

OCTOBER 31, 2011

RESULT

 Coverage view: **Cautious**

 Price (Rs): **25**

 Target price (Rs): **29**

 BSE-30: **17,805**

Stable operating performance. NHPC's reported profit of Rs10 bn was substantially ahead of our estimate of Rs6.7 bn, primarily on account of accrual of water cess charge of Rs4.6 bn allowed as a pass-through expense by CERC. Operational performance remained stable with generation of 7 BU, though delay in commissioning of capacities remains an area of concern. We continue to maintain our positive stance on NHPC due to reasonable valuations, absence of fuel risk and low cost of generation that insulate it from a constrained purchase budget of SEBs. Maintain ADD and PT of Rs29/share.

Company data and valuation summary

NHPC

Stock data

52-week range (Rs) (high,low) 32-22

Market Cap. (Rs bn) 305.7

Shareholding pattern (%)

Promoters 86.4

FIs 1.7

MFs 0.9

Price performance (%)

	1M	3M	12M
Absolute	6.0	0.6	(20.5)
Rel. to BSE-30	(1.7)	4.2	(10.7)

Forecasts/Valuations

	2011	2012E	2013E
EPS (Rs)	1.3	2.1	2.2
EPS growth (%)	(27.2)	52.4	5.4
P/E (X)	18.4	12.1	11.5
Sales (Rs bn)	51.4	62.9	65.6
Net profits (Rs bn)	16.6	25.3	26.7
EBITDA (Rs bn)	36.3	43.4	48.2
EV/EBITDA (X)	12.8	9.7	8.5
ROE (%)	6.4	9.2	9.1
Div. Yield (%)	2.4	2.3	2.4

Prior-period adjustments and other income drive outperformance

NHPC reported revenues of Rs18.3 bn (48% yoy), operating profit of Rs13 bn (28% yoy) and adjusted net income of Rs10 bn (45% yoy) against our estimates of Rs12.7 bn, Rs9.5 bn and Rs6.7 bn, respectively. Accrual of previously paid water cess yielded Rs4.6 bn of additional earnings. Net income was further boosted by Rs1.2 bn of interest from beneficiary states on account of finalization of tariff orders. Reported net income of Rs9.7 bn was dented by prior-period adjustment of Rs352 mn. Operational performance remained robust with gross generation of 7.1 BU against our estimate of 7 BU. We discuss the key details of the results in a subsequent section.

Hydro-based generation company; safer bet in times of fuel uncertainty

NHPC remains our preferred pick in the power sector, given (1) continued uncertainty over fuel availability, (2) constrained purchase budgets of distribution utilities now resorting to increased load-shedding, and (3) reasonable valuations for NHPC (1X P/B) with growth opportunities from capacities likely to commission over the next 12 months. Being a hydro-based generator, NHPC is one of the lowest cost producers of power in India and would invariably rank high in the merit order of dispatch.

Reiterate ADD with a revised target price of Rs29/share

We maintain our ADD rating on NHPC with a revised target price of Rs29 (previously Rs30) as we adjust for marginal commissioning delays. Attractive valuations of 1X FY2013E book and 11X on FY2013E EPS along with inherent security in the business model (as highlighted above) make NHPC one of our preferred picks in the sector. Our valuation includes (1) Rs18/share for operational as well as under-construction power projects and (2) Rs11/share for cash and cash equivalents. We have revised our EPS estimate to Rs2.1/share (previously Rs1.8/share) in FY2012E to account for extra revenue booking in 1HFY12.

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Exhibit 1: Prior-period adjustments and other income drive outperformance
Interim results for NHPC, March fiscal year-ends (Rs bn)

	2QFY12	2QFY12E	2QFY11	1QFY12	(% Chg.)			FY2011	FY2012E	(% Chg.)
					2QFY12E	2QFY11	1QFY12			
Net sales	18,307	12,682	12,404	14,314	44	48	28	42,253	52,096	23
Operating cost	(5,302)	(3,136)	(2,220)	(5,223)				(13,798)	(18,446)	
EBITDA	13,005	9,546	10,184	9,091	36	28	43	28,455	33,650	18
EBITDA margin (%)	71	75	82	64				67	65	
Other income	3,321	2,088	2,120	3,670				7,069	11,204	
Interest & finance charges	(883)	(915)	(1,091)	(865)				(4,136)	(4,915)	
Depreciation	(2,234)	(2,288)	(2,677)	(2,258)				(9,167)	(9,391)	
PBT	13,208	8,432	8,537	9,638	57	55	37	22,221	30,548	37
Provision for tax (net)	(3,191)	(1,686)	(1,635)	(1,808)				(7,118)	(7,532)	
Net profit	10,017	6,745	6,902	7,831	48	45	28	15,103	23,016	52
Extraordinary	(352)	0	0	80				6,564	0	
Reported PAT	9,665	6,745	6,902	7,911						
EBITDA margin (%)	71	75	82	64				67	65	
Tax rate (%)	24	20	19	19				32	25	
Key operating parameters										
Units generated (bn units)	7,102	6,968	7,138	6,284	2	(1)	13	18,604	18,952	
Tariff (Rs/kwh)	1.92	1.82	1.74	1.84				2.27	2.75	
O&M (Rs/kwh)	0.46	0.45	0.31	0.51				0.74	0.97	

Source: Company, Kotak Institutional Equities estimates

Exhibit 2: Our SOTP-based valuation yields a target price of Rs29/share
SOTP, NHPC (Rs mn, Rs/share)

	Value (Rs mn)	Value per share (Rs/share)
SOTP of power projects (Rs mn)	221,536	18
Cash (Rs mn)	111,128	9
Investments (Rs mn)	11,120	1
Loans and advances (Rs mn)	17,137	1
Total value (Rs mn)	360,921	29

Source: Kotak Institutional Equities estimates

Key highlights of 2QFY12 results

- ▶ **Revenues.** Reported revenues of Rs18.3 bn includes Rs4.6 bn recognised on account of favourable order by CERC allowing NHPC to bill its beneficiaries for the water cess paid to the J&K Government. We seek clarity from the management regarding the tax rate at which the tariffs were grossed up.
- ▶ **Operations.** NHPC's gross generation in 2QFY12 was 7,102 MU (-1% yoy) implying an average realization of Rs1.92/kwh (adjusted for additional water cess) and average O&M of 46p/kwh (adjusted for water cess provisioning of Rs2.1 bn).
- ▶ **Other income.** Other income included interest income of Rs1.2 bn against deferred revenues.
- ▶ **Tax rate.** Effective tax rate for 2QFY12 was 24%.

Exhibit 3: NHPC is trading at 1X P/B on FY2013E net worth
Valuation of NHPC at CMP

	2010	2011	2012	2013	2014	2015	2016
Valuations (at CMP)	533096-IN						24.8
No. of shares	12,301	12,301	12,301	12,301	12,301	12,301	12,301
Book value (Rs)	20	21	22	24	26	28	30
Networth	241,564	256,355	275,123	295,050	315,271	339,339	365,497
Market cap	305,058	305,058	305,058	305,058	305,058	305,058	305,058
P/B (X)	1.3	1.2	1.1	1.0	1.0	0.9	0.8
EPS	1.9	1.3	2.1	2.2	2.3	2.5	3.0
P/E (X)	13	18	12	11	11	10	8
RoE (%)	10	7	10	10	9	10	11
RoCE (%)	7	5	7	7	7	8	9
Net debt	101,620	125,063	79,559	67,796	43,074	13,149	(47,433)
EV	406,678	430,121	384,618	372,854	348,133	318,208	257,625
EV/EBITDA (X)	9.8	11.8	8.9	7.7	6.9	4.7	3.5

Source: Company, Kotak Institutional Equities estimates

Stalemate on capacity addition could be a dampener

The management is fairly confident of adding 515 MW in the next six months, including 44 MW at Chutak, 240 MW at Uri II and 231 MW at Chamera III. Further, the management has indicated that 45 MW at Nimmo Bazgo, one unit of Parbati III of 130 MW and one unit of Teesta Low Dam III of 33 MW could be commissioned by end-FY2012E on a best-effort basis, thus aggregating to potential capacity addition of 723 MW in FY2012E.

We, however, remain skeptical and accordingly factor a more conservative capacity addition of 515 MW in FY2012E. We do note that NHPC has added just 120 MW (Sewa II) in the past four years though also highlight that the inherent nature of hydro projects makes them vulnerable to delays and cost over-runs. In our view, incremental commissioning of capacities over the next few months could be a strong catalyst for the stock as it would restore investor faith in NHPC's delivery credentials, which have admittedly taken a hit due to this long draught in capacity additions.

We note that NHPC has incurred a capex of Rs9.4 bn in 1HFY12, just 30% of our full-year capex estimate of Rs31 bn, though highlight that the first half is in general a weak construction period and was further exacerbated by the earthquake in Sikkim.

Exhibit 4: Commissioning of projects in the medium term could be a key catalyst
Details of NHPC's projects under construction

	Total capacity (MW)	Design energy (mn units)	COD			Project execution cost (Rs bn)		Remarks
			Initial	Revised	Assumed	Latest	Original	
Teesta Low Dam III	132	594	FY2007	FY2013	Sep-12	14.1	7.7	Work held up at site from May-July 2010 due to local issues. Frequent interruption of work
Teesta Low Dam IV	160	720	FY2010	FY2014	Sep-13	14.6	10.6	Work held up at site from May-July 2010 due to local issues. Frequent interruption of work
Uri II	240	1,124	FY2010	FY2012	Dec-11	17.0	17.2	Work affected by earthquake and landslides
Parbati II	800	3,109	FY2010	FY2015	Sep-14	40.8	39.2	E&M work on power house has now been resumed
Chamera III	231	1,108	FY2011	FY2012	Sep-11	19.4	14.1	T&G erection for Unit 3 in progress
Nimmo-Bazgo	45	239	FY2011	FY2013	Jun-12	9.1	6.1	Delay in supply of E&M and HM parts by BHEL due to civil disturbance in Kashmir.
Parbati III	520	1,963	FY2011	FY2013	Sep-12	21.0	23.0	Delay in award of E&M contract
Chutak	44	213	FY2011	FY2012	Oct-11	9.8	6.2	Delay in supply of E&M and HM parts by BHEL due to civil disturbance in Kashmir.
Subansiri (Lower)	2,000	7,422	FY2011	FY2015	Jun-14	81.6	62.9	Plagued by law and order problems
Kishanganga	330	1,350	FY2017	FY2017	Jun-16	36.4	36.4	Progress affected due to civil disturbance in Kashmir
Total	4,502	17,842				263.9	223.4	

Note:

COD estimates are comparison of CEA estimates as of Sep 2011 and KIE estimates

Source: Company, Kotak Institutional Equities

Exhibit 5: NHPC incurred a capex of Rs9.4 bn in 1HFY12
NHPC, balance sheet as of September 2011 (Rs mn)

	Sep-10	Mar-11	Sep-11
Utilization of funds			
Gross block+CWIP	371,702	399,974	409,352
Accumultaed depreciation	(54,356)	(57,740)	(62,232)
Net block	317,346	342,233	347,120
Investments	58,464	53,995	29,225
Current assets	69,343	0	127,050
Cash & bank balances	35,559	28,641	43,918
Accounts receivable	10,473	19,086	30,809
Inventories	471	337	365
Loans & advances	14,377	13,654	31,824
Others	8,463	6,891	20,136
Current liabilities	40,444	57,628	85,689
Net current assets	28,900	10,982	41,362
Total	404,710	407,210	417,707
Source of funds			
Total debt	143,993	145,693	152,396
Paid-up common stock	123,007	123,007	123,007
Reserves and surplus	122,001	122,832	140,439
Shareholders' funds	245,008	245,839	263,447
Def. tax liability	2,067	1,613	1,864
Income on AAD	13,641	14,066	0
Total	404,710	407,210	417,707

Source: Company, Kotak Institutional Equities

Exhibit 6: Profit model, balance sheet, cash model of NHPC, March fiscal year-ends, 2008-15E (Rs mn)

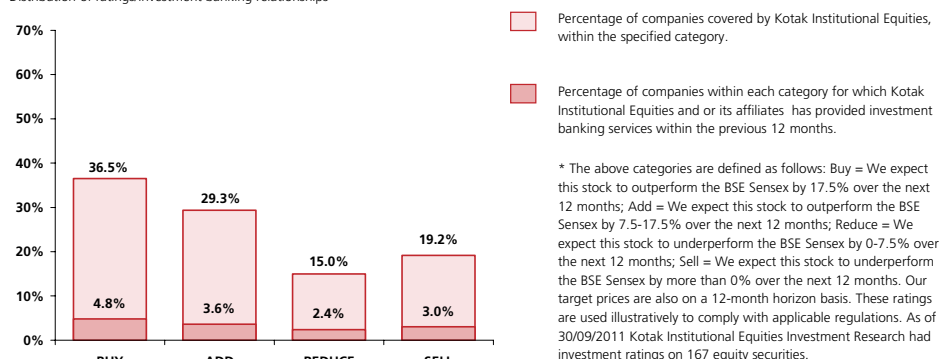
	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Profit model								
Net revenues	29,726	34,767	52,273	51,437	62,945	65,616	68,863	90,397
EBITDA	22,150	23,110	41,290	36,311	43,357	48,240	50,186	67,213
Other income	4,572	5,953	6,473	8,071	12,016	14,840	15,978	16,993
Interest expense	(6,377)	(7,760)	(7,394)	(6,709)	(6,650)	(10,019)	(10,113)	(18,622)
Depreciation	(5,455)	(6,441)	(12,827)	(11,666)	(11,892)	(13,889)	(15,324)	(18,892)
Pretax profits	14,890	14,863	27,542	26,008	36,831	39,172	40,727	46,692
Tax	(1,896)	(1,552)	(3,475)	(6,463)	(7,418)	(7,894)	(8,720)	(10,076)
Deferred taxation	—	—	(1,292)	(1,482)	(1,547)	(1,715)	(991)	(3,540)
Minority interest	(1,533)	(1,462)	(1,020)	(1,466)	(2,567)	(2,892)	(2,673)	(2,786)
Net income	11,462	11,849	21,756	16,597	25,299	26,671	28,344	30,289
Extraordinary items	—	—	—	6,565	—	—	—	—
Reported profit	11,462	11,849	21,756	23,162	25,299	26,671	28,344	30,289
Earnings per share (Rs)	1.0	1.1	1.9	1.3	2.1	2.2	2.3	2.5
Balance sheet								
Paid-up common stock	111,825	111,825	123,007	123,007	123,007	123,007	123,007	123,007
Total shareholders' equity	189,310	197,678	251,072	265,303	282,523	300,736	319,966	340,494
Advance against depreciation (AAD)	13,033	14,245	15,398	15,076	15,559	16,042	16,526	17,009
Minority interest	13,968	14,944	15,895	17,357	19,924	22,816	25,489	28,275
Total borrowings	128,555	149,310	163,515	167,716	202,090	203,632	200,372	183,804
Deferred tax liabilities	—	—	2,521	2,774	4,321	6,036	7,027	10,567
Total liabilities and equity	344,865	376,177	448,402	468,225	524,417	549,262	569,379	580,149
Net fixed assets	236,171	238,323	223,016	227,307	249,814	277,190	274,971	378,128
Capital work-in progress	74,098	105,050	140,620	171,696	168,112	153,132	156,623	43,170
Investments	20,468	17,912	33,455	43,194	11,120	9,000	6,880	4,759
Miscellaneous expenses not w/o	3	23	—	—	—	—	—	—
Cash	23,459	26,061	61,895	42,653	122,531	135,836	157,298	170,655
Net current assets (incl. cash)	14,124	14,868	51,311	26,029	95,370	109,940	130,905	154,091
Total assets	344,865	376,177	448,402	468,225	524,417	549,262	569,379	580,149
Free cash flow								
Operating cash flow, excl. working capital	20,594	20,964	39,277	36,223	41,788	45,650	47,815	55,991
Working capital changes	5,017	1,858	(608)	6,040	10,536	(1,265)	497	(9,829)
Capital expenditure	(35,265)	(39,545)	(33,090)	(47,032)	(30,816)	(26,284)	(16,596)	(8,596)
Free cash flow	(9,654)	(16,723)	5,579	(4,769)	21,508	18,101	31,715	37,565
Ratios								
Net debt/equity (%)	0	34	33	26	25	23	22	20
Return on equity (%)	6.7	6.5	10.3	6.7	9.6	9.5	9.5	9.5
Book value per share (Rs)	16	17	20	21	22	24	26	28
ROCE (%)	5.7	5.7	7.4	5.0	6.6	6.9	6.9	8.0

Source: Company, Kotak Institutional Equities estimates

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