

## COMPANY UPDATE

**Reliance Power (RPOL.BO)**

Sell

**RPWR-RNRL merger to make GSMA more expensive to RPWR; Sell****What's changed**

Reliance Power (RPWR) has announced the scheme of merger with Reliance Natural resources (RNRL) in an all stock deal, subject to necessary approvals. The share swap ratio is 1:4 (1 RPWR share for every 4 shares of RNRL) and RPWR will have to issue 17% of their shares outstanding (pre-merger) as part of the deal.

**Implications**

With RNRL as the signatory to the gas sales master agreement (GSMA), we believe a merger with RPWR will provide more clarity to the government for allocation of gas to RPWR's proposed gas based projects. The implied value of RNRL (using TP of RPWR of Rs119/share) is about US\$1.08bn and when valued asset wise, we believe RNRL effectively derives most of its value from GSMA as 85% of its FY09 gross block is composed of goodwill and its CBM and oil blocks are still in the exploratory stage.

Our calculations value GSMA at US\$760mn which implies a marketing margin of gas supplied under GSMA to RPWR power plants is US\$0.4/mmBtu versus US\$0.13/mmBtu earned by Reliance Industries (RIL) for its KG basin gas. With implied marketing margins being 3x the margins charged by RIL to other gas consumers, we believe the high cost will negatively impact the IRR's of RPWR's gas based projects.

The deal is 5% EPS dilutive for RPWR on FY10 numbers and with RNRL having no material operating assets, we believe RNRL's net profit will continue to be driven by income from financial investments.

**Valuation**

We re-iterate Sell on Reliance Power with 12-m SOTP TP of Rs119/share implying potential downside of 32%. We await for more clarity on the deal before making changes to our target price and earnings estimates.

**Key risks**

Completion of the projects ahead of estimated timelines.

**INVESTMENT LIST MEMBERSHIP**

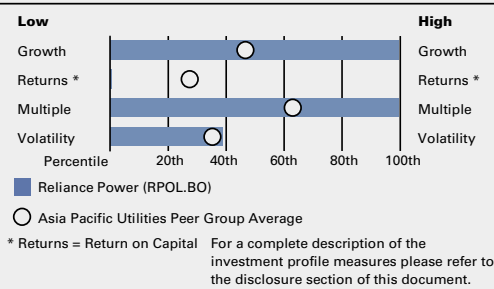
Asia Pacific Sell List

**Coverage View: Cautious**

India  
Power

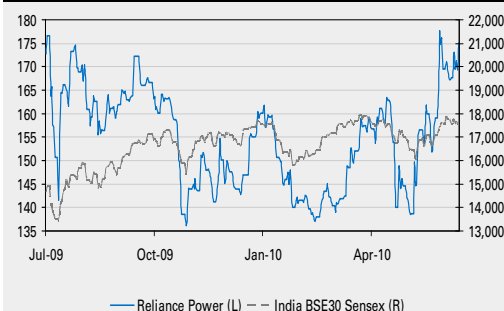
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**Investment Profile**

Key data	Current
Price (Rs)	175.15
12 month price target (Rs)	119.00
Market cap (Rs mn / US\$ mn)	420,295.4 / 8,987.4
Foreign ownership (%)	4.8

	3/10	3/11E	3/12E	3/13E
EPS (Rs)	2.85	1.90	2.52	2.09
EPS growth (%)	179.4	(33.3)	32.3	(16.9)
EPS (diluted) (Rs)	2.85	1.90	2.52	2.09
EPS (basic pre-ex) (Rs)	2.85	1.90	2.52	2.09
P/E (X)	61.5	92.1	69.6	83.8
P/B (X)	2.9	2.8	2.7	2.7
EV/EBITDA (X)	NM	134.1	83.8	59.6
Dividend yield (%)	--	--	0.2	0.2
ROE (%)	4.8	3.1	4.0	3.2
CROCI (%)	(0.9)	1.6	2.0	2.4

**Price performance chart**

Share price performance (%)	3 month	6 month	12 month
Absolute	15.2	12.9	1.4
Rel. to India BSE30 Sensex	16.7	13.0	(14.9)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 7/02/2010 close.

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# Reliance Power: Summary Financials

Profit model (Rs mn)	3/10	3/11E	3/12E	3/13E	Balance sheet (Rs mn)	3/10	3/11E	3/12E	3/13E
<b>Total revenue</b>	<b>207.2</b>	<b>9,964.4</b>	<b>18,503.2</b>	<b>33,093.3</b>	Cash & equivalents	107,656.6	75,032.6	40,929.6	8,069.1
Cost of goods sold	(221.0)	(4,383.3)	(7,330.4)	(13,632.7)	Accounts receivable	410.6	2,071.0	3,821.0	6,131.2
SG&A	(1,059.5)	(680.6)	(1,068.4)	(2,817.9)	Inventory	50.8	636.9	1,063.2	1,956.6
R&D	--	--	--	--	Other current assets	1,124.2	1,179.0	852.9	511.9
Other operating profit/(expense)	0.0	0.0	0.0	0.0	<b>Total current assets</b>	<b>109,242.3</b>	<b>78,919.6</b>	<b>46,666.6</b>	<b>16,668.9</b>
<b>EBITDA</b>	<b>(1,073.2)</b>	<b>4,900.5</b>	<b>10,104.4</b>	<b>16,642.6</b>	Net PP&E	178,647.1	383,800.5	576,316.7	723,251.1
Depreciation & amortization	(57.1)	(833.5)	(3,734.4)	(5,189.0)	Net intangibles	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>(1,130.3)</b>	<b>4,067.0</b>	<b>6,370.0</b>	<b>11,453.6</b>	Total investments	0.0	0.0	0.0	0.0
Interest income	8,226.6	3,089.4	3,530.3	1,460.0	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(70.2)	(2,097.6)	(3,277.2)	(7,252.3)	<b>Total assets</b>	<b>287,889.4</b>	<b>462,720.1</b>	<b>622,983.3</b>	<b>739,920.0</b>
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	Short-term loans	0.0	0.0	0.0	0.0
<b>Pretax profits</b>	<b>7,026.0</b>	<b>5,058.8</b>	<b>6,623.0</b>	<b>5,661.3</b>	Other current liabilities	512.2	1,012.8	839.9	822.5
Income tax	(186.8)	(494.3)	(524.0)	(269.7)	<b>Total current liabilities</b>	<b>512.2</b>	<b>1,012.8</b>	<b>839.9</b>	<b>822.5</b>
Minorities	0.0	0.0	(61.1)	(374.5)	Long-term debt	142,730.1	311,700.7	466,956.2	579,516.5
<b>Net income pre-preferred</b>	<b>6,839.2</b>	<b>4,564.5</b>	<b>6,037.9</b>	<b>5,017.1</b>	Other long-term liabilities	0.0	0.0	0.0	0.0
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	142,730.1	311,700.7	466,956.2	579,516.5
<b>Net income (pre-exceptionals)</b>	<b>6,839.2</b>	<b>4,564.5</b>	<b>6,037.9</b>	<b>5,017.1</b>	<b>Total liabilities</b>	<b>143,242.3</b>	<b>312,713.5</b>	<b>467,796.0</b>	<b>580,339.0</b>
Post tax exceptionals	0.0	0.0	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>6,839.2</b>	<b>4,564.5</b>	<b>6,037.9</b>	<b>5,017.1</b>	<b>Total common equity</b>	<b>144,647.1</b>	<b>149,211.6</b>	<b>154,331.1</b>	<b>158,350.3</b>
EPS (basic, pre-exception) (Rs)	2.85	1.90	2.52	2.09	Minority interest	0.0	795.0	856.2	1,230.7
EPS (basic, post-exception) (Rs)	2.85	1.90	2.52	2.09	<b>Total liabilities &amp; equity</b>	<b>287,889.4</b>	<b>462,720.1</b>	<b>622,983.3</b>	<b>739,920.0</b>
EPS (diluted, post-exception) (Rs)	2.85	1.90	2.52	2.09	<b>BVPS (Rs)</b>	<b>60.28</b>	<b>62.18</b>	<b>64.31</b>	<b>65.99</b>
DPS (Rs)	0.00	0.00	0.33	0.36	<b>Ratios</b>	<b>3/10</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>
Dividend payout ratio (%)	0.0	0.0	13.0	17.0	CROCI (%)	(0.9)	1.6	2.0	2.4
Free cash flow yield (%)	(31.7)	(47.9)	(44.8)	(35.7)	ROE (%)	4.8	3.1	4.0	3.2
<b>Growth &amp; margins (%)</b>	<b>3/10</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>	ROA (%)	3.1	1.2	1.1	0.7
Sales growth	--	NM	85.7	78.9	Inventory days	42.0	28.6	42.3	40.4
EBITDA growth	(4.1)	556.6	106.2	64.7	Receivables days	361.6	45.5	58.1	54.9
EBIT growth	(9.4)	459.8	56.6	79.8	Payable days	NM	NM	NM	NM
Net income growth	179.7	(33.3)	32.3	(16.9)	Net debt/equity (%)	24.2	157.8	274.5	358.1
EPS growth	179.4	(33.3)	32.3	(16.9)	Interest cover - EBIT (X)	0.1	NM	NM	2.0
Gross margin	(6.6)	56.0	60.4	58.8	<b>Valuation</b>	<b>3/10</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>
EBITDA margin	(517.9)	49.2	54.6	50.3	P/E basic (X)	61.5	92.1	69.6	83.8
EBIT margin	(545.4)	40.8	34.4	34.6	P/B (X)	2.9	2.8	2.7	2.7
<b>Cash flow statement (Rs mn)</b>	<b>3/10</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>	EV/EBITDA (X)	NM	134.1	83.8	59.6
Net income pre-preferred dividends	6,839.2	4,564.5	6,037.9	5,017.1	EV/GCI (X)	2.2	1.7	1.4	1.3
D&A add-back	57.1	833.5	3,734.4	5,189.0	Dividend yield (%)	--	--	0.2	0.2
Minorities interests add-back	0.0	0.0	61.1	374.5	<b>Additional metrics</b>	<b>3/10</b>	<b>3/11E</b>	<b>3/12E</b>	<b>3/13E</b>
Net (inc)/dec working capital	(3,016.9)	(1,788.5)	(2,023.0)	(2,880.0)	Unit coal costs (Rs/kWh)	--	--	--	--
Other operating cash flow	0.0	0.0	0.0	0.0	Wtd-avg tariffs-total (Rs/kWh)	2.46	2.52	2.92	2.28
<b>Cash flow from operations</b>	<b>3,879.4</b>	<b>3,609.5</b>	<b>7,810.5</b>	<b>7,700.5</b>	Wtd-avg tariffs-coal (Rs/kWh)	--	--	--	--
Capital expenditures	(129,045.4)	(205,986.9)	(196,250.6)	(152,123.4)	Wtd-avg tariffs-wind (Rs/kWh)	--	--	--	--
Acquisitions	0.0	0.0	0.0	0.0	Utilization rate-total (%)	85.0	85.0	84.7	82.8
Divestitures	0.0	0.0	0.0	0.0	Utilization rate-coal (%)	--	--	--	--
Others	0.0	0.0	0.0	0.0	Utilization rate-wind (%)	--	--	--	--
<b>Cash flow from investments</b>	<b>(129,045.4)</b>	<b>(205,986.9)</b>	<b>(196,250.6)</b>	<b>(152,123.4)</b>	Utilization rate-nuclear (%)	--	--	--	--
Dividends paid (common & pref)	0.0	0.0	(918.4)	(997.9)	Attributable capacity-total (MW)	300	600	1,500	3,480
Inc/(dec) in debt	129,405.2	168,970.6	155,255.5	112,560.3	Attributable capacity-coal (MW)	--	--	--	--
Common stock issuance (repurchase)	28.3	0.0	0.0	0.0	Attributable capacity-wind (MW)	--	--	--	--
Other financing cash flows	0.0	795.0	0.0	0.0	Attributable capacity-nuclear (MW)	--	--	--	--
<b>Cash flow from financing</b>	<b>129,433.5</b>	<b>169,765.6</b>	<b>154,337.1</b>	<b>111,562.4</b>	Power generation-total (kWh)	355	4,278	6,839	15,611
<b>Total cash flow</b>	<b>4,267.5</b>	<b>(32,611.7)</b>	<b>(34,103.0)</b>	<b>(32,860.5)</b>	Power generation-coal (kWh)	--	--	--	--
					Power generation-wind (kWh)	--	--	--	--
					Power generation-nuclear (kWh)	--	--	--	--

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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## Deal is 17% dilutive for RPWR; GSMA to dominate the valuation of RNRL, in our view

### Exhibit 1: The merger is 17% dilutive to Reliance Power.

Details of the scheme of merger between RPWR- RNRL

Particulars	
Oustanding shares of RNRL (mn)	1,633
Swap ratio	4:1
Fresh issue of RPWR shares pursuant to merger scheme (mn)	408
Valuation of the merger based on current market price (US\$ mn)	1,589
Valuation of the merger based on our current TP of RPWR at Rs119/share (US\$ mn)	1,080
Impact on Reliance Power	
Oustanding shares of RPWR (mn)	2,397
% dilution for RPWR	17%

Source: Company data, Goldman Sachs Research estimates

### Exhibit 2: We valued GSMA at US\$760mn which implies a marketing margin of US\$0.4/mmBtu which 3x the margin charged by RIL to its gas consumers

Details of implied valuations of RNRL and the marketing margins implied by valuation of GSMA

Particulars	Implied valuations/margins using current TP of RPWR	Implied valuations/margins using current market price of RPWR
Target price/Current market price of RPWR (Rs/share)	119	175.2
Implied value of RNRL (US\$ mn)	1,080	1,589
Net cash and receivables as of FY09 (US\$ mn)	322	322
Value of GSMA (US\$ mn)	758	1,267
Implied marketing margins (US\$/mmBtu)	0.40	0.66

#### Assumptions for calculating the implied marketing margins

Gas Quantity (mmscmd)	28
Validity of GSMA (years)	17
WACC	13%
Year of commissioning of RPWR gas based plants	FY14
Value of other businesses of RNRL	0

Source: Company data, Goldman Sachs Research estimates

**Exhibit 3: With CBM and oil blocks still at exploratory stage and no substantial cash investments appeared to have been made in these businesses, we believe the value of additional equity of Reliance Power primarily represents the value of the GSMA**  
 Details of the businesses of Reliance Natural resources

Asset	Status
CBM Blocks	* Awarded 4 CBM blocks over an acreage of 3,251 sq kms in CBM round III * PEL obtained for 3 out of 4 blocks * Exploration surveys and studies completed * Core hole drilling and testing was expected to commence in 1QFY10
Oil & Gas	* Awarded a block in Mizoram under NELP VI round * PEL obtained * Major pre-seismic surveys completed * Aero-Magnetic survey to commence followed by 2D seismic data acq.
Natural Gas Pipeline & Distribution	* Reliance Fuel Resources Limited (RFRL), wholly owned subsidiary, submitted an application to MoP&NG and PNGRB for grant of authorization for laying pipeline from Kakinada to Dadri * RFRL also submitted applications for grant of authorization for City Gas Distribution in Delhi, Mumbai and NCR
Coal Supply	* Entered into a freight contract for transportation of coal from Korba to Dahanu TPS * Supplied 5 lakh MT of imported coal to Dahanu TPS

Source: Goldman Sachs Research estimates

**Exhibit 4: The promoter stake in RPWR would decrease to 80.4% from 84.8% before the merger and the free float would increase to 19.6%**  
 Shareholding pattern before and after merger

Particulars	Before merger		After merger	
	%	Number of shares (mn)	%	Number of shares (mn)
Promoters				
ADAG group	39.8	954	42.0	1,178
Reliance Infrastructure	45.0	1,078	38.4	1,078
Others	15.2	365	19.6	549
Total	100.0	2,397	100.0	2,805

Source: Company data, Goldman Sachs Research

We also adjust our 03/2010 numbers for the year end. The change to our previously published forecasts was mainly due to a substantial increase in other income of the company which is primarily composed of income on its investments in liquid instruments.

**Exhibit 5: Profit and loss account of RNRL for FY08-FY10**

	FY08	FY09	FY10
Income from operations	2,028	2,700	2,984
Other Income	6	-	
<b>Net Revenue</b>	<b>2,034</b>	<b>2,700</b>	<b>2,984</b>
Cost of operations	1,800	2,201	2,624
Employee costs	24	48	56
Depreciation	69	1	1
Other exp	141	254	210
<b>Total expenditure</b>	<b>2,034</b>	<b>2,503</b>	<b>2,891</b>
<b>Profit from operation before other income and Int</b>	<b>(0)</b>	<b>197</b>	<b>92</b>
Other Income	1,639	1,489	1,868
<b>Profit before interest</b>	<b>1,639</b>	<b>1,687</b>	<b>1,961</b>
Interest and finance charges	782	951	889
<b>PBT</b>	<b>857</b>	<b>736</b>	<b>1,072</b>
Provision for taxes			
-current tax	169	17	162
-FBT	1	1	
-deferred taxes	1	2	3
<b>Net profit</b>	<b>686</b>	<b>715</b>	<b>908</b>
Share in profit/loss minority interest			(0.01)
<b>Net profit after Minority Interest</b>	<b>686</b>	<b>715</b>	<b>907</b>

Source: Company data

## Reg AC

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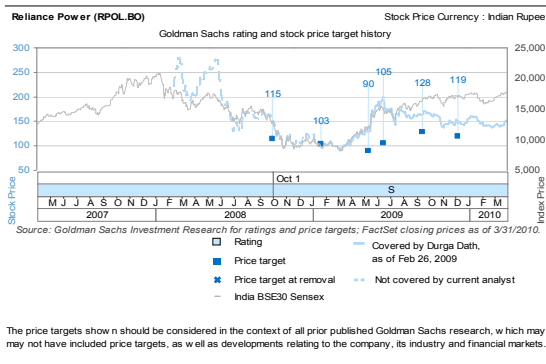
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## Price target and rating history chart(s)



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