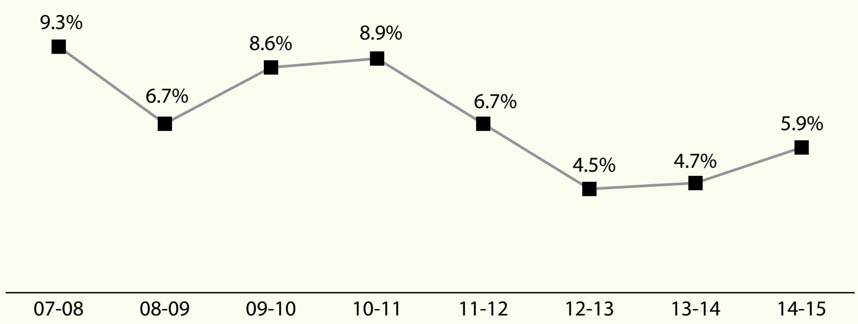
MANAGEMENT DISCUSSION AND ANALYSIS

Economic backdrop

The economic backdrop is a key factor impacting the performance of Companies across sectors including organized retail. Consumer sentiment and business confidence witnessed improvement in the financial year under review with economic growth gaining momentum especially in the second half of the year. This is possibly attributable to decreasing inflationary pressures, the easing of the monetary stance by the Reserve Bank of India and a more stable political & policy environment. Business sentiment is also aided by investor friendly tax proposals (albeit over the medium term), structural reforms being taken up (with respect to GST, land acquisition etc) and the stated intent of the Government to pursue further fiscal consolidation.

GDP growth (%) (YOY)



Source: RBI

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 FY09-10. This recovery gathered further momentum in FY10-11 and yielded strong double-digit like-for-like growth across most credible retail formats. Consumer sentiment thereafter was impacted in FY11-12 and continued to be muted till the second half of FY13-14 with high inflation expectations, pronounced interest rates and economic uncertainty being key contributing factors. Consumer sentiments improved in FY14-15 with apparel retailers have been reporting an improving trend and most other retail formats also witnessing an improved off take.

Organized retail opportunity

The Union budget has been rolled out by the new government, with promotion of overall economic growth as a key objective. FY15 has witnessed policy continuity and pursuit of certain reform measures aimed at reviving growth and surmounting structural constraints in the economy. On the other hand, the level of interest rates is still viewed by the markets to be on the higher side and a key factor in stifling investment commitments by industry.

Near term issues notwithstanding the organized retail opportunity in India continued to attract interest from both large Indian business houses and multinational retailers. It is our belief that over the medium to long term, most of the earlier arguments in favour of the sector continue to be valid. Consistent with the coverage in earlier reports, the following constitute the principal arguments in favour of organized retailing.

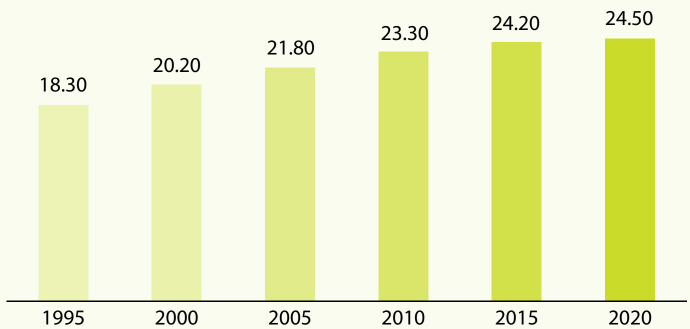
- Penetration of Organized Retail:

  About 8% of the total retail market in India is accounted for by the modern/ organized retail sector. The remaining market is served by small, independent retailers with an average of 500 sq. feet trading space, fragmented across sub-segments and offering limited shopping conveniences to customers. They are supported by a network of manufacturers, distributors and wholesale traders who operate with many global and local brands. This is in contrast to an average of 80% plus penetration of organized retail in many developed nations. Further, 69% of India's population lives in rural areas & this population contributes just 54% of the total retail consumption. In the recent years we have seen increasing traction for organized retail not only in tier 1 and tier 2 cities but in tier 3 cities as well.

- Demographics

  India is a young nation, with two third of the population under 35 years of age. While the global median age for population is 33 years, India's median age is around 23 years. The high percentage of youth population should drive the demand for more fashionable clothing as well as for ready meals & processed food due to their increased propensity to consume. The increasing desire to look good & presentable influenced by western culture and exposure to online & social media have boosted the organized retail markets. Immense scope is seen for banners offering an innovative product range to meet the aspirations of the brand conscious consumers with evolving preferences.

Population in Age group 15-25 (in Millions)

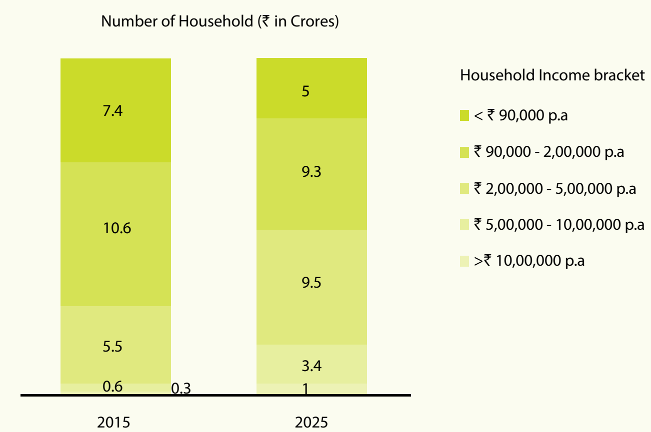


Source: India Retail Report, 2015

- Higher Disposable Income:

  Most research studies suggest rising incomes in the next decade. This is likely to continue propelling consumption by the middle class. Therefore, targeting the mid-market seems to offer substantial revenue potential. As the chart below depicts, number of households (in mn) with annual income brackets in the range of ₹ 90000 to ₹ 10 lakhs is expected to increase significantly over the next decade.

Growing Purchasing Power of Indian Middle Class



Source: McKinsey Report

The demographics coupled with less than 10% of the work force being directly employed by the organized sector seems to contribute to a constant shift upwards in the reference point of the average consumer – in terms merchandize aspired for. Besides the huge untapped market and the opportunity afforded by the demographics, the following factors/ trends are seen contributing to growth in spending overall, and particularly for organized retail over the medium term:

- Changing family level organization/ role definitions and exposure
  - More nuclear families
  - Increase in the number of working women
  - Kids being more informed and demanding
- Increasing exposure to and influence of cosmopolitan media; consequent adoption of Western habits and markedly higher brand consciousness
- Easier availability of jobs (especially Outsourcing & IT related); BFSI & related employment is expected to increase to over 12 million in the coming decade
- Increased availability of credit/ social acceptance of consumption aided by borrowings; it is estimated that about 15% of the people in urban cities are currently making monthly payments for loans

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 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 respect to infrastructure pose obstacles in ensuring availability for customers
- Complexity in taxation – inconsistent tax regime across various states makes it difficult to manage a pan-India network of stores

Organized retail industry in FY14-15

In our view, during the financial year under review the key factors and developments that impacted the organized retail industry in India were:

- the near term consumption triggers (GDP growth, inflation & interest rate levels)
- the emergence of online market places across a whole range of categories with aggressive discounting strategies funded by overseas investors
- supply chain issues and cost pressures (including minimum wages and energy costs)
- nebulous regulatory landscape especially with respect to FDI in multi brand retailing
- the intensity of micro market competition

With varying degrees of impact the retailers in India have witnessed during the Financial Year 2014-2015:

a) Consumer confidence and off-take especially in volume terms was muted especially in the first quarter of the year, with consumer spending possibly getting impacted by a lower level of discretionary household budget given the pronounced inflation witnessed in various categories coupled with higher borrowing costs. The consumer sentiment saw improvement in the latter part of the fiscal with the easing of inflation amongst other factors.

b) Aggressive e - commerce & digital retailing in the last two years has intensified the competition across categories; this challenge was even more pronounced for retailers offering primarily third party brands.

c) Significant operating cost pressures seen including in respect of wages, electricity and common area maintenance. Nevertheless, the cost pressures with respect to merchandize inputs remained moderate during this period.

d) The pronounced rentals involved in taking up of additional real estate for expansion especially given the limited pipeline of acceptable retail real estate developments. The limited pipeline of developments is in turn explained for the most part by:
   - attractiveness of alternate developments like residential apartments;
   - entry of international payers & their clustering in high street malls further lead to difficulty in obtaining properties at acceptable economics
   - the operational difficulties in managing retail mall/ shopping centre; and
   - importantly the significant liquidity squeeze faced by the real estate sector given the RBI policy

e) Higher intensity of competition in certain micro markets due to pronounced clustering of retailer presence with similar offers.

f) Increasing complexity of the indirect taxation and the uncertainty regarding the implementation of GST.

These macro observations have applied, though with varying emphasis to the predominant retailing formats (Westside, Star bazaar & Landmark) managed by the Company and Trent Hypermarket Limited (THL). In aggregate the Company registered encouraging growth, with consolidated revenue from operations at ₹ 2,284.25 Crores. This is not comparable with the reported consolidated income for FY13-14 especially consequent to the transition of THL to a 50:50 joint venture from being a wholly owned subsidiary earlier.

Consolidated revenue from operations (₹ Crores)

*Includes stores operated by Inditex Trent Retail India Private Limited and Trent Hypermarket Limited.

Principle formats and focus on sustainable growth

Our Company was one of the earliest to enter the organized retail sector in India and has focused on developing a robust business model in each of the retail formats pursued. We have consistently emphasized the importance of establishing the viability of a retail format with a limited portfolio of stores prior to embarking on rapid expansion. The above approach has yielded encouraging results and enabled the Company in coping with market challenges. The Company primarily operates stores across three formats – Westside, Star Bazaar & Landmark.

Westside – Trent's flagship format – offers apparel, footwear and accessories for men, women and children, along with furnishings, artifacts and a range of home accessories. Operating with a predominantly exclusive brands model, Westside continues to demonstrate the ability to compete effectively in the market place, despite having to face global competition for the mind space and share of wallet of a discerning audience. Westside products are known for style and class amongst fashion conscious consumers in 53 cities across 86 stores.

Star – hypermarket and convenience store chain – it offers a wide choice of products, including staple foods, beverages, health and beauty products, apparel, home furnishings, vegetables, fruits, dairy and non-vegetarian products. The market reception for Star stores have been encouraging and the format is in the process of establishing itself as a place offering a compelling range of quality merchandize at attractive prices. Star Daily and Star Market banners (having much smaller individual store footprints vis-à-vis Star Bazaar stores) have been launched in the recent quarters.

Landmark – a home entertainment format – offers a range of books, toys, sports merchandize, stationery & technology accessories. The back-end operations relating to the format have been significantly integrated with that of the Westside format to drive synergies and contain overhead costs. A significant restructuring exercise has been concluded during the period under review involving significant rationalization of the store portfolio, further restructuring of the product offer and material changes to the look & feel of the retained stores.

Operations – Westside

The Westside format offering predominantly an exclusive range of own branded fashion apparel continues to be the mainstay of the retailing business of the company. This format over the years has been rolled out across the country and currently covers 53 cities.

The Westside model involves active control across the value chain including with respect to design, branding, sourcing, logistics, distribution, pricing, display and promotion of almost 90% of the product range retailed. We believe this model is more robust than department store models that predominantly retail third party brands including from a 'return on capital employed' perspective. Empirical evidence also seems to suggest that globally, retailers who control the entire value chain are relatively more successful.

In the period under review we continued to focus on a number of internal improvements in Westside. Key initiatives included the launch/ refresh of a portfolio of exclusive brands, improved presentation in stores, focus on select newer categories and providing a better shopping experience to the customers by improving the look & feel of select existing stores. Aided by the strategies pursued and reasonably favorable market conditions the format registered a healthy 11% like-for-like growth in revenues in FY14-15.