

# Jawed Habib Hair & Beauty Limited

CRISIL IPO Grade 2/5 (Below average)

August 24, 2011

## Grading summary

CRISIL has assigned a CRISIL IPO grade of '2/5' (pronounced "two on five") to the proposed IPO of Jawed Habib Hair & Beauty Ltd (JHHBL). This grade indicates that the fundamentals of the IPO are below average relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

The assigned grade reflects JHHBL's dominant position and strong recognition as a promoter-led brand in the hair and beauty salon segment. It is one of the largest salon chains with a pan-India presence through a franchise-based model. JHHBL also runs hair-styling training centers, which not only address the supply of quality stylists but also provide a revenue stream. The grade also takes into account high growth prospects for the domestic wellness industry.

The grade is moderated by the significant challenges faced by JHHBL in maintaining quality service across all its outlets as it expands the business. This becomes more pertinent as JHHBL faces stiff competition in a highly fragmented hair and beauty salon market. The company plans to acquire other brands in the same field; its ability to identify a strategic fit and integrate them will be a key monitorable. The grade is further constrained by the company's high dependence on its promoter to maintain the brand value.

We believe the company will also have to significantly enhance its second line of management, systems and processes to support its next level of growth. JHHBL's ability to retain key personnel given the compensation structure is a challenge.

In FY10, JHHBL reported revenues of Rs 196 mn and a net worth of Rs 23 mn. EBITDA and PAT margins in FY10 were 11.8% and 3.5%, respectively. RoE has been more than 35% over the past two years driven by one-time franchise fees.

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## About the company

Jawed Habib Hair & Beauty Ltd (JHHBL) was founded in 2006 by Mr Jawed Habib Akhter, a renowned hair expert. The company has emerged as one of the leading hair and beauty salon chains in the country. The hair and beauty care services are mainly provided through franchisee-run outlets. Beginning with 37 outlets in the year of incorporation, the company has grown rapidly. As of January 2011, it runs eight owned and 176 franchised salons in 62 cities across India, and six owned academies and 35 franchised academic outlets across 36 cities. These hair styling and beauty academies provide training in cosmetology.

Type and number of outlets:

Types of outlet	Brand	Number of outlets
Self owned salons	Jawed Habib Hair & Beauty	8
	Hair Xpresso	0
Franchise-based salons	Jawed Habib Hair & Beauty	120
	Hair Xpresso	56
Self-owned academies	-	6
Franchise-based academies	-	35
Total		225

Source: DRHP

## Issue details

No. of shares being offered	Not available at the time of grading
As per cent of post issue equity	Not available at the time of grading
Amount proposed to be raised	Fresh issue of Rs 600 mn
Objects of the issue	Acquisition of brand (s) – Rs 134 mn Acquisition of Integrated ERP-CRM-BI software – Rs 126 mn Brand building – Rs 100 mn Setting up of own exclusive brand outlets – Rs 51.2 mn
	Repayment of debt – Rs 31.7 mn
Price band	Not available at the time of grading
Lead managers	BOB Capital Markets Limited

Source: DRHP

## Detailed Grading Rationale

### A. Business Prospects

- *Leading player in the hair and beauty segment*

Jawed Habib is one of the largest unisex salon chains in India. The promoter, Mr Jawed Habib Akhter, has built the brand over the past ten years by drawing on his expertise in the family profession, through premium services and by creating a differentiated model with a pan-India presence. The promoter's association with Sunsilk and Panasonic as their brand ambassador has also helped the 'Jawed Habib' brand gain popularity.

An early entrant in the branded hair and beauty salons segment, JHHBL has a pan-India presence. Brands like Juice (Mumbai), Bellezza (Maharashtra and Gujarat) and Naturals (Southern India) have a strong but local presence. Amongst the larger salons, only a handful – like Lakme and Shahnaz Hussain - has a wide network. However, Lakme and Shahnaz Hussain offer services exclusively to women, making Jawed Habib one of the few unisex salon chains in the organised segment.

Increasing disposable income, rising demand for branded services and JHHBL's first-mover advantage in the organised hair and beauty market will be the main factors driving the company's future growth. We believe that a strong brand presence and differentiated services like 'Jawed Habib Hair Xpresso' (a single service - dry hair-cut - at a lower price - Rs 99 - the only low-cost branded hair cut service available across India yet) will be critical for JHHBL to grow its existing service network and leverage new products/services.

- *Wellness services market poised for strong growth*

The Indian wellness industry, worth nearly Rs 280 bn in 2008, is growing at around 20% annually (source: DRHP, 2S Consulting Report 2008). Within the wellness industry, the products segment is expected to grow at a CAGR of 11-14% while the services segment is expected to grow at a much faster pace of ~30-35%. The hair and beauty salon market (a part of wellness services) in India is estimated to be ~Rs 69 bn, up from Rs 15 bn in 2005 - a five-year CAGR of 36%.

The growth of the Indian wellness industry shadows consumption-led growth. India's GDP has grown at a CAGR of 8.5% between FY06 and FY10. CRISIL Research expects GDP growth of 8% over FY12 and a healthy growth in the next five years. The overall economic growth has been accompanied by increased disposable income both in urban and rural markets. Over the past decade, the wellness industry has also benefited from the shift in consumption towards branded services. Strong economic growth, higher proportion of employable population, increasing urbanisation and higher demand for premium/branded personal care services is expected to continue to benefit the wellness industry.

- *Significant expansion undertaken in the past 2-3 years*

Over the past four years, JHHBL has expanded its presence across 62 cities (metros, Tier I, Tier II and Tier III) with its 'Jawed Habib Hair and Beauty' and 'Jawed Habib Hair Xpresso' brands. At present, the company has 184 salon outlets and 41 salon academies in India. The company has scaled up operations based on a franchise model; it self-operates only eight salons and six academies. The wide coverage of its outlets enables the company to exploit the largely untapped and highly unorganised market, strengthening its visibility.

Zone-wise spread of salons					City-wise spread of salons				
Region	Salons	Xpreso	Academy	Total	City	Salons	Xpreso	Academy	Total
North	52	24	16	93	Metros	54	41	12	107
West	35	28	15	78	Tier I	42	13	10	65
South	24	0	4	28	Tier II & III	33	1	19	53
East	17	3	5	25					
<b>Total</b>	<b>129</b>	<b>55</b>	<b>41</b>	<b>225</b>	<b>Total</b>	<b>129</b>	<b>55</b>	<b>41</b>	<b>225</b>

Source: Company, CRISIL Research

- *Backward integration into training institute*

JHHBL operates India's largest training facility for hair stylists. The strategy to establish academies not only helps address supply issues but also provides the company with an alternate revenue stream. The company trains more than a thousand hair stylists every year. A majority of these hair stylists get absorbed at JHHBL's salons. This negates any supply-side risks for the company as the enrollments at the training institutes more than cover JHHBL's stylist requirements. Although most peers also have academies of their own, few have enough scale to match JHHBL's reach. The employees range from fresh trainees to laterals who have to undergo a short training at the company's academy before being deployed at a salon.

- *Maintaining quality and scale will be key challenge*

With more than 95% of its outlets and 80% of its academies franchised out, maintaining service quality will be a key challenge for JHHBL as the company expands further. The challenges for a hair and beauty service company are more as the service cannot be mechanised unlike food joints or other tangible services. Hence, maintaining consistent quality is a key operational challenge in this industry.

JHHBL's growth depends on its ability to leverage the Jawed Habib brand. Failure to standardise the quality of services across all its franchises could lead to a dilution of its brand. Any significant litigation and claims by customers will damage the brand image and adversely affect the company's number of customer visits and profitability.

To maintain its quality of service across outlets and ensure customer satisfaction, JHHBL has been setting up training centers, upgrading skills of stylists through regular training and maintaining a reserve of 65 stylists to meet any sudden increase in demand, and setting up a system wherein the master franchise will supervise the various franchises under it in return for a share in JHHBL's royalty fees. JHHBL is also adopting an online ERP system for which it plans to spend Rs 126 mn to improve systems and processes by integrating operations, maintaining a standard billing system and tracking inventory.

- *Brand risk - high dependence on the promoter*

The "Jawed Habib" brand commands a strong brand recall among clients and future growth to a large extent depends on association of the promoter with the company. Mr Jawed Habib Akhter has been instrumental in building the brand over the past two decades. JHHBL derives considerable leverage from the 'Jawed Habib' brand and is able to attract customers on the strength of this brand. While it has been successful in doing so, any litigation/negative publicity against the promoter or his non-association with the company remains a key risk. JHHBL has a long way in increasing the strength and visibility of its brands before it could do without Mr Habib Akhter's association with the company.

- ***Low entry barriers with increasing competition***

Most of the players in the hair and beauty segment have chosen to operate through the franchisee model in their urgency to grab market share. There are seven to eight organised players (VLCC, Lakme, Shahnaz Hussain, Naturals, etc.) in a largely unorganised industry and few more like Bellezza and Enrich, are expected to expand and increase their spread.

Competition within the industry is expected to increase as most of the players have lined up rapid expansion strategies. However, considering the growing market and low penetration level of the organised players in the wellness industry, we believe that the pie is big enough for each player to grow. We expect players like Jawed Habib to grow faster as it is the only player which has different brands for different target markets. The ‘Jawed Habib Hair and Beauty Salon’ caters to the premium segment and enjoys higher margins. Of its 184 outlets, 56 are under the ‘Jawed Habib Hair Xpresso’ brand which offers a single service at a lower price (Rs 99). The presence of two established brands catering to different market segments differentiates JHHBL from its peers.

- ***Share deal with Sparrow Hill and Greenfield Investments 2***

Greenfield became a shareholder in JHHBL after financial investor Sparrow Hill Advisory Pvt Ltd exited its seven-month-old investment in the company with 32% return in December 2010. Sparrow Hill invested a total of Rs 59.6 mn in two tranches — Rs 39.6 mn in May 2010 (at Rs 110 per share) and Rs 20 mn in October 2010 (at Rs 40 per share). As per the management, the transaction in October 2010 was done as the company was in urgent need for funds for a probable acquisition.

Shortly thereafter, Sparrow Hill sold its entire stake of 44.35% to another investment entity, Greenfield Investments 2, (not much information about Greenfield Investments 2 available in the public domain) for Rs 81.2 mn (~Rs 94 per share) in December 2010. Greenfield Investments 2 does not have any representation on the board despite a 44.35% stake in the company. There has been a high level of volatility in the valuation of the company in the above deals during a short period of time.

- ***Acquisition of brands to remain a monitorable***

JHHBL plans to acquire brands offering services in the hair and beauty industry, both in domestic as well as international markets. The acquisition targets are still being identified and the company estimates to spend Rs 134 mn out of the IPO proceeds for the same. JHHBL's ability to acquire brands that offer a strategic fit and the company's ability to integrate these brands will be a key monitorable.

## B. Financial Performance

JHHBL's major revenue sources include revenues from providing hair and beauty services at various outlets, revenues from training academies, fees from franchises and fees from master franchises. JHHBL's consolidated revenues grew at a three-year CAGR of 28% to Rs 196 mn in FY10. Revenues grew to Rs 286 mn in the period till November 2010 backed by growth in the number of outlets and change in revenue recognition policy. Revenue growth was also due to change in the agreement with some franchisees wherein instead of recognizing royalty share, the company has started recognizing total revenue and then providing for the expenses of the share of the franchise owner.

EBITDA margins improved to 30.7% in the period till November 2010 from 11.8% in FY10 due to one-time revenues from sale of advertising space and license revenues. The margins also got boosted by upfront franchisee fees on sale of franchisee outlets and master franchisees. Consequently, PAT margins increased to 18.9% in November 2010 from 3.5% in FY10. We expect moderation in EBITDA and PAT margins going forward. RoCE was maintained above 25% over FY09-November 2010.

### Financial performance snapshot (consolidated)

Particulars	Unit	FY08	FY09	FY10	November 2010#
Operating income	Rs mn	130	192	196	286
EBITDA	Rs mn	(7)	17	23	88
EBITDA margins	%	(5.4)	9.0	11.8	30.7
Net profits	Rs mn	(12)	5.7	6.9	54
Net margins	%	(8.8)	3.0	3.5	18.9
ROCE	%	N.M	26.6	27.9	41.4
ROE	%	N.M	42.5	34.8	59.4
Basic EPS*	Rs	(4.8)	2.4	2.9	5.1
No. of equity shares (FV of Rs 10)*	mn	2.4	2.4	2.4	10.7
Net worth	Rs mn	11	16	23	159
Book value per share*	Rs	4.4	6.8	9.7	14.9
Current ratio	Times	1.8	1.7	1.5	3.4
Debt/Equity Ratio	Times	1.8	3.2	1.9	1.1

\* Basic EPS has been calculated on the number of shares at the end of the respective year. No. of equity shares for FY08-FY10 has been adjusted for issuance of 2:9 bonus shares in FY11.

#November 2010 numbers not comparable due to booking of one-time revenues

Source: DRHP, figures have been reclassified.

### Revenue break-down based on product group (standalone)

Category	FY08		FY09		FY10		November 2010	
	Rs mn	%	Rs mn	%	Rs mn	%	Rs mn	%
Hair beauty services	114	87.3	136	70.8	150	76.5	147	51.4
Franchise services	3	2.3	32	16.7	18	9.2	79	27.6
Academy income	13	10.0	23	12.0	27	13.8	60	21.0
<b>Total</b>	<b>130</b>	<b>100.0</b>	<b>192</b>	<b>100.0</b>	<b>196</b>	<b>100.0</b>	<b>286</b>	<b>100.0</b>

Source: DRHP

## C. Management Capabilities and Corporate Governance

On the back of its strong promoter-led brand image, JHHBL is one of the few companies to have an established salon chain across India. Mr Jawed Habib Akhter has over two decades of experience in the wellness industry. Mr Rohit Arora, who joined the company in 2008, heads the franchise business. Post his induction, the company has undertaken restructuring exercise to streamline its business and install various internal processes. He has played a key role in building the support system necessary for maintaining quality across the various salons. Overall, the management has handled expansion and growth well amid high competition while maintaining the quality of service.

- ***Second line needs to be strengthened***

There is a high level of involvement and awareness about the company's strategy across senior and second line of management. None of the promoters have been in other businesses which are related to that of JHHBL. The company has a relatively new second line of management. We believe that the company will have to enhance its management bandwidth in line with its expansion plans while retaining employees in the expanding market will be a challenge.

- ***Salary levels below industry average***

JHHBL's salary levels for the key management personnel are way below average industry standards in relation to their relevant work experience. We believe given such low salaries it will be difficult to retain key personnel. There have been audit qualifications related to excess remuneration being paid to the promoter in every financial year since its inception.

- ***Experienced independent directors on the board***

JHHBL's board has got three independent directors. They have a fair understanding of the overall business of the company. The board includes Mr Sudhir Tailang, who was awarded the Padma Shri in 2004 for his contribution to cartooning and journalism and Mr Ashutosh Satchidanand, chief operating officer of Reliance Big Broadcasting. The board also includes Mr Kapil Gupta who is the promoter of Deltronix India Ltd and also chairman of Wacorp Hyundai India Ltd. Following our conversation with the independent directors, we believe that they are fairly aware of their roles and responsibilities in the company.

- ***Systems and processes need to be scaled up in line with the growth plans***

JHHBL plans to expand its outlet network across the country primarily through the franchise model. In order to maintain quality on a larger scale, JHHBL will have to improve its internal control processes and systems. The company has taken the initial steps in this direction through their plans to implement the ERP system.

## Annexure I

### Business Profile

The company's entire range of services includes haircuts, shaving, hair styling, blow dry, hair straightening, chemical hair treatments, hair colouring, head massage, spa treatment, facial treatments (gold, bio marine and herbal), bleaching, threading, waxing, manicures, pedicures, make-up, etc. These services are offered through exclusive brand outlets - Jawed Habib Hair & Beauty and Jawed Habib Hair Xpresso.

#### *Jawed Habib Hair & Beauty*

It is a full service salon and entire range of services is offered under this brand. A typical JHHBL Hair & Beauty salon will be spread over 500 sq.ft. and serviced by seven competent and experienced personnel. Each salon has 4-8 styling stations, 2-4 shampoo stations and 1-3 beauty therapy rooms. The salons are equipped with the state-of-the-art apparatus. Moreover, they are run by professionals trained at JHHBL's own institute. Approximate foot falls at these salons - 10 per day, and the average billing is approximately around Rs 850.

#### *Jawed Habib Hair Xpresso*

It offers value for money - dry and contemporary hairstyling - services for just Rs 99. A Hair Xpresso salon will be around 100 to 300 sq ft in size and serviced by three competent and experienced personnel. Each salon has 3-6 styling stations. Approximate foot falls at these salons - 50 per day.

#### *Training academy*

JHHBL's institute trains over 1,000 stylists every year and most of them are absorbed by the company; some have been accepted by leading salons across India. As of date, the company has 41 institutes (owned and franchised) with an average of 1,000 students per year in locations like Mumbai, Delhi, Bangalore, Hyderabad, Siliguri, Nagpur, Ludhiana, Chandigarh, Jaipur, Indore, Ahmedabad, Baroda, Surat, Lucknow, Patna, Guwahati, Kolkata, etc.

## Annexure II: Profile of the Directors

Name	Designation	Age	Qualification	Experience & previous employments	Directorships / partnership in other entities
Mr. Jawed Habib Akhter	Chairman and Managing Director	47	Completed a course of instruction in Hair Colouring & Setting and Dressing Out from Morris School of Hair Design, London	-	Habibs Hair & Beauty Studio Private Ltd, Jawed Habib's Hair Xpresso Private Ltd, Jawed Habib Hair & Beauty Studio Private Ltd
Mrs. Shaheen Akhter	Whole Time Director	40	Certificate in Cosmetology/Hairstyling from Middlesex Country Adult Technical Schools	-	Jawed Habib Hair & Beauty Studio Private Ltd
Mr. Rohit Arora	Whole-time Director	32	Bachelors of Technology in Mechanical Engineering from IIT Bombay, Post-Graduate Programme in Management – Analytical Finance and Strategy & Leadership Specialization from the Indian School of Business (ISB), Hyderabad.	Percept Picture Company, Shri Adhikari Brothers Television Network Ltd, HSBC, KPMG Advisory Services Pvt. Ltd. and Andersen India Pvt. Ltd	Jawed Habib's Hair Xpresso Private Ltd, Jawed Habib Hair & Beauty Studio Private Ltd
Mr. Kapil Gupta	Independent Director	48	Graduation from Shri Ram College of Commerce, Delhi, Fellow member of Institute of Chartered Accountants of India	Deltronix India Ltd, Wacorp Hyundai India Ltd	Deltronix India Ltd, Wacorp Hyundai India Ltd, Deltronix Automotive Pvt Ltd, Sonia & Co. Pvt Ltd, Kayser India Pvt. Ltd
Mr. Sudhir Tailang	Independent Director	50	Bachelor of Science from University of Rajasthan	Illustrated Weekly of India, Hindustan Times, Indian Express, The time of India, Asian Age and Deccan Chronicle	-
Mr. Ashutosh Satchidanand	Independent Director	42	Bachelor of Arts (Honours Course) in History from University of Delhi and Post Graduate Diploma in Business Administration from K. J. Somaiya Institute of Management Studies and Research, Mumbai	Reliance Big Broadcasting, Sahara TV network	BIG CBS Networks Private Ltd

Source: DRHP

### Disclaimer

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