

Natural Resources & Energy
Independent Power Producers
 Equity – India

Underweight

Target price (INR)	75.00
Share price (INR)	80.45
Potential return (%)	-6.8

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	24.8	-6.4	-34.7
Relative ^A (%)	12.4	-6.6	-33.2

Index^A BOMBAY SE IDX

RIC	ADAN.NS
Bloomberg	ADANI IN

Market cap (USDm)	3,603
Market cap (INRm)	175,384

Enterprise value (INRm)	478,233
Free float (%)	27

Note: (V) = volatile (please see disclosure appendix)

7 February 2012

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Adani Power Ltd (ADANI IN)

Downgrade to UW: Disappointing results

- ▶ **Higher fuel costs and forex impacted the Q3 results, which to an extent we had factored in from FY13 onwards**
- ▶ **Stock is up c30% YTD; we believe market is factoring in the growth but needs clarity on price relief and coal supply for further price movement**
- ▶ **Reduce our estimates for FY13-14 by 7-10% and target price to INR75 from INR85, and downgrade to UW from OW**

3QFY12 results disappointing: Adani reported a net loss of INR3.6bn, which adjusted for a mark-to-market forex loss of INR2.0bn on long-term loans, aggregated to INR1.5bn versus a profit expectation of INR2.1-INR2.4bn (consensus and HSBC). The company attributed the loss to the steep increase in coal costs due to a change in Indonesian government policy – fuel cost up from INR1.48 per unit in Q2 to INR2.44/unit in Q3 (includes a forex impact of INR0.44/unit).

Agreement with AEL for coal supply seems to be partly discontinued: It appears from Adani Power's 3Q results that Adani Enterprises (AEL), its parent, is no longer supplying coal from sources other than Bunyu, Indonesia (c65% of the quantity consumed) at USD36/ton as per the existing contract. We had factored in the renegotiation from FY13 onwards. Also the cost of procurement of the low-grade coal in Q3 is higher at cUSD90/ton (per our calculation) in Q3. Accordingly we now factor in higher coal costs at USD75 per ton (from USD65) as well as a higher proportion of coal from sources other than Bunyu (50% from 35% earlier), resulting in 7-10% declines in our net profit estimates for FY13-14 and a 33% fall for FY12 (includes lower utilisation based on nine-month data).

Key sensitivities to fuel cost and forex: Our analysis suggests an increase of USD5 per ton would reduce FY13e EPS by INR1.1 (15%) and our target price by INR11 (15%). If the rupee appreciates by INR5, this would imply a FY13 EPS increase of INR1.3 (18%) and in our target price by 18% and vice versa.

Clarity on price relief and coal supply, an upside: The company is in dispute for two of its contracts – one with Gujarat for 1GW (15% of FY13e capacity) at INR2.35/unit and another for 1.32GW (20%) with Maharashtra at INR2.64/unit. Any price relief should provide upside – a 25paise hike would result in a 12% increase to our FY13 EPS (by INR0.9) and our target price (by INR8.8). The company expects additional domestic coal supply including re-allocation of its captive coal block. However, given the lack of clarity we do not factor this into our estimates.

Reduce TP to INR75 from INR85 and downgrade to Underweight from Overweight: Based on the sum of our DCF valuations for individual projects, our new TP is INR75, implying a c10x PE and 1.6x PB on FY14e. The stock has run up c30% YTD and we believe the market is factoring in the growth prospects (we expect EPS CAGR of 48% over FY12-14 versus consensus at 65% CAGR). We expect pressure on earnings due to lack of clarity on pricing of coal from AEL to Adani Power, which will be an overhang on the stock. **Key upside risks** are any tariff hike relief or lower-than-expected coal costs.

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	21,352	50,368	108,103	132,024
EBITDA	12,205	22,482	52,344	60,228
Depreciation & amortisation	-1,886	-5,726	-11,458	-14,744
Operating profit/EBIT	10,319	16,757	40,886	45,483
Net interest	-2,366	-7,972	-20,540	-24,898
PBT	8,132	9,285	21,346	22,085
HSBC PBT	8,132	9,285	21,346	22,085
Taxation	-3,000	-1,923	-4,328	-4,475
Net profit	5,136	7,261	16,212	16,560
HSBC net profit	5,136	7,261	16,212	16,560

Cash flow summary (INRm)

Cash flow from operations	-3,226	8,867	18,854	28,368
Capex	-139,759	-73,577	-74,446	-29,573
Cash flow from investment	-139,859	-73,577	-74,446	-29,573
Dividends	0	0	0	0
Change in net debt	138,275	63,260	53,579	533
FCF equity	-136,352	-65,210	-56,592	-2,705

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	324,381	392,232	455,220	470,048
Current assets	25,405	20,475	26,687	29,831
Cash & others	12,551	3,400	-11	-853
Total assets	349,886	412,808	482,007	499,979
Operating liabilities	33,187	33,187	33,187	33,187
Gross debt	245,027	299,137	349,305	348,996
Net debt	232,477	295,736	349,316	349,849
Shareholders funds	62,873	70,135	86,346	102,906
Invested capital	304,048	376,120	448,730	467,545

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	391.0	135.9	114.6	22.1
EBITDA	400.6	84.2	132.8	15.1
Operating profit	395.0	62.4	144.0	11.2
PBT	301.1	14.2	129.9	3.5
HSBC EPS	186.7	41.4	123.3	2.1

Ratios (%)

Revenue/IC (x)	0.1	0.1	0.3	0.3
ROIC	2.8	3.9	7.9	7.9
ROE	8.5	10.9	20.7	17.5
ROA	2.5	3.6	7.5	7.6
EBITDA margin	57.2	44.6	48.4	45.6
Operating profit margin	48.3	33.3	37.8	34.5
EBITDA/net interest (x)	5.2	2.8	2.5	2.4
Net debt/equity	339.2	382.3	362.4	305.1
Net debt/EBITDA (x)	19.0	13.2	6.7	5.8
CF from operations/net debt		3.0	5.4	8.1

Per share data (INR)

EPS reported (fully diluted)	2.36	3.33	7.44	7.60
HSBC EPS (fully diluted)	2.36	3.33	7.44	7.60
DPS	0.00	0.00	0.00	0.00
Book value	28.84	32.17	39.61	47.20

Key forecast drivers

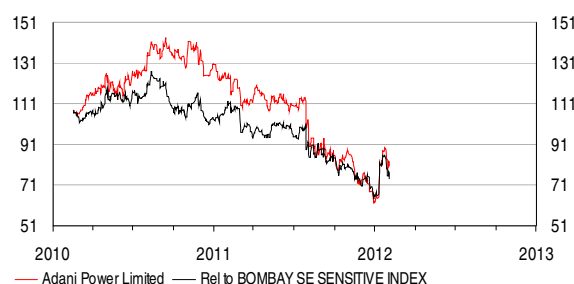
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Capacity (MW)	1,980	3,960	6,600	6,600
Unit Sold (MUs)	6,810	15,239	34,548	44,278
PLF %	85.0	74.6	82.7	82.1
Merchant Tariff (INR/unit)	4.1	4.0	4.0	4.0

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	19.4	9.5	4.9	4.1
EV/EBITDA	33.9	21.3	10.2	8.9
EV/IC	1.4	1.3	1.2	1.1
PE*	34.1	24.2	10.8	10.6
P/Book value	2.8	2.5	2.0	1.7
FCF yield (%)	-75.4	-35.7	-30.5	-1.4
Dividend yield (%)	0.0	0.0	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)

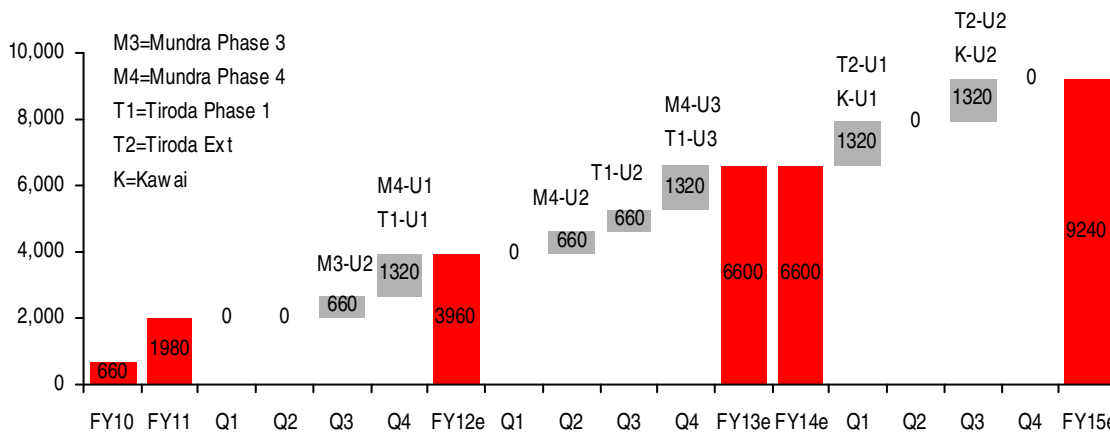
Price relative



Source: HSBC

Note: price at close of 03 Feb 2012

Adani: Strong capacity addition over the next year (in GW): company is confident of achieving capacity of 9,240GW by 2013



Source: Company data, HSBC estimates for FY12-15

Adani: PPAs in place for 7.2GW of total 9.2GW capacity expected by FY15

Customer	State	Capacity contracted (MW)	Tariff (INR/unit)	Project	PPA starts from	Comments	Total capacity (MW)	% tied up
GUVNL	Gujarat	1,000	2.89	Mundra Phase 1&2	Feb/June 2010	No escalation	1,320	76%
GUVNL	Gujarat	1,000	2.35	Mundra Phase 3	Aug-11	No escalation	1,320	76%
UHBVNL & DHBVNL	Haryana	1,424	2.94	Mundra Phase 4	Aug 2012 (475MW) Feb 2013 (949MW)	No escalation	1,980	72%
MSEDCL	Maharashtra	1,320	2.64	Tiroda	Aug-12	No escalation	1,980	67%
RRVNL	Rajasthan	1,200	3.24	Kawai	Aug-13	Fuel & Freight cost escalatable	1,320	91%
MSEDCL	Maharashtra	1,325	3.28	Tiroda - Extension	Apr-14	Fuel & Freight cost escalatable	1,320	100%
Total		7,269					9,240	79%

Note: GUVNL=Gujarat Urja Vikas Nigam Limited, UHBVNL=Uttar Haryana Biji Vitran Nigam Limited, DHBVNL=Dakshin Haryana Biji Vitran Nigam Limited, MSEDCL= Maharashtra State Electricity Distribution Company Limited and RRVNL=Rajasthan Rajya Vidyut Prasaran Nigam Ltd
Source: Company data

Adani: Summary of fuel source, tied up for two of its large projects (Mundra and Tiroda)

Project (in MT)	Mundra Phase 1-4 (4.6GW)	Tiroda Phase 1,2 (2.0GW)	Tiroda Phase 3 Ext (1.3GW)	Kawai (1.3GW)	Total
Requirement	16.6	8.3	5.5	7.0	37.4
Domestic Linkage	6.4	8.0	0.0	0.0	14.4
Source	MCL	SECL, WCL	NA	NA	
Applied for linkage			7.0	7.0	14.0
Imported	10.2				10.2
Agreement	With AEL for 14.5MT pa				
Source	Bunyu mine, Indonesia: Existing production 7MT (reserves of 180MT) and peak capacity to be 11MT pa	E-auction coal or imported coal from Indonesia	E-auction coal or imported coal from Indonesia/Australia	E-auction coal or imported coal from Indonesia/Australia	
	Take or pay contract for up to 21MT with PT Bukit Asam for mines in Sumatra	Alternate coal block if any allotted against Lohara block	Power project expected in FY15	Power project expected in FY15	
	Galilee coal mine in Australia - Production to start in 2014 with peak capacity of 60MT by 2020 in Phase 1				

Source: Company data, HSBC comments

Q3FY12 results highlights

Adani reported a net loss of INR3.6bn, which adjusted for a mark-to-market forex loss of INR2.0bn on long-term loans, aggregated to INR1.5bn versus a profit expectation of INR2.1-INR2.4bn (consensus and HSBC). The company attributed the loss to a steep increase in coal costs due to change in Indonesian government policy.

- ▶ Generation volumes increased to 3.8bn (up 75% y-o-y) on the back of a doubling of capacity. However, PLF were lower at 66% in Q3. The company attributed this to transmission bottlenecks seen in Q3.
- ▶ Realisations improved by 20% y-o-y to INR3.5 per unit, probably driven by merchant sales at the projects until the long-term contracts kick in (Mundra phase 3).
- ▶ Fuel costs up from INR1.48 per unit in Q2 to INR2.44/unit in Q3, which includes a forex impact of INR0.44/unit due to a change in Indonesian policy. It appears that AEL, its parent is no longer supplying coal from sources other than the Bunyu mine in Indonesia (c65% of the quantity consumed) at USD36 per ton (existing contract).

Adani: Summary of quarterly earnings

INRm	Q3FY12	y-o-y %	HSBC	Act v/s HSBC	BBG Cons.	Act v/s BBG Cons.	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Capacity	2,640	100%	2,640	0%	na	na	1,320	1,980	1,980	2,640
Generation (MU)	3,381	75%	3,705	-9%	na	na	1,931	3,007	3,190	3,298
Sales (MU)	3,018	76%	3,372	-10%	na	na	1,717	2,729	2,898	2,959
Revenue	10,595	111%	11,236	-6%	10,979	-4%	5,026	8,556	8,187	10,724
EBITDA	2,120	-22%	5,494	-61%	5,258	-60%	2,730	5,125	4,102	5,194
Margins %	20.0%	-3,430	48.9%	-2,888	47.9%	-2,788	54.3%	59.9%	50.1%	48.4%
PBT	-815	-146%	3,044	-127%	2,623	-131%	1,758	3,512	2,256	2,811
Net profit (adjusted)	-1,535	-241%	2,405	-164%	2,113	-173%	1,091	1,743	1,769	2,333
Net profit (reported)	-3,581	-428%	2,405	-249%	na	na	1,091	1,743	1,769	1,775
Per unit (INR)										
Realisation	3.51	20%	3.33	5%	na	na	2.93	3.14	2.82	3.62
Fuel cost	2.44	134%	1.35	81%	na	na	1.04	0.95	1.15	1.48
EBITDA	0.70	-56%	1.63	-57%	na	na	1.59	1.88	1.42	1.76
Net profit	-0.51	-180%	0.71	-171%	na	na	0.64	0.64	0.61	0.79

Source: Company data, HSBC estimates

Reduce our estimates for FY12-14

We reduce our net profit estimates for FY13-14 by 7-10% to factor in higher-than-expected coal costs as well as a higher proportion of coal from sources other than Bunyu (from 35% to 50% now) given the lower receipt of coal in FY12 and based on the ramp-up plan of production at Bunyu (parent's mine). This is offset by our assumption of higher merchant prices after accounting for increased coal costs. Note that on our analysis, Mundra requires about 15.7Mt tons of coal, assuming 2.6MT of domestic and 13.1MT of imported coal. The company expects to receive c3MT in FY12, 6-7MT in FY13 and 10-11MT in FY14 from Bunyu.

We lower our net profit estimate for FY12 by 33% primarily due to increased fuel costs on account of a) the retrospective impact of increased coal costs from AEL to Adani Power, which we had already factored in for FY13 onwards; b) a higher proportion of coal from sources other than Bunyu bought at higher prices and c) the impact of rupee depreciation. This is offset by the positive impact of revenue from merchant sales at higher prices (about cINR4.0/unit) from Gujarat Phase 3, since the company is not obligated to sell to Gujarat under the contract price (lower at INR2.35/unit) until the transmission line is in place, which is expected this month, unlike our earlier expectation of a sale under the contract to Gujarat.

Adani: Changes to HSBC forecasts

INRm	New			Old			Diff		
	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Capacity (MW)	3,960	6,600	6,600	3,960	6,600	6,600	0.0%	0.0%	0.0%
PLF %	75%	83%	82%	84%	82%	81%	-11.7%	1.2%	1.7%
Volumes (MT)	15,239	34,548	44,278	17,452	34,075	43,468	-12.7%	1.4%	1.9%
ASP (INR per unit)	3.31	3.13	2.98	2.95	3.05	2.93	12.0%	2.5%	1.8%
Fuel cost (INR per unit)	1.60	1.40	1.40	1.07	1.27	1.27	50.1%	10.7%	10.2%
Revenue	50,368	108,103	132,024	51,509	104,031	127,307	-2.2%	3.9%	3.7%
EBITDA	22,482	52,344	60,228	29,360	53,555	62,276	-23.4%	-2.3%	-3.3%
Net profit	7,261	16,212	16,560	10,872	17,417	18,300	-33.2%	-6.9%	-9.5%
EPS (INR)	3.33	7.44	7.60	5.0	8.0	8.4	-33.2%	-6.9%	-9.5%

Source: HSBC estimates

Valuation and risks

We use a SOTP valuation approach to value Adani, as the risk-reward profile differs from project to project. Based on our assumptions (see table below) our new target price is INR75 (from INR85), implying a 6.8% negative potential return. The reduction in our target price is largely due to our estimate changes for FY13-14 by 7-10% and beyond.

Our DCF-based target price implies a PE of 10.0x and PB of 1.6x on FY14 estimates, compared to its current FY13 10.8x PE and 2.0x PB. By comparison, its large-cap peers currently trade in a PE range of 11-15x and PB of 1.6-1.9x on FY13e earnings.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. As the potential return of -6.8% is below the Neutral band, we downgrade Adani Power stock to Underweight from Overweight. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

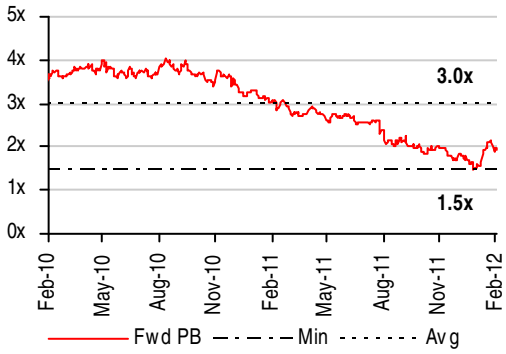
Upside risks: The company is in dispute for two of its contracts – one with Gujarat for 1GW (15% of FY13e capacity) at INR2.35/unit and other for 1.32GW (20%) with Maharashtra at INR2.64/unit. Any price relief should provide upside – a 25paise hike would imply a 12% increase in our FY13 EPS (by INR0.9) and target price (by INR8.8).

Adani: SOTP valuation summary

Particulars	Capacity (MW)	WACC %	Equity value (INRm)	Stake (%)	Value per share – New (INR)	Implied P/BV	Value per share – Old (INR)
Operating plants							
Mundra I&II	1,320	11.0%	43,545	100%	20.0	3.7	25.2
Mundra III	1,320	11.0%	18,561	100%	8.5	1.6	11.8
Sub-total	2,640		62,105		28.5	2.6	36.9
Under construction							
Mundra IV	1,980	11.0%	51,746	100%	23.7	2.9	27.3
Tiroda	1,980	11.0%	39,795	74%	13.5	2.1	11.4
Tiroda - Extension @ 50% discount	1,320	11.0%	10,303	74%	3.5	1.7	3.2
Kawai - @ 50% discount	1,320	11.0%	8,877	100%	4.1	1.5	3.8
Sub-total	6,600		110,721		44.8	1.8	45.8
Investments			100	100%	0.0	1.0	0.0
Net cash (FY12)			3,400	100%	1.6	1.0	2.3
Grand total	9,240		176,327		75.0	2.0	85.0

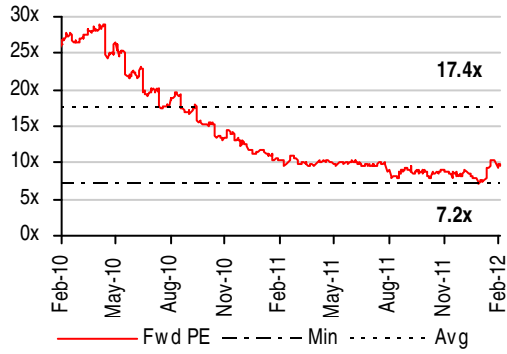
Source: HSBC estimates

Adani: c30% YTD run-up led to stock trading at PB of 2.0x, in line with large cap peers



Source: Thomson Reuters Datastream, PB based on 1yr fwd consensus earnings

Adani: On PE basis now trading at 10x, below peers



Source: Thomson Reuters Datastream, PE based on 1yr fwd consensus earnings

Disclosure appendix

Analyst Certification

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Important disclosures

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

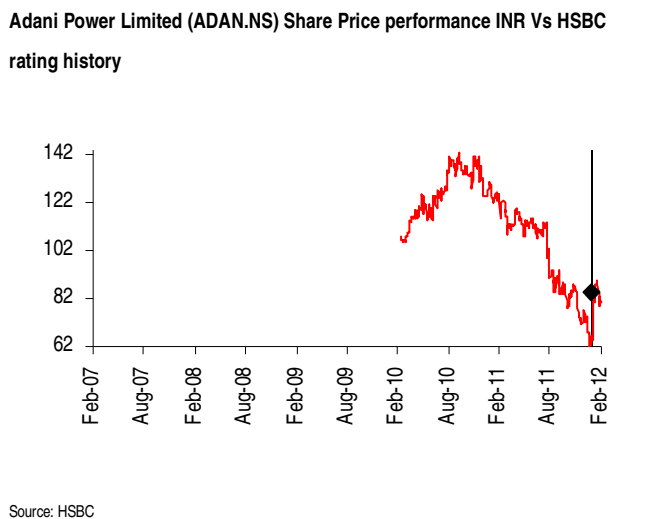
*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 06 February 2012, the distribution of all ratings published is as follows:

Overweight (Buy)	53%	(26% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(21% of these provided with Investment Banking Services)
Underweight (Sell)	11%	(13% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history		
From	To	Date
N/A	Overweight	01 January 2012
Target Price	Value	Date
Price 1	85.00	01 January 2012

Source: HSBC

HSBC & Analyst disclosures

None of the below disclosures applies to any of the stocks featured in this report.

- 1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
- 4 As of 31 December 2011 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
- 5 As of 31 December 2011, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
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- 7 As of 31 December 2011, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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