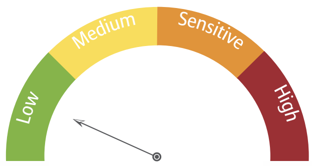
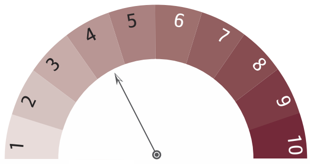
Retail in India

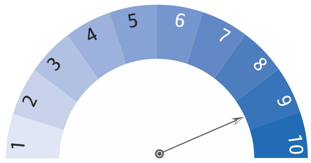
All bets are off



Retail Non-Payment Risk (Q1 2017)



Digital Pressure



Digital Potential

- **Indian retail sales will be stabilizing at a +3/+4% growth rate in 2016 and beyond, supported by strong demand growth, accommodating government policies.**
- **Publicly listed retailers have deleveraged, pushing down the debt ratio from 86% in 2013 to 70% in 2016. At the same time, margins have recovered up from 4% in 2013 to 7% in 2016.**
- **The food segment will benefit from a volume effect with the rise in consumer spending. Fashion's profits reached 7.9% in 2016 while general retail enjoys only a modest 2% EBIT.**

M-retail to support the digital in-store

Since November 2015, retail sales have recorded a rapid growth rate (exceeding +4% y/y) and enjoy bright prospects. Demand will be pushed up by expanding Millennials who make up a staggering two-thirds of the Indian population. Current consumer mindset is reflected by the break between the typically small, independent, family-owned "mom and pop stores" - currently 9 in 10 shops - and malls and hypermarkets. The latter's share is expected to account for 13% of the market by 2020, up from the current 8%. This trend is expected to spread to second and third tier cities such as Jaipur (3.5 million inhabitants) or Madurai (1.5 million), while adopting flexible models, considering the country's cultural diversity (780 languages, 6 major religions).

Yet, digital substitutes pose a major threat to Indian retailers. E-commerce is still making baby steps: only 10% of consumers shop online, while the APAC average stands at 13%. India was ranked at the bottom spot in our panel of 12 countries when it comes to technological penetration with only 0.01 server and 79 mobile subscriptions per 100 inhabitants. This leaves ample room for m-commerce development: mobile accounted for 59% of e-commerce in 2016. This opportunity was seized local online-only companies such as Flipkart and Snapdeal. These control, respectively, 46% and 23% of the e-market.

Upgrade infrastructures before offering a digital retail journey

The remarkable improvement of the debt ratio (from 95% in 2012 to 70% in 2016) illustrates the strong financial standing of 'organized' retail and the sector as a whole. The leveraged balance sheet position often stems of debt-funded capital expenditures required to open new stores in underserved regions. Profitability, recording a decent 7% in 2016, should be monitored closely though given the slowing growth of consumer prices. Overall, Euler Hermes assessed non-payment risk as Low.

The Euler Hermes Digital Retail survey shows that Indian retailers have a keen perception of the main challenges they face. Respondents placed mastering omni-channeling as a top priority, followed by mobile customer journey and customer loyalty. However, the latter seems somewhat superfluous taking into account the sheer number of millennials and their lack of brand loyalty.

India's logistical performance is lacking, especially when it comes to timeliness, international shipments and customs. This hinders companies' ability to follow through the "retail journey" and weighs on the country's attractiveness.

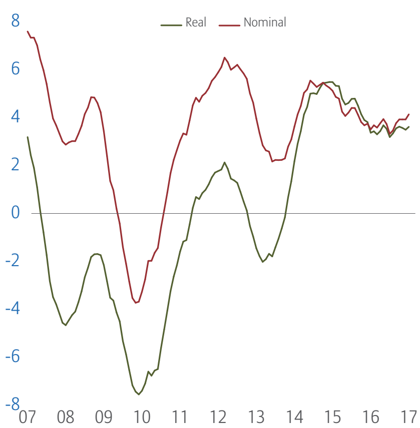
Looking forward: What does it all mean for businesses?

Retail prospects in India are shaped by the opposing forces at play. Increased competition puts pressure on profits while developing omni-channeling and store networks require large cash flows. However, the powerful demographic forces can boost volumes' growth.

✓ Promising sub-sectors: The food and apparel segments will benefit from a volume effect (the latter's profits stand at 7.9%). Online pure players benefit from the remarkable growth rate of internet users (+24% in 2015).

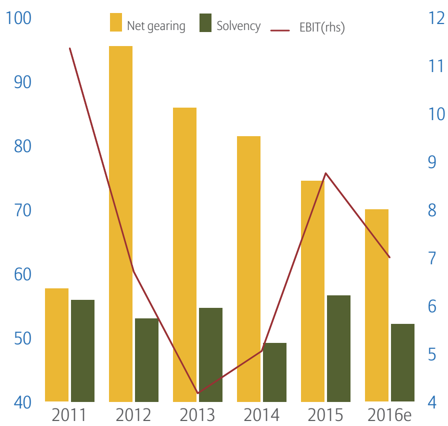
✓ Sensitive sub-sectors: General retail only enjoys 2% EBIT. Home & office also lacks disruptive impulse. ■

Chart 1 Retail sales in India
in %, 12m/12m, as of March 2017



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of Indian listed retailers



Sources: Bloomberg, Euler Hermes calculations