



NTPC

Neutral

Rs186

STOCK INFO. BLOOMBERG
BSE Sensex: 9,101 NATP IN
REUTERS CODE
S&P CNX: 2,797 NTPC.BO

20 January 2009

Previous Recommendation: Neutral

Equity Shares (m)	8,245.5
52-Week Range	243/113
1,6,12 Rel. Perf. (%)	12/40/39
M.Cap. (Rs b)	1,531.2
M.Cap. (US\$ b)	31.2

YEAR	NET SALES	PAT *	EPS*	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END *	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	326,317	68,647	8.3	17.9	22.3	3.2	13.9	19.8	4.5	14.7
03/08A	370,910	75,688	9.0	8.0	20.7	2.9	15.0	20.8	4.0	13.0
03/09E	414,928	74,057	9.1	1.4	20.4	2.7	13.5	19.2	3.8	14.0
03/10E	434,140	75,263	9.1	0.1	20.3	2.5	12.8	18.3	3.7	13.1

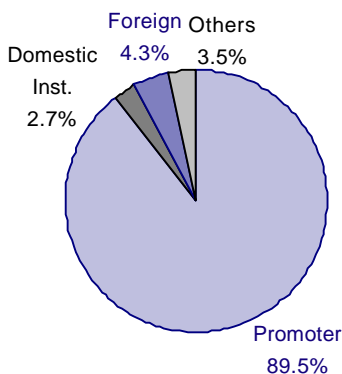
* Pre Exceptional Earnings

Revised CERC norms marginally positive: Central Electricity Regulatory Commission (CERC) has approved Tariff norms and Regulations for the period FY09-14 pertaining to power generation and transmission utilities, and are marginally positive as compared to the earlier norms. The key positive surprise has been increase in base ROE to 15.5%, from 14% earlier particularly in a scenario of declining interest cost. This largely offsets the impact due to tax provisioning on incentives, which was earlier recovered from consumers. While the current CERC norms are applicable to power projects that supply to more than one state under Power Purchase Agreement, we expect various State Electricity Regulatory Commissions (SERCs) to announce revised Tariff Orders going forward.

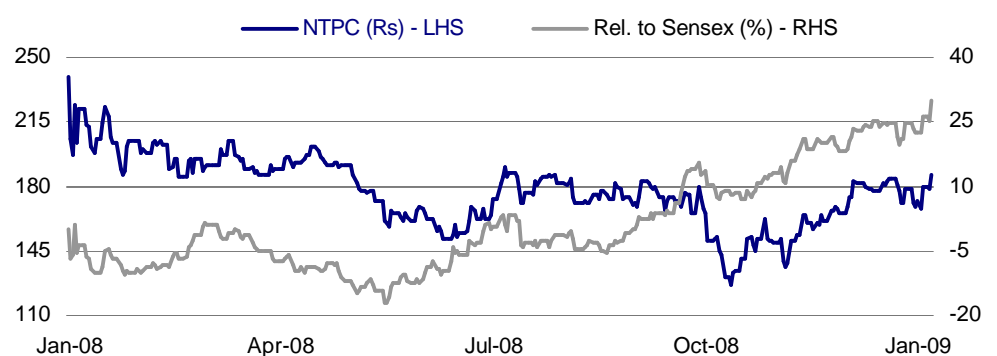
NTPC to witness earnings upgrade of 3.4% for FY10: The revision in Tariff norms is marginally positive for NTPC and has led to earnings upgrade of 3.4% for FY10. Also, the composition of earnings has improved with base ROE (at 15.5%) now accounting for 67% of the generation profit, vs. 56% in FY09. We now expect incentive composition during FY10 as: Thermal Efficiency 29%, PLF 25%, UI charges 25%, and others comprising of O&M incentive, working capital incentive, etc at 21%.

Earnings CAGR of 0.7% during FY08-10, 16.6% for FY10-12: We expect NTPC to report earnings CAGR of 0.7% over FY08-10E, driven largely by slower pace of capacity addition, tightening incentive norms and reduced interest income, given conversion of cash into CWIP / lower interest rates. We calculate NTPC's earnings CAGR till FY12 at 8.4%, comprising of 13.7% CAGR for generation profit and -11% CAGR for other income (including interest income). At CMP of Rs186, the stock quotes at PER of 20.4x FY09 and 20.3x FY10E. Maintain **Neutral**, with price target of Rs165/sh.

SHAREHOLDING PATTERN (SEP:08)



STOCK PERFORMANCE (1 YEAR)



Revised CERC norms: marginally positive

Central Electricity Regulatory Commission (CERC) has approved Tariff norms and Regulations for the period FY09-14 pertaining to power generation and transmission utilities. The revised norms are marginally positive as compared to the earlier norms. The key positive surprise has been increase in base ROE to 15.5%, from 14% earlier particularly in a scenario of declining interest cost. This largely offsets the impact due to tax provisioning on incentives, which was earlier recovered from consumers. While the current CERC norms are applicable to power projects that supply to more than one state under Power Purchase Agreement, we expect various State Electricity Regulatory Commissions (SERCs) to announce revised Tariff Orders going forward.

Tariff Regulations (FY10-14)

✍ **Base RoE increased to 15.5% post tax:** Regulated return for the generation and transmission utilities have increased to 15.5% post tax, to be grossed up with the applicable tax rate. Further, an additional return of 0.5% shall be allowed for projects commissioned post 1st April, 2009 and which are completed within the specified timeline.

TIME LINE FOR PROJECT EXECUTION (MONTHS)

UNIT SIZE	GREEN FIELD	BROWN FIELD	SUBSEQUENT UNITS
Coal Based Projects			
200 / 210 / 250	33	31	4
300 / 330 MW			
250 MW CFBC	36	34	4
500 / 600 MW	44	42	6
660 / 800 MW	52	50	6
Gas Based Project			
>100 MW	26	24	2
<100 MW	30	28	4

Source: CERC

✍ **Tax on Incentives to offset the increased RoE:** CERC norms stipulate that the tax on incentives including unscheduled interchange charges have to be borne by the generation company and cannot be recovered from the consumers, which will impact profitability. This will largely offset the gains available through increased RoE.

✍ **Depreciation rate increased, Advance Against Depreciation (AAD) abolished:** CERC norms have abolished AAD which was given to meet the obligations towards debt repayment, in excess of depreciation. Instead, the new norms have stipulated higher depreciation rates of 5.28% (vs 3.6% earlier) for first 12 years and 2% thereafter. This will improve cash flows in the initial years.

✍ **Refinancing gains to be shared:** CERC norms now allow the project developer to retain 33% of the gains through refinancing project debt. This was not permitted earlier. We believe that this could add in a meaningful manner to incentives, given the current trend of decline in interest cost.

- ✗ **Normative operational costs increased by ~50%:** The normative operational and maintenance expenses for FY10 have been increased by ~50% for 200/210/250MW projects, while annual escalation is specified at 5.72%. The increase has been largely towards incremental provisions for wage increase, post Sixth Pay Commission. The current norms are also 16-18% higher than the draft regulations.
- ✗ **Operational Efficiency norms linked to Plant Availability vs Plant Load Factor:** Operational efficiency incentives have been based on PAF v/s PLF, and normative rate has been revised to 85%, v/s 80% earlier. We believe that this revision is a positive, as the incentive quantum will now be calculated based on fixed capacity charges for the project, vs. incentive of Rs0.25/unit earlier. Also, for NTPC, PAF is higher than PLF, largely for gas based projects and thus is a positive.

NEW CERC NORMS

	EARLIER (FY04-09)		DRAFT PROPOSAL (FY10-14)		FINAL	
Base RoE	14% plus incentive		14% plus incentive		15.5% plus incentive, Addl 0.5% RoE for project execution w within schedule	
Normative DER	70:30		70:30		70:30	
O&M Expenses (Rs m/MW)*	Base	Escalation %	Base	Escalation %	Base	Escalation %
Year 1	12.17	4.02	15.70	5.15	18.20	-
Year 2	12.66	4.02	16.51	5.15	19.24	5.71
Year 3	13.17	4.02	17.36	5.15	20.34	5.72
Year 4	13.70	4.02	18.25	5.15	21.51	5.75
Year 5	14.25	4.02	19.19	5.15	22.74	5.72
Operating Efficiency	PLF Based		PAF Based		PAF Based	
Normative norm	80%		85%		85%	
Incentives @ Rs/unit	Rs0.25/unit		Based on fixed charge, Restricted to 50% of capacity for plant <10 yrs		Based on fixed charge, Restricted to 50% of capacity for plant <10 yrs	
Heat Rate Incentive						
Normative limits (kCal/kw h)	2,500 for 250MW size 2,450 for 500MW		2,450 for 250MW size 2,400 for 500MW		2,500 for 250MW size 2,425 for 500MW 2,385 for 500MW+ unit size	
Advance against depreciation (AAD)	Diff of book depreciation and debt repayment		AAD abolished Depr at 4.67% for first 15 years and 2% thereafter vs 3.6% for 25 years earlier		AAD abolished Depr at 5.28% for initial 12 years and 2% thereafter	
Debt Re-financing	No Incentives, Actual cost pass through to beneficiaries		Cost of re-financing to be borne by beneficiaries Net benefit to be shared in the ratio of 2:1 by beneficiaries and company, respectively		Cost of re-financing to be borne by beneficiaries Net benefit to be shared in the ratio of 2:1 by beneficiaries and company, respectively	
Tax on incentives and UI income	Pass through to consumers		Full tax on net UI income and Incentives to be borne by Generating company		Full tax on net UI income and Incentives to be borne by Generating company	

*O&M Expenses for plant configuration of less than 250MW.

O&M incentives can be positive for NTPC given incremental capacity addition will be with lower employee base, giving significant savings in O&M.

Source: CERC, MOSL

NTPC: earnings upgrade of 3.4% for FY10

The revision in CERC norms is marginally positive for NTPC and has led to earnings upgrade of 3.4% for FY10. However, the composition of earnings has improved with base RoE (at 15.5%) now accounting for 67% of the generation profit, vs. 56% in FY09. We now expect incentive composition during FY10 as: Thermal Efficiency 29%, PLF 25%, UI charges 25%, and others comprising of O&M incentive, working capital incentive, etc at 21%.

We estimate NTPC to report earnings CAGR of 0.7% over FY08-10E, driven largely by slower pace of capacity addition, tightening incentive norms and reduced interest income, given conversion of cash into CWIP / lower interest rates. We calculate NTPC's earnings CAGR till FY12 at 8.4%, comprising of 13.7% CAGR for generation profit and -11% CAGR for other income (including interest income).

Given conversion of cash / investments into CWIP, we expect other income to decline from Rs21b in FY08 to Rs13b in FY12

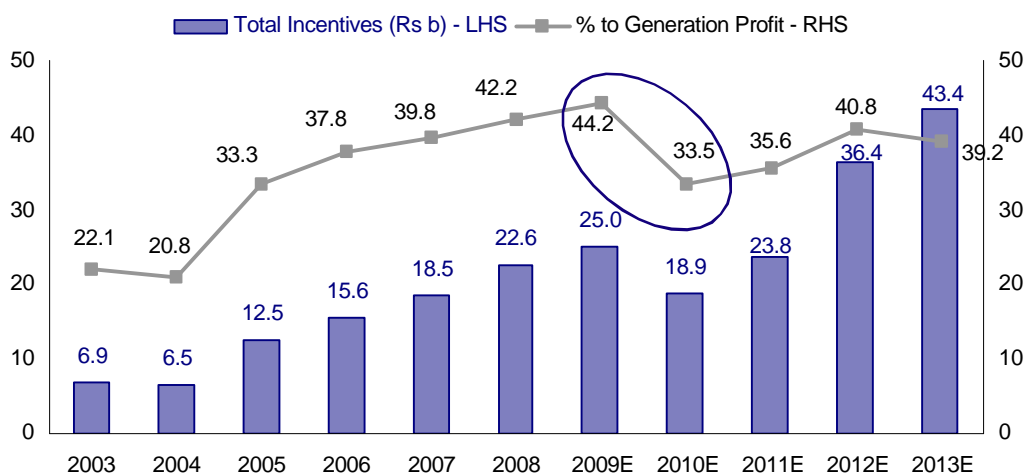
NET PROFIT COMPOSITION (RS B)

	FY08	FY09E	FY10E	FY11E	FY12E	CAGR (%)
Earnings Composition						
Base RoE	30.9	31.5	37.4	42.9	52.9	14.4
Incentives	22.6	25.0	18.9	23.8	36.4	12.7
Generation Profit	53.4	56.5	56.2	66.7	89.3	13.7
Other Income, including interest	20.7	18.7	19.0	18.1	13.0	-11.1
Total Net Profit	74.1	75.2	75.3	84.8	102.2	8.4

Source: MOSL

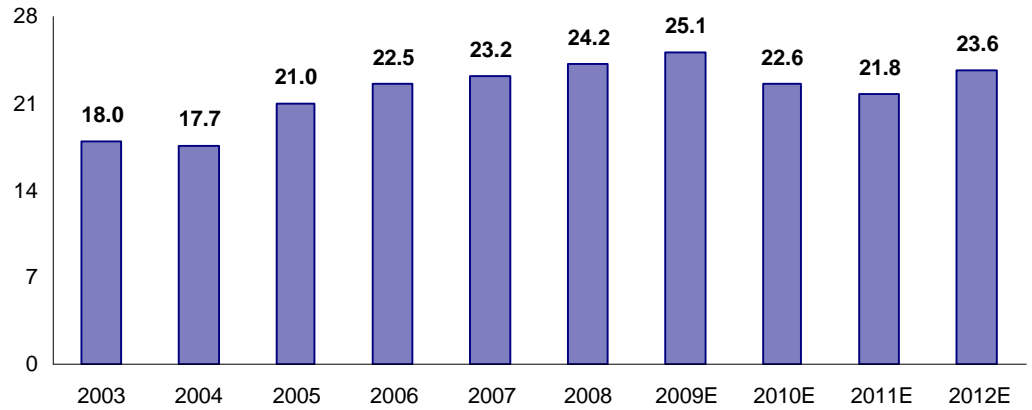
INCENTIVES ADD EXCITEMENT TO AN OTHERWISE UTILITY BUSINESS (RS B)

Earnings composition has improved with base RoE (at 15.5%) now accounting for 67% of the generation profit, vs. 56% in FY09



Source: Company/MOSL

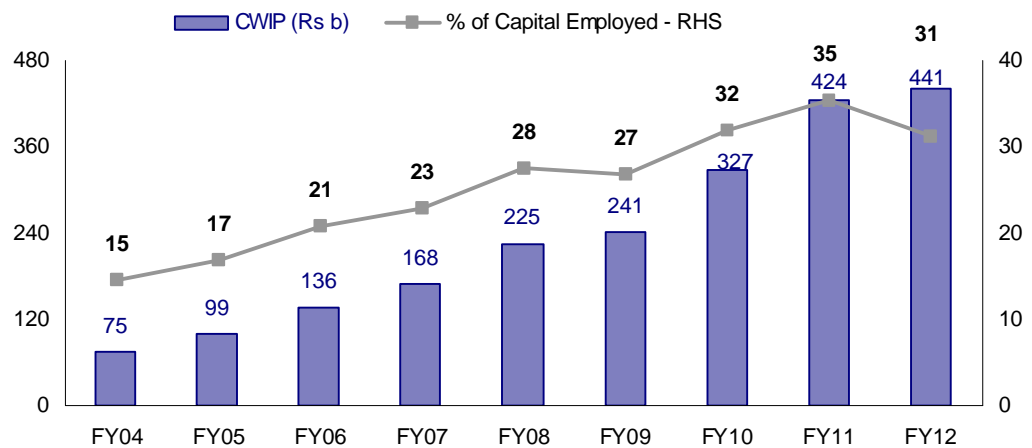
TREND IN ROE FROM CORE BUSINESS (ADJUSTED FOR CAPITAL WORK IN PROGRESS)



Source: Company/MOSL

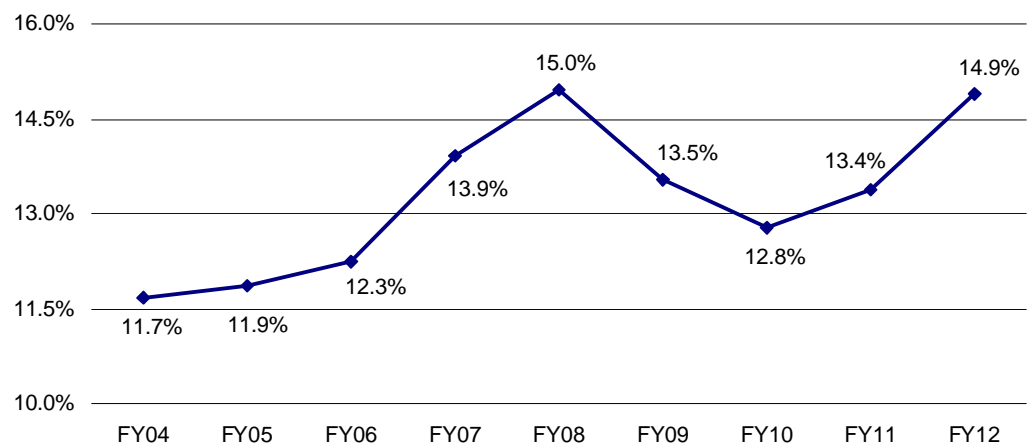
TREND IN CWIP AND % OF CAPITAL EMPLOYED

We expect CWIP to increase from 15% of capital employed in FY04 and 28% in FY08, to 35% in FY11, which impacts reported RoE.



Source: Company/MOSL

TREND IN REPORTED ROE (%)



Source: Company/MOSL

Valuations: Fully priced

Since January 2008, NTPC has witnessed outperformance of 18% v/s BSE Sensex. The stock trades at a premium of ~101% to Sensex P/E v/s historical average of 10.4%. Given the slowdown in earnings growth (-2% CAGR during FY08-10E v/s 18% CAGR during FY05-08) and increased valuation premium, we believe that valuations looks expensive. We arrive at price target of Rs165/sh, based on average of DCF (Rs184/sh) and SOTP methodology (Rs145/sh). We maintain **Neutral**.

INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2006	2007	2008	2009E	2010E	Y/E MARCH	2006	2007	2008	2009E	2010E
Net Sales	261,429	326,317	370,910	414,928	434,140	Basic (Rs)					
Change (%)	15.9	24.8	13.7	11.9	4.6	EPS (Pre Excep)	7.1	8.3	9.0	9.1	9.1
EBITDA	72,232	100,864	115,457	111,363	123,748	Cash EPS	10.2	11.3	11.8	11.7	12.3
Margin (%)	27.6	30.9	31.1	26.8	28.5	BV/Share	54.5	58.9	63.8	68.9	74.0
Depreciation	20,477	20,754	21,385	22,681	26,277	DPS	2.8	3.2	3.5	3.5	3.5
EBIT	51,755	80,110	94,072	88,682	97,471	Payout (%)	45.2	44.1	45.5	44.2	44.2
Interest	17,632	18,594	17,981	20,067	23,989	Valuation (x)					
Other Income - Rec.	26,101	27,558	26,458	30,725	26,523	P/E		22.3	20.7	20.4	20.3
Profit before Tax	60,224	89,074	102,549	99,339	100,005	Cash P/E		16.5	15.8	15.8	15.1
Current Tax	2,022	20,427	28,401	24,156	24,742	P/BV		3.2	2.9	2.7	2.5
Tax Rate (%)	3.4	22.9	27.7	24.3	24.7	EV/Sales		4.5	4.0	3.8	3.7
Reported PAT	58,202	68,647	74,148	75,183	75,263	EV/EBITDA		14.7	13.0	14.0	13.1
EO Expense / (Income)	-5,054	-3,618	-1,540	1,126	0	Dividend Yield (%)		1.7	1.9	1.9	1.9
Adjusted PAT	63,256	72,265	75,688	74,057	75,263	Return Ratios (%)					
Change (%)	9.0	14.2	4.7	-2.2	16	EBITDA Margins (%)	27.6	30.9	31.1	26.8	28.5
Margin (%)	24.2	22.1	20.4	17.8	17.3	Net Profit Margins (%)	24.2	22.1	20.4	17.8	17.3
						RoE	12.3	13.9	15.0	13.5	12.8
						RoCE	13.8	13.2	13.6	13.9	13.1
						Working Capital Ratios					
						Fixed Asset Turnover (x)	0.6	0.6	0.7	0.7	0.6
						Asset Turnover (x)	0.4	0.4	0.5	0.5	0.4
						Debtor (Days)	12	14	29	30	30
						Inventory (Days)	33	28	26	25	25
						Working Capital Turnover	16	21	28	18	5
						Leverage Ratio (x)					
						Current Ratio	2.6	3.2	3.3	1.8	1.7
						Interest Cover Ratio	2.9	4.3	5.2	4.4	4.1
						Debt/Equity	0.5	0.5	0.5	0.6	0.7
						CASH FLOW STATEMENT					
						(Rs Million)					
						Y/E MARCH	2006	2007	2008	2009E	2010E
						Oper. Profit/(Loss) befo	60,224	89,074	102,549	99,339	100,005
						Direct Taxes Paid	-2,022	-20,427	-28,401	-24,156	-24,742
						(Inc)/Dec in WC	-10,306	-7,289	-8,439	9,326	14,930
						CF from Operations	47,896	61,358	65,709	84,509	90,193
						(inc)/dec in FA	-66,389	-78,929	-82,798	-119,917	-163,751
						(Pur)/Sale of Investment	-15,086	-31,948	-8,271	83,524	-9,238
						CF from Investment	-81,475	-110,877	-91,069	-36,393	-172,989
						Issue of Shares	0	0	0	0	0
						(Inc)/Dec in Debt	31,095	42,871	27,062	49,954	74,393
						Dividend Paid	26,325	30,281	33,764	33,200	33,236
						Others	90	24,789	-19,280	-220,315	-8,898
						CF from Fin. Activit	57,510	97,941	41,546	-137,161	98,731
						Inc/Dec of Cash	23,931	48,422	16,186	-89,045	15,936
						Add: Beginning Balance	60,783	84,714	133,146	149,332	59,878
						Closing Balance	84,714	133,136	149,332	60,287	75,814

E: MOSL Estimates



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No
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No

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