

Pantaloon Retail

Rs400
OUTPERFORMER**RESULT NOTE**

Mkt Cap: Rs56bn; US\$1.3bn

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Result: Q3FY07

Comment: Ramp up blues!

Key valuation metrics

Year end Jun 30	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E	PER (x)
FY05	10,840	64.7	386	3.5	75.6	53.8	113.8
FY06	19,608	80.9	642	4.8	36.5	38.9	83.4
FY07E	32,554	66.0	1,290	9.2	91.9	27.2	43.5
FY08E	55,220	69.6	1,399	10.0	8.5	17.5	40.1
FY09E	80,474	45.7	2,123	15.1	51.7	13.1	26.4

Pantaloon Retail (PRIL) has reported sharp revenue growth of 89% in Q3FY07 at Rs8.6bn with value retailing growing at 87% and lifestyle retailing at 90%. PRIL added 800,000 sq. ft. of retail space in Q3FY07. As PRIL continues to be in high ramp up mode, builds up logistics (3.7m sq. ft. of warehousing) as also competitive intensity increases, operating costs have increased by 93% and EBITDA margins have shrunk by 150bp. This coupled with higher interest costs have restricted PAT growth at 15% in Q3FY07 at Rs187m.

Competitive intensity in the retail industry is intensifying, with entry of heavyweights like Reliance, A V Birla Group and Bharti-Walmart.. Well geared for it and knowing the need to scale up at a rapid pace, PRIL has plans to reach 10m sq. ft. of retail space by FY08 and 17m by FY09. PRIL currently operates across 4.8m sq. ft. of retail space. PRIL has 31 Pantaloons, 49 Big Bazaars, 76 Food Bazaars, 1 Hometown and various other specialty stores under operation. We continue to like PRIL's aggressive ramp up plans and willingness to experiment will multiple formats and segments. We are confident of PRIL's standalone revenues growing at 60% CAGR over FY06-09, besides another Rs13bn of revenues from Home Solutions business in FY09. We also see value being created, as PRIL capitalizes its various subsidiaries – Future Capital, Future Media, etc and unlocks value. We maintain our Outperformer call on Pantaloon Retail.

HIGHLIGHTS OF Q3FY07 RESULTS**□ Stays on high growth trajectory**

PRIL has reported sharp sales growth at 89% in Q3FY07 at Rs8.6bn, with value retailing growing at 87% and lifestyle retailing at 90%. Besides rapid expansion, PRIL's same store growth during the year has been at over 20%. PRIL maintains its high pace expansion and spreads across 4.8m sq. ft. of retail space. PRIL has 31 Pantaloons, 49 Big Bazaars and 76 Food Bazaars under operation, besides various specialty stores like Fashion Station, aLL, Collection I, E-Zone, Brand Factory, Show Factory, etc. We expect PRIL to continue to stay on high growth path as it adds incremental 8m of retail space by FY09.

❑ Margins decline – as anticipated

PRIL's EBITDA margins have declined by 150bp in Q3FY07 at 7% as PRIL has rapidly ramped up the operations, many of which are in early days of operations. Material cost has shot up from 66.6% in Q3FY06 to 67.5% in Q3FY07. Intensifying competition and rapid expansion has resulted in sharp increase in staff cost (up by 118%) and other expenditure (up by 87%). PRIL has also incurred substantial capex towards warehousing and has created 3.7m sq. ft. of warehousing facility, which will largely suffice to service its 10m sq. ft. of retail operations. Margins in value retailing have shrunk by 30bp at 7.5%, while in lifestyle retailing has shrunk by 140bp (at 11.6%). PAT growth has been restricted to 15% in Q3FY07, as interest cost has moved up by 127% at Rs228m. We believe that margins will continue to remain under pressure for the next few quarters, as PRIL keeps up the pace of growth. We also see likelihood of PRIL accounting for one time loss on inventory revaluations in FY07.

❑ Home Solutions – safely at home

PRIL's much awaited mother outlet under home solutions segment – Hometown, has begun its operations in Noida. Hometown is spread over 125,000 sq. ft. of retail space and caters to every need of home solutions – furniture, soft furnishing as also services. Besides strong retail offtake, we expect substantial revenues coming through the route of institutional sales to developers like Unitech, Prestige, etc. Other formats that PRIL has under this SBU are Collection I, E-Zone and Electronic Bazaar. We expect home solutions business to reach a revenue base of Rs13bn by FY09 (not a part of standalone numbers). We estimate home solutions business to be incurring losses to the tune of Rs300m in FY07. Competition is intensifying in the home décor and solution space - in electronic items (Videocon's *Next* and Tata-Woolworth's *Croma*), home solutions (Nilkamal's *@home*)

❑ Increasing competitive intensity – PRIL catching right nerves

Competition is intensifying in the retail space with Reliance stepping up its expansion plans, Bharti Enterprise entering into tie-up with Walmart and A V Birla firming up its retail foray, besides rapid expansion plans of existing players like Shopper's Stop and Subhiksha. We believe that PRIL has sensed this well and is addressing the critical issues – rapid ramp up, real estate tie – up and experimenting with multiple formats and segments. PRIL will have 17m sq. ft. of retail space under operations by FY09 and reach out to over 70% of the consumer spending pie. PRIL is also beefing up its logistics and back end tie up (through Indivision Fund). PRIL is ensuring adequate retail space availability through 51 property development under its real estate funds – Kshitij and Horizon. What impresses us the most about PRIL is the pace of execution and appetite to take risk of experimenting with model. We believe that prior to competition heating up, PRIL will be potent competitive force or best acquisition target.

❑ High growth traction - Maintain Outperformer

As PRIL continues to stay on high growth path, we are confident of PRIL's revenues growing at 60% CAGR over FY06-09. While currently stock trades at rich valuations of 26x FY09 earnings, it builds in potential value unlocking from PRIL's various subsidiaries – Future Capital, Future Media, etc. Impressed with PRIL's speed of execution, willingness to experiment and risk taking appetite, we maintain our Outperformer call on PRIL.

Quarterly results

(Rs Mn)	Q3FY06	Q4FY06	FY06E	Q1FY07	Q2FY07	Q3FY07	FY07E	FY08E	FY08E
Net Sales	4,554	5,752	19,608	6,033	7,527	8,610	32,554	55,220	80,474
% yoy	65.6	55.6	80.9	65.4	59.5	89.1	66.0	69.6	45.7
EBITDA	385.0	372.8	1,421	415.1	570.2	602.8	2,284	3,780	5,272
EBITDA (%)	8.5	6.5	7.2	6.9	7.6	7.0	7.0	6.8	6.6
Net interest	100.7	98.0	335	124.6	207.2	228.8	737	1194	1366
Depreciation	58.6	66.0	208	66.9	82.3	93.2	349	575	829
Other Income	4.6	29.7	42	355.5	377.7	9.4	787	77	92
Profit before Tax	230.3	238.5	919.8	579.0	658.4	290.2	1984.8	2088.5	3168.2
Tax	67.9	79.5	277	192.9	218.5	102.8	695	689	1046
Profit After Tax	162.4	159.0	642.4	386.1	439.8	187.4	1290.1	1399.3	2122.7
% yoy	52.0	47.4	66.6	185.6	137.0	15.4	100.8	8.5	51.7

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