



Reliance Energy

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,218	RELE IN
	REUTERS CODE
S&P CNX: 4,109	RLEN.BO

18 January 2007

Buy

Rs528

Previous Recommendation: Buy

	YEAR	NET SALES	PAT	EPS*	EPS	P/E*	P/BV	ROE	ROCE	EV/	EV/
	END	(RS M)	(RS M)	(RS)	GROWTH (%)	RATIO	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	212.4										
52-Week Range	701/362										
1,6,12 Rel. Perf. (%)	-5/-14/-66										
M.Cap. (Rs b)	112.2										
M.Cap. (US\$ b)	2.5										
	3/06A	40,335	6,504	27.7	2.2	19.1	1.6	10.7	9.4	2.1	11.5
	3/07E	55,439	8,227	35.0	26.5	15.1	1.4	10.5	10.1	1.2	11.0
	3/08E	55,718	9,667	41.2	17.5	12.8	1.3	10.7	10.6	1.0	6.7

* Consolidated, Pre-exceptionals

- During 3QFY07, Reliance Energy reported revenues of Rs15.3b up 55% YoY, EBITDA of Rs827m, down 53.9% and net profit of Rs2b, up 22% YoY. A significant part of the incremental profits is being driven by higher other income, while the core business performance has been disappointing due to higher power purchase cost and lag effect in passing on the same.
- EPC division recorded revenue growth of 253% YoY during 3QFY07 to Rs6b, driven by project execution. EPC business reported EBIT of Rs181m in 3QFY07 (EBIT margin 3%), v/s Rs513m during 3QFY06 (EBIT margin 29%). EPC order book now stands at Rs17.1b (v/s Rs35b as at March 2006).
- Other income increased 92% YoY to Rs2.9b, higher than our expectations of Rs2b. This increase is due to increased cash balances YoY, higher interest rates (on cash balances) and forex gains of Rs400-450m (due to rupee appreciation).
- During 3QFY07, Reliance Energy acquired 51% stake in Reliance Energy Transmission Ltd (RETL), which emerged as lowest bidder for two transmission packages invited by Power Grid Corporation for setting up power lines linked with the 'Western Region Strengthening Scheme' in Gujarat and Maharashtra (estimated capex Rs16-18b).
- At CMP of Rs528/share, Reliance Energy trades at a PER of 15.1x FY07E, 12.8x FY08E and 11.9x FY09E. The company quotes at a P/BV of 1.4x FY07E, 1.3x FY08E and 1.2x FY09E. Maintain **Buy**.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales	9,497	10,429	9,884	10,382	11,549	14,076	15,337	14,477	40,191	55,439
Change (%)	0.7	31.7	6.4	-29.2	21.6	35.0	55.2	39.4	-2.9	37.9
EBITDA	1,615	2,034	1,793	1,901	1,334	1,775	827	2,366	7,332	6,302
Change (%)	9.6	25.1	200.7	0.6	-17.4	-12.8	-53.9	24.4	4.4	-14.0
As of % Sales	17.0	19.5	18.1	18.3	11.6	17.0	17.0	16.3	18.2	11.4
Depreciation	817	871	907	891	619	635	612	787	3,486	2,653
Interest	433	553	467	477	459	671	551	526	1,919	2,207
Other Income	1,348	1,185	1,493	1,863	1,711	1,761	2,867	2,248	5,890	8,587
PBT	1,712	1,796	1,912	2,396	1,967	2,230	2,531	3,301	7,817	10,029
Tax (incl contingencies)	146	200	265	701	201	366	522	713	1,311	1,802
Effective Tax Rate (%)	8.5	11.1	13.9	29.3	10.2	15.0	20.6	21.6	6.5	11.8
Reported PAT	1,567	1,596	1,646	1,695	1,766	1,864	2,009	2,588	6,505	8,227
PAT (Pre Exceptionals)	1,567	1,596	1,646	1,695	1,666	1,864	2,009	2,688	6,505	8,227
Change (%)	52.3	24.5	22.1	14.6	12.7	16.8	22.0	52.7	25.1	26.5

E: MOST Estimates; Quarterly numbers are on standalone basis

3QFY07 performance driven by other income (incl. forex gains)

During 3QFY07, Reliance Energy reported revenues of Rs15.3b up 55% YoY, EBITDA of Rs827m, down 53.9% and net profit of Rs2b, up 22% YoY. The core business performance was impacted due to higher power purchase cost (from Tata Power), as there is a time gap of ~30 days to pass on the cost increases to the consumer, through Tariff Order. Power purchase cost increased to Rs4.3/unit during 3QFY07, up from Rs2.9/unit during 3QFY06 and Rs2.8/unit during 2QFY07.

A significant part of the incremental profits is being driven by higher other income. Other income increased 92% YoY to Rs2.9b, higher than our expectations of Rs2b. This increase is due to increased cash balances YoY, higher interest rates (on cash balances) and forex gains of Rs400-450m (due to rupee appreciation).

Energy business: operational highlights:

- ⌘ Electricity sales during 3QFY07 were up 6% YoY to 2009m units. Realization during 3QFY07 was Rs4.6/unit, v/s Rs4.3/unit in 3QFY06.
- ⌘ Operational performance of the Energy business remains satisfactory. PLF of Dahanu power plant improved to 101% during 3QFY07, as compared to 97% in 3QFY06.
- ⌘ Samalkot power plant (Andhra Pradesh) registered PLF of 47% during 3QFY07 against 51% in 3QFY06, a result of lower gas availability.
- ⌘ Electricity purchases stood at 1061m units, up 18% YoY during 3QFY07. Purchase cost during the quarter was up sharply to Rs4.3/unit vs Rs2.9/unit in 3QFY06.

ENERGY BUSINESS PERFORMANCE

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
Operational Performance						
Units Sold (m)	2,017	1,902	1,984	2,229	2,399	2,009
Realization (Rs/unit)	4.0	4.3	3.9	4.1	3.8	4.6
Units Purchased (m)	1,110	898	846	1,148	1,208	1,061
Cost (Rs/unit)	2.7	2.9	3.0	2.7	2.8	4.3
Financial Performance						
Revenues (Rs m)	8,095	8,153	7,711	9,176	9,049	9,211
EBIT (Rs m)	927	936	927	1,330	1,041	792

Source: Company/ Motilal Oswal Securities

EPC business

- ⌘ During 3QFY07, EPC division recorded revenue growth of 254% YoY to Rs6.1b, driven by project execution, up from Rs1.7b in 3QFY06.
- ⌘ EPC business reported EBIT of Rs181m in 3QFY07 (EBIT margin 3%), v/s Rs513m during 3QFY06 (EBIT margin 29.6%). Even in the past, E&C business margins have been volatile.
- ⌘ E&C order book now stands at Rs17.1b (v/s Rs35b as at March 2006), comprising Rs15b of Yamunanagar project and Rs6-7b of rural electrification work in Uttar Pradesh. The company has also bid for projects worth Rs100b (power EPC projects).

EPC BUSINESS PERFORMANCE (RS M)

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
Revenues	2,334	1,731	2,671	2,373	5,027	6,126
Order Book	35,000	35,000	33,000	33,500	23,660	17,100
EBIT	444	513	295	151	233	181

Source: Company/ Motilal Oswal Securities

Acquired 51% stake in Reliance Energy Transmission Ltd

During 3QFY07, Reliance Energy acquired 51% stake in Reliance Energy Transmission Ltd (RETL). RETL has recently emerged as lowest bidder for two transmission packages (B and C) invited by Power Grid Corporation for setting up power lines linked with the 'Western Region Strengthening Scheme' in Gujarat and Maharashtra (estimated capex Rs16-18b). This was the first International Competitive Bid invited by Power Grid under 100% private equity route.

Progress on expansion plans

Maharashtra (1,200MW, imported coal): Maharashtra was originally conceived as gas based power project, with capacity of 1,400MW in Phase 1 and 4,000MW eventually. With the gas fuel linkage yet to be tied up, the management now intends to set up 1,200-1,800MW on imported coal, and plans to invite EPC contract bids by end November 2006. In terms of project progress, significant part of land acquisition has been completed. Part of the power generation (600-700MW) would replace existing power

sourcing from Tata Power (currently at Rs2.8-3/unit). We believe that the project could be commissioned by March 2009, and Reliance Energy will have 50% stake in the project.

Rosa Power Project: Very recently, Reliance Energy Generation (Reliance Energy has 50% stake) acquired Rosa Power Plant in Uttar Pradesh (600MW) from Aditya Birla Group. REGL has acquired project equity largely at par, and the set up cost is expected at Rs26b, to be financed on 70:30 DER. The management stated that project could achieve financial closure in soon, as most of the linkages and government clearances are already in place. The Power Purchase Agreement with Uttar Pradesh Rajya Vidyut Utpadan Nigam is based on CERC norms and provides 14% RoE at 80% PLF. The government has also approved REGL's plans to double capacity of the project to 1,200MW.

Infrastructure segment

✍ **Mumbai Metro** - The consortium headed by Reliance Energy has won the Mumbai Metro project at a cost of Rs23b. The project would be financed as: Viability gap funding Rs6.5b and balance through 70:30 DER. The preliminary project work has already started. Reliance Energy would have 49% stake, ADAG group will have 25% stake and Mumbai Metropolitan Regional Development Authority (MMRDA) 26%.

✍ **Road projects** – Reliance Energy has bagged Rs7b road projects in Tamil Nadu on BOT basis. The projects would be financed as grant of Rs500m from NHAI and balance through 70:30 DER.

Other growth plans

- ✍ Reliance Energy intends to participate in bidding for Ultra Mega Power Projects
- ✍ Has four coal bed methane blocks
- ✍ Working on setting up 2,500 acres SEZ in Dadri
- ✍ Signed MOU with Govt of Arunachal Pradesh for 1,700MW of hydro power projects
- ✍ Planned foray in power transmission through setting up transmission networks for Parbati and Koldam projects in JV with Power Grid and setting up the evacuation facilities for Dadri, etc

Valuations

We expect Reliance Energy to report net profit of Rs8.2b (up 27% YoY) during FY07, Rs9.7b (up 18% YoY) during FY08 and Rs10.4b (up 8% YoY) during FY09. At CMP of Rs528/share, Reliance Energy trades at a PER of 15.1x FY07E, 12.8x FY08E and 11.9x FY09E. The company quotes at a P/BV of 1.4x FY07E, 1.3x FY08E and 1.2x FY09E. Maintain **Buy**.

Reliance Energy: an investment profile

Reliance Energy (formerly BSES), is one of the two leading private sector companies in the Indian power segment. The company's generation capacity, spread across five locations, stands at 942MW. It has a distribution licence in Mumbai, and during privatization by the State governments, acquired stakes in Delhi and Orissa discoms. Total energy input in distribution business (incl Orissa) stands at 30BUs. Cash in hand and liquid investments stand at Rs68b (Mar 2006). The company has announced several growth initiatives across the spectrum of the Indian power sector, which are in multiples of its current size.

Key investment arguments

- ✎ After a lull of nearly 18-24 months, we expect a pick up in Reliance Energy's capex plans, post gas supply contract with Reliance Industries. We expect the company to award contracts for 7000MW of combined generation capacity at Dadri and Maharashtra in the next 4-5 months.
- ✎ Cash in hand and liquid investments stands at ~Rs60b (September 2006), facilitating higher scalability
- ✎ Existing business, especially the Mumbai business earns returns @ 14% p.a., assuring stable earnings stream
- ✎ Reliance Energy is emerging as a sizeable player in the infrastructure segment.

Key investment risks

- ✎ Successful project implementation and execution.
- ✎ Macro risks pertaining to the viability of the overall Indian power sector.

Recent developments

- ✎ Acquired 51% stake in Reliance Energy Transmission Ltd which emerged as lowest bidder for two transmission packages invited by PGCIL for setting up power lines in Gujarat and Maharashtra (estimated capex Rs16-18b).
- ✎ Setting up transmission networks for Parbati and Koldam hydro power projects, in JV with Power Grid (24% stake) on BOOT basis at capex of Rs6.4b.

Valuation and view

- ✎ At CMP of Rs528/share, Reliance Energy trades at a PER of 15.1x FY07E, 12.8x FY08E and 11.9x FY09E
- ✎ Play on the future growth opportunities rather than the current assured stream businesses. Recommend **Buy**.

Sector view

- ✎ Indian power sector offers significant growth potential. Incumbents, enjoy growth optionality, which could be in multiples of the current size. Private companies and CPSUs have announced significant expansion projects.

COMPARATIVE VALUATIONS

		REL	NTPC (ADJ)*	TPC
P/E (x)	FY07E	15.1	13.7	21.1
	FY08E	12.8	12.4	18.3
P/BV (x)	FY07E	1.4	1.9	2.0
	FY08E	1.3	1.7	1.9
RoE (%)	FY07E	10.5	14.0	9.2
	FY08E	10.7	14.3	9.0

* Adjusted for higher depreciation in books as compared to tariff Order and write-back of Rebate on OTSS bonds

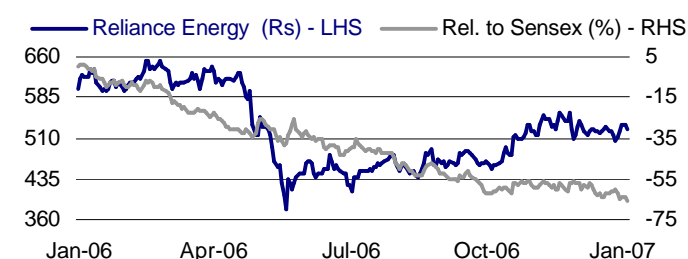
SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	29.7	29.7	51.0
Domestic Inst	29.5	29.3	21.3
Foreign	25.9	25.0	21.0
Others	14.9	16.0	6.7

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	35.0	33.2	5.5
FY08	41.2	35.8	15.0

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Sales	28,960	31,790	39,339	39,618	41,904	
Other Operating Income	12,438	8,545	16,100	16,100	20,100	
Total Revenues	41,398	40,335	55,439	55,718	62,004	
Change (%)	2.15	-2.6	37.4	0.5	11.3	
Cost of Electricity	11,032	12,016	20,941	18,757	20,739	
Cost of fuel	7,359	8,121	8,571	8,149	8,149	
Other Manufacturing Exp.	1,242	1,904	1,849	1,863	1,972	
Employee Expenses	1,836	1,909	2,004	2,105	2,210	
SG&A Expenses	1,261	1,621	1,636	1,746	1,911	
Cost of Contracts	11,646	7,288	14,135	14,669	18,251	
EBITDA	7,023	7,476	6,302	8,430	8,772	
% of Total Revenues	17.0	18.5	11.4	15.1	14.1	
Depreciation	3,464	3,486	2,653	2,767	2,858	
Interest	1,348	1,919	2,207	2,256	2,356	
Other Income	4,527	5,744	8,587	8,380	9,058	
PBT	6,738	7,815	10,029	11,786	12,615	
Tax	495	506	1,182	1,519	1,584	
Rate (%)	7.3	6.5	11.8	12.9	12.6	
Provisions for Contingencies	1,041	806	620	600	600	
Reported PAT	5,201	6,504	8,227	9,667	10,431	
Change (%)	41.7	25.0	26.5	17.5	7.9	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	1,856	2,124	2,278	2,278	2,278	
Reserves	54,021	69,088	83,821	91,951	100,844	
Net Worth	55,877	71,211	86,099	94,228	103,122	
Loans	37,387	42,669	42,055	42,055	42,055	
Consumer's Security Deposit	221	235	235	235	235	
Deferred Tax Liability	2,606	2,041	2,441	3,041	3,641	
Capital Employed	96,091	116,157	130,830	139,560	149,053	
Gross Fixed Assets	51,730	54,706	58,006	60,306	62,406	
Less: Dep and revaluation res	-32,050	-35,667	-38,320	-41,087	-43,946	
Net Fixed Assets	19,680	19,039	19,686	19,219	18,461	
Capital WIP	1,922	2,177	2,177	2,177	2,177	
Investments	6,962	11,927	11,927	11,927	11,927	
Curr. Assets	86,404	105,153	120,220	130,401	141,653	
Inventory	3,531	2,951	3,000	3,000	3,000	
Debtors	9,310	10,928	11,256	11,593	11,941	
Cash & Bank Balance	60,454	56,529	71,347	81,191	92,095	
Loans & Advances	11,701	31,617	31,617	31,617	31,617	
Other Current Assets	1,409	3,129	3,000	3,000	3,000	
Current Liab. & Prov.	18,878	22,140	23,179	24,165	25,165	
Other Liabilities	14,781	15,708	16,179	16,665	17,165	
Provisions	4,096	6,431	7,000	7,500	8,000	
Net Current Assets	67,527	83,014	97,040	106,237	116,489	
Application of Funds	96,091	116,157	130,831	139,560	149,054	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	29.9	30.6	36.1	42.4	45.8	
EPS (Fully Diluted)	27.1	27.7	35.0	41.2	44.4	
CEPS (Rs)	43.5	40.9	48.1	55.5	59.2	
Book Value	270.4	331.2	378.0	413.7	452.8	
DPS	4.7	4.9	5.0	6.0	6.0	
Payout (incl. Div. Tax.)	17.9	18.6	15.6	15.9	14.7	
Valuation (x)						
P/E	17.7	17.2	14.6	12.4	11.5	
EV/EBITDA	14.5	11.5	11.0	6.7	5.3	
EV/Sales	2.5	2.1	1.2	1.0	0.7	
Price/Book Value	2.0	1.6	1.4	1.3	1.2	
Dividend Yield (%)	0.9	0.9	0.9	1.1	1.1	
Profitability Ratios (%)						
RoE	11.1	10.7	10.5	10.7	10.7	
RoCE	10.1	9.4	10.1	10.6	10.6	
Turnover Ratios						
Debtors (Days)	82	99	74	76	70	
Inventory (Days)	31	27	20	20	18	
Asset Turnover (x)	0.4	0.3	0.4	0.4	0.4	
Leverage Ratio						
Debt/Equity (x)	0.5	0.7	0.6	0.5	0.4	

CASH FLOW STATEMENT		(RS MILLION)				
	2005	2006	2007E	2008E	2009E	
PBT before EO Items	6,738	7,815	10,029	11,786	12,615	
Add : Depreciation	3,464	3,486	2,653	2,767	2,858	
Less : Direct Taxes Paid	1,296	1,704	1,402	1,519	1,584	
(Inc)/Dec in WC	-1,375	856	792	648	652	
CF from Operations	7,531	10,453	12,072	13,682	14,541	
(Inc)/dec in FA	-2,723	-3,231	-3,300	-2,300	-2,100	
(Pur)/Sale of Investments	21,788	-25,233	0	0	0	
Others	2,942	254	-897	0	0	
CF from Investments	22,008	-28,210	-4,197	-2,300	-2,100	
(Inc)/Dec in Share Capital anc	6,183	9,080	8,824	0	0	
(Inc)/Dec in Debt	17,078	5,826	-600	0	0	
(Inc)/Dec in Customer Securi	44	14	0	0	0	
Dividend Paid	-991	-1,209	-1,281	-1,537	-1,537	
CF from Fin. Activity	22,314	13,712	6,943	-1,537	-1,537	
Inc/Dec of Cash	51,852	-4,046	14,818	9,844	10,904	
Add: Beginning Balance	8,602	60,454	56,529	71,347	81,191	
Closing Balance	60,454	56,529	71,347	81,191	92,095	

E: MOST Estimates



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Reliance Energy

- | | |
|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.