

Jaiprakash Power Ventures

Rs42

OUTPERFORMER

Value accretive merger with two project SPVs

Mkt Cap: Rs87bn; US\$1.9bn

16 February 2011
BSE Sensex: 18274

Power Utilities

Event

The Board of Jaiprakash Power Ventures Ltd. (JPVL) has approved the merger of the company with its subsidiaries Jaypee Karcham Hydro Power Corporation Ltd. (JKHCL) and Bina Power Supply Company Ltd. (BPSCL). The companies would now approach the respective High Courts for an approval of the merger scheme.

Details

JKHCL is the developer of the 1,000MW Karcham Wangtoo hydropower project, in which JPVL currently holds a 56.9% stake. The remaining 43.1% stake is held by Jaiprakash Associates (76.3% owner of JPVL). The swap ratio for the merger of JPVL and JKHCL has been fixed at 5:1, i.e., one share of JPVL to be issued to shareholders of JKHCL for every five shares held by them.

BPSCL is the developer of the 1,250MW (500MW in phase 1) Bina Thermal power project, and is held 100% by JPVL. The swap ratio for the merger has been fixed at 13:2, i.e., two shares of JPVL to be issued to shareholders of JPVL for every 13 shares held by them.

The swap ratios imply a value of Rs25.7bn for JKHCL and Rs7.6bn for BSCPL, considering the approximate average price of the JPVL stock over the past six months.

Merger scheme to create treasury shares in JPVL

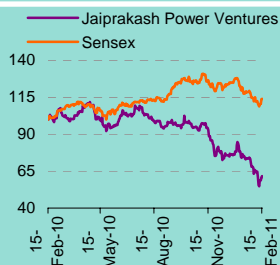
The swap ratios would require JPVL to issue a total of 556m shares – 429m to shareholders of JKHCL and 127.1m to shareholders of BPSCL. JPVL does not intend to cancel shares held by itself in these subsidiaries, resulting in the creating of 371.2m treasury shares. JPVL would dilute its equity by 26.5% on completion of the merger. With the merger, JPA's stake in JPVL would get diluted from 76.3% now to 67.2%.

Our view

We believe the merger is positive for JPVL as it would facilitate efficient transfer of cash from the projects to the HoldCo for deployment as equity in the pipeline of ~11,770MW under development by JPVL. The timing is especially important for the company since Karcham Wangtoo and Bina are set to be commissioned in FY12, with Karcham to be commissioned in phases starting as early as March 2011. The merger also provides JPVL with fairly liquid treasury shares (valued at ~Rs15.1bn at current market price), which can be sold to raise funds for investing in its power development pipeline. For JPA, the merger clears the structure of dual holding of JKHCL partly through JPA and partly through JPVL. However, the merger would be marginally negative for JPA since JKHCL has been, in our opinion, undervalued at Rs25.7bn (1.2x P/BV).

We have revised our FY12 earnings estimates for JPVL to factor in the change in holding structure of JKHCL from being a 57%-held subsidiary to a part of the parent company. As a result, we do not make any changes to our pre-minorities PAT estimate, but our post-minorities figure for FY12 stands upgraded to Rs10.2bn. Factoring in the dilution due to the merger, we upgrade our FY12 EPS estimate by 8% to Rs3.8/ share. Our FY11 earnings estimate stands downgraded by 8% to Rs0.6/share, mainly due to the dilution in equity capital. We revise our fair value estimate of JPVL to Rs76/share, factoring in dilution from the merger and the current subdued merchant rates.

Price chart



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SEBI Registration Nos.: INB23 12914 37, INF23 12914 37, INB01 12914 33, INB01 12914 33.

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JPA consolidated earnings downgraded by 4%

The dilution of JPA's stake in JPVL from 76.3% to 67.2% following the change in the holding structure, leads to a higher elimination of minorities' interest, and in turn, a 4% downgrade in JPA's FY12 consolidated earnings estimates to Rs10.6/share. Our FY11 consolidated earnings estimate stands downgraded by a marginal 1% to Rs8.5/share. We have also revised our SOTP-based fair value estimates of JPA to Rs153/share, mainly due to the dilution in stake in JPVL post the merger, as also the difference in our fair value estimate for JKHCL and the value implied in the merger scheme. For the computation of our SOTP value and determining JPA's economic interest in JPVL, we have considered JPVL's equity capital net of treasury shares issued. Resultant, while JPA's stake on issued equity will be 67.2%, adjusted for the treasury shares the company's economic interest would be 78.2%.

We maintain our Outperformer ratings on JPA and JPVL, with 12-month price targets of Rs76/share and Rs153/share respectively.

Exhibit 1: JPVL key financials

| As on 31 March | FY08 | FY09 | FY10 | FY11E | FY12E |
|------------------------|--------|-------|--------|--------|--------|
| Net sales (Rs m) | 3,008 | 2,967 | 6,907 | 7,368 | 28,373 |
| Adj. net profit (Rs m) | 1,330 | 1,473 | 2,518 | 1,660 | 10,164 |
| Shares in issue (m) | 491 | 491 | 2,096 | 2,652 | 2,652 |
| Adj. EPS (Rs) | 2.7 | 3.0 | 1.2 | 0.6 | 3.8 |
| % change | (11.5) | 10.7 | (59.9) | (47.9) | 512.4 |
| PE (x) | 15.3 | 13.8 | 34.5 | 66.3 | 10.8 |
| Price/ Book (x) | 2.0 | 1.9 | 1.9 | 1.6 | 1.4 |
| EV/ EBITDA (x) | 10.3 | 10.0 | 29.9 | 41.9 | 12.8 |
| RoE (%) | 13.7 | 14.0 | 9.0 | 3.0 | 14.0 |
| RoCE (%) | 11.8 | 11.8 | 6.1 | 2.7 | 8.1 |

Source: IDFC Securities Research

Exhibit 2: Merger swap ratios and stakes**Merger of JKHCL and JPVL**

| | |
|------------------------------------|---------|
| JKHCL invested equity (mn shares) | 2,145.0 |
| Swap ratio | 5 |
| Shares of JPVL to be issued | 429.0 |
| Mkt price of JPVL (6 months avg) | 60.0 |
| Implied valuation of JKHCL (Rs mn) | 25,740 |

Merger of BPSCL and JPVL

| | |
|------------------------------------|-------|
| BPSCL invested equity (mn shares) | 826.0 |
| Swap ratio | 7 |
| Shares of JPVL to be issued | 127.1 |
| Mkt price of JPVL (6 months avg) | 60.0 |
| Implied valuation of BPSCL (Rs mn) | 7,625 |

JPVL changes in shareholding

| | |
|---|---------|
| JPVL existing equity (mn shares) | 2,095.7 |
| Shares to be issued to Karcham shareholders | 429.0 |
| - Of which, to JPVL (56.9% stake) | 244.10 |
| - Of which, to JPA | 184.90 |
| Shares to be issued to Bina shareholders | 127.1 |
| - Of which, to JPVL | 127.1 |
| Expanded equity post merger (mn) | 2,651.8 |
| % dilution | 26.5% |
| Treasury shares (mn shares) | 371.2 |
| JPA stake in JPVL pre-merger | 76.3% |
| JPA shares held in JPVL pre-merger | 1,598.0 |
| Shares issued on merger | 184.9 |
| JPA shares held in JPVL post-merger | 1,782.9 |
| JPA stake in JPVL post-merger | 67.2% |

Source: IDFC Securities Research

JPA SOTP

| Rs mn | Valuation metric | | FY12E |
|--------------------------------|---|---------|----------------|
| Construction | EV/EBITDA | | |
| EBITDA | | 9,139 | |
| EV / EBITDA multiple | | 8 | |
| Construction EV | | | 73,112 |
| Cement | EV / ton | | |
| Capacity (mn tons) | | 35.6 | |
| EV / ton (US\$) | | 85 | |
| Cement EV | | | 137,837 |
| Power | | | |
| JPVL Equity value | DCF | 181,809 | |
| | | 78.2 | |
| Power equity value | | | 142,130 |
| Real Estate | | | |
| Jaypee Greens | NPV of cashflows @ 16% equity rate | 16,809 | |
| (% stake) | | 100 | |
| Yamuna Expressway | Net NPV of road and real estate cashflows | 158,993 | |
| (% stake) | | 83.1 | |
| JP Sports City | Book value | 5,000 | |
| Total Real Estate | | | 153,852 |
| Others | | | |
| 180mn ton coal mine in MP | Per ton basis | | 6,158 |
| Total EV | | | 513,089 |
| Less: Consolidated Debt | | | 218,426 |
| Market Capitalisation | | | 294,663 |
| No of share (m shares) | | | 1,929 |
| Target price (Rs/share) | | | 153 |

Source: IDFC Securities Research

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