

NOVEMBER 27, 2009
RESULT

 Coverage view: **Attractive**

 Price (Rs): **1,330**

 Target price (Rs): **1,400**

 BSE-30: **16,855**

Stable operations, reasonable valuations. Tata Power (TPWR) reported consolidated revenues of Rs45.6 bn, operating profit of Rs9.3 bn and net profit of Rs3.6 bn for 2QFY10, aided by a stable performance from the power business even as earnings from coal business were subdued due to weak realizations. We believe that TPWR is well positioned to meet its target capacity of 5.8 GW by FY2012 and maintain our ADD rating and target price of Rs1,400/share.

Company data and valuation summary

Tata Power

Stock data		Forecasts/Valuations			
		2009	2010E	2011E	
52-week range (Rs) (high,low)	1,490-602	EPS (Rs)	50.2	63.3	70.3
Market Cap. (Rs bn)	315.8	EPS growth (%)	57.5	26.1	11.1
Shareholding pattern (%)		P/E (X)	26.5	21.0	18.9
Promoters	31.1	Sales (Rs bn)	175.9	181.8	195.4
FIs	23.9	Net profits (Rs bn)	11.2	15.6	17.4
MFs	7.3	EBITDA (Rs bn)	37.2	38.4	42.7
Price performance (%)		EV/EBITDA (X)	12.0	13.2	12.9
Absolute	1M (5.1) 3M (2.3) 12M 102.9	ROE (%)	12.0	13.7	12.8
Rel. to BSE-30	(5.7) (8.5) 8.7	Div. Yield (%)	0.8	0.9	1.1

Stable earnings from power business, tepid performance from coal.

TPWR reported consolidated revenues of Rs45.6 bn (-1% yoy) contributed by Rs31.9 bn (-1% yoy) from power business and Rs11.3 bn (-7% yoy) for proportionate share from sale of coal in the mines in Indonesia. Lower revenues from power business were on account of a sharp decline in fuel costs, even as EBIT from power business grew 45% yoy to Rs4.2 bn. However a sharp decline in coal realizations coupled with stable-to-increasing production costs led to a 18% yoy decline in EBIT from coal business at Rs3.4 bn. Higher depreciation cost from recently commissioned power capacities (not significantly contributing to earnings) in the current year, and a substantially lower effective tax rate in 2QFY09 led to 30% yoy decline in net profits at Rs3.6 bn.

Moderating earnings from coal business, tweaking assumptions on volumes and realizations.

A strengthening domestic currency, stable prices for imported coal and higher production cost (on account of increasing crude prices) led to a tepid performance from the coal business and requires us to re-visit our assumptions on volume and realizations. We now factor realizations of US\$63.9/ton (US\$65.4/ton previously) in FY2010E and volume growth of 5% yoy, implying sales of 57.8 mn tons compared to 60.5 mn tons factored previously. Our revised estimates yield revenues of Rs49 bn (Rs53 bn previously) and EBIT of Rs15 bn (Rs16.9 bn previously) from the coal business in FY2010E.

Maintain ADD rating and target price of Rs1,400/share.

We maintain our ADD rating and SOTP-based target price of Rs1,400/share. Our SOTP valuation comprises four components—(1) value of operating power assets and projects nearing completion (Rs601/share), (2) valuation of investments and cash in books equivalent to Rs357/share, (3) projects under-implementation (Rs220/share) and (4) valuation of stake in coal mines in Indonesia valued at Rs217/share. Upside risks to our estimates emanate from (1) firmness in prices of imported coal, and (2) higher contribution from merchant sales due to improved realizations. We have revised our earnings estimates to Rs63.3 (Rs72 previously) for FY2010E, Rs70.3 (Rs80.9 previously) for FY2011E and Rs82.8 for FY2012E. Our EPS estimates also factor in the dilution on account of FCCB issuance.

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Exhibit 1: Earnings growth was marred by a tepid performance from the coal business
Interim results for Tata Power (Consolidated), March fiscal year-ends (Rs mn)

	2QFY10	2QFY09	1QFY10	(% Chg.)		FY2010E	FY2009	(% Chg.)
				2QFY09	1QFY10			
Net sales	45,612	46,272	44,693	(1)	2	181,764	175,875	3
Cost of electrical energy purchased	(12,177)	(11,850)	(11,505)			(44,451)	(43,724)	
Cost of fuel	(12,276)	(16,152)	(12,396)			(43,147)	(55,223)	
Coal processing charges	(4,706)	(2,829)	(4,195)			(13,659)	(13,071)	
Personnel costs	(2,484)	(1,635)	(1,849)			(3,808)	(6,128)	
Other expenses and provisions	(4,650)	(5,248)	(5,127)			(38,837)	(21,234)	
Total expenses	(36,294)	(37,713)	(35,071)			(143,902)	(139,379)	
EBITDA	9,318	8,559	9,622	9	(3)	37,862	36,496	4
Depreciation	(2,244)	(1,788)	(2,011)			(8,134)	(6,565)	
EBIT	7,074	6,771	7,611			29,728	29,931	
Other income	964	1,306	342			4,846	1,813	
Net interest	(1,877)	(1,695)	(2,055)			(8,561)	(8,129)	
PBT	6,160	6,382	5,898	(3)	4	26,013	23,616	10
Tax	(2,387)	(1,048)	(2,208)			(9,141)	(11,651)	
Statutory appropriations	(10)	(90)	199			—	453	
Minority interest and share of associates	(86)	35	(308)			(1,254)	(800)	
Net profit	3,677	5,279	3,580	(30)	3	15,617	11,618	34
Extraordinary	—	—	2,146			2,146	1,023	
Reported profit	3,677	5,279	5,727			17,763	12,640	
EBITDA margin (%)	20	18	22			21	21	
Effective tax rate (%)	39	16	37			35	49	
Segment revenues								
Power	31,986	32,190	30,991	(1)	3	124,710	120,339	4
Coal	11,308	12,133	11,584	(7)	(2)	49,720	47,766	4
Others	2,318	1,950	2,118	19	9	7,333	7,770	(6)
Total	45,612	46,272	44,693	(1)	2	181,764	175,875	3
Less: Inter segment revenues	—	—	—			—	—	
Net revenues	45,612	46,272	44,693			181,764	175,875	
EBIT								
Power	4,229	2,917	3,840	45	10	18,714	16,328	15
Coal	3,404	4,130	3,732	(18)	(9)	15,126	14,639	3
Others/ Unallocated	404	1,847	381	(78)	6	733	777	(6)
Total	8,037	8,893	7,953	(10)	1	34,574	31,744	9
EBIT margin (%)								
Power	13	9	12			15	15	
Coal	30	34	32			30	31	
Others	12	47	10			10	10	
Total	17	17	17			19	19	

Source: Company, Kotak Institutional Equities estimates

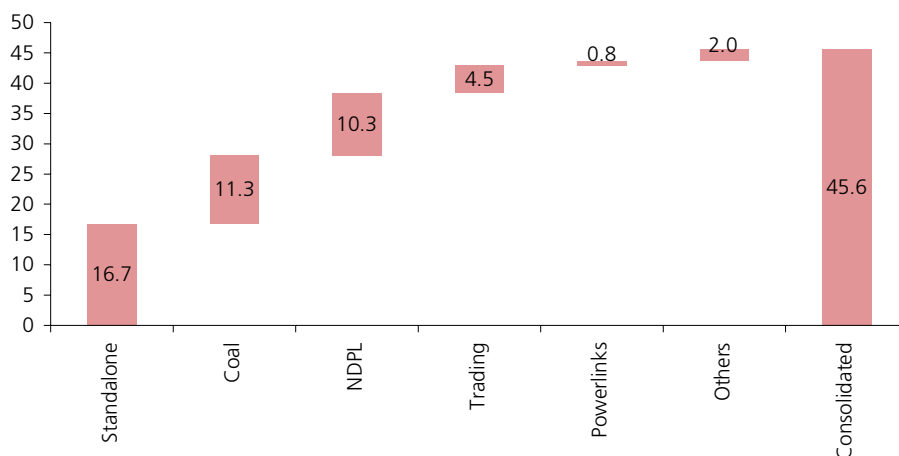
Business-wise analysis of quarterly results

- **Standalone:** TPWR reported standalone revenues of Rs16.7 bn, operating profit of Rs3.6 bn and net profit of Rs1.9 bn in 2QFY10. Lower per unit fuels costs are on account of declining prices of imported coal, while higher depreciation (+55% yoy) and interest expense (+49% yoy) reflect the commissioning of capacities at Trombay (250 MW), Haldia (120 MW) and additional wind capacities, all of which will likely start contributing to earnings more meaningfully in subsequent quarters.

- ▶ **Coal:** TPWR accrued proportionate revenues for the 30% ownership in the coal mines in Indonesia, which yielded revenues of Rs11.3 bn in 2QFY10 compared to Rs12.1 bn during the same period last year. Higher production cost on account of increased prices of fuel led to 400 bps contraction of EBIT margins at 30%. We note that prices of imported coal have not followed the firmness seen across other commodities, and any uptrend in prices of imported coal remains the key upside risk to our earnings and valuations.
- ▶ **NDPL:** Revenues from the Delhi distribution business increased 42% yoy at Rs10.3 bn, though a higher tax provision marred reported profits (-33% yoy) which came in at Rs257 mn.
- ▶ **Powerlinks:** The Tala transmission network benefited from (1) further capitalization of assets during the quarter, and (2) revision in tariff norms under CERC-based regulations, thereby yielding 34% yoy increase in revenues at Rs751 mn and near-double PAT at Rs206 mn.
- ▶ **Power trading:** Tata Power Trading reported revenues of Rs4.5 bn on trading volumes of 807 MU yielding profit of Rs16 mn. The implied average rate of power traded was Rs5.6/kwh compared to Rs7/kwh during the same period last year.

Exhibit 2: Contribution from coal, power trading and Delhi-distribution ably augmented revenues from the Mumbai business

Reconciliation of consolidated revenues for 2QFY10 (Rs bn)



Source: Company, Kotak Institutional Equities

FCCB issuance completes requirement of equity for project under construction

TPWR recently completed issuance of FCCBs aggregating US\$300 mn, with a conversion price of Rs1,456/share (conversion to be exercised over a period of five years). The issuance fills in the gap of Rs11 bn projected by the management towards equity requirement upto FY2012 for projects under various stages of implementation. The FCCB issuance of ~Rs13.8 bn will increase equity by ~9.4 mn shares, and are convertible over a period of five years from issuance. The FCCB issuance follows on the heels of US\$335 mn raised previously (at Rs1,090/share) through a GDR issuance.

Targeting portfolio of 10 GW, 5.8 GW by FY2012

TPWR has so far added 190 MW in 1HFY10 taking the aggregate capacity of the company to 2,975 MW. Power capacities commissioned during the quarter include 30 MW at Haldia, 120 MW under IEL (74% ownership by TPWR) and 40 MW of wind capacity. Management reported satisfactory progress in project implementation at Mundra (4,000 MW) and Maithon (1,050 MW) and expressed confidence in being able to commission these projects ahead of schedule. TPWR has signed an MoU with Tata Steel and Corus Staal BV for constructing a 525 MW power plant for the latter at its facilities in Netherlands.

TPWR has also recently signed an exclusive partnership agreement with SN Power of Norway, for setting up hydro projects aggregating 2,000 MW by FY2015E and 4,000 MW by FY2020E, through joint ventures in India and Nepal.

Exhibit 3: Tata Power, Sum-of-the-parts valuation

	Methodology	Key assumptions/comments	FY2010E Book value per share (Rs)	Per share value (Rs)
Mumbai (Generation, transmission & distribution business)	DCFe CoE: 12% Term. Yr. Grth: 4%	The business enjoys very high predictability of cash flows	101	245
Other generation assets	Price/Book (X)	P/B of 2X for operational generation capacity at Jojobera (548 MW), Belgaum (81 MW), Haldia (30 MW) and wind assets (181 MW); 5X for Haldia (merchant 90 MW) . P/B of 1.5X for projects under construction - 120 MW at Jojobera; CPPs and IPP under development in Orissa.	60	274
Powerlinks Transmission Ltd	Price/Book (X)	We value the equity investment at 1.5X book: The project earns a regulated RoE of 15.5% as per the CERC tariff guideline for interstate transmission project	10	15
Delhi Distcom (NDPL)	DCF CoE: 12% Term. Yr. Grth: 2%	NDPL earns 16% RoE provided it meets certain A,T&C loss reduction benchmarks. It is also incentivized by way of higher returns in the event of bettering the benchmarks	16	52
Tata BP Solar	P/E (X)	12X P/E on FY09	1	15
Investments	Various	20% discount to CMP/ KIE target price	82	161
Investible surplus on books	Market value	Marketable securities & cash on books	-	197
Bumi Resources	DCF	Net economic interest - based on dividend discount model	41	217
Mundra UMPP	DCF-equity	Levelized tariff of Rs2.26/unit for 25 years	112	174
Maithon	DCF-equity	74% stake in 1,050 MW project; 300 MW to be sold to DVC, 300 MW to NDPL, 300 MW to Punjab and 150 MW to West Bengal (regulated returns); Coal linkage allocated	23	46
TOTAL			498	1,395

Source: Kotak Institutional Equities estimates

Exhibit 4: Change in estimates for Tata Power (consolidated), March fiscal year-ends, 2010-11E (Rs mn)

	Revenues			EBITDA			Net profit		
	Old	New	% Chg.	Old	New	% Chg.	Old	New	% Chg.
2010E	186,189	181,764	(2.4)	44,793	42,708	(4.7)	17,084	15,617	(8.6)
2011E	201,226	195,357	(2.9)	49,608	46,959	(5.3)	19,198	17,353	(9.6)

Source: Kotak Institutional Equities estimates

Exhibit 5: Tata Power: Profit model, balance sheet, cash model (Consolidated) 2007-2012E, March fiscal year-ends (Rs mn)

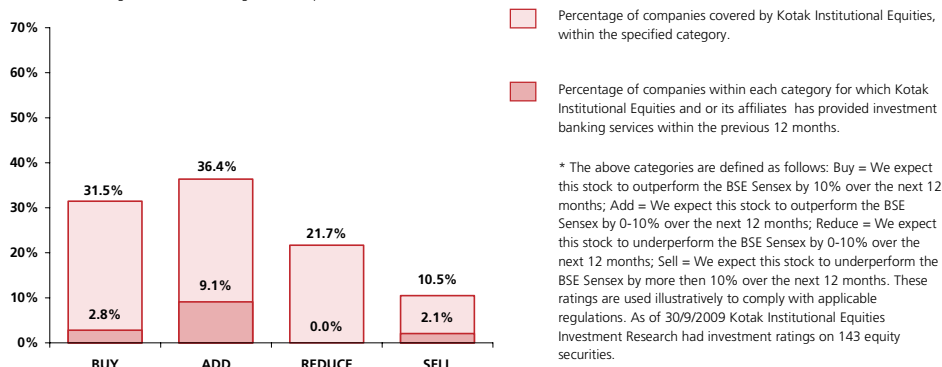
	2007	2008	2009	2010E	2011E	2012E
Profit model (Rs mn)						
Net sales	64,756	108,909	175,875	181,764	195,357	219,645
EBITDA	10,786	21,221	36,496	37,862	42,113	50,634
Other income	2,671	1,641	2,266	4,846	4,846	4,994
Interest	(2,833)	(4,881)	(8,129)	(8,561)	(9,533)	(12,656)
Depreciation	(4,148)	(5,593)	(6,565)	(8,134)	(9,242)	(11,500)
Pretax profits	6,476	12,389	24,069	26,013	28,184	31,471
Tax	(816)	(4,083)	(11,651)	(9,141)	(9,647)	(9,950)
Minority interest	6	(1,219)	(800)	(1,254)	(1,184)	(1,089)
Net profits	5,667	7,088	11,618	15,617	17,353	20,432
Extraordinary items	1,877	3,179	1,023	2,146	—	—
Earnings per share (Rs)	26.6	31.8	52.2	63.3	70.3	82.8
Balance sheet (Rs mn)						
Total equity	59,479	82,408	92,576	123,042	136,352	152,452
Deferred taxation liability	458	2,820	5,154	3,359	3,359	3,359
Total borrowings	51,784	91,136	141,434	228,537	265,356	299,499
Current liabilities	22,238	38,539	67,812	42,291	46,147	51,149
Capital contribution from Consumers	758	1,506	2,030	2,030	2,030	2,030
Minority interest	2,496	8,062	9,444	11,827	14,503	15,592
Total liabilities and equity	137,214	224,471	318,450	411,086	467,747	524,080
Cash	14,024	5,623	11,780	38,627	37,346	44,586
Current assets	29,293	44,426	62,686	50,457	52,404	53,913
Total fixed assets	63,001	140,901	205,780	281,410	337,406	384,990
Investments	30,833	31,253	32,512	34,899	34,899	34,899
Deferred expenditure	62	2,268	5,692	5,692	5,692	5,692
Total assets	137,214	224,471	318,450	411,086	467,747	524,080
Free cash flow (Rs mn)						
Operating cash flow, excl. working capital	10,255	19,587	22,396	20,390	29,115	33,661
Working capital	(2,849)	(1,265)	10,724	(8,620)	98	2,615
Capital expenditure	(11,054)	(77,900)	(71,444)	(83,764)	(65,238)	(59,084)
Investments	(1,767)	(2,625)	(4,684)	(2,387)	—	—
Free cash flow	(5,416)	(62,203)	(43,009)	(74,380)	(36,024)	(22,808)

Source: Company, Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of September 30, 2009

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