India | Electricity

16 July 2014

Reliance Infrastructure

Rebooting power business to drive recovery

- **Reliance Power's (RPWR) impetus to expedite the Chitrangi and Tilaya projects over FY15-16 should improve Reliance Infrastructure's (RELI) EPC order book and earnings.**
- **Stable environment in the distribution segment should help it in hiking tariffs to recover the accumulated losses.**
- **We expect the infrastructure segment (roads, metro and cement) EBITDA to be 40% of total in FY17E (FY14: 22%).**
- **RELI's valuations seem cheap at FY16E PER, EV/EBITDA and PBR of 10x, 12x and 0.7x, respectively, and a D/E of 0.8x. We believe the company has the ability to take on new growth opportunities without equity dilution. We maintain our OP rating and increase our PT to INR 849 from INR 623.**

RPWR projects to power RELI's growth. Our discussions with RELI and RPWR management suggest that the pace of execution of the long-delayed Chitrangi and Tilaya projects is likely to pick-up. We believe the construction of these projects may commence in FY15-16 – with land acquisition, relief and rehabilitation (R&R) and environment clearances in the advanced stages – and may revitalise RELI's EPC order book and earnings over FY15-17E.

Receding distribution woes. The Mumbai distribution business has improved as: (1) most of its long-term power requirement is tied up; (2) the cross-subsidy surcharge has stemmed customer attrition to Tata Power; and (3) the historical under-recovery (INR 55bn) is provided for in the FY14-17 tariff cycle. The Delhi distribution business has a larger accumulated under-recovery of INR 140bn, which would take longer time to recover, but the regulator has provided a comfort letter future tariff rise.

Infrastructure/cement key opportunities. Mumbai Metro has become operational. RELI has completed the capex for its infrastructure portfolio and is likely to triple infrastructure revenue to INR 19bn by FY17E. RELI commissioned its first 5MT cement unit in Madhya Pradesh in FY14 with scale-up plans over FY14-17.

Inexpensive valuation, attractive growth. RELI's valuations seem inexpensive based on FY16E multiples and a low D/E of 0.8x. We believe RELI is well-placed to capitalise on the capex upturn. We maintain our OP rating and raise our PT to INR 849 to factor in our valuation revisions in Mumbai distribution, roads and metro businesses, introduction of the cement business's valuation and reduction in the conglomerate discount to 10% from 20%.

OUTPERFORM (unchanged)

PRICE as of 16 Jul 2014	PRICE TARGET
INR 780.05	**INR 849.00**

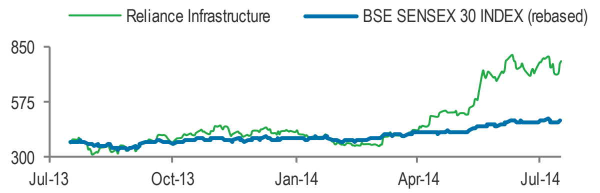
Bloomberg code	**Reuters code**
RELI IN	RELI.NS
Market cap	**12-month range**
INR 205.2bn (USD 3.4bn)	INR 308.20 - 819.90

EPS adj. est. change 2015E nm 2016E nm

Year-end: March	2014	2015E	2016E	2017E
Sales (INR bn)	190	231	247	280
EBITDA (INR bn)	28	36	38	40
EBIT (INR bn)	22	25	26	28
Pre-tax profit (INR bn)	18	21	21	25
Net profit adj. (INR bn)	18	19	20	23
FCF (INR bn)	11	(4)	14	19
EPS adj. (INR)	69.96	72.68	75.59	89.09
DPS (INR)	7.50	7.60	8.00	8.50
Book value/share (INR)	1,031.97	1,097.05	1,164.63	1,245.22
EPS growth adj. (%)	-17.9	3.9	4.0	17.9
DPS growth (%)	1.4	1.3	5.3	6.3
EBITDA margin (%)	14.5	15.6	15.3	14.2
EBIT margin (%)	11.7	10.8	10.6	10.0
Net margin adj. (%)	9.7	8.3	8.1	8.4
Div. payout (%)	10.7	10.5	10.6	9.5
Net gearing (%)	90.4	88.2	80.2	70.9
ROE (%)	6.9	6.8	6.7	7.4
ROCE (%)	4.3	4.6	4.7	5.0
EV/sales (x)	1.7	2.0	1.8	1.5
EV/EBITDA (x)	11.9	12.7	11.7	10.7
PBR (x)	0.4	0.7	0.7	0.6
PER adj. (x)	**5.5**	**10.7**	**10.3**	**8.8**
Dividend yield (%)	**1.9**	**1.0**	**1.0**	**1.1**

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	4	55	109
Relative to index	2	35	62
Relative to sector	-	-	-
Major shareholder			Promoter (48.5%)
Free float			51%
Average turnover (USD)			27,964,182

Source: Company, FactSet

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Valuation and outlook

RELI is a well-diversified infrastructure company. We value it using a sum-of-the-parts valuation methodology using its four key segments: EPC, Power, Infrastructure and Cement. We believe valuation based on earnings multiples is less robust than that based on the SOTP methodology for RELI, due to its complex business model, significant capital work-in-progress and earnings volatility historically. The details of our valuation for each of its segment are summarised in the table below.

Figure 1: RELI – Our SOTP valuation methodology

Business	Gross value (INR bn)	% stake	Net value (INR bn)	Value/sh (INR)	Methodology	Comments/ assumptions
EPC business	27,674	100	27,674	**105**	EV/EBITDA multiple of 5x FY15 and INR 13bn debt	Assume the Chitrangi and Tilaya projects to come into the order book by end-FY15.
Power business			**155,469**	**591**		
Mumbai license	44,586	100	44,586	170	1.5x FY15E Regulated equity book	Premium to the regulated equity factors in the mandated ROE of 15.5% and INR 55bn of under-recoveries to be recovered with tariff increase over the next few years.
BSES Rajdhani	22,427	51	11,438	43	2x FY15E Regulated equity book	Premium to the regulated equity factors in the mandatory ROE of 16% and INR 140bn of under-recoveries to be recovered with tariff increase over the next few years.
BSES Yamuna	12,230	51	6,237	24	2x FY15E Regulated equity book	
Transmission projects			8,125	31	DCFE	
Standalone power projects			11,933	45	DCFE	443MW of power projects that are not a part of the Mumbai licence area.
Reliance Power	173,300	42	73,150	278	DCFE	Valuation for 13.7GW, excluding Samalkot and Krishnapatnam projects, where we see no visibility.
Infrastructure projects			**41,107**	**156**	Valued on a post money basis	
Road projects		100	21,203	81	DCFE	
Mumbai Metro	28,846	69	19,904	76	DCFE	
Cement	**24,000**	**100**	**24,000**	**91**	**USD 130/t of installed capacity**	
SOTP Valuation			**248,250**	**944**	EV/EBITDA multiple of 5x FY15 and INR 13bn debt	
Discount to NAV				**10%**		
Price target				**849**	1.5x FY15E Regulated equity book	

Source: Standard Chartered Research estimates

RELI's relative valuations versus its peers are provided in Figure 2. We have factored in a lower discount-to-NAV for RELI due to three factors: (1) fewer listed subsidiaries, and hence lower conglomerate discount; (2) significantly lower leverage, and hence better headroom for growth opportunities; and (3) lower dilution risk.

Despite the limitations of the multiples-based approach as discussed above, we have analysed RELI's ratios to cross-check our SOTP-based valuation. As is clear from Figure 2, RELI is significantly undervalued in terms of PBR, and its PER is at the mid-point of its peer set. Its premium in terms of EV/EBITDA versus peers is because of RPWR (an associate company) earnings, which are added below the EBITDA level. RPWR contributes 29% to RELI's PBT.

Figure 2: Comparative valuations

	Rating	Mkt cap (USD mn)	Price (INR)	PT (INR)	NAV	Discount to NAV	PER FY15E	PER FY16E	EV/EBITDA FY15E	EV/EBITDA FY16E	PBR FY14	D/E FY14
Adani Enterprises	OP	8.3	452	575	704	18%	22.1	16.5	8.5	7.4	2.4	3.9
Jaiprakash Associates	OP	2.8	68	105	123	14%	9.9	8.7	7.2	6.2	1.1	4.8
Reliance Infrastructure	OP	3.5	780	849	944	10%	10.8	10.4	11.8	10.9	0.8	1.0

Share prices as of 16 July 2014

Source: Standard Chartered Research estimates

We have increased our SOTP-based based price target to INR 849 from INR 623. The key changes in our SOTP valuation and the rationale for those changes are summarised below.

Figure 3: Key changes to SOTP valuation

Business	New	Old	Changes/ Comments
EPC business	**105**	**173**	EPC awards for the Tilaya and Chitrangi projects have slowed from our earlier expectations due to the delay in approvals; however, they have picked up pace recently. But the formal project awards are still some time away, and hence order book remains constrained.
Power business	**591**	**539**	
Mumbai license	170	90	Added capex in transmission; issues on tariff, client attrition and cross-subsidies resolved.
BSES Rajdhani	43	64	The pace of tariff increase in both the Delhi distribution licenses has lagged our expectations, and under-recoveries have mounted. Despite the letter of comfort from the regulator that these will be recovered with future tariff increases, we remain apprehensive.
BSES Yamuna	24	45	
Transmission projects	31	28	
Standalone power projects	45	54	
Reliance Power	278	258	Picked up pace of execution. Sasan and Butibori projects have become operational in FY14.
Infrastructure projects	**156**	**68**	
Road projects	81	15	Five new projects have become operational.
Mumbai Metro	76	61	The project is completed and is now operational. Tariff is better than our expectation. Delhi Metro is no longer incorporated in our valuations.
Cement	**91**	**0**	Commissioned in FY14, hence were not factored in our earlier valuations.
SOTP valuation	**944**	**779**	
Discount to NAV	**10%**	**20%**	Factoring in significantly lower execution and regulatory risks, lower dependence on EPC earnings versus steady utility and infrastructure earnings and improvement in the overall operating environment.
Price target	**849**	**623**	

Source: Standard Chartered Research estimates

Key segments

Reliance Power – Picking up the pace on the existing projects

We estimate RPWR to have 13.7GW of operational power generation capacity by FY19 (current: 5GW) as summarised in the table below. Of the currently operational plants, Rosa and Butibori are fully operational, while Sasan is partially operational (we believe it is likely to be fully operational by FY15). The works at the Chitrangi and Tilaya projects are progressing behind schedule and may become operational in FY17, reaching full capacity by FY19. We do not have any visibility on the takeoff of the 3,960MW Krishnapatnam ultra-mega power plant (UMPP) in the near term, judging by the pronouncements of the new government. The 2,400MW Samalkot gas-fired power plant is ready but not operational due to the lack of gas. Here again, we do not have visibility of project becoming operational. We have not factored these projects in our valuation.

Figure 4: Reliance Power – Our SOTP valuation

Project	Capacity MW	Generation (mn kWh) FY14	PLF (%) FY14	DCFE valuation (FY15E) INR bn	Comments
Rosa Power	1,200	8,134	77	18	Fully operational.
Butibori	600	403	8	13	Off-take likely to improve due to the PPA with RELI that has come into force in FY15 (April 2014).
Sasan	3,960	2,939	17	41	Only three units are operational as of March 2014, one more unit operational in May 2014, remaining two units likely to be operational by end-FY15.
Chitrangi	3,960			58	Forest clearance for the Chattrahasal mine is pending, and plant construction may commence after that. The company is likely to take it up in two phases of 1980MW each. The first phase will start in mid-FY15 and the second phase in FY17.
Tilaya	3,960			43	Land for the plant is in place, while land acquisition for the mine and R&R plan approval are partly pending. Construction is likely to commence in FY16.
Coal-fired plants	13,680			173	
Total valuation	**13,680**			**173**	

Source: Company, Standard Chartered Research estimates

EPC – Performance hinged on Reliance Power

The key reason for RELI's slower earnings growth in the past couple of years has been the weak performance by the EPC business. With Sasan, Butibori and Rosa projects nearing completion and the Tilaya and Chitrangi projects progressing slowly, the EPC order book as of end-FY14 stands at INR 6.7bn (at a book-to-bill ratio of 1.5x). The order book does not include the Tilaya and Chitrangi projects. We expect the first phase of the Chitrangi project to be added in the order book in FY15, the Tilaya project in FY16 and the second phase of the Chitrangi project in FY17.

Figure 5: RELI – EPC order book, revenue and EBITDA evolution

INR bn	FY12	FY13	FY14	FY15E	FY16E	FY17E
EPC order book	173	102	66	105	224	241
Revenues	110	77	46	56	57	78
EBITDA	10	12	7	8	8	11
EBITDA margin (%)	9	16	16	15	15	15

Source: Company, Standard Chartered Research estimates

Mumbai distribution business – Issues sorted out

With three key developments listed below in FY14, the Mumbai distribution problems for RELI have been largely tackled, in our view.

- **A cross-subsidy charge** has been imposed on Tata Power's distribution arm in RELI's licence area. It has stemmed and largely reversed the high voltage (HV) client attrition. Additionally Tata Power's discom will also pay a wheeling charge to RELI.
- **Medium-term power purchase arrangements** that RELI had entered into with Reliance Power (Butibori: 300MW), Abhijeet Energy and KSK Energy (Wardha plant) have started supplying power. The average cost of power from these sources is INR 4-4.2/kWh. This will replace the high-cost short-term arrangements and reduce the average cost of power by 13% to INR 3.8/ kWh in FY15E, in our view.
- **Surplus at current tariff level.** At the current tariff levels, the Mumbai distribution business fully recovers the cost of supply (including the mandatory ROE). However, RELI has INR 55bn of past under-recoveries (recoverable along with a 9.25% annual carrying cost). With the reduction in the cost of power, this gap would be fully recovered in 3-4 years, in our view.

Delhi distribution business – Under-recoveries persist

The Delhi distribution business remains the key area of bother for RELI. Even with the last approved tariffs, the two Delhi discoms are barely covering the cost of supply. Further, the two discoms have an additional under-recovery of INR 140bn (including carrying costs) to be recovered against future tariff increases. RELI has recently received a comfort letter from the central electricity regulatory commission CERC that these under-recoveries will be recovered in future tariff increases. However, it must be noted that this letter was issued to enable RELI's discoms to raise bridge loans from Power Finance Corporation (PFC). CERC has not set any timeframe for the tariff increases. We believe that power price increases will be somewhat contentious and political in nature given that power pricing has been a contentious issue in the recent elections and a Controller and Auditor General (CAG) audit is pending on the issue. A faster recovery roadmap would offer potential upside to the stock

Mumbai Metro – On course with a fare surprise

Mumbai Metro has become operational and the initial response looks positive. The critical issue of fares remains and recent developments in this direction have been positive. The Mumbai high court has allowed RELI to fix the fare at INR 10/20/30/40, as against the government's plea to fix it at INR 9/10/11/13. The state government has decided to appeal in the higher courts. We believe that a via media solution will be worked out. Hence, we have assumed a fare range of INR 10-27 (average of INR 15/trip). Fares in line with RELI's expectation could add another INR 41/sh to the stock's valuation.

Roads – Growing fast

Currently, 10 of RELI's 11 road projects are collecting toll and the company reported a toll revenue of INR 6bn in FY14. We expect this to go up to INR 11bn by FY17E (22% CAGR over FY14/17) through project commencements, toll escalation and traffic ramp-up. The only remaining toll project, Kandla-Mundra, is likely to be operational by end-FY15. RELI has not won any road project in the past three years. A pick-up in the bidding activity in the sector may lead to more opportunities.

Figure 6: RELI – Road portfolio

Project	Length (lane-km)	Cost (INR bn)	Concession period	COD	DCFE valuation (INR bn)
Namakkal Karur	164	3.5	20	FY10	1.4
Dindigul Sam'lore	212	4.3	20	FY10	1.7
Trichy Dindigul	352	5.4	30	FY12	3.0
Salem Ulunderpet	544	10.6	25	FY13	(1.6)
Gurgaon Faridabad	264	7.8	17	FY13	5.1
Jaipur Reengus	208	5.6	18	FY14	1.7
Trichy Karur	320	7.3	30	FY14	3.1
Pune Satara	840	19.9	24	FY11	5.2
Hosur Krishnagiri	360	9.3	24	FY12	1.6
Delhi Agra	1080	29.5	26	FY13	0.1
Kandla Mundra	284	11.3	25	FY15E	(0.1)
Total valuation	**4,628**	**115**			**21.2**

Source: Company, Standard Chartered Research estimates

Cement – The new growth avenue

RELI's cement business operates by utilising the fly-ash from RPWR's Sasan UMPP project. The cement project has moved ahead of the power project and the company has completed the 5MTPA cement plant in Madhya Pradesh at a cost of INR 30bn in FY14. The project commenced operations in 4QFY14 and sold c0.2MT of cement with a revenue of INR 720mn. Our channel checks reveal that the 'Reliance' branded cement is now becoming available in the Central and Western Indian markets. We expect this business to ramp-up sizeably over FY14-17.

Income statement (INR bn)

Year-end: Mar	2013	2014	2015E	2016E	2017E
Sales	228	190	231	247	280
Gross profit	119	86	102	109	134
SG&A	(90)	(64)	(77)	(83)	(106)
Other income	0	0	0	0	0
Other expenses	0	0	0	0	0
EBIT	**28**	**22**	**25**	**26**	**28**
Net interest	(2)	(5)	(4)	(5)	(3)
Associates	0	0	0	0	0
Other non-operational	0	0	0	0	0
Exceptional items	0	0	0	0	0
Pre-tax profit	**26**	**18**	**21**	**21**	**25**
Taxation	(7)	(3)	(8)	(8)	(10)
Minority interests	4	3	6	7	8
Exceptional items after tax	0	0	0	0	0
Net profit	**22**	**18**	**19**	**20**	**23**
Net profit adj.	**22**	**18**	**19**	**20**	**23**
EBITDA	**37**	**28**	**36**	**38**	**40**
EPS (INR)	85.22	69.96	72.68	75.59	89.09
EPS adj. (INR)	85.22	69.96	72.68	75.59	89.09
DPS (INR)	7.40	7.50	7.60	8.00	8.50
Avg fully diluted shares (mn)	263	263	263	263	263

Cash flow statement (INR bn)

Year-end: Mar	2013	2014	2015E	2016E	2017E
EBIT	28	22	25	26	28
Depreciation & amortisation	9	5	11	12	12
Net interest	(2)	(5)	(4)	(5)	(3)
Tax paid	(7)	(3)	(8)	(8)	(10)
Changes in working capital	(23)	22	(6)	(1)	1
Others	0	0	0	0	0
Cash flow from operations	**4**	**42**	**19**	**24**	**28**
Capex	(35)	(31)	(22)	(9)	(9)
Acquisitions & Investments	(9)	(39)	0	0	0
Disposals	0	0	0	0	0
Others	5	(9)	8	9	10
Cash flow from investing	**(39)**	**(79)**	**(14)**	**(0)**	**1**
Dividends	2	2	2	2	2
Issue of shares	0	0	0	0	0
Change in debt	27	46	0	(12)	(6)
Other financing cash flow	(3)	(10)	(10)	(11)	(13)
Cash flow from financing	**26**	**38**	**(8)**	**(21)**	**(17)**
Change in cash	**(9)**	**2**	**(3)**	**2**	**12**
Exchange rate effect	0	0	0	0	0
Free cash flow	**(30)**	**11**	**(4)**	**14**	**19**

Balance sheet (INR bn)

Year-end: Mar	2013	2014	2015E	2016E	2017E
Cash	5	7	3	5	18
Short-term investments	0	0	0	0	0
Accounts receivable	38	50	58	59	64
Inventory	5	5	6	7	8
Other current assets	275	234	260	268	285
Total current assets	**323**	**296**	**327**	**339**	**374**
PP&E	213	239	250	247	245
Intangible assets	0	0	0	0	0
Associates and JVs	0	0	0	0	0
Other long-term assets	131	183	181	179	177
Total long-term assets	**344**	**421**	**431**	**426**	**422**
Total assets	**667**	**718**	**758**	**765**	**796**
Short-term debt	0	0	0	0	0
Accounts payable	68	65	79	84	97
Other current liabilities	114	110	125	127	139
Total current liabilities	**182**	**175**	**204**	**212**	**236**
Long-term debt	208	254	255	243	236
Convertible bonds	0	0	0	0	0
Deferred tax	6	6	6	6	6
Other long-term liabilities	8	9	9	9	9
Total long-term liabilities	**221**	**269**	**269**	**257**	**251**
Total liabilities	**403**	**444**	**473**	**469**	**487**
Shareholders' funds	261	271	289	306	328
Minority interests	2	3	(3)	(10)	(19)
Total equity	**264**	**274**	**285**	**296**	**309**
Total liabilities and equity	**667**	**718**	**758**	**765**	**796**
Net debt (cash)	203	248	251	237	219
Year-end shares (mn)	263	263	263	263	263

Financial ratios and other

Year-end: Mar	2013	2014	2015E	2016E	2017E
Operating ratios					
Gross margin (%)	52.0	45.3	44.3	44.2	47.7
EBITDA margin (%)	16.1	14.5	15.6	15.3	14.2
EBIT margin (%)	12.4	11.7	10.8	10.6	10.0
Net margin adj. (%)	9.8	9.7	8.3	8.1	8.4
Effective tax rate (%)	28.3	15.5	36.9	39.2	39.3
Sales growth (%)	-6.0	-16.9	21.7	6.9	13.4
Net income growth (%)	41.3	-17.9	3.9	4.0	17.9
EPS growth (%)	41.3	-17.9	3.9	4.0	17.9
EPS growth adj. (%)	41.3	-17.9	3.9	4.0	17.9
DPS growth (%)	1.4	1.4	1.3	5.3	6.3
Efficiency ratios					
ROE (%)	8.9	6.9	6.8	6.7	7.4
ROCE (%)	6.1	4.3	4.6	4.7	5.0
Asset turnover (x)	0.4	0.3	0.3	0.3	0.4
Op. cash/EBIT (x)	0.2	1.9	0.7	0.9	1.0
Depreciation/capex (x)	0.2	0.2	0.5	1.3	1.3
Inventory days	14.1	17.4	16.3	17.3	18.0
Accounts receivable days	69.2	84.5	85.6	86.5	79.9
Accounts payable days	289.7	234.9	204.3	216.1	226.1
Leverage ratios					
Net gearing (%)	77.1	90.4	88.2	80.2	70.9
Debt/capital (%)	42.9	46.9	45.9	43.9	42.2
Interest cover (x)	2.7	1.3	1.5	1.5	1.7
Debt/EBITDA (x)	5.3	8.4	7.1	6.6	6.0
Current ratio (x)	1.8	1.7	1.6	1.6	1.6
Valuation					
EV/sales (x)	1.4	1.7	2.0	1.8	1.5
EV/EBITDA (x)	8.6	11.9	12.7	11.7	10.7
EV/EBIT (x)	11.2	14.7	18.3	17.0	15.2
PER (x)	5.9	5.5	10.7	10.3	8.8
PER adj. (x)	5.9	5.5	10.7	10.3	8.8
PBR (x)	0.3	0.4	0.7	0.7	0.6
Dividend yield (%)	1.5	1.9	1.0	1.0	1.1

Source: Company, Standard Chartered Research estimates

Disclosures appendix

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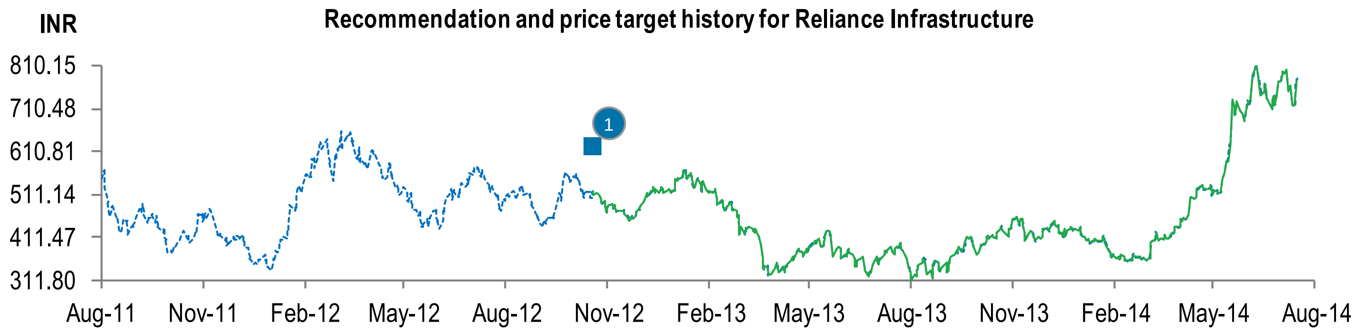

	Date	Recommendation	Price target	Date	Recommendation	Price target	Date	Recommendation	Price target
1	18 Oct 12	OUTPERFORM	623.00						

Source: FactSet prices, SCB recommendations and price targets

Recommendation Distribution and Investment Banking Relationships

	% of covered companies currently assigned this rating	% of companies assigned this rating with which SCB has provided investment banking services over the past 12 months
OUTPERFORM	55.8%	10.4%
IN-LINE	33.0%	10.1%
UNDERPERFORM	11.2%	8.1%

As of 30 June 2014

Research Recommendation

Terminology	Definitions
OUTPERFORM (OP)	The total return on the security is expected to outperform the relevant market index by 5% or more over the next 12 months
IN-LINE (IL)	The total return on the security is not expected to outperform or underperform the relevant market index by 5% or more over the next 12 months
UNDERPERFORM (UP)	The total return on the security is expected to underperform the relevant market index by 5% or more over the next 12 months

SCB uses an investment horizon of 12 months for its price targets.

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