Reliance Power Limited (RPL)

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Issue Summary

• **Type**	Public issue 100% Book building	• **Shares on offer**	260 m (including 32 m shares to be bought by promoters)
• **Size**	Rs 105 bn to Rs 117 bn	• **Face Value**	Rs 10 per share
• **Offer Price**	Rs 405 to Rs 450 per share (Rs 20 per share discount for retail bidders)	• **Pre / Post-issue promoter holding**	100.0% / 89.9%
• **Minimum subscription**	15 shares	• **Promoters**	Mr. Anil Dhirubhai Ambani, Reliance Energy Ltd.
• **Listing**	BSE and NSE	• **Lead Managers**	Enam, Kotak, ABN Amro, Deutsche Bank, UBS Securities, ICICI Securities, JM Financial, JP Morgan
• **Bid/Issue opens**	January 15, 2008	• **Bid/Issue closes**	January 18, 2008

Issue structure

	QIBs	Non-Institutional Investors	Retail Investors
No. of shares*	136,800,000	22,800,000	68,400,000
% of total size*	60%	10%	30%
Minimum Bid/Application size	Over Rs 100,000 and in multiples of 15 shares	Over Rs 100,000 and in multiples of 15 shares	15 shares and in multiples of 15 shares
Maximum Bid/Application size	Not exceeding the issue size	Not exceeding the issue size	Rs 100,000

* Excluding 32 m shares to be bought by promoters

Objects of the issue

RPL is currently pursuing the development of 13 power generation projects, which are currently under various stages of development. Out of these projects, one is being executed by the company itself and the remaining 11 projects are being developed by its nine subsidiaries which have been set up to develop these projects. One project will be executed through a subsidiary that remains to be transferred to RPL. The company intends to use around 75% to 80% portion of the net proceeds to partially fund 6 of these projects (as shown in the table below).

RPL: Projects to be part-funded through IPO

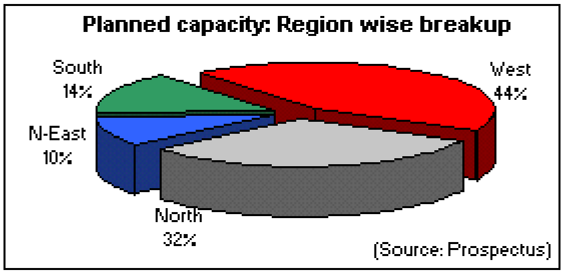
						Breakup of estimates cost						
Project (Rs m)	**Capacity (MW)**	**Commissioning**	**Fuel**	**Esti. Cost**	**Per MW cost**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**IPO financing**	**Debt financing**
Rosa-Phase I (UP)	600	March 2010	Coal	27,020	45	5,457	8,229	13,334	-	-	3,932	21,118
Rosa-Phase II (UP)	600	Sept. 2010	Coal	24,600	41	2,340	4,517	8,098	9,645	-	6,150	18,450
Butibori (Maharashtra)	300	June 2010	Coal	14,050	47	1,690	2,850	7,620		-		
Sasan (MP)	3,960	April 2016	Coal	183,420	46	10,383	27,607	30,550	72,180	42,700		
Shahapur (Maharashtra)	1,200	Dec. 2011	Coal	48,000	40	4,033	567	8,800	15,800	18,800	11,458	36,000
Urthing Sobla (Uttrakhand)	400	March 2014	Hydro	20,800	52	106	150	1,644	3,700	15,200	6,158	14,560
Total	**7,060**			**317,890**		**24,009**	**43,920**	**70,046**	**103,215**	**76,700**	**86,424**	**228,357**

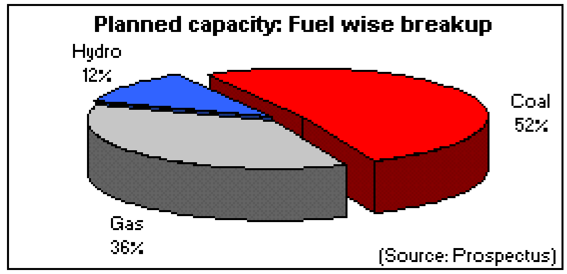
Source: IPO Prospectus

Company background

Business

RPL is part of the Reliance Anil Dhirubhai Ambani (Reliance ADA) group and was established with the purpose of developing, constructing and operating power projects domestically and internationally. The company is currently in the process of developing 13 medium and large sized power projects with a combined planned installed capacity of 28,200 MW. The identified project sites are located in western India (12,220 MW), northern India (9,080 MW) and northeastern India (2,900 MW) and southern India (4,000 MW). They include 7 coal-fired projects (14,620 MW) to be fueled by reserves from captive mines and supplies from India and abroad, 2 gas-fired projects (10,280 MW) to be fueled primarily by reserves from the Krishna-Godavari Basin off the east coast of India, and 4 hydroelectric projects (3,300 MW), three of them in Arunachal Pradesh and one in Uttarakhand.





Apart from the abovementioned 6 projects that will be part funded through the IPO money, RPL shall also working on the following 7 projects:

- Shahpur combined cycle gas-fired project - 2,800 MW
- Gas-fired Dadri project - 7,480 MW
- Krishnapatnam ultra-mega project - 4,000 MW
- Coal-fired MP Power project - 3,960 MW
- Hydroelectric projects - Siyom (1,000 MW), Tato II (700 MW) and Kalai II (1,200 MW)

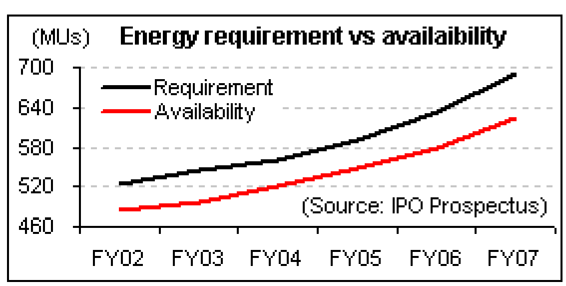
Key management profiles

Mr. Anil Dhirubhai Ambani is the non-executive Chairman of RPL. He holds a Bachelor's Degree in Science from the University of Bombay and a Master's Degree in Business Administration from The Wharton School, University of Pennsylvania, US. Mr. Ambani is also the Chairman of Reliance Communications Limited, Reliance Capital Limited, Reliance Energy Limited and Reliance Natural Resources Limited.

Mr. K.H. Mankad is the Manager, Company Secretary and Compliance Officer of RPL. He is a Bachelor of Commerce and Laws. He is an Associate Member of the Institute of Chartered Accountants of India, an Associate Member of the Institute of Company Secretaries of India and an Associate Member of the Institute of Cost and Works Accountants of India. He has over 32 years of experience in corporate finance, taxation, accounts, management and laws. He has been working with Reliance Energy since 1995 and was its Director (Finance). He has been deputed to RPL since March 12, 2007.

Reasons to apply

- **The 'power'ful opportunity:** India is a power-deficit country. The gap between demand and supply has been increasing, leading to increased power shortages. The peak deficit varies across India, ranging from 5.8% of peak demand requirements in the southern region to 26.5% of peak demand requirements in the western region. According to the government estimates, India's peak demand will reach 152,746 MW with an energy requirement of 968 billion units (BUs) by FY12. Then, by FY17, peak demand will reach 218,209 MW with an energy requirement of 1,392 BUs.



The 11th Five-Year Plan recommends generation planning based on an estimated 9.5% growth in required energy each year. As a result, a capacity addition of 78,577 MW is recommended in the 11th Five-Year Plan as given below:

XIth Plan generation capacity addition targets (MW)

Sector	Thermal	Hydro	Nuclear	Total
Central	26,800	9,685	3,380	**39,865**
State	24,347	3,605	-	**27,952**
Private	7,497	3,263	-	**10,760**
All-India	**58,644**	**16,553**	**3,380**	**78,577**

Source: IPO Prospectus

As per the XIth plan documents, total investment in the electricity sector (including conventional and non-conventional energy, mainly wind energy) is projected to amount to Rs 7,250 bn (US$ 184 bn). The government's projection assumes that private investment in the sector will grow at an average rate of 25% per annum in the backdrop of investments in Ultra Mega Power Projects during the period. Central and States' investment, which includes rural electrification schemes, will grow annually at 16% and 37% respectively.

According to the Ministry of Power, as of September 30, 2007, India has an installed generation capacity of approximately 135,782 MW. Despite the fact that the economic liberalization policies of the government, which began in 1992, were designed to fuel growth across all sectors, the power industry has not grown sufficiently to meet demand. The economy still faces an acute shortage of power. And therein lies the opportunity for companies operating/planning to operate in this space. RPL has a portfolio to develop 28,200 MW of generation capacity over the next few years, which is one of the most aggressive plans as far as the sector is concerns.

Reasons not to apply

- **Execution risks:** This is the biggest risk to applying to RPL, considering that the company does not have a stream of revenues, which shall rather flow when it is able to successfully execute its first project (Rosa-I) in March 2010. Investors need to understand that power projects have high gestation periods and even small size projects take a minimum of 2 to 3 years to complete. As far as large projects (like the UMPPs) are concerned, they take a period of over 5 to 6 years to just begin commercial production. But the way the issue of RPL has been promoted does not speak much of the execution risks that entail the projects.

This most concerning part is that RPL's promoter company, Reliance Energy has a history of under-achievements as far as generation capacity additions are concerned. Just last year, in a meeting with us, the management had indicated that generation projects would be tough to come by from the company if the power distribution segment (still a stronghold of the ailing state electricity boards) did not show signs of improvement via deregulation.

Now, here is a company, having the same parentage, talking about 'successfully' executing 28,000 MW of projects over the next 10 years! Where have all the concerns with respect to distribution gone? Where are the assured fuel supply arrangements? What about the equipments? Understood that financing will not be a difficult part (as seen from the readiness of so many banks to lend for these projects), but will the success of the company depend of the capital it can raise? Or will it depend on how efficiently and effectively it utilises this capital? Amidst the hysteria surrounding this issue, people might seemingly be concerned only of the former, giving little attention to the latter.

Let's talk about fuel first. RPL intends to procure coal and gas for some of its projects through RNRL, but it has not entered into any definitive agreement with the latter. Also, currently, RNRL does not have any rights to coal resources of its own. In addition, RNRL is in litigation with respect to its gas reserves, which may impact the availability or the pricing of fuel for RPL's two gas-fired thermal projects. Moving further, one of the three coal blocks allotted to the company's Sasan ultra-mega project is the subject of litigation between the Ministry of Coal and third parties.

And what about equipments? As has been reported by so many power generation companies and government agencies, there is a tremendous shortage of power equipments in India. So much so, a large number of projects have been shelved or delayed in the past due to non-availability of critical equipments like boilers, turbines and generators. The Central Electricity Authority (CEA) has estimated that for commissioning of 14,000 MW per year on the national scale (in order to achieve the XIth plan targets), equipments worth Rs 78 bn will be required. Out of this, equipments of value of Rs 17 bn are available and augmentation would be required for equipments worth Rs 61 bn. That is a staggering requirement and has been expressed as a major concern by power generating companies. While RPL has indicated its intentions of manufacturing power equipments in-house (though in joint ventures with global engineering companies), the shortage will continue to hamper progress for years to come.

As far as the fund requirement is concerned, RPL shall need significant capital resources to finance these projects. The prospectus indicates that the company will need to raise Rs 1,120 bn (approximately US$ 28 bn) to finance its 13 planned projects. Out of this, as per regulations, around 70% to 80% (Rs 780 bn to Rs 900 bn) will have to raised as third-party debt. This is a huge sum and shall increase the risk on the company's balance sheet. Further, the company's ability to meet its debt service obligations (interest payment and capital repayment) will depend primarily upon the cash flows generated through its business, which in itself has a huge execution risk attached to it.

- **No non-compete clause with Reliance Energy:** RPL's parent company, Reliance Energy, currently operates 941 MW of power generation projects. While the group has stated that it intends for RPL to be its primary vehicle for investments in the power generation sector in the future, it has no non-compete agreement in place with other companies of the group, including Reliance Energy. If these other group companies develop power generation projects in the future and compete with RPL, it will dilute the entire business rationale for the latter to be in existence.

Financials Analysis

RPL does not have any business earnings as of now. As such, we have avoided putting up the financial statements.

Concluding remarks

There is no real comparison for RPL in the Indian context. There are large listed players like NTPC and Tata Power (also Reliance Energy) that can be talked about as comparables for RPL. But these companies have steady revenue streams unlike RPL, which shall generate its first business income possibly in 2010, when Phase I of the Rosa project gets commissioned. In this context, readers need to go back a bit in the past.

RPL's promoter, Reliance Energy's proposal to set up the world's largest gas based generation unit almost 4 years back but is yet to materialise. We recognise that this particular project has suffered because of political influence and infighting between the brothers on the fuel issue. But that is the point. Mega projects attract mega headaches.

What is the guarantee that these sorts of issues will not dog the ambitious power plans of RPL? We are not saying that it is a bad project or that the management of RPL cannot make this work. But these are time-sensitive issues that can hurt the returns on any project. These are serious issues.

As far as valuations are concerned, we believe that other listed power generators are available at much attractive levels than RPL (where there is no underlying business to calculate the valuations!). Even if one were to assume the equity value post the IPO, which will be around Rs 137 bn (at the higher price level of Rs 450 per share) or a per share value of Rs 61, the price to book value at which the issue has been priced is 7.4 times.

Compared to this, India's leading public sector banks, which have a long and good track record and earning return on equity (RoE) of nearly 14% to 16% are available at almost 3 to 3.5 times book value.

Alternatively, we have calculated the equity value of RPL using a 20-year discounted cash flow model (10 years of investment phase and 10 years of growth phase). We have assumed the company's RoE to range between 14% and 19% (19% because we expect some part of the capacity to be available for merchant users where RoE can touch 30% levels) and a discount rate of 12%, which is in fact lesser than Infosys' 14%. This way, the equity value of the company comes to Rs 338 per share. This is 25% lesser than Rs 450 at which the IPO has been priced at the higher end. Our cash flow estimates underpin a best-case scenario for the company as we have assumed that all planned projects will be commissioned on time, which in itself is questionable.

Finally, even if the price of RPL doubles on the listing day, the company's market capitalisation will be higher than NTPC's, which already operates over 28,000 MW of generation capacity and plans to take it to 51,000 MW by 2012.

Overall, considering the execution risks involved, expensive valuations and serious corporate governance issues, we would recommend our subscribers to **'AVOID'** applying to the IPO.