

Asia India

Transportation Infrastructure

19 November 2009

# GVK Power & Infra.

Reuters: **GVKP.BO** Bloomberg: **GVKP IN** Exchange: **BSE** Ticker: **GVKP**

## Preparing to take off, initiating with a Buy

**Manish Saxena**Research Analyst  
(+91) 22 6658 4034  
manish.saxena@db.com**Deepak Agrawala**Research Analyst  
(+91) 22 66584214  
deepak-m.agrawala@db.com**Anup Kulkarni**Research Associate  
(+91) 22 6658 4265  
anup.kulkarni@db.com

### RoE likely to surge going forward; Initiating with a Buy (TP INR61/sh)

GVK's business model stands at an inflection point for RoE improvement due to (1) existing 901MW of power assets to sell up to 20% in spot rates from Dec'09 onwards; (2) Mumbai airport is likely to see 18%yoy passenger traffic growth in H2FY10e vs. a 1.6%yoy in H1FY10; (3) a prime land sale of ~0.5 mn sf in FY11e and 1 mn sf in FY12e near Mumbai airport. Strategy to acquire Bangalore airport could become value accretive if passenger traffic picks up. Our estimates are 43% higher than consensus in FY11e and 31% in FY12e. Buy with TP INR61/sh.

### GVK operations likely to see quantum improvement

We estimate that RoE from the power business will rise from 6% in FY10e to 24% in FY11e, while the road business's RoE will jump from 16% in FY09 to 37% in FY12e. We estimate operating cash flows including Mumbai airport will jump ~6x from levels of INR2.7bn in FY10e to INR15.8bn by FY12e. Further, the recent 12% acquisition in Bangalore airport becomes value accretive if there is a sustained traffic growth of 8% and lease rentals are ~INR35/sf (62% disc. to that of Mumbai Airport).

### Our estimates are above consensus

Our earnings estimates factor in a real estate property sale to the extent of 0.5 mn sf in FY11e and 1 mn sf in FY12e on a lease rental basis of INR90/sf and INR92.7/sf respectively. (4) Our earnings estimates are 43% and 31% higher than consensus in FY11e and FY12e.

### Buy, with a target price of INR61/sh

YTD, GVK's stock has outperformed the Sensex by 77% but has underperformed its infrastructure peers like Lanco Infratech, Jaiprakash Associates, HDIL by 124%, 56% and 47% respectively. We have used a SoTP approach using an average of NPV, exit P/E multiple, and exit P/B multiples to value each of the businesses of GVK to arrive at our TP, - (see page 3 for more detail). Key downside risks include an extended global slowdown leading to a delay in recovery of passenger/aircraft traffic at Mumbai airport, significant fall in short-term power tariffs and gas supply decrease to match high utilization rates.

### Forecasts and ratios

Year End Mar 31	2008A	2009A	2010E	2011E	2012E
Sales (INRm)	4,496.3	4,938.2	<b>17,143.0</b>	20,513.9	21,624.4
EBITDA (INRm)	1,748.8	1,639.9	<b>5,953.8</b>	8,582.1	9,638.1
Reported NPAT (INRm)	1,354.7	1,075.6	<b>1,916.9</b>	4,154.5	4,703.6
DB EPS FD(INR)	1.65	0.77	<b>1.28</b>	2.63	2.98
DB EPS growth (%)	-32.8	-53.6	<b>67.9</b>	104.8	13.2
PER (x)	34.2	39.0	<b>39.4</b>	19.2	17.0
EV/EBITDA (x)	28.9	42.5	<b>18.0</b>	13.0	12.4

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Deutsche Bank

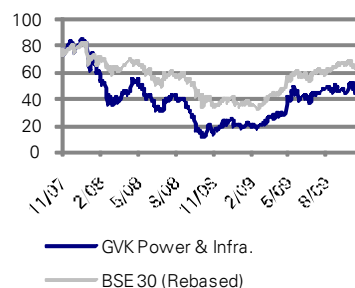


## Coverage Change

### Buy

Price at 18 Nov 2009 (INR)	<b>50.60</b>
Price target - 12mth (INR)	<b>61.00</b>
52-week range (INR)	<b>52.40 - 12.95</b>
BSE 30	<b>17,051</b>

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.4	9.4	247.3
BSE 30	-1.6	13.4	90.8

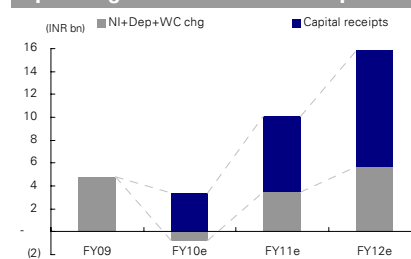
### Stock data

Market cap (INRm)	<b>79,908</b>
Market cap (USDm)	<b>1,726</b>
Shares outstanding (m)	<b>1,579.2</b>
Major shareholders	<b>Promoters (54.25%)</b>
Free float (%)	<b>46</b>
Avg daily value traded (USDm)	<b>16.9</b>

### Key indicators (FY1)

ROE (%)	<b>6.9</b>
Net debt/equity (%)	<b>92.0</b>
Book value/share (INR)	<b>20.55</b>
Price/book (x)	<b>2.5</b>
Net interest cover (x)	<b>1.7</b>
Operating profit margin (%)	<b>22.7</b>

### Operating FCF with Mumbai airport



Source: Deutsche Bank, Company data

Deutsche Bank AG/Hong Kong

All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies. Deutsche Bank does and seeks to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Independent, third-party research (IR) on certain companies covered by DBSI's research is available to customers of DBSI in the United States at no cost. Customers can access IR at <http://gm.db.com/IndependentResearch> or by calling 1-877-208-6300. DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1. MICA(P) 106/05/2009

Model updated: 17 November 2009

## Running the numbers

Asia

India

Infrastructure

## GVK Power &amp; Infra.

Reuters: GVKP.BO

Bloomberg: GVKP IN

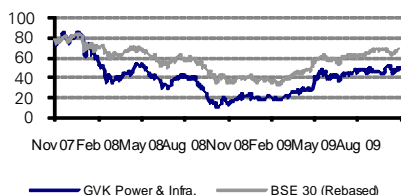
## Buy

Price (18 Nov 09)	INR 50.60
Target price	INR 61.00
52-week Range	INR 12.95 - 52.40
Market Cap (m)	INRm 79,908 USDm 1,726

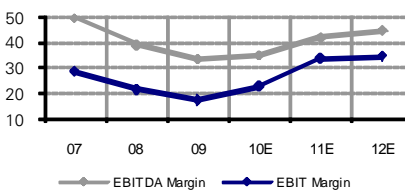
## Company Profile

GVK Power & Infrastructure Limited is a diversified company with a focus on infrastructure (power, airports, roads, oil & gas etc.) along with interests in hospitality and services. The company operates 1 BOT road project, 3 operating power projects of ~ 900MW capacity and manages the Mumbai International Airport. GVK has earmarked massive expansion plans in different sectors of infrastructure and also going in for backward integration into coal.

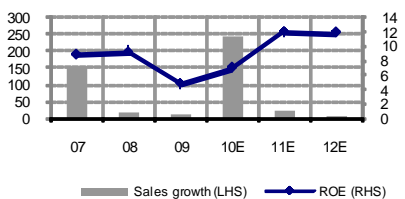
## Price Performance



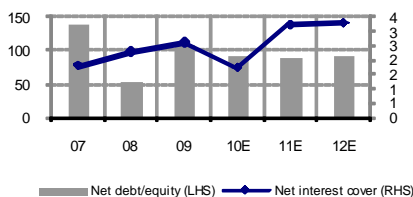
## Margin Trends



## Growth &amp; Profitability



## Solvency



Manish Saxena

+91 22 6658 4034

manish.saxena@db.com

Fiscal year end 31-Mar	2007	2008	2009	2010E	2011E	2012E
<b>Financial Summary</b>						
DB EPS (INR)	2.45	1.65	0.77	1.28	2.63	2.98
Reported EPS (INR)	2.45	1.65	0.77	1.28	2.63	2.98
DPS (INR)	0.00	0.00	0.00	0.00	0.00	0.00
BVPS (INR)	33.1	15.6	16.5	20.5	23.7	27.1
Weighted average shares (m)	236	821	1,406	1,492	1,579	1,579
Average market cap (INRm)	5,708	46,328	41,953	79,908	79,908	79,908
Enterprise value (INRm)	20,278	50,532	69,619	107,032	111,579	119,708
<b>Valuation Metrics</b>						
P/E (DB) (x)	9.8	34.2	39.0	39.4	19.2	17.0
P/E (Reported) (x)	9.8	34.2	39.0	39.4	19.2	17.0
P/BV (x)	1.04	2.58	1.41	2.46	2.14	1.86
FCF Yield (%)	nm	nm	nm	nm	nm	nm
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
EV/Sales (x)	5.2	11.2	14.1	6.2	5.4	5.5
EV/EBITDA (x)	10.6	28.9	42.5	18.0	13.0	12.4
EV/EBIT (x)	18.3	51.9	80.9	27.5	16.1	16.0
<b>Income Statement (INRm)</b>						
Sales revenue	3,876	4,496	4,938	17,143	20,514	21,624
Gross profit	1,916	1,749	1,640	5,954	8,582	9,638
EBITDA	1,916	1,749	1,640	5,954	8,582	9,638
Depreciation	806	776	780	2,065	1,672	2,177
Amortisation	0	0	0	0	0	0
EBIT	1,111	973	860	3,889	6,911	7,461
Net interest income/(expense)	-627	-431	-334	-2,302	-2,158	-2,285
Associates/affiliates	336	407	316	567	687	808
Exceptionals/extraordinaries	0	0	12	0	0	0
Other pre-tax income/(expense)	337	746	325	76	81	86
Profit before tax	821	1,287	864	1,663	4,833	5,262
Income tax expense	250	239	100	182	558	618
Minorities	328	101	3	131	808	748
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	580	1,355	1,076	1,917	4,154	4,704
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	580	1,355	1,076	1,917	4,154	4,704
<b>Cash Flow (INRm)</b>						
Cash flow from operations	1,886	244	3,551	-1,125	2,014	3,665
Net Capex	-9,897	-5,443	-27,226	-4,863	-10,537	-15,236
Free cash flow	-8,010	-5,199	-23,675	-5,989	-8,523	-11,571
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0
Net inc/(dec) in borrowings	0	0	0	0	0	0
Other investing/financing cash flows	0	0	0	0	0	0
Net cash flow	-8,010	-5,199	-23,675	-5,989	-8,523	-11,571
Change in working capital	0	0	0	0	0	0
<b>Balance Sheet (INRm)</b>						
Cash and other liquid assets	631	1,643	1,562	3,204	6,257	9,340
Tangible fixed assets	21,227	25,776	52,091	54,775	63,524	76,972
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	2,974	7,068	3,214	8,060	8,060	8,060
Other assets	2,763	3,241	2,669	6,136	7,178	7,311
Total assets	27,595	37,728	59,536	72,175	85,020	101,682
Interest bearing debt	15,446	12,910	29,798	35,613	42,405	52,869
Other liabilities	1,589	2,947	3,865	1,342	1,624	1,623
Total liabilities	17,035	15,857	33,663	36,955	44,029	54,491
Shareholders' equity	7,831	21,866	23,229	32,445	37,408	42,860
Minorities	2,729	6	2,644	2,775	3,583	4,331
Total shareholders' equity	10,561	21,872	25,873	35,220	40,990	47,191
Net debt	14,814	11,266	28,236	32,409	36,148	43,529
<b>Key Company Metrics</b>						
Sales growth (%)	157.6	16.0	9.8	247.1	19.7	5.4
DB EPS growth (%)	388.6	-32.8	-53.6	67.9	104.8	13.2
EBITDA Margin (%)	49.4	38.9	33.2	34.7	41.8	44.6
EBIT Margin (%)	28.7	21.6	17.4	22.7	33.7	34.5
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0
ROE (%)	8.8	9.1	4.8	6.9	11.9	11.7
Capex/sales (%)	255.3	121.1	551.3	28.4	51.4	70.5
Capex/depreciation (x)	12.3	7.0	34.9	2.4	6.3	7.0
Net debt/equity (%)	140.3	51.5	109.1	92.0	88.2	92.2
Net interest cover (x)	1.8	2.3	2.6	1.7	3.2	3.3

Source: Company data, Deutsche Bank estimates

# Investment thesis

## Outlook

We initiate coverage of GVK with a Buy rating and a target price of INR61/sh based on the following: - (1) We believe that the existing operating assets of GVK are at an inflection point for ROE. We estimate that the RoE of the power business will rise from 6% in FY10e to 24% in FY11e, while the RoE of the road business will jump from 16% in FY09 to 37% in FY12e. We estimate operating cash flows including Mumbai airport will jump ~6x from levels of INR2.7bn in FY10e to INR15.8bn by FY12e. (2) recent 12% acquisition in Bangalore airport will become value accretive if there is a sustained traffic growth of 8% and lease rentals are ~INR35/sf (62% discount to Mumbai Airport lease rental rates) (3) Our earnings estimates factor in a real estate property sale to the extent of 0.5 mn sf in FY11e and 1 mn sf in FY12e on a lease rental basis of INR90/sf and INR92.7/sf respectively. (4) Our earnings estimates are 43% and 31% higher than consensus in FY11e and FY12e. (5) YTD, GVK's stock has outperformed the Sensex by 77% but has underperformed its infrastructure peers like Lanco Infratech, Jaiprakash Associates, Housing Development and Infrastructure Ltd (HDIL) by 124%, 56% and 47% respectively.

## SoTP method gives a value of INR61/sh

We have used SoTP approach to arrive at our target price of INR61/sh. Further, we have used an average of NPV, exit P/E multiples, and exit P/BV multiples to value each of the businesses of GVK. The cost of equity of 13.5% is based on a risk-free rate of 8.1%, a risk premium of 5.3% (both in line with Deutsche Bank estimates), and a beta of 1.0 (based on weekly stock prices from Bloomberg). Note however, for the operating power assets we have assumed a lower CoE of 12% since there is no execution/construction risk attached to these assets. Our sensitivity analysis suggests potential upside of 2% to our TP if lease rentals realized from Mumbai airport are 10% higher than our estimates. Likewise, our TP could go up 7% if GVK is successful in raising its stake in Bangalore airport from 12% to 29% at a price similar to that paid to acquire the original 12%.

Our SoTP comprises of the following:

- **Power business:** We have valued 1,231MW of power generation assets of GVK (901MW operating and 330MW under construction) using (1) NPV at CoE of 12%, exit P/E of 20x FY11e and exit P/BV of 2.5x FY11e for 901MW operating asset; (2) NPV at CoE of 13.5%, exit P/E of 12x FY13e, and exit P/BV of 2x FY13e for the 330MW project under construction and discounted back to FY11e at 13.5%; and (3) for the 540MW project, we have valued on the equity invested till FY09 as the project has yet to achieve financial closure. Accordingly, we get an average value of power assets at INR32/sh.
- **Airports:** We have valued the Mumbai airport using an average of NPV at a CoE of 13.5%, exit P/E of 20x FY11e, and exit P/BV of 2.5x FY11e, deriving an average value of INR11/sh. For the real estate development at the Mumbai airport, we have used the NPV approach at a CoE of 16.5% in line with our real estate analyst Abhay Shanbhag's real estate valuation models giving a value of INR7.4/sh. According to Abhay, the real estate has higher beta from higher stock volatility and greater risk on execution. For the Bangalore airport, we have valued at the acquisition cost that GVK had paid, which gives a value of INR3/sh.
- **Road asset:** We have valued the Jaipur expressway using an average of NPV at a CoE of 12%, exit P/E of 20x FY11e and an exit P/BV of 2.5x FY11e, giving an average of INR7/sh.
- Other investments are valued at book value as of FY09, giving a value of INR0.4/sh.

---

## Risks

Key downside risks include an extended global slowdown leading to a delay in recovery of passenger/aircraft traffic at Mumbai airport, significant fall in short-term power tariffs and gas supply decrease to match high utilization rates. If the tariff realized on the short-term sale of power is lowered by INR1/kWh, then the earnings could potentially decrease by 7% in FY12. If annual vehicle traffic at the Jaipur expressway is 10% below our estimates, then earnings could potentially decrease by 5% in FY10e and 2% in FY11e.

**Table of Contents**

<b>Operating assets at an inflection point in cycle.....</b>	<b>6</b>
GVK manages a good bouquet of infrastructure assets.....	6
A stable and diversified business model.....	7
RoE from power assets to jump by 18% in the forecast period.....	7
Operating cash flow from Mumbai Airport also likely to surge.....	9
Operating leverage also coming to play in roadways.....	12
<b>GVK has successfully grown inorganically in India.....</b>	<b>14</b>
Project implementation in India has missed targets .....	14
GVK chose to build and buy assets.....	17
Acquisition of stake in Bangalore airport.....	17
Timing may just be right for pick up of stake in Bangalore Airport.....	18
<b>Assumptions and forecasts .....</b>	<b>20</b>
Key assumptions.....	20
Summary forecasts .....	24
Operating cash flows may be a better alternative than RoE .....	26
Deutsche Bank vs. consensus .....	27
<b>Valuations .....</b>	<b>28</b>
Stock performance vs. infrastructure peers .....	28
Stock performance.....	28
Trading bands .....	29
SoTP method gives a value of INR61/sh .....	29
Our SoTP does not capture the value of the following businesses .....	30
Comparative valuation.....	30
Our target price of INR61/sh implies an exit P/E of 23x FY11e .....	32
<b>Sensitivity and risk analysis .....</b>	<b>33</b>
Sensitivity analysis for the power generation assets .....	33
Sensitivity analysis for airports.....	33
Sensitivity analysis for roads .....	35
Other industry risks .....	35
<b>Appendix A: An all-round infrastructure company.....</b>	<b>38</b>
GVK has assets across power, transport, energy, and SEZ .....	38
Expansion projects in power are 100% regulated .....	41
Financial performance.....	41
Management.....	42
Tapped capital markets to fund growth .....	43
<b>Appendix B: Mumbai airport.....</b>	<b>44</b>
Contractual framework of Mumbai International Airport.....	44
Multiple sources of revenues.....	45
Cost structure at the airport.....	46
Real estate development .....	46

# Operating assets at an inflection point in cycle

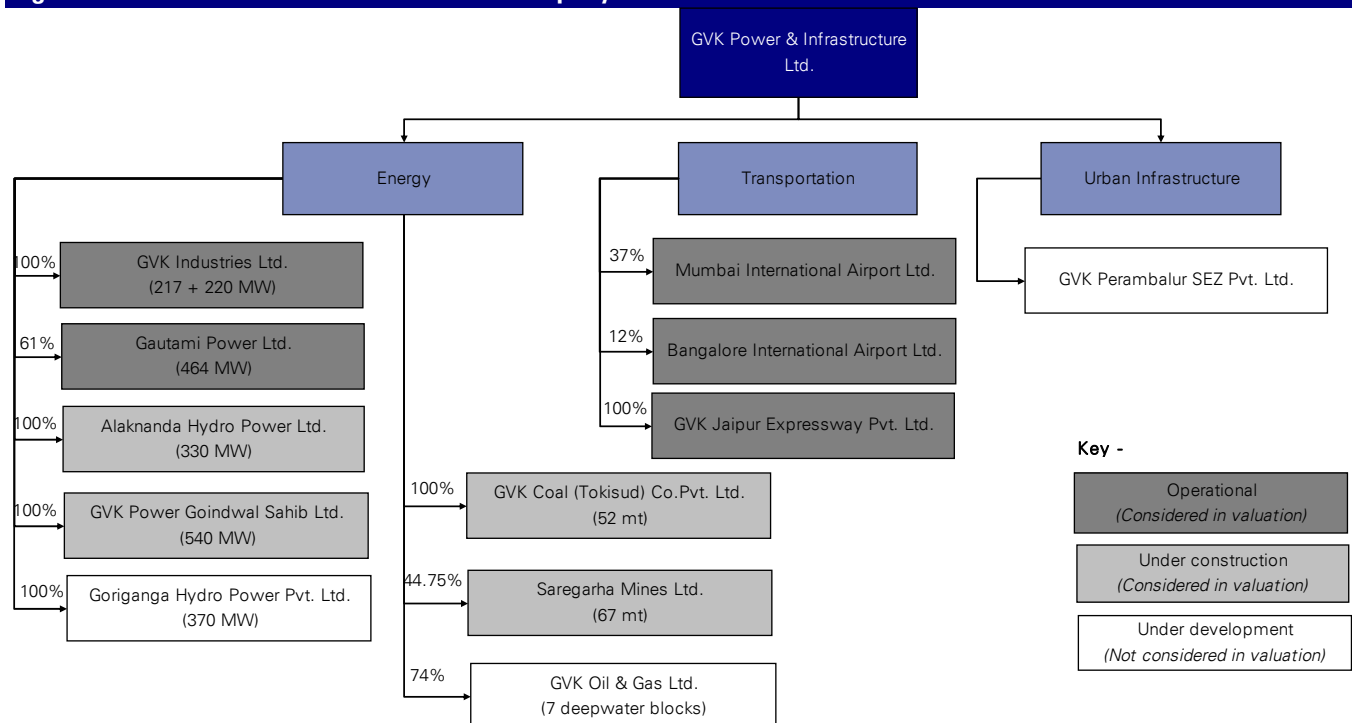
## GVK manages a good bouquet of infrastructure assets

GVK Power and Infrastructure's portfolio of infrastructure assets can be divided into three important verticals:

1. Energy – comprising of 901MW of operating power assets, 1,240MW of projects under implementation includes (330MW Alaknanda hydro project, 540MW Goindwal Sahib project and 370MW Goriganga hydro projects) and ownership of coal blocks with reserves of 119mt and seven deep water oil blocks.
2. Transportation – comprising of 60-year concessions to operate the Mumbai airport and the recently acquired 12% minority interest in Bangalore airport. GVK acquired its share of the Mumbai Airport in a consortium with Airports Company South Africa (ACSA) and Bid Services Division.
3. In addition, the company has concessions to operate a 90km stretch of the Jaipur-Kishangarh six-lane expressway until 2023.
4. Urban Infrastructure is largely through the proposed development of a Special Economic Zone (SEZ) of the company in South India.

Figure 1 gives a snapshot of the structure of various subsidiaries, associates, and joint ventures of GVK Power across sectors.

**Figure 1: GVK is an all-round infrastructure company**

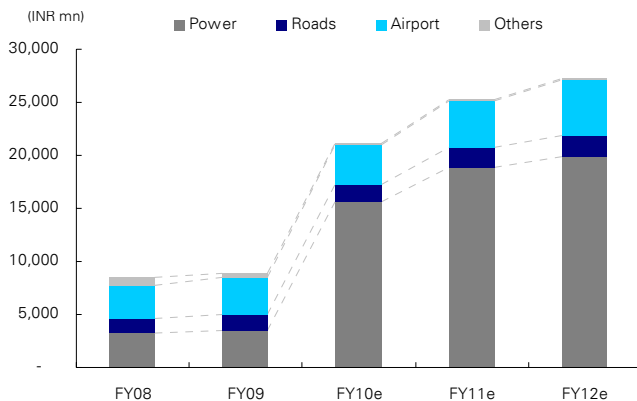


Source: Company data

## A stable and diversified business model

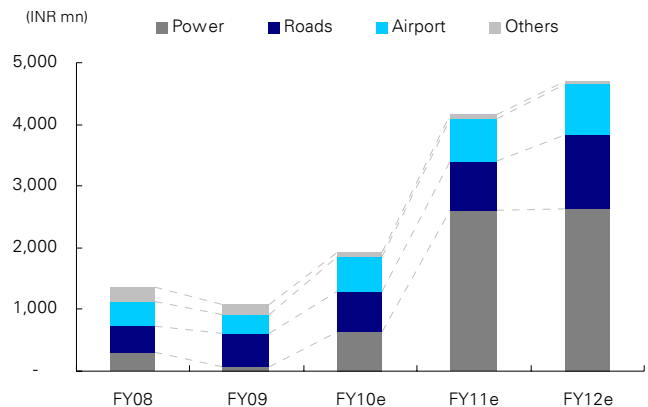
The following figures show that GVK has a balanced proportion of income from power, road and airports in FY09. However in the immediate near term, the permission to sell up to 20% of its output in the short term market coupled with availability of natural gas have made the proportion of revenues and income skewed towards the power sector.

**Figure 2: Revenue mix**



Source: Deutsche Bank. For Mumbai airport, we have added the proportionate revenue. Note that the revenue from Mumbai airport is not added in reported consolidated financials as the MIAL is consolidated on associate accounting basis

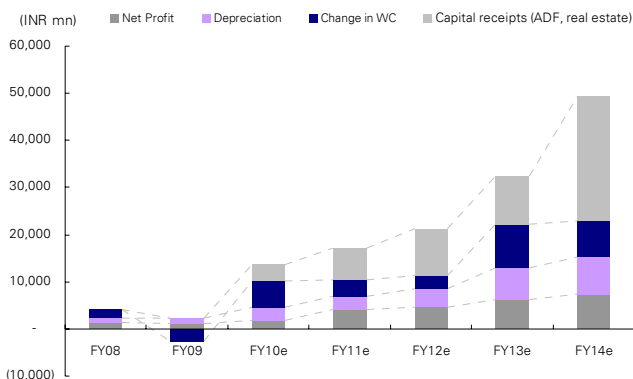
**Figure 3: Net Income mix**



Source: Deutsche Bank, Company data.

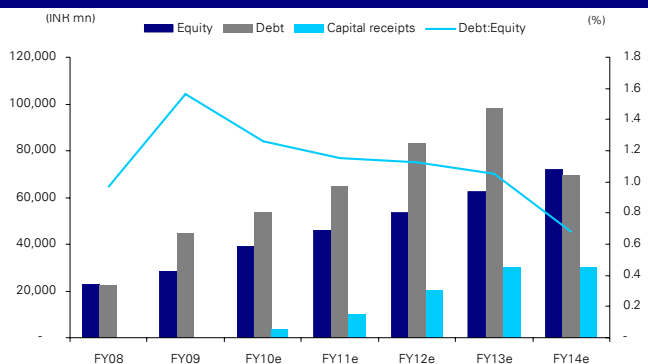
A closer look shows a far bigger jump in cash flow from operations. This is largely due to the impact of capital receipts which are based on (1) defined user charges for Airport development fees and (2) modest assumptions on sale of real estate as a part of the concession agreement to modernize and run the airport for 60 years.

**Figure 4: Operating free cash flow (inclusive of Mumbai airport)**



Source: Deutsche Bank, Company data

**Figure 5: Debt – Equity mix**



Source: Deutsche Bank, Company data

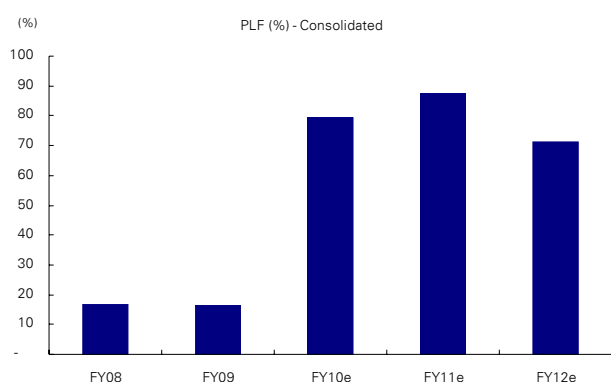
The most interesting part of GVK's business model is that all its operating assets are at an inflection point in generating cash flows from operations and RoE.

## RoE from power assets to jump by 18% in the forecast period

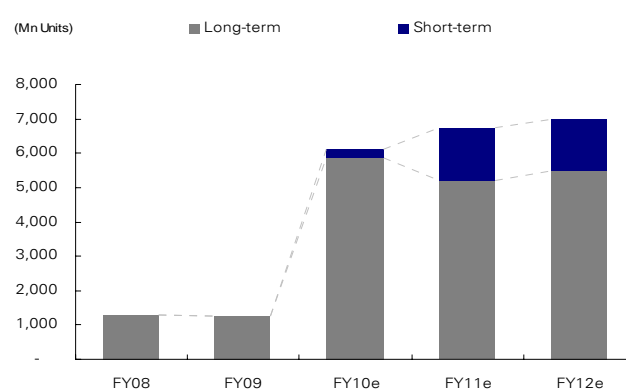
**High leverage to enhanced domestic gas supply from KG basin**

GVK has three operating power assets totaling 901 MW; namely, 217MW of JP I, 220MW of JP II, and 464MW of the Gautami power project. The power assets have one of highest leverage to enhanced domestic gas supplies from Reliance Industries' KG basin. Of the

901MW, about two-thirds of the capacity; i.e. 684MW (JP II and Gautami power projects), was lying idle for want of gas. These plants were completed three years back, but have slowly started ramping up capacity as gas supplies have picked up. In 2009, GVK got the gas allocation from the new discoveries of Reliance Industries and subsequently executed a gas supply and transport agreement. Thereafter, JP II and Gautami began generation in Apr'09 and Jun'09, respectively.

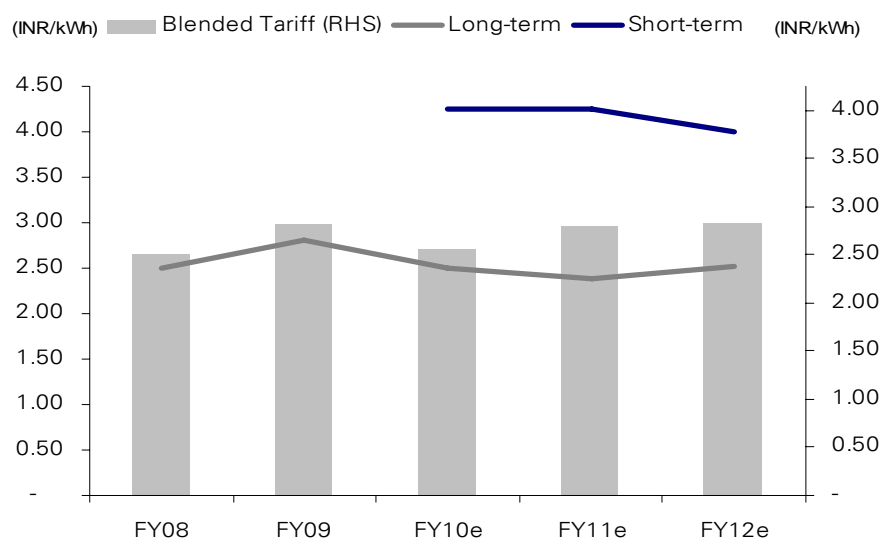
**Figure 6: Consolidated PLF for GVK**

Source: Deutsche Bank, Company data, JP II and GPL commenced operations in FY10e

**Figure 7: Rising volumes through short-term sales**

Source: Deutsche Bank, Company data

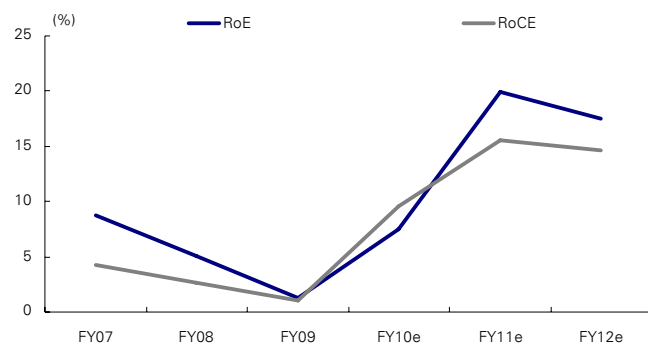
Going forward from December 07, 2009, the company will be selling up to 20% of 660MW o/p at a tariff of INR4.29/unit, which is ~2x the tariff for the remaining 80% of the o/p.

**Figure 8: Overall realization (INR/kWh)**

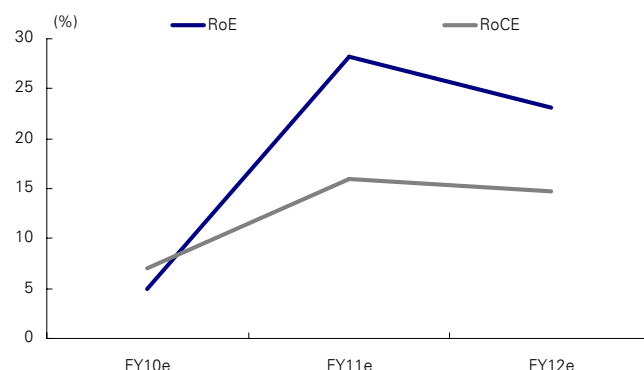
Source: Deutsche Bank, Company data

This by itself would improve the RoE from Q4FY2009e onwards and more than offset the loss from recovery of additional depreciation of INR120mn/quarter no longer available with the company.



**Figure 9: RoE and RoCE of JP I and JP II ( 437MW)**

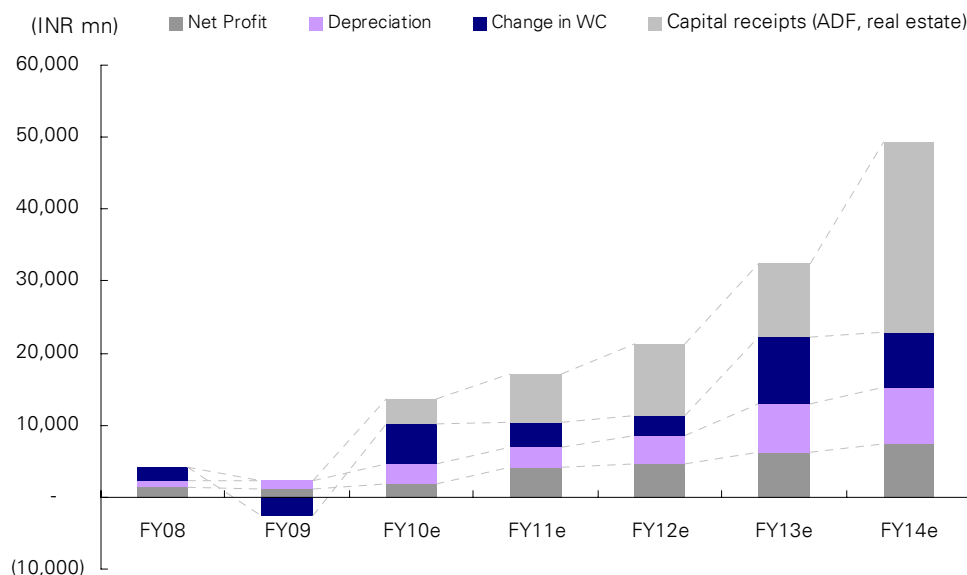
Source: Deutsche Bank, Company data, JP II commenced operations in FY10e

**Figure 10: RoE and RoCE of Gautami Project(464MW)**

Source: Deutsche Bank, Company data, GPL commenced operations in FY10e

## Operating cash flow from Mumbai Airport also likely to surge

The Mumbai Airport project involved modernization cum expansion of the existing airport at Mumbai at an estimated capex of INR98bn spread over FY07-14e. On completion, the maximum traffic that the airport can handle is 40 mn passengers (1.7x from FY09 levels) and 1 mnt of cargo (1.9x FY09 levels).

**Figure 11: Operating cash flow (inclusive of Mumbai Airport)**

Source: Company data, Deutsche Bank

As seen in the figure above, the Mumbai Airport also appears to be at an inflection point for operating free cash improvement due to the following: