

Company In-Depth

10 April 2007 | 10 pages

Jaiprakash (JAIA.BO)

Upgrading to Buy: Stock Correction Plus Plenty of Triggers

 Rating change
 Target price change
 Estimate change

- Buy with target price of Rs674** — We are upgrading JPA to Buy/Low Risk following a 30%-plus correction and in anticipation of plenty of stock triggers in the next 12 months. However, we are cutting our target price to Rs674 based on a lower valuation for the cement business.
- Negatives priced in** — We believe the government's intention to control cement prices and RBI's CRR hikes to reign in inflation have already been digested by the JPA's 30%-plus correction from its peak. JPA's parent business trades at an adjusted P/E multiple of 10.2x FY08E, which we find too inexpensive to ignore.
- Strong 4QFY07E quarter ahead** — We expect JPA to grow earnings 63% YoY driven by sales growth of 10% YoY and a 548bps EBITDA margin expansion in 4QFY07E. This should be mainly due to cement volumes of 1.88mn tonnes, up 5% YoY, and realizations of Rs2964/tonne, up 28% YoY.
- Technical and business triggers ahead** — The FII stake limit hike to 45% in April 2007 is a technical trigger. Business triggers are: 1) allotment of second parcel of land in Noida post UP elections; 2) 4.0 MMTPA HP cement plant commissioning between Jun-Dec 2007; and (3) 2.5 MMTPA UP cement plant commissioning by March 2008.
- Key Risks** — 1) We see election uncertainty since following the last UP elections the Taj Expressway project was delayed; and (2) the cement business has lost some pricing power, while demand and supply dynamics could turn adverse in FY09E.

Buy/Low Risk	1L
<i>from Hold/Low Risk</i>	
Price (10 Apr 07)	Rs525.00
Target price	Rs674.00
<i>from Rs802.00</i>	
Expected share price return	28.4%
Expected dividend yield	0.6%
Expected total return	29.0%
Market Cap	Rs114,305M
	US\$2,678M

Price Performance (RIC: JAIA.BO, BB: JPA IN)



See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. JPA – Statistical Abstract

Year to	Net FD EPS Profit	EPS Growth	Cons. FD EPS	EPS Growth	P/E	Cons. P/E	EV / EBITDA	P / Book	ROE	ROCE
31-Mar	(Rsmn)	(Rs)	(x)	(%)	(x)	(x)	(x)	(x)	(%)	(%)
FY05A	2,076	10.66	13.28	2.8%	49.2	39.5	21.9	7.6	18.2%	6.1%
FY06A	2,786	11.83	13.78	3.7%	44.4	38.1	21.8	5.3	16.5%	5.7%
FY07E	3,822	16.23	22.60	64.0%	32.3	23.2	16.6	4.6	16.6%	6.6%
FY08E	4,903	20.82	27.19	20.3%	25.2	19.3	13.2	3.5	17.1%	7.7%
FY09E	7,141	30.33	36.70	35.0%	17.3	14.3	9.3	2.5	18.3%	9.7%

Source: Citigroup Investment Research estimates

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	49.2	44.4	32.3	25.2	17.3
EV/EBITDA adjusted (x)	23.7	20.1	14.9	12.1	8.4
P/BV (x)	7.6	5.3	4.6	3.5	2.5
Dividend yield (%)	0.5	0.5	0.6	0.6	0.7
Per Share Data (Rs)					
EPS adjusted	10.66	11.83	16.23	20.82	30.34
EPS reported	10.66	27.18	16.23	20.82	30.34
BVPS	69.39	99.75	114.11	152.17	210.37
DPS	2.40	2.70	3.00	3.30	3.60
Profit & Loss (RsM)					
Net sales	28,145	31,648	36,895	44,046	57,689
Operating expenses	-24,128	-26,816	-30,083	-35,811	-46,452
EBIT	4,018	4,832	6,812	8,235	11,237
Net interest expense	-2,134	-2,397	-2,374	-2,074	-1,734
Non-operating/exceptionals	1,404	1,598	1,443	1,381	1,484
Pre-tax profit	3,287	4,032	5,880	7,542	10,987
Tax	-1,211	-1,246	-2,058	-2,640	-3,845
Extraord./Min.Int./Pref.div.	0	3,614	0	0	0
Reported net income	2,076	6,400	3,822	4,903	7,142
Adjusted earnings	2,076	2,786	3,822	4,903	7,142
Adjusted EBITDA	5,351	6,346	8,698	10,863	14,680
Growth Rates (%)					
Sales	15.4	12.4	16.6	19.4	31.0
EBIT adjusted	14.2	20.3	41.0	20.9	36.5
EBITDA adjusted	11.7	18.6	37.1	24.9	35.1
EPS adjusted	10.7	11.0	37.2	28.3	45.7
Cash Flow (RsM)					
Operating cash flow	1,188	5,239	6,471	7,451	10,675
Depreciation/amortization	1,333	1,515	1,886	2,628	3,443
Net working capital	-3,010	-2,681	762	-80	91
Investing cash flow	-7,508	-8,849	-11,607	-10,315	-8,300
Capital expenditure	-3,131	-5,198	-10,890	-7,315	-1,500
Acquisitions/disposals	-4,377	-3,652	-717	-3,000	-6,801
Financing cash flow	11,365	13,035	-5,736	784	-624
Borrowings	11,826	10,209	-5,000	-2,500	-6,000
Dividends paid	-482	-662	-736	-809	-883
Change in cash	5,044	9,425	-10,872	-2,080	1,751
Balance Sheet (RsM)					
Total assets	61,367	85,842	85,220	91,953	100,510
Cash & cash equivalent	7,272	16,697	5,825	3,745	5,493
Accounts receivable	3,703	4,224	4,924	5,878	7,700
Net fixed assets	24,390	28,074	37,078	41,765	39,822
Total liabilities	49,139	64,389	60,681	59,226	55,269
Accounts payable	4,079	4,041	4,297	4,683	5,440
Total Debt	31,989	42,198	37,198	34,698	28,699
Shareholders' funds	12,228	21,453	24,540	32,726	45,242
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.0	20.1	23.6	24.7	25.4
ROE adjusted	18.2	16.5	16.6	17.1	18.3
ROIC adjusted	9.8	10.3	11.1	11.1	14.1
Net debt to equity	202.1	118.9	127.8	94.6	51.3
Total debt to capital	72.3	66.3	60.3	51.5	38.8

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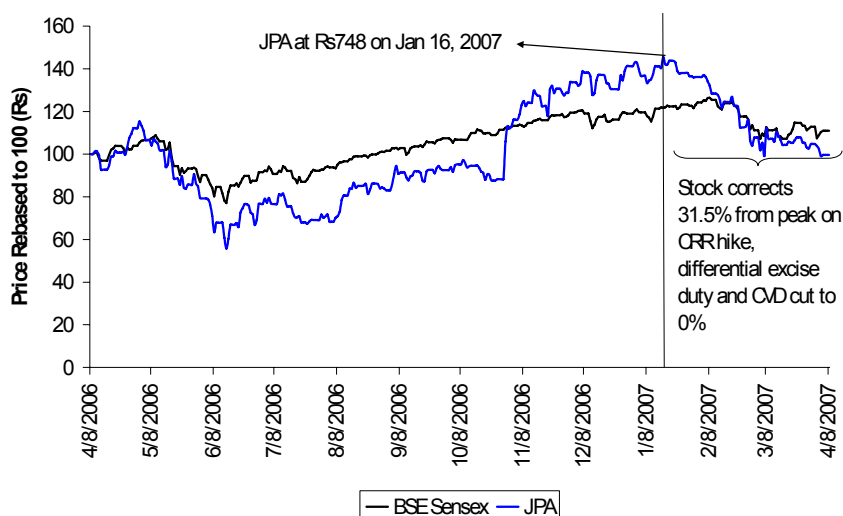


Upgrade to Buy from Hold

We are upgrading Jaiprakash Associates (JPA) to Buy/Low Risk from Hold/Low Risk on the back of:

- The stock has corrected 31.5% from its peak of Rs748 on Jan 16, 2007 after a series of negative developments that hit sentiment on JPA's cement and real estate businesses. JPA's parent business comprising cement and construction now trades at P/E multiples of 10.2x FY08E, cheap in our view.

Figure 2. JPA v/s BSE Sensex – Price Performance Chart



Source: DataCentral and Citigroup Investment Research estimates

- Trigger 1: Likely hike of the FII stake limit in April 2007
- Trigger 2: Expectations of + 63% YoY earnings growth in 4QFY07E
- Trigger 3: Likely allotment of second parcel of land post UP elections
- Trigger 4: 4.0 MMTPA HP plant commissioning between Jun-Dec 2007
- Trigger 5: 2.5 MMTPA UP plant commissioning by March 2008

Target Price Cut to Rs674

We have also cut our target price to Rs674 from Rs802 earlier based on a reduction in our cement EV/tonne multiple from 1) US\$150/tonne to US\$110/tonne for existing capacity; and 2) US\$150/tonne to US\$90/tonne for capacity commissioned in FY08E. Repeated government actions have hit JPA stock as this might have removed the last leg of pricing upside before the next batch of cement capacity arrives.

Figure 3. JPA – Sum of the Parts

Parts	New Methodology	Old Methodology	Value	JPA/Share
Construction	10x FY08E EV/EBITDA	10x FY08E EV/EBITDA	50,879	216
Cement				
Existing Capacity 7 MMTPA	EV/Tonne of US\$110	EV/Tonne of US\$150	34,650	147
HP Expansion 3 MMTPA + 1 MMPTA	EV/Tonne of US\$90 (FY08E Commissioning)	EV/Tonne of US\$150	16,200	69
UP State Cement (2.5 MMPTA)	EV/Tonne of US\$90 (FY08E Commissioning)	EV/Tonne of US\$150	10,125	43
Siddhi Cement (1.5 MMTPA)	Investments in FY07E/FY08E at BV	Investments in FY07E/FY08E at BV	4,000	17
Total EV			115,854	492
Net Debt	Net Debt as of FY08E		(30,953)	(131)
Cement + Construction Equity Value			84,901	361
Hydel BOT Projects				
JHPL (Baspa II)	20% discount to the market value	20% discount to the market value	8,708	37
Vishnuprayag	2.0x Equity Investment	2.0x Equity Investment	9,107	39
Karcham Wangtoo	Investments till March 2008 at BV	Investments till March 2008 at BV	10,000	42
Hydel BOT Projects Equity Value			118	
Jaypee Greens	NPV @ Discount Rate of 15%	NPV @ Discount Rate of 15%	8,454	36
Jaypee Hotels	20% discount to 72.18% Stake at MV	20% discount to 72.18% Stake at MV	2,611	11
JPA Per Share w/o Taj Expressway			123,782	526
Taj Expressway Project				
Rs60bn Work Order Over 7 years	NPV @ Discount Rate of 15%	NPV @ Discount Rate of 15%	3,566	15
Residual Land Value	Scenario 3 - Residual Land @ Rs44mn/acre	Scenario 3 - Residual Land @ Rs44mn/acre	31,250	133
36 year concession period BOT Project	Debt for for project repaid using the toll revenues	Debt for project repaid using the toll revenues	0	0
Total Value			34,816	148
Discount Used	0% as work on the Taj Expressway has started	0% as work on the Taj Expressway has started	0	0
Taj Expressway Discounted Value			34,816	148
JPA Equity Value			158,598	674

Source: Citigroup Investment Research estimates

Negative news that has already been digested

Cement business

- In Budget FY08 excise duty on cement was cut from Rs408/tonne (Rs20 per 50 kg bag) to (1) Rs361/tonne if retail price does not exceed Rs190/bag or (2) Rs618/tonne (Rs31/bag) if prices exceed Rs190/bag.
- Following protracted negotiations, the cement industry agreed to freeze cement prices at current levels for the next year. The industry also apparently agreed to absorb any cost increases over this period. The industry may have to pass on any government roll back of the excise duty hike.
- The government also reduced countervailing duty (CVD) from 16% to nil and additional customs duty from 4% to nil on imported cement.

Considering these developments, we are now being more conservative on JPA's cement business valuations. We are now using an EV/tonne of US\$110/tonne for existing capacity and US\$90 for capacity being commissioned in FY08E

Real estate business

- RBI hiking the Cash Reserves Ratio (CRR) by 50bps in mid-February and once again hiking it by 50bps in first week of April.

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We believe that since we have been conservative on our land price estimates, it is not necessary to cut our equity value for the Taj Expressway and Jaypee Greens equity valuations.

Trigger 1: FII stake limit will probably be raised to 45%

Management indicates the FII stake limit will likely be raised from 24% now to 45% following results of the postal ballot in April 2007.

Trigger 2: 4QFY07E earnings to grow 63% YoY

- We expect JPA to grow earnings 63% YoY driven by sales growth of 10% YoY and a 548bps EBITDA margin expansion.
- We expect cement volumes of 1.88 mn tonnes up 5% YoY and realizations of Rs2964/tonne up 28% YoY and 2% QoQ.
- On construction we expect a 11% revenue shrinking and 149bps margin expansion.

Figure 4. JPA – 4QFY07E Estimates

Year End Mar31 (Rsmn)	4Q06	4Q07E	% Chg
Sales	8550	9392	10%
Total Expenditure	(7010)	(7185)	3%
EBITDA	1540	2207	43%
EBITDA Margin	18.0%	23.5%	
Depreciation	(380)	(430)	13%
EBIT	1160	1777	53%
EBIT Margin	13.6%	18.9%	
Interest	(580)	(680)	17%
Other Income	540	660	22%
PBT	1120	1757	57%
PBT Margin	13.1%	18.7%	
Total Tax	(420)	(615)	46%
Tax Rate	37.5%	35.0%	
Recurring PAT	700	1142	63%
Revenues			
Cement	4130	5562	35%
Construction	4920	4400	-11%
Hospitality & Golf Course	20	30	50%
Unallocated	150	200	33%
Total	9220	10192	11%
Less: Intersegment	(130)	(200)	
Income from Ops	9090	9992	10%
PBIT			
Cement	760	1555	105%
Construction	960	924	-4%
Hotel	0	0	
Total	1720	2479	44%
Interest	(580)	(680)	
Unallocables	(20)	(42)	
PBT	1120	1757	57%
PBIT Margin			
Cement	18.4%	28.0%	
Construction	19.5%	21.0%	
Hotel	0.0%	0.0%	

Source: Citigroup Investment Research estimates

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Trigger 3: Second land parcel likely allotted post UP elections

We believe that the second land parcel related to the Taj Expressway will be allotted following results of the UP election. These will be held in seven phases, with results announced on 11 May.

- **Positive:** We have used a discount of 20% on the last transacted sale value to value the land and we see upside potential.
- **Negative:** We remain cognizant that the last time the ruling party changed following UP elections the Taj Expressway project was delayed three years.

Trigger 4 & 5: Cement capacity addition on track

The Himachal Pradesh 3 + 1 MMTPA is due for commissioning between June and December 2007, and the 2.5 MMTPA UP State Cement plant by end-FY08E.

Jaiprakash

Company description

JPA is a conglomerate with interests in engineering and construction (hydel power, river valley & roads), cement, hydroelectric build-own-operate-transfer (BOOT) projects, hotels and real estate.

Investment thesis

We rate JPA Buy/Low Risk. Driven by a strong hydroelectric capex tail wind, JPA's construction business fundamentals look solid with an order backlog of ~ Rs70bn. With its status as the leading hydroelectric E&C and EPC contractor in the country, JPA looks poised to exploit the vast hydroelectric E&C opportunity over the next decade. The cement business should provide a growth kicker, with JPA increasing capacity to 19.7 MMTPA by FY09-10E. However, we believe JPA's trump cards are 1) the recent award of the Taj Expressway project that provides a civil contract of Rs60bn, a sweetener of 6,250 acres and a 36-year BOT contract; and 2) the portfolio of hydroelectric BOOT projects.

Valuation

Our target price is Rs674 based on a sum-of-the-parts valuation given the company's profile: 1) Construction business: Using an FY08E EV/EBITDA of 10x at a 30% discount to L&T and BHEL, despite higher EBITDA margins, JPA's EBITDA is growing at a much slower pace. 2) Existing 7 MMTPA of capacity: Using an FY08E EV/tonne of US\$110, at a discount to front-line cement majors. 3) 3 MMTPA HP Plant + 1 MMTPA Panipat grinding unit + 2.5 MMTPA UPSC Plant: Using an FY08E EV/tonne of US\$90 as capacity additions are due for commissioning by end-FY08E. 4) 1.5 MMTPA Siddhi plant: At BV of investments until FY08E as the plant is due for commissioning in FY09E. 5) Hydel BOOT projects: We value the Baspa project at a 20% holding-company discount to its market value and the Vishnuprayag projects at a P/BV of 2.0x and Karcham Wangtoo at BV. 6) Jaypee Greens: DCF using a discount rate of 15%. 7) Jaypee Hotels: At a 20% holding company discount to the market value.

Risks

We rate JPA Low Risk, which differs from the Medium Risk assigned by our quantitative risk-rating system that tracks 260-day historical share price volatility. This is primarily because JPA's E&C order book of Rs70bn+ implies sales coverage of 3x FY07E, providing earnings visibility for the medium term. Key downside risks to our target price include: the construction business is subject to project risks; and is sensitive to economic variables; the cement business is subject to demand-supply dynamics; further delays in the Taj Expressway project; slowdown in India's hydroelectric power capex; development and commercial risks in developing and selling the land associated with the Taj Expressway project; and substantial declines in real estate prices in the northern parts of India.

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Appendix A-1

Analyst Certification

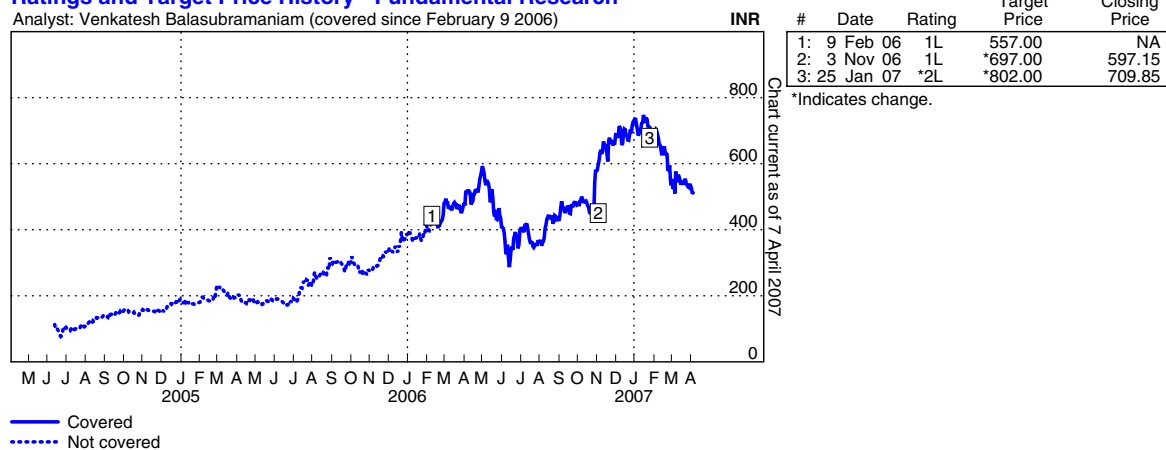
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Analyst: Venkatesh Balasubramaniam (covered since February 9 2006)



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