

Speciality Restaurants Ltd. (SRL) : "Long term Subscribe"

17th May, 2012

SRL is a fine dining operator in India, with 69 restaurants and 13 confectionaries as of February 29, 2012, featuring certain well recognized brands in the Indian restaurant industry.

The Company's restaurants consist of different restaurant concepts and are located across India, particularly in the western region. SRL flagship brand is Mainland China which serves Chinese cuisine in a standalone fine dining setting. As of February 29, 2012, Mainland China brand encompassed 36 restaurants across India as well as one in Bangladesh. Mainland China restaurants contributed 53.27%, 57.03%, 60.28% and 61.13% to its total revenues from food and beverages in Fiscal Years 2009, 2010, 2011 and the nine months ended December 31, 2011, respectively.

Its other core brand, Oh! Calcutta, encompassed seven restaurants across India as well as one in Bangladesh as of February 29, 2012 and features a range of cuisines from the east Indian city of Kolkata, including Bengali, Nawabi, British and Continental cuisines served in a fine dining setting. Some of its other restaurant brands are Sigree, Flame & Grill, Haka, Just Biryani, KIBBEH, Kix, Machaan, Shack, as well as a confectionary brand, Sweet Bengal.

At the upper band of the issue price, SRL is valued at 36x at its annualized 9MFY12 EPS of Rs. 4.34 which seems expensive considering the secondary market conditions. In addition, same store sales growth is bit of concern and growth in sales would be dependent on opening of new stores. However, with due consideration to the following factors like a) leading portfolio of core brands including its flagship brand, "Mainland China", b) focus on guest needs, c) diversified business model within the food service industry, d) presence in strategic locations, e) robust processes and scalable model, d) strong financial position and profitability, we recommend "Long term investors to Subscribe the issue"

Financial summary (Consolidated)

Y/e 31 Mar (Rs. mn)	9MFY 12	FY11	FY10	FY09
Net Sales	1,497.3	1,731.6	1,288.1	1,156
EBITDA Margin (%)	20.9	22.0	20.5	17.0
PBT	219.7	240.8	142.3	118.5
Reported PAT	153.4	156.3	111.9	63.1
PAT margin (%)	10.2	9.0	8.7	5.5
Equity Capital	352.2	349.4	17.1	17.1
Networth	1,126.4	973	706.7	554.8
Total Debt	315.8	197.6	236.8	241.8
Debt/Equity (x)	0.28	0.20	0.34	0.44
RoNW (%)	14.6	18.6	17.7	12.1
RoCE (%)	15.2	19.1	15.7	15
Adjusted EPS on Post Issue	3.26	3.3	2.4	1.3
P/E at Upper Price Band	35.7*	46.6	65.1	115.4
P/E at Lower Price Band	33.6*	43.9	61.3	108.7

Source: RHP, Ajcon Research *P/E on annualized EPS

Issue date	16 th May – 18 th May, 2012
Issue size	Rs. 1,819.6 mn at upper end of the price band
FV	Rs.10
Price Band	Rs. 146 - 155 per share
Fresh Issue	11.73 mn shares
Issue structure	QIB: 50% Retail: 35% Non – Institutional: 15%
Equity shares post issue	46.95 mn shares
Post issue market capitalization	Rs. 7,278 mn
Book Running Lead Managers	Kotak Mahindra Capital Company Ltd.
IPO Grading	Grade 4/5 by CRISIL indicating above average fundamentals
Registrar to the issue	Link Intime India Pvt. Ltd.

Shareholding Pattern (%)	Pre Issue	Post Issue
Promoters	80.9	60.7
Non Promoter	19.1	14.3
Public	-	25.0
Total	100	100

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Objects of the issue

Particulars	Amount (Rs. cr)
Development of new restaurants	131.6
Development of a food plaza	15.1
Repayment of term loan facilities	9.42
General corporate purposes	*15.28 -25.8
Total	*171.4 -181.96

Source: RHP, Ajcon Research, * denotes at lower end of the price band

Key advantages

A leading portfolio of core brands including its flagship brand, Mainland China

The Company believes that its core brands, *Mainland China* and *Oh! Calcutta* (the "Core Brands") are well recognised fine dining brands in India. *Mainland China* and *Oh! Calcutta* brands have had a presence for over 17 years in an industry characterised by high brand mortality. The Company's Core Brands have won multiple awards in India. In 2011, *Mainland China* restaurants won the Golden Spoon Award for the most admired food service retailer of the year for dine-in international cuisine. In 2010, 2011 and 2012, *Mainland China* and *Oh! Calcutta* restaurants won the Times Good Food Awards in several cities for being the best Chinese and Bengali cuisine restaurants, respectively. In addition, some of its *Mainland China* restaurants and *Oh! Calcutta* restaurant in Mumbai, Bengaluru and Kolkata were listed on the Miele Guide 2010/2011 list of Asia's finest restaurants. It also currently owns nine other brands, each of which have either established and developed or acquired from its Promoters or Directors. The Company currently owns all the interest of its Promoters and Directors in the restaurant business. It has historically concentrated its efforts on its Core Brands, each of which enjoys brand recognition in India.

Mainland China is the flagship brand, contributing to 60.28% and 61.13% of its total revenues from food and beverages in Fiscal Year 2011 and in the nine months ended December 31, 2011, respectively. The Company believes that brand awareness of *Mainland China* has strengthened in the last two years partially as a result of its effective marketing efforts, such as its television advertising campaign with Pepsi Foods Private Limited ("Pepsi") both to promote new menu offerings and to build the image of its *Mainland China* brand. In addition, it has been engaged by Random House Publishers India Pvt. Ltd., the Indian arm of an international publishing house, to prepare a Chinese cookbook, the *Mainland China Cookbook*. The cookbook is currently being marketed in India and SRL expects it to enhance brand affinity for *Mainland China*.

The company has retained a strong market position and is able to expand across India in an industry that is fragmented and highly competitive. For Fiscal Year 2011 and the nine months ended December 31, 2011, the guests served in *Mainland China* company owned and operated restaurants were approximately 4,361 and 5,196 per day with a cover turnaround (per day) of approximately 1.55 and 1.65 times, respectively. For Fiscal Year 2011 and the nine months ended December 31, 2011, guests served in *Oh! Calcutta* company owned and operated restaurants were approximately 677 and 701 per day with a cover turnaround (per day) of approximately 1.01 and 1.09 times, respectively.

Diversified business model

Each of its brands has a distinctive appeal. Although several of its brands serve broadly the same demographic profile of guests, each offers a unique dining experience. For instance, *Mainland China* offers authentic Chinese cuisine, *Oh! Calcutta* offers diverse cuisines traditionally found in the east Indian city of Kolkata and *Sigree* offers authentic Indian cuisine slow cooked over a charcoal flame. From time to time, it also introduces new brand concepts serving food in different formats, such as *Flame & Grill* which serves kebabs grilled at the table, *Machaan* which offers traditional Indian dishes and dishes for children in a tropical theme ambience and *KIBBEH* which offers

Lebanese cuisine in a bar lounge format. As of February 29, 2012, the Company has eight joint brand locations divided between four combos where two branded restaurants are co-located ("Combos") and four multibrands where more than two branded restaurants are co-located ("Multibrands"), typically combining an established brand, such as Mainland China, with a newer brand. Its Combos and Multibrands provides the Company with operational synergies by offering a combination of its branded restaurants in one location with a common kitchen, back-of-the-house operations, management and staff. In addition, SRL Combos and Multibrands allows it to leverage the popularity of its Mainland China brand to promote newer brands. In future, it may also develop additional brands to cater to different segments of the population. For example, it plans to develop an all day Italian café concept to cater to the 18 to 30 age group. In 2011, the Indian population was expected to include more than 220 million persons in the 20 - 29 age group (Source: *Population Projections for India and States 2001 – 2026, Report of the Technical Group on Population Projections constituted by the National Commission on Population, May 2006*). This will promote further diversification of its guest base as its current brands are targeted at guests who mainly visit our restaurants for formal meals with family, colleagues and business partners. It plans to target Italian café concept at the 18 to 30 age group, which the Company expects will visit café for coffee and snacks as well as affordable informal meals.

Strategic locations

It has strategically-located restaurants across 21 cities in India and one city in Bangladesh as of February 29, 2012. Among these, its flagship *Mainland China* restaurants are located in all 22 cities in which it operate. In most of the cities the Company operates in, SRL implemented a modern fine dining format and modern service standards outside the five-star hotel setting that it believes has assisted SRL in creating a base of loyal guests. SRL restaurant location portfolio consists of quality sites, located in business districts, neighborhoods and high streets, each of which the Company believes has guest traffic. SRL mix of locations, including both geographic spread and location type, leads to guest diversification.

Most of its restaurants, and particularly *Mainland China* restaurants, are located in Metros and Tier I cities. The majority of the restaurants are located in western India which, according to the NRAI Report 2010, has the highest proportion of people dining out regularly. In Fiscal Year 2011 and nine months ended December 31, 2011, 39.07% and 40.67% of its total revenues from food and beverages were attributable to its restaurants in western India, respectively. It opened its first restaurant outside India in February 2010, a *Mainland China* franchise restaurant in Dhaka, Bangladesh. In February 2011, it opened its second restaurant outside India, an *Oh! Calcutta* franchise restaurant in Dhaka, Bangladesh. Creating this network has provided us with important practical experience on which to draw on as we explore further expansion.

The company also believes that its strong presence in the Indian market positions it to capitalise on the anticipated growth in consumer spending from expected increases in the level of disposable income of guests in India. In addition, starting from the commencement of its first franchise arrangement in early 2008, the company has created a framework for franchising its brands, including, *Mainland China*, *Machaan* and *Flame & Grill* through which it gets access to certain Tier I and Tier II cities. The Company controls the quality of food and service in its franchise restaurants by following the franchisee owned, company operated ("FOCO") model, which allows it to control substantially all aspects of the franchise restaurant operations. Using its internally developed systems, the company is able to attract, retain and support franchisees in the Indian market. The Company is continuing to expand in Metros and Tier I cities and selectively, in Tier II cities. SRL intends to continue to roll-out primarily company owned and operated and opportunistically, franchise operations across India and in certain international destinations.

Strong financial position and profitability

As of March 31, 2011 and December 31, 2011, it had Rs. 47.81 million and Rs. 80.08 million of cash and cash equivalents and secured borrowings of Rs. 138.90 million and Rs. 260.02 million, respectively. The net sales have grown at a CAGR of 35.2% over FY07 to FY11 whereas; the PAT has grown at a CAGR of 49.7% over the same period.

The Company believes that its strong financial position and capital structure will provide it with the financial flexibility to fund its growth and expansion and allow it to respond quickly and competitively to further capitalise on emerging opportunities in the Indian restaurant market. In addition, it follows an “asset light model” as it leases all of the properties occupied by its owned and operated restaurants, which allows it to optimise capital for growth.

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