Infrastructure India

Maturing portfolio not reflected in valuations

Initiation of coverage

Investment Trusts

IIP's focused portfolio of Indian transport and power infrastructure assets is starting to approach maturity, which should result in cash flows flowing through to the parent, in turn enabling IIP to provide dividend guidance to investors. Increasing clarity on the timing of this process and on the further potential value accruing from the VLMS subsidiary's acquisition of Freight star, should help to close the discount to both NAV and the peer group. Longer term, the discount could also be addressed by the reduction of the 51% controlling stake of GGIC (also managed by GFPM, the asset manager), thereby increasing the free float and, potentially, stock liquidity.

Year end	Revenue (£m)	Net profit* (£m)	EPS* (p)	NAV (p)	P/NAV (x)	Yield (%)
03/12	0.0	0.8	0.43	95	0.27	0.0
03/13	0.0	20.8	7.08	78	0.33	0.0
03/14e	0.0	2.6	0.75	79	0.32	0.0
03/15e	0.0	14.5	4.22	83	0.31	0.0

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

Portfolio: Projects' maturity to improve cash flows

Management's strategy is to pay dividends when the projects reach a level of maturity capable of sustaining the payout. With four of its five investments expected to be cash flow generating by year-end and only one still in the construction phase, IIP anticipates providing clarity about the timing of dividends once VLMS is fully operational. The recent Freightstar acquisition provided an NAV boost in FY13, but VLMS has four container terminals due for substantial completion during FY14 and the potential for further synergies. Evidence of funding progress at SMHPCL would also be positive, but in our view less likely to move the share price in the short term.

Financials: Fair value gains to offset costs from FY15

IIP has a strong capital structure, with no debt at the fund level as at FY13 and, after agreeing a US$17m working capital facility with GGIC recently, sufficient funding for the foreseeable future. IIP has adopted the amendment to IFRS 10 from FY13, before its mandatory introduction in January 2014. It therefore does not now consolidate its wholly owned subsidiaries, which means anticipating the timing of project dividends is more difficult for investors. Therefore, the main income driver will remain fair value movements, which should start to offset the management and administration expenses from FY15, assuming the local currency stabilises.

Valuation: Large discount to NAV and peers

IIP trades on a discount of 67% to FY13 NAV of 78p and a wide discount to its peer group, which can be partly explained by its small free float and low stock liquidity, with the two main shareholders controlling 64%, as well as the lack of yield and the unclear dividend timing. We are not forecasting dividends for FY14-15, although the projects should start to be cash flow positive from FY15. Closing the discount is likely to require a clearer payout strategy, further financial visibility and a simpler corporate structure, as borne out by the developed market peers' premium to NAV.

28 August 2013

Price	**25.5p**
Market cap	**£87m**
Net cash (FY13)	£2.1m
Shares in issue	342.7m
Free float	36%
Code	IIP
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(3.8)	(19.1)	(20.3)
Rel (local)	(2.4)	(17.2)	(30.2)
52-week high/low		33.25p	21.0p

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.

Next events

AGM/Continuation vote	26 September 2013

Analysts

Mark Cartlich +44 20 3077 5700

Roger Johnston +44 20 3077 5722

industrials@edisongroup.com

Edison profile page

Infrastructure India is a research client of Edison Investment Research Limited

Investment summary

Company description: Transport and power focused portfolio

IIP's strategy is to invest in projects that have the potential to generate capital growth and deliver sustained income. The fund focuses on investing in power and transport infrastructure assets in India, with five investments, at varying stages of maturity, two wholly owned and three in partnership with third parties. They are at varying stages of maturity, with the majority of the portfolio starting to deliver steady cash flows for reinvestment, debt repayment or cash returns over the next year and only one project still in the construction phase.

Fund structure: Early compliance with IFRS 10

IIP has chosen to comply with the amendments to IFRS 10 before its introduction in 2014, which means that as an investment fund, its project subsidiaries are not consolidated, but recorded at fair value on the balance sheet. This makes its reporting less complicated, but for investors produces less clarity over the timing of project cash flows, dividends and ultimately value. IIP has been managed since 2011 by Guggenheim Franklin Park Management (GFPM), which also manages Guggenheim Global Infrastructure Company (GGIC), a global infrastructure investment company, which has a majority 51% stake in IIP.

Valuation: Large discount to NAV and peers

IIP currently trades at a c 67% discount to the last reported NAV of 78p in March 2013 and a wide discount to its peer group. The reasons for this include: the lack of stock liquidity, resulting from the small free float and the controlling shareholder's 51% stake, the unclear timing for dividend payments, the execution risk inherent in the projects and also the structure of the fund, with two minority holdings. The previously narrower discount has not returned since the VLMS bridge loan, director share sale and dilutive placing in 2012. Macroeconomic factors include: the risk perception of India as an investment destination, from an economic and business perspective, the cost and difficulty of financing the projects locally and the currency risk associated with investing in India.

Addressing the NAV discount

There is little IIP can do about macroeconomic, business and sector risk in India, but it has made some progress in financing and improving disclosure, in an attempt to improve the discount. Further progress could come from confirming a date for the start of dividend payments and for the potential reduction of GGIC's holding back below 50%, to improve the free float, plus guidance on the cash flows from majority held projects and providing clarity on how value will be realised from the portfolio's minority holdings. Rationalisation of the portfolio, with a greater focus on wholly owned assets, could also improve the valuation in our view. The minority investment in SMHPCL, for example, is dependent on the funding capacity of the project promoter, which has majority control.

Financials: Project dividends anticipated as portfolio matures

After consolidating VLMS and IEL since acquisition in FY12, IIP changed to unconsolidated investment accounting from FY13, which management believes better reflects the nature of the fund. All projects are incorporated at fair value in the balance sheet, with unrealised gains and losses from revaluation taken through the income statement. Therefore, the main source of income will remain the change in fair value of investments. However, management hopes the projects will be generating sufficient cash flow to be able to pay dividends to the fund from 2015 when all projects should be fully operational, boosting IIP's profitability and cash flows. However, we are not forecasting that IIP itself will pay a dividend for FY14-15.

Exhibit 1: Fund at a glance

Investment objective and background	Recent developments
Infrastructure India's investment objective is to provide shareholders with capital growth and income by investing in assets in the Indian infrastructure sector, with a particular focus on assets and projects related to energy and transport.	9 April 2013: Announcement of a working capital facility of up to US$17m from GGIC running until April 2016 to cover the cost of running IIP. The loans are repayable by April 2017, at a rate of 7.5% with an arrangement fee of US$0.17m. 18 March 2013: Completion of the Freightstar acquisition by VLMS (more detail on page 6).

Forthcoming		Capital structure		Fund details	
AGM	September	Total expense ratio	2.3%	CEO	Sonny Lulla
Interim results	December 2014	Net gearing FY13	0% (consolidated basis)	Website	www.iiplc.com
Year end	March	Annual mgmt fee	2% of gross assets	Address	IOMA House, Hope Street, Douglas, Isle of Man, IM1 1AP
Dividend paid	N/A	Performance fee	None		
Launch date	2008	Fund life	Indefinite	Phone	01624 681 250
Continuation vote	September 2013	Loan facilities	US$17m working capital		

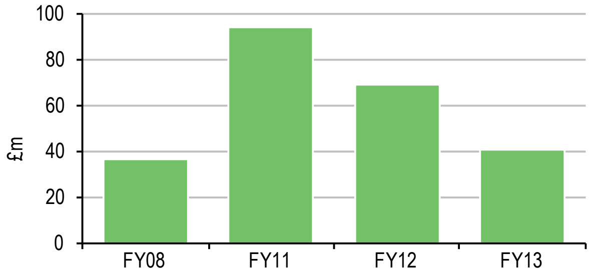
Dividend policy and history

There is no dividend history, but management intends to pay a regular dividend once IIP's projects reach a level of maturity to sustain one.

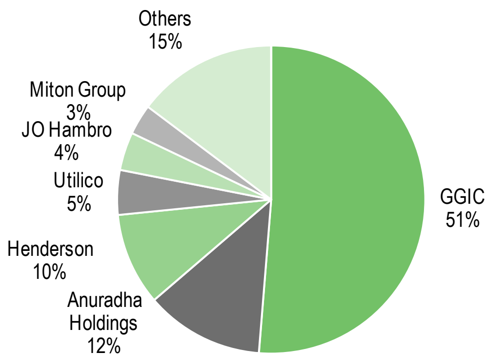
- The infrastructure projects the group invests in should generate predictable and long-term cash flows following the commencement of stable operations.
- Infrastructure projects typically produce steady, long-term revenues once the asset is in operation, over the life of the concession. The directors believe these long-term revenues will allow the company to make dividend payments in the foreseeable future.
- It is the intention of IIP's board to start generating an income stream for investors, while also ensuring an appropriate level of earnings consistent with management of the company's activities.

Share issues

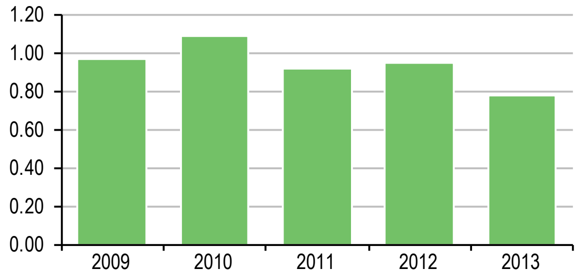
Shares issued since 2008, including shares issued to acquire VLMS, IHDC and IEL. There have been no share buybacks and there is no buyback policy.



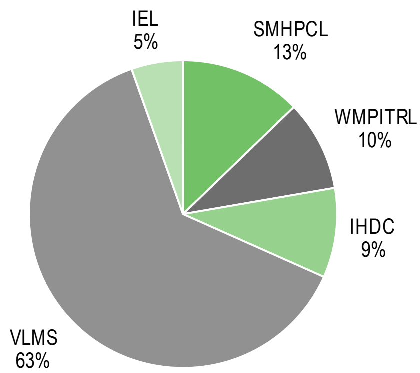
Shareholder structure (as at June 2013)



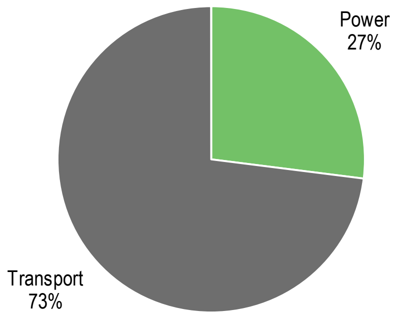
NAV per share record (£)



Portfolio composition by value (as at 31 March 2013)



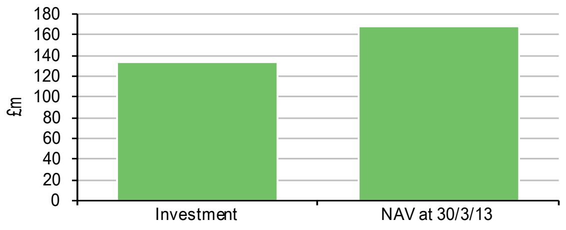
Portfolio composition by sector (as at 31 March 2013)



Source: Infrastructure India plc, Edison Investment Research.

Exhibit 2: Five investments at a glance

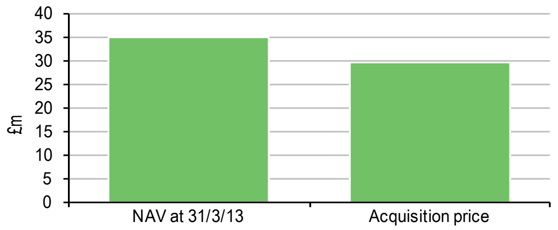
Vikram Logistic & Maritime Services Pvt. Ltd	IIP discount rate: 14.6%	Asset value: £168m*



Holding	**99.99%**
Industry/Sector	Transport
Listing	N/A
Website	www.vikramlogistics.com

- **VLMS** is a national transportation and container infrastructure company, building a strong presence across Indian supply chains.
- It is developing four large container handling facilities: in Chennai, Bangalore, Palwal and Nagpur, including one Free Trade Warehousing Zone bonded container warehouse facility.
- The recent acquisition of Freightstar gives it a national footprint and puts it in the top three private logistics operators in India.

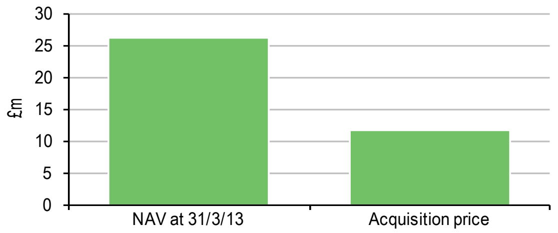
Shree Maheshwar Hydel Power Corp Ltd	IIP discount rate: 14.0%	Asset value: £35m*



Holding	**17.7% (8.6% post dilution)**
Industry/Sector	Power
Listing	N/A
Website	www.maheshwarhydel.com

- **SMHPCL** is a 400MW run-of-river hydro-electric plant under construction in the south-west of Madhya Pradesh.
- The project has a regulated ROE of 16% from a long-term (35-year) PPA with the state government's electricity board.
- IIP has a guaranteed IRR of 15% and 17% on its two tranches.
- Currently expected to be operational within 12 months of funding, with three out of 10 turbines installed so far.
- Dependent on the promoter Entegra raising equity of £40m.

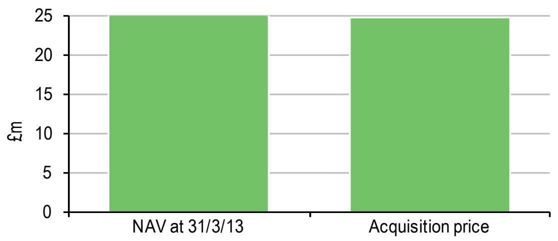
Western MP Infrastructure and Toll Roads Private Limited	IIP discount rate: 11.0%	Asset value: £26m*



Holding	**26.0%**
Industry/Sector	Transport
Listing	N/A
Website	N/A

- **WMPITRL** operates a 125km toll road in the central state of Madhya Pradesh, connecting Lebad and Jaora in the west of the state, developed by Essel Group, part of the Zee Entertainment Group.
- 25-year BOT concession starting in April 2008 with the MP Road Development Corporation, full commercial operations from June 2011.
- Tolls per vehicle fixed with a 7% escalation per year.
- 26% stake acquired in September 2008 for £11.7m.
- Managed by 74% partner Essel Group, at a cost of £0.2m per year.

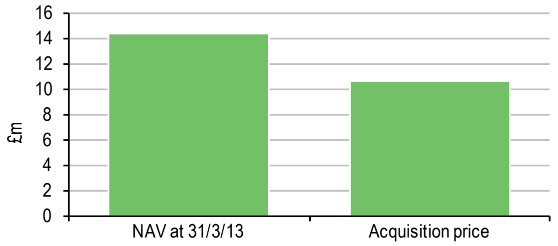
India Hydropower Development Company LLC	IIP discount rate: 11.6%	Asset value: £25m*



Holding	**50.0%**
Industry/Sector	Power
Listing	N/A
Website	N/A

- **IHDC** develops and operates small hydro-electric power projects.
- 62MW in operation at six plants, including 4MW that became operational at Panwi in FY13 and a further 24MW under construction or in development.
- The projects typically have long-term PPAs with state electricity boards.
- Partner DLZ Corporation has over 30 years' experience of design and operation in the hydro sector.

Indian Energy Ltd	IIP discount rate: 10.0%	Asset value: £14.4m*



Holding	**100.0%**
Industry/Sector	Power
Listing	N/A
Website	N/A

- **IEL** operates two wind farms with total capacity of 41MW.
- Gadag (24.8MW, PLF 22%) has a 20-year PPA with the Karnataka SEB.
- Theni (16.5MW, PLF 31%) recently converted to a group captive scheme.
- The management team has over 20 years' experience in the Indian power market and has identified a further pipeline of wind projects across India.
- IIP acquired a 100% stake in September 2011.

Source: IIP plc, Edison Investment Research. Note: *As at September 2012.

Company description: Maturing infrastructure portfolio

IIP is an externally managed investment company focused on investing in power and transport infrastructure assets in India and has been listed in London since June 2008. It currently has five investments, two of which are wholly owned and three are in partnership with third parties. They are at varying stages of maturity, with the majority of the portfolio starting to deliver steady cash flows for reinvestment or debt repayment from this year and only one project still in the construction phase. Further clarity on the timing of dividend payments from these projects, and in turn by IIP, is expected to be released when construction is completed at VLMS and SMHPCL and both are fully operational, which we believe would be the key to addressing the NAV discount.

Strategy: Focus on energy and transport

IIP's strategy is to invest in projects that have the potential to generate capital growth and deliver sustained income. The sector focus is on energy and transport, which have some of the best potential growth rates and returns and encompass power generation, transmission and distribution, oil and gas infrastructure assets, renewable fuel production and energy assets, as well as roads, rail, ports and airport assets, transport interchanges and distribution hubs. Investments in other economic and social infrastructure sectors within India are allowed, when opportunities occur, offering similar risks and returns to the core sectors.

Management: Alignment vs related party risk

IIP has been managed by Guggenheim Franklin Park Management (GFPM) since 2011, when the former management was replaced and a capital increase enabled IIP to continue as a listed company and complete the acquisitions of IHDC and VLMS from Guggenheim Global Infrastructure Company (GGIC) and later IEL as well. GFPM also manages GGIC, which focuses on global infrastructure investment and is the majority shareholder of IIP, with a 51% stake. This is not intended by GGIC to be the situation in the long term (it held 31% until last year's capital increase), but the most likely scenario for reducing it is via dilution on any further capital increase.

The former promoter and main shareholder of VLMS is also the largest personal shareholder in IIP, while GGIC is the largest corporate shareholder in IIP, as well as being managed by GFPM, the asset manager, thereby aligning management's interests with shareholders. IIP thus believes the trade-off between alignment with shareholders and any potential conflict of interest between management and minorities is clearly in favour of alignment. The potential risk for minorities, with the majority shareholders controlling over 64% of the shares (the top three have 75%), is also mitigated by the historical support from GGIC and its significant current exposure to IIP. This gives a clear message that GGIC is committed to making a success of IIP.

The management team is led by the CEO, Sonny Lulla, a senior vice president and co-founder of GGIC, with over 20 years' experience in infrastructure M&A, operations and financing. IIP's chairman, Tom Tribone, is the president, CEO and co-founder of GGIC, having previously been the number two at AES Corporation, an investor in power and infrastructure in emerging markets, which had over 20m customers and 50,000 employees. The other main operational director is Vikram Viswanath, the current chairman and previously the promoter/director of VLMS. He also has a 12% stake in IIP via Anuradha Holdings. He is one of two board directors based in India, although each investment has a local management team on the ground, even if wholly owned by IIP. MS Ramachandran, the former chairman of Indian Oil Corporation, is also a non-executive director.

Fees

IIP changed its management fee structure as of April 2012 to 2% of gross assets, with no charge on cash and no introductory or performance fees. Prior to that date the fees were 0.5% of existing assets and 1.5% of the value of new assets, for 24 months (from March 2011) and thereafter 2% of NAV. Management estimates that the new arrangement equates to the fees payable under the previous contract for 2012 and a reduction thereafter. On top of management fees there are administration expenses of approximately £1.5m per year, which comprise legal fees, corporate advisory services, directors' fees and other professional costs. There was a sharp increase in fees in FY13, but it was in line with the increase in the group's assets in H213 and the ratio was the same as in H112. So, although there was a 61% y-o-y increase in fees in H113, this can be explained by the 64% expansion of the asset base to £251m.

Exhibit 3: Management and valuation fees

£m	H112	H113	2012	2013
Asset management & valuation services	(1.22)	(1.97)	(2.82)	(4.26)
LT assets & investments	153	251	245	267
Annualised ratio to LT assets	1.6%	1.6%	1.1%	1.6%

Source: IIP

Portfolio

Infrastructure India has five investments in the transport and power sectors, which have some of the highest potential growth rates and the best potential returns in the Indian economy. Our forecasts for the five individual projects are laid out below, showing proportionate project revenues, adjusted for IIP's holdings, for the current fiscal year, of £31m, plus EBITDA of £14m, as VLMS starts to complete construction and ramps up operations.

Exhibit 4: Project cash flow forecasts*

			Sales	EBITDA
£m			**2014e**	**2014e**
VLMS			19.8	4.6
WMPITRL			2.8	2.5
SMHPCL			0.0	0.0
IHDC			3.8	2.8
IEL			4.7	4.0
Total			**31.1**	**13.9**

Source: Edison Investment Research forecasts. Note: *Adjusted for IIP's stake in each asset.

Vikram Logistics and Maritime Services Ltd (VLMS)

VLMS is in the process of creating one of the top three nationwide container freight logistics companies in the private sector, offering trucking, rail transport logistics for domestic and international cargo, various forms of warehousing, including within a free trade zone, container handling and storage, freight forwarding, third-party logistics and bulk cargo services. VLMS has previously also operated terminals and container transportation for Container Corporation of India (CONCOR) and Central Warehousing Corporation and short-term contracts with some of India's largest companies. The recent acquisition of Freightstar from ETA Engineering brings a Category 1 licence from Indian Railways to transport containers, as well as its container handling facilities, under construction on land at Nagpur and Palwal, and a third-party logistics business.

Freightstar integration

VLMS had already started the process of integrating Freightstar over the past year (funded by an advance of £10.8m from IIP), as it waited for final lender documentation to be completed for the acquisition, which was first announced in October 2011. Revenue improvements and debt refinancing are expected to be more significant than cost synergies, as VLMS establishes itself as an integrated provider of logistics services, with road and rail transport, large-scale warehousing and inland terminals. The final cost of the acquisition, which completed in March 2013, was £8m, with assumed debt of £22m and further debt funded investment commitments of £6m, for the terminal facilities under construction. VLMS expects previously approved debt facilities from the lending consortia of VLMS and Freightstar to fund both companies' terminal construction, with expected completion by year-end FY14. IIP believes it was able to achieve a favourable valuation, because the previous majority shareholder, ETA, was effectively a forced seller, with liabilities it needed to cover. It had also not invested in the business recently, which further reduced the acquisition price.

Exhibit 5: VLMS and Freightstar assets

	VLMS	Freightstar
Integrated Logistics Parks (ILPs)	*Bangalore	*Nagpur and *Palwal
Inland Container Terminals (road linked)	Hassan	
Domestic Terminals (planned)	*Chennai	
Free Trade Warehouse Zone (FTWZ)	*Chennai	
Warehousing @ ILPs	Up to 4m sq ft	
Branches	20	
Land	247 acres	140 acres
Trucks	143	
Handling assets	36	
Container trains		11
Rail licence		Category 1

Source: IIP. Note: *Under construction.

Western Madhya Pradesh Infrastructure and Toll Roads Ltd (WMPITRL)

WMPITRL operates a 125km four-lane expressway between Lebad and Jaora under a 25-year, 7% annual escalation toll road concession with the Madhya Pradesh Road Development Corporation. Traffic growth was expected to be 10% per year, but has historically beaten projections, as a number of feeder roads have been accelerated. The road links National Highway 8 to eastern Rajasthan, Indore and National Highway 3, which runs from Mumbai to Agra. The road was completed in two phases, in November 2009 and June 2011. As the road is fully operational it is largely de-risked, although management still assigns it a "ramp-up" rating in its valuation. Quarterly year-on-year growth rates were 43%, 48%, 32% and 23% in FY12, but traffic volumes are affected by weather and the economy and estimates have been reduced to 6.1% in FY14 and 6.7% in FY15, before moderating to 5% after the seven- to eight-year ramp-up phase. IIP acquired its stake in September 2008 for £11.7m and it was valued at £27m in September 2012. The £75m debt was provided by a consortium of banks, with a 15-year maturity.

Shree Maheshwar Hydel Power Corporation Ltd (SMHPCL)

SMHPCL is a 400MW hydroelectric power project at Mandleshwar on the Narmada River in Madhya Pradesh, with a long-term state government commitment via a 35-year Power Purchase Agreement (PPA) from the State Electricity Board (SEB), with a fixed 16% return on equity, with potential to generate additional returns for production above the targeted level. Under most probable outcomes IIP is guaranteed an IRR of 15% on the first tranche of investment and 17% on the second. IIP's 17.7% stake, at a cost of £29.7m, is expected to be diluted to 8.6% after the injection of the remaining equity. Full commercial operation is expected within twelve months of the promoter raising further capital to fund its equity contribution, which is expected to be resolved this year. SMHPCL and other stakeholders, under the guidance of the Ministry of Finance, are exploring options to complete the project. Three of the 10 turbines have been installed and the remainder will become operational in phases, within 12 months of the capital being raised, so distributions to IIP are expected after that. The total project cost is £505m, funded with £125m of equity and £380m of debt, of which £284m has been drawn down.

India Hydropower Development Company (IHDC)

IHDC is a developer of small hydroelectric power projects, of typically less than 25MW. These developments are supported by a number of Indian states via long-term PPAs, carbon credits and tax breaks. It has six operating projects with 62MW of capacity, after the 4MW Panwi project become operational in FY13. A further 24MW is in construction or development, for delivery by FY17. All but two of the projects have long-term PPAs of 30-40 years with state electricity boards, giving IHDC fixed tariffs, or indexation to retail prices. IIP's partner is DLZ Corporation, which has over 30 years' experience of designing and operating hydro projects in India.

Indian Energy Ltd (IEL)

IEL is a developer of wind projects. It was London-listed until the company and its management were fully acquired in September 2011 for £10.6m. It has two operating wind farms at Gadag in Karnataka, with 24.8MW of capacity, and Theni in Tamil Nadu, with 16.5MW. Gadag has a 20-year PPA with the state government, while Theni has recently converted to a group captive structure, with higher rates paid by a group of industrial customers. IEL has identified a short-term pipeline of wind projects totalling 125MW, with another 200MW of medium-term opportunities. Generally it has limited exposure to development risk, preferring to acquire projects once they are fully permitted. Wind is one of the fastest growing renewable energy sectors in India, growing 15-20% in 2010 and 2011, partly due to the support of state governments from preferential tariffs and partly due to demand, which means by 2015 there could be additional wind capacity nationally of up to 10,000MW.

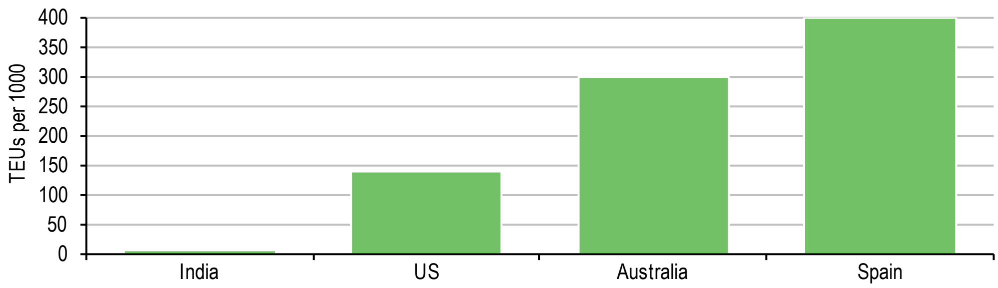
Infrastructure overview

Infrastructure within India is extremely under-developed by all measures and, with the economy growing at over 5% per year, remains the key to improving the country's sustainable growth rate. However, it is the main focus of the government's current 12th Five Year Plan, which is intended to see US$1,000bn invested on infrastructure by 2017.

Transport

The lack of logistics and transport infrastructure is a major drag on growth, with logistics costs of 13% of GDP compared with a global average of 10%. The most startling statistics relate to containerisation, with per capita TEUs (20 foot equivalent units) handled by Indian ports of just seven per 1,000, compared with 140 in North America and 400 in Spain. Also, just 22% of traffic in India is in containers, as opposed to over 90% in developed markets. Nevertheless, strong growth in the domestic economy and increased containerisation produced average TEU growth of 13.4% between 2002 and 2010.

Exhibit 6: TEUs per 1,000 people



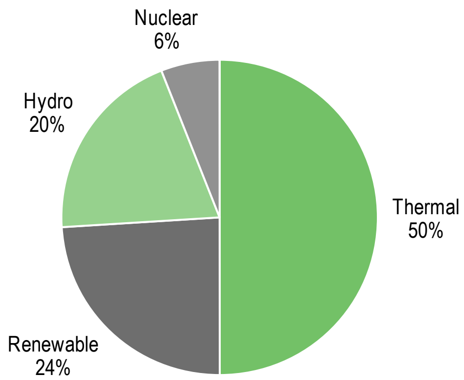
Source: IIP

Warehousing demand is also growing strongly and the lack of supply is producing huge pent-up demand. This is anticipated to increase to 734m square feet by 2015, compared with existing supply of just 433m sq ft. If all currently planned projects are built, supply is forecast to reach 615m sq ft, leaving unmet demand of 120m sq ft. The government has tried to address the problem by creating free-trade bonded warehouse zones for freight and logistics with tax free status, called Free Trade Warehousing Zones (FTWZ). VLMS is developing an FTWZ in Chennai.

Power

India suffers from a severe power supply shortage, which was 11% at peak in 2012-13 and is forecast to continue rising, as potential GDP growth of 6-7% a year increases per capita consumption from just 800kWh (less than 30% of the level in China). With this backdrop exacerbated by fuel shortages for thermal power and the phasing out of fuel subsidies, there is policy support at both federal and state level for renewable energy. The Indian power sector had 199GW of capacity in FY13, of which 11%, or 22GW, is classified as renewable. By 2020, the total capacity is expected to double to 399GW, but the proportion of renewables is also expected to more than double to 24%, which implies 84GW of capacity. This means renewable capacity will nearly quadruple and 62GW will need to be added over the next seven years. This is necessary for India to meet its emissions targets, but also to enable the industry to be able to meet the expected per capita consumption of 1,900kWh in 2020, which would still be 26% lower than the current level in China.

Exhibit 7: Projected capacity split in 2020



Source: Ministry of Power

NAPCC and RPOs

This growth in supply has been supported by a number of regulatory measures and incentive mechanisms, starting with the Indian government's National Action Plan for Climate Change (NAPCC) in June 2008. This set out a roadmap for increasing the share of renewable energy in the total generation capacity of the country. It also set the minimum renewable energy purchase obligation (RPO) target at 5% of the total energy procurement in 2009-10, with a 1% year-on-year increase for the next 10 years, thus reaching 10% by 2014-15 and 15% by 2019-20.

State-level RPO regulations, which must be met by obligated entities (distribution licensees, group-captive and open-access customers) by purchasing renewable energy, either by entering into PPAs with renewable energy producers and/or by purchasing renewable energy certificates, are imposed by state electricity regulatory commissions (SERCs) in most states.

Income tax holiday

Companies involved in the generation or distribution of power can take advantage of a 10-year tax holiday for renewable energy plants generating power before 31 March 2013. However, they have to pay the minimum alternative tax at a rate of 20%, which can be offset in future years. The draft provisions of a new direct tax code, to be effective from this year, outline an alternative mechanism of expenditure-based incentives for the generation, transmission and distribution of power. All revenue and capital expenditure would be allowed as an upfront tax deduction, instead of claiming depreciation on the capital expenditure and there would be no tax holiday available.

Valuation

NAV

IIP's company level reported NAV was 78p per share as at March 2013, when the last portfolio valuation was performed by the asset manager, using a DCF methodology and a range of discount rates, depending on the maturity of the asset. NAV has increased over 600% since 2009, but the majority of this growth has been the result of share issues of over £200m in that period. On a per share basis NAV has fallen 19% over three and a half years, or 6% on a compound basis, owing to a range of factors including the dilutive share issues. Exhibit 8 breaks down the valuation, showing that transport dominates the portfolio and within that VLMS is by far the largest investment, accounting for 63% of portfolio value. This valuation includes the impact of the Freightstar acquisition, which was completed in March and contributed to the £53m or 46% increase in the value of VLMS, which added 15p per share to IIP's reported NAV at year-end. This was reflected in the NAV at year-end March 2013, but could be increased by any further synergies and cost savings management is able to find from the transaction.

Exhibit 8: NAV breakdown (31 March 2013)

£m	Value	Holding	Breakdown
VLMS	167.7	100%	63%
WMPITRL	25.3	26%	10%
Transport	**193.0**		**73%**
SMHPCL	34.0	18%	13%
IHDC	25.1	50%	9%
IEL	14.4	100%	5%
Energy	**73.5**		**27%**
Fair value of Investment assets	**266.5**		**100%**
Cash & advances	0.8		
NAV	**267.3**		
Shares	342.7		
NAV/share (£)	**0.78**		
Discount	**67%**		

Source: IIP

The current discount and how it could be addressed

IIP currently trades at a 67% discount to the last reported company NAV of 78p in March 2013, which widened further at year-end after the Freightstar deal. There are a number of obvious reasons for this including: the lack of liquidity in the stock, owing to the 51% stake of the controlling shareholder and small free float, the lack of a dividend yield and the unclear timing for the payout to start, the execution risk inherent in the projects and also the structure of the fund, with two minority holdings. Other factors include the perception of India as an investment destination from an economic and business perspective, the difficulty of financing projects in India and the currency risk associated with investing there. There is little IIP can do about macroeconomic, business and sector risk in India, but it has made progress recently in financing (raising £41m of new equity last year and a US$17m working capital facility this year) and improving disclosure in an attempt to improve transparency. There is potentially more that could be done to address the discount including: guidance on prospective cash flows from majority held projects, setting a date for the start of dividend payments and further clarity on how value will be realised from the portfolio's two minority holdings. Reducing the GGIC holding back below 50% would also improve the free float and stock liquidity.

Valuation methodology: DCF and comparatives

We have back tested the valuation for each investment, by forecasting the project cash flows and discounting them at the rates used by the directors in their most recent valuation and then tested the sensitivity to a range of discount rates. Management's discount rates range between 11% for WMPITRL, which is fully operational, and 14% for SMHPCL, which is still in construction. We have laid out the main operational assumptions and discount rates for the initial 10-year forecast period in Exhibit 9 below. To reduce the distortion to the revenue growth rates at VLMS and SMHPCL from start-up nature of the businesses and VLMS's acquisition of Freightstar, we have taken a 10-year average from 2015 and 2016 respectively. The DCF forecasts are generally for the life of the project, so with the exception of VLMS, there are no perpetual growth rates in the valuations.

Exhibit 9: 10-year DCF forecast assumptions

£m	VLMS	WMPITRL	SMHPCL	IHDC	IEL
Average revenue growth	40.9%	12.7%	27.9%	10.4%	2.6%
Average EBIT margin	18.2%	61.1%	84.3%	55.3%	25.5%
Discount rate (cost of equity)	14.6%	11.0%	14.0%	11.6%	10.0%
Debt cost	14.8%	13.5%	10.5%	10.7%	13.3%
Debt:equity ratio (FY13)	65.0%	68.0%	80.0%	62.0%	60.0%

Source: Edison Investment Research, IIP

From these project equity DCF models we have calculated a total NPV of £273m for IIP from the total net present value of the five projects, adjusted for IIP's stake in each asset. From this we have added FY13 cash and advances of £0.8m to reach a NAV of £274m. After adjusting for the present value of the management fees and administration expenses of £36m, which is the cost of running the fund, we reach an adjusted NAV of £239m or 70p per share, which is 11% below the FY13 NAV, the main difference versus the FY13 reported NAV being the adjustment for the cost of the fund.

Exhibit 10: Project NPVs (IIP's share)

£m	
VLMS	169
WMPITRL	28
SMHPCL	35
IHDC	25
IEL	16
Total NPV	**273**
Cash and advances (FY13)	0.8
NAV	**274**
PV of fees & administration expenses	(36)
Adjusted NAV	**239**

Source: Edison Investment Research

Sensitivities

Exhibit 11 shows the sensitivity of the IIP valuation to changes in discount rates. A 1% reduction in the discount rate for each project DCF would result in a 10% increase in the total equity value, while a 1% increase would produce a 9% fall. Even if each project's discount rate were increased by 2%, reducing the equity value by 17%, the adjusted NAV per share of £0.56 would still be more than double the current share price and if we assume 20% rupee depreciation, the value would fall 17%.

Exhibit 11: NPV sensitivities

£m	NPV	Equity value	Change	Per share @ Rs85 / £	Per share @ Rs102 / £
Discount rate -1%	302	303	10%	0.78	0.65
Discount rate	**273**	**274**		**0.70**	**0.58**
Discount rate +1%	249	250	(9%)	0.62	0.52
Discount rate +2%	**227**	**228**	**(17%)**	**0.56**	**0.46**

Source: Edison Investment Research

Comparative valuations

We have compared IIP to six other infrastructure funds, which manage a mixture of developed and emerging market assets. The weighted average valuation is a 13% premium to NAV, with all but one fund trading at a premium. Indeed, if VNI is excluded the premium rises to 12%, while IIP trades at a discount of 67%. VNI, which trades on a 28% discount to NAV, over half the level of IIP, could be regarded as the most relevant comparative, as it also invests in emerging market assets.

Exhibit 12: Comparative valuations

£m	Market cap	2012** P/NAV (x)	2012 yield (%)	TER *(%)
3i Infrastructure	1,196	1.12	4.8	2.16
Bilfinger & Berger Global Infrastructure	344	1.15	4.6	1.58
HICL	1,560	1.12	5.3	1.10
International Public Partnerships	1,002	1.13	4.5	1.26
John Laing Infrastructure Fund	657	1.14	5.1	1.77
Vietnam Infrastructure (VNI)	86	0.72	0.0	3.66
Total/average	**4,845**	**1.13**	**4.0**	**1.92**
IIP	87	0.33	0.0	2.71

Source: Edison Investment Research, Bloomberg, Morning Star. Note: *TER is total expense ratio; **2013 P/NAV for IIP owing to its March year-end. VNI is quoted in US$

Similarly, the average yield is 4%, or 4.9% if VNI, which does not pay a dividend, is excluded. IIP does not pay a dividend yet either, which partly explains the discount to the developed peers, but not to VNI. The discount to VNI could be explained by VNI's strategy of share buybacks rather than dividends, which has started to narrow its discount to NAV recently. The total expense ratio of the two Asian funds (3.7% and 2.7%) is also higher than the developed peers (1.1% to 2.2%), which may also contribute to their discount. Other factors discussed above to explain IIP's NAV discount could also apply to its discount relative to its sector peers.

Financials

After consolidating VLMS and IEL since acquisition in FY12, IIP changed to unconsolidated investment accounting for the FY13 accounts, as management believes it better reflects the nature of the fund. Management decided to adopt the amended IFRS 10 requirement early, whereby investments held by investment funds and similar entities will be accounted for at fair value through the income statement. Therefore, associates and subsidiaries are both now recorded at fair value, with unrealised gains and losses from revaluation taken through the income statement. The wholly owned subsidiaries, VLMS and IEL, were previously consolidated, in accordance with IAS 27, whereby they were accounted for at cost. As a result, the main source of income in the P&L is the change in fair value of investments, based on the valuations now performed by management.

Earnings: Fair value gains should boost earnings from FY14

In light of the accounting and consolidation decisions above, the main driver for earnings will continue to be fair value gains and losses. Fair value movements were positive until a loss of £4m in FY12 when the weakness of the Indian rupee caused a loss on translation. This continued in H113, but was offset by a recovering currency and lower bond yields in H213. Assuming a stable currency we forecast a fair value gain from project upgrades of £10m in FY14 and £19m in FY15. We expect these gains to start offsetting asset management and valuation fees of over £5m (2% of gross assets) and administration expenses of c £1.6m (including audit, advisory, consultancy and legal costs), which are forecast to increase with inflation.

The other main expense is interest costs, which we expect will remain low until the working capital facility is fully drawn down during FY14. IIP is resident in the Isle of Man for tax purposes, paying no tax in 2012-13, which we assume will remain the case for FY14-15. After a profit of just £2.6m in FY14, following the £21m reported in FY13 on higher fair values, we forecast profits of £14m in FY15 on further fair value gains and project dividends. Therefore, we do not currently see any prospect of dividends until at least FY15, when project cash flows start to justify paying dividends to IIP.

Balance sheet and cash flow

Since the 2013 year-end IIP secured a working capital facility of US$17m from GGIC at 7.5%. There is currently no debt on the holding company balance sheet, although we forecast the US$17m working capital facility will be drawn down in FY14-15. However, given the infrastructure nature of the projects, they obviously tend to be funded by both debt and equity. Gearing at the group level is limited to no more than 50% of NAV, while debt at the SPV level, which is non-recourse to the parent, is typically on a debt/equity ratio of 70/30. IIP increases gearing at the project level when appropriate, but tries to ensure that gearing at the SPV level does not exceed 90% of total capital. As a result of the revised accounting practice the debt previously consolidated in the subsidiaries was not consolidated in the FY13 accounts and will not be going forward, as the projects are recorded at fair value, rather than being consolidated. Exhibit 13 shows the current debt:equity ratios and outstanding debt for each of the projects, to give an idea of the level of debt at the SPV level, which is not consolidated, whether the group has a minority or majority holding.

Exhibit 13: FY13 project debt

£m	Debt:equity	O/S debt
VLMS	65%	52.3
WMPITRL	68%	67.2
SMHPCL	80%	296.8
IHDC	62%	19.5
IEL	60%	13.2
Total		**448.9**

Source: IIP

IIP is not currently cash generating, as it is an investment vehicle, raising capital to invest in infrastructure projects, which have included the acquisitions of VLMS and IEL in FY12 and Freightstar in FY13. IIP raised £41m of new equity (£39m net of costs) in August 2012, which was used for working capital purposes, to repay debt and for the Freightstar acquisition. With equity of over £200m issued in the past three financial years and NAV increasing by £232m in the same period, the net NAV gain is thus just £32m.

As discussed above, management intends to pay a dividend when project progress makes it possible for the investments to pay dividends to the parent company. We currently expect to see positive project cash flows from FY15, which could allow a dividend to start being paid by the holding company from then onwards, although we are not currently forecasting dividend payments by IIP in our FY13-15 forecast period and management is not able to guide for them either.

Sensitivities

The main macroeconomic risks for IIP, other than the recent growth slowdown in India and the effect that has on the prospects for individual projects, are inflation, higher interest rates and currency depreciation. Recent high inflation in India has been addressed by the authorities raising interest rates, in turn raising bank lending rates. Given the gearing inherent in infrastructure projects, higher debt costs affect them more than other businesses. 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.

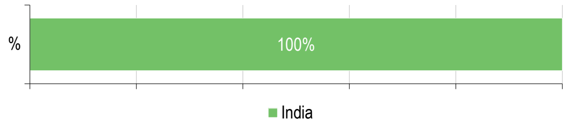
The main company specific risks are execution and politics, which can be inter-related. The delay in SMHPCL's completion, which is partly due to the project promoter's difficulties in raising the equity required, exemplifies the problem of executing in India, as well as the complication of being in a minority position. Conversely, 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 14: Financial summary

£m	2011	2012 consolidated	2012 restated	2013	2014e	2015e
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
Administration expense	(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)	(5.5)
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	10.2	19.4
Operating Profit	7.5	(12.7)	0.9	23.0	3.3	12.2
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)	(5.0)
Profit Before Tax (IFRS)	7.5	(12.8)	0.8	20.8	2.6	14.5
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)	(5.0)
Net income (IFRS)	7.5	13.7	0.8	20.8	2.6	14.5
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)	(1.45)
EPS - normalised full diluted (p)	(6.81)	(6.51)	(2.82)	(2.71)	(2.22)	(1.45)
EPS - (IFRS) (p)	15.42	(6.51)	0.43	7.08	0.75	4.22
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	276.7	296.1
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	276.7	296.1
Current Assets	27.3	13.1	8.6	2.1	5.9	1.1
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	1.1
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	269.9	284.3
CASH FLOW						
Operating Cash Flow	(3.4)	(8.9)	(4.2)	(5.9)	(6.8)	(3.5)
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)	(4.9)
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	10.3

Source: Edison Investment Research, company accounts

EDISON

Contact details	Revenue by geography
IOMA House, Hope Street, Douglas, Isle of Man, IM1 1AP 01624 681 250 www.iiplc.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 2011-15e	N/A	ROCE 14e	N/A	Gearing 14e	N/A	Litigation/regulatory	◖
EPS 2013-15e	N/A	Avg ROCE 2011-15e	N/A	Interest cover 14e	N/A	Pensions	○
EBITDA 2011-15e	N/A	ROE 14e	N/A	CA/CL 14e	N/A	Currency	●
EBITDA 2013-15e	N/A	Gross margin 14e	N/A	Stock days 14e	N/A	Stock overhang	○
Sales 2011-15e	N/A	Operating margin 14e	N/A	Debtor days 14e	N/A	Interest rates	○
Sales 2013-15e	N/A	Gr mgn / Op mgn 14e	N/A	Creditor days 14e	N/A	Oil/commodity prices	○

Management team

Chairman: Tom Tribone

Tom is the president and CEO of GGIC Ltd. (GGIC). He has led GGIC's growth from its initial start-up until today. Prior to founding GGIC, Tom was the executive vice president of The AES Corporation. He has extensive transaction and operating experience including the completion of transactions with a value totalling over US$30bn worldwide.

CEO: Sonny Lulla

Sonny is a senior vice president of GGIC and has over 17 years of experience in infrastructure M&A, operations, and financing. Prior to co-founding GGIC, Sonny was employed by AES where he was president of AES Brasil Energia with responsibility for several businesses in Brazil generating over US$1bn in annual revenue.

NED: Vikram Viswanath

Vikram Viswanath is the chairman and managing director of Vikram Logistic & Maritime Services Private Limited (VLMS). Prior to this position, he was a promoter director at VLMS, becoming managing director in 2000. He has extensive international experience in trading operations, cargo transportation and logistics.

Principal shareholders	
GGIC	51.17%
Anuradha Holdings	12.40%
Henderson	9.66%
Utilico	4.69%
JO Hambro	3.99%
Miton Group	3.17%
Others	14.70%

Companies named in this report

3i Infrastructure (3IN), Bilfinger & Berger Global Infrastructure (BBGI), HICL (HICL), International Public Partnerships (INPP), John Laing Infrastructure Fund (JLIF), Vietnam Infrastructure (VNI)