Phoenix Mills

One up on High Street. Like the product... like the stock. Initiate with OW

Initiation
Overweight
PHOE.BO, PHNX IN
Price: Rs214.70
Price Target: Rs280.00

India
Property

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- **Initiate with OW and Mar-12 PT of Rs280:** Phoenix Mills is a leading and the only listed play on retail real estate in India. We believe the company offers stability and near-term earnings growth via a combination of high-quality retail-led mixed use developments which are completing over the next 12 months. The portfolio has seen substantial pre-lease commitments, which should translate into a steadily growing annuity stream. This gives healthy visibility on our forecast rent growth of 57% over FY10-13E, which should, in turn, be the prime driver of earnings CAGR of 61% during FY10-13E.
- **Like the product, like the stock…:** PML's key asset "High Street Phoenix" in South Mumbai (~45% of value) is one of the most successful retail malls in India, which records footfalls of >1MM/month. The mall has marked the maiden entry of a few marquee international retailers. Improving retailer trends and management's ability to leverage the High Street Phoenix experience to other developments have seen leasing pick up materially over the past two quarters. Most of the projects are anywhere between 55% and 75% leased, implying high rent visibility. 2Q was the first quarter in which PML saw contributions from revenue share starting to flow in (~10% of base rent) and this provides additional revenue upside potential in the near term.
- **Drivers of the stock higher** near term, in our view, will be: 1) further improvement in pre-leasing within the portfolio; 2) opening of ShangriLa hotel & market city projects over the next 6-12 months; 3) any evidence of cap rate compression due to better-than-expected retail fundamentals.
- **Valuation and PT**: Our SOTP-based Mar-12 PT is Rs280 (WACC: 13%; and cap rate: 11%), of which the HSP asset (income generating) accounts for almost 45%, implying confidence on the numbers. While relative valuations at FY12E P/E/P/B of 19.2x/1.7x may look expensive relative to local RE developers, given PML's pure retail focus, there is no direct comparable in the local market. Comparing PML to CapitaMall Asia (Singapore)/other emerging market players as well as Indian retailers, it is at a meaningful discount, despite offering higher earnings growth. High execution/leasing visibility on assets nearing completion lend reasonable comfort on PML's earnings estimates over the next two years.
- **Key risks,** in our view, relate to PML's minority stakes in SPV's developing market city projects. This raises concerns about potential exits required by private investors (Rs10B invested) once assets become operational (though still it is two-three years away).

Company data

52-wk range (Rs)	269.9 - 148.5
Mkt cap. (Rs MM)	33,314
Mkt cap. (US$ MM)	738
Avg. daily volume (MM)	0.1
Average daily value (Rs MM)	26.7
Average daily value (US$ MM)	0.6
Shares O/S (MM)	145
Index (BSE Sensex)	20,254
Exchange rate	45.1

Source: Bloomberg

Bloomberg: PHNX IN; Reuters: PHOE.BO

Rs in millions, year-end March	FY09	FY10	FY11E	FY12E	FY13E
Sales	996	1,230	2,094	3,575	5,516
Net profit	768	620	961	1,597	2,608
EPS (Rs)	5.4	4.3	6.7	11.2	18.2
P/E (x)	40.1	49.6	32.0	19.2	11.8
Net D/E	13%	22%	27%	20%	7%
P/B	2.0	1.9	1.8	1.7	1.5
ROE (%)	5%	4%	6%	9%	13%

Source: Company reports, J.P. Morgan estimates. Share price is as of 29 November 2010.

See page 27 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

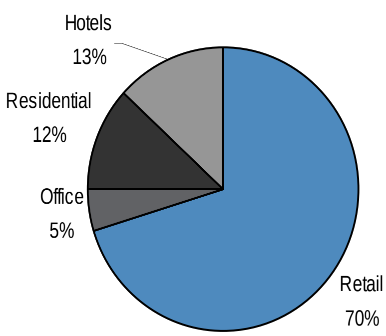
Phoenix Mills (PML) began operations as a textile manufacturing company in 1905 on 17.3 acres of land in Lower Parel, Mumbai. In 1987, the company largely exited the textile sector and entered into the real estate market in Mumbai by developing High Street Phoenix (HSP) on its textile mill property in Lower Parel. With three phases already operational, the property currently offers 1msf of retail space. PML is replicating its High Street model across key metros via its market city projects. In addition to this, the company has made its retail foray into tier II/III cities via investments in EWDPL and Big Apple.

Valuation and EPS sensitivity metrics

	NAV impact (%)	EPS impact (%)
Price/rent growth in FY11E		
Impact of each 5% point change	3%	2%
Cap rate assumption		
Impact of each 1% point change	3%	0%

Source: J.P. Morgan estimates.

NAV break up (FY11E)



Source: J.P. Morgan estimates.

EPS: J.P. Morgan vs. consensus

	J. P. Morgan	Consensus
FY11E	6.7	6.4
FY12E	11.2	11.1

Source: Bloomberg, J.P. Morgan estimates.

Price target and valuation analysis

We initiate coverage on Phoenix Mills with an Overweight rating and Mar-12 price target of Rs280. Our PT is based on a 20% discount to our SOTP value. This implies FY12E P/E of 25x and FY12E P/B of 2.2x. We use a 13% WACC and 11% cap rate to value the company's retail portfolio.

Key risks to our price target, in our view, pertain to PML's minority stakes in SPV's developing market city projects. This could raise concerns over exits required by private investors (Rs10 billion invested) once assets become operational (though still some time away).

Key potential share price catalysts include

1. Progress/response on opening of the market cities are keys to watch. Phoenix's market cities are close to completion with Pune being the first one to become operational (by end-FY11), while the remaining are expected to be operational over the next 6-12 months.
2. Any clarity on permissible FSI in phase IV at HSP, thereby increasing the developable area.
3. Improving retailer sales trends bodes well for Phoenix's rental income given the revenue sharing model being undertaken for recent lease agreements.
4. Potential listing of EWDPL could unlock value.

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Investment thesis

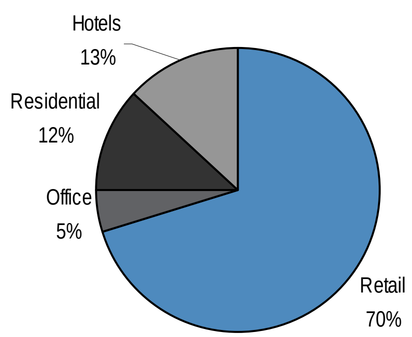
Phoenix is a high-quality retail play

Phoenix mills (PML) is a leading developer and owner of large format retail malls in city-centric locations across India. PML via its investments and partnerships is currently developing over 35msf (PML's stake - ~12msf) of projects across India, primarily focused on retail malls.

The company's main asset is "High Street Phoenix" (HSP) on 17.3 acre prime land parcel in Lower Parel, Central Mumbai. This property providing ~1msf of retail space is one of the most successful retail formats in India and houses some of the marquee local and international retailers (Zara and Hamley's).

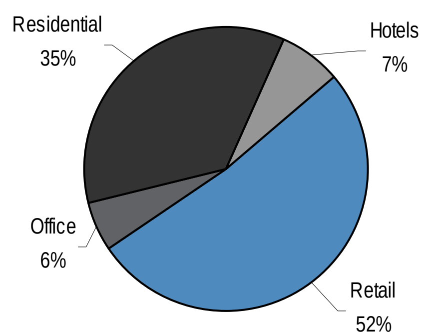
PML intends to replicate its HSP model across key Indian cities as well as in tier II/III cities via its market city developments and partnership with EWDPL/Big Apple, respectively. Initial phases of its market city developments are nearing completion (launch expected over 4QFY11-2QFY12) and are expected to boost PML's rental portfolio to ~3msf/Rs3 billion by FY12 from 1msf/Rs800 million in FY10.

Figure 1: Phoenix—Value break-up by asset class



Source: Company reports, J.P. Morgan estimates.

Figure 2: Phoenix—Area break-up by asset class



Source: Company reports, J.P. Morgan estimates.

Table 1: Phoenix—Operational and upcoming lease portfolio

	Developable area (msf)	PHNX's stake (msf)	FY12E rental income (Rs MM)
High Street Phoenix	0.9	0.9	1,782
EWDPL	1.0	0.3	163
Big Apple	0.7	0.4	185
Market Cities (Pune, Kurla, Bangalore, Chennai)	4.4	1.6	766
Total	7.0	3.3	2,896

Source: Company reports, J.P. Morgan estimates.

… Where real estate risks have largely been taken out

A significant portion of Phoenix's portfolio will be completed over the next one year and significant pre-leasing (> 55-75%) has also been achieved on the same. Hence, construction and leasing, the two biggest risks on real estate, have largely been taken out. Once these assets stabilize (FY12E onwards), we believe investors would start looking at Phoenix more as a consumption play rather than a pure real estate play. This can result in disproportionately high valuations (on a P/E and P/B basis) vs. real estate to sustain.

Table 2: Phoenix—Market City development details

	PHNX stake (%)	Total area (msf)	Retail	Exp lease rate	% Leased	Status
Phoenix Market City, Pune	58.5%	1.9	1.2	65	75%	- Key anchor tenants have already moved in for fit outs - Response to Phase I commercial office (0.3msf) is encouraging - PML recently increased its stake by 8% in this market city
Phoenix Market City, Bangalore (E)	32.7%	1.5	0.85	65	70%	- Handover to the tenants has already commenced - Leasing momentum is quite strong - Stake increased recently to 32.7% from 28.1%
Phoenix Market City, Kurla (E)	24.3%	2.5	1.3	100	55%	- Handover commenced for fit outs - Phase I commercial (0.3msf) has been 80% sold out
Phoenix Market City, Chennai	31.0%	1.5	1.0	80	60%	- Possession expected by Q4FY11 - Handover for fit outs expected to commence in Q4FY11

Source: Company reports, J.P. Morgan estimates.

Comparing Phoenix with Indian retail plays, we note that Phoenix offers higher near-term earnings growth, better margins, and is still cheaper on P/E and P/B basis.

Table 3: India retailer valuations

	Mcap	P/E		EPS growth		P/B		ROE	
	US$ MM	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Phoenix	700	32.0	19.2	55%	66%	1.8	1.7	5.8%	9.0%
Pantaloon Retail	2,057	31.3	22.9	73%	37%	2.9	2.5	9.3%	10.9%
Shoppers Stop	658	44.2	33.1	60%	33%	5.5	4.6	18.5%	18.3%

Source: Company reports, J.P. Morgan estimates. Shoppers Stop nos. are based on consensus & Pantaloons are adjusted for its core retail business. Prices are as of close of November 29, 2010.

Further, retail fundamentals are improving…

The retail market has witnessed a meaningful improvement in lease enquiries over the past few quarters. Most retailers (Pantaloons and Shoppers Stop) have reported healthy sales trends over the past six months driven by improved consumer spending and now seem to have resumed back their expansion plans.
PML is one of the few developers in India with a retail focus and is expected to be a prime beneficiary of the improving retail fundamentals, in our view.

We note that PML has witnessed a decent leasing traction at its upcoming market city projects (c55%-75% leased) even while the retail sector recovery is as yet in its nascent stage. This could be attributable to:

a) **Prime location of its assets** – Most of PML's projects are city-centric assets in key metros (Mumbai, Bangalore, Chennai and Pune) and in close proximity to established residential catchments.

b) **High near-term execution visibility** – PML's market city projects (providing ~4.5msf of retail space) are at advanced stages of completion and

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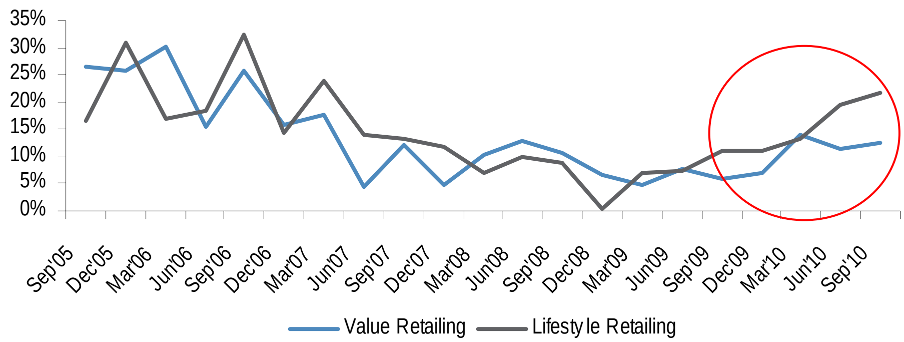
are expected to be operational over the next 6-12 months. Even while retail fundamentals are improving, retailers have been cautious and incremental leasing has been limited to completed properties/properties nearing completion. PML's market city projects fit the bill here.

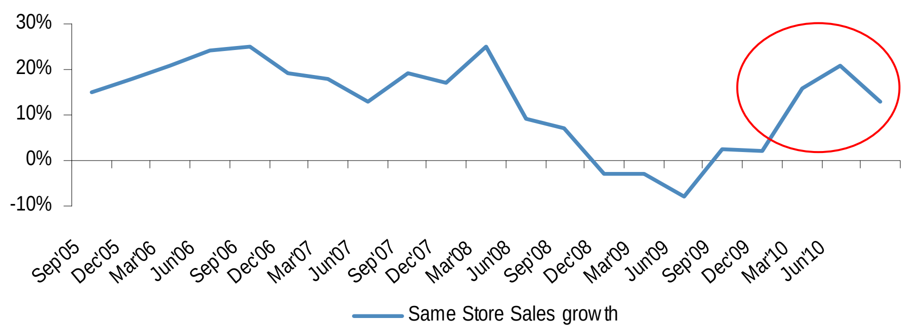
Key retailers have registered a healthy same-store sales growth trends over the past one year

Figure 3: Pantaloons—Same-store sales trends



Source: Company data.

Figure 4: Shoppers Stop—Same-store sales trends



Source: Company data.

…And the company is poised to transition from a single asset play to a pan India retail player

Phoenix is looking to replicate its "High Street Phoenix" model in other prime locations (Mumbai, Pune Bangalore and Chennai) via its market city developments. Market cities are essentially large format retail-led mixed use developments (retail, residential and hotel) in large consumption centers across India.

PML has been able to leverage its experience and relationships at HSP and has met with initial success in terms of leasing (55-75% leased) at its market city developments. Initial phases of these projects providing 4.4msf of retail space (PML's stake – 1.6msf) are nearing completion and are expected to be launched over 4QFY11-1QFY12.

In addition to its market city developments, the company has also made its retail foray into tier II/II cities (Raipur, Jaipur, Bhillai, Nanded, etc) via its partnerships/investments in Entertainment World Developers Limited (EWDPL, 40% stake) and Big Apple Real Estate (BARE, 74% stake).

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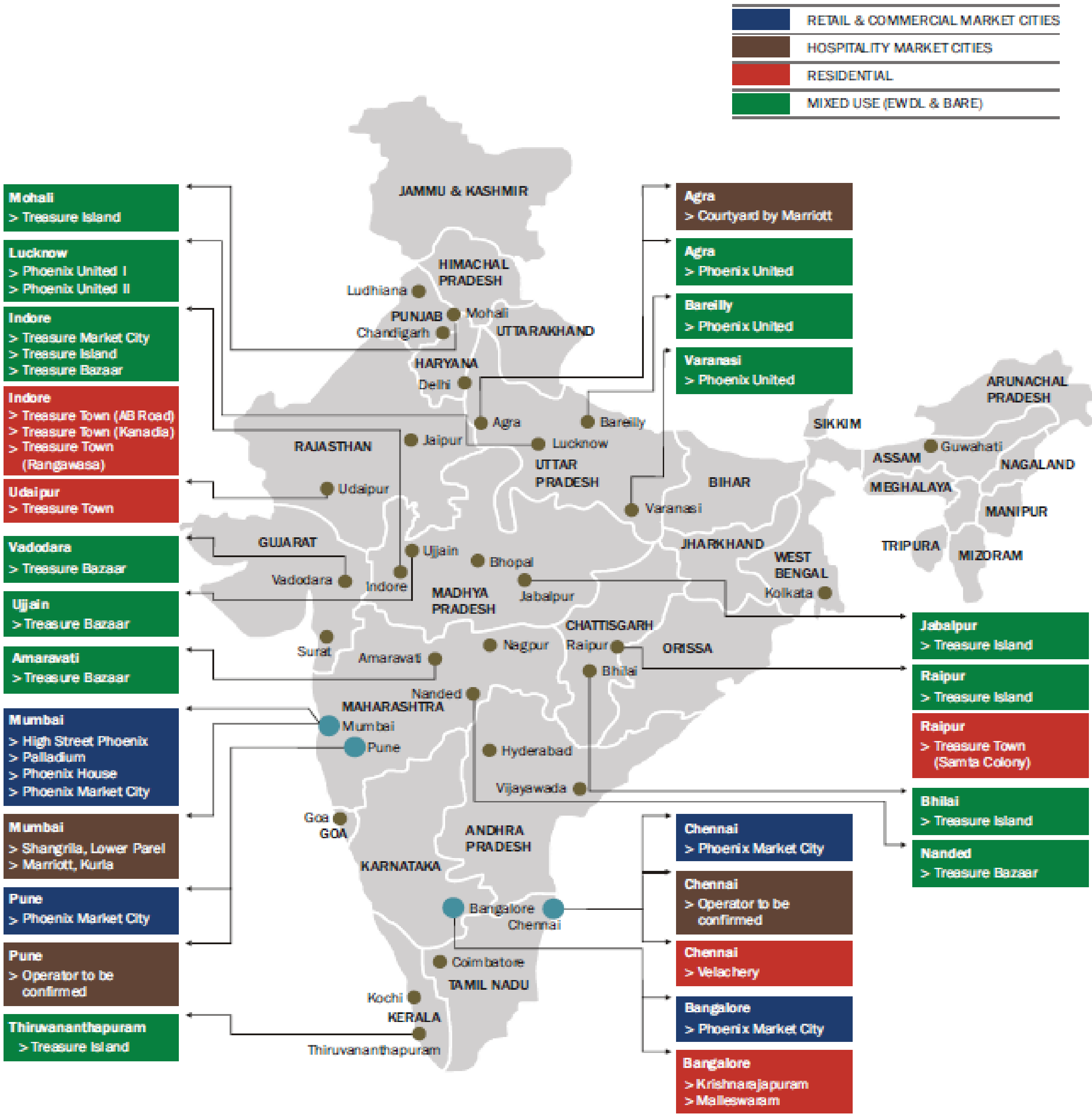
EWDPL currently holds 1msf of operational lease assets (in Indore/Nanded) and has a development pipeline of over 20msf of mixed use developments across tier II/II cities in India. Big Apple, on the other hand, currently has two retail projects providing 0.7msf of retail space in Lucknow and Bareilly.

Figure 5: Phoenix's completed and ongoing properties



Source: Company reports, J.P. Morgan.

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High Street Phoenix is a robust cash flow generator and has potential to offer more growth…

High Street Phoenix (HSP) is PML's landmark asset located on a 17.3 acre prime land parcel in Lower Parel, South Central Mumbai. The property, developed over phases, offers a mix of retail, residential, multiplexes and also a luxury hotel - Shangri-La - in the heart of Mumbai.

Currently HSP provides ~1msf of retail space operating at over 90% occupancy and boasts of record footfall (>1 million per month). The mall houses some of the marquee tenants (Marks and Spencer, FCUK, Burberry, etc.) and has marked the maiden entry of a few international retailers into India (Zara, Hamleys, Manchester United, etc).

We expect the rental income from HSP to double to over Rs1.7 billion in FY12E from Rs800 million in FY10 and to be a key driver of 61% earnings CAGR over FY10-12E. This would primarily be driven by:

a) Stabilization of the recently opened premium mall, Palladium (0.3msf), which became operational toward end-FY10. The property is currently operating at ~90% occupancy as against 98% occupancy levels for earlier phases of HSP.

b) Upcoming rental renewals - PML has 0.15msf of space coming up for renewal by end-FY11 from key anchor tenants (Big Bazaar, Pantaloons, etc.) in Phase I. This is likely to push up the average rentals at HSP to Rs160psf pm from Rs145 psf pm currently.

In addition to this, PML has a development pipeline of 0.25msf at HSP (Phase IV). While the development planning for the same is currently underway, management is looking to avail of higher FSI for the property (hospitality FSI). This could potentially substantially increase the developable area under Phase IV from 0.25msf currently.

Table 4: High Street Phoenix—Portfolio details (as of Mar-10)

Phases	Asset	Area (msf)	Occupancy	Key tenats
Phase I/II	The Coutyard and The Skyzone	0.5	98%	Hamley's, Big Bazaar, Pantaloons, Marks and Spencer, etc
Phase III	The Grand Galleria	0.1	88%	Croma, Fab India, Costa Coffee, Base Camp Tranveller
Phase III	The Palladoum	0.3	86%	Zara, Deisel, The Comedy Store, Manchester United Café, Landmark etc
Phase III	Shangri-La Hotel	0.8	NA	Management agreement for a 420-room hotel with Shangri-La. Expected to start operation in 1HFY12
Phase IV	Planning underway	0.3	NA	FSI expected to increase. This can increase the development potential to 1.8msf (as per the company) from 0.25msf currently

Source: Company reports.

c) Upsides from revenue share model has started to flow in - Phoenix has started earning revenue share (approximately 10% of rent) via its revenue share agreements with retailers that entitle the company to a share of retailers' revenue over and above the minimum guaranteed rent. This is on account of improving retailer sales trends and the marquee nature of Phoenix's assets. This incentive revenue flows straight to the bottom line and more than offsets some under recovery on asset maintenance (around 5%).

Table 5: Revenue-sharing model

	Percentage of revenue as rent (%)
Hypermarket	3%-4%
Departmental Stores	7%-8%
Apparel	12%-18%
Footwear	15%-18%
Jewellery	2%-2.5%
Health and Beauty	10%-12%
Food	15%-20%
Entertainment	8%-10%

Source: ET.

d) Strong brand equity at HSP helps mitigate leasing risk for future developments- High Street Phoenix is one of the most successful retail malls in the country and thereby creates a strong brand equity for PML. Phoenix has been able to leverage on this experience/relationship with large business groups (Tata Group, Future Group and Reliance Group) and key international retailers (Zara, Marks and Spencer). This has enabled PML to secure anchor tenants for its market city developments. Further, PML provides a platform for pan-India expansion, especially for new retailers, given its presence via its market city developments across most key metros. For instance, Zara (already present in HSP) has signed up as an anchor tenant across all of PML's market city properties. These strategic relationships mitigate incremental leasing risks, in our view.

All this should translate into steadily growing rental income…

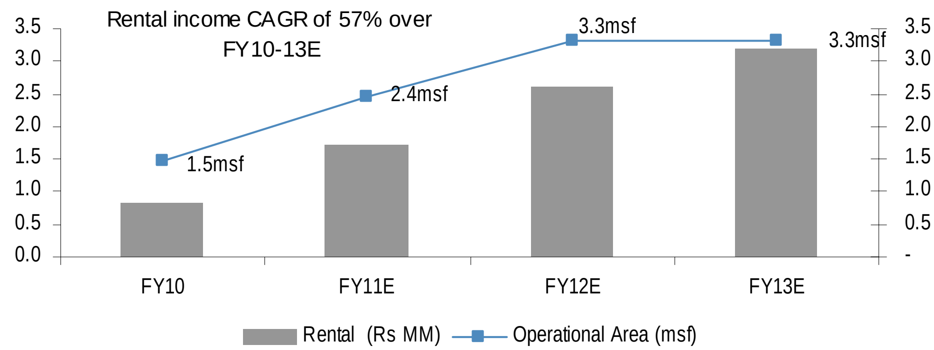
PML's rental income is expected to grow to Rs2.9 billion by end-FY12E from Rs800 million in FY10. While this would primarily be driven by the stabilization of Phase III (Palladium + Galleria) of HSP, which became operational toward end of FY10, the market cities should start contributing meaningfully from FY13E onwards once they are fully operational.

In addition to this, PML is looking to provide mall management services to the market city developments. While plans are yet at a nascent stage, we believe this can start to become meaningful once the market cities are fully operational (total retail area under these assets is 4.4msf).

Even while we expect the market cities to generate rental income of Rs3.6 billion (PML's stake: Rs1.3 billion) in FY13E, the flow through to the holding companies (PML) is likely to be limited in the near term, given the retail developments (Phase I) at its market city projects are 50-60% debt-funded. Rental income would primarily go toward meeting the interest commitment on the SPV debt.

However, the company is planning to develop residential and commercial complexes (for sale) as part of phase II at its market city projects. This should provide comfort on cash flows, given the pre-sales model followed for residential projects (negative working capital) as compared to commercial, which is an asset-heavy model. Cash flow from second phases would primarily be used to repay debt, thereby freeing up the rental income and thereon should enable PML to reap rich dividends from these associated entities.

Figure 6: Phoenix—Rental portfolio



Source: Company reports, J.P. Morgan estimates.

Table 6: Phoenix—Operational and upcoming lease portfolio

	Developable area	PHNX's stake	FY12E rental income (Rs MM)	FY13E rental income (Rs MM)
High Street Phoenix	0.9	0.9	1,782	1,871
EWDPL	1.0	0.3	163	171
Big Apple	0.7	0.4	185	185
Market Cities (Pune, Kurla, Bangalore, Chennai)	4.4	1.6	766	1,255
Total	7.0	3.3	2,896	3,482

Source: Company reports, J.P. Morgan estimates.

Unique SPV financing structure has kept gearing levels in check despite the asset heavy model…

Phoenix has roped in financial investors (IL&FS, Kshitij, Saffron Capital, Sapphire Capital and Horizon Venture Capital) at regular intervals in its market city projects at early stages of the development, thereby mitigating the financial and execution risk. This has also enabled the company to keep its gearing levels in check despite retail development being an asset-heavy model (lease model).

While the company's reported consolidated net D/E (Sep-10) currently stands at 0.3x, the gearing does not appear to be stretched even after we adjust for its effective stake in market city's debt.

Table 7: Phoenix—Net D/E

	Rs B
Consolidated Net Debt	4.7
Equity	16.5
Reported Net D/E	0.3
Standalone net Debt	(0.4)
Debt (market cities)	5.0
Debt at ShangriLa	0.9
Total Debt	5.5
Adjusted Net D/E	0.33

Source: Company Data.

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Potential listing of EWDPL could unlock more value

EWDPL is looking for a primary listing and has already filed a draft prospectus with SEBI (the market regulator). The company is looking to raise Rs5-6 billion by selling a 30% stake. Post the issue, PML's stake in the company is expected to come down to 23-24% (conversion of ICIC Ventures and IPO) from 40.28% currently and implies a value of Rs4 billion. This is against Phoenix's investment of Rs1.6 billion in EWDPL. Any value unlocking here is a key catalyst, in our view. We have valued EWDPL at Rs3.3 billion vs. Phoenix's investment of Rs1.6 billion (2x P/B).

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Valuation and share price analysis

Mar-12 price target of Rs280

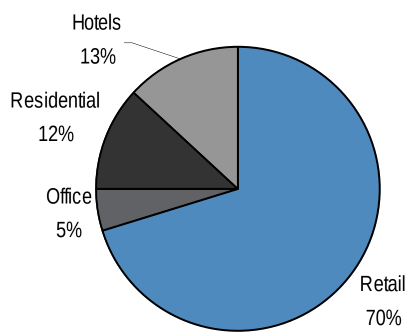
We initiate coverage on Phoenix Mills with an Overweight rating and Mar-12 price target of Rs280. Our price target of Rs280 is based on a 20% discount to our SOTP valuation. This implies a FY12E P/E of 25x and FY12E P/B of 2.2x.

Table 8: PML—Sum-of-the-parts valuation

	Stake	Attributable Area (msf)	Avg rent Rs psf pm	Avg. SP residential/office Rs psf	Value (Rs MM)	Per share Rs/share
High Street Phoenix						
Phase-I-III	100%	0.9	Rs165 psf pm		16,200	113
Phase-IV	100%	0.3		12,000	3,000	21
Shangri-La	53%	-		ARR 10000	5,927	41
Market City Portfolio		4.1			18,590	129
Pune	59%	1.1	65	6,500	5,906	41
Bangalore W	70%	1.4	NA	5,500	3,499	24
Kurla	24%	0.6	90	8,500	4,269	30
Bangalore E	33%	0.5	65	3,200	2,134	15
Chennai	34%	0.5	75	6,000	2,781	19
EWDPL	40.3%	5.4	Rs35-40psf pm	2700	3,383	23
Big Apple	74%	0.43	Rs40-45 psf pm		1,764	12
Hospitality (at investment)	>1000 rooms across 4 hotels				1,100	8
Add: Net cash (Parent Co.)					550	4
Total Debt at SPVs					(5,904)	(41)
DCF Value					44,610	310
Forward NAV						350
PT (20% discount to FNAV)						280

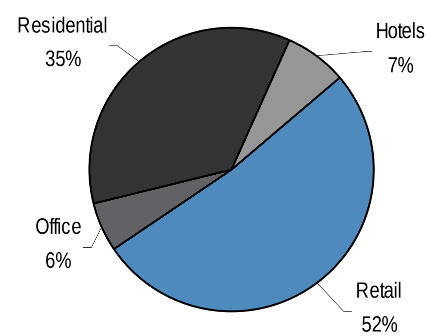
Source: Company reports, J.P. Morgan estimates.

Figure 7: Phoenix—Value break-up by asset class



Source: Company reports, J.P. Morgan estimates.

Figure 8: Phoenix—Area break-up by asset class



Source: Company reports, J.P. Morgan estimates.

Table 9: PML—Key SOTP assumptions

WACC	13%
Cap rate	11%
Price/rent growth	5%

Source: J.P. Morgan estimates.

We compare PML's valuations with real estate players (local and regional) as well as retailers. While the stock is expensive relative to Indian developers on both a P/E and P/B basis, it is meaningfully cheaper as compared to other emerging market players as well as retailers despite offering higher earnings growth. High execution and lease visibility on assets nearing completion lend comfort to our earnings estimates for PML over the next two years.

Valuations relative to real estate

Given PML is the only pure listed play on retail real estate (70% of value), there is no direct comparable for the company among listed companies. However, we do note that the company's valuation is expensive relative to the real estate sector. The stock is trading at FY12E P/E of 19.2x, which is at a meaningful premium to the sector average; however, this is supported by high earnings growth (EPS CAGR of 61% over FY10-12E).

On a P/B basis, the stock is trading at FY12E P/B of 1.7x, which is largely in line with the sector average, despite its ROE profile being muted relative to its peers.

Table 10: Indian developers' valuation

	Market Cap	P/E		EPS growth		P/B		ROE		
	US$MM	FY11E	FY12E	FY 11E	FY 12E	FY11E	FY12E	FY11E	FY12E	NAV discount
DLF	10,359	22.9	17.2	24%	33%	1.8	1.6	8%	10%	-31%
Unitech	3,404	18.1	11.3	22%	61%	1.3	1.2	8%	11%	-53%
IBREL	1,216	38.5	16.8	NA	129%	0.6	0.7	2%	4%	-47%
HDIL	1,592	8.4	6.3	30%	32%	0.8	0.7	11%	12%	-53%
Phoenix	658	32.0	19.2	55%	66%	1.8	1.7	6%	9%	-39%
DB Realty	1,047	9.3	5.5	176%	70%	1.4	1.1	15%	20%	-70%
Puravankara	449	12.8	9.8	13%	31%	1.3	1.1	11%	12%	-45%
Sobha	642	18.2	11.5	23%	59%	1.6	1.4	9%	13%	-32%
Brigade	266	10.3	8.2	158%	25%	1.1	1.0	11%	13%	-44%
AIT	532	16.4	13.6	7%	21%	1.1	1.1	9%	9%	-8%

Source: Company reports, J.P. Morgan estimates. Pricing as of Nov 29.

Valuations relative to regional retail plays

While there are no pure listed retail real estate players in India, among regional peers CapitaMall Asia (Singapore) is the closest peer for PML. CML, too, follows a similar SPV financing structure for its upcoming developments. Below we compare PML with CapitaMall Asia and other listed pure retail players across various emerging markets (Brazil, the Philippines, and Thailand).

We note that PML is trading at a meaningful discount to the regional peer group on a forward P/E basis despite offering higher near-term earnings growth (CAGR of 61% over FY10-12) coming from projects which are substantially completed and pre-leased (both execution and leasing risks have been alleviated).

On a P/B basis, PML's valuations (at 1.7x CY11 P/B) may appear expensive relative to CapitaMall Asia (CMA); however, this is explainable by revaluation of assets in the case of CMA. Hence, its book value is closer to the market value unlike PML, wherein assets are being carried at construction cost/investment. Further, a substantial part of PML's portfolio is under development ,which is expected to be completed over the next 12 months.

Lastly, on an NAV metric too, the stock is trading at a ~40% discount versus 5-20% in the case of most regional players.

Table 11: Regional retail valuation

Company	Country	MCap (US$MM)	P/E CY10E	P/E CY11E	EPS growth CY10E	EPS growth CY11E	P/B CY10E	P/B CY11E	ROE (%) CY10E	ROE (%) CY11E	NAV discount
Phoenix Mills	India	713	32.0	19.2	55%	66%	1.8	1.7	5.8%	9.0%	-39%
CapitaMalls Asia	Singapore	6,071	16.2	28.2	25%	-43%	1.3	1.3	8.6%	4.6%	-22%
SM Prime Holdings	Philippines	3,630	19.5	17.8	10%	9%	2.9	2.7	15.7%	15.8%	-18%
Alliansce Shopping Centers	Brazil	1,167	41.8	26.8	-41%	56%	2.0	1.9	6.3%	7.2%	-5%
Central Pattana^	Thailand	2,120	29.8	25.0	-10%	18%	3.0	2.8	10.4%	11.2%	-16%

Source: Company reports, J.P. Morgan estimates. ^Bloomberg estimates for NR companies. Pricing as of November 29, 2010.

Valuations relative to retailers

We view PML as more of a consumption play rather than a pure real estate play given:

a) A significant portion of PML's portfolio is completing over the next one year and substantial pre-leases are in place. Hence, construction and leasing, the two biggest risks for the real estate sector, have largely been taken out.

b) Its steady earnings profile primarily constituting annuity stream (rental income) coming in from retail assets already completed/nearing completion.

c) PML has presence across key consumption centers in India (Bangalore, Mumbai, Chennai and Pune) via its market city developments.

d) Improving retailer sales bodes well for PML, given revenue-sharing emerging as a favorable lease format.

Comparing Phoenix with retail plays, we note that PML offers higher near-term earnings growth, better margins and is still cheaper on a P/E and P/B basis.

Table 12: India retailer valuations

	Mcap US$ MM	P/E FY11E	P/E FY12E	EPS growth FY11E	EPS growth FY12E	P/B FY11E	P/B FY12E	ROE FY11E	ROE FY12E
Phoenix	700	32.0	19.2	55%	66%	1.8	1.7	5.8%	9.0%
Pantaloon Retail	2,057	31.3	22.9	73%	37%	2.9	2.5	9.3%	10.9%
Shoppers Stop	658	44.2	33.1	60%	33%	5.5	4.6	18.5%	18.3%

Source: Company reports, J.P. Morgan estimates. Numbers for Shoppers Stop are based on consensus valuations. Note: For Pantaloons, we take the valuation estimates for the core retail business only. Figures are as of November 29 close.

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Key share price catalysts

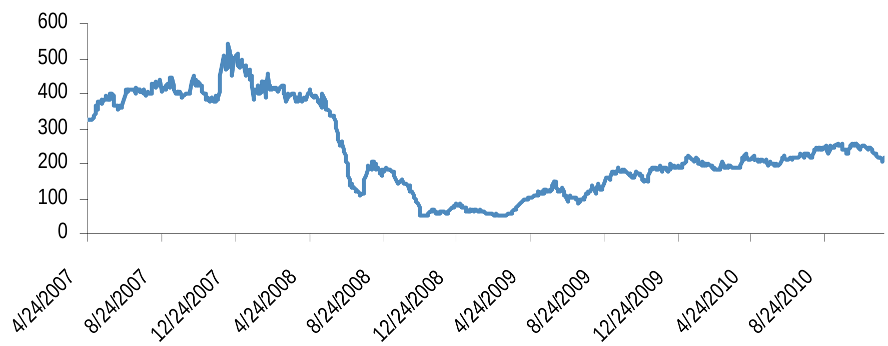
1. Progress/response on opening of market cities is key to watch. Phoenix's market cities are close to completion, with Pune being the first one to become operational (by end-FY11), while the remaining are expected to be operational over the next 6-12 months.

2. Any clarity on permissible FSI in Phase IV at HSP, thereby increasing the developable area.

3. Improving retailer sales trends bode well for Phoenix's rental income, given the revenue-sharing model being undertaken for recent lease agreements.

4. Potential listing of EWDPL could unlock value.

Figure 9: Phoenix stock price (Rs)



Source: Bloomberg.

SWOT analysis

Strengths

- PML's High Street Phoenix is one of the biggest consumption centers in Mumbai, providing a stable annuity stream of Rs1.6 billion based on minimum license terms.
- Steadily growing rental income via completing market city developments and partnership with EWDPL/Big Apple.
- Most of PML's projects are city-centric assets in key metros (Mumbai, Bangalore, Chennai and Pune) and in close proximity to established residential catchments.
- Near-term execution visibility remains high, given most of the market city developments are nearing completion.
- Strong brand equity on the back of HSP mitigates leasing risk for its market city developments.

Weaknesses

- Lack of established brand name in the residential segment may affect offtake/realizations adversely.
- Even while market cities are expected to garner healthy rental income, the flow through to PML is likely to be muted in the near term, given these projects are 50-60% debt funded.

Opportunities

- Improving retail trends bode well for PML's rental income, given the revenue-sharing model for lease agreements.
- PML is one of the early entrants in the retail segment in tier II/III cities via EWDPL/Big Apple. These cities can potentially provide a significant opportunity, given limited competition and lack of quality ready retail real estate.
- Opportunities for new developments over and above the existing portfolio. We expect Phoenix to turn FCF positive in FY13 onwards.

Threats

- A recovery in the retail segment is as yet in its nascent stage and faces oversupply issues. Further, the retail demand is yet to take off meaningfully in tier II/II cities.
- Minority stake in SPV's developing market cities could potentially restrict PML's decision making. More importantly, it exposes company to an exit risk by any partner in future.
- A foray into hospitality could challenge the company's marketing and execution ability.
- Any slowdown in the economic recovery, thereby impacting retailers' sales and expansion plans.

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Key investment risks

Minority stake in SPVs could limit its decision making and raises concerns about exits required by private investors

The majority of the SPV partners for PML are private equity players. Hence, at some point the company may need to start thinking about monetizing the partner's holdings and create exit opportunities for these funds. Overall, PML's partners have invested Rs10 billion as equity across its market city projects and most of these have been made during the peak times of 2006-08.

As per the company, exits are a few years away and there is no formal obligation on PML's part to provide an exit to any SPV partner. Key SPV partners for PML at its market city developments include Saffron Capital, IL&FS, Saphire Capital Edelweiss and local developers (HBS, Pradhan Housing).

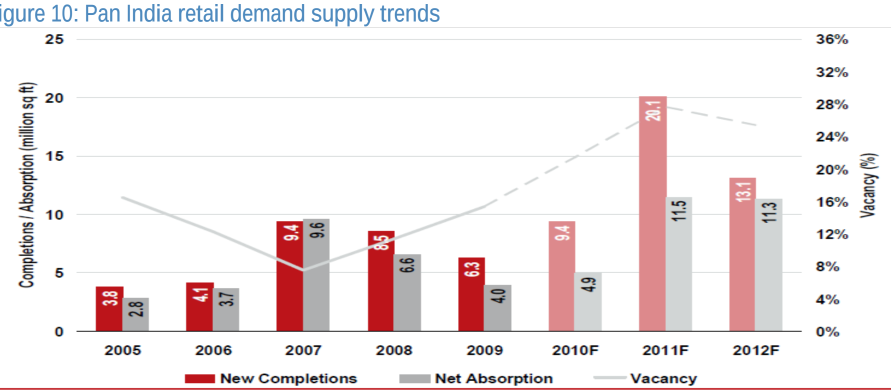
Further, Phoenix has a minority stake in most of its market city projects, which can potentially restrict the company's decision-making capability, given multiple partner involvement.

Oversupply risks remain in retail…demand in tier II/II cities yet to take off

2011 is expected to witness completion of 20msf of retail space vs. an estimated absorption of ~12msf (source: JLL). All the expected future supply in 2010/2011 is at fairly advanced stages of construction. This would keep vacancy levels elevated (c>20%) and rentals in check.

Further, the recovery in the retail sector is as yet in its nascent stages and has been limited to only key metro cities. Phoenix's upcoming market city developments are substantially pre-leased and hence face negligible leasing risk. However, the company's expansion plans in tier II/III cities may be at risk, given retail demand in tier II/III cities has not shown meaningful signs of improvement. Further, organized retail culture is fairly new to these cities and the success of such big developments in tier II/III cities is yet to be seen.

Figure 10: Pan India retail demand supply trends



Source: JLL REIS.

Residential foray into newer markets

Phoenix has traditionally been a textile company which later forayed into retail real estate development by developing High Street Phoenix in South Mumbai in 1987. The company's limited track record has primarily been retail-dominated; however, it is incrementally foraying into residential development. We note that while retail leasing is typically centralized and is relationship-driven, especially with key anchor tenants, lack of established brand names in the residential segment could adversely affect offtake/price realizations, in our view.

Diversification into hospitality

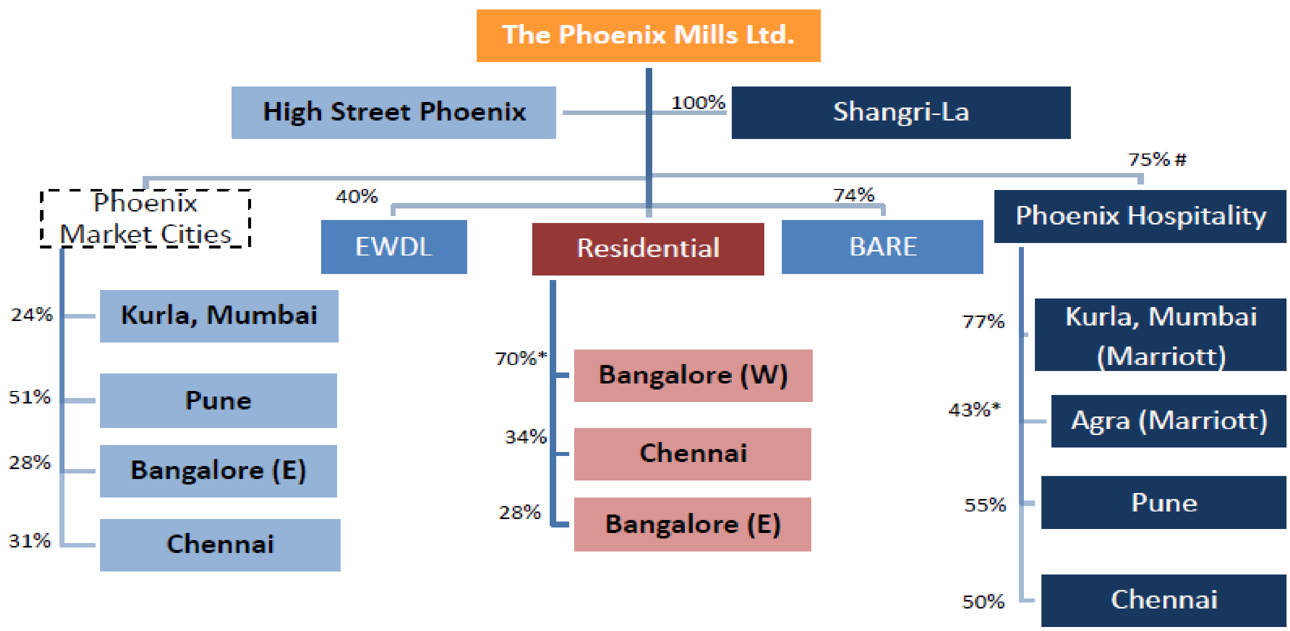
Phoenix Mills has historically been a retail developer and is now aggressively entering into the hospitality segment. While managements of these hotels are to be given out to global hospitably chains (Hilton, Marriott, Shangri La, etc), we believe entry into a relatively new asset class can potentially challenge the company's marketing and execution ability. Further, it could act as a drain on PML's financial resources, given the capital-intensive nature of the business.

Company profile

Promoted by the Ruia group, Phoenix Mills (PML) began operations as a textile manufacturing company in 1905 on 17.3 acres of land in Lower Parel, Mumbai. In 1987, the company largely exited the textile sector and entered into the real estate market in Mumbai by developing High Street Phoenix (HSP) on its textile mill property in Lower Parel. With three phases already operational, the property currently offers 1msf of retail space.

PML is replicating its High Street model across key metros (Bangalore, Chennai, Pune and Mumbai) via its market city projects. Market city projects are essentially retail-led mixed use projects. In addition, the company has made its retail foray into tier II/III cities via investments in EWDPL and Big Apple. Overall, PML via its investments and partnerships is developing ~35msf (PML's stake - ~12msf) of projects across India, primarily focused on retail malls.

Figure 11: IPIT—Corporate structure



Source: Company data.

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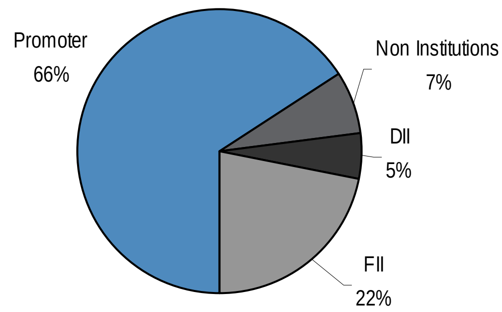
Figure 12: Shareholding pattern



Source: Company data.

Table 13: PML—Key milestones

1905	Incorporated in Mumbai to manufacture cotton textile goods on 17.3-acre Mill property in Lower Parel, Mumbai.
1987	Entered the real estate market by redeveloping the mill property.
	Came under provisions of Sick Industrial Companies (Sp. Provisions) Act, 1985 (BIFR).
1992	The first multi-storied Phoenix residential towers were built on the Phoenix Mills Land.
1996	Opened doors for South Asia's largest 20-lane bowling concourse, the first of its kind in India.
1999	PML declared no longer sick by BIFR.
2001	Introduced India 's first hyper market concept 'Big Bazaar' at High Street Phoenix.
2002	The first multi-storied Phoenix residential towers were built on the Phoenix Mills Land.
2003	Pantaloon and Lifestyle, two large departmental stores, each covering approximately 50,000 sq ft of retail shopping, were operational.
2004	High Street Phoenix had 400,000 sq ft of retail with the introduction of Skyzone, and other retail stores.
2006	Announced its new project at High Street Phoenix and a five-star luxury hotel.
2008	Ruia Real Estate Development Company merged with the company with effect from 1 November 2007. This entity owned the market cities which were merged with PML in 2008.
	Entered into a strategic alliance with EWDPL acquiring a 40% stake for Rs1.6 billion.
2009	Acquired a 39% stake in Big Apple Real Estate Private Limited.
2010	Phase III of HSP (Palladium) became operational.

Source: Company data.

Table 14: PML—Promoter profile

Mr. Ashokkumar Radhakrishna Ruia, Chairman and Managing Director	Mr. Ruia provides strategic direction to the company for all its new projects. Mr. Ruia is currently an executive Director of R R Hosiery Private Limited and a director of several Promoter Group companies. Mr. Ruia is a graduate of Cambridge University and has pursued an active career in business and sports.
Mr. Atul Ashokkumar Ruia, Joint Managing Director	Mr. Atul Ruia has been responsible for charting the strategic direction of the real estate expansion. Mr. Ruia is a graduate in Chemical Engineering from the University of Pennsylvania and holds a degree in Business Management from the Wharton School of Finance.

Source: Company data.

Portfolio details

High Street Phoenix

High Street Phoenix is the company's key asset located in South Central Mumbai developed on an erstwhile mill property (17.3-acre parcel). With three phases already operational, the property provides 1msf of retail space operating at over 90% occupancy. HSP boasts of record footfalls (12 million per annum) and houses some of the marquee tenants (Marks and Spencer, FCUK, Burberry, etc) and has marked the maiden entry of a few international retailers into India (Zara, etc.).

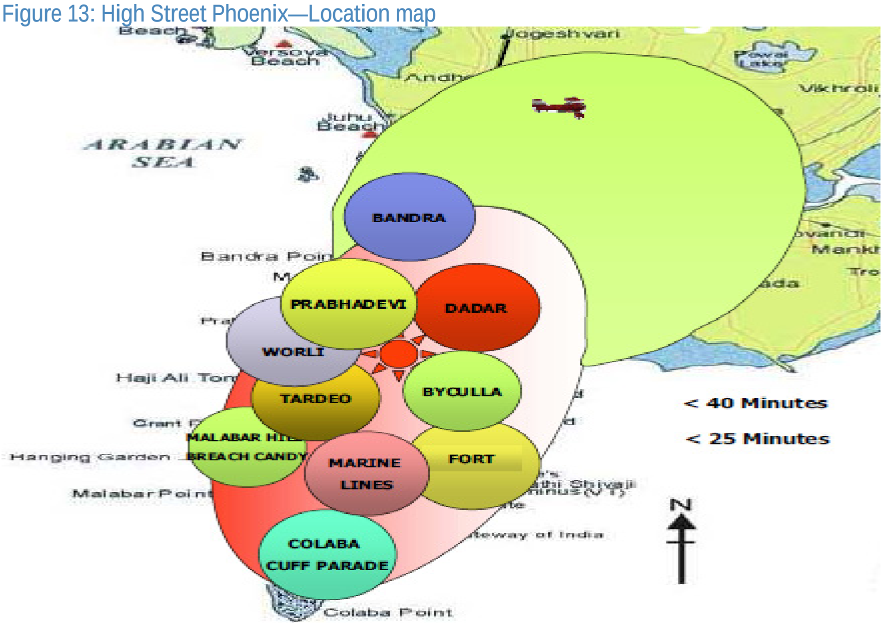
Rental income from HSP is expected to increase to Rs1.7 billion by FY12 from Rs800 million in FY10. This would primarily be driven by the stabilization of Phase III (Palladium + Galleria) of HSP, which became operational toward end-FY10.

Table 15: High Street Phoenix—Portfolio details (Mar-10)

Phases	Asset	Area (msf)	Occupancy	Key tenants
Phase I/II	The Coutyard and The Skyzone	0.5	98%	Hamley's, Big Bazaar, Pantaloons, Marks and Spencer etc
Phase III	The Grand Galleria	0.1	88%	Croma, Fab India, Costa Coffee, Base Camp Tranveller
Phase III	The Palladoum	0.3	86%	Zara, Deisel, The Comedy Store, Manchester United Café, Landmark etc
Phase IV	Shangri-La Hotel	0.8	NA	Management agreement for the 420-room hotel with Shangri-La. Expected to start operations by end-FY11.
Phase IV	Planning underway	0.3	NA	FSI expected to increase

Source: Company reports.

Figure 13: High Street Phoenix—Location map



Source: Company data.

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Market city projects

Phoenix is looking to replicate its "High Street Phoenix" model in other prime locations (Mumbai, Pune Bangalore and Chennai) via its market city developments. Market cities are essentially retail-led mixed-use developments (retail, residential and hotel) being developed over two phases.

Phase I of these projects providing 4.5msf of retail space (Phnx stake – 1.6msf) is nearing completion and has been substantially pre-leased (55-75% leased). While Pune market city will be the first one to be operational by end-FY11E, others (including Kurla, Bangalore and Chennai) are expected to be operational over the next 12 months. Work on the second phase of these developments (office/residential for sale) is expected to provide ~5msf of area (PML stake – 2.3msf) and is yet to begin.

We expect market cities to generate rental income of Rs3.6 billion (Phoenix's stake – Rs1.3 billion) once initial phases of these assets are fully operational (in FY13E).

Table 16: Phoenix—Market city development details

	PHNX stake (%)	Total area (msf)	Retail	Lease rate	% Leased	Status
Phoenix Market City, Pune	58.5%	1.85	1.2	65	75%	- Key anchor tenants have already moved in for fit outs - Response to Phase I commercial office (0.3msf) is encouraging - PML is proposing to increase its stake by 8% in SPV
Phoenix Market City, Bangalore (E)	32.7%	1.5	0.85	65	70%	- Handover to the tenants has already commenced - Leasing momentum is quite strong - Stake increased recently to 32.7% from 28.1%
Phoenix Market City, Kurla (E)	24.3%	2.45	1.3	100	55%	- Handover commenced for fit outs - Phase I commercial (0.3msf) has been 80% sold out - Possession expected by Q4FY11
Phoenix Market City, Chennai	31.0%	1.5	1.0	80	60%	- Handover for fit outs expected to commence in Q4FY11

Source: Company reports.

EWDPL (40.28% stake)

EWDPL is a retail-led mixed use developer focused on tier II/III cities across Central India. The company operates under the brand "Treasure" and currently has 1msf of operational mall in Indore and Nanded. Further, the company is developing 22msf (leasable/saleable area of 13msf) of mixed-use properties across tier II/III cities (such as Raipur, Jabalpur, Bhillai, Jabalpur, Bhillai, etc.). Phoenix Mills owns 40.28% of EWDPL for its investment of Rs1,580 million. Another investor at the entity level along with Phoenix is ICICI Ventures.

EWDPL is looking for a primary listing and has already filed a draft prospectus with SEBI (market regulator). The company is looking to raise Rs5-6 billion by selling a 30% stake, implying a total valuation of Rs17 billion. Post the issue, PML's stake in the company is expected to come down to 23-24% (conversion of ICIC Ventures and IPO) from 40.28% currently.

Table 17: EWDPL portfolio (Phoenix holds 40.28% stake)

Projects	City	Stake	Developable area (msf)
Completed projects			
Treasure Island, Indore	Indore	100%	0.5
The Treasure Central, Indore	Indore	50%	0.3
The Treasure Bazaar, Nanded	Nanded	75%	0.3
Total			1.0
On going projects			
Retail/Commercial	Tier II/III	55%	5.3
Residential		55%	11.0
Total			
Forthcoming projects			
Residential	Tier II/III	74%	4.9
Total			~23msf

Source: Company reports, J.P. Morgan estimates.

Big Apple (74% stake)

Big Apple Real Estate is developing retail and hotel properties in tier II/III cities in North India. The company operates under the brand name "Phoenix United" and currently has only one operational mall (0.36msf) in Lucknow. In addition to this, the company has one retail mall under development in Bareilly (0.4msf), which is expected to be operational over the next 12 months.

Phoenix Hospitality

Phoenix Mills via its majority-held subsidiary "Phoenix Hospitality" is developing hotel projects across tier 1 and tier II cities. While PML will develop these hotels, management is being given out to leading hospitality chains (Marriott, ShangriLa, Hilton, etc). Overall, the company is planning to add over 1,000 rooms over the next two-three years. Currently, Phoenix Hospitality has four hotels under development across Kurla, Pune, Chennai, and Agra.

Figure 14: Phoenix Hospitality

Location	Operator	No of rooms	Expected launch date
Pune	Hilton	400	FY13
Agra	Marriott	160	FY13
Kurla	Marriott	300	FY13
Chennai	NA	240	FY13

Source: Company reports.

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Financials

Revenue growth over FY11-12E would be primarily driven by an increase in rental income from HSP (on the stabilization of Palladium). Further, contribution from market cities also is expected to start kicking in from FY12 onwards

Rental revisions, higher occupancy (in Palladium) and kicking in of revenue contribution from retailers should result in margin improvement in FY11. In 1HFY11, the company reported a margin of 72%

Associate income pertains to rental income from market cities (Bangalore, Pune and Chennai). This is expected to pick up meaningfully from FY12 onwards once the assets become operational and stabilize

Table 18: PML—Income statement

Rs MM, Year end March	FY09	FY10	FY11E	FY12E
Sales	8	8	8	8
License Fees and rental income	528	788	1,488	2,166
Hospitality			-	303
Income from projects		-	160	572
Service charges	451	421	446	535
Sales	996	1,230	2,094	3,575
% Y/Y	21%	23%	70%	71%
Expenditure				
Purchase for resale and variation in inventory	(6)	(12)	-	-
Employee expenses	(108)	(67)	(84)	(105)
% of sales	11%	5%	4%	3%
Operating and other expenses	(280)	(377)	(571)	(1,099)
% of sales	28%	31%	27%	31%
Total expenditure	(394)	(455)	(654)	(1,203)
EBITDA	602	775	1,440	2,372
EBITDA Margin	60%	63%	69%	66%
Depreciation	(94)	(172)	(293)	(366)
EBIT	508	603	1,147	2,006
EBIT Margin	51%	49%	55%	56%
Financial expenses	(55)	(86)	(186)	(410)
Other income	503	243	239	222
PBT	957	759	1,199	1,817
Total Tax	(190)	(147)	(240)	(454)
Tax Rate	20%	19%	20%	25%
Share of profit/loss in associates	-	5.93	-	232
Minority interest	0.70	1.44	1.4	1.4
Profit after tax	768	620	961	1,597
EPS	5.4	4.3	6.7	11.2
Net Margin (%)	77%	50%	46%	45%

Source: Company reports, J.P. Morgan estimates.

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Fixed assets to increase primarily on account of the completion of ShangriLa Hotel and Pune market city

Loans and advances primarily consist of money advanced for stake in hospitality SPV (Rs1.8B) and is pending allotment as yet

Loans to increase in FY11E on account of the build-out of ShangriLa and Pune market city.

Table 19: PML—Balance sheet

Rs MM, year end March	FY09	FY10	FY11E	FY12E
Gross block	4,881	7,955	9,163	10,131
Less: Depreciation	(462)	(633)	(926)	(1,292)
Net Block	4,419	7,321	8,237	8,838
CWIP	9,004	9,137	10,296	11,163
Total Fixed Assets	13,423	16,458	18,533	20,002
Investments	2,982	3,212	3,212	3,212
Current Assets				
Inventories	3	3	3	3
Sundry Debtors	351	431	431	431
Cash and bank balance	3,453	3,059	3,333	4,096
Loans and advances	4,079	3,628	3,634	3,667
Total Current Assets	7,886	7,121	7,401	8,197
Current Liabilities	1,354	1,724	1,804	2,472
Provisions	230	244	244	244
Current Liabilities and provisions	1,584	1,969	2,049	2,716
Net Current Assets	6,302	5,152	5,352	5,481
Deferred tax asset	11	24	-	-
Miscellaneous expenditure	0	0	0	0
Total Assets	22,718	24,823	27,097	28,694
Liabilities				
Unsecured Loans	5,110	6,398	7,898	7,898
Secured Loans and others	342	210	-	-
Total Loans	5,452	6,608	7,898	7,898
Share Capital	290	290	290	290
Reserves and Surplus	14,858	15,759	16,719	18,316
Equity application money	-			
Shareholder Funds	15,147	16,048	17,009	18,606
Total Liabilities and Equity	22,718	24,847	27,097	28,694
Net Debt	1,999	3,549	4,565	3,802

Source: Company reports, J.P. Morgan estimates.

FCF should turn positive from FY12 onwards as we expect rental income to increase substantially on the back of the stabilization of Palladium in HSP and contribution from market cities. Further, the capex on upcoming developments will be largely incurred

Table 20: PML—Cash flow statement

Rs MM, year end March	FY09	FY10	FY11E	FY12E
EBITDA	602	775	1,440	2,372
Other income	503	243	239	222
Taxes	(190)	(147)	(240)	(454)
Associate income	-	6	-	232
Change in working capital	300	756	73	635
Cash flow from operations	1,215	1,632	1,512	3,006
Capex	(5,191)	(3,206)	(2,368)	(1,835)
Change in investments	(853)	(230)	-	-
Net Cash flow	(4,829)	(1,804)	(856)	1,171
Interest expense	(55)	(86)	(186)	(410)
Change in debt	2,404	1,156	1,290	-
Equity	1366			
Others	333	340	26	1
Net Cash flow	(780)	(394)	274	763

Source: Company reports, J.P. Morgan estimates.

Phoenix Mills: Summary of financials

Profit and Loss statement

Rs MM, year-end Mar	FY09	FY10	FY11E	FY12E	FY13E
Revenues	996	1,230	2,094	3,575	5,516
% change Y/Y	21%	23%	70%	71%	54%
EBITDA	602	775	1,440	2,372	3,018
% change Y/Y	19%	29%	86%	65%	27%
EBITDA Margin (%)	60%	63%	69%	66%	55%
EBIT	508	603	1,147	2,006	2,615
% change Y/Y	18%	19%	90%	75%	30%
EBIT Margin (%)	51%	49%	55%	56%	47%
Net financial income	448	157	53	(188)	(278)
Earnings before tax	957	759	1,199	1,817	2,337
% change Y/Y	54%	-21%	58%	52%	29%
Tax	(190)	(147)	(240)	(454)	(584)
as % of EBT	20%	19%	20%	25%	25%
Net Income (adjusted)	768	620	961	1,597	2,608
% change Y/Y	78%	-19%	55%	66%	63%
Shares Outstanding	143	143	143	143	143
EPS (adjusted)	5.4	4.3	6.7	11.2	18.2
% change Y/Y	78%	-19%	55%	66%	63%

Cash flow statement

	FY09	FY10	FY11E	FY12E	FY13E
EBITDA	602	775	1,440	2,372	3,018
Other income	503	243	239	222	235
Taxes	(190)	(147)	(240)	(454)	(584)
Associate income	-	6	-	232	854
Change in working capital	300	756	73	635	836
Cash flow from operations	1,215	1,632	1,512	3,006	4,358
Capex	(5,191)	(3,206)	(2,368)	(1,835)	(1,500)
Change in investments	(853)	(230)	-	-	-
Net Cash flow	(4,829)	(1,804)	(856)	1,171	2,858
Interest expense	(55)	(86)	(186)	(410)	(512)
Change in debt	2,404	1,156	1,290	-	(700)
Equity	1,366	-	-	-	-
Others	333	340	26	1	1
Net Cash flow	(780)	(394)	274	763	1,647

Balance sheet

	FY09	FY10	FY11E	FY12E	
Cash and cash equivalents	3,453	3,059	3,333	4,096	5,743
Accounts receivable	351	431	431	431	431
Inventories	3	3	3	3	3
Loans and advances	4,079	3,628	3,634	3,667	
Current assets	7,886	7,121	7,401	8,197	
Total Investments	2,982	3,212	3,212	3,212	3,212
Net fixed assets	13,423	16,458	18,533	20,002	21,099
Liabilities	1,354	1,724	1,804	2,472	2,734
Provisions	230	244	244	244	244
Total current liabilities	1,584	1,969	2,049	2,716	2,978
Total assets	22,718	24,823	27,097	28,694	30,603
Total debt	5,452	6,608	7,898	7,898	7,198
Shareholders' equity	15,147	16,048	17,009	18,606	21,214
BVPS	106	112	119	130	148

Ratio analysis

%, year-end March	FY09	FY10	FY11E	FY12E	FY13E
EBITDA margin	60%	63%	69%	66%	55%
EBIT margin	51%	49%	55%	56%	47%
Net profit margin	77%	50%	46%	45%	47%
Sales growth	21%	23%	70%	71%	54%
Net profit growth	78%	-19%	55%	66%	63%
D/E	0.7	1.0	0.7	0.5	0.4
Net D/E	0.1	0.2	0.3	0.2	0.1
Asset Turn	0.0	0.0	0.1	0.1	0.2
Average ROE	6%	5%	4%	6%	9%
Average ROCE	4%	4%	3%	4%	7%

Source: Company reports, J.P. Morgan estimates.

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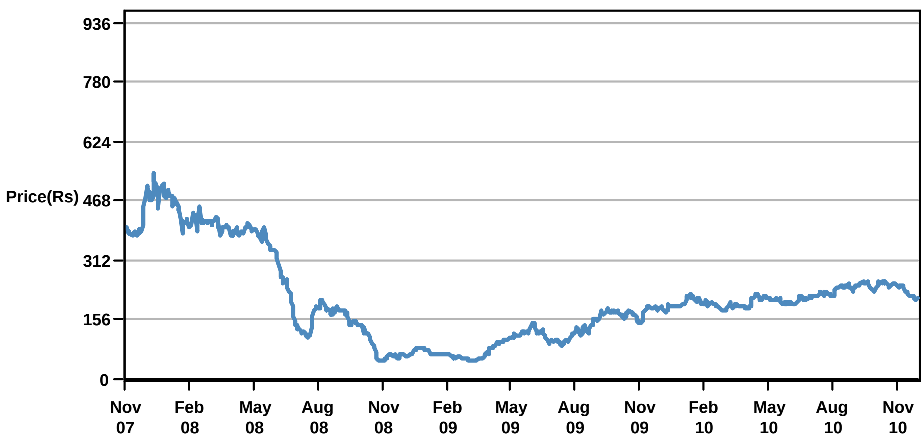
Phoenix Mills (PHOE.BO) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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Coverage Universe: **Gunjan Prithyani:** Brigade Enterprises (BRIG.BO), Puravankara Projects Ltd (PPRO.BO)

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