INDIA RESEARCH

Pantaloon Retail

Rs339
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs59bn; US$1.2bn

Analyst: Bhushan Gajaria (91-22-6638 3367; bhushangajaria@idfcsski.com)
Result: FY09
Comment: Focus on efficiency!
Last report: 24 September 2009 (Price Rs334; Recommendation: Outperformer)

Key valuation metrics

Year end Mar 31	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E	PER (x)
FY08	50,478	56.0	1,248	7.8	(4.1)	16.6	43.3
FY09	63,418	25.6	1,409	8.1	3.1	13.0	41.9
FY10E	81,490	28.5	2,092	11.7	44.3	11.0	29.1
FY11E	103,152	26.6	3,215	17.9	53.7	8.8	18.9

**Standalone*

HIGHLIGHTS OF FY09 RESULTS

- In line with our estimates, Pantaloon Retail (PRIL) standalone has reported revenue growth of 26% at Rs63.4bn, EBITDA of Rs6.7bn and PAT growth of 13% at Rs1.4bn in FY09
- PRIL has during the year added 1.8m sq. ft. of retail space with 9.7m sq. ft. of retail operations under standalone entity. As on June 2009, PRIL had 116 Big Bazaar stores, 45 Pantaloons and 9 Central. With capital being a constraint, PRIL has slowed down the pace of expansion (2.8m sq. ft. added in FY08)
- With overall economic slowdown, PRIL's same store sales growth has slowed down to 7.4% in value retailing (10% in FY08) and 6% in lifestyle retailing (10.3% in FY08). While sales per sq. ft. has increased to Rs6816 in Pantaloons (Rs6576 in FY08), same has dropped for Big Bazaar (from Rs7925 to Rs7412) and for Central (from Rs7817 to Rs6616).
- Being ahead of the curve, PRIL has taken cost correction measures and the same is reflecting in 140bp of margin expansion during the year at 10.5% in FY09.
- However, gross margins have contracted by 30bp with value retailing growing faster. Share of value retailing has increased by 20bp at 71.9%
- While the EBITDA growth during the year stood at 45.5%, PAT growth was subdued on account of 72% increase in interest cost at Rs3.2bn. Debt at the end of the year stood at Rs28.5bn (Rs21.9bn in FY08).
- Of the total Rs13bn of capital deployment during the year, Rs5.2bn has gone towards fixed assets, Rs4bn towards working capital and Rs3.7bn towards investments in subsidiaries. Retail business RoCE has increased to 18.6% from 17.7% in FY08
- During the quarter Q4FY09, PRIL's revenues have grown by 20.4% at Rs16.6bn (estimates of Rs16.7bn), EBITDA of Rs1.83bn (estimates of Rs1.83bn) and PAT of Rs367m (estimates of Rs378m)
- PRIL, on a consolidated basis, has reported revenue growth of 31% at Rs76.7bn, EBITDA of Rs5.1bn and PAT post minority interest at Rs100m in FY09
- Amongst the subsidiaries, insurance business has been the biggest drag with losses of Rs1.06bn

- While Home Solutions business was expected to turn profitable in FY09, slow down in the housing market led to sharp decline in same store sales and overall sales growth stood at 12% (Rs10.7bn) and incurred operating loss of Rs360m. Future Logistics business has turned profitable – revenues of Rs1.94bn and EBITDA of Rs100m.
- While insurance business is expected to continue to incur losses in the near future, other businesses are either expected to turn profitable or the losses are expected to be curtailed as PRIL goes for a calibrated growth approach
- PRIL has recently raised Rs3bn through equity issuance to promoters and BCCL Group. PRIL has also raised USD10m for 10% stake sale in Future Logistics to Li & Fung. Li & Fung has option to increase the stake to 26% on further infusion of upto USD20m.

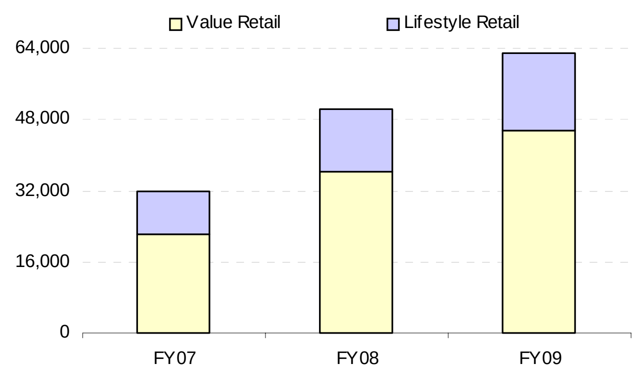
Our liking for PRIL has been on the back of scale of operations (3x the nearest competitor) as also the width of formats across fashion, food, general merchandise and home solutions. While PRIL would continue to be the fastest growing retailer even going forward, we believe that growth would be more calibrated – 2.5m-3m sq. ft. of retail expansion including home solutions and focus on flagship formats (Pantaloons, Big Bazaar, Central, Food Bazaar and Brand Factory). Also, with external capital being a constraint, the focus is now shifting on efficiency – capital efficiency in particular through effective store rightsizing and inventory management. PRIL is expected to bring down the inventory levels from Rs1850/ sq. ft. now to Rs1400/ sq. ft. by FY11, as gains from Automatic Replenishment System, Warehouse Management System, inventory rightsizing, cut down on order fulfillment time, etc come to the fore. All these factors would converge to Rs9bn of cash profit generation over FY09-11E, 60% of the incremental growth funding through internal accruals and reduced dependence on debt fund. Further trigger would come in as PRIL is scouting for Rs10bn of fund raise to further deleverage the balance sheet, rope in strategic partner for value retail operations and put the subsidiaries on self funding mode. With healthy margins, efficient deployment of capital and lower debt, we maintain our Outperformer rating on PRIL with a price target of Rs408.

KEY TAKEAWAYS OF POST EARNINGS CONFERENCE CALL

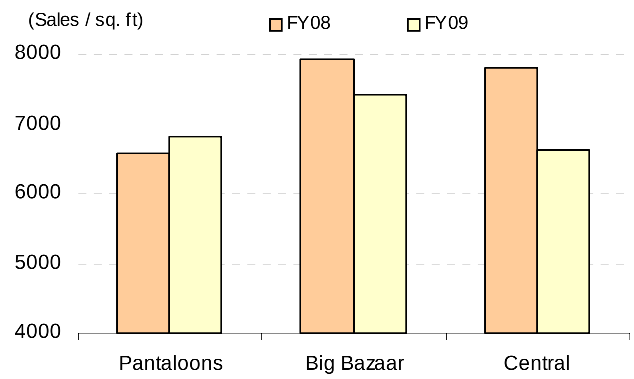
- The focus from here on would be more on calibrated growth and focus on limited formats. While PRIL plans to add 2.5m-3m sq. ft. of retail space annually for the next couple of years. The focus would remain on the key formats like Big Bazaar (~30 stores to be added in FY10), Central (6 outlets), Pantaloons (14 outlets) and Brand Factory. Overall growth is expected to pick up with same store sales now nearing 10%.
- With a view to improve upon the profitability in the business, PRIL is increasing the private label contribution to the overall sales (foods in particular). PRIL is launching community staples under the brand *Ekta* (45 SKU launches). PRIL is also expected to launch private label toothpaste in the near future.
- PRIL's investment in retail business is at Rs1800/ sq. ft. towards working capital and Rs1800/sq. ft. towards fit outs and deposits. The investments are expected to drop (Rs400-450/sq. ft. of savings on inventory)
- Efforts towards inventory management have already begun. PRIL has cut down on number of warehouses to 7 large DCs and Warehouse Management System has been implemented across all the DCs. Also 50% of the SKUs have moved to Auto Replenishment System and post SALE fill rates have improved to 3-4 days from 3 weeks earlier.
- PRIL has during the year increased the investments by over Rs3.5bn, with substantial investments going towards Home Solutions, Future Generali (Rs1bn) and acquisition of 2 properties (Rs1.3bn over 2 years). Future Logistics has got into self funding mode and PRIL has no plans to increase its investments in other subsidiaries like Future Media, Future Knowledge, Future Brands, etc,
- Amongst the various subsidiaries of PRIL, Future Logistics, Future Knowledge Services and Future Learning and Development are shaping up well. On the other hand, PRIL has scaled down its operations under Future Bazaar, Future Media, telecom business, etc.

- Home Solutions business is expected to breakeven, as same store sales show signs of improvement and PRIL reduces its exposure to low margin electronics business.
- PRIL would likely restructure the business into three parts – retail group, financial group and retail support business group
- PRIL is scouting for fund raise for retail business growth, deleveraging the balance sheet and funding of non retail subsidiaries. While substantial portion of the incremental growth funding requirement would be met internally, PRIL needs Rs12bn of capital for growth and deleveraging the balance sheet (bring debt equity ratio below 1x). PRIL is also in talks with financial investors, likely at the holding company level.
- PRIL is looking for a strategic partner (potentially with global retailers like Carrefour) for the value retail business. PRIL may look at demerging the Big Bazaar operations to unlock value. On the other hand, PRIL would also divest part of its stake in non retail ventures to de-risk the balance sheet of retail business

Increasing share of value retail

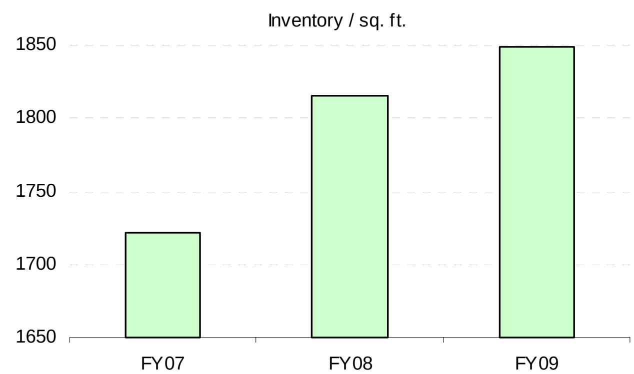


Sales per sq. ft

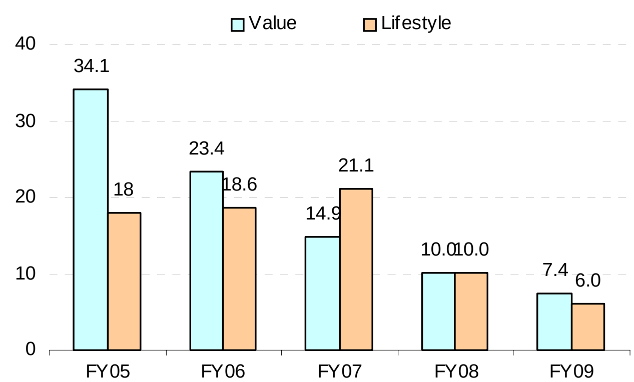


Source: Company

Inventory levels



Same store sales growth



Source: Company

Performance of subsidiaries

Subsidiary	PRIL's stake (%)	Revenues (Rs m)	EBITDA %	Capital Employed (Rs m)
Future Capital	54.8	1360	31.5	12170
Home Solutions Retail	66.9	10710	(3.4)	6740
Future Agrovet	96.2	3910	0.4	610
Future Logistics	94.2	1940	5.3	350
Future Brands	76.3	190	1.7	150
Future Media	84.2	460	(13.0)	420
Future Knowledge	100	470	3.0	450
Future Learing & Development	100	50	21.9	330
Future E-commerce infrastructure	72	1180	(20.5)	540
Winner Sports Limited	100	330	5.9	430

Source: Company

PRIL's SoTP valuations

	Basis of valuation	Entity valuations (Rs m)	Per share value
Standalone retail operations	8x EV/E FY11E	82,453	459.6
Home Solutions	Capital Employed	1,180	6.6
Future Logistics	90% stake valued strategic value attached by Li Fung	4,320	24.1
Future Capital	55% holding - current market cap	9,912	55.3
Other subsidiaries	Capital Employed	3,997	22.3
Total Entity valuation		**101862.6**	**568**
Less Net Debt - standalone		28719.6	160.1
Equity value		**73143.0**	**408**

Source: IDFC SSKI Research

Quarterly results

Rs Mn	Q4FY08	FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	FY09	FY10E	FY11E
Net Sales	**13,814**	**50,478**	**15,112**	**15,257**	**16,421**	**16,627**	**63,418**	**81,490**	**103,152**
%yoy	*35.5*	*56.0*	*39.1*	*24.4*	*21.2*	*20.4*	*25.6*	*28.5*	*26.6*
Operating profit	**1411.5**	**4,594**	**1548.8**	**1573.1**	**1730.2**	**1832.3**	**6,683**	**8,324**	**10,307**
EBITDA %	**10.2**	**9.1**	**10.2**	**10.3**	**10.5**	**11.0**	**10.5**	**10.2**	**10.0**
Net Interest	655	185	684	742	847	910	3180	3500	3519
Depreciation	254	834	319	325	369	388	1401	1779	2093
Other Income	1	38	12	15	16	18	61	100	140
Profit before tax	503.6	1944.7	557.5	522.1	530.3	552.4	2163.1	3145.4	4835.0
Tax	178.3	697	195.7	186.7	186.4	185.0	754	1054	1620
PAT	**325.3**	**1248.2**	**361.8**	**335.4**	**343.9**	**367.4**	**1409.3**	**2091.7**	**3215.3**
%yoy	*73.7*	*4.1*	*21.9*	*6.2*	*7.1*	*12.9*	*12.9*	*48.4*	*53.7*

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6638 3300
Pathik Gandotra	Head of Research; Financials, Strategy	pathik@idfcsski.com	91-22-6638 3304
Shirish Rane	Construction, Power, Cement	shirish@idfcsski.com	91-22-6638 3313
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhilvora@idfcsski.com	91-22-6638 3308
Ramnath S	Automobiles, Auto ancillaries, Real Estate, Oil & Gas	ramnaths@idfcsski.com	91-22-6638 3380
Nitin Agarwal	Pharmaceuticals	nitinagarwal@idfcsski.com	91-22-6638 3395
Chirag Shah	Metals & Mining, Pipes, Textiles, Telecom	chirag@idfcsski.com	91-22-6638 3306
Bhoomika Nair	Logistics, Engineering, Power	bhoomika@idfcsski.com	91-22-6638 3337
Hitesh Shah, CFA	IT Services	hitesh.shah@idfcsski.com	91-22-6638 3358
Bhushan Gajaria	Retailing, FMCG, Media, Mid Caps	bhushangajaria@idfcsski.com	91-22-6638 3367
Ashish Shah	Construction, Power, Cement, Telecom	ashishshah@idfcsski.com	91-22-6638 3371
Salil Desai	Construction, Power, Cement	salil@idfcsski.com	91-22-6638 3373
Ritesh Shah	Metals & Mining, Pipes, Textiles	riteshshah@idfcsski.com	91-22-6638 3376
Neha Agrawal	Financials	neha@idfcsski.com	91-22-6638 3237
Swati Nangalia	Mid Caps, Media, Exchanges	swati@idfcsski.com	91-22-6638 3260
Sameer Bhise	Strategy, Pharmaceuticals	sameer@idfcsski.com	91-22-6638 3390
Shweta Dewan	Mid Caps, Education, FMCG	shweta.dewan@idfcsski.com	91-22-6638 3290
Nikhil Salvi	Cement, Construction	nikhil.salvi@idfcsski.com	91-22-6638 3239
Rajeev Desai	Real Estate	rajeev@idfcsski.com	91-22-6638 3231
Chinmaya Garg	Financials	chinmaya@idfcsski.com	91-22-6638 3325
Aniket Mhatre	Automobiles, Auto ancillaries	aniket@idfcsski.com	91-22-6638 3311
Probal Sen	Oil & Gas	probal@idfcsski.com	91-22-6638 3238
Rupesh Sonawale	Database Analyst	rupesh@idfcsski.com	91-22-6638 3382
Dharmesh Bhatt	Technical Analyst	dharmesh@idfcsski.com	91-22-6638 3392

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6638 3300
Naishadh Paleja	MD, CEO	naishadh@idfcsski.com	91-22-6638 3211
Paresh Shah	MD, Dealing	paresh@idfcsski.com	91-22-6638 3341
Vishal Purohit	MD, Sales	vishal@idfcsski.com	91-22-6638 3212
Nikhil Gholani	MD, Sales	nikhil@idfcsski.com	91-22-6638 3363
Sanjay Panicker	Director, Sales	sanjay@idfcsski.com	91-22-6638 3368
V Navin Roy	Director, Sales	navin@idfcsski.com	91-22-6638 3370
Suchit Sehgal	AVP, Sales	suchit@idfcsski.com	91-22-6638 3247
Pawan Sharma	MD, Derivatives	pawan.sharma@idfcsski.com	91-22-6638 3213
Dipesh Shah	Director, Derivatives	dipeshshah@idfcsski.com	91-22-6638 3245
Jignesh Shah	AVP, Derivatives	jignesh@idfcsski.com	91 22 6638 3321
Sunil Pandit	Director, Sales trading	suniil@idfcsski.com	91-22-6638 3299
Mukesh Chaturvedi	SVP, Sales trading	mukesh@idfcsski.com	91-22-6638 3298
Viren Sompura	VP, Sales trading	viren@idfcsski.com	91-22-6638 3277
Rajashekhar Hiremath	VP, Sales trading	rajashekhar@idfcsski.com	91-22-6638 3243

Disclaimer

This document has been prepared by IDFC-SSKI Securities Ltd (IDFC-SSKI). IDFC-SSKI and its subsidiaries and associated companies are full-service, integrated investment banking, investment management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities.

This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction.

The information contained herein is from publicly available data or other sources believed to be reliable. While we would endeavor to update the information herein on reasonable basis, IDFC-SSKI, its subsidiaries and associated companies, their directors and employees ("IDFC-SSKI and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent IDFC-SSKI and affiliates from doing so.

We do not represent that information contained herein is accurate or complete and it should not be relied upon as such. This document is prepared for assistance only and is not intended to be and must not alone betaken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved). The investment discussed or views expressed may not be suitable for all investors.

Affiliates of IDFC-SSKI may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject IDFC-SSKI and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

IDFC-SSKI & affiliates may have used the information set forth herein before publication and may have positions in, may from time to time purchase or sell or may be materially interested in any of the securities mentioned or related securities. IDFC-SSKI and affiliates may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall IDFC-SSKI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. Any comments or statements made herein are those of the analyst and do not necessarily reflect those of IDFC-SSKI and affiliates.

This Document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed to and may contain confidential and/or privileged material and is not for any type of circulation. Any review, retransmission, or any other use is prohibited.

Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. IDFC-SSKI will not treat recipients as customers by virtue of their receiving this report.

Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

1. IDFC - SSKI and its affiliates may have received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and Other corporate advisory services.
2. Affiliates of IDFC - SSKI may have mandate from the subject company.
3. IDFC - SSKI and its affiliates may hold paid up capital of the company.
4. IDFC - SSKI and its affiliates, their directors and employees may from time to time have positions in or options in the company and buy or sell the securities of the company(ies) mentioned herein.