2 September 2010 | 7 pages

Adani Power (ADAN.BO)

Equity

Cannot Terminate 1000MW PPA With GUVNL

- **What's New** — GERC has requested the Government of Gujarat to ask APL to withdraw the termination notice of the PPA with GUVNL to supply 1,000 MW of power for 25 years at a rate of Rs2.35/kWh. GERC has also asked the Government of Gujarat to impress upon GMDC for prompt necessary action for execution of fuel supply agreement with APL to ensure supply of 1000 MW power to GUVNL at competitive rate to meet future demand of the state.

- **No guarantee from GUVNL for fuel supply** — According to GERC, GUVNL did not propose to provide for any arrangement for fuel for the project and APL had to provide details of the same at the time of submission of bid. The bid documents also do not envisage any conditional bid, which is linked to availability of fuel from an identified source. APL had mentioned in the bid that the company had tied up imported coal with Coal Orbis Trading, Germany and Kowa Company.

- **Arrangement with GMDC is not co-terminus with PPA with GUVNL** — Arrangement with GMDC was an internal matter of APL and the obligation of APL under the PPA is not co-terminus with its arrangement for supply of fuel by GMDC. Since the obligation to arrange fuel is with APL it becomes incumbent on APL to arrange fuel if its arrangement with GMDC does not go through.

- **Impact on APL** — Our discussion with the APL management suggests that they are yet to decide on what legal course they are likely to resort to – (1) Accept the decision or (2) Appeal in the appellate tribunal of electricity (ATE). Under the circumstance that APL accepts the order and does not get coal from GMDC our EPS estimates could lower by 1-6% over FY12E-15E and our target price could go down to Rs149 from Rs159 currently (~6% downside), all else being equal. This would also have a negative impact on Adani Enterprise which owns a 70.2% stake in APL.

Buy/Low Risk	**1L**
Price (01 Sep 10)	Rs138.05
Target price	Rs159.00
Expected share price return	15.2%
Expected dividend yield	0.0%
Expected total return	**15.2%**
Market Cap	Rs300,954M
	US$6,448M

Price Performance (RIC: ADAN.BO, BB: ADANI IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	-26	-0.01	89.3	nm	11.2	-0.1	0.0
2010A	1,701	0.78	na	176.9	5.2	4.2	0.0
2011E	11,472	5.26	574.4	26.2	4.3	18.1	0.0
2012E	49,501	22.71	331.5	6.1	2.5	52.7	0.0
2013E	53,506	24.54	8.1	5.6	1.7	36.8	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Figure 1. Scenario Analysis - Potential Impact on EPS

	FY11E	FY12E	FY13E	FY14E	FY15E
Mundra III PPA Accepted	5.3	22.5	23.3	24.6	19.5
CIRA Current Assumption	5.3	22.7	24.5	25.9	20.8
Change	0.0%	-0.9%	-4.9%	-4.8%	-6.0%

Source: Citi Investment Research and Analysis estimates

Adani Power

Company description

Adani Power Limited (APL) has five thermal power projects in various stages of development, with combined capacity of 16,500 MW, namely: (i) Mundra Power Project with 4,620MW (ii) Tiroda Power Project with 3,300MW (iii) Kawai Power Project with 1,320MW (iv) Dahej Power Project with a capacity of 2,640MW (v) Chhindwara Power Project with a capacity of 1320MW and (vi) Bhadreshwar with a capacity of 3300MW.

Investment strategy

Adani Power Buy / Low (1L) risk as Adani Power is an interesting case of private sector entrepreneurship at its best, capitalizing on persistent power deficits and exploiting high medium term merchant tariffs before the start of long term PPAs to reduce project payback, using faster-than-BHEL execution time cycles of Chinese equipment suppliers. Impressive progress on 4620MW of capacity at Mundra and 3300MW at Tiroda; and the Adani Group's experience in executing mega projects like the Mundra Ports and SEZ project bolsters the investment case.

APL during its IPO had projects under development of 6,600MW and pipeline projects of 3,300MW. The under development projects have increased to 9,240MW and pipeline projects have increased to 7,200MW.

As the pace of execution in Mundra 4,620MW and Tiroda 3,300MW has been ahead of execution which we observed during our visit to Mundra and from the Tiroda site photographs shared with us by the management. Mundra site currently has ~17,000 workers which include ~300 Chinese workers and execution is currently happening at a frenetic pace.

Purchase of the 100% interest in the Galilee coal tenement though not a short term positive significantly improves fuel supply security to achieve APL’s long term vision of having 20GW of operational capacity by 2020. 30MMTPA of coal can fuel 10.5GW of capacity at 90% PLF using supercritical plants with a heat rate of 2100kcal/kWh assuming coal GCV of 5800kcal/kg and 60MMTPA of coal can fuel 21GW of capacity.

Valuation

Traditional valuation methodologies like P/E and EV/EBITDA multiples can be misleading if used to value pure infrastructure asset holders, as profitability of the projects can be lumpy, primarily on the basis of year of commissioning and the life of the asset. In some years, when projects are commissioned, the company may look attractive on a PE multiple basis, while in another year, when the asset life ends, the stock may appear relatively expensive. Infrastructure assets and more specifically Electric Utilities generate regular and largely predictable cash flow streams for a fixed time period. Therefore, discounted cash flow (DCF) is best-suited to value BOT projects. While applying DCF one can choose free cash flow to the firm (FCF) or free cash flow to equity (FCFE). We prefer FCFE as individual projects are highly geared and gearing changes as debt is rapidly paid off. If we assume APL executes all its projects flawlessly in line with our assumptions we would arrive at a value of Rs159 for the stock.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Low Risk rating to Adani Power.

Downside risks that could impede the stock from reaching our target price include: 1) Insufficient quantity of coal in Bunyu to fire the Mundra project; 2) The total reserves of 150mn tonnes have three licenses. While the counterparties of 2 of the 3 mines have procured long-term exploitation licenses the third license has not yet been granted to the counterparty; 3) Regulatory risk in Indonesia; 4) Fuel supply to Mundra Phase IV and Tiroda is contingent on AEL achieving certain milestones and finalizing the coal supply agreements and timely mining; 5) Fuel pricing risk for the Indonesian coal; 6) Merchant tariff risks; 7) Execution risks; 8) Chinese equipment quality risks; and 8) Interest rate risk.

Upside risks include: 1) Better than expected operating parameters; 2) Faster than expected execution; 3) Higher than expected merchant tariffs; and 4) Significant progress on 3300MW of projects now in planning stages.

Appendix A-1

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Adani Power (ADAN.BO)

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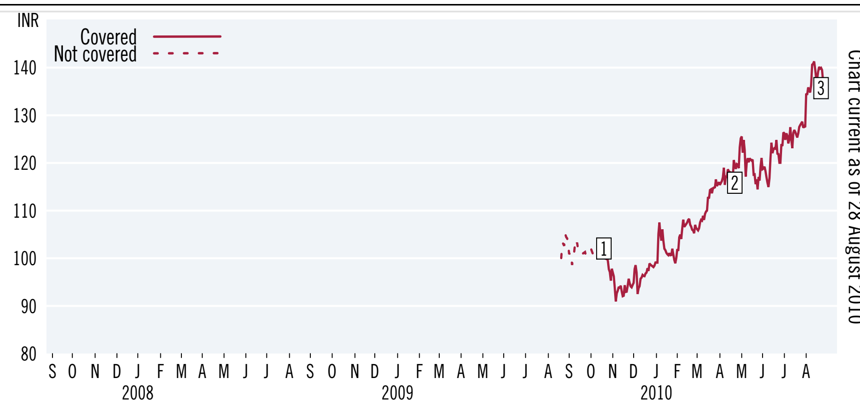
Fundamental Research

Analyst: Venkatesh Balasubramaniam
Covered since October 20 2009



	Date	Rating	Target Price	Closing Price
1	20-Oct-09	*3M	*88.00	100.15
2	22-Apr-10	3M	*106.00	119.50
3	23-Aug-10	*1L	*159.00	139.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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