



# Power & Banking Sector

## Bhavin Vithlani

Executive Director – Power & Cap Goods  
Email: bhavin@enam.com  
Tel: 9122 6754 7634

## Praveen Agarwal

Executive Director – BFSI  
Email: praveen.agarwal@enam.com  
Tel: 9122 6754 7609

### Our recos:

	CMP (Rs)	TP (Rs)	% Upside	Rating
PFC	161	200	24	BUY
REC	187	201	8	HOLD

Source: ENAM Research

### Our recos:

Cos	TP (Rs)	% upside	Rating
NTPC	171	(0)	HOLD
Tata Power	1,202	22	BUY
JSPL	662	22	BUY
Adani Power	98	13	BUY
JSW Energy	61	(3)	HOLD
JPVL	49	47	BUY
PGCIL	120	21	BUY

Source: ENAM Research

Prices as on 16<sup>th</sup> Sep-2011

## LATERAL MEETS INDICATE SEB REFORMS UNDERWAY

We recently met with the senior management's of PFC, REC, NTPC, JSPL and the Ministry of Finance (MoF). The objective was to understand the SEB and coal situations and the possible reforms.

**Key takeaways: SEB reforms have been initiated through tariff hikes - Rajasthan which constitutes 1/4<sup>th</sup> of total SEB losses has recently raised tariff by 20%+. TN, which has similar loss levels to follow with ~25% tariff hike in Q3FY12E.**

Due to coal shortage, viability of ~26 GW capacity with fixed price PPAs is under question. **PPA tariff revision is likely over 1 to 1.5 yrs post SEBs beef-up their cash flows through tariff hikes.**

**Key beneficiaries of SEB reforms would be power financiers (PFC & REC) and merchant gencos (Adani, JSW & JPVL). Maintain BUY on PFC.**

**Key beneficiaries of PPA tariff revision - Tata Power & Adani Power. Until these reforms go through, prefer cos with net-long coal or NO fuel risk like JSPL, Tata Power and PGCIL.**

### Key takeaways w.r.t. SEB & Coal supply situation:

- The SEB losses (without subsidy) have risen from Rs 520 bn in FY09 to ~Rs 610 bn in FY10. The SEB losses, considering subsidy received, have risen from Rs 310 bn in FY09 to ~Rs 420 bn in FY10. The consolidated SEB debt outstanding is at ~Rs 1.8 trn.
- Of the total SEB losses post subsidy, TN and Rajasthan constitutes ~25% each, UP is ~13%, MP and AP are ~9% each.
- MoF has asked the banks to stop lending to SEBs until they demonstrate a clear roadmap for returning to profitability and raise tariffs for end-consumer, meaningfully.

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- Due to coal shortage, coal linkage availability from CIL has been reduced from ~60% PLF (70% of 85% PLF) to ~43% PLF (50% of 85% PLF). The coal situation would further aggravate with change in the Indonesian mining law.
- Hence project viability for ~26 GW with fixed price PPAs is under question. Tariff revision to take time and likely over 1 to 1.5 yrs. This is because SEBs needs to beef-up their cash flows through tariff hikes pre raising PPA tariffs

#### Key takeaways from the PFC meeting

- PFC has done a rigorous stress-test analysis on all the power projects it has lend till date. The analysis reveals that a project of ~700 MW (i.e. less than 0.5% of total loan book) is currently under stress. In 1QFY12, PFC's total loan book was ~Rs 1.04 trn.
- On SEBs, they have not seen any default till date and all states inclusive TN, have honored their dues as recently as Aug 2011.

#### Other details on PFC:

- PFC maintains ~1% of total loans as reserve which can be used in case of any restructuring.
- Maheshwar Hydel Project has received an equity infusion of Rs 1.2 bn from Infrastructure India Plc. PFC's exposure to this project is at ~Rs 7 bn and the co. has received special dispensation from Gol to recognize it as a standard asset till March 2012.

#### NBFC Valuations:

- **PFC:** At CMP of Rs 161, PFC is trading at 1.0x FY12E ABV of Rs 155 and 0.9x FY13E ABV of Rs 172. We **maintain BUY** with a target price of Rs 200 (1.2x FY13E ABV) – upside of 24% from CMP.
- **REC:** At CMP of Rs 187, REC is trading at 1.3x FY12E ABV of Rs 139 and 1.2x FY13E ABV of Rs 155. We **maintain HOLD** with a target price of Rs 201 (1.3x FY13E ABV) – upside of 8% from CMP.

#### Power Sector Recommendations:

##### A) In the current scenario (with No SEB reforms/ no PPA tariff revisions):

**BUY** stocks with least fuel price/ availability risk thereby having lower earnings volatility:

- **JSPL** – At CMP, JSPL's valuations factor in only operational assets. Substantial growth potential remains from future projects (power & steel) and overseas mines (coal & iron ore), which are available today at nearly free of cost! Further, upside from increase in merchant rates and coal surplus usage is possible. Our TP of Rs 662 implies a 22% upside from CMP of Rs 544.
- **PGCIL** – PGCIL's capacity build-out (& profits) of 1.5x over next 3 yrs is largely dependant on the projects nearing completion for

NTPC/ Mundra & Sasan UMPPs – thus having low risk. Our TP of Rs 120 implies a 21% upside from CMP of Rs 99.

- **Tata Power** – In our opinion, the stock has been hit thrice from Rs 1,400 to ~Rs 1,000 on the same negative news of Indonesian mining law. The maximum impact of this event, in our estimate, would be to the extent of Rs 145/sh. Our TP of Rs 1,202 implies a 22% upside from CMP of Rs 984.

**B) If SEB reforms go through:**

If the SEB reforms are implemented thereby raising PPA and merchant rates, stocks such as **Adani Power (CMP: Rs 84)** and **JSW Energy (CMP: Rs 57)** could provide healthy potential returns in the 40-60% range (though their current upsides are at ~5%). For **JPVL (CMP: 33)**, easier financing environment could also result in an upside of over 4z% from its **CMP of Rs 33**.

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