INSTITUTIONAL RESEARCH

Sector Thematic

Food & Grocery

From a disruptor's lens

The view from a disruptor's lens is a salivating one as short of a few well-capitalised operators, the organised Food & Grocery ecosystem remains (1) profitless, (2) cash-strapped and (3) supported by increasing crutches (high gross margins, inefficient cost structures and increasing vendor support). Our read-through across the ecosystem suggests (1) the phase of capital dumping by global/domestic biggies may soon be upon us, (2) selection/pricing arbitrage vis-a-vis industry bellwether DMART continues to shrink, (3) margin cracks are imminent and (4) Reliance Retail-FRL combination could change the complexion of competition in top Indian districts.

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HDFC securities 20 YEARS

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From a disruptor's lens

The view from a disruptor's lens is a salivating one as short of a few well-capitalised operators, the organised Food & Grocery ecosystem remains (1) profitless, (2) cash-strapped and (3) supported by increasing crutches (high gross margins, inefficient cost structures and increasing vendor support). Our read-through across the ecosystem suggests (1) the phase of capital dumping by global/domestic biggies may soon be upon us, (2) selection/pricing arbitrage vis-a-vis industry bellwether DMART continues to shrink, (3) margin cracks are imminent and (4) Reliance Retail-FRL combination could change the complexion of competition in top Indian districts.

- **Capital dumping is likely to take center-stage:** Global/domestic retailers Amazon, Walmart-backed Flipkart and Reliance Retail (refer link) have significantly strengthened their war chests for investments in supply chain, fulfillment capabilities and pricing/selection. An inkling of this can already be seen in the **reducing selection/pricing arbitrage** of DMART over these biggies. Fulfillment/supply chain investments of Amazon's F&G unit (adj. for scale) is already >6x that of DMART's **(Comparison: DMART Ready vs Amazon).** Former remains aggressive on footprint expansion.
- **Margin crack for ecosystem is imminent:** Over FY15-20, despite low competitive intensity, most organised grocers' sales velocity (1-4% CAGR) has undershot inflation, signaling a gradual but structural footfall reduction. Most (1) continue to hide behind high gross margins as cost of retailing remains inefficient and (2) have bare-bone investments in online fulfilment capabilities. Moreover, as subsidised home delivery becomes table stakes, even the best (D-MART) may get arm-twisted into bringing a part of online fulfillment costs on their books (not factored in, remains a risk to estimates). Thus, the imperative to remain competitive (reducing GMs) + rising cost of retailing is likely to crack operational margins for the ecosystem over FY21-25. This has played out globally too **(Walmart's CY15-20 margin crack).**
- **Reliance + Future Retail > DMART in store density:** Post integration and, if executed well, the Reliance Retail + FRL store network is likely to get nearly as dense as DMART's **(Refer table)** in the latter's key markets (HSIE: 48% of DMART's stores, 65-70% of revenue). These markets are the most populated/over-retailed districts in India with high PCI. Hence, the rise in competitive intensity/price action and near-zero sourcing margin arbitrage seems to be a foregone conclusion. The high population density in these districts could help fulfill JioMART orders within controlled costs too.
- **Meanwhile, well-funded e-grocers are scaling up nicely:** Even pre-COVID19, e-grocers had been scaling up nicely. The concoction of (1) higher AoVs and GMs (3) lower CACs and (4) better national brands representation has changed the complexion of online grocers' P&L during the pandemic.
- **Survivors don't offer any margin of safety:** While consolidation in F&G is imminent, survivors (DMART) do not offer any margin of safety at 75x+ FY23 P/E. DMART's growth is likely to be healthy (21/23/23% revenue/EBITDA/PAT CAGR), largely underpinned by network expansion. Alas, pressure on sales velocity and margins remains probabilistically high as deep-pocketed operators enter DMART's key catchments. We maintain our SELL recommendation on DMART with a DCF-based TP: 2,160/sh – implying 34x FY23 EV/EBITDA + 2x FY23 sales for e-comm. Note: we currently have an SOTP-based fair value of Rs. 3,743bn for RRVL, implying 20x FY23 EV/EBITDA + 3x FY23 sales for its e-comm business.

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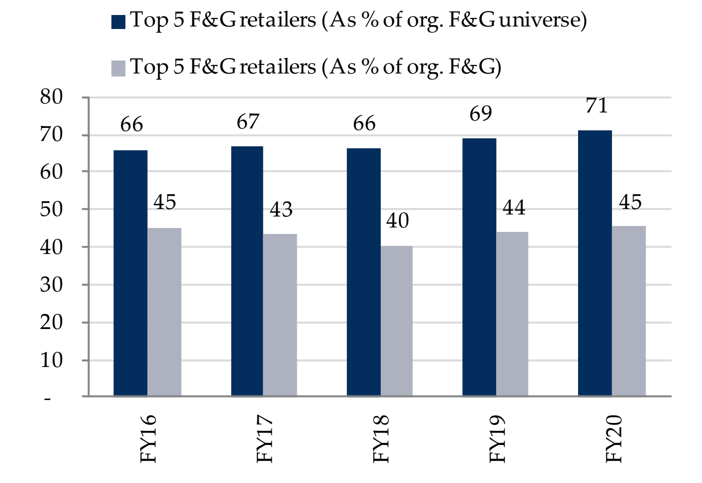
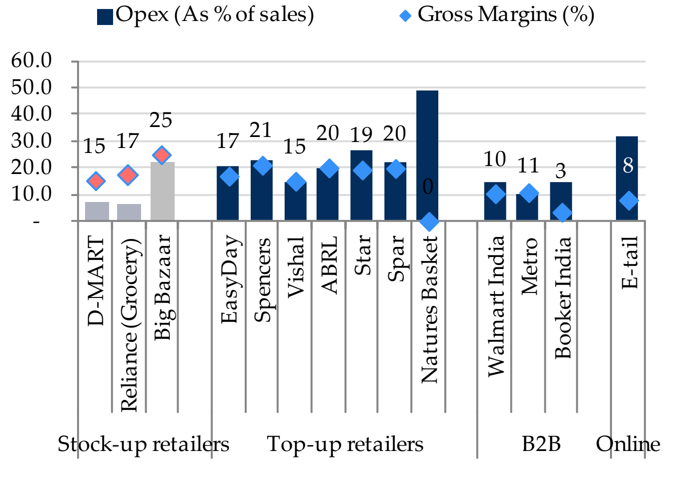
Story in Charts

Food & Grocery continues to get top-heavy



Source: Company, HSIE Research, Note: Top 5 is ex-FRL

...as profit spreads for most remain absent (since inception)



Source: Company, HSIE Research, Figures are for FY20

Cash position remains sorry Pre-COVID too. Some seem precariously placed

FY20	CFO (Rs. mn)	Capex (Rs. Mn)	Cash & Eq (Rs. mn)
Reliance Retail	169,067	74,325	7,304
DMART	12,874	17,529	32,182
FRL	(17,553)	44,410	906
Star	(827)	480	
Walmart India	(1,967)	1,158	2,981
Spar	356	344	5
Spencers	1,141	2,134	813
Booker India	(260)	6	60
ABRL	2,388	687	1,634
Metro	(90)	102	2,364
Vishal (B2C)	642	387	606

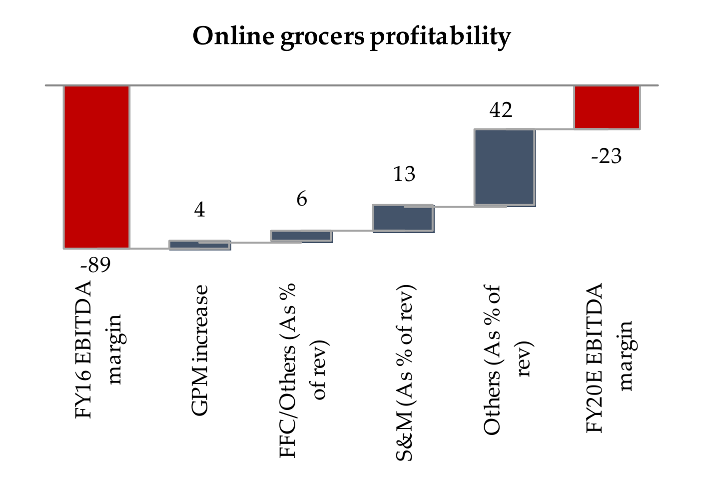
Source: Company, HSIE Research

...meanwhile global/domestic biggies + well-funded e-grocers seem to be increasing their commitment in F&G

Flipkart Farmermart	Incorporated on 4th Oct 2019 with an authorized share capital of Rs. 18.5bn. Note: Application rejected by DPIT. Company is in the process of evaluating filing a fresh application. Note: Walmart India was acquired by Flipkart Pvt Ltd in FY21. This will help Flipkart strengthen its India footprint and beef up it supply F&G chain
Amazon Retail	-Incorporated on 29th May 2017 with an authorized share capital of Rs. 1.55bn -Authorized share capital increased from Rs. 1.55bn to Rs. 1.65bn (11th May 2018) -Authorized share capital increased from Rs. 1.65bn to Rs. 3.55bn (5th Mar 2019) -Authorized share capital increased from Rs. 3.55bn to Rs. 35bn (29th Aug 2019) -Infused Rs.1.72bn on 17th Oct 2019 -Paid up capital bumped up to Rs. 8.12bn (Earlier Rs. 3.55bn) in FY20
Reliance Retail	-Raised ~Rs. 473bn for ~10.5% stake to taken on the might of Amazon and Walmart across categories in FY21
Grofers	Cumm. funds raised - USD477mn, Series F - USD247mn
Big Basket	Cumm. funds raised - USD1bn, Series F - USD190mn
ABRL (acquired by Samara/Amazon)	Authorized/Paid up capital raised from Rs. 35bn to Rs. 85bn/Rs.31.7bn to Rs. 76.7bn in FY19

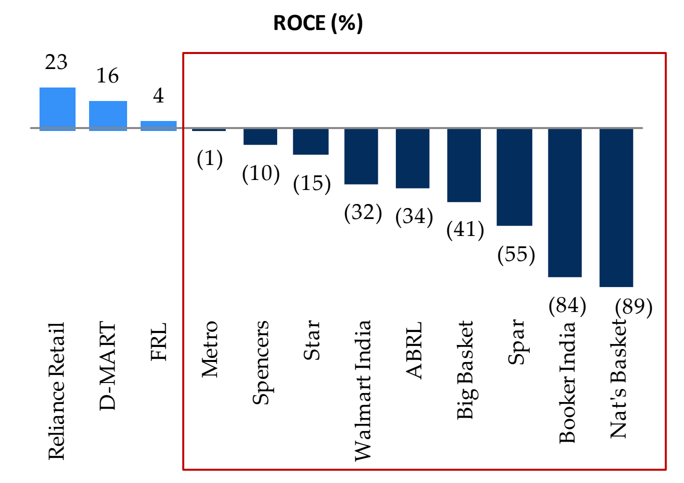
Source: Company, HSIE Research

E-grocers' fixed cost absorption continues to improve



Source: Company, HSIE Research

...Ergo, casualties are imminent



Source: Company, HSIE Research

Contents

Capital dumping to take centerstage....4

Margin crack for the ecosystem is imminent 4

Increasing cost of retailing and margin crack is a global trend....5

Case Study: Globally, even the best got bruised! 7

Could this happen to DMART? 8

DMART Ready vs Amazon India's F&G performance 8

Reliance Retail + Future Group > DMART in store density: 9

District-wise store map across per capita income and population density 10

Market share gain in top districts unlikely for DMART 10

D-MART's pricing/assortment arbitrage over peers continues to shrink 11

Well funded e-grocers scaling up nicely 14

Case Study: Grofers....15

The heat is being felt by offline grocers already....16

Comparative Analysis....17

Capital dumping to take center stage

- Capital dumping is likely to take center stage over the next 4-5 years as global/domestic biggies ramp up their supply chain and pricing/assortment investments.
- Margin crack for the ecosystem is imminent. Is there a global precedent? Yes!
- Our grocery pricing analysis suggests that D-MART's pricing and assortment availability arbitrage over peers continues to shrink.
- Our store network analysis across key grocers suggests that while D-MART ranks best on real estate choices and network density, RR is fast catching up.

- **Capital dumping is likely to take center stage over the next 4-5 years:** Global/domestic biggies are expected to ramp up their supply chain and pricing/assortment investments. This could accentuate the bleed for the F&G tail. Even the best could get bruised.

Global/Domestic biggies aggression in F&G palpable

Flipkart Farmermart	Incorporated on 4th Oct 2019 with an authorised share capital of Rs. 18.5bn. Note: Application rejected by DPIT. Company is in the process of evaluating filing a fresh application. - Parent in Singapore (Flipkart Pvt Ltd) has acquired Walmart India in FY21 to strengthen its India footprint and beef up F&G supply chain
Amazon Retail	-Incorporated on 29th May 2017 with an authorised share capital of Rs. 1.55bn -Authorised share capital increased from Rs. 1.55bn to Rs. 1.65bn (11th May 2018) -Authorised share capital increased from Rs. 1.65bn to Rs. 3.55bn (5th Mar 2019) -Authorised share capital increased from Rs. 3.55bn to Rs. 35bn (29th Aug 2019) -Infused Rs.1.72bn on 17th Oct 2019 -Paid up capital bumped up to Rs. 8.12bn (Earlier Rs. 3.55bn) in FY20
Reliance Retail	-Raised ~Rs. 473bn for ~10.5% stake to take on the might of Amazon and Walmart across categories in FY21
Grofers	Cumm. funds raised - USD477mn, Series F - USD247mn
	DMART via its FY20 QIP had raised Rs. 40.78bn. Note: Of this, ~25.43bn remain unutilised. We suspect there could be another dilution round 4-5 years later.
Big Basket	Cumm. funds raised - USD1bn, Series F - USD190mn
ABRL (acquired by Samara/Amazon)	Authorised/Paid up capital raised from Rs. 35bn to Rs. 85bn/Rs.31.7bn to Rs. 76.7bn in FY19

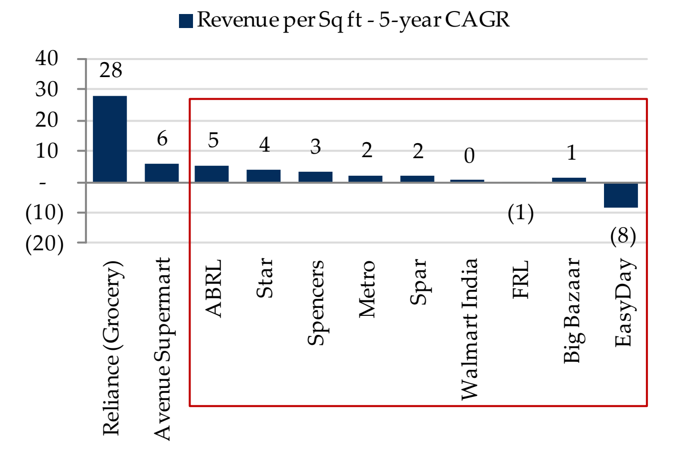
Source: Company, HSIE Research

- **Margin crack for the ecosystem is imminent:**

  Over FY15-20, despite low competitive intensity (courtesy low customer overlap), most Indian organised grocers haven't been able to outpace even inflation signaling a gradual but structural reduction in footfalls. Most continue to hide behind high gross margins as cost of retailing remains inefficient.

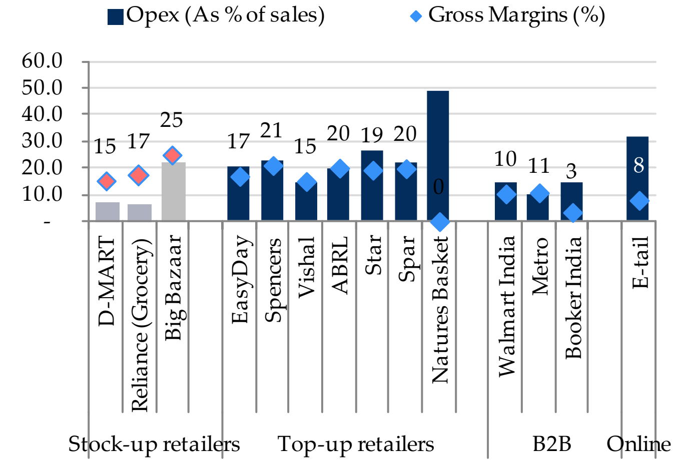
  To add insult to injury, subsidised home delivery is likely to be table stakes now as (1) deep-pocketed global/domestic grocers step up their aggression on customer recruitment and (2) strong incumbents attempt at ring-fencing their convenience-seeking consumer base. **Even the best-in-class (Read D-MART) may find itself arm-twisted into bringing online fulfillment costs/part thereof on their books (not factored in). Hence, we believe a margin crack for the ecosystem (courtesy increasing cost of retailing) is imminent over FY21-25.**

Most grocers have not been able to match inflation…signaling a gradual but structural reduction in footfalls (FY15-20)



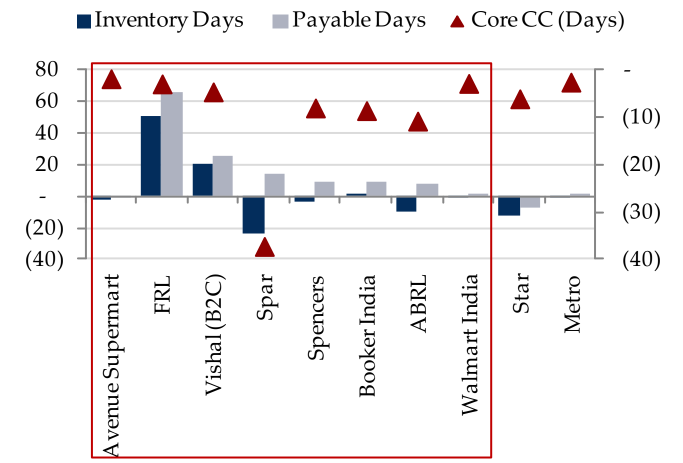
Source: Company, HSIE Research

Most continue to hide behind high gross margins as cost of retailing remains inefficient



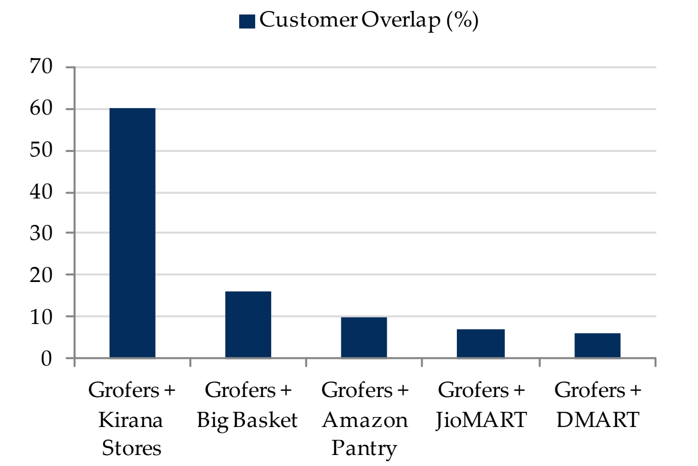
Source: Company, HSIE Research

…and vendors' crutch (higher creditors) continues to increase (5-year WC movement)



Source: Company, HSIE Research

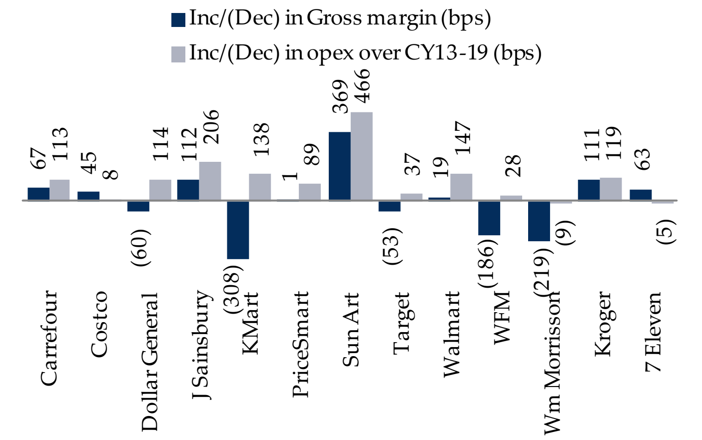
Current customer overlap among organized peers is low. This is likely to change over 4-5 years

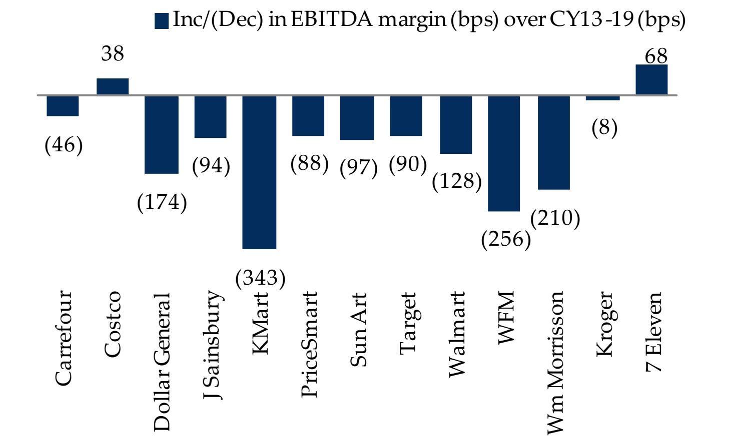


Source: Grofers, HSIE Research

- **Increasing cost of retailing and margin crack is a global trend.** Cost of retailing has inched up globally too as investments in online fulfillment capabilities increased over CY13-19.
- Bulk of retail Capex across international operators is now earmarked towards building online fulfillment capabilities. Global Grocery retail footprint (14-member universe used as proxy) has remained flat over CY13-19.

Cost of retailing has inched up globally too as investments in online fulfilment capabilities increased (CY13-19)





Source: Company, HSIE Research

Source: Company, HSIE Research

- However, most Indian B&M grocers currently have bare-bone investments in the same given (1) weak cash position, (2) absence of internal accruals/earnings power.

Alas, most Indian grocers have bare-bone investments in online fulfillment capabilities as cash position remains weak

Rs. mn (FY20)	CFO (Rs. mn)	Capex (Rs. Mn)	FCFF (Rs. mn)	Cash & Eq (Rs. mn)
Rel. Retail	169,067	74,325	94,742	7,304
DMART	12,874	17,529	(4,655)	32,182
FRL	(17,553)	44,410	(61,964)	906
Star	(827)	480	(1,307)	
Walmart India	(1,967)	1,158	(3,125)	2,981
Spar	356	344	12	5
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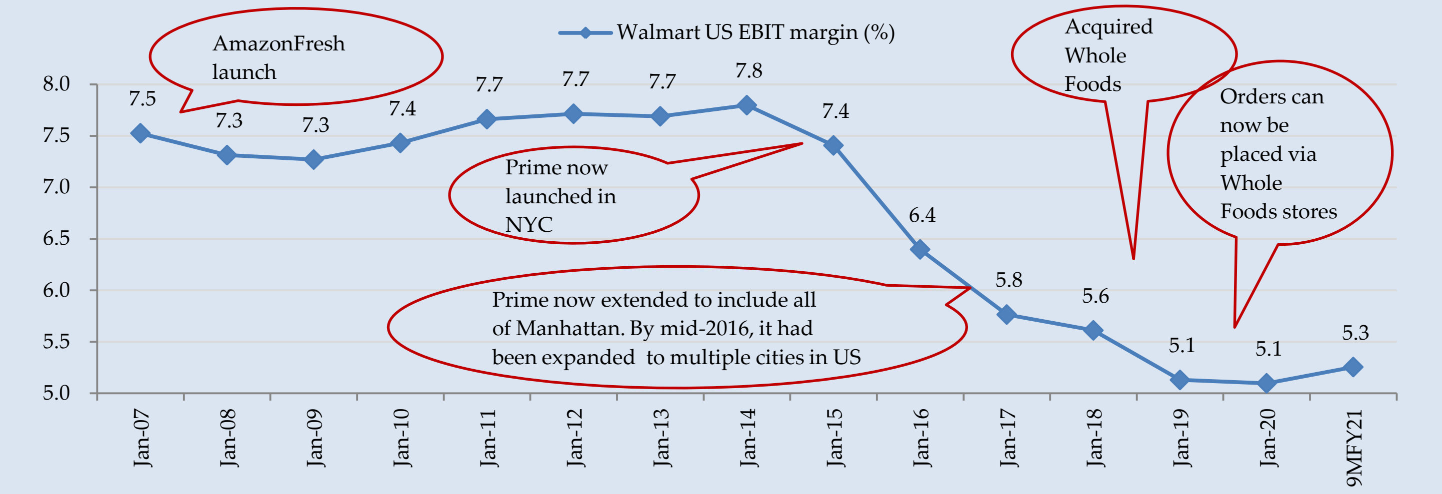
Metro	(90)	102	(191)	2,364
Vishal (B2C)	642	387	255	606

Source: Company, HSIE Research

Globally, even the best got bruised!

Over FY14-9MFY21, as Amazon continued to sharpen its delivery options in F&G, most grocers have had to match Amazon and sharpen their omni-investments too. Ergo, the margin crack throughout the universe (including Walmart).

Walmart US' margin cracks as Amazon sharpens delivery offerings in grocery



Source: Company, HSIE Research

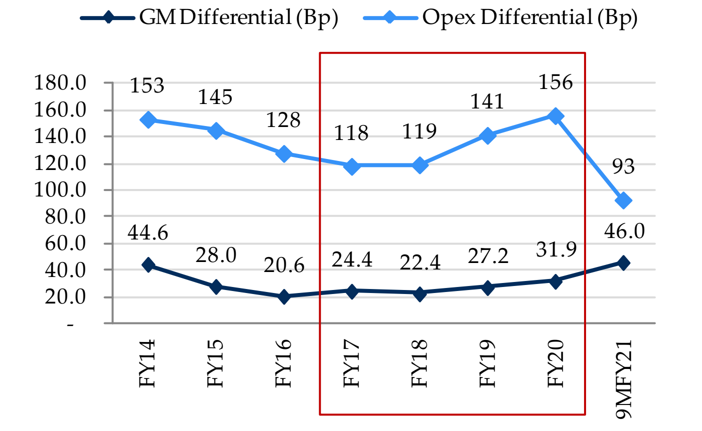
Walmart's annual report commentary over the years on stepping up investments in technology/online fulfilment

2015	We did not meet our objective of growing operating expenses at a slower rate than net sales as operating expenses as a percentage of net sales increased 27 basis points. Overall, lower than anticipated sales, higher investment in global leverage and digital retail initiatives we key reasons for the spike
2016	For several years, our performance metrics emphasized three financial priorities: growth, leverage and returns. We are currently making strategic investments in our associates and in the integration of digital and physical retail. These investments support long-term growth while we maintain our heritage of everyday low prices which are supported by everyday low cost. During this time of increased investments, we have shifted our financial priorities to focus primarily on growth, balanced by the long-term health of the Company including returns. While leverage remains important to everyday low cost, during this time of increased investments, operating expenses may grow at a rate that is greater than or equal to the rate of our net sales growth, and operating income may grow at a rate that is equal to or less than the rate of our net sales growth.
2017	Operating expenses as % of sales increased 101/113 basis points for fiscal 2017/2016, respectively, vs previous fiscal year. For fiscal 2017, the increase was primarily driven by an increase in wage expense due to the continued investment in the associate wage structure; a $249 million charge related to discontinued real estate projects; and our continued investments in digital retail and information technology
2018	Operating expenses as % of sales increased vs. previous fiscal year. For fiscal 2018, the increase in operating expenses was primarily due to ~$0.6bn in charges related to Sam's Club closures and discontinued real estate projects, ~$400mn related to a lump sum bonus paid to associates, $300mn related to Home Office severance, legal accrual of $283mn related to the FCPA matter in 3Q, $244 mn related to discontinued real estate projects in Walmart U.S, to exit certain international properties and wind down the Brazil eCommerce operations and our continued investments in eCommerce and technology.
2019	For fiscal 2019, operating expenses as a percentage of net sales decreased 48 basis points, YoY The improvements in fiscal 2019 were partially offset by additional investments in eCommerce and technology, as well as a $160 million charge related to a securities class action lawsuit
2020	For fiscal 2020, operating expenses as a percentage of net sales decreased 8 basis points over FY19 due to Walmart's focus on expense management combined with growth in comparable store sales. Improvement were partially offset by USD0.9bn in business restructuring charges consisting primarily of non-cash impairment charges.

Source: Company, HSIE Research

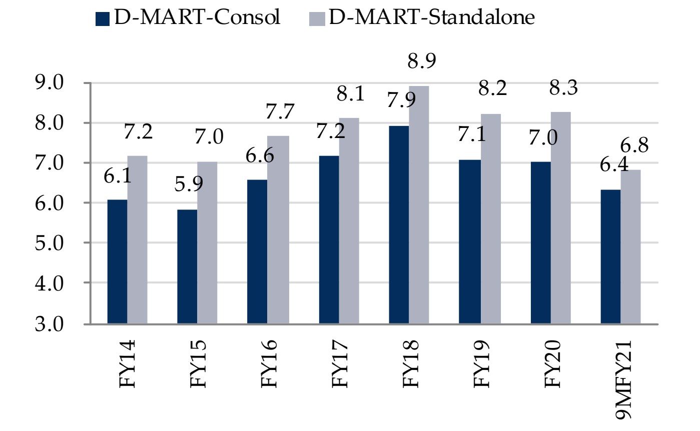
- **Could this happen to DMART?** Certainly, an inkling of this can already be seen in margin differential between D-MART's standalone and consolidated operations over the years (not material yet!). While GM differential between consolidated and standalone operations continues to increase, the differential in cost of retailing has outpaced the GM differential. Note: Currently, DMART charges for home delivery. Hence, **<u>if the ecosystem dictates subsidised home delivery, DMART's cost of retailing could spiral over the next few years (not factored in) – this is the biggest risk to its lofty valuations.</u>**

Cost differential between consolidated and standalone operations is on its way up already



Source: Company, HSIE Research

DMART's EBITDA margin profile (%)



Source: Company, HSIE Research

- **Balance sheet arbitrage to ensure DMART's online foray is a restrained one:** Balance sheet arbitrage of global biggies/Reliance Retail over DMART and the inherent lower profitability in e-grocery is likely to keep DMART's online expansion a restrained one. **This already can be seen if one compares the ramp-up of DMART Ready operations vs that of Amazon India's F&G unit and Reliance Retail's JioMART and their respective cash burns. Management, too, conceded that it is more comfortable with small trials, reviews and controlled acceleration for DMART Ready** (not that we are complaining, it's the right thing to do given relative finite resources). Note, DMART recently did a soft launch of DMART Ready services in Ahmedabad, Bangalore and Hyderabad.
- Cross category subsidising opportunities could mean that if horizontal online platforms manage to streamline their F&G supply chain and assortment availability, they stand a better chance of scaling up operations (vis-à-vis a pure-play grocer) with controlled group-level cash burn by subsidising grocery via cash flows from profitable categories.
- While still early days, there are quite a few low-hanging fruits in terms of cost rationalisation in case of Amazon India's F&G unit such as legal fees and platform selling costs <u>(HSIE Research will be glad to help with more nuances).</u>

DMART Ready vs Amazon India's F&G unit

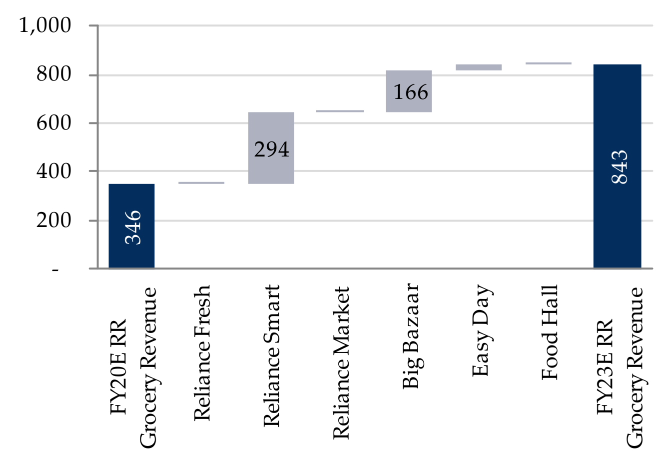
Rs. Mn	D-MART Ready		Amazon (F&G)	
	FY19	FY20	FY19	FY20
Revenue	1,436	3,540	1390	7144
COGS	1,278	3,177	1405	6188
Gross Profit	**158**	**363**	**(15)**	**956**
GPM (%)	**11.0**	**10.3**	**(1.1)**	**13.4**
Total Operating expenses	562	773	1263	3882
EBITDA	**(404)**	**(410)**	**(1,278)**	**(2,926)**
EBITDAM (%)	**(28.1)**	**(11.6)**	**(91.9)**	**(41.0)**
EBIT	**(514.2)**	**(737.6)**	**(1,288.0)**	**(3,033.0)**

Source: Company, HSIE Research

Reliance Retail + Future Group > DMART in store density:

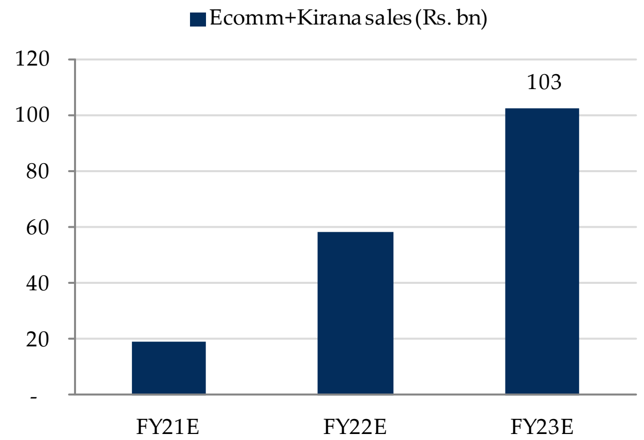
- **Key catchments could see heightened rise in competitive intensity post the merger. Our district-wise store map (~500 districts) suggests if and when the Reliance Retail and Future group combination materialises, the store network overlap would increase significantly in key catchments of DMART. Consequently, these catchments could see heightened rise in competitive intensity and price action as the biggies wrestle each other for market share.**
- Within the per capita income group of Rs. 300-500k, Mumbai, Kalyan and Hyderabad (population density > 5000/sq. km) and Bengaluru (population density 3000-5000/sq. km) have significant store network overlaps between DMART and Reliance Retail + FRL. Pune, Thane and Ahmedabad – two strong DMART catchments are likely to be closely contested too.
- The bump-up in Delhi stores could help take on established e-grocers such as Grofers on their turf. Note: DMART has historically struggled to establish a footprint in Delhi-NCR yet.
- Of note, ~48% of D-MART's stores (HSIE: Revenue contribution ~65-70%) reside in the aforementioned 7 districts, which happen to be among the most populated and over retailed ones in India.
- Southern cities of Ernakulum and Kanyakumari too is likely to see heightened competitive intensity
- If executed well, Reliance (All grocery formats) + Big Bazaar + Easyday could prove to be a strong omni-channel play, given the population density it will cater to in the aforementioned districts. This could help fulfill JioMART orders within controlled cost structures. We expect Reliance Smart + Big Bazaar to add Rs. 460bn to Reliance's offline grocery revenue and spur JioMART sales too. **The operating words in this argument being "if executed well". No wonder Amazon seems to be persistent with stalling the acquisition.**
- **Note:** The Reliance-Future Group deal has received approvals from the Competition Commission of India (CCI) and SEBI (conditional) already. NCLT remains the last stop for approvals. Currently, Amazon and Future Group continue to battle it out in the Delhi High Court and as per media articles Future Group has refuted a possibility of settlement.

Reliance Smart + Big Bazaar likely to be growth anchors for RR



Source: Company, HSIE Research

...could help spur JioMART sales too



Source: Company, HSIE Research

District-wise store map across per capita income and population density

PCI/Popn Density	District (#)	Population (mn)	D Mart	Big Bazaar	Reliance Smart	Reliance Fresh	Reliance Market	Rel + BB	Rel S+F+M+BB	Spencers	Star Bazaar	Spar	Natures Basket
<Rs. 100K	**222**	**501**	**1.3**	**1.8**	**1.3**	**3.9**	**1.0**	**0.3**	**0.5**	**3.8**		**1.0**	
<300 Km²	79	105	1.0	1.2	1.1	2.7		0.3	0.4				
1000-3000	48	163		2.1		1.0	1.0	0.5	0.5	4.2			
3000-5000	2	7	1.0	6.0	4.0			5.0	5.0	2.0		1.0	
300-500	24	47	1.5	1.0	1.3	1.0		0.3	0.4				
500-1000	69	179		1.0	1.4	7.0	1.0	0.2	0.7				
100-150K	**111**	**218**	**1.4**	**1.5**	**1.6**	**5.1**	**1.0**	**0.8**	**1.5**	**1.7**			
<300	50	74	1.2	1.0	1.0	3.0		0.2	0.3				
1000-3000	9	34	1.0	1.8	1.7	3.7	1.0	1.3	2.7	2.0			
3000-5000	1	5		2.0		1.0		2.0	3.0	1.0			
300-500	38	78	1.3	1.2	1.6	3.2	1.0	0.9	1.6	2.0			
500-1000	13	27	2.5	2.4	2.4	12.7	1.0	1.8	4.9	1.0			
150-200K	**86**	**188**	**2.1**	**2.0**	**1.6**	**4.8**	**1.0**	**1.2**	**2.4**	**7.1**	**1.0**	**3.0**	**1.0**
<300	31	67	1.4	1.0	1.4	1.0	1.0	0.6	0.7	1.0			
1000-3000	4	15	4.0	1.3	1.3	4.0	1.0	2.3	3.8				
300-500	28	52	2.7	1.3	1.5	3.6	1.0	0.7	1.5	3.3			
5000+	2	9	1.0	12.0	3.0	14.0	1.0	15.0	29.5	19.0		3.0	1.0
500-1000	21	46	2.3	1.3	1.7	4.0	1.0	1.3	3.4		1.0		
200-250K	**30**	**72**	**1.4**	**1.8**	**1.7**	**2.8**	**1.0**	**1.5**	**2.9**	**2.3**		**1.5**	
<300	3	3		1.0				0.3	0.3			1.0	
1000-3000	7	23		2.7	1.3	3.2		1.7	4.0	5.0			
300-500	8	18	1.0	2.0	1.7	2.0	1.0	1.1	1.8				
500-1000	12	28	1.8	1.3	1.9	2.7	1.0	1.9	3.7	1.0		2.0	
250-300K	**6**	**28**	**13.5**	**6.3**	**3.5**	**10.3**	**2.0**	**7.7**	**13.2**		**8.0**		**2.0**
1000-3000	3	16	9.0	7.0	2.7	9.5	2.0	7.3	14.3				
300-500	1	1		2.0	1.0			3.0	3.0				
500-1000	2	10	18.0	9.0	6.0	12.0		10.5	16.5		8.0		2.0
300-500K	**12**	**57**	**14.4**	**7.8**	**5.3**	**17.0**	**1.0**	**9.3**	**19.5**	**4.8**	**7.5**	**4.3**	**10.0**
<300	1	0						-	-				
1000-3000	1	2		1.0	1.0	4.0		2.0	6.0	2.0			
3000-5000	1	10	19.0	19.0	9.0	54.0	1.0	28.0	83.0	2.0	18.0	8.0	8.0
300-500	2	3	1.0	2.0	2.0			3.0	3.0			2.0	
5000+	4	35	17.3	14.7	7.0	12.8	1.0	18.0	31.0	9.5	4.0	3.5	11.0
500-1000	3	8		1.0	2.0	10.0	1.0	1.3	5.0	1.0			
500K+	**2**	**3**		**4.0**	**2.5**	**6.0**		**6.5**	**9.5**	**4.0**		**1.0**	
1000-3000	2	3		4.0	2.5	6.0		6.5	9.5	4.0		1.0	
Gujarat	**26**	**55**	**3.0**	**1.6**	**2.0**	**3.6**	**1.0**	**1.3**	**2.1**	**1.0**			
<300	12	19	2.0	1.0	2.0	1.0	1.0	0.9	1.1				
1000-3000	1	0	1.0					-	-				
300-500	5	13	2.5	1.0	1.0		1.0	0.6	0.8				
500-1000	8	22	3.7	2.3	2.5	4.3	1.0	2.4	4.8	1.0			
Grand Total	**495**	**1,122**	**3.2**	**2.4**	**1.9**	**5.7**	**1.0**	**1.0**	**1.9**	**4.1**	**6.5**	**2.8**	**6.6**

Source: Company, HSIE Research, Note: BB – Big Bazaar, S+F+M+BB = Reliance (grocery segment) +Big Bazaar

- Back of the envelop calculations suggests DMART caters to 25%+ of the household universe in top 7 districts. Share gains for DMART in these catchments are unlikely as the merged entity - Reliance Retail + FRL (given improved store density + Jiomart sales) could enjoy similar sourcing margins (these are typically negotiated catchment-wise). Consequently, latter is likely to be as competitive as DMART over the medium to long term.

DMART's household share gain in top districts seems restricted from hereon

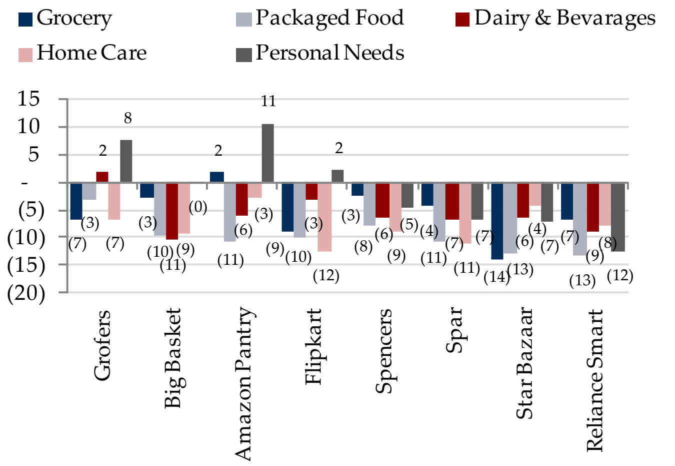
FY20 DMART Bill cuts (mn)	201
Assuming 35% of bil cuts come from Top 7 Districts	70
No. Of HH catered to by Top 7 Districts	4
No. Of HH in Top 7 Districts	15
Purchase frequency/year	18
No. Of stores in Top 7 Districts	106
Bill cuts/store/day	1,818
HH share in 7 Districts (%)	25.9

Source: Company, HSIE Research Note: HH - Household

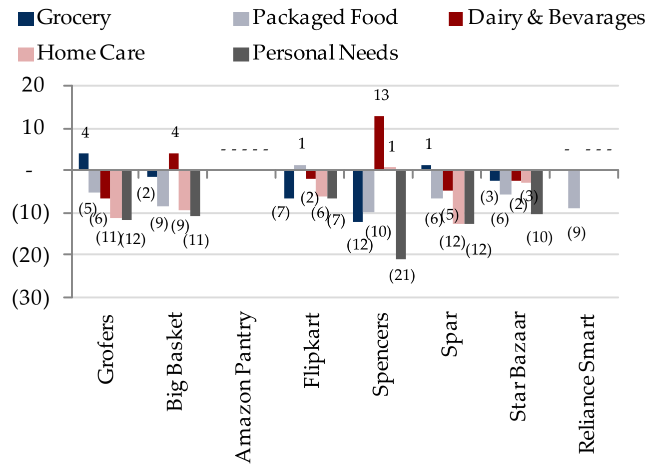
D-MART's pricing/assortment arbitrage over peers continues to shrink:

1. Our Grocery price tracker across key grocers suggests that DMART's low price edge over peers has shrunk over the course of the pandemic.
2. While Amazon and Flipkart remain less competitive, their product selection continues to improve and white spaces in products have reduced significantly. If consistency in assortment is improved upon (a function of sourcing deals). This could certainly spur orders, average order values and consumer stickiness over the next 3-5 years.
3. Since its launch, Reliance Retail's JioMART has been the most aggressive on pricing and offers free delivery at any order size. Assortment availability continues to improve, but still lags DMART.
4. Grofers has upped the ante in number of SKUs on offer from typically ~1800 to ~3000 SKUs. More national brands have found their way in Grofers SKU roster making it a better rounded one. We suspect the pandemic has helped Grofers extract better sourcing margins from national brands too as it continues to scale up well.
5. DMART's essential products pricing while still lower than most grocers, continues to remain at a premium to its pre-pandemic levels as the company remains focused on safeguarding gross margins from the impact of significantly lower non-essential sales.

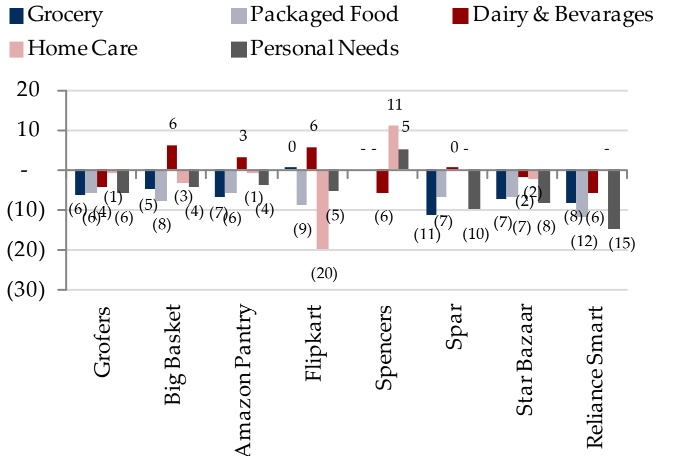
DMART's discount over peers (WC 14th Mar)



DMART's discount over peers (WC 15th Apr)

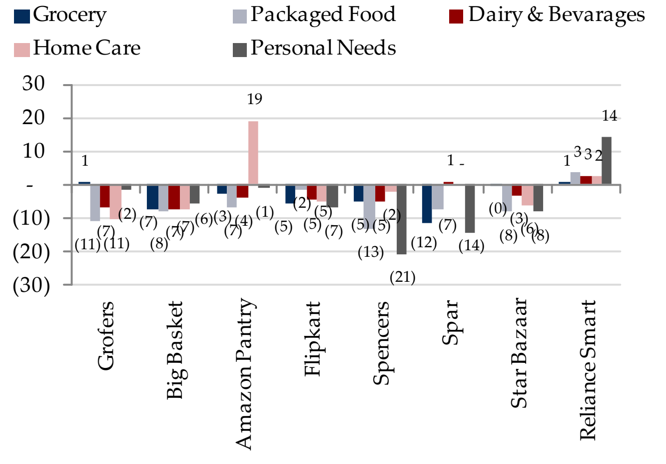


DMART's discount over peers (WC 15th May)



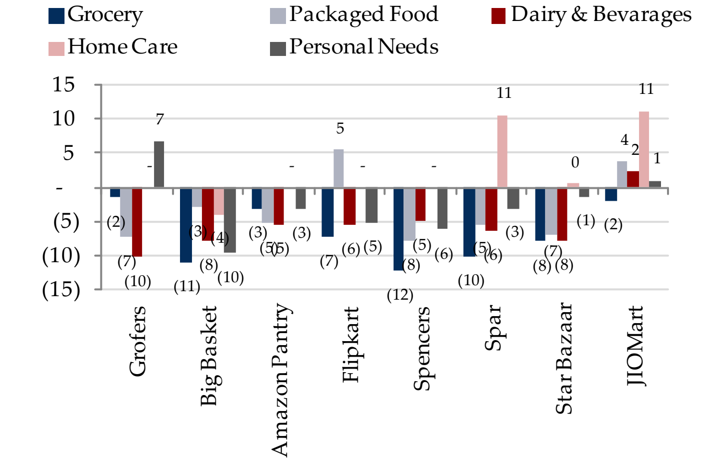
Source: Company, HSIE Research

DMART's discount over peers (WC 12th June)



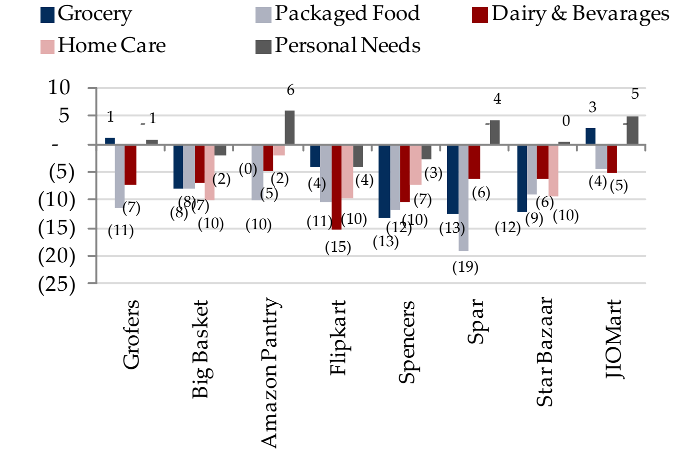
Source: Company, HSIE Research

DMART's discount over peers (WC 10th July)



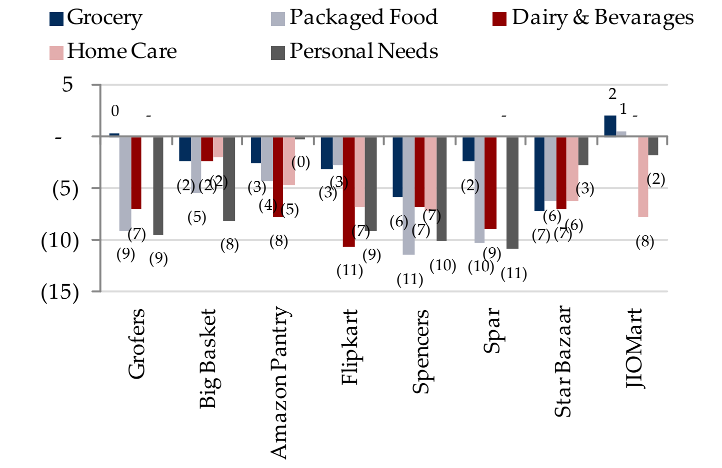
Source: Company, HSIE Research

DMART's discount over peers (WC 14th Aug)



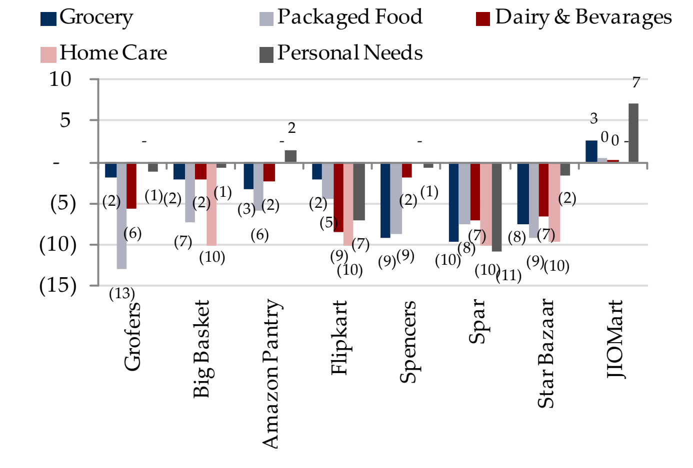
Source: Company, HSIE Research

DMART's discount over peers (WC 11th Sep)



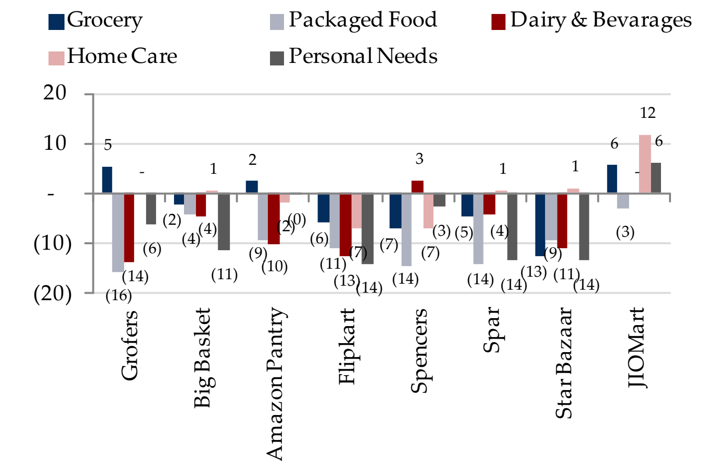
Source: Company, HSIE Research

DMART's discount over peers (WC 09th Oct)



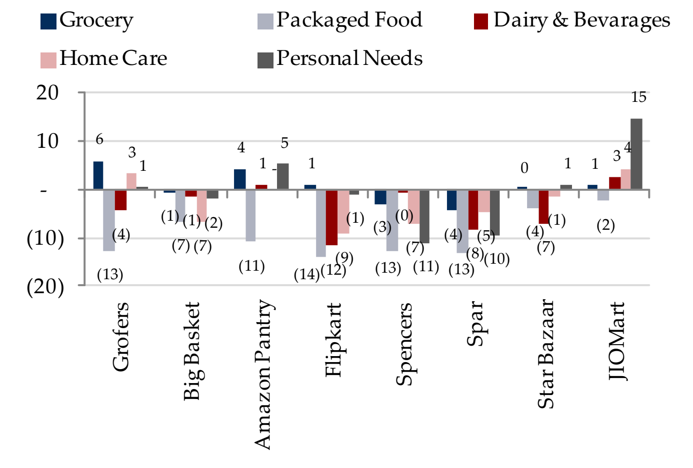
Source: Company, HSIE Research

DMART's discount over peers (WC 13th Nov)



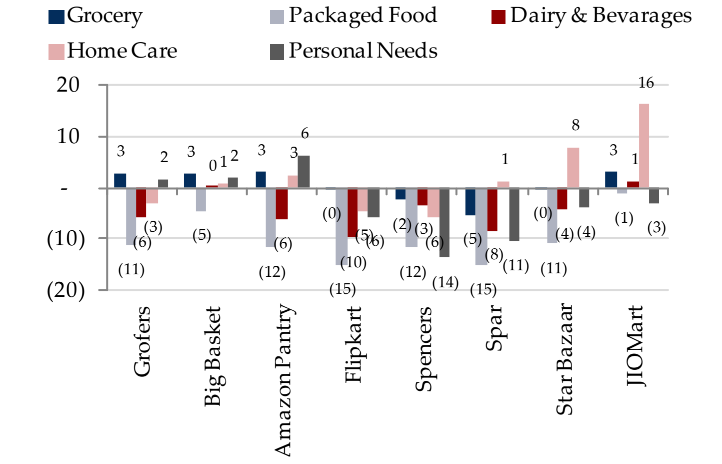
Source: Company, HSIE Research

DMART's discount over peers (WC 11th Dec)



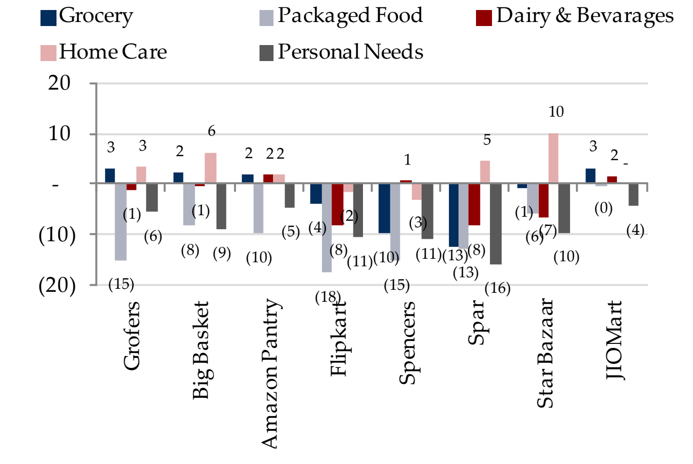
Source: Company, HSIE Research

DMART's discount over peers (WC 08th Jan-21)



Source: Company, HSIE Research

DMART's discount over peers (WC 15th Jan-21)



Source: Company, HSIE Research

Peers catching up on one of DMART's key value proposition – assortment availability

	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21
DMART	7	20	13	7	8	8	10	12	12	6	6
Grofers	24	22	28	25	22	23	18	21	24	16	8
Big Basket	13	15	14	8	9	9	11	10	10	8	5
Amazon Pantry	34	45	30	19	14	11	12	11	9	8	5
Flipkart	28	23	18	20	26	22	18	17	12	11	12
Spencers	34	40	37	31	30	21	25	21	20	19	19
Spar	21	34	36	23	20	22	19	19	14	11	10
Star	3	6	5	6	4	3	6	10	11	8	8
JIOMART	23	46	30	26	24	20	16	17	18	18	9

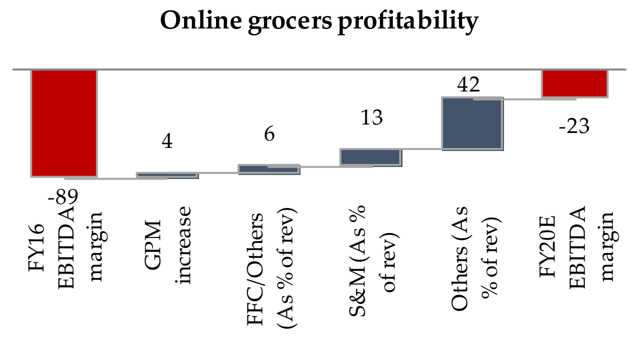
Source: Company, HSIE Research: How to Read: In Jan-21, of 50 fast moving commodities, only 6 were unavailable in DMART

Well-funded e-grocers scaling up nicely

...and heat is being felt by offline grocers already!

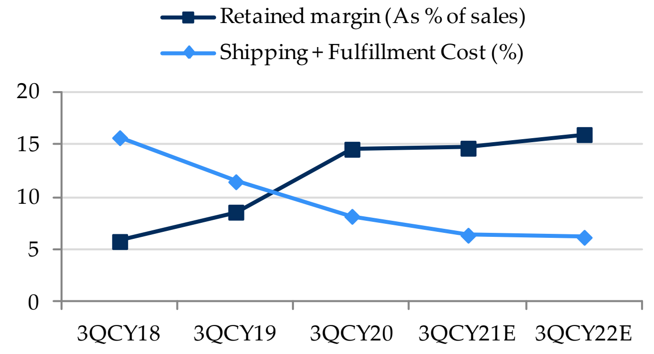
- Even pre-COVID19, major e-grocers had been scaling up nicely. However, the pandemic has only expedited the shift to online with improving unit economics.
- During the pandemic, four momentary shifts in consumer purchasing behaviour have decisively tipped the scales in favour of e-grocers:
  1. The average order values are now up 30%+ (up 40-50% at peak of the pandemic) as consumers' initial essential hoarding behavior seems to be graduating to a preference for regular stock up purchases, even among first time users. (a year-long consumer sampling period, courtesy the pandemic coupled with JioMART's free delivery proposition has certainly helped) Note: retention rates for online grocers for new users is as high as 60%.
  2. Salience of discounts reduced during the pandemic (D-MART's primary value proposition). This trend is increasingly mean-reverting now.
  3. Improved online scale has helped e-grocers fish out better sourcing/trade margins and more representation from national brands.
  4. Significant reduction in customer acquisition and marketing costs (CAC) for e-grocers due to the organic shift during the pandemic.
- This concoction of (1) higher AoVs, (2) higher gross (retained) margins, (3) lower CACs and (4) better national brands representation has changed the complexion of the online grocers' P&L. Selection arbitrage vis-à-vis DMART has also reduced. Better unit economics, we suspect, is likely to help e-grocers earmark incremental funding largely for footprint expansion and sporadic upticks in marketing spends. The above trends are amply supported by Grofers' performance during the pandemic.
- Interestingly, some online folks are reining in fulfilment costs smartly by getting closer to the consumer via expansion of warehouse/dark store/channel partner footprint. Amazon and Flipkart, too, are on the cusp of extracting their pound of flesh in F&G. Both, in order to have latitude in pricing, are already working on operating on a low-cost structure (i.e., low fulfilment costs) via stake purchases/acquisition of offline assets (More Retail and Walmart India).
- Amazon India's F&G unit now (As on FY20) is able to reach 125 cities (2,50,000 leased storage space) and continues to focus on increasing fulfillment capabilities. The retailer continues to build on sourcing and delivery capabilities for a varied spread of food such as dry grocery, packaged foods, fruits, vegetables, protein foods, dairy and other frozen products. The company launched its first collection Center in Manchar, Maharashtra, and processing center in Navi Mumbai and now buys from farmers directly. Management in its annual report highlighted that it plans to ***open new collection centers, processing centers, and temperature-controlled hubs in other major cities to service more customers in FY21***.

Despite being competitive, e-grocers' fixed cost absorption has improved, implying better trade margins



Source: Company, HSIE Research

Retained (gross) margins have now surpassed fulfilment costs for Grofers



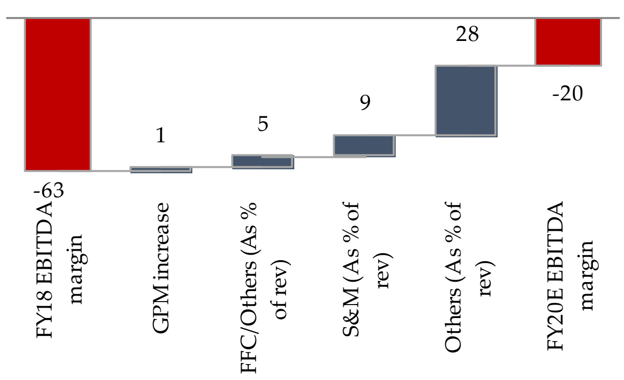
Source: Company, HSIE Research

Grofers – smartly inching towards self-sustenance

- The aforementioned trends are best explained via Grofers' performance during the pandemic.
- Online F&G penetration remains abysmally low at <1%. While there are two major vertical players catering to the segment - Grofers and Big Basket - deep-pocketed horizontal retailers have also been making moves to join the race and capture their share of the biggest pie in retail (USD600bn). Grofers' strong catchment remains the Delhi-NCR region, and its overall presence spans 30 cities. net sales stood at ~Rs. 29bn (>2x YoY) in FY20 (annualised GMV of USD600mn).
- Since the onset of the nationwide lockdown, Grofers has managed to (1) increase its AoV by ~30% to Rs. 1,950 (Rs. 2,200 at Pandemic's peak) and (2) improve upon its retained margins (GMs) as consumers prioritised safety over selection choices and were more open to sample private labels. The AoV reset remains significantly above pre-pandemic levels (Rs. 1,450) and retention rates after four quarters of consumer on-boarding remains healthy at 55%. (85% of business is repeat business). It signals a clear shift in consumer purchasing behavior
- Grofers has also increased its SKU base to 3,000 (earlier 1,800) with higher representation from national brands **(Refer Assortment Unavailability table).**
- Rising AOVs and GMs have helped Grofers improve upon its fixed cost absorption to the point that now the cash burn is restricted to a mere USD1mn per month, thereby buying them time to scale the business even further.
- Shrinking wallets (courtesy job losses/uncertainty) coupled with heightened safety needs during the pandemic fed into the surge in packaged private label sales (50-60% of new users were Kirana store shoppers, a lot of whom typically rely on unpackaged commodities who migrated to packaged food). Given the share gain is courtesy unpackaged to packaged commodity categories, we suspect the stickiness to the platform once sampled is likely to be high.
- As Grofers continues to scale well, this increase in scale can then be used to better sourcing margins with national brands and improve upon selection, which further feeds into higher AoVs, better fixed cost absorption and better traffic quality.
- Note: A&P and marketing spends have significantly reduced as the pandemic has organically sharpened the awareness of e-grocers in the ecosystem. Customer acquisition costs in April had come down to as low as USD0.05 and even currently is USD1.5 (vs USD6-7 a couple of years ago).
- Grofers intends to hit EBITDA break-even in the next 6-9 months.

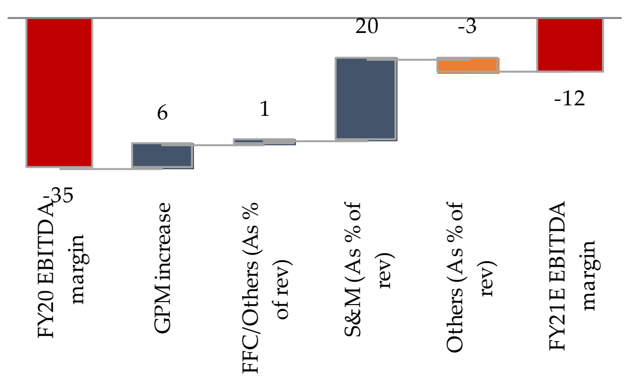
While pre-COVID, profitability was improving, the pandemic has only expedited the rate of improvement for Grofers

Grofers profitability FY18-20E



Source: Company, HSIE Research

Online Grofers profitability



Source: Company, HSIE Research

The heat is being felt by offline grocers already

The heat is being felt by offline grocers already and their actions continue to corroborate the increasing preference for online and omni investments!

"Price discounting has gone up in the last 1-1.5 years. This is a new variable playing out as earlier competition was not discounting as much as they have begun in the last 12 to 18 months. Hence, it is very tough to predict what will happen next year" **- FY19 Avenue Supermarts' Annual Analyst Meet**

"There continues to be a distinct behaviour of shopping more efficiently by shoppers. Lesser trips and higher basket values continue to be the norm. While there is a general reduction in basket values compared to peak pandemic levels, they still continue to be relatively higher than pre-COVID levels". This coupled with DMART's 3QFY21 growth rate (10%) suggests that footfall recovery hasn't yet reached the pre-COVID level.
"Post COVID-19, environment is creating opportunities to launch DMart Ready in more cities. However, we will continue with our approach of small trials, reviews and controlled acceleration for DMart Ready" **– Commentary in 3QFY21 results**
- CEO Neville Noronha

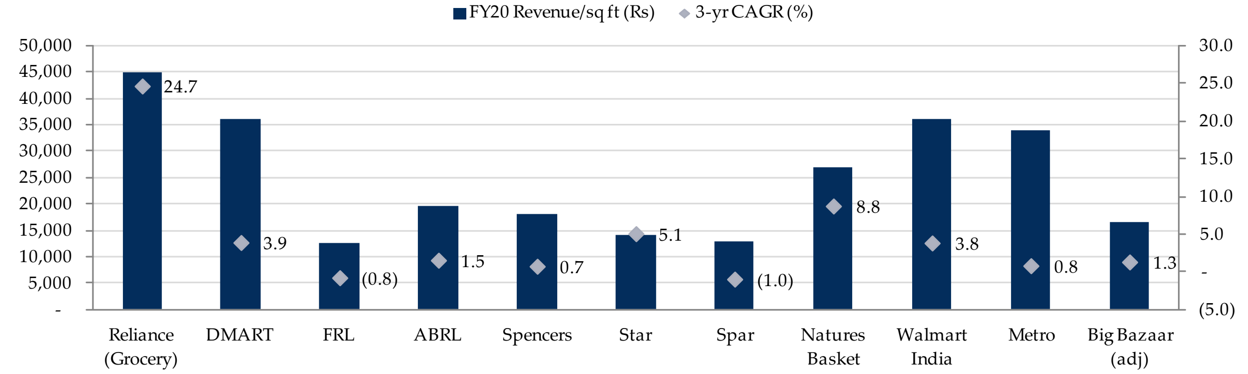
"We witnessed deep and consistent investment in pricing by brick-and-mortar retailers, primarily to match and/or ward off e-commerce players who were aggressively focused on customer acquisition and, hence, are passing on huge benefits to recruit customers. This aggressive push by e-commerce has started impacting offline monthly shopping missions, forcing brick-and-mortar retailers to follow suit in order to stay competitive and relevant for the customer. As seen in other markets, we expect India to go through this phase of intensive price-based competition before reaching a mature environment"
-ABRL (now More Retail) in its FY19 Annual Report
"Company expects the pandemic-led challenges to continue. The customer is changing the way he/she shops. There is a significant share of orders moving to online platforms, and the company is making sure to fulfill all the customer's requirement"
– More Retail (earlier ABRL) FY20 Annual Report.

"We revamped our pricing policy making great deals always available to more customers, provided greater choice through a wide assortment and made it easier for our customers to shop with us with easy credit, payment and delivery options. This resulted in a healthy double-digit growth in these core customer segments".
"We further expanded our foot print with 5 new store openings in the cities of Vijaywada, Indore, Nizamabad, Warangal and Kurnool, taking the total tally to eight new openings in the last 18 months. In line with our strategy to build strong tech capability supporting superior omni-channel customer experience, we completed roll out of new front-end system across all stores and introduced a digital solution for member on-boarding. We also launched a new e-Commerce website & application to make it easier for our members to shop with us in ways that are most convenient to them"

"Finally, our endeavor towards building capabilities for the future is continuing via investments to expand our Omni channel reach. The increased capex during the year reflects the investments that we are making to build for long term growth".
"The management believes that it is in growth phase and had expected to incur losses for carrying wholesale cash and carry business in India. The Company has got a commitment of continued financial support from the Ultimate Holding Company (Walmart Inc.) to contribute to the shortfall of the capital requirements, if any".
- Walmart India in its FY20 Annual Report

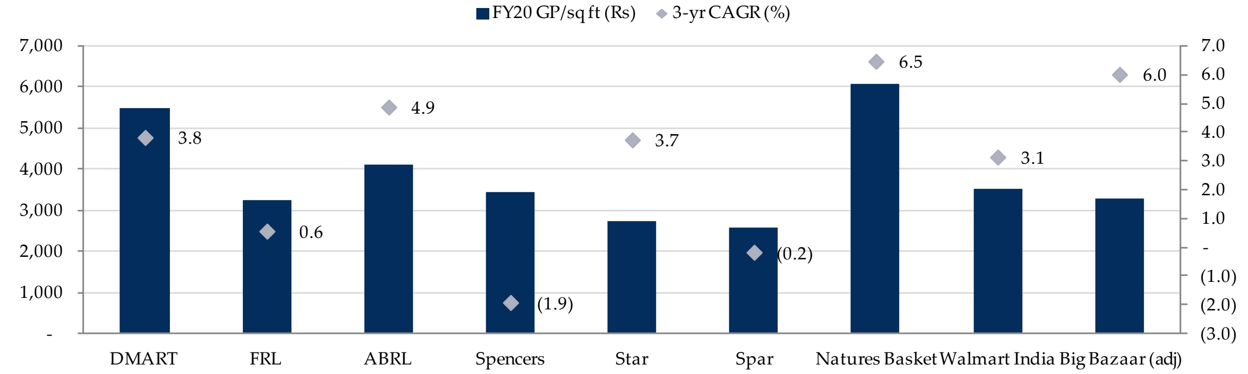
Comparative Analysis

Few grocers' sales velocity has matched inflation despite their low base. Seems like footfalls are gradually moving away.



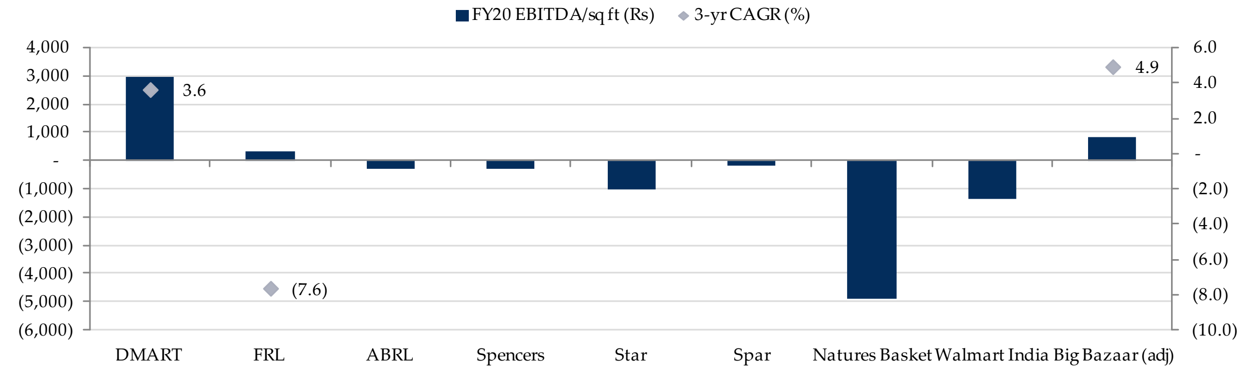
Source: Company, HSIE Research

Growth in GP/sq ft for most top up formats have lagged revenue per sq. ft as competitive intensity remains high



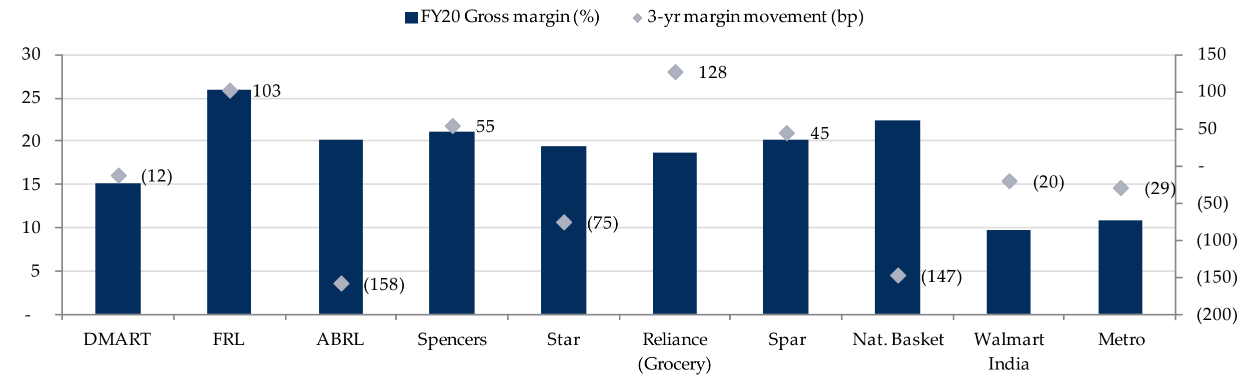
Source: Company, HSIE Research

Barring DMART, none make a profit spread



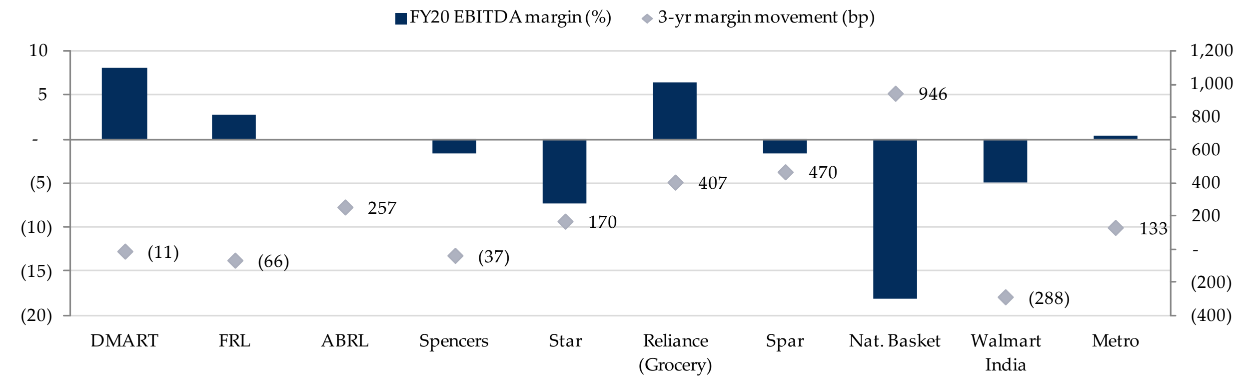
Source: Company, HSIE Research

Peer-wise Gross margin and 3-year movement (bp)



Source: Company, HSIE Research

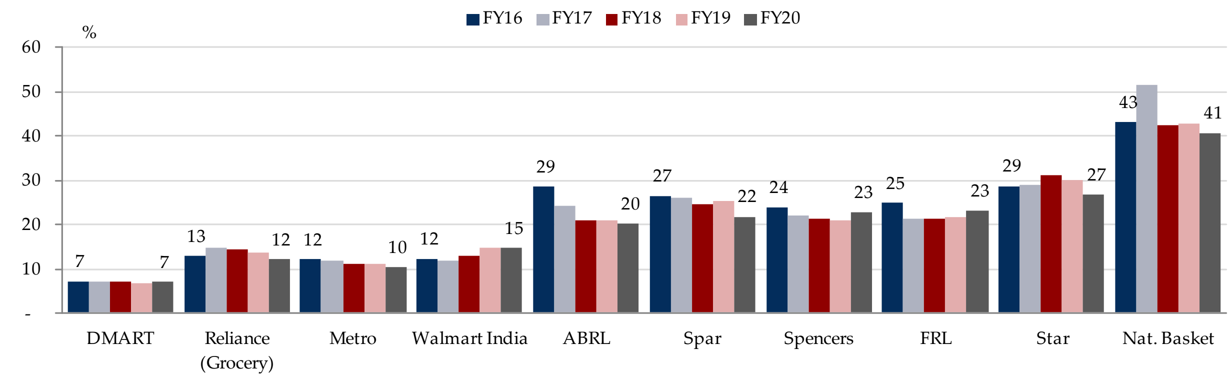
Peer-wise EBITDA margin and 3-year movement (bp)



Source: Company, HSIE Research

- Most F&G retailers continue to hide behind high gross margins (GM), while reducing their cost of retailing to reduce their respective cash burns. This is evident in their deteriorating GM differential vs DMART. Only More Retail down south and Trent's Star have in recent times improved upon their value proposition and reduced their cost structure.
- Most, given their incompetence in the marketplace, continue to lose relative market share.

Most grocers haven't managed to rein in cost of retailing (in %) meaningfully



Source: Company, HSIE Research

GM Differential: Peers over DMART

%	FY16	FY17	FY18	FY19	FY20
FRL	11.1	9.6	9.7	11.7	10.7
More Retail	8.6	6.4	4.7	5.3	5.0
Spencers	5.5	5.3	4.6	6.2	6.0
Star	4.6	4.8	4.0	7.0	4.2
Reliance (Grocery)	0.7	2.1	2.4	4.1	3.5
Spar	3.6	4.5	3.9	4.9	5.1
Natures Basket	9.3	8.7	9.2	11.1	7.3
Walmart India	(5.6)	(5.4)	(5.6)	(4.6)	(5.4)
Metro	(3.2)	(4.1)	(4.5)	(3.7)	(4.3)

Source: Company, HSIE Research

Cost arbitrage: Peers vs DMART

	FY16	FY17	FY18	FY19	FY20
FRL	17.6	14.4	14.2	14.7	16.1
More Retail	21.3	17.2	14.2	14.1	13.1
Spencers	16.7	14.8	14.4	14.0	15.8
Star	21.6	22.1	24.0	23.2	19.7
Reliance (Grocery)	5.6	7.9	7.4	6.6	5.1
Spar	19.3	19.0	17.5	18.5	14.8
Natures Basket	35.9	44.6	35.6	35.9	33.6
Walmart India	5.1	4.9	6.1	8.0	7.6
Metro	4.9	5.0	4.2	4.1	3.4

Source: Company, HSIE Research

- Most F&G retailers while improving on inventory management, haven't been passing on the savings to vendors (as DMART does). This is primarily as most can't afford to accentuate their cash burn further. More Retail, per channel checks has got favorable terms of trade from vendors since its acquisition by Amazon/Samara.
- There are two north-heavy grocers (one being FRL) who seem to be facing serious working capital/liquidity pain. This could perhaps be an opportune time for some of the serious contenders in F&G to aggressively look at the North market.

Peer-wise Core cash conversion cycle:

Inventory Days	FY17	FY18	FY19	FY20	3-yr Variance
Avenue Supermarts	29	28	29	29	(0)
FRL	80	87	92	95	15
More Retail	31	28	32	23	(9)
Spencers	43	43	45	34	(9)
Star	35	28	27	21	(14)
Spar	29	32	31	15	(14)
Natures Basket	23	29	29	29	5
Walmart India	30	32	36	31	1
Metro	26	28	28	25	(1)

Receivable Days	FY17	FY18	FY19	FY20	3-yr Variance
Avenue Supermarts	1	1	1	0	(0)
FRL	5	5	6	13	8
More Retail	2	1	1	1	(1)
Spencers	5	7	7	9	4
Star	7	10	8	5	(2)
Spar	2	2	2	2	(0)
Natures Basket	4	10	10	10	6
Walmart India	0	0	0	1	0
Metro	3	3	3	3	(0)

Payable Days	FY17	FY18	FY19	FY20	3-yr Variance
Avenue Supermarts	8	8	8	6	(2)
FRL	59	68	53	100	41
More Retail	23	22	36	34	11
Spencers	47	49	52	52	4
Star	40	42	38	32	(8)
Spar	29	33	38	36	7
Natures Basket	30	33	33	33	2
Walmart India	25	30	29	21	(4)
Metro	33	36	36	25	(8)

Core Cash Conv. Cycle (Days)	FY17	FY18	FY19	FY20	3-yr Variance
Avenue Supermarts	22	21	22	23	1
FRL	25	25	44	8	(18)
More Retail	10	8	(3)	(10)	(20)
Spencers	1	0	0	(8)	(9)
Star	2	(4)	(3)	(6)	(8)
Spar	3	1	(5)	(19)	(21)
Natures Basket	(3)	6	6	6	9
Walmart India	6	2	8	11	5
Metro	(5)	(5)	(5)	2	7

Source: Company, HSIE Research

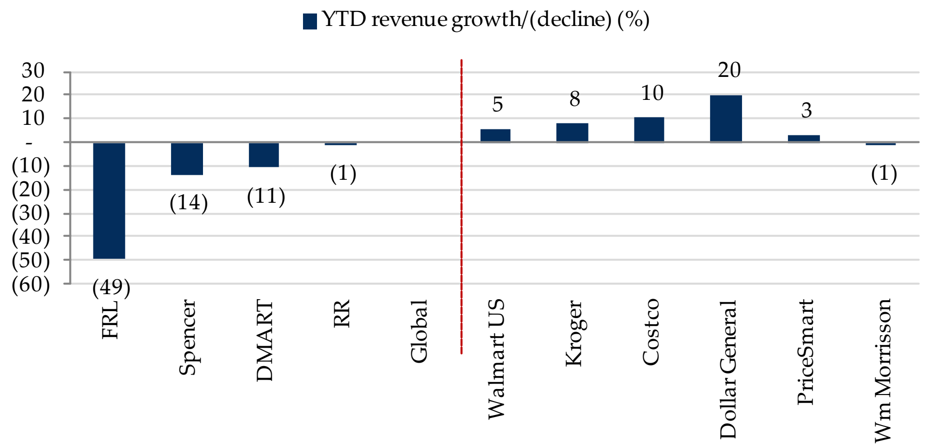
Most grocers continue to lose market share

Relative Market share (%)	FY17	FY18	FY19	FY20
Avenue Supermart	19.5	21.3	21.9	21.9
FRL	28.0	26.1	22.1	17.7
-Big Bazaar	14.4	14.3	12.1	10.0
-EasyDay	2.7	3.3	3.3	2.5
ABRL	6.3	5.7	4.7	4.3
Spencers	3.3	2.9	2.4	2.1
Star	1.4	1.3	1.1	1.1
Reliance (Grocery)	17.8	19.6	25.6	30.5
Spar	1.8	1.6	1.5	1.3
Natures Basket	0.5	0.4	0.4	0.2
Walmart India	5.9	5.2	4.4	4.3
Metro	9.2	8.2	7.2	6.1
Booker India	0.4	0.3	0.3	0.2
Big Basket	1.9	2.2	3.0	3.9
Grofers	0.2	0.8	1.4	2.5
Vishal (B2C)	3.7	4.2	4.1	3.8

Source: Company, HSIE Research

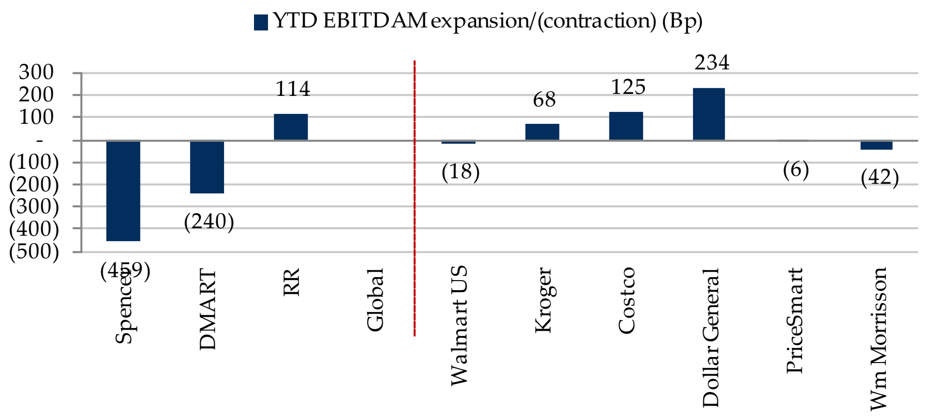
- **How has the pandemic treated global grocers?** Global grocers have outdone their Indian counterparts, given (1) the topography of the country, (2) lack of a ubiquitous alternative like Kiranas in India, and (3) most grocers offer subsidized online fulfillment options.

Domestic vs Global grocers top-line performance



Source: Company, HSIE Research

Domestic vs Global Margin performance



Source: Company, HSIE Research

Domestic vs Global grocers top-line performance

Company	CMP	M cap (Rs bn)	Reco	TP	Revenue (Rs. bn)			EBITDA (Rs. bn)			EBITDAM (%)			EPS (Rs)			P/E (x)			EV/EBITDA (x)			RoE (%)		
					FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E	FY 21E	FY 22E	FY 23E
Retail																									
Avenue	2,962	1,887	SELL	2,160	239	353	439	18	31	38	7.4	8.7	8.7	18.0	31.9	39.4	164.2	92.9	75.3	106.7	61.5	47.4	10.0	15.5	16.3
ABFRL	170	146	BUY	200	55	89	101	2	12	14	3.9	13.5	14.0	(6.7)	(0.8)	0.5	NM	NM	NM	78.1	13.5	9.6	(44.6)	(3.5)	1.6
Shoppers Stop	202	18	SELL	175	17	30	33	(1)	2	2	(7.9)	5.1	6.0	(12.7)	(5.4)	(2.7)	NM	NM	NM	NM	11.1	8.2	(14.6)	(6.8)	(2.9)
V Mart	2,477	45	ADD	2,650	11	17	22	0	1	2	4.0	8.4	8.8	8.4	55.5	73.2	293.8	44.6	33.8	92.9	28.1	20.6	2.3	11.0	12.9
Trent	691	213	SELL	575	20	38	46	2	7	8	11.2	17.5	16.8	(2.6)	4.5	4.8	NM	NM	NM	103.8	33.2	28.3	(3.9)	6.5	6.6
TCNS	413	25	REDUCE	400	7	11	13	(1)	1	1	(10.8)	8.4	9.5	(5.2)	9.8	11.8	NM	38.0	33.8	(33.0)	25.2	19.7	(5.2)	10.6	11.2
Titan	1,576	1,399	SELL	1,280	195	262	309	14	29	34	7.4	11.0	11.1	8.6	19.7	24.0	183.1	80.1	65.6	100.2	50.3	42.2	11.2	23.7	26.1
Reliance Retail	560	3,746	NR	560	1,408	2,032	2,427	74	117	133	5.3	5.7	5.5	7.3	14.1	15.1	77.2	42.2	39.6	45.9	29.1	25.6	10.7	12.2	12.0
Paints																									
Asian Paints	2,480	2,379	SELL	2,300	205	244	274	45	52	58	22.1	21.3	21.1	30.1	35.6	40.8	82.4	69.7	60.8	52.2	45.1	40.3	26.5	27.5	27.8
Berger Paints	763	741	SELL	600	63	77	86	11	13	15	16.8	17.2	17.3	6.6	8.3	9.4	115.8	91.5	81.4	70.4	56.1	49.4	22.3	24.0	22.7
Kansai Paints	593	330	ADD	650	48	57	65	8	9	11	17.3	16.5	16.8	9.6	11.0	12.7	61.6	53.7	46.8	39.0	34.3	30.1	13.2	13.7	14.2

Source: Company, HSIE Research

Thematic reports by HSIE

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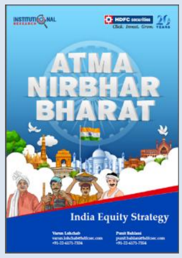

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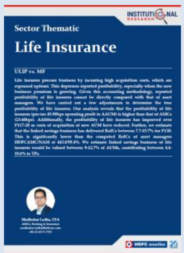

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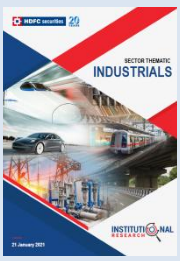

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