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# **Power utilities & Infra Developers**

## **2QFY11 Results Review**

**November 2010**

## Executive Summary

## Power Utilities and Infra Developers

### Seasonality depresses merchant prices; worst is over as we look ahead for a better 2HFY11

The 11 Indian Power Utilities and Infra Developers in our coverage witnessed a muted 2Q generating aggregate revenues of Rs. 135.7bn (down 1% qoq). This is due to peaking hydro power generation (36% qoq increase in country-wide volumes) which inundated the merchant power market where volumes went up by 30% qoq, resulting in a fall in merchant power prices during the quarter (~Rs. 4.9/unit average realization in 2QFY11 in the bilateral market vs. ~Rs.5.8/unit in 1QFY11). As a result GMR, Torrent Power, Adani Power and Lanco were affected adversely (our coverage companies that depend on merchant power). Conversely PTC benefitted due to the higher merchant volumes while NHPC had a stellar quarter due to higher generation in its snow-melt hydel projects

**Power Segment witnesses multiple hiccups:** Temporary plant shut-downs (in Adani, GVK and Lanco), lower PLFs (Adani, GIPCL and Torrent), lower merchant power realizations (mainly for Lanco) were the key reasons why companies such as Lanco, GIPCL, Torrent Power and Adani Power missed our estimates.

**Monsoons impede construction:** Good monsoons also meant decelerating execution-pace in the construction arm of the companies in our coverage. Hence IRB, GMR and Lanco (EPC business) exhibited slower project execution registering low topline growth which cascaded to the EBITDA and PAT level.

**Airports lackluster:** ATMs and Passenger traffic did not witness any significant growth in the quarter except at Hyderabad airport. Commencement of operations at T3 in Delhi caused a disproportionate increase in the operations cost of the airport (Interest and Depreciation) which resulted in operating losses at Airports vertical for GMR.

BoT roads operated by companies in our coverage registered a sluggish revenue growth of -0.5% and a PBT growth of 15% on a qoq basis. The profits growth was attributable to the lack of major maintenance expense at GVK's road project, more than anything else.

Aggregate EBITDA and PAT grew only marginally qoq due to the above mentioned reasons. EBITDA came-in at Rs. 51.0bn (qoq growth of 2%) and PAT came-in at Rs. 21.89bn (down 1% qoq).

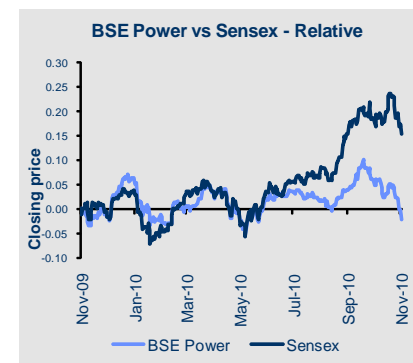
### We retain our positive stance on the sector

Despite the muted quarterly financial performance of the companies under our coverage, we believe that the sector's fundamentals remain in tact. Expected recovery in the merchant power market coupled with improved execution traction at the construction arms of the infrastructure developers should boost the financial performance of these companies during 2HFY11. While the P&L performance of these companies is expected to improve, we note that most of the stocks have corrected significantly since our initiating coverage note dated 23<sup>rd</sup> August 2010, providing attractive investment opportunities. We reiterate our positive outlook on the sector.

Based on our comprehensive framework of analysis, which weighs various factors such as capacity growth, non-linear earnings growth potential, balance sheet quality and valuations, our top picks are PTC and Lanco.

| Date      | Nov 19, 2010 |
|-----------|--------------|
| SENSEX    | 19585        |
| Nifty     | 5890         |
| BSE Power | 2981         |

| Market performance % |      |      |      |
|----------------------|------|------|------|
|                      | 1m   | 3m   | 12m  |
| Sensex               | -2.0 | 6.1  | 16.7 |
| Nifty                | -2.3 | 6.3  | 18.1 |
| BSE Power            | -6.7 | -4.0 | -1.2 |



Vijaykumar Bupathy  
[vijaykumar@sparkcapital.in](mailto:vijaykumar@sparkcapital.in)  
 +91 44 4344 0036

Bharanidhar Vijayakumar  
[bharanidhar@sparkcapital.in](mailto:bharanidhar@sparkcapital.in)  
 +91 44 4344 0038

## 2QFY11 - Results Snapshot

| Company | 2QFY11 (Rs.bn) |        |     | 2QFY10 (Rs.bn) |        |       | 1QFY11 (Rs.bn) |        |     | yoy growth % |        |      | qoq growth % |        |      |
|---------|----------------|--------|-----|----------------|--------|-------|----------------|--------|-----|--------------|--------|------|--------------|--------|------|
|         | Revenues       | EBITDA | PAT | Revenues       | EBITDA | PAT   | Revenues       | EBITDA | PAT | Revenues     | EBITDA | PAT  | Revenues     | EBITDA | PAT  |
| Adani   | 4.0            | 2.1    | 1.3 | 0.0            | (0.0)  | (0.0) | 3.5            | 2.1    | 1.1 | NM           | NM     | NM   | 12%          | -2%    | 10%  |
| CESC    | 11.1           | 3.2    | 1.6 | 9.6            | 2.3    | 1.3   | 11.0           | 2.6    | 1.1 | 15%          | 41%    | 23%  | 1%           | 24%    | 41%  |
| GIPCL   | 2.1            | 0.4    | 0.2 | 2.0            | 0.4    | 0.1   | 2.5            | 0.6    | 0.4 | 6%           | 0%     | 24%  | -15%         | -31%   | -63% |
| GMR     | 12.2           | 3.6    | 0.7 | 12.0           | 3.8    | 0.5   | 12.3           | 3.8    | 0.3 | 2%           | -7%    | 32%  | -1%          | -6%    | 150% |
| GVK     | 5.0            | 1.5    | 0.4 | 4.9            | 1.5    | 0.4   | 4.9            | 1.3    | 0.3 | 2%           | -4%    | -3%  | 3%           | 15%    | 28%  |
| Lanco   | 20.4           | 4.2    | 0.7 | 19.1           | 2.9    | 1.2   | 21.1           | 5.8    | 1.9 | 7%           | 42%    | -43% | -3%          | -28%   | -64% |
| NHPC    | 12.8           | 10.6   | 6.9 | 12.5           | 10.5   | 6.2   | 10.6           | 8.5    | 5.4 | 3%           | 1%     | 12%  | 21%          | 25%    | 28%  |
| PGCIL   | 21.3           | 17.9   | 6.5 | 17.5           | 14.7   | 4.6   | 20.0           | 16.7   | 7.0 | 22%          | 21%    | 42%  | 6%           | 7%     | -7%  |
| PTC     | 24.7           | 0.4    | 0.4 | 24.6           | 0.3    | 0.3   | 27.6           | 0.3    | 0.3 | 0%           | 26%    | 29%  | -10%         | 42%    | 48%  |
| Torrent | 17.3           | 5.0    | 2.2 | 14.5           | 4.6    | 2.1   | 18.2           | 5.9    | 3.0 | 19%          | 8%     | 6%   | -5%          | -16%   | -27% |
| IRB     | 4.9            | 2.4    | 1.0 | 3.6            | 1.8    | 0.7   | 5.3            | 2.7    | 1.2 | 35%          | 30%    | 40%  | -8%          | -13%   | -16% |

## 2QFY11 - Actuals vs. Estimates

| Company        | Actual 2QFY11<br>(Rs.bn) |        |     | Spark Estimates<br>(Rs.bn) |        |     | Delta % |        |      | Comments on quarterly performance  |
|----------------|--------------------------|--------|-----|----------------------------|--------|-----|---------|--------|------|--|
|                | Revs.                    | EBITDA | PAT | Revs.                      | EBITDA | PAT | Revs.   | EBITDA | PAT  |  |
| <b>Adani</b>   | 4.0                      | 2.1    | 1.3 | 4.3                        | 2.4    | 1.2 | -7%     | -12%   | 2%   | Moderate qoq revenue growth of 12% due to relatively low PLFs of 82%<br>EBITDA down 2% qoq , largely due to lower merchant realizations (Rs. 4.9/unit)               |
| <b>CESC</b>    | 11.1                     | 3.2    | 1.6 | 10.9                       | 2.7    | 1.3 | 2%      | 17%    | 22%  | Flattish revenues vis-à-vis 1QFY11<br>Rs. 2bn net other expenditure boosted EBITDA significantly   |
| <b>GIPCL</b>   | 2.1                      | 0.4    | 0.2 | 1.9                        | 0.3    | 0.2 | 12%     | 28%    | -15% | Poor PLFs at the operational plants results in 15% qoq fall in revenues<br>EBITDA (down 31% qoq) and PAT (down 63% )affected adversely as a result                   |
| <b>GMR</b>     | 12.2                     | 3.6    | 0.7 | 13.1                       | 4.6    | 0.2 | -7%     | -22%   | 347% | Revenues remained flat largely due to sluggish performance of power vertical<br>Increased cost due to capitalization of T3 results in net loss for airports vertical |
| <b>GVK</b>     | 5.0                      | 1.5    | 0.4 | 5.0                        | 1.4    | 0.4 | 1%      | 7%     | 19%  | Despite a good show by JKEL, partial shut-down in J-1 led to qoq flat revenues<br>Airports revenues in-line with expectations with PAT beating estimates             |
| <b>Lanco</b>   | 20.4                     | 4.2    | 0.7 | 23.3                       | 6.2    | 2.6 | -12%    | -33%   | -73% | Low UI realizations from Amarkantak II depress revenues<br>Low merchant realizations and low EPC margins affected PAT adversely                                      |
| <b>NHPC</b>    | 12.8                     | 10.6   | 6.9 | 13.8                       | 11.7   | 7.9 | -7%     | -10%   | -13% | High seasonal generation & commissioning of Sewa II ups revenues qoq (21%)<br>PAT increases qoq (29%) due to 25% qoq increase in generation                          |
| <b>PGCIL</b>   | 21.3                     | 17.9   | 6.5 | 19.9                       | 16.6   | 6.3 | 7%      | 8%     | 3%   | Flat revenues from regulated business, STPA revenues buoys overall numbers<br>Qoq PAT marginally depressed due to higher depreciation                                |
| <b>PTC</b>     | 24.7                     | 0.4    | 0.4 | 23.9                       | 0.3    | 0.3 | 3%      | 12%    | 28%  | Higher trading volumes (up 21% qoq), lower merchant prices marked the quarter<br>Good margins (Rs.0.062 per unit) & one-off ESOP expense reversal boosts PAT         |
| <b>Torrent</b> | 17.3                     | 5.0    | 2.2 | 17.4                       | 4.9    | 2.3 | -1%     | 1%     | -2%  | Low PLFs left lesser units for the merchant market which depressed topline qoq<br>PAT fell qoq by 27% due to low merchant power realizations                         |
| <b>IRB</b>     | 4.9                      | 2.4    | 1.0 | 5.8                        | 2.9    | 1.1 | -16%    | -17%   | -8%  | Execution impeded by monsoons results in 16% drop in revenues qoq<br>EBITDA and PAT was lower due to the cascading effect of lower revenues                          |

## Estimate revisions and TP changes since 2QFY11 Results

|                | FY11E    |        |         | FY12E    |        |        | Old |      | New |      |
|----------------|----------|--------|---------|----------|--------|--------|-----|------|-----|------|
| Company        | Revenues | EBITDA | PAT     | Revenues | EBITDA | PAT    | TP  | Reco | TP  | Reco |
| <b>Adani</b>   | -33.1%   | -38.0% | -41.4%  | -8.8%    | -14.2% | -22.3% | 130 | UPF  | 107 | UPF  |
| <b>CESC</b>    | 12.4%    | 3.4%   | 5.4%    | 13.2%    | -0.8%  | -2.3%  | 470 | OPF  | 472 | OPF  |
| <b>GIPCL</b>   | 0.0%     | 0.0%   | 0.0%    | 0.0%     | 0.0%   | 0.0%   | 108 | UPF  | 108 | UPF  |
| <b>GMR</b>     | -4.2%    | -7.5%  | -132.3% | -1.9%    | -3.6%  | -23.3% | 50  | UPF  | 49  | UPF  |
| <b>GVK</b>     | 0.0%     | 0.0%   | 0.0%    | 0.0%     | 0.0%   | 0.0%   | 50  | UPF  | 50  | UPF  |
| <b>Lanco</b>   | -13.9%   | -13.6% | -29.8%  | 1.5%     | 6.1%   | -46.1% | 90  | OPF  | 85  | OPF  |
| <b>NHPC</b>    | -4.5%    | -5.2%  | -1.0%   | -6.3%    | -7.2%  | -6.8%  | 38  | OPF  | 38  | OPF  |
| <b>PGCIL</b>   | 4.6%     | 5.4%   | 10.7%   | 1.7%     | 2.0%   | 0.6%   | 110 | UPF  | 110 | UPF  |
| <b>PTC</b>     | 0.1%     | 11.4%  | 11.2%   | 0.1%     | 9.6%   | 10.2%  | 134 | OPF  | 156 | OPF  |
| <b>Torrent</b> | 11.7%    | -9.7%  | 8.3%    | 5.5%     | -13.0% | -14.3% | 438 | OPF  | 371 | OPF  |
| <b>IRB</b>     | 0.0%     | 0.0%   | 0.0%    | 0.0%     | 0.0%   | 0.0%   | 150 | UPF  | 150 | UPF  |

## Valuation Matrix

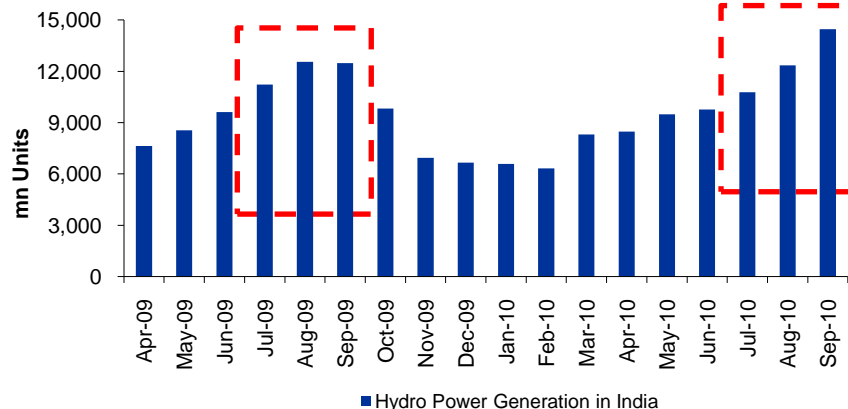
| Company | Revenues, Rs.bn |       |       | EBITDA, Rs.bn |       |       | PAT, Rs.bn |       |       | RoE  |       |       | FY10-12E CAGR |        |      |
|---------|-----------------|-------|-------|---------------|-------|-------|------------|-------|-------|------|-------|-------|---------------|--------|------|
|         | FY10            | FY11E | FY12E | FY10          | FY11E | FY12E | FY10       | FY11E | FY12E | FY10 | FY11E | FY12E | Revs          | EBITDA | PAT  |
| Adani   | 4.3             | 20.6  | 61.0  | 2.4           | 12.4  | 35.0  | 1.7        | 7.0   | 16.8  | 4%   | 12%   | 23%   | 275%          | 279%   | 215% |
| CESC    | 41.0            | 41.5  | 42.1  | 8.2           | 10.7  | 10.8  | 4.3        | 4.8   | 5.4   | 9%   | 9%    | 9%    | 1%            | 15%    | 11%  |
| GIPCL   | 9.5             | 13.5  | 16.1  | 2.3           | 4.4   | 4.7   | 1.1        | 1.5   | 1.6   | 8%   | 10%   | 10%   | 30%           | 44%    | 22%  |
| GMR     | 51.2            | 51.4  | 66.0  | 13.6          | 17.2  | 24.7  | 2.3        | (1.6) | 2.3   | 3%   | 2%    | 4%    | 14%           | 35%    | 1%   |
| GVK     | 17.9            | 22.0  | 22.7  | 4.7           | 5.6   | 5.9   | 1.6        | 1.5   | 0.8   | 3%   | 2%    | 1%    | 13%           | 12%    | -28% |
| Lanco   | 80.3            | 114.5 | 180.3 | 14.5          | 27.4  | 50.8  | 4.9        | 8.5   | 10.1  | 14%  | 16%   | 14%   | 50%           | 87%    | 43%  |
| NHPC    | 52.3            | 47.3  | 50.3  | 41.3          | 36.2  | 38.8  | 22.8       | 18.7  | 20.1  | 9%   | 7%    | 7%    | -2%           | -3%    | -6%  |
| PGCIL   | 71.3            | 89.8  | 103.7 | 58.7          | 76.3  | 89.0  | 20.4       | 21.5  | 27.6  | 13%  | 12%   | 11%   | 21%           | 23%    | 16%  |
| PTC     | 77.7            | 100.7 | 125.0 | 0.7           | 1.0   | 1.3   | 0.9        | 1.1   | 1.3   | 8%   | 11%   | 12%   | 27%           | 42%    | 19%  |
| Torrent | 58.2            | 66.3  | 72.1  | 17.0          | 21.3  | 23.2  | 8.4        | 10.8  | 11.1  | 21%  | 22%   | 19%   | 11%           | 17%    | 15%  |

| Company | Net Debt to Equity (x) |       |       | CMP | Shares | M.Cap | Power ABV per share, Rs. |      |        | Power - Price / ABV (x) |       |       | Target |       | Rating |
|---------|------------------------|-------|-------|-----|--------|-------|--------------------------|------|--------|-------------------------|-------|-------|--------|-------|--------|
|         | FY10                   | FY11E | FY12E |     |        |       | Rs.                      | (mn) | Rs. bn | FY10                    | FY11E | FY12E | FY10   | FY11E |        |
| Adani   | 2.4                    | 3.2   | 2.6   | 133 | 2,180  | 289.9 | 25                       | 28   | 36     | 5.4                     | 4.8   | 3.7   | 3.0    | 107   | UPF    |
| CESC    | 0.3                    | 0.4   | 0.5   | 380 | 125    | 47.5  | 347                      | 389  | 426    | 1.3                     | 1.2   | 1.1   | 1.3    | 472   | OPF    |
| GIPCL   | 0.8                    | 0.7   | 0.4   | 115 | 151    | 17.4  | 88                       | 98   | 108    | 1.3                     | 1.2   | 1.1   | 1.0    | 108   | UPF    |
| GMR     | 3.2                    | 1.9   | 1.9   | 53  | 3,893  | 204.4 | 6                        | 14   | 19     | 5.6                     | 2.3   | 1.7   | 1.5    | 49    | UPF    |
| GVK     | 1.0                    | 1.7   | 2.8   | 44  | 1,584  | 69.0  | 15                       | 18   | 26     | 1.3                     | 1.1   | 0.7   | 1.0    | 50    | UPF    |
| Lanco   | 1.5                    | 2.6   | 2.6   | 63  | 2,408  | 151.7 | 16                       | 25   | 33     | 2.7                     | 1.7   | 1.3   | 2.0    | 85    | OPF    |
| NHPC    | 0.4                    | 0.4   | 0.4   | 31  | 12,301 | 386.2 | 22                       | 23   | 25     | 1.4                     | 1.3   | 1.3   | 1.5    | 38    | OPF    |
| PGCIL   | 2.1                    | 1.6   | 1.7   | 103 | 4,209  | 433.5 | 38                       | 49   | 55     | 2.7                     | 2.1   | 1.9   | 2.0    | 110   | UPF    |
| PTC*    | (0.0)                  | (0.1) | (0.1) | 134 | 295    | 39.5  | 71                       | 73   | 77     | 1.9                     | 1.8   | 1.8   | 10.0   | 156   | OPF    |
| Torrent | 0.8                    | 0.8   | 0.7   | 294 | 472    | 138.9 | 84                       | 104  | 124    | 3.5                     | 2.8   | 2.4   | 3.0    | 371   | OPF    |

\*P/E for PTC

# Industry Overview – Merchant power volumes peak in 2QFY11 resulting in lower merchant prices

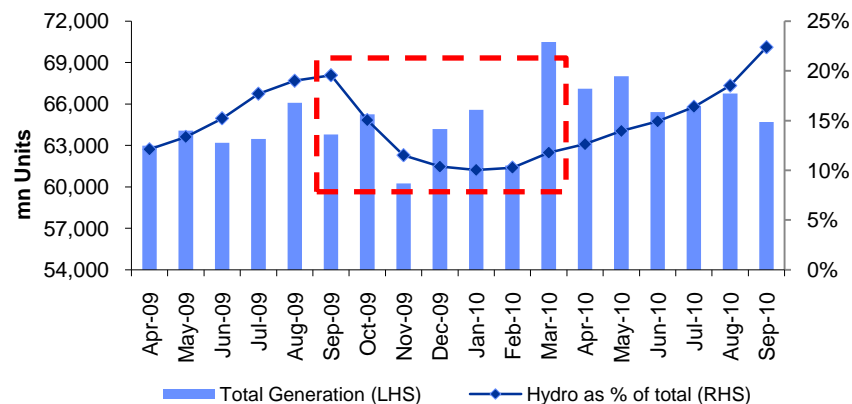
## High hydel generation in 2Q, power surplus in merchant market...



■ Hydro Power Generation in India

Source: CEA

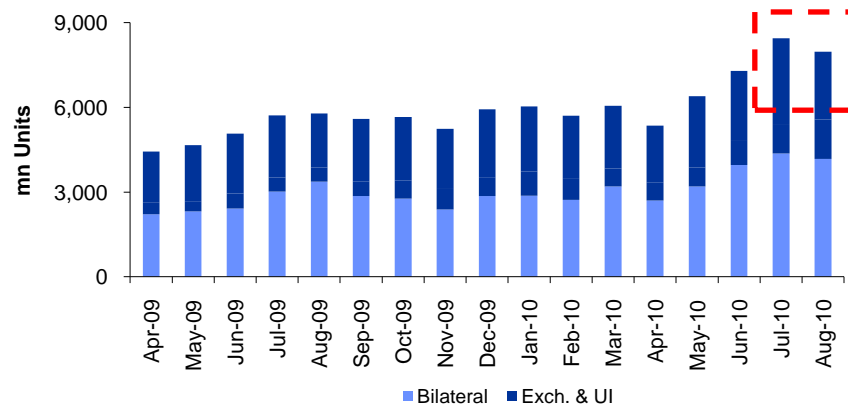
## .....but to taper-off in 3Q & 4Q



■ Total Generation (LHS)    ◆ Hydro as % of total (RHS)

Source: CEA

## Merchant Power volumes increased in 2QFY11....



■ Bilateral    ■ Exch. & UI

Source: CERC

## .....results in lower demand & lower realizations in bilateral market



■ Rate in Bilateral trading market

Source: CERC

## Business Overview – Power, Roads and Airports

### Generation Capacity Additions (MW)

| Company | 4QFY10, 1QFY11       | 2QFY11                    |
|---------|----------------------|---------------------------|
| Adani   | 330 - Mundra P1 U2   | 330 - Mundra P2 U1        |
| CESC    | 250 – Budge Budge II | -                         |
| GIPCL   | -                    | 250 – Surat Lignite Exp   |
| GMR     | -                    | 235 - Kakinada            |
| Lanco   | 300 – Amarkantak II  | 133 – K II, Steam Turbine |
| NHPC    | -                    | 120 – Sewa II             |

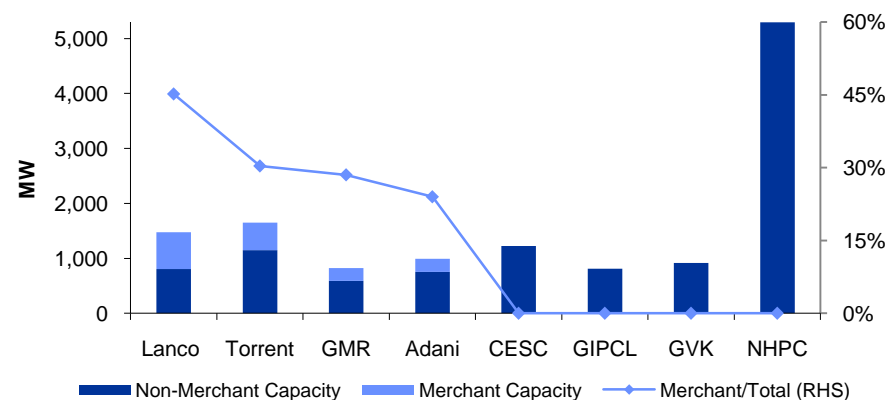
Source: Company, Spark Research

### Key Developments in the quarter

| Company | Development  |
|---------|--|
| CESC    | Achieves financial closure of the Haldia (600MW) project   |
| GMR     | Consortium with Malaysia Airports Holdings won a bid to build, operate, modernize and expand Male International airport, Maldives<br>Hyderabad airport gets clearance from AERA to increase the User Development Fee for all outbound passengers |
| GVK     | Divested 21.1 % stake in its wholly-owned subsidiary, GVK Energy for Rs. 12 bn to 3i's India Infrastructure Fund   |
| Lanco   | Achieves financial closure for Kondapalli III (732MW), Babandh (1320MW) & Vidharbha (1320 MW) power plants   |
| PGCIL   | Comes-out with an FPO for 20% of current paid-up capital, half of it is new issue and the other half is divestment of Govt's stake   |

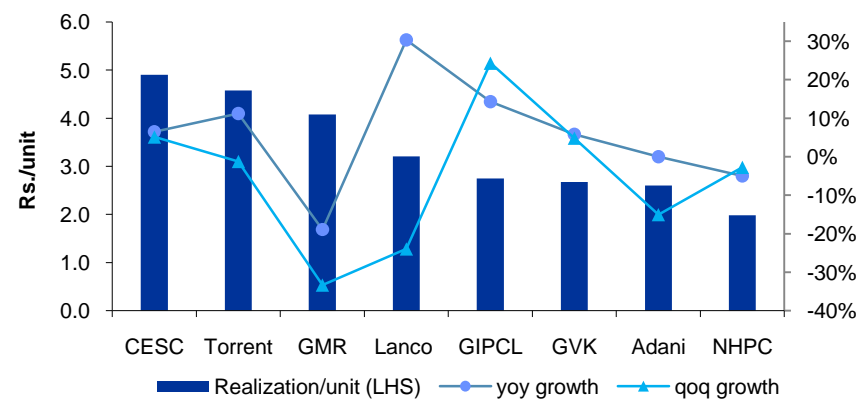
Source: Company, Spark Research

### Lanco, Torrent , GMR, Adani 20-50% merchant dependence in 2Q..



Source: Company, Spark Research

### ....realizations impacted as a result

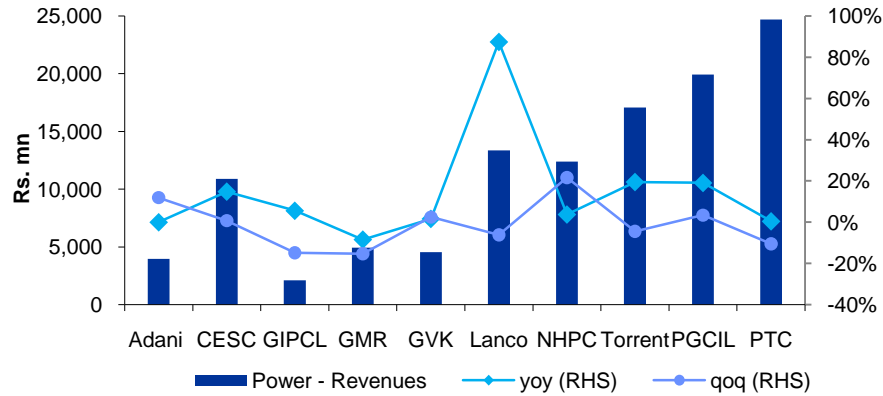


Source: Company, Spark Research



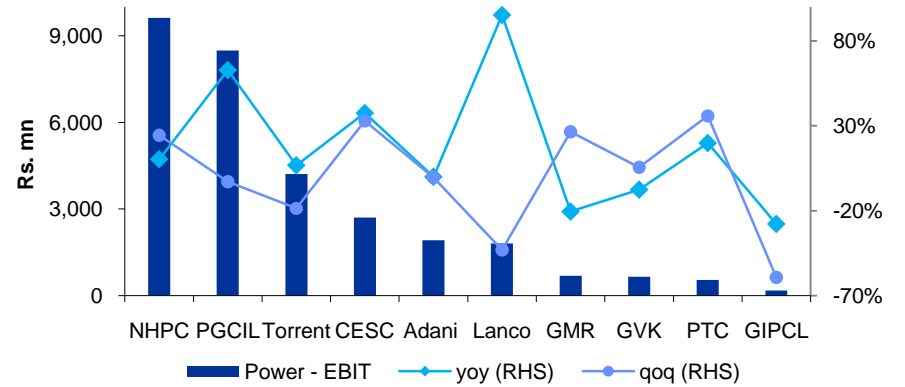
# Business Overview – Power, Roads and Airports

## Power segment revenues were muted on a qoq basis



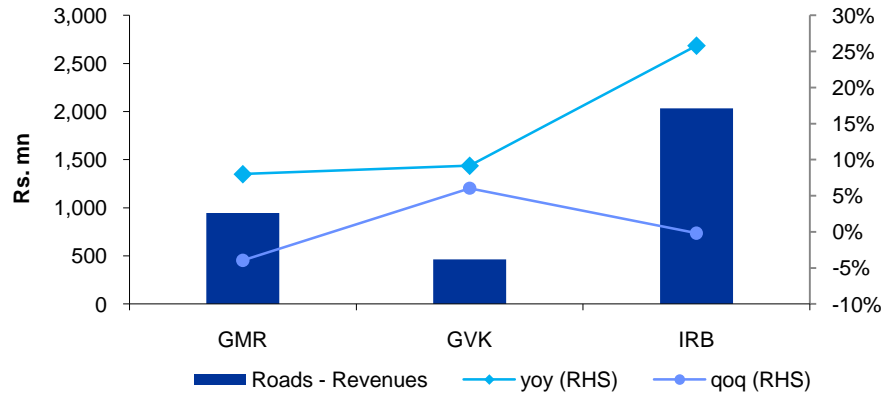
Source: Company, Spark Research

## Power - Lanco and Torrent affected the most in profitability terms



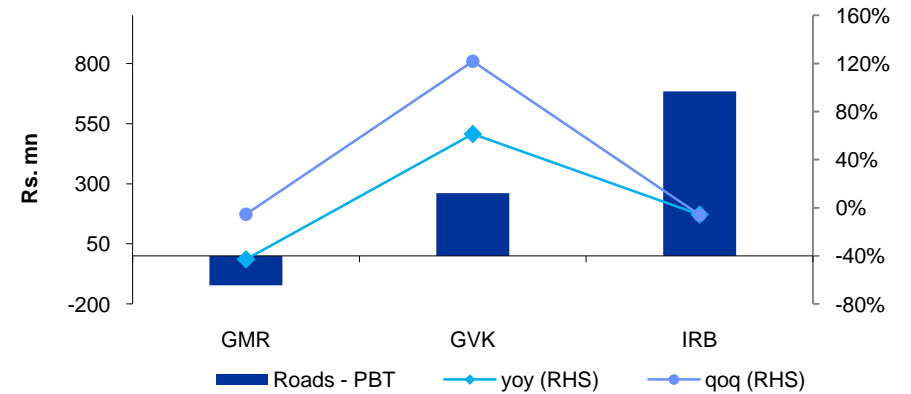
Source: Company, Spark Research

## Roads – IRB’s road portfolio saw maximum revenue growth



Source: Company, Spark Research

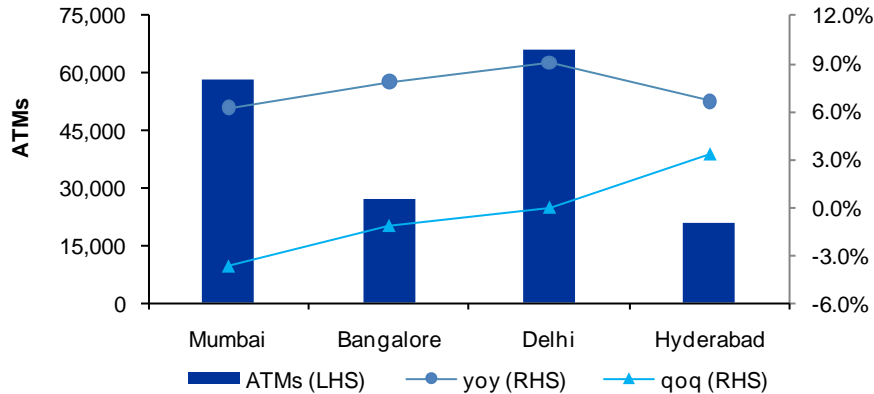
## Roads - GVK’s JKEL benefited from absence of MME



Source: Company, Spark Research

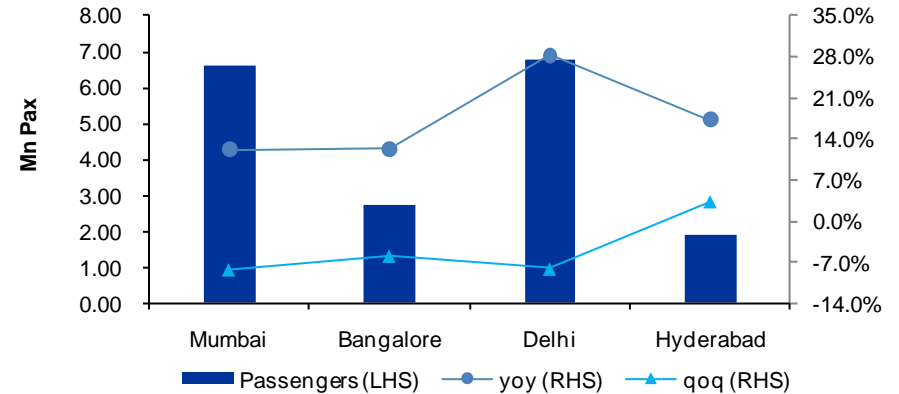
# Business Overview – Power, Roads and Airports

## Airports - ATMs were muted on a qoq basis



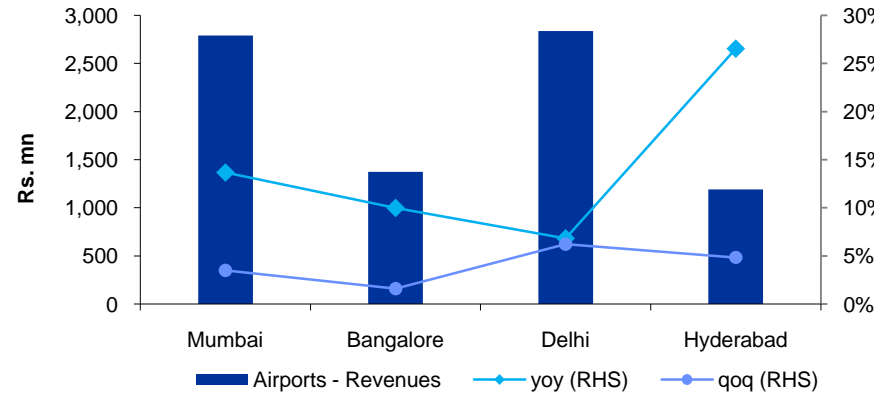
Source: Company, Spark Research

## Airports - Stagnant passenger traffic as a result



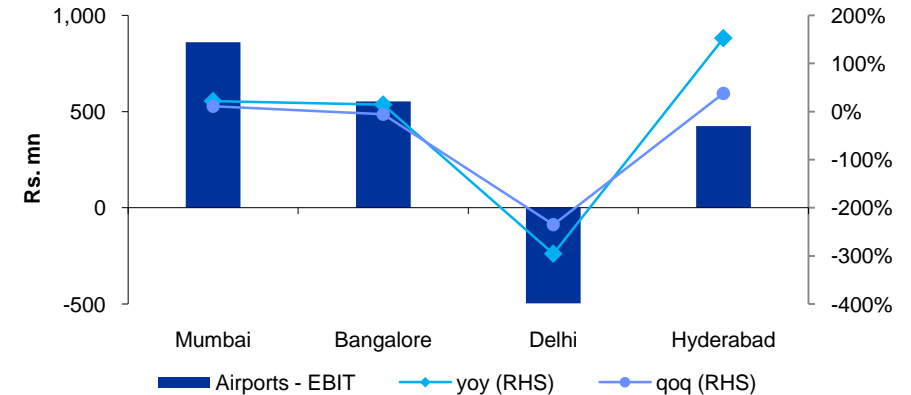
Source: Company, Spark Research

## No substantial change in the Airports segment revenue profile



Source: Company, Spark Research

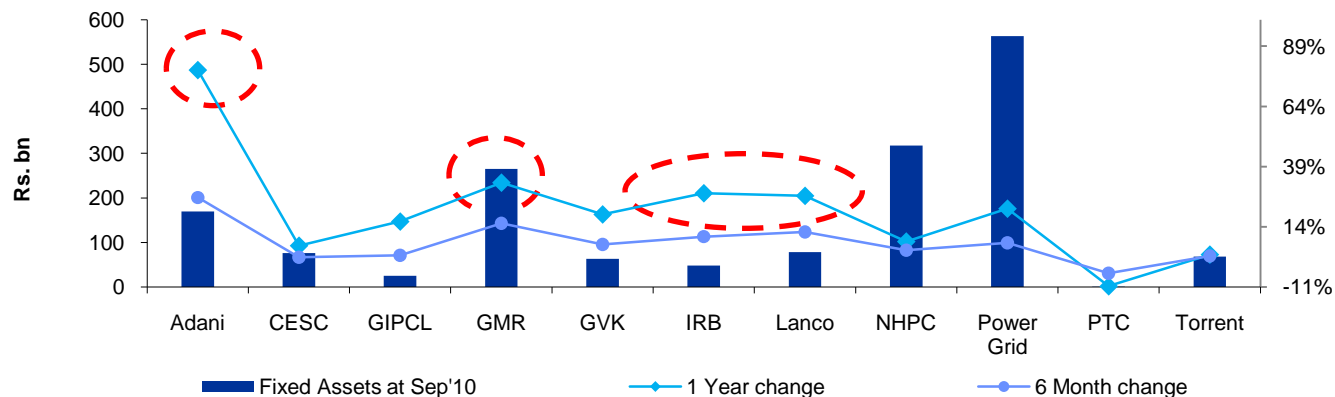
## DIAL profitability adversely impacted due to capitalization of T3



Source: Company, Spark Research

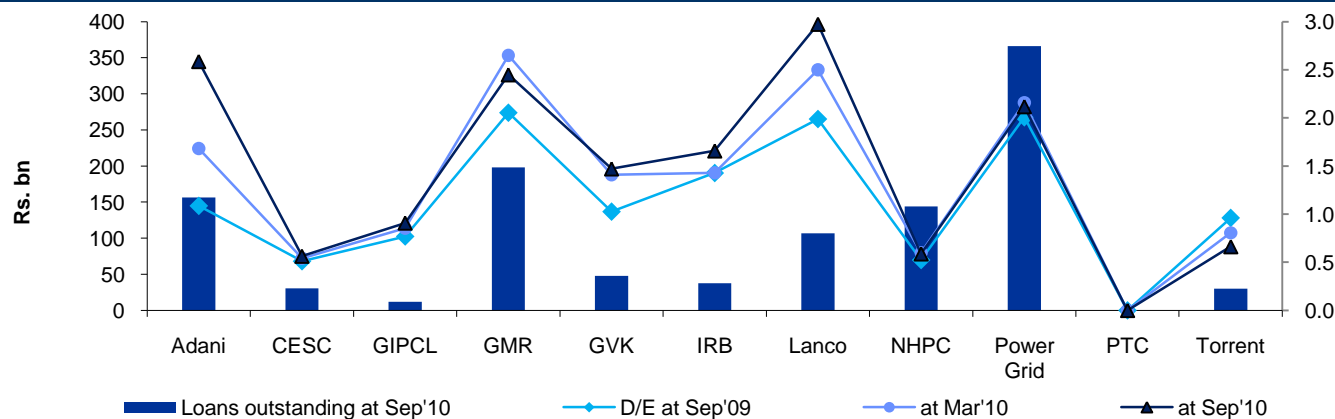
## Business Overview – Bird's eye view at the company level

### Lanco, IRB, GMR and Adani show maximum execution traction



Source: Company, Spark Research

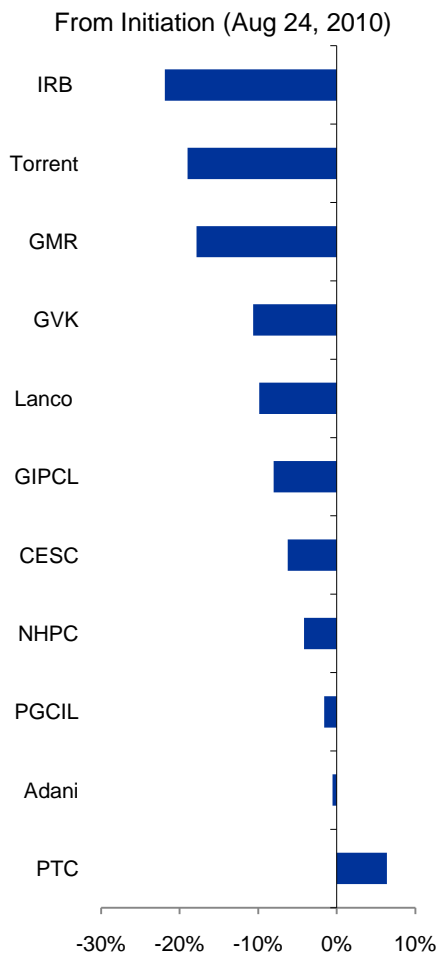
### Adani, GMR, Lanco and PGCIL leveraged most aggressively



Source: Company, Spark Research

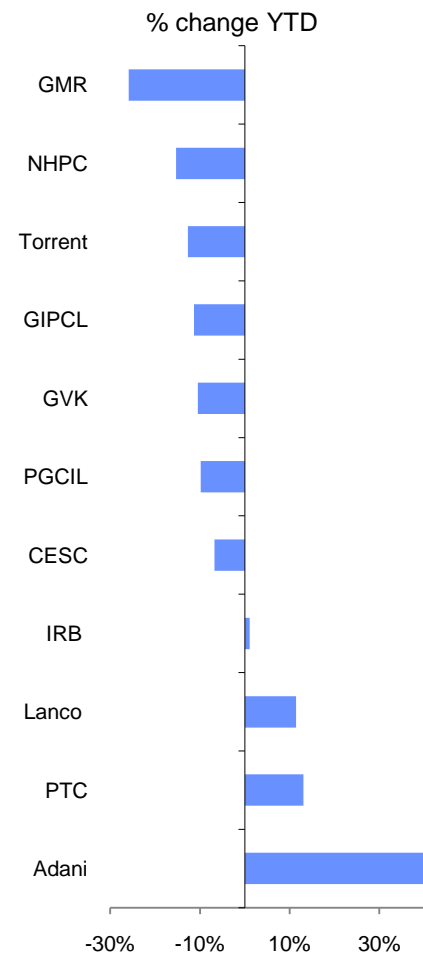
## Stock Performance – Sector has underperformed significantly over the last 3 months

Coverage Universe performance since date of initiation



Source: Bloomberg

Coverage Universe performance YTD



Source: Bloomberg

## Rating Interpretation

|                     |   |
|---------------------|---|
| <b>BUY</b>          | <b>More than 100% absolute return over a maximum of three years</b>                       |
| <b>OUTPERFORM</b>   | <b>We expect the stock to outperform peers/ relevant sector index but is not a Buy</b>    |
| <b>UNDERPERFORM</b> | <b>We expect the stock to underperform peers/ relevant sector index but is not a Sell</b> |
| <b>SELL</b>         | <b>More than 25% downside to the stock price</b>  |

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