GVK Power & Infrastructure Ltd.

EQUITY REPORT

May 9, 2014

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GVK Power & Infrastructure Ltd (GVK), established in 1994, is the flagship company of GVK Group. The company is engaged in the business of providing operation and maintenance services, manpower & consultancy services and incidental services to owners of power plants, airports and infrastructure companies. The company operates mainly in four business, namely, Power, Roads, Airport and Others. It conducts and operates its business through seven subsidiaries, 16 step down subsidiaries and two associate companies (as on March 31, 2013).

Investor's Rationale

GVK cuts losses by 20% in Q3FY'14: On account of dismal performance from its power segment coupled with higher interest cost, GVK witnessed another quarter of losses. However, the company managed to cut the losses by ~20% in Q3FY'14 to ₹454 mn against a net loss of ₹570 mn in Q3FY'13 driven by improved performance from the airports and roads divisions. An impressive growth in net sales and PAT by 57.6% and 119.4% YoY, respectively, from Mumbai International Airport Ltd (MIAL) helped in cutting the losses in Q3FY'14.

Airport division revenue trend promises well for long term: Revenue from GVK's airport division (contributed ~34.3% to the total revenue in FY'13) is expected to grow at a CAGR of ~55.2% to ~₹22,704 mn in FY'14E and is likely to witness a two-fold growth in FY'15E to ~₹45,408 mn. During FY'13, the segment showcased a decent performance marking a 143.1% YoY growth in revenue to ₹14.629 mn. We expect the segment to continue the trend as the strong revenue trend promises well for the long-term prospects of the company.

GVK to benefit from a rise in RIL's KG output: We believe that GVK is likely to see an improvement in profitability with an increase in output from RIL's KG basin as many of the company's plants are completely dependent over the gas (major fuel for power plants) supplied from the KG basin. RIL has announced in January 2014, that it will invest USD 747 mn in increasing production and expects a rise in production by 3-4 million standard cubic metres per day (mscmd) by the end of FY'15.

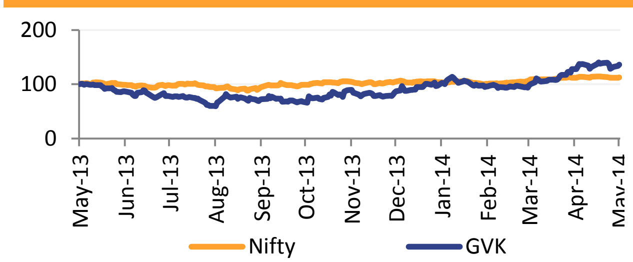
Real Estate monetisation - a boon for the debt-laden infrastructure giant: GVK's debt in Mumbai International Airport Ltd (MIAL) currently stands at ₹79.0 bn and reduction of MIAL debt is the key to support the company to lower the losses. The debt sitting in the airport vertical with heavy interest burden is also hitting the consolidated numbers. In a move to reduce the debt burden, GVK is planning to monetise assets in airport verticals. We believe that fructification of this move would be potentially positive for the company as the debt taken for stake acquisition, which has been key dragger for the bottomline, could be repaid.

Market Data	
Rating	**BUY**
CMP (₹)	13.5
Target (₹)	**16**
Potential Upside	~18.5%
Duration	Long Term
Face Value (₹)	1.0
52 week H/L (₹)	13.6/5.5
Decline from 52WH (%)	0.6
Rise from 52WL (%)	145.8
Beta	1.0
Mkt. Cap (₹bn)	21.4
Enterprise Value (₹bn)	184.0

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	24.9	26.1	29.3	52.5
EBITDA (₹bn)	6.9	6.8	10.3	20.0
Net Profit (₹bn)	0.6	(3.4)	(2.3)	(0.9)
Adj EPS (₹)	0.4	(2.1)	(1.4)	(0.6)
P/E (x)	34.7	-	-	-
P/BV (x)	0.3	0.3	0.3	0.3
EV/EBITDA (x)	21.1	26.9	23.0	12.7
ROCE (%)	2.4	1.5	2.5	5.0
ROE (%)	0.9	-	-	-

One year Price Chart



Shareholding Pattern	Mar'14	Dec'13	Diff.
Promoters	54.2	54.2	-
FII	14.9	14.4	0.5
DII	2.8	2.8	-
Others	28.1	28.6	(0.5)

GVK Power & Infrastructure Ltd – the leading company with diversified interest across various sectors of economic significance

GVK is engaged in the business of owning, operating, and maintaining power plants by itself and through its subsidiaries.

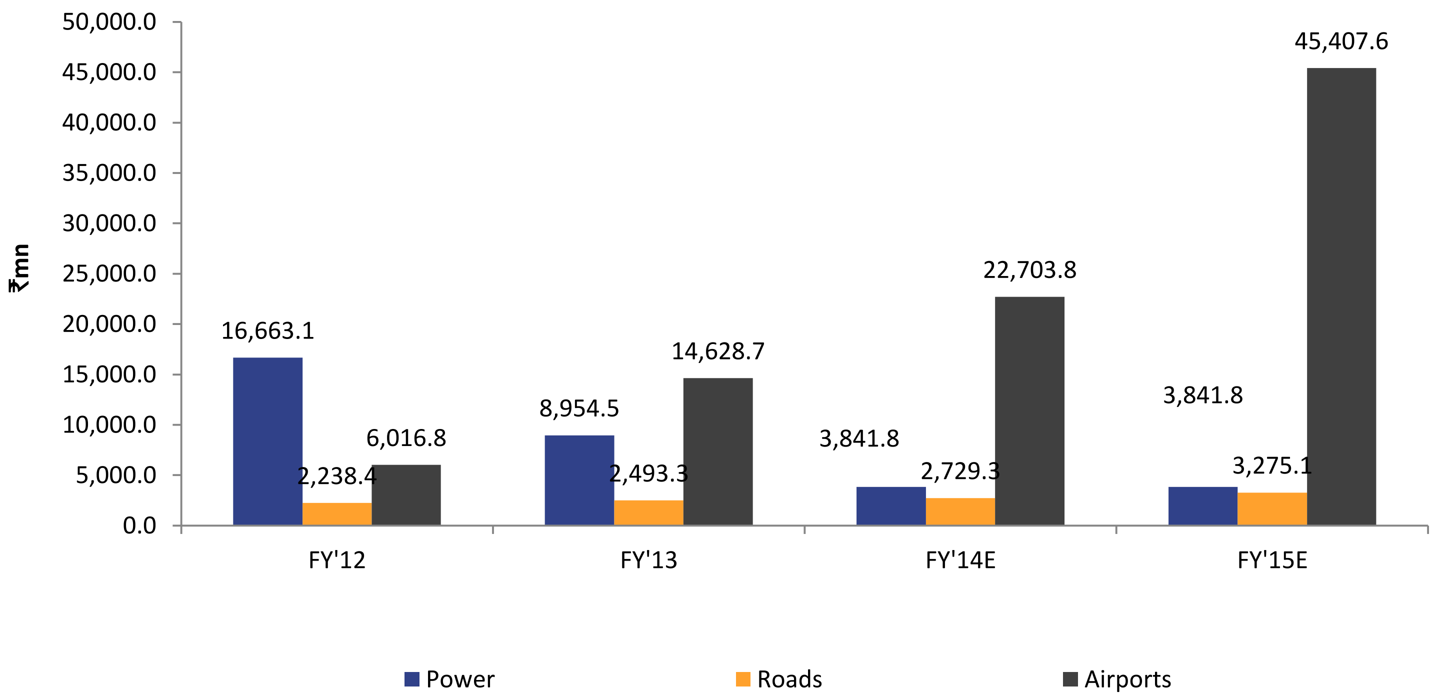
GVK Power & Infrastructure Ltd (GVK), the leading Indian conglomerate is a part of the GVK Group that has diversified interests across various sectors of economic significance. Established in 1994, the company is amongst India's largest infrastructure developers with experience and expertise spanning areas including hospitality, manufacturing, power, roads, airports, SEZs and urban infrastructure. GVK is engaged in the business of owning, operating, and maintaining power plants by itself and through its subsidiaries. GVK operates through its four business segments, namely, Power, Roads, Airport and Others. It conducts and operates its business through seven subsidiaries, 16 step down subsidiaries and two associate companies (as on March 31, 2013).

The company has pioneered various infrastructure projects viz. setting up India's first Independent Power Plant (IPP), first six-lane road project and first Brownfield airport under the Public Private Partnership (PPP) model.

Having already invested over ₹200.0 bn (USD 4.3 bn), GVK has projects worth over another ₹300.0 bn (USD 6.6 bn) in the pipeline, in India. The company has pioneered various infrastructure projects viz. setting up India's first Independent Power Plant (IPP), first six-lane road project and first Brownfield airport under the Public Private Partnership (PPP) model. It has over 900 MW operational power plants and around 5,000 MW projects under various stages of construction and development.

In 2013, the company has acquired the Australian Coal Mines in Queensland with 8 bn tonne reserves and a capacity of more than 80 mn tonne per annum for USD 1.26 bn. It also plans to set up a 500 km. rail line and upto 80 mtpa port as a part of the 'pit-to-port' logistics solution. The project envisages a total investment of USD 10 bn. Thus, looking at the company's plans, the future of GVK seems brighter.

Revenue trend of GVK's major businesses



RIL to ramp up gas output – a key positive development for GVK

During FY'13, many of GVK's projects were completely shut down due to the shortage of supply of its major fuel by the KG D6 basin.

GVK's major power projects, namely 217MW Jegurupadu CCPP Phase 1 (JP I), the 228 MW Jegurupadu CCPP Phase 2 (JP II) and 469MW Gautami CCPP uses gas as their major fuel. Since the company is very much dependent on Reliance Industries Ltd's (RIL), KG basin for gas supply to its power projects, any increase or decrease in gas output by RIL will have a remarkable impact on GVK's revenue base. KG-D6 fields, which began gas production in April 2009, had hit a peak of 69.43 mscmd in March 2010 before various factors such as geological complexity, the natural decline in the fields and higher than envisaged water ingress led to a fall in gas production, which also had a significant impact on GVK's profitability. During FY'13, many of its projects were completely shut down due to the shortage of supply of its major fuel by the KG D6 basin.

RIL's plans to raise production from KG block to benefit GVK, as the company is very much dependent on RIL's KG basin for gas supply to its power projects

Recently, RIL has announced that it will increase production from its D1 and D3 fields in its Krishna Godavari block, by three or four million standard cubic metres per day (mscmd) by the end of FY'15. This would be a positive development for GVK as the company is very much dependent on RIL's KG basin for gas supply to its power projects.

So, RIL's plans to raise production from these fields augur well for the company. Additionally, the RIL is hopeful that gas production will see a boost from the R-series and the satellite fields in FY'18. This also ensures a continuous gas supply to the company from FY'16 onwards and eliminates the gas risk availability and thus the future prospects for the company seem promising.

Commissioning of Terminal 2 - a significant event

The new terminal, T2 in Mumbai, should lead to higher non-aero revenues, over the next few years, on the back of higher F&B, retail and car parking revenues

The commissioning of second terminal (T2) in Mumbai in Q3FY'14 is a significant milestone for the company, considering the hurdles it faced, in the form of political agitations and land encroachments. In financial terms, the new terminal should lead to higher non-aero revenues, over the next few years, on the back of higher F&B, retail and car parking revenues. The commissioning of the airport would also make it easier for GVK, to find a private equity investor for its airport portfolio – desperately needed, to reduce debt on its balance sheet.

Real Estate monetisation – hopes of debt cut priced in

We believe that the results of real asset monetisation would be potentially positive for GVK as the debt taken for stake acquisition, which has been key dragger for the bottomline, could be repaid.

In a move to reduce the huge debt burden of ₹79.0 bn, as in Q3FY'14, GVK has bid for land monetisation of MIAL wherein it is looking to monetise four land parcels aggregating 1.8 mn sq ft. The company has indicated that negotiations are going on for the same and should be completed in Q4FY'14 itself. We believe that proceeds from monetisation will be key in meeting the funding gap of MIAL.

Also, the company is in initial talks with PE players led by IDFC for an investment of USD 400 mn in the airport division. While the company refused to comment on the details, it confirmed that it continues to look for an airport stake sale in its holding company for debt reduction. We believe that fructification of any such move would be potentially positive for the company as the debt taken for stake acquisition, which has been key dragger for the bottomline, could be repaid.

GVK gets Australian Court nod for Queensland project

GVK has got the nod from the Land Court of Australia to develop and go ahead with expansion plans of their Queensland project worth USD 10 bn. The court has granted conditional clearance to Alpha Coal Mine project being developed by the GVK Group there. In 2011, GVK had acquired 79% stake in the Alpha Coal and Alpha West projects and 100% stake in the Kevin's Corner project in Queensland from Hancock Prospecting Pty Ltd. GVK's Alpha Coal Mine is located in the Galilee Basin with the first coal expected to be extracted by 2016.

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When fully commissioned, the mine will produce 32 mn tonnes of thermal coal per year for the Asian export market. The company, which expects significant benefits from the project, is expected to see improvement in its profitability in the long run.

Power business remains a concern, Airport division promising

GVK continued to struggle to trim debt and prune interest charges, while struggling with fuel shortages in the power segment. The company's power business, which contributed ~34.3% of the total revenue in FY'13, reported a 58.8% YoY decline in revenue at ₹977 mn against ₹2,371 mn in the corresponding quarter previous year. However, the airports and roads divisions, which contributed around ~56.1% and 9.6% of the total revenues in FY13, reported good numbers, which helped the company to trim its losses in Q3FY'14. The airports and roads divisions posted ~63.6% and ~7.8% growth in net profit at ₹5,682 mn and ₹692 mn respectively. Since the major part of revenue comes from Airport and Power division, decline in power segment's revenues impacted the profitability to a greater extent in Q3FY'14.

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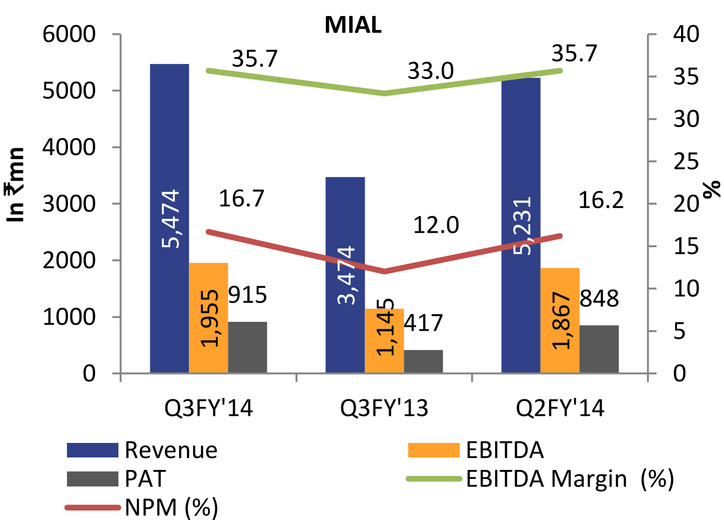
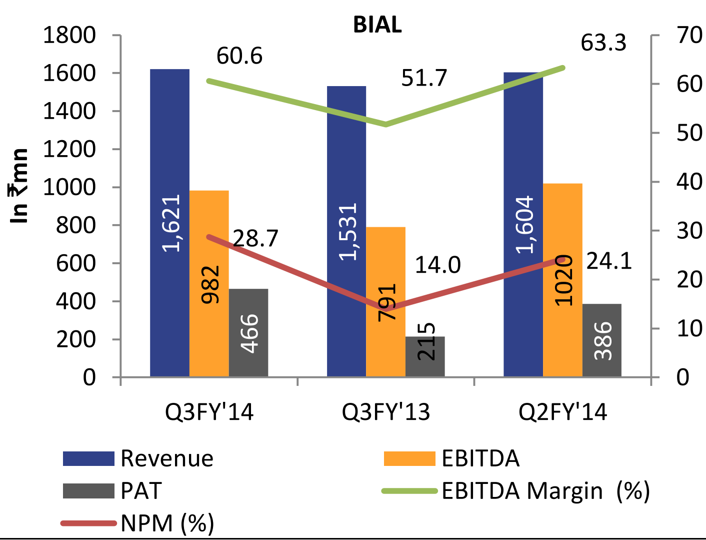
Airport division – to grow at a CAGR of ~55.2% in FY'14E: During Q3FY'14, the airports division performed particularly well posting revenue of ₹5,682 crore, up 63.6% YoY, given the tariff revision implemented from February 2014 onwards. Passenger traffic was healthy in Q3FY'14 with BIAL and MIAL reporting 9.2% and 5.2% YoY growth in passenger traffic, respectively, thereby boosting the revenue base.

Despite of the debt burden of ₹79.0 bn on MIAL, we are hopeful for a recovery in FY'14E and Q4FY'14E as the company is planning to monetise assets in airport verticals and this move would be potentially positive for GVK as the debt taken for stake acquisition, which has been key dragger for the bottomline, could be repaid.

MIAL and BIAL's performance in Q3FY'14





As per our estimates, the road segment is likely to grow merely by ~4.2% QoQ in Q4FY'14E and by ~9.5% YoY in FY'14E with the expectations for the partial tolling of Deoli Kota Expressway to commence from April, 2014.

Going forward, we expect the airports vertical to grow at a CAGR of ~55.2% in FY'14E and by almost ~100% in FY'15E as we are optimistic over the recent developments in the division. Revenue from the segment showcased a triple digit growth of 143.1% YoY in FY'13 at ₹14,629 mn. Moreover, during the quarter, GVK commissioned a new terminal at Bangalore and T2 terminal at Mumbai airports and this is expected to bolster GVK's results in the quarters to come.

Road division – growth to remain muted: The company's transportation business, GVK Jaipur Expressway Pvt Ltd recorded revenue of ₹692 mn in Q3FY'14, reflecting a growth of 8% YoY, driven by traffic growth of 2% YoY and tariff hike of ~6%. Also, in a move to reduce its debt burden, GVK is looking to sell its stake in the Jaipur- Kishangarh project and the Bagodara-Vasad project wherein private equity firms, SBI-Macquarie being one of them, have shown interest.

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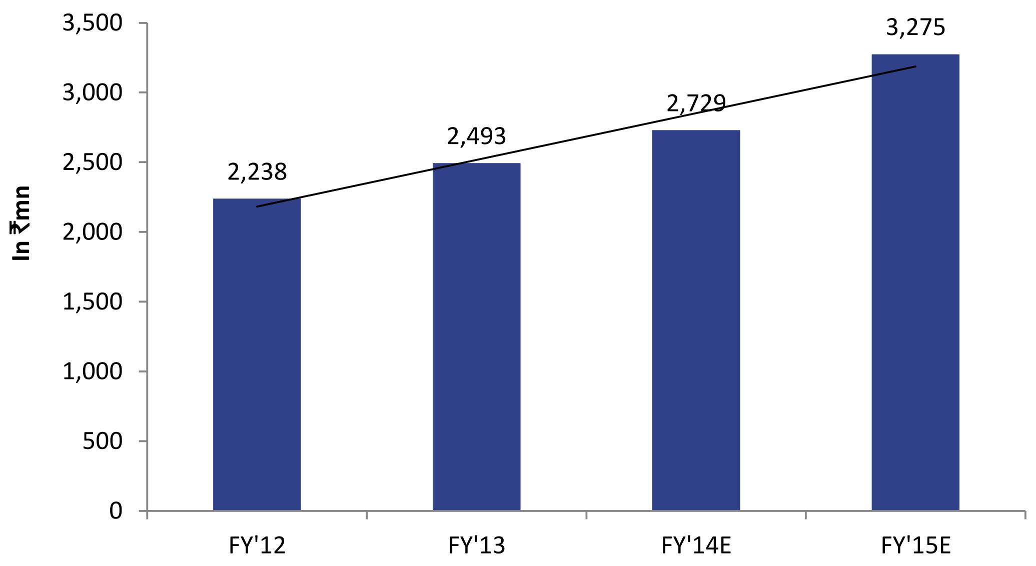
Revenues from roads business to remain elevated

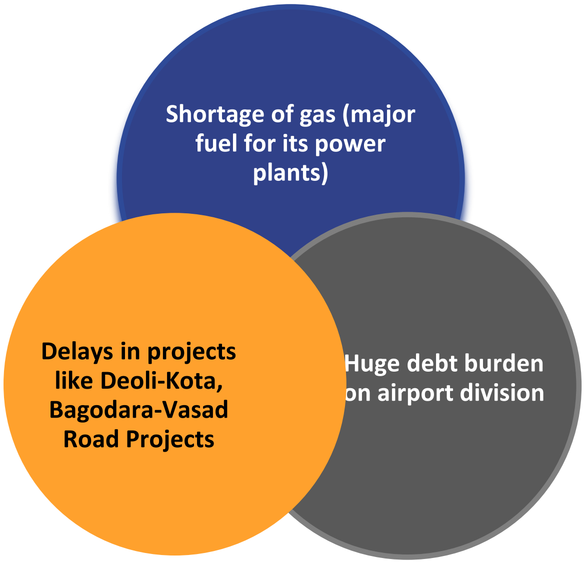


The commissioning of 220 MW hydroelectric project developed on Alaknanda river in Uttarakhand in March 2014 will help the company to come out of the blues.

Power division – to recover in Q4FY'14: Revenue from the company's power division declined massively by 58.8% YoY to ₹977 mn as against ₹2,371 mn in Q3FY'13 due to the unavailability of gas, which continued to hurt the profitability of GVK. The power plant, JP I had a decent plant load factor (PLF) of 55% (vs. 46% PLF in Q2FY'14) given the partial gas supply from GAIL. The PLF at JP II and Gautami had nil output yet again in Q3FY'14 as the supply from the KG Basin completely stopped during the quarter.

However, we believe that the segment will come out of the losses, given the commissioning of 220 MW hydroelectric project developed on the Alaknanda river in Uttarakhand in March 2014, which will boost the power production capacity. As per our estimates, the power division is expected to grow by ~6.3% QoQ in Q4FY'14E, however, for FY'14E as a whole, the decline in revenue may widen by 57.1% YoY as against a decline of 46.3% YoY in FY'13.

Major areas of concerns for GVK



Shortage of gas, delays in various projects and a huge debt burden on its airport vertical are the major concerns for GVK.

Key Concerns

- All Gas based power projects of GVK were severely affected in the recent past due to a shortage of gas. However, the company remains hopeful that the issue of non-availability of gas from the KG basin will be resolved by October 2016.

- Many of the company's projects like Deoli-Kota and Bagodara-Vasad have been facing delays due to land acquisition issues due to which the roads division is facing a muted growth. However, it is expected that partial tolling for Deoli Kota may commence by the end of April 2014, which may ease some of its concerns.

- The huge debt sitting in the airport vertical and the interest burden is hitting the consolidated numbers. Debt is going up to the extent of the interest that GVK is funding it through additional debt. There is an incremental interest that is being debited to the consolidated profit and loss account. However, GVK is focusing on reducing the debt burden on its books and is taking steps like asset monetisation in order to lower its debt burden.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Equity Capital	1,579	1,579	1,579	1,579
Minority interest	31,168	33,188	34,350	34,350
Reserve and surplus	33,235	29,874	29,041	28,128
Net Worth	**65,982**	**64,642**	**64,970**	**64,057**
Deferred Income	1,643	1,573	1,533	1,533
Long term borrowings	1,11,155	1,50,236	1,80,550	1,98,604
Deferred tax liabilities	3,014	3,311	3,248	3,248
Other long term liabilities	2,845	2,704	3,546	3,546
Long term provisions	298	427	571	596
Current liabilities	43,808	55,973	47,486	58,822
Capital Employed	**2,28,745**	**2,78,865**	**3,01,904**	**3,30,406**
Fixed assets	1,65,318	2,05,060	2,27,076	2,49,784
Intangible assets under development	1,763	5,329	5,329	5,329
Non-current investments	18,979	19,488	19,935	19,935
Deferred tax assets	6	4	5	5
Long-term loans and advances	13,529	13,617	11,270	12,397
Trade receivables	812	812	812	812
Other non-current assets	400	1,633	1,571	1,571
Current assets	27,937	32,922	35,907	40,575
Capital Deployed	**2,28,745**	**2,78,865**	**3,01,904**	**3,30,406**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	27.9	26.2	35.0	38.0
EBIT Margin (%)	17.9	12.7	21.5	26.1
NPM (%)	2.5	-	-	-
ROCE (%)	2.4	1.5	2.5	5.0
ROE (%)	0.9	-	-	-
EPS (₹)	0.4	(2.1)*	(1.4)*	(0.6)*
P/E (x)	34.7	-	-	-
BVPS (₹)	41.8	40.9	41.1	40.6
P/BVPS (x)	0.3	0.3	0.3	0.3
EV/Operating Income (x)	5.9	7.1	8.1	4.8
EV/EBITDA (x)	21.1	26.9	23.0	12.7

**Loss per share*

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Total Income	**24,918**	**26,077**	**29,336**	**52,525**
Operating Expense	17,978	19,244	19,068	32,565
EBITDA	**6,941**	**6,833**	**10,268**	**19,959**
Depreciation	2,489	3,512	3,968	6,245
EBIT	**4,452**	**3,321**	**6,299**	**13,715**
Interest	4,673	7,461	8,207	12,919
Other income	889	1,361	1,361	1,361
Profit Before Tax	**667**	**(2,779)**	**(546)**	**2,157**
Tax	678	1,287	1,931	3,282
Add: MI/Share of Profit & Loss of Associates	1,064	509	646	646
Less: Minority Interest	439	(197)	434	434
Net Profit	**615**	**(3,360)**	**(2,265)**	**(913)**

Valuation and view

Despite of a dismal performance in Q3FY'13, we reiterate our positive stance on the stock, as there are near-term triggers in the counter such as the MIAL real estate monetisation or any development on the private equity deal in the airport or road division, which would have a positive impact on the company's profitability going forward. Also, the expectation of higher output from RIL's KG basin will help GVK to get an improvement in profitability in the coming time. Besides, the completion of the new Terminal 2 at the Chhatrapati Shivaji International Airport has fuelled hopes that the debt burden will ease.

At a current market price (CMP) of ₹13.5, the stock trades at 23.0x FY14E and of 12.7x FY15E, EV/EBITDA. We recommend 'BUY' with a target price of ₹16.0, which implies potential upside of ~18.5% to the CMP from long term (1 year) perspective.

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