

Utilities

Waiting for Godot

Top picks

Tata Power

Q4FY07 marked the end of the X Five Year Plan (FYP) with the power industry falling short ~38% (~23GW capacity addition) of the revised target of 37GW (from 41GW earlier) to close the year at 130GW generation capacity. In NTPC alone, projects with 2GW capacity slipped into Q1FY08. The low achievement rate in a scenario of surging power demand across the nation (industrial, services, household and rural segments) has resulted in power deficit increasing to 13% on an average and to 15% in peak hours for the quarter. Adhering to project timelines is one concern that needs to be addressed in a healthy demand environment. We remain positive on Tata Power and NTPC on the back of robust order books through the next 4-5 years. We maintain Tata Power as our top pick backed by attractive valuations and potential triggers (such as unlocking value through sale of investments in Tata Teleservices) expected in the medium term.

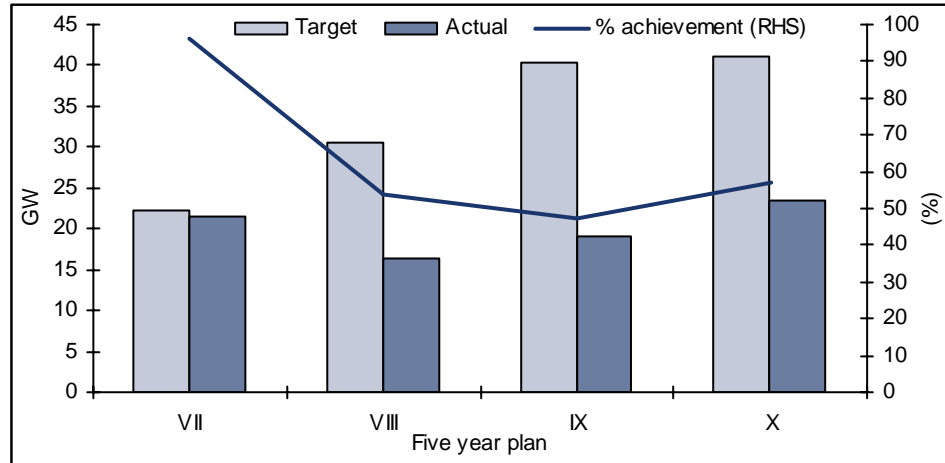
- ▶ **Power industry fell short ~38% of the X FYP target capacity addition.** On account of this, the year closed with just ~23GW addition as against the revised target of 37GW. Part of this gap (~5GW) is expected to come on-stream by end Q1FY08. This raises concerns as regards the probability of the ambitious ~68GW target set for the XI FYP being realised. We believe that a larger proportion of this target would be executed, partly accelerated by ultra mega power projects (UMPPs) and on the back of highest addition achieved (in the X FYP) till date (Chart 1).
- ▶ **Power deficit grows to 13%.** With CAGR of 6% for power demand versus 5% for power supply, the deficit has been consistently increasing (Chart 2). During Q4FY07, power deficit increased to 13% on an average, while the peak deficit rose to 15% (Chart 3). This implies that unless steps are taken to catalyse capacity expansion and electricity distribution, meeting the rising demand would be difficult.
- ▶ **UMPPs may provide respite, though execution remains a big challenge.** The Ministry of Power has identified nine UMPPs, majority of which would be awarded in FY08 itself. The Krishnapatnam UMPP based in Andhra Pradesh would likely be awarded by end April '07. The UMPPs are expected to be big triggers in capacity expansion, while their timely execution remains a major concern. The two already awarded UMPPs are facing troubled waters with the Sasan project likely to witness re-bidding (on account of concerns over Globeleq's stake sale to Lanco and the Jindals) and the Mundra project experiencing delays (due to the power purchase agreements not yet been signed by Tata Power).
- ▶ **Top pick – Tata Power** stands out as a value play, especially considering the value of its investments at Rs345/share. The recent acquisition of 30% stake in two Indonesian coal mines would help the company address fuel requirements for its planned projects over the next 4-5 years.

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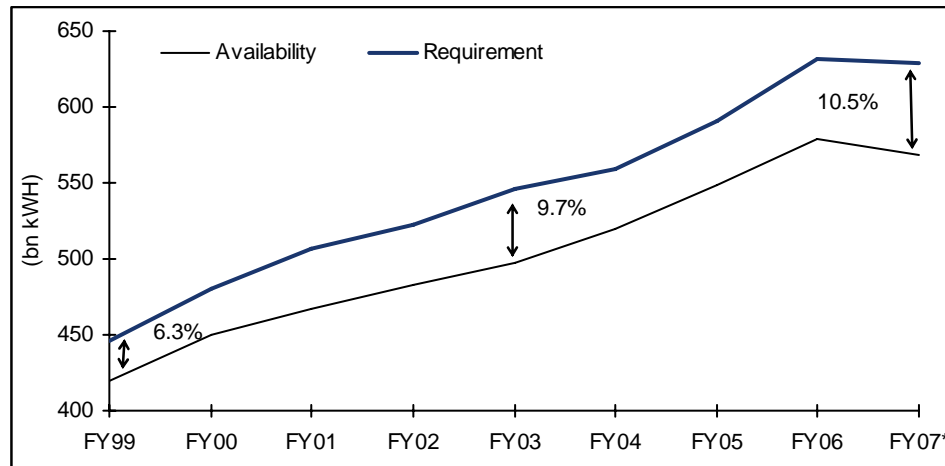
Chart 1: Highest capacity addition in any FYP, though at a low % achievement



Source: CEA

Chart 2: Burgeoning demand-supply gap

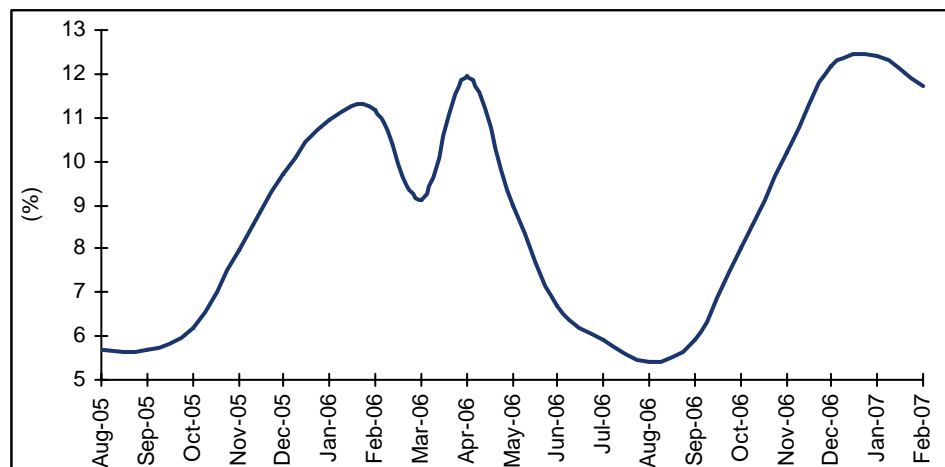
Power deficit has been continuously increasing on account of delay in capacity roll outs



* Apr'06 - Feb'07
Source: CEA

Chart 3: Power deficit trend through 18 months

Peak time power deficit has increased to an alarming 15%



Source: CEA

Table 1: Generation statistics*(bn Kwh)*

| | Jan- Feb '07 | Jan- Feb '06 | % chg | YTDFY07 | YTDFY06 | % chg |
|----------------------|--------------|--------------|--------|---------|---------|-------|
| Total Units | 109.96 | 103.92 | 5.82 | 600 | 562 | 6.8 |
| Thermal | 96.30 | 90.00 | 7.00 | 495 | 466 | 6.2 |
| Hydel | 13.66 | 13.92 | (1.82) | 105 | 94 | 11.4 |
| PLF (Thermal plants) | 82.40 | 80.10 | - | 76.3 | 73.3 | - |
| Power Shortage (%) | 12.10 | 10.90 | - | 9.5 | 8.2 | - |

Source: CEA

Table 2: Quarterly summary

| Company | Sales | | | EBITDA | | | PAT | | |
|-----------------|---------|-------|--------|---------|--------|--------|---------|--------|--------|
| | % Chg | | | % Chg | | | % Chg | | |
| | Q4FY07* | (YoY) | (QoQ) | Q4FY07* | (YoY) | (QoQ) | Q4FY07* | (YoY) | (QoQ) |
| (Rs mn) | | | | | | | | | |
| NTPC | 83,171 | 14.1 | 2.1 | 22,256 | 14.6 | (1.5) | 20,218 | 15.5 | (3.9) |
| Tata Power | 12,101 | 3.3 | 0.8 | 1,622 | 3.1 | (23.1) | 679 | (37.6) | (43.6) |
| Reliance Energy | 13,418 | 29.2 | (12.5) | 1,072 | (43.6) | 29.7 | 1,564 | (7.7) | (22.2) |

*Jan-Feb '07

Source: i-SEC Research

NTPC (Buy)

(QoQ chg: 16.6%; YTD chg: 15.9%)

Quarterly estimates

(Rs mn, year ending March 31)

| | Q4FY07E | Q4FY06 | YoY (%) | QoQ (%) | YTDFY07* | YTDFY06* | YoY (%) |
|----------|---------|--------|---------|---------|----------|----------|---------|
| Revenues | 83,171 | 72,914 | 14.1 | 2.1 | 221,142 | 188,515 | 17.3 |
| EBITDA | 22,256 | 19,423 | 14.6 | (1.5) | 60,963 | 54,562 | 11.7 |
| PBT | 21,534 | 17,540 | 22.8 | (3.9) | 55,995 | 49,905 | 12.2 |
| PAT | 20,218 | 17,503 | 15.5 | (3.9) | 53,054 | 47,920 | 10.7 |

Source: Company data, i-SEC Research

* Apr-Dec '06

- NTPC missed its target addition of 7,710MW for the X FYP with 2,000MW slipping into Q1FY08. Total generation capacity in FY07 increased 12% with ~2,400MW capacity addition. However, unit sales would likely grow 7% YoY due to 1,000MW capacity being operational for less than 20 days.
- EBITDA margins are expected to expand marginally 20bps resulting in 15% EBITDA growth. Interest costs would continue to be low (in line with the past two quarters' due to favourable forex movement), though net impact is expected to be lower (at Rs0.8bn) than that in Q3FY07 (Rs1.6bn).

Tata Power (Buy)

(QoQ chg: (9.4%); YTD chg: (13.7%))

Quarterly estimates

(Rs mn, year ending March 31)

| | Q4FY07E | Q4FY06 | YoY (%) | QoQ (%) | YTDFY07* | YTDFY06* | YoY (%) |
|----------|---------|--------|---------|---------|----------|----------|---------|
| Revenues | 12,101 | 11,711 | 3.3 | 0.8 | 37,780 | 33,829 | 11.7 |
| EBITDA | 1,622 | 1,573 | 3.1 | (23.1) | 7,184 | 6,694 | 7.3 |
| PBT | 951 | 1,473 | (35.4) | (67.4) | 5,188 | 6,002 | (13.6) |
| PAT | 679 | 1,088 | (37.6) | (43.6) | 4,419 | 3,313 | 33.4 |

Source: Company data, i-SEC Research

* Apr-Dec '06

- Revenues are expected to grow 3% YoY on the back of higher income from electricity, while remaining almost flat QoQ.
- EBITDA would likely increase 3% YoY as margins remain stable at 13.4%. On a QoQ basis, margins are expected to decline 420bps, resulting from higher SG&A.
- Tata Power is acquiring stake in two Indonesian coal mining companies to gain access to sufficient imported coal reserves for its upcoming projects. With lined up projects and inorganic expansions under consideration, the company would require ~US\$2bn in the near term and is expected to raise debt for majority of this requirement.
- The Maharashtra Electricity Regulatory Commission is still considering revision in tariffs with the final verdict expected in the near future.

Reliance Energy (Hold)

(QoQ chg: (7.1%); YTD chg: (22.5%))

Quarterly estimates

(Rs mn, year ending March 31)

| | Q4FY07E | Q4FY06 | YoY (%) | QoQ (%) | YTDFY07* | YTDFY06* | YoY (%) |
|----------|---------|--------|---------|---------|----------|----------|---------|
| Revenues | 13,418 | 10,382 | 29.2 | (12.5) | 40,962 | 29,808 | 37.4 |
| EBITDA | 1,072 | 1,901 | (43.6) | 29.7 | 4,237 | 5,442 | (22.1) |
| PBT | 1,868 | 2,396 | (22.0) | (26.2) | 6,929 | 5,502 | 25.9 |
| PAT | 1,564 | 1,695 | (7.7) | (22.2) | 5,840 | 4,891 | 19.4 |

Source: Company data, i-SEC Research

* Apr-Dec '06

- Reliance Energy (REL) bagged two major EPC contracts during the quarter (1,200MW Hisar thermal power project and 'Balance-of-plant-package' for the 2x250mw Parichha project), taking its total order book to ~Rs60bn. We expect Rs4bn worth EPC contracts to be executed in Q4FY07, registering 51% YoY growth for the segment. The electricity sales segment would take a slight hit due to grid failure for three hours in February '07. Overall, we expect income from electricity to grow 22% YoY.
- The increasing contribution from the low margin EPC segment would result in EBITDA margins dropping 1,030bps YoY. Though there would be a 260bps QoQ improvement due to a 34% decline in EPC revenues.
- REL would gain from a favourable rupee movement against the US\$ in the form of higher other income, though it will be significantly lower than the previous quarter's (Rs670mn as against Rs1,500mn for the past quarter).

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