Gujarat Industries Power Company

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,377	GIP IN
	REUTERS CODE
S&P CNX: 2,537	GJIP.BO

13 October 2005

Subscribe at Rs63

Public Offer Price Band Rs63-75

GIPCL is coming out with a fresh issue of Rs2.75b, at a price band of Rs63-75 per share, in order to part finance the 250MW lignite based power plant. Post expansion the power generation capacity of GIPCL would increase to 805MW. We recommend subscribe at Rs63.

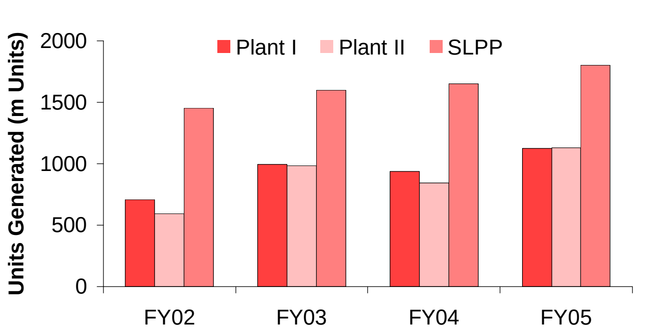
Station I, a merchant plant

Station I is a merchant plant, which was established primarily with the objective of meeting the power requirements of its promoter companies. Power from this plant is sold to the promoter companies as per the terms of the MoU signed with these companies. As this is not covered by the IPPA, the returns from this plant are not limited to 14%, as is the case with other plants/utilities. The plant has no fixed costs (depreciation and interest) as depreciation has been provided over the last 13 years and loan taken for the plant, repaid. Hence, with only variable costs, returns from the plant will help the company earn RoE above the limits set under the power purchase agreement (PPA).

Targeting incentive returns on Plant II and SLPP

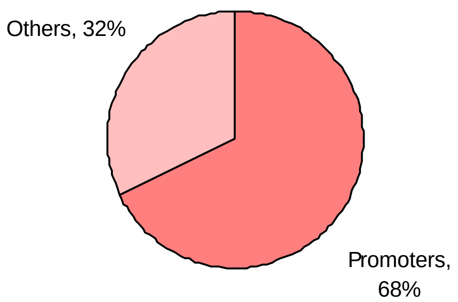
Station II and SLPP supply power to GEB as per the terms of the IPPA, under which it is entitled to RoE of 13% plus incentive in case the PLF exceeds 80%. Incentive is calculated at 25 paise per unit for every unit exported in excess of PLF of 80%. GIPCL is entitled to fixed charges for operation and maintenance and savings in these charges lead to higher returns. In FY05, PLF stood at 80.85% and 82.39% for plant II

HIGHER PRODUCTION...



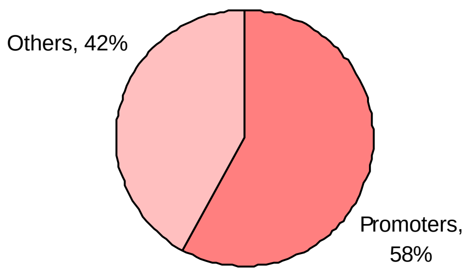
Source: Motilal Oswal Securities / Company

SHAREHOLDING PATTERN : PRE DILUTION



Source: MOSL

SHAREHOLDING PATTERN : POST DILUTION

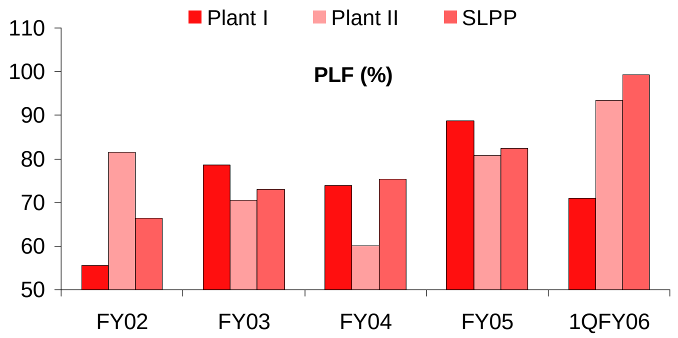


Source: MOSL

Vishal Saraf (Vishal@MotilalOswal.com) + 91 22 56575365

and SLPP, respectively. The PLF was above 90% for both the plants in 1QFY06. While PLF for Plant II increased due to availability of gas, stabilization of SLPP helped the company achieve PLF of over 90%.

... LEADS TO HIGHER PLF



Source: Motilal Oswal Securities / Company

Gas supply problem resolved

GIPCL had been facing fuel shortage at Plant II. While the plant can run on both gas and naptha, naptha is costlier which led to tariff exceeding Rs4 per unit, and unavailability of gas led to plant shutdowns. However, the problem of non-availability of gas has now been resolved and the company has entered into agreements for natural gas and R-LNG from Gail and GSPC-Niko. This has lead to a YoY increase in PLF and generation for Station I and Station II in FY05. The trend of rising PLF has continued in FY06, except for Plant I, which had to be shut down for major repairs, which are undertaken once in six years.

Financial status of GEB improving

Financial condition of Gujarat Electricity Board (GEB) has improved, which has helped GIPCL recover its dues from GEB and restructure and reduce its loans. It is now getting its payment in time, which helps it keep working capital under control.

Public offer objective - undertaking expansion

GIPCL is setting up a 250 MW lignite-based power plant (with an option of increasing it by 20% to 300 MW), at its existing SLPP site. The plant is scheduled for commissioning in FY10. The proposed plant, along with SLPP, will source lignite from captive mines, which have reserves to support capacity of 1,000 MW for over 30 years.

The cost of the project is estimated to be around Rs12,950m for a 250 MW plant (Rs14,480m for 300 MW). The cost comprises of Rs11,170m for 250 MW (Rs12,700m for 300 MW) towards the power plant and Rs1,780m for mining. The cost is being financed by debt and equity in the ratio of 75:25, which works out to Rs9,712m of debt and Rs3,238m of equity for a 250 MW plant. Details of financing are as follows:

PROPOSED PROJECT FINANCING

Particulars	Proposed expansion 250MW	Proposed expansion 300MW
Equity	(Rs m)	(Rs m)
Internal accruals	488	870
Public issue	2,000	2,000
Promoters contribution	750	750
Total Equity	**3,238**	**3,620**
Debt		
Rupee term loans	9,712	10,860
Total debt	**9,712**	**10,860**
Total	**12,950**	**14,480**

Further expansions also on the anvil

GIPCL has entered into an MoU with the Government of Gujarat (GoG) to set up two lignite-based power plants of 1,000 MW each (cost Rs45bn/plant) in south Gujarat. GIPCL has invited expression of interest for a 1,000 MW power plant and is currently in the process of reviewing the request for qualification from interested parties. It plans to take a 49% stake in the JV for the project.

Background

Gujarat Industries Power Company (GIPCL), engaged in generating power since 1992, has three power plants in Gujarat with a total capacity of 555 MW. (Station I: 145MW- gas based; Station II: 160 MW-gas/naptha based and Surat Lignite Power Plant (SLPP): 250 MW- lignite based). It is promoted by Gujarat Electricity Board, Gujarat State Fertilizers & Chemicals (GSFC), Gujarat Alkalies & Chemicals (GACL) and Petrofils Co-operatives.

Concerns

GIPCL derives majority (>75%) of its revenues from supply of power to its promoters (GEB and GSFC) which are in a weak financial position. GEB, one of its promoters and customers for Station II and SLPP, had incurred losses for the period 1999 to 2003. GSFC, one of its promoter customers has reported profits in FY03-04 and in FY04-05 but had reported losses earlier.

Terms of the PPAs and MoUs are determined after discussions with its promoters. The terms of the MoU and PPAs may adversely affect its profitability and/or liquidity, as the promoters have the bargaining power. GUVNL (Gujarat Urja Vikas Nigam Ltd.) has proposed a reduction in RoE @ SBI PLR + 1.50%, which GIPCL has not accepted and the matter has been represented to GoG for maintaining the existing RoE at 13%. In case the RoE is revised downwards, the profitability would be affected.

Public issue

It plans to raise Rs2.75b through an equity issue. Of this, Rs750m is being brought in by the promoters. The balance Rs2b is being funded by way of public issue of shares. The shares are being issued by way of book building and the issue has been priced at a band of Rs63-75 per share. The issue opens on 13 October and closes on 19 October, 2005. GIPCL would issue around 33.3-40m shares at the upper and lower price bands respectively, which would increase the equity capital from Rs1.1b to around Rs1.45-1.5b.

Financials & Valuations

The equity shares are being issued to finance the 250 MW (or 300 MW)lignite-based power plant, which would take three years for commissioning, and hence the benefits from the plant would start flowing in to the bottom line only from FY10. This will lead to dilution in earnings per share as the equity will increase without a corresponding increase in the profits for the next three years. Similarly, the increase in net worth would lead to a decline in the RoE for the next three years. Thus, though the project is beneficial from a long-term perspective, it will lead to a temporarily decline in EPS, RoE and RoCE.

With no new project expected to be commissioned in the next three years and the returns for power utilities being regulated by the government, we expect the revenue and PAT for GIPCL to remain stable over the next three years, until the new project starts generation. This makes the company look unattractive considering forward earnings and valuations. Non-diluted book value as on 31 March.'06 is expected to be Rs60.42. Considering the effect of dilution, it comes to Rs61.15-64 at the lower and upper price bands respectively. RoE, pre-dilution, works out to 16.66% and post dilution to 12%. The stock is priced at around 1.03x and 1.17x FY06E book value at the lower and upper price bands. We recommend subscribing to the IPO at Rs63.

FINANCIALS AND VALUATIONS ASSUMING ISSUE PRICE OF RS75 PER SHARE

YEAR END	EQUITY (RS M)	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	BOOK VALUE (Rs)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES (X)	EV/ EBITDA (X)
3/05A	1,108	7,447	848	7.7	60.6	50.8	9.8	1.5	15.1	18.0	2.0	4.8
3/06E	1,475	7,500	1,105	7.5	-2.1	63.6	10.0	1.2	11.8	14.4	2.5	5.9
3/07E	1,475	9,120	1,220	8.3	10.4	68.5	9.1	1.1	12.1	12.2	2.3	6.2

FINANCIALS AND VALUATIONS ASSUMING ISSUE PRICE OF RS63 PER SHARE

YEAR END	EQUITY (RS M)	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	BOOK VALUE (Rs)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES (X)	EV/ EBITDA (X)
3/05A	1,108	7,447	848	7.7	60.6	50.8	8.2	1.2	15.1	18.0	1.8	4.4
3/06E	1,545	7,500	1,105	7.2	-6.5	60.7	8.8	1.0	11.8	14.4	2.3	5.5
3/07E	1,545	9,120	1,220	7.9	10.4	65.2	8.0	1.0	12.1	12.2	2.2	5.8

FINANCIALS AND VALUATIONS ASSUMING ISSUE PRICE OF RS75 PER SHARE AND CURRENT MARKET PRICE OF RS81

YEAR END	EQUITY (RS M)	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	BOOK VALUE (Rs)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES (X)	EV/ EBITDA (X)
3/05A	1,108	7,447	848	7.7	60.6	50.8	10.5	1.6	15.1	18.0	2.1	5.0
3/06E	1,475	7,500	1,105	7.5	-2.1	63.6	10.7	1.3	11.8	14.4	2.6	6.2
3/07E	1,475	9,120	1,220	8.3	10.4	68.5	9.7	1.2	12.1	12.2	2.4	6.5

For more copies or other information, please contact
Institutional: Navin Agarwal. **Retail:** Relationship Manager (RM) or MOSt Franchisee
Phone: (91-22) 56575200 Fax: (91-22) 22816161. E-mail: inquire@motilaloswal.com

Disclosure of Interest Statement	GIPCL
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.