



Pantaloon Retail

STOCK INFO.	BLOOMBERG
BSE SENSEX: 19,243	PF IN
	REUTERS CODE
S&P CNX: 5,702	PART.BO

26 October 2007

Buy

Previous Recommendation: Buy

Rs608

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	151.0	06/07A	32,367	611	4.2	-12.8	146.0	7.4	5.0	7.0	3.0	45.5
52-Week Range	625/359	06/08E	55,889	1,119	7.6	83.2	79.7	6.8	8.5	9.9	1.8	28.8
1,6,12 Rel. Perf. (%)	-1/9/17	06/09E	86,065	1,874	12.4	63.0	48.9	5.5	11.2	12.1	1.2	19.7
M.Cap. (Rs b)	91.8											
M.Cap. (US\$ b)	2.3											

- Pantaloon Retail's 1QFY08 results were above expectations with adjusted PAT increasing 83.6% to Rs297m, primarily due to benefits of operating leverage. Net sales at Rs10.8b were lower than our estimates of Rs11.8b. Gross margin declined 260bp from 34.1% to 31.5%, far better than 550bp decline reported in 4QFY08. Strong performance from fashion segment resulted in QoQ increase in margins. The company has undertaken quality improvement in fashion format with 10-12% price increase, which has gone down well with the consumers.
- EBITDA margin increased 200bp due to leverage benefit in staff cost and overheads, which declined 470bp YoY and 100bp QoQ. The company added 0.8msf during the quarter and expects to add another 1.2msf in 2QFY08. Interest burden has increased 200% for 1QFY08 to Rs352m, an increase of 5% on QoQ basis. Our estimates factor in interest burden of Rs1.27b in FY08, up from Rs898m in FY07.
- Management has guided for incorporating change in inventory valuation in the coming quarter which should address concerns regarding the inventory. Strong momentum in stores opening would increase overhead costs in the coming quarters. Management expects the company to end FY08 with 11msf of retail space as against 5.5msf in FY07. Future Generali Insurance has started operations while Future Capital is expected to hit the markets with an IPO in December, which should unlock value for the shareholders.
- We expect gross margins to improve on a sequential basis, although we expect the EBITDA margin to remain soft. The stock trades at 30.8x FY09E earnings (excluding the value of subsidiaries). Maintain **Buy**.

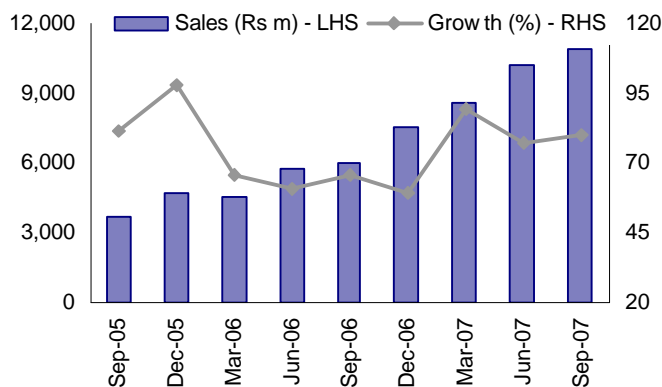
QUARTERLY PERFORMANCE										(Rs Million)	
Y/E JUNE	FY07				FY08				FY07	FY08E	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			
Net Sales	6,034	7,527	8,610	10,196	10,864	13,400	14,200	17,425	32,367	55,889	
YoY Change (%)	65.4	59.5	89.1	77.3	80.1	78.0	64.9	70.9	73.3	72.7	
Total Exp	5,618	6,957	8,008	9,629	9,908	12,510	13,350	16,582	30,211	52,350	
EBITDA	415	570	603	568	956	890	850	843	2,156	3,539	
Margins (%)	6.9	7.6	7.0	5.6	8.8	6.6	6.0	4.8	6.7	6.3	
Depreciation	67	82	93	126	153	145	150	137	369	585	
Interest	125	207	229	337	352	335	325	312	898	1,323	
Other Income	17	5	9	0	7	15	15	27	32	64	
PBT	241	286	290	105	459	425	390	421	921	1,695	
Tax	79	94	103	36	162	142	170	102	311	576	
Rate (%)	32.7	33.0	35.5	34.0	35.3	33.4	43.6	24.2	33.7	34.0	
Adjusted PAT	162	191	187	69	297	283	220	319	611	1,119	
YoY Change (%)	19.6	3.1	15.3	-56.2	82.9	47.8	17.6	360.0	-4.8	83.2	
Exceptional Income	224	249	0	117	0	0	0	0	589	13	
Repoorted PAT	386	440	187	187	297	283	220	319	1,200	1,132	

E: MOST Estimates

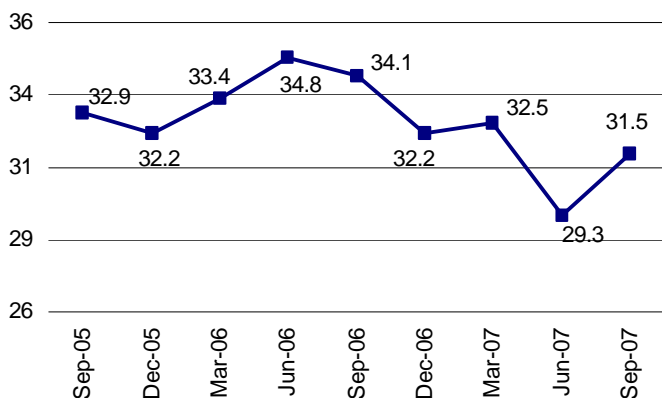
Product realignment improves gross margin

Pantaloon’s 1QFY08 revenue grew 80% YoY to Rs10.8b, although short of our estimates of Rs11.8b. Lifestyle retailing accounted for 27.6% of sales in comparison to 23.7% in 4QFY07. Value retailing accounted for 66.3% of sales. Sales mix shifted in favor of higher margin lifestyle retailing which was instrumental in increasing the gross margin by 220bp QoQ, although it declined 260bp YoY. In addition, the company undertook 10-12% price increase along with substantial improvement in quality across fashion retailing in both the Pantaloons and Big Bazaar formats which has contributed to increase in margins. This quality improvement has gone down well with the consumers and the future outlook continues to be encouraging. We expect gross margins to soften in the coming quarters on YoY basis due to rising sales of Big Bazaar, Food Bazaar and electronics. Our FY08 gross margin estimates are 30.2% in comparison to 31.5% achieved during 1QFY08.

QUARTERLY SALES TREND

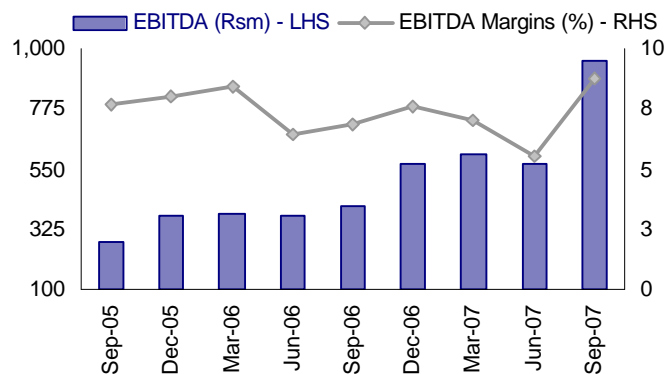


QUARTERLY GROSS MARGIN TREND



Source: Company/Motilal Oswal Securities

QUARTERLY EBITDA MARGIN TREND



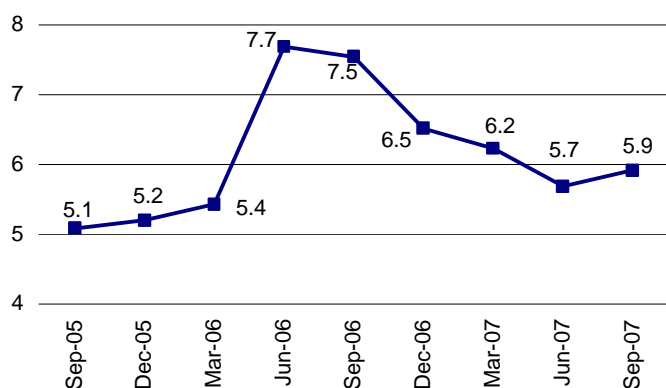
Source: Company/Motilal Oswal Securities

Store openings to accelerate; overheads likely to increase

Pantaloon added 0.8msf of retail space during 1QFY08 v/s 2.5msf for FY07. The company plans to add 1.2msf in the coming quarter. Management expects to end the current year with retail space of 11msf. Sharp increase in retail space will provide economies of scale in sourcing and distribution.

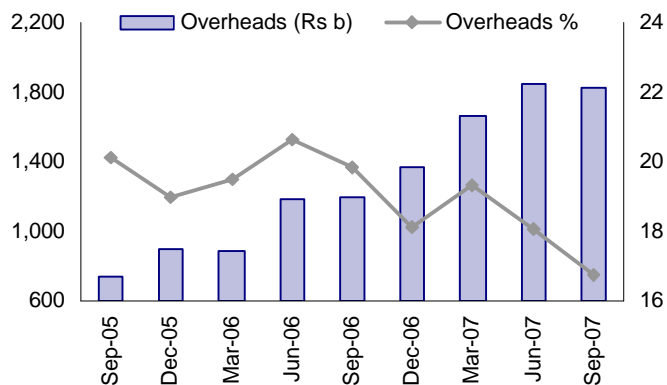
Staff costs as a % of sales have increased during 1QFY08 after showing a decline in the last four quarters. Overheads during the quarter decline by 130bp QoQ. Overheads as a percentage of sales have been declining from the last two quarters. 1QFY08 overheads have declined in absolute numbers, a trend which we believe will change in the coming quarter. We estimate 70bp and 40bp decline in overheads as a percentage of sales in FY08 and FY09 respectively.

QUARTERLY TREND IN STAFF COST



Source: Company/Motilal Oswal Securities

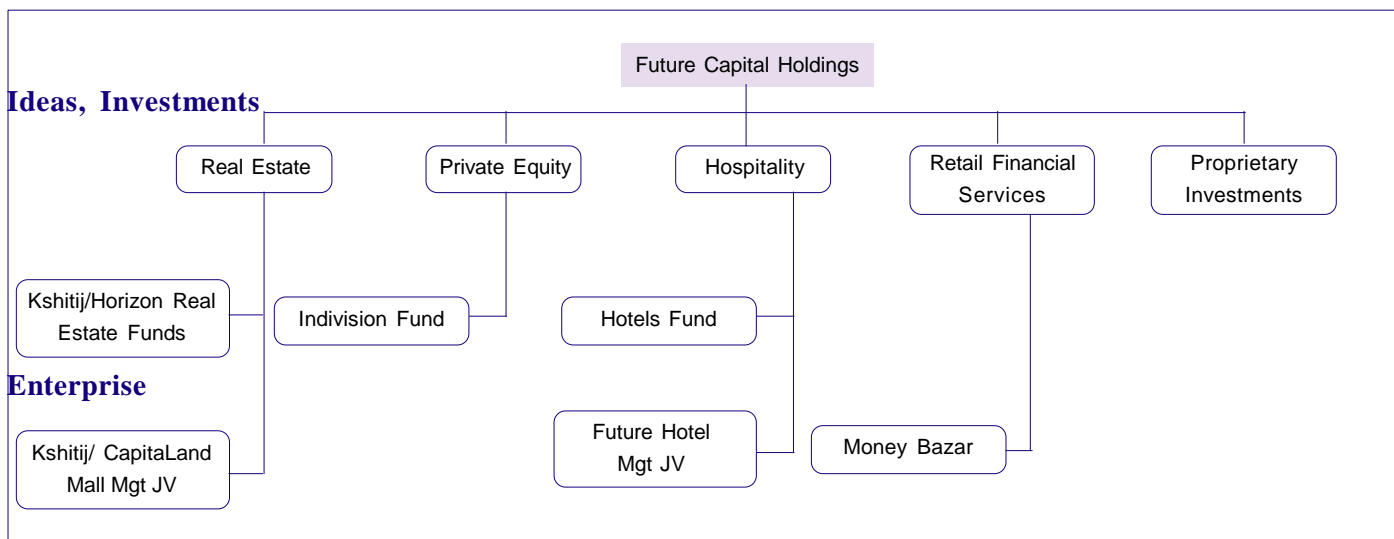
OVERHEADS EXPECTED TO RISE



Source: Company/Motilal Oswal Securities

Future Capital's listing to unlock value

Pantaloon Retail currently holds 74% stake in Future Capital. This company currently manages more than \$1b under various funds. The company has Kshitij (Rs3.5b domestic real estate fund), Horizon (\$350m offshore real estate fund), Indivision (\$450m domestic private equity fund), and \$200m Hotels fund. In addition, it plans to have one logistics and another venture capital fund which will increase the corpus to more than \$2b. The company earns 2% management fee and 20% profit share above the hurdle rate of 8%. While Kshitij has been deployed, Horizon and Indivision fund have been deployed to the extent of 65% and 35% respectively. We estimate 20% return CAGR in private equity fund and 15% in rest of the funds on a conservative basis. Our estimates don't factor in benefits of leverage in these funds as these are yet to be fully deployed.



VALUATION OF AMC		YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9
Income From AMC	Corpus									
Kshitij	INR 3,500m	35	35	35	35	35	157	173	191	-
Horizon	US\$350m	140	140	140	140	140	630	692	762	-
Indivision	US\$400m	180	180	180	180	180	1,573	1,931	2,373	-
Hotels	US\$200m	-	120	120	120	120	120	120	540	593
Logistics	US\$500m	-	-	200	200	200	200	200	200	900
Venture Fund	US\$600m	-	-	240	240	240	240	240	240	1,080
Discounted Value	10,290									
PIL Share Post IPO (%)	67									
	6,894									
Per Share Value	40									

Source: Motilal Oswal Securities

Future Capital's financing arm Future Money is into retail consumer financing. The company is currently financing the durables purchased at its stores. The number of locations is expected to increase from 75 currently to 150 by FY08, which would include 30 independent branches. The company plans to expand its area of operations from consumer financing to investments in future which can provide a lot of fee-based income. The company aims to attain a loan book of US\$2b by FY10 with a profit margin of 4%.

We estimate the value of Future Capital at Rs94 per share of Pantaloon Retail (asset management business at Rs40 per share and Future Money at Rs54 per share) assuming 10% dilution in the proposed equity issue of Future Capital. Future Capital has already filed for DRHP and the company is likely to enter the capital markets in December 2007.

Valuation and view

Management has guided for incorporating change in inventory valuation in the coming quarter which should address concerns regarding the inventory. Strong momentum in stores opening would increase overhead costs in the coming quarters. Management expects the company to end FY08 with 11msf of retail space as against 5.5msf in FY07. Future Generali Insurance has started operations while Future Capital is expected to hit the markets with an IPO in December, which should unlock value for the shareholders.

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Pantaloon Retail: an investment profile

Company description

Pantaloon Retail is the largest organized retailer in India with a retail space of more than 2m square feet under its belt. Pantaloon retails multiple categories through different format offerings like departmental stores (Pantaloon), hypermarkets (Big Bazaar), seamless mall (Central) and standalone stores. The company is targeting revenues of US\$2b in FY09, a 68% CAGR over FY05-09.

Key investment arguments

- ✍ Pantaloon is the best play on organized retail play and is planning to increase retail space under its coverage from 5.5m sq ft to more than 11m sq ft by FY08
- ✍ The company is in the process of unlocking value from listing of shares in Future Capital and Future Ventures. It has already sold minority stakes in Home Solutions and Future Bazaar. We estimate the value of its investments at Rs224 per share.

Key investment risks

- ✍ Pantaloon has an aggressive expansion plan where a timely and profitable execution is a critical issue.
- ✍ Pantaloon has a aggressive inventory valuation practice where in-store inventory at 'retail price less mark-up' as opposed to the usual 'lower of cost or market price'.

COMPARATIVE VALUATIONS

		PANTALOOON	SHOPPERS	TITAN
P/E (x)	FY08E	79.7	40.1	47.0
	FY09E	48.9	28.8	31.5
EV/EBITDA (x)	FY08E	28.8	17.8	27.0
	FY09E	19.7	13.2	19.2
EV/Sales (x)	FY08E	1.8	1.4	2.6
	FY09E	1.2	1.1	2.0
P/BV (x)	FY08E	6.8	5.3	21.9
	FY09E	5.5	4.8	11.4

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	43.5	44.7	44.2
Domestic Inst	12.3	11.8	6.6
Foreign	25.3	26.1	28.6
Others	18.9	17.4	20.6

Recent developments

- ✍ Planning IPO of Future Capital (74% Subsidiary) and Rs20b fund raising plan under Future ventures. Sold 25% stake in Future ventures at a valuation of US\$80m.
- ✍ Entered the personal wash segment with the launch of its new Vatika – Honey & Saffron Soap. Added 1.5sq ft of retail space in the sept. quarter and its subsidiary Future Generali Insurance gets certificate of commencement of operations.

Valuation and view

- ✍ We have EPS forecasts of Rs7.6 for FY08E and Rs12.4 for FY09E.
- ✍ We value the stock at Rs624 based on SOTP. We maintain **Buy**.

Sector view

- ✍ We are positive on the sector. We expect the sector to clock a revenue growth of 30-35% CAGR over the next five years.
- ✍ Players like Pantaloon Retail with a strong hypermarket format and presence in larger number of categories are likely to be bigger winners.
- ✍ Longer term prospects bright, given rising incomes and low penetration.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	7.6	9.7	-21.1
FY09	12.4	13.6	-8.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
608	624	2.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E JUNE	2005	2006	2007E	2008E	2009E	
Net Sales	10,528	18,678	32,367	55,889	86,065	
Change (%)	63.6	77.4	73.3	72.7	54.0	
Total Expenditure	-9,619	-17,257	-30,211	-52,350	-80,814	
EBITDA	909	1,420	2,156	3,539	5,251	
Change (%)	65.1	56.3	51.8	64.1	48.4	
Margin (%)	8.6	7.6	6.7	6.3	6.1	
Depreciation	-133	-208	-369	-585	-786	
Int. and Fin. Charges	-275	-335	-898	-1,323	-1,721	
Other Income - Recurring	31	42	32	64	66	
Profit before Taxes	531	919	921	1,695	2,810	
Change (%)	117.6	73.0	0.3	84.0	65.7	
Margin (%)	5.0	4.9	2.8	3.0	3.3	
Tax	-145	-277	-311	-576	-936	
Tax Rate (%)	-27.4	-30.2	-33.7	-34.0	-33.3	
Profit after Taxes	386	642	611	1,119	1,874	
Change (%)	94.3	66.3	-4.8	83.2	67.5	
Margin (%)	3.7	3.4	1.9	2.0	2.2	
Extraordinary Items	13	12	589	13	14	
Reported PAT	399	653	1,200	1,132	1,888	

BALANCE SHEET		(RS MILLION)				
Y/E JUNE	2005	2006	2007E	2008E	2009E	
Share Capital	220	269	293	293	301	
Reserves	1,995	5,000	11,818	12,803	16,463	
Net Worth	2,215	5,269	12,111	13,097	16,764	
Loans	2,862	6,014	13,207	16,311	19,105	
Deferred Tax	130	279	587	933	1,494	
Capital Employed	5,208	11,562	25,906	30,341	37,364	
Gross Block	2,511	3,660	5,906	8,180	10,769	
Less: Accum. Deprn.	-374	-566	-963	-1,547	-2,334	
Net Fixed Assets	2,137	3,094	4,943	6,633	8,435	
Capital WIP	158	861	1,463	2,048	2,663	
Investments	319	1,406	5,503	5,803	5,803	
Curr. Assets, L&A	4,039	8,824	18,397	23,139	31,569	
Inventory	2,759	5,070	8,681	13,174	17,796	
Account Receivables	123	170	300	512	794	
Cash and Bank Balance	215	218	1,370	512	1,560	
Others	941	3,366	8,047	8,941	11,420	
Curr. Liab. and Prov.	1,448	2,623	4,403	7,283	11,107	
Other Liabilities	1,271	2,298	3,906	6,673	10,137	
Provisions	177	325	496	611	969	
Net Current Assets	2,591	6,201	13,994	15,855	20,462	
Miscellaneous Expenditure	3	0	2	1	0	
Application of Funds	5,208	11,562	25,906	30,341	37,364	

E: MOST Estimates

RATIOS						
Y/E JUNE	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	3.5	4.8	4.2	7.6	12.4	
Cash EPS	4.7	6.3	6.7	11.6	17.6	
BV/Share	20.1	39.2	82.5	89.2	111.2	
DPS	2.5	0.5	0.6	0.8	1.2	
Payout %	71.3	10.5	14.4	10.5	9.7	
Valuation (x)						
P/E		127.3	146.0	79.7	48.9	
Cash P/E		96.1	91.1	52.4	34.4	
EV/Sales		5.1	3.0	1.8	1.2	
EV/EBITDA		67.7	45.5	28.8	19.7	
P/BV		15.5	7.4	6.8	5.5	
Dividend Yield (%)		0.0	0.0	0.0	0.1	
Return Ratios (%)						
RoE	17.4	12.2	5.0	8.5	11.2	
RoCE	15.5	10.8	7.0	9.9	12.1	
Working Capital Ratios						
Debtor (Days)	4	3	3	3	3	
Asset Turnover (x)	2.0	1.6	1.2	1.8	2.3	
Leverage Ratio						
Debt/Equity (x)	13	11	1.1	1.2	1.1	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E JUNE	2005	2006	2007E	2008E	2009E	
OP/(loss) before Tax	775	1,212	1,787	2,954	4,465	
Int./Div. Received	31	42	32	64	66	
Depreciation and Amort.	133	208	369	585	786	
Interest Paid	-275	-335	-898	-1,323	-1,721	
Direct Taxes Paid	-145	-277	-311	-576	-936	
(Incr)/Decr in WC	-948	-3,608	-6,642	-2,719	-3,559	
CF from Operations	-429	-2,758	-5,662	-1,015	-899	
Extraordinary Items	13	12	609	13	14	
(Incr)/Decr in FA	-677	-1,852	-2,848	-2,859	-3,203	
(Pur)/Sale of Investments	-267	-1,087	-4,097	-300	0	
CF from Invest.	-931	-2,927	-6,336	-3,146	-3,190	
Issue of Shares	944	2,519	5,813	0	2,000	
(Incr)/Decr in Debt	501	3,152	7,193	3,104	2,794	
Dividend Paid	-63	-77	-100	-134	-206	
Others	55	94	244	334	549	
CF from Fin. Activity	1,437	5,688	13,150	3,304	5,137	
Incr/Decr of Cash	77	3	1,152	-857	1,048	
Add: Opening Balance	138	215	218	1,370	512	
Closing Balance	215	218	1,370	512	1,560	

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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