

Infrastructure India

Interim results

Hindered by project delays and rupee devaluation

Investment trusts

IIP's two main projects suffered construction delays in H1FY14 caused by debt disbursement issues. IIP may be able to resolve the problems at VLMS internally, but for SMHPCL it is awaiting a directive from the government committee now overseeing the project. The other investments performed in line with expectations, but IIP's NAV showed a 19% sequential fall in H1 to 63p, as a direct result of the weaker Indian rupee and the higher risk-free rate assumptions used for asset valuations. If the exchange rate alone had remained stable, IIP's £217m NAV would have been £49m higher. We have downgraded our forecasts to reflect the lower values, which leaves the stock trading on a 72% discount to 2014e NAV.

11 February 2014

Price 17.25p
Market cap £59m

Net debt (£m) at 30 September 2013	2.8
Shares in issue	342.7m
Free float	36%
Code	IIP
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.0)	(25.8)	(36.1)
Rel (local)	(6.0)	(25.2)	(40.6)
52-week high/low		33.25p	17.25p

Business description

Infrastructure India (IIP) is an externally managed investment company, focused on investing in power and transport infrastructure assets in India. It currently has five investments, two of which are wholly owned and three in partnership with third parties.

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Analysts

Mark Cartlich	+44 20 3077 5700
Roger Johnston	+44 20 3077 5722

industrials@edisongroup.com
[Edison profile page](#)

Year end	Revenue (£m)	Adj net profit* (£m)	Adj EPS* (p)	NAV (p)	P/NAV (x)	Yield (%)
03/12	0.0	0.8	0.4	95	0.18	N/A
03/13	0.0	20.8	7.1	78	0.22	N/A
03/14e	0.0	(55.2)	(16.1)	62	0.28	N/A
03/15e	0.0	15.6	4.6	66	0.26	N/A

Note: *IFRS net profit and EPS include fair value movements. Figures for all years are unconsolidated.

H1FY14 hit by construction delays and weak rupee

IIP's two main projects suffered construction delays in H1FY14. Vikram Logistics & Maritime Services (VLMS) had problems securing debt disbursements from public sector banks, which delayed the construction schedules for its new terminals. At the Shree Maheshwar project (SMHPCL), the lead lender will make recommendations to the government committee now overseeing the project to try to resolve the delay. IIP's H1 NAV fell 19% sequentially (9% y-o-y) to £217m (63p per share). This was mainly due to the 23% devaluation of the Indian rupee in H1 and an increase in the assumed Indian risk-free rate. Profits were also hit by £48m of negative fair value movements, contributing to a pre-tax loss of £51m (loss per share of 14.8p).

Financials: Forecasts downgraded for FY14

We have downgraded our forecasts for FY14 (NAV cut from 79p to 62p) to reflect the negative fair value movements in the first half. We do not expect any valuation upgrades until FY15, when there is a decent chance of asset revaluations, as projects under construction reach completion for VLMS and IHDC, providing there is no further local currency devaluation. We are assuming fair value gains from the projects in FY15 and that improved project cash flows could be reflected in a first dividend contribution from the investment portfolio to the group level.

Valuation: Discount unchanged despite NAV fall

The discount to our FY14 NAV forecast has widened to 72% from 68% in our [outlook note](#), as the share price and NAV declines have diverged (down c 32% and 22% respectively). There has been no impetus for the discount to narrow, with the low free float, stock liquidity and lack of dividends continuing to weigh on valuation. We would now add the need for project progress to the list, especially at VLMS and SMHPCL, where positive developments would have the greatest impact on NAV.

Project updates

Vikram Logistics & Maritime Services (VLMS)

Two of IIP's main investments also suffered from operational delays. VLMS, the logistics business, had problems securing disbursements of approved debt facilities from public sector banks, which had an impact on the delivery of construction schedules for its new terminals. It also meant that working capital at the company was extremely tight. Nevertheless, construction at the Nagpur terminal was largely complete, with operations expected to start in the first half of CY14. Meanwhile, land acquisitions at the Palwal site continued and were substantially secured by September. VLMS's management has been looking at other options for debt facilities, given the current liquidity constraints, to enable construction to be completed. The valuation was downgraded on the back of the debt issues, project delays, weaker economy and lower volume and market share assumptions.

Shree Maheshwar Hydrel Power Corporation (SMHPCL)

For the Shree Maheshwar hydro project, which has been stalled for some time, a meeting of stakeholders in October decided that the lead lender would complete an analysis and make recommendations for the government committee now overseeing the project under the Ministry of Finance's guidance. If acceptable to the stakeholders, this should result in a formal directive for debt restructuring and project progress, although there is no clarity on the timing of this. Management believes that once capital is made available, construction could restart quickly and be completed within 16 months. In the meantime, the valuation was downgraded 33% from March owing to currency devaluation, a higher risk-free rate, projects delay and higher investment cost.

Other investments in line with expectations

WMPITRL performed as anticipated in H114, seeing a rebound in traffic volumes, with revenues up over 7% y-o-y. The results of the other investments, India Hydropower Development Company (IHDC) and Indian Energy (IEL), were also in line with management expectations. IHDC commissioned the 4MW Panwi project during the period and benefited from steady monsoon rains in Maharashtra and Himachal Pradesh, after a weaker Q1. The Raura and Melan projects are also on track for their targeted commissioning dates. IEL reported generation in line at Gadag during the monsoon, but production below expectations at Theni, owing to grid availability problems in Tamil Nadu, which are now being addressed by the state government. Weaker generation at Theni was offset by higher tariffs, after it switched to a group captive agreement last year.

Interim results: Hit by rupee and higher discount rates

Financial performance affected by weaker rupee

IIP reported a 19% sequential fall (9% y-o-y) in NAV from £267m to £217m or 63p per share. The fall was largely the result of the devaluation of the Indian rupee during the period, which fell 23% from March to September, when it exceeded INR101/£, plus an increase in the Indian risk-free rate, from below 8% to 8.76%. Rupee depreciation alone accounted for a 23% (£49m) fall in the value of the portfolio (£221m). The income statement was also dominated by asset valuation movements, with fair value downgrades of £48m contributing to a pre-tax loss of £51m and a loss per share of 14.8p. If the exchange rate alone had remained stable during the period, IIP's net income would have actually increased by £49.4m.

Exhibit 1: Interim results

£m	H113 Sep-12	H114 Sep-13	Change y-o-y
Fair value movements	(4.340)	(47.568)	996.0%
Asset management & valuation services	(1.969)	(2.439)	23.9%
Administration expenses/fees	(0.934)	(0.626)	(33.0%)
Net operating profit	(7.243)	(50.633)	599.1%
Interest income	0.003	0.001	(66.7%)
Interest expenses	(1.774)	(0.138)	(92.2%)
Forex gain/loss	(0.199)	0.175	nm
Profit before tax	(9.213)	(50.595)	449.2%
Tax charge	0.000	0.000	0.0%
Profit after tax	(9.213)	(50.595)	449.2%
Average shares outstanding (m)	245.2	342.7	39.8%
Basic & diluted EPS (p)	(3.8)	(14.8)	292.9%
NAV/share (p)	69.3	63.2	(8.7%)

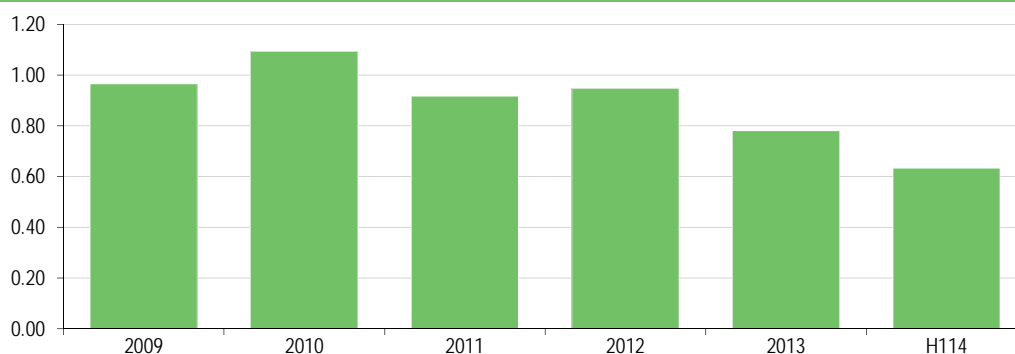
Source: IIP, Edison Investment Research

Summary

The comments from the chairman and CEO conveyed how difficult the operating environment is for IIP, given the scarcity and cost of finance in a “deteriorating” Indian debt market. However, management said the fundamental value of the businesses was maintained and is confident of making further progress across the portfolio. Clearly the US\$17m working capital facility arranged with GGIC in April 2013 is part of the reason for that optimism. Unfortunately progress is largely beyond management's control in its two largest investments (VLMS and SMHPCL), although the ability to fund working capital from group resources is a clear advantage over purely local businesses.

Valuation: NAV discount has widened to 72%

The shares trade at a 72% discount to our FY14 NAV forecast of 62p, which has widened since our [outlook note](#), when the discount was 68% to a forecast NAV of 79p, as the share price decline has exceeded the NAV forecast reduction (32% and 22% respectively). IIP faced a combination of negative factors in the first half of FY14, which seem unlikely to be repeated in H2. It is even possible that project progress, local currency strength, or lower risk-free rates could produce valuation upgrades in FY15. We do not expect NAV growth this year, but with project progress and completions in FY15, we are forecasting 7% growth to 66p.

Exhibit 2: NAV per share performance (£)


Source: IIP

Financials

Earnings: Forecasts downgraded for FY14

We have downgraded our forecasts for this year to reflect the negative fair value movements in the first half. We now forecast NAV of 62p versus 79p in our initiation note. We have not forecast any further fair value downgrades, as the rupee has actually strengthened slightly since the end of September and Indian bond yields are unchanged. However, we do not expect any valuation upgrades until FY15, assuming there is no further local currency devaluation. There is a good chance of upgrades in FY15, as projects under construction reach completion for VLMS and IHDC. Any progress at SMHPCL could also be reflected in a higher valuation, as risk factors are reduced. We are thus assuming fair value gains from the projects in FY15 and improved project cash flows could also be reflected in a first dividend contribution to the group from the investment portfolio.

Cash & balance sheet: Supplemented by working capital facility

The cash outflow before financing was £5m in H1, so even with no further investment in H2 and the additional cash from the working capital facility, we estimate it will need to be supplemented in FY15 unless the investments start to make a contribution to the group before then. The cash balance at the end of September was £0.5m, but another US\$4m was drawn down on the GGIC working capital facility at the beginning of October to boost liquidity. The group has now drawn down US\$9m of the US\$17m facility, but has no other debt, so gearing is minimal and servicing costs are manageable. As at 10 December, the company had approximately US\$2m in cash balances.

Sensitivities: Interest rates and currency depreciation

The main macroeconomic risks for IIP, other than the growth slowdown in India and its effect on the prospects for individual projects, are inflation, higher interest rates and currency depreciation. High inflation in India has been addressed by higher interest rates, in turn raising bank lending rates. Given the gearing inherent in infrastructure projects, higher debt costs generally have a significant impact on profitability. Higher interest rates have also not prevented currency depreciation over the past few years. As IIP's projects all operate in local currency, a weaker rupee has a translation impact, both on asset values and on any dividends.

The main company specific risks are execution and politics, which can be interrelated. The delay in SMHPCL's completion, which is partly due to the project promoter's difficulties raising the equity required, exemplifies the problem of executing in India, as well as the complication of being in a minority position. Where IIP has a majority holding, as with VLMS and IEL, it is able to pursue its investment and acquisition strategies unhindered by any issues with partners. On the upside, we have not factored in any refinancing benefits from the Freightstar acquisition, so if they feed through as the company intends, there is upside potential to both the financials and valuation.

Exhibit 3: Financial summary

£m	2011	2012 consol	2012	2013	2014e	2015e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Total Revenue	0.0	1.9	0.0	0.0	0.0	0.0
Cost of Sales	0.0	(4.7)	0.0	0.0	0.0	0.0
Administrative expenses	(3.2)	(3.0)	(2.3)	(1.5)	(1.6)	(1.7)
EBITDA	(3.2)	(5.8)	(2.3)	(1.5)	(1.6)	(1.7)
Asset management & valuation services	(0.2)	(2.8)	(2.8)	(4.3)	(5.3)	(4.4)
Other income	0.0	0.2	0.0	0.0	0.0	0.0
Fair value movements	10.8	(4.3)	5.9	28.7	(47.6)	19.4
Operating Profit	7.5	(12.7)	0.9	23.0	(54.5)	13.4
Other financial income, dividends and expenses	(0.0)	2.0	0.1	(0.4)	0.0	3.7
Net Interest	0.0	(2.0)	(0.1)	(1.8)	(0.7)	(1.4)
Profit Before Tax (norm)	(2.0)	(3.3)	(5.1)	(8.0)	(7.6)	(3.8)
Profit Before Tax (IFRS)	7.5	(12.8)	0.8	20.8	(55.2)	15.6
Tax	0.0	0.9	0.0	0.0	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Adj Net Income	(3.3)	13.7	(5.1)	(8.0)	(7.6)	(3.8)
Net income (IFRS)	7.5	13.7	0.8	20.8	(55.2)	15.6
Average Number of Shares Outstanding (m)	48.7	182.4	182.4	293.8	342.7	342.7
EPS - normalised (p)	(6.81)	(6.51)	(2.82)	(2.71)	(2.22)	(1.11)
EPS - normalised fully diluted (p)	(6.81)	(6.51)	(2.82)	(2.71)	(2.22)	(1.11)
EPS - (IFRS) (p)	15.42	(6.51)	0.43	7.08	(16.11)	4.56
Dividend per share (p)	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	N/A	N/A	N/A	N/A	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A	N/A
Operating Margin (%)	N/A	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET						
Fixed Assets	111.3	245.2	215.8	266.5	218.9	238.3
Intangible Assets	0.0	81.2	0.0	0.0	0.0	0.0
Tangible Assets	0.0	74.8	0.0	0.0	0.0	0.0
Investments	111.3	89.3	215.8	266.5	218.9	238.3
Current Assets	27.3	13.1	8.6	2.1	5.9	2.2
Non current assets for sale	0.0		0.0	0.0	0.0	0.0
Debtors	0.0	2.5	0.0	0.0	0.0	0.0
Cash	27.3	10.3	8.6	2.1	5.9	2.2
Other	0.0	0.3	0.0	0.0	0.0	0.0
Current Liabilities	(0.6)	(26.7)	(17.1)	(1.3)	(12.7)	(12.8)
Creditors	(0.6)	(6.1)	(1.5)	(1.3)	(1.4)	(1.5)
Short term borrowings	0.0	(20.6)	(15.6)	0.0	(11.3)	(11.3)
Long Term Liabilities	0.0	39.5	0.0	0.0	0.0	0.0
Long term borrowings	0.0	(39.5)	0.0	0.0	0.0	0.0
Other long term liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Net Assets	138.0	192.1	207.3	267.3	212.1	227.7
CASH FLOW						
Operating Cash Flow	(3.4)	(8.9)	(4.2)	(5.9)	(6.8)	(2.3)
Net Interest	0.0	0.1	0.0	(1.8)	(0.7)	(1.4)
Tax	0.0	(0.0)	0.0	0.0	0.0	0.0
Capex	(1.3)	(17.6)	(98.6)	(21.9)	0.0	0.0
Acquisitions/disposals	0.0	(3.2)	0.0	0.0	0.0	0.0
Financing	30.7	(47.6)	68.3	39.2	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Net Cash Flow	26.1	(77.2)	(34.5)	9.6	(7.5)	(3.7)
Opening net debt/(cash)	(1.2)	(27.3)	(27.3)	7.1	(2.1)	5.4
Other	0.0	0.0	0.1	(0.5)	0.0	0.0
Closing net debt/(cash)	(27.3)	49.9	7.1	(2.1)	5.4	9.1

Source: IIP accounts, Edison Investment Research

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