

## Pantaloon Retail

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,366	PF IN
	REUTERS CODE
S&P CNX: 3,570	PART.BO

3 October 2006

**Buy**

*Previous Recommendation: Buy*

**Rs1,853**

Equity Shares (m)	26.9
52-Week Range	2,060/1,080
1,6,12 Rel. Perf. (%)	9/-14/-29
M.Cap. (Rs b)	49.8
M.Cap. (US\$ b)	1.1

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
06/06A	18,678	642	23.9	31.6	77.6	12.6	16.2	15.3	2.9	37.6
06/07E	30,960	1,113	41.4	73.5	44.8	10.0	22.3	16.8	1.8	22.9
06/08E	53,388	2,117	75.3	82.0	24.6	5.9	23.9	20.3	1.1	13.4

- ✍ Pantaloon's 4QFY06 results were below expectations, with the company reporting a PAT of Rs158m against our estimate of Rs197m.
- ✍ Sales for the quarter grew 60.9% YoY to Rs5.7b, driven largely by strong growth in the Value Retailing segment. The company's Value Retailing segment (Big Bazaar and Food Bazaar) grew 90% YoY; while its Lifestyle Retailing segment (Pantaloon and Central Mall) grew 45% YoY.
- ✍ EBITDA margins increase of 20bp YoY to 6.5% in 4QFY06 despite 140% jump in staff costs (to 7.7% of sales from 5.1% on YoY basis due to new staff addition in planned formats) infuses confidence in the company's ability to increase margins.
- ✍ We expect retail space addition to accelerate in the current year as the company is expected to add 0.7m sq ft in the coming two months itself. We have assumed retail space increase to 4.6m sq ft in FY07 and 6.9m sq ft in FY08 from current levels of 2.6m sq ft.
- ✍ We expect the company to change the inventory valuation method to lower of cost and market value from the current method which includes a part of mark-up also. Consequently, we have lowered our FY07 EPS estimate from Rs45.7 to Rs41.4. We are increasing our FY08 EPS estimate from Rs71.1 to Rs75.3 due to expected increase in margins due to cost efficiencies and economies of scale.
- ✍ We expect the company to unlock value from stake divestment in Real Estate and Private Equity Venture as also its Home Solutions Retail. The stock is currently valued at 44.8x FY07E earnings and 24.6x FY08E earnings. We maintain **Buy**.

### QUARTERLY PERFORMANCE

(Rs Million)

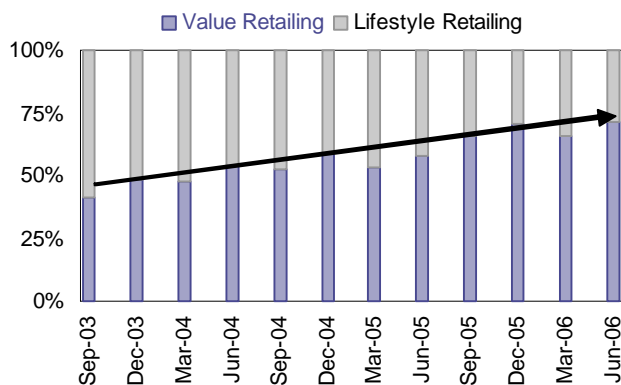
Y/E JUNE	FY06				FY07E				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Net Sales	3,648	4,720	4,554	5,752	6,100	7,600	7,700	9,560	18,678	30,960
YoY Change (%)	81.4	98.0	65.6	55.6	67.2	61.0	69.1	66.2	72.3	65.8
Total Exp	3,368	4,341	4,169	5,379	5,605	6,955	7,055	8,875	17,257	28,490
EBITDA	280	379	385	373	495	645	645	685	1,420	2,470
Margins (%)	7.7	8.0	8.5	6.5	8.1	8.5	8.4	7.2	7.6	8.0
Depreciation	-38	-46	-59	-66	-65	-70	-90	-91	-208	-316
Interest	-57	-79	-101	-98	-115	-130	-155	-183	-335	-583
Other Income	7	4	5	30	6	4	5	4	42	19
PBT	192	258	230	239	321	449	405	415	919	1,590
Tax	-57	-72	-68	-80	-94	-120	-114	-150	-277	-477
Rate (%)	29.7	28.0	27.0	33.6	29.1	26.7	28.1	36.0	30.2	30.0
PAT	135	186	162	158	228	329	291	266	642	1,113
YoY Change (%)	94.9	83.0	52.0	46.7	68.2	77.2	79.2	67.7	66.5	73.5

E: MOST Estimates

**Value retailing driving overall revenue growth; margins likely to expand**

Pantaloon’s 4QFY06 revenues grew 60.9% YoY to Rs5.7b, driven by Value Retailing segment (Big Bazaar and Food Bazaar). Value Retailing grew 90% YoY for the quarter, while Lifestyle revenues grew 45%. For FY06, value retailing grew 114% YoY and Lifestyle retailing reported a growth of 52% YoY. Value retailing reported flattish margins with 4bps increase in 4QFY06 and 8bps decline in FY06, which shows the rising impact of private labels and economies of scale. The trend looks encouraging especially as the company had increased area under low margin (15% Gross margins) Food bazaar format by 48% as against 37% (Gross Margin 25%) increase in area under higher margin Big Bazaar format in value retailing. Lifestyle retailing reported 30bps and 180bps decline in PBIT margins mainly as the lower margin Central Seamless Mall format operated for the entire year.

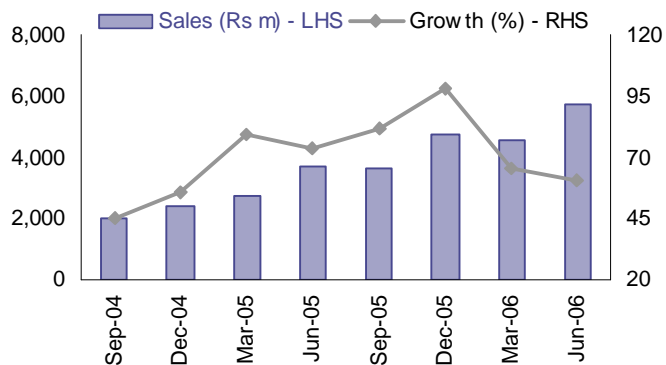
VALUE RETAILING: RISING SALES PROPORTION



Source: Company/ Motilal Oswal Securities

We expect value retailing to continue driving the revenue growth during FY07 due to higher stores addition in this format during the current year. The company plans to add nearly 0.7m to its retail space in the coming 2 months which will be mostly in the value retailing segment. Despite higher share of value retailing we expect the overall margins to improve in the coming years as Pantaloon shifts to increased sale of private labels and brands of associate companies across formats. In addition higher economies of scale will also enable the company to have better sourcing arrangements, which would boost the reported profitability.

TREND IN SALES GROWTH

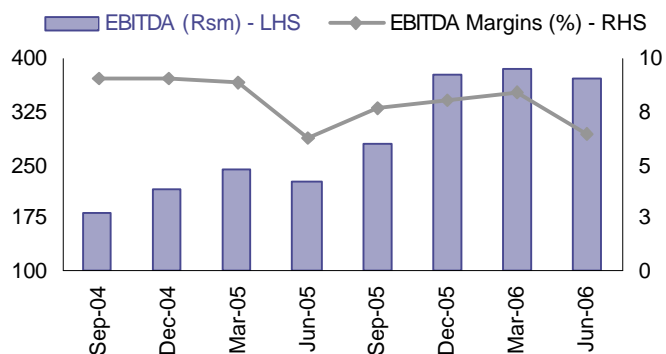


Source: Company/ Motilal Oswal Securities

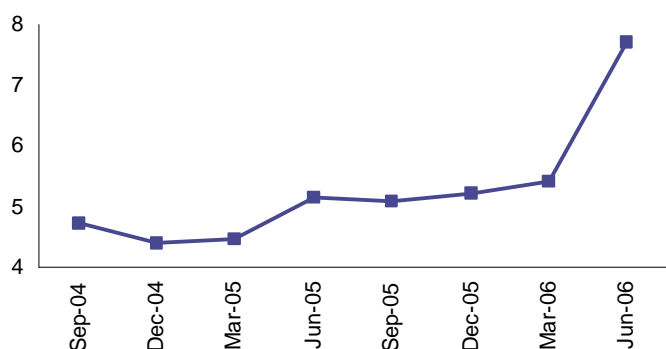
**Higher staff cost cuts EBITDA margin expansion**

Pantaloon reported 20bps increase in EBITDA margin in 4QFY06 despite 140% jump in staff costs, which increased from 5.1% of sales to 7.7%. Increased hiring of new staff for the upcoming retail stores and new formats (Electronics, Health and Beauty etc) contributed to nearly 50% of increase in the staff costs. Management expects staff costs to decline as new businesses scale up.

TREND IN EBITDA MARGIN



SHARP INCREASE IN STAFF COST (%)



Source: Company/ Motilal Oswal Securities

**Inventory valuation impact; lowering FY07 estimates but upgrading FY08 estimates**

While Pantaloon was expected to change the method of valuation of closing stock from current trend which includes markup over the cost price to the standard method, the same is likely to be introduced from the next year. We estimate the impact to be at 5% of the incremental inventory cost for the company. Consequently we have reduced the EPS estimates for the company from Rs44.9 to Rs41.4 for FY07. However we expect Pantaloon to report 50bps EBITDA margin improvement in the coming two years as the benefits of economies of scale, better negotiations with vendors and scale up in higher margin formats like Pantaloons, Gini & Jony and ALL, logistics venture and long term contracts with vendors for Agri products and increased sale of its own and associate brands in the Central format accrue.

Subsidiaries to unlock value; capital infusion to aid expansion  
Pantaloon seems best placed to encash the unfolding retail story in India. The company has announced issue of 12m shares to promoters which would be followed by a preferential issue. We expect the company to garner Rs4.5b from these issues. Pantaloon plans to hive off 24% stake in Home Solutions Retail, Future capital and other subsidiaries

to generate another Rs5b. Infusion of Rs10b in the company would strengthen the operations and enable it to expand the retail operations at a fast pace.

We expect some of the ventures like Real Estate Fund and private equity to add value to the company in the coming few years. We have conservatively valued Pantaloon's share in these funds at over Rs175 per share. We have not factored into the inflows from the preferential issue to investors, sale of stakes as well as investment in some of the new initiatives like insurance etc. Although it does not seem tangible to access the value in these subsidiaries as of now but once they scale up, value unlocking for the company can be significant.

**Valuation and view**

We expect domestic retail industry to become increasingly competitive due to the entry of new players. However, we believe that Pantaloon retail is the best play on the organised retailing in India. We expect stake sale in subsidiaries to act as trigger for further re-rating of the stock. The stock is currently valued at 44.8x FY07E EPS, 24.6x FY08E EPS based on the diluted equity after issue to promoters. We maintain **Buy**.

## Pantaloon Retail: an investment profile

### Company description

Pantaloon Retail is the largest organized retailer in India with retail space of more than 2.7m sq. ft. Pantaloon retails multiple categories through different format offerings like departmental stores (Pantaloon), hypermarkets (Big Bazaar), seamless mall (Central) and Food bazaars (Grocery stores).

### Key investment arguments

- ☞ Pantaloon is the best play in the fast-growing organized retail market due to rapid scale up in operations, tied up real estate and established retail formats.
- ☞ The Company has set up a clutch of subsidiaries in Real estate and Private equity management, logistics, joint ventures for insurance and various retail formats which unlock substantial value in the coming few years.

### Key investment risks

- ☞ High inventory levels, slippages in development of real estate and unrelated diversification into areas like insurance.

### Recent developments

- ☞ Announced 5:1 stock split, issue of 12m shares to promoters and Rs2.6b preferential issue.
- ☞ plans to unlock value in subsidiaries by raising Rs5b.

### Valuation and view

- ☞ We forecast EPS to be Rs41.4 for FY07E and Rs75.3 for FY08E based on diluted equity after issue to promoters.
- ☞ The stock currently trades at 44.8x FY07E earnings and 24.6x FY08E earnings. We maintain **Buy**.

### Sector view

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

#### COMPARATIVE VALUATIONS

		PANTALOOON	SHOPPERS	TITAN
P/E (x)	FY07E	44.8	56.5	27.6
	FY08E	24.6	44.8	20.2
EV/EBITDA (x)	FY07E	22.9	28.2	17.6
	FY08E	13.4	20.7	13.6
EV/Sales (x)	FY07E	1.8	2.4	2.1
	FY08E	1.1	1.7	1.7
P/BV (x)	FY07E	10.0	6.4	13.8
	FY08E	5.9	5.8	8.8

#### SHAREHOLDING PATTERN (%)

	JUN-06	MAR-06	JUN-05
Promoter	44.2	44.2	43.1
Domestic Inst	6.7	5.7	2.8
Foreign	28.7	28.7	30.0
Others	20.4	21.3	24.1

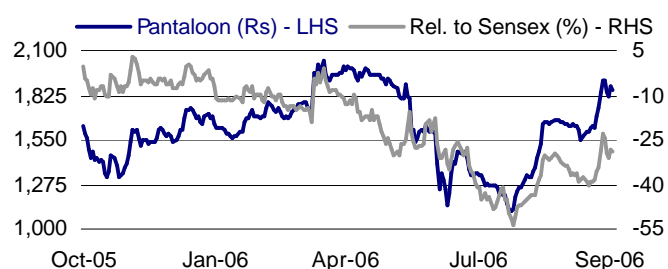
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	41.4	46.1	-10.2
FY07	75.3	75.3	-

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,853	2,025	9.3	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(RS MILLION)					
Y/E JUNE	2004	2005	2006AE	2007E	2008E						
<b>Net Sales</b>	<b>6,583</b>	<b>10,840</b>	<b>18,678</b>	<b>30,960</b>	<b>53,388</b>						
Change (%)	48.0	64.7	72.3	65.8	72.4						
Total Expenditure	-6,033	-9,944	-17,257	-28,490	-49,047						
<b>EBITDA</b>	<b>550</b>	<b>896</b>	<b>1,420</b>	<b>2,470</b>	<b>4,341</b>						
Change (%)	-89.9	62.9	58.5	73.9	75.8						
Margin (%)	8.4	8.3	7.6	8.0	8.1						
Depreciation	-88	-133	-208	-316	-463						
Int. and Fin. Charges	-231	-275	-335	-583	-874						
Other Income - Recurring	13	43	42	19	20						
<b>Profit before Taxes</b>	<b>244</b>	<b>531</b>	<b>919</b>	<b>1,590</b>	<b>3,025</b>						
Change (%)	-95.5	117.7	73.0	73.0	90.2						
Margin (%)	3.7	4.9	4.9	5.1	5.7						
Tax	-46	-145	-277	-477	-907						
Tax Rate (%)	-18.7	-27.4	-30.2	-30.0	-30.0						
<b>Profit after Taxes</b>	<b>198</b>	<b>386</b>	<b>642</b>	<b>1,113</b>	<b>2,117</b>						
Change (%)	-96.5	94.4	66.4	73.5	90.2						
Margin (%)	3.0	3.6	3.4	3.6	4.0						
Extraordinary Items	3	13	0	0	0						
<b>Reported PAT</b>	<b>201</b>	<b>399</b>	<b>642</b>	<b>1,113</b>	<b>2,117</b>						

BALANCE SHEET						(RS MILLION)					
Y/E JUNE	2004	2005	2006E	2007E	2008E						
Share Capital	191	220	269	269	281						
Reserves	758	1,965	3,692	4,715	8,566						
<b>Net Worth</b>	<b>949</b>	<b>2,185</b>	<b>3,961</b>	<b>4,984</b>	<b>8,847</b>						
Loans	2,361	2,862	4,019	7,451	9,300						
Deferred Tax	60	130	224	510	1,054						
<b>Capital Employed</b>	<b>3,370</b>	<b>5,178</b>	<b>8,204</b>	<b>12,945</b>	<b>19,202</b>						
Gross Block	1,847	2,511	3,739	5,985	8,259						
Less: Accum. Deprn.	-243	-374	-446	-762	-1,225						
<b>Net Fixed Assets</b>	<b>1,604</b>	<b>2,137</b>	<b>3,292</b>	<b>5,222</b>	<b>7,033</b>						
Capital WIP	144	158	246	268	417						
Investments	53	319	195	195	195						
<b>Curr. Assets, L&amp;A</b>	<b>2,300</b>	<b>4,039</b>	<b>6,688</b>	<b>10,870</b>	<b>18,088</b>						
Inventory	1,576	2,759	4,590	7,559	12,316						
Account Receivables	176	123	251	497	860						
Cash and Bank Balance	138	215	249	471	855						
Others	410	941	1,597	2,343	4,056						
<b>Curr. Liab. and Prov.</b>	<b>734</b>	<b>1,448</b>	<b>2,220</b>	<b>3,612</b>	<b>6,533</b>						
Other Liabilities	665	1,265	1,928	3,175	5,758						
Provisions	69	183	292	437	775						
<b>Net Current Assets</b>	<b>1,566</b>	<b>2,591</b>	<b>4,468</b>	<b>7,258</b>	<b>11,555</b>						
Miscellaneous Expenditure	4	3	3	2	1						
<b>Application of Funds</b>	<b>3,370</b>	<b>5,178</b>	<b>8,204</b>	<b>12,945</b>	<b>19,202</b>						

E: MOST Estimates

RATIOS					
Y/E JUNE	2004	2005	2006E	2007E	2008E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>10.5</b>	<b>18.1</b>	<b>23.9</b>	<b>41.4</b>	<b>75.3</b>
Cash EPS	15.0	23.6	31.6	53.2	91.8
BV/Share	49.6	99.3	147.3	185.4	314.8
DPS	15	2.5	2.5	3.0	4.0
Payout %	14.3	13.8	10.5	7.2	5.3
<b>Valuation (x)</b>					
P/E		102.2	77.6	44.8	24.6
Cash P/E		78.5	58.6	34.9	20.2
EV/Sales		4.8	2.9	1.8	1.1
EV/EBITDA		58.2	37.6	22.9	13.4
P/BV		18.7	12.6	10.0	5.9
Dividend Yield (%)		0.1	0.1	0.2	0.2
<b>Return Ratios (%)</b>					
RoE	20.9	17.6	16.2	22.3	23.9
RoCE	14.1	15.6	15.3	16.8	20.3
<b>Working Capital Ratios</b>					
Debtor (Days)	10	4	5	6	6
Asset Turnover (x)	2.0	2.1	2.3	2.4	2.8
<b>Leverage Ratio</b>					
Debt/Equity (x)	2.5	13	10	15	11

CASH FLOW STATEMENT						(RS MILLION)					
Y/E JUNE	2004	2005	2006E	2007E	2008E						
OP/(loss) before Tax	462	763	1,212	2,154	3,878						
Int./Div. Received	13	43	42	19	20						
Depreciation and Amort.	88	133	208	316	463						
Interest Paid	-231	-275	-335	-583	-874						
Direct Taxes Paid	-46	-145	-277	-477	-907						
(Incr)/Decr in WC	-1,432	-948	-1,843	-2,568	-3,913						
<b>CF from Operations</b>	<b>-1,146</b>	<b>-429</b>	<b>-994</b>	<b>-1,139</b>	<b>-1,333</b>						
Extraordinary Items	3	13	0	0	0						
(Incr)/Decr in FA	-1,994	-677	-1,315	-2,269	-2,423						
(Pur)/Sale of Investments	62	-267	125	0	0						
<b>CF from Invest.</b>	<b>-1,929</b>	<b>-931</b>	<b>-1,191</b>	<b>-2,269</b>	<b>-2,423</b>						
Issue of Shares	183	0	0	0	0						
(Incr)/Decr in Debt	2,361	501	1,157	3,432	1,849						
Dividend Paid	-33	-63	-90	-90	-126						
Others	701	998	1,152	288	2,417						
<b>CF from Fin. Activity</b>	<b>3,212</b>	<b>1,436</b>	<b>2,219</b>	<b>3,630</b>	<b>4,140</b>						
<b>Incr/Decr of Cash</b>	<b>138</b>	<b>76</b>	<b>34</b>	<b>222</b>	<b>384</b>						
Add: Opening Balance	0	138	215	249	471						
<b>Closing Balance</b>	<b>138</b>	<b>215</b>	<b>249</b>	<b>471</b>	<b>855</b>						



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<b>Disclosure of Interest Statement</b>	<b>Pantaloon Retail</b>
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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