

Company In-Depth

13 September 2007 | 12 pages

Pantaloon (PART.BO)

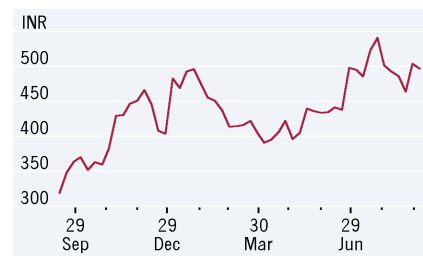
Buy: Raising Target Price; London Investor Conference Takeaways

 Rating change
 Target price change
 Estimate change

- Value unlocking imminent:** We recently hosted Pantaloon management at our London Investor Conference. Value in three of Pantaloon's subsidiaries is likely to be unlocked over the next three months, with the listing of Future Capital and private placements of Future Bazaar and Future Media.
- Future Capital IPO imminent:** Future Capital is likely to list over the next three months (10% dilution). Pantaloon expects a valuation of Rs25bn-30bn. We value this at Rs18.6bn. Future Capital now has 75 retail locations and management expects a credit book of US\$1.5-2bn by FY11, while assets under management are about US\$1.2bn.
- Future Media & Future Bazaar:** Management expects 10-15% dilution in the media & e-tailing subsidiaries through private equity placement. Management indicates a base valuation of US\$50mn for Future Media and US\$70mn for Future Bazaar.
- Increasing margin focus:** Pantaloon's focus is now shifting from the top line towards margins and ROE. It has employed McKinsey & Co to carry out operational restructuring and expects 40bps net margin improvement in FY08.
- Raising price target:** We increase our SOTP based price target to Rs626 (from Rs545 earlier), incorporating the value of Future Bazaar and Future Media, as well as rolling forward our target 30x P/E multiple for core Pantaloon to mid-FY09E. We roll forward as we are approaching 2Q FY08 and expect the stock to increasingly reflect FY09E earnings.

Buy/Medium Risk	1M
Price (13 Sep 07)	Rs507.10
Target price	Rs626.00
	<i>from Rs545.00</i>
Expected share price return	23.4%
Expected dividend yield	0.1%
Expected total return	23.6%
Market Cap	Rs74,417M
	US\$1,844M

Price Performance (RIC: PART.BO, BB: PF IN)



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

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
30 Jun	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	386	3.51	69.4	144.5	25.2	24.4	0.1
2006A	642	4.86	38.5	104.3	12.7	17.1	0.1
2007E	1,049	7.24	48.9	70.1	8.1	14.6	0.1
2008E	1,890	13.03	80.1	38.9	9.1	22.0	0.1
2009E	2,394	16.51	26.7	30.7	7.1	26.0	0.2

Source: Powered by dataCentral

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¹Citigroup Global Markets India Private Limited

Fiscal year end 30-Jun	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	144.5	104.3	70.1	38.9	30.7
EV/EBITDA adjusted (x)	84.5	54.9	34.8	20.3	16.0
P/BV (x)	25.2	12.7	8.1	9.1	7.1
Dividend yield (%)	0.1	0.1	0.1	0.1	0.2
Per Share Data (Rs)					
EPS adjusted	3.51	4.86	7.24	13.03	16.51
EPS reported	3.51	4.86	7.24	13.03	16.51
BVPS	20.14	39.91	62.62	55.61	71.19
DPS	0.50	0.51	0.36	0.65	0.83
Profit & Loss (RsM)					
Net sales	10,528	18,678	31,079	56,094	76,930
Operating expenses	-9,753	-17,465	-29,108	-52,555	-72,099
EBIT	775	1,212	1,971	3,539	4,831
Net interest expense	-275	-335	-640	-860	-1,410
Non-operating/exceptionals	31	42	800	100	100
Pre-tax profit	531	919	2,131	2,779	3,521
Tax	-145	-277	-682	-889	-1,127
Extraord./Min.Int./Pref.div.	0	0	-400	0	0
Reported net income	386	642	1,049	1,890	2,394
Adjusted earnings	386	642	1,049	1,890	2,394
Adjusted EBITDA	909	1,420	2,270	4,070	5,574
Growth Rates (%)					
Sales	60.1	77.4	66.4	80.5	37.1
EBIT adjusted	68.0	56.3	62.6	79.5	36.5
EBITDA adjusted	65.3	56.3	59.8	79.3	36.9
EPS adjusted	69.4	38.5	48.9	80.1	26.7
Cash Flow (RsM)					
Operating cash flow	-403	-2,626	-1,085	381	-2,023
Depreciation/amortization	133	208	299	531	743
Net working capital	-1,020	-3,610	-2,575	-2,089	-5,160
Investing cash flow	-1,145	-1,335	-1,935	-1,166	0
Capital expenditure	-1,145	-1,335	-1,935	-1,166	0
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	1,133	5,565	4,723	3,642	6,739
Borrowings	496	3,152	1,983	2,749	6,875
Dividends paid	-63	-77	-59	-107	-135
Change in cash	-415	1,604	1,703	2,858	4,717
Balance Sheet (RsM)					
Total assets	6,651	14,174	21,153	26,388	38,862
Cash & cash equivalent	215	218	300	5	5
Accounts receivable	123	170	255	307	422
Net fixed assets	2,295	3,955	5,169	8,509	11,294
Total liabilities	4,441	8,916	12,073	18,324	28,539
Accounts payable	1,271	2,298	3,189	5,955	8,583
Total Debt	2,862	6,014	7,997	10,746	17,620
Shareholders' funds	2,215	5,269	9,080	8,064	10,323
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.6	7.6	7.3	7.3	7.2
ROE adjusted	24.4	17.1	14.6	22.0	26.0
ROIC adjusted	15.6	12.4	10.6	15.3	15.0
Net debt to equity	119.5	110.0	84.8	133.2	170.6
Total debt to capital	56.4	53.3	46.8	57.1	63.1

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Value Unlocking in Subsidiaries Imminent, Raising Price Target

We recently hosted Pantaloon's management at our Corporate Day in London. According to management, unlocking value in three of its subsidiaries – Future Capital, Future Bazaar and Future Media – is imminent. Future Capital will likely list in the next three months, with management indicating a valuation of Rs25bn-Rs30bn. We value Future Capital at Rs18.6bn. Additionally, there could be about 10% dilution each in Future Media and Future Bazaar through placements to private equity. Management indicates a base valuation of US\$50m (with a five year conversion option) for Future Media and a base valuation of US\$70m-US\$100m for Future Bazaar. So far, we have not attributed any value to these businesses in our SOTP based price target. We now do so, given that they have been scaled up and value realisation is imminent. We also roll forward our target P/E multiple for the parent Pantaloon to mid-FY09E (average of FY08E and FY09E EPS). We now value the Pantaloon parent at Rs440 per share against Rs390 per share, based on 30x mid-FY09E P/E. We roll forward our numbers, as we are already nearing 2QFY08E and believe that the street is likely to increasingly discount the FY09E EPS in valuations. Our new price target for Pantaloon is Rs626 based on our sum-of-the-parts:

Figure 1. Pantaloon: Sum of the Parts Valuation

Business	Valuation Methodology	Per Share Value (Rs)
Pantaloon	30x mid-FY09E P/E, benchmarked off trading multiples of Asian peer group	440
Home Solutions	Valued at Rs10bn, using mid-point of stake sale valuation and 1.2x FY08E market cap / sales valuation	60
Future Capital	Valued at NPV of cash flows to Pantaloon, assuming annual 15% fund NAV improvement and 15% discount rate for already deployed funds and 12% NAV appreciation and 15% discount rate for new funds	95
Future Media	Valued at US\$50mn (base valuation) and assume 10% dilution	13
Future Bazaar	Valued at US\$70mn and assume 10% dilution	18
Total		626

Source: Citigroup Investment Research

Future Capital IPO Likely Soon

As widely reported, Future Capital is likely to be listed on the Indian stock exchanges over the next three-months. Management indicates a valuation of Rs25bn-Rs30 upon listing, compared with our valuation of Rs18.6bn. Future Capital is the real estate, venture fund and consumer credit subsidiary of Pantaloon. Total equity assets under management are US\$1.1bn, which is likely to increase to US\$2bn by Jun 2008. Of the current funds, 'Kshitij', which is the Rs3.5bn domestic real estate fund, has been fully deployed. The international real estate fund, Horizon has deployed 65% of its UD\$350m assets. The venture capital fund, Indivision has deployed 35% of its US\$425m. The company has recently raised US\$200m under a hotels fund, which will invest in the hospitality industry.

In addition, the consumer credit business, Future Money, has started to roll out and currently has a presence in 75 locations, which should increase to 150 over

the next 1-2 quarters. Management indicates that it is targeting a consumer credit book size of US\$1.5bn-US\$2bn by FY10-FY11E.

We detail our valuation methodology for Future Capital below. We do not capture any value for the consumer credit business in our model yet, given that it is in an initial rollout phase. We assume 15% NAV appreciation for already deployed funds, and 12% NAV appreciation for the new funds. We build in 2% management fee for seven years and a 20% carry for Pantaloon over 8% hurdle rate of return. We discount the cash flows using a 15% discount rate to calculate the NPV, which comes to about Rs129 per share, valuing Pantaloon's 74% stake at Rs95 per share. We assume the profit share for Pantaloon to be back ended as we are unable to predict the timings of investment sales. Management indicates that profit share will start flowing in from FY09E, which would increase the NPV value of the cash flows. To that extent our value could be conservative.

Figure 2.Future Capital Valuation Analysis

Kshitij Fund							
Rs.mn	Y1	Y2	Y3	Y4	Y5	Y6	Y7
Debt Servicing	490	490	490	490	490	490	3,990
Management Fee	70	70	70	70	70	70	1,987
Outflows	560	560	560	560	560	560	5,977
Final Project NAV (15% appreciation)							125,296
Inflows	0	0	0	0	0	0	125,296
Net Inflow (Rs.mn)	(560)	(560)	(560)	(560)	(560)	(560)	119,319
WACC	15%						
NPV of Cash Flows	1,012						

Horizon Fund							
Rs.mn	Y1	Y2	Y3	Y4	Y5	Y6	Y7
Debt Servicing	2,156	2,156	2,156	2,156	2,156	2,156	17,556
Management Fee & Carry	308	308	308	308	308	308	8,335
Outflows	2,464	2,464	2,464	2,464	2,464	2,464	25,891
Final Project NAV (15% appreciation)							81,929
Inflows	0	0	0	0	0	0	81,929
Net Inflow (Rs.mn)	(2,464)	(2,464)	(2,464)	(2,464)	(2,464)	(2,464)	56,037
WACC	15%						
NPV of Cash Flows	4,299						

Indivision							
Rs.mn	Y1	Y2	Y3	Y4	Y5	Y6	Y7
Debt Servicing	2,556	2,556	2,556	2,556	2,556	2,556	22,400
Management Fee & Carry	308	308	308	308	308	308	9,826
Outflows	2,864	2,864	2,864	2,864	2,864	2,864	32,226
Final Project NAV (15% appreciation)							97,144
Inflows	0	0	0	0	0	0	97,144
Net Inflow (Rs.mn)	(2,864)	(2,864)	(2,864)	(2,864)	(2,864)	(2,864)	64,918
WACC	15%						
NPV of Cash Flows	4,860						

New Funds							
Rs.mn	Y1	Y2	Y3	Y4	Y5	Y6	Y7
Debt Servicing + payback	5,600	5,600	5,600	5,600	5,600	5,600	45,600
Management Fee & Carry	800	800	800	800	800	800	14,460
Outflows	6,400	6,400	6,400	6,400	6,400	6,400	60,060
Final Project NAV (12% appreciation)							176,855
Inflows	0	0	0	0	0	0	176,855
Net Inflow (Rs.mn)	(6,400)	(6,400)	(6,400)	(6,400)	(6,400)	(6,400)	116,794
WACC	15%						
NPV of Cash Flows	8,464						
Total NPV	18634						
Pantaloos Share (74%)	13789						
Per Share Value (Rs)	95						

Source: Citigroup Investment Research estimates

Future Bazaar, Future Media Rolled Out

According to management, both Future Media (outdoor media subsidiary) and Future Bazaar (online retailing) have been scaled up and value will be unlocked in these within the next quarter. Future Media has rolled out 500 LCD screens, which should expand to 1,000 screens over the next few quarters and to 5,000-6,000 screens over the next three years.

Management indicates that it has signed long-term contracts with advertisers. However, it has not disclosed revenues and terms of the contract. We expect a base valuation of US\$50mn (with five-year conversion option). An approximate 10% stake in Future Media is likely to be placed with a private equity player within the next three months.

A 10% dilution of Future Bazaar is also expected and the management is confident of a value of US\$70-100mn. Future Bazaar currently has a turnover of Rs30-40mn/month; but expects it to increase to Rs3bn in FY08.

We have incorporated the value of Future Bazaar and Future Media into our SOTP based price target. While we do not have much operational and financial details on these businesses yet, we are valuing these based in the "base valuations" that have been indicated to us by management. Management also indicates that it is confident in these valuations, and that dilution in these businesses is imminent.

Core Business Focus Shifting Towards Margins & ROE

While new stores for Pantaloon are being rolled out aggressively, the internal focus is now shifting from the top line towards margins & ROE. Pantaloon has deployed McKinsey & Company to carry out an operational restructuring as well as initiate cost savings for it. While the management will still not detail the cost saving initiatives, it indicates a benefit of 40 bps should accrue to the net margin in FY08. We do not incorporate these into our estimates; leaving room for positive earning surprises.

On the store roll out front, the total space is likely to double from 5.5mn sq ft to 11mn sq ft in the next year. This is much above our estimates, so to that extent, there is room for positive surprises to our numbers. The key drivers for space addition over the next 12 months will be the Home Town & Central formats. According to the company, Home Town has been hugely successful & management is looking to roll out five new stores over the next 12 months; taking the total to eight stores. There will also be an addition of four Central stores.

On the Real Estate front, management is not signing leases for retail space in malls (25mn sq ft already signed). The rentals are expected to decrease in FY09-10, given a significant retail space supply during that time. It may restart signing for space in FY09-10.

Figure 3. Estimated Space Expansion

Space (Sq Ft)	FY06	FY07E	FY08E	FY09E
Pantaloon	474,550	532,550	1,000,000	1,500,000
Big Bazaar	1,220,200	1,918,000	3,750,000	5,250,000
Food Bazaar	428,308	669,608	819,608	1,019,608
Central	478,000	587,440	1,080,000	1,500,000
Fashion Station	91,500	111,000	200,000	350,000
Brand Factory		135,000	330,000	500,000
E-Zone		150,000	300,000	400,000
Electronic Bazaar		32,500	97,500	125,000
Collection i		112,500	187,500	225,000
Furniture Bazaar		96,000	200,000	300,000
Home Town		225,000	800,000	1,250,000
Space	2,692,558	4,569,598	8,764,608	12,419,608

Source: Citigroup Investment Research estimates

Pantaloon

Company description

Pantaloon is the largest organized modern-format retailer in India, with a presence in apparel, general merchandise, home products and food retailing. It has retail space of about 3.5m sq. ft. with plans to expand to 30m sq. ft. by FY11. Pantaloon retails fashion apparel and accessories through its Pantaloon stores, and general merchandise, and food through its discount department stores, Big Bazaar and Food Bazaar. It has presence in retail property management services through Central Malls, managing retail space for concessionaries fees and a share of sales. It recently launched Home Town for home interiors, which it plans to expand aggressively. Its real estate investment subsidiary, Kshitij Retail Destinations plans to set up 51 malls across India spanning 14.5m sq. feet in the next three years. Through subsidiaries, Pantaloon also has interests in media, logistics, brand management and e-tailing.

Investment thesis

We rate Pantaloon Buy/Medium Risk (1M) with a target price of Rs626. In the near term, stock upside triggers should come from stake sales in subsidiaries. We include the Home Solutions, Future Capital, Future Media and Future Bazaar subsidiaries into our valuation. We believe that the risk profile of the business has come down, and that Pantaloon is now better positioned to grow from its current base. While we are cognizant of the emerging competitive landscape, we believe that Pantaloon has sustainable competitive advantages: 1) strong brands and well-established retail formats; 2) judicious product mix; 3) below-market rentals locked in with long-term leases, and 4) longstanding experience in understanding Indian consumer behaviour.

Valuation

Our Rs626 target price is based on sum of the parts. We value parent Pantaloon Retail at Rs440 per share based on 30x mid-FY09E P/E, similar to early-stage valuations for Chinese retailers. Our 30x multiple is also benchmarked against

our regional retail universe. We expect a two-year EPS CAGR of 64% for Pantaloon, vs. 30% for our Asian retail universe. We benchmark valuations of Home Solutions against recent stake sales (mid point of Rs7.5bn-Rs10bn). We also use market cap/sales valuation of 1.2x FY08E, at par with Pantaloon's valuations. Our fair value per share for the Home Solutions subsidiary is Rs60 per share. We attribute per share value of Future Capital at Rs95, based on the NPV of cash flows to Pantaloon from the three seven-year close-ended funds (management fee + carry) and new funds that are being raised, which should increase the total assets under management to US\$2bn by FY08E. We assume a 15% increase in the fund NAV every year, and a 15% discount rate to calculate NPV of cash flows for the funds already deployed, and a 12% NAV increase and 15% discount rate for new funds. Also, assuming 10% dilution, Future Media is valued at base valuation of US\$50mn as Rs13 per share. Future Bazaar is valued at US\$70mn and 10% dilution is assumed giving Rs18 per share.

Risks

We assign a Medium Risk rating to Pantaloon Retail based on our quantitative risk-rating system. The main downside risks to our target price include: 1) delay in store opening plans, 2) legislative changes that allow FDI in retail; 3) increase in competitive intensity, irrational competition, and 4) continued pressure on rentals, which could result in lower than expected margins. The main upside risks to our target price and estimates include: 1) better-than-expected sales growth, 2) value unlocking in subsidiaries through listing/stake sales, and 3) any significant acquisitions perceived to be creating value.

Appendix A-1

Analyst Certification

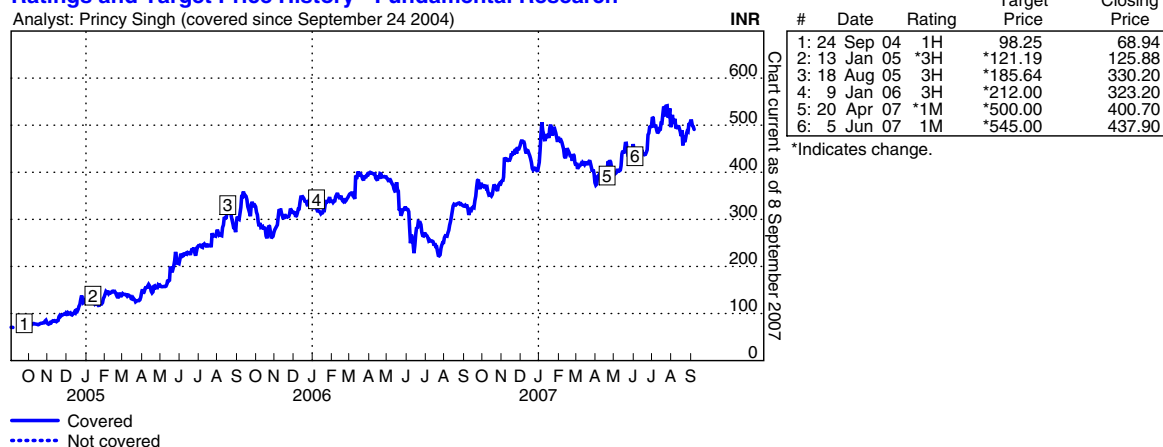
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Analyst: Princy Singh (covered since September 24 2004)



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