Company Focus

SMALL & MID CAP

26 April 2009 | 10 pages

Pantaloon (PART.BO)

Target price change ☑
Estimate change ☑
Results ☑

Sell: 3Q Net Profit Below Expectations as Capital Costs Soar

- **3QFY09 operational performance strong...** — EBITDA margins expanded ~210bps Y/Y and ~20bps sequentially to 10.5%; marginally above our estimates. Management's strategy of outsourcing non core operations to subsidiaries continues, resulting in lower employee costs and improving operating leverage (at the parent level).
- **...but PAT disappoints as capital costs soar** — Despite 52% growth in EBITDA, PAT growth was a muted 7% Y/Y as interest and depreciation expenses rose sharply by 98% and 65% Y/Y respectively. Capital costs as a % of operating profit (70% in 3Q) have been rising steadily over the last 10 quarters.
- **Reducing EPS estimates —** by 18-30% over FY09-11E factoring in: (i) planned equity dilution over FY09E; (ii) 2-16% reduction in net profit estimates as we pare our revenue forecasts and hike capital costs. Our new target price of Rs180 (Rs184 earlier) values Pantaloon (parent) at Rs139/share, based on 15x FY10 PE (maintaining 20% premium to regional peers), Home Solutions and Future Capital are both valued at Rs21/sh of PART.
- **Debt equity ratios to trend lower, post infusion of funds** — We incorporate the impact of the company's plan to raise equity worth cRs2.8bn in our estimates. Consequently, debt equity ratios trend down to 1.4x from 1.8x (for FY10E). That said, our forecasts don't yet incorporate incremental debt on the equity raised.
- **Restructuring imponderables remain** — Little clarity available on management's plan to restructure the retail and fashion divisions. We view the conversion of PART to a holding company format as a prima facie negative.

Sell/Medium Risk	3M
Price (24 Apr 09)	Rs202.05
Target price	Rs180.00
from Rs184.00	
Expected share price return	-10.9%
Expected dividend yield	0.1%
Expected total return	**-10.8%**
Market Cap	Rs32,185M
	US$649M

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

Statistical Abstract

Year to 30 Jun	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	1,200	8.18	68.2	24.7	2.7	14.8	0.3
2008A	1,260	7.91	-3.3	25.5	1.7	8.6	0.2
2009E	1,393	7.32	-7.4	27.6	1.7	6.8	0.2
2010E	1,763	9.26	26.5	21.8	1.4	7.1	0.2
2011E	2,818	14.81	59.9	13.6	1.2	9.5	0.3

Source: Powered by dataCentral

Jamshed Dadabhoy[1]
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Aditya Mathur[1]
aditya.mathur@citi.com

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

[1]Citigroup Global Markets India Private Limited

Fiscal year end 30-Jun	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	24.7	25.5	27.6	21.8	13.6
EV/EBITDA adjusted (x)	18.0	9.6	7.5	6.5	5.2
P/BV (x)	2.7	1.7	1.7	1.4	1.2
Dividend yield (%)	0.3	0.2	0.2	0.2	0.3
Per Share Data (Rs)					
EPS adjusted	8.18	7.91	7.32	9.26	14.81
EPS reported	8.18	7.91	7.32	9.26	14.81
BVPS	74.42	115.93	118.69	141.87	170.32
DPS	0.51	0.33	0.30	0.38	0.61
Profit & Loss (RsM)					
Net sales	32,367	50,489	64,212	79,227	100,978
Operating expenses	-30,580	-46,718	-59,000	-73,101	-92,845
EBIT	**1,787**	**3,771**	**5,213**	**6,125**	**8,133**
Net interest expense	-898	-1,853	-3,097	-3,586	-4,111
Non-operating/exceptionals	920	38	48	198	353
Pre-tax profit	**1,810**	**1,956**	**2,163**	**2,737**	**4,376**
Tax	-610	-697	-770	-974	-1,558
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,200**	**1,260**	**1,393**	**1,763**	**2,818**
Adjusted earnings	1,200	1,260	1,393	1,763	2,818
Adjusted EBITDA	2,156	4,605	6,606	8,153	10,875
Growth Rates (%)					
Sales	73.2	56.0	27.2	23.4	27.5
EBIT adjusted	42.1	111.0	38.2	17.5	32.8
EBITDA adjusted	47.1	113.6	43.4	23.4	33.4
EPS adjusted	68.2	-3.3	-7.4	26.5	59.9
Cash Flow (RsM)					
Operating cash flow	**-4,649**	**-4,216**	**1,674**	**5,126**	**6,148**
Depreciation/amortization	369	834	1,394	2,028	2,742
Net working capital	-6,496	-6,429	-1,113	1,335	588
Investing cash flow	**-5,374**	**-11,410**	**-9,291**	**-11,047**	**-13,916**
Capital expenditure	-4,471	-8,065	-8,822	-10,541	-13,369
Acquisitions/disposals	-903	-3,345	-469	-507	-547
Financing cash flow	**11,435**	**15,207**	**11,383**	**7,916**	**10,728**
Borrowings	6,982	8,922	8,656	5,269	8,132
Dividends paid	-88	-61	-68	-86	-137
Change in cash	**1,412**	**-419**	**3,766**	**1,994**	**2,961**
Balance Sheet (RsM)					
Total assets	**28,072**	**47,439**	**62,291**	**74,229**	**90,927**
Cash & cash equivalent	1,630	1,211	4,977	6,973	9,937
Accounts receivable	652	1,132	1,407	1,736	2,213
Net fixed assets	8,057	15,288	22,716	31,229	41,856
Total liabilities	**17,150**	**28,973**	**39,705**	**47,229**	**58,510**
Accounts payable	2,237	2,720	3,630	4,868	6,665
Total Debt	12,996	21,918	30,574	35,842	43,974
Shareholders' funds	**10,922**	**18,466**	**22,587**	**26,997**	**32,411**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	6.7	9.1	10.3	10.3	10.8
ROE adjusted	14.8	8.6	6.8	7.1	9.5
ROIC adjusted	7.8	11.3	11.6	11.1	12.0
Net debt to equity	104.1	112.1	113.3	106.9	105.0
Total debt to capital	54.3	54.3	57.5	57.0	57.6

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Reiterate Sell (3M): New target price- Rs180

We marginally pare our target price to Rs180 (from Rs184), based on sum of the parts (SOTP) methodology.

Figure 1. Pantaloon Retail (Parent): Sum of the Parts Valuation

	Valuation Methodology	Per Share Value (Rs)
Pantaloon	Based on 15xFY10E P/E (20% discount to regional peers)	~139
Future Capital	1.2x FY08 P/BV and 20% holding company discount	~ 21
Home Solutions	0.6xFY10E Sales and 20% holding company discount	~ 21
Per Share Target Price		**180**

Source: Citi Investment Research and Analysis

We value core retail business at ~Rs139 / share (based on 15x FY10 EPS). We increase our target multiple from 12x to 15x, in-line with past methodology of maintaining c20% premium to regional peers.

We have not changed our valuations for Home Solutions and Future Capital. However, post the equity dilution, the valued attributed to Home Solutions is Rs21/share (vs. Rs25 earlier), based on 0.6x FY10E EV/sales. Future Capital is valued at Rs21/share (vs. Rs25 earlier), at 1.2x FY08 P/B. A 20% holding company discount has been ascribed for both Home Solutions and Future Capital.

Reduce Earnings by 18-30% over FY09-11E

We reduce earnings by 18-30% over FY09-11E, as we reduce our recurring profit estimates by 2-16% over the same period, factoring significant escalation in capital costs. Revenue forecasts remain fairly static; we've cut our space additions marginally by 1-4% in FY09-11E (we were significantly below company guidance initially). We increase our EBITDA forecasts by 2-3% in FY09/10E, giving the company benefit from operating leverage demonstrated this fiscal (demonstrated in the parent earnings, though we await consolidated results for more details).

There is a c20% dilution in FY09 over FY08, as we incorporate the company's capital raising plans and the issue of Class B shares.

Figure 2. Pantaloon Retail (Parent): Earnings Revision Summary

PART.BO	Old 2009	New 2009	% Change	Old 2010	New 2010	% Change	Old 2011	New 2011	% Change
Sq feet (mn sq ft)	9.6	9.3	-4%	11.0	10.8	-1%	13.0	12.8	-1%
Net revenues (Rs Mn)	67,422	64,212	-5%	82,370	79,227	-4%	106,597	100,978	-5%
EBITDA (Rs Mn)	6,414	6,606	3%	8,025	8,153	2%	11,547	10,875	-6%
EBITDA Margin (%)	9.5%	10.3%	77bps	9.7%	10.3%	55bps	10.8%	10.8%	-6bps
Interest costs (Rs Mn)	2,887	3,097	7%	3,321	3,586	8%	3,791	4,111	8%
PAT (Rs Mn)	1,428	1,393	-2%	1,801	1,763	-2%	3,360	2,818	-16%
EPS(Rs)	9.0	7.3	-18%	11.3	9.3	-18%	21.1	14.8	-30%

Source: Citi Investment Research and Analysis

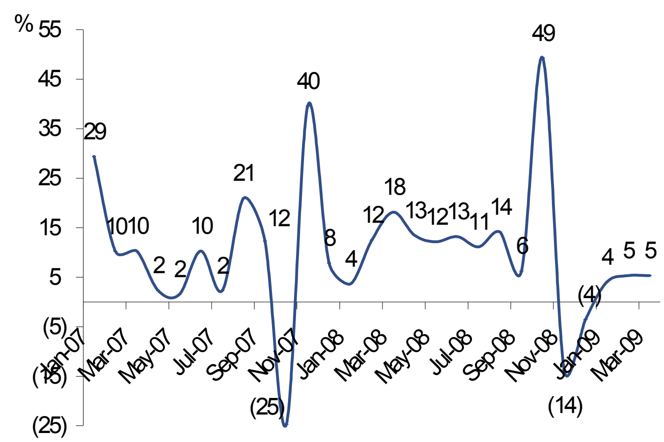
3QFY09 Results Review

Figure 3. Pantaloon (Parent): 3QFY09 Results Review (Rupees in Million, Percent)

	3QFY08	3QFY09	% Change
Net Sales	**13,543**	**16,421**	**21.2**
Total Expenditure	-12,402	-14,691	18.5
EBITDA	**1,141**	**1,730**	**51.6**
EBITDA Margin (%)	*8.4*	*10.5*	*211 bps*
Interest	-429	-847	97.6
Depreciation	-223	-369	65.1
Other Income	17	16	-3.0
PBT	**506**	**530**	**4.8**
Tax	-185	-186	0.8
Tax Rate (%)	*36.6*	*35.2*	*-140 bps*
PAT	**321**	**344**	**7.1**
Extraordinary Items	0	0	nm
Reported Profit	**321**	**344**	**7.1**
Key Costs			
Raw Materials and Finished Goods	9,526	11,500	20.7
% of Sales	*70.3*	*70.0*	*-30 bps*
Staff Costs	725	695	-4.1
% of Sales	*5.4*	*4.2*	*-112 bps*
Other Expenditure	2,151	2,496	16.0
% of Sales	*15.9*	*15.2*	*-68 bps*

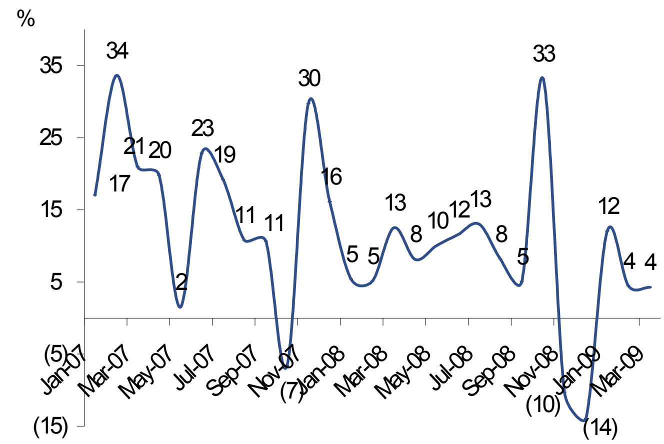
Source: Company Reports

Figure 4. Same-Store Sales Growth- Value Retailing (%)



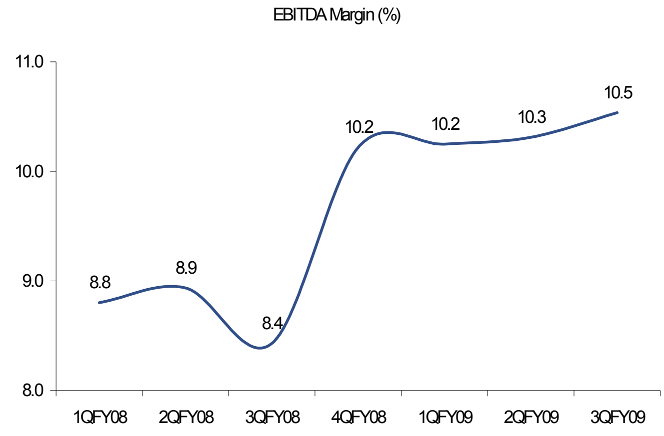
Source: Company Reports

Figure 5. Same-Store Sales Growth- Lifestyle Retailing (%)



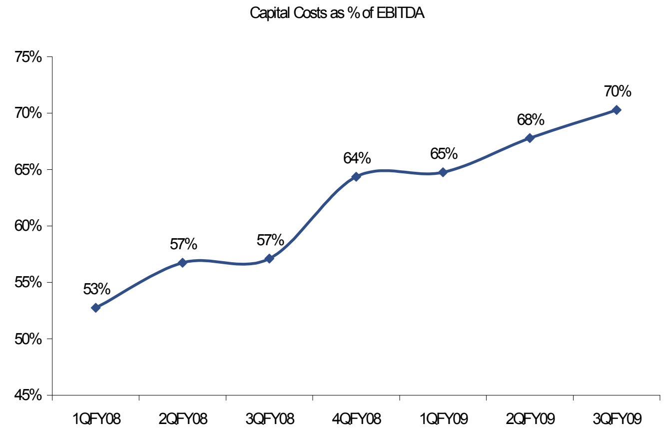
Source: Company Reports

Figure 6. EBITDA Margin Trends (%)



Source: Company Reports

Figure 7. Capital Costs as a % of EBITDA



Source: Company Reports

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 9m sq. ft. (including Home Retail) with plans to expand to 25m sq. ft. by FY11. Pantaloon retails fashion apparel and accessories through its Pantaloon stores, and general merchandise and food through 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 has 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. Pantaloon also has interests in media, logistics, brand management and e-tailing, through subsidiaries.

Investment strategy

We rate Pantaloon Retail (India) Ltd. (PRIL) Sell/Medium Risk (3M). We believe that the paucity of capital (given the tight conditions in the equity and credit markets) will constrain PRIL's growth trajectory. We forecast only around 13m sq feet of retail space for Pantaloon's various formats (excluding Home Solutions) by end 2011 (vs. management's forecasts of ~20 m sq feet). PRIL's debt–equity ratio is forecast to rise over the next 2 years. Capital constraints also have an impact on the company's valuations, as we believe there is a strong element of reflexivity embedded in the valuation–growth dynamic of PRIL's stock price.

Moreover, as the business model matures and is tested in the decelerating economic environment, the high valuations that PRIL enjoyed in the past won't be applicable over the medium term. We believe the key risk is a significant deceleration in SSS growth, as consumers curtail discretionary spends, and also as the overlapping footprints of various retail players leads to cannibalization of store sales. PRIL's management has indicated that SSS could decelerate to 5-6% over the next 3-4 years (our estimates are far higher because we factor in a far smaller retail footprint).

Valuation

Our Rs180 target price is based on sum of the parts. We value Pantaloon at 15x FY10 PE, which gives us Rs139/share. Our target multiple of 15x is at around a c20% premium to the peer group average, keeping in mind the higher earnings growth profile for Pantaloon. Home Solutions is valued at Rs21/share (based on 0.6x FY10E EV/sales – in line with global peers), and Future Capital is valued at Rs21/share (at 1.2x FY08 P/B). A 20% holding company discount has been ascribed for both Home Solutions and Future Capital.

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

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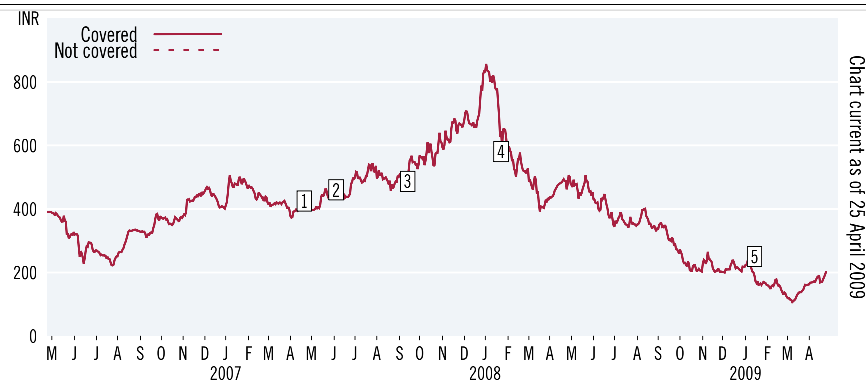
Pantaloon (PART.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008



Date	Rating	Target Price	Closing Price
1 20-Apr-07	*1M	*500.00	400.70
2 5-Jun-07	1M	*545.00	437.90
3 13-Sep-07	1M	*626.00	507.10
4 23-Jan-08	*3M	*520.00	644.95
5 14-Jan-09	3M	*184.00	189.70

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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