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GVK POWER AND INFRASTRUCTURE

INR 42

Tough job on hand, but prospects good

ACCUMULATE

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Redeveloping India's largest and busiest airport

GVK Power and Infrastructure (GVK) is leading the consortium appointed for modernising and expanding the Mumbai International Airport (MIAL). MIAL is India's largest, handling over 26 mppa and has seen extremely high rates of traffic growth. The monopoly status of MIAL is assured at least till 2012, and it could see peak utilisation ahead of the projected period. However, the crossed position of the existing runaways and slum encroachment limit land available for further expansion.

Gas from Reliance fields could rejuvenate stranded power projects

GVK had an early start as a power developer with the commercialisation of its Jegurupadu (phase I) gas-fired project in 1997. The company's next two projects have, however, failed to commence operations, despite completion, on account of failure to secure gas. GVK is trying to secure gas from Reliance Industries' (Reliance) Krishna Godawari KG basin gas fields; generation from gas plants could boost GVK's earnings substantially.

Real estate from MIAL & ROFR for Navi Mumbai airport could provide upsides

GVK has the right to use for commercial purposes about 10% of the 2,000 acres allotted for the Mumbai Airport. However, a substantial portion of this land is encroached by slum dwellers. Given the land's prime location, even a modest success in clearing the encroachments could provide significant upside to the company. GVK also has a right of first refusal (ROFR) for the Navi Mumbai airport, which is being actively considered by both the central and state governments.

Outlook and valuations: Downside protected; initiating with 'ACCUMULATE'

Our sum-of-the-parts (SOTP) valuation for the company is INR 43 per share with 47% of the value represented by Mumbai Airport. At the CMP of INR 42, the stock is trading at P/E of 23x to FY09E earnings and P/B of 2.4x to FY09E book. Our current valuations factor in the value of operational businesses of airport, power projects, and roads; upsides from these levels will take time to materialise, and have some uncertainty attached. We, therefore, initiate coverage on the stock with an **'ACCUMULATE'** recommendation.

Financials

Year to March	FY07	FY08	FY09E	FY10E
Revenue (INR mn)	4,091	5,322	10,897	19,695
Rev. growth (%)	*1.6*	*0.3*	*1.0*	*0.8*
EBITDA (INR mn)	2,119	2,483	5,228	9,681
Net profit (INR mn)	433	1,055	1,940	3,195
Shares outstanding (mn)	940	1,405	1,405	1,405
EPS (INR)	0.4	1.0	1.8	2.6
EPS growth (%)	*(0.8)*	*1.3*	*0.9*	*0.4*
P/E (x)	100.8	43.9	23.3	16.1
EV/ EBITDA (x)	25.7	25.7	19.8	15.0
ROAE (%)	7.0	9.8	11.1	14.1
ROACE (%)	7.0	6.5	7.3	7.3

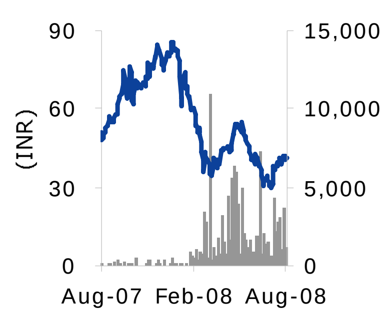
Reuters	:	GVKP.BO
Bloomberg	:	GVKP IN

Market Data		
52-week range (INR)	:	94 / 29
Share in issue (mn)	:	140.6
M cap (INR bn/USD mn)	:	5.8 / 134.3
Avg. Daily Vol. BSE ('000)	:	3,091.4

Share Holding Pattern (%)		
Promoters	:	60.9
MFs, FIs & Banks	:	5.0
FIIs	:	24.8
Others	:	9.3

Relative Performance (%)

	Sensex	Stock	Stock over Sensex
1 month	11.7	36.8	25.1
3 months	(16.0)	(21.6)	(5.6)
12 months	1.5	(18.8)	(20.3)



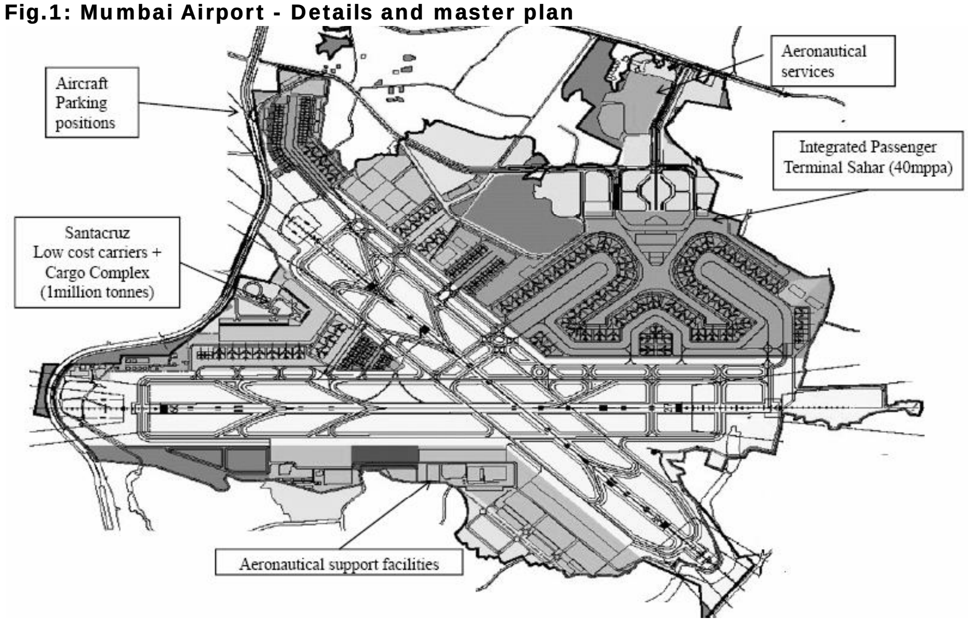
Investment Rationale

Redeveloping India's largest and busiest airport

GVK, together with Airports Company South Africa (ACSA), bagged the project for modernisation of the Mumbai International Airport (MIAL). The renovation project, though highly prestigious and visible, is one of the most complicated projects in terms of scope and size. It involves renovation and modernisation of the exiting domestic terminals 1A and 1B, followed by modernisation of international terminals 2A and 2B. The project will culminate with integration of all the terminals into a single 4-level passenger terminal. The scope of expansion, will however, be limited on account of the position of the two runaways; both cross each other and there is no additional land in the vicinity, which could be used to straighten them. Given the position of the two runways, only one of them can be used at any given point of time for take-off or landing, and this places a fundamental limitation on the extent to which air-side capacity can be expanded.

Further, this project has limited scope for air-side improvement, which means there could be only marginal growth in the airport capacity, going forward. This air-side work will comprise developing new rapid exit taxiways and additional parking bays for aircrafts, as shown in the master plan below.

Fig.1: Mumbai Airport - Details and master plan



Source: MIAL

The total capacity at the end of the expansion phase in 2012 is likely to be 40 mppa and about 1,100 air traffic movements (ATMs) against the current actual traffic of 26 mppa and 841 ATMs.

The revenue model that MIAL follows limits returns on aeronautical revenues, though non-aeronautical revenues are unlimited. The non-aeronautical revenues however are in a way function of passenger traffic and limitation on traffic growth will cap the growth potential from the airport project.

The cost for the first and only phase is estimated to be INR 900 bn, and will be funded through debt: equity of 80:20. GVK and ACSA hold 37% each in MIAL. GVK has an option to buy out ACSA's stake in MIAL piecemeal or in entirety.

The table 1 summarises the key project details:

Table 1: MIAL - Project highlights

Estimated project cost (INR bn)	900
Debt (INR bn)	675
Equity (INR bn)	225
AAI share of revenues (%)	38.7
Share of GVK in the consortium	37.0
Date of completion	2012
Project details	
Passenger capacity (mn)	40
ATMs per day	1,100
Cargo handled (MT)	1,000
Terminal area (sq mt)	500,000

Source: Edelweiss research

Gas from Reliance fields could rejuvenate stranded power projects

GVK had an early start as a power developer with the commercialisation of its Jegurupadu (phase I) gas-fired project in 1997. The company's next two projects (Jegurupadu phase II and Gautami power projects) have, however, failed to commence operations, despite completion, on account of failure to secure gas. Moreover, the operation of Jegurupadu phase I has been erratic due to irregular gas supply from Gas Authority of India (GAIL). The plant, so far, has been running partly on naphtha; all the three plants are technically configured to run on both natural gas and naphtha. All the three plants, however, have a power purchase agreement (PPA) with Andhra Pradesh Power Distribution Company (APDISCOM); hence, the offtake from these projects is secured.

However, GVK has been unable to negotiate with the Andhra Pradesh government to allow it to run the plant on naphtha. Hence, the Jegurupadu phase II and Gautami power projects have not been able to commence operations yet. The company is facing an additional problem with Jegurupadu phase II project, as it had funded the project by leveraging the balance sheet of the special purpose vehicle (SPV) used to construct Jegurupadu phase I; this means, there is no moratorium on the interest payment for this phase. Thus, GVK has been paying interest on Jegurupadu phase II, even though the project has not become operational. This is poised to reduce returns on the project, once it is operational.

The company is in discussion with Reliance Industries for gas supply from the latter's Krishna Godavari gas fields, once they begin production in July 2008. If it materialises, generation at Jegurupadu phase II and Gautami power plants could commence in FY09, after a delay of almost two years since project completion. This delay has added to the company's interest during construction (IDC), increasing its capital costs. To compensate for these losses, APDISCOM has allowed 20% of its committed capacity to be sold through the merchant route, to give GVK better profitability. In return, GVK is giving up the option to run these plants on dual fuel i.e., naphtha.

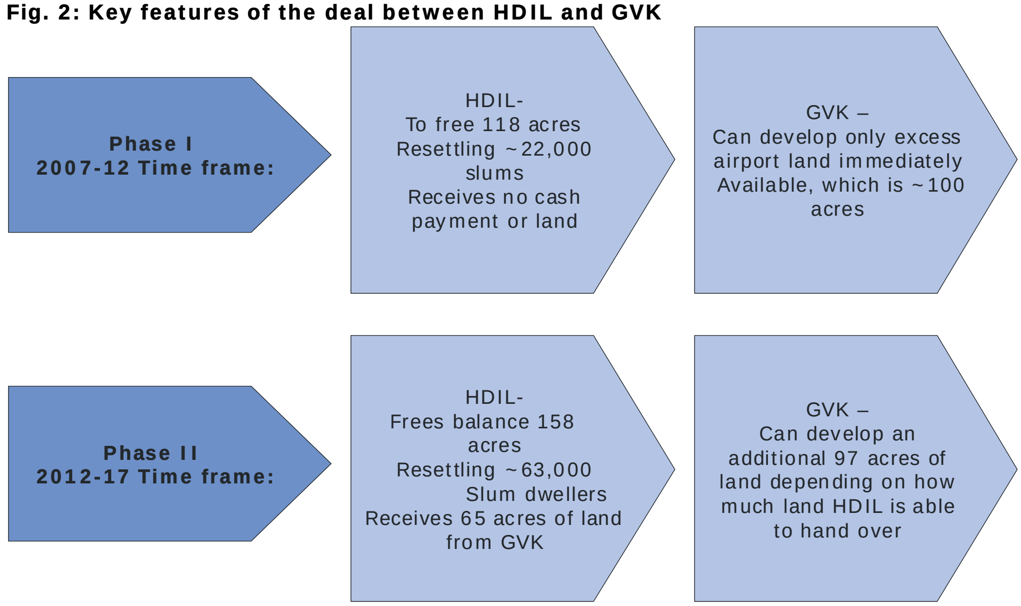
Diversifying power project pipeline: Hydro and pit-head power projects on track

In addition to gas-based projects, the company has a diversified portfolio of power projects under construction and development. This portfolio consists of two hydro projects in Uttaranchal and a coal-fired plant in Punjab. Of the two hydro plants, construction work on the Alaknanda project has already commenced; here, the company has already achieved the milestone of diverting the river. The Detailed Project Report (DPR) for the Goriganga project is still under preparation. The company is also developing a 550 MW Goindwal Sahib coal-fired project in Punjab for the state distribution company. The company has been allotted a coal mine of 55 mn tonnes in Tokisud, Jharkhand, which will be linked to the Goindwal Sahib project.

Real estate from MIAL and ROFR for Navi Mumbai airport could provide upsides

Under Operating and Management Agreement (OMDA) for MIAL, GVK is allowed to commercially exploit ~10% (197 acres) of the total airport land. However, a substantial portion of this land is encroached by slum dwellers. Given the land's prime location, even a modest success in clearing the encroachments could provide significant upside to the company. GVK has entered into an arrangement with the real estate company Housing Development and Infrastructure (HDIL) for clearing the entire encroachment, which the latter will undertake as follows:

Fig. 2: Key features of the deal between HDIL and GVK



Source: Edelweiss research

Note: HDIL has already started work on phase I of the deal. It has acquired 53 acres of land in Kurla for INR 19 bn, to rehabilitate the slum dwellers from the encroached land.

Given the complications involved in the above-mentioned process, we see following scenarios on land availability:

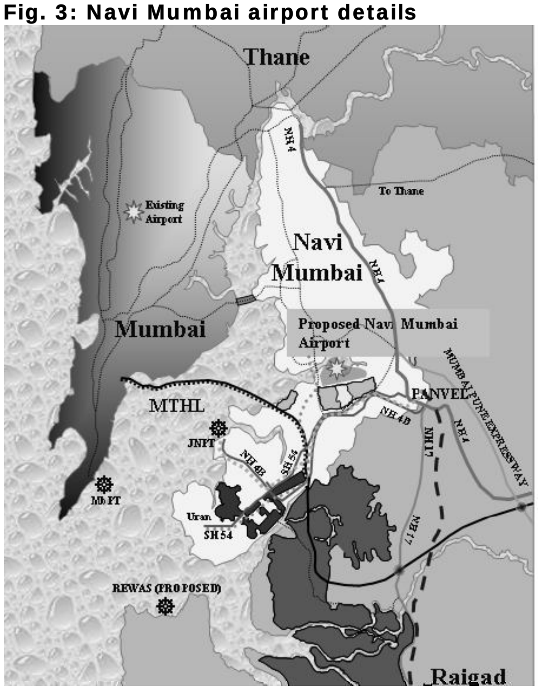
Table 2: Scenarios on availability of land for commercial development in MIAL

Scenario	Details	Impact/Outcome
Worst case	Only encroachment-free land is available for development	100 acres are developed commercially
Average case	Optimised location of airport facilities to lead to additional free land for development	152 acres are developed commercially in MIAL
Best case	HDIL succeeds in clearing encroachments from whole 276 acres of airport land	HDIL gets 65 acres to develop, 197 acres are developed commercially in MIAL (due to cap on maximum of 10% of total airport land area allowed for commercial development)

Source: Edelweiss research

Further, GVK has a right of first refusal (ROFR) for any airport that is to come up within 150 km of MIAL. This also applies to the proposed new airport at Panvel, in Navi Mumbai, which both central and state governments are pursuing with great commitment. Under ROFR, GVK gets the right to match the winning bid for developing the new airport as long as its bid is within 10% of the winning bid. Given the project's strategic location, bagging it could give GVK significant upsides, going forward. On the flip side, losing this project could skim the cream off GVK's existing airport business, in our view.

Fig. 3: Navi Mumbai airport details



Total project cost	:	USD 2.4 bn
Phase 1 project cost	:	USD 1.0 bn
Targeted operation by	:	2012-13
Design capacity	:	40 MPPA

Source: Ministry of Civil Aviation

Valuation

We value GVK using the SOTP method. We have used a discounted cash flow to equity holders (DCFE) method to value the airport concessions, using cash flows from current to the date of expiry of the concession. However, the DCFE model will include only the aeronautical and non-aeronautical revenues. The real estate sweeteners for the project have been valued using the net asset value (NAV) method. We have taken a 25% discount to our NAV values for SEZs for our SOTP valuation. For power projects, we use the DCFE for individual projects for cash flows from current to the expiry of the PPAs or the life of the asset, with no terminal value. We have used DCFE to value the road concessions, discounting all the cashflows to equity holders for the length of the concession. The table below summarises the SOTP valuation for the company.

Table 3: GVK Power and Infra - SOTP valuation

(fig in INR mn)	Methodology	Value	GVK stake	Equity contribution	Per share contribution
MIAL					
Airport concession	DCFE - base case	29,381			
Real estate	50% discount to NAV; 152 acre availability	50,435			
Total MIAL		**79,816**	**37.0%**	**29,532**	**21**
Roads	DCFE	4,558	100%	4,558	3
Power	DCFE				
Jegurupadu phase 1		4,163	100%	4,163	
Jegurupadu phase 2		2,880	100%	2,880	
Gautami Power		3,822	51%	1,949	
Total Existing				**8,992**	**6**
Power proposed					
Proposed hydro projects	DCFE	4,412	100%	4,412	
Proposed coal-fired projects	DCFE	1,946	100%	1,946	
Total proposed power projects				**6,359**	**5**
Perambalur SEZ	25% discount to NAV	5,591	100%	5,591	4
Add cash outstanding less corporate debt				5,487	4
Total GVK SoTP value				**60,518**	**43**

Source: Company reports, Edelweiss research

MIAL: Conservative approach to factor in uncertainties

We have used the DCFE method to value the airport concession, which includes the aeronautical and non-aeronautical revenues from the airport facility. The airport is likely to reach a point of saturation by FY12E, and we can see only up to 25% overloading being allowed into the airport. Like the Delhi Airport, MIAL will have revenues based on actual charges until FY09 and on CPI-X thereafter. Revenues under this model will be dependant on the capex phasing in the expansion stage. Our model assumes that the capex for the project will be INR 15 bn, INR 18 bn, INR 19 bn, INR 17 bn, INR 12.5 bn, INR 10 bn, and INR 4 bn during FY08-14E. As there is likely to be very little capex beyond FY14E, the aeronautical revenues are likely to plateau, and then start declining. Growth in non-aeronautical revenues is also expected to be limited as the airport reaches saturation.

Table 4: MIAL - Assumptions and valuations **(INR mn except stated otherwise)**

	2008E	2009E	2010E	2011E	2012E	2016E	2020E	2024E	2028E	2036E	2066E
Operational parameters											
Airport capacity (mn.)	26	26	26	36	36	40	40	40	40	40	40
Domestic passenger traffic (mn.)	17.0	17.0	18.7	21.5	24.8	30.0	30.0	30.0	30.0	30.0	30.0
International passenger traffic (mn.)	9.2	9.2	10.1	11.6	13.3	20.0	20.0	20.0	20.0	20.0	20.0
Domestic cargo ('000 mt)	138.7	145.6	167.5	194.3	225.4	347.2	455.1	596.5	781.9	1343.5	10227.1
International cargo ('000 mt)	334.2	350.9	403.5	468.1	543.0	836.6	1096.5	1437.4	1884.1	3237.2	24642.3
Domestic ATMs	151	192	176	187	215	260	256	256	256	256	256
International ATMs	58	58	59	68	76	113	103	103	103	103	103
Revenue model											
User charges revenue (FY08-09)	5,713.3	6,197.5									
CPI-X model											
Return on base	903	1,793	3,458	5,633	7,948	8,293	6,629	4,965	3,301	0	0
OM - Efficeint operation & maintenance cost	2,764	3,223	3,868	4,446	5,109	7,948	10,563	12,357	14,456	19,784	64,166
Depreciation	229	294	582	1,122	1,842	3,228	3,228	3,228	3,228	3,021	0
Corporate tax	426	567	899	901	1,262	7	1,274	3,276	5,191	12,285	452,160
revenue	1,463	1,814	2,206	2,595	3,098	5,324	7,528	10,838	15,786	34,575	855,563
Target revneues	**2,858**	**4,062**	**6,601**	**9,507**	**13,063**	**14,153**	**14,165**	**12,987**	**10,390**	**513**	**0**
Total aeronautical revenues	**5,713**	**6,197**	**6,601**	**9,507**	**13,063**	**14,153**	**14,165**	**12,987**	**10,390**	**513**	**0**
Key non-aero components											
Cargo handling	1,731	2,239	2,704	3,293	4,011	7,511	11,966	19,066	30,377	77,114	2,537,029
Other aero related revenues	3,383	3,809	4,648	5,356	6,315	10,236	13,127	17,062	22,244	38,138	314,847
Revenues	**4,878**	**6,048**	**7,352**	**8,649**	**10,325**	**17,747**	**25,094**	**36,128**	**52,621**	**115,252**	**2,851,877**
Gross revenues	**8,568**	**12,245**	**13,953**	**18,156**	**23,388**	**31,899**	**39,259**	**49,116**	**63,011**	**115,765**	**2,851,877**
Revenue sharing	3,316	4,739	5,400	7,027	9,051	12,345	15,193	19,008	24,385	44,801	1,103,676
Net revenues	**5,252**	**7,506**	**8,553**	**11,130**	**14,337**	**19,554**	**24,066**	**30,108**	**38,626**	**70,964**	**1,748,201**
Valuation assumptions											
Return on capital employed (	11.6										
Valuation summary											
Cost of equity (%)	14.0										
DCFE	29,381										
GVK share (%)	37.0										
GVK value	10,871										

Source: Company reports, Edelweiss research

Valuation sensitivity

We have drawn of three different scenarios for the valuation of airport based on traffic projections.

Table 5: MIAL valuation summary **(INR mn)**

Case	DCFE valuation
Pessimistic	13,312
Base	29,413
Optimistic	52,705

Source: Company reports, Edelweiss research

Assumptions					(%)
		FY09E	FY10E	FY11-14E	Long term
Pessimistic	Passenger traffic growth	(10.0)	5.0	10.0	6.0
	Cargo volume growth	0.0	10.0	12.0	6.0
Base	Passenger traffic growth	0.0	10.0	15.0	7.0
	Cargo volume growth	5.0	15.0	16.0	7.0
Optimistic	Passenger traffic growth	10.0	15.0	20.0	8.0
	Cargo volume growth	10.0	20.0	20.0	8.0

Source: Company reports, Edelweiss research

Real estate: Evaluation of multiple scenarios

We have used NAV valuation to value the real estate potential of GVK's airport project. We see several different scenarios that could emerge for GVK in developing the Mumbai Airport real estate. We have shown the valuation for GVK in all the three scenarios that we had considered earlier, in table 6. In this table, we have also considered the different FSI that GVK could avail. The global FSI for development in the area is 1; if the company intends to raise it to 2, it needs to purchase TDRs, priced at ~INR 4,000/ sq ft, according to the prevailing ready reckoner rates.

Table 6: MIAL – Land valuation sensitivity **(INR mn)**

Total area (acres)	**197**	**152**	**100**	**197**	**152**	**100**
FSI	1	1	1	2	2	2
Total developable area in mn. sq ft	8.6	6.6	4.4	17.2	13.2	8.7
Loading (%)	25	25	25	25	25	25
Total saleable area in mn. sq ft	11	8	5	21	17	11
Sale Price in INR/ sq ft	25,000	25,000	25,000	25,000	25,000	25,000
AAI revenue sharing	7,175	7,175	7,175	7,175	7,175	7,175
CoC INR/ sq ft	2,500	2,500	2,500	2,500	2,500	2,500
Other cost INR/ sq ft	1,000	1,000	1,000	1,000	1,000	1,000
PBT INR/ sq ft	14,325	14,325	14,325	14,325	14,325	14,325
Tax	4,813	4,813	4,813	4,813	4,813	4,813
PAT	9,512	9,512	9,512	9,512	9,512	9,512
Total PAT	102,030	78,723	51,792	204,059	157,447	103,584
Cash flow duration (yrs)	3	3	3	3	3	3
Cost of equity (%)	16	16	16	16	16	16
NAV	65,366	50,435	33,181	130,732	100,870	66,362
Discount to NAV (%)	50	50	50	50	50	50
Valuation to GVK	**32,683**	**25,217**	**16,590**	**65,366**	**50,435**	**33,181**

Source: Edelweiss research

The valuation of this land portion is sensitive to the price of land, the portion of land that can be ultimately cleared from encroachment and also the timeframe over which the development can take place. We have assumed cash flow duration of three for the project because we expect the real estate development to take place over a period of next six years.

Power generation: Timely gas supply key to growth

Table 7 highlights GVK's power projects that have either started operation or are at least complete. Currently, only the Jegurupadu phase I is operational, and hence, we have valued it with a lower cost of equity of 12%. The other two projects are still awaiting gas supplies; hence, we have assigned a higher risk weightage to these projects. It must be noted that Jegurupadu phase II has been funded by leveraging the balance sheet of the subsidiary that owns the Jegurupadu project. We have estimated a debt:equity of 80:20 for the project, though the project has been funded entirely through debt.

Table 7: Existing power plants – Assumptions and valuations **(INR mn)**

	Jegurupadu phase 1	Jegurupadu phase 2	Gautami Power
Capacity (MW)	217	220	464
Fuel	Natural gas	Natural gas	Natural gas
Sustainable PLF (%)	60	60	60
Tariff formula	PPA as per CERC norms	2-part fixed plus variable pass throguh	2-part fixed plus variable pass through
Fixed tariff (INR/ unit)	1.7	0.9	0.9
Merchant tariff (INR/ unit)	NA	NA	NA
Fuel price (INR/ unit)	4.7	5.0	6.0
Cost of equity (%)	12	14	14
DCFE value	4,163	2,880	3,822
GVK stake (%)	100	100	51
GVK share	**4,163**	**2,880**	**1,949**

Source: Company reports, Edelweiss research

Power generation: New units still to get off ground

GVK's power expansion consists of two medium-sized hydro projects, one each in Alaknanda and Goriganga (both in Uttaranchal), and a coal-fired plant in Tokisud (Punjab). Of these projects, construction work on the Alaknanda plant has already begun, and the plant has secured all the necessary clearances and entered into a PPA. Therefore, we have used DCFE to value this project. The Goriganga project has, however, neither achieved financial closure nor has initial construction work commenced on it; hence, we have used a higher cost of equity to value it.

Table 8: GVK Hydro - Portfolio details **(INR mn)**

	Alaknanda	**Goriganga**
Location	Uttaranchal	Uttaranchal
Capacity (in MW)	330	370
Type	Run of the river	Run of the river
Expected FC date	Aug-08	Mar-09
Expected CoD	Jul-11	Dec-12
Royalty (%)	12	12
PLF assumptions (%)	50.0	43.0
Offtake	PPA with UPPCL for 30+20 years under CERC norms: 14% roE	Merchant
Capex	20,690	22,500
Debt to equity	70:30	70:30
Cost of equity (%)	16	16
DCFE	**3,996**	**416**

Source: Company reports, Edelweiss research

The Tokisud coal-fired project in Punjab has secured coal linkage from a captive mine in Jharkhand, and has also signed a PPA with Punjab State Electricity Board (PSEB). Therefore, though the project has achieved financial closure, we have valued the project using DCFE. The captive coal block in Jharkhand for this project will be developed by January 2009, while the slated date for completion of the power project is March 2011. In the interim, the coal from this mine can be sold to PSEB. The price for sale of coal would be at 10-15% discount to Coal India prices. While we have factored this in our earnings forecasts, we do not provide for this in the valuations, as sales will not be on a sustainable basis.

Table 9: Goindwal Sahib power plant and Tokisud coal mines **(INR mn)**

Power plant location	Goindwal Sahib Punjab
Capacity (in MW)	540
Expected FC date	
Expected CoD	Mar-11
Offtake	PPA with PSEB under CERC norms
PLF assumptions (%)	85
Capex	29800
Debt to equity (%)	80
Mine location	Tokisud, Jharkhand
Expected mine development date	Jan-09
Total reserves (MT)	55
Mine capacity (mmtpa)	2
Cost of mining and transportation (INR/MT)	900
Mine development cost	1,800
Calorific value expected (kcal/kg)	3,700
Cost of equity (%)	16
DCFE	1,946

Source: Company reports, Edelweiss research

Roads: Secured income from tolls; upsides from traffic growth remain

The Jaipur-Kishengarh Expressway has been operational, generating steady earnings for the past three years. Except for a force majeure, we do not see any significant risk to the project's earnings; we expect it to match at least the current profit levels for the period of concession. Therefore, to value the project, we have used DCFE for the period of concession with a lower cost of equity of 12%

Table 10: Jaipur Kishengarh - Assumptions and valuations	(INR mn)
Length (km)	90.35
Concession period start date	Apr-03
Commencement of operations	May-05
Concession period (years)	20
End of concession	Mar-23
2007 Traffic (pcu)	50,000
Estimated growth rates (%)	7
Toll rates (INR/ pcu)	60
Estimated toll growth (%)	5
Capital cost	6,812
Grant	1,876
Debt outstandiing	2,893
Revenues (FY08E)	1,397
PAT (FY08E)	637.3
Cost of equity (%)	12
DCFE value	**4,558**

Source: Company reports, Edelweiss research

Perambalur SEZ: Early stages of development

GVK has an MoU with Tamil Nadu Industrial Development Corporation (TIDCO) to develop a multiproduct industrial SEZ at Perambalur, near Trichy. The company is in the process of land acquisition for this project; so far, it has managed to acquire 1,800 acres of land at ~INR 0.33 mn/acre. It has applied for notification of SEZ by board of approvals. There is not much detail about how this project will be developed, its quantum, and rates. Hence, we have taken a discount of 50% to our NAV for this project. Table 11 below summarises our assumptions and valuations for this project.

Table 11: Perambalur SEZ - Assumptions and valuations	(INR mn)
Total area (acres)	3018
Developable area (%)	70
Development Area in acres	2,113
Development cost/ acre (INR mn)	50
Development cost (INR mn)	105,630
Debt (INR mn)	79,223
Equity (INR mn)	26,408
Sale price: industrial (INR mn/ acre)	40
Sale price: residential (INR mn/ acre)	50
Advance Lease deposit as a % of total price (%)	75
Lease deposit period	30
Infrastructure charge in INR mn/ acre	5
Cost of construction for residential	33.0
SG&A as % of sales	10
Interest cost (%)	12
Depreciation as a % of gross block	5
Cost of equity (%)	16
NAV of SEZ (INR mn)	11,181.3
Discount to NAV (%)	50
Valuation of SEZ (INR mn)	5,591
GVK stake (%)	100
GMR Value in SEZ (INR mn)	**5,591**

Source: Company reports, Edelweiss research

Key Risks

Natural gas security for existing power plants

GVK's current power plants are running short of gas. Currently, the company has only signed a MOU with Reliance for the supply of gas from the KG gas fields from July. This has legal sanctity only in the event of a favourable ruling on the Reliance dispute. Since the company has given up the dual fuel (naphtha) option for its Jegurupadu II and Gautami projects, timely availability of gas is crucial for the company.

MIAL: Securing land from encroachments

A part of the mandatory projects that GVK has to execute under the terms of agreement depends on the land that will be acquired by clearing sum encroachments on it. A significant part of the commercial real estate development from the project also depends on clearing of the encroached land. The company's valuation, hence, depends on the ability of HDIL to fulfill its obligation. However, the risk for GVK in this deal is not as significant as is the risk for HDIL, as the latter has already commenced investment in the project and will not receive any benefits from it until achieving certain targets of freeing the land of encroachments.

Competition from second airport in Mumbai

The central government has already approved the plan to construct the second airport in Navi Mumbai, and the government of Maharashtra is trying to acquire land for it. The airport bidding offers an opportunity to GVK on account of the ROFR clause. However, if GVK loses the bid, the new airport could compete with the existing airport, hampering the latter's profitability. Moreover, as MIAL has relatively lesser leeway to modernise the airport vis-à-vis the new airport on account of space constraints, the new airport could end up eating into the juicier bits of MIAL's business such as cargo traffic and international traffic. For instance, while MIAL will continue to effectively have only one usable runaway , the new airport will have two parallel runaways as a part of the original design.

Company Description

GVK was promoted by Mr. GV Krishna Reddy, and is a part of the GVK Group that has interests in infrastructure, bioscience, and hospitality. The company is the flagship of the group and holds its infrastructure assets under it. GVK entered the infrastructure segment by building the 216MW Jegurupadu phase I power project in Andhra Pradesh. The company has since then expanded across different infrastructure verticals with presence in airports, power, roads, and urban infrastructure. Winning the bid for developing the Mumbai Airport has been a major milestone for the company. It is also bidding for deep sea gas blocks under the National Exploration Licensing Plan (NELP –VII) in partnership with BHP Billiton.

Management overview

Mr. GV Krishna Reddy: This first generation entrepreneur has over 40 years experience in various lines of business. He founded Novopan Industries in 1979 (manufacturer of pre-laminated particle board), followed by GVK Petrochemicals and GVK America.

Mr. GV Sanjay Reddy: He has been involved with various lines of business, including the setting up of the Jegurupadu units. Currently, he manages the MIAL project in addition to other group businesses.

Mr. Somanadri Bhupal: He is the managing director of GVK Industries - the holding company for the Jegurupadu power project. He was also instrumental in executing the Jaipur-Kishengarh project and is also involved with various other initiatives of the group. Prior to joining GVK, Mr. Bhupal was the joint managing director of Novopan India, managing the hotel business.

Mr. Issac George: Has been the CFO of the company since its inception, and has garnered over 25 years of experience with the GVK Group.

Business Description

Mumbai International Airport

GVK, in a 50-50 consortium with Airports Company South Africa (ACSA), won a bid to pick up 74% stake in the Mumbai International Airport (MIAL). The company now has a concession to modernise, expand, and operate the airport for a concession period of 30 years, which is extendable by another 30 years at the option of the consortium.

The first phase, comprising renovation and modernisation of terminal 1B, is already complete. The financial closure for the entire project is also over. The total project cost is INR 60 bn, which will be funded through 73:27 debt-equity.

The total development potential of the site is ~20 mn sq ft across land development phases, which can be developed over a period of 5-8 years, according to company estimates. The first task as things stand today is in freeing the land from encroachment. Table 12 shows schedule of freeing encroachment.

Table 12: MIAL land status

Phase	Time frame	Land freed (acres)
1	6-36 mths	158
1(i)	6-18 mths	78
1(ii)	18-24 mths	20
1(iii)	24-36 mths	60
2	36-48 mths	118
Total	Upto 48 mths	276
Less HDIL share		65
Net GVK share		211

Source: Company reports, Edelweiss research

The maximum global FSI that can be secured for construction in the Mumbai suburban district is 1. However, the company will not get any free TDR. In addition, the company can purchase additional TDRs, which can increase the global FSI to 2. The company estimates the total city side development potential associated with the airport to be ~20 mn sq ft, incorporating FSI of 2.

Existing power projects

The company was an early entrant in private power generation in India by setting up the 216 MW Jegurupadu phase I power project in Andhra Pradesh, in 1997. It expanded its generation capacity by adding the 220 MW Jegurupadu phase II and 464 MW Gautami power project in the same region.

Proposed power projects

GVK is currently in the process of developing two hydro projects with a total generation capacity of 700 MW, and one coal-fired plant with a capacity of 540 MW at Goindwal Sahib, in Punjab. All these plants are being built with PPAs and secure fuel linkages, and are likely become operational by 2012.

Alaknanda: The first one is the 330 MW Alaknanda power project in Uttaranchal. This project is under construction and is likely to commence operations in July 2011. This project has a PPA with Uttar Pradesh Power Corporation (UPPCL) under the conventional 2-part tariff plan that guarantees the company 14% RoE plus incentives. The financial closure was achieved in July 2007. Civil works for the project is being carried out and the key work of diversion of the river has been successfully completed.

Goriganga: The other hydro project is the 370 MW Goriganga project in Uttaranchal, which the company won through a process of competitive bidding. The company is planning to develop the project as a merchant power plant with no long-term PPA. The project has not yet achieved financial closure and is slated to begin commercial production in 2012.

Goindwal Sahib: The third power project under development is the 540 MW coal-fired Goindwal Sahib power project in Punjab, which was also won through a process of competitive bidding. To fuel this project, GVK has been allotted 55 MT coal block in Tokisud, Jharkhand. The development of this mine is on, and is expected to cost INR 1.8 bn; it is likely to be completed by January 2009. The mine development plan has been approved by the Government of India (GoI). The mine output will be ~2 MTPA, which falls slightly short of requirement. To make up for the shortfall, the company is also in the process of developing the Saregraha mine in Jharkhand, jointly with Mittal group. This gives it access to another 1 MTPA of coal.

Road / Urban infrastructure

Jaipur Kishengarh road project: GVK was awarded the contract to build the 90 km Jaipur-Kishengarh stretch on the Mumbai Delhi highway on a BOT basis with a concession period of 20 years, including the construction date starting March 28, 2003. The project involved 30-month construction period and toll collection for the remaining concession period. GVK executed the project ahead of schedule in April 2005. The road stretch has seen a total traffic of 6.8 mn passenger car units (pcus) in FY08, which is a growth of 8% over last year. Toll revenues for this project are not capped; however, there is a provision for sharing revenues in excess of INR1.11 bn with the National Highway Authority of India (NHAI).

Perambalur SEZ: GVK is in the process of developing a 3,018 acre multi-product SEZ at Perambalur, Tamil Nadu, under an MoU with Tamil Nadu Industrial Development Corporation (TIDCO). The location of this SEZ is about 225 km away from Chennai, along NH7. The company is in the process of acquiring land for the project and has acquired 2,600 acres of land at ~INR 0.33 mn/acre; it is awaiting a formal SEZ notification, once the process of land acquisition is complete. Currently, ~2,600 acres of land has been acquired. The composition of industries to be housed in the SEZ is not yet decided; Mahindra Consulting has been appointed as consultant to the project. The options being explored are auto and auto ancillaries and chemicals.

Financial Outlook

Gas availability to provide medium-term push to earnings

In FY08, power contributed ~INR 3.5 bn to GVK's revenues, and road projects INR 1.4 bn. FY09 could witness great spurt in revenues, if the Jegurupadu phase II and Gautami Power projects commence operations. We estimate production from these projects to commence in the second half of FY09, contributing INR 5 bn to revenues. In the first full year of operations (FY10), their contribution to revenues is likely to be INR 10.9 bn. Also, we expect GVK to get revenues of INR 630 mn and INR 2.5 bn in FY09E and FY10E, respectively, from the sale of coal from its Tokisud mines. Collectively, revenues are expected to rise to INR 11.4 bn in FY09E, and INR 20 bn in FY10E.

Table 13: Revenue break-up for GVK

(INR mn)	2007A	2008A	2009E	2010E
Roads	1,164	1,397	1,233	1,331
Power	2,912	3,205	8,413	15,222
Coal mine	0	0	630	2,520
Total revenues	**4,077**	**4,602**	**10,276**	**19,073**

Source: Edelweiss research

Bottom-line to increase faster than top-line, powered by MIAL's growth

Barring a buyout of ACSA's stake in MIAL by GVK, revenues from MIAL will not be consolidated into the top-line. MIAL contributed INR 336 mn and INR 414 mn to the bottom-line in FY07 and FY08, respectively, and will contribute INR 883 mn to profit after tax in FY09E. GVK's total revenues are likely to, thus, expand to INR 11.4 bn and INR 20 bn in FY09E and FY10E, respectively. The power division will be another major contributor to revenues, where we expect PAT (post minority interest) to increase to INR 258 mn in FY09E and to INR 373 mn in FY10E. Overall, we expect the adjusted PAT to be INR 2.59 bn and INR 3.7 bn in FY09E and FY10E, respectively. Note that our estimates do not incorporate earnings from Perambalur SEZ, as the company has not spelt out the timeframe when the earnings from this project will come about. This could give a further upside to our earnings estimates, going forward.

Table 14: GVK PAT adjusted for minorities

(INR mn)	2007A	2008A	2009E	2010E
Airports	336	414	871	875
Roads	(110)	637	353	430
Power	238	101	248	355
Coal mine	-	-	76	682
Total	**464**	**1,152**	**1,548**	**2,341**

Source: Edelweiss research

Financial Statements

Income statement (INR mn)

Year to March	FY06	FY07	FY08	FY09E	FY10E
Income from operations	1,547	4,091	5,322	10,897	19,695
Direct costs	717	1,228	1,736	4,214	6,981
Employee costs	41	134	146	-	-
Other expenses	-	611	957	1,455	3,032
Total operating expenses	757	1,973	2,839	5,669	10,013
EBITDA	790	2,119	2,483	5,228	9,681
Depreciation and amortisation	269	806	776	1,598	2,890
EBIT	520	1,313	1,707	3,631	6,791
Interest expenses	143	631	414	1,046	2,553
Profit before tax	378	683	1,293	2,585	4,238
Provision for tax	10	250	239	645	1,043
Core profit	368	433	1,055	1,940	3,195
Extraordinary items	(0)	(1)	-	-	-
Profit before minority interest	368	432	1,055	1,940	3,195
Minority interest	140	373	101	248	355
Share of profit in associate co.	-	336	407	871	875
Profit after minority interest	228	397	1,361	2,563	3,715
Shares outstanding	109	940	1,405	1,405	1,405
EPS (INR) basic	2.1	0.4	1.0	1.8	2.6
Diluted shares (mn)	109	940	1405	1405	1405
EPS (INR) fully diluted	2.1	0.4	1.0	1.8	2.6
Dividend per share	0.0	0.2	0.0	0.0	0.0
Dividend payout (%)	-	56	-	-	-

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08	FY09E	FY10E
Operating expenses	48.9	48.2	53.3	52.0	50.8
Depreciation and amortization	17.4	19.7	14.6	14.7	14.7
Interest expenditure	9.2	15.4	7.8	9.6	13.0
EBITDA margins	51.1	51.8	46.7	48.0	49.2
Net profit margins	23.8	10.6	19.8	17.8	16.2

Growth metrics (%)

Year to March	FY06	FY07	FY08	FY09E	FY10E
Revenues	1,975.6	164.5	30.1	104.8	80.7
EBITDA	1,838.0	168.3	17.2	110.6	85.2
PBT	10.8	0.8	0.9	1.0	0.6
Net profit	2,084.4	117.8	243.6	183.9	164.7
EPS	5.3	(0.8)	1.3	0.9	0.4

Balance sheet (INR mn)

As on 31st March	FY06	FY07	FY08	FY09E	FY10E
Equity capital	236	236	1,406	1,406	1,406
Reserves & surplus	5,102	5,719	20,460	23,023	26,738
Shareholders funds	5,339	5,956	21,866	24,429	28,144
Minority interest	2,621	2,729	6	254	608
Secured loans	7,401	11,353	12,639	-	-
Unsecured loans	565	4,093	271	-	-
Borrowings	7,966	15,446	12,910	50,656	92,060
Deferred Revenue	-	1,876	1,758	1,758	1,758
Sources of funds	**15,926**	**26,006**	**36,540**	**77,098**	**122,571**
Gross block	10,112	18,890	19,044	34,044	53,844
Depreciation	4,603	5,874	6,769	8,367	11,257
Net block	5,509	13,016	12,275	25,677	42,587
Capital work in progress	7,092	8,211	13,501	42,300	70,864
Total fixed assets	12,601	21,227	25,776	67,977	113,451
Investments	1,322	2,974	7,068	7,068	7,068
Inventories	231	285	227	227	227
Sundry debtors	769	828	652	652	652
Cash and equivalents	580	631	1,643	0	0
Loans and advances	2,242	1,648	2,356	2,356	2,356
Total current assets	3,821	3,392	4,879	3,236	3,236
Sundry creditors and others	589	638	269	269	269
Provisions	36	59	28	28	28
Total CL & provisions	625	696	297	297	297
Net current assets	3,197	2,696	4,582	2,939	2,939
Net deferred tax	(1,193)	(891)	(886)	(886)	(886)
Uses of funds	**15,926**	**26,006**	**36,540**	**77,098**	**122,571**
Book value per share (BV)(INR)	49	6	16	17	20

Free cash flow (INR mn)

Year to March	FY06	FY07	FY08	FY09E	FY10E
Net profit	228	397	1,361	2,563	3,715
Depreciation	269	806	776	1,598	2,890
Deferred tax	(1,194)	303	4	-	-
Others	3,042	-2,372	-879	-3,039	355
Gross cash flow	2,345	(867)	1,262	1,122	6,960
Less: Changes in W. C.	2,612	(1,712)	(389)	(3,287)	(0)
Operating cash flow	(268)	845	1,650	4,409	6,960
Less: Capex	5,934	27,703	66,932	92,163	75,824
Free cash flow	**(6,201)**	**(26,857)**	**(65,281)**	**(87,754)**	**(68,864)**

Cash flow metrices

Year to March	FY06	FY07	FY08	FY09E	FY10E
Operating cash flow	(268)	845	1,650	4,409	6,960
Financing cash flow	3,440	3,734	15,280	37,747	41,404
Investing cash flow	(2,594)	(4,528)	(23,133)	(43,799)	(48,364)
NET CASH FLOW	578	51	(6,202)	(1,643)	-
Capex	(5,934)	(27,703)	(66,932)	(92,163)	(75,824)
Dividends paid	-	(222)	-	-	-
Share issuance/(buyback)	4077.6	-1.0	0.0	0.0	0.0

Profitability & Liquidity ratios

Year to March	FY06	FY07	FY08	FY09E	FY10E
ROAE (%)	8.4	7.0	9.8	11.1	14.1
ROACE (%)	7.1	7.0	6.5	7.3	7.3
Current ratio	6.1	4.9	16.4	10.9	10.9
Debtors (days)	91	71	51	22	12
Average fixed assets t/o (x)	0.6	0.4	0.4	0.6	0.6
Average working capital t/o (x)	1.2	1.7	2.1	3.7	6.7
Average capital employed t/o (x)	0.2	0.2	0.2	0.2	0.2
Debt / Equity	1.5	2.6	0.6	2.1	3.3
Debt/EBITDA	10.1	7.3	5.2	9.7	9.5
Adjusted Debt/Equity	1.5	2.6	0.6	2.1	3.3

Operating ratios

Year to March	FY06	FY07	FY08	FY09E	FY10E
Total asset turnover	0.18	0.20	0.17	0.19	0.20
Average fixed assets t/o (x)	0.56	0.44	0.42	0.57	0.58
Equity turnover	0.57	0.72	0.38	0.47	0.75

Du pont analysis

Year to March	FY06	FY07	FY08	FY09E	FY10E
NP margin (%)	14.7	9.7	25.6	23.5	18.9
Total assets turnover	0.2	0.2	0.2	0.2	0.2
Leverage multiplier	3.1	3.7	2.2	2.5	3.8
ROE (%)	8.4	7.0	9.8	11.1	14.1

Valuation parameters

Year to March	FY06	FY07	FY08	FY09E	FY10E
Diluted EPS (INR)	2.1	0.4	1.0	1.8	2.6
Y-o-Y growth (%)	*5.3*	*(0.8)*	*1.3*	*0.9*	*0.4*
CEPS (INR)	15.6	1.0	1.5	3.0	4.7
Diluted P/E (x)	20.3	100.8	43.9	23.3	16.1
Price/BV(x)	0.9	6.7	2.7	2.4	2.1
EV/Sales (x)	8.6	13.3	12.0	9.5	7.4
EV/EBITDA (x)	16.8	25.7	25.7	19.8	15.0
Dividend yield (%)	-	0.01	-	-	-