



Reliance Energy

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,724	RELE IN
	REUTERS CODE
S&P CNX: 3,678	RLEN.BO
Equity Shares (m)	212.4
52-Week Range	701/362
1,6,12 Rel. Perf. (%)	-7/-36/-71
M.Cap. (Rs b)	96.1
M.Cap. (US\$ b)	2.1

19 October 2006

Buy

Previous Recommendation: Buy

Rs452

YEAR	NET SALES	PAT	EPS*	EPS	P/E*	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	RATIO	(X)	(%)	(%)	SALES	EBITDA
3/06A	40,335	6,504	27.7	2.2	16.3	1.4	10.7	9.4	1.7	9.2
3/07E	50,591	8,434	35.9	29.7	12.6	1.2	10.7	10.3	1.0	7.0
3/08E	55,718	9,553	40.7	13.3	11.1	1.1	10.6	10.5	0.7	4.6

* Consolidated, Pre Exceptionals

- For 2QFY07, Reliance Energy reported revenues of Rs14.1b (up 35% YoY), EBITDA of Rs1.8b (down 12.8% YoY) and net profit of Rs1.9b (up 17% YoY). The reported net profit is largely in line with our estimate of Rs1.8b.
- Other income increased 49% YoY to Rs1.8b, in line with our expectations, largely driven by increased cash balances. Depreciation declined from Rs871m in 2QFY06 to Rs635m, as the company now does its calculations in accordance with the Companies Act vis-à-vis the Electricity Act, earlier.
- The EPC division recorded revenues of Rs5b (up 115% YoY) and EBIT of Rs233m (EBIT margin 4.6%), v/s Rs444m during 2QFY06 (EBIT margin 19%). Even in the past, EPC margins have been volatile. EPC order book now stands at Rs23.6b (v/s Rs35b as at March 2006), comprising Rs15b of Yamunanagar project and Rs6-7b of rural electrification work in Uttar Pradesh. The company has also bid for projects worth Rs100b (power EPC projects).
- At the CMP of Rs452, Reliance Energy trades at a PER of 12.6x FY07E and 11.1x FY08E. We maintain our **Buy** rating. We believe that the stock is largely a play on future growth opportunities rather than on existing assured return businesses.

QUARTERLY PERFORMANCE

Y/E MARCH	(Rs Million)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	9,497	10,429	9,884	10,382	11,549	14,076	12,395	12,571	40,191	50,591
Change (%)	0.7	31.7	6.4	-29.2	21.6	35.0	25.4	21.1	-2.9	25.9
EBITDA	1,615	2,034	1,793	1,901	1,334	1,775	2,107	2,187	7,332	7,403
Change (%)	9.6	25.1	200.7	0.6	-17.4	-12.8	17.5	15.0	4.4	1.0
As of % Sales	17.0	19.5	18.1	18.3	11.6	17.0	17.0	17.4	18.2	14.6
Depreciation	817	871	907	891	619	635	700	841	3,486	2,795
Interest	433	553	467	477	459	671	585	492	1,919	2,207
Other Income	1,348	1,185	1,493	1,863	1,711	1,761	1,950	2,430	5,890	7,852
PBT	1,712	1,796	1,912	2,396	1,967	2,230	2,772	3,284	7,817	10,253
Tax (incl contingencies)	146	200	265	701	201	366	499	754	1,311	1,820
Effective Tax Rate (%)	8.5	11.1	13.9	29.3	10.2	15.0	18.0	23.0	6.5	11.7
Reported PAT	1,567	1,596	1,646	1,695	1,766	1,864	2,273	2,531	6,505	8,434
PAT (Pre Exceptionals)	1,567	1,596	1,646	1,695	1,666	1,864	2,273	2,631	6,505	8,434
Change (%)	52.3	24.5	22.1	14.6	12.7	16.8	38.1	49.3	25.1	29.6

E: MOST Estimates; Quarterly numbers are on standalone basis

For 2QFY07, Reliance Energy reported revenues of Rs14.1b (up 35% YoY), EBITDA of Rs1.8b (down 12.8% YoY) and net profit of Rs1.9b (up 17% YoY). The reported net profit is largely in line with our estimate of Rs1.8b. Other income increased 49% YoY to Rs1.8b, in line with our expectations, largely driven by increased cash balances. Depreciation declined from Rs871m in 2QFY06 to Rs635m, as the company now does its calculations in accordance with the Companies Act vis-à-vis the Electricity Act, earlier.

Energy business: operational highlights

- ⌘ Electricity sales during 2QFY07 were up 19% YoY to 2,399m units. Realization was lower at Rs3.8/unit, v/s Rs4/unit in 2QFY06.
- ⌘ PLF of the Dahanu power plant improved to 99.2% during 2QFY07, as compared to 94% in the corresponding period last year. Samalkot power plant (Andhra Pradesh) registered PLF of 48.9% during 2QFY07 against 51% in 2QFY06, a result of lower gas availability.
- ⌘ Electricity purchases stood at 1,208m units, up 9% YoY. Purchase cost during the quarter was up marginally to Rs2.8/unit v/s Rs2.7/unit in 2QFY06.

ENERGY BUSINESS PERFORMANCE

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Operational Performance						
Units Sold (m)	2,161	2,017	1,902	1,984	2,229	2,399
Realization (Rs/unit)	3.6	4.0	4.3	3.9	4.1	3.8
Units Purchased (m)	1,067	1,110	898	846	1,148	1,208
Cost (Rs/unit)	2.6	2.7	2.9	3.0	2.7	2.8
Financial Performance						
Revenues (Rs m)	7,832	8,095	8,153	7,711	9,176	9,049
EBIT (Rs m)	780	927	936	927	1,330	1,041

Source: Company

EPC business

- ⌘ The EPC division recorded revenue growth of 115% YoY during 2QFY07 to Rs5b, driven by project execution.
- ⌘ EPC business reported EBIT of Rs233m in 2QFY07 (EBIT margin 4.6%), v/s Rs444m during 2QFY06 (EBIT margin 19%). Even in the past, EPC business margins have been volatile.

- ⌘ EPC order book now stands at Rs23.6b (v/s Rs35b as at March 2006), comprising Rs15b of Yamunanagar project and Rs6-7b of rural electrification work in Uttar Pradesh. The company has also bid for projects worth Rs100b (power EPC projects).

EPC BUSINESS PERFORMANCE (RS M)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Revenues	1,664	2,334	1,731	2,671	2,373	5,027
Order Book	35,000	35,000	35,000	33,000	33,500	23,660
EBIT	119	444	513	295	151	233

Source: Company

Progress on expansion plans

Maharashtra (1,200MW, imported coal): Its Maharashtra project was originally conceived as a gas-based power project, with capacity of 1,400MW in Phase 1 and 4,000MW eventually. With the gas fuel linkage yet to be tied up, the management now intends to set up 1,200-1,800MW on imported coal, and plans to invite EPC contract bids by end-November 2006. In terms of project progress, significant part of land acquisition has been completed. Part of the power generation (600-700MW) would replace existing power sourcing from Tata Power (currently at Rs2.8-3/unit). We believe that the project could be commissioned by March 2009, and Reliance Energy will have 50% stake in the project.

Infrastructure segment

- ⌘ **Mumbai Metro:** The consortium headed by Reliance Energy has won the Mumbai Metro project at a cost of Rs23b. The project would be financed as: viability gap funding Rs6.5b and balance through 70:30 debt-equity. The project work is expected to start from end-October 2006. Reliance Energy would have 49% stake, ADAG group will have 25% stake and Mumbai MMRDA 26%.
- ⌘ **Road projects:** Reliance Energy has bagged Rs7b road projects in Tamil Nadu on BOT basis. The projects would be financed as grant of Rs500m from NHAI and balance through 70:30 debt-equity.

Other growth plans

- ✍ Reliance Energy intends to participate in bidding for Ultra Mega Power Projects
- ✍ Has four coal bed methane blocks
- ✍ Working on setting up 2,500 acres SEZs
- ✍ Signed MoU with Government of Arunachal Pradesh for 1,700MW of hydro power projects
- ✍ Planned foray in power transmission through setting up transmission networks for Parbati and Koldam projects in JV with Power Grid and setting up the evacuation facilities for Dadri, etc

Valuation and view

We expect Reliance Energy to report net profit of Rs8.4b (up 21% YoY) during FY07, Rs9.5b (up 13% YoY) during FY08, and Rs10.3b (up 8% YoY) during FY09. At the CMP of Rs452, the stock trades at a PER of 12.6x FY07E, 11.1x FY08E and 10.0x FY09E. Cash balance (net of debt) stood at Rs43.3b (Rs204/share) as at March 2006 and we estimate the same at Rs59.1b (Rs259/share) as at March 2007. We maintain **Buy**.

Reliance Energy: an investment profile

Reliance Energy (formerly BSES), is one of the two leading private sector companies in the Indian power segment. The company's generation capacity, spread across five locations, stands at 942MW. It has a distribution licence in Mumbai, and during privatization by the state governments, acquired stakes in Delhi and Orissa discoms. Total energy input in distribution business (incl. Orissa) stands at 30BUs. Cash balance (net of debt) stood at Rs43.3b (Rs204/share) as at March 2006. The company has announced several growth initiatives across the spectrum of the Indian power sector, which are in multiples of its current size.

Key investment arguments

- ✍ After a lull of nearly 18-24 months, we expect a pick up in Reliance Energy's capex plans, post gas supply contract with Reliance Industries. We expect the company to award contracts for 7,000MW of combined generation capacity at Dadri and Maharashtra in the next 4-5 months.
- ✍ Cash balance (net of debt) stood at Rs43.3b (Rs204/share) as at March 2006.
- ✍ Existing business, especially the Mumbai business earns returns @ 14% p.a., assuring stable earnings stream
- ✍ Reliance Energy is emerging as a sizeable player in the infrastructure segment

COMPARATIVE VALUATIONS

		REL	NTPC (ADJ)*	TPC
P/E (x)	FY07E	12.6	13.7	18.7
	FY08E	11.1	12.4	16.1
P/BV (x)	FY07E	1.2	1.9	1.8
	FY08E	1.1	1.7	1.7
RoE (%)	FY07E	10.7	14.0	9.3
	FY08E	10.6	14.3	9.0

* Adjusted for higher depreciation in books as compared to tariff

Order and write-back of Rebate on OTSS bonds

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	29.7	53.4	51.0
Domestic Inst	29.3	22.8	20.8
Foreign	5.0	16.6	21.2
Others	16.0	7.2	7.0

Key investment risks

- ✍ Successful project implementation and execution
- ✍ Macro risks pertaining to the viability of the overall Indian power sector

Recent developments

- ✍ Bagged the contract to set up transmission networks for Parbati and Koldam hydro power projects in JV with Power Grid (24% stake) on BOOT basis at capex of Rs6.4b
- ✍ Bagged two road projects in Tamil Nadu (Rs5b) and the Andheri - Versova -Ghatkopar metro project (Rs24b - in JV)
- ✍ Signed MoA with the Government of Arunachal Pradesh for setting up 1,700MW of hydro power projects on BOOT basis

Valuation and view

- ✍ The stock trades at a P/E of 12.6x FY07E.
- ✍ Play on future growth opportunities rather than the current assured stream businesses. Recommend Buy.

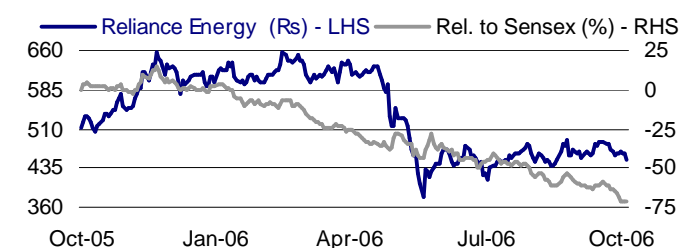
Sector view

- ✍ The Indian power sector offers significant growth potential. Incumbents enjoy growth optionality, which could be in multiples of the current size. Private companies and CPSUs have announced significant expansion projects.

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	35.9	33.3	7.9
FY08	40.7	35.7	13.9

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Sales	28,960	31,790	37,491	39,618	41,904	
Other Operating Income	12,438	8,545	13,100	16,100	20,100	
Total Revenues	41,398	40,335	50,591	55,718	62,004	
Change (%)	2.15	-2.6	25.4	10.1	11.3	
Cost of Electricity	11,032	12,016	17,480	18,757	20,739	
Cost of fuel	7,359	8,121	8,571	8,149	8,149	
Other Manufacturing Exp.	1,242	1,904	1,761	1,863	1,972	
Employee Expenses	1,836	1,909	2,004	2,105	2,210	
SG&A Expenses	1,261	1,621	1,636	1,746	1,911	
Cost of Contracts	11,646	7,288	11,735	14,669	18,251	
EBITDA	7,023	7,476	7,403	8,430	8,772	
% of Total Revenues	17.0	18.5	14.6	15.1	14.1	
Depreciation	3,464	3,486	2,795	2,915	3,011	
Interest	1,348	1,919	2,207	2,256	2,356	
Other Income	4,527	5,744	7,852	8,404	9,084	
PBT	6,738	7,815	10,253	11,662	12,489	
Tax	495	506	1,200	1,510	1,574	
Rate (%)	7.3	6.5	11.7	12.9	12.6	
Provisions for Contingencies	1,041	806	620	600	600	
Reported PAT	5,201	6,504	8,434	9,553	10,315	
Change (%)	4.17	25.0	29.7	13.3	8.0	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	1,856	2,124	2,278	2,278	2,278	
Reserves	54,021	69,088	84,028	92,043	100,821	
Net Worth	55,877	71,211	86,305	94,321	103,098	
Loans	37,387	42,669	42,055	42,055	42,055	
Consumer's Security Deposit	221	235	235	235	235	
Deferred Tax Liability	2,606	2,041	2,441	3,041	3,641	
Capital Employed	96,091	116,157	131,037	139,652	149,030	
Gross Fixed Assets	51,730	54,706	58,006	60,306	62,406	
Less: Dep and revaluation res	-32,050	-35,667	-38,462	-41,377	-44,388	
Net Fixed Assets	19,680	19,039	19,544	18,929	18,018	
Capital WIP	1,922	2,177	2,177	2,177	2,177	
Investments	6,962	11,927	11,927	11,927	11,927	
Curr. Assets	86,404	105,153	120,568	130,784	142,072	
Inventory	3,531	2,951	3,000	3,000	3,000	
Debtors	9,310	10,928	11,256	11,593	11,941	
Cash & Bank Balance	60,454	56,529	71,695	81,574	92,514	
Loans & Advances	11,701	31,617	31,617	31,617	31,617	
Other Current Assets	1,409	3,129	3,000	3,000	3,000	
Current Liab. & Prov.	18,878	22,140	23,179	24,165	25,165	
Other Liabilities	14,781	15,708	16,179	16,665	17,165	
Provisions	4,096	6,431	7,000	7,500	8,000	
Net Current Assets	67,527	83,014	97,389	106,619	116,907	
Application of Funds	96,091	116,157	131,038	139,653	149,030	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	29.9	30.6	37.0	41.9	45.3	
EPS (Fully Diluted)	27.1	27.7	35.9	40.7	43.9	
CEPS (Rs)	43.5	40.9	49.5	55.7	59.3	
Book Value	270.4	331.2	378.9	414.1	452.7	
DPS	4.7	4.9	5.0	6.0	6.0	
Payout (incl. Div. Tax.)	17.9	18.6	15.2	16.1	14.9	
Valuation (x)						
P/E	15.1	14.8	12.2	10.8	10.0	
EV/EBITDA	12.1	9.2	7.0	4.6	3.3	
EV/Sales	2.0	1.7	1.0	0.7	0.5	
Price/Book Value	1.7	1.4	1.2	1.1	1.0	
Dividend Yield (%)	1.0	1.1	1.1	1.3	1.3	
Profitability Ratios (%)						
RoE	11.1	10.7	10.7	10.6	10.6	
RoCE	10.1	9.4	10.3	10.5	10.5	
Turnover Ratios						
Debtors (Days)	82	99	81	76	70	
Inventory (Days)	31	27	22	20	18	
Asset Turnover (x)	0.4	0.3	0.4	0.4	0.4	
Leverage Ratio						
Debt/Equity (x)	0.5	0.7	0.6	0.5	0.4	

CASH FLOW STATEMENT		(RS MILLION)				
	2005	2006	2007E	2008E	2009E	
PBT before EO Items	6,738	7,815	10,253	11,662	12,489	
Add : Depreciation	3,464	3,486	2,795	2,915	3,011	
Less : Direct Taxes Paid	1,296	1,704	1,420	1,510	1,574	
(Inc)/Dec in WC	-1,375	856	792	648	652	
CF from Operations	7,531	10,453	12,420	13,716	14,578	
(Inc)/dec in FA	-2,723	-3,231	-3,300	-2,300	-2,100	
(Pur)/Sale of Investments	21,788	-25,233	0	0	0	
Others	2,942	254	-897	0	0	
CF from Investments	22,008	-28,210	-4,197	-2,300	-2,100	
(Inc)/Dec in Share Capital anc	6,183	9,080	8,824	0	0	
(Inc)/Dec in Debt	17,078	5,826	-600	0	0	
(Inc)/Dec in Customer Securi	44	14	0	0	0	
Dividend Paid	-991	-1,209	-1,281	-1,537	-1,537	
CF from Fin. Activity	22,314	13,712	6,943	-1,537	-1,537	
Inc/Dec of Cash	51,852	-4,046	15,166	9,878	10,940	
Add: Beginning Balance	8,602	60,454	56,529	71,695	81,574	
Closing Balance	60,454	56,529	71,695	81,574	92,514	

E: MOST Estimates

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Reliance Energy

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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