

COMPANY UPDATE

GVK Power and Infrastructure (GVKP.BO)

Neutral

Equity Research

Hancock acquisition - long term benefits – financing remains key**What's changed**

GVK group announced the acquisition of Hancock coal mines on Friday for \$1.26bn through a subsidiary. The acquired assets include Alpha, Alpha west and Kevin's Corner coal mines with combined resources of 7.9bn tonnes of coal, and associated rail and port projects. The payment for the deal will be in three parts of \$500mn to be paid immediately, \$200mn (1 year after deal close) and \$560mn (at financial closure of project), to be financed through \$1bn of debt and \$260mn of equity. In addition, the asset would require infrastructure to be built over the next 3 years requiring additional capex of US\$10 bn. GVK Infra (GVKPIL) has a 10% stake in the subsidiary with an option to increase it to 49%. They will also have an option to buy 20mn ton/yr coal through GVK Energy.

Implications

Based on our initial assumptions of similar assets in Australia and management estimates, we expect the asset to generate about US\$50 EBITDA/ton and ROE in the 16-20% range. We expect the project to start generating free cash flow within 3-4 years of commencement of the first phase of operation. Hence we see this as operationally positive.

Apart from execution challenges, financing of this large deal is key – GVKPIL will have to invest Rs6 bn over the next 15 months on its part, putting pressure on an already leveraged Balance Sheet (1.3X Net Debt/Equity-FY12E).

Valuation

We make no change to our valuation and look forward to the closing of the transaction (scheduled for the next 2-3 months) and further execution from the company. We retain Neutral and our 12m SOTP-based TP of Rs 23.

Key risks

Upside: Monetization of Mumbai Airport land; Downside: (1) Regulatory uncertainty on Airport regulation and (2) Further delay in monetization of Mumbai Real Estate

INVESTMENT LIST MEMBERSHIP

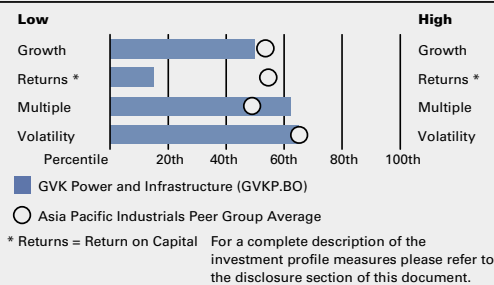
Neutral

Coverage View: Neutral

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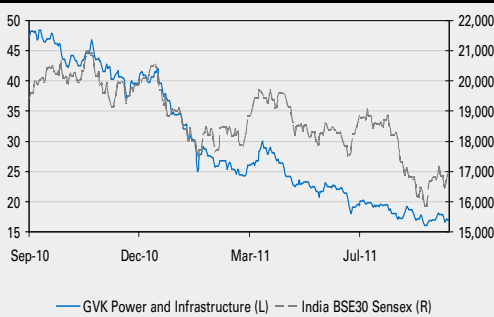
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Investment Profile

Key data	Current
Price (Rs)	17.00
12 month price target (Rs)	23.00
Market cap (Rs mn / US\$ mn)	23,899.4 / 505.6
Foreign ownership (%)	17.1

	3/11	3/12E	3/13E	3/14E
EPS (Rs)	0.98	1.46	2.30	2.51
EPS growth (%)	(3.6)	49.1	56.9	9.2
EPS (diluted) (Rs)	0.98	1.46	2.30	2.51
EPS (basic pre-ex) (Rs)	0.98	1.46	2.30	2.51
P/E (X)	17.3	11.6	7.4	6.8
P/B (X)	0.8	0.7	0.7	0.6
EV/EBITDA (X)	22.6	14.1	10.1	8.2
Dividend yield (%)	--	0.2	0.2	0.2
ROE (%)	4.7	6.6	9.6	9.5
CROCI (%)	6.1	6.5	9.0	11.3

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	(21.5)	(33.1)	(64.0)
Rel. to India BSE30 Sensex	(16.6)	(27.4)	(58.7)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 9/16/2011 close.

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GVK Power and Infrastructure: Summary Financials

Profit model (Rs mn)	3/11	3/12E	3/13E	3/14E	Balance sheet (Rs mn)	3/11	3/12E	3/13E	3/14E
Total revenue	19,146.6	23,212.7	30,305.6	34,357.7	Cash & equivalents	3,326.4	2,372.9	2,441.6	4,211.7
Cost of goods sold	(13,253.5)	(15,715.0)	(19,547.1)	(21,525.1)	Accounts receivable	693.0	840.2	1,096.9	1,243.6
SG&A	(2,589.6)	(3,371.8)	(4,377.4)	(5,023.3)	Inventory	430.9	510.9	635.5	699.8
R&D	--	--	--	--	Other current assets	3,502.3	4,302.3	6,102.3	6,902.3
Other operating profit/(expense)	0.0	0.0	1.0	1.0	Total current assets	7,952.6	8,026.3	10,276.3	13,057.4
EBITDA	5,139.9	6,377.5	9,261.1	11,125.8	Net PP&E	66,348.4	77,025.3	84,358.5	86,358.5
Depreciation & amortization	(1,563.7)	(2,251.6)	(2,879.0)	(3,315.5)	Net intangibles	7,820.2	6,891.7	5,679.5	5,679.5
EBIT	3,303.5	4,125.9	6,382.1	7,810.3	Total investments	25,017.1	25,017.1	25,017.1	25,017.1
Interest income	98.4	166.3	118.6	122.1	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(2,631.4)	(2,826.7)	(3,713.6)	(4,904.4)	Total assets	107,138.3	116,960.3	125,331.3	130,112.4
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	2,069.5	2,509.0	3,275.6	3,713.6
Others	186.9	200.0	200.0	200.0	Short-term debt	3,000.8	3,000.8	3,000.8	3,000.8
Pretax profits	957.4	1,665.5	2,987.1	3,227.9	Other current liabilities	1,667.5	821.1	157.0	1,598.2
Income tax	(213.2)	(366.4)	(657.2)	(774.7)	Total current liabilities	6,737.8	6,330.9	6,433.4	8,312.7
Minorities	804.9	1,011.3	1,296.0	1,506.1	Long-term debt	52,482.9	62,388.1	66,588.1	65,088.1
Net income pre-preferred dividends	1,549.1	2,310.4	3,626.0	3,959.4	Other long-term liabilities	2,516.2	29.6	29.6	29.6
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	54,999.1	62,417.7	66,617.7	65,117.7
Net income (pre-exceptionals)	1,549.1	2,310.4	3,626.0	3,959.4	Total liabilities	61,736.9	68,748.6	73,051.1	73,430.4
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	1,549.1	2,310.4	3,626.0	3,959.4	Total common equity	33,867.8	36,178.2	39,746.6	43,648.5
EPS (basic, pre-exception) (Rs)	0.98	1.46	2.30	2.51	Minority interest	11,533.6	12,033.6	12,533.6	13,033.6
EPS (basic, post-exception) (Rs)	0.98	1.46	2.30	2.51	Total liabilities & equity	107,138.3	116,960.3	125,331.3	130,112.4
EPS (diluted, post-exception) (Rs)	0.98	1.46	2.30	2.51	BVPS (Rs)	21.45	22.91	25.17	27.64
DPS (Rs)	0.00	0.04	0.04	0.04					
Dividend payout ratio (%)	0.0	2.5	1.6	1.5					
Free cash flow yield (%)	(14.2)	(23.3)	(1.8)	30.2					
Growth & margins (%)	3/11	3/12E	3/13E	3/14E	Ratios	3/11	3/12E	3/13E	3/14E
Sales growth	7.2	21.2	30.6	13.4	CROCI (%)	6.1	6.5	9.0	11.3
EBITDA growth	9.8	24.1	45.2	20.1	ROE (%)	4.7	6.6	9.6	9.5
EBIT growth	(0.2)	24.9	54.7	22.4	ROA (%)	1.6	2.1	3.0	3.1
Net income growth	(0.6)	49.1	56.9	9.2	ROACE (%)	3.1	3.2	4.5	5.1
EPS growth	(3.6)	49.1	56.9	9.2	Inventory days	10.8	10.9	10.7	11.3
Gross margin	30.8	32.3	35.5	37.4	Receivables days	13.0	12.1	11.7	12.4
EBITDA margin	26.8	27.5	30.6	32.4	Payable days	43.1	53.2	54.0	59.3
EBIT margin	17.3	17.8	21.1	22.7	Net debt/equity (%)	114.9	130.7	128.4	112.7
					Interest cover - EBIT (X)	1.3	1.6	1.8	1.6
Cash flow statement (Rs mn)	3/11	3/12E	3/13E	3/14E	Valuation	3/11	3/12E	3/13E	3/14E
Net income pre-preferred dividends	1,549.1	2,310.4	3,626.0	3,959.4	P/E (analyst) (X)	17.3	11.6	7.4	6.8
D&A add-back	1,836.4	2,251.6	2,879.0	3,315.5	P/B (X)	0.8	0.7	0.7	0.6
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	22.6	14.1	10.1	8.2
Net (inc)/dec working capital	(87.4)	212.3	385.3	227.0	EV/GCI (X)	1.2	0.8	0.9	0.9
Other operating cash flow	788.0	981.0	1,630.9	2,608.1	Dividend yield (%)	--	0.2	0.2	0.2
Cash flow from operations	4,086.1	5,755.3	8,521.2	10,110.0					
Capital expenditures	(13,167.7)	(12,000.0)	(9,000.0)	(2,000.0)					
Acquisitions	(41,208.8)	0.0	0.0	0.0					
Divestitures	37,455.6	0.0	0.0	0.0					
Others	61.5	166.3	118.6	122.1					
Cash flow from investments	(16,859.4)	(11,833.7)	(8,881.4)	(1,877.9)					
Dividends paid (common & pref)	0.0	0.0	(57.5)	(57.5)					
Inc/(dec) in debt	10,980.2	9,905.2	4,200.0	(1,500.0)					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	4,611.7	(4,780.3)	(3,713.6)	(4,904.4)					
Cash flow from financing	15,591.9	5,124.9	428.8	(6,461.9)					
Total cash flow	2,818.6	(953.5)	68.7	1,770.1					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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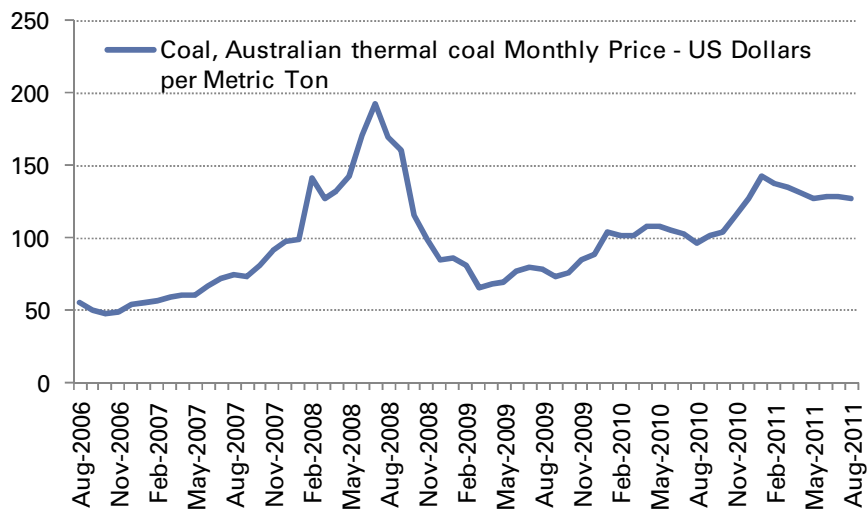
Overview:

Exhibit 1: Asset to start generating free cash flow in the initial few years itself given the high margins generated... Simplified project economics - Hancock coal assets

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	.....	2051	2052	2053
Production and Profitability																
units		7.5	22.5	30	30	30	30	30	30	30	60	60	.....	30	30	30
Sale Price USD / ton (FOB Newcastle)		115	116	117	118	120	121	122	123	125	126	127	.....	165	166	168
yoy increase		1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	.....	1%	1%	1%
Cost of production/logistics		68	68	69	70	70	71	72	72	73	79	80	.....	103	104	105
yoy increase		1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	.....	1%	1%	1%
Revenue		863	2,613	3,519	3,555	3,590	3,626	3,662	3,699	3,736	7,546	7,622	.....	4,936	4,986	5,035
EBITDA		356	1,079	1,453	1,467	1,482	1,497	1,512	1,527	1,542	2,815	2,843	.....	1,841	1,860	1,878
margin		41%	41%	41%	41%	41%	41%	41%	41%	41%	37%	37%	.....	37%	37%	37%
Depreciation @ 3.3%		330	330	330	330	330	330	330	330	330	330	330	.....	330	330	330
Interest @ 8%		767	767	735	703	671	639	607	595	851	806	761	.....	-	-	-
Tax @ 30%		(222)	(6)	116	130	144	158	172	90	108	504	526	.....	453	459	464
PAT		(519)	(13)	271	304	336	369	402	211	253	1,175	1,226	.....	1,058	1,071	1,084
margin		-60%	0%	8%	9%	9%	10%	11%	6%	7%	16%	16%	.....	21%	21%	22%
ROE		-5%	-5%	-5%	-35%	-1%	15%	17%	16%	17%	12%	9%	.....	4%	4%	4%
Cash Flow:																
CFO		(189)	317	601	634	666	699	732	541	583	1,505	1,556	.....	1,388	1,401	1,414
Principal repayment @ in 20 years			400	400	400	400	400	400	560	560	560	560	.....	560	560	560
Free cash		(489)	(489)	(489)	(189)	(83)	201	234	266	299	332	(19)	.....	828	841	854
IRR		18%											.....		
Capex																
Total		USD mn	10000													
Finance		Debt	8000	9,592	9,192	8,792	8,392	7,992	7,592	11,192	10,632	10,073	9,513	8,954	.....	-
		Equity	2000	1,481	1,468	1,752	1,772	2,089	2,141	3,491	2,352	3,744	3,527	4,970	.....	25,993
																25,113
																27,077

Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Australian coal has traded close to average realization of +US\$100 per metric ton over the last few years Australian thermal coal - realizations

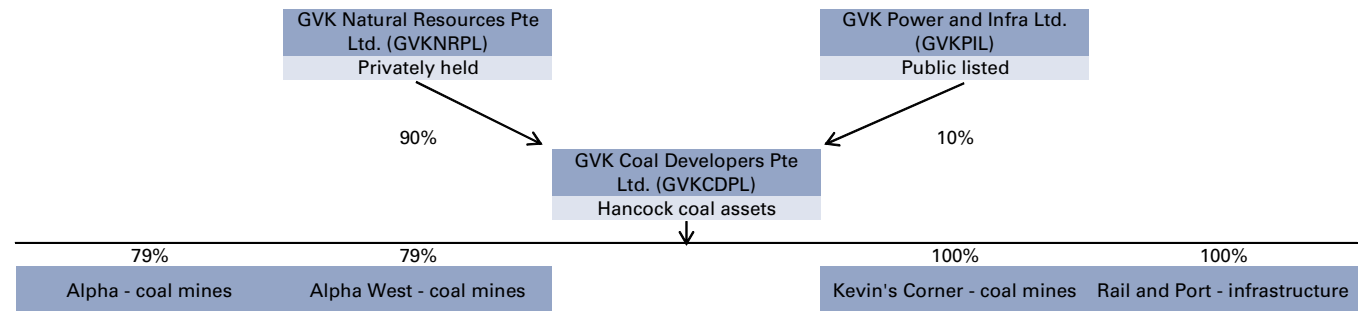


Note: less than 1% sulfur, 14% ash, FOB Newcastle US Dollars per Metric Ton

Source: globalCOAL, Goldman Sachs Research.

Exhibit 3: GVKPIL to hold 10% in the asset – with option to increase stake to 49%

Structure of the deal



Source: Company data, Goldman Sachs Research.

Exhibit 4: Funding scheme for the Hancock Asset – seems challenging currently

Initial funding plans

	Date of payment	GVKPIL	GVKNRPL	Comment
cost of acquisition (US\$ mn)	Sep-11	50	450	US\$ 1bn debt and 260mn in equity - funds have been tied up based on management comments
	Sep-12	20	180	
	Dec-12	56	504	
cost of development (US\$ mn)	by FY14E	1000	9000	will be financed by possible stake sale in the asset - based on management comments

Source: Company data, Goldman Sachs Research.

Reg AC

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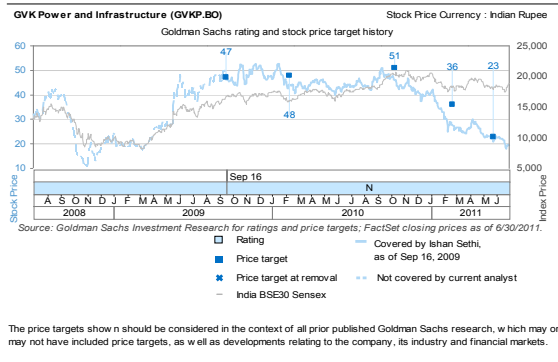
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Price target and rating history chart(s)



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