

Vakrangee: Potential to fortify Amazon's rural e-commerce presence

Industry Overview

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An innovative way to address non mobile users by Amazon

In our previous notes (Clash of the titans [part 1](#) and [part 2](#)), we had highlighted that the top 3 e-commerce companies – Flipkart, Amazon India and Snapdeal are looking to grow their GMV (Gross Merchandise Value) led by improving mobile internet penetration. In this note, we flag an innovative approach taken by Amazon India to expand its addressable market from current “urban mid-to-high-end consumers” to “non-mobile/non internet low-end consumers” by tying up with Vakrangee (by leveraging its 20K outlets in under- developed areas). Through this tie-up Amazon is able to expand its addressable market in a cost effective way and has potential to fortify its position in these rural areas. In this report we analyze **1)** Vakrangee's tie-up with Amazon; **2)** Highlights from our on-the-ground store visit feedback and **3)** Flag key takeaways from the Vakrangee management meeting.

Vakrangee at a glance: Strong network in rural areas

Vakrangee historically was acting as an e-Governance enabler. Though its various centers named as “Vakrangee Kendra” it provides various ancillary services to the rural population. Some of the services offered by Vakrangee are collection of bills, printing of voter ID cards, recruitment services, health initiatives etc. Currently, the company has a total of 20K outlets and wants to extend them to 75K outlets by 2020. In July'15 Vakrangee tied up exclusively with Amazon (Flipkart/Snapdeal cannot use these outlets). As part of the 5 year agreement, Amazon (Buy, US\$713.3) will use these outlets as physical ordering and collection points for Amazon India's products and will pay 4-15% of the GMVs as commission.

Key advantage for Amazon India vs competition

Key advantages for Amazon: **1) Gets stronger in under-developed areas:** The tie-up gives Amazon the potential to increase its presence in rural areas as against its current stronghold in urban areas; **2) Access to different subs-base:** The Vakrangee tie up gives Amazon access to a completely different and untapped customer base. Although early days, such stores are showing good traction with an avg of 20-25 orders/day and **3) Improve last-mile connectivity:** Going forward, Amazon and Vakrangee may also experiment with alternate delivery models which would see Vakrangee and its franchisees playing a deeper role in Amazon India's logistics chain. In our view, if the partnership with Vakrangee is successful, then Amazon India may accelerate the pace of growth and extend its market share in the ecommerce space.

Store visit takeaways: Momentum visible

1) At these outlets, consumers are assisted by outlet agents to order goods they want and are advised on pick-up date/time. There are no delivery charges for consumer and in almost all the cases it was cash-on-delivery; **2)** The key goods purchased in the stores most of the times were mobile phones, clothes and other day-to-day related items like shampoo, soaps etc. We found consumers well versed with the Amazon India value proposition and some stated they come to buy daily items as it is cheaper than buying in near-by offline shops; **3)** Stores we visited were getting 20-25 orders/day. The avg. Amazon India order ticket size for these stores is around Rs 350.

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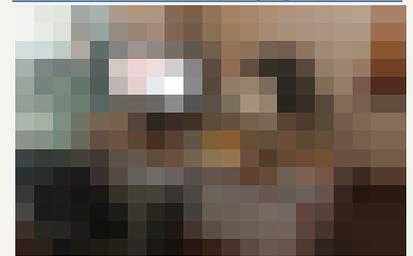
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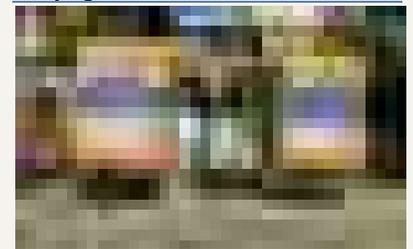
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Exhibit 1: Assisted ordering model with dual screen with same displays



Source: BofA Merrill Lynch Global Research, Vakrangee

Exhibit 2: Localized marketing campaigns on mobile vans



Source: BofA Merrill Lynch Global Research, Vakrangee

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What is Vakrangee?

Company background: Vakrangee is a US\$ 1.5 bn market cap company which was incorporated in 1990 by Mr. Dinesh Nandwana and owns close to 40% of the company. Apart from banking services, the company also provides various ancillary services to the rural population through its last mile network. It has mainly two lines of businesses – eGovernance enabler and Vakrangee Kendra (providing last mile connectivity for goods and services).

- **eGovernance:** Vakrangee offers system integration services, and provides services such as collection of bills, printing of voter ID cards, recruitment services, health initiatives etc. The projects it is currently working on include UID (Unique Identification Project), SSA (Sarve Shiksha Abhiyan), PDS (Public Distribution System), RSBY (Rashtriya Swasthya Bima Yojana) amongst others.
- **Vakrangee Kendras (V-Marts)** are small outlets primarily in rural areas, intended to provide last mile services to the remote regions of the country. The different services provided through the Vakrangee Kendras include Banking, Insurance, ATM, eGovernance and e-Commerce.

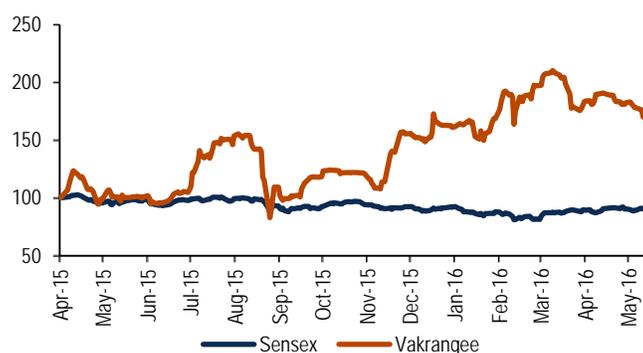
Under its e-Commerce initiative, Vakrangee has exclusively tied up with Amazon India to stock and deliver its products to Kendra's catchment area in return for commission. As of March, 2016, the company has a total of 20K Vakrangee Kendras in operation and wants to extend them to 75K outlets by 2020, by which time the company expects c. 90% of its revenues to come from the Vakrangee Kendras business.

Exhibit 3: Vakrangee divisional revenue break up

Segment	FY16 Revenue	FY20E Revenue	Area of Business	Type of service	Revenue model	Vakrangee Kendra Revenue split	
						Current	FY'20E
Vakrangee Kendra	53%	> 90%	Banking	Bank account opening Deposits, Retail loans, Direct Benefit Transfer, etc	Rs 20/ Account opening 48 bps of transaction size	30 - 35%	30%
			Insurance	Life/Non Life Insurance, Government schemes, Tie-up with Tata AIG to distribute product	10 - 25% commission	5 - 10%	5 - 10%
			E-Governance services	Card Enrolments, Utility Bills, Taxes, and Levies, etc Land records, Rail Tickets, Exam fee payments, etc	Varied based on type of service	10 - 15%	10%
			E-commerce	Mobile/DTH Recharge & bill payment, Education Exclusive tie up with Amazon India Other tieups - Redbus, Ricoh, M&M group	Mobile/DTH: 2 - 5% of Recharge Amazon: 4 - 15% of GMV	35 - 40%	45 - 48%
E-Governance	47%	< 10%	Legacy E-Governance project implementation	National E-Governance Plan (NEGP) projects like Unique Identification Project (UID), PDS, etc	Varied based on terms of contract		

Source: Vakrangee, including estimate figures given.

Chart 1: Vakrangee 1 year stock price performance vs Sensex



Source: Bloomberg

Exhibit 4: Vakrangee key financials

In USD mn	FY12	FY13	FY14	FY15	FY16
Revenue	206	235	297	422	484
Growth%	53%	14%	26%	42%	15%
EBITDA	37	59	82	110	125
EBITDA margin (%)	18%	25%	28%	26%	26%
Net Income	11	16	27	49	60
Net Income margin (%)	5%	7%	9%	12%	12%
ROE (%)	18%	22%	27%	32%	29%
ROIC (%)	11%	12%	16%	23%	23%

*Financials converted to USD mn using the exchange rate 1USD = INR 66

Source: Company report

Partnership with Amazon India: A game-changer?

Tie-up with Amazon: In July'15 Vakrangee tied up exclusively with Amazon India. As part of the 5 year agreement, Amazon will use V-Marts as physical ordering and collection point for Amazon's products and will pay 4-15% of the GMVs as commission to Vakrangee. Given its exclusive tie-up, Vakrangee will not be carrying products of competitors like Flipkart and Snapdeal. Vakrangee started rolling out stores facilitating Amazon since Nov-15. Currently it has c. 400 such stores.

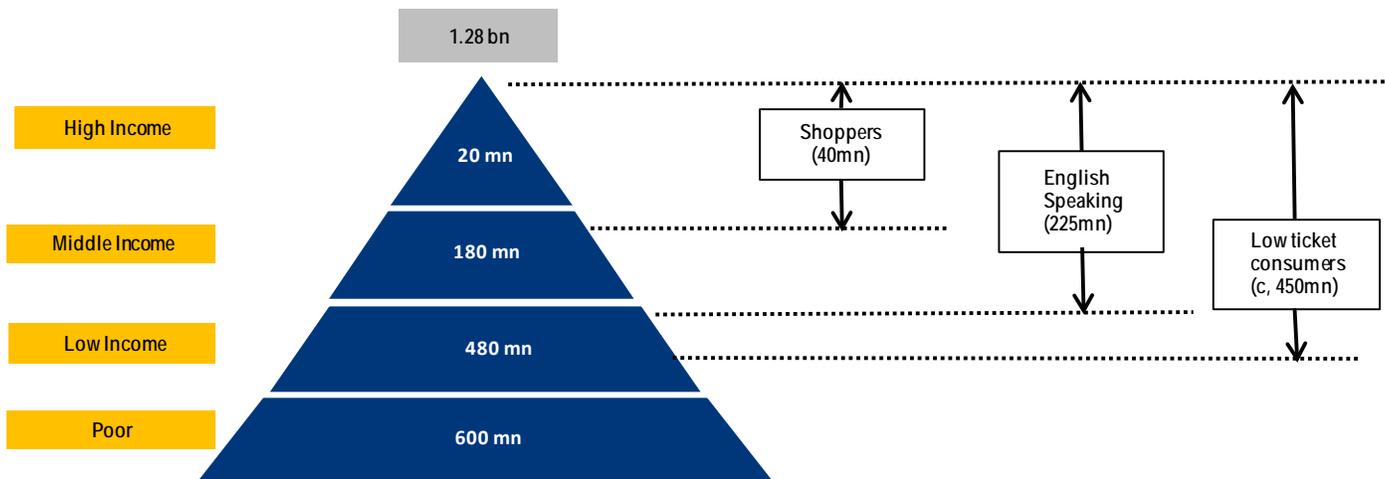
Tie-up post detailed due diligence by Amazon India: Before its tie-up with Vakrangee, Amazon India performed a lengthy due diligence process for about 18 months with PWC as the auditor, wherein they checked the corporate governance, labor policies among other things.

Advantages for Amazon India from tie-up:

- **Gets stronger in rural areas:** Since its inception, in the e-commerce domain, Amazon has been strong in urban areas like Mumbai/Delhi with its competitors like Snapdeal/Shopclues strong in rural areas. The tie-up with Vakrangee gives Amazon the potential to increase its presence in rural areas in a cost effective manner.
- **Access to different subs-base:** The Vakrangee tie up gives Amazon India access to a completely different and untapped customer base. Based on our retail checks, each V-Mart outlet is generating close to 20-25 orders per day for Amazon, with a ticket size of close to Rs. 350.
- **Improve last-mile connectivity:** Going forward, Amazon India and Vakrangee may also experiment with alternate delivery models which would see Vakrangee and its franchisees playing a deeper role in Amazon India's logistics chain.

How does it work? Under the arrangement, consumers within the V-Marts catchment area can approach the outlet, and order products on the website with the assistance of the booth attendant. Subsequently Amazon India delivers the products to the outlet, and collects back the returned goods. It saves costs of the last mile delivery and hence does not charge any delivery fees under the model.

Exhibit 5: Amazon can address mid to low-income consumers not using mobile/internet with tie-up with Vakrangee

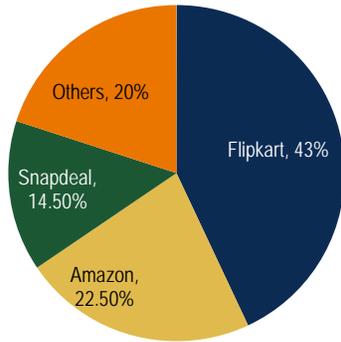


Source: BofA Merrill Lynch Global Research

Likely to help Amazon India expand the addressable market: In our view, with this kind of arrangement Amazon is able to expand its addressable market to consumers who do not own a mobile/smartphone and helps Amazon target mid-to-low-end income consumers.

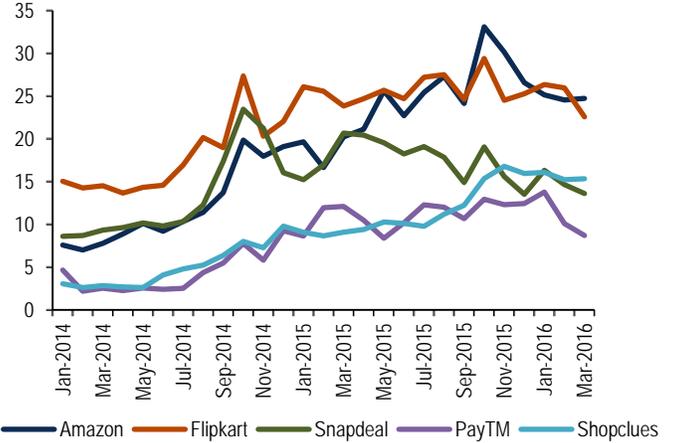
Furthermore, we note that Amazon India continues to show a strong business momentum in India. Recent unconfirmed media articles have suggested that Amazon has overtaken Snapdeal to become India's second-largest online marketplace. In our view, if the partnership with Vkrangee is successful, then Amazon may accelerate the pace of growth and extend its market share in the ecommerce space. For details pls click [here](#).

Chart 2: GMV share of India ecommerce market



Source: Economic Times

Chart 3: Monthly unique visitors ('000) for leading e-commerce firms



Source: Comscore

In line with management's target of 20k Amazon India outlets (by Mar'17), and discussions with stores of a rise in number of orders to 40 in a few years timeframe, we run a sensitivity on the total GMV (Gross Merchandise Value) Amazon India can realize out of the Vkrangee outlets. At 40 orders per day and order size of Rs. 350 per order, Amazon is likely to derive c. \$1.5bn of annual GMV through these outlets over the medium term.

Exhibit 6: GMV sensitivity to change in order ticket size

Sensitivity to Amazon GMV	I	II	III	IV	V
Amount per order (Rs.)	150	250	350	450	550
Number of orders per day	40	40	40	40	40
Number of stores	20,000	20,000	20,000	20,000	20,000
GMV contribution (Rs. Mn)	43,200	72,000	100,800	129,600	158,400
GMV contribution (USD Mn)	655	1,091	1,527	1,964	2,400

Source: BofA Merrill Lynch Global Research, Company Data

Exhibit 7: GMV sensitivity to change in number of daily orders per store

Sensitivity to Amazon GMV	I	II	III	IV	V
Amount per order (Rs.)	350	350	350	350	350
Number of orders per day	30	35	40	45	50
Number of stores	20,000	20,000	20,000	20,000	20,000
GMV contribution (Rs. Mn)	75,600	88,200	100,800	113,400	126,000
GMV contribution (USD Mn)	1,145	1,336	1,527	1,718	1,909

Source: BofA Merrill Lynch Global Research, Company Data

Vakrangee-Amazon India store visit info

We visited 2 Vakrangee Kendras in Mumbai (mainly located in rural pockets). Below are a few observations from our visits:

- **Stores open for 12 hrs; Need low man-power:** The stores are open from 9 am to 9 pm every-day and 11 am to 9 pm on Sundays. The man-power in each of the stores was restricted to 2-3 people working on Amazon. The Amazon delivery staff came twice a day: once at 9.30 am and then at evening 7 pm. They handle reverse logistics, payment collection etc.
- **Assisted model for ordering:** A consumer comes and sits in front of a computer screen. The contents of the screen are shared with the Vakrangee representative. The representative orders all the contents the consumer wants and is later advised on pick-up date/time. There are no delivery charges for consumer and in almost all the cases it was cash-on-delivery. The consumer is encouraged to open the pack at the Kendra to check if it is damaged or in-line with expectations.
- **Key goods purchased:** The key goods purchased in the stores most of the times were mobile phones, clothes and other day to day related items like shampoo, soaps etc. When we visited, we found unique things like “Roti makers” being sold. We found consumers well versed with Amazon India value proposition and noted that they come to buy daily items as they viewed them as cheaper than buying in near-by offline shops.
- **Peak hours/Order sizes etc.:** The peak hours for these Kendras starts from 6 pm in evening where consumers come post their work hours to order. The stores we visited stated that when they opened, they were getting 10 orders/day but overtime with word-of-mouth publicity they are now getting 20-25 orders/day. The average ticket size of these stores is around Rs. 350. Based on our discussions with management, the centers achieves an avg. of 6-7% of commission.
- **Marketing done by Amazon India :** All marketing related activities are done by Amazon with Kendras not bearing any expenses. Mainly these are localized with “feet on the street” campaigns and pamphlets in local language with address of the Kendra. During key sales/promotions, the marketing activities pick-up with special banners in front of the Kendra.

We believe that overtime, Vakrangee has potential to fortify Amazon India’s presence in rural markets and amongst low-income groups by improving the addressable market for Amazon India. We note that currently Vakrangee has c. 400 stores and intends to increase the number of stores to 1,000 by June-16. By end of next year, Vakrangee intends to open 20k such stores.

Exhibit 8: A Vakrangee Kendra: Co-branded with Amazon



Source: BofA Merrill Lynch Global Research, company reports

Exhibit 9: Localized marketing campaigns on mobile vans



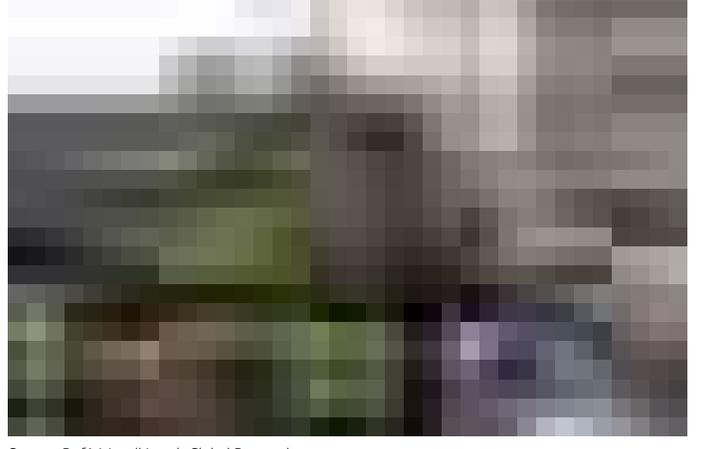
Source: BofA Merrill Lynch Global Research, company report

Exhibit 10: Assisted ordering model with dual screen with same displays



Source: BofA Merrill Lynch Global Research, company report

Exhibit 11: Storage area: CCTV secured place to store customer parcels



Source: BofA Merrill Lynch Global Research, company report

Exhibit 12: Feet on the street ads: Carrying banners on their backs



Source: BofA Merrill Lynch Global Research, company report

Exhibit 13: Vakrangee/Amazon print ad in local languages



Source: BofA Merrill Lynch Global Research, company report

Key takeaways from meeting with mgmt

Mentioned below are key takeaways after our meeting with Vakrangee management

- Management believes that the two most favorable things in their model are 1) The asset light model, which will see them being able to expand fast, and 2) The tie up with Amazon which is expected to contribute to an increasingly larger share of revenues going forward.
- For the next 4-5 years, management expects the ecommerce/telephone and DTH recharges segment to continue to increase in revenue share aggressively on the back of Amazon's partnership and other new initiatives. While other revenue streams like banking and insurance are also expected to grow in absolute terms, however, they may be stable in terms of revenue share.
- The company plans to gradually eliminate revenues from the eGovernance verticals. While they plan to honour their ongoing commitments, the company will not seek extension of contracts.
- The overall company EBITDA margins are currently at close to 26%. The margins for Vakrangee Kendras are slightly lower at 21%. The company expects these margins to gradually come down further to 17%.
- Even though Vakrangee Kendras are a slightly lower EBITDA margin business, because of their asset light model, they have a higher PAT margin at 11% compared to the company's legacy revenue margin of 7%.
- The new model focused on franchisee driven outlets will be capex light, allowing the company to increase their return on equity when compared to the legacy model, which is relatively more capital heavy.
- The company has been steadily reducing its working capital requirements, which has come down significantly in this fiscal year. Earlier the working capital cycle was for 150 days, but has been reduced to the current 60 days.
- The company is also venturing into the ATM business. The capex per ATM would be Rs. 300k. The company expects their ATM costs to be almost half of the normal ATMs as it will be a shared ATM with the Kendra, resulting in sharing of overhead expenses.
- The government has recently expanded the scope of DBT (Direct Benefit Transfer) scheme like MGNREGA, NSAP, PAHAL etc. This is likely to increase the scope of banking transactions at Vakrangee Kendras, leading to robust growth of banking services.
- For FY'16, the management declared a dividend payout which was 20% of the net income of the company. However, from FY'17 onwards, the board has approved to maintain a dividend payout in the range of 15-25% of net profits.

Appendix: Vakrangee Kendra

Origination of Vakrangee Kendra: In 2011, under its financial inclusion plans, the government of India invited tenders for opening brick and mortar Business Correspondent (BC) branches, which would act as a remote extension of the public sector banks. As an added incentive, the government decided to allow the BCs to undertake ancillary activities in order to aid the financial viability of the outlets. Vakrangee won rights to rolling out outlets in 2 out of 20 clusters. As of December'15, Vakrangee has rolled out a total of 18k outlets and plans to have 75k outlets by FY'20 (50k rural and 25k urban centers). For statewise breakup of outlets, Vakrangee plans to have 13.5k outlets in Maharashtra, 11.5k outlets in Rajasthan and balance 50k outlets in other states.

Franchisee model for Vakrangee Kendras: Vakrangee follows a franchisee model for its outlets in order to reduce capex spends and grow faster. On every outlet, Vakrangee spends a capex of about 20k, post which all the expenses are borne by the franchisee. Under the terms of the agreement, the company has an 80:20 revenue sharing deal, under which the company takes 20% of the total revenues generated by the outlet. Earlier, the sharing arrangement used to be 65%:35%, but the company has scaled down its share in order to make the proposition more lucrative for franchisees.

Maturity of outlet within 6-9 months: For the franchisee, the capex for a rural outlet without ATM is approx. 125-150k, and increases to approx 425-450k in case the outlet is opened along with an ATM. Capex for a semi urban/urban outlet with ATM varies between Rs. 550-700k (including Rs. 300k as upfront franchisee fee for ATM and interior for outlet). In terms of working capital requirement, it varies between Rs. 50-100k for a rural outlet to Rs.750-850k for an urban outlet with ATM. Currently, in terms of revenues, the collections are 75k per month for rural outlet and 200k per month for urban outlets. As per the management, a franchisee typically reaches maturity within 6-9 months.

Exhibit 14: Typical cost structure for a Vakrangee outlet

	Rural Outlet w/o ATM	Rural Outlet with ATM	Semi-urban/Urban Outlet with ATM
Capex for Franchisee: Initial one time set up cost (INR)	Approx. Rs 1,25,000 to Rs 1,50,000	Approx. Rs 4,25,000 - Rs 4,50,000 (Including 3,00,000 as Upfront Franchisee Fee for ATM)	Approx. 5,50,000 - 7,00,000 (Including 3,00,000 as Upfront Franchisee Fee for ATM and as well as Interior for Outlet)
Working Capital for Franchisee (INR)	Approx. Rs 50,000 to Rs 1,00,000	Approx. Rs 2,50,000 - Rs 5,00,000 (Including ATM working capital)	Approx. Rs. 7,50,000 to Rs. 8,50,000 (including ATM working capital)
Total Number of Outlets planned for FY2020	49,000	1,000	25,000
State wise break up of Planned Rollout of Outlets by FY2020	Break up of 50,000 Rural outlets State wise: Maharashtra: 11,000 Rajasthan: 9,000 Other states: 30,000		Break up of 25,000 Semi-urban/Urban outlets: Maharashtra: 2,500 Rajasthan: 2,500 Other states: 20,000

Source: Company Data

Exhibit 15: Vakrangee: Evolution of business

Business Evolution (E-Governance)	
1990	Company Incorporation
1993	Computerisation of Central Election Commission
2005	MCA 21 Project - Ministry of Corporate Affairs
2007	Land Record Digitization in UP
2007	RSBY (Smart Card Project) – UP, Haryana & Rajasthan
2009	Land Record Digitisation for Govt. of Philippines
2010	Passport Seva Kendra Project & CSC Project in Punjab
2010	Sarva Shiksha Abhiyan
2011	UID Enrollments
2011	UID linked Haryana PDS
2013	IGRS
2013	National Population Register
2013	CSC Project in Rajasthan
Business Transformation (Vakrangee Kendra)	
2013	Financial Inclusion Project – MoF & RBI
2014	WLA License – RBI
2015	Foray into E-Commerce

Source: Company Data

Exhibit 16: Statewise distribution of Vakrangee Kendras as of March'16

States	Rural Branches	Urban Branches	Total
Rajasthan	8,066	2,097	10,163
Maharashtra	3,285	1,655	4,940
Uttar Pradesh	3,283	405	3,688
Gujarat	178	179	357
Madhya Pradesh	526	289	815
Punjab	50	151	201
Haryana	82	82	164
Bihar	95	22	117
Chhattisgarh	40	22	62
Goa	19	9	28
Himachal Pradesh	8	5	13
Delhi	1	29	30
Orissa	18	40	58
Jharkhand	12	14	26
Uttarakhand	8	6	14
Chandigarh	0	1	1
Total	15,671	5,006	20,677

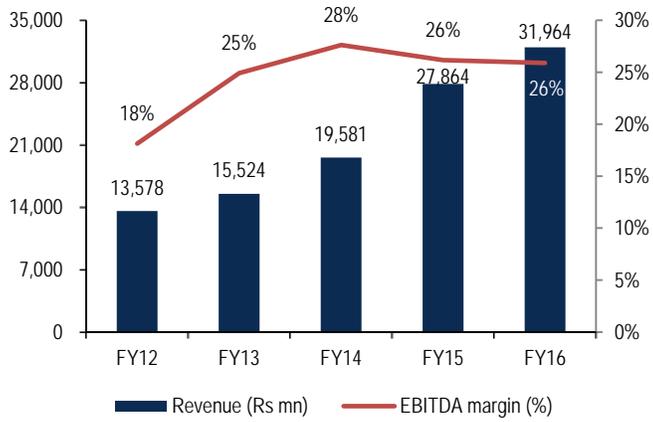
Source: Company Data

Exhibit 17: Key personnel

Name	Designation	Profile
Dinesh Nandwana	Managing Director and CEO	25 years business experience. Main responsibility include policy formulation and decision making. Bachelor's degree in commerce and certified Chartered Accountant.
Sumit Jain	CEO - eCommerce	Mr. Sumit Jain joined Vakrangee as Sr. Vice President and is heading the eCommerce vertical. MBA from Stern School, B.Tech from IIT Bombay
Rajeev Ranjan	CEO - eGovernance	Mr. Rajeev Ranjan was a former Chief Executive Officer, with Vakrangee e-Solutions INC. at Manila Mr. Ranjan is a Post-graduate and former Tata group senior executive
Rahul Dev Pal	CEO - Banking Business	Rahul Dev Pal is an economics graduate with experience of almost 26 years in the field of sales and marketing Starting his career with HCL he worked with companies like Xerox, Pertech Computers, BPL and Godrej.
Nitin Sharma	CEO - ATM Business	Over 17 years of cross-cultural experience in Operations, Implementation, Retail and Project Management. MBA Degree from IIM Kolkata and Masters in Operations, IR and Social Work from Premier Institute, Udaipur
Nishikant Hayatnagarkar	Director - R&D	24 years of business experience in IT. Main responsibility include software development, IT compliance and technical support Holds a Doctorate in Computer Science from the Indian Institute of Technology, Mumbai
Vinay Bhartia	CEO - Logistics	Setup and ran successfully 3 business's in international trade with trade Logistics with over 10 countries. Graduate from Purdue University, founded MYPACCO in September 2014 - a home to home online courier offering

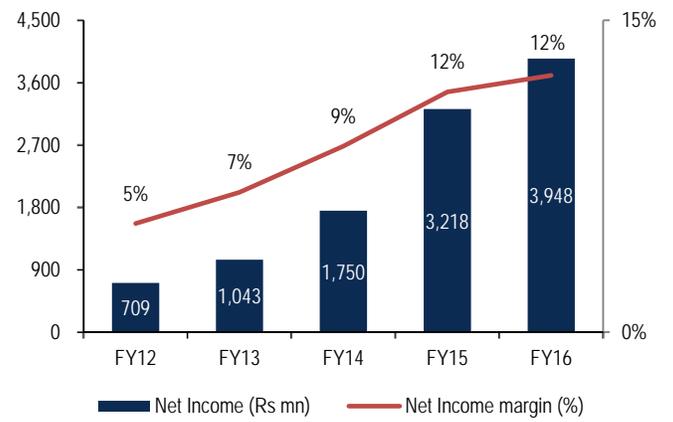
Source: Company Data

Chart 4: Vakrangee: Revenue and EBITDA margin



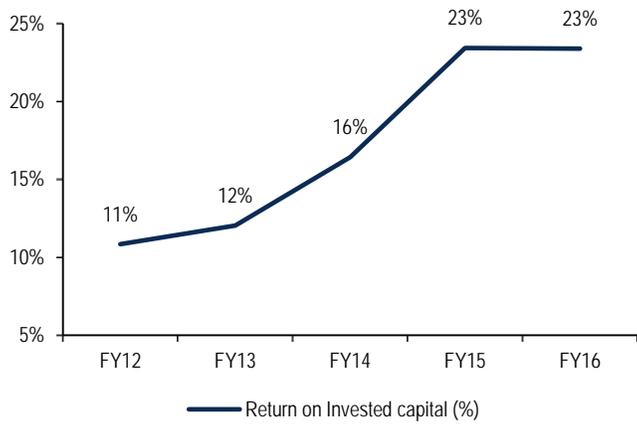
Source: Company Data

Chart 5: Vakrangee: Net Income and net income margin (%)



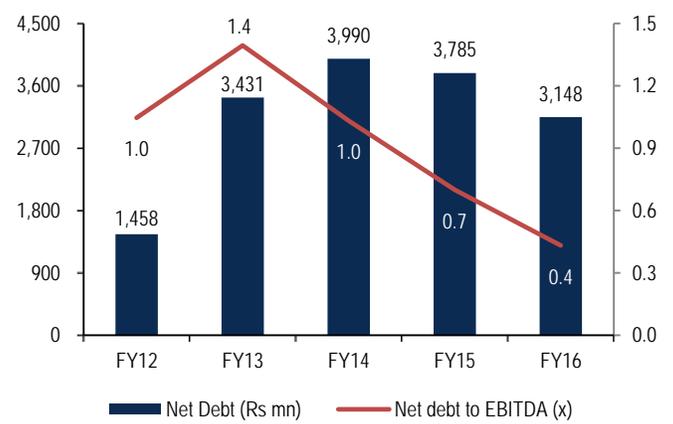
Source: Company Data

Chart 6: Vakrangee: Return on Invested Capital



Source: Company Data

Chart 7: Vakrangee: Net Debt and Net Debt to EBITDA



Source: Company Data

Exhibit 18: Vakrangee Profit & Loss statement

Income Statement (Rs mn)	FY11	FY12	FY13	FY14	FY15	FY16
Total Revenue	8,903	13,578	15,524	19,581	27,864	31,964
Growth%		53%	14%	26%	42%	15%
Operating expenses	(7,107)	(10,920)	(11,510)	(13,550)	(20,226)	(23,265)
Change In Inventory	35	51	292	(137)	46	56
Employee Benefit expenses	(265)	(125)	(285)	(314)	(196)	(254)
Other Expenses	(171)	(123)	(153)	(173)	(196)	(225)
Total Expenses	(7,509)	(11,117)	(11,657)	(14,173)	(20,573)	(23,687)
EBITDA	1,394	2,462	3,867	5,408	7,291	8,277
EBITDA margin%	15.7%	18.1%	24.9%	27.6%	26.2%	25.9%
Growth%		77%	57%	40%	35%	14%
Depreciation and Amortization	(550)	(874)	(1,571)	(1,809)	(1,649)	(1,640)
Finance Costs	(176)	(558)	(860)	(779)	(749)	(560)
Profit before tax	668	1,029	1,437	2,820	4,893	6,076
Tax Expense	(187)	(320)	(394)	(1,070)	(1,675)	(2,128)
Minority Interest	0	(0)	0	1	0	0
Net Income	481	709	1,043	1,750	3,218	3,948
Net Income margin%	5%	5%	7%	9%	12%	12%
Growth%		47%	47%	68%	84%	23%
Basic EPS	1.07	1.42	2.08	3.48	6.39	7.59
Growth%		33%	46%	67%	84%	19%
Diluted EPS	0.97	1.40	2.04	3.44	6.06	7.44

Source: Company report

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