



Pantaloon Retail

STOCK INFO.	BLOOMBERG
BSE SENSEX: 17,151	PF IN
	REUTERS CODE
S&P CNX: 5,001	PART.BO

27 September 2007

Buy

Previous Recommendation: Buy

Rs525

		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)	146.7	06/07A	32,367	611	4.2	-12.8	126.2	6.4	5.0	7.0	2.6	38.7
52-Week Range	580/344	06/08E	55,889	1,132	7.6	83.2	68.9	5.9	8.5	9.9	1.6	24.6
1,6,12 Rel. Perf. (%)	-6/-2/4	06/09E	86,065	1,888	12.4	63.0	42.3	4.7	11.2	12.1	1.0	16.9
M.Cap. (Rs b)	77.1											
M.Cap. (US\$ b)	1.9											

- ✦ Pantaloon Retail's 4QFY07 results were below expectations. Adjusted PAT declined 56.2% to Rs69m, primarily due to 320bp QoQ decline in gross margin and higher interest burden. Staff cost and overheads declined 200bp and 250bp, respectively, thus cushioning the decline in EBITDA margin at 90bp.
- ✦ The company posted net sales of Rs10.2b against our estimate of Rs10.8b. Gross margin took a beating due to realigning of store formats, lower markdowns and organizational changes.
- ✦ Staff costs as a percentage of sales are unlikely to increase significantly as store openings have accelerated (1.5m square feet in the last three months). The company expects to end FY08 with 11m square feet of retail space as against 5.5m square feet in FY07.
- ✦ Interest burden increased 246% for 4QFY07 and 168% for FY07 due to increase in real estate deposits and investment in subsidiaries. We expect it to increase to Rs1.3b in FY08 from Rs89.8m in FY07, although the pace of increase could decline.
- ✦ The company has divested 25% stake in Future Bazaar (online shopping portal) for US\$20m, which has resulted in a profit of Rs177m. We value 67% stake in Future Capital (post IPO) at Rs94 per share (post dilution of 10% stake).
- ✦ We expect gross margins to decline 150bp in FY08E and 60bp in FY09E, while EBITDA margins are likely to decline 40bp in FY08E and 20bp in FY09E due to lower increase in overheads. We are reducing our adjusted PAT estimates from Rs1.28b to Rs1.1b for FY08E and from Rs1.96b to Rs1.9b for FY09E. We value the stock at Rs624 based on SOTP. The stock trades at 25x FY09E earnings (excluding the value of subsidiaries). We maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

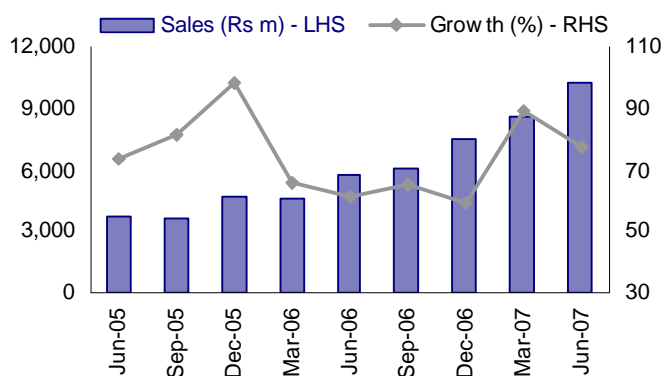
Y/E JUNE	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	3,648	4,720	4,554	5,752	6,034	7,527	8,610	10,196	18,678	32,367
YoY Change (%)	81.4	81.4	98.0	65.6	65.4	59.5	89.1	77.3	77.4	73.3
Total Exp	3,368	4,341	4,169	5,379	5,618	6,957	8,008	9,629	17,257	30,211
EBITDA	280	379	385	373	415	570	603	568	1,420	2,156
Margins (%)	7.7	8.0	8.5	6.5	6.9	7.6	7.0	5.6	7.6	6.7
Depreciation	38	46	59	66	67	82	93	126	208	369
Interest	57	79	101	98	125	207	229	337	335	898
Other Income	7	4	5	30	17	5	9	0	42	32
PBT	192	258	230	239	241	286	290	105	919	921
Tax	57	72	68	80	79	94	103	36	277	311
Rate (%)	29.7	28.0	29.5	33.6	32.7	33.0	35.5	34.0	30.2	33.7
Adjusted PAT	135	186	162	158	162	191	187	69	642	611
YoY Change (%)	95.0	83.0	52.0	43.5	19.6	3.1	15.3	-56.2	65.4	-4.8
Exceptional Income	0	0	0	0	224	249	0	117	0	589
Reported PAT	135	186	162	158	386	440	187	187	642	1,200

E: MOST Estimates

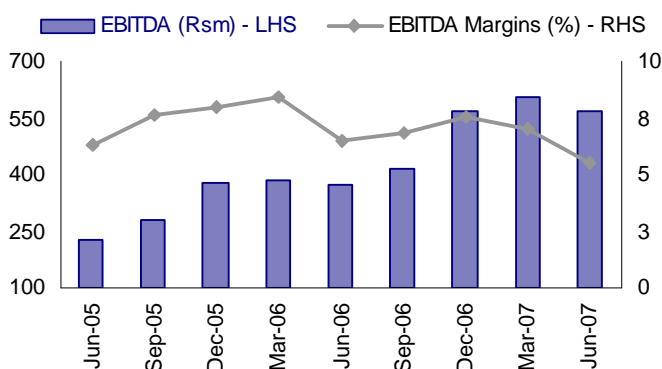
Poor same store sales, business realignment depress margins

Pantaloon’s 4QFY07 revenues grew 77.3% YoY to Rs10.2b, although short of our estimate of Rs10.8b. Lifestyle retailing accounted for 23.7% of sales in comparison to 27.2% in 4QFY07. Poor sales mix resulted in 550bp decline in gross margin for 4QFY07. Rising proportion of value retailing sales due to sharp ramp up in Food Bazaar and Big Bazaar formats and verticals such as electronics impacted margins. The company undertook business realignment to have clear focus on profits and SBUs. This resulted in adjustments in some formats and lower markups, which depressed the margins.

QUARTERLY SALES TREND



QUARTERLY EBITDA MARGIN TREND



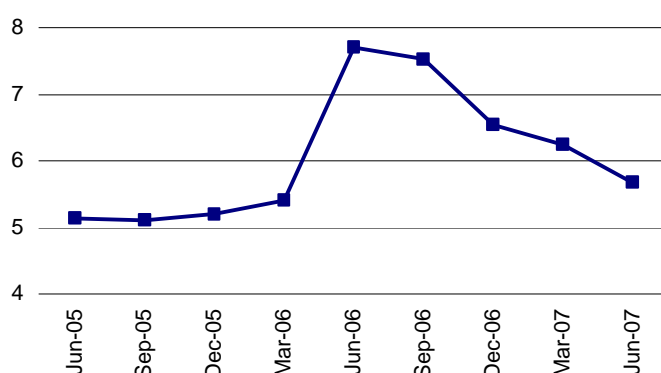
Source: Company/Motilal Oswal Securities

Management expects the benefits of re-alignment to start reflecting from 1QFY08, with an improvement in gross margin on a sequential basis. We expect gross margin to decline 150bp in FY08E and 60bp in FY09E due to rising sales of grocery and electronics. Our FY08E gross margin estimate is 30.2% – 190bp higher than the gross margin for 4QFY07.

Lease rentals to remain high; overheads to decline

Lease rentals continued to hurt the company, as the service tax impact was reflected in 4QFY07. We expect the impact to be nearly 5% due to partial absorption by the developers (they can avail of modvat benefits). In addition, the deposits on real estate have increased from 1-2 months of rent to 5-6 months of rent, which impacted interest outflow. We expect EBITDA margin to decline just 40bp in FY08E and 20bp in FY09E despite gross margin declining 150bp in FY08E and 60bp in FY09E, as we expect overheads to decline as a percentage of sales due to higher utilization of resources.

QUARTERLY TREND IN STAFF COST AS A PERCENTAGE OF SALES



Source: Company/Motilal Oswal Securities

Store openings to accelerate; competition to keep check on gross margin

Pantaloon added 0.7m square feet of retail space during 4QFY07 and 2.5m square feet during FY07. Store openings are accelerating and the company has added 1.5m square feet of retail space in 1QFY08. The management expects to end FY08E with retail space of 11m square feet. The sharp increase in retail space will provide economies of scale in sourcing and distribution. We expect competition to increase in the coming quarters from players like Reliance, Subhiksha, Spencer’s and Bharti. Despite economies of scale, we expect gross margin to decline 150bp in FY08E and 60bp in FY09E, partly led by rising sales of value retailing formats. We expect EBITDA margin to decline 40bp in FY08E and 20bp in FY09E, as lower overheads will cushion margin decline. We expect gross

margin to stabilize at 29-30% and EBITDA margin to stabilize at 6-6.2% over time.

Future Capital’s listing to unlock value

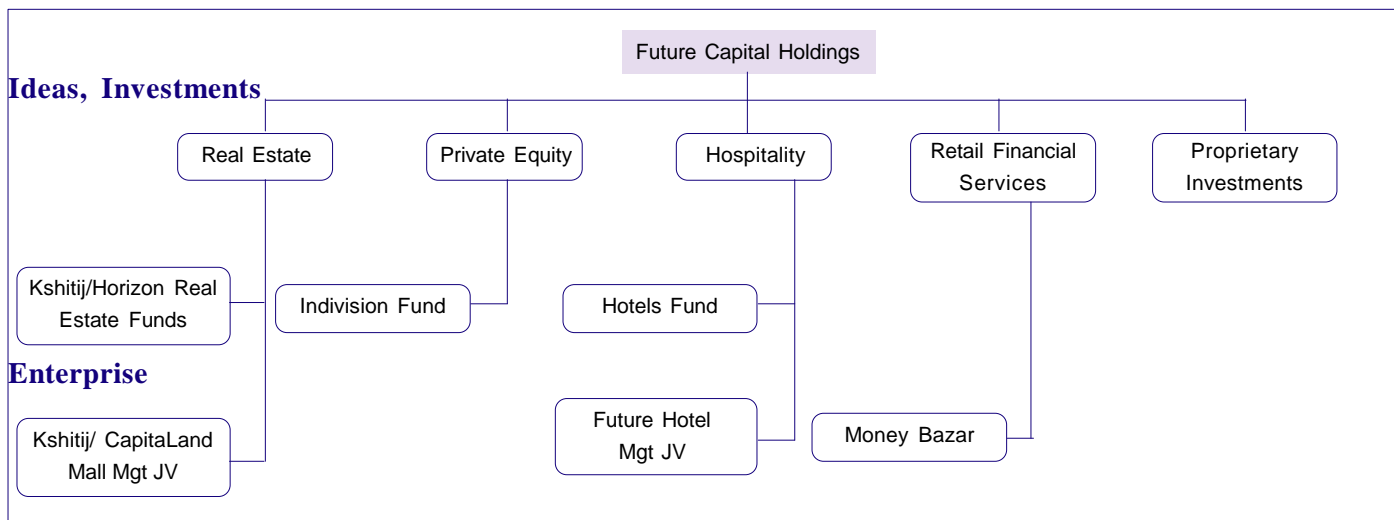
Pantaloon Retail currently holds 74% stake in Future Capital, which manages over US\$1b under various funds. Future Capital has Kshitij (Rs3.5b domestic real estate fund), Horizon (US\$350m offshore real estate fund), Indivision (US\$450m domestic private equity fund), and a US\$200m hotels fund. It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

Future Capital’s financing arm, Future Money is in retail consumer financing. The company currently finances the durables sold in Pantaloon’s stores. The number of locations is expected to increase from 75 currently to 150 by FY08E, which would include 30 independent branches. The company plans to expand its area of operations from consumer financing to investments, which can provide considerable fee 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.

Home Solutions Retail – fast ramp up likely

Pantaloon’s Home Solutions Retail operates stores under formats such as E Zone, Electronics Bazaar, Collection I, Furniture Bazaar and Home Town. The formats such as Electronics Bazaar and Furniture Bazaar are aimed at mass-



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

market consumers while E Zone and Collection I are targeting up-market consumers. In addition, Home Town has started a concept of large stores (100,000-125,000 square feet per store), which offer building material and all the accessories required in a new house.

The company does not have any competition in this segment except electronics, where there are a number of organized players like Vijay Sales, Viveks and Croma. Sourcing and financing deals is likely to provide significant edge to the company in electronics. Moreover, the company has diversified product portfolio, including higher margin furniture, which will enable it to offer better value to the consumer than a standalone electronics store.

Home Town has evoked good response and the first store at Noida is already close to breakeven. The company has started getting bulk orders from builders and has been awarded a contract for supply of material for 4,000 flats by Unitech and 4,500 flats by Prestige Group. We expect the Home Town concept to do well in the coming years, as the company has been able to tie up with leading builders. We expect the company to increase the number of Home Town stores to 7 in 2008 and 15 by 2009.

Although Home Solutions has early mover advantage and offers to the consumer a one-stop shop for all the home building and furnishing needs, the company is facing execution challenges. Supply of proper quality of bulky material like furniture, financing for products in home building and furnishing, undercutting by the players having shop-in-shops and service are some of the key challenges. Management expects the company to go public in another 2-3 years. Home Solutions had undertaken private placement at a valuation of Rs11b in September 2006. Based on our estimates of FY09, we value 85% stake of the company at Rs98 per share of Pantaloon Retail.

Future Ventures IPO to focus on new investments

Pantaloon Retail has floated another company called Future Ventures, which will have a capital of Rs25b for investment in new ventures. PRIL will hold 30% stake in this entity and has already sought permission to invest upto Rs3.25b

in the share capital of this company. Future Ventures will invest 25% of corpus in creating and managing new joint ventures in the retailing space, which will include tie-ups for opening specialty stores. 75% of the investments will be in private equity, real estate, distress assets and public markets. The company would focus on non-FDI areas like retail, media and insurance in private equity, consumption-linked investment in public markets and real estate with area upto 0.5m square feet. The company will relieve Pantaloon Retail from further investment in new ventures for entering new segments in retail, which will bolster its balance sheet.

Future Brands – encasing private label brands

Pantaloon's garments business is built on strong private label brands like *John Miller*, *Bare*, etc. In addition, the company has created private labels in food, grocery and household products. It has devised an innovative strategy whereby the private labels are being launched under new brands and not the store name of the company.

PRIVATE LABELS AT PANTALOOON OUTLETS

PRIVATE LABELS	PRODUCT CATEGORY/SEGMENT
Fresh & Pure	Refined Oil, Spices, Atta, Ready Mixes, Butter
Tasty Treat	Jam, Ketchup, Noodles, Potato Chips, Papad, Traditional Snacks
Clean Mate	Dishwash Bar, Utensil Cleaner, Glass cleaner Toilet Cleaner, Disposable paper, Green Phenyl Premium Harvest Basmati Rice, Sugar, Dals and Staples
Knighthood	Garments
John Miller	Garments
Ruf & Tuf	Jeans
JM Sports	Garments
Lombard	Garments
Bare	Casuals
Annabelle	Women wear
Akkriti	Traditional women wear

Source: Company/Motilal Oswal Securities

Pantaloon plans to adopt the model of build, own, operate and sell concept in brands. While most of the brands are in the fashion category, the company has created some brands like *Fresh & Pure*, *Tasty Treat*, *Clean Mate* and *Premium Harvest* in foods and grocery. Current sales of private labels are Rs10b; Pantaloon expects this to increase to Rs100b in another 3-4 years. Thereafter, it plans to monetize the brands

by taking them out of these stores or even leasing out the brands for a fee before disposing them off. The strategy looks enticing given the fact that most of the good brands in FMCG and garments space would go for at least 1.5x sales. But the concept of taking the brand national and leasing it is completely new and yet to be tested. We have not assigned any value to Future Brands in our SOTP valuation.

Future Media – OOH & store advertising

Future Media, Pantaloon's 90% subsidiary, will get 30m square feet of Pantaloon's retail space for digital signage and advertising. In addition, it would get about 22m square feet in properties being developed by Kshitij. The company currently has 500 TVs operational in stores and expects the number to increase to 1,500 by next year and 15,000 in another 3-4 years.

The Group has a magazine "My World" which is sent to the "Big Bazaar" customers and is also sold on the shelves. The product has been revamped recently and the company is using the same for advertising its private labels as well as other brands.

The company has tied up with Inox for advertising space at its multiplexes, which will enable advertisers to target select premium-end customers. The trend of OOH advertisements in stores and malls is yet to catch up in a big way in India, but the potential looks good, as the advertiser targets the customers right the point of purchase. The company has placed 10% of its equity with WPP at a valuation of Rs2b, which contributes Rs10 to our SOTP valuation.

Future Generali Insurance – entry into services

Pantaloon Retail holds 58% stake in Future Generali Insurance, a JV with Assicurazioni Generali – the third-largest insurance company in Europe and the largest international insurer in China. The company will enter both general and life insurance verticals, and has obtained certificate of commencement. The insurance foray marks the entry of Future Group in the services business in India. The company plans to launch its first products in the coming

2-3 months. The target customer is the shopper in the malls although Future Money outlets would also be used for selling policies. The insurance business offers huge potential in India, as the penetration is just 3%. The private insurance sector has been growing at 80-100% during the past few years and the growth rates are expected to be 40-50% for the coming few years. Although competition is fast rising in this vertical, a strong partner enthuses confidence. We are factoring in insurance business at the base valuations only.

SOTP valuation indicates 19% upside; maintain Buy

We expect the core business to report higher sales growth, as retail space is increasing at a fast clip (1.5m square feet addition in the past three months). Rising competition and deteriorating sales mix will result in further decline in gross margins (150bp in FY08E and 60bp in FY09E) but lower overheads will cushion EBITDA margin decline at 40bp in FY08E and 20bp in FY09E. We expect the pace of interest burden increase to slow down due to capital infusion of nearly Rs5.8b during the year. The company will go for IPO of Future Capital in a few months, which will unlock value for shareholders. We arrive at a value of Rs624 for Pantaloon Retail based on SOTP at fully diluted equity of Rs342m.

SOTP (PANTALOOON RETAIL) - FY09E

	STAKE	TOTAL VALUE	PRIL SH.	PER SH.
Retailing	100	68,338	68,338	400.0
Home Solutions	85	19,618	16,675	97.6
Future Capital	67	24,143	16,176	94.7
Future Media	90	2,000	1,800	10.5
Future Bazaar	75	3,200	2,400	14.0
Future Generali Life	58	1,000	580	3.4
Future Generali General	58	1,000	580	3.4
			106,549	624.0

Source: Motilal Oswal Securities

We are downgrading our adjusted EPS estimates from Rs9 to Rs7.6 for FY08E and from Rs13.9 to Rs12.4 for FY09E. We expect the valuation premium to sustain, given the value being created in various subsidiaries and ventures. Excluding the value of subsidiaries, the stock trades at 25x FY09E earnings. We maintain **Buy**.

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	68.9	44.7	40.3
	FY09E	42.3	32.1	27.0
EV/EBITDA (x)	FY08E	24.6	19.8	23.2
	FY09E	16.9	14.6	16.5
EV/Sales (x)	FY08E	1.6	1.6	2.2
	FY09E	1.0	1.2	1.7
P/BV (x)	FY08E	5.9	5.9	18.8
	FY09E	4.7	5.4	9.8

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	44.7	42.3	44.3
Domestic Inst	11.8	11.6	6.7
Foreign	26.1	27.3	28.7
Others	17.4	18.8	20.3

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.

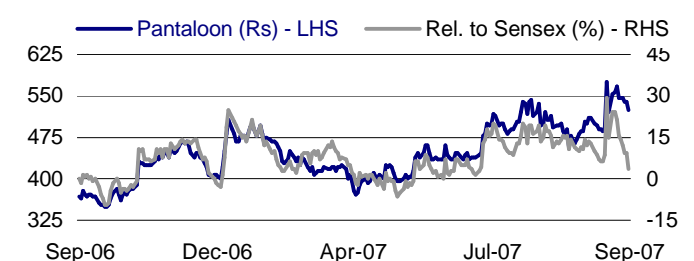
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	7.6	10.5	-27.7
FY09	12.4	16.7	-25.9

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
525	624	18.9	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	30,340	37,363					

E: MOST Estimates

RATIOS					
Y/E JUNE	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	17.5	4.8	4.2	7.6	12.4
Cash EPS	23.6	6.3	6.7	11.6	17.6
BV/Share	100.7	39.2	82.5	89.2	111.2
DPS	2.5	0.5	0.6	0.8	1.2
Payout %	14.3	10.5	14.4	10.5	9.7
Valuation (x)					
P/E		110.1	126.2	68.9	42.3
Cash P/E		83.1	78.7	45.3	29.8
EV/Sales		4.4	2.6	1.6	1.0
EV/EBITDA		57.4	38.7	24.6	16.9
P/BV		13.4	6.4	5.9	4.7
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					



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1. Analyst ownership of the stock	No
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