

Reliance Power and Reliance Infrastructure

RPWR-RNRL merger dynamics: Still prefer RELI over RPWR

- **RPWR to merge with RNRL (RNR IN, Not Covered) in an all stock deal.** As per joint press release, the boards have approved an exchange ratio of 1 new share of RPWR for every 4 shares of RNRL.
- **At the stated exchange ratio, RPWR is to buy RNRL 31.5% cheaper than current market value,** as per our calculation assuming CMP (as on market close of 2nd July) for RPWR (Rs175.3) and RNRL (Rs64). Implied valuation of RNRL is 3.8x its FY10 book value.
- **RPWR-RNRL merger was imminent:** As per the government's gas utilization policy, natural gas could have been allocated only to end-users (RPWR) and traders (RNRL) were barred. The move paves the way for a Gas Sale Purchase Agreement (GSPA) b/w RIL-RPWR. Anticipating improved prospects of gas availability for RPWR we had already factored in Rs33/share for 7GW pipeline in our SOP PT of Rs145 (see our report: [Buy the superset, sell the subset](#) dated 17th June 2010). It also offers an exit to RNRL shareholders, as the company has been reduced to a shell with no advantage in gas pricing, in our view.
- **Move appears earnings dilutive for RPWR.** In our view, RNRL's share in CBM blocks, and proposed coal supply logistics and shipping business plans, are still nascent and will not contribute materially to earnings of the merged entity in the medium term. Assuming stable PAT (FY10: Rs908MM) for RNRL which is mostly financial income currently, the merger is earnings' dilutive, in our view.
- **RELI's holding in RPWR will fall to 38.5% post merger from 45% currently.** We prefer to play the superset (RELI, OW) instead of subset (RPWR, UW) to benefit from the merger, at a discount to RNRL's market price. Our Mar-11 SOP PT for RELI (Rs1360) factors in value for RPWR stake at Rs145/share (17% discount to CMP, our PT for RPWR). Execution delay is key downside risk for RELI, on-time commissioning of RPWR projects, financial closure of Chitrangi (4GW) is a key upside to PT.
- **Merger is subject to shareholder and other legal approvals; the press release does not specify a timeline.** RPWR is hosting a call at 8:15AM, 5th July. Conference call, dial in no. +91 22 3036 0400 (Password: 86394973).

Reliance Power and Reliance Infra: Valuations

Year-end March

Company	Rating	CMP (Rs)	PT (Rs)	Mkt. cap (US\$ bn.)	P/E (x)		EV/EBITDA (x)		P/B (x)	
					FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Reliance Power	UW	175	145	9.0	88.6	54.1	85.5	46.5	2.8	2.7
Reliance Infra	OW	1,197	1,360	6.3	18.7	15.8	22.0	14.5	1.4	1.3

Source: J.P. Morgan estimates. Note: Share prices on market close of 2nd July 2010.

RPOL.BO, RPWR IN
Underweight
Rs175.30

Price Target: Rs145.00

RLIN.BO, RELI IN
Overweight
Rs1,197.00

Price Target: Rs1,360.00

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Inside this report-

- Pre & post merger shareholding and implied market value
- Merger statistics: Implied discount to RNRL's CMP
- Snapshot of financials of RPWR and RNRL

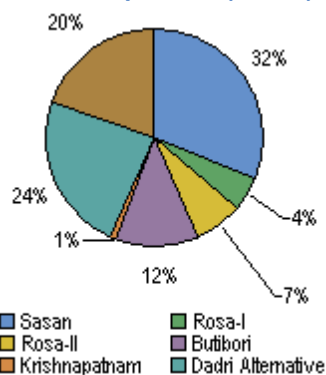
See page 8 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company Description

Reliance Power has an operating capacity of 600MW (Rosa I). In addition, the company has 5.8GW under construction and 26.7GW under development. The company has 3 UMPPs in its project portfolio. Reliance Infrastructure has a 45% stake in RPWR.

EBITDA composition (FY14E)



Source: Company reports.

EPS: J.P. Morgan vs consensus

	J. P.	
	Morgan	Consensus
FY11E	2.0	2.6
FY12E	3.2	2.9
FY13E	8.6	5.0

Source: Bloomberg, J.P. Morgan estimates.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
Merchant tariff	-3.00%	-2.10%
Impact of Rs0.5 decrease in FY11		
Coal Cost		
Impact of 10% increase in coal cost	-8.8%	-11.5%

Source: J.P. Morgan estimates.

Price target and valuation analysis

Our Mar-11 SOTP price target of Rs. 145/share includes Rs.34 for the operating and under construction projects: Sasan (Rs.6), Rosa I (Rs. 3), Rosa II (Rs. 9) and Butibori (Rs. 16); Rs. 31 for the pipeline UMPPs Krishnapatnam and Tilaiya and Rs.33 for the 7GW gas project pipeline.

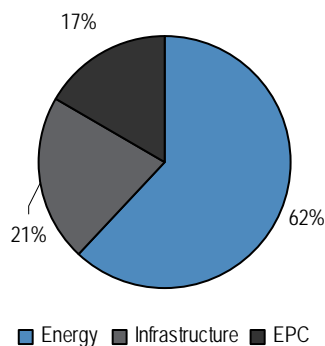
	Value of RPWR's stake (Rs B)	In Rs/share
Sasan	14.4	6.0
Rosa I	7.3	3.0
Rosa II	21.3	8.9
Butibori	37.7	15.7
Tilaiya	28.8	12.0
Krishnapatnam	44.6	18.6
Dadri alternative	33.7	14.0
Shahpur II	46.4	19.4
Excess Coal	23.3	9.7
433MW transferred from RELI	9.2	3.8
Net Cash at parent	82.3	34.3
Total	348.9	145.6

RPWR trades at 85x FY11 EV/EBITDA, the most expensive amongst pure play IPPs like Adani 42x, NATP 13x and TPWR 13x on account of lack of fuel security. Faster than expected execution and low free float are key upside risks to our PT and rating.

Company Description

Reliance Infrastructure is a diversified conglomerate with exposure to power generation (500MW at Dahanu and 45% stake in RPWR) and stable regulated distribution business (Mumbai and Delhi), roads (9 projects of which 2 are operational), transmission (5 projects), metros (2 projects under construction in Mumbai and Delhi) and EPC businesses. RELI has the largest pipeline of non-power infra BOT projects in the country.

EBITDA composition (FY11E)



Source: J.P. Morgan estimates.

EPS: J.P. Morgan vs consensus

	J. P. Morgan	Consensus
FY11E	64.0	62.9
FY12E	76.2	74.6
FY13E	107.6	86.8

Source: Bloomberg, J.P. Morgan estimates.

P&L sensitivity metrics

	EBITDA impact (%)	EPS impact (%)
EPC segment margins		
Higher by 100bps in FY12	3.50%	4.30%
Road traffic growth		
Higher by 200bps in FY12	0.20%	0.20%

Source: J.P. Morgan estimates.

Price target and valuation analysis

Our SOP based Mar-11 PT to Rs.1,360, RPWR (UW) constitutes 47% value, cash adjusted for unallocable debt accounts for 18%, stable regulated Mumbai/Delhi businesses account for 16, EPC 6% (valuation implies 5.8x FY11 FV/EBITDA), metro 9%, roads 2% and transmission BOT balance 1.2%.

	(Rs B)	(Rs/share)
Regulated business	54.6	223
Reliance Power	156.4	639
Reliance Infra projects (EPC)	19.8	81
Reliance Infra ventures	42.5	174
Transmission	3.9	16
Roads	7.3	30
Metros	31.3	128
Net Cash	59.8	244
Overall	333	1,360

RELI is the cheapest stock in P/B terms in our infra & power utilities coverage at 1.3x FY12 and in-line with GVK and TPWR on P/E terms (~15.5x). Execution delay is key downside risk for RELI, on-time commissioning of RPWR projects, financial closure of Chitrangi (4GW) is a key upside to PT.

Table 1: Pre and post merger shareholding and market value

	Pre-merger		Post-merger [a]
	RPWR	RNRL	RPWR
CMP (Rs)	175.3	63.95	175.3
Shares o/s (mn)	2396.8	1633.1	2805.1
Market cap (Rs B)	420.2	104.4	491.7
In US\$B (USD/INR: Rs46)	9.1	2.3	10.7
Promoter's shareholding (%)	84.8	54.8	80.4
Mcap of promoter's holding (Rs B)	356.2	57.3	395.5

Source: J.P. Morgan estimates. Note: [a] Using proposed exchange ratio for calculating shares o/s of merged entity, using CMP of RPWR for calculating Market cap of merged entity

Table 2: RPWR-RNRL merger statistics

Ratio of Market cap (RPWR:RNRL)	4.0
Exchange ratio (New RPWR share: RNRL share)	1.0:4.0
New RPWR share issue (mn)	408.3
Estimates EPS dilution for RPWR in FY13 [c]	(10.8)
Scenario-I: RPWR shares issued at CMP (Rs175.3)	
Value of new RPWR shares issued at latter's CMP (Rs B) [a]	71.6
Discount to RNRL's current Market cap (Rs B)	(31.5)
Implied FY10 P/B for RNRL (x)	3.8
Scenario-I: RPWR shares issued at JPM PT (Rs B)	
Value of new RPWR shares at JPM SOP PT (Rs B) [b]	59.2
Discount to RNRL's current Market cap (Rs B)	(43.3)
Implied FY10 P/B for RNRL (x)	3.2
Ratio of market cap of promoter holding (RPWR:RNRL)	6.2
Ratio of NW (RPWR:RNRL)	7.5

Source: J.P. Morgan estimates. Note: [a] Implied market cap of RNRL, [b] JPM Mar-11 SOP PT of RPWR of Rs145/share, [c] Assuming RNRL maintains FY10 PAT of Rs908MM in FY13 (for reasons stated in the note)

Table 3: RPWR and RNRL: Snapshot of key financials (FY10)

Rs. in millions, year-end March

	RPWR	RNRL
Revenue	207	2,984
EBITDA	(1,073)	111
PAT	6,839	908
Net worth	140,660	18,735
Net-debt (Debt less C&CE)	(50,519)	(5,992)
Net-D/E	(0.36)	(0.32)
Gross Block	16,000	4,712

Source: J.P. Morgan, Company data.

Table 4: Reliance Power: SOTP Valuation

Rs. in billion, year-end March

	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	G (%)	WA CC (%)	Terminal value	EV	FY10 net-debt	Equity value	In Rs/share
Certain projects															
Sasan	(39)	(58)	(42)	2	28	28	27	27	(7)	10.3	79	19	5	14	6.0
Rosa I	(0)	4	4	4	4	4	4	3	(8)	10.0	10	28	21	7	3.0
Rosa II	(10)	(1)	7	6	6	5	5	5	(3)	10.3	19	31	10	21	8.9
Butibori	(10)	(6)	2	10	8	8	8	8	(5)	10.5	25	38	0	38	15.7
Subtotal -- (1)														81	33.6
Less certain proj															
Tilaiya	0	0	(38)	(48)	(49)	(35)	21	40	(6)	10.7	117	29	0	29	12.0
Krishnapatnam	(16)	(40)	(48)	(33)	(2)	32	35	36	(6)	10.7	105	45	0	45	18.6
Dadri/ Other gas (4.2GW)	(14)	(26)	(42)	(13)	18	31	30	29	(10)	12.5	57	34	0	34	14.0
Shahpur II	(1)	(26)	(29)	(13)	25	25	25	24	(10)	12.0	50	46	0	46	19.4
Subtotal -- (2)														153	64.0
Excess Sasan coal -- (3)														12	4.9
Excess Tilaiya coal -- (4)														12	4.9
433MW transferred from RELI -- (5)														9	3.8
Net cash at parent level -- (6)														82	34.3
Grand Total -- (1)+(2)+(3)+(4)+(5)+(6)														349	145.6
Potential upside															
Chitrangi	(32)	(40)	(41)	(26)	32	44	44	43	(9)	11.5	101	71	0	71	29.8
Excess Indonesian coal														23	9.4
															184.8

Source: J.P. Morgan estimates.

Table 5: Reliance Infrastructure: SOTP Valuation

	Equity value		RELI % stake	Value for RELI			% of value
	Rs bn	US\$ bn		Rs bn	US\$ bn	Rs/share	
Regulated business	66.3	1.4		54.6	1.2	223.1	16.4
Mumbai license area	43.4	0.9	100%	43.4	0.9	177.3	13.0
New Delhi - BSES Yamuna	7.1	0.2	49%	3.5	0.1	14.3	1.0
New Delhi - BSES Rajdhani	15.7	0.3	49%	7.7	0.2	31.5	2.3
Reliance Power	347.5	7.5	45%	156.4	3.4	638.6	46.9
Reliance Infraprojects	19.8	0.4		19.8	0.4	80.8	5.9
EPC(current OB US\$4.1 B)	19.8	0.4		19.8	0.4	80.8	5.9
Reliance Infraventures	45.2	1.0		42.5	0.9	173.6	12.8
Transmission business	3.6	0.1		3.9	0.1	16.1	1.2
Koldam	(1.5)	(0.0)	74%	(1.1)	(0.0)	(4.5)	(0.3)
WRSS	4.0	0.1	100%	4.0	0.1	16.3	1.2
MSS	1.1	0.0	100%	1.1	0.0	4.3	0.3
Roads	7.3	0.2		7.3	0.2	29.8	2.2
Metro rail	34.4	0.7		31.3	0.7	127.7	9.4
Delhi Airport Express Link	29.1	0.6	95%	27.7	0.6	112.9	8.3
MRTS- Mumbai Line I	5.3	0.1	69%	3.6	0.1	14.8	1.1
Net cash on balance sheet	59.8	1.5	100%	59.8	1.5	244.4	18.0
Total				333.2	7.4	1,360	100.0

Source: J.P. Morgan estimates.

Reliance Power: Summary of Financials

Profit and Loss statement					Cash flow statement				
Rs in millions, year-end Mar	FY09	FY10	FY11E	FY12E		FY09	FY10E	FY11E	FY12E
Revenues	0	207	11,811	25,953	EBITDA	(1,014)	(1,073)	5,280	13,035
% change YY	NA	NA	5699%	220%	Net tax paid	(125)	(187)	(1,130)	(1,780)
EBITDA	(1,014)	-1,073	5,280	13,035	Operating profit after tax	2,475	6,967	7,876	14,370
% change YY	NA	NA	-492%	247%	Change in working capital	(4,065)	(2,343)	(3,948)	(3,571)
EBITDA Margin (%)	NA	-518%	45%	50%	Operating cash flow	(1,590)	4,624	3,928	10,799
EBIT	(1,016)	-1,130	4,304	11,139	Capital expenditure	(39,332)	(44,298)	(84,182)	(160,932)
% change YY	NA	NA	-381%	259%	Investing cash flows	(11,271)	17,606	(63,548)	(150,615)
EBIT Margin (%)	NA	-545%	36%	43%	Interest expense	(18)	(70)	(2,165)	(4,710)
Other income	3,614	8,227	3,727	3,115	Interest income	0	0	0	0
Interest	(18)	(70)	(2,165)	(4,710)	Principal payment	1,368	0	0	0
Earnings before tax	2,580	7,026	5,866	9,544	Equity issuance	8,842	22,845	70,302	122,076
% change YY	280%	272%	83%	163%	Dividend payment	0	0	0	0
Tax	(125)	(187)	(1,130)	(1,780)	Financing cash flows	10,193	22,774	68,137	117,366
as % of EBT	5%	3%	19%	19%	Change in Cash	(2,668)	45,004	8,517	(22,450)
Net Income (adjusted)	2,455	6,839	4,735	7,764	Opening cash	4,270	216	45,419	53,936
% change YY	288%	279%	69%	164%	Closing cash	216	45,419	53,936	31,486
Minority Interest	(0)	-	-	-					
PATAMI	2,455	6,839	4,735	7,764					
% change YY	288%	279%	69%	164%					
Balance sheet					Ratio Analysis				
	FY09E	FY10E	FY11E	FY12E	%, year-end Mar	FY09E	FY10E	FY11E	FY12E
Assets					EBITDA margin	NA	-518%	45%	50%
Cash and cash equivalents	216	45,419	53,936	31,486	EBIT margin	NA	-545%	36%	43%
Net current assets	(1,931)	412	4,360	7,931	Net profit margin	NA	3300%	40%	30%
Investments	103,172	41,269	20,634	10,317	Sales growth	NA	NA	5699%	220%
Gross Block	2,879	16,000	45,000	105,837	Net profit growth	288%	279%	69%	164%
Accumulated Depreciation	-	(256)	(1,232)	(3,128)	Debt to total capital	9%	20%	42%	59%
Net Block	2,879	15,744	43,768	102,709	Net debt to equity	-65%	-35%	21%	119%
Capital WIP	46,780	77,956	133,139	233,234	Sales/assets	NA	0%	5%	7%
Total Fixed assets	49,659	93,700	176,907	335,943	Assets/equity	110%	125%	171%	245%
Total Assets	151,116	180,800	255,837	385,677	ROE	2%	5%	3%	5%
Liabilities									
Total debt	13,325	36,170	106,471	228,547					
Total liabilities	13,325	36,170	106,471	228,547					
Shareholder's equity	137,792	144,631	149,366	157,130					

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

Reliance Infrastructure: Summary of Financials

Profit and Loss statement					Cash flow statement				
Rs in millions, year-end Mar	FY09	FY10	FY11E	FY12E	Rs in millions, year-end Mar	FY09	FY10E	FY11E	FY12E
Revenues	125,013	144,960	149,511	198,347	EBITDA	10,660	11,515	15,905	25,260
% change Y/Y	50%	16%	3%	33%	Net tax paid	(783)	(1,498)	(1,656)	(1,846)
EBITDA	10,660	11,515	15,905	25,260	Operating profit after tax	9,876	10,016	14,249	23,414
% change Y/Y	101%	8%	38%	59%	Change in working capital	4,595	(5,637)	(758)	(3,482)
EBITDA Margin (%)	8.5%	7.9%	10.6%	12.7%	Operating cash flow	14,471	4,379	13,491	19,932
Depreciation	3,304	4,724	6,736	9,695	Capital expenditure	(47,470)	(57,795)	(28,885)	(37,295)
EBIT	7,356	6,790	9,169	15,565	Strategic investments	(866)	(500)	(500)	(500)
% change Y/Y	228%	-8%	35%	70%	Investing cash flows	(48,336)	(58,295)	(29,385)	(37,795)
EBIT Margin (%)	5.9%	4.7%	6.1%	7.8%	Financing cash flows	40,481	20,039	49,529	19,193
Other income	10,412	11,937	11,937	11,937	Net increase/(decrease) in cash	6,616	(33,877)	33,635	1,329
Interest	4,394	5,251	6,050	10,717	Opening C&CE balance	89,000	95,616	43,040	76,674
Earnings before tax	13,374	13,476	15,055	16,784	Closing C&CE balance	95,616	61,740	76,674	78,003
% change Y/Y	8%	1%	12%	11%					
Tax	(783)	(1,498)	(1,656)	(1,846)					
PATAMI & Associate adj.	13,531	15,194	15,664	18,608					
% change Y/Y	15%	12%	3%	19%					
Shares Outstanding	226.1	244.9	244.9	244.9					
EPS (adjusted)	59.9	62.0	64.0	76.0					
% change Y/Y	20%	4%	3%	19%					
Balance sheet					Ratio Analysis				
Rs in millions, year-end Mar	FY09	FY10E	FY11E	FY12E	%, year-end Mar	FY09	FY10E	FY11E	FY12E
Equity share capital	2,261	2,449	2,449	2,449	EBITDA Margin	8.5%	7.9%	10.6%	12.7%
Shareholder's equity	168,976	200,398	214,081	230,709	Net profit margin	10.8%	10.5%	10.5%	9.4%
Minority Interest	1,116	1,116	1,116	1,116	Energy cost/sales	63%	59%	46%	36%
Debt	101,054	93,319	132,662	150,635					
Other liabilities	2,113	4,313	8,613	8,613	Sales growth	50%	16%	3%	33%
Total Liabilities	273,259	299,146	356,472	391,073	Net profit growth	15%	12%	3%	19%
					EPS growth	20%	4%	3%	19%
Net block	54,694	60,346	138,287	158,166	Debt to equity	0.6	0.5	0.6	0.7
Capital work-in progress	35,582	83,001	27,210	34,931	Net debt to equity	0.0	0.2	0.3	0.3
Net current assets (ex-cash)	19,036	8,673	9,431	12,913	Sales/assets	0.5	0.5	0.4	0.5
Investments	159,364	119,864	120,364	120,864	Assets/equity	1.6	1.5	1.7	1.7
Cash & cash balance	4,583	27,262	61,181	64,199	ROE	8.1%	8.2%	7.6%	8.4%
Total Assets	273,259	299,146	356,472	391,073	ROCE	6.8%	6.0%	5.9%	6.9%
Net-debt	5,437	31,579	55,987	72,632					
BVPS	747	818	874	942					

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

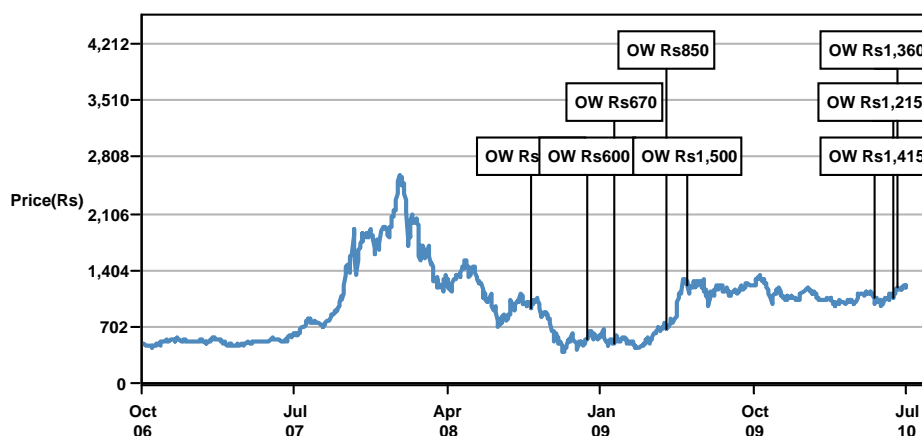
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- **Client of the Firm:** Reliance Infrastructure Ltd is or was in the past 12 months a client of JPMSI; during the past 12 months, JPMSI provided to the company non-investment banking securities-related services and non-securities-related services.
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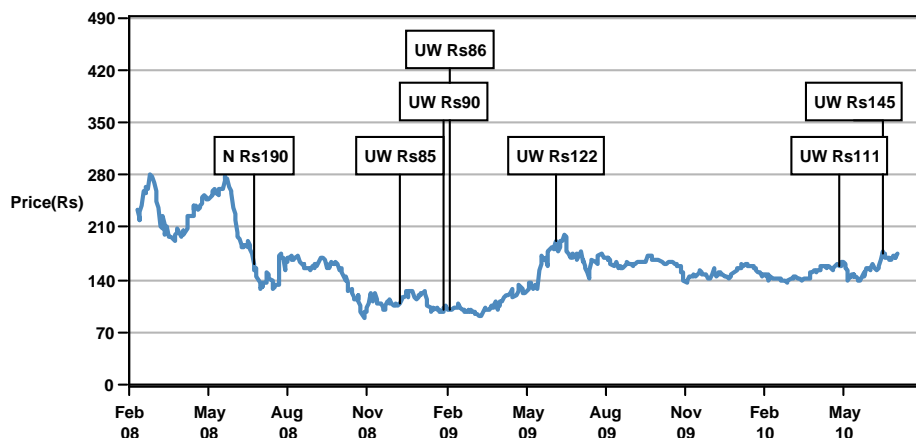
Reliance Infrastructure Ltd (RLIN.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
28-Aug-08	OW	935.30	1200.00
09-Dec-08	OW	553.85	600.00
26-Jan-09	OW	485.50	670.00
28-Apr-09	OW	662.15	850.00
05-Jun-09	OW	1226.80	1500.00
08-May-10	OW	1064.65	1415.00
09-Jun-10	OW	1068.75	1215.00
16-Jun-10	OW	1183.60	1360.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Break in coverage Mar 07, 2004 - Aug 30, 2004. 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. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

Reliance Power (RPOL.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
23-Jun-08	N	162.25	190.00
09-Dec-08	UW	109.70	85.00
28-Jan-09	UW	100.65	90.00
04-Feb-09	UW	100.10	86.00
05-Jun-09	UW	190.45	122.00
26-Apr-10	UW	159.75	111.00
16-Jun-10	UW	174.85	145.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Jun 23, 2008. 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. J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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