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Stock Rating
Overweight

Industry View
In-Line

Initiation

Reliance Energy

Initiating with Overweight: Potential to Outperform as Opportunities Emerge

Initiating coverage of Reliance Energy with Overweight rating and price target of Rs609: Reliance Energy is one of India's largest integrated utility companies in the private sector. Our SOTP-based price target implies 19% upside potential from current levels. Moreover, we think the risk to our base case is skewed to the upside, with further opportunities likely to emerge as sector reform gathers momentum.

Key positives: We expect the company to benefit from: (i) the Indian government's thrust to expand generation capacity and increase private participation in the transmission and distribution segments; (ii) growth in the consumer base and per capita consumption (Mumbai business);and (iii) the scope to pursue value-accretive opportunities provided by its financial assets of US$1.95 billion. We think a revenue CAGR of 11% and an earnings CAGR of 14% over F2007-09E should enable the stock to outperform its peers. Moreover, should the company increase its generation capacity significantly (e.g. via the UMPP route) our forecasts and price target could rise.

Where are we different? At current levels, we believe recent negative news flow is priced in. Moreover, the market seems to be valuing the company's cash surplus at book. In contrast, our base case assumes that this cash is deployed for returns that exceed the cost of equity, thus warranting a premium to book value.

Where could we be wrong? The sector remains vulnerable to regulatory and political risk. Moreover, Reliance Energy's performance depends on the availability of opportunities in the sector. While the signs are promising, slower-than-expected progress on reforms could result in our growth forecasts proving too optimistic. Non-deployment of the company's financial assets would also depress ROE and future growth rates.

Key Ratios and Statistics

Reuters: RLEN.BO Bloomberg: RELE IN
India Utilities

Price target	Rs609.00
Shr price, close (Apr 20, 2007)	Rs511.05
Mkt cap, curr (mn)	US$2,808
52-Week Range	Rs646.25-362.05
Sh out, basic, curr (mn)	228.5

Fiscal Year (Mar)	2006	2007e	2008e	2009e
ModelWare EPS (Rs)*	33.88	34.03	38.14	44.12
Revenue, net (Rs mn)	40,335	54,830	70,018	67,274
ModelWare net inc (Rs mn)	7,124	8,047	9,018	10,431
P/E	18.1	15.0	13.4	11.6
P/BV	1.6	1.3	1.2	1.1
EV/EBITDA	11.3	12.4	9.7	6.9
Div yld (%)	0.8	1.1	1.3	1.3

*** =** Please see explanation of Morgan Stanley ModelWare later in this note.
e = Morgan Stanley Research estimates

Financial Summary

Income Statement

Rs Mn(Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Total Revenues	**41,337**	**40,335**	**54,830**	**70,018**	**67,274**
Power Revenue	28,899	31,790	36,644	44,424	49,217
EPC and Other Revenue	12,438	8,545	18,186	25,594	18,057
Total operating expenses	**34,715**	**32,859**	**49,522**	**63,652**	**59,380**
Power purchase cost	10,041	10,876	15,451	21,129	22,921
Fuel cost	7,363	8,121	9,041	9,662	9,841
Repairs,Electricity Tax & Other costs	3,830	4,717	5,500	6,526	7,257
Employee cost	1,836	1,857	2,227	2,473	2,720
EPC expenses	11,646	7,288	17,303	23,863	16,640
EBITDA	**6,623**	**7,476**	**5,308**	**6,366**	**7,894**
Depreciation	3,464	3,486	2,498	2,640	2,783
EBIT	**3,158**	**3,989**	**2,810**	**3,726**	**5,112**
Other income	3,923	5,559	9,116	9,377	9,696
Interest and finance charges	1,348	1,919	2,347	2,368	2,389
PBT	**5,732**	**7,630**	**9,580**	**10,735**	**12,418**
Taxation	495	506	1,533	1,718	1,987
Tax rate (%)	9%	7%	16%	16%	16%
PAT	**5,237**	**7,124**	**8,047**	**9,018**	**10,431**
Extraordinary items	-35	-621	1,386	0	0
PAT after extraordinary items	**5,203**	**6,503**	**9,433**	**9,018**	**10,431**
EPS (Rs)	25.59	33.88	34.03	38.14	44.12
DPS (Rs)	4.70	5.00	5.50	6.50	6.50

Balance Sheet

Rs Mn(Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Liabilities					
Share Capital	1,856	2,124	2,285	2,285	2,285
Share Warrants	5,680	882	0	0	0
Reserves and surplus	55,863	75,727	84,582	91,891	100,614
Shareholders funds	63,399	78,733	86,867	94,176	102,899
Secured loans	7,850	19,198	19,198	19,198	19,198
Unsecured loans	29,537	23,471	23,471	23,471	23,471
Others Liabilities	2,827	2,276	2,276	2,276	2,276
Total Liabilities	**103,612**	**123,678**	**131,812**	**139,122**	**147,845**
Assets					
Gross Block	51,730	54,706	57,206	59,706	62,206
Accumulated Depreciation	24,529	28,146	31,653	35,306	39,105
Net Block	27,201	26,561	25,553	24,400	23,101
CWIP	1,922	2,177	2,177	2,177	2,177
Investments	4,789	1,893	3,393	5,893	6,893
Inventories	3,531	2,951	3,270	3,564	3,716
Sundry debtors	9,310	10,928	12,733	16,705	18,370
Cash and Cash Equivalents	62,627	66,563	71,309	74,366	80,476
Deposits	4,478	21,181	22,240	23,352	24,520
Other current assets	8,633	13,565	16,567	19,166	22,122
Sundry creditors	7,391	6,621	8,071	11,088	12,054
Other Current Liab. & Prov.	11,487	15,519	17,359	19,412	21,476
Net current assets	69,700	93,048	100,689	106,652	115,674
Total Assets	**103,612**	**123,678**	**131,812**	**139,122**	**147,845**

Cash Flow

Rs Mn(Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
PAT	5,203	6,503	9,433	9,018	10,431
Depreciation	3,464	3,486	2,498	2,640	2,783
Interest	1,348	1,919	2,347	2,368	2,389
Changes in Working Capital	-1,381	-20,035	-3,133	-3,169	-2,912
Cash flow from operations	**8,635**	**-8,127**	**11,145**	**10,857**	**12,691**
(Purchase)/sale of fixed assets, net	-1,655	-3,100	-1,490	-1,487	-1,484
(Purchase)/sale of investment, net	704	2,896	-1,500	-2,500	-1,000
Cash flow from investing activities	**-951**	**-204**	**-2,990**	**-3,987**	**-2,484**
Proceeds from equity issuance	11,863	10,447	146	0	0
Proceeds/(repayment) of loan	17,078	5,283	0	0	0
Dividend	1,007	585	1,209	1,445	1,708
Interest expense	1,348	1,919	2,347	2,368	2,389
Other items	-3,502	-958	0	0	0
Cash flow from financing activities	**23,085**	**12,268**	**-3,409**	**-3,814**	**-4,098**
Change in cash and cash equiv	30,768	3,937	4,746	3,057	6,110
Opening cash and cash equiv	**31,858**	**62,627**	**66,563**	**71,309**	**74,366**
Closing cash and cash equiv	**62,627**	**66,563**	**71,309**	**74,366**	**80,476**

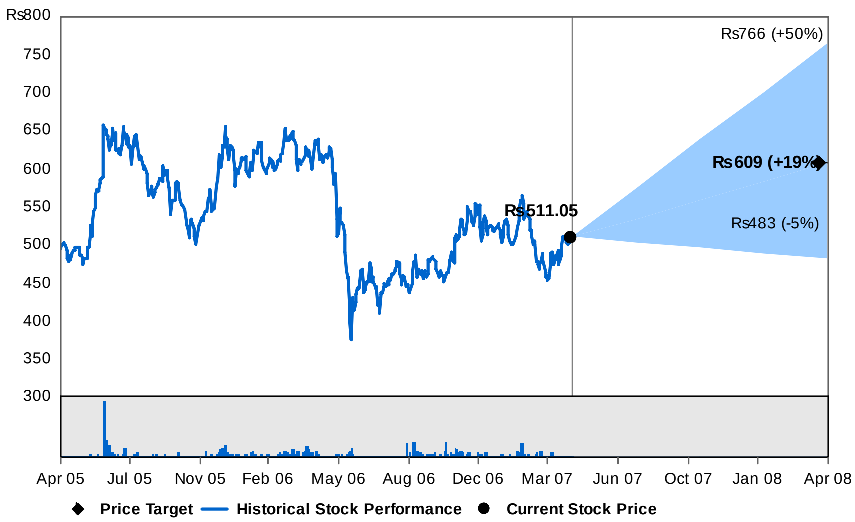
Ratio Analysis

(Year-end March)	F2005	F2006	F2007E	F2008E	F2009E
Growth (%)					
Revenues	21%	-2%	36%	28%	-4%
EBITDA	3%	13%	-29%	20%	24%
EBIT	-2%	26%	-30%	33%	37%
Net Profit	50%	36%	13%	12%	16%
EPS	20%	32%	0%	12%	16%
Margins (%)					
EBITDA	16%	19%	10%	9%	12%
EBIT	8%	10%	5%	5%	8%
EBT	14%	19%	17%	15%	18%
Net Profit	13%	18%	15%	13%	16%
Return (%)					
ROE	9.1%	10.0%	9.7%	10.0%	10.6%
ROCE	5.9%	6.3%	6.3%	6.7%	7.3%
ROA	5.0%	5.3%	5.3%	5.5%	5.9%
Gearing					
Debt/Equity	0.59	0.54	0.49	0.45	0.41
Net Debt/Equity	NC	NC	NC	NC	NC
Valuations					
EV/EBITDA	9.8	8.5	12.4	9.7	6.9
P/E	20.0	15.1	15.0	13.4	11.6
P/BV	1.5	1.4	1.3	1.2	1.1
Dividend Yield (%)	1%	1.0%	1.1%	1.3%	1.3%
Turnover (days)					
Inventory	183	139	139	139	139
Debtors	90	98	98	98	98
Creditors	87	72	72	72	72

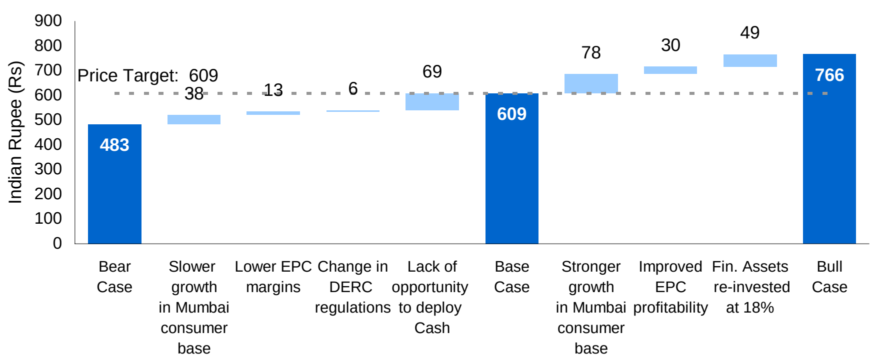
E= Morgan Stanley Research estimates; NC = Net Cash
Source: Company data, Morgan Stanley Research

Risk-Reward Snapshot: Reliance Energy (RLEN.BO, Rs511, OW, PT Rs609)

Risk-Reward View: Positive



Price Target Rs609	
Bull Case Rs766	**Better opportunities to deploy cash:** We increase the consumer base and the total consumption in the Mumbai distribution business, increase the option value of cash and improve the profitability of the EPC business.
Base Case Rs609	**Higher visibility on the government's strategy:** We assume the thrust provided by the government to increase generation capacity (especially through UMPPs) is positive for the company. We value the financial assets at 1.3x book and the EPC business at a 20% discount to the average EV/EBITDA of its construction peers.
Bear Case Rs483	**Slow pace of reforms:** We assume there are limited opportunities available to private players as the government delays awarding projects to private players. We reduce the growth in the consumer base for the Mumbai distribution business, compress margins in the EPC business and value the financial assets at book.



Source: FactSet, Morgan Stanley Research estimates

Investment Thesis

- One of India's largest integrated electric utilities in the private sector with experience in generation and distribution businesses
- Surplus cash position lends it the capability to finance large power projects
- EPC division can benefit from the increasing activity in the generation space as a result of the government's XIth five-year plan

Key Value Drivers

- Regulatory regime improving in India
- Thrust provided by the government to increase private participation in the utility sector

Potential Catalysts

- Winning the bid for a UMPP
- Go-ahead given to the two transmission projects that are currently stalled
- Obstacles removed for the Shahapur/Dadri projects

Key Risks

- Non-deployment of surplus cash, thus depressing ROE

Investment Case

Summary & Conclusions

We are initiating coverage on Reliance Energy with an Overweight rating and a price target of Rs609. Our investment thesis is based on the following key points:

1. Reliance Energy is one of India's largest integrated power companies in the private sector. It has a total generating capacity of about 775 MW (excluding subsidiaries) and distributes electricity in Mumbai and Delhi. We believe the power sector in India has tremendous potential to grow given the fast pace of economic growth and increasing per capita consumption of electricity. The Ministry of Power projects India's electricity demand to rise 9% a year over F2007-12. To meet this burgeoning demand for power, significant addition will be required to India's existing capacity, along with installation of an efficient transmission and distribution system. The government's efforts to privatize the generation, transmission and distribution segments can increase opportunities for Reliance Energy.

2. Reliance Energy had financial assets (cash and cash equivalents and inter corporate deposits) aggregating US$1.95 billion at the end of F2006, representing 71% of its net assets. We believe the company should be able to create value by selectively deploying its financial assets into projects that can yield returns higher than its cost of capital. We expect opportunities to present themselves in the following segments:

   - Generation – via ultra mega power projects (UMPPs).
   - Transmission – execution of privatized projects to earn a 14% post tax ROE.
   - Distribution – execution of privatized projects to earn a 16% post tax ROE.
   - EPC – construction of internal/external power projects.

3. Reliance Energy stock has underperformed the BSE Sensex by 28% in the last 12 months and has marginally underperformed YTD. We believe that uncertainty surrounding planned capacity additions, delays to awarding of transmission projects and lackluster performance in the Delhi distribution business are some of the primary reasons for this underperformance. However, all these factors are well known by the market and hence pose little downside risk, in our view. We are positive on the generation segment of the Indian utility sector, given the government's drive to increase capacity. We see scope for the company to increase its participation in the generation segment via the UMPP route. While we do not factor this into our valuation at present due to limited visibility, we see it as a source of substantial upside potential.

4. We forecast a revenue CAGR of 11% and an earnings CAGR of 14% over F2007-09. Reliance Energy is trading at 12.8x our 12-month forward earnings estimate, implying a 20% discount to the BSE Sensex. Reliance Energy has historically traded at a 17% premium to the Sensex.

Our Rs609 target price for Reliance Energy shares is based on a sum-of-the-parts valuation model. The key downside risk to our target price is non-deployment of the company's financial assets, which would depress ROE and future growth rates. Like its peers in the industry, the company is also exposed to the risk of regulatory and/or political intervention. Upside risks to our price target include a greater-than-expected increase in capacity (e.g. via a UMPP) or a substantial increase in the EPC order book.

Company Description

Reliance Energy is one of India's largest integrated electric utility companies. It has a generation capacity of 775 MW and distributes power in Mumbai and Delhi. The company also has an EPC business for constructing internal/external power projects. The promoters own a 30% stake in the company.

India Utilities

Industry View: In-Line

The government's thrust to increase generation capacity should benefit companies in the sector. However, the slow pace of reform and political intervention continue to dampen positive sentiment.

MSCI Country: India

Asia Strategist's Recommended Weight: 1.6%
MSCI Asia/Pac All Country Ex Jp Weight: 6.3%

Investment Positives

Industry Has Significant Growth Potential

India's total electricity generation capacity is 128 GW, with coal being the primary source of generation (54% of total capacity). The current electricity shortfall (demand vs. supply) is estimated at 14 GW at peak levels, due largely to a lack of adequate generation capacity, inefficiencies in generation plants and high AT&C losses (aggregate technical and commercial losses) in the distribution system. Per capita consumption of electricity in India is low vs. other developing countries and we believe this will increase as the economy grows and power consumption increases. The Ministry of Power projects India's electricity demand to rise by 9% a year over F2007-12. To meet this burgeoning demand for power, significant addition will be required to India's existing capacity, along with installation of an efficient transmission and distribution system. The government's XIth five-year plan (March 2007-2012) envisages total capacity additions of 68,869 MW (in addition to 7,191 MW of capacity slippage from the Xth Plan period into the XIth Plan period). In addition, the government's efforts to privatize the transmission and distribution businesses should open up opportunities for private players such as Tata Power and Reliance Energy.

Exhibit 1
Key Initiatives Taken by the Government

11th Five-year Plan	• Generation: Capacity addition of 69 GW • Transmission: Capacity to increase by 20 GW to reach about 37 GW
UMPP	• 9 locations identified for UMPPs, of which 2 are already awarded (Sasan and Mundra)
Captive Coal	• 15 captive coal blocks up for allotment to private players
Transmission	• 15 transmission projects identified for competitive bidding/private sector participation

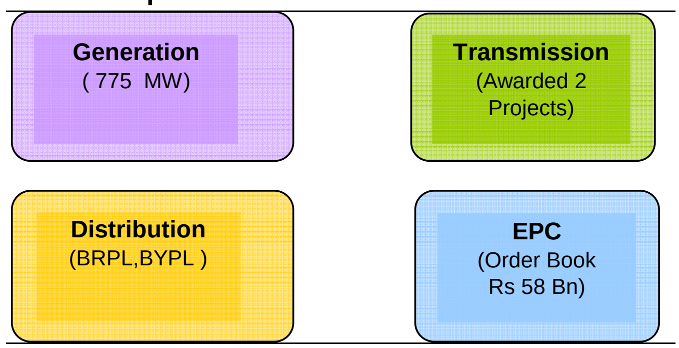
Source: Morgan Stanley Research

Present in All Segments of the Industry

Reliance Energy has interests in all the three segments of the power sector – generation, transmission and distribution. It currently has installed capacity of 775 MW, of which 500 MW in Dahanu (Maharashtra) is for the supply of power to the Mumbai license area. In the transmission business, the company has been scouting for opportunities to enter into a joint venture with PowerGrid Corporation (PGCIL) for the Parbati-Koldam transmission line project in Himachal Pradesh and the Western Region Strengthening Scheme. In the distribution business, Reliance Energy has a 51% stake in BRPL and BYPL, which distribute electricity in Delhi, and it also distributes electricity in the city of Mumbai.

Reliance Energy is one of the key utility companies in India and has the expertise to participate in any segment of the industry. Hence, we expect it to be a key beneficiary of the government's increasing focus on the utility sector and the drive to increase electricity supply in the country by F2012.

Exhibit 2
RELE: Snapshot of Various Business Interests



Source: Company data, Morgan Stanley Research

Financial Strength to Pursue Opportunities

Reliance Energy had cash and cash equivalents (including inter-corporate deposits) aggregating US$1.95 billion at the end of F2006. We believe the company should be able to create value by selectively deploying its financial assets in the following ways:

- Increase its generation capacity (earn a 14% post tax ROE on the regulatory capital base, plus incentives).
- Participate in privatized transmission projects (earn a 14% post tax ROE on the regulatory capital base).
- Participate in privatized distribution projects (earn a 16% post tax ROE on the regulatory capital base, plus incentives).
- Increase participation in EPC contracts

EPC Business Can Leverage Generation Growth

Reliance Energy started up the EPC business to construct in-house power projects. However, this segment has now increased its exposure to external contracts in the power and infrastructure sectors. The order book as at end-February

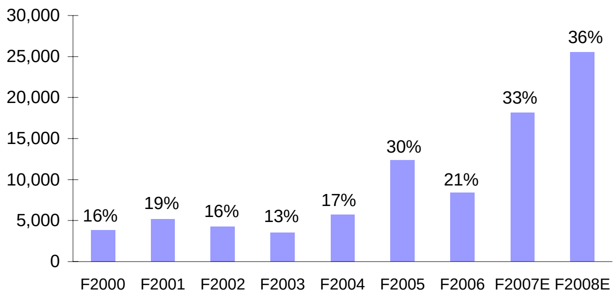
2007 was approximately Rs58 billion, executable over the next two to three years. While this segment's contribution to overall operating profit is currently about 15%, we see significant scope for upside going forward as infrastructure spending in India picks up and the company wins more EPC projects.

Exhibit 3
RELE: Breakdown of EPC Order Book (Rs mn)

Project	Original Cost of Project
BRPL - Delhi	750
BYPL - Delhi	750
UP Rural Electrification	7,347
Haryana Power Gen Co (Yamunanagar)	20,970
Hisar	37,630
UPRVUN	3,950
Total Order Book	**71,397**
Executed(April 2006-till date)	13,397
Current Order Book as at end-Feb '07	**58,000**

Source: Company data, Morgan Stanley Research

Exhibit 4
RELE: Revenue from EPC Business (Rs mn)

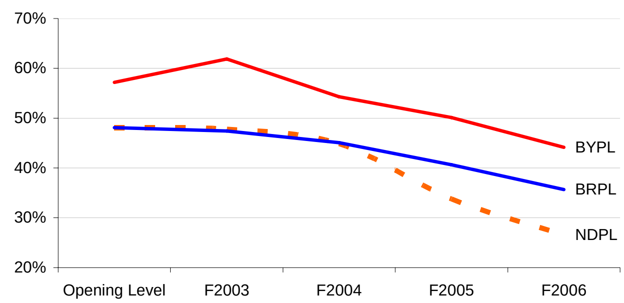


Note: Percentages represent EPC revenue as % of total revenue.
E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Experience in the Delhi Distribution Business

Tata Power and BSES (now Reliance Energy) were the two companies that were awarded the three distribution circles in Delhi in July 2002. NDPL was Tata Power's joint venture company, while BRPL and BYPL were Reliance Energy's joint venture companies operating in Delhi. While the performance of BRPL and BYPL has not been as impressive as that of NDPL, we believe Reliance Energy has gathered adequate experience to manage other distribution circles that may be privatized by the government in the future.

Exhibit 5
Delhi Distribution Business (NDPL): Movement in AT&C Losses Since Privatization



Source: GNCTD, Morgan Stanley Research

Resolution of Pending Issue on Standby Charges with Tata Power

Reliance Energy and Tata Power had been involved in a long legal battle regarding standby charges that were paid by Tata Power to MSEB for the Mumbai license area and, in turn, recovered from Reliance Energy and BEST. This issue appears to have been resolved in favour of Reliance Energy. The total compensation owed to Reliance Energy was Rs4.2 billion, of which 50% was received in F4Q07 and a bank guarantee has been issued by Tata Power for the balance.

Investment Concerns

Change in Regulations Could Impact Earnings

The Maharashtra Electricity Regulatory Commission (MERC) regulates Reliance Energy's operations in Maharashtra, while the Delhi Electricity Regulatory Commission (DERC) regulates its distribution activities in Delhi. These regulators determine the returns that the company can make on its generation, transmission and distribution businesses. Any change in the current regulations could therefore have significant implications for Reliance Energy's earnings. While we have no reason to believe that these regulatory bodies are considering any drastic changes to the regulations, investors should be aware that this risk exists.

Exhibit 6

Key MERC and DERC Regulations

MERC

- 14% post tax ROE on regulatory equity at the beginning of the year for generation business
- 14% post tax ROE on regulatory equity at the beginning of the year and on 50% of additions during the year for transmission business
- 16% post tax ROE on regulatory equity at the beginning of the year and on 50% of additions during the year for distribution business
- Incentive at Rs0.25/unit if PLF > 80%

DERC

- 16% post tax ROE on regulatory equity at the beginning of the year and on 50% of additions during the year for distribution business
- Benefits of AT&C loss reduction beyond the Government's stipulated targets would be shared equally by the distribution companies and the consumers

Source: MERC, DERC, Morgan Stanley Research

Significant Risk of Political Intervention

The Indian power sector has been plagued by significant political intervention, which has resulted in inefficiencies, high AT&C losses, resistance to tariff increases and slow development of the privatization process. For instance, the company's foray into the transmission business has stalled due to differences with the PowerGrid Corporation (PGCIL), the key government company that participates in the transmission business. Reliance Energy had been looking at a joint venture with PGCIL for the Parbati-Koldam transmission line project in Himachal Pradesh (total value of Rs8 billion) and the Western Region Strengthening Scheme (total value of Rs50 billion). There has also been political intervention in the Delhi distribution business, where the Government of Delhi has rolled back tariff increases resulting in the creation of regulatory assets. Furthermore, the privatization of the Karnataka distribution circle fell through due to a change in the state government.

We believe the power sector in India will remain vulnerable to political interference. Hence, any negative or retrograde steps taken by the government could affect financial performance and dampen investor sentiment.

Exhibit 7

Retrograde Steps Taken to Date by the Government

Roll-back of tariff increase	In Kerala, in 2002 the state government rolled back its proposed tariff hike of 75% for 2002
Karnataka	Privatisation process fell through due to a change in state government
Orissa	Exit of Reliance Energy, distribution now handled by the Appellate
Cross subsidization	Certain states offer free/subsidized power to farmers /certain segments of society. This is in turn recovered from industrial and commercial consumers
Reliance: Parbati Koldam	Disagreement with PGCIL on buy-out liability

Source: Morgan Stanley Research

Uncertainty Surrounding Planned Capacity Additions

Reliance Energy has installed capacity of 775 MW, of which 500 MW in Dahanu (Maharashtra) is for the supply of power to the Mumbai license area. The company also has plans for a number of other plants that have yet to come to fruition. These include:

- 5,600 MW gas plant at Dadri (Uttar Pradesh) – held up due to lack of fuel linkage. The company is considering converting part of the capacity into coal.
- 4,000 MW gas plant in Shahapur (Maharashtra) – held up due to pending land issue with Tata Power.
- 280 MW hydro plant in Uttranchal – DPR and financial closure process is ongoing. Construction of the project will start subsequent to the achievement of all approvals and will take about five years.
- 1,700 MW hydro plant in Arunachal Pradesh – DPR and financial closure process is ongoing. Construction of the project will start subsequent to the achievement of all approvals and will take about five years.
- 300 MW captive plant in Nagpur – land acquisition and finalization of the customer list is ongoing.

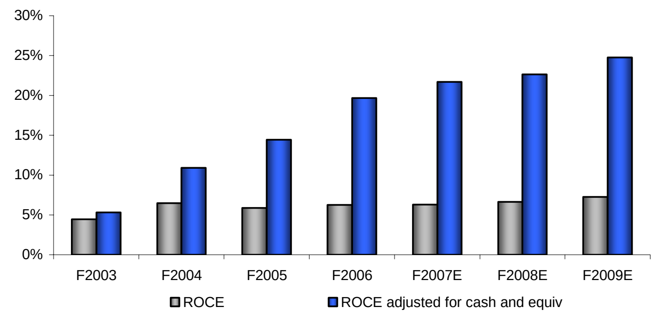
Along with the uncertainty surrounding the implementation of these projects, we believe that lack of gas linkages will be a key impediment to Reliance Energy's capacity expansion. Hence, we expect earnings progression from the generation business to be static until new capacity comes on-stream.

Reinvestment Risk in Respect of Financial Assets

Reliance Energy's total cash and cash equivalents (including inter-corporate deposits) at the end of F2006 aggregated to US$1.95 billion, representing about 71% of its total net assets. Furthermore, we expect the company to generate healthy operational cash flows going forward. To improve ROE (10% in F2006), we think the company needs to find ways to deploy these funds to earn a post-tax ROE of at least 14%; otherwise, it will need to increase its dividend payout. If the funds remain as financial assets, they will dampen ROE.

Exhibit 8

RELE: ROCE



E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Potential Dilution Due to Conversion of FCCBs

The company has issued FCCBs aggregating US$178 million at a zero coupon rate that are convertible at Rs1,010/share.

Should these FCCBs be converted into equity, they would dilute EPS by about 3%.

Acquisition of Coal Reserves Overseas

Reliance Energy has been scouting for a stake in coal mines overseas so as to ensure fuel linkage. While coal from international mines has higher calorific value, thus reducing coal consumption per unit of electricity generated, it involves high capital expenditure. In our view, captive coal mining – and that too internationally – may involve high operating expenditure and consume significant management bandwidth.

Valuation

Intrinsic Value and Price Target Methodology

Reliance Energy has a presence in various business segments, hence we use a sum-of-the-parts model to derive our price target. In valuing the stock, we consider the following:

- Supply of electricity in the Mumbai license area.
- EPC business.
- Delhi distribution business.
- Holding in the Rosa Power Project (600 MW coal plant to be commissioned in 2010).
- Potential value of financial assets (cash and cash equivalents and inter-corporate deposits).

We arrive at a target price of Rs609, the components of which are set out in Exhibit 9.

Exhibit 9
RELE: Base Case Sum-of-the-Parts Valuation

	Exhibit #	Rs/share
Generation (incl Mumbai license area)	11	213
EPC business	12	57
Delhi distribution business	14	31
Holding in Rosa	15	16
Value of Financial assets	16	292
Price Target		**609**

Source: Morgan Stanley Research estimates

We have not factored any of the following projects into our valuation due to the uncertainty surrounding their implementation:

- 5,600 MW gas plant at Dadri (Uttar Pradesh) – held up due to lack of fuel linkage.
- 4,000 MW gas plant in Shahapur (Maharashtra) – held up due to pending land issue with Tata Power.
- 1,980 MW hydro plants in Uttranchal and Arunachal Pradesh – DPR and financial closure process is ongoing.
- 300 MW captive plant in Nagpur – land acquisition and finalization of the customer list is ongoing.
- Western Region Strengthening Scheme – letter of intent has yet to be received from PowerGrid.
- Parbati Koldam transmission project – project stalled due to differences with PowerGrid.
- Possible award of a UMPP.

Mumbai License Area: We use a DCF model to value the Mumbai license area. In our view, the Mumbai license area business will continue to expand on the back of a growing consumer base (primarily residential and commercial consumers) and rising per capita consumption. We have assumed a 5% CAGR in the consumer base over F2007-12 and a 3% CAGR in consumption during the same period. The company earns regulated returns on its generation, transmission and distribution businesses, which we believe will continue into the future.

Our COE calculation and DCF model are shown in Exhibits 10 and 11, respectively. Since the net debt is assumed separately to calculate the value of financial assets, we use the cost of equity to value the Mumbai license area.

Exhibit 10
RELE: Mumbai License Area – Key Assumptions

Beta	1.03
Risk free rate	8.00%
Market premium	5.00%
Cost of equity	**13.2%**

Source: Morgan Stanley Research estimates

Exhibit 11

RELE: DCF Valuation of Generation Business (including Mumbai License Area)

	F2006	F2007E	F2008E	F2009E	F2010E	F2011E	F2012E
Revenue	31790	36644	44424	49217	52429	53876	55411
YoY growth	*10%*	*15%*	*21%*	*11%*	*7%*	*3%*	*3%*
EBIT	2733	1928	1995	3695	4993	4740	5174
Margin (%)	*8.6%*	*5.3%*	*4.5%*	*7.5%*	*9.5%*	*8.8%*	*9.3%*
Effective tax rate	6.6%	16.0%	16.0%	16.0%	20.0%	20.0%	20.0%
EBIT (1-Tax)	2552	1619	1676	3104	3994	3792	4139
Depreciation	3486	2498	2640	2783	2925	3068	3210
Capex	-3100	-1490	-1487	-1484	-1480	-1477	-1474
Change in Working Capital	-20035	-3133	-3169	-2912	-1958	-1417	-1452
Other Investments and non-cash items	2896	-1500	-2500	-1000	0	0	0
Net investment in Capital	**-16753**	**-3625**	**-4515**	**-2613**	**-514**	**174**	**284**
Free cash flow	**-14201**	**-2006**	**-2840**	**491**	**3480**	**3965**	**4423**
Compounding period			0	1	2	3	4
Discounting factor			1.00	0.88	0.78	0.69	0.61
PV of cash flows			**-2840**	**434**	**2718**	**2737**	**2698**

Forecast horizon	5,748
PV of Terminal Value	42,900
Firm value	**48,648**
Net Debt	Refer note below
Equity Value	**48,648**
# shares outstanding	228.5
Equity value/share (Rs/share)	**213**

Note: We have taken net debt separately to value the option value of financial assets, hence we have not factored it into our DCF. We use the cost of equity to arrive at the net present value.
E = Morgan Stanley Research estimates Source: Company data, Morgan Stanley Research

EPC Business: Reliance Energy's EPC business specializes in the construction of power projects. The company had a strong order book position as at end-February 2007 and we believe its experience on these projects will strengthen its chances of winning more such projects in the future. The Ministry of Power has chalked out an aggressive capacity addition plan for F2007-12, and we believe India's economic growth will continue to drive demand for electricity thereafter. This should open up additional opportunities for Reliance Energy's EPC business. Since revenues and profits from the EPC business are lumpy (given the nature of the construction business), we believe it is best to peg the value of this business to the average EV/EBITDA multiple of other construction companies such as Jaiprakash and Gammon. We think this comparison is valid, in light of the following:

- Reliance Energy's EPC business has seen reasonable levels of revenue compared with its peers over the last five years.
- Reliance Energy's EPC business has delivered EBITDA margins of 7-9%, similar to peer levels.
- Likely strong order book growth should benefit all companies across the industry.

The above factors would support the application of a peer-average EV/EBITDA multiple to Reliance Energy's EPC business. However, we apply a conservative discount of 20% to the average peer EV/EBITDA multiple when valuing this business to adjust for its smaller size, which makes it more lumpy and hence limits the visibility of future earnings. Accordingly, our target EV/EBITDA multiple for Reliance Energy's EPC business is 7.8x, which implies a value for the EPC business of Rs57/share, based on our F2008 estimates.

Exhibit 12

RELE: Valuation of EPC Business

F2008E EBITDA of EPC business	1675
Average EV/EBITDA of peer group (x)	9.8
Discount	20%
Target multiple (x)	7.8
Enterprise value for RELE (Rs mn)	13,113
Net debt	Refer note below
EPC value (Rs/share)	**57**

Note: We have taken net debt separately to value the option value of financial assets.
Based on our estimates for covered companies and IBES estimates for non-covered companies (see Exhibit 13)
Source: Morgan Stanley Research estimates

Exhibit 13

Indian Construction: Comparable Valuations

Price (in local currency)	Price (in local currency)	EV/EBITDA F06	F07E	F08E
Jaiprakash Associates(1)	571.0	10.6	14.7	11.5
Gammon India(1)	330.6	12.9	11.0	8.6
IVRCL Infrastructure (1)	288.2	12.1	8.3	5.8
Hindustan Construction*	98.6	14.8	12.3	9.2
Nagarjuna Construction*	168.5	22.7	12.9	9.3
Mean		**12.4**	**13.0**	**9.8**

(1) Adjusted for Other Businesses * IBES estimates
Note: Stock prices as at April 18, 2007
E = Morgan Stanley Research estimates, except where noted (*)
Source: Company data, Morgan Stanley Research

Delhi Distribution Business: This comprises BRPL and BYPL, in which Reliance Energy holds stakes of 51%. Reliance Energy earns a 16% ROE on the regulatory capital base of these companies. While we believe the DERC is considering a reduction in ROE to 14%, we think the distribution companies would strongly resist such a reduction. However, we have we not considered any incentives going forward, since we believe it will be hard for these companies to reduce AT&C losses below the government's stipulated levels. Accordingly, our residual income model values Reliance Energy's stakes in BRPL and BYPL at Rs31/share, assuming a cost of equity of 14% (risk free rate of 8% and expected risk premium of 6%) and terminal growth of 4%.

Exhibit 14

RELE: Valuation of Stakes in BRPL and BYPL

(Rs Mn)	F2007E	F2008E	F2009E
BRPL	6,811	7,492	8,241
BYPL	2,269	2,496	2,746
Total book value	**9,080**	**10,533**	**12,218**
ROE	16%	16%	16%
Beginning book		10,533	
Forecast period		263	
Terminal Value (growth = 4%)		2,993	
Equity value		**13,789**	
Value per share(Rs/share)		60	
Value for RELE (51% holding)		**31**	

Source: Morgan Stanley Research estimates

Holding in Rosa Power: The Rosa plant is a 600 MW coal-fired plant that will supply electricity to the Uttar Pradesh Power Corporation at Rs2.69/unit. We understand that the project is likely to be operated by the company's 50% subsidiary, Reliance Energy Generation Limited. The construction of this project commenced in January 2007 and will be completed in the next 33-36 months at a total estimated cost of Rs27.5 billion, according to management. The equipment sourcing and EPC contract has been awarded to Shanghai Electric. Our residual income model values the Rosa project at Rs16/share, assuming a discount rate of 13% (risk-free rate of 8% and expected risk premium of 5%) and terminal growth of 5%.

Exhibit 15

RELE: Valuation of Holding in Rosa

Size (MW) #	600
Cost of project (Rs mn) #	27,500
Assumed equity mix	30%
Equity component (Rs mn)	8,250
RELE's holding #	50%
RELE's equity stake in the project (Rs mn)	4,125
Assumed ROE	14%
COE	13.0%
Assumed terminal growth rate	5%
Intrinsic Value based on RI model (Rs mn)	4,641
Derived P/B on the RI model	1.1
Value per share (Rs/share)	20
Years to commissioning (1 year forward)	2
Present value for RELE (Rs/share)	**16**

Data from company
Note: Assumed capital is in line with normal practice for power projects.
Source: Morgan Stanley Research estimates, except where noted

Option Value of Financial Assets: Reliance Energy had cash and cash equivalents (including inter-corporate deposits) aggregating US$1.95 billion at the end of F2006. These represented 71% of total net assets of the company. While the company has not been able to successfully deploy this surplus cash in projects that may yield it returns in the range of 14-18%, we consider it necessary to attribute a value to this surplus in the belief that the company will invest all or part of it in future projects. We expect additional opportunities to arise, given the potential in the industry, the government's thrust to increase generation capacity and the company's desire to aggressively participate in the industry. We have used a residual income model to determine an option value for the company's financial assets of Rs292/share, assuming that 75% of these assets are re-invested to earn an 18% ROE while the balance earns a 10% return. We believe the market's view on this option value will be the key trigger for the stock going forward.

Exhibit 16

RELE: Valuation of Financial Assets

Total financial assets (Rs mn)	93,549
Total debt (Rs mn)	42,669
Net financial assets (Rs mn)	50,879
Assumed ROE	16%
COE	13.2%
Assumed terminal growth rate	4%
Intrinsic value based on the RI model (Rs mn)	66,727
Implied P/B	1.3
Value per share (Rs/share)	**292**

Note: We assume the company re-invests 75% of its financial assets to earn an 18% ROE while the balance earns a 10% return.
Source: Morgan Stanley Research estimates

The potential value of financial assets is extremely sensitive to our ROE and the terminal growth rate assumptions. We have presented a sensitivity analysis in Exhibit 17.

Exhibit 17

RELE: Sensitivity of Financial Assets Valuation

Rs/share			**ROE**		
Terminal Growth Rate	**12%**	**14%**	**16%**	**18%**	**20%**
0%	203	237	271	305	339
1%	202	238	275	312	348
2%	200	240	280	319	359
3%	197	241	285	329	373
4%	195	243	**292**	341	389
5%	191	246	300	355	410
6%	187	249	311	374	436

Source: Morgan Stanley Research estimates

Risks to Our Target Price

The key upside risks to our target price are:

- A greater-than-expected increase in generation capacity, which could include UMPPs and other projects such as the Dadri and Shahapur projects.
- Stronger-than-expected growth in the EPC order book, driven by both internal and external power projects.
- Better-than-expected utilization of the cash surplus or a larger-than-expected dividend payout.

The key downside risks to our target price are:

- A significant change in regulations that could negatively impact the company's business in Mumbai and Delhi.
- Continued lack of clarity on the deployment of the cash surplus, in turn depressing ROE.
- Slow growth in the EPC order book and/or compression of operating margins.
- Significant political intervention.

Relative Valuations

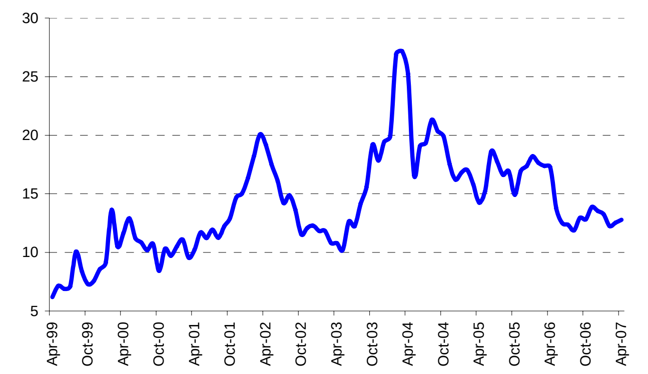
Reliance Energy is trading at 12.8x our 12-month forward earnings estimate, implying a 20% discount to the BSE Sensex. Reliance Energy has historically traded at a 17% premium to the Sensex and we believe a contraction in this premium has been due largely to the following factors:

- Uncertainty surrounding capacity addition plans.
- Lackluster performance in the Delhi distribution business.
- Negative experience in the Orissa distribution business.
- Delays in receiving award from PGCIL for the two transmission projects.

We believe these negatives have been priced in at current levels, while the market appears to be valuing the company's cash surplus at book with no premium attached for potential value-accretive opportunities.

Exhibit 18

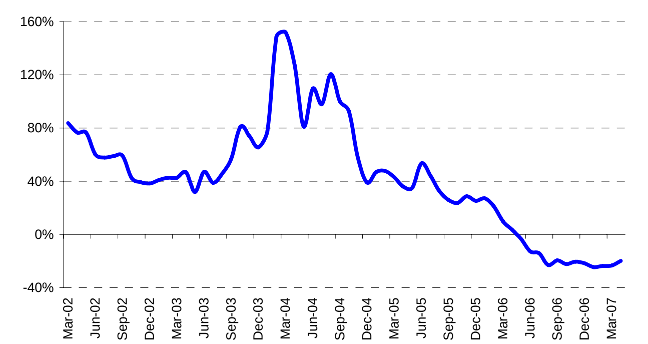
RELE: 12-Month Forward P/E



Source: Bloomberg, Morgan Stanley Research

Exhibit 19

RELE: Forward P/E: Premium/Discount to Sensex



Source: Bloomberg, Morgan Stanley Research

Bull Case Scenario

In this scenario, our valuations of Reliance Energy's Delhi distribution business and Rosa holding remain in line with our base case. However, we make aggressive assumptions on the Mumbai distribution business, deployment of surplus cash and valuation of the EPC business on the basis that significant opportunities arise for the company in the future. Our key bull-case assumptions are as follows:

- We assume a 6% CAGR in the consumer base over F2007-12 and a 6% CAGR in consumption during the same period. The value of the generation business (including the Mumbai license area) increases to Rs 291/share.

- The entire financial assets are re-invested at an 18% ROE as significant opportunities arise in the generation, transmission and distribution businesses. However, the terminal growth rate remains at 4%.

- We assume EBITDA margin expansion in the EPC business from 7% (base case scenario) to 10% on the back of greater efficiencies. We continue to use the target EV/EBITDA multiple of 7.8x (as in the base case) and value the EPC business at Rs 87/share.

Exhibit 20

RELE: Bull Case – Sum-of-the-Parts Valuation

	Rs/share
Generation (incl Mumbai license area)	291
EPC business	87
Delhi distribution business	31
Holding in Rosa	16
Value of Financial assets	341
Bull Case	**766**

Source: Morgan Stanley Research estimates

Bear Case Scenario

Our valuation of Reliance Energy's Rosa holding remains in line with our base case, but we assume that a slow pace of reform reduces visibility on the growth outlook in other areas. Our key bear-case assumptions are as follows:

- We assume a 2% CAGR in the consumer base over F2007-12 and a 2% CAGR in consumption during the same period. The value of the generation business (including the Mumbai license area) moves down to Rs175/share.

- We assume margins contract in the EPC business from 7% (base case scenario) to 5% due to competition and greater cost pressures. We value the EPC business at Rs44/share using our target EV/EBITDA multiple of 7.8x.

- ROE for the Delhi distribution business falls from 16% to 14%, in line with the change being considered by the DERC.

- We value the financial assets at book, as opportunities to deploy these assets turn out to be more limited than we expect.

Exhibit 21

RELE: Bear Case – Sum-of-the-Parts Valuation

	Rs/share
Generation (incl Mumbai license area)	175
EPC business	44
Delhi distribution business	25
Holding in Rosa	16
Value of Financial assets	223
Bear Case	**483**

Source: Morgan Stanley Research estimates

Exhibit 22

Global Valuation Comparables: P/E Multiples

Name	Currency	Month Reported	Stock Price * (Local Currency)	M Cap (US$mn)	EPS (Local Currency) Dec 05/Mar 06	EPS Dec 06/Mar 07E	EPS Dec 07E/Mar 08E	P/E Dec 05/Mar 06	P/E Dec 06/Mar 07E	P/E Dec 07E/Mar 08E	EPS CAGR
Asia-Pacific Companies											
Cheung Kong Infra.	HKD	Dec	28.1	8,108	1.76	1.59	1.98	16.0	17.7	14.2	6%
China Resources Power	HKD	Dec	13.5	6,580	0.49	0.62	0.70	27.5	21.7	19.2	20%
CLP Holdings	HKD	Dec	57.2	17,616	3.89	3.95	4.24	14.7	14.5	13.5	4%
Datang Int'l Power	CNY	Dec	9.3	6,396	0.44	0.49	0.60	21.3	19.0	15.5	17%
Hongkong Electric	HKD	Dec	42	11,378	3	3	3	12.7	13.0	12.4	1%
Huadian Power Int'l	CNY	Dec	3.4	2,628	0.18	0.20	0.20	19.3	17.1	17.4	5%
Huaneng Power	CNY	Dec	7.6	11,788	0.40	0.43	0.44	18.9	17.9	17.2	5%
Korea Electric Power	KRW	Dec	38,400	26,460	3,654	3,617	3,444	10.5	10.6	11.2	-3%
Shenergy	CNY	Dec	14	4,957	0.50	0.52	0.60	28.7	27.2	23.7	10%
Yangtze Power	CNY	Dec	13.4	14,186	0.41	0.43	0.50	32.8	30.9	26.7	11%
Tokyo Electric Power	JPY	Mar	4,060	46,260	180	214	200	22.5	18.9	20.3	5%
Malakoff Berhad	MYR	Aug	10	2,681	0.49	0.84	1.07	20.8	12.2	9.6	47%
Tenaga Nasional Bhd	MYR	Aug	12.0	14,429	0.35	0.53	0.85	34.3	22.9	14.1	56%
European Companies											
Drax	GBP	Dec	809	5,972	18.5	92.0	102.3	43.8	8.8	7.9	135%
E.ON	EUR	Dec	107.1	96,017	5.26	10.42	7.09	20.3	10.3	15.1	16%
EDF	EUR	Dec	62.2	154,259	1.99	2.50	2.95	31.3	24.9	21.1	22%
ENDESA	EUR	Dec	40.3	58,097	2.09	2.40	2.20	19.3	16.8	18.4	2%
ENEL	EUR	Dec	8	70,502	0.63	0.49	0.64	13.3	17.1	13.1	1%
RWE AG	EUR	Dec	79.5	60,818	4.41	5.20	5.66	18.0	15.3	14.1	13%
Suez	EUR	Dec	41	70,422	1.80	1.81	2.22	22.7	22.5	18.4	11%
Scottish & Southern	GBP	Mar	1,530	26,348	89.4	95.8	95.0	17.1	16.0	16.1	3%
American Companies											
Consolidated Edison	USD	Dec	51.9	13,477	2.95	2.95	3.15	17.6	17.6	16.5	3%
Dominion	USD	Dec	89.1	31,525	4.53	5.70	6.02	19.7	15.6	14.8	15%
TXU Corp	USD	Dec	64.7	30,378	3.32	5.56	5.44	19.5	8.3	6.1	28%
India Companies											
Lanco Infratech Ltd	INR	Mar	145.7	802	NA	7.80	10.54	NA	18.7	13.8	NA
NTPC	INR	Mar	160.0	31,918	6.86	8.07	8.88	23.3	19.8	18.0	14%
Reliance Energy	INR	Mar	511.1	2,786	33.88	34.03	38.14	15.1	15.0	13.4	6%
Tata Power	INR	Mar	546.3	2,540	26.05	28.05	30.74	21.0	19.5	17.8	9%

Notes:
* : Stock Prices for India and Asia Pacific Companies are as of 20 April, 2007; prices for European and American companies are as of 19 April, 2007.
NA = Not Available; Lanco was listed in Nov 2006 and hence per share data not comparable
E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 23

Global Valuation Comparables: P/B and EV/EBITDA Multiples

Name	Currency	Month Reported	Stock Price * (Local Currency)	M Cap (US$mn)	Rev. (US$mn) Dec 05/Mar 06	P/B Dec 05/Mar 06	P/B Dec 06/Mar 07E	P/B Dec 07E/Mar 08E	EV/EBITDA Dec 05/Mar 06	EV/EBITDA Dec 06/Mar 07E	EV/EBITDA Dec 07E/Mar 08E
Asia-Pacific Companies											
Cheung Kong Infra.	HKD	Dec	28.10	8,108	290	1.7	1.9	1.8	11.1	16.7	12.9
China Resources Power	HKD	Dec	13.5	6,580	764	1.3	2.9	3.0	8.1	14.2	11.8
CLP Holdings	HKD	Dec	57.2	17,616	5,044	2.2	2.5	2.3	9.4	11.2	10.5
Datang Int'l Power	CNY	Dec	9.3	6,396	2,230	1.7	2.5	2.3	9.8	10.5	7.9
Hongkong Electric	HKD	Dec	41.7	11,378	1,499	2.0	1.9	1.8	8.9	9.3	8.6
Huadian Power Int'l	CNY	Dec	3.4	2,628	1,648	1.0	1.4	1.4	8.4	12.7	11.6
Huaneng Power	CNY	Dec	7.6	11,788	4,967	1.6	2.2	2.0	8.0	9.6	8.7
Korea Electric Power	KRW	Dec	38,400	26,460	24,587	0.6	0.6	0.5	5.6	5.7	5.4
Shenergy	CNY	Dec	14	4,957	987	1.5	3.5	3.2	5.8	12.2	11.9
Yangtze Power	CNY	Dec	13.4	14,186	900	2.5	4.4	4.0	10.8	18.1	15.2
Tokyo Electric Power	JPY	Mar	4,060.0	46,260	45,055	1.8	1.7	1.6	8.9	8.1	8.3
Malakoff Berhad	MYR	Aug	10.20	2,681	523	2.4	2.2	1.9	13.1	9.1	7.5
Tenaga Nasional Bhd	MYR	Aug	12.00	14,429	5,539	1.9	2.2	2.0	9.3	8.6	7.9
European Companies											
Drax	GBP	Dec	809	5,972	1,451	9.0	13.1	13.0	10.9	5.9	6.3
E.ON	EUR	Dec	107.1	96,017	66,471	1.3	1.4	1.4	6.2	6.2	6.2
EDF	EUR	Dec	62.2	154,259	60,445	2.7	4.5	4.1	8.0	10.2	9.5
ENDESA	EUR	Dec	40.33	58,097	21,583	1.8	3.0	2.8	7.0	9.1	8.9
ENEL	EUR	Dec	8.4	70,502	40,326	2.1	2.6	2.7	6.6	7.4	8.0
RWE AG	EUR	Dec	79.5	60,818	54,240	3.1	3.5	3.1	9.3	8.0	6.8
Suez	EUR	Dec	41	70,422	50,257	1.3	1.8	1.7	7.6	9.3	8.4
Scottish & Southern	GBP	Mar	1,530	26,348	20,493	4.9	4.3	4.0	11.1	10.4	10.3
American Companies											
Consolidated Edison	USD	Dec	51.9	13,477	10,504	1.8	1.8	1.8	9.1	9.4	9.9
Dominion	USD	Dec	89.1	31,525	18,041	2.8	2.5	1.5	10.3	9.2	6.0
TXU Corp	USD	Dec	64.7	30,378	10,437	50.8	15.4	13.0	9.3	7.5	7.5
India Companies											
Lanco Infratech Ltd	INR	Mar	145.7	802	201	0.8	2.1	1.7	4.6	11.3	13.0
NTPC	INR	Mar	160.0	31,918	6,188	3.0	2.7	2.5	19.8	18.1	16.6
Reliance Energy	INR	Mar	511.1	2,786	960	1.4	1.3	1.2	8.5	12.5	9.8
Tata Power	INR	Mar	546.3	2,540	1,086	2.1	2.0	1.9	13.2	13.6	12.6

Notes:
* : Stock Prices for India and Asia Pacific Companies are as of 20 April, 2007; prices for European and American companies are as of 19 April, 2007.
E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Earnings Drivers

Capacity Additions

Reliance Energy's total generation capacity of 775 MW comprises the following:

- 500 MW Dahanu thermal plant that supplies its total generation to the Mumbai license area.
- 220 MW gas plant at Samalkot (Andhra Pradesh).
- 48 MW combined cycle plant at Goa.
- 7.59 MW of wind generation capacity at Chitradurga

In addition to the above, the company's 100% subsidiary BSES Kerala owns 165 MW of capacity. Further capacity that the company will be adding includes a 600 MW coal-based plant in Uttar Pradesh and 150 MW of wind capacity that will be added over a period of time. Both assets will be owned by SPVs in which Reliance Energy will hold a 50% stake.

The company also has plans for a number of other plants that have yet to come to fruition. These include:

- 5,600 MW gas plant at Dadri (Uttar Pradesh) – held up due to lack of fuel linkage. The company is considering converting part of the capacity into coal.
- 4,000 MW gas plant in Shahapur (Maharashtra) – held up due to pending land issue with Tata Power.
- 280 MW hydro plant in Uttranchal – DPR and financial closure process is ongoing. Construction of the project will start subsequent to the achievement of all approvals and will take about five years.
- 1,700 MW hydro plant in Arunachal Pradesh – DPR and financial closure process is ongoing. Construction of the project will start subsequent to the achievement of all approvals and will take about five years.
- 300 MW captive plant in Nagpur – land acquisition and finalization of the customer list is ongoing.

Along with the uncertainty surrounding the implementation of these projects, we believe that lack of gas linkages will be a key impediment to Reliance Energy's capacity expansion. Hence, we expect earnings progression from the generation business to be static until new capacity comes on-stream.

Mumbai License Area

Reliance Energy had a total consumer base of 2.56 million in Mumbai at the end of December 2006. Residential consumers comprise about 85% of this total, followed by commercial consumers (14%) and industrial consumers (1%). Reliance Energy supplied 6,895 million units of electricity in the Mumbai license area during F2006 at a tariff of Rs3.78/unit. While the Dahanu plant supplied 3,995 million units, it purchased the balance from Tata Power.

Reliance Energy's consumer base grew at a 4% CAGR between F2001 and F2006, and we believe this growth will continue due to increasing numbers of residential and commercial consumers. Along with the expansion in the consumer base, we believe consumption will also increase as income levels rise, driving significant growth in the total energy requirement of the Mumbai license area. We forecast growth of 8% in total units supplied, plus tariff growth of nearly 10% over F2007-09. Accordingly, we expect revenues in the Mumbai license area to grow by 19% during this period.

Exhibit 24

RELE: Mumbai License Area – Customer Base

	F2004	F2005	F2006	F2007E	F2008E	F2009E
Residential Base (Mn)	1.97	2.04	2.13	2.23	2.34	2.46
y-o-y		3.6%	4.2%	5.0%	5.0%	5.0%
Tariff (Rs/Unit)	2.72	2.41	2.41	2.60	2.99	3.14
Industrial Base (Mn)	0.05	0.03	0.03	0.03	0.03	0.03
y-o-y		-40.0%	-6.7%	2.0%	2.0%	2.0%
Tariff (Rs/Unit)	4.60	4.60	4.60	4.97	5.71	6.17
Commercial Base (Mn)	0.30	0.31	0.34	0.35	0.37	0.38
y-o-y		3.3%	9.7%	4.0%	4.0%	4.0%
Tariff (Rs/Unit)	5.41	5.38	5.85	6.32	7.26	7.63
Total	2.32	2.38	2.49	2.61	2.74	2.87
y-o-y		2.6%	4.7%	4.8%	4.8%	4.8%
Avg Tariff (Rs/Unit)	3.84	3.63	3.78	4.07	4.66	4.90

E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

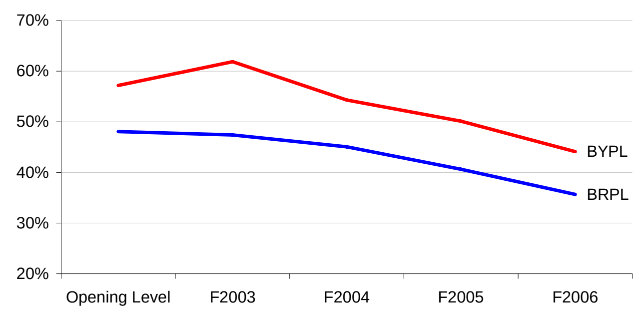
Delhi Distribution Business

BRPL and BYPL are the two distribution companies in Delhi in which Reliance Energy has a 51% stake. Both these companies have been operating in Delhi since distribution was privatized in June 2002 and have been successful in reducing AT&C losses. However, since these companies have not managed to reduce the losses below the minimum level set by the Delhi government, they have not earned any incentives.

These companies have earned only the stipulated 16% ROE on the regulatory capital base. While we do not consolidate the results of BRPL and BYPL, we assume that these companies will continue to earn a 16% ROE, although we note that the DERC is contemplating a reduction to 14%. We do not think such a reduction is likely as we believe it would meet strong resistance from the distribution companies.

Exhibit 25

RELE: Movement in AT&C Losses in Delhi



Source: Company data, Morgan Stanley Research

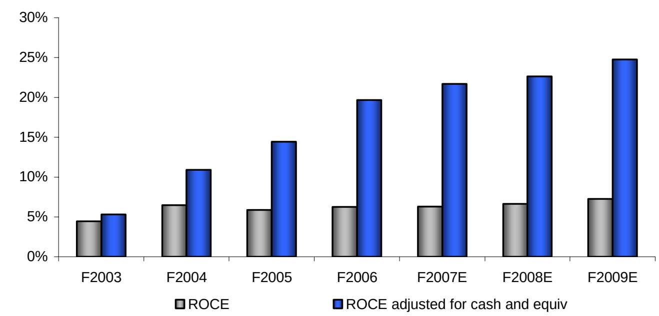
Financial Assets

Reliance Energy had cash and cash equivalents (including inter-corporate deposits) aggregating US$1.95 billion at the end of F2006. We believe the company should be able to create value by selectively deploying its financial assets in the following ways:

- Increase its generation capacity (earn a 14% post tax ROE on the regulatory capital base, plus incentives).
- Participate in privatized transmission projects (earn a 14% post tax ROE on the regulatory capital base).
- Participate in privatized distribution projects (earn a 16% post tax ROE on the regulatory capital base, plus incentives).
- Increase participation in EPC contracts.

Exhibit 26

RELE: ROCE



E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

EPC Business

The company's EPC segment specializes in the construction of power projects. The company had an order book of Rs58 billion as at end-February 2007, which should be executable by June 2008. We believe the EPC business has significant potential going forward, as several power projects are slated for construction in accordance with the government's XIth five-year plan. We expect the Yamunanagar and Hisar projects to start generating substantial revenues in F2007 and F2008, such that the contribution to revenues of the power business will start increasing. Moreover, since these projects are accounted for on a percentage of completion basis, margins tend to be lumpy. With work on most of the large projects having started in F2007, operating margins remain low at present – but they should start to move up once more than 30% of the project work is completed.

Exhibit 27

RELE: Breakdown of EPC Order Book (Rs mn)

Project	Original Cost of Project
BRPL - Delhi	750
BYPL - Delhi	750
UP Rural Electrification	7,347
Haryana Power Gen Co (Yamunanagar)	20,970
Hisar	37,630
UPRVUN	3,950
Total Order Book	**71,397**
Executed(April 2006-till date)	13,397
Current Order Book as at end-Feb '07	**58,000**

Source: Company data, Morgan Stanley Research

Exhibit 28

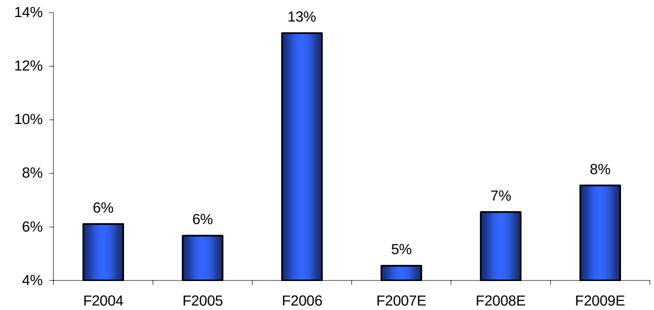
RELE: Segmental Split of Total Revenue (Rs mn)

	F2006	F2007E	F2008E	F2009E
Power Segment Rev.	31790	36644	44424	49217
% of Total Revenue	79%	67%	63%	73%
EPC Revenue	8,400	18,129	25,538	18,000
% of Total Revenue	21%	33%	36%	27%
Other Revenue	144	57	57	57
% of Total Revenue	0.4%	0.1%	0.1%	0.1%
Total Revenue	40,335	54,830	70,018	67,274

E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 29

RELE: EPC EBITDA Margin



E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 30

Reliance Energy: Detailed Income Statement

	F2001	F2002	F2003	F2004	F2005	F2006	F2007E	F2008E	F2009E
Revenue from power supply	**21,762**	**22,371**	**24,412**	**28,301**	**28,997**	**31,874**	**36,741**	**44,541**	**49,346**
Less: Cash Discount	(24)	26	33	92	98	84	96	117	129
Less: Withdrawal of bill	-	14	1,346	-	-	-	-	-	-
Net revenue from power supply	**21,738**	**22,331**	**23,033**	**28,210**	**28,899**	**31,790**	**36,644**	**44,424**	**49,217**
EPC Income	**5,126**	**4,269**	**3,529**	**5,737**	**12,347**	**8,400**	**18,129**	**25,538**	**18,000**
Liabilities Written Back	-	-	12	16	13	33	-	-	-
Lease Rental	-	-	2	2	2	2	2	2	2
Others	37	54	144	31	41	92	50	50	50
Sale of Elastimold	46	45	39	72	36	18	5	5	5
Other Revenues Total	**83**	**99**	**196**	**120**	**92**	**144**	**57**	**57**	**57**
Total revenue	**26,947**	**26,699**	**26,758**	**34,067**	**41,337**	**40,335**	**54,830**	**70,018**	**67,274**
Growth (%)	15.2%	-0.9%	0.2%	27.3%	21.3%	-2.4%	35.9%	27.7%	-3.9%
EXPENSES									
Power purchase cost	10,054	9,918	11,329	10,337	10,041	10,876	15,451	21,129	22,921
Units purchased	-	2,979	3,241	3,072	3,352	3,921	4,642	5,520	5,988
Cost per unit	0	3.3	3.5	3.4	3.0	2.8	3.3	3.8	3.8
Fuel cost	3,936	4,222	4,299	6,738	7,363	8,121	9,041	9,662	9,841
Dahanu - Coal	0	0	0	0	4,641	5,094	5,663	5,945	6,063
Samalkot - Gas	0	0	0	0	979	969	1,114	1,226	1,287
Goa - Naptha	0	0	0	0	1,742	2,058	2,264	2,491	2,491
Tax on sale of electricity	154	426	372	474	991	1,140	1,326	1,642	1,865
Repairs and maintenance	570	785	1,098	1,188	1,209	1,880	2,219	2,441	2,685
Employee cost	1,110	757	641	1,475	1,836	1,857	2,227	2,473	2,720
Employee nos	5,281	5,196	5,178	-	5,281	5,172	5,272	5,272	5,272
Cost per employee	0	145	124	285	348	355	426	469	516
Provision for doubtful debts/bad debts	59	271	291	270	336	0	0	0	0
Provision for disputed matters	0	950	350	900	0	0	0	0	0
Foreign currency liability	238	0	0	0	0	0	0	0	0
Other operating expenses	674	671	803	875	1,294	1,696	1,955	2,443	2,707
Total EPC expenses	4,954	3,896	3,515	5,386	11,646	7,288	17,303	23,863	16,640
TOTAL OPERATING EXPENSES	**21,749**	**21,894**	**22,698**	**27,644**	**34,715**	**32,859**	**49,522**	**63,652**	**59,380**
% of total revenue	81%	82%	85%	81%	84%	81%	90%	91%	88%
EBITDA	**5,198**	**4,805**	**4,060**	**6,423**	**6,623**	**7,476**	**5,308**	**6,366**	**7,894**
EBITDA margin (%)	19%	18%	15%	19%	16%	19%	10%	9%	12%
Total depreciation	1,968	2,251	2,598	3,187	3,464	3,486	2,498	2,640	2,783
EBIT	**3,230**	**2,555**	**1,462**	**3,236**	**3,158**	**3,989**	**2,810**	**3,726**	**5,112**
Interest cost	553	657	764	699	1,348	1,919	2,347	2,368	2,389
% of debt	7%	10%	12%	5%	5%	5%	6%	6%	6%
Interest income	486	426	338	646	2,775	4,799	8,611	8,846	9,122
Swap income	-	-	-	-	461	243	243	243	243
Forex fluctuation	-	316	-	-	-	279	-	-	-
Misc income	244	280	388	814	687	238	262	288	331
Total other income	**731**	**1,022**	**726**	**1,459**	**3,923**	**5,559**	**9,116**	**9,377**	**9,696**
Growth (%)	-4%	40%	-29%	101%	169%	42%	64%	3%	3%
PBT	**3,408**	**2,920**	**1,424**	**3,995**	**5,732**	**7,630**	**9,580**	**10,735**	**12,418**
Tax	290	211	(97)	503	495	506	1,533	1,718	1,987
PAT - standalone	**3,117**	**2,709**	**1,521**	**3,493**	**5,237**	**7,124**	**8,047**	**9,018**	**10,431**
Total Extraordinary items	(163)	342	(302)	249	(35)	(621)	1,386	-	-
Reported profits - standalone	**2,954**	**3,051**	**1,219**	**3,741**	**5,203**	**6,503**	**9,433**	**9,018**	**10,431**

E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 31

Reliance Energy: Detailed Balance Sheet

	F2001	F2002	F2003	F2004	F2005	F2006	F2007E	F2008E	F2009E
Share capital	**2,008**	**1,378**	**1,378**	**1,753**	**1,856**	**2,124**	**2,285**	**2,285**	**2,285**
Share warrants	**0**	**0**	**0**	**0**	**5,680**	**882**	**0**	**0**	**0**
CRR	1,087	1,143	1,143	1,143	1,143	1,143	1,143	1,143	1,143
Share Premium	7,957	7,966	7,752	23,261	29,340	44,317	45,184	45,184	45,184
Revaluation reserve	0	0	0	7,522	7,522	7,522	7,522	7,522	7,522
General Reserve	8,500	9,000	7,912	9,224	10,896	14,987	22,974	30,284	39,007
P/L	1,144	862	938	1,226	2,003	2,759	2,759	2,759	2,759
Other reserves	5,064	6,429	6,512	6,982	4,958	4,998	4,998	4,998	4,998
Total reserves	**23,753**	**25,400**	**24,257**	**49,357**	**55,863**	**75,727**	**84,582**	**91,891**	**100,614**
Secured loans	6,344	5,381	600	6,850	7,850	19,198	19,198	19,198	19,198
Unsecured loan	600	1,225	5,719	13,458	29,537	23,471	23,471	23,471	23,471
Total debt	**6,944**	**6,606**	**6,319**	**20,308**	**37,387**	**42,669**	**42,669**	**42,669**	**42,669**
Deferred tax liability	0	734	1,779	2,366	2,606	2,041	2,041	2,041	2,041
Service line deposit from consumers	164	168	144	177	221	235	235	235	235
Total liabilities	**32,870**	**34,286**	**33,877**	**73,961**	**103,612**	**123,678**	**131,812**	**139,122**	**147,845**
Gross block	30,111	31,181	32,660	50,112	51,730	54,706	57,206	59,706	62,206
Accumulated depreciation	10,404	12,506	15,054	20,018	24,529	28,146	31,653	35,306	39,105
Net block	**19,707**	**18,675**	**17,607**	**30,094**	**27,201**	**26,561**	**25,553**	**24,400**	**23,101**
CWIP	**1,095**	**837**	**549**	**838**	**1,922**	**2,177**	**2,177**	**2,177**	**2,177**
Investments	**3,738**	**4,875**	**8,715**	**5,494**	**4,789**	**1,893**	**3,393**	**5,893**	**6,893**
BRPL	0	0	1,197	1,197	1,197	1,197	1,197	1,197	1,197
BYPL	0	0	303	303	303	303	303	303	303
Sonata Investments	0	0	0	0	230	230	230	230	230
Reliance Infrastructure Ltd	0	150	4,703	3,023	3,023	103	103	103	103
Other investments	3,738	4,725	2,512	971	37	61	1,561	4,061	5,061
Inventory	1,153	1,139	767	1,042	3,531	2,951	3,270	3,564	3,716
Sundry debtors	8,733	8,510	5,742	4,661	9,310	10,928	12,733	16,705	18,370
Cash and equiv	4,376	2,535	2,103	31,858	62,627	66,563	71,309	74,366	80,476
Advances recoverable	1,594	1,923	2,272	4,616	5,943	7,345	8,814	9,695	10,665
Advance tax	2,613	1,401	1,731	1,001	1,186	2,970	4,503	6,220	8,207
Deposits	1,041	2,505	3,844	6,063	4,478	21,181	22,240	23,352	24,520
EPC contract+retention	885	914	3,082	1,466	1,146	1,737	1,737	1,737	1,737
Other current assets	242	922	976	1,015	357	1,514	1,514	1,514	1,514
Sundry creditors	6,339	3,760	3,400	5,125	7,391	6,621	8,071	11,088	12,054
Deposits from customers	1,015	1,532	2,556	2,453	1,485	3,706	3,706	3,706	3,706
Contracts in progress	489	0	1,299	1,177	4,612	3,987	3,987	3,987	3,987
Other liabilities	1,413	1,410	1,828	1,378	1,294	1,394	1,464	1,537	1,614
Provision for tax	2,428	1,561	2,262	1,342	1,264	2,922	4,454	6,172	8,159
Proposed dividend	621	592	684	312	296	920	1,157	1,420	1,420
Provision for disputed matter	0	950	1,300	2,200	2,200	2,200	2,200	2,200	2,200
Provision for leave encashment	0	142	182	199	336	390	390	390	390
Net current assets	**8,331**	**9,900**	**7,007**	**37,535**	**69,700**	**93,048**	**100,689**	**106,652**	**115,674**
Total assets	**32,870**	**34,286**	**33,877**	**73,961**	**103,612**	**123,678**	**131,812**	**139,122**	**147,845**

E = Morgan Stanley Research estimates
Source: Company data, Morgan Stanley Research

Exhibit 32

Reliance Energy: Detailed Cash Flow Statement

	F2001	F2002	F2003	F2004	F2005	F2006	F2007E	F2008E	F2009E
PAT	**2,954**	**3,051**	**1,219**	**3,741**	**5,203**	**6,503**	**9,433**	**9,018**	**10,431**
Depreciation	1,968	2,251	2,598	3,187	3,464	3,486	2,498	2,640	2,783
Interest	553	657	764	699	1,348	1,919	2,347	2,368	2,389
(Inc)/dec in stock	312	13	372	-275	-2,489	580	-320	-294	-152
(Inc)/dec in debtors	-1,911	223	2,768	1,081	-4,649	-1,618	-1,805	-3,972	-1,665
(Inc)/dec in Advances recoverable	-882	883	-679	-1,613	-1,513	-3,185	-3,002	-2,599	-2,956
(Inc)/dec in deposits	-815	-1,493	-3,508	-603	1,906	-17,294	-1,059	-1,112	-1,168
(Inc)/dec in other items	-23	-679	-54	-40	658	-1,157	0	0	0
Inc/(dec) in creditors	2,323	-2,579	-361	1,726	2,266	-770	1,451	3,017	966
Inc/(dec) in deposits	-925	28	2,323	-225	2,466	1,597	0	0	0
Inc/(dec) in other liabilities	289	-3	418	-450	-84	100	70	73	77
Inc/(dec) in provisions	324	225	1,091	-3	59	1,712	1,533	1,718	1,987
Changes in working capital	-1,309	-3,382	2,370	-401	-1,381	-20,035	-3,133	-3,169	-2,912
Cash flow from operations	**4,167**	**2,577**	**6,950**	**7,227**	**8,635**	**-8,127**	**11,145**	**10,857**	**12,691**
Capex	-1,693	-960	-1,243	-15,963	-1,655	-3,100	-1,490	-1,487	-1,484
Purchase of investments	-610	-1,137	-3,840	3,221	704	2,896	-1,500	-2,500	-1,000
Cash flow from investing activities	**-2,303**	**-2,097**	**-5,083**	**-12,742**	**-951**	**-204**	**-2,990**	**-3,987**	**-2,484**
Equity issuance	-232	-622	-214	15,884	11,863	10,447	146	0	0
Loan proceeds	-928	-339	-286	13,989	17,078	5,283	0	0	0
Dividend	566	623	592	1,167	1,007	585	1,209	1,445	1,708
Interest	553	657	764	699	1,348	1,919	2,347	2,368	2,389
Others	-16	-80	-444	7,265	-3,502	-958	0	0	0
Cash flow from financing activities	**-2,295**	**-2,321**	**-2,300**	**35,271**	**23,085**	**12,268**	**-3,409**	**-3,814**	**-4,098**
Net change in cash	-432	-1,842	-432	29,756	30,768	3,937	4,746	3,057	6,110
Opening cash and equiv	4,808	4,376	2,535	2,103	31,858	62,627	66,563	71,309	74,366
Closing cash and equiv	4,376	2,535	2,103	31,858	62,627	66,563	71,309	74,366	80,476

E = Morgan Stanley Research estimates   Source: Company data, Morgan Stanley Research

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of March 31, 2007)

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	Coverage Universe		Investment Banking Clients (IBC)		
Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**843**	**38%**	**292**	**44%**	**35%**
Equal-weight/Hold	**991**	**45%**	**284**	**42%**	**28%**
Underweight/Sell	**364**	**17%**	**95**	**14%**	**26%**
Total	**2,198**		**671**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Equal-weight (E or Equal) - The stock's total return is expected to be in line with the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

Underweight (U or Under) - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V) - We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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Industry Coverage:India Utilities

Company (Ticker)	Rating (as of)	Price (04/20/2007)
Parag Gupta		
LANCO Infratech Ltd (LAIN.BO)	E-V (04/23/2007)	Rs145.70
NTPC (NTPC.BO)	E (04/23/2007)	Rs160
Reliance Energy (RLEN.BO)	O (04/23/2007)	Rs511.05
Tata Power Co (TTPW.BO)	O (04/23/2007)	Rs546.3

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