

Q4FY06 result, downgrade to Sell

Tata Power Company

Bloomberg: TPWR IN
Reuters: TTPW.NS
Mkt cap: Rs102.2bn/US\$2.2bn

SELL
(Downgraded from Buy)

Current price: Rs516
Target price: Rs530

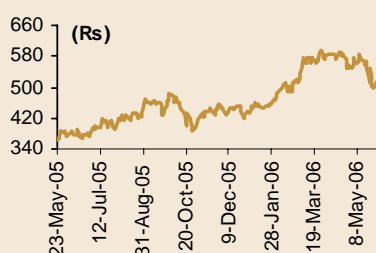
Operating performance in line

Positive surprise in PAT is due to tax credit and higher other income

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Stock performance



| (%) | Absolute | Relative |
|-----------|----------|----------|
| 3 months | (0.6) | (5.2) |
| 6 months | 14.0 | (6.0) |
| 12 months | 38.3 | (15.3) |

Key financials

| Y/E 31 Mar | FY06 | FY07E | FY08E |
|-------------------|-------------|-------------|-------------|
| Net sales (Rs m) | 45,628 | 47,134 | 47,076 |
| Net profit (Rs m) | 6,105 | 4,330 | 4,240 |
| Adj EPS (Rs) | 23.0 | 21.9 | 21.4 |
| PER (x) | 22.4 | 23.6 | 24.1 |
| PCE (x) | 13.9 | 14.0 | 14.2 |
| EV/Core | | | |
| EBITDA (x) | 13.3 | 13.2 | 13.6 |
| Price/Book (x) | 2.1 | 2.0 | 1.9 |
| ROE (%) | 9.8 | 8.8 | 8.1 |
| ROCE (%) | 9.1 | 9.0 | 8.5 |
| Consensus | | | |
| EPS (Rs) * | | 24.8 | 26.0 |

* Bloomberg

TPWR's Q4FY06 reported PAT at Rs1,388m came in significantly higher than our estimate on account of a positive surprise in other income, reversal of earlier provisions, and lower taxes. Adjusting for a Rs300m write-back of contingency provision, EBITDA came in at Rs1.57bn, almost exactly in line with our estimate of Rs1.59bn. TPWR also reported a profit of Rs224.3m on account of sale of its Power Systems Division. The tax rate in Q4FY06 is 6.8%, against the previous three quarters' average of 27.2%.

At Rs516, Tata Power is trading at a P/E of 22.4 on FY06, 23.6 on FY07E and 24.1 on FY08E. We maintain our DCF-based price target of Rs530, and downgrade the stock to Sell because it is trading very close to our target. Our price target not only prices in the current business but also the future growth opportunity.

Figure 1: Quarterly result

| | (Rs m) | | | |
|---|--------------|---------------|---------------|---------------|
| | Q4FY05 | Q3FY06 | Q4FY06A | Q4FY06E |
| Generation | 3,310 | 3,208 | 3,367 | 4,032 |
| Sales | 3,207 | 3,352 | 3,306 | 3,911 |
| Revenue from power supply | 8,609 | 11,624 | 11,062 | 11,668 |
| Income from other operations | 1,014 | 689 | 649 | 644 |
| Total revenue | 9,623 | 12,314 | 11,711 | 12,311 |
| Staff cost | 652 | 447 | 485 | 428 |
| Cost of power purchased | 990 | 2,081 | 1,305 | 1,413 |
| Cost of fuel | 4,620 | 6,453 | 6,365 | 6,337 |
| Provision for Contingencies | 300 | - | (300) | |
| Total Expenditure | 8,354 | 10,346 | 9,838 | 10,720 |
| Operating profit (Core EBITDA) | 1,269 | 1,968 | 1,873 | 1,592 |
| Depreciation | 1,029 | 712 | 734 | 772 |
| PBIT | 240 | 1,256 | 1,139 | 820 |
| Interest | 401 | 424 | 420 | 477 |
| Other income | 1,921 | 446 | 530 | 419 |
| PBT | 1,760 | 1,278 | 1,249 | 762 |
| Current tax | 97 | 366 | 177 | 21 |
| Deferred tax | (42) | (44) | (92) | 183 |
| PAT | 1,706 | 957 | 1,164 | 558 |
| Extra-ordinary Items | - | (1,320) | (224) | - |
| Adjusted profit after extra-ordinaries | 1,706 | 2,277 | 1,388 | 558 |

Source: Company, Brics Research

Q4FY06 result highlights

Decline in generation at Trombay made up by higher generation in Jojobera

The generation at the Trombay power plant declined by 8% YoY on account of scheduled shutdown of Unit 5 and lower gas availability for Unit 7. The loss on account of lower thermal generation was somewhat compensated by the 23% YoY growth in hydel generation due to high carry-over in hydro lakes.

Q4FY06 core EBITDA in line with our estimates

TPWR's Q4FY06 EBITDA came in at Rs1,873m, against our estimate of Rs1,592m. The difference is on account of the Rs300m write-back of contingency provision. Adjusting for this write-back, the quarter's EBITDA is exactly in line with our estimate.

Higher other income, lower interest expense and lower tax

The company reported an other income of Rs530m, as against our estimate of Rs419m. Interest expense was Rs57m lower than our estimate of Rs477m. The total tax liability came in at Rs85m, against our estimate of Rs204m. We do not know the reason for this lower tax provision.

Extraordinary gain on account of sale of Power Systems Division

TPWR reported a profit of Rs224.3m from sale of its Power Systems Division. Adjusted for the extraordinary gains from this sale, PAT came in at Rs1,164m.

The company has declared a dividend of Rs8.5/share, which translates into a dividend yield of 1.67%.

Appellate Tribunal sets aside TPWR's distribution rights to retail consumers

The Appellate Tribunal of Electricity has set aside against an MERC (Maharashtra Electricity Regulatory Commission) order that allowed TPWR to distribute electricity to retail consumers in Mumbai within the licence area of Reliance Energy Ltd (REL). The Tribunal held that Tata Power has not been granted a licence to undertake retail distribution of electricity in the area where REL has been distributing power to retail consumers. In another case, the Tribunal has set aside an order by MERC on a plea by TPWR, which had barred REL from giving rebate to its consumers in Mumbai.

The company has said that it would take necessary steps after studying the order of the Tribunal. The financial impact of the Tribunal's order is not known as yet. We do not expect the adverse judgment to have any material impact on TPWR.

Tala Transmission Project completed

The first phase of TPWR's Tala Transmission project has achieved completion, and is expected to start contributing to earnings from Q2FY07 onwards. Once the entire project is completed, it is expected to contribute Rs250m to the consolidated PAT every year.

Expansion projects

250 MW expansion project at Trombay

TPWR is setting up a 250MW coal-based plant at Trombay. The project has received all clearances, and project site development activities are in progress. The project is expected to be commissioned in FY09.

100MW diesel generating sets

TPWR is setting up a 100MW low-capital-cost diesel generating sets to meet the additional requirements of the Mumbai Licence Area. The project is expected to be commissioned in FY08.

1,000MW project in coastal Maharashtra

TPWR is setting up an imported coal-based 1,000MW power plant in coastal Maharashtra. The project is in a nascent stage, and the company has approached the government for land acquisition. We are sceptical on the prospects of this project.

Maithon Project

TPWR has completed the acquisition of 74% equity stake in Maithon Power Limited (MPL) from DVC for implementing the 1,000MW Maithon Right Bank Thermal Power Project. The project has got all clearances, and is in the land acquisition stage. The project is expected to be completed in FY10.

Captive power plants for Tata Steel

TPWR is setting up a 120MW captive plant for Tata Steel in Jamshedpur. This plant would run on waste gases from the company's steel furnaces. The project gestation period is expected to be 26 months. The company is also exploring the possibility of setting up captive power plants for Tata Steel's expansion projects in Chattisgarh, Orissa and Jharkhand

Ultra mega power projects (UMPPs)

TPWR will be participating in the bidding of the Sasan and Mundra ultra mega power projects. We believe that TPWR is a leading contender to win one of the four UMPPs.

Exploring opportunity in South Africa

TPWR, along with its local partners, has pre-qualified and has been invited to participate in the bidding process for a 290-380MW Open Cycle Gas Turbine Peaking IPP project in South Africa.

Our price target is Rs530

Our price target of Rs530 on TPWR is based on the following assumptions:

1. 10% cost of equity
2. Book value for telecom investments
3. Capitalised value of profits for power investments
4. No replacement of TPWR's thermal capacities
5. Growth option value assuming 14% return on equity on cash and investments invested in equities over six years.

Figure 2: Sum-of-parts valuation

| | Value per share (Rs) |
|---------------------|----------------------|
| Current business | 212 |
| Investments | 244 |
| Growth option value | 74 |
| Total | 530 |

We downgrade to Sell with an end FY07 price target of Rs530

At Rs516, Tata Power is trading at a P/E of 22.4 on FY06, 23.6 on FY07E and 24.1 on FY08E. We maintain our DCF-based price target of Rs530, and downgrade the stock to Sell because it is trading very close to our target. Our price target not only prices in the current business but also the future growth opportunity.

Figure 2: DCF valuation

| | FY07 | FY08 | FY09 | FY27 | FY42 | FY50 | FY51 |
|--|----------------|-------|---------|-------|-------|-------|--------|
| Net Income from business | 3,155 | 2,964 | 2,668 | 2,688 | 1,771 | 1,783 | 1,813 |
| Depreciation | 2,963 | 2,963 | 2,976 | 115 | 195 | 213 | 2,159 |
| Change in working capital | (255) | 173 | - | - | - | - | - |
| Capex | (500) | (500) | (256) | (96) | (35) | (35) | - |
| Change in debt | - | - | (1,803) | (643) | (275) | (118) | - |
| FCFE | 5,364 | 5,600 | 3,585 | 2,063 | 1,657 | 1,842 | 39,722 |
| Value of power business @ 10% cost of equity | 41,862 | | | | | | |
| Net cash at end-FY07 | 48,233 | | | | | | |
| Value of current business+Cash | 90,095 | | | | | | |
| Growth option value | 14,603 | | | | | | |
| Total equity value | 104,698 | | | | | | |
| Target price (Rs) | 530 | | | | | | |

| Income statement | | Rs m | | | | |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|--|
| Year ended 31 Mar | FY04 | FY05 | FY06 | FY07E | FY08E | |
| Net sales | 42,373 | 39,270 | 45,628 | 47,134 | 47,076 | |
| <i>growth (%)</i> | <i>(1.5)</i> | <i>(7.3)</i> | <i>16.2</i> | <i>3.3</i> | <i>(0.1)</i> | |
| Operating expenses | (30,453) | (30,043) | (36,973) | (38,450) | (38,668) | |
| Core EBITDA | 11,920 | 9,227 | 8,655 | 8,684 | 8,408 | |
| Other income | 1,600 | 3,871 | 1,712 | 1,771 | 1,923 | |
| EBITDA | 13,519 | 13,099 | 10,367 | 10,455 | 10,331 | |
| Depreciation | (3,340) | (3,596) | (2,783) | (2,963) | (2,963) | |
| EBIT | 10,180 | 9,502 | 7,583 | 7,491 | 7,368 | |
| Interest paid | (2,837) | (1,914) | (1,653) | (1,560) | (1,560) | |
| Non-recurring items (net of taxes) | 0 | 0 | 1,544 | 0 | 0 | |
| Pre-tax profit | 7,343 | 7,588 | 7,474 | 5,931 | 5,808 | |
| Tax (current + deferred) | (2,092) | (1,697) | (1,369) | (1,601) | (1,568) | |
| Profit after tax | 5,250 | 5,891 | 6,105 | 4,330 | 4,240 | |
| Net profit | 5,250 | 5,891 | 6,105 | 4,330 | 4,240 | |
| Adjusted net profit | 5,250 | 5,891 | 4,561 | 4,330 | 4,240 | |
| <i>growth (%)</i> | <i>(1.9)</i> | <i>12.2</i> | <i>(22.6)</i> | <i>(5.1)</i> | <i>(2.1)</i> | |

| Cash-flow | | Rs m | | | | |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|--|
| Year ended 31 Mar | FY04 | FY05 | FY06E | FY07E | FY08E | |
| Pre-tax profit | 7,343 | 7,588 | 7,474 | 5,931 | 5,808 | |
| Depreciation | 3,340 | 3,596 | 2,783 | 2,963 | 2,963 | |
| Tax paid | (2,020) | (3,696) | (123) | (1,644) | (1,601) | |
| Chg in working capital | 4,245 | 4,703 | 1,965 | 1,124 | 1,095 | |
| Other operating activities | 86 | (666) | 227 | 0 | 0 | |
| Cash flow from operations (a) | 12,993 | 11,525 | 12,327 | 8,375 | 8,264 | |
| Capital expenditure | (2,341) | (1,079) | (5,028) | (500) | (500) | |
| Chg in investments | (2,770) | (7,741) | 3,984 | (6,088) | (6,455) | |
| CF from investing (b) | (5,111) | (8,820) | (1,044) | (6,588) | (6,955) | |
| Free cash flow (a+b) | 7,883 | 2,705 | 11,283 | 1,787 | 1,309 | |
| Equity raised/(repaid) | (403) | (2,953) | 0 | 0 | 0 | |
| Debt raised/(repaid) | (6,778) | 11,386 | (4,600) | 0 | 0 | |
| Dividend (incl. tax) | (1,466) | (1,600) | (3,168) | (1,407) | (1,319) | |
| Other financing activities | (107) | (261) | (491) | (4) | 0 | |
| CF from financing (c) | (8,753) | 6,572 | (8,259) | (1,411) | (1,319) | |
| Net chg in cash (a+b+c) | (870) | 9,277 | 3,023 | 376 | (10) | |

| Balance sheet | | Rs m | | | | |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|--|
| Year ended 31 Mar | FY04 | FY05 | FY06E | FY07E | FY08E | |
| Current assets | 19,189 | 25,354 | 27,606 | 28,205 | 28,147 | |
| Investments | 27,288 | 35,029 | 31,045 | 37,133 | 43,589 | |
| Fixed assets | 34,318 | 32,467 | 34,711 | 32,248 | 29,785 | |
| Other assets | 822 | 0 | (900) | (1,800) | (2,700) | |
| Total assets | 81,617 | 92,850 | 92,462 | 95,786 | 98,820 | |
| Current liabilities | 12,902 | 8,678 | 10,553 | 10,798 | 10,812 | |
| Total Debt | 17,214 | 28,600 | 24,000 | 24,000 | 24,000 | |
| Other liabilities | 6,908 | 10,188 | 10,175 | 10,275 | 10,375 | |
| Total liabilities | 37,024 | 47,466 | 44,728 | 45,073 | 45,187 | |
| Paid-up capital | 1,979 | 1,979 | 1,979 | 1,979 | 1,979 | |
| Reserves & surplus | 42,614 | 43,404 | 45,754 | 48,734 | 51,653 | |
| Shareholders' funds | 44,593 | 45,383 | 47,733 | 50,713 | 53,632 | |
| Total equity & liabilities | 81,617 | 92,850 | 92,462 | 95,786 | 98,820 | |

| Key ratios | | | | | | |
|--------------------------|-------------|-------------|-------------|--------------|--------------|--|
| Year ended 31 Mar | FY04 | FY05 | FY06 | FY07E | FY08E | |
| Adjusted EPS (Rs) | 26.5 | 29.8 | 23.0 | 21.9 | 21.4 | |
| Adjusted EPS growth (%) | (1.9) | 12.2 | (22.6) | (5.1) | (2.1) | |
| Core EBITDA growth (%) | 0.7 | (22.6) | (6.2) | 0.3 | (3.2) | |
| Core EBITDA margin (%) | 28.1 | 23.5 | 19.0 | 18.4 | 17.9 | |
| Pre-tax margin (%) | 17.3 | 19.3 | 16.4 | 12.6 | 12.3 | |
| ROE (%) | 12.2 | 13.1 | 9.8 | 8.8 | 8.1 | |
| ROCE (%) | 14.5 | 12.4 | 9.1 | 9.0 | 8.5 | |
| Net debt/Equity (%) | 37.4 | 41.4 | 26.4 | 24.1 | 22.9 | |

| Valuation parameters | | | | | | |
|-----------------------------|-------------|-------------|-------------|--------------|--------------|--|
| Year ended 31 Mar | FY04 | FY05 | FY06 | FY07E | FY08E | |
| PER (x) | 19.5 | 17.3 | 22.4 | 23.6 | 24.1 | |
| PCE (x) | 11.9 | 10.8 | 13.9 | 14.0 | 14.2 | |
| Price/Book (x) | 2.3 | 2.3 | 2.1 | 2.0 | 1.9 | |
| Yield (%) | 1.4 | 1.5 | 1.6 | 1.2 | 1.1 | |
| EV/Net sales (x) | 2.8 | 3.1 | 2.5 | 2.4 | 2.4 | |
| EV/Core EBITDA (x) | 10.0 | 13.1 | 13.3 | 13.2 | 13.6 | |

Tata Power: Recommendation history

| Date | Stock price (Rs) | Report | Recommendation | Price target (Rs) |
|-----------|------------------|--|----------------|-------------------|
| 23-Jun-05 | 378 | Undervalued generation business, investments | BUY | 447 |
| 29-Jul-05 | 392 | Strong performance in power business | BUY | 447 |
| 9-Aug-05 | 417 | Growth visibility? Undervalued asset with potential for unlocking | BUY | 462 |
| 1-Sep-05 | 451 | Rollback of tariff hike: No impact on Tata Power – We raise price target to capture upsides from new growth opportunities | BUY | 530 |
| 6-Oct-05 | 475 | TPC signs MoU with Jharkhand for 3000MW power project | BUY | 530 |
| 19-Oct-05 | 428 | Operating performance in line with estimates – Net profit bolstered by lower depreciation and interest costs | BUY | 530 |
| 9-Jan-05 | 447 | Tata Power may acquire hydropower equipment firm – Successful acquisition could trigger a re-rating | BUY | 530 |
| 20-Jan-06 | 453 | Q3FY06 result: Operating performance below estimates - Sale of broadband business bolsters earnings | BUY | 530 |
| 30-May-06 | 516 | Q4FY06 result: Operating profit in line; positive surprise in PAT is due to tax credit and higher other income | SELL | 530 |

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