

Outlook for Retail sector remains bright; FDI in multi-brand retail issue lingers

April 9, 2015

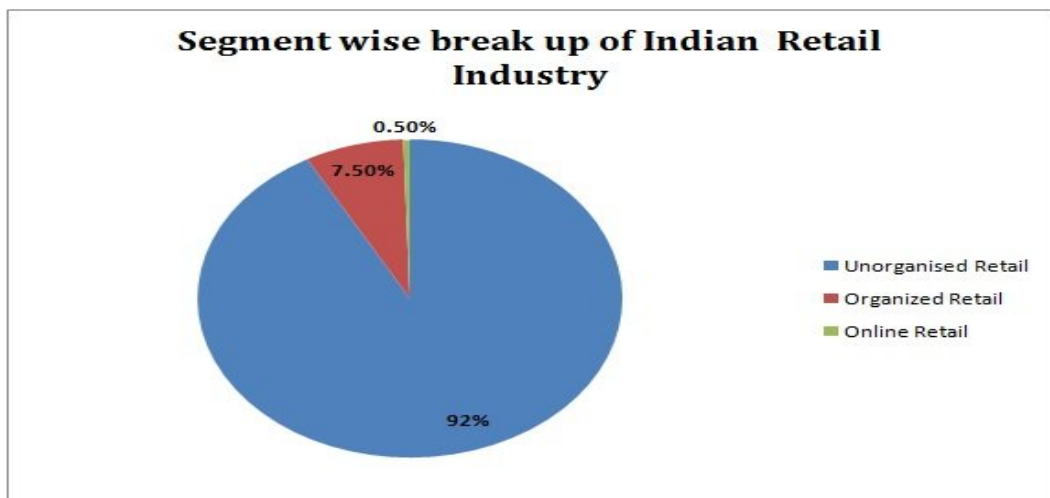
Indian retail sector has been at the helm of India's growth story. The sector accounts for 22% of the gross domestic product (GDP) and contributes to 8% of the total employment. Indian Retail sector continues to grow despite irregular global economic trends. A report has estimated that the total retail sales in India to grow from \$411 billion in 2011 to \$804 billion by 2015. Robust economic growth, high disposable income with the end-consumer and rapid construction of organized retail infrastructure are key factors behind the forecast.

However, the sector for past few years has been battling against several challenges, including high consumer price inflation, currency fluctuations, and strict FDI policies. To boost growth in the sector, India allowed 100% FDI in single-brand retail in 2012 with a requirement of 30 per cent of items sold to be sourced from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors, while it allowed 51% FDI in multi-brand retail segment with the similar condition. The new government although gave a nod to 100% FDI in single-brand retail, it simply dismantled the reform of 51% FDI in multi-brand retail in line with its manifesto on the basis of which we won the elections.

Also, currently, there are no well-defined, clear rules pertaining to e-commerce. As a result, the industry is being split by channels of trade. Retail can at most be segregated by categories of products and services traded rather than by channels or brands.

Market Pattern & Size:

Over the last decade, the Indian retail industry has grown phenomenally with a remarkable shift towards organized retailing formats. However, more than 90% of the Indian retail sector still falls in the unorganized sector category. While, the market of organized retail segment despite the downturn is growing exponentially as economic growth brings more people into the consuming classes and organized retail lures more shoppers into its open doors, its share remains to be at nascent 7.50%. Meanwhile, online retail business, which is relatively a new phenomenon in India, a format, which has high potential for growth in the near future, has share of 0.50%.

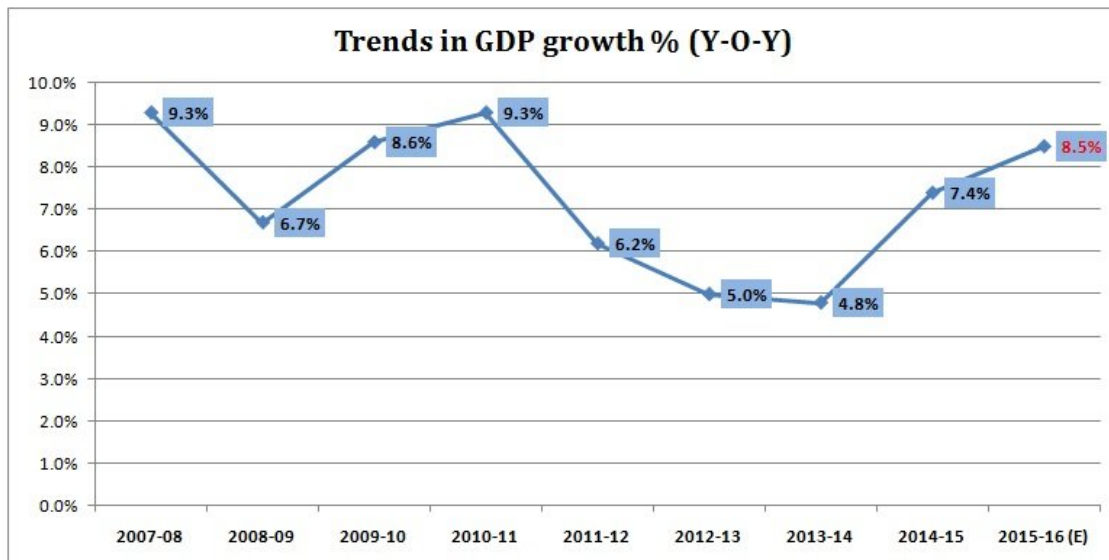


At about 60%, food and grocery segment is the highest contributor to the Indian retail market followed by the clothing and fashion segment, which contributes 8%. While unorganized retailing accounts for most of the food and grocery segment, penetration of the organized sector is highest in the clothing and fashion segment at 33%. The Indian retail industry has experienced high growth over the last decade with a noticeable shift towards organized retailing formats. Nevertheless, the entire industry is gradually shifting towards a modern concept of retailing, which is a seamless blend of online and offline formats. This concept is called 'Omni-Channel' retailing, which focuses on employing all kinds of shopping channels like internet, brick and mortar, television, direct mail and radio among many others. Merging the two formats of online and offline retailing is to blend technology with smart merchandising and imbibe community building, customer engagement and targeted marketing in their operations.

Organized retail Industry

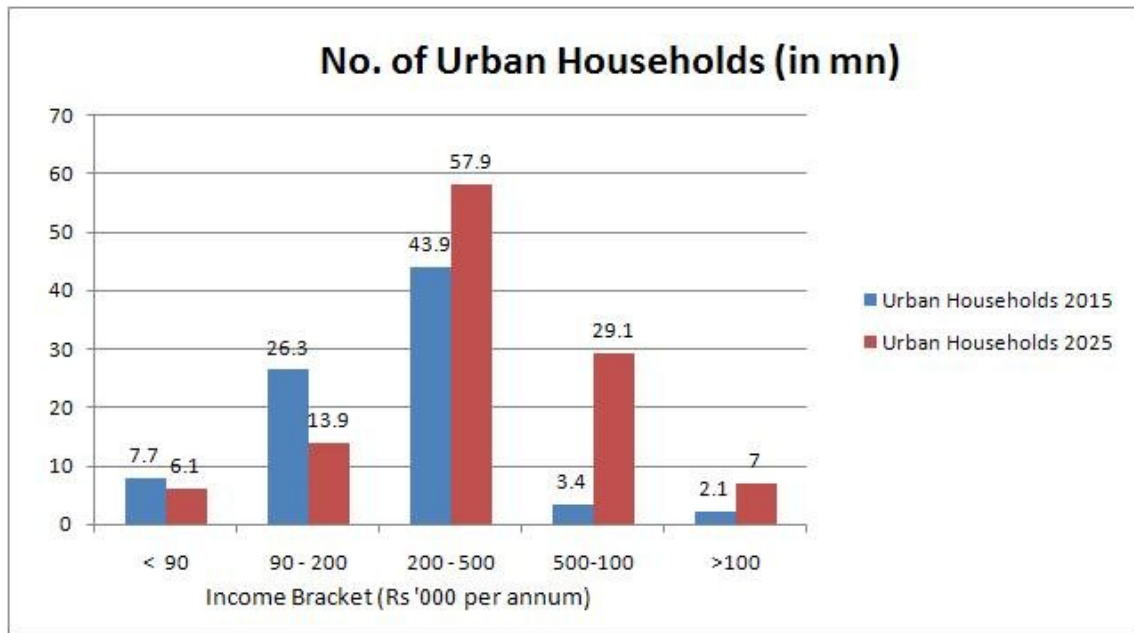
Growth Drivers

1) Economic backdrop: The economic backdrop is a key factor impacting the performance of companies across sectors including retail. Consumer sentiment and business confidence have all turned positive after a clear victory of BJP led government. These developments coupled with an improving global economic scenario and sharp uptick in India's GDP adds to positive for the sector. In an encouraging development, the Union Budget pegged India's real GDP growth for 2015-16 has been estimated at 8.0-8.5%, as against the current year's estimate of 7.4%. The Indian economy is projected to grow 7.4% in the current financial year ending March, compared with 6.9% last year, according to the new gross domestic product growth series, released by the Central Statistics Office. Based on the earlier series, the Indian economy was projected to grow by modest 5.5% in 2014-15 compared to 4.7% a year earlier. Meanwhile, inflation continues to remain well within RBI's comfort zone of 6% for January 2016 with RBI now slashing rates by 50 basis points to 7.5% since January 15, as consumer inflation came down to 5%.



As observed in prior years, the organized retail space in the first decade of this century was viewed as offering enormous potential for growth in India. However, post FY08 the industry witnessed a sharp moderation in expectations with most retailers across formats facing significant head winds in terms of like-for-like growth and viability of stores. Following the pronounced slowdown, the industry witnessed a modest recovery in FY10. This recovery gathered further momentum in the first three quarters of FY11 and yielded strong double-digit like-for-like growth across most credible retail formats. Consumer sentiment thereafter was impacted in FY12 and continued to be muted till the second quarter of FY14 with high inflation expectations, pronounced interest rates and economic uncertainty being key contributing factors. In the recent quarters consumer sentiment improved, which was seen with retailers reporting an improving trend and tad better muted offtake.

Growing Purchasing Power of Indian Middle Class: This is yet another driving force or organized retail industry. Most research studies suggest rising incomes in the next decade. This is likely to continue propelling the rise of the middle class whose consumption will become the largest in the country. Therefore, targeting the mid-market seems to offer substantial revenue potential. As the chart below depicts, number of households with annual income brackets in the range of Rs 200,000 to Rs 10 lakhs is expected to increase significantly in the next decade.



Challenges for organized retail Sector

There is no denying the tremendous opportunity that organized retail offers in India, but there are also some significant challenges that need to be tackled including:

- Cost pressures:** There has been significant inflation in energy costs and common area maintenance charges in malls in the last few years.
- Availability of retail talent:** The last few years have seen challenges related to paucity of skills and retention of trained talent

Quality real estate: There is limited availability of quality real estate. This coupled with high rentals and non-adherence to committed schedule by builders pose significant challenges to deployment of strategic plans related to expansion.

Local legislations: Multiple local legislations across the country make it challenging for any organization with pan-India presence

Supply chain management: Multiple issues with infrastructure pose obstacles in ensuring availability for customers especially with respect to categories like food and grocery.

Complexity in taxation: Inconsistent tax regime across various states makes it difficult to manage a pan-India network of stores.

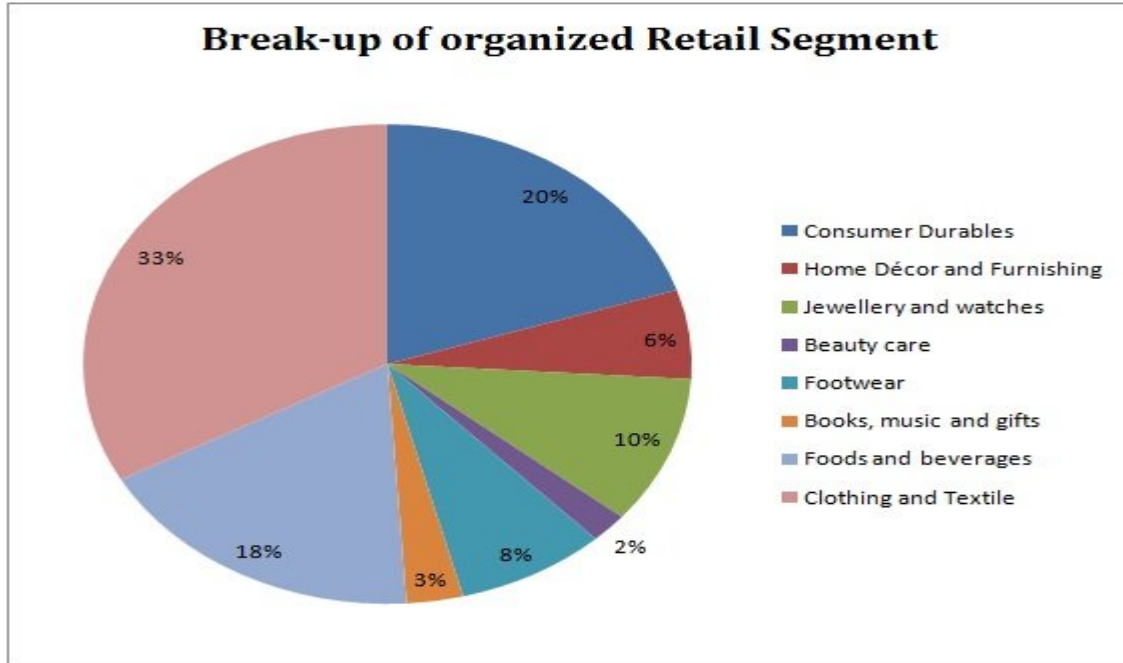
Incremental Competition: With the entry of big players in retail Industry due to the permissible 100% FDI in single brand retailing and 51% in multi brand retailing, the competition will become intense. Increase in competition is expected to alter the dynamics of industry and further sustaining/ acquiring space and manpower resources, thereby making it difficult for the players to compete in the market situations and maintain its margin for future growth.

However, India currently has a small penetration within the organized retail segment as compared to other emerging markets such as China, which has a penetration of more than 20% within organized retail according to the Global Retail Index report by the World Retail Conference.

Unorganized Sector

Undeniably, around 92% of Indian retail sector is unorganized and hence majority of sales take place through unorganized stores popularly known as kirana or mom-and-pop stores. Though organized sector is growing at a faster rate, unorganized sector is still preferred by the customers as they are more convenient and easy to approach. The kirana shop owner knows that the buyer buys the place first. They offer that utility.

In un-organized market, Clothing and Textile segment occupies 33%, followed by Consumer Durables segment occupying 20%. Indian textile industry has grown noticeably in organized retailing of textile products. The negative phase in exports may have compelled the Indian textile retailers to explore the opportunities in the domestic market substantially causing the outstanding growth in the concerned segment. These indications give a positive notion that organized retailing has arrived in the Indian market and is here to stay.



The unorganized sector is expected to grow at the rate of 10% per annum but the relatively weak financial of the sector constraints expansion prospects; making it insufficient enough to meet the growing demand.

Online Retail

The online retail industry, which has been growing like gangbusters in India, with revenues surging from around Rs 1,500 crore in 2007-08 to an estimated Rs 13,900 crore in 2012-13 or a compounded annual growth rate of 56%, is estimated to become Rs 50,000 crore industry by 2016. The growth is expected to come on the back of increasing internet penetration and changing lifestyles and primarily driven by books, electronics and apparel.

E-commerce, as a retail chain has seen phenomenal growth over the last couple of years. It is driven by demand factors such as substantial rise in internet penetration, increasing speed of broadband connections, increasing use of smart phones, etc. in the urban areas and by supply factors such as increased proliferation of venture capitalists, private equity funded e-commerce start-ups. According to the government's estimate, the country's e-commerce sector is expected to reach Rs 50,400 crore in terms of sales by 2015-16, excluding tickets and online sales. Multinationals including Amazon alongside the domestic players like Flipkart have been pitching for opening up of the B2C segment.

The government allows 100% FDI in the business-to-business (B2B) e-commerce segment, which has provided several small and medium manufacturers a platform to sell their products through market place model. In a market place model, online retailers do not actually stock the products but act as a facilitator for vendors who sell their products through their platform. In turn, the e-retailers get commission for the platform use. This, the DIPP has argued, helps the manufacturing activities.

Recent Development

Budget 2015-16:

The Budget 2015-16 turned out to be mixed bag for Indian retail sector. While government's full-fledged budget did deliver some hits towards the betterment of the sector, it also had some misses.

Hits

- Allocation of Rs 1,000 crore to create a Self-Employment and Talent Utilization (SETU) scheme to boost young entrepreneurs.
- Replace multiple prior regulatory permissions with pre-existing regulatory mechanism to make clearances easier
- Incentivise credit or debit card transactions, and disincentivise cash transactions to move towards a cashless economy.
- New law to curb black money.
- Focus on skill development across ministries.

Misses

- No focus towards retail as an industry
- No tax benefits for e-commerce players
- No clarity on GST implementation, apart from the date of implementation, which is April 2016

Outlook

The outlook for Indian retail industry remains positive as the sector continues to remain an attractive long-term retail destination despite it facing many challenges in the past few years. The sector remains attractive with 58.3% of the Indian population being below 30 years and around 31 per cent of this population living in urban areas with rising disposable income.

Although the issue on FDI in multi-brand retail continues to cast shadow on the sector, the government has not yet reversed the notification that the UPA government had issued to open up the multi-brand retail sector.

Also, Union Budget 2015-16 has much to offer for the sector. With announcements like allocations of Rs 1000 crores to technology and startup sectors, promotion of cashless transactions via RUPay debit cards, reduction in Corporate tax from 30% to 25% over next four years, it is evident that the government is focusing on promoting e-commerce, innovation and entrepreneurship.

Companies Financial Data In Industry

Company Name	CMP	MCAP (Rs Crore)	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Trent Ltd.	1451.25	4822.73	421.43	0.48	34.17	42.47
V-Mart Retail Ltd.	550.00	990.86	115.09	0.18	21.12	26.04
Store One Retail India Ltd.	32.70	90.25	53.99	0.00	10.10	3.24
Shoppers Stop Ltd.	410.05	3418.50	91.14	0.18	4.62	88.70
SRS Ltd.	24.45	340.57	45.03	0.00	4.29	5.70
Future Retail Ltd.	108.85	4226.88	138.96	0.55	1.68	64.65
Archies Ltd.	22.25	75.16	31.63	1.80	1.18	18.90
Creative Merchants Ltd.	103.50	51.75	10.06	0.00	0.07	0.00
eDynamics Solutions Ltd.	8.35	18.11	14.24	0.00	0.01	577.40
V2 Retail Ltd.	39.55	88.59	121.41	0.00	-0.58	0.00
Thomas Scott (India) Ltd.	8.00	2.71	32.47	0.00	-1.78	0.00
REI Six Ten Retail Ltd.	0.45	6.62	3.69	0.00	-2.79	0.00
Brandhouse Retails Ltd.	0.99	5.31	11.17	0.00	-5.45	0.00
Pantaloons Fashion & Retail Ltd.	119.00	1104.24	44.03	0.00	-25.34	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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