Company

29 July 2010 | 10 pages

Phoenix Mills (PHOE.BO)

Equity ☑
Target price change ☑
Estimate change ☑

Buy: Q1FY11 a Promising Quarter- High on High Street Phoenix

- **High Street Phoenix (HSP) performing well** — Another good quarter, reflecting the strength of a high-yielding asset and an unabated execution story so far. 1QFY11 revenues and EBITDA grew 63% and 56% YoY with operating margins back to 70%-levels. PAT growth tapered to 19% YoY/16% QoQ, due to higher depreciation and lower other incomes. Average rentals in HSP have increased to Rs 166/sf vs Rs 142/sf earlier as Palladium Mall is almost fully operational.

- **Progress in Market Cities largely on track** — Market Cities are largely on track but for Kurla, where handover of space to retailers has been delayed to Oct10, though leasing has picked up vs Q4 (47% lease at Rs 90/sf avg). Commercial space at Kurla ('15 LBS', 0.25msf) was launched in Jul10 at Rs8200-8500/sf; 10-15% already booked and enquiries are strong. In other places, leasing is encouraging: Pune (75% at Rs 60/sf avg), Bangalore (+55% at Rs 60/sf avg) & Chennai (50% at Rs 75/sf avg). Handover of licensed premises has begun in Pune.

- **EWDPL IPO to unlock further value when it comes through** — EWDPL, in which Phoenix holds a 40% stake, has filed its DRHP with SEBI In Jul10 to raise a capital-diluting 30% stake. While we attribute ~Rs25/share to EWDPL holdings, we believe this transaction would further unlock value for Phoenix. **Other highlights**- 1) Start of Ph-IV in HSP is at least six months away; 2) Residential launches planned in Bangalore (3) and Chennai before end of this CY.

- **Maintain Buy; Raise our TP to Rs 274** — We raise NAV to Rs 335 (up 3%) as we roll forward to Mar-11, and build in a few project delays and higher construction costs. HSP forms a substantial chunk of NAV (51%) and stock price (77%) - It now has increased earnings visibility and we further anticipate the revenue share model to kick in for more retailers as footfall picks up. Hence, this asset will drive FY11 earnings, further supported by other Market Cities going live in 2HFY11.

Buy/Medium Risk	1M
Price (29 Jul 10)	Rs223.05
Target price	Rs274.00
from Rs265.00	
Expected share price return	22.8%
Expected dividend yield	0.5%
Expected total return	**23.4%**
Market Cap	Rs32,308M
	US$691M

Price Performance (RIC: PHOE.BO, BB: PHNX IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	428	3.15	-90.4	70.8	2.4	6.2	0.4
2009A	766	5.29	67.8	42.2	2.1	5.5	0.4
2010E	620	4.28	-19.1	52.1	2.0	4.0	0.5
2011E	1,223	8.44	97.3	26.4	1.9	7.5	0.5
2012E	1,842	12.72	50.7	17.5	1.7	10.3	0.6

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	70.8	42.2	52.1	26.4	17.5
P/E reported (x)	70.8	42.2	52.1	26.4	17.5
P/BV (x)	2.4	2.1	2.0	1.9	1.7
Dividend yield (%)	0.4	0.4	0.5	0.5	0.6
Per Share Data (Rs)					
EPS adjusted	3.15	5.29	4.28	8.44	12.72
EPS reported	3.15	5.29	4.28	8.44	12.72
BVPS	94.68	104.58	108.85	117.29	130.01
NAVps ordinary	na	na	na	na	na
DPS	1.00	1.00	1.20	1.20	1.25
Profit & Loss (RsM)					
Net operating income (NOI)	**501**	**602**	**775**	**1,696**	**1,875**
G&A expenses	0	0	0	0	0
Other Operating items	-76	-93	-166	-201	255
EBIT including associates	**425**	**508**	**609**	**1,495**	**2,130**
Non-oper./net int./except.	196	448	157	153	182
Pre-tax profit	**620**	**957**	**765**	**1,648**	**2,312**
Tax	-192	-190	-147	-427	-471
Extraord./Min. Int./Pref. Div.	0	-1	1	2	2
Reported net income	**428**	**766**	**620**	**1,223**	**1,842**
Adjusted earnings	428	766	620	1,223	1,842
Adjusted EBIT	425	508	603	1,495	1,653
Adjusted EBITDA	501	602	775	1,696	1,875
Growth Rates (%)					
NOI	-30.1	20.2	28.8	118.8	10.6
EBIT adjusted	-34.0	19.7	18.5	148.1	10.6
EPS adjusted	-90.4	67.8	-19.1	97.3	50.7
Cash Flow (RsM)					
Operating cash flow	**233**	**514**	**2,160**	**787**	**2,366**
Depreciation/amortization	76	93	172	200	222
Net working capital	-109	71	839	-1,280	-698
Investing cash flow	**-13,846**	**-2,027**	**-2,649**	**-3,302**	**-2,193**
Capital expenditure	-12,890	-2,561	-2,251	-2,476	-1,650
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**13,561**	**3,402**	**360**	**2,018**	**-883**
Borrowings	-1,460	3,386	534	2,192	-702
Dividends paid	-94	-167	-174	-174	-181
Change in cash	**-52**	**1,888**	**-129**	**-497**	**-709**
Balance Sheet (RsM)					
Total assets	**18,968**	**24,300**	**26,602**	**30,623**	**32,099**
Cash & cash equivalent	22	1,910	1,957	1,490	783
Net fixed assets	8,326	13,423	15,502	17,777	19,206
Total liabilities	**5,311**	**7,034**	**8,185**	**10,483**	**9,296**
Total Debt	3,048	5,452	5,986	8,178	7,476
Shareholders' funds	**13,658**	**17,266**	**18,417**	**20,140**	**22,803**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	51.7	51.0	49.0	70.8	70.8
ROE adjusted (%)	6.2	5.5	4.0	7.5	10.3
ROA adjusted (%)	3.6	3.5	2.4	4.3	5.9
Net debt to equity (%)	22.2	20.5	21.9	33.2	29.4
Interest coverage (x)	11.3	11.0	9.0	14.8	16.7

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Update on Financial Performance

Figure 1. Q1FY11 Results Analysis

	4QFY10	1QFY10	1QFY11	YoY	QoQ
Revenues	**344.7**	**247.9**	**404.3**	**63.1%**	**17.3%**
Operating Expenses	146.7	59.1	110.7		
EBITDA	**198.0**	**188.8**	**293.6**	**55.5%**	**48.3%**
EBITDA Margin	57.4%	76.2%	72.6%		
Interest	35.1	9.5	34.5	262.8%	-1.5%
Other Income	57.6	52.7	43.6	-17.2%	-24.3%
Depreciation	59.1	24.0	68.5		
PBT	**161.5**	**208.0**	**234.2**	**12.6%**	**45.0%**
Tax	4.4	54.7	51.6	-5.7%	1059.0%
% Tax	2.8%	26.3%	22.0%		
PAT	**157.0**	**153.3**	**182.6**	**19.1%**	**16.3%**

Source: Company Reports

Other Highlights from Conference Call

- HSP average minimum guarantee rentals have shot up to Rs 166/sf from Rs 142/sf with Palladium becoming fully operational. Footfall is now at over 1.0 million/month at HSP. Parking revenue at HSP is at Rs 7.4m quarter.

- Of the total Rs 400m revenue recorded in Q1, approx. 1/3 has accrued from Palladium. Palladium avg rentals (minimum guarantee) is at ~Rs 185-190/sf. Zara, occupying 24,000sf, opened up in June 2010 and Phoenix has an 8% pure revenue sharing agreement with the retailer. Effective rentals would translate to Rs 300/sf going forward.

- Shangri-La – work progressing on track. Façade work should be complete by October. Installations to begin in Sept 10.

- Market City Kurla's formal launch expected by year end. 250,000sf commercial saleable area launched at a target rate of Rs. 8200-8500/sf (under the name "15 LBS"). Company has booked 10-15% already, with enquiries for over 80%. Revenue recognition would happen in last Q of FY11, as per the management.

- From the 228,000sf saleable area (Retail + Office) in Pune Market City, 132,000sf has already been sold at an average of Rs 6,000/sf.

- Residential launch is being planned in Bangalore West (1.8-1.9msf) and Chennai before the close of this calendar year.

- As at Jun-10, consolidated debt stood at Rs. 6.3bn and cash was at Rs.3.0bn (including investments in subsidiaries).

Target Price raised to Rs 274

We raise our NAV estimate to Rs 335 and target price to Rs 274 as we -

- Roll forward to Mar-11 from Mar-10 earlier
- Build in six months' delay in the Kurla project and a three month delay in the Shangri-La Hotel, Lower Parel, versus our earlier assumptions
- Increased construction costs slightly across Market City projects

HSP forms a substantial chunk of the NAV- It now has increased earnings visibility and we further anticipate the revenue share model to kick in for more retailers, with footfall picking up. Hence, this asset will drive FY11 earnings and will only be further supported by other Market Cities going live in 2HFY11.

Figure 2. Valuation Snapshot Mar'11E NAV & Target Price

	NAV (Rs m)	NAV Per Share Rs	Target Disc	Target Value (Rs m)	Target Value Per Share
High Street Phoenix	24,910	172	10%	22,419	155
Market Cities (Kurla, Pune, Chennai & B'lore)	10,014	69	25%	7,510	52
EWDPL & BARE projects	4,725	33	35%	3,071	21
Phoenix Hospitality	8,912	62	25%	6,684	46
No. of shares	*145*				
Total	**48,561**	**335**	**18%**	**39,685**	**274**

Source: Citi Investment Research and Analysis

We are slightly modifying our FY11-12E earnings estimates by -5%/-3% factoring in higher depreciation, increased construction costs, higher finance charge and base rental changes based on the last actual statement released.

Figure 3. Phoenix Mills Ltd - Estimate Changes Summary

	FY11E			FY12E		
	New	Old	Change	New	Old	Change
Total Revenues (Rs m)	2,110	2,110	0.0%	2,333	2,296	1.6%
EBITDA (Rs m)	1,696	1,701	-0.3%	1,875	1,850	1.3%
Net Profit (Rs m)	1,223	1,286	-4.9%	1,842	1,896	-2.9%
EPS (Rs)	8.44	8.88	-4.9%	12.72	13.09	-2.9%

Source: Citi Investment Research and Analysis estimates

Phoenix Mills

Company description

Phoenix Mills, listed on the BSE in 1959, is a leading Indian developer of large-format retail-led mixed use developments. It began operations as a textile manufacturing company in 1905 on 17.3 acres of land in Lower Parel, Mumbai. In 1987, it largely exited the textile sector and entered into the booming real estate market in Mumbai. High Street Phoenix was the first consumption centre developed by the Phoenix Group, on its textile mill property in Lower Parel, which has itself become a destination in Mumbai (though still under expansion), covering >3.0 msf of space housing retail, entertainment, commercial and residential complexes with car parking. Over the last few years, PML has spread its wings across Tier I, II and III cities in India, by entering into JVs with established regional players and bringing in strategic investors to support the growth of its asset-heavy model. The company is controlled and managed by the Ruia Group, which owns a 66% stake.

Investment strategy

We rate Phoenix Mills Buy/Medium Risk, with a target price of Rs274. We see it evolving as a leading developer/owner of large-format retail malls and hotel assets with a pan-India presence. It differentiates itself by its prime-location assets across key cities like Mumbai, Chennai, Bangalore, Pune; unique asset-holding associate/subsidiary ownership model; steady cash flows; near-term execution visibility; and a de-leveraged balance sheet. It has plans to develop ~29msf, having an economic interest of ~10.9msf, with a focus on retail malls (74% of GNAV) and hotels. Furthermore, the flagship HSP property is a landmark in Lower Parel, South Mumbai and we regard it as a cash cow which will drive an earnings CAGR of 37% over FY10-12E. Taking HSP as a benchmark, Phoenix is looking to create similar value through its 'Market City' projects, positioned as consumption centres. Most will be in operation over the next 1-2 years and risks are shared with other partners, and we see this as a big opportunity. Additionally, likely NAV upside from increased FSI in HSP Phase IV and the revenue-sharing model are potential stock re-rating catalysts.

Valuation

Our target price of Rs274 is at an 18% discount to our Mar11 NAV of Rs335. This is based on a combination of rental yield for HSP and NAV-method for under-development assets. The lower discount (vs. 25-35% ascribed to tier-II peers) is a combination of: 1) strong rental annuity and de-leveraged balance sheet; 2) near-term execution visibility of Market City; and 3) likely delays for EWPDL, BARE and hospitality projects. Our NAV estimate of Rs338 is based on the following assumptions: 1) Rs156 per share for High Street Phoenix using a rental yield model with 10% cap-rate, 4% terminal growth; and Phase IV land (0.25msf) valued at Rs8000/sf; 2) 3.8 msf economic interest in Market City projects (ex-hotels); 3) 5.1 msf economic interest in EWPDL & BARE project; and 4) Rs15-20mn capital cost per room for ~1,000 rooms following its 75% stake in the hospitality venture. This apart, we have factored in: a) total consolidated debt of Rs8.55bn adjusted for Rs2.2bn of cash; b) cost of capital of 13%; and c) a tax rate of 25%.

Risks

We rate Phoenix Mills as Medium Risk. This differs from the High Risk rating assigned by our quantitative risk rating system (which measures the stock's volatility over a 260-day period). Our key reasons are: 1) Relatively stable and healthy cash flows with near-term visibility; 2) strong asset portfolio of strategically located land parcels, fully paid for; and 3) de-risked business model and de-leveraged balance sheet. However, the main downside risks to our investment thesis and target price include: 1) concentration in the retail and hospitality segment, which hasn't yet recovered post downturn, and where risk of excess supply over the next 2-3 years is high; 2) any leasing/footfall disappointment on the launch of forthcoming projects will likely prove detrimental to the company's reputation built on HSP and our valuation assumptions; 3) relationships with strategic investors are critical as they have an impact on the liquidity and execution plans of PML and hence on our valuations; 4) a rapidly changing property market environment could lead to property price-demand risks, regulatory risks and potential supply risks.

Appendix A-1

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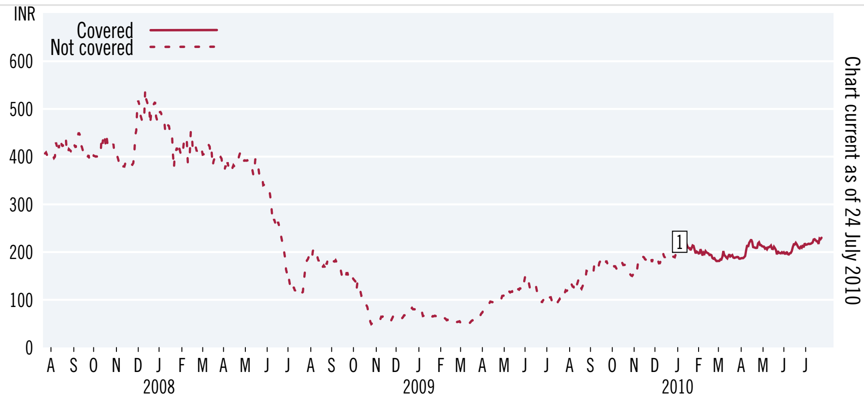
Analyst: Surendra Goyal, CFA
Covered since June 1 2010



	Date	Rating	Target Price	Closing Price
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* Indicates change

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