30 July 2009 | 9 pages

Reliance Infrastructure (RLIN.BO)

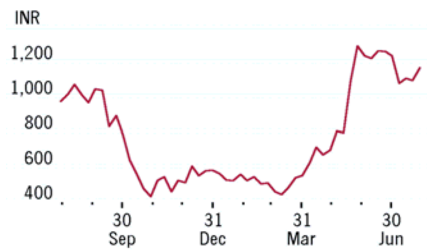
Equity

Buy: 1QFY10 Recurring PAT up 42% YoY

- **Recurring PAT up 42% YoY** — At Rs3.2bn, PAT was 11% below CIRA estimates but well ahead of full year growth expectations of 18% YoY. PAT was below expectations on lower than expected execution on the EPC side and higher-than-expected other expenditure. Operational results were decent, with EBITDA growing 34% YoY, but unallocable income of Rs2.0bn vs. Rs190m of unallocable cost in the previous year in the segmental results is hard to explain.
- **Rs50.5bn of Rs90.9bn in cash/debt funds** — According to management the company had Rs90.9bn (Rs100bn end FY09) of cash/cash equivalent. Of this, Rs50.5bn (Rs54bn end FY09) is in cash/debt funds. Promoters subscribed to 42.9m warrants, convertible into equity for further capital infusion of ~Rs43bn. Total debt on the books is Rs61.6bn.
- **Rs10.34bn+ of regulatory assets is a worry** — In FY09 the company had created regulatory assets of 10.34bn (Rs3.56bn because of a revenue gap and Rs6.78bn because of unrecovered fuel adjustment charges). This likely has to be recovered through future tariff orders and is a key concern. We believe more regulatory asset would have been created in 1QFY10.
- **Update on buyback** — The shareholders of the company had approved a buyback of Rs20bn. Till end FY09 the company has bought back 11.26m shares at an average price of ~Rs823 totalling to Rs9.27bn. The company has bought back additional 0.75m shares in 1QFY10 which has reduced the current outstanding share count to 225.27m.

Buy/Medium Risk	1M
Price (30 Jul 09)	Rs1,185.10
Target price	Rs1,535.00
Expected share price return	29.5%
Expected dividend yield	0.6%
Expected total return	**30.1%**
Market Cap	Rs266,968M US$5,530M

Price Performance (RIC: RLIN.BO, BB: RELI IN)



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	7,503	31.84	2.7	37.2	3.1	9.5	0.4
2008A	9,913	42.07	32.1	28.2	2.5	10.1	0.5
2009E	10,665	47.10	11.9	25.2	2.4	9.5	0.6
2010E	12,558	55.46	17.7	21.4	2.2	10.6	0.7
2011E	14,739	65.09	17.4	18.2	2.0	11.4	0.8

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	37.2	28.2	25.2	21.4	18.2
EV/EBITDA adjusted (x)	53.6	48.8	30.3	21.6	18.9
P/BV (x)	3.1	2.5	2.4	2.2	2.0
Dividend yield (%)	0.4	0.5	0.6	0.7	0.8
Per Share Data (Rs)					
EPS adjusted	31.84	42.07	47.10	55.46	65.09
EPS reported	34.01	46.03	50.29	55.46	65.09
BVPS	378.06	468.69	499.81	545.90	600.46
DPS	5.30	6.30	7.00	8.00	9.00
Profit & Loss (RsM)					
Net sales	57,100	63,643	96,749	128,322	151,160
Operating expenses	-54,526	-60,407	-91,376	-120,494	-142,396
EBIT	**2,574**	**3,235**	**5,373**	**7,828**	**8,764**
Net interest expense	-2,503	-3,088	-3,305	-4,766	-4,766
Non-operating/exceptionals	8,653	11,370	9,866	11,540	13,140
Pre-tax profit	**8,724**	**11,517**	**11,934**	**14,602**	**17,138**
Tax	-1,221	-1,604	-1,269	-2,044	-2,399
Extraord./Min.Int./Pref.div.	511	933	723	0	0
Reported net income	**8,015**	**10,846**	**11,389**	**12,558**	**14,739**
Adjusted earnings	7,503	9,913	10,665	12,558	14,739
Adjusted EBITDA	4,975	5,465	7,822	10,411	11,471
Growth Rates (%)					
Sales	41.6	11.5	52.0	32.6	17.8
EBIT adjusted	-35.5	25.7	66.1	45.7	12.0
EBITDA adjusted	-33.5	9.8	43.1	33.1	10.2
EPS adjusted	2.7	32.1	11.9	17.7	17.4
Cash Flow (RsM)					
Operating cash flow	**-39,441**	**34,301**	**30,308**	**11,513**	**17,078**
Depreciation/amortization	2,401	2,229	2,449	2,583	2,707
Net working capital	-50,129	21,053	16,471	-3,628	-368
Investing cash flow	**-18,441**	**-59,618**	**-35,677**	**-3,000**	**-3,000**
Capital expenditure	-5,250	-8,093	-3,500	-3,000	-3,000
Acquisitions/disposals	-13,191	-51,525	-32,177	0	0
Financing cash flow	**23,112**	**4,434**	**14,811**	**-2,097**	**-2,360**
Borrowings	15,914	-8,694	23,431	0	0
Dividends paid	-1,417	-1,728	-1,855	-2,120	-2,385
Change in cash	**-34,770**	**-20,883**	**9,442**	**6,416**	**11,718**
Balance Sheet (RsM)					
Total assets	**177,327**	**196,786**	**227,889**	**238,675**	**252,177**
Cash & cash equivalent	21,759	876	10,318	16,734	28,451
Accounts receivable	10,564	13,514	30,884	32,418	32,097
Net fixed assets	24,064	29,928	30,979	31,396	31,689
Total liabilities	**90,914**	**86,353**	**114,708**	**115,055**	**116,204**
Accounts payable	11,607	11,069	17,127	15,553	15,158
Total Debt	58,583	49,889	73,320	73,320	73,320
Shareholders' funds	**86,413**	**110,433**	**113,181**	**123,619**	**135,974**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.7	8.6	8.1	8.1	7.6
ROE adjusted	9.5	10.1	9.5	10.6	11.4
ROIC adjusted	1.7	1.6	4.8	7.4	7.8
Net debt to equity	42.6	44.4	55.7	45.8	33.0
Total debt to capital	40.4	31.1	39.3	37.2	35.0

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Figure 1. R-Infra 1QFY10 Results

Year End Mar31 (Rs mn)	1QFY09	1QFY10	% Chg	1QFY10E	- Remarks
EPC Order Backlog	210,440	200,750	-5%		
Generation (mu)	1,486	1,628	10%	1,493	- On higher generation in Dahanu and Samalkot
Power Purchased (mu)	1,449	1,544	7%	1,530	
Sales (mu)	2,539	2761	9%	2,615	
Realization (Rs/kwh)	6.95	6.72	-3%	6.53	
Purchase Cost (Rs/kwh)	7.47	6.38	-15%	6.00	
Fuel Cost (Rs/kwh)	2.00	1.99	-1%	1.66	
Net Sales-Sale of Electrical Energy	**17,637**	**18,553**	**5%**	**17,085**	
Income from EPC	4,344	5,519	27%	8,000	- Execution has been poor in 1QFY10
Total Income	**21,981**	**24,072**	**10%**	**25,085**	
Cost of Purchases	10,823	9,848		9,176	
% of electricity sales	61.4%	53.1%		53.7%	
Cost of Fuel	2,968	3,234		2,473	- Higher cost of fuel
% of electricity sales	16.8%	17.4%		14.5%	
Materials & Direct expenses	3,571	4,407		6,400	
% of EPC Income	82.2%	79.9%		80.0%	
Surcharge on Generation	370	423		380	
% of electricity sales	2.1%	2.3%		2.2%	
Staff Cost	1,245	1,549		1,560	
% of total sales	5.7%	6.4%		6.2%	
Other Expenses	1,067	2,006		1,200	- Higher than expected
% of total sales	4.9%	8.3%		4.8%	
Total Expenditure	**20,045**	**21,468**	**7%**	**21,189**	
EBITDA	**1,937**	**2,604**	**34%**	**3,896**	
% margin	**8.8%**	**10.8%**		**15.5%**	
Interest	(774)	(1,037)		(1,100)	
Depreciation	(612)	(722)		(710)	
Other Income	1,869	2,442		1,800	- Higher than expected
Derivatives Loss	(766)	-		-	
Other Operational Income	922	391		300	
PBT	**2,575**	**3,678**	**43%**	**4,186**	
Provision for Taxation	(300)	(530)			
Provision for deferred Tax	(25)	32			
FBT	(15)	(15)			
Total Tax	**(340)**	**(513)**		**(628)**	
Tax Rate (%)	13.2%	13.9%		15.0%	
Recurring PAT	**2,235**	**3,166**	**42%**	**3,558**	- 11% below estimates
					- But well ahead of full year expected growth of 17 - 20%
Tax adjustment for previous years	291	-		-11.0%	
Reported PAT	**2,526**	**3,166**	**25%**	**3,558**	

Source: Company reports and Citi Investment Research and Analysis

Figure 2. R-Infra 1QFY10 Segmental Results

Year End Mar31 (Rs mn)	1QFY09	1QFY10	% Chg
Electrical energy	18,464	18,805	2%
EPC and Contracts	4,439	5,658	27%
Gross	**22,903**	**24,463**	**7%**
PBIT			
Electrical energy	1,874	1,769	-6%
EPC and Contracts	474	541	14%
Total	**2,348**	**2,310**	**-2%**
Interest and Finance Expense	(774)	(1,037)	
Interest Income	1,191	367	
Other unallocable income	(190)	2,038	
PBT	2,575	3,678	43%
PBIT Margins			
Electrical energy	10.1%	9.4%	
EPC and Contracts	10.7%	9.6%	
Total	**10.3%**	**9.4%**	

Source: Company reports and Citi Investment Research and Analysis

Reliance Infrastructure

Company description

Reliance Energy (RELE) became Reliance Infrastructure (R-Infra) as it has forayed aggressively into the infrastructure business over the past 2.5 years: Projects include: 1) EPC player with Rs90.5bn order book; 2) Power transmission infrastructure developer including the Western Region Strengthening System (WRSS), the only 100%-owned power transmission project developed by a private player; 3) Metro rail project developer with 12km VAG corridor in Mumbai and 22.7 km airport link in Delhi; 4) 562km of highway projects; 5) L1 bidder to construct the 25-km-long bridge over sea link (MTHL) in Mumbai. RI is also constructing a 100-storey corporate park in Hyderabad with plans to set up SEZs in Noida and Mumbai and is in advanced stages of bidding for several metro, airports, highway and energy distribution projects. Further it has re-structured into six verticals: to provide clarity about the holding structure and to facilitate fundraising below the holding company level, either through private equity placement or an initial public offering (IPO).

Investment strategy

We rate R-Infra Buy/Medium Risk (1M) with a target price of Rs1,535. Our assumptions about sales growth in the EPC business, equity IRRs in the road projects, equity IRRs in transmission projects, and equity IRRs in the metro projects are conservative vis-à-vis management expectations. We believe our assumptions adequately factor in: 1) executions risks, 2) capital risks, 3) interest-rate risks, and 4) de-rating of sectors in which RI operates given market conditions. Recently, the company: 1) successfully IPOed Reliance Power; 2) initiated a share buyback programme; and 3) re-named and restructured RELE as R-Infra. In addition, recent disclosures and seriousness evident in the recent analyst meeting for R-Infra/R-Power has forced a re-examination. Interaction with senior/middle/junior management has given us confidence to undertake a detailed valuation exercise of each of its entities. We see Reliance Infrastructure as "An Infrastructure Goliath in the Making".

Valuation

Our 12-month SOTP target price for R-Infra of Rs1,535 is composed of: 1) EPC + Power business using an EV/EBITDA multiple of 10x Sept-2010E; 2) We value the projects in Reliance Infra Ventures using a discounted cash flow (DCF) methodology; 3) We value the Delhi distribution business at a P/Equity Base of 2.0x; and 4) We value the projects in Reliance Power at a 20% discount to discounted cash flow (DCF) value, reflecting the chance of further litigation.

Risks

We rate R-Infra Medium Risk, which is different from the High Risk rating that our quantitative risk-rating system accords. Our risk rating is higher than that of peers like NTPC, Tata Power and CESC. Key downside risks to our target price are: 1) Execution risks on its infrastructure projects leading to delayed commissioning; 2) Failure to secure fuel supply for incremental power projects; 3) Failure to financially close incremental infrastructure projects; 4) Higher interest rates and market risk premium leading to lower valuations for various infrastructure projects; 5) Right of way and clearance risks; 6) Change in regulatory mechanism; and 7) Hydrology-related risks for the hydel power projects.

Appendix A-1

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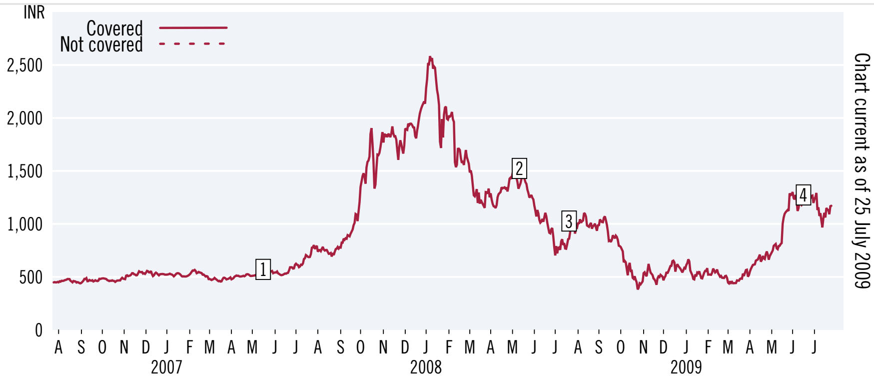
IMPORTANT DISCLOSURES

Reliance Infrastructure (RLIN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam



	Date	Rating	Target Price	Closing Price
1	16-May-07	*3L	*510.00	505.95
2	12-May-08	*1L	*1,675.00	1,357.05
3	21-Jul-08	*1M	*1,170.00	860.50
4	16-Jun-09	1M	*1,535.00	1,268.55

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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