



Reliance Energy

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,218	RELE IN
	REUTERS CODE
S&P CNX: 4,167	RLEN.BO

25 April 2007

Buy

Previous Recommendation: Buy

Rs524

Equity Shares (m)	212.4
52-Week Range	644/362
1,6,12 Rel. Perf. (%)	2/0/-37
M.Cap. (Rs b)	111.2
M.Cap. (US\$ b)	2.7

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
3/07A	56,930	7,410	31.6	13.9	16.6	1.4	9.5	9.4	1.2	14.3
3/08E	55,700	8,286	35.3	11.8	14.8	1.3	9.3	9.6	1.0	10.1
3/09E	62,013	9,087	38.7	9.7	13.5	1.2	9.3	9.6	0.8	7.3

* Consolidated, Pre-exceptionals

- 4QFY07 performance driven by other income & lower tax provision:** During 4QFY07, Reliance Energy reported revenues of Rs16.1b (up 56% YoY), EBIDTA of Rs598m (down 69%) and net profit of Rs2.4b (up 40% YoY). A significant part of incremental profits is being driven by higher other income and tax writeback of Rs527m.
- MERC order impacts power business performance:** MERC through October 2006 Order (pertaining to truing up of cost and revenues) had disallowed expenses of Rs2.6b incurred during FY05 and FY06. Thus during 2HFY07, impact pertaining to these adjustments were provided for, impacting profitability. Appellate Tribunal in April 2007 has upheld the appeal and permitted Reliance Energy to recover Rs2.64b in three equal installments (Rs880m each during FY08, FY09 and FY10).
- Key takeaways from concall:** (1) Cash balance stood at Rs80b during March 2007, up from Rs56b during March 2006 (2) During FY07, BSES Rajdhani reported AT&C losses of 29.9% (v/s targeted levels of 31.1%) and BSES Yamuna at 39.1% (v/s targeted levels of 40.0%) (3) Samalkot power plant w.e.f. April 2007 has been converted to dual fuel, and thus expect PLF improvement (4) E&C order book stands at Rs53b (excl. Rosa power project Rs26b), to be executed over 2.5 years (5) Rosa power project expected to achieve financial closure by mid May 2007.
- Valuations:** We expect Reliance Energy to report net profit of Rs8.3b (up 12% YoY) during FY08 and Rs9.1b (up 10% YoY) during FY09. At CMP of Rs524/sh, Reliance Energy is trading at PER of 16.6x FY07, 14.8x FY08E and 13.5x FY09E. We do not factor in the possible recovery of Rs880m per annum in earnings during FY08 until FY10, as permitted by the Appellate Tribunal. The stock is trading at a P/BV of 1.4x FY07E, 1.3x FY08E and 1.2x FY09E. Maintain **Buy**.

QUARTERLY PERFORMANCE										(Rs Million)	
Y/E MARCH	FY06				FY07				FY06	FY07	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
Sales	9,497	10,429	9,884	10,382	11,549	14,076	15,337	16,143	40,191	56,930	
Change (%)	0.7	31.7	6.4	-29.2	21.6	35.0	55.2	55.5	-2.9	41.6	
EBITDA	1,615	2,034	1,793	1,901	1,334	1,775	827	598	7,332	4,804	
Change (%)	9.6	25.1	200.7	0.6	-17.4	-12.8	-53.9	-68.5	4.4	-34.5	
As of % Sales	17.0	19.5	18.1	18.3	11.6	12.6	5.4	3.7	18.2	8.4	
Depreciation	817	871	907	891	619	635	612	535	3,486	2,401	
Interest	433	553	467	477	459	671	551	823	1,919	2,503	
Other Income	1,348	1,185	1,493	1,863	1,711	1,761	2,867	2,754	5,890	8,823	
PBT	1,712	1,796	1,912	2,396	1,967	2,230	2,531	1,994	7,817	8,724	
Tax (incl contingencies)	146	200	265	701	201	366	522	-380	1,311	709	
Effective Tax Rate (%)	8.5	11.1	13.9	29.3	10.2	16.4	20.6	-19.1	16.8	8.1	
Reported PAT	1,567	1,596	1,646	1,695	1,766	1,864	2,009	2,374	6,505	8,015	
PAT (Pre Exceptionals)	1,567	1,596	1,646	1,695	1,666	1,864	2,009	1,848	6,505	7,388	
Change (%)	52.3	24.5	22.1	14.6	12.7	16.8	22.0	40.1	25.1	23.2	

E: MOST Estimates; Quarterly numbers are on standalone basis

4QFY07: Driven by other income & lower tax provision

During 4QFY07, Reliance Energy reported revenues of Rs16.1b (up 56% YoY), EBIDTA of Rs598m (down 69%) and net profit of Rs2.4b (up 40% YoY). A significant part of incremental profits is being driven by higher other income and tax write back of Rs527m. Adjusted net profit grew by 9% YoY to Rs1.9b, in line with our estimate.

A significant part of the incremental profits is being driven by higher other income. Other income increased 48% YoY to Rs2.8b during 4QFY07. This is due to increased cash balances YoY (Rs80b during March 2007, up from Rs56b during March 2006), higher interest rates (on cash balances) and forex gains of Rs500m-Rs550m (due to rupee appreciation).

On a consolidated basis, Reliance Energy reported revenues of Rs68b during FY07 and net profit of Rs8.3b (post minority interest). In Delhi distribution, BSES Rajdhani reported AT&C losses of 29.9% (v/s targeted levels of 31.1%) and BSES Yamuna at 39.1% (v/s targeted levels of 40%).

MERC order, Fuel cost impacts power business performance

Power business performance was impacted due to:

- ✍ MERC through October 2006 order (pertaining to truing up of cost and revenues) had disallowed expenses of Rs2.6b incurred during FY05 and FY06. Thus during 2HFY07, the impact pertaining to these adjustments were provided for, impacting the profitability for power business.
- ✍ Higher fuel cost and power purchase cost (from Tata Power) also impact profitability to a certain extent as there is a time gap to pass on the cost increases to the consumer, through tariff order. Power purchase cost increased to Rs4.1/unit during 4QFY07, up from Rs3.0/unit during 4QFY06.

Appellate Tribunal permits recovery of Rs2.6b

The Appellate Tribunal has upheld the appeal regarding disallowance of employees expenses, administrative

expenses and income tax by MERC through the October 2006 Order (pertaining to truing up of cost and revenues). Based on the Appellate Tribunal Order, MERC in its recent tariff order (24 April 2007) has permitted Reliance Energy to recover Rs2.64b in three equal installments of Rs880m each during FY08, FY09 and FY10.

GAINS FROM APPELLATE TRIBUNAL (ATE) ORDER (RS M)

	FY05			FY06		
	MERC	ATE	GAINS	MERC	ATE	GAINS
Employee Exp.	1,619	2,073	455	1,828	2,073	245
A&G Expense	740	1,020	280	760	1,016	256
Income tax	80	1,010	930	270	740	470
Total			1,665			971

Source: MERC Tariff Order

Energy business: Operational highlights

- ✍ Electricity sales during 4QFY07 were up 7.3% YoY to 2,129m units. Realization during 4QFY07 was Rs4.2/unit, v/s Rs4.0/unit in 4QFY06.
- ✍ Operational performance of the Energy business remains satisfactory. PLF of Dahanu power plant improved to 102% during FY07, compared with 99% in FY06.
- ✍ Samalkot power plant (Andhra Pradesh) registered a PLF of 50.6% during FY07 versus 51.2% in FY06, a result of lower gas availability. Management stated that w.e.f. April 2007, the plant has been converted to dual fuel, and thus they expect PLF improvement during FY08.
- ✍ Electricity purchases stood at 1,037m units, up 23% YoY during 4QFY07. Purchase cost during the quarter was up sharply to Rs4.1/unit v/s Rs3.0/unit in FY06.

ENERGY BUSINESS PERFORMANCE (RS M)

	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
Operational						
Units Sold (m)	1,902	1,984	2,229	2,399	2,009	2,129
Realiz. (Rs/unit)	4.3	3.9	4.1	3.8	4.6	4.2
Units Purch. (m)	898	846	1,148	1,208	1,061	1,037
Cost (Rs/unit)	2.9	3.0	2.7	2.8	4.3	4.1
Financial						
Revenues	8,153	7,711	9,176	9,049	9,211	8,849
EBIT	936	927	1,330	1,041	792	73

Source: Company/Motilal Oswal Securities

EPC business

- ⚡ During 4QFY07, EPC division recorded revenue growth of 159% YoY to Rs7.3b, driven by project execution, up from Rs2.8b in 4QFY06.
- ⚡ EPC business reported EBIT of Rs661m in 4QFY07 (EBIT margin 9%), v/s Rs119m during 4QFY06 (EBIT margin 4.2%). Even in the past, E&C business margins have been volatile.
- ⚡ E&C order book now stands at Rs53b (v/s Rs33b as at March 2006), as the company received orders of Rs41.6b during 4QFY07. This includes EPC contracts of Rs37.6b for the 1,200 MW Hissar power from Haryana Power Generation Corporation to be completed over 35-38 months and the remaining plant work for Panchha thermal power project of Rs4b from Uttar Pradesh Rajya Vidyut Utpadan Nigam.

EPC BUSINESS PERFORMANCE (RS M)

	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
Revenues	1,731	2,671	2,373	5,027	6,126	7,294
Order Book	35,000	33,000	33,500	23,660	17,100	52,500
EBIT	513	295	151	233	181	661

Source: Company/Motilal Oswal Securities

Acquired 51% stake in NOIDA SEZ, 69% in Mumbai Metro

During 4QFY07, Reliance Energy acquired 51% stake in NOIDA Global SEZ Pvt. Ltd. and 69% stake in Mumbai Metro One Pvt. Ltd. NOIDA Global SEZ has received approval for setting up 2,500 acre SEZ at NOIDA. Mumbai Metro One Pvt. Ltd. is setting up a 13km Mass Rapid Transport system from Andheri-Ghatkopar in Mumbai. ADAG group has 5% stake, while Mumbai Metropolitan Regional Development Authority has 26% in the project. The project cost is estimated at Rs23.56b, including viability gap funding of Rs6.5b. Management stated that the initial survey has been started and the project would be completed over a 3-year period.

Progress on expansion plans

Maharashtra (1,200MW, imported coal): Maharashtra was originally conceived as a gas-based power project, with capacity of 1,400MW in Phase 1 and scaling up to 3,000MW

eventually. With the gas fuel linkage yet to be tied up, management now intends to set up 1,200MW-1,800MW on imported coal. In terms of project progress, a significant part of land acquisition has been completed. Part of the power generation (600MW-700MW) would replace existing power sourcing from Tata Power (currently at Rs4.0/unit).

Rosa Power Project: Reliance Energy Generation (Reliance Energy has 50% stake) acquired Rosa Power Plant in Uttar Pradesh (600MW) from the Aditya Birla Group during November 2006. REGL has acquired project equity largely on a par, and the set up cost is expected at Rs26b, to be financed on 70:30 DER. Management stated that the project could achieve financial closure by end-May 2007, as most of the linkages and government clearances are already in place. The power purchase agreement (PPA) with Uttar Pradesh Rajya Vidyut Utpadan Nigam is based on CERC norms and provides 14% RoE at 80% PLF. The government has also approved REGL's plans to double capacity of the project to 1,200MW.

Transmission projects: During 3QFY07, Reliance Energy acquired 51% stake in Reliance Energy Transmission Ltd. (RETL). RETL had emerged as lowest bidder for two transmission packages (B and C) invited by Power Grid Corporation for setting up power lines linked with the 'Western Region Strengthening Scheme' in Gujarat and Maharashtra (estimated capex Rs16-18b). This was the first International Competitive Bid invited by Power Grid under the 100% private equity route. As we understand, the project deadlock is on account of RETL not agreeing for an unlimited buyout clause.

Road projects: Reliance Energy has bagged four road projects in Tamil Nadu entailing 300km, at a cost of Rs30b. In the first two projects, Reliance Energy has equity stakes of ~49%.

Other growth plans

- ⚡ Dadri power project (7,480MW)
- ⚡ Has four coal bed methane blocks
- ⚡ Signed an MoU with the 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.

Valuations

We expect Reliance Energy to report net profit of Rs8.3b (up 12% YoY) during FY08 and Rs9.1b (up 10% YoY)

during FY09. At CMP of Rs524/sh, Reliance Energy is trading at PER of 16.6x FY07, 14.8x FY08E and 13.5x FY09E. We do not factor in the possible recovery of Rs880m per annum in earnings during FY08 until FY10, as permitted by the Appellate Tribunal. The stock is trading at a P/BV of 1.4x FY07E, 1.3x FY08E and 1.2x FY09E. 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 license 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 in hand and liquid investments stand at Rs80b (March 2007). 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

- ✍ Cash in hand and liquid investments stand at ~Rs80b (Mar 2007), facilitating higher scalability.
- ✍ Existing business, particularly the Mumbai business, earns returns @ 14% p.a., assuring a stable earnings stream.
- ✍ Reliance Energy is emerging as a sizeable player in the infrastructure segment.

Key investment risks

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

Recent developments

- ✍ Acquired 51% stake in NOIDA Global SEZ Pvt. Ltd. and 69% stake in Mumbai Metro One Pvt. Ltd.
- ✍ Rosa power project expected to achieve financial closure by May 2007.

Valuation and view

- ✍ At CMP of Rs524/sh, Reliance Energy is trading at PER of 16.6x FY07, 14.8x FY08E and 13.5x FY09E.
- ✍ Play on the future growth opportunities rather than the current assured stream businesses. Recommend **Buy**.

Sector view

- ✍ 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.

COMPARATIVE VALUATIONS

		REL	NTPC (ADJ)*	TPC
P/E (x)	FY07E	16.6	13.7	21.1
	FY08E	14.8	12.4	18.3
P/BV (x)	FY07E	1.4	1.9	2.0
	FY08E	1.3	1.7	1.9
RoE (%)	FY07E	9.5	14.0	9.2
	FY08E	9.3	14.3	9.0

* Adjusted for higher depreciation in books as compared to tariff Order and write-back of Rebate on OTSS bonds

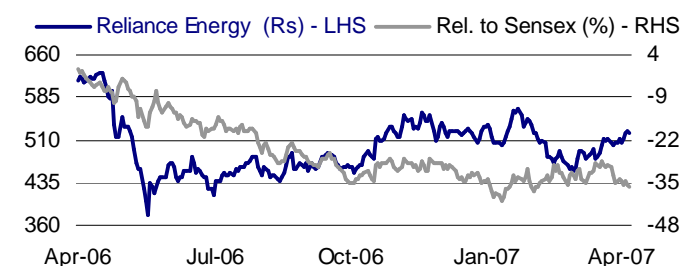
SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	34.6	29.8	53.4
Domestic Inst	28.7	29.4	21.4
Foreign	23.3	25.9	18.6
Others	13.4	14.9	6.6

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	35.3	35.5	-0.6
FY09	38.7	37.9	2.1

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Sales	28,960	31,790	36,110	39,600	41,913	
Other Operating Income	12,438	8,545	20,820	16,100	20,100	
Total Revenues	41,398	40,335	56,930	55,700	62,013	
Change (%)	2.15	-2.6	41.1	-2.2	11.3	
Cost of Electricity	11,032	12,016	16,571	21,460	22,901	
Cost of fuel	7,359	8,121	9,213	8,199	8,199	
Other Manufacturing Exp.	1,242	1,904	1,982	1,862	1,973	
Employee Expenses	1,836	1,909	3,135	2,105	2,210	
SG&A Expenses	1,261	1,621	2,818	1,746	1,911	
Cost of Contracts	11,646	7,288	18,406	14,669	18,251	
EBITDA	7,023	7,476	4,805	5,659	6,568	
% of Total Revenues	17.0	18.5	8.4	10.2	10.6	
Depreciation	3,464	3,486	2,401	2,767	2,858	
Interest	1,348	1,919	2,503	2,256	2,356	
Other Income	4,527	5,744	8,823	9,686	9,841	
PBT	6,738	7,815	8,724	10,322	11,194	
Tax	495	506	709	1,436	1,507	
Rate (%)	7.3	6.5	8.1	13.9	13.5	
Provisions for Contingencies	1,041	806	0	600	600	
Reported PAT	5,201	6,504	8,015	8,286	9,087	
Change (%)	41.7	25.0	23.2	3.4	9.7	

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	83,004	89,752	97,302	
Net Worth	55,877	71,211	85,282	92,030	99,580	
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	130,013	137,361	145,511	
Gross Fixed Assets	51,730	54,706	58,006	60,306	62,406	
Less: Dep and revaluation res	-32,050	-35,667	-38,320	-41,087	-43,946	
Net Fixed Assets	19,680	19,039	19,686	19,219	18,461	
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	119,402	128,203	138,111	
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	70,529	78,993	88,553	
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	96,223	104,038	112,946	
Application of Funds	96,091	116,157	130,014	137,362	145,512	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
EPS	29.9	30.6	32.5	36.4	39.9	
EPS (Fully Diluted)	27.1	27.7	31.6	35.3	38.7	
CEPS (Rs)	43.5	40.9	44.6	49.6	53.4	
Book Value	270.4	331.2	374.4	404.1	437.2	
DPS	4.7	4.9	5.0	6.0	6.0	
Payout (incl. Div. Tax.)	17.9	18.6	17.3	18.6	16.9	
Valuation (x)						
P/E		17.1	16.1	14.4	13.1	
EV/EBITDA		11.4	14.3	10.1	7.3	
EV/Sales		2.1	1.2	1.0	0.8	
Price/Book Value		1.6	1.4	1.3	1.2	
Dividend Yield (%)		0.9	1.0	1.1	1.1	
Profitability Ratios (%)						
RoE	11.1	10.7	9.5	9.3	9.3	
RoCE	10.1	9.4	9.4	9.6	9.6	
Turnover Ratios						
Debtors (Days)	82	99	72	76	70	
Inventory (Days)	31	27	19	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	0.5	

CASH FLOW STATEMENT		(RS MILLION)				
	2005	2006	2007E	2008E	2009E	
PBT before EO Items	6,738	7,815	9,173	10,322	11,194	
Add : Depreciation	3,464	3,486	2,653	2,767	2,858	
Less : Direct Taxes Paid	1,296	1,704	1,363	1,436	1,507	
(Inc)/Dec in WC	-1,375	856	792	648	652	
CF from Operations	7,531	10,453	11,254	12,301	13,198	
(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	14,000	8,463	9,560	
Add: Beginning Balance	8,602	60,454	56,529	70,529	78,993	
Closing Balance	60,454	56,529	70,529	78,993	88,553	

E: MOST Estimates

N O T E S



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Reliance Energy

- | | |
|---|----|
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| 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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