal control systems. Its net margins too have improved from 0.4% in FY04 to 4.2% in FY07. The investments in systems have helped the company optimize the inventory level and maximize the gross returns on inventory and retail space.

Chart 3: Improving margins



Source: Company, Edelweiss research

Financials

For FY07, VRL posted revenues of INR 6,026 mn and net profits of INR 250 mn, a Y-o-Y growth of 109% and 101%, respectively. EBITDA margins have expanded 200bps, mainly on account of lower cost of goods (on account of higher mark up). For the 9 months ended December 2008 the company posted revenues of INR 6.8 bn and net profit of INR 303 mn. The margin improvement has continued with a 130bps improvement in gross margins to 43.8%, and a 130bps improvement in EBITDA margins, to 12.4%. Net margins have also improved 30bps, to 4.4%. Higher interest costs led to slower growth in net profits.

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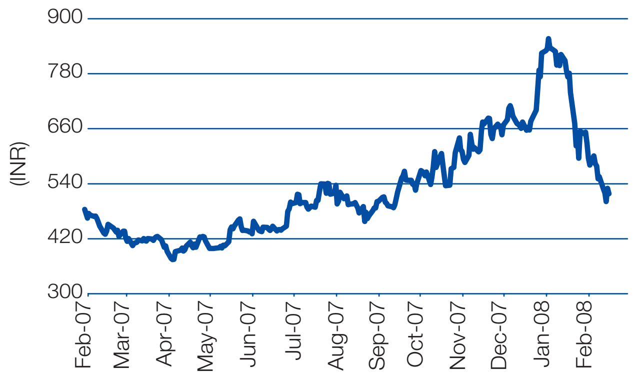
Coverage group(s) of stocks by primary analyst(s): Retail, FMCG & Media

Retail: Pantaloon Retail, Shoppers' Stop

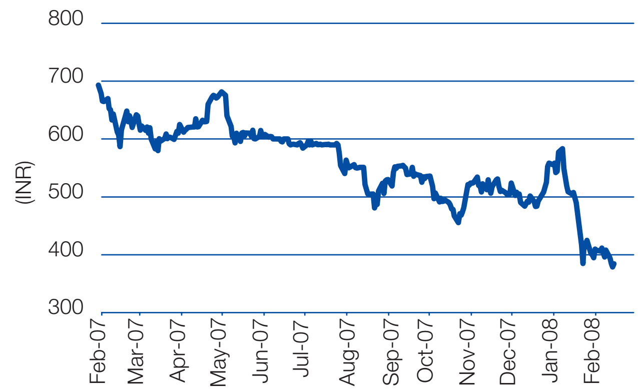
FMCG: Asian Paints, Colgate, Dabur, Godrej Consumer, Hindustan Lever, ITC and Marico

Media: Inox Leisure, MIC Electronics, PVR, Shringar Cinemas, Television Eighteen India, TV Today Network, Zee Entertainment Enterprise

Pantaloon Retail



Shoppers' Stop



Recent Research

Date	Company	Reports	Price	Recos
14-Feb-08	Hindustan Unilver	Impressive quarter; *Result Update*	203	Accum.
01-Feb-08	TV 18	Performance better than *expectations; Result Update*	433	Accum.
11-Jun-07	Vishal Retail	Value for money; *IPO Note*	230-270	Subscribe
18-Sep-07	Koutons Retail India	Scorching growth; *IPO Note*	370-415	Subscribe
14-Dec-06	Retail	Getting organised; *Sector Update*		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution	112	44	11	1	188

* 14 stocks under review / 6 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	88	74	26

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

Edelweiss
Ideas create, values protect

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