

KSK Energy Ventures Ltd.

Price Band	: Rs240 - 255 per share	June 23, 2008
Issue open during	: June 23 - 25, 2008	
Recommendation	: Subscribe with a long term view	
Book Running Lead Managers	: Kotak, IDFC-SSKI, Morgan Stanley, Edelweiss	
To list on	: NSE & BSE	
IPO Grading	: 3 / 5 by Fitch	
Market Cap post-listing	: Rs88.26Bn or \$2.05Bn (based on the cap price)	

IPO of 34.61mn equity shares of Rs10 each, aggregating to Rs883Cr or \$205mn (at the cap price)

Shareholding Pattern

Shareholder Categories	Pre-issue		Post-issue	
	No. of shares	% Holding	No. of shares	% Holding
Promoters	19,12,22,031	61.4%	19,12,22,031	55.2%
Pre - IPO investors				
- LB India Holdings Mauritius	9,83,32,552	31.6%	9,83,32,552	28.4%
- Suyash Outsourcing	46,32,857	1.5%	46,32,857	1.3%
- Others*	1,73,06,300	5.6%	1,73,06,300	5.0%
QIBs excluding Mutual Funds	-	-	1,97,28,250	5.7%
Mutual Funds	-	-	10,38,350	0.3%
Non Institutional Investors	-	-	34,61,100	1.0%
Public	-	-	1,03,83,300	3.0%
Total	31,14,93,740	100.0%	34,61,04,740	100.0%

* Tree Line Asia, Macquarie Bank, IDFC, Universities Superannuation Scheme, Axis Bank and GE Capital and a few individual investors

Synopsis

- KSK Energy Ventures Ltd. (KSKEVL) was incorporated in 2001 to develop power projects. The company has a power generating capacity 144MW.
- India is facing a tremendous shortage of power which is 15% at peak period. Even in spite of consistent efforts to improve the situation, lack of presence of the private sector and huge T&D losses, the demand-supply mismatch remains.
- The Electricity Act 2003 liberalized the power sector, allowing private sector players to develop power projects. The Act helped many companies to set up their captive power plants.
- The Government, in its mission "Power for All by 2012" has stated objectives to provide sufficient, reliable and inexpensive power. It has targeted 78,577MW capacity addition in 11th five year plan period, i.e., 2007-12.
- In the last few years, many private sector players have entered the fray, to develop power plants, e.g., Tata Power, Reliance Power, etc. The sector will attract huge investments going forward, as demand for power is unlikely to come down.
- KSKEVL plans to generate 8,993MW of power by 2013, through a mix of thermal and hydro power projects. While it already generates 144MW of power, a generating capacity of 2,648MW is under construction and development, while 6,345MW is in the planning stage. The company has already ensured fuel supply for most of the projects.
- The company has arranged finance for projects of 2,518MW, while finance for rest 6,475MW projects is yet to be tied up. Further, it is also bidding for 2,320MW power projects in Punjab and Karnataka. We expect a large burden of debt, as well as further equity dilution in the future, in order to fill the gap in funding needs.
- Lehman Brothers affiliate LB India Holdings Mauritius I Ltd. (LB India) took a substantial stake of 31.57% (post-dilution 28.41%) @ Rs34.55 per share, as recently as January 25, 2008. The pricing of the placement is at a fraction of the cap price for the IPO. (Please read the note on LB India on page 4).
- We note a lack of clarity in the company's policies. After converting from a private company into a public company in 2002, it again changed status to private limited company in 2006, and yet again to public limited company in 2008.

- We also note the lack of transparency in the transaction of acquisition of 513.1mn shares of KSK Electricity Financing India Pvt. Ltd. (KSKEFIL) from LB India, for aggregate consideration of Rs695.75Cr. KSKEFIL, a VC firm, has minuscule revenues. The consideration for the original sale of stake in KSKEFIL to LB India has not been disclosed in the RHP. Investors need clarity on the valuation of KSKEFIL and profit taken by LB India on this particular transaction.
- Interestingly, the balance sheet of KSKEVL, as at March 31, 2008 (as per the RHP) does not tie up, leaving a gap of Rs7.20Cr on the assets side.
- As per the valuation exercise on page 5, the IPO is priced at Rs2.5Cr per MW (considering only existing projects and projects under construction / development) which looks expensive vis-à-vis established peers like NTPC which trades at Rs2.1Cr per MW and Tata Power at Rs2.3Cr per MW. Considering the long term execution tenure of the projects (to be completed by 2013), risk of delays, financing risk, interest rate risk and execution risk would remain. We recommend subscribing with a long term view only.

Company Background

Incorporated in 2001, KSKEVL was promoted by KSK Energy Ltd. (KSKEL) which is a subsidiary of KSK Power Ventur plc (KSKPV), a company listed on the Alternative Investment Market (AIM) of the London Stock Exchange. KSKPV was promoted by Mr. S. Kishore and Mr. K.A. Sastry.

Mr. S. Kishore, director, heads business development and Capital Formation Group of KSKEVL. He is a chartered accountant and has 22 years of experience.

Mr. K. A. Sastry, director, heads execution and operations division. He too is a chartered accountant and has 22 years of experience.

KSKEL

KSKEL was incorporated in Mauritius as Bijlee Bharat Holdings in June, 2005.

Overview of the Indian Power Sector

The government has stated an objective to provide “Power for All” by 2012. It would be uninterrupted, sufficient, reliable and inexpensive power.

Electricity Act 2003 - the key development

To broaden the supply base to stimulate country-wide growth, the Government passed the Electricity (Supply) Act in 1948. The act created the institutional framework under which the electrical power industry was to be primarily regulated. It led to the creation of State Electricity Boards (“SEBs”). However, due to systemic deficiencies and the need to overcome the failures of the existing regime, which focused primarily on generation and not on transmission and distribution (“T&D”), the Electricity Act was passed in 2003.

The Electricity Act, 2003 is a comprehensive legislation which replaced the Indian Electricity Act, 1910, the Supply Act and the Electricity Regulatory Commission Act, 1998 Till date, 13 states including Delhi and Orissa have unbundled/corporatized their SEBs under the Accelerated Power Development and Reforms Programme (“APDRP”).

The Act liberalized and de-licensed the power generation sector. It resulted into increase in the captive capacity additions by industrial units.

Power Capacity Additions in 10th Five Year Plan (2002-07) (MW)

Sector	Thermal	Hydro	Nuclear	Total	Achievement
Central	7330	4495	1180	13005	57%
State	3553	2691	0	6244	56%
Private	1231	700	0	1930	27%
Total	12114	7886	1180	21180	52%
Achievement	48%	55%	91%	52%	

Power shortage situation in India

The peak demand of energy in India is currently around 106,624MW, whereas the actual peak energy generated is 90,793 MW, which is 85% of the peak demand. The situation is far worse in some parts of the country, with states such as Maharashtra facing a peak level shortage as high as 22.6%. (Source: CEA, Executive Summary, December 2007).

1. Transmission and Distribution Losses

The transmission and distribution (T&D) losses (as high as 33% in 2003-04) indicate systemic inefficiency. Countries such as the US, UK, Germany, Japan and China had T&D losses of 6%, 8%, 4%, 4% and 7%, respectively, in 2001.

The Government expects T&D losses to come down to 22% in 2012 and further to 16% in 2022, through efficient management and best operation and maintenance practices.

2. Inadequate capacity additions

Another important reason for power shortage is the inadequate capacity additions that took place historically. During the 10th Plan, the total capacity addition was around 21,180MW, (52% of the target). The average is a little over 50% during the last few plans, indicating poor achievement in spite of Government's efforts for increased capacity addition through various means.

The reasons for the shortfall were delays in finding supplies and erection of plants by suppliers/ contractors, non-availability of gas, delays in environmental clearance and other legal issues, geological surprises and projects not taken up or financial closure not achieved.

Business Overview

KSKEVL develops and operates power plants. The company has a power generation capacity of 144MW and projects of 8,993MW generation capacity under construction, development or planning stages. The company sells or signs power purchase agreements (PPAs) with industrial (captive) as well as state-owned consumers.

Status of operational and proposed plants

Power Plant	Capacity (MW)	Project type	Location	Expected Date of completion
Operational				
Arasmeta	43	Coal	Chattisgarh	
Sai Regency	58	Natural Gas	Tamil Nadu	
Sitapuram	43	Coal	Andhra Pradesh	
Under Construction				
VS Lignite	135	Lignite	Rajasthan	Dec-08
Wardha Warora	540	Coal	Maharashtra	Dec-09
Under Development				
Arasmeta Expansion	43	Coal	Chattisgarh	Q1FY11
Wardha Chattisgarh	1,800	Coal	Chattisgarh	Q2FY12
KSK Dibbin	130	Hydro	Arunachal Pradesh	Q4FY11
Planned				
KSK Narmada	1,800	Coal	Chattisgarh	Q2FY13
JR Power	1,800	Coal	Orissa	Q4FY12
Wardha Naini	1,800	Coal	Orissa	Q1FY13
Kameng Dam	600	Hydro	Arunachal Pradesh	Q4FY12
Kameng Basin Projects	345	Hydro	Arunachal Pradesh	Q2FY13

Key Features of the Business Model

1. KSKEVL has entered into private-public partnerships with government enterprises for sourcing fuel for all its plants, whether operational or under construction or under development or planned.
2. The company forms SPV to conduct the business. Its captive power plants are developed by entering into strategic tie-up with customers. The company and customer share equity which makes the business model more sustainable. This structure limits the capital outlays of the company, while allowing it to retain the economic interest in the project.
3. The company enters into long-term, medium-term and short-term PPAs with the consumers. These arrangements fix the predetermined rate of power sold to consumers, while also providing the flexibility to the company to sell surplus power to third parties in unregulated markets.

Business Strategies

Capitalize on the Growth of the Indian Power Generation Sector

India faces severe shortage of power, which, at peak levels, is at 13,869MW as of November 2007. As per the 11th plan (2007-12) 78,577MW capacity addition is expected.

Continue focus on business model

- Evaluation of opportunities
- Increasing portfolio of power projects
- Fuel supply security
- Strategic tie-ups with consumers

Expansion Project

The company is raising Rs6874Cr for its Wardha Chattisgarh Power Project. The said project, expected to be completed by Q2FY12, will have a generating capacity of 1,800MW.

Funding Pattern

Particulars	(RsCr)
IPO Proceeds	882.58
Debt	5,156.00
Pre-IPO Placement	215.34
Equity Contribution	620.08
Total	6,874.00

Note on LB India Holdings Mauritius I Ltd. (LB India)

1. Acquisition of stake in KSK Electricity Financing India Pvt. Ltd. (KSKEFIL)
 KSKEFIL was formed in September 2005 as a Venture Capital firm, to finance, acquire, and own power generation projects including captive power projects. The company had a modest topline of Rs2.16Cr and made losses of Rs0.95Cr in FY08. In January 2008, LB India sold 513.1mn shares of KSK Electricity Financing India Pvt. Ltd. (KSKEFIL) to KSKEVL, for aggregate consideration of Rs695.75Cr. Post this transaction, KSKEVL holds the entire share capital in KSKEFIL.
 While the consideration for the transfer has been disclosed in the RHP (Rs695.75Cr), the consideration for the original sale of stake to LB India has not been disclosed. Investors need clarity on the valuation of KSKEFIL and profit taken by LB India on this particular transaction, particularly when the investee company had a minuscule topline of Rs2.18Cr and losses of Rs0.95Cr.
2. Pre-IPO placement to LB India and other investors
 KSKEVL issued 98.3mn shares (post-dilution stake of 28.4%) to LB India and 4.6mn shares (1.3%) to other investors @ Rs34.55 per share, again in January 2008, which is at a substantial discount to the cap price for the IPO.

Valuation

We valued KSKEVL using the “equity value per MW” criterion, instead of earnings multiple. For all companies, we have assumed a capex of Rs5Cr per MW and a debt : equity mix of 75:25.

We considered two approaches, one considering only existing projects and projects under construction / development, and the other considering all projects, including planned projects. For this, we have considered projects of all companies, which are expected to be completed by FY13.

Under the former approach, KSKEVL is priced almost on par with the most expensive player Reliance Power, even though KSKEVL’s installed capacity (2792MW) is just 1/5th of that of Reliance Power.

Under the latter approach (based on all projects including planned projects), KSKEVL looks quite attractive. However, given the fact that the planned projects are likely to be completed only during FY12 and FY13, taking cognizance of these in the valuation may be aggressive.

We therefore would consider the former approach only.

Case - I (Considering existing projects & projects under construction / development)

Figures in RsCr except as stated otherwise	NTPC	Reliance Power	Tata Power	KSKEVL
Generating Capacity in MW (2013) (I)	50,004	12,980	10,100	2,792
Total Value of project (II)	2,50,020	64,900	50,500	13,960
Debt component (75%) (III)	1,87,515	48,675	37,875	10,470
Equity component (25%) (IV)	62,505	16,225	12,625	3,490
Value per MW (IV/I)	2.1	2.6	2.3	2.5

Case - II (Considering all projects incl. planned projects)

Figures in RsCr except as stated otherwise	NTPC	Reliance Power	Tata Power	KSKEVL
Generating Capacity in MW (2013) (I)	50,004	12,980	10,100	9,137
Total Value of project (II)	2,50,020	64,900	50,500	45,685
Debt component (75%) (III)	1,87,515	48,675	37,875	34,264
Equity component (25%) (IV)	62,505	16,225	12,625	11,421
Value per MW (IV/I)	2.1	2.6	2.3	0.8

Peer-group Comparison

(RsCr)

Company Name	NTPC	Reliance Power	Tata Power	KSKEVL
Sales Turnover	37050.10	0.00	5228.84	239.13
Profit After Tax	7414.80	85.38	614.43	118.77
Paid-up Equity Capital	8245.46	2396.80	230.67	311.49
Price Rs (20-Jun-08)	162.60	175.05	1253.05	255.00
Market Cap	134071	41956	28904	8826
EPS (Rs)	8.99	0.36	26.64	3.81
Book Value (Rs)	63.84	56.50	320.42	25.27
P/E (x)	18.1	491.4	47.0	74.3
P/B (x)	2.5	3.1	3.9	10.1
P/S (x)	3.6	-	5.5	36.9
EBITDA margin	30.3%	-	15.0%	42.7%
52 Week High (Rs)	291	374.94	1641	-
52 Week Low (Rs)	149.55	175.15	598	-
FVPS (Rs)	10	10	10	10

* post issue equity capital

Annualised

Profit and Loss Statements

(RsCr)

For year to,	31.3.04	31.3.05	31.3.06	31.3.07	31.3.08
Net Sales	25.91	30.73	27.78	77.55	239.13
Expenditure					
Raw Materials Consumed	10.68	7.38	6.81	23.96	74.80
Manufacturing Expenses	1.61	2.20	1.77	6.57	12.06
Employees Expenses	0.42	0.83	1.65	4.16	7.38
Admin. and Selling Expenses	6.35	7.55	9.71	12.03	42.85
Prel. & Pre-Op. expenses	0.80	0.07	0.07	0.20	0.00
Total Expenditure	19.87	18.03	20.02	46.92	137.09
EBITDA	6.05	12.70	7.76	30.63	102.04
Other Income	1.64	2.82	9.65	15.27	118.82
Interest	2.72	2.96	3.94	9.97	62.71
PBDT	4.96	12.57	13.46	35.93	158.14
Depreciation	3.68	4.49	4.46	8.97	22.36
PBT before Extra-ord. items	1.28	8.07	9.00	26.96	135.78
Extra-ordinary items	0.90	0.00	0.03	0.00	-5.06
Profit Before Tax	0.38	8.07	8.97	26.96	140.85
Tax	0.27	1.56	1.70	8.10	22.08
Profit After Tax	0.10	6.51	7.27	18.86	118.77
EBITDA margin	23.3%	41.3%	27.9%	39.5%	42.7%
EPS (Rs)	0.09	2.19	2.44	2.07	4.04
Book Value (Rs)	20.71	14.83	16.98	25.17	25.27

Balance Sheets

(RsCr)

As at,	31.3.04	31.3.05	31.3.06	31.3.07	31.3.08
Sources of Funds					
Equity Share Capital	11.44	29.77	29.77	91.03	294.19
Preference Share Capital	9.25	1.25	1.25	30.00	0.00
Share Appl. money	0.45	6.28	8.28	0.00	26.60
Reserves and Surplus	-0.04	2.58	6.24	88.47	342.76
Capital of JV Entities	2.59	4.25	4.99	19.59	79.91
Total Shareholder Funds	23.70	44.14	50.54	229.09	743.46
Secured Loans	25.57	44.72	79.06	85.83	1121.64
Unsecured Loans	2.45	5.38	25.73	110.31	130.60
Total Debt	28.02	50.09	104.80	196.14	1252.23
Total Liabilities	51.72	94.24	155.34	425.23	1995.70
Applications of Funds					
Gross Block	43.16	68.32	67.97	139.69	514.49
Less: Acc. Depreciation	12.15	16.66	19.05	46.23	23.52
Net Block	31.01	51.66	48.92	93.46	490.97
CWIP	3.80	16.25	64.15	35.25	940.25
Goodwill	0.00	0.00	0.71	0.00	190.83
Investments	0.01	0.61	7.57	32.19	84.92
Current Assets and Loans & Adv.					
Inventories	1.01	1.34	1.32	3.38	7.57
Sundry Debtors	3.61	4.92	4.89	13.76	32.41
Cash & Bank Balances	5.96	8.12	20.91	109.18	415.66
Loans and Advances	11.85	25.09	36.66	162.86	269.61
Total Current Assets	22.44	39.47	63.78	289.18	725.26
Less: Current Liab. & Provisions					
Current Liabilities	5.35	10.16	27.46	12.38	410.15
Provisions	0.35	3.16	2.22	14.05	32.36
Total Current Liabilities	5.70	13.32	29.69	26.43	442.51
Net Current Assets	16.74	26.15	34.09	262.74	282.75
Misc. Expenditure Not w/o	0.27	0.25	0.16	2.54	2.69
Net Deferred Tax	-0.12	-0.68	-0.26	-0.96	-3.91
Total Assets	51.72	94.24	155.34	425.23	1988.50*

* In our view, Balance Sheet as at March 31, 2008, is not matching (shortfall of Rs7.20Cr on assets side)

Keynote Capitals Ltd.

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Subscribe & Hold	:	subscribe for listing gains, hold for further appreciation
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Subscribe with a medium term view	:	stock can deliver only over 6-8 months after listing
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Await listing	:	good fundamentals; consider valuations on listing

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