

Company Flash

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Shoppers Stop (SHOP.BO)

Sell: 4QFY07- Lower Than Expected

- Loss in 4Q07** – While Shoppers Stop's 4Q sales growth of 37% was ahead of our expectations (30% growth), its profitability was a negative surprise. Shoppers Stop reported a loss of Rs22.7m vs. our expectation of a 32% YoY growth in 4Q07 (4Q06 profit was Rs73.7m).
- Higher depreciation and tax rate led to loss** – The Rs22.7m loss was primarily on account of: (1) a 73bp decline in EBITDA margins due to higher staff costs and selling & distribution expenses; (2) higher depreciation costs, which rose by 300%+. SHOP has reviewed its assets and revised its depreciation rates (added Rs100m to 4Q's depreciation); and (3) higher tax provisioning of Rs49m.
- Operating parameters strong** – Despite the poor profitability in 4Q, key operating metrics exhibited good growth – sales per sq ft were up by 16% to Rs2,120, like-to-like sales growth was up 18%, customer footfalls increased by 15%, transaction size was up 15%, and average ASP was up by 9%.
- Maintain Sell/Medium Risk (3M)** – While we like the Shoppers Stop's growth story, valuation at 50x FY08E P/E is steep, in our view, and seems to be building unfeasible expectations from HyperCity, in which Shoppers has a 19% stake (and an option to take it to 51% by Dec 2008). We maintain our Sell (3M) rating.

Sell/Medium Risk	3M
Price (30 Apr 07)	Rs695.55
Target price	Rs421.00
Expected share price return	-39.5%
Expected dividend yield	0.3%
Expected total return	-39.2%
Market Cap	Rs23,915M US\$583M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	190	6.93	57.6	100.4	20.1	21.9	0.1
2006A	271	7.88	13.8	88.2	8.9	14.9	0.2
2007E	369	10.74	36.3	64.7	8.0	13.0	0.3
2008E	479	13.94	29.8	49.9	7.1	15.1	0.4
2009E	677	19.68	41.2	35.3	6.2	18.8	0.7

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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4QFY07 Results Analysis

Figure 1. Shoppers Stop 4QFY07 Profit and Loss Summary (Rupees in Millions, Percent)

	4QFY06	4QFY07	% Change
Net Sales/ Inc from operations	1,525.9	2,097.3	37.4
Operating Costs	(1,402.4)	(1,940.4)	38.4
EBITDA	123.5	156.9	27.1
<i>EBITDA Margin (%)</i>	<i>8.1</i>	<i>7.5</i>	<i>-61 bps</i>
Depreciation	(33.0)	(142.6)	332.2
Interest	(6.9)	7.4	(206.5)
Other Income	27.4	5.0	(81.8)
PBT	110.9	26.6	(76.0)
Provision for Tax	(37.3)	(49.3)	32.3
<i>-Tax Rate (%)</i>	<i>33.6</i>	<i>185.4</i>	<i>15181 bps</i>
Net Profit	73.7	(22.7)	(130.8)
<i>Net Profit Margin (%)</i>	<i>4.8</i>	<i>(1.1)</i>	<i>(122.4)</i>

Source: Company

Figure 2. Shoppers Stop 4QFY07 Cost Details (Rupees in Millions, Percent)

	4QFY06	4QFY07	% Change
Inc in inventories	-124.7	-114.38	-8.3
Purchases	1,101.6	1459.46	32.5
Cost of Sales	976.9	1,345.1	37.7
<i>As a % of sales</i>	<i>-64.0</i>	<i>-64.1</i>	<i>-11 bps</i>
Employees cost	116.5	168.35	44.6
<i>As a % of sales</i>	<i>-7.6</i>	<i>-8.0</i>	<i>-40 bps</i>
Operating & Admin Costs	277.1	380.04	37.2
<i>As a % of sales</i>	<i>-18.2</i>	<i>-18.1</i>	<i>4 bps</i>
Selling & Distribution Costs	32.0	46.89	46.5
<i>As a % of sales</i>	<i>-2.1</i>	<i>-2.2</i>	<i>-14 bps</i>

Source: Company

Shoppers Stop Company description

Shoppers Stop is one of India's largest department-store chains. It opened its first store, retail menswear, in 1991. Since then, it has expanded to 22 stores in large Indian cities, retailing apparel and non-apparel products. The company plans to expand its reach from 0.1m sq feet now to almost 2.5m sq ft by FY08E by entering new cities and having 39 stores by FY08E. Its subsidiary, Crossword (which it acquired in FY00), has the largest bookstore chain in India with 26 stores. It is also expanding its presence in other specialty formats through brands such as Home Stop (furniture and home furnishings), Brio (Café), MAC (Cosmetics) and Mother Care (apparel and accessories)

Investment thesis

We rate Shoppers Stop Sell/Medium Risk (3M). Current valuations not only seem to be factoring in growth but are also building in high expectations from a potential 51% stake acquisition in Hypercity. As such, the risk-reward balance seems unfavorable. In addition, Shoppers Stop is likely to have difficulty expanding beyond tier-one cities as it caters to the 'lifestyle' higher-income segment. The department-store segment is the most crowded of India's retail formats, and competes with specialty and single brand stores.

Valuation

We value Shoppers Stop using sum of the parts valuation, factoring in the value its 19% stake in Hypercity. Our sum-of-the-parts valuation returns a target price of Rs421 per share, valuing the parent company at Rs376 and the Hypercity stake at Rs45 per share. We value the parent Shoppers Stop based on 27x FY08E P/E, for a target price of Rs376. Our target multiple is benchmarked against our regional retail universe and Indian market leader Pantaloon. We believe Shoppers Stop could trade at 10% premium to its regional peers given its superior earnings growth profile. We expect two-year EPS CAGR of 36% vs. a 30% CAGR for our Asian retail universe. We assign a 10% valuation discount for Shopper's Stop to our Pantaloon target valuation, due to limited growth opportunities for Shoppers Stop. Its business is confined to the higher-end lifestyle segment, likely to offer fewer growth opportunities. We use P/E as our primary valuation methodology given the fair degree of earnings visibility. Our valuation for Hypercity is based on a 1.2x FY08E sales multiple, benchmarked off our regional peer group average.

Risks

We assign a Medium Risk rating to Shoppers Stop based on our quantitative risk-rating system. Key upside risks to our target price and estimates include: 1) better-than-expected margins; 2) better-than-expected sales growth; 3) any potential acquisitions, including increasing its stake in Hypercity. Key downside risks to our target price include: 1) intensifying competition; 2) execution risks; and 3) increasing competition from global retailers.

Appendix A-1

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Shoppers Stop (SHOP.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since August 18 2005)



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