

Jaiprakash Associates Ltd

Amalgamation scheme – positive for JPVL

The Jaiprakash group has announced an amalgamation scheme which aims at transferring the 43.1% stake held by Jaiprakash Associates (JPA) in the 1,000MW Karcham Wangtoo hydropower project (being developed by Jaypee Karcham Hydro Corporation Ltd (JKHCL)) to its 76% subsidiary Jaiprakash Power Ventures (JPVL). The stake transfer implies valuation of JKHCL at P/B of 0.8x (based on the CMP of JPVL) in consideration for new shares of JPVL. Given that the 1,000MW Karcham Wangtoo plant is on the verge of completion and will be profitable (in our view), the transfer at 0.8x P/B is marginally negative for JPA and positive for JPVL. Firstly, it will be value-accretive for JPVL, which will need to raise capital for its power projects in future. Secondly, this transaction will lead to the creation of 279mn treasury shares in JPVL, which can later be sold in the open market, translating to cash flows of ~Rs 11.5bn (based on CMP of Rs 41).

Development: JPVL has announced a restructuring scheme, wherein it proposes to merge two subsidiary companies—the 56.9% owned Jaiprakash Karcham Hydro Power (JKHCL) and the 100% owned Bina Power Supply Company (BSCPL)—with itself. In the case of JKHCL, JPA owns the remaining 43.1% stake — this will be transferred to JPVL in consideration for the issue of new shares of JPVL. For every 5 shares of JKHCL, holders will get 1 share of JPVL. In the case of BSCPL, for every 13 shares, holders will get 2 shares of JPVL. This will lead to the creation of 279mn treasury shares in JPVL.

Rationale for amalgamation: The management intends to capture the cash flows from these two power projects (commissioning expected in the next 12 months) in JPVL. This will provide a boost to JPVL's cash flow and valuations as we expect the Karcham Wangtoo project to be quite profitable (first unit of Karcham Wangtoo to be commissioned by March '11 and that of Bina Power by December '11).

In the process, 279mn treasury shares are also being created, which can be used to raise money through sale in the open market. At the CMP of Rs 41, JPVL can raise ~Rs 11.5bn, which will help reduce its dependence on capital raising to meet its equity commitment on the power projects. We note that JPVL's board has also passed a resolution to raise up to Rs 35bn from the market through a mix of instruments (QIP/FCCB/ADR/GDR/FPO/CCPS).

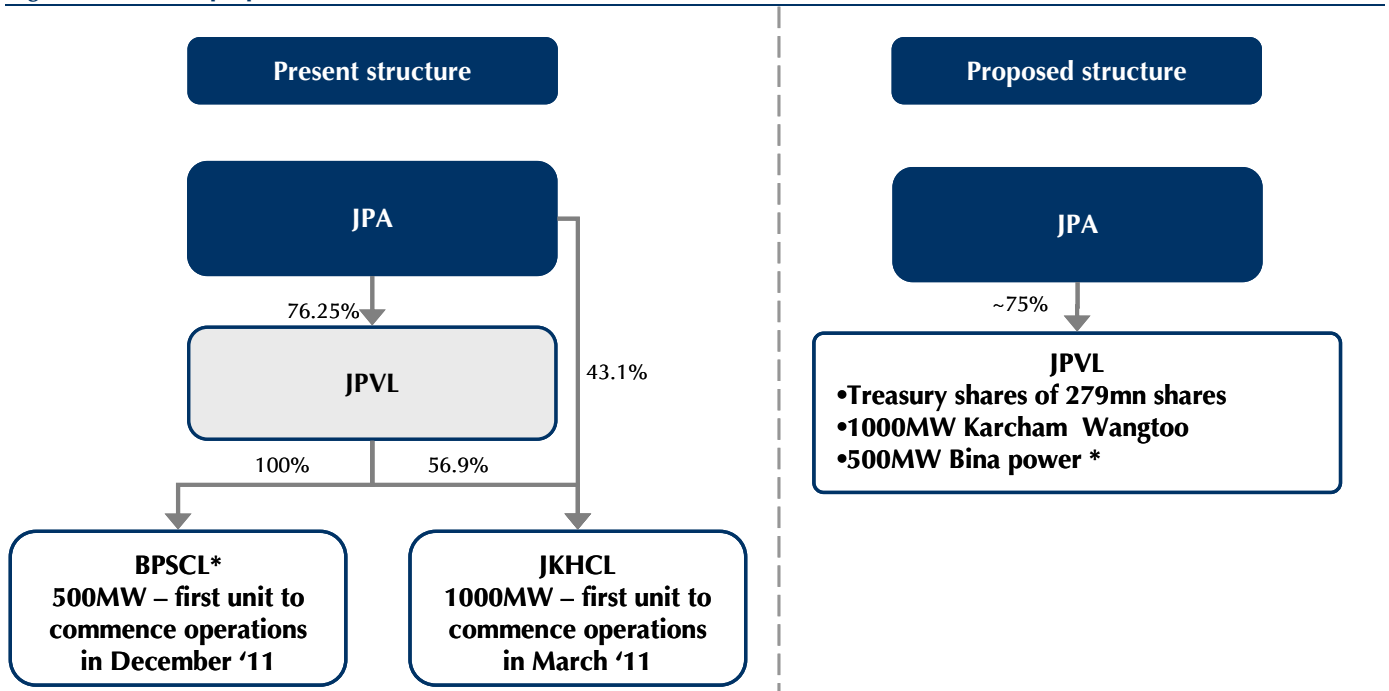
Positive for JPVL and marginally negative for JPA: This amalgamation will lead to the transfer of JPA's 43.1% stake in JKHCL in return for 185mn shares of JPVL. Based on JPVL's CMP (Rs 41), the implied value of JKHCL is Rs 18bn. This implies a P/B valuation of 0.8x (total book value being Rs 21.5bn) for the stake transfer. The valuation appears low as the JKHCL project is (1) on the verge of completion, (2) expected to be profitable, and (3) the entire equity has already been infused. In our view, the fair value would be 1.5–2x book. Hence, this transfer of stake is positive for JPVL and negative for JPA.

However, since JPA already holds 76% in JPVL, some of the negative impact will be compensated by the rise in value of its existing stake in JPVL. As far as the merger of BSCPL is concerned, since it is 100% owned by JPVL, there is no impact on the value of any of the entities, except for creation of treasury shares to the tune of 34.5mn. We view this amalgamation scheme as a positive development for JPVL shareholders.





Fig 1 - Present and proposed structure



* Planning to add another 1000MW in subsequent phases

Source: RCML Research

Fig 2 - Implied value of JKHCL based on proposed amalgamation is 0.8x book value

Particulars

Total amount invested by JPA in JKHCL (Rs mn)	9,250
Total shares held by JPA in JKHCL (mn shares)	925
JPA stake in JKHCL (%)	43.1
No of new shares of JPVL issued for every 5 shares of JKHCL	1.0
No of new shares of JPVL issued to JPA (mn shares)	185
JPVL CMP (Rs)	41.4
Value of these new shares at CMP (Rs mn)	7,659
Implied value of JKHCL project (Rs mn)	17,770
Total equity invested in JKHCL project (Rs mn)	21,450
Implied price to book multiple	0.8x

Source: RCML Research

Fig 3 - JPVL can raise Rs 11.5bn through sale of treasury shares in open market

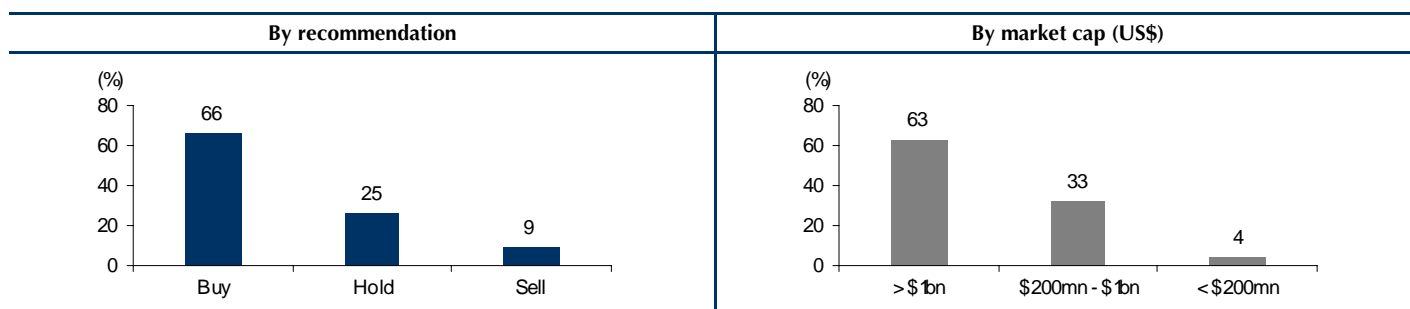
Particulars

JPVL's holding in JKHCL (mn shares)	1,221
Resultant treasury shares due to merger of JKHCL (mn shares) (A)	244
JPVL's holding in BSCPL* (mn shares)	224.2
Resultant treasury shares due to merger of BSCPL (mn shares) (B)	34.5
Total treasury shares (mn shares) (A+B)	279
CMP of JPVL (Rs)	41.4
Money that can be raised from market through sale of treasury shares (Rs bn)	11.5

Source: RCML Research * - based on JPVL FY10 annual report



Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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