December 11, 2006

GUJARAT INDUSTRIES POWER CO. LTD. (CMP: RS.56) BUY
TARGET: RS. 107

Investment Argument

Gujarat Industries Power Company Ltd (GIPCL), incorporated in 1985, has a power generation capacity of 555MW with plans of adding another 250MW by FY09. It was originally setup with a 145MW plant to generate power for its promoters in Vadodara and has over the years increased capacity by 410MW, which is being sold to the state distribution utility Gujarat Urja Vikas Nigam Ltd (GUVNL).

The company has three plants in Gujarat– two gas based plants in Vadodara and 1 lignite based plant in Surat. In FY06 GIPCL achieved an overall PLF of 86% with a weighted average tariff of Rs 1.92 per unit after incurring Re 0.95 towards fuel cost. The company also owns captive mines which is sufficient to generate 1000 MW power for 30 years with average PLF of 80%.

GIPCL's performance in early 2000 was severely impacted due to large outstanding from GUVNL leading to huge working capital loans. In 2003, while the receivables were swapped with bonds RoE for the non-IPP plants were also lowered to 13% from 16%.

Despite this, GIPCL's performance, has improved considerably. Its core power business RoE has improved from 5.5% in FY03 to 17% in FY06. This has been possible due to higher PLF, efficient plant utilization, lower interest costs and efficiency gains.

GUVNL's financial position has improved significantly and is amongst the top state utilities in India. In this process GIPCL has gained in the form of prompt payment of receivables, approval of delayed payment charges and acknowledgement of tax refund of Rs 340 million. GIPCL has also taken up the issue of lower RoE, which we believe would be hiked during next round of negotiation. The IPP MOU will be renewed in March 2007 and the PPAs would be renegotiated in March 2008. Post-successful execution of these agreements the improvement in PAT could be around 12%.

The company has raised Rs 2.75 billion through a public issue in October 2005 to finance the equity portion of the proposed lignite based 250 MW expansion. The management could undertake further expansion to use the redemption proceeds from state electricity bonds and internal accruals. Going forward, we expect GIPCL to gain from improved efficiencies, benefits from the expansion plans and increase in the RoE rate to further aid profit growth.

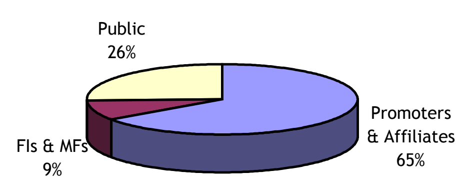
The stock has significantly under performed vis-à-vis the Sensex since its FPO in October 2005. At the current market price of Rs 56 the stock is trading at attractive levels of 0.77x FY08 book value and discounting FY08 EPS 7.7x. Based on a combination of replacement cost and P/BV methodologies we recommend a BUY on the stock with an 18-month target price of Rs 107.

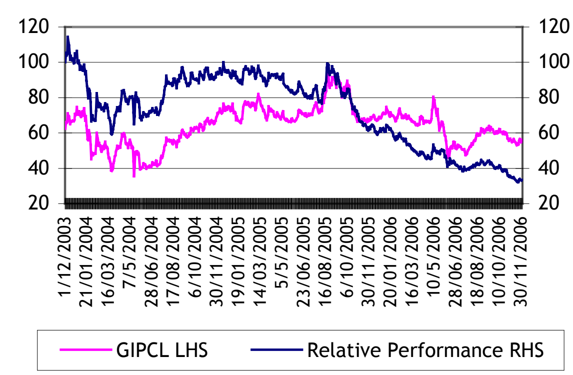
		Major Shareholders	(%)
Market Cap (mn)	8507.8	Major Shareholders	(%)
Issued Shares (mn)	151.25	Promoters & Affiliates	65%
Avg. Daily Volume	201900	FIs / MFs	9%
BSE Sensex	13799	Public & Others	26%

Price Performance (%)	1mt	3mt	12mt
GIPCL	4.8	-7.6	-17.2
Sensex	5.6	17.1	54.6

Year End Mar	FY04	FY 05	FY 06	FY 07E	FY 08E	FY 09E
Revenues	7454.0	7446.7	7565.9	7739.4	8202.6	8440.7
Adj. PAT	690.5	876.9	992.5	1091.9	1103.3	1104.8
Adj EPS (Rs.)	6.2	7.9	6.6	7.2	7.3	7.3
P/E (x)	9.0	7.1	8.6	7.8	7.7	7.7
Adj RoAE (%)	15.3	16.8	13.2	11.0	10.2	9.6
BV (Rs.)	43.6	50.8	60.7	67.8	72.9	78.1
P/BV	1.3	1.1	0.9	0.8	0.8	0.7
Div. Yield (%)	3.0	2.6	2.5	4.1	4.1	4.1
Power ROE (%)	21.9	17.5	16.9	15.1	13.3	11.2

Shareholding Pattern





Background

Gujarat Urja Vikas Nigam Ltd (GUVNL), Gujarat State Fertilizer Company Ltd (GSFC), Gujarat Narmada Valley Fertilizer Company Ltd (GNFC), Gujarat Alkalies & Chemical Ltd (GACL), Petrofils Co-operative Ltd (Petrofils) and Heavy Water Project (Government of India unit) promoted Gujarat Industries Power Company Ltd (GIPCL), incorporated in 1985. The main objective was to setup and operate a 120 MW coal based power station which will cater to the power requirements of its promoters. In 1998, however due to availability of gas and low cost of capital the project was converted in a 145 MW gas based one in Vadodara.

In November 1997, another 160 MW combined cycle gas based power plant in Vadodara was commissioned taking its total capacity to 305 MW. In 2000, after securing lignite mining rights and all other approvals a 2x125 MW power plant was commissioned in 2000. In October 2005, GIPCL raised through a fresh issue of equity shares Rs 2.75 billion to finance its 250 MW lignite based power plant including cost of mining. The 125 MW first phase of this plant would commence operations in November 2008 and the balance in February 2009.

While the MoU for the first plant and PPA for the remaining two plants are already signed the PPA for the new plant would be signed in FY08.

Board Of Directors

Name	Designation	Other Directorships
Mr Balwant Singh	Chairman	GSPC, GNFC, GSFC, GSIC
Mr L Chuaungo, IAS	Managing Director	GUVNL, DGVCL, GIDC
Mr PK Taneja	Director	GACL, DGVCL, TPL,
Mr AK Joti	Director	GIDC, GMDC, Guj Power
Mr Kirankumar Joshi	Director	
Mr MS Agarwal	Director	
Mr A Khandual		
Dr PK Das		
Mr AN Mandke		
Prof Sekhar Chaudhuri		

Snapshot of Power units and PPA details

	Plant I	Plant II	SLPP I & II
Capacity	145	160	250
Unit Size	3x32, 1x49	1x106, 1x54	2x125
Location	Vadodara	Vadodara	Surat
Fuel	Gas	Gas	Lignite
Fuel Source	Natural Gas - GAIL, GSPCL & Niko and R-LNG - GAIL		Captive Mines
Cost per MW (Rs Mn)	14.8	22.9	48.4
Yr of Commissioning	Feb-92	Nov-97	Nov-99
Consumer	Promoters	GEB	GEB
PPA expires on	March 2007	August 2016	April 2027
Tariff re-negotiation		**Every 3 yrs - next due in March 2008**	
PPA PLF	70%	80%	75%
RoE	9%	13%	13%
Incentive threshold	70%	80%	75%*
Incentive Rate	Re 0.10	Re 0.25	Re 0.25
FY06 Details			
PLF (%)	87.0	86.76	85.58
Tariff / unit in Rs	1.90	1.79	2.02
Fuel Cost / unit in Rs	1.13	1.37	0.87
Overall RoE FY06	17.4%	14.9%	13.0%

* - wef April 2006. Earlier it was capped at 80%

Operational Performance

Year	FY01	FY02	FY03	FY04	FY05	FY06
PLF	67.69%	67.93%	73.75%	70.53%	83.60%	86.29%
Gen - Mus	2,313	2,750	3,586	3,438	4,065	4,195
Sold-Mus	2,167	2,562	3,370	3,210	3,827	3,945
T&D loss	*6.3%*	*6.8%*	*6.0%*	*6.6%*	*5.8%*	*5.9%*
Sale in Rs Mn	7,033	7,036	8,237	7,454	7,447	7,566
AvgTariff / unit (Rs)	*3.25*	*2.75*	*2.44*	*2.32*	*1.95*	*1.92*
Fuel Exps in Rs Mn	2749	2351	3503	2871	3578	4002
Fuel cost per unit	1.19	0.85	0.98	0.83	0.88	0.95
Contribution / unit	*2.06*	*1.89*	*1.47*	*1.49*	*1.07*	*0.96*
O&M Exps	830	844	893	796	786	787
O&M Rs/u	0.36	0.31	0.25	0.23	0.19	0.19
Adj PAT Rs in Mn	156	90	203.4	690.5	876.9	992.5
PAT/unit	*0.07*	*0.04*	*0.06*	*0.22*	*0.23*	*0.25*

GICPL's performance has improved significantly which is highlighted from the above table. With the steady increase in PLFs, diligent utilization of fuel and constant focus on cost the company has managed **to both lower tariff as well as increase profits sharply**.

Profit after Tax for the last two fiscal includes extraordinary income to the extent of Rs. 245 million and Rs. 279 million respectively. Bulk of these adjustments pertains to past dues along with accrued interest.

GIPCL is likely to report recurring PAT of Rs 850-900 million from power & mining business including efficiencies over the next three years. Since the company has sizeable investments (SEB bonds) and cash equivalents (issue proceeds) we believe GIPCL would continue to earn interest income till FY09.

First Half Performance

For the six months ending September 30, 2006 GIPCL has reported revenues of Rs 3.9 billion against Rs 3.8 billion last year. The floods in Surat and completion of annual maintenance at SLPP in Q2 itself (last year it spilled over to Q3) resulted in an overall PLF of 77.6% during H1FY07 against 82.8% registered in H1FY06. Since revenues included claim towards income tax reimbursement of Rs 340.4 million the company reported a flat topline in its half yearly results.

The average tariff per unit during the period improved to Rs 2.03 per unit against Rs. 2.01 per unit last year despite rise in fuel costs which were at Rs. 1.01 per unit against Re. 0.94 per unit in H1FY06. But due to higher PLF at Vadodara I plant and flat operating and maintenance costs the PAT increased by Re. 0.02 at Re. 0.26 per unit.

Going forward we expect the Vadodara II unit to undergo maintenance in February 2007 which could result in its annual PLF to be marginally down at 85% against 86.8%. Since the other plants are operating at maximum capacity we do not expect significant loss in revenues and profits for FY07.

Financial Performance

Income Statement

Year end 31st Mar (Rs mn)	FY04	FY 05	FY 06	FY 07E	FY 08E	FY 09E
Net Sales	7454.0	7446.7	7565.9	7739.4	8202.6	8440.7
Fuel Expenses	2871.0	3578.2	4001.9	4668.2	5059.4	5368.9
O&M Expenses	796.0	786.0	787.4	806.7	826.8	847.5
Total Expenses	3667.0	4364.2	4789.3	5474.9	5886.2	6216.5
Operating Profit	3787.0	3082.5	2776.6	2264.5	2316.4	2224.2
EBIDTA	51%	41%	37%	29%	28%	26%
Depreciation	1012.0	943.5	913.7	886.3	868.6	859.9
Total Interest	1866.0	949.5	567.7	395.6	370.5	259.8
Other Income	287.0	213.0	196.0	290.8	238.8	200.5
PBT	1196.0	1402.5	1491.2	1273.4	1316.2	1305.0
Prior Period Items	-32.0	255.5	233.7	340.4	0.0	0.0
Taxes	492.0	621.3	576.8	230.0	212.9	200.2
PAT Reported	672.0	1036.7	1148.1	1383.8	1103.3	1104.8
PAT Adjusted	690.5	876.9	992.5	1091.9	1103.3	1104.8

Balance Sheet	FY04	FY 05	FY 06	FY 07E	FY 08E	FY 09E
Year end 31st Mar (Rs mn)						
Share Capital	1,190.0	1,108.1	1,512.5	1,512.5	1,512.5	1,512.5
Share Premium	986.1	986.1	3,331.7	3,331.7	3,331.7	3,331.7
Reserves & Surplus	2657.4	3530.7	4,463.3	5,502.3	6,260.6	7,020.5
Total Networth	4,833.1	5,624.9	9,307.5	10,346.5	11,104.8	11,864.7
Secured Loans	11,199.0	7,097.5	5,993.1	4,183.2	11,027.2	13,571.2
Unecured Loans	1,400.0	777.3	21.6	-	-	-
Total Loans	12,599.0	7,874.8	6,014.7	4,183.2	11,027.2	13,571.2
Deferred Tax Liability	567.4	1,073.9	1,073.9	1,073.9	1,073.9	1,073.9
Total Liabilities	17,999.4	14,573.6	16,396.1	15,603.6	23,205.9	26,509.8
Net Fixed Assets + Cap WIP	12,192.8	11,291.5	11,250.3	12,816.5	20,940.4	24,985.6
Mine Development Exps	1,500.0	1,675.1	1,527.0	1,389.6	1,264.5	1,150.7
Total Investments	2,406.5	1,357.2	1,357.2	1,357.2	1,126.2	895.2
Inventory	839.8	812.9	860.2	933.6	1,011.9	1,073.8
Sundry Debtors	2,453.2	1,046.2	1,092.9	954.2	898.9	809.4
Cash & Bank Balance	62.7	78.6	1,031.0	320.5	316.8	99.0
Total Curr Liab & Prov	1,664.5	2,117.9	2,619.5	2,493.4	2,637.0	2,751.6
Net Current Assets	1,900.2	249.9	2,141.7	(54.9)	(196.5)	(569.2)
Miscellaneous Expenses	-	-	119.1	95.3	71.5	47.6
Total Assets	17,999.4	14,573.6	16,396.1	15,603.6	23,205.9	26,509.8

Assumptions:

1. We expect the 250MW expansion to come into effect in Q1FY 2010. While interest cost will be capitalized we have assumed debt to be raised by FY09 itself.
2. Tax payment is lower due to Sec 80IA benefit for the Surat plant.

Ratio Analysis	FY04	FY 05	FY 06	FY 07E	FY 08E	FY 09E
Valuation Ratios						
Dividend Yield (%)	3.0%	2.6%	2.5%	4.1%	4.1%	4.1%
P/E (x)	9.0	7.1	8.6	7.8	7.7	7.7
ROAE (%)	14.7%	17.0%	13.3%	11.7%	10.2%	9.6%
P/BV (x)	1.43	1.11	0.91	0.82	0.77	0.72
EV/EBIDTA (x)	5.1	4.6	5.23	5.6	8.4	9.9
Per Share Ratios						
DPS (Rs)	1.56	1.47	1.42	2.3	2.3	2.3
Adj EPS (Rs)	5.65	7.9	6.6	7.7	7.3	7.3
Cash EPS (Rs)	14.2	16.4	12.6	13.6	13.1	13.0
Book Value (Rs)	39.3	50.7	61.5	68.4	73.4	78.8
Profitability Ratios						
Operating margin (%)	50.8%	41.4%	36.7%	29.3%	28.2%	26.4%
PBT margin (%)	16.0%	18.8%	19.7%	16.5%	16.0%	15.5%
ADJ PAT MARGINS	9.3%	11.8%	13.2%	14.1%	13.5%	13.1%
EBIT Margins (%)	29.6%	31.5%	31.8%	27.9%	26.6%	25.6%
Other Ratios						
Stock Turnover (days)	41	40	41	44	45	46
Current Ratio	2.1	0.9	1.1	0.9	0.8	0.7
Debt-Equity Ratio	2.7	1.4	0.7	0.4	1.0	1.1
Avg Collection Period (days)	120	51	53	45	40	35
Avg Payment Period (days)	202	216	239	195	190	187

Valuations

Price to Book Analysis: Since the profits are broadly regulated, stocks in this vertical are closely linked to the reported RoE.

RoE	FY 07E	FY 08E	FY 09E
NTPC	13.2%	13.6%	13.8%
TPC - Con	10.4%	10.3%	9.9%
REL - Con	8.1%	8.3%	7.4%
GIPCL	11.7%	10.2%	9.6%

P/BV	FY 07E	FY 08E	FY 09E
NTPC	2.20	2.05	1.91
TPC - Con	2.32	2.17	1.76
REL - Con	1.33	1.24	1.15
GIPCL	0.82	0.77	0.72

Replacement Cost: We have assumed a replacement cost of Rs 45 million/MW for thermal plants and Rs 30/MW for gas-based plants.

Rs in Million	GIPCL		* NTPC	
	FY06	FY09E	FY06	FY12E
Capacity Mar'06	555	805	23,935	42,252
Replacement cost	24,975	36,225	1,017,750	2,330,737
Cap WIP as on Mar'06			103,999	103,999
Debt Required for incremental capacities		12,250		
Add Inv, Cash less debt	3,804		86,761	-204,205
Eq Value	21,171	23,975	1,208,510	2,230,530
Discounted EQ value		16,233		1,242,719
Value per share	140	107	146	151
% upside	*149%*	*91%*	*-1%*	*0%*
Current Share price Rs	56.25	56.25	155	155

* refer to our report dated 20th Sept. 2006

Issues / Concerns:

1. Lower RoE: The benchmark RoE awarded to GIPCL by GUVNL is 13% (for Vadodara and Surat plants) as compared to 14% for other companies. SLPP contributes around 55% of the total profits followed by Vadodara II at 20%.
2. Huge outstandings: In the past GIPCL had raked up large receivables from GUVNL due to state utility's losses. The debtors had reached Rs. 4.8 billion in FY02 which has since then been reduced to Rs. 1.1 billion in FY06.
3. Expansion project: In October 2005 GIPCL had tapped the capital market to raise equity money to finance its 250 MW lignite based power plant. While the project is likely to be commissioned in FY09 the balance sheet of the company already reflects the equity contribution resulting in lower RoE for the next three financial years.
4. Promoters are also customers: GIPCL was originally promoted as an IPP to cater to the requirements of its 56% stakeholders - GUVNL (ex-GEB), GACL, GSFC and Petrofils. Due to this GIPCL had weak bargaining power to garner RoE in line with the market and also ensure prompt payments.

Light at the end of the tunnel

1. MoU and PPAs likely to be renewed at a higher rate: The Vadodara I plant's PPA would be renewed in March 2007 post the 15 year MOU expiry. The Vadodara II and SLPP PPA would come up for renegotiation in March 2008. The management expects higher RoE due to GUVNL's better financial position and its own competitive tariff.
2. Improved collection: GIPCL has been successful in reducing its debtors over the last couple of years with the average debt collection period down to 53 days in FY06 from 120 days in FY04 and going forward is likely to be even lower. This has been possible due to prompt payment by GUVNL and allocation of bonds worth Rs. 1.18 billion in lieu of past receivables.
3. While the company is eligible for 13% RoE however, on its core power business it has been able to earn higher due to efficiency gains. The new 250MW plant will earn 14% RoE since GUVNL has signed other recent PPAs at this level.
4. Customer base widening: GIPCL's Vadodara I plant would be the only plant that would cater to its promoters. The rest including the proposed 250MW plant would aid the state's power requirement.
5. Due to better cash flows we expect higher payout, which would enhance dividend yield.
6. The management is working on further expansion plans at its existing facilities subject to regulatory approvals.

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