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BSE Sensex: 17729

IDFC INSTITUTIONAL SECURITIES

India Research

Rs247

Pantaloon Retail

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs55bn; US$1.2bn

Analyst: **Bhushan Gajaria (91-22-6622 2562; bhushan.gajaria@idfc.com)**

Result: **Q2FY11**

Comment: **Interest cost drags profitability**

Key valuation metrics

Year end June 30 (Rs m)	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E (x)	PER (x)
FY09	63,416	25.6	1,407	8.1	2.2	10.5	30.6
FY10	89,261	40.8	2,296	11.1	37.0	9.4	22.3
FY11E	115,276	29.1	2,220	9.9	(10.4)	8.4	24.9
FY12E	139,924	21.4	3,240	14.5	46.0	7.1	17.1

Key highlights

- Pantaloon Retail's (PF) operational performance is marginally better than our estimates, however, higher interest cost drags the profitability
- PF (core retail) has reported revenue growth of 31% to Rs27.6bn (estimates of Rs27.1bn), EBITDA of Rs2.38bn (estimates of Rs2.3bn) and PAT of Rs472m (estimates of Rs534m)
- Interest cost came in substantially ahead of our estimates at Rs1.08bn (estimates of Rs960m) with debt of Rs35.5bn. Sharp increase in debt is attributed to Rs5.9bn of inventory addition in the first half and Rs2bn of incremental investments in subsidiaries.
- On the operational front, PF has added 1m sq. ft. in H1FY11 to 14.2m sq. ft. – total stores under value retail stand at 401 (8.34m sq. ft.) and 252 stores under lifestyle and home solutions (5.8m sq. ft.)

Retail presence

	Q2FY11		Q1FY11	
	Stores	m sq. ft.	Stores	m sq. ft.
Value Retail				
Big Bazaars	143	7.4	136	7.0
Food Bazaars	54	0.5	55	0.5
KB Fair Price	170	0.2	134	0.1
Others	34	0.3	34	0.3
Lifestyle				
Pantaloons	53	1.5	48	1.3
Central + Brand Factory	29	2.4	27	2.2
Others	116	0.4	116	0.4
Home Solutions				
Home Town	11	1.1	11	1.1
e-Zone	43	0.5	42	0.5
Total	653	14.2	603	13.4

Source: IDFC Securities Research

- During the quarter, value retail has witnessed same store sales growth of 11.5%, lifestyle segment same store sales grows at 20.9% and 18.3% in home solutions segment. We believe that same store sales growth is partially helped by inflation
- On the expected lines, EBITDA margins have eroded by 147bp yoy to 8.6% (40bp qoq improvement). With value retail and home solutions growing fastest, besides increasing commodity costs, gross margins have eroded by 210bp to 28.8%
- Employee cost has increased by 26% to Rs1.2bn and other expenditure has grown by 27% to Rs4.3bn
- Key concern in PF currently pertains to increasing debt in the wake of increasing working capital requirement. Debt has increased by Rs6bn in H1FY11 to Rs35.5bn. Inventory days improvement, monetization in few of its investments and demerger of Future Capital and Future Generali would be key to the balance sheet of PF
- PF's board has approved transfer of the consumer durables business 'e-zone' to a wholly owned subsidiary. Given the low margins in the business and competitive environment, PF continues to incur losses in this business – our estimates of Rs150m of losses per quarter, Hence, PF is unlikely to further scale up the business.

Valuations and View

With consumer sentiments being upbeat (double digit same store sales growth) and 2m sq. ft. of retail space addition a year, PF continues to witness 30%+ growth. As PF scales up its retail space from 14.2m now to 17.5m sq. ft. by FY12 and same store sales growth stabilizes at 8-10%, PF's core retail business is expected to scale up to Rs140bn by FY12 (25% CAGR). While remaining upbeat on the growth, we expect margins to remain at the current levels of 8.5-9% as value retail growth faster and inflationary pressure builds up on other cost structures. We expect EBITDA growth at 23% CAGR. While PF has started taking measures on improving working capital cycle through better inventory management (ERP implementation, Auto Replenishment System, SKU rationalization, etc), results are yet to become visible. Till then as debt remains high and with interest rates increasing in the wake of tightening liquidity, we are increasing our interest cost estimates and thereby downgrading our earnings estimates by 13% for FY11 and 10% for FY12. However, we believe that recent price correction is way ahead of number downgrade and at the current price, the stock is trading at just 17x FY12E earnings, leave aside the value for all its subsidiaries (few of which PF is in process of demerging). Believe that this sharp correction offers an attractive buying opportunity. Maintain Outperformer.

Quarterly results

(Rs Mn)	Q2FY10	Q3FY10	Q4FY10	FY10	Q1FY11	Q2FY11	FY11E	FY12E
Net Sales	**21,031**	**20,576**	**24,940**	**89,261**	**25,814**	**27,585**	**115,276**	**139,924**
% yoy	*37.8*	*25.3*	*50.0*	*-*	*32.1*	*31.2*	*29.1*	*21.4*
EBITDA	**2125.3**	**2156.0**	**2130.0**	**8,191**	**2,127.0**	**2,382.8**	**9,988**	**12,451**
EBITDA	10.1	10.5	8.5	9.2	8.2	8.6	8.7	8.9
Net interest	962.3	858.6	970.0	3919	933.0	1077.8	4245	4692
Depreciation	506	465	580	2123	630	650	2679	3042
Other Income	22	14	790	728	81	52	200	120
Profit before Tax	**678.6**	**847.2**	**1,370.0**	**2877**	**645.2**	**707.1**	**3,264.0**	**4,836.2**
Tax	230.7	288.0	390.0	582	196.8	235.1	1044	1596
Profit After Tax	**447.9**	**559.2**	**980.0**	**2296**	**448.4**	**472.0**	**2,219.5**	**3,240.3**
% yoy	*33.5*	*62.6*	*166.7*		*73.5*	*5.4*	*(3.3)*	*46.0*

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Explanation of Ratings:

1. Outperformer: More than 5% to Index
2. Neutral: Within 0-5% to Index (upside or downside)
3. Underperformer: Less than 5% to Index

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