INITIATING COVERAGE

FUTURE CONSUMER

Rising brand and distribution muscle

India Equity Research| Consumer Goods

Future Consumer (FCL), within just five years, has made its mark in the branded FMCG market. Through its differentiated offerings, the company is not only expanding existing categories, but also launching innovative products in emerging categories. This, along with prudent pricing strategy, ensures higher wallet share of consumers. Moreover, FCL has efficiently leveraged group company Future Retail's (FRL) retail muscle—879 stores—giving it competitive edge. Factoring these, we estimate FCL to clock revenue CAGR of 42.5% and EBITDA margin to expand by 379bps over FY17-20. Initiate coverage with 'BUY' and DCF-based TP of INR77.

Tapping emerging categories; prudent pricing strategy

FCL has its finger on the pulse of evolving trends in consumer tastes and preferences. To play these themes, the company is not only expanding existing categories via differentiated offerings, but also launching innovative products in emerging categories. Moreover, prudent pricing strategy—at a discount to competition in "me-too" products and at a premium in niche products—ensures higher consumers' wallet share.

Future Group's retail muscle: Potent catalyst

FCL's success story is bolstered by the formidable retail muscle of group company FRL—one of India's largest retailers. With 879 stores and >12mn sq ft of retail space under FRL's belt, FCL has had a huge head start (~77% of revenue comes from FRL's retail formats; ~67% excluding Aadhaar and Nilgiris), helping its products create brand equity with a loyal customer base. Moreover, FRL's organic and inorganic growth initiatives (Retail 3.0) are expected to further expand FCL's opportunity pie (estimate store count to reach 1,860 by FY22).

Outlook and valuations: Promising opportunity; initiate with 'BUY'

We estimate FCL to clock revenue CAGR of 42.5% and EBITDA margins to expand 379bps over FY17-20 underpinned by: i) robust innovation drive; ii) retail footprint expansion; iii) operational efficiencies; and iv) favourable product mix. We also expect the company to turn profitable from FY19, FCF positive from FY20 and generate RoE of 12.9% by FY20 (negative for 9mFY18). Though we believe FY20 EBITDA margins (4.2%) and RoE (12.9%) are modest, they entail significant long-term upside. We initiate coverage with **'BUY/SO'** and DCF-based TP of INR77 (implied ~2.5x FY20E EV/Sales).

Financials

Year to March	FY17	FY18E	FY19E	FY20E
Revenues (INR mn)	21,158	30,072	42,956	61,231
Rev. growth (%)	*24.3*	*42.1*	*42.8*	*42.5*
EBITDA (INR mn)	96	481	1,246	2,602
Adjusted Profit (INR mn)	(610)	(359)	203	1,258
Adjusted Diluted EPS (INR)	(0.3)	(0.2)	0.1	0.7
Diluted P/E (x)	NM	NM	NM	83.8
EV/Sales (x)	5.1	3.6	2.6	1.8
ROAE (%)	(10.7)	(6.1)	1.2	12.9

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

MARKET DATA *(R: FTRE.BO, B: FCON IN)*

CMP	: INR 58
Target Price	: INR 77
52-week range (INR)	: 80 / 29
Share in issue (mn)	: 1,824.0
M cap (INR bn/USD mn)	: 111 / 1,706
Avg. Daily Vol.BSE/NSE('000)	: 7,540.3

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	43.1	44.7	48.8
MF's, FI's & BK's	1.1	1.1	1.0
FII's	19.9	17.0	18.3
Others	35.9	37.2	31.9
** Promoters pledged shares (% of share in issue)*	:		*20.2*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	1.4	7.7	6.2
3 months	(1.9)	(24.3)	(22.4)
12 months	14.2	61.0	46.8

Alok Shah
+91 22 6620 3040
alok.shah@edelweissfin.com

Click on image to view video

Abneesh Roy
+91 22 6620 3141
abneesh.roy@edelweissfin.com

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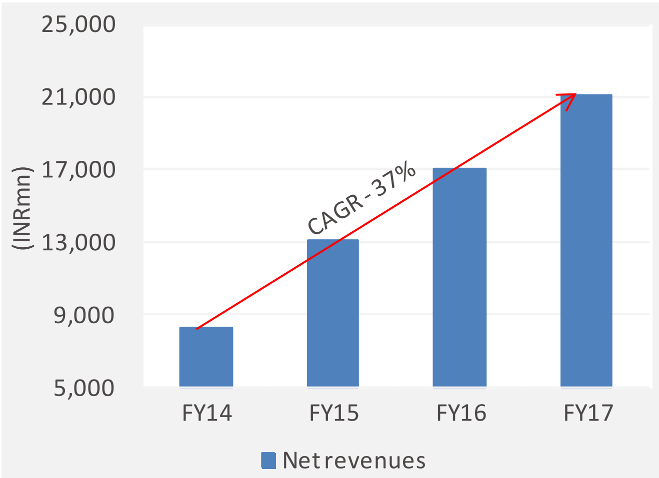
Story in charts

Chart 1: Robust revenue trajectory led by new launches as well as prominence of existing products



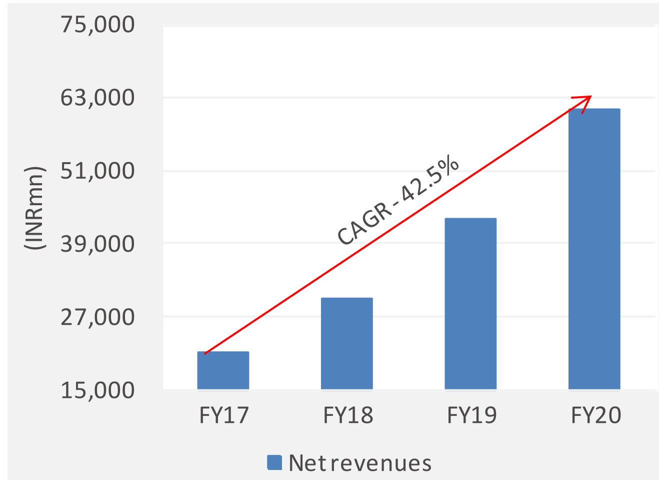
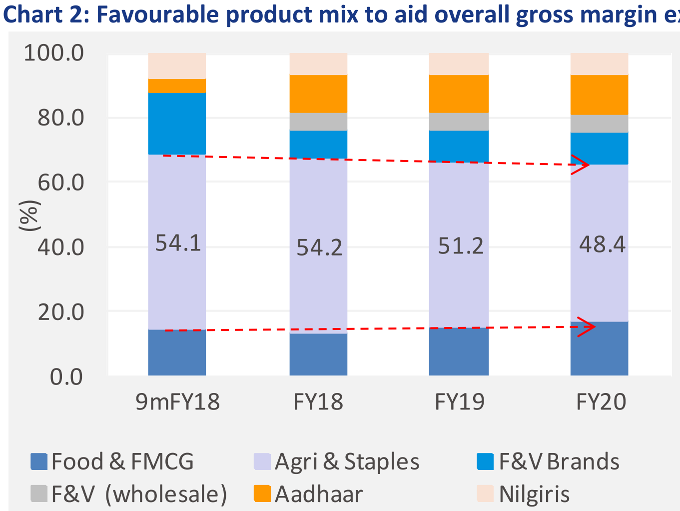


Chart 2: Favourable product mix to aid overall gross margin expansion; operating efficiencies to boost EBITDA margins



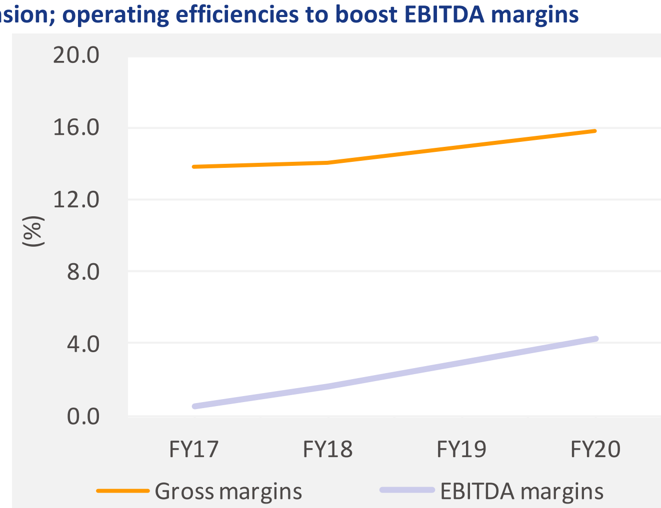
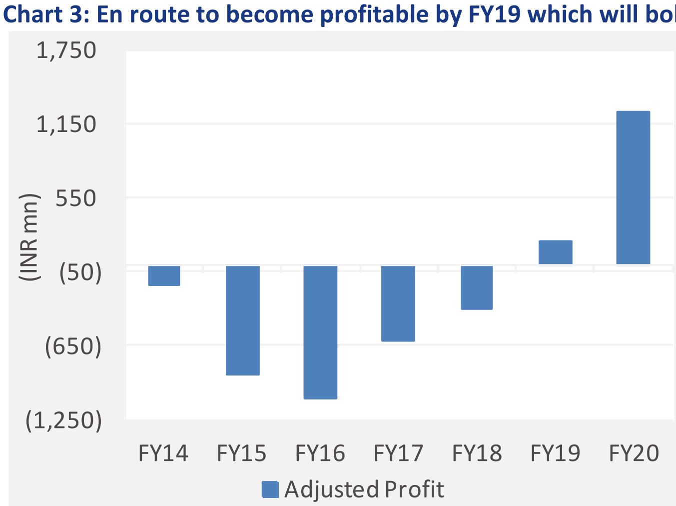
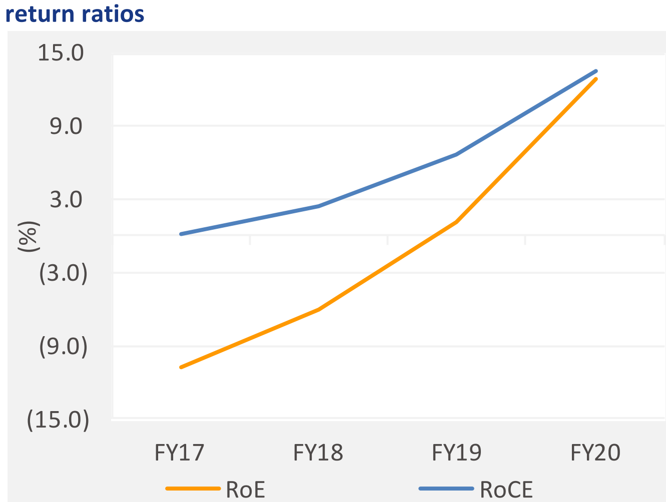


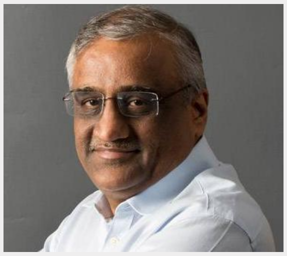
Chart 3: En route to become profitable by FY19 which will bolster return ratios





Source: Company, Edelweiss research

Executive Summary



"Online retail has a threat from us, we don't"

Kishore Biyani
Vice Chairman

Tapping emerging categories with innovative offerings

A rapid transformation is underway in India's consumption pattern propelled by evolving consumer tastes and preferences. To play this trend, **FCL is not only expanding existing FMCG categories via differentiated products, but also launching innovative offerings in emerging categories.** The fact that the company has launched products in more than 50 sub-categories since FY16, leading to revenue CAGR of 37% over FY14-17, is a testimony to its excellent execution capability. Going forward, we not only expect this momentum to sustain, but to also accentuate further, inter-alia, with recent launches gaining scale—**estimate 42.5% revenue CAGR over FY17-20**.

Future Group's retail muscle: Potent catalyst

FCL has been fortunate to get the backing of group company FRL—one of India's largest retailers. With 879 stores and >12mn sq ft (as at December 2017) of retail space (relevant for FCL) under FRL's belt, FCL has had a huge head start, helping its products create brand equity with a loyal customer base. **The company clocks ~77% of revenue through Future Group's retail format (67% excluding Aadhaar and Nilgiris).** With expansion of *Easy Day* (overall store count pegged at 1,860 by FY22), we expect FCL to get huge retail foot print. **FRL already has a track record of clocking double digit SSSG (for over 6-7 quarters now) and with FCL's niche offerings we envisage this healthy run rate to sustain**.

Prudent pricing strategy

FCL follows a prudent pricing strategy—in segments where its offerings are mere "me-too" products, the company's prices are at a discount to peers. In products where it has a niche, the company charges a premium. **This differentiated pricing strategy ensures higher wallet share of consumers**. Additionally, FCL relies more on sampling than mass media ad spends—almost ~1% compared to peer set's ~5-11%. These savings help improve margins and are ploughed back into offering products at a discount compared to peers or alternatively expended on innovation and/or new product launches.

Integrated player from farm to fork

The in-house production capability and integrated nature of farm to fork makes it easier for FCL to experiment in different products sans outsourcing hassles. The company has, wherever necessary, smartly entered into JVs / partnerships with leading domestic and MNCs to enter specialised segments.

Expanding offerings, improving product mix to boost performance

We estimate FCL to clock 42.5% revenue CAGR (37% over FY14-17) over FY17-20 led by: i) new launches gaining brand equity; ii) new store roll outs by FRL across different formats; and iii) favourable product mix. Segment-wise, we envisage overall revenue pie to tilt from low-margin agri & staples to high-margin food & FMCG. This, we estimate, to **lead to 196bps improvement in overall gross margin**. Moreover, improving efficiencies, operating leverage benefit and lower ad spends are likely to **boost EBITDA margin by 379bps over FY17-20**. We estimate FCL to become profitable by FY19 and the company to turn free cash flow positive in FY20 despite factoring capex requirement of ~INR900-1,000mn p.a. Thus, with improving total asset turnover (from 1.7x in FY17 to 3.3x in FY20E), we estimate **RoE to jump to 12.9% in FY20 from -10.7% in FY17**.

"We have destroyed the classical definition of FMCG at Future Consumer,"

Ashni Biyani
Director

Valuation

Considering that FCL has just turned EBITDA positive and is likely to become profitable only from FY19, the company would appear expensive if one values it on either EV/EBITDA or P/E basis. **We believe at this stage, valuing the company at DCF would be more appropriate. Based on DCF valuation methodology, we arrive at a TP of INR77**. Our **TP implies ~2.5x FY20E EV/sales, which is at ~60% discount to peer set and hence reasonable**. Once the business gains scale and turns profitable, we will eventually move valuation methodology to EV/EBITDA and then to PE, in line with peers.

Key risks

Apart from macro-economic and changing customer tastes risks, inter- group transactions is the key risk for FCL. With the company earning ~77% revenue through the Future Group's retail formats (67% excluding Aadhaar and Nilgiris channel), single-party concentration risk remains critical. Moreover, a large part of the company's growth also hinges on the success of the *Easy Day* format. If the latter's growth and margin expectations are belied, FCL's growth will be delayed.

Investment Rationale

Tapping emerging categories with innovative offerings

- We anticipate rapid transformation in India's consumption pattern over the next decade as consumer tastes and preferences become more "Glocal". FCL is well placed to benefit from this as it offers differentiated products in not only existing, but also categories of tomorrow.
- FCL has launched products in more than 50 sub-categories since FY16 and commendably clocked 37% revenue CAGR over FY14-17. This is a testimony to the success of its niche offerings. Going forward, we expect this momentum to sustain as, *inter-alia*, FCL's recent launches gain scale.

A potent combination of favourable demographics, expanding per capita incomes and rapid urbanisation holds promise of surge in aspirational consumption, especially as India is on the cusp of crossing the USD2,000 per capita GDP mark. Globally, it has been observed that once the USD2,000 per capita threshold is crossed, there is a disproportionate increase in consumers' discretionary spending. We estimate India to cross this mark in 2019 and the consumption pattern to evolve and become more "Glocal". The challenge for companies then will be to successfully understand and presciently identify what constitutes a flood, an eddy and a one-time ripple as the evolution progresses.

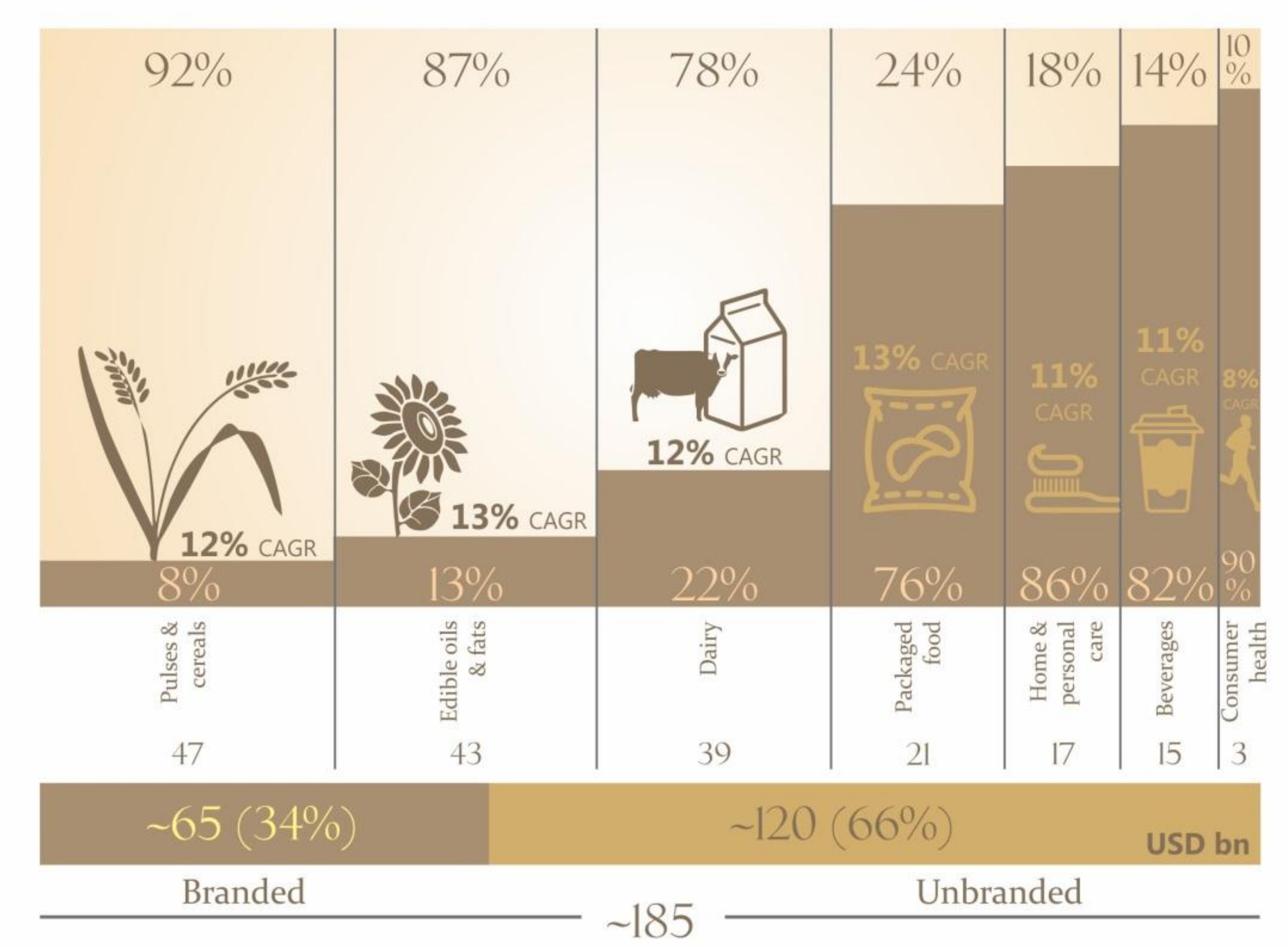
We anticipate a rapid transformation in India's consumption pattern over the next decade, especially in the top 15 cities. A case in point is the rising consumption of processed and packaged food currently, and the trend has, one can safely surmise, barely scratched the surface. Be it consumption of differentiated attas, processed foods, beverages, packaged food or healthy snacks, the consumption pattern is indeed set for a decisive shift.

However, existing FMCG players have failed to keep up with the rapid changes. For example, 92% of pulses and cereals sold are unbranded and ~78% of dairy sold is loose & unbranded. This entails huge potential for new players to grab the hitherto untapped opportunity. And, this opportunity is not restricted to only the foods segment; humungous changes are expected in the Home and Personal Care (HPC) category as well where there are a handful of global/national players with splintered tail.

FCL: Eye for identifying opportunities and prudently tapping categories of tomorrow

FCL has identified this changing consumer trend & preference and has already set itself to become FMCG 2.0 through both entering existing categories and expanding them via differentiated products or entering categories of tomorrow.

Fig. 1: High potential categories of tomorrow



Source: Euromonitor, Company, Edelweiss research

Note: CAGR mentioned inside the chart are 2005-15 category growth rates

A few categories of tomorrow that FCL is focusing on are:

a. **Multi-grains and oats variant**: For long, wheat has been the staple flour in India. However, multi-grains and oats are fast catching up and seem to have a long run way ahead. FCL is focusing on these categories and launching new offerings.

b. **Organic food products:** While the overall market for organic foods is minuscule currently, it is picking up significantly. FCL has a range of products under the *Mother Earth* brand through which it offers organic staples such as rice, pulses, sugar, etc.

c. **Processed foods:** Currently, only a handful of branded ready mix packs are available in the market and with consumers relying more on processed foods, consumption of pakodas, dosas, khaman, etc., are set for a robust spurt. FCL with its broad range of products will be key beneficiary.

d. **Healthy snacks:** Rising health consciousness is propelling consumers towards healthy snacks. Hence, FCL has launched a range of products under *KOSH* and *Tasty Treat* labels.

Fig. 2: Differentiated offering to capture higher pie of customer's wallet share

Source: Company, Edelweiss research

Moreover, FCL's existing product range covers a wide spectrum of food and HPC categories essential for every household, thereby ensuring strong engagement with customers.

Table 1: List of key brands along with its broad description and relative competitive intensity

Brand	Offerings	Competitive Intensity from organised players
Food & Groceries		
Golden Harvest	Caters to everyday kitchen essentials by providing premium quality flour, pulses, rice, dry fruits, cereals and spices	Low
Golden Harvest Prime	Offers a select range of pulses, millets, super grains, spices	Low
Karmiq	Offers a range of green teas, dry fruits, alternate healthier & exotic oils, flavoured nuts & seeds	Medium
Fresh & Pure	Range of products in tea, coffee, honey, lemon juice, and oils such as mustard oil, sunflower oil and soyabean oil	High
Mother Earth	Organic staples, such as rice, pulses, spices, sugar	Medium
Desi Atta	Ready mix - besan pakoda, classic dosa, dahi vada, khaman dhokla, thepla mix;	Medium
KOSH	Premium oats - broken oats, instant oats, wheat oats; flavoured oats - Banana caramel, chinese chilli, chole masala, lively lemon, magic mango, terrific tomato	Medium
EKTAA	Curates a wide range in regional rice, flours, spices and special food items	Medium
Mera Swad	Healthy digestives, mouth fresheners, candies with flavours of mango, papaya, paan	Low
Dairy, Bakery & Confectionary		
Nilgiris	Dairy products such as set curd, flavoured milk, yogurt, butter, cheese, ghee, paneer; Bakery items such as bread, bun, cakes, kulchas	Low
Gruezi	Assortment of swiss chocolates in two special packs Grüezi Swiss Matterhorn chocolates and Grüezi Assorted Centre filled chocolates	High

Source: Company, Edelweiss research

Table 1: List of key brands along with its broad description and relative competitive intensity (Contd…)

Brand	Offerings	Competitive Intensity from organised players
Snacks & Beverages		
POOOF!	Delicious and flaky treats such as wafflets, kettle chips and popcorn	Medium
Sunkist	Sunkist fruit juices, nectars and frusion drinks such as Kiwi lemon, Citrus twist, Apple Ginger honey, etc	High
Sangi's Kitchen	Magic mixes of chutneys, sauces, dips, dressings and spreads, pastes and spice mixes	Low
Veg affaire	Range of frozen fruits and vegetables, with no hassles of cleaning, peeling, and cutting	Low
Baker Street	Seasoned with flavourful herbs & spices Baker Street's bruschetta, breadsticks, biscotti, garlic bread, melba toast, pita chips, etc	Low
Tasty Treat	Ready-to-eat snacks, pop-corns, beverages, wafer-biscuits, sauces, frozen snacks, tidbits, soups, pasta, namkeens, etc	High
Personal Care		
Kara	Unique range of beauty products like refreshing wipes, skin care wipes, acetone free nail polish remover wipes and make up remover wipes	Medium
Swiss Tempelle	Range of body washes, shower gels, spa-like hand and face wash and fragrant lotions	High
Think Skin	Range of body wash available in five variants - AquaSplash, ActiveSports, WildRose, SandalClear and LemonFresh	Medium
TS	Grooming range including hair accessories, bath accessories and make up accessories	Low
Puretta	Complete baby care products	High
Home Care		
Clean Mate	Effective cleaning solutions for a wide range of household needs - toilet cleaner, floor cleaner, glass cleaners, air freshner	High
Care Mate	Range of facial tissues, toilet tissues, aluminium foils, cling films, handwash, hand sanitizer & party disposables	High
Prim	Range of wipes, cleaning sponge, fabric care products, odour/moisture removers & food storage solutions	Medium
Pratha	Range of incense sticks ranging from regular, masala, natural, yoga, woody to aromatherapy and various products such as lamp oils, ghee vati, camphor, kumkum, haldi, sambrani cups, etc	Low

Source: Company, Edelweiss research

In this backdrop, with ~60% of portfolio in staples (including fruits & vegetables) and balance in food & HPC segment, we believe **FCL is at an inflection point as it is a formidable player with expanding presence in these categories of tomorrow.** Of course other consumer goods companies too are innovating, but as proportion of overall revenue FCL has a much larger pie.

Product mix: The perfect blend

FCL's wide range of products is a perfect blend of existing categories as well as categories of tomorrow, which dramatically improves the probability of success. Besides this, there are multiple factors that go into making a brand / product successful—product, price, competition, place of offering, storytelling approach, customer centricity, etc.

Hector Beverages: Case study

Hector Beverages, with an eye on functional drinks, started selling an *aam pana* flavoured drink in 2012 in the cut-throat competitive traditional Indian beverages segment. The company now boasts of INR690mn turnover as at FY17 with 62.9% CAGR over FY14-17. Now, the company offers 15 flavours and has also diversified into snacks like chikki.

So, what worked for Hector Beverages?

a) **Product:** Most of the ingredients used are naturally found spices and condiments, making it a differentiated product from other brands in the crowded soft drink segment.
b) **Price:** Multiple SKUs have helped build connect with customers across income spectrum.
c) **Competition:** There was extremely low product-wise competition in differentiated beverage market from organised players.
d) **Distribution channel:** Paper Boat now sells at >2 lakh retail touch points including airports, airlines, etc.

Drawing parallels for FCL

FCL, like Hector Beverages, has and continues to innovate its products, create and expand new categories (refer table above). On the price front as well, the company is playing through its strengths (refer section: Prudent pricing strategy). In addition to levers which worked for Hector Beverages', FCL has an added lever—distribution muscle through Future Retail. It is also pertinent to note that Hector Beverages has spent a sizeable amount on A&P leading to EBITDA loss of INR680mn in FY17 (almost same as revenue) whereas FCL's ad spends is ~1% of revenue. **Thus, we continue to believe that any company which has a differentiated offering, at right price points, and has retailing prowess can make its mark and become a FMCG giant in a profitable manner.**

Vibrant product basket complemented by robust execution

From an execution perspective, FCL has launched and sustained healthy growth across all categories. And, commendably, this has been achieved without management taking its foot off the innovation and new launches pedal. Moreover, the company has also invested ~INR1,500mn in setting up its own food park ensuring in-house manufacturing.

The fact that FCL has launched products in more than 50 sub-categories since FY16, leading to revenue CAGR of 37% over FY14-17 (24% YoY growth in FY17) is a testimony to the company's execution capabilities. Going forward as well we do not see any reason why FCL will not be able to sustain its innovation pipeline and new product launches, which is expected to lead to a strong revenue trajectory.

Future Group's retail muscle: Potent catalyst

- FCL has been fortunate to get the backing of group company Future Retail (FRL)—one of India's largest retailers. With 879 stores and >12mn sq ft (as at December 2017) of retail space, FCL has had a huge head start.
- The company clocks ~77% revenue through Future Group's retail formats (67% excluding Aadhaar and Nilgiris).
- With FRL's overall store count set to catapult to ~1,860 by FY22, we expect huge addition in retail space for FCL.
- FRL is already clocking double digit SSSG and with FCL's niche offerings, we expect this healthy run rate to sustain.

For a consumer goods company, distribution & retailing, the number of touch points, proportion of wholesale vis-à-vis retail, are extremely crucial. **For FCL, it is much sorted considering that group's flagship company—Future Retail (FRL)—is one of the top retailers in India.**

Our analysis, buttressed by commentary of FMCG companies, indicates that MT and e-commerce are the fastest growing categories within overall trade channels. And, this pace has only accentuated post demonetisation and GST. Considering these coupled with incremental cost of selling through other formats, most of the FMCG companies are re-crafting their route to market to focus more on MT and e-commerce. We also believe that the long route to market (as described below) is set to get much leaner.

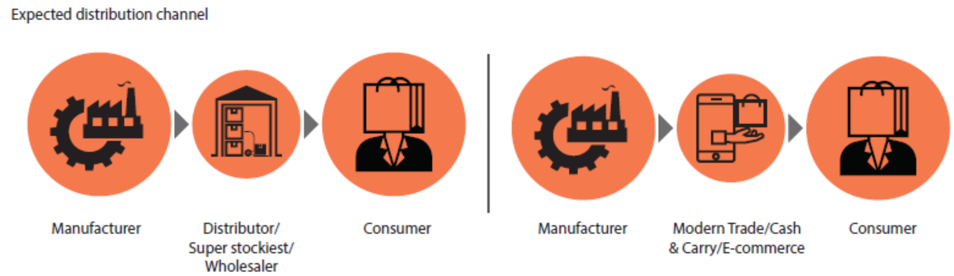
Fig. 3: Traditional run-of-the-mill route to market

Source: Edelweiss research

This route-to-market has remained stagnant for many decades (barring a few consolidations at wholesaler / super stockiest level), leading to a long chain, in turn, and delaying launch of new products or hindering the innovation pace. Multiple layers are also a hindrance for FMCG companies to gain consumer insights, understanding of changing tastes and dynamics.

With the emergence of MT and e-commerce distribution platforms, this model is now being seriously tested. We are not saying that the GT format will not survive over the next decade, but we expect the proportion of MT (at ~10-12% of overall FMCG market currently) to jump significantly hereon. By 2025, we also expect the route-to-market to look as depicted in the figure below.

Fig. 4: Expected route-to-market by 2025



Source: Edelweiss research

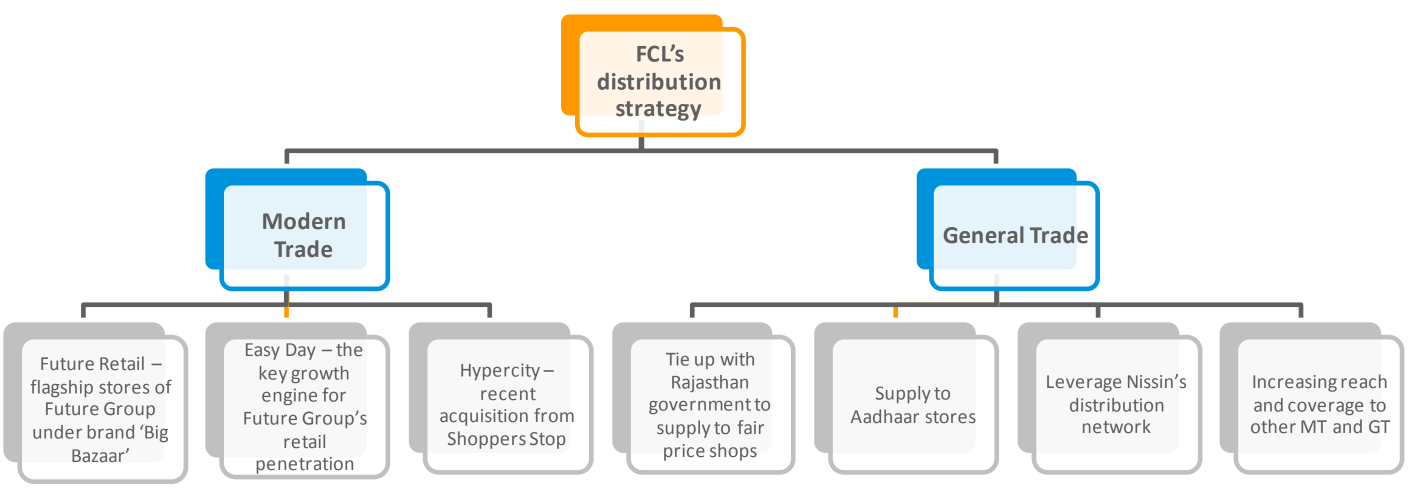
So, how will FCL gain out of this?

The FMCG sector is ready for disruption—while on one hand consumers have evolved and are demanding a wider range of products and categories, on the other, a large number of big companies continues to offer the same old products. Most companies follow the traditional approach of creating one brand for one product and a few variants that are sold through a multi-layered distribution model largely through GT. Innovation is limited to what and how products can be sold in the small 300 sq ft kirana format.

However, the consumer base in Metros and Tier 1 is getting younger who are aware of global tastes and trends, and FCL's product range is designed largely to focus on catering to consumers shopping at MT formats. As stated earlier, this is one of the fastest growing formats.

The MT format also enables FCL to do sampling, differentiated promotions, shelf level communication as well as gather direct feedback from consumers. This, in turn, brings more science and innovation behind brands, helps it grow faster and much more efficiently. For FCL, garnering distribution through MT is relatively easier as Future Group's retail chain Future Retail (FRL) is one of the top MT retail outlets in India. **FCL clocks ~77% of revenue through Future Group retail formats (67% excluding Aadhaar and Nilgiris), thus would be one of the prime beneficiaries.**

Fig. 5: FCL's distribution game plan



Source: Company, Edelweiss research

FRL's retail game plan

FRL has retail formats across different hypermarkets, supermarkets as well as convenience store formats through *Hypercity, Foodhall, Big Bazaar* and *Easy Day*. The Future Group's primary focus now is to ramp up *Easy Day* format stores with the membership concept. The game plan is to have 10,000 stores by CY22 (from >600 stores as at December 2017) with each store having ~2,000 members. **With p.a. potential spends at INR75,000 per member, this format alone entails potential to generate INR150bn revenue for FRL from the *Easy Day* and convenience store format**. Apart from *Easy Day*, steady expansion in Big Bazaar, Hypercity and Foodhall will propel revenue trajectory further.

Table 2: Future Group's retail footprint expansion

	Mar-16	Dec-17	Mar-22
Big Bazaar	228	259	325
Easy Day	320	611	1,500
Foodhall	4	9	35
Hypercity	NA	19	22
Total stores	**552**	**879**	**1,860**

Source: Company, Edelweiss research

Note: FY22 store count is Edelweiss estimates

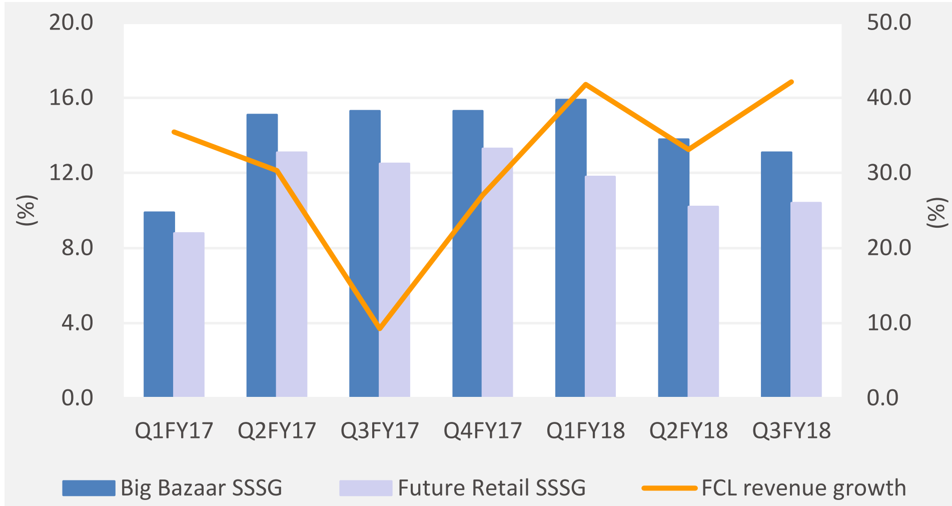
Within all formats, and especially *Easy Day*, the plan is to house more FCL products. With expanding retail footprint, FCL will be able to enhance its distribution penetration, entice customers to try newer products through sampling, thereby gaining customer loyalty. This way, some of its products will also start becoming brands with their own recall value.

Apart from this, FRL is now also becoming more competitive by changing its discount pricing strategy to **'Har Din Low Prices'**, mimicking Walmart's global everyday low pricing business model, putting pressure on its rivals to drop grocery prices. Company has also called out that these markdowns in Big Bazaar will be consistent throughout the year, and will further go up if rivals try to match it.

Fig. 6: Aggressive stance adopted by FRL

Source: Newspaper advertisement, Company

Chart 4: Positive correlation of FRL's SSSG as well as FCL's revenue growth

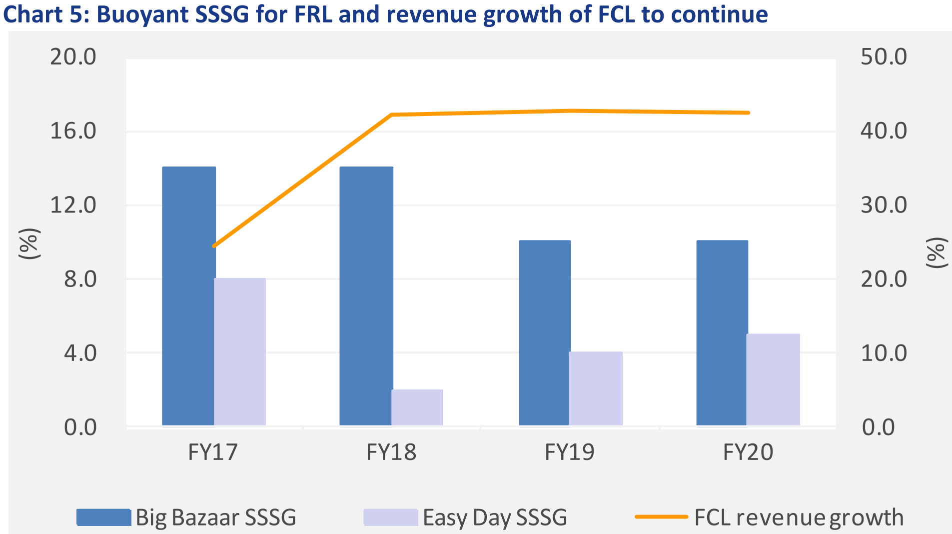


Source: Company, Edelweiss research

Note: KB's fair price convenience stores were hived off from FCL in Feb 2016. Adjusting for these, growth rates for FCL for Q1 to Q4FY17 would be higher than plotted on the chart.

FRL has been able to sustain its double digit SSSG run rate over the past five-six quarters. We expect this trend to sustain or accentuate going ahead. This growth rate is on soft SSSG of *Easy Day*. Once *Easy Day* and *Hypercity* as formats sustain, it will further give a fillip to overall SSSG. Thus, riding strong growth from different retail formats of FRL and positive correlation between FRL's SSSG and FCL's top line growth, we continue to remain confident of strong sales for FCL (refer financial outlook section).

Chart 5: Buoyant SSSG for FRL and revenue growth of FCL to continue

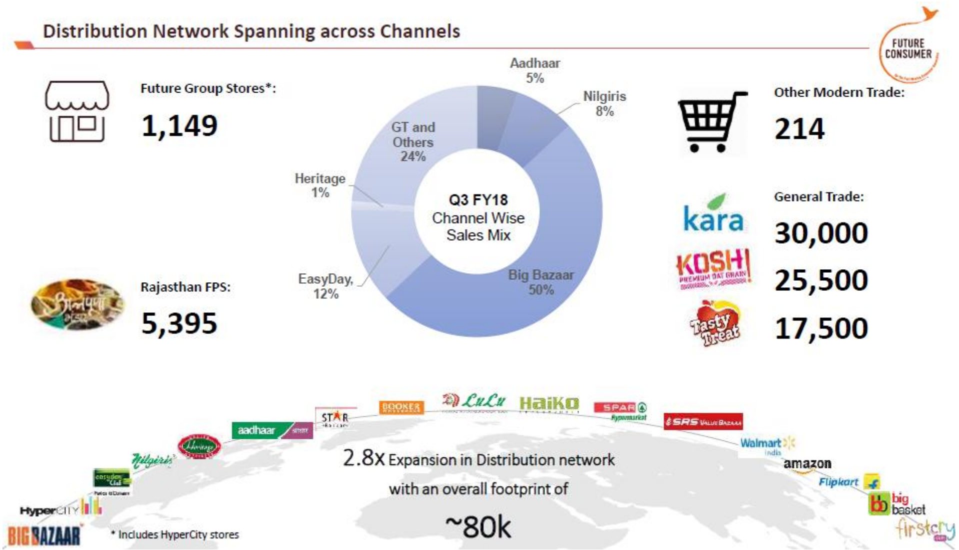


Source: Company, Edelweiss research

Distribution outside Future Group's retail footprint: Optional value

Though FCL works on a simple philosophy, *"We may reach fewer number of stores, but the number of upwardly mobile consumers the modern retail chains attract in urban centres can be compared favorably with general trade,"* there are pockets of GT channel too where the company is penetrating.

Fig. 7: Existing distribution reach



Source: Company, Edelweiss research

Apart from FRL's retail format, FCL also has started venturing into other trade channels. With the company's products gaining brand equity, rising traction in MT and GT will be additional growth driver.

Prudent pricing strategy

- FCL follows a prudent pricing strategy—discount in me-too products and charges premium in niche offerings.
- This differentiated pricing strategy ensures desired traction even in categories where there are established players.
- Additionally, the company relies more on sampling than mass media ad spends. The savings in ad costs help improve margins and are ploughed back into offering products at a discount compared to peers or alternatively spend on innovation and/or new product launches.

FCL primarily plays in two segments: (i) established categories where FCL's modus operandi is to expand the market with differentiated offerings; and (ii) categories where FCL will be a pioneer & take lead in terms of category building & expansion. Broadly, in every product category – be it processed foods, staples, HPC, etc there are multiple branded and unbranded products vying for the customer's wallet share. The moot question then is, why will consumers prefer FCL's products over those sold by established brands?

In order to understand the same, we evaluated FCL's pricing strategy. Based on its product pricing vis-à-vis competitors, we bucket FCL's products under three categories: **Category 1**–pricing at discount to peers; **Category 2**–pricing in same range as peers; and **Category 3**–pricing at a premium to peers.

In segments where FCL's offerings are mere me-too products (atta, talcum powder, green tea, etc.), the company's rates are competitive and at a discount to peers, thereby falling in **Category 1**. In products where the company has a niche, where there is scope for shift of demand from unorganised to organised segment or where it has the potential to compete equally with other products or where it is creating a new category itself, FCL does not shy away from charging a premium, thereby falling in **Category 3**.

Thus, FCL's pricing is determined by factors like right to win, scope of expansion into modern trade & general trade, presence of unbranded products, etc.

Table 3: Bucketing of key brands

Category 1	Category 2	Category 3
Priced at discount to peers	**Priced in the same range as peers**	**Priced at premium compared to peers**
Fresh & Pure	Swiss Tempelle	Kara
Tasty Treat	Fresh & Pure	Puretta
Clean mate	Golden Harvest Prime	Pratha
Swiss Tempelle		KOSH
Care mate		Sunkist
Karmiq green teas		Karmiq dry fruits
Golden Harvest		Desi Atta
		Pooof
		Mother Earth
		Nilgiri's

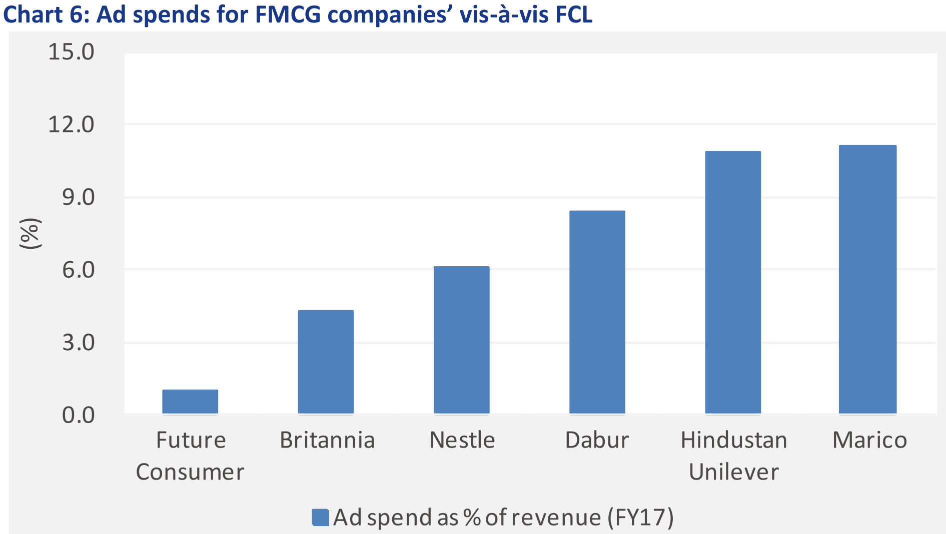
Source: Company, Edelweiss research

In line with this strategy, FCL's staples such as tea, coffee and a few HPC products are priced at a discount to peers, whereas offerings such as *Kara, Sunkist, KOSH*, among others, where FCL has a significant product differentiation and right to win are priced at a premium. Thus, through a prudent pricing model, the company has made its mark in the market and cornered customer's wallet share.

We do agree that selling products at a lower rate could pressurise gross margins. However, since FCL sells its products largely through MT formats, it relies more on sampling of products at point of sales rather than via big bang mainstream advertisements. The in-store sampling opportunity is also easily available within the Future Group eco-system at *Big Bazaar, Food hall, Hypercity, Easy Day*, etc., which is not an expensive proposition. Sampling also enables FCL tap into customers who have anyways come to the store with a shopping mindset. With ~400mn annual footfalls across Future Group's retail outlets, FCL is able to promote its products to a wide shopping audience.

This prudent strategy enables savings on ad cost (for peers, ad cost is in the ~5-11% range), which is ploughed back into offering products at a discount compared to peers or alternatively spend towards innovation and/or new product launches.

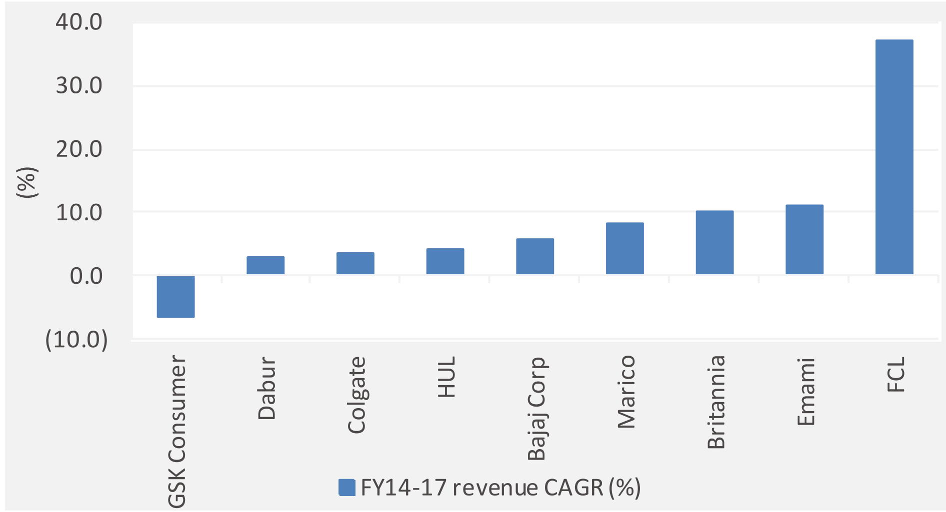
Chart 6: Ad spends for FMCG companies' vis-à-vis FCL



Source: Company, Edelweiss research

This pricing strategy as well as focussed distribution and sampling have enabled FCL clock 37% revenue CAGR over FY14-17 vis-à-vis most other FMCG peers who have, at best, clocked ~10% revenue CAGR. Though there could be some base impact fueling FCL's robust growth, credit also goes to the company's excellent execution strategy.

Chart 7: FY14-17 growth rates for FCL vis-à-vis peers



Source: Company, Edelweiss research

Integrated player from farm to fork

- The in-house production capability and integrated farm-to-fork model help FCL innovate without resorting to outsourcing.
- FCL has, wherever necessary, smartly entered into JVs / partnerships with leading domestic and MNCs to venture into specialised segments.

FCL's flagship food park is located at Tumkur, Karnataka. The food park is associated with more than 1,200 farmers and has the capability to source and process more than 0.15mt agri produce, imparting it the ability to manufacture products as diverse as schezwan sauces and frozen dimsums to offering more than 40 variants of flour, alphonso mango pulp, frozen snacks (cocktail samosa, malabar paratha), among others.

The company has developed 71 sourcing hubs across the country and has APMC licenses in 26 states. It also has 34 warehouses and 11 processing centers. Apart from the Tumkur food park, it also has an oats facility in Sri Lanka and a facility for fruits & vegetables, frozen snacks and sauces & dips in South India. FCL has one manufacturing facility each for dairy and bakery products close to Bengaluru with milk handling capacity of 0.18mn per day, which has the potential to make a wide range of products including milk, butter, variants of cheese (2,100kg), curd (22,000litres), etc. FCL's dairy currently procures 54,000litres of milk everyday from a network of >9,000 farmers.

Apart from FCL's core manufacturing facilities, Nilgiri's is another feather in the cap with its flagship range of dairy and beverage products.

Fig. 8: FCL's farm to fork model

Source: Company, Edelweiss research

The in-house production capability and integrated nature of farm to fork makes it easier for FCL to experiment in different products sans outsourcing manufacturing. The company has, wherever necessary, smartly entered into JVs / partnerships with leading domestic and MNCs to enter specialised segments.

Joint ventures / partnerships to make niche products

FCL has entered into JV with leading domestic & multinational companies for entry in specialised segments like organic & toddler food, personal care, oats-based products and the highly competitive branded rice segment.

Some of the partnerships are:

i. **Mibelle AG:** Swiss-based Mibelle, part of the Migros Group, is amongst the largest consumer goods companies in Central Europe and has **partnered with FCL for personal care products**. The *Swiss Tempelle* brand has launched body wash and lotions and is planning to further extend this range. In ensuing years, the JV also aims to start local production, improving time to market, reducing launch cost, etc.

ii. **Hain Celestial:** Amongst the largest suppliers of whole foods, Hain Celestial is a leading organic, natural, and better-for-you products company. Best known for Tilda rice in India, the **JV will introduce brands and products comprising Terra vegetable chips, Garden of Eatin tortilla chips, Dream rice & soya milk, health snacks for toddlers**, etc along with a manufacturing base at India Food Park, Tumkur.

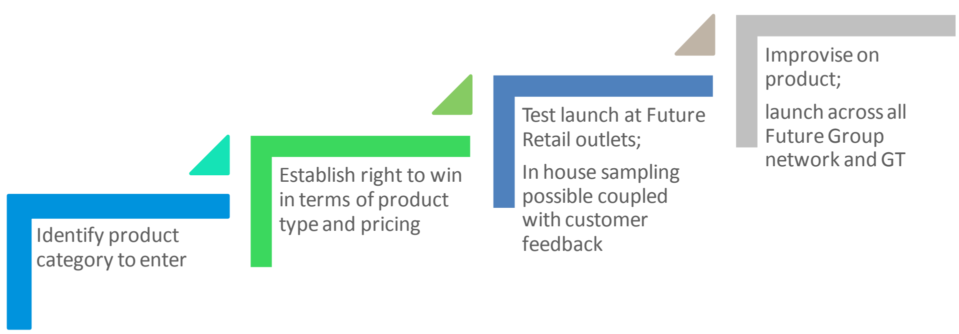
iii. **Kosh:** The *Kosh* brand has been launched to make oats. It **offers instant oats, broken oats, wheat and oats flour**. It has also launched instant oats in multiple flavours—sweet (mango, banana caramel) and savory (lively lemon, Chinese chili flavour, chole masala, terrific tomato) categories.

iv. **LT Foods:** LT Foods is amongst the leaders in packaged rice led by basmati rice brand *Dawaat*. A **milling and processing plant in JV with LT Foods at India Food Park, Tumkur, has been operationalised for Sona Masoori rice**, a popular variant in South India, with an objective of developing the first national, branded and packaged rice brand beyond basmati rice.

Shortening time to reach market

In spite of catering to a wide portfolio of products, FCL's time to reach market, understanding consumer dynamics & feedback and working upon products is quick and effective. This has been possible due to the company's integration across all touch points—sourcing, manufacturing, distribution and retailing.

Fig. 9: Short road to product launches



Source: Company, Edelweiss research

Pruning investments in non-core assets

- As at FY17, FCL had non-current investments (on standalone basis) of INR6,360mn. While most of these are in subsidiaries / JVs, some are non-core investments.
- Management, to improve capital deployment, has decided to hive-off investments in non-core assets. We do not expect any significant hair cut on these exits.

As at FY17, FCL had non-current investments (on standalone basis) of INR6,360mn. Of these, ~72% pertained to investment in Aadhar Wholesale and acquisition of Nilgiri's dairy farm. Of the balance, while most investments were in subsidiaries or JVs, small investment have been in non-core assets—INR640mn in Amar Chitra Katha and a few non-operating subsidiaries.

Management has, in order to improve capital deployment, decided to hive off investments in non-core assets. The company's Board of Directors has already announced the following: (i) sale of investment in Amar Chitra Katha for equity valuation of not less than INR600mn; (ii) disposal of non-functional / non-core investments in two subsidiary companies—Star & Sitara Wellness and Express Retail; and (iii) transfer of 40% stake in Bloom Foods & Beverages.

This, we believe, will free up FCL's capital partially, which can be utilised for its capex requirements. We perceive this as a prudent step which will alleviate investor concerns, to some extent, on capital deployment.

Valuations

- FCL is a long-term play on India's evolving consumption segment, which will be boosted by new launches and building of brand equity of existing products, phenomenal store addition of FRL, improvement of SSSG of FRL as well as deepening its reach in other trade channels,.
- Considering FCL has already turned EBITDA positive in 4 years of operations with PAT profitability anticipated in FY19, the robust earnings trajectory has just begun.
- We value FCL on DCF basis and arrive at TP of INR77. Our TP is also backed by comparable EV/Sales (implied ~2.5xFY20 EV/Sales, ~60% discount to peerset).

FMCG companies under our coverage are characterised by long history of operation, strong profit and free cash flows with minimal capex as majority of the products is outsourced. Thus, we use the PE multiple valuation methodology to value these FMCG companies.

However, this conventional valuation methodology possesses challenges while valuing a company like FCL—with ~five years of operations and which has just turned EBITDA positive. Valuing FCL even on EV/EBITDA will be flawed since it was only in FY17 that the company has turned EBITDA positive and hence will take at least five-seven years before it starts clocking sustainable EBITDA margin.

FCL is a long-term play on India's evolving consumption segment, which will be boosted by new launches and building of brand equity of existing products, phenomenal store addition of FRL as well as deepening its reach in other trade channels, improvement of SSSG of group company FRL. Considering FCL has already turned EBITDA positive in 4 years of operations with PAT profitability anticipated in FY19, the earnings story has just begun.

We believe at this stage DCF is more appropriate. **As per DCF methodology, we arrive at target price of INR77.** Our TP is also backed by comparable EV/Sales (implied ~2.5xFY20 EV/Sales, ~60% discount to peerset). As FCL's business gains scale, profitability and sustainability emerges, we will eventually move valuation methodology to EV/EBITDA and then to PE in line with peers.

Table 4: Key variables used in DCF valuation

Calculation of WACC & Terminal growth rate					
	Cost	**Weight**	**Weighted cost**		
Equity	12.2%	55%	6.7%		
Debt after tax	7.4%	45%	3.3%		
			10.0%		
	Debt calculation			**Equity calculation**	
	Debt Cost	11%		Risk free	8%
	Tax rate	33%		Beta	1.1
				RM	5%
					12.2%
Terminal Growth rate		8.5%			

Source: Edelweiss research

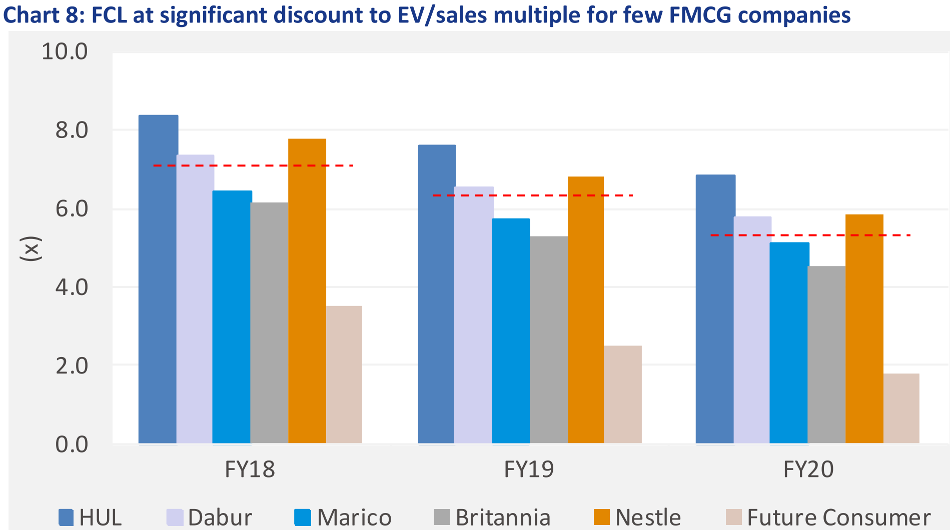
Table 5: Discounted Cash Flow computation

INR mn	FY16	FY17	FY18	FY19	FY20	FY21	FY22
EBIT	(448)	(230)	92	810	2,122	4,595	6,585
Less: Tax	(2)	9	-	-	231	886	1,521
Add: Depreciation	284	326	389	435	480	517	547
Cash flow	**(162)**	**88**	**481**	**1,246**	**2,371**	**4,226**	**5,612**
Less: Change in WC	(2,067)	991	(120)	1,337	1,623	2,478	2,959
Less: Capex	789	1,236	950	1,050	900	750	600
Free Cash Flow	**1,115**	**(2,139)**	**(349)**	**(1,141)**	**(152)**	**997**	**2,053**
Discounting factor (10.2%)			1.00	0.91	0.83	0.75	0.68
Discounted free cash flow			**(349)**	**(1,037)**	**(125)**	**749**	**1,400**
Free Cash flows	987						
Terminal Value	144,651						
			Per share				
Value of firm	**145,638**		**80**				
Less Debt	7,415						
Add Cash	1,681						
Add Investment	0						
Value of Equity	**139,903**						
No of shares	1,824						
Value per share	**77**						

Source: Edelweiss research

We have also benchmarked FCL's valuation vis-à-vis FMCG peers. While FCL is trading at EV/sales of ~1.8x FY20E, FMCG behemoth HUL is trading 6.8x FY20E EV/sales. Even when compared to average valuation of a few other FMCG companies (average FY20E EV/sales of 5.6x), FCL is trading at >60% discount.

Chart 8: FCL at significant discount to EV/sales multiple for few FMCG companies



Source: Edelweiss research

Note: (i) Red dotted lines in each year signifies average EV/Sales multiple for peerset; (ii) For calculation of EV/Sales, CMP as of 9 April 2018 is considered

Even if one discounts comparable multiple to account for difference in size, brand establishment risk, dependence on single retailer, etc., we would still be comfortable assigning ~2.5x FY20E EV/sales to FCL (>50% discount to FMCG average), which too will lead to target price of ~INR77.

FCL, with less than five years of operations, has turned profitable at the EBITDA level with the likelihood of turning PAT positive by FY19. We, therefore, believe **it is the stock to own to ride the burgeoning consumption story as it is armed with differentiated offerings, establishing brand equity and is underpinned by strong distribution muscle. Hence, we initate coverage with 'BUY' recommendation and 'SO' rating with TP of INR77 (implied ~2.5x FY20E EV/sales).**

Financial Outlook

- We estimate FCL to clock 42.5% revenue CAGR over FY17-20 led by: i) new launches; ii) other products gaining brand equity; iii) new store roll outs by FRL across different formats; and iv) penetration in other distribution channels.
- We estimate 196bps gross margin improvement led by improving product mix.
- Moreover, improving efficiencies, operating leverage benefit and lower ad spends are likely to boost EBITDA margin by ~379bps over FY17-20E.
- We estimate FCL to become profitable by FY19 and turn free cash flow positive in FY20 despite factoring consistent capex outlay of ~INR900-1,000mn p.a.
- Thus, with improving asset turnover (from 1.7x in FY17 to 3.3x in FY20E), we estimate RoE to jump to 12.9% in FY20 from -10.7% in FY17.

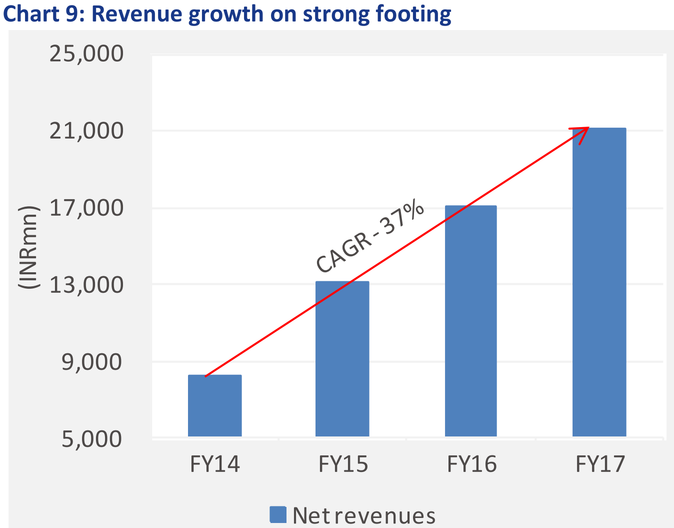
As has been rightly stated, *"we always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten years."* This aptly applies to FCL.

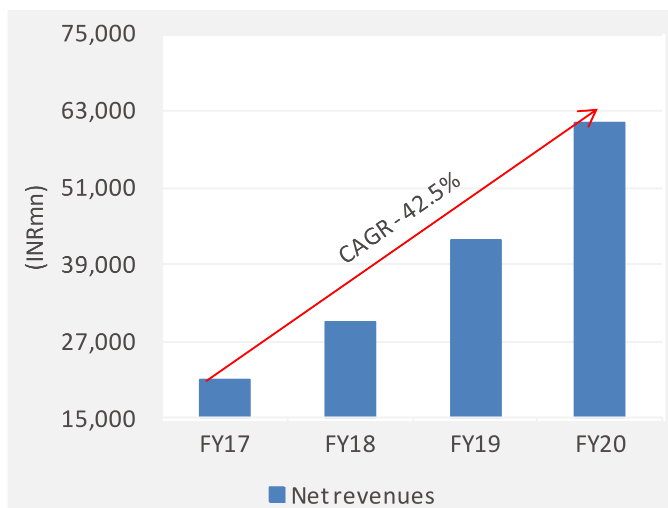
New launches, deepening distribution to spur revenue

Over FY14-17, FCL has clocked 37% revenue CAGR. While compared to peers (who have clocked ~10% average revenue CAGR) the company's growth has been much faster (though on a soft base), we believe this growth is still not a true reflection of FCL's growth potential since most of FCL's products have been introduced over the past three years and have not attained full potential.

Thus, we estimate FCL to clock 42.5% revenue CAGR over FY17-20 driven by recent launches becoming bigger brand and gaining prominence, further deepening of distribution network and more shelf space offered by FRL, etc.

Chart 9: Revenue growth on strong footing

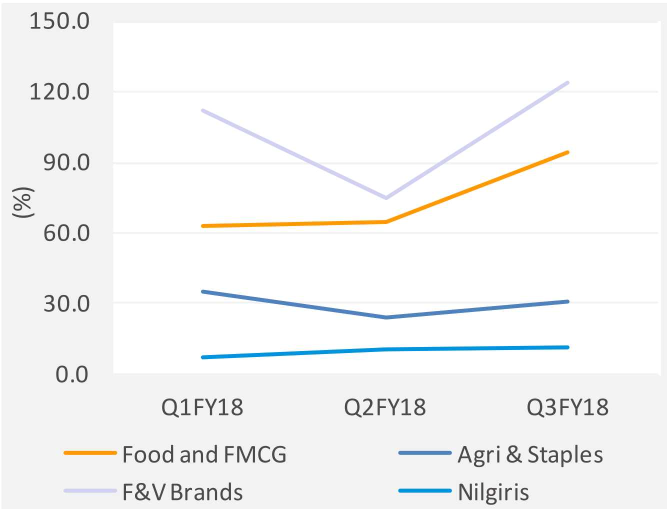


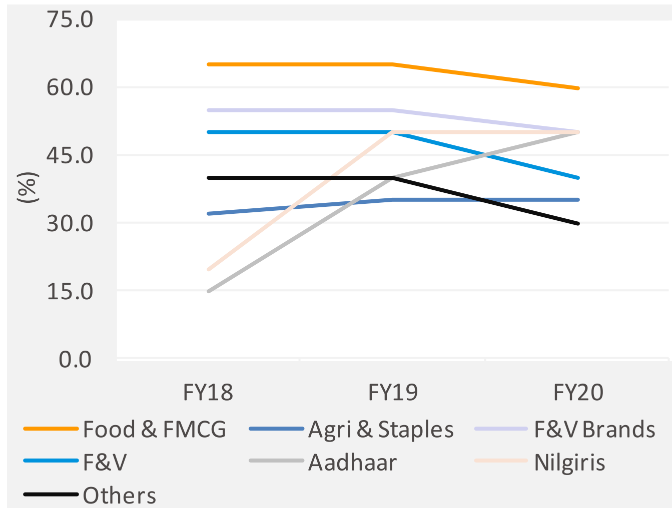


Source: Company, Edelweiss research

Segment-wise, we believe maximum revenue traction will remain in food and FMCG, which have been the company's focus areas and clocked ~74% YoY growth in 9mFY18. This will be followed by strong spurt in the fruits & vegetables (F&V) segment. With this, we envisage the overall revenue pie to start tilting from agri & staples (share expected to dip from ~54.1% of revenue as at 9mFY18 to 48.4% by FY20) to food & FMCG as well as F&V and others (share expected to improve from 14.7% as at 9mFY18 to 17.1% by FY20 and from 19.3% as at 9mFY18 to 20.9% by FY20, respectively).

Chart 10: Strong historical category growth rates to sustain





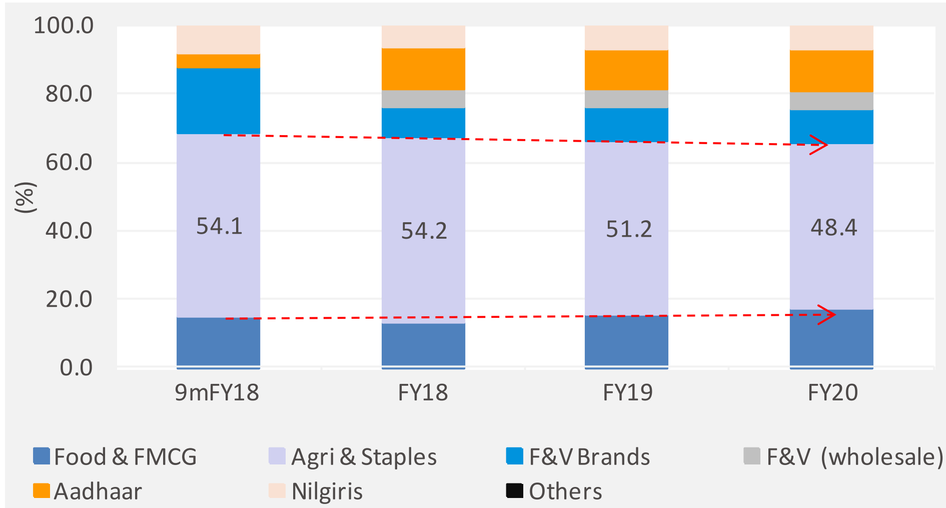
Source: Company, Edelweiss research

Mix tilt in favour of high-margin products to lead to operating leverage

Over FY14-17, FCL's gross margin improved by mere 120bps YoY. This tepid pace was on account of focus on introducing new products, which entailed product sampling cost as well as promotion expenses; this pressurised gross margin to some extent. Further, during the period, key revenue growth drivers were relatively low-margin products / channels viz., Golden Harvest, F&V, Aadhaar, etc.

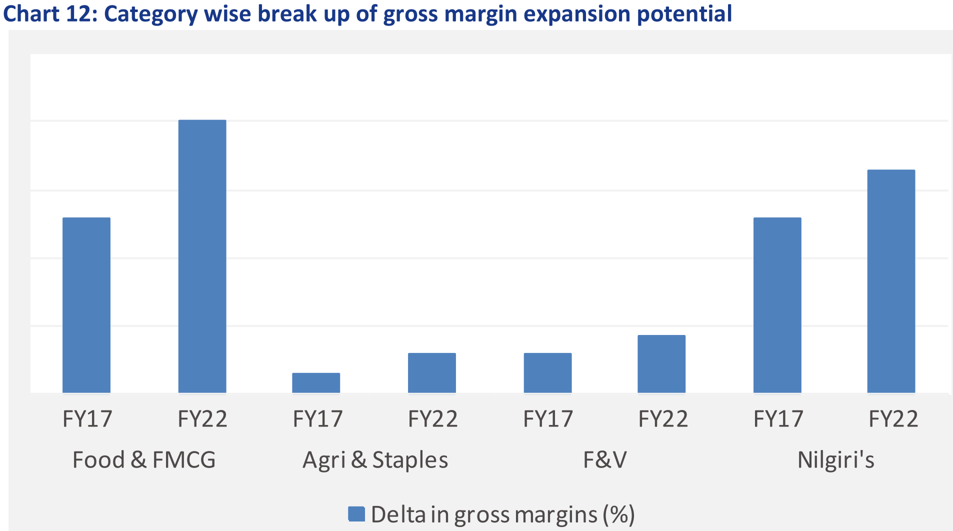
Now, with the launch of multiple products under processed foods and HPC, as well as completion of course correction in the Nilgiris segment, we expect the product mix to tilt in favour of high-margin foods and FMCG businesses. Riding these changes, we estimate ~196bps improvement in overall gross margin. The improvement will also be driven by rising offtake leading to benefit of operating leverage as well as better economies of scale.

Chart 11: Product mix shifting towards high margin categories



Source: Company, Edelweiss research

Chart 12: Category wise break up of gross margin expansion potential

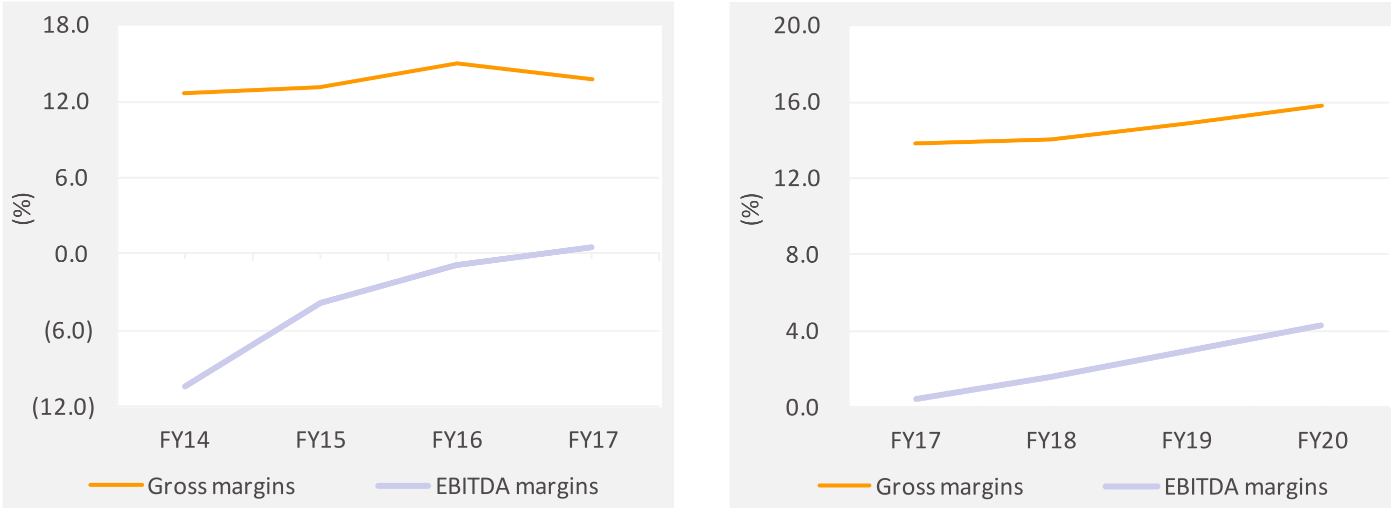


Source: Company, Edelweiss research

On the EBITDA front, FCL has turned around from an EBITDA margin of -10.4% in FY14 to 0.5% in FY17. Apart from gaining benefit of operating leverage and corporate expenses being spread across a wide range of products, the company stands to gain from low ad spends compared to peers. Its marketing strategy focuses primarily on sampling within Future group stores and less on mass media ad spends. This too will help save ad spends and boost EBITDA margin. **Hence, we estimate EBITDA margin to improve from 0.5% in FY17 to 4.2% in FY20.**

Having said that, FCL will also do mass media print as well as TV spends to back some of its product categories, but these will be done selectively.

Chart 13: Gross margin expansion coupled with operating efficiencies to propel EBITDA margin expansion

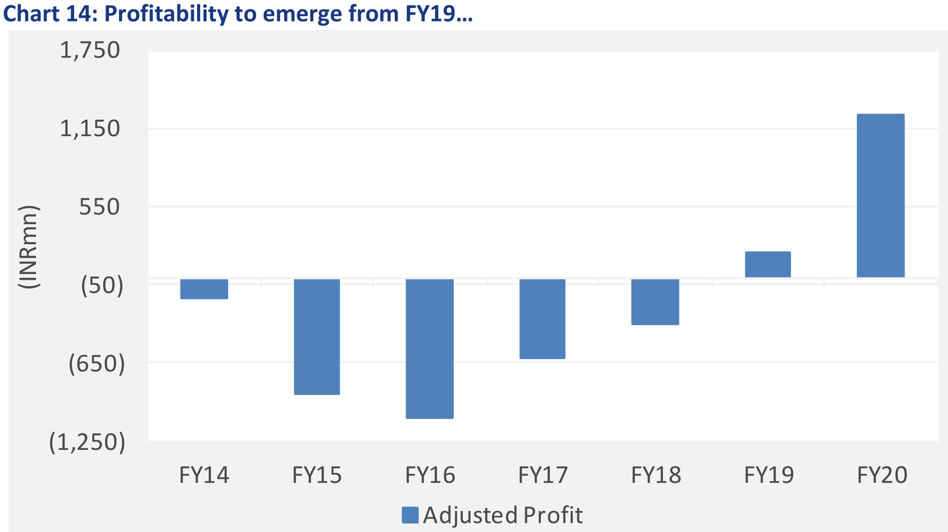


Source: Company, Edelweiss research

To turn profitable by FY19

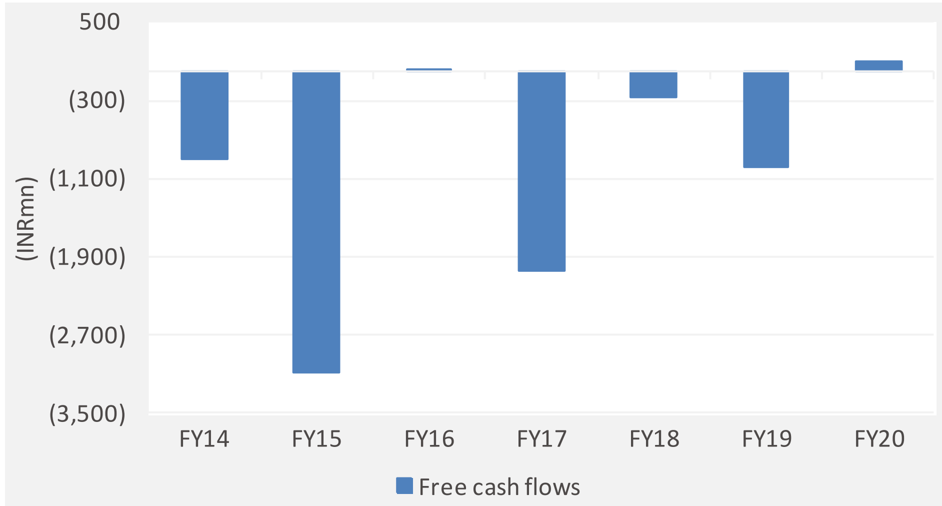
We estimate FCL to turn PAT positive by FY19 bolstered by commendable revenue growth and margin traction. From a free cash flow perspective, we expect the company to turn positive in FY20; this, despite factoring consistent capex requirement of ~INR900-1,000mn p.a.

Chart 14: Profitability to emerge from FY19...



Source: Company, Edelweiss research

Chart 15: … and free cash flows positive by FY20

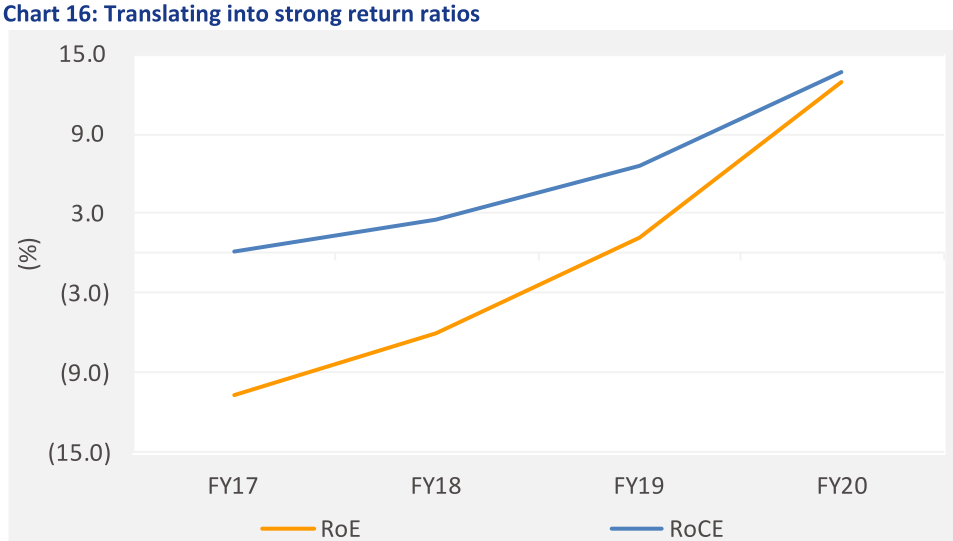


Source: Company, Edelweiss research

Improving return ratios

Robust revenue, EBITDA and PAT CAGR will also spur FCL's return ratios—RoE is likely to improve to 12.9% by FY20 from -10.7% in FY17. Major part of this will be contributed by improving asset turnover—estimated to improve from 1.7x in FY17 to 3.3x in FY20. Improving return ratios is also an outcome of balance sheet growth of 13.5% over FY17-20, vis-à-vis revenue growth of 42.5% CAGR and PAT of INR1,258mn in FY20 from loss of INR610mn in FY17.

Chart 16: Translating into strong return ratios



Source: Company, Edelweiss research

Key Risks

Failure of Future Group's retail plans

The Future Group has big plans for its retail ventures through *Big Bazaar* and *Easy Day*. A large part of the optimism on FCL hinges on the Future Group successfully scaling up its retail business. In case, the group is not able to build its retail arm as expected and if *Easy Day* does not turn around well in time, there will be lower offtake of FCL's products, which will affect its revenue prospects.

Diversifying into more categories

FCL already has over 30 brands and is present in multiple categories and hundreds of SKUs. If the company diversifies into more new categories, its profitability is likely to be delayed further. This will also keep RoEs in single digit for longer than expected.

Price wars with FMCG peers

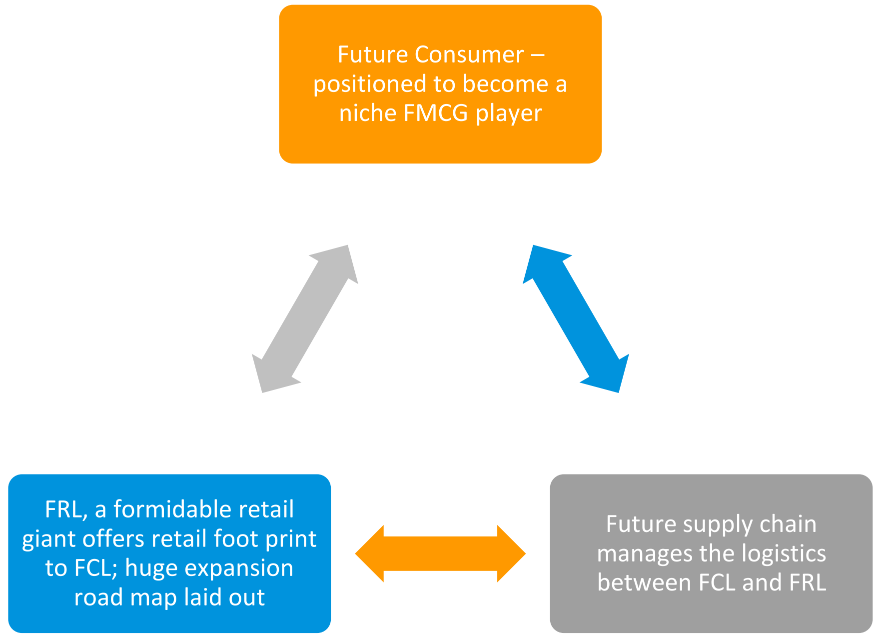
Severe price wars intiated by peers to keep competition from FCL at bay can dent the latter's growth and margins.

Failure of distribution strategy

While FCL curently earns ~77% of revenue through Future group retail formats (~67% excluding Aadhaar and Nilgiris), it aims to reduce this dependence. The company's growth could take a hit if it fails to venture into other MT and GT channels.

Company Description

Fig. 10: Future Group offers integrated platform to FCL



Source: Company, Edelweiss research

FCL (formerly Future Consumer Enterprise) is India's integrated food and HPC company established by the Future Group. Starting from the seeding of food at the farm to its consumption from plate, FCL acts as a catalyst for each of its stakeholders. From sourcing, processing, retailing to final act of consumption, FCL is a vital link in the lives of the farmer, a factory labourer, a shop floor worker as well as housewife. The company sources best quality commodities from the world over, has an extensive portfolio of established brands in food & HPC space, and has access to urban convenience stores / hypermarkets for key metros and cash-&-carry rural distribution models for other cities across India (integrated front end to back end).

The company derives benefits from strategic relationship within the Future Group and also has access to the expertise of latter's management team. It leverages the group's experience and understanding of consumption-led businesses, consumer insights, brand building and supply chain management.

Future Group, India's leading retail group with over 15 years of organised retail experience, has conceptualised, supported and developed various consumption-led business concepts such as *Central, Big Bazaar, Easy Day, Foodhall* and *Home Town*, which command significant brand recognition and customer loyalty. FCL leverages this by being the group's private label arm (to start of which) and then expand its horizon and emerge to become a formidable FMCG company, whose presence will not only be restricted at *Big Bazaar, Easy Day, Foodhall* or *Hypercity* but would spread to multiple other MT's as well as GT's.

Integrated food park

FCL has set up India Food Park in partnership with the Ministry of Food Processing Industries, Government of India. This state-of-the-art food park facilitates end-to-end food processing along the value chain (grading, sorting, pulping, packaging & distribution) from the farm to the market. Equipped with world-class food processing units, 22,000tonne storage capacity, a cold storage unit and in-house pulping, milling, flouring, spice & dal units, the massive park is spread across 110 acres in Karnataka's Tumkur region.

The India Food Park facilitates the functioning of several food processing companies by operating through a single window system. The Tumkur region is surrounded by the districts of Kolar and Shimoga which are rich in millets, oilseeds, vegetables and fruits. The park is convenient for farmers as it eliminates the hassle of reaching out to multiple vendors and helps them sell their crops to a single point of contact.

The food park has been built with best line of facilities to foray into newer food categories such as branded fruits and vegetables, canola and rice bran oils, frozen and processed food products.

FCL largely caters across following 5 segments through a portfolio of their brands and products.

Table 6: Vibrant bouquet of offerings

	Portfolio of brands and products
Food & groceries	Golden Harvest, Golden Harvest Prime, Karmiq, Fresh & Pure, Mother Earth, Desi Atta, KOSH, Ektaa, Shubhra
Dairy & bakery	Nilgiris
Snacks & beverages	Pooof!, Sunkist, Sangi's kitchen, Veg affaire, Baker street, Tasty Treat
Personal care	Kara, Swiss Tempelle, Think skin, Puretta
Home care	Clean Mate, Care Mate, Prim, Pratha

Source: Euromonitor, Company, Edelweiss research

Management Overview

Board of Directors

Mr. G. N. Bajpai, Chairman: Mr. G.N. Bajpai has been on FCL's board since February 20, 2008. He completed his Master of Commerce degree from the University of Agra and Bachelor's degree in Law from the University of Indore. Previously, he was the Chairman of Securities Exchange Board of India (SEBI), Life Insurance Corporation of India (LIC), the Corporate Governance Task Force of International Organisation of Securities Commission and Chairperson of the Insurance Institute of India.

Mr. Kishore Biyani, Vice Chairman: Mr. Kishore Biyani is the founder and Group CEO of the Future Group. He is widely credited as being the pioneer of modern retail industry in India. Over the past two decades, he has created and led some of India's most popular retail chains like *Big Bazaar, Central, Brand Factory, Foodhall, fbb, Home Town, eZone*, among others. Over time, various retail chains like *Hypercity, Nilgiris, Aadhaar, Easy Day*, fabfurnish.com, among others, have also become part of the Future Group.

Mr. Frédéric de Mévius, Director: Mr. Frédéric de Mévius is a non-executive director of Verlinvest portfolio companies. Between 1991 and 2004, he was a member of the Board of Directors of Interbrew (now Ab-Inbev). Prior to these industrial assignments, he had an investment banking career in London and New York. From 1985 until 1993, he was at Lehman Brothers in New York and London as an Executive Director and between 1981 and 1985 at S.G. Warburg & Co in London. He holds a BA degree in Finance and Economics from the University of Louvain-la-Neuve.

Ms. Vibha Rishi, Director: Ms. Vibha Rishi has a Master's degree in Business Administration from the Faculty of Management Studies, University of Delhi. She was associated with the Future Group as Group Strategy and Consumer Director and was responsible for marketing, communication and customer strategy of group companies. She has previously worked with Tata Administrative Services and PepsiCo.

Mr. Deepak Malik, Director: Mr. Deepak Malik holds a Bachelor's degree in Economics from Delhi University, a Master's degree in Economics from the Delhi School of Economics and an MBA from Cornell University. He is a Managing Director of the private equity team in Proterra Investment Partners. He currently sits on the boards of various companies that Proterra's private equity funds have invested in.

Mr. Narendra Baheti, Director: Mr. Narendra Baheti is a commerce graduate and M.A. in Economics. He is associated with Future Group since the inception of 1st Big Bazaar in 2002 and continues to contribute in formulation of Integrated Food Strategy. He has set up the sourcing, processing and distribution centers for Staples (Agribusiness) through multiple firms in Mumbai, Delhi, Kolkata, Bangalore and Hyderabad etc. for ensuring city specific assortment to suit the established consumption pattern.

Mr. K K Rathi, Director: Mr. Rathi holds a bachelor's degree in commerce and is a qualified chartered accountant and company secretary with approximately 25 years of professional experience. He has prior experience in corporate finance, strategic business planning and investment advisory, while working with KEC International, H&R Johnson, Future Retail and Motilal Oswal Private Equity Advisors. He has previously worked as Group CFO with Future

Retail where he was responsible for strategic planning, mergers and acquisitions, treasury management and corporate governance. Mr. Rathi is also a director of various companies including Future Generali India Life Insurance Company, Future Generali India Insurance Company, Sprint Advisory. He has been on the Board of Future Consumer since 15th November, 2014.

Mr. Adhiraj Harish, Director: Mr. Adhiraj Harish holds a Bachelors degree in Management Studies and a Masters degree in Legislative Laws (University of Mumbai). He is a member of the Bar Council of Maharashtra & Goa and has been practicing as an Associate at D.M. Harish & Co., Advocates, since 2011.

Ms. Ashni Biyani, Director: Ms. Ashni Biyani has graduated as a textile designer at Srishti School of Art, Design and Technology in Bengaluru. She has also attended courses on scenario planning at New York's Parsons School of Design and the Summer Institute of General Management at Graduate School of Business, Stanford University. In her current role, she leads a team that understands the nuances of Indian consumers. Ms Biyani has led the conceptualisation and launch of a number of retail formats for the Future Group. She is currently focusing on creating futuristic food and fashion retail concepts. She has been on the Board of Future Consumer since November 15, 2014.

Leadership Team

Mr. Sadashiv Nayak, Interim CEO: With over 20 years of experience in the industry, Mr. Nayak has been with Future Group for more than 12 years. He was previously employed with Hindustan Lever & Asian Paints. Mr. Nayak holds a Post Graduate Diploma in Business Management from XLRI Jamshedpur.

Mr. Ravin Mody, CFO: Mr. Mody recently joined Future Consumer as the CFO. Mr. Mody has over 11 years experience at Marico of working in various positions such as Head-Treasury, IR, M&A Experience across Corporate Finance, Cross Border M&A, post acquisition integration, treasury, forex, fund raise etc.

Industry Outlook

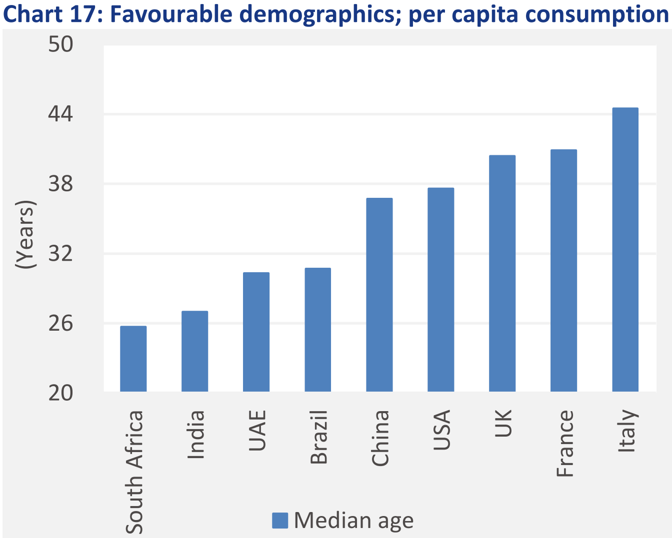
The overall FMCG market is estimated to be ~USD180bn of which branded market is ~USD65bn (34%). These market has grown at 12% over 2005-15. As per various industry estimates, FMCG market is expected to grow at 14% CAGR over 2015-25, implying branded FMCG market to be 3.6x current size i.e. USD220-240bn.

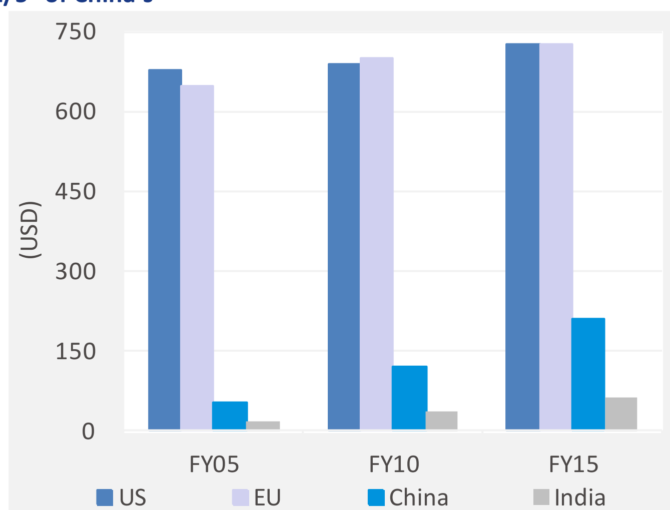
Food consumption (proportion of overall food consumption which is relevant to FCL) in India was estimated at INR13.7tn in FY12, which has risen to INR24.5tn by FY17, a whopping 12.3% CAGR. It is estimated to post atleast 12-13% CAGR till FY25. A large part of this market growth will be led by creation of new categories, entry of new companies as well as launch of premium products. This surge in consumption will be led by following factors:

a. **Rising disposable income levels:** Discretionary spending has high correlation with disposable incomes. Pertinently, disposable income is a function of economic growth, a lynchpin for new jobs creation. Recovery in discretionary spending will help revive growth of India's organised retail market.

b. **Attractive demographics:** With a median age of 27, India's demographics are currently one of the most enviable in the world. These aged Indians are well read and have developed global culinary taste, which needs to be satisfied. Further, 50% of the population is in the working age bracket (20-60 years) and discretionary consumption is poised to grow rapidly.

Chart 17: Favourable demographics; per capita consumption still 1/5th of China's





Source: Industry, Edelweiss research

c. **Urbanisation:** Urbanisation, as a trend, has been picking up in India. Urbanisation happens not only in the pursuit of job opportunities, but also to improve the standard of living. As per 2011 census, the share of urban India's population to total residents stood higher at 31.2% (from 28.5% in 2001). A UN report on world population, estimates 40.8% of India's population to reside in urban areas by 2030.

d. **Lower penetration, per capita consumption indicate strong opportunity:** Under the GST regime, the unorganised market will face regulatory hurdles and find it difficult to evade the tax net. Hence, we envisage organised Brick & Mortar retail penetration to improve to 12% in FY20 from 9% in FY16. The most important organised categories are F&G (USD13bn), apparels & accessories (USD11bn) and jewellery & watches (USD13bn). We expect a combination of factors like lower penetration & competition and higher entry barriers to fuel growth in these categories. We expect F&G, followed by jewellery & watches and then apparels & accessories to benefit.

Table 7: Retail penetration (%) to improve from 9.0% in FY16 to 12.0% in FY20

	FY16			FY20		
	Retail market size (USD bn)	Organised retail market size (USD bn)	Organised as % of overall retail	Retail market size (USD bn)	Organised retail market size (USD bn)	Organised as % of overall retail
Food & Grocery	413	13	3.1	634	31	4.9
Apparel & Accessories	49	11	22.0	74	24	32.3
Jewellery & Watches	47	13	27.0	77	23	29.8
CDIT	35	9	25.1	63	20	31.6
Home & Living	27	3	10.0	42	5	12.0
Pharmacy & Wellness	18	2	10.1	28	3	11.7
Footwear	7	3	40.5	12	5	43.4
Others	20	2	12.1	30	4	13.4
Total	**616**	**55**	**9.0**	**960**	**115**	**12.0**

Source: Technopark Analysis, Edelweiss research

Table 8: Share of organised brick & mortar retail (%) in FY16

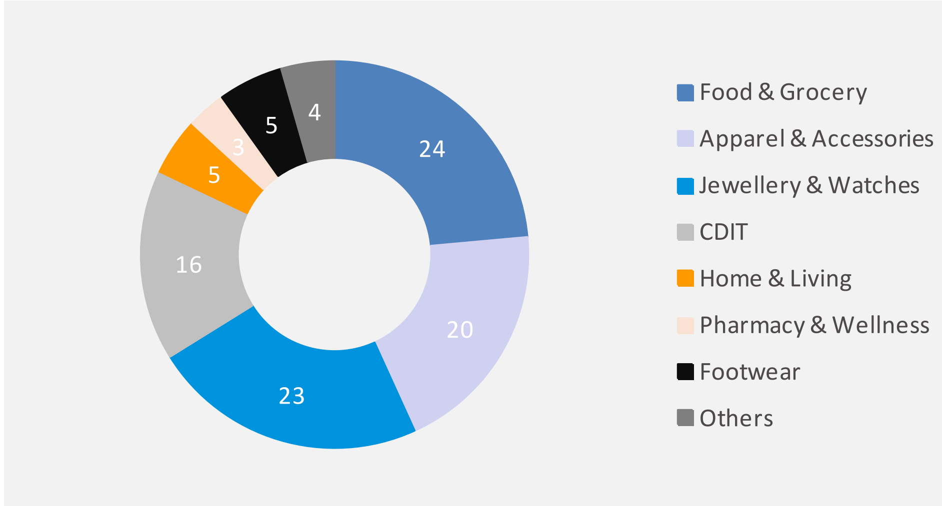
	Market size (USD bn)	Penetration (%)
Total retail size (USD bn)	616	
Total organised retail size (USD bn):	55	9.0
Organised retail break up (USD bn)		**Share of organised retail market**
Food & Grocery	13	23.6
Apparel & Accessories	11	19.7
Jewellery & Watches	13	22.9
CDIT	9	15.9
Home & Living	3	4.8
Pharmacy & Wellness	2	3.3
Footwear	3	5.4
Others	2	4.4

Source: Technopark Analysis, Edelweiss research

*Note: *Others incl Books & Stationery, Toys, Eyewear, Sports Goods, Alcoholic Beverages & Tobacco, etc*

** Accessories includes Bags, Belts, Wallets*

Chart 18: F&G had the highest share of organised brick & mortar retail in FY16



Source: Edelweiss research

Organised share **in F&G segment—**least penetrated at 3.1% in FY16—is projected to jump to 4.9% in FY20. Further, its contribution to overall organised B&M retail stood the highest at 23.6% (USD13bn of USD55bn) in FY16, which is set to increase to 26.9% (USD31bn out of USD115bn) in FY20E aided by improved assortment and convenience.

F&G retailers are readying to realign category offerings, rationalise space and consolidate formats over the next few years, leading to margin efficiency and profitability. It will also boost productivity and efficiency, **driving higher organised retail penetration in the segment**.

On account of these factors, we expect organised retail to be the next growth driver for FMCG companies. FCL, with its fortunes tied to the growth of organised retail, is likely to be benefit significantly by this macro tectonic shift.

Financial Statements

Key assumptions

Macro assumptions	FY17	FY18E	FY19E	FY20E
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.6	4.5	5.0
Repo rate (exit rate)	6.25	6.00	6.00	6.50
USD/INR (Avg)	67.1	64.5	66.0	66.0
Company Assumptions				
Revenue growth (Y-o-Y %)				
Food and FMCG Brands	NM	65.0	65.0	60.0
Agri & Staples Brands	NM	32.0	35.0	35.0
F&V Brands	NM	55.0	55.0	50.0
F&V (Wholesale)	NM	50.0	50.0	40.0
Aadhaar (Wholesale)	NM	15.0	40.0	50.0
Nilgiris	NM	20.0	50.0	50.0
Others	NM	40.0	40.0	30.0
Margin assumptions (%)				
Cost of materials	86.2	86.0	85.1	84.2
Employee costs	4.6	4.4	4.2	4.1
Warehousing expenses	3.1	2.9	2.8	2.8
A&P spends	1.0	0.8	0.8	0.8
Others	4.6	4.3	4.2	4.2
EBITDA margin	0.5	1.6	2.9	4.2
NP margin	(3.7)	(1.8)	0.2	2.0
Financial assumptions				
Tax rate (%)	(2.1)	-	-	15.0
Debtor days	42	42	41	40
Inventory days	25	25	25	24
Payable days	27	28	27	27
Cash conv. cycle (days)	40	39	39	37
Capex (INR mn)	1,236	950	1,050	900
Dividend as % of net profit	-	-	5.0	7.0

Income statement (INR mn)

Year to December	FY17	FY18E	FY19E	FY20E
Net revenues	21,158	30,072	42,956	61,231
Cost of materials	18,231	25,862	36,555	51,373
Gross profit	2,928	4,210	6,400	9,858
Employee costs	981	1,323	1,804	2,510
Warehousing & Distribut. exp.	664	872	1,203	1,714
A&P spends	213	241	344	459
Others	974	1,293	1,804	2,572
EBITDA	96	481	1,246	2,602
Depreciation & amortisation	326	389	435	480
EBIT	(230)	92	810	2,122
Less: Interest Expense	448	525	758	884
Add: Other income	250	250	250	300
Profit before tax	(427)	(184)	303	1,539
Less: Provision for Tax	9	-	-	231
Profit after tax	(436)	(184)	303	1,308
Add: Min. Int. & Adjustments	(174)	(175)	(100)	(50)
Reported Profit	(610)	(359)	203	1,258
Adjusted Profit	(610)	(359)	203	1,258
No. of Diluted SO (mn)	1,824	1,824	1,824	1,824
Adjusted Diluted EPS	(0.3)	(0.2)	0.1	0.7
Adjusted Cash EPS	(0.2)	0.0	0.3	1.0
Dividend per share (DPS)	0.0	0.0	0.0	0.1
Dividend Payout Ratio (%)	-	-	5.0	7.0
Tax rate	(2.1)	-	-	15.0

Common size metrics (%)

Year to March	FY17	FY18E	FY19E	FY20E
Cost of materials	86.2	86.0	85.1	84.2
Employee costs	4.6	4.4	4.2	4.1
Warehousing & Distribut. exp.	3.1	2.9	2.8	2.8
A&P spends	1.0	0.8	0.8	0.8
Others	4.6	4.3	4.2	4.2
EBITDA margin	0.5	1.6	2.9	4.2
EBIT margin	(1.1)	0.3	1.9	3.5
Net profit margin	(3.7)	(1.8)	0.2	2.0

Growth metrics (%)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	24.3	42.1	42.8	42.5
EBITDA	NM	398.7	158.9	108.9
PBT	NM	NM	NM	408.5
Adjusted Profit	NM	NM	NM	520.9
EPS	NM	NM	NM	520.9

Balance sheet				(INR mn)
As on 31st March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Share capital	9,884	9,884	9,884	9,884
Reserves & Surplus	(999)	(1,357)	(1,167)	(15)
Shareholders' funds	8,885	8,526	8,717	9,869
Minority interest	78	78	78	78
Long term borrowings	1,623	2,923	3,923	4,173
Short term borrowings	1,842	3,342	4,242	4,492
Total Borrowings	3,465	6,265	8,165	8,665
Long Term Liab. & Provisions	508	508	508	508
Deferred tax liability	441	441	441	441
Sources of funds	**13,378**	**15,819**	**17,909**	**19,561**
Net block	4,566	4,995	5,560	6,136
Capital work in progress	607	607	607	607
Intangible Assets	2,486	2,545	2,594	2,438
Total Fixed Assets	7,659	8,147	8,762	9,182
Goodwill on Consolidation	1,677	1,677	1,677	1,677
Deferred tax assets	1	1	1	1
Non current investments	404	404	404	404
Cash and cash equivalents	475	2,548	2,687	2,295
Inventories	1,757	1,771	2,504	3,378
Sundry debtors	3,242	3,460	4,825	6,710
Loans & advances	1,073	1,033	993	953
Other Current Assets	630	630	630	630
Total Current Assets (ex cash)	6,702	6,895	8,952	11,671
Trade payable	1,671	1,984	2,704	3,800
Short Term Provisions	1,869	1,869	1,869	1,869
Total Current Liab. & Provisions	3,540	3,853	4,573	5,669
Net current assets (ex cash)	3,162	3,042	4,379	6,002
Uses of funds	**13,378**	**15,819**	**17,909**	**19,561**

Free cash flow

Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Reported Profit	(610)	(359)	203	1,258
Add: Depreciation	326	389	435	480
Interest (Net of Tax)	300	352	508	592
Others	163	173	250	292
Less:Changes in WC	991	(120)	1,337	1,623
Operating cash flow	(812)	676	59	998
Less: Capex	1,236	950	1,050	900
Free cash flow	(2,048)	(274)	(991)	98

Cash flow metric

Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Operating cash flow	(812)	676	59	998
Financing cash flow	2,584	2,275	1,130	(490)
Investing cash flow	(1,474)	(950)	(1,050)	(900)
Net cash Flow	298	2,001	139	(391)
Capex	1,236	950	1,050	900
Dividends paid	-	-	(12)	(106)

Ratios

Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
ROAE (%)	(10.7)	(6.1)	1.2	12.9
Pre-tax ROCE (%)	0.2	2.5	6.7	13.6
Inventory days	25	25	25	24
Debtor days	42	42	41	40
Payable days	27	28	27	27
Cash conversion cycle (days)	40	39	39	37
Current ratio	2.0	2.5	2.5	2.5
Gross Debt/EBITDA	35.9	13.0	6.6	3.3
Gross Debt/Equity	0.4	0.7	0.9	0.9
Interest coverage (x)	(0.5)	0.2	1.1	2.4

Operating ratios

Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Total asset turnover	1.7	2.1	2.5	3.3
Fixed asset turnover	3.2	4.1	5.5	7.3
Equity turnover	5.8	6.8	9.9	13.1

Valuation parameters

Year to March	**FY17**	**FY18E**	**FY19E**	**FY20E**
Adjusted Diluted EPS (INR)	(0.3)	(0.2)	0.1	0.7
Y-o-Y growth (%)	(48.7)	(41.2)	(156.5)	520.9
Diluted P/E ratio (x)	NM	NM	520.3	83.8
Enterprise Value / Sales (x)	5.1	3.6	2.6	1.8
Enterprise Value / EBITDA (x)	1,123.5	226.8	89.0	43.0

Peer comparison valuation

	Market cap	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
Name	**(USD mn)**	**FY19E**	**FY20E**	**FY19E**	**FY20E**	**FY19E**	**FY20E**
Future Consumer	1,706	NM	83.8	89.0	43.0	1.2	12.9
Hindustan Unilever	46,448	49.0	43.1	34.1	29.6	80.4	83.8
Dabur	9,295	36.7	31.4	31.8	27.0	26.7	26.9
Emami	3,924	49.5	38.6	26.8	22.2	24.8	27.7
Marico	6,532	41.5	36.5	28.2	24.9	35.0	34.2

Source: Edelweiss research

Additional Data

Directors Data

Mr. G. N. Bajpai	Chairman	Mr. Kishore Biyani	Vice Chairman
Mr. Frédéric de Mévius	Director	Ms. Vibha Rishi	Director
Mr. Deepak Malik	Director	Mr. Narendra Baheti	Director
Mr. K K Rathi	Director	Mr. Adhiraj Harish	Director
Ms. Ashni Biyani	Director		

Auditor - Deloitte Haskins & Sells

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Arisaig Partners Asia Pte	7.95	Tata Asset Management	0.82
Black River Food	7.82	Godrej Agrovet	0.68
Verlinvest Sa	7.34	Pil Industries	0.28
Bennett Coleman & Co	4.85	Sanjay Jain	0.27
Mohini Resources	4.04	Dimensional Fund Advisors Lp	0.22

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
17-Jan-18	Manoj Gagvani	Sell	15,000
1-Mar-18	Saurabh Kumar Lal	Sell	25,000
16-Mar-18	Future Capital Investment Private Limited	Buy	1,379,128
21-Mar-18	Future Capital Investment PvtLimited	Buy	1,500,000
23-Mar-18	Future Capital Investment Private Limited	Buy	3,974,546
26-Mar-18	Future Capital Investment Private Limited	Buy	227,475

**in last one year*

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.
Board: (91-22) 4009 4400, Email: *research@edelweissfin.com*

Aditya Narain
Head of Research
aditya.narain@edelweissfin.com

ADITYA NARAIN

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***Coverage group(s) of stocks by primary analyst(s):** Consumer Goods*

Asian Paints, Bajaj Corp, Berger Paints, Britannia Industries, Colgate, Dabur, Future Consumer, Godrej Consumer, Emami, Hindustan Unilever, ITC, Marico, Nestle Ltd, Pidilite Industries, GlaxoSmithKline Consumer Healthcare, United Spirits

Recent Research

Date	Company	Title	Price (INR)	Recos
05-Apr-18	**Consumer Goods**	Volumes growth slowly improving; rural revival key; *Result Preview*		
02-Apr-18	**Colgate Palmolive**	Naturals to stem market share loss; *Visit Note*	1,057	Hold
28-Mar-18	**Marico**	Sanguine on improving trajectory; *Visit Note*	326	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

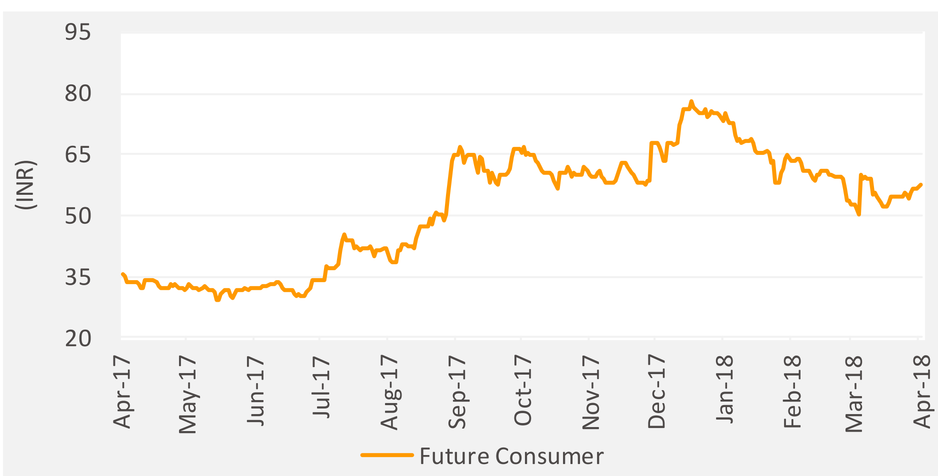
	Buy	Hold	Reduce	Total
Rating Distribution* * 1stocks under review	161	67	11	240

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	156	62	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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