

Company In-Depth

20 April 2007 | 16 pages

Shoppers Stop (SHOP.BO)

 Rating change
 Target price change
 Estimate change

Sell: Valuations Building Excessive Expectations from HyperCity

- Valuations pricing in growth opportunities** — We like the Shoppers Stop growth story, leveraged to rapidly growing high-end urban consumption. However, at 43x FY08E P/E valuations are steep and seem to be building unfeasible expectations from HyperCity. As such, the stock has underperformed the Sensex by 9% and we expect valuation roadblocks to continue. Maintain SELL
- Excessive expectations from HyperCity** — Based on our scenario analysis, we estimate that Shoppers Stop's stock price is implying a steep valuation premium for HyperCity - ranging from 32%-290% over Pantaloon's valuations (India's leading hypermarket player), unsustainable in our view
- Premium positioning, but exposed to competition** — Shopper's stores have high end positioning and are located in tier I cities. While stores are well positioned to capture high income urban growth opportunity, competitive intensity in these locations is also likely to be the highest, resulting in slowing same store sales growth, including cannibalization as Shopper's own stores increase in each city
- Expansion to specialty segment** — Shoppers is increasing its retail space by 2.5x to 2.5m sq. ft over next 2-years. We expect 20% of this space to be dedicated to specialty formats offering a higher margin profile
- Raising Price Target** — Raising our target price to Rs421 from Rs275, reflecting 1) rolling forward of our 27x target P/E multiple from FY07E to FY08E and 2) incorporating value of 19% stake in HyperCity at Rs45 per share. Our price target of Rs421 is 40% below consensus target price of Rs723

Sell/Medium Risk	3M
<i>from Sell/Speculative</i>	
Price (19 Apr 07)	Rs635.00
Target price	Rs421.00
<i>from Rs270.00</i>	
Expected share price return	-33.7%
Expected dividend yield	0.3%
Expected total return	-33.4%
Market Cap	Rs21,833M
	US\$522M

Price Performance (RIC: SHOP.BO, BB: SHOP IN)



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

Figure 1. Shoppers Stop – Statistical Abstract

Year to	Net Profit	FD EPS	EPS Growth	P/E	Adj.P/E*	DPS	Yield	RoE
31-Mar	(Rs Mils.)	(Rs)	(%)	(x)	(x)	(Rs)	(%)	(%)
2005	189.9	6.9	57.6	91.0	84.5	1.0	0.2	21.9
2006	271.1	7.9	13.8	79.9	74.2	1.5	0.2	14.9
2007E	369.4	10.7	36.3	58.6	54.4	1.9	0.3	13.0
2008E	479.4	13.9	29.8	45.2	42.0	3.1	0.5	15.1
2009E	676.7	19.7	41.2	32.0	29.7	4.7	0.8	18.8

Source: Company Reports and Citigroup Investment Research estimates; *Adjusted for Hypercity stake

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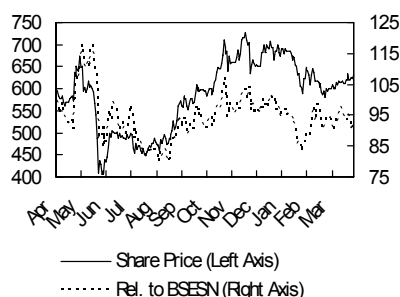
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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	91.7	80.6	59.1	45.5	32.3
EV/EBITDA adjusted (x)	68.5	44.6	33.8	25.8	18.0
P/BV (x)	18.4	8.1	7.3	6.5	5.7
Dividend yield (%)	0.2	0.2	0.3	0.5	0.7
Per Share Data (Rs)					
EPS adjusted	6.93	7.88	10.74	13.94	19.68
EPS reported	6.93	7.88	10.74	13.94	19.68
BVPS	34.55	78.51	87.07	97.50	111.84
DPS	1.00	1.50	1.94	3.11	4.73
Profit & Loss (RsM)					
Net sales	4,160	5,882	7,060	9,609	14,382
Operating expenses	-3,922	-5,531	-6,578	-8,967	-13,414
EBIT	238	350	481	642	968
Net interest expense	-39	-24	-42	-48	-89
Non-operating/exceptionals	8	76	112	122	132
Pre-tax profit	207	402	551	716	1,010
Tax	-17	-131	-182	-236	-333
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	190	271	369	479	677
Adjusted earnings	190	271	369	479	677
Adjusted EBITDA	328	490	623	829	1,240
Growth Rates (%)					
Sales	25.4	41.4	20.0	36.1	49.7
EBIT adjusted	55.8	47.2	37.4	33.4	50.6
EBITDA adjusted	44.1	49.4	27.2	33.0	49.7
EPS adjusted	57.6	13.8	36.3	29.8	41.2
Cash Flow (RsM)					
Operating cash flow	173	403	422	218	333
Depreciation/amortization	90	139	142	186	273
Net working capital	-106	-7	-89	-447	-616
Investing cash flow	-431	-511	-509	-800	-1,360
Capital expenditure	-416	-269	-359	-800	-1,360
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	258	1,192	-56	-121	837
Borrowings	285	-289	19	0	1,020
Dividends paid	-31	-59	-75	-121	-183
Change in cash	1	1,085	-143	-702	-190
Balance Sheet (RsM)					
Total assets	2,480	4,130	4,646	5,190	7,275
Cash & cash equivalent	10	1,098	951	249	59
Accounts receivable	26	53	45	61	91
Net fixed assets	1,096	1,225	1,442	2,056	3,143
Total liabilities	1,532	1,427	1,652	1,838	3,429
Accounts payable	626	783	897	1,213	1,804
Total Debt	874	586	605	605	1,625
Shareholders' funds	947	2,699	2,994	3,352	3,846
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.9	8.3	8.8	8.6	8.6
ROE adjusted	21.9	14.9	13.0	15.1	18.8
ROIC adjusted	14.7	12.1	14.3	14.7	15.6
Net debt to equity	91.2	-19.0	-11.6	10.6	40.7
Total debt to capital	48.0	17.8	16.8	15.3	29.7

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Figure 2. Shoppers Stop – Stock Price Relative to Sensex



Source: DataStream

Great Story, But Price into Valuations

We like the Shoppers Stop story – it is a leading department store in India with a premium position. Management has been conservative in expanding the business, managing growth carefully, focusing on strong operations and not unduly stressing the balance sheet. Shoppers Stop's positioning has also been at the premium end, with a strategy focusing on product assortment and quality, rather than discounts, driving sales. It is also expanding in the specialty format, focusing on food, cosmetics, books and apparel. We estimate retail space to increase from about 1m sq. ft. in FY06 to 2.5m by FY09E, driving a 36% CAGR in earnings over FY07E-FY09E. Shoppers Stop also has the option to acquire up to a 51% stake in HyperCity, the hypermarket format owned by its promoter. Of this, the company has already acquired 19%, and further increase in stake is imminent. However, current valuations seem to be pricing in growth profile of the business, and seem to be attributing an unsustainable premium to HyperCity's valuations. While we see clear upsides from Shoppers Stop acquiring 51% stake in HyperCity, we believe that too much is being built into the stock price. We maintain our Sell rating, but revise our price target upwards to Rs421 from Rs270 earlier, factoring in the value of its 19% stake in HyperCity acquired recently (Rs45 per share). We value Shopper's Stop (standalone entity) as Rs376 per share based on 27x FY08E P/E.

Figure 3. Shoppers Stop – Stock Price Performance, Absolute and Relative to Sensex (%)

(%)	3M	6M	12M
Absolute	(6.7)	5.7	5.9
Rel. to .BSESEN	(3.0)	(0.6)	(8.5)

Source: DataStream

Revising Price Target, Factoring in HyperCity Stake

We are increasing our price target for Shoppers Stop to Rs421 from Rs270, factoring in the value of 19% stake in HyperCity acquired recently (Rs45 per share). We value Shopper's Stop (standalone entity) as Rs376 per share, which we increase from Rs270 earlier. Our increase in per share value is on account of our rolling forward our target P/E multiple from FY07E to FY08E, given that we are already in FY08 and the stock valuations should start discounting in FY08E earnings. We maintain our 27x target P/E multiple. We also revise down our FY07E and FY08E EPS estimates by 12.2%-13.9%, factoring in lower sales due to delays in space roll out as well as lower margins.

Figure 4. Shoppers Stop – Earnings Revision Table

	Profits (Rs Million)			EPS (Rs)			DPS (Rs)		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
FY07E	420.6	369.4	-12.2	12.2	10.7	-12.2	2.2	1.9	-12.3
FY08E	646.0	479.4	-25.8	18.8	13.9	-25.8	3.8	3.1	-18.9

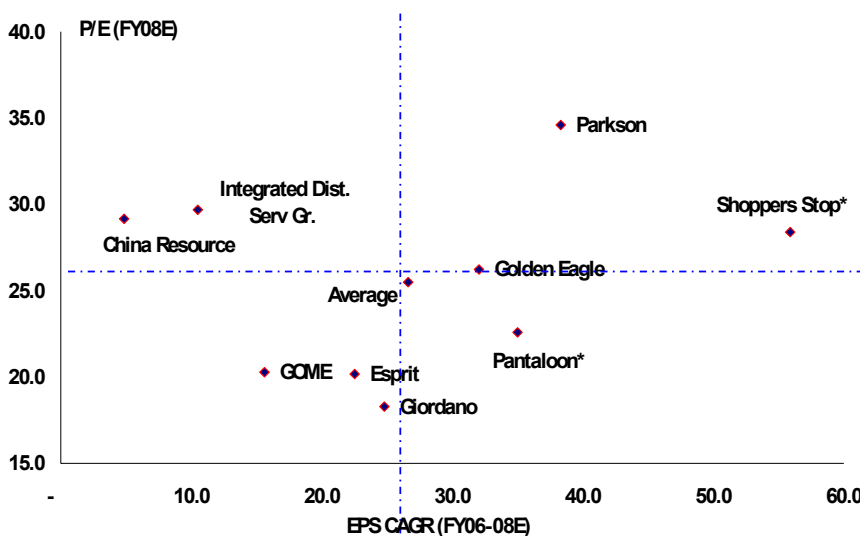
Source: Company Reports and Citigroup Investment Research estimates

Our target multiple is benchmarked against our regional retail universe and Indian market leader, Pantaloon. We believe Shoppers Stop could trade at a 10% premium to its regional peer group given its superior earnings growth

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profile. We expect a two-year EPS CAGR of 36% for Shopper's Stop, vs. a 30% CAGR for our Asian retail universe. We have assigned a 10% valuation discount for Shopper's Stop to our Pantaloon target valuation, due to limited growth opportunities for Shopper's Stop. Its business is confined to the higher-end lifestyle segment, and, therefore, is likely to offer fewer growth opportunities. We use P/E as our primary valuation methodology given the fair degree of earnings visibility for the company.

Figure 5. Asian Retail Universe – P/E v/s 2-year EPS CAGR



Source: Company reports; Citigroup Investment Research estimates; * P/E adjusted for subsidiary values

Figure 6. Asian Retail Sector – Valuation Summary*

Company	Ticker	Rating	Price	P/E 2007	P/E 2008	EV/EBITDA 2007	EV/EBITDA 2008	Dividend Yield 2008	RoE 2008	RoCE 2008	EPS CAGR 2006-08E
Golden Eagle Retail Group	3308.HK	1M	6.3	37.3	25.8	16.9	11.8	2.1%	40.7%	64.6%	32.0
Parkson Retail Group	3368.HK	2L	56.2	49.6	34.8	25.8	19.7	1.4%	35.0%	46.9%	38.3
China Resources Enterprise	0291.HK	3L	29.9	33.0	31.5	17.1	15.7	2.6%	9.3%	8.0%	4.8
Esprit	0330.HK	1L	92.7	24.8	19.9	17.5	13.8	3.8%	51.8%	64.1%	22.5
GOME	0493.HK	1M	11.7	25.1	20.4	19.1	14.8	1.5%	26.3%	52.7%	30.7
Giordano International	0709.HK	3L	3.7	18.1	17.2	7.8	7.4	5.8%	15.1%	21.7%	24.8
Integrated Distribution Services Group	2387.HK	1L	25.0	45.8	33.8	24.3	19.4	1.8%	22.3%	16.2%	10.5
Pantaloon	PART.BO	1M	399.0	55.1	30.6	25.8	14.4	0.2%	23.4%	18.7%	51.0
Shoppers Stop	SHOP.BO	3M	630.0	58.6	45.2	34.2	25.7	0.5%	15.1%	14.3%	33.0
Average				38.6	28.8	20.9	15.9	2.2%	26.5%	34.0%	27.5

Source: Company Reports and Citigroup Investment Research.*Priced as of April 18.

We value Shoppers Stop's recently acquired 19% stake in HyperCity at Rs45 per share. Our valuation for HyperCity is based on a 1.2x FY08E sales multiple, which is benchmarked off our regional peer group average. We use a sales multiple to value HyperCity given lack of margin disclosures and also that we believe that HyperCity is an early growth stage and FY08E profits are unlikely to reflect the margin potential of the business. Shopper's Stop has the option to increase its stake in HyperCity. Our sum of the parts table is enumerated below:

Figure 7. Shoppers Stop – Sum of the Parts Valuation

Business	Valuation Methodology	Per Share Value (Rs)
Shoppers Stop	27x FY08E P/E benchmarked off regional retail peer group	376
HyperCity	1.2x FY08E Market Cap/Sales, benchmarked off regional retail peer group and attributing proportionate value to Shoppers Stop 19% stake	45

Source: Company Reports and Citigroup Investment Research estimates

Excessive Expectations from HyperCity Stake

Shopper's Stop has the option to acquire up to 51% stake in its promoter's owned hypermarket store, HyperCity. This allows Shopper's Stop to make the acquisition at cost + annual 10% return or market price, whichever is lower. It recently acquired a 19% stake in HyperCity, for an undisclosed amount. We believe that further acquisition of stake to 51% is imminent, but already factored into valuations. Based on our fair value of Rs376 for the parent company, current stock price seems to imply a per share value of Rs259 per share for a potential 51% stake in HyperCity. Our scenario analysis suggests that the implied per share price for the HyperCity stake not only assumes that acquisition of a 51% stake is imminent, but also implies a premium of 32%-290% over Pantaloon's (leading hypermarket player in India) valuations. Our scenario analysis is enumerated below:

- We have stripped off our target fair value (Rs376) of the parent company from the current stock price of Rs635, implying that residual Rs259 is the option value of Shopper's Stop stake in HyperCity increasing to 51%.
- We assume (based on recent 19% stake purchase and indications from management) this stake will be increased to 51% by 2008. Since we don't have enough disclosures on the cost of HyperCity (while we can estimate store set up cost, we don't have data on overheads), we have not assumed any cost to Shoppers Stop for the stake – so to that extent we are understating the valuation premium being attributed to HyperCity.
- We base our growth assumptions for HyperCity on management guidance of 3-4 stores every year – assuming stores increasing to seven in the worst case and 13 in the best case by FY09E. We also base our net margin assumptions of 3% in worst case (close to Pantaloon's current net margins) and 7% in best case (premium to Shoppers current margins)
- We benchmark implied valuations based on Market Cap / Sales and P/E over Pantaloon's valuations.

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Figure 8. Asian Retail Universe – Scenario Analysis: Implied Valuations for HyperCity

	Worst Case	Median Case	Best Case
No of Stores in FY09E	7	9	13
FY09E Sales (Rs Million)	9,375	12,188	18,563
FY09E Net Margin (%)	3%	4%	5%
Implied FY09E Market Cap / Sales (x)	2.7	2.1	1.4
Implied premium to Pantaloon's valuations (%)	261%	177%	82%
Implied FY09E P/E (x)	90	59	30
Implied premium to Pantaloon's valuations (%)	292%	158%	32%

Source: Citigroup Investment Research estimates

Despite our view on valuations, we do not deny the merit of increasing a stake in HyperCity, which will provide Shoppers Stop with exposure to the fast growing Hypermarket format. Now, only one store is located in Mumbai, and it expects to add four stores every year going forward, with a target to increase the total number of stores to 29 by end 2009. HyperCity's product mix includes 30% sales from food items, a fast growing segment. Additionally, private label sales account for 25%, which management is targeting to increase to 30%. We enumerate below our key base case operating assumptions for HyperCity:

Figure 9. HyperCity – Key Operating Parameters (Rupees in Million, Percent)

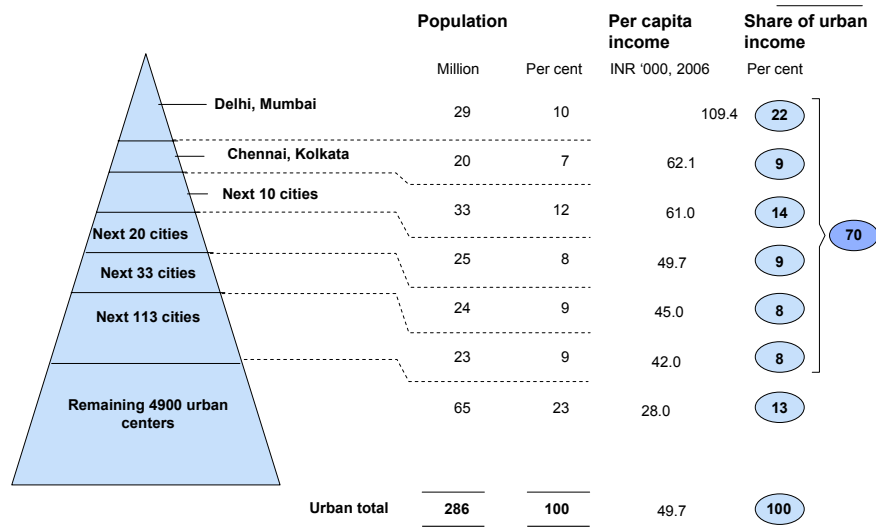
Sales Breakup	FY06	FY07E	FY08E	FY09E
Sales (Rsm)	813	3,250	7,313	12,188
Growth (%)		300	125	66.7
Total Space (Sq Feet)	125,000	375,000	750,000	1,125,000
Growth (%)	nm	200.0	100.0	50.0
Space Added (Sq. Ft.)		250,000	375,000	375,000
Average Space (Sq Ft)	62,500	250,000	562,500	937,500
No. of Stores	1	3	6	9
Sales / Sq Ft. (Rs)	13,000	13,000	13,000	13,000
Space/Store (Sq ft)	125,000	125,000	125,000	125,000

Source: Company reports; Citigroup Investment Research estimates

Premium Positioning, but Exposed to Competitive Risks

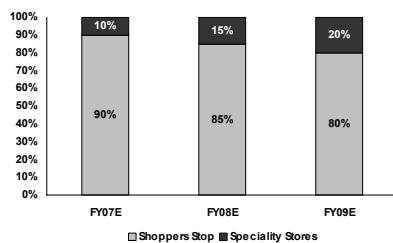
Shopper's Stop department stores are positioned at the premium end, catering to upper-mid and upper income segments. Shoppers Stop's outlets are likely to be concentrated in tier-I cities, where majority of the organized retail expenditure is likely to be concentrated. Top 14 cities in India contribute to almost 45% of total urban income in India and that Shopper's Stop is well positioned to capture this predominantly urban opportunity. However, its formats are also exposed to competitive risks, especially given that mall concentration is likely to be the highest in tier I cities. We expect slowing same store sales growth going forward, driven by rising competitive intensity, and to partly due to cannibalization by Shopper's own store expansions in these cities.

Figure 10. Urban India – Population and Income Pyramid



Source: Census of India 2001; NCAER "The Great Indian Middle Class"; Market Skyline 2006; McKinsey & Company

Figure 11. Space contribution from Specialty Stores (%)

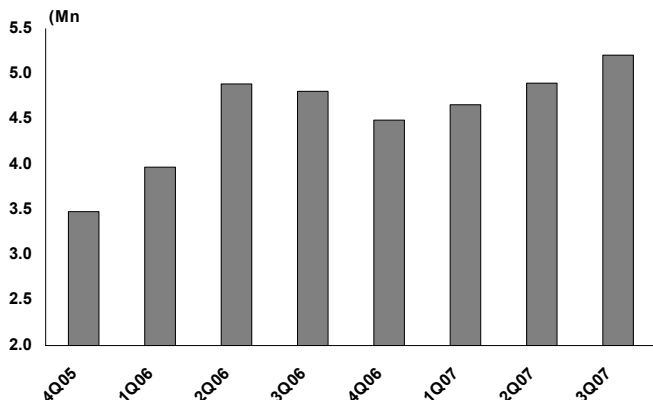


Source: Company Reports and Citigroup Investment Research estimates

Shopper's Stop is expanding its presence in the specialty segment. The company's specialty stores include Crossword (books), Home Stop (furniture and home furnishings), Brio (Café), MAC (Cosmetics) and Mother Care (apparel and accessories). We expect area under specialty formats to increase to 0.5m sq. ft., or almost 20% of total retail area by FY09E. We estimate that sales contribution from the specialty format will be higher than overall company average. We understand from management that these new formats have already turned profitable.

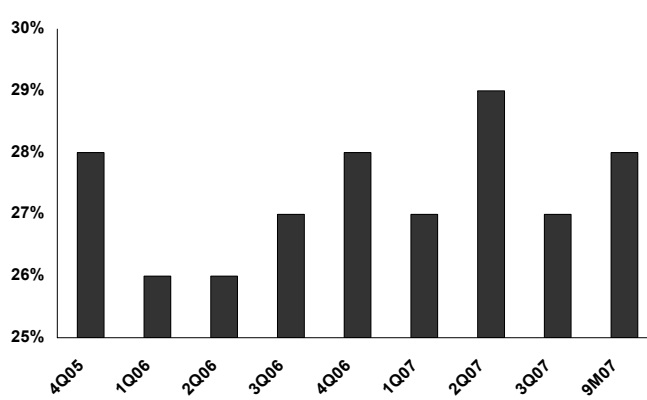
Shoppers Stop operating parameters remain strong and its stores are well managed. This is evident from continuous improvement in trends in footfalls, conversion ratios, ticket size and sales per sq. However, we believe that as competition in tier-I cities picks up, some of these parameters could start to taper.

Figure 12. Shoppers Stop – Customer Entry Trend (Million)



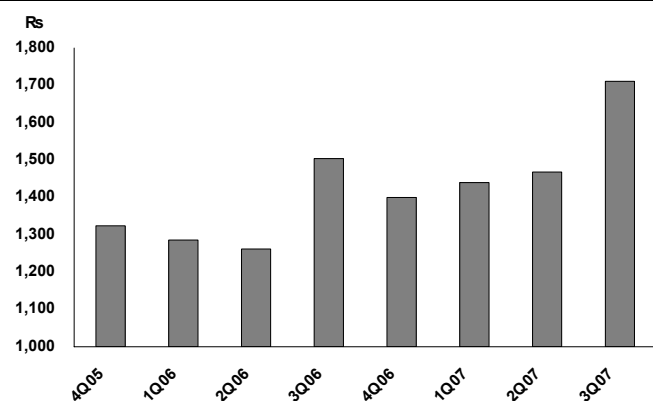
Source: Company reports

Figure 13. Shoppers Stop – Conversion Ratios (Percent)



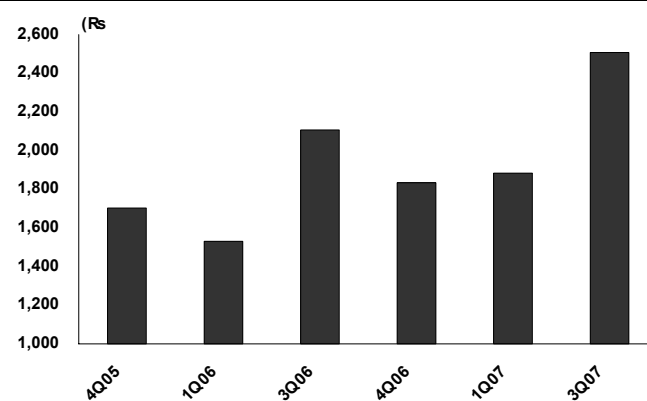
Source: Company reports

Figure 14. Shoppers Stop – Average Ticket Size Trend (Rupees)



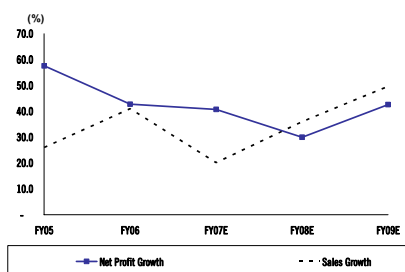
Source: Company reports

Figure 15. Shoppers Stop – Quarterly Same Store Sales Trend (Rupees/Sq. ft.)



Source: Company reports

Figure 16. Shoppers Stop – Sales and Profit Growth Trend (% YoY)



Source: Company Reports and Citigroup Investment Research estimates

EPS CAGR of 36% over FY07E-FY09E

We forecast an EPS CAGR of 36% over FY07E-FY09E drive by sales growth CAGR of 43% during the same period. We expect rising rentals and wage inflation to pare margins, mitigated partly by improving product mix. We estimate retail space for Shoppers Stop to increase from about 1m sq. ft. in FY06 to 2.5m by FY09E. Our space addition estimates are slightly below management guidance, factoring in delays mall developments. Our key sales growth assumptions are enumerated below:

Figure 17. Shoppers Stop – Sales Growth Assumptions (Rupees in Million, Percent)

	FY05	FY06	FY07E	FY08E	FY09E
Gross Retail Sales	5,000.7	6,660.3	8,198.9	11,148.7	16,686.4
Less: Cost of consignment merchandise	(798)	(582)	(1,599)	(2,174)	(3,254)
<i>As a % of consignment merchandise</i>	<i>74%</i>	<i>70%</i>	<i>65%</i>	<i>65%</i>	<i>65%</i>
Less: Value Added Tax	(114)	(311)	(328.0)	(445.9)	(667.5)
<i>As a % of gross sales</i>	<i>2%</i>	<i>5%</i>	<i>4%</i>	<i>4%</i>	<i>4%</i>
Net Retail Sales	4,089.5	5,767.0	6,928.1	9,420.6	14,100.0
<i>% growth</i>	<i>26.0</i>	<i>41.0</i>	<i>20.1</i>	<i>36.0</i>	<i>49.7</i>
Other Retail Operating Income	70.6	114.8	131.6	188.4	282.0
Total Retail Sales	4,160.1	5,881.9	7,059.7	9,609.0	14,382.0
<i>% Growth</i>	<i>25%</i>	<i>41%</i>	<i>20%</i>	<i>36%</i>	<i>50%</i>
Sales Break Up (%)					
<i>Apparels</i>	<i>65%</i>	<i>65%</i>	<i>60%</i>	<i>60%</i>	<i>60%</i>
<i>Non-Apparels</i>	<i>35%</i>	<i>35%</i>	<i>40%</i>	<i>40%</i>	<i>40%</i>
Total Space (Sq. Feet)	752,848.0	950,701.0	1,150,701.0	1,650,701.0	2,500,701.0
<i>% Change</i>	<i>7.4%</i>	<i>26.3%</i>	<i>21.0%</i>	<i>43.5%</i>	<i>51.5%</i>
Space Added (Sq. Feet)	52,152.0	197,853.0	200,000.0	500,000.0	850,000.0
Average Space (Sq. Feet)	726,772.0	851,774.5	1,050,701.0	1,400,701.0	2,075,701.0
<i>% Change</i>	<i>7%</i>	<i>26%</i>	<i>21%</i>	<i>43%</i>	<i>51%</i>
No of Stores	16.0	22.0	22.0	40.0	58.0
Sales / Sq Ft. (Rs)	7,152.0	7,576.0	7,803.3	7,959.3	8,038.9
Merchandise Split					
Own Merchandise	3,916.2	5,828.1	5,739.2	7,804.1	11,680.5
<i>As a % of Sales</i>	<i>78.3%</i>	<i>87.5%</i>	<i>70.0%</i>	<i>70.0%</i>	<i>70.0%</i>
Consignment Merchandise	1,084.5	832.2	2,459.7	3,344.6	5,005.9
<i>As a % of Sales</i>	<i>36.8%</i>	<i>28.2%</i>	<i>30.0%</i>	<i>30.0%</i>	<i>30.0%</i>

Source: Company Reports and Citigroup Investment Research estimates

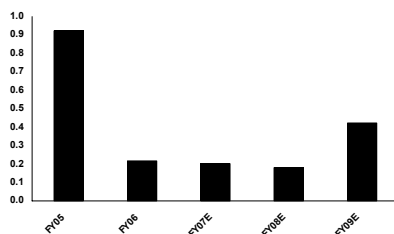
We expect margins will decline going forward due to pressure on rentals and wage cost. However, operating leverage and improving product mix (higher share of non-apparel sales) is likely to mitigate margins pressure to some extent. Our key margin assumptions are enumerated below.

Figure 18. Shoppers Stop – Margin Assumptions (Rupees in Million, Percent)

	FY05	FY06	FY07E	FY08E	FY09E
Total Retail Sales	4,160.1	5,881.9	7,059.7	9,609.0	14,382.0
% Growth	25%	41%	20%	36%	50%
Cost of Goods Sold	(2,623.9)	(3,739.8)	(4,394.6)	(5,998.0)	(8,994.0)
Gross Profit	1,536.1	2,142.0	2,665.1	3,611.1	5,388.0
Gross Margin (%)	30.7%	32.2%	32.5%	32.4%	32.3%
Employee Costs	-288.3	-402.9	-532.9	-724.7	-1,084.6
As % of Sales	5.8%	6.0%	6.5%	6.5%	6.5%
Operating and Administrative Expenses	-920.0	-1,249.4	-1,509.1	-2,057.6	-3,063.0
As % of Sales	18.4%	18.8%	18.4%	18.5%	18.4%
Total Operating Expenses	-1,208.2	-1,652.3	-2,042.0	-2,782.3	-4,147.6
As % of Sales	24.2%	24.8%	24.9%	25.0%	24.9%
EBITDA	327.9	489.8	623.1	828.8	1,240.5
EBITDA Margin (%)	6.6%	7.4%	7.6%	7.4%	7.4%

Source: Company Reports and Citigroup Investment Research estimates

Figure 19. Shoppers Stop – Gearing Trend (%)



Source: Company Reports and Citigroup Investment Research estimates

Strong Balance Sheet, Improving Capital Efficiency

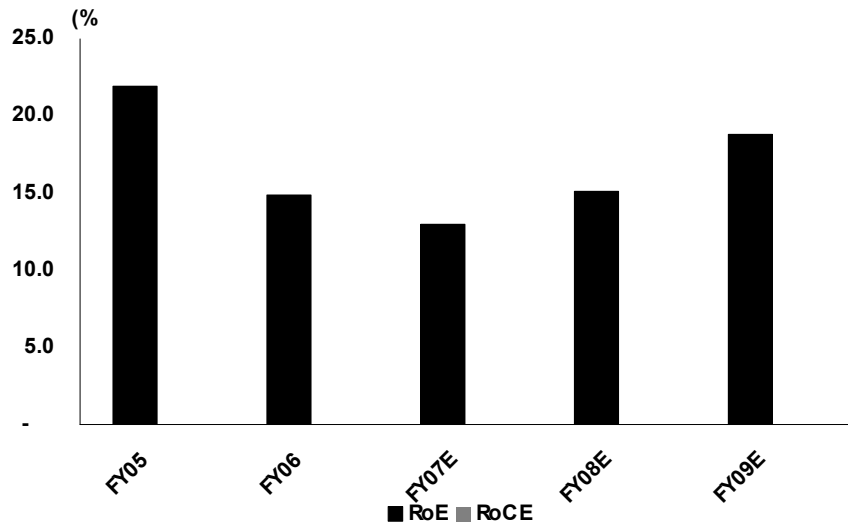
Shoppers stop has a strong balance sheet, with low gearing. We expect gearing to remain under manageable levels, even after taking into account store expansion till FY09E. However, even in FY09E, we estimate gearing to be only about 0.5x. We would like to caveat that our estimates do not build in potential fund raising for acquisition of HyperCity stake, and to that extent our debt levels could be understated.

We estimate that typically, each sq. ft. of incremental addition would require about Rs1600 for capital expenditure and about Rs700 in inventories. Shopper's Stop does not carry the inventory of its concessionaries onto its balance sheet, and with rising contribution of concessionaries, we expect per sq. ft. inventories to decline.

We expect ROE and ROCE to continue to improve, driven rising profits and continued improvement in working capital.

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Figure 20. Shoppers Stop – ROE and ROCE (Percent)



Source: Citigroup Investment Research estimates

Shoppers Stop

Company description

Shopper's Stop is one of India's largest department-store chains. It opened its first store, retail menswear, in 1991. Since then, it has expanded to 22 stores in large Indian cities, retailing apparel and non-apparel products. The company plans to expand its reach from 0.1m sq feet now to almost 2.5m sq. ft. by FY08E by entering new cities and having 39 stores by FY08E. Its subsidiary, Crossword (which it acquired in FY00), has the largest bookstore chain in India with 26 stores. It is also expanding its presence in other specialty formats through brands such as Home Stop (furniture and home furnishings), Brio (Café), MAC (Cosmetics) and Mother Care (apparel and accessories)

Investment thesis

We rate Shopper's Stop Sell/Medium Risk (3M). Current valuations not only seem to be factoring in growth but are also building in high expectations from a potential 51% stake acquisition in HyperCity. As such, the risk-reward balance seems unfavorable. In addition, Shopper's Stop is likely to have difficulty expanding beyond tier-one cities as it caters to the 'lifestyle' higher-income segment. The department-store segment is the most crowded of India's retail formats, and competes with specialty and single brand stores.

Valuation

We value Shoppers Stop using sum of the parts valuation, factoring in the value its 19% stake in HyperCity. Our sum of the parts valuations returns a target price of Rs421 per share, valuing the parent company at Rs376 and the HyperCity stake at Rs45 per share. We value the parent Shoppers Stop based on 27x FY08E P/E, for a target price of Rs376. Our target multiple is benchmarked against our regional retail universe and Indian market leader Pantaloon. We believe Shoppers Stop could trade at 10% premium to its regional peers given its superior earnings growth profile. We expect two-year EPS CAGR of 36% vs. a 30% CAGR for our Asian retail universe. We assign a 10% valuation discount for Shopper's Stop to our Pantaloon target valuation, due to limited growth opportunities for Shopper's Stop. Its business is confined to the higher-end lifestyle segment, likely to offer fewer growth opportunities. We use P/E as our primary valuation methodology given the fair degree of earnings visibility. Our valuation for HyperCity is based on a 1.2x FY08E sales multiple, benchmarked off our regional peer group average.

Risks

We assign a Medium Risk rating to Shopper's Stop based on our quantitative risk-rating system. Key upside risks to our target price and estimates include: 1) Better-than-expected margins; 2) better-than-expected sales growth; 3) Any potential acquisitions, including increasing its stake in HyperCity. Key downside risks to our target price include: 1) intensifying competition; 2) execution risks; and 3) increasing competition from global retailers.

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Appendix A-1

Analyst Certification

I, Princy Singh, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Shoppers Stop (SHOP.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since August 18 2005)



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