INDIA

Retail

Shoppers Stop

Management meet/Target price revision **9 Sep 2009**

Buy

Target Price: Rs332

CMP: Rs271*

Upside: 22.6%

**as on 8 Sept 2009*

Earnings visibility improves

We organized a conference between the management of Shoppers Stop and investors on 4 Sep 2009 in Mumbai. The management indicated strong recovery and higher-than-estimated store rollouts going forward, which has led us to raise our target price to Rs332 (earlier Rs220). We have also raised our PAT estimates due to change in depreciation policy but our operating assumptions remain unchanged.

- **Target price raised; reiterate Buy:** We value the company at 9.4x FY11E EV/EBITDA (vs 6.4x earlier) due to improved earnings visibility. We believe Shoppers Stop should command a premium over Pantaloon, given its low-leveraged balance sheet, positive operating cash flows and superior return ratios.
- **Expansion plans on track:** Shoppers Stop plans to open 16 stores over next 40 months, to be funded entirely through internal accruals. The company would continue to focus on the luxury segment by allocating higher space to super premium brands (*Tommy, Calvin, Fcuk*) to tap the premium customer segment.
- **To clock single-digit same-store-sales-growth:** The management expects to clock single-digit same-store-sales-growth, which is lower than historical average. It attributes this to self cannibalization and intense competition. However, it expects to see traction in growth rates from H2FY10 onwards.
- **Cost rationalization sustainable:** The company has indicated that new properties would be leased at Rs20-22/sq ft or 7% of sales, whichever is higher. The impact of lower rentals and initiatives to control costs through reduction in staff expenses and corporate overheads would be visible in the coming quarters.
- **Hypercity acquisition – value-accretive:** Shoppers Stop intention to hike its stake in Hypercity to 51% (19% currently) would cost it Rs1.1bn and we value this deal at 0.45-0.5x FY11E Mcap/sales. Hypercity's expected turnaround in profit and a benchmark valuation of 0.5x-0.6x Mcap/sales for global hypermarkets underpins our argument.
- **Estimates revised on change in depreciation policy:** We have raised our PAT estimates by 141% to Rs225mn for FY10E and by 39% to Rs513mn for FY11E. The company has changed its aggressive depreciation policy (16% of gross block) to more or less in line with other retailers (7%).

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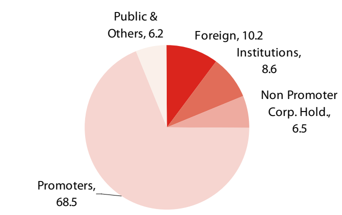
Key Data

Bloomberg Code	SHOP IN
Reuters Code	-
Current Shares O/S (mn)	34.9
Diluted Shares O/S(mn)	34.9
Mkt Cap (Rsbn/USDmn)	9.5/194.8
52 Wk H / L (Rs)	322/71
Daily Vol. (3M NSE Avg.)	63,703
Face Value (Rs)	10

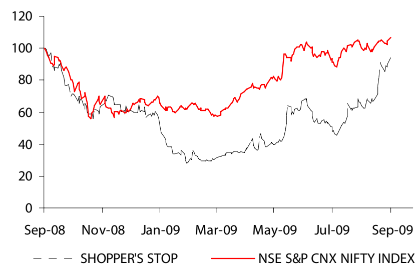
USD = Rs48.6

Shareholding Pattern



As on 30 June 2009

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Shoppers Stop	47.3	195.8	(6.5)
NIFTY	7.2	86.7	7.5

Source: Bloomberg, Centrum Research
**as on 8 September 2009*

Y/E Mar (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	Fully DEPS	ROE (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
FY08	11,514	33.8	562	4.9	70	(73.3)	2.0	2.4	1.8	134.6	19.8
FY09	13,356	16.0	425	3.2	(371)	(628.5)	(10.6)	(14.0)	(4.5)	(25.5)	26.7
FY10E	14,827	11.0	885	6.0	225	(160.8)	6.5	9.3	7.5	41.9	12.6
FY11E	17,624	18.9	1,312	7.4	513	127.8	14.7	19.0	12.8	18.4	8.2
FY12E	20,777	17.9	1,657	8.0	735	43.3	21.1	23.1	16.4	12.8	6.2

Source: Company, Centrum Research Estimates

Target price raised, maintain Buy

We have raised our target price to Rs332 (earlier Rs220), valuing the company at 9.4x FY11E EV/EBITDA. In our initiation report *Set for a turnaround* (17 August 2009), we had valued Shopper's Stop at 6.4x FY11E EV/EBITDA (25% discount to Pantaloon). However, we believe that Shoppers Stop should command a premium to Pantaloon given its low-leveraged balance sheet, positive operating cash flows and better return ratios. We therefore provide a 10% premium to Pantaloon's target EV/EBITDA and value Shoppers Stop at 9.4x FY11E EV/EBITDA, which gives us a revised target price of Rs332 per share (Rs 316 per share for standalone business and Rs16 per share for its 19% stake in Hypercity). Reiterate Buy on the stock.

Profitability estimates revised to factor in change in depreciation policy

We have raised our PAT estimates by 141% to Rs225mn for FY10E and 39% to Rs513mn for FY11E to factor in the change in the company's depreciation policy. The company was following an conservative policy, wherein it was depreciating assets at a higher rate (approximately 16.8% of gross block), equivalent to about 4.7% of net revenue. This was the highest compared to the industry norm of about 2% of net revenue.

The management has decided to have a re-look at its depreciation policy and has extended the useful life of its assets to almost double. In addition, it has been able to re-engineer some of its fit-outs which have resulted in considerable cost savings. The company now expects to incur capex of Rs1,200-Rs1,400 per sq ft vis-à-vis Rs1,600-1,800 per sq ft estimated earlier. We have revised our depreciation rates (now 7.5% of gross block). Accordingly, we have revised our profitability estimates, assuming no changes in cash flows and other operating parameters. We remain positive on the company's business prospects. However, our operating assumptions do not change even though the management's overall guidance is higher than our estimates.

Exhibit 1: Profitability estimates revised

	Revised estimates			Old estimates			*Change (%)*		
(Rsmn)	**FY10E**	**FY11E**	**FY12E**	**FY10E**	**FY11E**	**FY12E**	***FY10E***	***FY11E***	***FY12E***
PBT	358	773	1,108	160	556	863	*124.4*	*39.0*	*28.5*
PBT Margin (%)	*2.4*	*4.4*	*5.3*	*1.1*	*3.2*	*4.2*	*134*	*123*	*118*
PAT	225	513	735	93	369	572	*141.0*	*39.0*	*28.5*
PAT Margin (%)	*1.5*	*2.9*	*3.5*	*0.6*	*2.1*	*2.8*	*89*	*82*	*78*

Source: Centrum Research Estimates

Expansion plans on track

Shoppers Stop plans to open 16 stores over the next 40 months (about 4-5 stores with a capital outlay of Rs750mn per annum). The company would generate Rs800-1,000mn of operating cash flows per annum over FY10-12E, which would be sufficient to fund its growth. While its specialty segment, *Homestop* (four stores of consumer durables and furniture) and *Arcelia* (two high-end cosmetic stores) are still EBITDA negative, the management is reviewing their operations closely and expects to take the final decision on these two businesses during FY10.

Focus on luxury segment

The company plans to focus on the luxury segment and will likely continue to provide an assortment of branded products under one roof. Its standalone stores, *Clinique*, *Estee Lauder* and *Mac* cater to high-end beauty product requirements and its department stores offer more than 30 brands of watches. It has clearly been focusing more on non-apparels (beauty products, accessories and jewellery) where the through-put is higher. The share of non-apparels has increased to 42.1% in Q1FY10 from 39.8% in Q1FY09.

During Q1FY10, the company registered double-digit same-store-sales-growth in beauty, ladies western wear, watches and kids wear segments. However, the menswear segment has been languishing. To improve same-store-sales-growth in the menswear segment, the company is expanding its product offerings to include brands such as *Tommy Hillfigure*, *Calvin Klien, French Connection,* etc. This would help Shoppers Stop in tapping the premium layer of customer traffic, which was not present earlier.

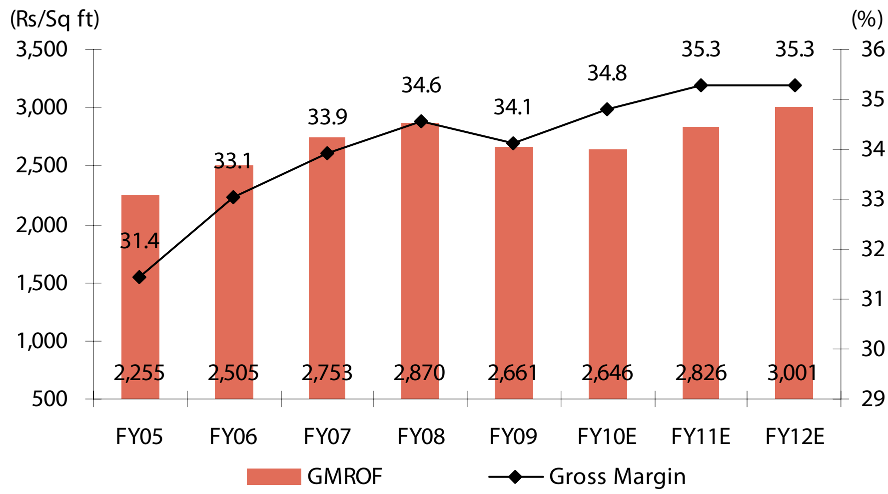
Single digit same-store-sales-growth

The company expects to achieve single digit same-store-sales-growth vis-à-vis double digit same-store-sales-growth in last 2-3 years and has guided flat growth in FY10E, 7% growth in FY11E and 8% in FY12E. It attributes the lower growth to self cannibalization and intense competition. However, we estimate average sales per sq ft growth of -3% in FY10E, 5% in FY11E and 6% in FY12E. Further, we have assumed average sales per sq ft of Rs7,863 in FY10E, Rs8,265 in FY11E and Rs8,777 in FY12E vs Rs8,200, Rs8,500 and Rs9,200 guided by the management, respectively. We would watch same-store-sales-growth in Q3FY10 and Q4FY10 before revising our estimates, which was -7.5% in Q1FY10. The management expects an up-tick in sales from H2FY10 onwards.

Gross margins to improve further

Under the non-apparel segment, the company sells watches and beauty products, which attract high import duties (in the range of 50-100%). The management believes these exorbitant duties are unsustainable and believes the same would be lowered over the next couple of years. Lower duties (whilst maintaining same selling price) would help the company garner higher margins. The company periodically reviews its gross margins per sq ft (GMROF) to review non-performing merchandise and determine better space allocation for higher margin products, effectively improving overall gross margins.

Exhibit 2: Higher GMROF on the back of higher gross margins



Source: Company, Centrum Research Estimates

Cost rationalization to boost margins

The company has managed to rationalize operating costs over the last 2-3 quarters. However, given that there was no cost rationalistion in occupation and power, management sees further scope for improvement in costs.

Staff costs: The company has not changed job profiles, but refrained from replacing one-third of the total staff (300-odd employees). In addition, the top 150 employees have agreed to undertake a 15% salary cut for a year. The impact of the salary cut would be visible over the next 3-4 quarters before a bounce-back.

Corporate overheads: The company has already shrunk 20% of its total corporate office space and reduced 40% of its corporate overheads (namely, planning travel in advance, re-negotiating contracts with housekeeping, etc). The management hopes to sustain these cost control control measures in future too.

Power cost: The company has managed to lower power consumption by 12%. However, it pays higher cost per unit in Mumbai (Rs13 per unit vs Rs6 per unit in other states). Since Mumbai accounts for 35% of its total sales, any significant cut in power rates would help boost its operating margins. The management expects savings of Rs50mn in FY10 post tariff rationalization.

Advertising and sales promotion: Logo change and re-branding exercise resulted in the company incurring a cost of Rs180mn in FY09, which we believe is unlikely to be repeated in future.

Occupation cost: According to the management, there is no scope of re-negotiating rentals in existing properties (except two stores in Delhi). It is currently negotiating a revenue-sharing model for all of its new properties, wherein it would pay a fixed sum (Rs20-22 per sq ft per month) or 7% of store sales, whichever is higher.

Optimum working capital management: The company has made conscious effort towards reducing the proportion of bought-outs and increasing the proportion of goods under consignment and commissionaire arrangement. Proportion of bought-outs has declined from 59% to 51% in Q1FY10. This model ensures the company a fixed percentage of total revenue, subject to the minimum guarantee. It facilitates optimum inventory management, shields the company against inventory obsolescence and reduces working capital requirement.

Hypercity acquisition – value accretive

Shoppers Stop plans to exercise its option to increase its stake in Hypercity to 51% from 19% currently and we expect the acquisition to be value-accretive for shareholders. The acquisition price is expected to be cost plus 10% per annum, which would be close to Rs1.1bn by June 2010 (for the additional 32% stake according to the management). With this, we arrive at a value of Rs3,437mn for Hypercity, which translates into Mcap/sales of 0.45x-0.50x FY11E. Globally, hypermarkets trade at 0.5x-0.6x Mcap/sales, about 10-15% higher than the expected acquisition price..

Hypercity currently has four stores under operation and plans to add two more during the year. The management has guided addition of 3-4 stores per annum post FY10 and expects Hypercity to break-even at the EBITDA level by FY11E and turn PBT positive by FY12E.

Financials

Exhibit 3: Income Statement

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	11,514	13,356	14,827	17,624	20,777
-Growth (%)	*33.8*	*16.0*	*11.0*	*18.9*	*17.9*
Cost of goods sold	7,535	8,800	9,666	11,404	13,446
% of sales	*65.4*	*65.9*	*65.2*	*64.7*	*64.7*
Gross Profit	3,979	4,556	5,161	6,219	7,331
% of sales	*34.6*	*34.1*	*34.8*	*35.3*	*35.3*
Staff expenses	783	872	914	1,054	1,229
% of sales	*6.8*	*6.5*	*6.2*	*6.0*	*5.9*
Other operating expenses	2,634	3,259	3,361	3,853	4,445
% of sales	*22.9*	*24.4*	*22.7*	*21.9*	*21.4*
EBIDTA	562	425	885	1,312	1,657
-EBIDTA margin (%)	*4.9*	*3.2*	*6.0*	*7.4*	*8.0*
Depreciation	393	631	377	432	507
EBIT	170	(207)	509	880	1,150
Interest expenses	112	256	208	174	119
PBT from operations	57	(463)	301	706	1,031
Other non operating income	88	86	57	67	77
PBT	146	(377)	358	773	1,108
-PBT margin (%)	*1.3*	*(2.8)*	*2.4*	*4.4*	*5.3*
Provision for tax	76	(6)	133	260	373
Effective tax rate (%)	*51.8*	*1.7*	*37.1*	*33.7*	*33.7*
PAT	70	(637)	225	513	735
Adj. for Extraord. items	0	266	0	0	0
Adj PAT	70	(371)	225	513	735
-Growth (%)	(73.3)	(628.5)	(160.8)	127.8	43.3
-Net profit margin (%)	*0.6*	*(2.8)*	*1.5*	*2.9*	*3.5*

Source: Company, Centrum Research Estimates

Exhibit 4: Balance Sheet

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Share capital	349	349	349	349	349
Reserves & surplus	2,609	1,972	2,146	2,541	3,107
ESOP	10	10	10	10	10
Total shareholder's fund	2,967	2,331	2,504	2,899	3,465
Loan fund	1,729	2,078	2,078	1,578	1,078
Deferred tax liability	17	-	(5)	73	239
Total capital employed	**4,713**	**4,408**	**4,577**	**4,550**	**4,782**
Gross block	3,253	4,035	4,508	4,985	5,886
Accumulated depreciation	(1,078)	(1,679)	(2,056)	(2,488)	(2,995)
Net Block	2,175	2,355	2,452	2,497	2,891
Capital WIP	229	232	55	116	31
Net fixed assets	2,404	2,587	2,506	2,613	2,922
Investments	807	974	974	974	974
Cash and bank	58	157	384	315	240
Inventories	1,699	1,450	1,668	1,968	2,358
Debtors	82	113	108	129	152
Other current assets & loans	1,763	1,789	1,775	1,900	2,033
Total current assets & loans	3,602	3,509	3,936	4,312	4,781
Current liabilities & provisions	2,100	2,662	2,839	3,349	3,896
Net current assets	1,502	847	1,097	963	886
Total assets	**4,713**	**4,408**	**4,578**	**4,550**	**4,783**

Source: Company, Centrum Research Estimates

Exhibit 5: Cash flow

Y/E March (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Cash flow from operating					
Pre tax profit from operations	145	(644)	358	773	1,108
Depreciation	393	631	377	432	507
Interest expenses	112	198	208	174	119
Dividend income	(63)	-	(20)	(20)	(20)
Other non cash charges	2	267	-	-	-
Op. profit bef. WC change	589	453	923	1,359	1,714
Working capital adjustments	(324)	628	(24)	65	2
Direct tax paid	(123)	(71)	(138)	(183)	(207)
Net cash from operating	142	1,010	762	1,242	1,509
Cashflow from investing					
Capex	(1,275)	(833)	(296)	(539)	(816)
Investments	(318)	(167)	-	-	-
Int/divid. rcvd/sale of securities	63	58	20	20	20
Net cash from investing	(1,530)	(942)	(276)	(519)	(796)
Cash flow from financing					
Proceeds from sh. Cap & premium	6	1	-	-	-
Borrowings/(Repayments)	598	348	-	(500)	(500)
Interest paid	(112)	(256)	(208)	(174)	(119)
Dividend paid	(61)	(61)	(52)	(118)	(169)
Net cashflow from financing	431	32	(260)	(792)	(789)
Net cash increase/(decrease)	(957)	100	226	(69)	(75)

Source: Company, Centrum Research Estimates

Exhibit 6: Key Ratios

Y/E March	FY08	FY09	FY10E	FY11E	FY12E
Profitability ratios (%)					
EBIDTA margin	4.9	3.2	6.0	7.4	8.0
PBIT margin	1.5	(1.5)	3.4	5.0	5.5
PBT margin	1.3	(2.8)	2.4	4.4	5.3
PAT margin	0.6	(2.8)	1.5	2.9	3.5
Growth (%)					
Revenue	33.8	16.0	11.0	18.9	17.9
EBIDTA	(14.3)	(24.5)	108.5	48.2	26.3
Net profit	(73.3)	(628.5)	(160.8)	127.8	43.3
Return ratios (%)					
ROCE	1.8	(4.5)	7.5	12.8	16.4
ROIC	2.5	(5.7)	10.4	18.0	22.4
ROE	2.4	(14.0)	9.3	19.0	23.1
Turnover Ratios					
Asset turnover ratio (x)	2.6	2.9	3.3	3.9	4.5
Working capital cycle (days)	42	30	20	19	17
Average Inventory period (days)	69	65	63	63	64
Average collection period (days)	2	3	3	3	3
Average payment period (days)	76	91	95	92	90
Per share (Rs)					
Basic EPS	2.0	(18.3)	6.5	14.7	21.1
Fully diluted EPS	2.0	(10.6)	6.5	14.7	21.1
Book value	85.2	66.9	71.9	83.2	99.5
Solvency Ratio					
Debt-equity	0.6	0.9	0.8	0.5	0.3
Interest coverage ratio	1.5	(0.8)	2.4	5.1	9.6
Valuation					
P/E	134.6	(25.5)	41.9	18.4	12.8
P/BV	3.2	4.0	3.8	3.3	2.7
EV/Sales	1.0	0.9	0.8	0.6	0.5
EV/EBIDTA	19.8	26.7	12.6	8.2	6.2
M-cap/Sales	0.8	0.7	0.6	0.5	0.5

Source: Company, Centrum Research Estimates

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