

'Rentals are down and revenue-shares are in'

These are not the best times for the retail business. And Thomas Varghese, who took over as CEO, Aditya Birla Retail, just eight months ago, admits it's baptism by fire. He has closed 70 unviable stores leaving the More chain with 640 outlets and two hypermarkets. But he's also rolling out new ones and believes the business could turn profitable in the next few years with net margins of 2-3 per cent — fairly typical for the food and grocery segment. Varghese won't talk numbers but rough calculations suggest he has a turnover of just over Rs 1,000 crore. Excerpts from a conversation with Shobhana Subramanian:

It's not a great time to be in the retail business, is it?

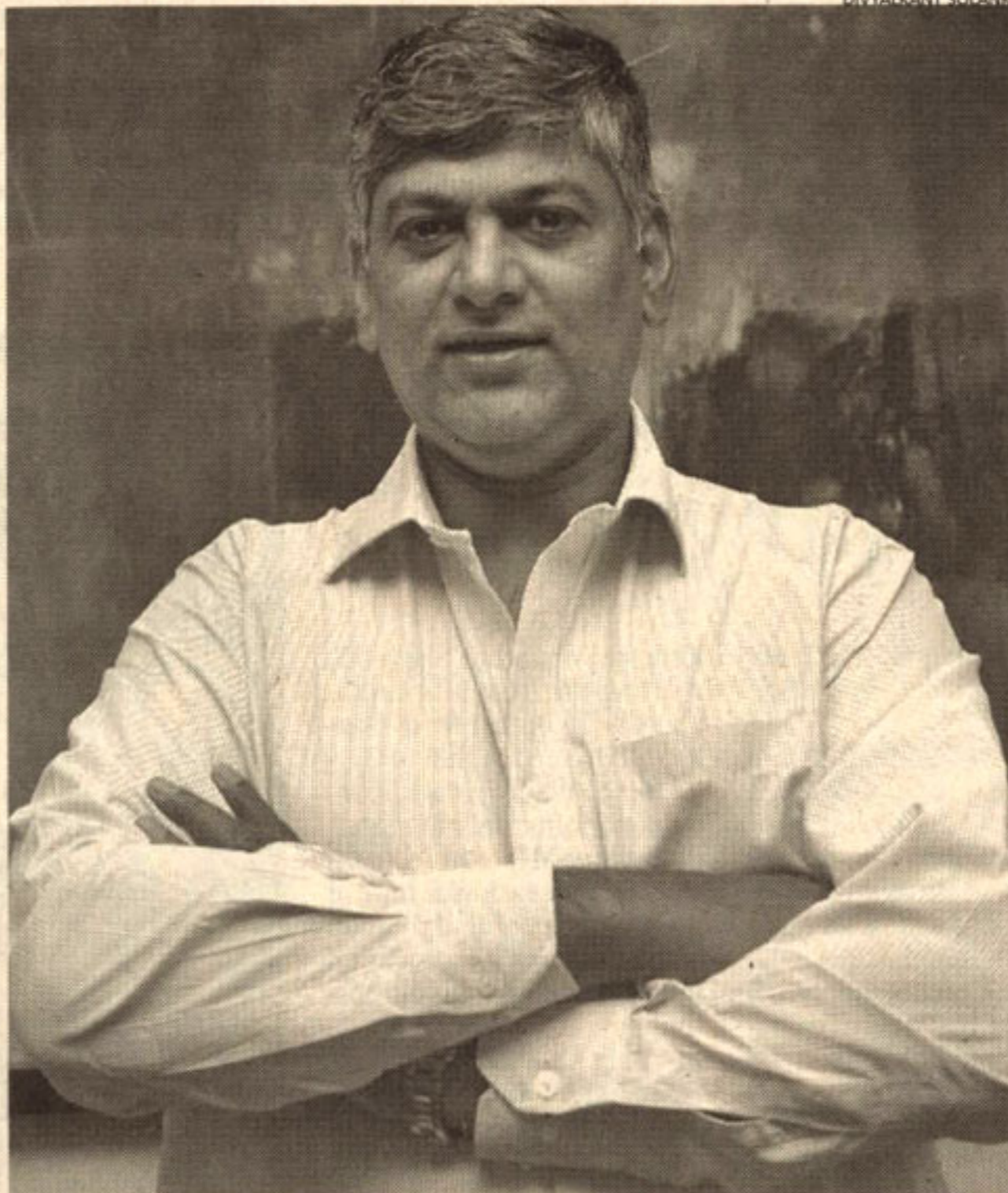
No, these are tough times and the downturn is having an impact. Also, although there are players who've been around for 10 to 15 years, there aren't many who are pan-India players — many of the older retailers are regional and localised players. Also, if they've been around, they're struggling to come to terms with the business model.

What is Aditya Birla Retail hoping to achieve in terms of financial parameters in the next few years?

Within supermarkets, we're looking at a model that generates anywhere between 20 and 24 per cent gross margins, with operating costs in line with the rest of the world. And a ratio of rent-to-revenues of 3.5-4 per cent. Thanks to the boom in retail in the last few years, our rent-to-revenue ratio isn't close to this level. But, perhaps, by the end of this year we could be close because a good part of our network is in the south — about 387 out of 640 stores. We'll be happy if we end up with a 2-3 per cent net margin (that's gross margins of 20-24 per cent). For hypermarkets, we're looking at net margins of 4-5 per cent (gross margins of 24-25 per cent).

What is the optimum network you're looking at, and what is the share from private labels that will allow you to achieve this?

We are looking at 2,200 supermarkets by 2014. We haven't rolled out too many of the hypermarkets over the last two years — we have only two. As for the share from private labels, in a steady-state situation, we would be looking at a share of 20 per cent of our revenues coming from here. Right now, it's about 4 per cent and by the end of this year, we're hoping it'll be around



12-15 per cent.

How much have you invested in the business so far?

I don't think we would like to talk about that just yet (*smiles*). We paid about Rs 690 crore for Trinethra which brought us 167 stores or about 3.68 lakh sq ft of space. The business should deliver a return on capital employed of 25-30 per cent. More than that, we are looking at internal rate of returns (IRRs) which could be around 20-25 per cent. Worldwide, IRRs may be around 16-17 per cent with the rate of growth being lower in mature markets — but in India, the high growth rates will drive IRRs.

What is your growth target?

We got more than 100 per cent last year on a small base. We're targeting 35-40 per cent in the next few years. Same-store sales, I feel, would grow at a CAGR of around 15-20 per cent. In 2007-08, Trinethra's revenues were about Rs 270 crore.

What makes you so confident you will achieve our targets?

We are tracking these rates today. Obviously, there is competition but competition is also disappearing in many cases — the closure of many competitors and the imminent closure of many more, demonstrates that this is a business which requires deep pockets and undivided attention.

What kind of revenues per sq foot are you generating currently?

I don't think we can discuss that, but we're looking at revenues anywhere between Rs 25-30 per sq ft per day. In steady-state, we should be doing a little better than that. Most retailers are clocking below this.

Why do you think they're not able to do better?

There are a number of revenue-drivers. For instance, you can have a store doing Rs 600 per sq ft today and Rs 800 per sq ft next month and the only difference is that the store fill-rates have gone up. As you know, the vendor fill-rates from FMCG companies are abysmally low at this point in time, even the best firms don't have more than 50-

60 per cent fill-rates. So the efficiency of the supply chain matters. Also, we made some mistakes in selecting the location or assessing the catchment and so on, which we're rectifying now.

Assuming that retailers get their end right, do you think customers will buy enough?

Indian customers are discerning and demanding. But *kiranas* give you only convenience, they don't give you breadth, which is what shoppers are looking for. Our research shows women like to shop in organised retail shops even for food and groceries and we believe the trend will only get accentuated as the share of working women rises. Even today, the best deals are from organised retailers and the world over, as affluence increases, working women move to organised retail. Already, modern trade is giving women more control and choice and is making them feel smarter and progressive — because they're buying in more hygienic conditions and getting better value.

Is the tipping point far away?

I can't predict that. But if Hyderabad today can have a 35 per cent penetration for organised retail even in food and grocery, surely the rest of India can be at 5 per cent?

How do you read the retail slowdown?

Non-food retail has certainly seen a slowdown since September, especially for consumer durables and apparel — including our own group's apparel business. Consumer confidence is low, even well-to do people are not so sure as they were six months ago. But our hypermarket in Baroda is doing well and Trent's Star India Bazaar too is doing well.

When will retailers make money?

That's a million dollar question. It's going to be a difficult business and you won't get returns over a short duration. Retail is a very difficult business, we can't take our eyes off the ball.

When will you make money?

Perhaps in four or five years. We're expecting the organised retail market to grow at 10-15 per cent from about \$380 billion today and we'll get our fair share.

Are lease rentals falling?

In the small-box formats, very little, just about 10 per cent. Maybe 15-20 per cent in some places. But we're expecting a further fall because the economy is likely to remain in the present condition for at least two to three quarters. And I don't believe real estate developers have the wherewithal to hold on, they will crack at some point. But for the big-box formats, the difference could be as high as 40-50 per cent. Also, revenue-sharing is beginning to happen because mall owners have very few alternatives. Even in our hypermarket contracts — which are not in malls — we are getting into revenue-share agreements.