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INDIA RESEARCH

Reliance Infrastructure (Rel Infra)

Rs1,058
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs239bn; US$5.1bn

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Result: Q2FY10

Comment: In-line operating results offset by lower other income and higher tax rate; FY10E earnings downgraded by 7%

Last report: 15 October 2009 (Price Rs1320; Recommendation: Outerperformer)

Key valuation metrics

Year to March (Rs mn)	Sales	yoy chg (%)	Net Profit	EPS (Rs)	yoy chg (%)	PER (x)
2007	57,100	42	7,503	35.2	(2)	30.0
2008	63,642	11	9,913	43.4	23	24.4
2009	96,821	52	11,899	51.6	19	20.5
2010E	105,001	8	14,068	56.3	9	18.8
2011E	123,050	17	15,987	59.2	5	17.9

Highlights of Q2FY10 results

- Revenues increased by 5.6% yoy to Rs25.7bn, ahead of estimates of Rs23.6bn, mainly due to higher EPC business revenues.
- Revenues of the power division fell by 17.4% yoy to Rs16.8bn, driven mainly by lower pass through of costs of fuel and of purchased power. Cost of purchased power fell by 31.5% yoy to Rs6.28/unit, leading to a 24.1% yoy decline in average realizations to Rs6.39/unit.
- EPC revenues jumped by 119.5% yoy to Rs9.7bn, as execution picked up at power generation and transmission projects under construction (6 plants with ~7,000MW capacity and 1 transmission project under construction and work commenced on a new road project awarded to the company on BOT basis.
- Higher than expected raw material costs (for the EPC business) led to a marginal negative surprise of ~90bps on EBITDA margins (down 70bps yoy to 9.1%). Consequently, Q2FY10 EBITDA fell by 1.5% yoy to Rs2.4bn, in line with estimates.
- Other income although flat on a yoy basis at Rs2.4bn, was below estimates of Rs2.9bn, as the company utilized surplus cash on books to repay debt during the quarter. The resulting reduction in cash and cash equivalents was reflected in sharply lower than estimated interest expenses to Rs740mn (+13.3% yoy). As on September 30 2009, Rel Infra had cash and cash equivalents of Rs80bn and total debt of Rs43bn on books.
- Tax provision during the quarter at an effective rate of 19.5%, reflected the increase in the MAT rate, and was higher than estimates.
- Overall, led by the sharply lower than expected other income and higher tax rate, Q2FY10 PAT declined by 9.2% yoy to Rs2.6bn, below estimates of Rs3.1bn.

- Adjusted for extraordinary items of Rs425mn (write back of prior period tax), reported PAT increased by 6.2% yoy to Rs3.1bn.
- The MERC had approved the FY10 tariff order for Rel Infra's Mumbai distribution on June 15, 2009. Subsequently on July 15, 2009, the MERC has withheld the applicability of tariff hikes for consumers. The company has, during the quarter, recognized revenues on the basis of the revised tariff order issued on July 15, 2009. Effectively, Rel Infra has accounted for revenues on the basis of tariffs charged in FY09.

Power business snapshot

Power business	1Q09	2Q09	3Q09	4Q09	FY09	1Q10	2Q10
Units sold (mn)	2,539	2,411	2,407	2,224	9,581	2,761	2,623
Realization (Rs / unit)	7.23	8.42	8.44	5.78	7.50	6.81	6.39
Units bought (mn)	1,449	1,327	1,406	1,201	5,383	1,544	1,402
Cost (Rs / unit)	7.47	9.18	8.78	5.99	7.90	6.38	6.28
	2.72	2.84	2.58	2.98	2.78		
Growth, % yoy							
Units sold (mn)	2.0	1.7	3.0	8.3	3.6	8.7	8.8
Realization (Rs / unit)	38.7	56.4	58.1	0.1	40.5	(5.9)	(24.1)
Units bought (mn)	8.4	2.4	16.9	18.7	11.0	6.6	5.7
Cost (Rs / unit)	48.8	83.2	62.9	16.8	54.0	(14.6)	(31.5)
(Rs mn)							
Revenues	18,368	20,294	20,312	12,856	71,831	18,805	16,754
Cost of purchase (Rs mn)	10,823	12,177	12,339	7,201	42,540	9,848	8,811
EBIT	1,776	1,805	2,230	431	6,242	1,769	1,483
EBIT Margin (%)	9.7	8.9	11.0	3.4	8.7	9.4	8.8

EPC business snapshot

EPC business	1Q09	2Q09	3Q09	4Q09	FY09	1Q10	2Q10
Revenues	4,439	4,438	6,864	9,249	24,990	5,658	9,742
EBIT	474	353	398	818	2,042	541	918
EBIT Margin (%)	10.7	7.9	5.8	8.8	8.2	9.6	9.4
Order Backlog	210,440	207,900	215,100	206,250	206,250	200,750	196,200
Order booking	136,379	1,898	14,064	399	152,740	158	(308)
Growth, % yoy							
Revenues	30.7	54.6	144.7	45.2	73.0	27.5	119.5
EBIT	174.9	5.3	56.9	46.2	87.9	14.1	160.3
Order Backlog	318.0	340.7	159.2	162.7	162.7	(4.6)	(5.6)
Order booking	10830.5	(734.5)	(63.6)	(78.7)	277.7	(99.9)	(116.2)

OTHER HIGHLIGHTS / PROJECT UPDATES

- Gas availability from the KG-D6 basin continued to drive higher PLF at the Samalkot power plant, which increased from 51.6% in Q2FY09 to 83.3% in Q2FY10
- The EPC order backlog as of September 30 2009 was Rs196bn.
- Rel Infra has received approval from the MERC to procure 1,000MW power on a medium term basis and 1,500MW on a long term basis, in order to meet the demand of the Mumbai circle. The company has already initiated the process of such procurement and expects to finalise the same shortly.
- WRSS (transmission BOO project): financial closure was achieved in May 2009 and the right of way has also now been obtained and construction work has commenced.
- Parbati-Koldam (transmission project in JV with power Grid Corporation): power transmission agreement signed with all 13 beneficiaries; all required clearances obtained; sanction received from PFC for major portion of the debt and financial closure likely soon
- Mumbai strengthening (transmission system for distribution circle): all regulatory approvals received and work commenced
- Road BOTs: NK and DS roads commenced toll collections; other 3 projects on schedule for commissioning by Q2FY11; achieved financial closure of the Gurgaon-Faridabad 4-laning project and the construction contract awarded to the company's EPC division; awarded the 52km Jaipur-Reengus project in Rajasthan. Remains preferred bidder for the Western Freeway Sea-link project in Mumbai
- Metro projects: Delhi and Mumbai metro projects are progressing on schedule. The company has emerged the sole bidder for the Mumbai metro line 2, connecting Charkop-Bandra-Mankhurd.

VALUATIONS & VIEW

We are downgrading our FY10 and FY11 earnings estimates for Rel Infra by 7% and 9.2% respectively, led by the lower than estimated other income and higher tax rate. Our revised earnings estimates for Rel infra are Rs56.3/share and Rs59.2/share for FY10 and FY11 respectively. We continue to like the company's business model of backward integration of its distribution business by setting up generating capacity across various fuels such as gas, coal and hydel and diversifying in to the fast growing infrastructure development sector. With R-Power fully funded and Rs37bn of net cash on its own books, Rel Infra is extremely well placed to fund all current projects despite all-round challenges in securing debt as well as equity funding. Further, we believe the free cash would allow the company to accelerate growth in the increasingly competitive infrastructure development space in India. Maintain Outperformer with a target price of Rs1,508/share.

Quarterly results

(Rs mn)	1Q09	2Q09	3Q09	4Q09	FY09	1Q10	2Q10	FY10E
Net Sales	**21,981**	**24,348**	**26,473**	**24,019**	**96,821**	**24,072**	**25,719**	**105,001**
Raw Material Consumed (EPC)	3,571	3,314	5,877	10,630	23,392	4,407	8,116	31,722
Cost of purchased power	10,823	12,177	12,339	7,201	42,540	9,848	8,811	35,670
Employee Expenses	1,245	1,372	1,436	(114)	3,940	1,549	1,610	5,909
Power, Oil & Fuel	2,968	3,074	2,582	3,044	11,668	3,234	3,056	12,176
Tax on electricity	370	416	388	355	1,530	423	399	1,575
Other Expenses	1,068	1,607	1,435	2,807	6,917	2,006	1,375	6,920
Total expenses	**20,045**	**21,960**	**24,056**	**23,924**	**89,986**	**21,468**	**23,366**	**93,974**
EBITDA	**1,937**	**2,388**	**2,416**	**95**	**6,836**	**2,604**	**2,352**	**11,028**
OPM (%)	8.8	9.8	9.1	0.4	7.1	10.8	9.1	10.5%
Other Income	2,024	2,422	3,670	3,970	12,086	2,833	2,409	12,245
Interest	774	653	865	1,013	3,305	1,037	740	3,382
Depreciation	612	620	589	627	2,449	722	740	2,941
PBT	**2,575**	**3,537**	**4,632**	**2,425**	**13,168**	**3,678**	**3,283**	**16,949**
Tax	315	446	405	649	1,815	545	665	2,712
Deferred Tax	25	180	150	(901)	(546)	(32)	(26)	169
Tax Rate (%)	13.2	17.7	12.0	-10.4	9.6	13.9	19.5	17.00
Profit After Tax	**2,235**	**2,911**	**4,077**	**2,677**	**11,899**	**3,166**	**2,644**	**14,068**
Less: Extra-ordinary exp	-	22	1,565	(352)	1,234	-	-	-
Less: Extra ordinary income	291	-	-	433	723	-	425	-
Profit After Extra-ordinary item	**2,525**	**2,890**	**2,512**	**3,462**	**11,389**	**3,166**	**3,069**	**14,068**
EPS (Rs)								
Outstanding shares (m)	227.8	227.8	227.8	226.0	226.0	227.8	227.8	225.3
EPS (Rs)	9.8	12.8	17.9	11.8	51.6	13.9	11.6	56.3
Cash EPS (Rs)	12.5	15.5	20.5	14.6	55.3	17.1	14.9	69.4
PER (x)	33.6	25.8	18.4	27.9	25.6	23.7	28.4	23.4
P/CEPS (x)	26.4	21.3	16.1	22.6	-	19.3	22.2	-
Growth (%)								
Sales	35.4	57.9	75.8	46.3	52.1	9.5	5.6	8.4
Expenses	32.3	66.5	68.1	54.1	54.7	7.1	6.4	4.4
EBITDA	78.1	7.2	225.9	(89.4)	25.1	34.5	(1.5)	61.3
Other Income	(29.9)	11.8	27.5	18.6	6.3	39.9	(0.5)	1.3
Interest	11.7	(23.6)	1.3	47.6	7.0	33.9	13.3	2.3
Depreciation	5.3	11.6	4.1	19.2	9.9	18.0	19.3	20.1
PBT	(4.7)	18.5	110.5	(20.0)	14.3	42.9	(7.2)	28.7
PAT	0.9	18.2	168.0	(14.0)	20.0	41.7	(9.2)	18.2
Reported PAT	14.0	15.6	(16.7)	11.2	(0.5)	25.4	6.2	23.5

Reliance Infra valued at Rs1,508/share

Business	Valuation methodology	Project value (Rs mn)	Rel Infra Stake (%)	Rel Infra value (Rs mn)
Distribution				
Mumbai	DCF	58,144	100	58,144
Delhi	DCF	11,398	50	5,699
		69,542		63,843
EPC	EV / EBITDA	28,109	100	28,109
Reliance Power				
29,520MW power plants	DCF	423,607	45	190,623
Urthing Sobla	DCF	6,810	20	1,362
		430,417		191,985
Transmission				
WRSS	DCF	1,630	100	1,630
Parbati	DCF	333	75	250
		1,963		1,880
Road BOTs	DCF	7,068	100	7,068
Real Estate				
Hyderabad	NAV	20,387	89	18,144
Navi Mumbai	NAV	7,702	100	7,702
		28,088		25,846
Metro Rail				
Mumbai	DCF	2,474	69	1,707
Delhi	DCF	1,442	95	1,370
		3,915		3,077
Sub-total		**569,104**		**321,808**
Add: Cash				92,329
Less: Debt				(73,322)
Net value				**340,815**
No. of shares (FD)				226.0
Value (Rs / share)				**1,508**

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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