Company

23 October 2009 | 12 pages

NTPC (NTPC.BO)

Equity

Hold: Steady Quarter of Profit Growth

- **Recurring PAT Rs20.9bn up 32% YoY** — 2QFY10 recurring PAT was 10% ahead of CIRA expectations of Rs19.0bn (up 20% YoY), on lower-than-expected effective tax rate. Reported PAT at Rs21.5bn was up 2% YoY on exceptional items of Rs5.3bn of tax refunds in 2QFY09, and Rs644mn of excess provisions for employee benefits which was written back net of taxes. It is worth noting that NTPC had a weak 1HFY09 and strong 2HFY09 which has led to higher profit growth in 1HFY10.
- **Operational performance** — Gross generation at 50.4bn kWh was up 7% YoY, marginally below CIRA expectations of 51.1bn kWh. PLF of coal stations at 82.42% v/s 83.10% and of gas stations at 76.78% v/s 62.20%.
- **To achieve 55% of target in the XIth plan —** Out of a target of 22.4GW in the XIth Plan (FY08-FY12E), NTPC has commissioned 2.7GW over FY08-09 and we expect 9.5GW of additions over FY10E-12E (55% achievement at 12.3GW). Work on the 600MW Loharinagpala has been suspended temporarily on the advice of the Ministry of Power pending a committee report.
- **Working on an additional pipeline of 24.4GW** — NTPC is currently working on a pipeline of 24,422MW, out of which 5,940MW (9x 660MW) will be tendered in bulk in October 2009 and the order should be given out by March-April 2010.
- **Sectoral call** — We remain cautious on the Indian Electric Utilities with Sells on Adani Power, PGCIL and CESC, and Holds on NTPC and Tata Power. For investors looking to take exposure in this sector, we prefer NTPC and Tata Power – in that order.

Hold/Low Risk	**2L**
Price (23 Oct 09)	Rs216.20
Target price	Rs220.00
Expected share price return	1.8%
Expected dividend yield	1.8%
Expected total return	**3.5%**
Market Cap	Rs1,782,669M
	US$38,283M

Price Performance (RIC: NTPC.BO, BB: NATP IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	80,528	9.77	11.7	22.1	3.4	15.9	1.6
2009A	76,568	9.29	-4.9	23.3	3.1	13.9	1.7
2010E	88,527	10.74	15.6	20.1	2.8	14.8	1.8
2011E	105,522	12.80	19.2	16.9	2.6	16.0	1.9
2012E	116,544	14.13	10.4	15.3	2.3	16.0	1.9

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	22.1	23.3	20.1	16.9	15.3
EV/EBITDA adjusted (x)	16.3	18.3	13.7	11.4	10.3
P/BV (x)	3.4	3.1	2.8	2.6	2.3
Dividend yield (%)	1.6	1.7	1.8	1.9	1.9
Per Share Data (Rs)					
EPS adjusted	9.77	9.29	10.74	12.80	14.13
EPS reported	8.99	9.95	10.74	12.80	14.13
BVPS	63.84	69.58	75.87	83.99	93.21
DPS	3.50	3.60	3.80	4.00	4.20
Profit & Loss (RsM)					
Net sales	370,974	419,922	480,963	554,773	622,767
Operating expenses	-284,105	-344,521	-371,079	-417,685	-467,798
EBIT	**86,869**	**75,401**	**109,884**	**137,088**	**154,970**
Net interest expense	-10,778	-13,529	-16,702	-19,540	-22,945
Non-operating/exceptionals	29,203	32,806	29,372	30,980	32,806
Pre-tax profit	**105,294**	**94,678**	**122,554**	**148,529**	**164,831**
Tax	-24,766	-18,110	-34,027	-43,006	-48,287
Extraord./Min.Int./Pref.div.	-6,380	5,445	0	0	0
Reported net income	**74,148**	**82,013**	**88,527**	**105,522**	**116,544**
Adjusted earnings	80,528	76,568	88,527	105,522	116,544
Adjusted EBITDA	108,254	99,046	136,789	168,116	191,300
Growth Rates (%)					
Sales	13.7	13.2	14.5	15.3	12.3
EBIT adjusted	21.1	-13.2	45.7	24.8	13.0
EBITDA adjusted	17.0	-8.5	38.1	22.9	13.8
EPS adjusted	11.7	-4.9	15.6	19.2	10.4
Cash Flow (RsM)					
Operating cash flow	**89,648**	**90,855**	**113,918**	**136,361**	**152,428**
Depreciation/amortization	21,385	23,645	26,906	31,029	36,330
Net working capital	-8,439	-12,794	-1,515	-190	-445
Investing cash flow	**-66,794**	**-116,545**	**-103,029**	**-144,222**	**-159,486**
Capital expenditure	-82,232	-131,351	-113,920	-154,648	-164,944
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-6,668**	**39,074**	**14,279**	**36,615**	**35,626**
Borrowings	27,062	73,772	50,937	75,203	76,143
Dividends paid	-33,764	-34,700	-36,659	-38,588	-40,517
Change in cash	**16,186**	**13,384**	**25,167**	**28,754**	**28,567**
Balance Sheet (RsM)					
Total assets	**893,880**	**1,052,248**	**1,162,293**	**1,316,112**	**1,480,589**
Cash & cash equivalent	149,332	162,716	187,883	216,637	245,204
Accounts receivable	29,827	35,842	39,462	44,695	50,366
Net fixed assets	485,720	593,426	680,440	804,060	932,675
Total liabilities	**367,494**	**478,547**	**536,723**	**623,608**	**712,059**
Accounts payable	48,263	64,469	69,551	78,788	88,496
Total Debt	271,906	345,678	396,615	471,818	547,961
Shareholders' funds	**526,386**	**573,701**	**625,570**	**692,504**	**768,530**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	29.2	23.6	28.4	30.3	30.7
ROE adjusted	15.9	13.9	14.8	16.0	16.0
ROIC adjusted	12.5	9.5	10.7	11.5	11.3
Net debt to equity	23.3	31.9	33.4	36.8	39.4
Total debt to capital	34.1	37.6	38.8	40.5	41.6

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Figure 1. NTPC — 2QFY10 Results

Year End March 31 (RsM)	1QFY09	1QFY10	% Chg	2QFY09	2QFY10	% Chg	CIRA 2QFY10E	% Chg
Net Sales	**95,395**	**120,027**	**25.8%**	**96,614**	**107,828**	**11.6%**	**110,268**	**14.1%**
Fuel Cost	(61,386)	(77,427)		(59,559)	(66,068)		(68,146)	
% of net sales	64.3%	64.5%		61.6%	61.3%		61.8%	
Employee Cost	(5,779)	(5,904)		(6,047)	(5,040)		(6,172)	
% of net sales	6.1%	4.9%		6.3%	4.7%		5.6%	
Others	(4,012)	(4,939)		(5,533)	(5,411)		(6,175)	
% of net sales	4.2%	4.1%		5.7%	5.0%		5.6%	
EBITDA	**24,218**	**31,757**	**31.1%**	**25,476**	**31,308**	**22.9%**	**29,776**	**16.9%**
% Margin	**25.4%**	**26.5%**		**26.4%**	**29.0%**		**27.0%**	
Depreciation	(5,524)	(6,700)		(5,267)	(6,438)		(6,700)	
EBIT	**18,693**	**25,057**	**34.0%**	**20,210**	**24,871**	**23.1%**	**23,076**	**14.2%**
% Margin	**19.6%**	**20.9%**		**20.9%**	**23.1%**		**20.9%**	
Interest	(4,219)	(6,128)		(5,264)	(5,407)		(6,128)	
Other Income	7,172	9,000		7,448	7,410		9,400	
PBT	**21647**	**27929**	**29.0%**	**22394**	**26874**	**20.0%**	**26348**	**17.7%**
Provision for tax	(4,508)	(7,009)		(6,608)	(5,998)		(7,377)	
Tax Rate	20.8%	25.1%		29.5%	22.3%		28.0%	
Recurring PAT	**17,139**	**20,920**	**22.1%**	**15,786**	**20,875**	**32.2%**	**18,971**	**20.2%**
Exceptional Items	126	-		5,319	829		-	
Tax Adjustments					(185)			
Reported PAT	**17,265**	**20,920**	**21.2%**	**21,105**	**21,520**	**2.0%**	**18,971**	**-10.1%**

Source: Company Information and Citi Investment Research and Analysis Estimates

NTPC

(NTPC.BO; Rs214.65; 2L)

Company description

NTPC is India's largest power generator with 31GW of capacity (19% of installed capacity) and generates 207bu (31% of generation). Capacity is spread across coal-based units (24.4GW), gas-based units (3.9GW) and JV projects (2.3GW). NTPC's output is contracted through long-term PPAs (25 years for coal-based and 15 years for gas-based) with customers (SEBs 99% of its sales). All billing to SEBs is secured through letters of credit. It plans to be a 75GW company by FY17E.

Investment strategy

We rate NTPC Hold/Low Risk (2L), believing it has limited upside potential. The Indian regulatory system of cost pass-throughs works well and provides a defensive characteristic to NTPC's financials, unlike other Asian generators. Capex is well-funded with low gearing (0.63x), high cash balance of Rs188bn, strong credit rating and high annual CFO. NTPC has faced many roadblocks over the past 2 years: 1) projects were delayed; 2) coal supply was inadequate to generate high generation efficiency gains; 3) poor quality coal supply in some plants; and (4) lack of gas supply preventing higher utilization of gas plants.

Valuation

We value NTPC using a DCF method with a WACC of 9.7% and terminal growth rate of 3%. Our assumptions are a risk-free rate of 8.5%, market risk premium of 6%, and beta of 0.9. We believe DCF is the best way to capture the value inherent in NTPC's unprecedented capacity addition plan against a backdrop of persistent peak and base load deficits. Further, at our Rs220 target price NTPC would trade at a P/BV of 2.6x FY11E. We see this as reasonable given the Indian regulatory system of cost pass-throughs works well and provides a defensive characteristic to NTPC's financials, unlike other Asian generators.

Risks

We rate NTPC Low Risk according to our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks to our target price are: 1) NTPC raising capacity addition plans for the XIth plan; 2) Faster-than-expected capacity ramp-up; 3) Positive change in regulatory structure in terms of returns and incentives; 4) Significant drop in interest rates leading to a fall in cost of capital; and 5) Additional allocation of coal mines by Ministry of Coal. Key downside risks to our target price are: 1) NTPC's operations depend on timely availability of fuel. NTPC's gas-based plants were hampered by poor fuel supply, resulting in sub-optimal capacity utilization. 2) NTPC is implementing larger modules and newer technologies such as 660MW and 800MW super critical technology and alternative fuels such as gas and hydro more aggressively, which could place demands on its project management and technology absorption skills. 3) UI rates are very high compared with normal tariff rates creating pressure from the SEBs to reduce this spot market premium. 4) Future payment risk due to resurfacing of free power supply to agricultural customers as a populist measure by a few states. 5) NTPC has entered a JV with GasPatrol - France, and Canoro Resources - Canada and has bid for an oil & gas exploration block in northeast India. This raises the risk of non-discovery, as with any exploration & production (E&P) venture.

Adani Power

(ADAN.BO; Rs100.30; 3M)

Valuation

- Adani Power (APL) is an interesting case of private sector entrepreneurship at its best, capitalizing on the persistent power deficits and exploiting high medium term merchant tariffs prior to the start of long term PPAs to reduce the payback of projects, using the faster than BHEL execution time cycles of the Chinese equipment suppliers.

- Impressive progress on 4620MW of capacity at Mundra and the Adani Group's experience in executing mega projects like the Mundra Ports and SEZ project successfully does bolster the investment case.

- However, we believe there are quite a few loose ends which need to be tied - (1) insufficient coal for 6600MW of capacity for 25 years, (2) coal mining license risk, (3) fuel pricing for Indonesian coal from AEL and (4) dependence on reasonable merchant rates to extract higher than regulated peer value. We believe some of these loose ends will be tied up in time.

- We give APL the benefit of the doubt and model in flawless execution of 6600MW and arrive at a fair value of Rs93/share. Despite this the current stock price does not leave too much on the table for investors who are prepared to back the Adani Group's entrepreneurial ability. We have a Sell/ Medium (3M) Risk rating and a target price of Rs88 on APL.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Speculative Risk rating to Adani Power given the relative short trading history of the stock. However, we believe a Medium Risk rating is more appropriate based on a number of factors, namely industry-specific risks, financial risk and management risks.

Downside risks include: (1) Insufficient quantity of coal in Bunyu to fire the Mundra project (2) The total reserves of 150mn tonnes have 3 licenses. While the counterparties of 2 of the 3 mines have procured long term exploitation licenses the third license has not yet been granted to the counterparty (3) Regulatory risk in Indonesia (4) Fuel supply to Mundra Phase IV and Tiroda is contingent on AEL achieving certain milestones and finalizing the coal supply agreements and timely mining (5) Fuel pricing risk for the Indonesian coal (6) Merchant tariff risks (7) Execution risks (8) Chinese equipment quality risks and (8) Interest rate risk

Upside risks include: (1) Better than expected operating parameters (2) Faster than expected execution (3) Higher than expected merchant tariffs and (4) Significant progress on 3300MW of projects currently in planning stages.

CESC

(CESC.BO; Rs383.80; 3M)

Valuation

Our Rs369 target price is based on a sum of the parts methodology. We value the power business using a DCF at Rs388. The negative NPV of the power business support to retail business is Rs58. We value CESC Plaza at Rs4 using a DCF and value the 35 acres of the Mulajore plant area at Rs3 (Rs20m/acre and a 50% discount to NAV). We also value CESC's 94.72% stake in Spencer's Retail at an EV/Sales of 1.0x FY08 giving us a value of Rs32.

Risks

We rate CESC Medium Risk in line with our quantitative risk-rating system that tracks 260-day historical share price volatility.

Key upside risks are: 1) the company exiting the retailing business; 2) better-than expected WBERC tariff orders; and/or 3) faster-than-expected execution of new power plants.

Power Grid Corporation of India

(PGRD.BO; Rs110.10; 3L)

Valuation

Amongst Indian Electric Utilities the closest listed comparables to PGCIL are NTPC and NLC, even though PGCIL is a transmission company whereas NTPC and NLC are generators. This is because these utilities share a similar regulatory tariff regime. If one analyzes the P/E and P/BV charts of NTPC and PGCIL, one can clearly see that PGCIL has traded at a premium to NTPC post listing. However, one has to take cognizance that PGCIL's listing happened prior to the Reliance Power IPO and the associated euphoric valuations for all Indian Electric Utility stocks. Our Rs89 target price is based on a target P/BV multiple of 2.3x FY10E. We set our target multiple at a ~10% discount to NTPC's target P/BV multiples on: 1) NTPC's ability to make superior ~22% returns on regulated equity compared to PGCIL's ~17%, 2) NTPC's under-reported but higher RoEs compared to PGCIL, and 3) NTPC's stronger balance sheet structure with more comfortable debt:equity ratios.

Risks

We rate PGCIL Low Risk, as opposed to the Speculative Risk rating assigned by our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key upside risks are: 1) Faster-than-expected project execution leading to earlier-than-expected capitalization of capex; 2) Higher-than-expected short-term open access revenues due to a spurt in power trading, and 3) Higher-than-expected revenues and profitability in consulting and telecom businesses.

Tata Power

(TTPW.BO; Rs1,461.10; 2L)

Valuation

Our Rs1,389 target price is based on a sum-of-the-parts approach: 1) The parent business is valued using DCF as of March 2010E, using a WACC of 12.3% (risk free rate of 8.5%, market risk premium of 6%, beta of 1.06, D/E of 67%) 2) Tata Power's 51% stake in NDPL is valued at 2.5x FY11E P/BV; 3) Tata Power's stake in Powerlinks is valued at 1.5x FY11E P/BV; 4) Holdings in Tata Teleservices (Maharashtra) and VSNL are valued at a 20% discount to the market price prices; 5) Stake in Tata Teleservices is valued at a 30% discount to the NTT Docomo valuations; 6) Mundra UMPP using FCFE and Cost of Equity = 12.5%; 7) The Maithon project is valued like Mundra UMPP; and 8) 30% stake in KPC and Arutmin coal mines at FCFE and CoE = 12.5%.

Risks

We rate Tata Power shares Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks are: 1) Unfavorable judgement in the MERC order petition and standby charges case vs. R-Infra could hit Tata Power's financials; 2) The power sector is gradually liberalizing, but regulatory and tariff structures are still evolving. Companies in the sector are vulnerable to delays, mid-term corrections and dramatic policy changes; under the existing system, litigation following discord may be time-consuming, and a lack of precedents adds to uncertainty; 3) Delays and cost escalation in capacity expansion and an unfavorable interest rate environment; 4) The nature of the Asian coal market means an inability to fill orders or expand capacity in Indonesian coal mines will have a material impact on profitability, as will regional coal prices; and 5) Coal mines rely heavily on contract miners; changing relations could materially affect operations. Key upside risks that could drive the shares above our target price include: 1) Positive judgment on the MERC order and standby charges case vs. R-Infra could positively impact investor sentiment but have no positive bearing on Tata Power's financials, on our estimates; 2) Tata Power exiting its telecom holdings at a significant premium to their current market value; 3) Significant progress on pipeline of 6.2GW of projects beats expectations and 4) New UMPP win.

Appendix A-1

Analyst Certification

Each research analyst(s) principally responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

NTPC (NTPC.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam

	Date	Rating	Target Price	Closing Price
1	28-Nov-06	1L	*181.00	149.85
2	21-Nov-07	*3L	*231.00	239.50
3	19-Feb-08	*1L	*235.00	204.60
4	27-Oct-08	1L	*152.00	125.95
5	4-Dec-08	*3L	*149.00	164.55
6	21-Jan-09	*2L	*195.00	179.65
7	27-Jul-09	2L	*224.00	214.45
8	14-Oct-09	2L	*220.00	210.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Adani Power (ADAN.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam

Covered since October 20 2009

	Date	Rating	Target Price	Closing Price
1	20-Oct-09	*3M	*88.00	100.85

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

CESC (CESC.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam

	Date	Rating	Target Price	Closing Price
1	13-Nov-07	1L	*650.00	571.00
2	3-Jan-08	1L	*777.00	679.20
3	23-Jul-08	1L	*509.00	370.20
4	24-Nov-08	*1M	*290.00	200.05
5	3-Jun-09	*3M	*369.00	354.45

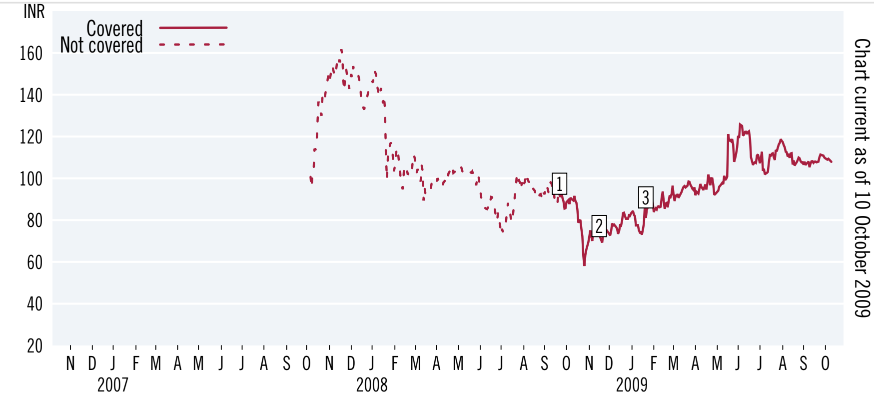
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Power Grid Corporation of India (PGRD.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam
Covered since September 22 2008



	Date	Rating	Target Price	Closing Price
1	22-Sep-08	*3L	*86.00	92.05
2	17-Nov-08	3L	*69.00	75.60
3	21-Jan-09	3L	*89.00	81.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tata Power (TTPW.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam

	Date	Rating	Target Price	Closing Price
1	8-Feb-07	*2L	*648.00	605.05
2	8-Oct-07	*1L	*1,078.00	900.45
3	30-Jan-08	1L	*1,494.00	1,317.75
4	9-Sep-08	1L	*1,453.00	1,086.50
5	25-Nov-08	1L	*1,027.00	651.00
6	26-Mar-09	1L	*900.00	781.40
7	5-Jun-09	1L	*1,209.00	1,081.35
8	23-Sep-09	*2L	*1,389.00	1,305.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Sep 2009	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	44%	38%	18%
% of companies in each rating category that are investment banking clients	47%	45%	36%

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