

Tata Power

BUY

Upgrade from Hold

Coal play at an attractive price tag

Rs1,151

Reason for report: Recommendation change

We upgrade Tata Power (TPL) to BUY from Hold given the recent correction in the stock price – TPL has underperformed the Sensex 20% in the past year and risk-reward seems favourable at the current levels. We prefer TPL as: i) it is the only Indian utility to be net long on coal given our bullish view on coal price; also, cashflow related concerns for Bumi are now behind, ii) low overall merchant exposure (2% in FY13E) given our negative stance on merchant sales, iii) likely cashflow improvement for North Delhi Power (NDPL) with the reversal of regulatory assets and iv) upside from sale of non-core investments. Also, the Maithon plant will be available on merchant basis in FY12, which is an added positive. Key risks to our call are: i) underperformance by the Mundra project on operational parameters, ii) stake dilution at non-accretive prices and iii) coal availability at Maithon. Given the low risk from integrated and/or cost-plus business model and attractive valuation of FY12E P/B of 1.8x, we upgrade TPL to BUY and rate it as a top pick among large-caps in the sector. Our target price of Rs1,313/share implies an upside of 14%.

- ▶ **Net long on coal; cashflow concerns for Bumi behind.** TPL received ~US\$95mn as dividends and accrued fees in H2CY10 (which is a clear positive), thus assuaging cashflow concerns from Bumi. TPL is the only Indian utility to be net long on coal (~23.3mnmt in FY14) and would benefit from rising coal prices.
- ▶ **TPL low on merchant sales – Low-risk model.** We prefer TPL's regulated/bidding based portfolio, which hardly relies on merchant sales (2% of capacity in FY13E). TPL's business model is cost plus or integrated – hence, a low-risk model despite weak power sector outlook.
- ▶ **NDPL – Cashflow improvement likely.** NDPL has Rs16bn regulatory assets – falling power purchase costs and possible tariff hikes can reverse regulatory assets, leading to cashflow improvement.
- ▶ **Upgrade to BUY; unrelated investment sale could be an added positive.** We upgrade TPL to BUY with a target price of Rs1,313. Also, possible divestment of non-core investments (stakes in group companies) can provide further upside (Rs80/share) and assuage concerns over likely dilution to fund growth.

Market Cap	Rs273bn/US\$6.0bn	Year to Mar (Cons.)	FY10	FY11E	FY12E	FY13E
Reuters/Bloomberg	TTPW.BO/ TPWR IN	Revenue (Rs mn)	187,129	208,268	240,886	294,873
Shares Outstanding (mn)	237.3	Net Income (Rs mn)	19,668	20,221	23,567	26,656
52-week Range (Rs)	1,433/1,151	DEPS (Rs)	79.9	82.1	95.7	108.2
Free Float (%)	68.2	% Chg YoY	55.6	2.8	16.5	13.1
FII (%)	20.1	P/E (x)	14.4	14.0	12.0	10.6
Daily Volume (US\$/'000)	9,382	CEPS (Rs)	120.5	124.9	151.6	190.9
Absolute Return 3m (%)	(11.7)	EV/E (x)	10.2	9.7	8.2	5.9
Absolute Return 12m (%)	(9.7)	Dividend Yield (%)	1.0	1.1	1.2	1.2
Sensex Return 3m (%)	(7.7)	RoCE (%)	9.2	7.2	7.6	8.9
Sensex Return 12m (%)	10.0	RoE (%)	19.7	16.5	16.8	16.5

Power

Target price Rs1,313

Shareholding pattern

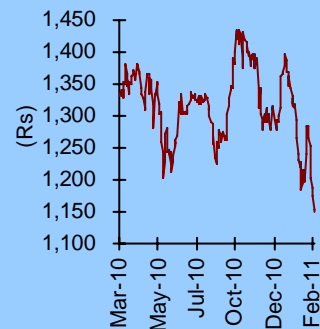
	Jun '10	Sep '10	Dec '10
Promoters	31.8	31.8	31.8
Institutional investors	47.1	47.7	48.1
MFs and UTI	6.2	4.7	3.7
Insurance/FIs	23.0	23.5	23.9
FIs	17.6	19.1	20.1
Others	21.1	16.7	20.1

Source: NSE

Target price revision

Rs1,313 from Rs1,304

Price chart



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Net long on coal

Bumi's cashflow concerns behind

TPL is the only Indian utility to be net long on coal – it enjoys 30% stake in Bumi Resources mines, thus securing a ~23mnte long position in Indonesian coal through FY14E. A 15% surge in the long-term realisations from Bumi increases the fair value ~10% (Rs136/share).

Table 1: Net long on coal

	Quantity (mnte)
Bumi production (FY14E)	100
TPL's share (30%)	30
Mundra consumption	12.3
of which pass through	5.6
of which non-pass through	6.7
TPL – (Bumi + Mundra) position on coal	
Long on coal (mntpa)	30
Short on coal (mntpa)	6.7
Net long on coal	23.3

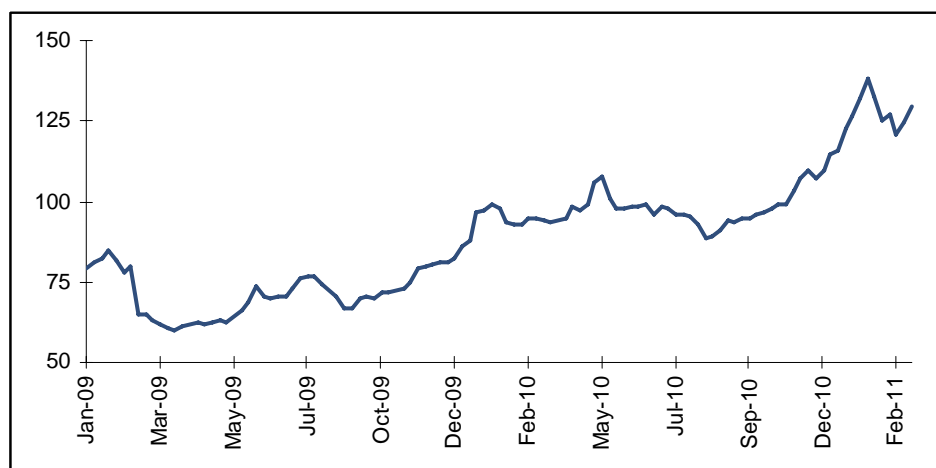
Source: I-Sec Research

TPL received US\$39mn dividend in Q2FY11 and US\$56mn accrued fees in Q3FY11

Further, TPL received a sizeable dividend from Bumi in Q2FY11 (after five quarters of minimal dividend) and accrued fees in Q3FY11. Regular cashflows are a clear positive.

Though realisation were somewhat sticky in Q3FY11, with the international thermal coal prices surging 39% in the past six months, realisations from Bumi are expected to increase once the long-term contracts come up for renewal. We are also of the view that the firmness in the coal prices is here to stay in the near-to-mid term, thus benefiting Bumi on a sustainable basis.

Chart 1: Rising international coal prices



Source: Bloomberg

Table 2: Bumi Resources – Key assumptions

	FY12	FY13	FY14	Unit
Sales	80	90	101	mnte
Long-term average realisations	65	67	70	US\$/te
Long-term average cash costs	34	34	33	US\$/te

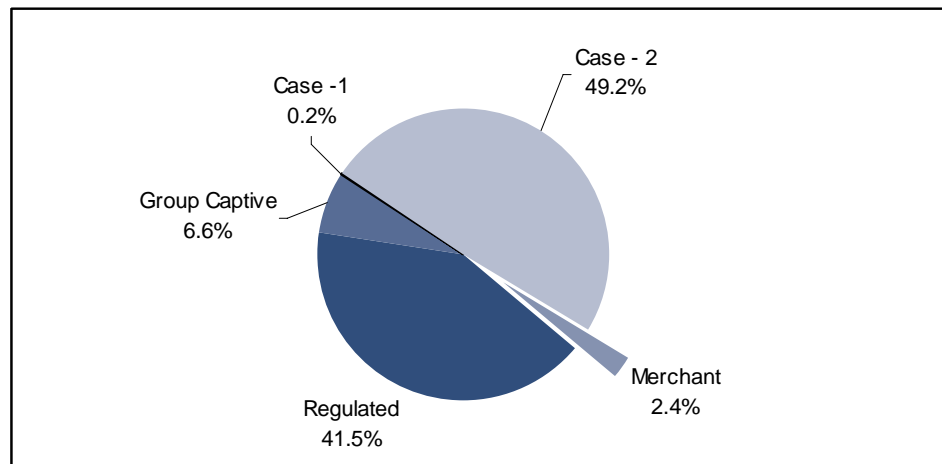
Source: I-Sec Research

TPL low on merchant sales – Low-risk model

TPL prudently follows a largely stable cashflow business model with little reliance on merchant power (~2% in FY13E). Bulk of the capacity (~98%) is under regulated-RoE and case-based bidding model, thus providing TPL with stable cashflows. Further coal integration reduces the risk of bidding-based business.

Also, the management has guided that TPL would be able to sell units on a merchant basis from its Maithon plant in FY12, thereby providing added upside from pre-PPA merchant sales. The Maithon plant enjoys 1mtpa middling coal supply from Tata Steel and has the capability to run on imported coal if it does not get the full supply as per its linkage with Coal India.

Chart 2: Cost plus or integrated model – Low reliance on merchant sales



Source: Company data, I-Sec Research

NDPL – Cashflow improvement likely

With external power purchase costs falling and the Delhi distribution region possibly facing a tariff hike, it is likely that regulatory assets in the next three years will reverse (currently at ~Rs16bn). Increasing supply volumes at relatively lower costs can help recoup the under-recovery.

Non-core investments – Possible upside exists

We value TPL's non-core investments (in Tata Group companies) at ~Rs25bn or Rs105/share. Possible sale can provide a further upside of Rs80/share (if the TTSL stake is sold at the initial transaction value entered into with NTT DoCoMo) and can free up resources – this would partially negate the need for dilution to fund growth.

Table 3: Non-core investments – Snapshot

(Rs mn)

Company	Sector	Value	Stake	Value for TPL	Value/share (Rs)
Tata Teleservices (Mah)	Telecom	28,553	7%	2,067	9
Tata Communications	Telecom	61,275	5%	2,886	12
Tata Teleservices	Telecom	38,124		19,062	80
Nelco	IT	1,666	49%	810	3
Total		129,617		24,825	105

Source: I-Sec Research

Mundra project – Walking the tight rope

Mundra ultra mega power project (UMPP) will likely be India's first UMPP to go on stream. With a capacity of 4,000MW (800MWx5), the project uses imported coal and has a coal requirement of ~12mtpa. The management expects the first unit to be operational from September '11 and hopes that the rest of the units will start every four months. Coal will be sourced from the Bumi mines. We assume a heat rate of 2,000Kcal/KwHr and a GCV of 5,400Kcal/Kg. Post stabilisation in FY14, we expect the plant to operate at 95% PLF and use 5% of its power for auxiliary consumption. We value the Mundra UMPP at Rs23/share.

A subdued operational performance can erode Mundra's fair value significantly. To illustrate, lower heat rate (by 50Kcal/KwHr) can erode the plant's fair value to nil. But with tariffs at ~Rs2/unit, we do not expect the offtake side to pose a problem.

While Mundra's performance would be a key factor to watch out for, possible upside from coal realisation and non-core investment sales more than address the concern.

Table 4: Mundra UMPP – Valuation sensitivity to PLF and heat rate

PLF (%)	Heat rate (Kcal/KwHr)					
	1,900	1,950	2,000	2,050	2,100	2,150
75	(32)	(51)	(70)	(88)	(107)	(125)
80	(7)	(27)	(46)	(66)	(86)	(105)
85	18	(2)	(23)	(44)	(65)	(85)
90	44	22	(0)	(22)	(44)	(66)
95	69	46	23	0	(23)	(46)

Source: I-Sec Research

Table 5: Status of projects under construction

Project	Capacity (MW)	TPL's interest	Project cost (Rs bn)	Capex till March '10 (Rs bn)	Remark
Mundra	4,000	100%	170	73	As per the management, the project is 71% complete. Plans to complete the first unit are ahead of schedule. Unit-1 boiler- turbine work is complete. Evacuation work by Power Grid is on track, challenges exist in Right of Way for transmission project. Boiler hydro testing for Unit-II complete
Maithon	1,050	74% (JV with Damodar Valley Corporation)	48	23	92% project complete; Unit-I BLU completed in Q3FY11; 400KVA switchyard back charging complete. Plans to transport coal by road since rail arrangements are delayed. Unit -1 expects to achieve synchronisation in February '11
Jojobera Unit 5	120	74% (JV with Tata Steel)	6.2	6.2	120MW synchronised in January '11. CoD likely in Q4FY11

Source: Company data

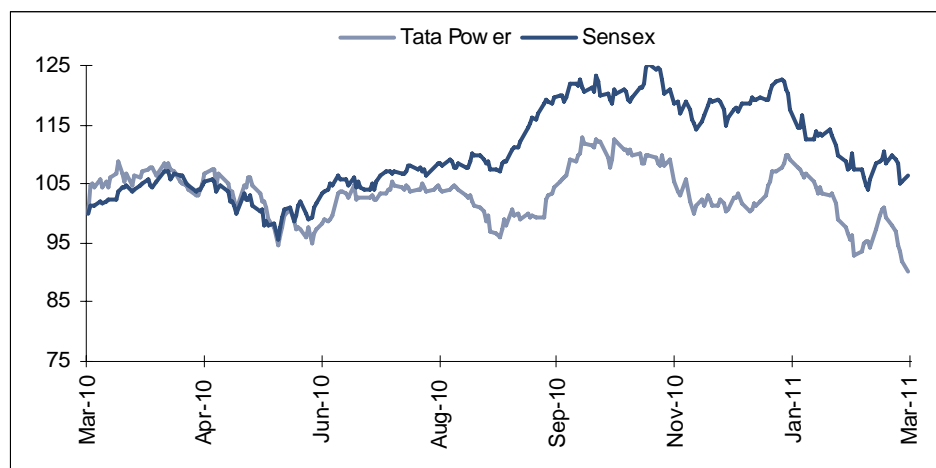
Table 6: TPL – Sum-of-the-parts valuation

Project	Status	Method	Discount rate (%)	Value (Rs mn)	TPL's share (%)	Value for TPL (Rs mn)	Value/share
TPL's businesses							
Mumbai+ Haldia regulated	Existing	FCFF	10.1	56,358	100	56,358	237
Merchant (Haldia+Unit 8)	Existing	FCFE	13.0	18,457	100	18,457	78
IPPs + Wind	Existing	FCFE	13.0	19,485	100	19,485	82
Maithon	Under const	FCFE	13.0	25,091	74	18,568	78
IEL (Jojobera+Jamshedpur	Under const	FCFE	13.0	4,555	74	3,371	14
NDPL	Existing	FCFE	13.0	29,442	51	15,015	63
Power Links - Tala	Existing	FCFE	13.0	8,038	51	4,099	17
Power Trading Business	Existing	PE FY12 10x		1,275	100	1,275	5
Bumi resources & Mundra	Coal mine + UMPP	FCFE	13% for UMPP & 15% for coal mines	340,503	100 & 30	105,993	447
Investments							
			CMP (Rs)				
Tata Teleservices (Maharashtra)	Investment	C Mcap	15	28,553	7	2,067	9
Tata Communications	Investment	C Mcap	215	61,275	5	2,886	12
Tata Tele Svc	Investment	50% discount to value ascribed in NTT DoCoMo deal		38,124		19,062	80
Nelco	Sub	C Mcap	73	1,666	49	810	3
All other investments	Investment	BV	1	18,390	100	18,390	77
Cash net of unallocated debt	Investment	BV		25,534	100	25,785	109
						Share value	1,313

Source: Company data, I-Sec Research

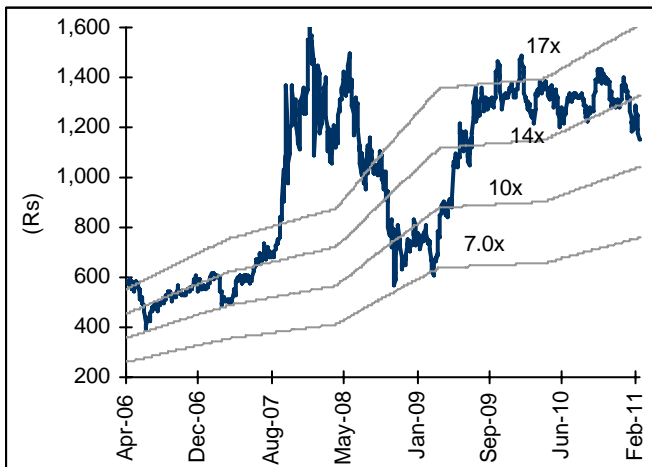
Valuation methodology and risks

We upgrade TPL to BUY from Hold with a DCF-SOTP based target price of Rs1,313/share. The key risks to our call are: i) dilution of holdings in assets to fund growth, ii) below-par operational performance of Mundra UMPP and iii) lower-than-expected realisations from the Bumi mines.

Chart 3: TPL has underperformed the Sensex 20% since January '10

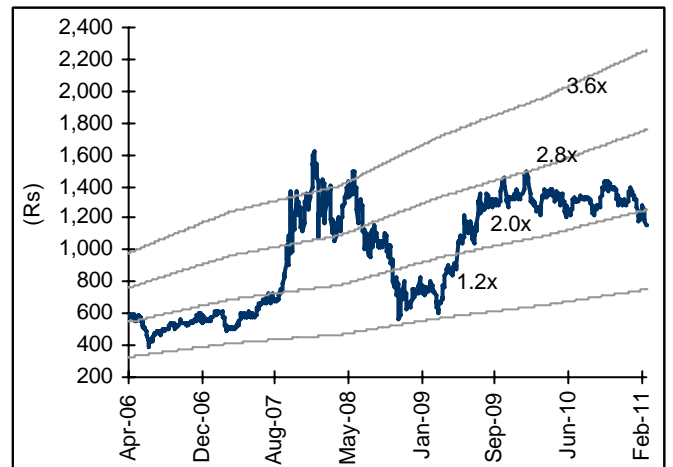
Source: Bloomberg

Chart 4: P/E bands



Source: Bloomberg, I-Sec Research

Chart 5: P/BV bands



Financial summary (Consolidated)

Table 7: Profit and Loss statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Income (Sales)	187,129	208,268	240,886	294,873
of which Power	124,579	138,298	168,722	212,903
of which Coal	56,210	63,630	65,824	75,630
of which Others	6,340	6,340	6,340	6,340
Operating Expenses	147,366	160,198	181,556	216,137
EBITDA	39,763	48,070	59,330	78,736
% margins	21.2%	23.1%	24.6%	26.7%
Depreciation & Amortisation	8,930	9,404	12,404	18,654
Gross Interest	7,818	7,647	11,153	19,575
Other Income	2,489	2,370	2,260	2,799
Recurring PBT	25,504	33,389	38,033	43,306
Add: Extraordinaries	2,169	-	-	-
Less: Taxes	6,287	12,281	12,968	15,041
Less: Minority Interest	(2,335)	(1,534)	(2,178)	(2,324)
Net Income (Reported)	19,668	20,221	23,567	26,656
Recurring Net Income	19,668	20,221	23,567	26,656

Source: Company data, I-Sec Research

Table 8: Balance sheet

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Assets				
Total Current Assets	96,901	98,831	117,272	147,147
of which cash & cash eqv.	23,108	23,762	33,797	45,035
Total Current Liabilities & Provisions	74,081	72,696	79,398	90,491
Net Current Assets	22,821	26,135	37,875	56,656
Investments	30,823	15,823	15,823	15,823
of which				
Other Marketable	30,823	15,823	15,823	15,823
Net Fixed Assets	267,402	343,537	378,057	376,807
of which				
Capital Work-in-Progress	116,927	186,958	113,283	24,776
Goodwill	3,895	6,400	8,905	11,409
Total Assets	324,940	391,895	440,659	460,695
Liabilities				
Borrowings	184,469	233,413	260,325	255,275
Deferred Tax Liability	4,308	4,308	4,308	4,308
Equity Share Capital	2,373	2,373	2,373	2,373
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	111,631	128,109	147,783	170,545
Net Worth	114,004	130,482	150,155	172,917
Total Liabilities	324,940	391,895	440,659	460,695

Source: Company data, I-Sec Research

Table 11: Quarterly trend

	Mar-10	Jun-10	Sep-10	Dec-10
Net sales	53,125	51,838	47,978	44,129
% growth (YoY)	-	12.2	13.2	(1.7)
EBITDA	10,768	11,389	11,257	10,266
Margin (%)	20.3	22.0	23.5	23.3
Other income	4,033	370	1,077	742
Add: Extraordinaries	519	(994)	2,200	321
Net profit (Reported)	10,365	3,542	6,755	4,424

Source: Company data, I-Sec Research

Table 9: Cashflow statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Cash flow	23,940	27,256	33,711	42,510
Working Capital Changes	(4,839)	(2,660)	(1,705)	(7,543)
Capital Commitments	(70,551)	(85,540)	(46,924)	(17,405)
Free Cash Flow	(51,450)	(60,944)	(14,917)	17,562
Cash flow from Investing				
Activities	5,967	14,865	(244)	295
Issue of Share Capital	15,493	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	43,035	48,943	26,912	(5,049)
Dividend paid	(3,344)	(3,616)	(3,894)	(3,894)
Extraordinary Items	2,169	-	-	-
Chg. in Cash & Bank balance	11,312	655	10,035	11,238

Source: Company data, I-Sec Research

Table 10: Key ratios

(Year ending March 31)

	FY10	FY11E	FY12E	FY13E
Per Share Data (Rs)				
EPS(Basic Recurring)	82.9	85.2	99.3	112.3
Diluted Recurring EPS	79.9	82.1	95.7	108.2
Recurring Cash EPS	120.5	124.9	151.6	190.9
Dividend per share (DPS)	11.6	13.0	14.0	14.0
Book Value per share (BV)	480.4	549.9	632.8	728.7
Growth Ratios (%)				
Operating Income	3.6	11.3	15.7	22.4
EBITDA	8.9	20.9	23.4	32.7
Recurring Net Income	61.4	2.8	16.5	13.1
Diluted Recurring EPS	61.4	2.8	16.5	13.1
Diluted Recurring CEPS	42.3	3.6	21.4	26.0
Valuation Ratios (x)				
P/E	14.4	14.0	12.0	10.6
P/CEPS	9.6	9.2	7.6	6.0
P/BV	2.4	2.1	1.8	1.6
EV / EBITDA	10.2	9.7	8.2	5.9
EV / Operating Income	2.2	2.2	2.0	1.0
EV / Operating FCF	(7.8)	(7.7)	(32.4)	16.9
Operating Ratio				
Employee cost / Revenue	13.4	12.2	11.1	9.4
Operating expenses / Revenue	4.3	4.1	4.4	4.4
Other Income / PBT (%)	9.8	7.1	5.9	6.5
Effective Tax Rate (%)	24.6	36.8	34.1	34.7
NWC / Total Assets (%)	(0.1)	0.6	0.9	2.5
Inventory Turnover (days)	19.2	17.9	17.7	17.3
Receivables (days)	68.8	67.4	58.1	54.5
Payables (days)	115.7	125.4	104.7	97.2
D/E Ratio (x)	1.7	1.8	1.8	1.5
Return/Profitability Ratio (%)				
Recurring Net Income Margins	10.4	9.6	9.7	9.0
RoCE	9.2	7.2	7.6	8.9
RoNW	19.7	16.5	16.8	16.5
Dividend Payout Ratio	14.0	15.3	14.1	12.5
Dividend Yield	0.9	1.0	1.1	1.1
EBITDA Margins	21.2	23.1	24.6	26.7

Source: Company data, I-Sec Research

Financial summary (Standalone)

Table 12: Profit and Loss statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Income (Sales)	68,459	72,917	75,989	78,573
Operating Expenses	52,360	54,138	57,086	59,737
EBITDA	16,099	18,779	18,903	18,836
% margins	23.5%	25.8%	24.9%	24.0%
Depreciation & Amortisation	4,779	4,899	4,993	5,046
Gross Interest	4,066	3,797	3,462	3,160
Other Income	2,296	1,713	1,083	811
Recurring PBT	9,549	11,795	11,532	11,440
Add: Extraordinaries	3,044	-	-	-
Less: Taxes	3,205	3,041	2,951	2,919
Net Income (Reported)	9,388	8,754	8,580	8,521
Recurring Net Income	6,344	8,754	8,580	8,521

Source: Company data, I-Sec Research

Table 13: Balance sheet

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Assets				
Total Current Assets	59,543	43,332	41,271	37,694
of which cash & cash eqv.	12,776	3,633	2,335	(327)
Total Current Liabilities & Provisions	21,683	21,946	22,383	22,776
Net Current Assets	37,860	21,386	18,887	14,917
Investments	66,886	80,815	85,516	94,016
of which				
Strategic/Group	59,521	73,450	79,150	87,650
Other Marketable	7,365	7,365	6,365	6,365
Net Fixed Assets	62,290	63,379	62,843	60,185
of which				
Capital Work-in-Progress	3,646	3,646	3,646	3,646
Total Assets	167,035	165,580	167,246	169,118
Liabilities				
Borrowings	58,720	52,007	48,857	45,972
Deferred Tax Liability	8,328	8,328	8,328	8,328
Equity Share Capital	2,373	2,373	2,373	2,373
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus	91,167	96,514	101,418	106,264
Net Worth	99,988	105,246	110,061	114,818
Total Liabilities	167,036	165,580	167,246	169,118

Source: Company data, I-Sec Research

Table 16: Quarterly trend

	Mar-10	Jun-10	Sep-10	Dec-10
Net sales	17,751	18,679	16,361	16,519
% growth (YoY)	20.4	4.7	(4.9)	5.4
EBITDA	3,781	4,509	3,510	3,319
Margin (%)	21.3	24.1	21.5	20.1
Other income	410	1,035	1,570	794
Add: Extraordinaries	833	510	366	58
Net profit	2,306	2,690	2,517	1,531

Source: Company data, I-Sec Research

Table 14: Cashflow statement

(Rs mn, year ending March 31)

	FY10	FY11E	FY12E	FY13E
Operating Cash flow	9,761	11,941	12,490	12,757
Working Capital Changes	(2,070)	5,811	(320)	(212)
Capital Commitments	(21,077)	(19,918)	(10,157)	(10,888)
Free Cash Flow	(13,386)	(2,166)	2,013	1,657
Cash flow from Investing Activities	5,999	3,233	3,603	2,331
Issue of Share Capital	15,493	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	6,738	(6,713)	(3,150)	(2,884)
Dividend paid	(3,233)	(3,496)	(3,765)	(3,765)
Extraordinary Items	3,044	-	-	-
Chg. in Cash & Bank balance	12,321	(9,143)	(1,299)	(2,662)

Source: Company data, I-Sec Research

Table 15: Key ratios

(Year ending March 31)

	FY10	FY11E	FY12E	FY13E
Per Share Data (Rs)				
EPS(Basic Recurring)	26.7	36.9	36.2	35.9
Diluted Recurring EPS	25.9	35.7	35.0	34.7
Recurring Cash EPS	46.9	57.5	57.2	57.2
Dividend per share (DPS)	11.6	13.0	14.0	14.0
Book Value per share (BV)	421.3	443.5	463.7	483.8
Growth Ratios (%)				
Operating Income	(5.4)	6.5	4.2	3.4
EBITDA	41.1	16.6	0.7	(0.4)
Recurring Net Income	21.5	38.0	(2.0)	(0.7)
Diluted Recurring EPS	13.4	38.0	(2.0)	(0.7)
Diluted Recurring CEPS	22.0	22.7	(0.6)	(0.0)
Valuation Ratios (x)				
P/E	44.4	32.3	32.9	33.1
P/CEPS	24.6	20.0	20.1	20.1
P/BV	2.7	2.6	2.5	2.4
EV / EBITDA	19.6	16.9	16.8	16.8
EV / Operating Income	4.6	4.4	4.2	4.0
EV / Operating FCF	2,273.4	27.0	41.1	31.2

Operating Ratio

Employee cost / Revenue	9.3	8.4	8.5	8.2
Operating expenses / Revenue	4.5	4.5	5.1	5.5
Other Income / PBT (%)	24.0	14.5	9.4	7.1
Effective Tax Rate (%)	33.8	25.8	25.6	25.5
NWC / Total Assets (%)	15.0	10.7	9.9	9.0
Inventory Turnover (days)	32.9	28.4	26.7	26.4
Receivables (days)	97.9	88.4	73.5	73.7
Payables (days)	59.0	61.3	61.3	63.2
D/E Ratio (x)	0.7	0.6	0.5	0.5

Return/Profitability Ratio (%)

Recurring Net Income Margins	9.0	11.7	11.1	10.7
RoCE	5.9	7.0	6.7	6.5
RoNW	7.0	8.5	8.0	7.6
Dividend Payout Ratio	43.3	35.2	38.7	39.0
Dividend Yield	1.0	1.1	1.2	1.2
EBITDA Margins	23.5	25.8	24.9	24.0

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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