18th May, 2012

Speciality Restaurants Ltd (SRL) IPO note – "SUBSCRIBE Long Term Investors

Issue at a Glance

Issue Summary	
Total Issue of Shares (lk)	117.39
QIB Investors (lk)	58.69
Non -Institutional Investors (lk)	17.60
Retail Investors (lk)	41.10
Issue opens on	16th May,2012
Issue closes on	18th May,2012
Price Band (Rs.)	146-155
Lot size (No. of shares) and multiple	40
Face Value (Rs)	10
Issue Size (Rs in Cr.)	171.39 – 181.96
Equity Shares outstanding prior to the Issue	35,218,242
Equity Shares outstanding after the Issue	46,957,657

Shareholding Pattern

	Pre-Issue (%)	Post- Issue (%)
Promoters and Promoter Group Holdings	80.92	60.69
Non Promoters	19.08	14.31
Public	-	25.00
Total Share Capital	100	100

CRISIL has assigned an IPO Grade 4 to SRL IPO indicating company has 'Above Average Fundamentals'.

Issue Objectives

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	**171.39 -181.96**

Company Background

SRL is one of the 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. It focuses on providing guests an affordable fine dining experience with quality food and service in a modern ambience. The Promoters launched the first restaurant of its restaurant network in 1992 under the name Only Fish, which was later renamed Oh! Calcutta in the year 1996. In 1994, Promoters launched the first Mainland China restaurant in Mumbai. Over the years, it has grown in 21 cities in India and one city in Bangladesh. In Fiscal Year 2011 and the nine months ended December 31, 2011, the number of guests served at its owned and operated restaurants was approximately 2.59 million and 2.09 million, or, on average over7,313 and 8,127 guests each day, respectively.

The restaurants consist of different restaurant concepts and are located across India, particularly in the western region. The flagship brand is Mainland China which serves Chinese cuisine in a standalone fine dining setting. Chinese cuisine is the most popular foreign cuisine in India according to the India Retail Report 2009.

As of February 29, 2012, its main brand Mainland China brand encompassed 36 restaurants across India as well as one in Bangladesh. The 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.

The 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.

The other restaurant brands are Sigree, Flame & Grill, Haka, Just Biryani, KIBBEH, Kix, Machaan, Shack, as well as a confectionary brand, Sweet Bengal.

Competitive Strengths

- **Core brands, Mainland China and Oh! Calcutta is well recognized fine dining brands in India.**

Mainland China and Oh! Calcutta brands have had a presence for over 17years in an industry characterized 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.

- **Focus on guest needs**

SRL's founding principle is based on the traditional Indian principle of Atithi Devo Bhava, or Guest is God. Together with its Promoters, it has amassed over 19 years of experience in catering to guest tastes and preferences in India which has provided them with knowledge of the expectations of the Indian guest. It strives to build a loyal base of guests through its quality dishes and guest-focused service. Based on its experience, it carefully design and adjust its menus to suit what it believes are the tastes and preferences of its target guests.

➢ 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. It's 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 allow 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 their 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 capitalize 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 capitalize 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 optimize capital for growth.

Food Services Industry – An Overview

- The food services industry is becoming an increasingly important segment of India's economy. The size of the Indian food industry estimated at US$200 billion in the year 2006-07 and is estimated to reach US$300 billion by2015 (Source: Technopak Report 2009).

- The food services industry is the second largest component of discretionary spending, following the grocery stores industry (Source: India Retail Report 2009). In recent years, the food services industry has emerged as one of the fastest growing industries with numerous domestic and international food chains entering the market (Source: India Retail Report 2009).

- The revenues of players operating in the restaurant industry in 2010 amounted to Rs. 430 billion with an annual growth rate of 5-6% (Source: NRAI Report 2010).

- In spite of the recent economic slowdown, the food services industry in India is expected to remain one of the fastest growing industries in the Asia Pacific (Source: Technopak Report 2009). Expansion is expected to come from domestic and international companies opening new outlets (Source: Technopak Report 2009).

- In addition, as players continue to build strong regional brands, expansion is also likely to come from franchising outlets (Source: Technopak Report2009).

- In the affluent and middle classes, while the expenditure on food (vis-à-vis other products and categories) as a percentage share of consumption expenditure has dropped, the total expenditure on food has increased across all classes of the Indian population (Source: Technopak Report 2009).

- Food expenditure was earlier concentrated around basic food items like food grains, vegetable oils, and sugar (Source: Technopak Report 2009). However, there is a shifting trend of increased spending on fruits and vegetables, eggs, meat, beverages and processed foods as a result of both increased availability and affordability (Source: Technopak Report 2009).

Key Investment Rationale

- **Favorable demographic profile and growing working population to augment demand for restaurant chains in India**

  The demographic rise in younger population and the working class in India are expected to provide a great impetus to the restaurant business. KSA Technopak's 2009 survey revealed that in India mostly people aged 21-40 years eat out regularly. As per the National Commission on Population (NCP), nearly 68% of the 1.1 bn population in 2006 was below the age of 35 years (with a median age of 24 years). Besides, with the expected strong long-term GDP growth rate in India likely to create more employment opportunities, the present base of working population will also increase. As per the Central Statistical Organisation, the proportion of working age population (comprising 15-59 years) in India will rise to 62% by 2016 from 59% in 2006.

- **Increasing urbanization and rising middle class to expand the 'dining out' consumer base**

  As per industry sources, the number of people living in Indian cities will go up by 250 million to reach 590 million by 2030.In addition, the increase in the middle income segment coupled with an increasing proportion of population living in urban centres is leading to an increase in dining out as a lifestyle choice. Further more than 100 million Indian households will join the middle income segment (with an annual income of Rs 0.2 mn to Rs 10 mn).

- **Successful brand image amidst a strong competitive environment**

  Speciality has been able to build a successful brand presence in an industry which is highly fragmented and strongly competitive. Its flagship brand, Mainland China, is a well recognized fine dining brand in India, operating for more than 16 years in the domestic market. It contributes more than 50% to the overall food and beverage revenue and has served 1.54 mn guests in FY11 with an average per day cover turnaround of 1.55 times. Over the years, this brand has gained significant market acceptance – currently it runs 37 restaurants across 21 cities in India and two in Dhaka, Bangladesh. Besides, it has won accolades like "Times Good Food Awards in 2011" for being the best Chinese restaurant in several cities and also found a place in the "Miele Guide 2010/2011" (a listing of Asia's finest restaurants), which demonstrates the strength of Mainland China's brand recognition in the market.

- **Diversifying into multiple cuisines in tune with changing consumer preferences**

Guided by changing consumer preferences, the company has introduced new brand concepts of serving food in different formats. With theme-based restaurants gaining popularity in the fine dining segment, Speciality's theme-based brands, like Machaan, are rapidly gaining brand recognition. Besides, the company also plans to develop Italian cafés - with a cover capacity 60-65 each - to cater to the 18 to 30 age group, as these restaurants - with out-of-the-box offerings in terms of ambience, cuisine and décor - are gaining acceptance in the market.

- **Quality of food and guest services leading to higher number of repeat guests**

Speciality's branded restaurants are known for providing a great dining experience through a combination of quality food, great ambience and attentive services. To maintain the standard, the company follows several steps. The operations teams regularly monitor and adjust menus to suit the changing tastes and preferences of dynamic consumers. From time to time, the company invites chefs from China to visit the Mainland China restaurants to train their chefs and to introduce new items into their menus. Apart from providing training to its internal staff (from waiting staff to security to valet), the company actively manages its service standards by putting strong emphasis on guest reviews and their feedbacks. All these have resulted in repeated guest visits across its restaurants.

- **Strategic locations lead to higher cover turnaround even for new restaurants**

The success of any restaurant depends – among other things - upon the identification of locations having continuous high consumer traffic, which can potentially result in daily higher cover turnaround. Every restaurant of Speciality is located in high consumer traffic zones - be it business districts or prominent high streets - and this has enabled the company to generate a higher cover turnaround per day for all its restaurants. Besides, a few of its Mainland China restaurants have themselves turned into destinations - for example, the restaurants at Sakinaka, Mumbai or at Silver Spring, Kolkata. Also, most of its restaurants are located in either metro or tier-I cities with a majority of them in western India, a region which has the highest proportion of people dining out regularly.

- **Huge expansion plans to drive future growth – Mainland China continues to dominate**

In the fine dining business, revenues from same outlets tend to hit the plateau in four to five years. To achieve incremental growth, companies have to consistently set up new outlets. Despite a healthy mix of new and mature outlets, Speciality has robust expansion plans for the next two years to penetrate further into the metro and tier-I / tier II cities. The company plans to open 32 new restaurants, mostly in metro and tier I cities. In the past, the company has judiciously selected locations for its new restaurants in high traffic areas and will use the same experience for its proposed expansion as well. The company also has plans to develop a food plaza in Rajarhat, Kolkata, West Bengal, which will consist of banquet hall(s) and its various restaurants.

- **Focus on COCO (Company Owned Company Operated) model reduces the risk of dilution of quality, service and overall brand value**

The company seeks to expand mainly through the ownership model and opportunistically through the franchise model. All the 32 new restaurants under the proposed plan will be on the ownership model. Besides, of the existing portfolio, only 20 restaurants are on a franchise model and rest are all owned and operated by the company. The company uses the franchise route selectively while moving into tier II locations. Even then, the company controls the critical aspects of its business including food quality and guest attention.

- **Clubbing other brands with Mainland China enhances visibility for newer brands and optimizes costs**

The company's new restaurant formats such as combos and multi-brands are enabling it to promote new brands by leveraging Mainland China's brand popularity. Currently, the company has eight such format restaurants in place (four combos and four multi-brands) where it includes other brands like Flame and Grill or Sigree or Machaan alongside a Mainland China restaurant. For instance, the multi-brand restaurant in Hyderabad has combined Sigree and Flame & Grill with Mainland China in the same premises. These formats also lead to operational synergies like enabling the company to negotiate a better lease rental deal with the property owner by seeking a large space, using a common kitchen space which frees up more area to accommodate more covers and hence generate higher revenues, while a common management and staff reduces employee cost. Riding on the success of its existing eight format restaurants, the company is planning to launch more of its proposed restaurants under such formats.

- **Expansion through internal accruals enabled the company to manage overall risk**

Speciality's prudent expansion strategy has continuously yielded surplus cash from operations on the back of margin expansion. The company has always used internal accruals or equity infusion for expanding its restaurants portfolio that has enabled the company to manage the overall risk in the fine dining restaurant business, which is characterized by a high cost structure. The strong cash flows depict the strength of its brand and enable the company to manage its expansion plan without going in for too much of leverage

Risks & Concerns

- **Too much dependence & market recognition on Mainland China leading to concentration risk**

  Speciality's business is dominated by the success of its brand Mainland China, which currently contributes more than 50% to overall revenue. Though the launch of various new brands has reduced the proportion to 57% in FY10 from 84% in FY06, any shift in consumer preferences (away from Chinese cuisine) may impact the sales of Mainland China and hence Speciality's overall growth.

- **High real estate costs and shortage of skilled manpower may affect fine-dining players**

  A majority of the restaurant players, including Speciality, operate under leased premises. Hence rising real estate lease rentals may impact the players' profitability and the growth of the industry. Operating fine-dining restaurants in India has become costly due to rising lease rentals as well as increasing cost of interior décor

- **SRL's inability to identify, open and operate new restaurant locations profitably may adversely affect its business.**

- **SRL generates a majority of its revenues from western India. Any event negatively affecting the consumer food services industry in western India could have a material adverse effect on its overall business and results of operations.**

- **Changing consumer preferences and inability to adapt to the changes may affect the results of the operations leading to high concentration risks.**

FINANCIALS

Profit & loss Account

Particulars (Rs in Mn)	FY09	FY10	FY11	9MFY12
Total Income from Operations	1,156.12	1,288.05	1,731.63	1,497.28
Other Income	10.03	9.52	19.01	23.83
Total Income	**1,166.15**	**1,297.57**	**1,750.64**	**1,521.11**
Expenditure	**959.05**	**1,023.69**	**1,350.10**	**1,184.32**
Operating Profit	**207.10**	**273.88**	**400.54**	**336.79**
Int Charges	19.22	17.24	16.71	25.81
Depreciation	69.35	114.39	143.03	91.29
Profit Before Tax	**118.53**	**142.25**	**240.80**	**219.69**
Tax	43.50	45.70	80.57	69.51
Profit After Tax	**75.03**	**96.55**	**160.23**	**150.18**
Restated Adjustments	(11.95)	15.31	(3.95)	3.26
Adj Profits as Restated	63.08	111.86	156.28	153.44

Balance Sheet

Balance Sheet (Rs In Mn)	FY09	FY10	FY11	9MFY12
Fixed Assets				
Gross Block	730.15	897.38	1,035.03	1,183.33
Less: Dep	189.46	281.63	409.67	489.25
Net Block	540.69	615.75	625.36	694.08
WIP	137.87	98.93	101.86	198.83
Total Fixed Assets	678.56	714.68	727.22	892.91
Investments	0.02	55.48	250.73	202.98
Current Assets, Loans & Adv				
Inventory	11.08	12.47	19.76	23.01
Sundry Debtors	13.59	21.12	55.90	98.56
Cash & Bank Bal	9.01	38.32	47.81	80.08
Loans & Adv	272.11	294.06	346.17	436.27
Sub Total	305.79	365.97	469.64	637.92
Deferred Tax Assets	2.27	5.34	25.63	37.27
Total Assets	986.64	1,141.47	1,473.22	1,771.08
Liabilities & Provisions				
Sec Loans	182.13	179.22	138.90	260.02
UnSec Loans	59.62	57.58	58.67	55.82
Current Liabilities & Provisions	190.05	197.97	302.67	328.82
Total Liabilities	431.80	434.77	500.24	644.66
Net worth				
Represented by				
Share Capital	17.08	17.08	349.36	352.18
Share Appln Money Pending Allotment	-	40.00	-	-
Reserve & Surplus	537.76	649.62	623.62	774.24
Net worth	986.64	1,141.47	1,473.22	1,771.08

Valuations...

- The main focus is to scale Mainland China to 100 restaurants by 2016. It also plans to expand Sigree to a formidable Indian fine dining brand over next few years.

- No peer group comparison is possible since there is no player with the same business model

- The annualized earnings on diluted equity for FY12E is Rs 4.4 valued at a P/E of 33.5-35.6x.

Currently the primary and secondary equity markets are seeing daily massacre on the streets & the IPO seems to be richly priced any sought of non performance will not be pardoned.

However as the number of core brand Mainland China restaurants scale up revenue growth will be seen at a healthier pace and commercial property market which has seen fall in rentals could lead to further expansion on margins and result in increased scalability & profitability going forward.

"We recommend only Long term Investors to "Subscribe" to the SRL IPO since the business model seems to be robust with the direct relation of the increase in restaurants to its revenue increase with maintained EBITDA and PAT margins over a future period will result into promising growth potential going forward.

Disclaimer:

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions. This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients and Associates of arm research. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither arm research, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without arm research's prior written consent.

Contact us at: pr@armresearch.in , research@armresearch.in

Tel No: 022- 26394073/97