DEBACLE OF RELIANCE POWER IPO – A CASE STUDY

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During January 2008, the maiden public issue of Reliance Power Limited, India, was oversubscribed 73 times and garnered an astronomical $190 billion. It created many world records. It was the largest subscription of any IPO (initial public offering) anywhere in the history of global capital markets with a record five million applicants. It became 10 top listed companies in India with the largest number of shareholders in any listed company in the world.

The high growth Reliance Group companies are known for producing stock-market gains from the moment they are listed. No issue since its inception in the year 1965 had failed to date in the stock market. So the highly oversubscribed issue was keenly awaited to open on February 11, 2008 in the twin stock exchanges National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) of Mumbai, India.

But for the first time in history of Indian stock markets the Reliance magic did not work. For a few moments on the opening day, Reliance Power surged 19% to 538 rupees ($10.94) from the IPO price of 450 rupees ($9.15). After the initial surge of four minutes the dream vanished and RPL dived to 355rupees ($7.23) per share never to return even close to the issue price. By the close of the day, it was down 17% at 372.50 ($7.57) rupees, Four billion of its market capitalization wiped out and with it billions of rupees of investors' wealth.

The aftermath

In the following days, the nightmare worsened as another $5 billion of the market capitalization was lost. The blow was severe and went far beyond Reliance Power. The listing affected all the group companies of the Reliance Group.

As a face saving measure Reliance Power Ltd issued free bonus shares to all categories of shareholders, excluding the promoter group (comprising of Reliance Energy Ltd.(REL) and the ADA Group), in the ratio of 3 shares for every 5 shares held. The proposed bonus offering resulted in reduction of the cost of Reliance Power shares with an offer price of Rs. 269 ($5.47) per share for retail investors, 40% lower than the IPO price of Rs. 430($8.74) and Rs. 281($5.71) per share for other investors, and 37% lower than the IPO price of Rs. 450 ($9.15). REL announced buyback of the shares to prevent the shares to slide further which didn't happen although. The performance of Reliance Power Ltd. after the IPO was good (Annexure VI to IX) but not so excellent to support this exorbitantly high IPO Pricing.

Post mortem

Several analysis and reasons were ascribed to the Reliance Power debacle.

1) Reliance Power was a new company. It had almost no assets and cash flow. It was riding on the Reliance brand name and also the euphoria in India's stock markets. This was further aggravated through the exorbitant price quoted in the grey market before the issue. The "Power On, India On" slogan created hype and tried to portray over dependence of India's economic growth on

availability of power.

2) Indian investor considers IPO as a means of making quick money. The shares are sold out immediately on opening of the issue. This may be a reason of the Reliance Power debacle.

3) The IPO was not helped by a souring in global market mood as the reverberations of the US subprime and credit crisis swept around the world. Between January 4, when the IPO was announced, and the listing date of February 11, the benchmark Sensex index fell over 4,000 points, or almost 20%, from historic highs of around 20,686 points to 16,630.91 points.

4) It was observed that few Mauritius-based foreign institutional investors (FIIs) and a domestic bank offloaded almost their entire shareholding in the company within minutes of the opening bell.

Trading data indicated that as much as 23.77 million shares, 10.4% of the total 228 million shares sold through the Reliance Power IPO, changed hands on the twin bourses of Mumbai (Bombay Stock Exchange and National Stock Exchange) within the first four minutes. Sell orders were made at progressively declining prices. It was pointing towards a pre-mediated manipulation in the dealings although an investigation by Securities Exchange Board of India (the regulatory body of Indian Stock Market) cleared the dealings as genuine.

5) Reliance Power's downfall was linked to aggressive pricing of the IPO. Analysts suggested that it was overvalued when compared with peer companies in India. For instance, the IPO price was 450 against the price of NTPC, (the government power company) at Rs.250/-. RPL was planning a 28000 MW power plant in 2017 and did not have a single operational power plant whereas NTPC had 27350 MW of operational power plant in the year 2007. (Annexure I). Comparison of the financials of Tata Power and NTPC also did not show a very promising picture of RPL. (Annexure II)

On the contrary, it was advocated that the retail investors may have been swayed by the hype, but that cannot be told about the Foreign Institutional Investors (who have got all the expertise and knowhow of valuation of shares).

Background of the Issue

Power Sector in India

The Indian power sector has grown significantly since 1947 and India today is the third largest producer of power in Asia. The power generating capacity has increased from 1,362 MW in 1947 to over 160,000 MW by mid of 2010. Despite significant growth in electricity generation over the years, the shortage of power continues to exist primarily on account of growth in demand for power outstripping the growth in generation and capacity additions in power generation.

Historically, India has experienced shortages in energy and peak power requirements. The average energy deficit was 9.1 percent and the average peak power deficit was 12.8 percent between 2003 and 2010. According to projections made in the National Electricity Plan, demand for power is expected to grow at an average annual rate of 9% during the 11th Plan period (2007-12) and at an average annual rate of 7% during the 12th Plan period (2012-17). The gap between demand and supply has not decreased in the last few years, leading to persistent power shortages. The prevailing and expected electricity demand and supply imbalance in India presents significant opportunities in the power generation sector. (Annexure III).

Indian power sector has been regulated for almost a century through 'The Electricity Act 1910' and subsequently 'The Electricity (Supply) Act 1948'. By and large it was state controlled through the state electric boards and the performance of power sector was dismal during this period. As the Indian Economy started opening up to private sector and foreign players power sector also attracted lot of investment.

The year 2003 marked a new beginning of reforms in the Electricity Sector in India with enactment of the Electricity Act with lot of regulatory changes. The Central Government came out with National Electricity Policy on 6th February 2005. Now 100 percent Foreign Direct Investment (FDI) is allowed in generation, transmission and distribution segments. Incentives are given to the sector through waiver of duties on capital equipment under the Mega Power Policy. These policy initiatives have resulted in building up investor confidence in the power sector and have created an ideal environment for increased participation by the private sector.

During December 2012, "Cabinet Committee on Investments (CCI)" was formed to enable Greenfield projects to get the required clearances in a timely manner, including those related to land acquisition. Eight states have revised their power tariffs and another eight are supposed to revise during 2013-14. A framework for Fuel & Power Purchase Cost adjustment (FPPCA) has been approved in many of the states during 2011-12. But still power companies are facing the acute shortage of coal and banks do not extend loan to power companies easily due to its lack of viability on many account.

Reliance Group

The Reliance Group, founded by Dhirubhai H. Ambani (1932-2002), is India's largest private sector enterprise, with businesses in the energy and materials value chain. Group's annual revenues are in excess of US$ 58 billion. The flagship company, Reliance Industries Limited, is a Fortune Global 500 company and is the largest private sector company in India.

Backward vertical integration has been the cornerstone of the evolution and growth of Reliance. Starting with textiles in the late seventies, Reliance pursued a strategy of backward vertical integration - in polyester, fibre intermediates, plastics, petrochemicals, petroleum refining and oil and gas exploration and production - to be fully integrated along the materials and energy value chain. The Group's activities span exploration and production of oil and gas, petroleum refining and marketing, petrochemicals (polyester, fibre intermediates, plastics and chemicals), textiles, retail, telecom, finance, entertainment and special economic zones.

Reliance enjoys global leadership in its businesses, being the largest polyester yarn and fibre producer in the world and among the top five to ten producers in the world in major petrochemical products. Reliance Companies are widely known as cash rich zero debt companies. After the demise of Dhirubhai Ambani , the business of Reliance Group was divided among the two sons of the founder. The elder brother Mukesh holds companies in Petroleum and Poly Yarn whereas Younger brother Anil holds telecom and power business. (Annexure IV)

Both brothers have cashed in on the goodwill of Dhirubhai, who died in 2002 after shaping India's equity culture by attracting millions of retail investors in a market that was then dominated by financial institutions. Through repeated public offerings of Reliance Industries since its IPO in 1977, none of the issues went below their issue price. Dhirubhai revolutionized the country's capital markets by generating billions of rupees in wealth for those who put their trust in his companies.

Reliance Power

The younger brother Anil Dhirubhai Ambani holds the power business. The company was incorporated in January 1995 as Bawana Power Private Limited and many times changed its name to be finally known as Reliance Power Limited.

The Reliance Anil Dhirubhai Ambani Group (ADAG) intends Reliance Power to be its primary vehicle for investments in the power generation sector in the future. Other companies of the ADAG group like REL, RNRL and Reliance Energy transmission have associative arrangement to draw upon considerable expertise and resources that they possess in the Indian energy sector. But they do not have non-compete agreement between them. These companies will provide Engineering, Procurement and Construction (EPC) services, fuel sourcing and transmission services for some of RPL projects. RPL also expects to enter into off-take arrangements with its affiliates, including REL and Reliance Energy Trading.

RPL has started with an ambitious growth plan. It wants to develop power plants on various energy sources like Hydro, Coal, and Gas in various locations of the country. Simultaneously work has started at various plant sites. But during the time of issue none of the plants were operational. .

Securing adequate supplies of fuel is critical to the success of a power project. It intends to secure fuel for the projects by seeking captive fuel sources, procuring long-term contracts with domestic and foreign suppliers and entering into supply arrangements with its affiliates, including RNRL. RPL will source the coal needed for its 3,960 MW Sasan project from three captive mines in the Singrauli coalfields. RPL intends to seek supplies of coal for its supercritical coal-fired projects, Shahapur Coal (1,200 MW) and Krishnapatnam (4,000 MW), through RNRL or third parties. In addition, it is planning to seek supplies of natural gas from RNRL for its gas-fired projects at Shahapur (2,800 MW) and Dadri (7,480 MW), primarily from its rights to KG Basin gas reserves. RPL is also considering opportunities for securing fuel for other power generation projects with the supplies expected to be available from CBM exploration activities led by RNRL.

RPL intends to sell the power generated by these projects under a combination of long-term and short-term PPAs to state-owned and private distribution companies and industrial consumers.

It also aims at achieving optimal project operating efficiency through supercritical technology (beginning with Sasan UMPP) to reduce the amount of required coal supplies for the coal-fired projects and combined cycle gas turbine technology to increase output for gas-fired projects. To finance the ambitious power projects RPL has floated the mega issue with all the turmoil in the IPO market. (Annexure V)

An extract from an analysis by K.R. Balasubramanyam in Business Today, dated January 29th 2013 is depicted below to exhibit the present scenario of Reliance Power Limited. Billionaire entrepreneur Anil Ambani's ambitious venture, Reliance Power Limited, is slowly picking up. But investors are miles away from recovering even half their investments, let alone make profits.

Anil Ambani later issued three bonus shares for every five shares that retail investors held, diluting his own stake in the company. He now controls 75 per cent of the Mumbai-headquartered company. The stock was trading at Rs 93.40 on the Bombay Stock Exchange (NSE) at 2 pm on Tuesday, January 29. The retail investor, who got a small discount in the IPO price, will recover his investment only if the stock touches Rs 271. On the performance front, the company, led by Jayarama Chalasani, has been doing well. The 3,960 MW Sasan ultra mega power project is expected to go on-stream in the next few weeks, ahead of schedule. The 1,200 MW Rosa power project in Uttar Pradesh operated at 103 percent load factor. At Rs 493 crore in the October-December quarter, EBITDA (earnings before interest, taxes, depreciation and amortisation) rose 252 percent, delivering a profit of Rs 266 crore at the net level. Announcing the results on January 25, Chalasani said: "The third quarter has proved to be an excellent one for the company as we turned in outstanding operational and financial numbers."

Valuation & Investor Dilemma

Behavioral finance advocates that valuation of a share should never be guided by subjective analysis. Although in this case the indomitable reputation of reliance group, their ability to grow at unparalleled speed, expertise in executing the project are some of the important factors to be considered for the valuation of IPO, a base price must be found out which may be leveraged with the above factors. Analysts suggest various base to value the IPO. They are

1) Dividend Discounting
2) Net worth
3) Market price of Competitors
4) Market Price of existing group companies.

It is imperative for each investor to adopt some or other method to get a base figure of the price and further inflate or discount it on his own perception. If in general efficient market hypothesis rules the market, an en mass suicidal subscription & debacle may not be the roost of the day.

It was a good performance, but analysts believe the price at which the stock is trading is fair. The stock, they say, will move up the price curve only if its liquidity and profits improve dramatically, to reflect in its book value and earnings per share.

Industry analysis, Promoter's reputation in the market, critical factors (power purchase agreement & captive supply of coal in this case) may be few factors an investor will like to analyze before investing in an IPO. As it seems, in spite of all kinds of analysis the investor cannot safeguard his investment as exemplified in this case. Few failures of mega IPOs like this have an adverse impact on the primary market of the country.

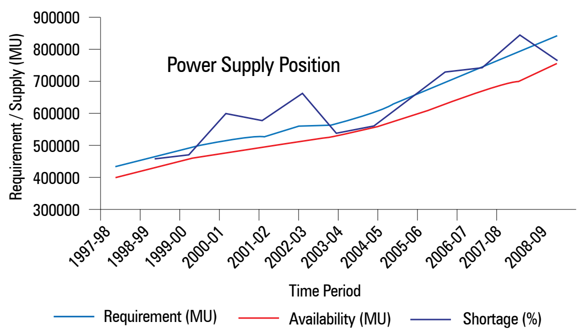
Annexure I

Capacity Reliance Power, NTPC and Tata Power

Year/Company	RPL	NTPC	Tata Power
2008	0	27350	2623
2009	0	27850	2700
2010	1500	31704	2977
2011	5500	34194	5297
2012	5500	37014	5300
2013	16980	41000	8500
2017	28200	75000	25000

Source: Figures extracted from various internet sources

Annexure III: Power requirement vs. supply over the years



Source: CEA, Power Scenario at a Glance, July 2010

Annexure II

Comparison of RPL against Tata Power & NTPC

	RPL	Tata Power	NTPC
Income	2007	2007	2007
Total Income (crores)	2.24	5285.98	35507.30
Total Expenses (Crores)	0.87	4208.47	22461.60
Operating Profit (Crs)	1.38	701.74	10170.10
Reported Net Profit	0.16	696.80	6864.70
Shares in issue (lakhs)	2000.40	1978.98	82454.64
Earning Per Share (Rs)	0.01	35.21	8.33
Equity Dividend (%)	0.00	95.00	32.00
Book Value per share (Rs)	10.00	302.73	58.94
Market Price of Share		1470.95	250.05
Equity base (31/3/2007) (Rs/Crores)	2259.95	220.72	8245.5
Face Value (15/1/2008)	10	10	10

Source: icicidirect.com

Annexure IV						
Major Companies under Anil Ambani Group (ADAG)						
Name of the Company	**Share Price (31/3/2008) In Rs.**	**Annualized Profit (31/3/2008) Rs. Million**	**Market Capitalization (31/3/2008) Rs. Million**	**Book Value (31/3/2008) per share**	**P/E Ratio (31/3/2008)**	**Price / BV (31/3/2008)**
Reliance Capital	1375	10220.4	301919.56	245.27	29.45	5.01
Reliance Communication Limited	531.5	25864.5	1050641.28	120.35	40.56	4.22
Reliance Infrastructure Limited	1320	10846.3	294709.03	435.51	29.73	2.87
ADLABS	679.7	459.1	28291.49	147.01	52.51	4.17
RNRL	104	686	162904.8	10.59	237.35	9.41
Source: icicidirect.com						

Annexure V	
Issue Details	
Reliance Power Limited	
Issue opens	15th January 2008
Issue Closes	18th January 2008
Date of Listing	11th February 2008
Size of Issue	68400000 shares with a face value of Rs. 10.
Advisors to the IPO	Kotak Mahindra, ICICI Securities, JM Financial and Enam Financial
Price Band	Rs 405-450
Oversubscription	FII 82 times, High Net worth Individual 163 times Retail Investors 15 times.
Amount of Subscription Made	190 billion Dollar
Total Issue *Promoter's Contribution* *QIB* *Mutual Fund* *QIB including Mutual Fund* *Retail Investors*	1300000000 160000000 684000000 34200000 649800000 342000000
Source: Extracted from Issue Prospectus & other internet sources	

Annexure VI						
Income Expenditure Summary						
Income & Expenditure Summary (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Currency: Rs. Crore (Non-Annualised)	12 mths	12 mths	12 mths	12 mths	12 mths	12 mths
Total income	2.25	132.87	334.72	388.07	492.44	536.38
Sales	2.25			8.55	36.38	66.12
Industrial sales	2.25					
Income from non-financial services				8.55	36.38	66.12
Income from financial services		132.83	334.69	379.48	424.95	463.29
Interest income				3.18	91.48	178.53
Dividends		112.79	273.78	212.02	141.91	88.91
Income from treasury operations		20.04	60.91	164.28	191.56	195.85
Prior period and extra-ordinary income					20.91	5.93

Annexure VI						
Income Expenditure Summary						
Income & Expenditure Summary (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Change in stock						
Total expenses	2.09	38.2	85.82	114.84	217.89	225.52
Operating expenses	0.88	18.61	67.41	92.85	169.02	130.47
Raw materials, stores & spares						
Purchase of finished goods					4.33	6.89
Packaging and packing expenses						
Power, fuel & water charges						
Compensation to employees	0.26	3.2	20.76	38.93	60.6	43.18
Indirect taxes	0.6	9.7	0.25	0.06	25.11	0.05
Royalties, technical know-how fees, etc						
Rent & lease rent			16.67	14.54	15.14	4.26
Repairs & maintenance		0.02	0.37	0.69	1.63	1.3
Insurance premium paid		0.01	0.15	0.37	0.74	1.5
Outsourced manufacturing jobs						
Outsourced professional jobs		3.89	18.53	26.45	17.74	21.89
Non-executive directors' fees		0.04	0.15	0.12	0.14	0.12
Selling & distribution expenses			0.19	0.26	0.65	0.21
Travel expenses		0.17	2.82	3.22	2.72	5.84
Communications expenses			3.31	3.36	10.91	3.82
Printing & stationery expenses			2.8	2.94	4.28	2.02
Miscellaneous expenditure	0.01	1.58	0.92	1.48	2.91	0.92
Other operational exp of industrial ent	0.01					
Other operational exp of non-fin services ent			0.49	0.43	22.12	38.47
Share of loss in other enterprises						
Financial charges	0.82	7.47	4.58	5.76	47.67	64.24
Fee based financial services expenses	0.82	7.47	4.58	5.76	8.15	7.06
Fund based financial services expenses					39.52	57.18
Interest paid					33.42	44.51
Financial charges on instruments					6.1	12.67
Provisions	0.01					
Non-cash charges			0.2	0.51	1.14	30.71
Depreciation			0.2	0.51	1.14	2.93
Amortisation						
Write-offs						27.78
Prior period and extra-ordinary expenses		5.92	6.06	0.01	0.06	0.1
Provision for direct tax	0.38	6.2	7.57	15.71		
Profit after tax	0.16	94.67	248.9	273.23	274.55	310.86
PBDITA	1.37	108.34	261.25	295.21	323.36	405.81
PBT	0.54	100.87	256.47	288.94	274.55	310.86
Source: CMIE Prowess						

Annexure VII						
Asset Summary						
Assets Summary (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Currency: Rs. Crore (Non-Annualised)	12 mths	12 mths	12 mths	12 mths	12 mths	12 mths
Gross fixed assets	67.28	67.41	78.18	81.15	96.53	102.21
Cumulative depreciation	0.99	1.07	1.57	2.4	11.3	14.22
Arrears of depreciation						
Net fixed assets	66.29	66.34	76.61	78.75	85.23	87.99
Intangible assets				0.24	0.26	2.52
Land	65.91	65.91	65.91	65.91	65.91	65.91
Buildings	0.02	0.01	7.99	7.85	7.58	7.3
Plant & machinery, computers and electrical assets	0.32	0.29	1.49	2.16	3.05	3.51
Transport & commn equipment and infrastructure		0.09	1.01	2.32	6.55	6.82
Furniture, social amenities and other fixed assets	0.04	0.04	0.21	0.27	1.88	1.93
Net lease reserve adjustment						
Capital work-in-progress	35.97	37.45	29	28.1	9.41	12.22
Net pre-operative exp pending allocation	14.85	23.69	26.85	27.2	30.4	
Investments	81	13,015.35	9,149.60	10,340.68	12,257.93	13,532.59
Investment in equity shares	0.06	110.26	417.24	1,667.87	2,285.34	3,540.54
Investment in preference shares				593.51	3,875.80	5,898.40
Investment in mutual funds	41.23	8,379.49	5,865.47	4,951.66	2,417.18	180.18
Investment in debt instruments						
Investment in approved securities						
Investment in assisted companies						
Investment in others	39.72	4,525.60	2,866.89	3,127.64	3,679.61	3,913.47
Less: provn for dimin in value of investments	0.01					
Memorandum						
Investments in group companies	41.29	8,489.75	6,282.71	6,418.55	6,161.14	9,438.94
Investments in non-group companies				794.49	2,417.18	180.18
Market value of quoted investments	43.56	8,412.03	6,046.44	3,658.77	1,865.05	199.95
Deferred tax assets						
Current assets	3.02	361.21	14.43	101.41	1,362.99	588.06
Cash & bank balance	0.77	361.16	14.43	98.22	1,234.91	366.22
Inventories						
Receivables	2.25	0.05		3.19	128.08	221.84
Assets held for sale and transfer						
Loans & advances	3.7	470.29	4,555.67	3,556.28	3,855.44	2,093.96
Miscellaneous expenses not written off						
Total assets	204.83	13,974.33	13,852.16	14,132.42	17,601.40	16,314.82
Source: CMIE Prowess						

Annexure VIII						
Liability Summary						
Liabilities Summary (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Currency: Rs. Crore (Non-Annualised)	12 mths	12 mths	12 mths	12 mths	12 mths	12 mths
Shareholder's funds	200.06	13,542.67	13,792.82	14,066.04	15,896.56	16,101.33
Net worth	200.06	13,542.67	13,792.82	14,066.04	15,896.56	16,101.33
Total capital	200.04	2,259.95	2,396.80	2,396.80	2,805.13	2,805.13
Paid up equity capital	200.04	2,259.95	2,396.80	2,396.80	2,805.13	2,805.13
Forfeited equity capital						
Paid up preference capital						
Capital contribution & funds by govt., others						
Convertible warrants						
Share application money & suspense account						
Reserves and funds	0.02	11,282.72	11,396.02	11,669.24	13,091.43	13,296.20
Free reserves	0.02	99.29	348.2	621.43	2,023.62	2,228.39
Specific reserves		11,183.43	11,047.82	11,047.81	11,067.81	11,067.81
Revaluation reserves						
Accumulated losses						
Borrowings					1,554.05	
Borrowing from banks						
Borrowing from financial institutions						
Borrowings from central & state govt						
Borrowings syndicated across banks & institutions						
Debentures and bonds						
Foreign currency borrowings					1,339.05	
Loans from promoters, directors and shareholders						
Inter-corporate loans					215	
Deferred credit						
Interest accrued and due						
Hire purchase loans						
Fixed deposits						
Commercial papers						
Other borrowings						
Deferred tax liability						
Current liabilities & provisions	4.77	431.66	59.34	66.38	150.79	213.49
Sundry creditors	3.02	58.24	28.54	27.94	32.09	27.57
Acceptances						
Deposits & advances from customers,etc						
Interest accrued but not due					35.65	
Share application money - refundable		359.3	10.51	3.95	8.07	7.19
Other current liabilities	0.51	6.32	4	1.72	39.71	170.29
Provisions	1.24	7.8	16.29	32.77	35.27	8.44
Total liabilities	204.83	13,974.33	13,852.16	14,132.42	17,601.40	16,314.82
Memorandum						
Tangible net worth	200.06	13,542.67	13,792.82	14,065.80	15,896.30	16,098.81
Total outside liabilities	3.53	423.86	43.05	33.61	1,669.57	205.05
Total term liabilities					1,554.05	
Contingent liabilities	9.03	608.57	608.13	1,200.00	2,649.65	2,440.13
Authorised equity capital	1,000.00	11,000.00	11,000.00	11,000.00	11,000.00	11,000.00
Issued equity capital	200.04	2,260.00	2,396.80	2,396.80	2,805.13	2,805.13
Source: CMIE Prowess						

Annexure IX						
Cash Flow Summary						
Cash Flow (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Currency: Rs. Crore (Non-Annualised)	12 mths	12 mths	12 mths	12 mths	12 mths	12 mths
Net cash flow from operating activities	-38.8	337.41	-524.57	-110.96	-252.43	-94.63
Net profit before tax & extra-ordinary income	0.54	101.44	256.47	288.94	253.64	310.94
Add: Adjustments for non-cash and non-operating expenses	0.19	0.2	1.11	2.99	45.33	91.07
Depreciation			0.2	0.51	1.14	2.93
Amortisation and w offs						27.78
Unrealised foreign exchange loss					1.06	
Provision for contingencies						
Other provisions like RDD etc	0.19	0.2	0.91	0.78	0.72	
Interest Paid				1.69	42.35	60.34
Loss on sale of investments						
Loss on sale of assets				0.01	0.06	0.02
Other non-cash and non-operating expenses						
Less: Adjustments for non-cash and non-oper income	0	132.84	334.69	379.49	424.95	464.69
Unrealised foreign exchange gain						20.39
Provision or liabilities written back						1.4
Interest income		0.01	0.01	3.19	91.48	178.53
Dividend income		112.79	273.78	212.02	141.91	88.91
Profit on sale of investments		20.04	60.9	164.28	191.56	175.46
Profit or loss on sale of assets						
Other non-cash and non-operating income						
Operating cash flow before working capital changes	0.73	-31.2	-77.11	-87.56	-125.98	-62.68
Add:Cash inflow due to	3.1	374.96	0	0	19.51	0
Decrease in trade & other receivables		1.31				
Decrease in inventories						
Increase in trade & other payables	3.1	373.65			19.51	
Increase in deposits						
Decrease in advances						
Increase in other current liabilities						
Less: Cash outflow due to	41.97	0	439.42	4.91	133.41	52.47
Increase in trade & other receivables	41.97		99.09	2.03	133.41	18.24
Increase in inventories						
Decrease in trade & other payables			340.33	2.88		34.23
Decrease in deposits (banks or fis)						
Increase in advances (banks or fis)						
Decrease in other current liabilities						
Cash flow generated from operations	-38.14	343.76	-516.53	-92.47	-239.88	-115.15
Cash outflow due to direct taxes paid	0.66	6.35	8.04	18.49	12.55	2.25
Cash inflow due to direct taxes refund						
Cash outflow due to dividend tax paid						
Cash flow before extraordinary items	-38.8	337.41	-524.57	-110.96	-252.43	-117.4
Cash outflow due to extraordinary items						
Cash inflow due to extraordinary items						22.77
Cash outflow due to misc expend						
Net cash inflow from investing activities	-58.69	-12,267.06	217.09	203.01	1,061.87	1,101.63
Less: Cash outflow due to investing activities	114.38	29,916.44	8,154.17	5,091.92	4,633.32	3,735.42
Purchase of fixed assets	19.33	9.13	5.16	2.2	7.33	8.53
Increase in capital work in progress						
Acquisition or merger of companies or units						
Purchase of investments	95.05	29,447.96	5,829.54	5,089.72	4,466.89	3,186.89

Annexure IX						
Cash Flow Summary						
Cash Flow (In Rs. Crore)						
Reliance Power Ltd.	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
Currency: Rs. Crore (Non-Annualised)	12 mths	12 mths	12 mths	12 mths	12 mths	12 mths
Loans to subsi or group companies		459.35	2,319.47			
Loans to other companies						540
Profit or (loss) on redemption of shares						
Other income					159.1	
Disbursements						
Add: Cash inflow due to investing activities	55.69	17,649.38	8,371.26	5,294.93	5,695.19	4,837.05
Sale of fixed assets				0.06	0.24	0.06
Decrease in capital work in progress	0.24					
Merger or hiving off of companies or units		0.03			209.14	0.06
Sale of Investments	55.45	17,536.55	8,097.47	4,062.92	4,484.06	2,523.08
Redemption of shares						
Loans from subs or group companies				1,019.92	817.29	2,022.41
Loans from other companies						
Interest received		0.01	0.01	0.01	45.35	120.43
Dividend received		112.79	273.78	212.02	139.11	82.12
Other income						88.89
disbursements						
Net cash inflow or (outflow) from financing activities	97.63	12,290.04	-39.26	-8.26	165.67	-1,785.92
Less: Cash outflow due to financing activities	0	72.14	40.24	8.26	49.33	2,009.88
Issue expenses		72.14	40.24			
nterest paid				1.69	49.33	95.99
Dividend paid						
Repayment of borrowings						1,913.89
Repayment of long term liabilities						
Repayment of short term liabilities						
Cash (outflow) due to redemption or buyback of capital				6.57		
Cash inflow or (outflow) due to other cash receipts or payables from financing activities						
Add: Cash inflow from financing activities	97.63	12,362.18	0.98	0	215	223.96
Proceeds from share issue	97.63	12,362.18	0.98			
Cash Subsidy						
Proceeds from borrowings					215	223.96
Proceeds from long term borrowings						
Proceeds from short term borrowings						
Other cash receipts or payables from financing activities						
Net increase or (decrease) in cash & cash equivalents	0.14	360.39	-346.74	83.79	975.11	-778.92
Cash & bank - opening balance	0.58	0.72	361.16	14.42	2.57	977.68
Cash & bank - closing balance	0.72	361.11	14.42	98.21	977.68	198.76
Net increase or (decrease) in cash & cash equivalents(cl-op)	0.14	360.39	-346.74	83.79	975.11	-778.92
Source: CMIE Prowess						

Annexure X						
Capital Expenditure Projects						
Capital Expenditure Projects (In Rs. Crore)						
Project name	Location	Cost	Product	Capacity	Unit	Status
Samalkot Power Expansion Project	Samalkot East Godavari Andhra Pradesh	10,000.00	Steam Turbine	960	Mw	Under Implementation
Kakinada FSRU LNG Import Terminal Project	Kakinada East Godavari Andhra Pradesh	5,400.00	Kakinada FSRU LNG Import Terminal	5	MTPA	Announced
Jaisalmer Solar Power Expansion Project	Dhoorsar Jaisalmer Rajasthan	3,000.00	Solar Power	160	Mw	Announced
Source: CMIE Prowess						

Discussion about the case study

1. The book building process of Initial Public Offer (IPO)

The very first sale of stock to the general public is called an IPO. The issuer may be a new company or an old company. The issuer and the investment banker jointly decide the price band of the new issue and once the price band is determined the investment banker managed the IPO through book building process.

Till early 1990's the new issue in India was governed by the Controller of Capital Issue (CCI) where the company decides one price to issue the share after taking the due approval from CCI. This was known as Fixed Price regime. After the abolition CCI, the book building process was introduced, which is a mechanism in between fixed price and free price.

The Book Building Process:

(i) The company first appoints a book runner or an investment banker.

(ii) The investment banker prepares and submits a draft document to SEBI for approval.

(iii) The issuer and the investment banker jointly decide the share price with a price band.

(iv) The investment banker takes up all the promotional activities to sell the shares.

(v) Offers regarding the demand for security at different price level are invited from different market participants (Financial Institutions, Brokers, Mutual funds, Foreign Institutional investors, Individual investors, etc).

(vi) Based on the bid received, the issuer and the investment banker jointly decide a Cut-Off Price.

(vii) In 100% book building – proportional allotment-50% Qualified Institutional Bidders, 15% High Net-worth Individual and 35% Retail investors.

(viii) If any portion is over subscribed, allotment is done on proportional basis.

2. Pros & Cons of book building process.

Book building process is considered to be the superior process as compared to the fixed price process. Under fixed price process the investors has no say over the price of an IPO. The price is determined by the company. The company does not consider feedback from the investors while determine the IPO price.

The book building process considers the investors decision and feed-back partially (if not full). The complete investors feed-back regarding price are possible only in case of free price mechanism, which has a practical problem of extremely divergent view of price by the investor's community. Therefore, the company decide an initial price band (floor and ceiling price is decided by the company) and the investors decide a particular price within the price band based on his perception and valuation about the stock. He is allowed to change the price during the issue opens. As investors feed-back is taken in this process, the price discover in this process is high and the possibility of large price fluctuation after listing is not so high.

3. The role of an IPO manager in Indian context.

IPO's in India are managed by IPO Manager's. IPO Manager's are financial organizations registered with stock exchanges and SEBI. They are categorized broadly as Lead Manager's, IPO Registrar and Syndicate Members (or The Members of the Syndicate).

Lead Managers

Lead managers are independent financial institutions appointed by the company going public to manage the IPO. They are the main body responsible for most of the IPO processing. Lead managers examine company documents including financial documents, documents relating to litigation like commercial disputes, patent disputes, disputes with collaborators, etc. and other materials, in connection with the finalization of the draft red herring prospectus for the IPO. Lead managers are responsible to write the Red Herring Prospectus (RHP) and get it approved by SEBI.

SEBI contact lead managers for any irregularities or lapses in RHP and ask them to clarify, add or review certain sections of the document. Lead managers certifies to SEBI that all the disclosers made in Draft Red Herring Prospectus are true, correct, adequate and comply with SEBI guidelines to help investors in making a well-informed decision. In brief Lead Manager's responsibilities include, initiate the IPO processing, write draft herring prospectus and get it approve by SEBI, help company in selling the IPO Shares and road shows, help company in finalize the issue price, issue opening & closing dates, listing date etc. Lead Manager's are also known as Book Running Lead Manager and Co-Book Running Lead Managers. Issuer Company can appoint more than one lead manager to manage big IPO's.

IPO Registrar

IPO Registrars are independent financial institutions registered with stock exchanges and appointed by the company going public for mainly to keep record of the issue and ownership of company shares. Responsibility of a registrar at the time of IPO involves, processing of IPO applications, allocate shares to applicants based on SEBI guidelines, process refunds and transfer allocated shares to investors de-mat accounts. Investors can contact the Registrar to the Issue in case of any pre-Issue or post-Issue related problems such as non-receipt of letters of allotment, credit of allotted shares in the respective beneficiary accounts, refund orders etc. The full name of the sole or First Bidder, Bid cum Application Form number, Bidders Depository Account Details, number of Equity Shares applied for, date of bid form, name and address of the member of the Syndicate where the Bid was submitted and cheque or draft number and issuing bank thereof.

Syndicate Member

Issuer Company with the help of lead manager appoints underwriters or syndicate members for the IPO. Lead managers are responsible for examining the worth of underwriters and there capabilities to buy the shares and assure the same to SEBI. Syndicate members are commercial or investment banks responsible for underwriting IPO's. Syndicate members are usually registered with SEBI or registered as brokers with BSE / NSE Stock Exchanges.

4. Learning points in the RPL debacle

The learning point in case of RPL IPO case could be discussed from various angles:

(i) In January 2008, the R-Power launched an IPO, which was the highest ever IPO in the history of Indian capital market, tried to mobilize Rs.8,000 crore. The maiden public issue of Reliance Power Limited, India, was oversubscribed 73 times and garnered an astronomical $190 billion. It created many world records. It was the largest subscription of any IPO (initial public offering) anywhere in the history of global capital markets with a record five million applicants. It became 10 top listed companies in India with the largest number of shareholders in any listed company in the world. Despite the size of the IPO, the price falls like ninepin after few minutes on the listing day. This could be shown as a very good example that large IPO can also be fallen in the absence of depth in the market like Indian stock market, where few large Foreign Institutional Investors can dictate the price in the market.

At this juncture the instructor can also explain the depth and breadth of the market and how the breadth and depth plays an important role in the process of price discovery.

(ii) Through the case the instructor can also explain the alternative available to the company to deal with this kind of debacle. For example the company issued free bonus shares to all categories of shareholders, excluding the promoter, in the ratio of 3 shares for every 5 shares held.

(iii) Through this case the instructor may touch the issues related to the timing of the initial offer. Usually, during the boom phase of market, almost all the IPO moves up very smoothly (even register some first day pop), but during the crisis period the IPO of good companies may suffer.

(iv) The instructor may touch the valuation aspect through this case. R-Power's downfall may be linked to aggressive pricing of the IPO. Analysts suggested that it was overvalued when compared with peer companies in India. For instance, the IPO price was 450 against the price of NTPC, (the government power company) at Rs.250/-. RPL was planning a 28000 MW power plant in 2017 and did not have a single operational power plant whereas NTPC had 27350 MW of operational power plant in the year 2007. (Annexure I). Comparison of the financials of Tata Power and NTPC also did not show a very promising picture of RPL. (Annexure II). Here at this point, the instructor may bring the concept of relative valuation methods and explain the multiples like PE, Price to book, price to sales to Economic value to EBITDA etc.

5. Critically evaluation of the roles and responsibilities of the market regulator.

In the light of the above case, the roles and responsibilities of the market regulator has gone up many folds. During fixed price regime the CCI (an arm of regulator) and the issuing company jointly decided the issue price, but in the book building process the market regulator has a very little role on determination of issue price. Taking the advantage of this some unscrupulous managers may decides an unjustified issue price band. When small investors understood it, is too late for them to react and the stock price collapse after the listing.

Indian stock market is suffering from lack of breadth and depth. Under this scenario, the large foreign investors (FIIs) with their relatively large investable corpus control the price movements. It is a challenging task for the market regulator to have control over these FIIs and if they play any unfair game at the cost of marginal investors, frame laws to penalize them.

The market regulator should increase the corpus the Investor's Protection Fund (IPF) and in case of any fraudulent activity happen and marginal investors lose their money, the IPF can be used to protect them.

6. Valuation and justification of the IPO.

Reliance will achieve a capacity of 28200 MW capacity in the year 2016, which is presently held by NTPC. If we presume that there will be no fresh issue of shares by RPL the present operating profit and the resultant market price of NTPC will be same as RPL will be achieving in 2016. So price of Reliance after considering the price multiple against face value and the present market price of NTPC will be 8245.5/2259.95*250 = 912.13. If it is further discounted for eight years the present price of RPL should be 912.13*0.404 (discounting factor for eight years at the rate of 12%) =368.50. The price should further be discounted for the risk factor involved in the implementation of the project. But looking into the growth rate of reliance in last 50 years and their capability of executing projects in time we may ignore the risk factor. Here we may subjectively consider two factors. 1) We have ignored the interest amount on the extra equity invested in NTPC (8245.5-2259.95= 5985.55) and assumed that RPL will generate the fund from internal accrual. 2) NTPC has the advantage of being a government company and it will never face the problem of raw material due to the patronage of government. (Majority of the mines in India are owned by Government and there is a strict regulatory measure on leasing of mines). 2) Government companies in the country have the obligation of adapting to standardized Corporate Governance policies which may add to the cost of NTPC thereby reducing the profitability. 3) As reliance is using various kinds of raw materials for its projects it may be easier for it to manage operating cost.

The pricing of Government vs Private Companies will be more clear if we consider RPL vis-à-vis Tata Power. Tata Power has a capacity of 2623 MW now which RPL will achieve in the year 2010. Price of Reliance considering the price multiple of Tata Power will be 220.72/2259.95*1470.95 = 143.65 If it is further discounted for two years present value the price will be 28.73*.797=114.48. It seems the benefit of being a government company favours NTPC. But we are considering the same equity base over a period of time which may not be true.. Tax exemption for new power plants may favour Reliance power for a better price. We find profitability is justified with the capacity of the company. If we compare NTPC with Tata Power , the former is 10 times bigger in capacity and so also the profit. So we can assume that Reliance's Profitability will also follow the same trend.

Valuing the company on the base of its book value is not appropriate here as the company has hardly started its operation. In present economic scenario when the investor is focused on the capital gain , dividend hardly plays any role in valuation of a share. So dividend discounting method may not be the appropriate mode of valuing the share.

Perception in the market about the management of the company is also quite important in determining the price. We may proceed in the following way :

1) Find out the quarterly profit of all the group companies of ADAG on 31st March 2007.
2) Annualize the profit by multiplying with four.
3) Next step is to find out the overall market capitalization of those companies.
4) Ratio of Market capitalization to annualized profit should be found out.
5) As we find profitability of power sector remains uniform, we can presume that the profitability of NTPC now will be same as the profitability of RPL in 2016.
6) Discount the current year profit of NTPC with a discounting factor for eight years.
7) Multiply the market capitalization to annualized profit ratio (step 4) with the discounted profit found out in step 6.
8) Divide the total number of shares with market capitalization found out ins step 7. This becomes the expected issue price of the IPO.

Here we have ignored the profitability across industry. But finally what matters is the profitability in the organization. Of course the expected growth over a period across industries can be another deciding factor. To arrive at a concrete figure let us assume that growth is typical to the mindset of the management than the scope provided by the industry. So across industries ADAG will have the same growth and hence the market perception of other companies of the ADAG group can be a base for determining the price of RPL.

Four years have passed since RPL had its IPO in January 2008. The researcher can analyze the time overrun of the project, raw material supply scenario, power tariff change and compare against the projected ones. The market price should take into consideration the bonus given by RPL to the shareholders after the debacle. MA

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