

## Sector Thematic

# Retail

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### Whose flywheel is broken?

The COVID-19 pandemic playing havoc in the high fixed cost Food & Grocery space is a foregone conclusion. More important is to assess which business model survives an extended version of the pandemic. This led us to assess multiple COGS of the proverbial retail flywheel: (1) Location: Store exposure to most impacted districts (~600 districts analyzed on COVID19 severity, population density and per capita income) (2) impact on GMs, cost of retailing and fixed cost cover, (3) fear-inflicted shifts in consumer behaviour and consequent habit formation and (4) selection and discounting trends.

Bottom-line: The pandemic is likely to push the already stressed org. top-up formats/indisciplined operators closer to their 'To be, or not to be' moment. E-grocers are scaling up well (Higher AoVs have significantly improved their unit economics) and are likely to win share from the top-up format in their respective catchments. Industry bellwether D-MART's footfall pain is likely to spill-over in 2Q. However, it remains well-capitalized to take the impact on its chin.

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Retail

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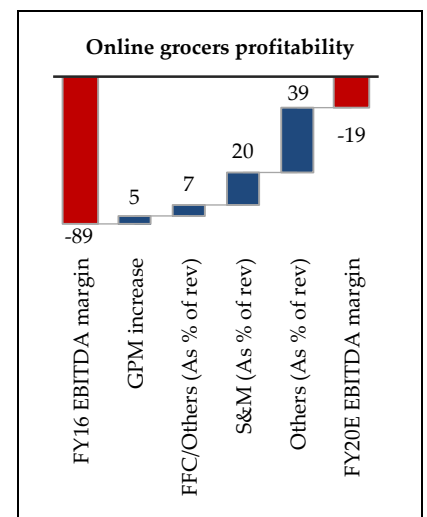
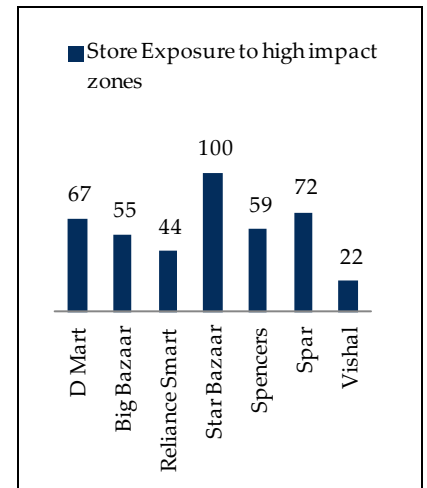
# Retail

## Whose flywheel is broken?

The COVID-19 pandemic playing havoc in the high fixed cost retail sector is a foregone conclusion. More important is to assess which business model survives an extended version of the pandemic. This led us to assess multiple COGS of the proverbial retail flywheel: (1) store exposure to most impacted districts, (2) impact on GMs, cost of retailing and fixed cost cover, (3) fear-inflicted shifts in consumer behaviour and consequent habit formation and (4) selection and discounting trends. Note: We restrict our scope to the Food & Grocery (F&G) space in this report. DMART's (RECO: SELL) footfall pain is likely to spill over in 2Q as well, as (1) its store exposure to most affected districts remains high (67% of stores). Hence, footfall cuts are likely to remain steep, and higher AoVs will not be enough to make up for the footfall cuts. (2) Org. top-up formats were already struggling even pre-COVID; the pandemic is likely to cause further stress on their cost of retailing and respective cash cover for fixed cost absorption. Meanwhile, e-grocers have been scaling up nicely in some of these catchments.

- Soldier down – DMART most exposed, but well-covered:** While most grocers are likely to see severe footfall cuts, our district-wise store map (~600 districts) on COVID-19 severity, population density and per capita income suggests that ~45% of D-MART's stores are located in seven of the most populated/impacted districts (Mumbai, Pune, Thane, Kalyan, Ahmedabad, Bangalore and Hyderabad). Also, D-MART's significantly higher footfall density per store (base) vs peers (2,824 bill cuts per store/day) likely means that the delta loss in footfalls, at least momentarily (1HFY21), will remain the highest among peers (note: D-MART's revenue declined 34% YoY in 1QFY21). That said, its recent fund raise makes it among the most well-capitalised grocers from a fixed-cost cover point of view, while peers remain precariously placed on this front.
- ...Managing discounts well to restrict the bottom-line pain:** D-MART has smartly reduced its discounts across its product portfolio to reduce the impact on profitability as, during the pandemic, assortment availability is likely to take precedence over value/discounts for a consumer.
- Is COVID-19 e-grocers' 'demonetisation moment'? Probably Yes!** (1) Consumers' obvious predisposition for safety during the pandemic, (2) income uncertainty, (3) shift from unpackaged to packaged food and sporadic availability of national brands have fed into the surge in private label consumption across categories, (ergo, AoVs for e-grocers have spiked). Also, first-time users sampling e-grocer services have significantly jumped. We suspect the stickiness to the platforms once sampled is likely to be high. Note: AOVs for top e-grocers is up 40-50% in 1Q, giving a significant fillip to their unit economics (refer: a case study on Grofers).
- Pandemic to make organised F&G even more top-heavy:** Online grocery purchases are likely to increase during the pandemic as consumers seek safety. This, in turn, is likely to put pressure on the cost of retailing for the industry as investments in online fulfilment capabilities increasingly becomes imperative. Most retailers today have bare-bone investments in the same, given (1) weak cash position, and (2) risk of bleeding further. Note: Most grocers don't make a profit spread in India. Hence, we expect the pandemic to expedite the process of consolidation in F&G.

Company	Reco
Avenue Supermarts	SELL



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## Soldier down, (not out)!

**Even the best not spared:** Our district-wise store mapping (on per capita income-population and COVID density) suggests that most offline organised grocers are likely to be impacted as higher bill sizes are not expected to make up for the loss in footfalls. The situation is likely to be even grimmer for (1) retailers with a higher presence in top cities, (2) higher mall-based presence.

- A point to note, ~45% of D-MART's stores are in seven of the most populated and, hence, severely COVID-stricken districts (Mumbai, Pune, Thane, Kalyan, Ahmedabad, Bangalore, and Hyderabad). In each of these districts, the confirmed COVID cases are >10,000, Caseload (active/confirmed cases) is >25% and the confirmed/tested ratio is 15-35%, i.e., the possibility of a second wave cannot be ruled out. We suspect the contribution of these districts to revenue is likely to be over 65-70% (HSIE).
- The above, coupled with D-MART's significantly higher footfall density per store (base) vs peers (2,824 bill cuts per store per day in FY20), suggests that the delta loss in footfalls for D-MART, at least momentarily (1HFY21), is expected to be the highest among peers (note: D-MART's revenue declined 34% YoY in 1QFY21).
- Kirana network and online grocers' presence in these districts is also extremely dense. Ergo, alternatives to avail and avoid a trip to an organised grocer are more in these geographies.
- The ability to maneuver product mix to cushion profitability remains stifled (improving though) as most consumers in these geographies prefer or are restricted by law to purchasing essentials only (note: D-MART's gross margin contracted 245bp YoY to 13.7% in 1QFY21). That said, D-MART has been smartly reining in discounts across categories to restrict the impact of revenue decline on profitability.
- Big Bazaar and Spencer's have a significant mall-based presence (40-50% of stores) wherein footfalls are likely to be impacted the most.
- Reliance Smart is likely to be the least impacted, given its predominant Tier 2/3 presence wherein the outbreak of the virus is limited. Also, local Fresh Markets in some of Reliance Smart's districts are weak and, hence, alternatives to shop for fruits and vegetables are less.

### Estimated Mall-based presence across key grocers

D-MART	0
Big Bazaar	40-45
Spencer's Retail	50
Star Bazaar/Market	20
Spar	60-70
Reliance Smart	<10

## Retail : Sector Thematic

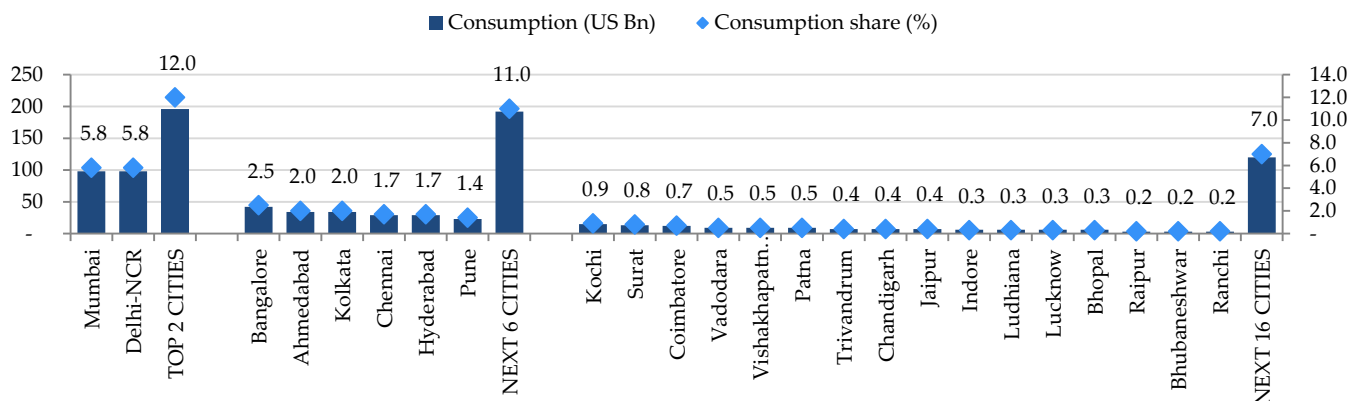
## Store exposure to high impact districts. D-MART and Star remain most exposed

	District (#)	Population (mn)	COVID Cases	D Mart	Big Bazaar	Reliance Smart	Star Bazaar	Spencers	Spar	Vishal Megamart
<Rs. 100K	14	50	25,640	0.5	8.0	2.1	-	13.0	4.0	8.2
<300 Km <sup>2</sup>	2	5	5,374	-	0.4	0.4	-	-	-	0.6
300-500	3	8	6,407	-	0.4	-	-	-	-	-
500-1000	2	9	2,323	-	-	-	-	-	-	-
1000-3000	6	23	8,260	-	5.1	-	-	11.4	-	3.8
3000-5000	1	5	3,276	0.5	2.2	1.7	-	1.6	4.0	3.8
<b>100-150K</b>	<b>15</b>	<b>52</b>	<b>36,283</b>	<b>2.0</b>	<b>4.7</b>	<b>5.0</b>	<b>-</b>	<b>3.3</b>	<b>-</b>	<b>3.1</b>
<300	1	2	1,517	-	-	-	-	-	-	-
300-500	9	25	20,709	2.0	2.5	3.3	-	2.4	-	0.6
500-1000	1	2	1,336	-	0.7	1.2	-	-	-	1.3
1000-3000	3	18	8,601	-	0.7	0.4	-	-	-	1.3
3000-5000	1	5	4,120	-	0.7	-	-	0.8	-	-
<b>150-200K</b>	<b>23</b>	<b>84</b>	<b>70,327</b>	<b>13.4</b>	<b>11.6</b>	<b>9.5</b>	<b>2.6</b>	<b>23.6</b>	<b>-</b>	<b>4.4</b>
<300	9	31	21,761	5.5	0.7	2.5	-	1.6	-	0.6
300-500	4	18	13,626	2.5	2.2	2.5	-	7.3	-	-
500-1000	8	24	16,799	2.5	1.8	3.3	2.6	-	-	2.5
1000-3000	1	6	8,115	3.0	0.4	0.8	-	-	-	-
5000+	1	4	10,026	-	6.5	0.4	-	14.6	-	1.3
<b>200-250K</b>	<b>12</b>	<b>41</b>	<b>30,425</b>	<b>3.5</b>	<b>4.0</b>	<b>5.4</b>	<b>-</b>	<b>1.6</b>	<b>8.0</b>	<b>2.5</b>
300-500	3	8	6,506	0.5	1.1	0.8	-	-	-	0.6
500-1000	6	20	13,359	3.0	1.5	4.1	-	1.6	8.0	0.6
1000-3000	3	12	10,560	-	1.5	0.4	-	-	-	1.3
<b>250-300K</b>	<b>3</b>	<b>22</b>	<b>112,229</b>	<b>10.9</b>	<b>6.9</b>	<b>5.4</b>	<b>20.5</b>	<b>-</b>	<b>-</b>	<b>0.6</b>
500-1000	1	9	39,125	7.5	3.3	4.6	20.5	-	-	0.6
1000-3000	2	13	73,104	3.5	3.6	0.8	-	-	-	-
<b>300-500K</b>	<b>6</b>	<b>35</b>	<b>156,143</b>	<b>32.8</b>	<b>19.3</b>	<b>14.5</b>	<b>76.9</b>	<b>17.1</b>	<b>60.0</b>	<b>3.1</b>
300-500	1	2	2,353	-	1.1	0.8	-	-	8.0	-
500-1000	1	5	2,600	-	-	0.8	-	-	-	-
3000-5000	1	10	19,702	9.0	6.9	3.7	46.2	1.6	32.0	2.5
5000+	3	18	131,488	23.9	11.3	9.1	30.8	15.4	20.0	0.6
<b>Gujarat</b>	<b>2</b>	<b>4</b>	<b>3,126</b>	<b>3.5</b>	<b>0.7</b>	<b>1.7</b>	<b>-</b>	<b>0.8</b>	<b>-</b>	<b>-</b>
500-1000	1	4	3,126	3.0	0.7	1.7	-	0.8	-	-
1000-3000	1	0	-	0.5	-	-	-	-	-	-
<b>Grand Total</b>	<b>75</b>	<b>289</b>	<b>434,173</b>	<b>66.7</b>	<b>55.3</b>	<b>43.6</b>	<b>100.0</b>	<b>59.3</b>	<b>72.0</b>	<b>22.0</b>

Source: Company, HSIE Research

Note: Covid cases are as on 13th July 2020, Districts culled out – COVID cases &gt; 10000, Active/Confirmed Cases &gt; 25%

## Top 22 cities account for ~30% of consumption

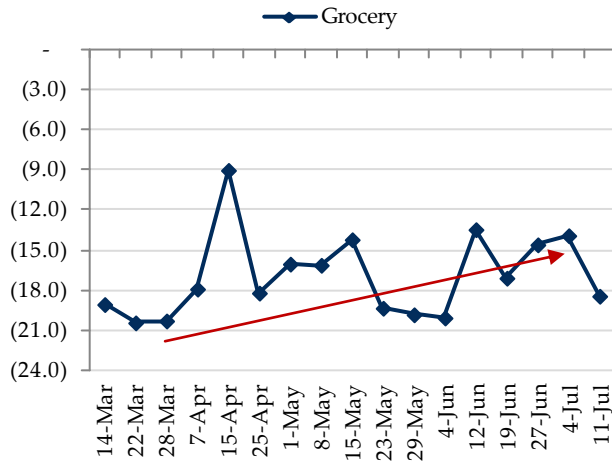


Source: Technopak

**Retail : Sector Thematic**

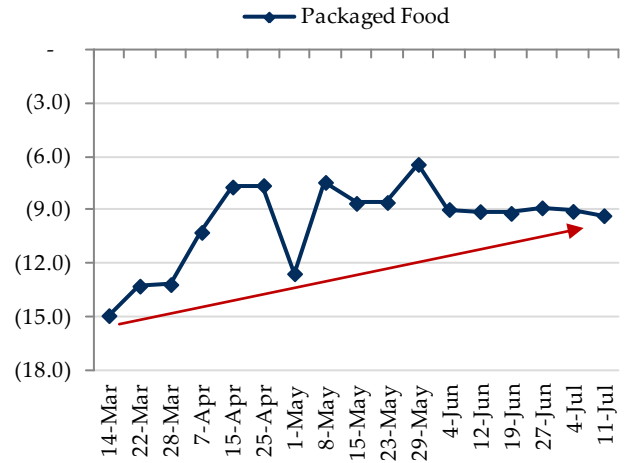
- **D-MART is managing discounts well to restrict the bottom-line pain:** D-MART has smartly reduced its discounts across its product portfolio to reduce the impact on profitability as, during the pandemic, assortment availability is likely to take precedence over value/discounts for a consumer.

**DMART's weekly discount trends in Grocery**



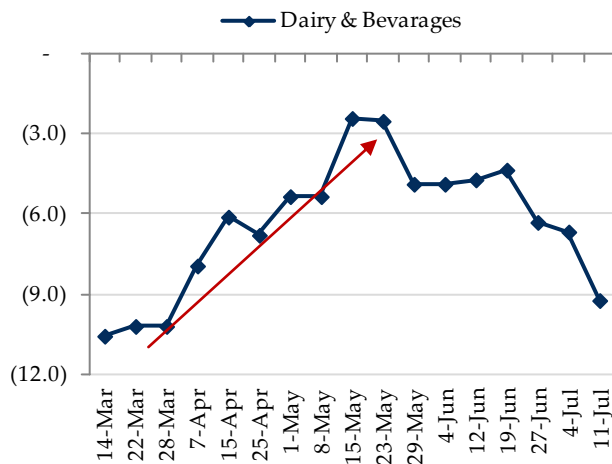
Source: Company, HSIE Research

**DMART's weekly discount trends in Packaged food**



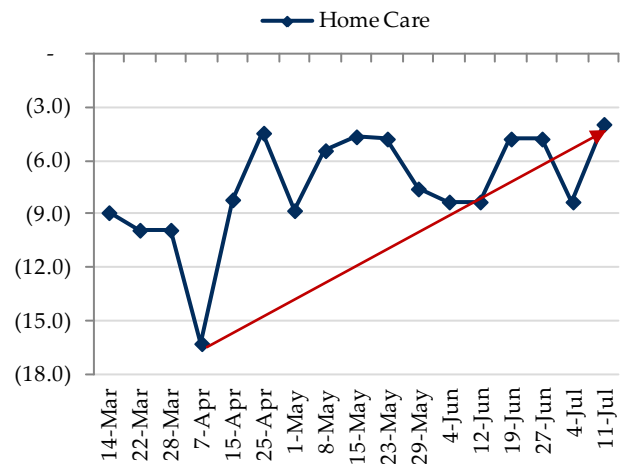
Source: Company, HSIE Research

**DMART's weekly discount trends in Dairy & beverages**



Source: Company, HSIE Research

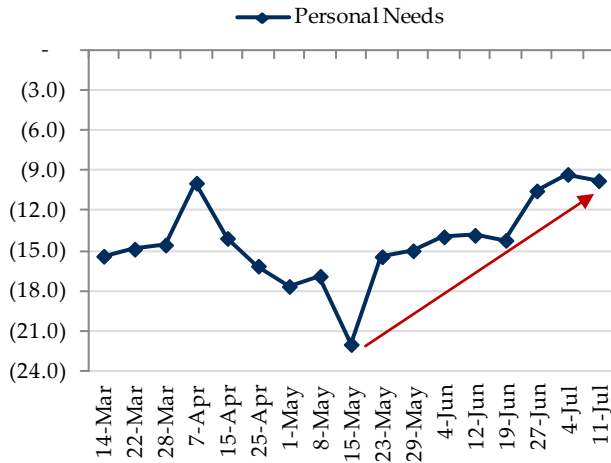
**DMART's weekly discount trends in Home Care**



Source: Company, HSIE Research

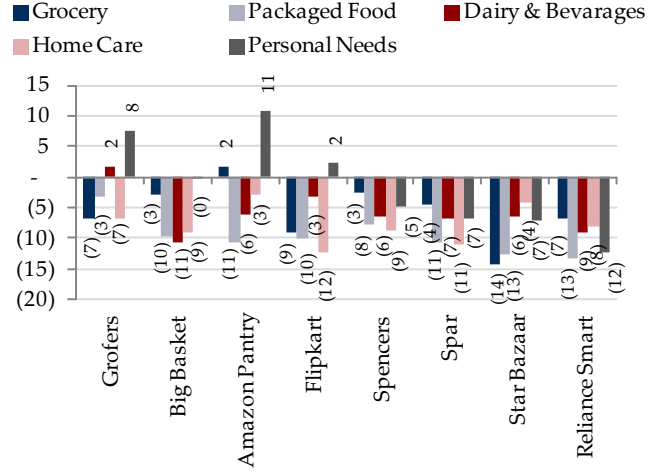
**Retail : Sector Thematic**

**DMART's weekly discount trends in Personal Needs**



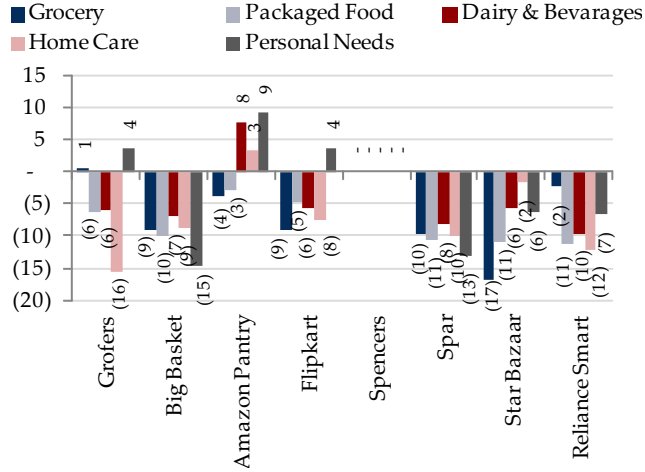
Source: Company, HSIE Research

**WC 14-Mar: DMART's discount edge over Peers**



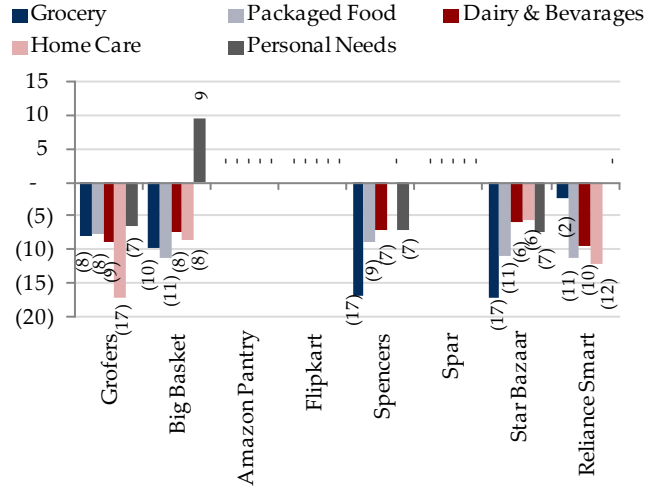
Source: Company, HSIE Research

**WC 22-Mar: DMART's discount edge over Peers**



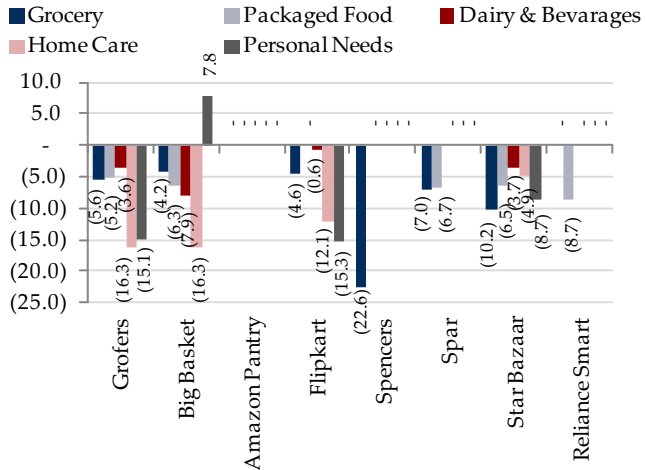
Source: Company, HSIE Research

**WC 28-Mar: DMART's discount edge over Peers**



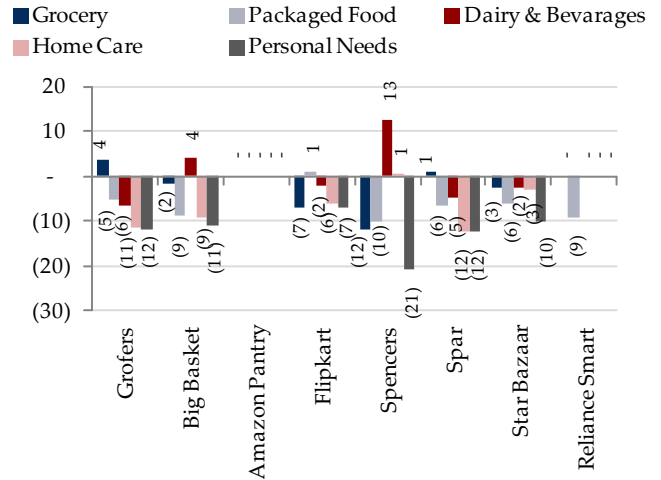
Source: Company, HSIE Research

**WC 07-Apr: DMART's discount edge over Peers**



Source: Company, HSIE Research

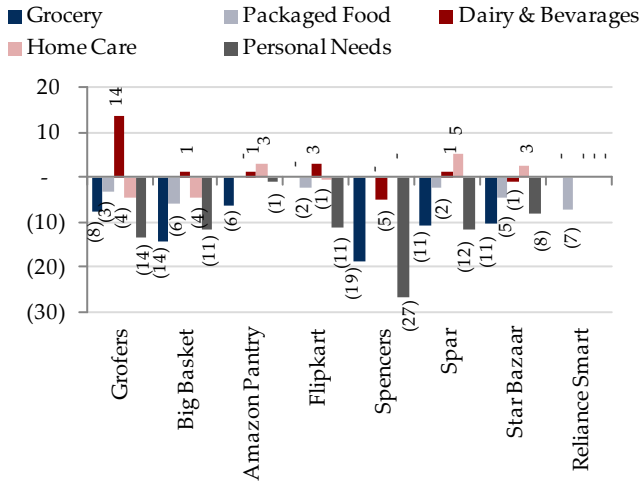
**WC 15-Apr: DMART's discount edge over Peers**



Source: Company, HSIE Research

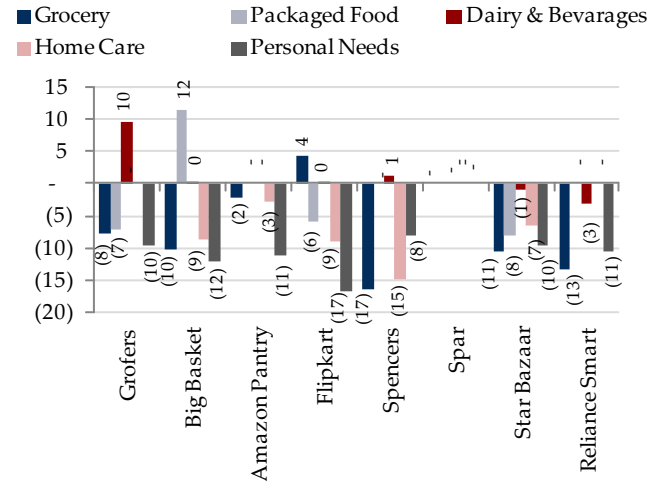
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**WC 25-Apr: DMART's discount edge over Peers**



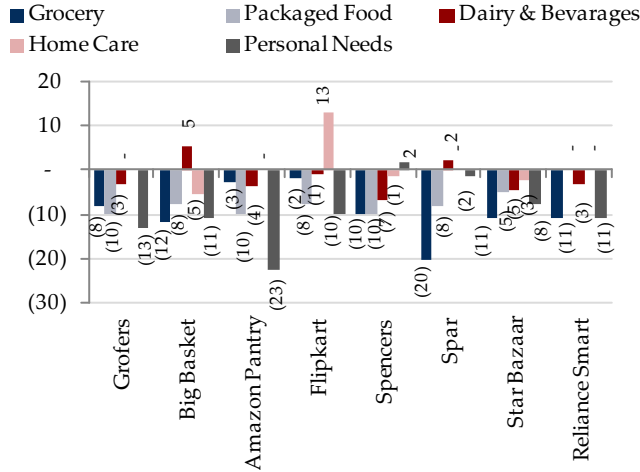
Source: Company, HSIE Research

**WC 01-May: DMART's discount edge over Peers**



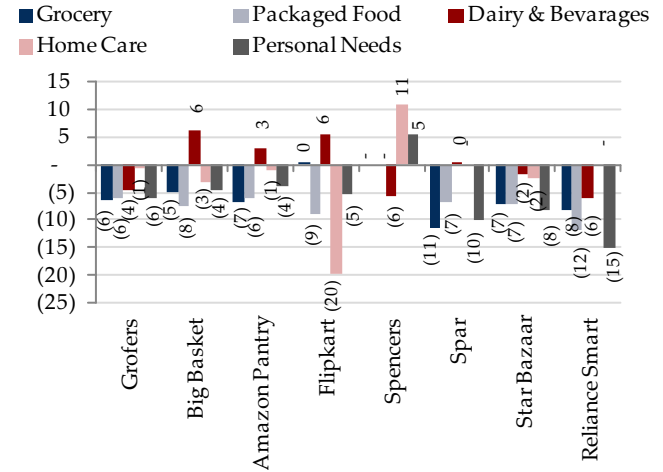
Source: Company, HSIE Research

**WC 08-May: DMART's discount edge over Peers**



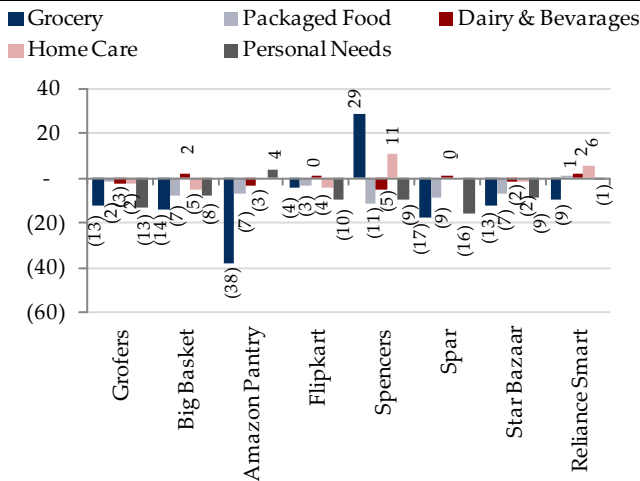
Source: Company, HSIE Research

**WC 15-May: DMART's discount edge over Peers**



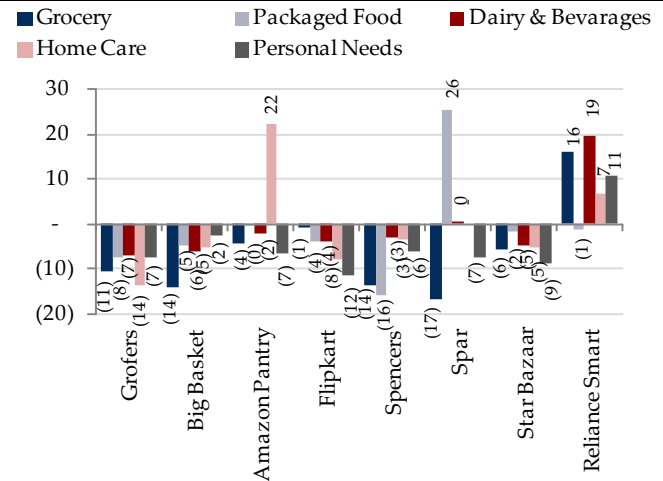
Source: Company, HSIE Research

**WC 23-May: DMART's discount edge over Peers**



Source: Company, HSIE Research

**WC 29-May: DMART's discount edge over Peers**

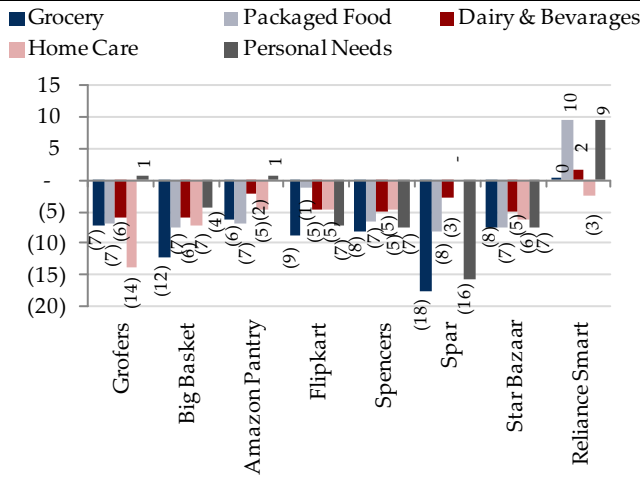


Source: Company, HSIE Research



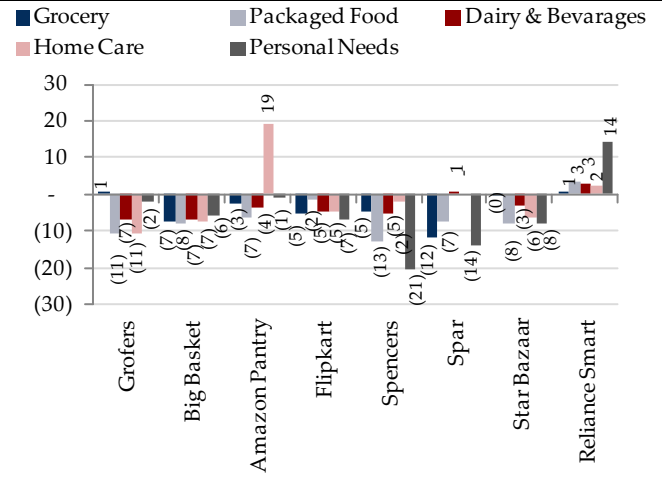
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**WC 04-Jun: DMART's discount edge over Peers**



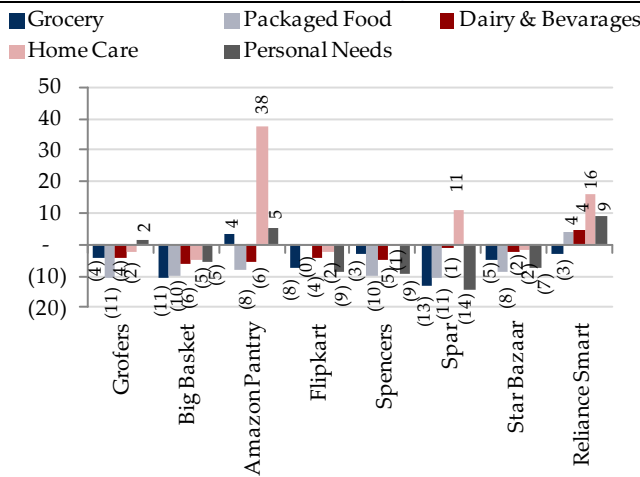
Source: Company, HSIE Research

**WC 12-Jun: DMART's discount edge over Peers**



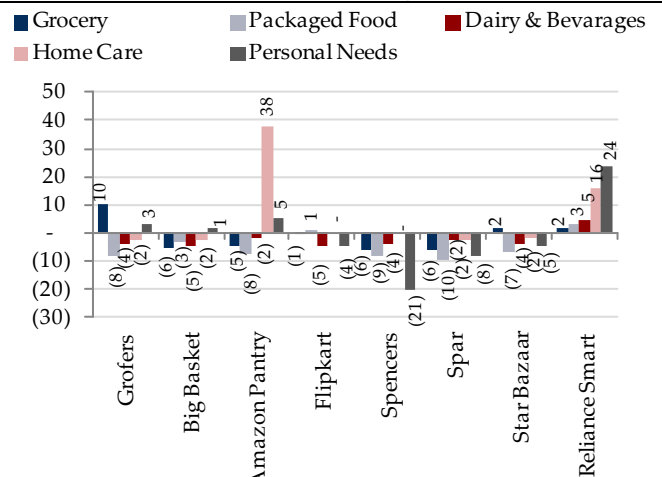
Source: Company, HSIE Research

**WC 19-Jun: DMART's discount edge over Peers**



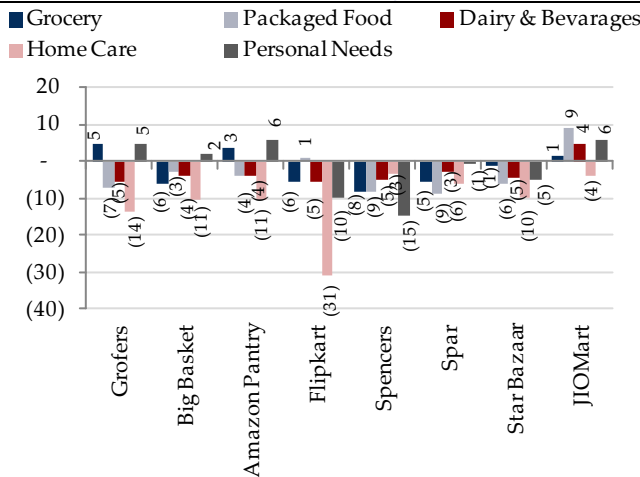
Source: Company, HSIE Research

**WC 27-Jun: DMART's discount edge over Peers**



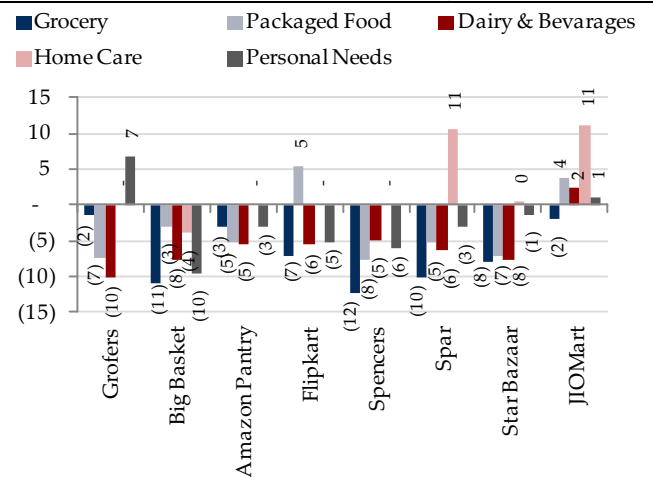
Source: Company, HSIE Research

**WC 02-Jul: DMART's discount edge over Peers**



Source: Company, HSIE Research

**WC 10-Jul: DMART's discount edge over Peers**



Source: Company, HSIE Research

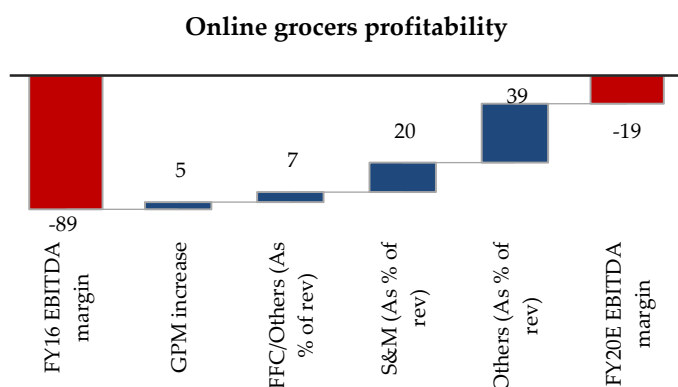
## Is COVID19, E-grocers' de-monet moment?

### E-grocers scaling well, Selection remains a concern though

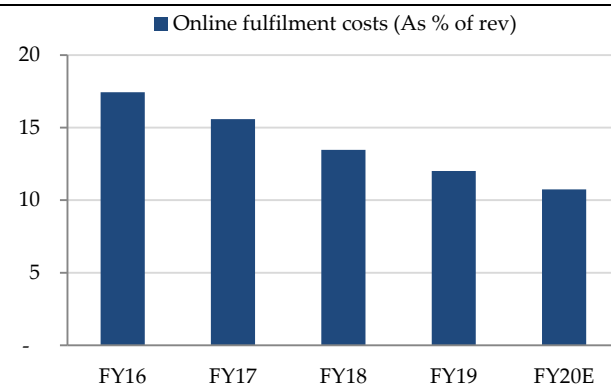
- Even pre-COVID, the major e-grocers had been scaling up nicely. Despite rising discounts, margin profile – both at the gross and operational level – had been improving with each passing year for online grocers. This implies that (1) trade margins are improving as they achieve scale and (2) incremental funding is now primarily earmarked towards footprint expansion, marketing and strengthening vendor/private label manufacturer ecosystem.
- As consumers grapple with the pandemic, three momentary shifts in consumer purchasing behaviours have decisively tipped the scales in favour of e-grocers – just like demonetisation did for digital payment companies.
  1. Larger basket sizes are driven by the propensity to move towards a more stock-up behaviour with customers buying more product categories in one go (note: AoVs have inched up by 40-50% during 1QFY21 for e-grocers).
  2. The salience of discounts and national brands' selection has come off (at least momentarily), i.e., consumers are less discerning in their purchases today and more open to sampling private labels; ergo, retail margins have inched up
  3. Consumers' preference for lesser grocery trips to avoid exposure to the virus (at-least in top cities) has led to more first-time users sampling e-grocer services. This has also led to a significant reduction in customer acquisition and marketing costs for e-grocers.

Consequently, the unit economics of e-grocers has significantly improved.

**Despite rising discounts, online grocers' fixed cost absorption has improved, implying that trade margins have improved**



Source: Company, HSIE Research



Source: Company, HSIE Research

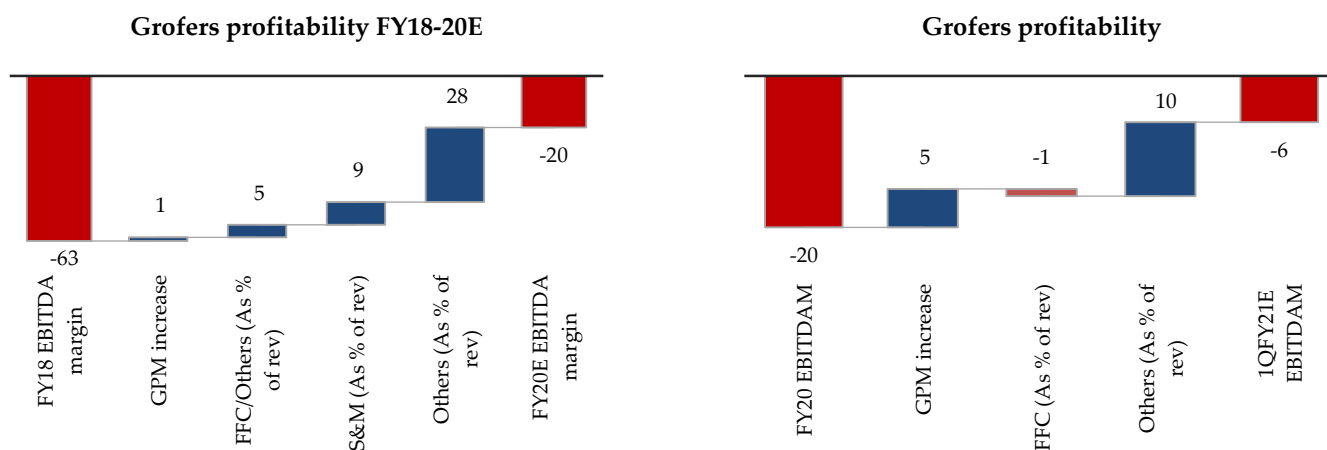
- While some of these momentary behavioral shifts may revert to their mean, the questions to solve for are:
  1. How many consumers sampling online grocery for the first time today end up forming a habit? What does this mean for offline folks?
  2. Can e-grocers scale up during the pandemic to a point where they become a strong distribution platform for national brands? Hence, sourcing margins improve, ergo economics improve?
  3. Do e-grocers have enough dough to see them through this scale up?

**We use Grofers as a case study to attempt answering these questions**

## Grofers – Smartly inching towards self-sustenance

- 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. Grofers' strong catchment remains the Delhi-NCR region, and its overall presence spans 30 cities.
- Since the onset of the nationwide lockdown, Grofers has managed to (1) increase its AoV by ~40% to Rs. 2,300 and (2) improve upon its GMs (now ~15%) as consumers prioritised safety over selection choices and were more open to sample private labels. Private labels mix increased to 35% of sales (earlier 30%). Hence, 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 over five years 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 from unpackaged to packaged commodity categories, we suspect the stickiness to the platform once sampled is likely to be high (once the consumer is in Grofers-fold, the e-grocer manages to maintain a 70/60% monthly and annual retention rate). This helps the e-grocer scale faster and more profitably at that. Scale can then be used to better sourcing margins with national brands and improve upon selection, which further feeds into 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 sub USD1 (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



Source: Company, HSIE Research

- What does this mean for offline folks?** Given the higher presence of Grofers in Delhi-NCR, Bihar, UP, and Kolkata, inefficient operators such as Big Bazaar and Vishal Megamart (high presence in Delhi-NCR) are likely to feel the heat, given their higher GPMs, higher cost of retailing and low cash cover on fixed costs. Consequently, these operators are likely to cede share to the e-grocer in these catchments.
- Selection remains a concern, though, for most:** Across our basket of 50+ fast-moving CPG items, D-MART selection/availability continues to score the highest and is well-synced to its respective catchments. However, the same cannot be said for most in the ecosystem. While such uncertain times may spur private label consumption, in the long-term, a well-rounded mix of national brands and private labels is key to attract footfalls/traffic. We believe e-grocers could perhaps use the scale achieved during the pandemic to fish out better deals with national brands and improve their selection.

### D-MART leads the pack in selection of national brands, selection edge remains significant vs peers

	14-Mar	22-Mar	28-Mar	7-Apr	15-Apr	25-Apr	1-May	8-May	15-May	23-May	29-May	4-Jun	12-Jun	19-Jun	27-Jun	2-Jul	10-Jul
DMART	2	11	9	31	15	14	15	16	10	11	8	9	6	7	7	7	9
Grofers	17	27	28	19	26	22	27	33	26	27	28	23	25	22	29	22	25
Big Basket	6	15	17	15	13	16	14	17	13	12	10	4	6	8	13	10	8
Amazon Pantry	19	32	51	51	51	34	35	37	21	25	18	18	17	20	20	21	14
Flipkart	11	21	51	32	26	12	23	14	18	18	20	16	19	21	23	19	33
Spencers	11	51	39	46	34	41	39	37	39	32	34	32	30	29	34	31	32
Spar	5	6	51	45	29	29	51	31	31	32	33	32	24	20	14	15	20
Star	1	4	5	6	7	5	4	5	4	5	5	6	6	5	5	6	5
JIOMART	9	29	31	46	46	46	39	35	21	26	35	39	21	23	22	22	23

Source: Company, HSIE Research, Note: the above table highlights the number of unavailable commodities, ergo lower the number better the selection

**Commodities tracked:**

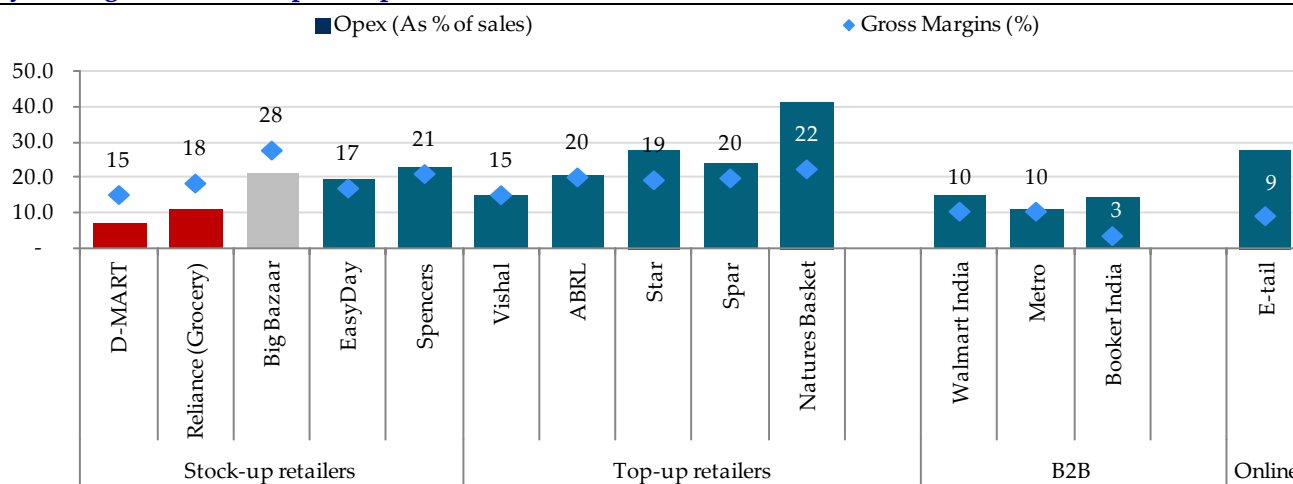
Category	Brand	Quantity
<b>Grocery</b>	Saffola Active Oil	1 L
	Fortune Sunlite Refined Sunflower Oil	1 L
	India Gate Basmati Rice - Feast Rozzana	5 Kg
	Tur dal - private label	1 kg
	Branded sugar	1 kg
	<b>Tomato</b>	<b>1 kg</b>
	Onion	1 kg
	Potato	1 kg
	Urad dal	1 kg
	Moog dal (Tata Sampann)	1 kg
	Toor dal (Tata Sampann)	1 kg
	Chana dal (Tata Sampann)	500 gms
	Aashirwad Select Sharbati Atta	5 kg
	Tata salt	1 kg
<b>Packaged Food</b>	Kellogg's Cornflakes - Original	875 gm
	Tropicana Orange Delight Juice	1 L
	Parle G Biscuits	800 gm
	Hide and Seek Biscuits	350 gm
	Britannia Bourbon	<b>150 gm</b>
	Britannia Treat Jim Jam Cream Biscuits	150 gm
	Maggi	560 gm
	Bournvita	1 Kg
	Maggi Tomato Ketchup	1 Kg
	Heinz Tomato Ketchup	900 gm
<b>Dairy</b>	Amul Butter	500 gm
	Amul Taaza Toned Milk	1 L
	Amul Processed Cheese	1 Kg
<b>Beverages</b>	Nescafe Jar	100 gm
	Society Tea	1 Kg
	Brookebond Red Label Tea	1 Kg
<b>Home Care</b>	Surf Excel Quick Wash	2 kg
	Ariel Complete Detergent Powder	2 kg
	Surf Excel Matic Top Load	1 L
	Ariel Matic Top Load	1 kg
<b>Personal Care</b>		
<b>Shampoo</b>	Parachute Coconut Hair Oil	550 ml
	Head and Shoulder Smooth and Silky	675 ml
	Dove Hair Fall Rescue	340 ml
	Sunsilk Stunning Black Shine	650 ml
	TRESemme Smooth and Shine	580 ml
<b>Soap</b>	Cinthol Lime Soap	4x100 gm
	Lux Fresh Splash	3x150 gm
	Dettol Soap	4x125 gm
	Lifebuoy Soap Total 10	5x125 gm
	<b>Lifebuoy Handwash</b>	750 ml
	Pears Soap	3x125 gm
<b>Toothpaste</b>	Closeup Deep Action Red Hot Gel Toothpaste	2x150 gm
	Pepsodent Expert Protection Gum Care	2x140 gm
	Patanjali Dant Kanti Dental Cream	200 gm
	Dabur Red Toothpaste	300 gm
	Colgate Swarna Vedshakti	200 gm
	Colgate Calci-lock	500 gm

## Imminent increase in cost of retailing + Online heat + Weak cash position warrants partnerships

### Cost of retailing to inch up

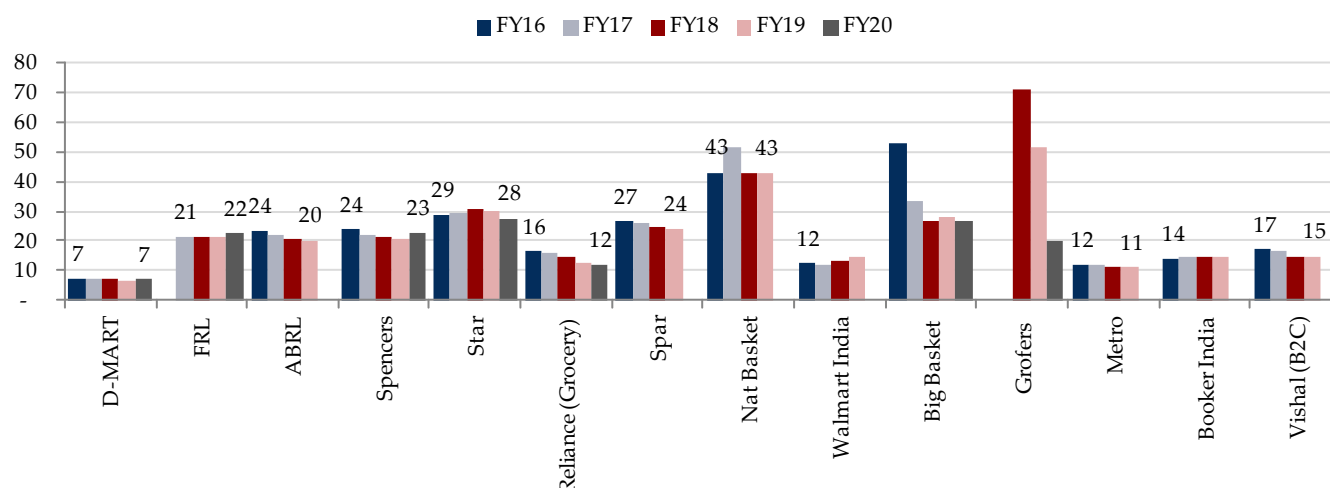
- Online grocery purchases are likely to increase during the pandemic as consumers seek safety and convenience. This, in turn, is likely to put pressure on the cost of retailing for the industry as an investment in online fulfilment capabilities increasingly becomes imperative. Hence, top-up formats remain most vulnerable as pricing/GM levers (typically sell low GM food/non-food FMCG-heavy product mix) to manage profitability remain absent at a time when the cost of doing business is likely to inch up.
- A point to note is that most Indian B&M grocers, currently, have bare-bone investments in the same given (1) weak cash position, and (2) risk of bleeding further at the operational level. Hence, most would require partnerships with stronger retailers or a significant fund raise to survive.

### Only a few grocers make a profit spread



Source: Company, HSIE Research

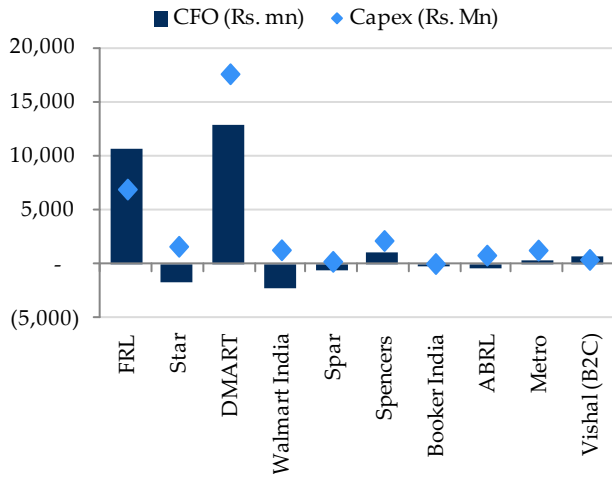
### Most grocers haven't managed to reduce cost of retailing materially over the last 4-5 years, pandemic is likely exude more pressure



Source: Company, HSIE Research

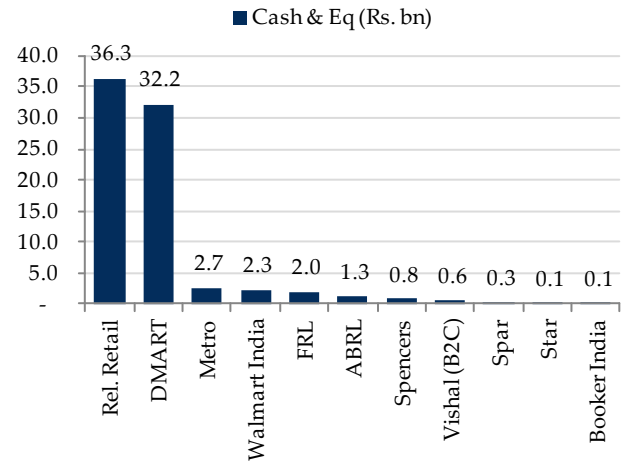
Retail : Sector Thematic

Capex continues to outstrip CFO for most...



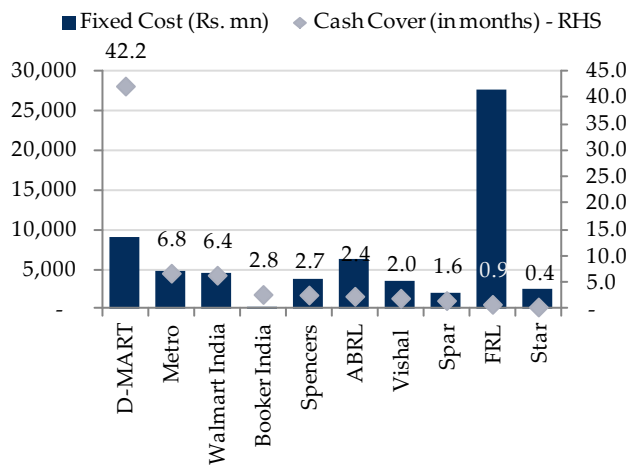
Source: Company, HSIE Research

...& Cash to scale remains low for most



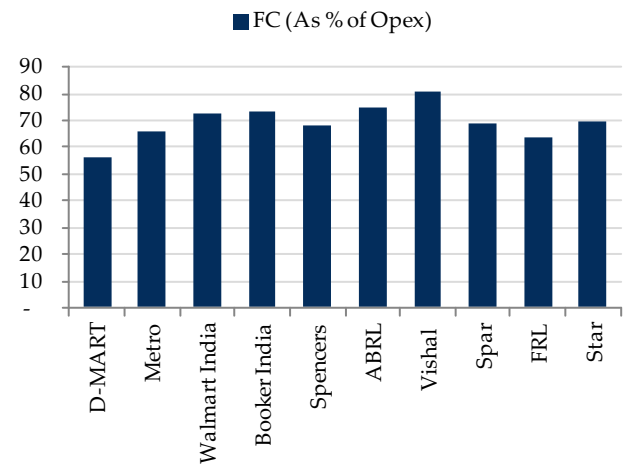
Source: Company, HSIE Research, FY19 financials used for unlisted retailers

Fund Infusion a must for most as cash cover remains wafer-thin



Source: Company, HSIE Research

Grocer-wise estimated Fixed cost base

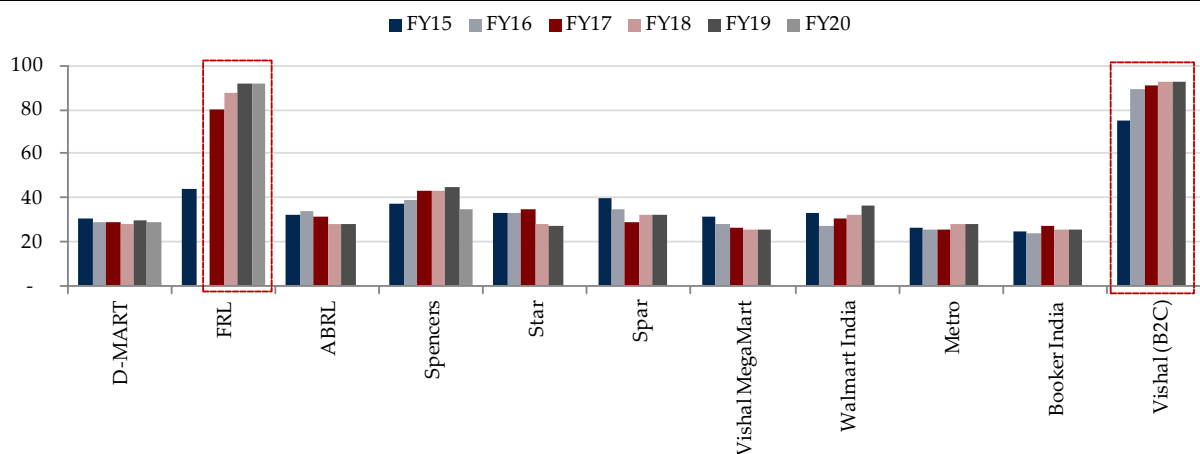


Source: Company, HSIE Research

- Precarious working capital position warrants rationalisation for some grocers:** Some grocers continue to face working capital challenges as SKU management remains weak. This may warrant a momentary shift in strategy from growth to cash release. This trend may perhaps be exacerbated during the pandemic as respective vendors may require support.

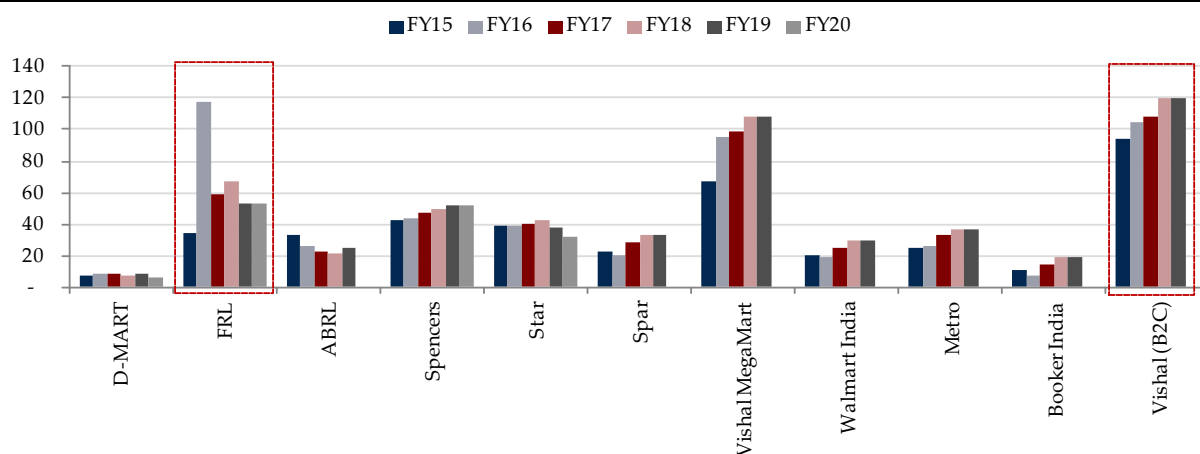
Retail : Sector Thematic

FRL and Vishal Megamart continue to face SKU management issues, ergo, cash remains stuck in inventory; major write-offs cannot be discounted



Source: Company, HSIE Research

COVID19 pandemic will likely warrant additional support to vendors which may put additional strain on select grocers (Payable days)



Source: Company, HSIE Research



**Rating Criteria**

BUY: >+15% return potential  
 ADD: +5% to +15% return potential  
 REDUCE: -10% to +5% return potential  
 SELL: > 10% Downside return potential

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