



Russian retail consumer electronics market challenges

Exclusively for PMR: Mr. Art Vartanian, General Director of Retail Solutions, shares with *Retail Update Russia* with his experience within the Russian consumer electronics market and comments on Technosila, recently offered for sale.

The electronics market in Russia has really come a long way from the old days of the Garbushka marketplace in Moscow (where one can still find an amazing array of electronics products at great prices) and independent stores. Back then, many companies were formed and grew from Moscow, as well as other regions, fuelled by a booming economy and on the back of an insatiable consumer demand for new products and innovation. For some time, Eldorado was the leader. It was started by two brothers, as was Technosila, followed by M.Video, Mir, and others. All of these companies had a very bright future at one time or another and had the wind at their backs for quite a long time. The market has changed now – has it ever.

Eldorado – one of the largest successes

The story of Eldorado is an interesting one that began to blaze a path during the turn of the century and by 2004 had over \$3bn in sales, with 1,200+ stores in most federal districts – not to mention Ukraine. This performance attracted Dixon's, the prominent UK electronics retailer who was interested in emerging markets. In 2005, Dixon's signed an option agreement with Eldorado, enabling them to conduct due diligence to gain a better understanding of the Eldorado chain and the Russian market prior to making a 10% investment in 2007. If this investment was made in 2007, Dixon's would have

the option to acquire the remainder of the company for a predetermined price. After due diligence, the Dixon's board concluded that it was "not appropriate to proceed with the investment."

At the time, this sounded like the deal of the decade. However, coupled with Dixon's challenges back in the UK, the due diligence process must have exposed to various deficiencies beyond the good sales figures and locations. In 2007, the deal cratered. Later, the company ended up defaulting to its Czech creditor PPF, which ended up with 50% of the company and lately the remainder. Quite a downfall for such a giant, which in this case, occurred despite the booming economy. Today, Eldorado operates less than 350

stores and trying to merge with its competitor M.Video.

Market conditions become harsher

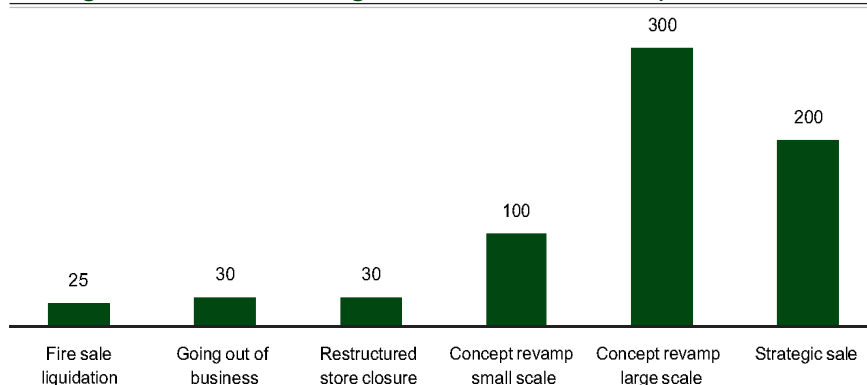
It was quite clear many years ago, after meeting with most all the owners of the sector's big players (mentioned in the text) companies and touring the stores, that some would clearly survive and others had little chance and were doomed. Competition also increased over this period, with new market entrants such as Media Markt and primarily mobile phone retailer Svyaznoy. The crisis of 2008 soon changed all that, and put incredible stress on many of the segment players. Some are doing well, others have survived but are limping, and others have bitten the dust.

Early on, it was clear that M.Video would be a survivor, if not excel, and companies such as Mir, Technosila and Eldorado would face more challenges in the long term. In July of 2004, I was taken around by a key shareholder and top management of M.Video and shown the latest format taken from the best international players/advisors. It was a well-designed merchandised prototype and store, and systems and infrastructure, such as their inventory management one on the floor, one in the back, which is critical in electronics. M.Video worked with foreign consultants who understood the need for infrastructure and proper inventory management and the result was clear. Conversely, when visiting the other chains one would see massive amounts of unorganised inventory in the stores and back rooms. This was partly due to Asian bulk imports, private label, and unofficial or even black products – not to mentioned 122 irons and 137 types of vacuum cleaners – not exactly what one would call proper category management.

In other areas, training was also an issue, at the management level and store level as well. In electronics, it is difficult for a business to spend the capital to teach and train every level of detail and employees should know how to properly sell a product. So hiring techniques and rapid training methods need to be used. I recall going to one of these shops when asked about the differences between the DVD players. The sales clerk looked a bit bewildered and said "I really don't know – just different manufacturers".

During the past few years, many of the large electronics chains, such as M.Video and soon to follow Eldorado, have benefited from

Strategic scenarios – creating value (\$ m) with each option



Source: Retail Solutions, 2012

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Restructuring phases

- I: analysis of situation
- II: protect the assets
- III: stabilise
- IV: develop strategic options
- V: operational review
- VI: rapid action plan
- VII: implementation/results

cooperation with consultants from the West, particularly from Best Buy. This has proven to be successful to some degree for these companies.

Possible scenarios for Technosila (recently offered for sale)

The Technosila brand has been damaged, undoubtedly, from the beginning. The struggles of the past few years have left the company with little value, and a sale today would result in a fire-sale price focused mainly on lease locations. For a logical candidate to come forward, the company needs to embark on a restructuring plan and start to show progress with implementation. Only then will the company become a viable target.

Recent reports established a value between \$200-260m for the 100-store chain. However, this value will be difficult to obtain,

especially with competitors only interested in lease rights – thus values of \$20-30m are rumoured. Technosila needs to truly understand the cash generated from various strategic options and then begin to execute change, in order to support a higher enterprise value. At this stage, it is critical for Technosila to show early indications of longer term potential, if a value above fire-sale is to be achieved.

Chances of Technosila's business recovery

Retail sales are a big part of the Russian economy. Therefore, as the consumer goes, so goes the economy and retailers – in particular those selling mostly non-essential goods, such as

consumer electronics retailers. Fortunately, in 2012, the news and trends related to spending on electronics are almost positive as the macro economy grows, new products are released (iPhone/iPad, etc.)

The recovery is not impossible but it is contingent on a number of factors, the most important being the willingness of management to think outside of the box and to bring on ideas and talent that understands maximising turnaround situations. Other internal and external factors include: development in the Russian and global economies, rate of competition advancements, and new product development. The chain needs to identify its strengths, such as: good locations, brand

recognition, relationships with suppliers, etc. Then they need to begin capitalising on these while aggressively confronting its internal weaknesses. A proper turnaround strategy can be accomplished once the base line is established. However, the starting point needs to be in determining the liquidation value then what programmes can be implemented to show value potential. These might include: 1) customer focused efforts, 2) efficient store operations, 3) test format refits, 4) private label assessment, 5) improved employee morale, 6) test new value added services, 7) leverage existing IT and management reporting systems, and finally to show progress. So the chances of a recovery will largely be dependent on how skilled their efforts are.

Potential interest towards Technosila business

A merger with another company or strategic investor is possible. However, the potential buyer needs to highlight its value beyond a pure breakup value. Timing will be critical and showing operational improvements may generate interest with one of the regional players, such as: Poisk, Sibvez, Rembitekhnika, Beringov, or V-Lazer, the biggest electronics chain based in the Far Eastern Federal District. Such a merger would dramatically increase their buying power, however, at the expense of closing stores, as well as store refits, rebranding, remerchandising, etc. ■

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