INDIA

Retail

Pantaloon Retail

FY09 Result **30 September 2009**

Not Rated

Fair Value: Rs389

CMP: Rs344*

**as on 29 Sep 2009*

Focus shifts to profitability

Pantaloon Retail India's (PRIL) revenue for FY09 (June year ending) rose 25.6% YoY to Rs63.4bn and EBITDA surged 45.2% to Rs6.7bn, inline with our estimates. However, higher depreciation resulted in lower 11.6% PAT growth at Rs1.4bn vs our estimate of Rs1.5bn. EBIDTA margin expanded 142bp to 10.5%, mainly on account of cost reduction.

- **Average sales per sq ft down:** Same-stores-sales growth was tepid at 7% and this coupled with lower contribution from new stores resulted in 7% reduction in average sales per sq ft to Rs7,220 (vs Rs7,763 in FY08). The company expects to add 3mn sq ft over the next three years.
- **Cost rationalisation helps boost margin:** The 142bp expansion in margin to 10.5% surprised as it was achieved despite the 40bp fall in gross margin. The management attributed this margin expansion to rationalisation across heads.
- **EBIDTA margins to improve:** We believe steps to increase full price merchandise and core merchandise would help improve sales per sq ft. Further, rationalisation of warehousing and logistic costs is also expected to boost EBITDA margins going forward.
- **Focus shifts to profitability:** The management has shifted its strategy from store roll-out to profit growth. We remain positive on the company and maintain our fair value of Rs389 on SOTP. We value retail business on DCF at Rs345, FCH at Rs39 and HSRIL at Rs6.

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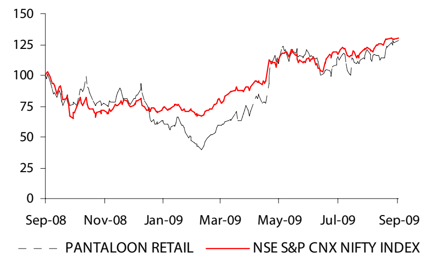
Key Data

Bloomberg Code	PF IN
Reuters Code	PART.BO
Current Shares O/S (mn)	159.3
Diluted Shares O/S(mn)	159.3
Mkt Cap (Rsbn/USDbn)	54.7/1.1
52 Wk H / L (Rs)	365/105
Daily Vol. (3M NSE Avg.)	459,953
Face Value (Rs)	2
USD = Rs48.0	

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
Pantaloon Retail	9.4	112.3	32.3
NIFTY	7.4	65.7	27.7

Source: Bloomberg, Centrum Research
**as on 29 Sep 2009*

Y/E June (Rsmn)	FY09	FY08	*YoY (%)*	FY09E	*Variance(%)*
Net sales	**63,417**	**50,489**	***25.6***	**65,898**	***(3.8)***
Consumption of RM	44,300	35,112		46,280	
% of sales	*69.9*	*69.5*		*70.2*	
Employee costs	2,743	2,741		2,785	
% of sales	*4.3*	*5.4*		*4.2*	
Other costs	9,691	8,032		10,156	
% of sales	*15.3*	*15.9*		*15.4*	
EBITDA	**6,684**	**4,605**	***45.2***	**6,677**	***0.1***
EBITDA Margin (%)	***10.5***	***9.1***	***142bp***	***10.1***	***41bp***
Dep and amortisation	1,401	834		1,266	*10.6*
Interest	3,182	1,853		3,152	*1.0*
EBT	2,102	1,918		2,259	
Other income	61	38		69	
PBT	**2,162**	**1,956**	***10.6***	**2,328**	***(7.1)***
Exceptional item (reported)	-	-		-	
Provision for tax	757	697		829	
Effective Tax Rate %	*35.0*	*35.6*		*35.6*	
Minority share in profit / loss	-	-		-	
PAT (reported)	**1,406**	**1,259**	***11.6***	**1,499**	***(6.2)***
PAT (adjusted)	**1,406**	**1,259**	***11.6***	**1,499**	***(6.2)***
NPM (%)	***2.2***	***2.5***	***(28)bp***	***2.3***	***(6)bp***

Source: Company, Centrum Research

Y/E June (Rsmn)	Rev	*YoY (%)*	EBITDA	*EBITDA (%)*	Adj PAT	*YoY (%)*	Fully DEPS	*ROE (%)*	*ROCE (%)*	P/E (x)	EV/EBITDA (x)
FY08	50,489	*56.0*	4,605	*9.1*	1,259	*106.2*	7.9	*8.6*	*7.4*	41.4	15.8
FY09	63,417	*25.6*	6,684	*10.5*	1,406	*11.6*	7.4	*6.8*	*7.3*	44.3	12.9
FY10E	86,157	*35.9*	8,863	*10.3*	2,685	*91.0*	13.7	*10.9*	*8.7*	23.8	10.2
FY11E	103,747	*20.4*	11,349	*10.9*	4,226	*57.4*	21.6	*14.9*	*10.6*	15.1	8.0
FY12E	119,319	*15.0*	13,237	*11.1*	5,385	*27.4*	27.6	*16.5*	*11.5*	11.9	6.7

Source: Company, Centrum Research Estimate

Q4FY09 result lower than estimates

Q4 revenue increased 20.4% YoY to Rs16.6bn, lower than our estimate of Rs19.1bn, mainly due to lower-than-estimated space addition. The 80bp expansion in EBIDTA margin to 11.0% surprised (vs our estimate of 9.5%). Higher EBITDA margin offset the fall in sales and resulted in 29.8% growth in absolute EBITDA to Rs1.8bn, in line with our estimates. Higher depreciation and financing cost has restricted profit growth to Rs365mn, up 12.1% YoY.

We are maintaining our estimates as the management is turning more confident about consumer sentiment and increased throughput. The management's focus has been now shifted towards increasing profitability and ROI of individual business from the earlier space rollout. We are of the view that this is a welcome step by the management.

Exhibit 1: Q4 financial highlights

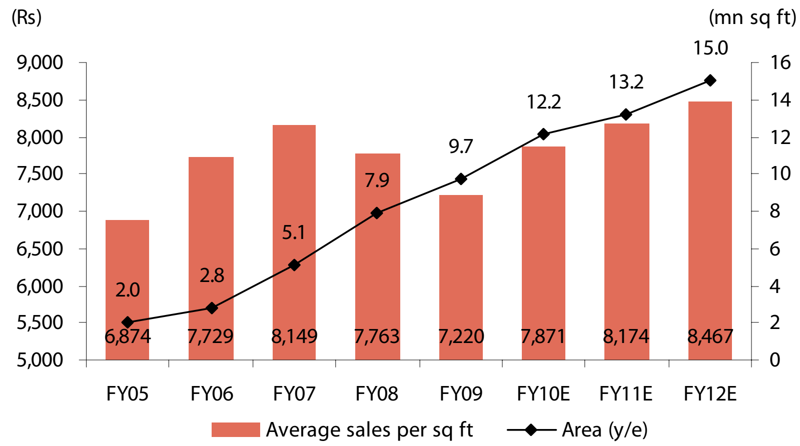
Y/E June (Rsmn)	Q4FY09	Q4FY08	YoY (%)	Q3FY09	QoQ (%)	Q4FY09E	Variance (%)
Net sales	**16,627**	**13,814**	***20.4***	**16,421**	***1.3***	**19,108**	***(13.0)***
Consumption of RM	11,518	9,607		11,500		13,499	
% of sales	*69.3*	*69.5*		*70.0*		*70.6*	
Employee costs	700	674		695		742	
% of sales	*4.2*	*4.9*		*4.2*		*3.9*	
Other costs	2,576	2,121		2,496		3,042	
% of sales	*15.5*	*15.4*		*15.2*		*15.9*	
EBITDA	**1,832**	**1,412**	***29.8***	**1,730**	***5.9***	**1,825**	***0.4***
EBITDA Margin (%)	***11.0***	***10.2***	***80bp***	***10.5***	***48bp***	***9.5***	***147bp***
Dep and amortisation	388	254		369		254	*52.8*
Interest	910	655		847		879	*3.4*
EBT	535	503		514		692	
Other income	18	1		16		26	
PBT	**552**	**504**	***9.71***	**530**	***4.2***	**718**	***(23.0)***
Exceptional item (reported)	-	-		-		-	
Provision for tax	188	178		186		260	
Effective Tax Rate %	*34.0*	*35.4*		*35.2*		*36.2*	
Minority share in profit / loss	-	-		-		-	
PAT (reported)	**365**	**325**	***12.1***	**344**	***6.1***	**458**	***(20.3)***
PAT (adjusted)	**365**	**325**	***12.1***	**344**	***6.1***	**458**	***(20.3)***
NPM (%)	***2.2***	***2.4***	***(16)bp***	***2.1***	***10bp***	***2.4***	***(20)bp***

Source: Company, Centrum Research Estimates

Proportion of retail space skewing towards lifestyle

The space under the *Central* (lifestyle seamless malls) retail delivery format increased 44.4% YoY to 1.3mn sq ft, *Pantaloons* by 20% to 1.2mn sq ft and *Big Bazaars* by 24% to 6.2mn sq ft (Big Bazaar has got highest sales per sq ft amongst all delivery formats). Effectively, the proportion of space under the *Big Bazaar* format has been marginally reduced (from 64.1% to 63.9%), Further, *Central's* sales per sq ft declined 15.4% to Rs6,616 on account of subdued consumer sentiment. This, coupled with the change of space under different formats, resulted in PRIL's average sales per sq ft declining 7% to Rs7,220 in FY09 from Rs7,763 during FY08.

Exhibit 2: Average sales per sq ft declined FY09

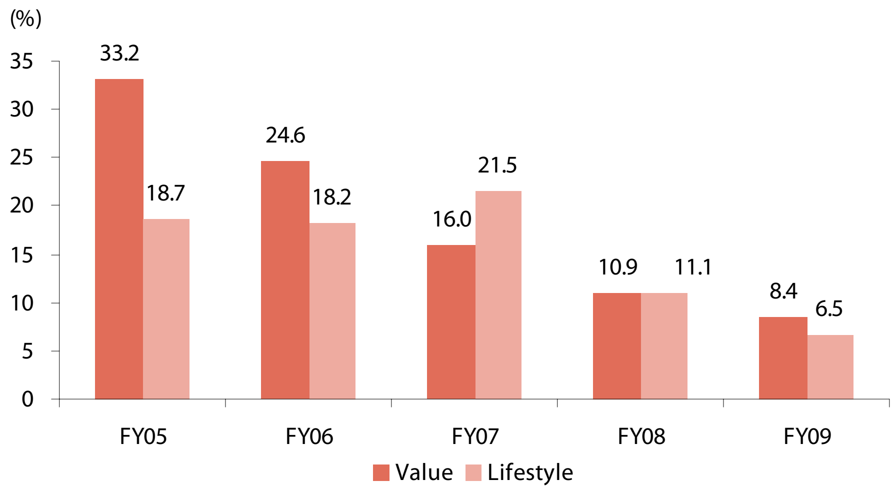


Source: Company, Centrum Research Estimates

Changing product mix strategy

During FY09, value retailing accounted for 71.9% of PRIL's total sales and lifestyle retaining the balance 28.1%. The average same-store-sales growth in value retailing was 8.4% vs 6.5% in lifestyle retailing. The management proposes to change this mix and increase the proportion of lifestyle retailing, where margins are higher, to 35% of the total sales mix. For instance, in fashion retailing which contributed 65% of revenue in FY09, the company plans to focus on fully-priced merchandise and core merchandise where there is consistent demand, products priced higher and through-put is higher. The Company intends to increase the proportion of fully-priced merchandise from the existing 25% of fashion sales to 35% and core merchandise from 10% to 25%. We believe this change in product mix along with higher same-store-sales growth would help PRIL clock higher sales per sq ft. We expect 5.5% sales per sq ft CAGR to Rs8,467 over FY10-12E.

Exhibit 3: Same-store-sales growth in value and lifestyle retailing



Source: Company

Improving operational efficiencies

PRIL has revamped its supply chain operations which would help it to reap operational efficiencies and cost savings going forward. Implementation of these programmes would help in rationalizing stock keeping units (SKUs) which in turn would help in reducing inventory holding costs and reduce working capital requirement to Rs1,600 per sq ft in FY10 from the existing Rs1,850 per sq ft. This would be further reduced to Rs1400 per sq ft over the next 15-18 months.

The company has consolidated its warehouses and now operates only from 8 distribution centres vs more than 15 earlier. PRIL relies on mechanized and automated warehouse management systems which ensure timely and accurate replenishment of products to retail stores. It has implemented a auto-replenishment system (ARS), which facilitates timely product availability of fast-moving SKUs. In addition this programme helps in conducting stock ageing analysis, thereby lowering obsolescence and resulting in lower mark downs. Currently, 80% of the stocks are covered by ARS, where the delivery time to stores is within 48-70 hours. PRIL intends to reduce this time to 14-16 hours over the next 3-4 years.

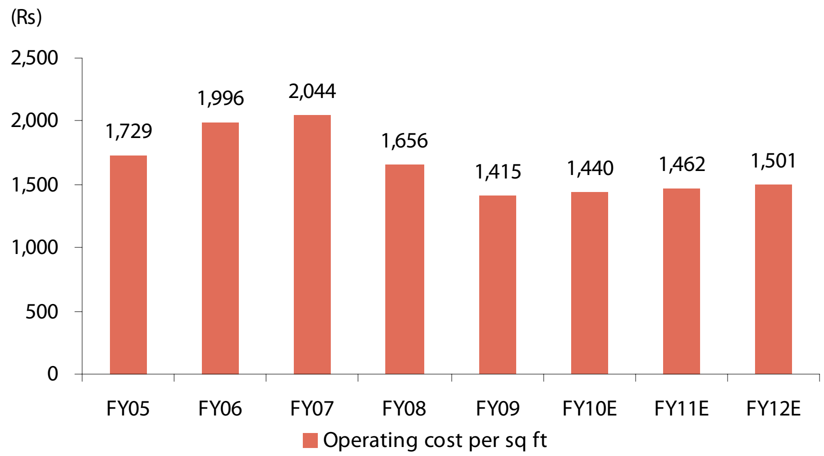
Order fulfilment refers to availability of products in warehouse to fulfil the demand placed by stores. Currently, the order fulfilment rate is at 72%. Company intends to increase this rate further to 88-90% and thereafter to almost 98%. The company would be working in collaboration with its vendors to implement this over the next three to six months.

Gross margins expected to improve on backward integration …

Gross margin declined 31bp to 30.1% in FY09 on account of *Big Bazaar's* expansion (24% increase in space from 5.2mn sq ft to 6.2mn sq ft) where the overall gross margins are in the range of 28-30% vis-à-vis Pantaloon where gross margins, net of mark-down, are in the range of 57-58%.

The management foresee expansion in gross margin going forward. This could be attributed to the fact that PRIL has a back-ward integrated model for its fashion business – right from sourcing of fabrics to designing and delivering of the final product to the end customer which helps in grossing higher margins. It plans to implement similar model for its food business where the backward integrates model would help it increase its gross margins to 38%.

Exhibit 4: Operating cost per sq ft declined



Source: Centrum Research Estimates

… and help expand EBITDA margins

EBIDTA margin for FY09 increased 142bp to 10.5% (from 9.1%), mainly on account of various cost control measures. On an absolute basis, PRIL reported 45.2% increase in EBITDA to Rs6.6bn. Staff costs as a percentage of sales declined 110bp to 4.3% in FY09. Senior management executives of the company agreed to take a voluntary pay-cut in addition to increase in the productivity area per employee. We believe implementation of various measures (like introducing warehousing systems) would help achieve operational efficiencies and garner higher operating margins, going forward. We would revisit our estimates once we see the same going through.

Depreciation and interest costs higher

On a standalone basis, PRIL's PAT margin decreased 28bp to 2.2%. This could be attributed to the higher depreciation costs (absolute depreciation expenses increased 67.9%) incurred by the company on account of higher capex on back-end and new store openings. Interest as a percentage of sales increased 135bp to 5%. As per our calculation, the average interest rate stands at 12.6% for FY09. PRIL's existing debt-equity ratio stands at 1.25x in FY09. The Company would be comfortable bringing this ratio below 1x through internal accruals and debt repayments.

Maintain space addition guidance

PRIL and Home Solutions Retail India (HSRIL) plan to increase retail space to ~ 25mn sq ft by FY13-14. This will give the company the advantage of economies of scale to sustain and grow the business in a competitive external environment. The management noted that PRIL and HSRIL together would add approximately 3mn sq ft of space per annum. According to the management, at a capex per sq ft rate of Rs1,800, company would require Rs27bn over the next five years.

Consolidated profit declines on the back of loss making subsidiaries

On a consolidated basis, PRIL's PAT declined by 54.1% to Rs100mn on the back of the following losses incurred by its subsidiaries.

Exhibit 5: Net profit/loss in subsidiaries

Subsidiaries	PAT (Rsmn)
Future logistics	2
Home solutions	(60)
Future Media	(80)
Future Generali India Life Insurance	(840)
Future Generali India Insurance	(220)
Others	(108)

Source: Company

Valuation

The management has shifted its strategy from store roll-out to profit growth, which is a welcome step. We remain positive on the company and maintain our fair value of Rs389 on SOTP. We value the core retail business on DCF at Rs345, FCH at Rs39 and HSRIL at Rs6.

Financials

Exhibit 6: Income Statement

Y/E June (Rsmn)	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	**50,489**	**63,417**	**86,157**	**103,747**	**119,319**
-Growth (%)	*56.0*	*25.6*	*35.9*	*20.4*	*15.0*
Cost of goods sold	35,112	44,300	61,530	73,846	84,930
% of sales	*69.5*	*69.9*	*71.4*	*71.2*	*71.2*
Gross Profit	**15,377**	**19,118**	**24,627**	**29,901**	**34,389**
% of sales	*30.5*	*30.1*	*28.6*	*28.8*	*28.8*
Staff expenses	2,741	2,743	3,444	3,935	4,439
% of sales	*5.4*	*4.3*	*4.0*	*3.8*	*3.7*
Other operating expenses	8,032	9,691	12,320	14,618	16,713
% of sales	*15.9*	*15.3*	*14.3*	*14.1*	*14.0*
EBIDTA	**4,605**	**6,684**	**8,863**	**11,349**	**13,237**
-EBIDTA margin (%)	*9.1*	*10.5*	*10.3*	*10.9*	*11.1*
Depreciation	834	1,401	1,595	1,801	2,011
EBIT	3,771	5,284	7,268	9,548	11,226
Interest expenses	1,853	3,182	3,290	3,255	3,194
PBT from operations	1,918	2,102	3,978	6,293	8,032
Other non operating income	38	61	90	109	125
PBT before extra-ordinary items	1,956	2,162	4,068	6,402	8,157
Extra-ordinary income/(exp)	0	0	0	0	0
PBT	**1,956**	**2,162**	**4,068**	**6,402**	**8,157**
-PBT margin (%)	*3.9*	*3.4*	*4.7*	*6.2*	*6.8*
Provision for tax	697	757	1,383	2,176	2,773
Effective tax rate (%)	*35.6*	*35.0*	*34.0*	*34.0*	*34.0*
PAT	1,259	1,406	2,685	4,226	5,385
Adjustment for Extraordinary items	-	-	-	-	-
Adj PAT	**1,259**	**1,406**	**2,685**	**4,226**	**5,385**
-Growth (%)	*106.2*	*11.6*	*91.0*	*57.4*	*27.4*
-Net profit margin (%)	*2.5*	*2.2*	*3.1*	*4.1*	*4.5*

Source: Company, Centrum Research Estimate

Exhibit 7: Balance Sheet

Y/E June (Rsmn)	FY08	FY09E	FY10E	FY11E	FY12E
Share capital	319	381	391	391	391
Equity warrants	633	229	0	0	0
Reserves & surplus	17,515	22,251	26,102	29,844	34,611
Total shareholder's fund	18,466	22,860	26,493	30,235	35,002
Loan fund	21,918	28,500	29,000	29,000	28,000
Deferred tax liability	678	1,160	1,770	2,665	3,725
Total capital employed	**41,063**	**52,520**	**57,263**	**61,900**	**66,727**
Gross block	13,688	18,796	22,122	24,052	27,512
Accumulated depreciation	1,706	3,106	4,702	6,502	8,513
Net Block	11,982	15,690	17,420	17,549	18,998
Capital WIP	3306	3450	965	1730	1820
Net fixed assets	15,288	19,140	18,385	19,279	20,818
Investments	5,865	9,540	9,365	9,365	9,365
Cash and bank	1211	1312	324	605	905
Inventories	14298	16992	22758	26301	29086
Debtors	1,132	1,327	1,611	1,940	2,231
Other current assets & loans & adv.	9623	13200	15513	17321	19689
Total current assets & loans	26,264	32,830	40,205	46,167	51,911
Current liabilities & provisions	6,377	8,980	10,683	12,901	15,357
Net current assets	19,910	23,840	29,513	33,255	36,544
Total assets	**41,063**	**52,520**	**57,263**	**61,900**	**66,727**

Source: Company, Centrum Research Estimate

Exhibit 8: Cash Flow

Y/E June (Rsmn)	FY08	FY09E	FY10E	FY11E	FY12E
Cash flow from operating					
Pre tax profit from operations	1,956	2,162	4,068	6,402	8,157
Depreciation	834	1,401	1,595	1,801	2,011
Interest expenses	1,853	3,182	3,290	3,255	3,194
Dividend income	(5)	-	-	-	-
Other non cash charges	14	-	-	-	-
Operating profit bef. WC change	4,652	6,745	8,953	11,457	13,362
Working capital adjustments	(7,617)	(3,862)	(6,555)	(3,374)	(2,904)
Direct tax paid	(435)	(389)	(773)	(1,280)	(1,713)
Prior period items	0	-	-	-	-
Net cash from operating	**(3,399)**	**2,494**	**1,625**	**6,803**	**8,745**
Cashflow from investing					
Capex	(8,079)	(3,458)	(2,635)	(2,695)	(3,550)
Investments	(3,296)	(3,675)	175	-	-
To/from subsidiaries	518	-	-	-	-
Int/divid. rcvd/sale of securities	5	-	-	-	-
Net cash from investing	**(10,852)**	**(7,132)**	**(2,460)**	**(2,695)**	**(3,550)**
Cash flow from financing					
Proceeds from sh. Cap & premium	6,851	3,657	686	-	-
Borrowings/(Repayments)	8,922	7,000	500	-	(1,000)
Interest paid	(1,853)	(3,182)	(3,290)	(3,255)	(3,194)
Dividend paid	(88)	(129)	(246)	(485)	(617)
Net cashflow from financing	**13,832**	**7,345**	**(2,350)**	**(3,739)**	**(4,811)**
Net cash increase/(decrease)	**(419)**	**2,707**	**(3,185)**	**369**	**384**

** Cash Flow Balance will not match as only some figures in balance sheet has been changed to actuals, rest is projected*

Source: Company, Centrum Research Estimate

Exhibit 9: Key Ratios

Y/E June	FY08	FY09E	FY10E	FY11E	FY12E
Profitability ratios (%)					
EBIDTA margin	9.1	10.5	10.3	10.9	11.1
PBIT margin	7.5	8.3	8.4	9.2	9.4
PBT margin	3.9	3.4	4.7	6.2	6.8
PAT margin	2.5	2.2	3.1	4.1	4.5
Growth (%)					
Revenue	56.0	25.6	35.9	20.4	15.0
EBIDTA	113.6	45.2	32.6	28.0	16.6
Net profit	106.2	11.6	91.0	57.4	27.4
Return ratios (%)					
ROCE	7.4	7.3	8.7	10.6	11.5
ROIC	8.9	9.0	10.8	12.7	13.7
ROE	8.6	6.8	10.9	14.9	16.5
Turnover Ratios					
Asset turnover ratio (x)	1.3	1.2	1.3	1.5	1.5
Working capital cycle (days)	113	120	111	110	106
Cash conversion cycle (days)	88	88	79	82	78
Average Inventory period (days)	120	129	118	121	119
Average collection period (days)	6	7	6	6	6
Average payment period (days)	38	48	45	45	47
Per share (Rs)					
Basic EPS	7.9	7.4	13.7	21.6	27.6
Fully diluted EPS	7.9	7.4	13.7	21.6	27.6
Book value	115.9	120.1	135.6	154.8	179.2
Solvency Ratio					
Debt-equity	1.2	1.2	1.1	1.0	0.8
Interest coverage ratio	2.2	1.7	2.2	2.9	3.5
Valuation					
P/E	41.4	44.3	23.8	15.1	11.9
P/BV	2.8	2.7	2.4	2.1	1.8
EV/Sales	1.4	1.4	1.1	0.9	0.7
EV/EBIDTA	15.8	13.1	10.2	8.0	6.7
M-cap/Sales	1.0	1.0	0.7	0.6	0.5

Source: Company, Centrum Research Estimate

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