

29 October 2010

CAPACITY SLIPPAGES – TO HAMPER GROWTH MOMENTUM

• **Capacity slippages envisaged on account of unforeseen events:** On account of political disturbances in Jammu and Kashmir, Uri II project (240 MW) shall slip from FY11 to FY12, while Chutak project (44 MW) and Nimoo Bazgo project (45 MW) are as per our estimates. Similarly, on account of Gorkha movement/protests in West Bengal, TLD –III project (132 MW) shall slip from end of FY11 to FY12 and TLD – IV (160 MW) is likely to slip by one year to FY13. On account of environmental concerns and NGO protests, progress at Subansiri lower (2000 MW) project is slower and is now likely to be delayed by 1 year to FY14.

Impact: As compared to our earlier estimates, net units sold to be lower by 2% in FY11E; 6% in FY12E and 12% in FY13E. Lower sales to an extent to get off-set with lower depreciation on account of slippages in capacity addition and modest growth in other operating income.

• **Regulated equity to report a CAGR of 17% by FY13E:** Based on the slippages envisaged, regulated equity shall be at Rs 107 bn by FY13E registering a CAGR growth of 17%. As compared to earlier estimates, CAGR growth has declined by 4 bps, on account of capacity slippages.

• **“Draft” CERC norms on peak and off-peak tariffs to have a marginal positive impact on revenues:** In case of hydro power plant, peak hours during a day shall be 3 hours (in line with the principles enunciated in the CERC tariff regulations 2009-14). However, prima-facie the provisions for peaking tariffs shall not apply to Run of River (ROR) projects. (Final CERC regulation is expected by Nov-10)

Tariff provisions related to recovery of capacity charge and energy charge has more or less remained the same. The proposed regulation shall be revenue neutral, except to the extent of incentive for generation beyond normative targets. Incentives shall be calculated on the expanded base – i.e. @75% of the capacity charge instead of the existing 50% of the capacity charge.

• **CERC proposal to provide ROE on CWIP has been put on hold:** Based on our interactions with CERC, we understand that the proposal to allow ROE on CWIP has been put on hold and is unlikely to be rolled out in the future. However, an additional 1% ROE (above 15.5% ROE) is being contemplated specifically for hydro power developers.

• **Adjusted sales revenue up 5%:** Sales of 1HFY11 included prior period sales (Chamera and other projects) of Rs 970 mn vs Nil in 1HFY11. On a like to like basis, sales have increased by 5% at Rs 22.6 bn in 1HFY11.

• **Generation and units sold up ~7-8%:** Gross generation and sales has increased by ~7% and 8% YoY at 12.8BU and 11.3BU respectively in 1HFY11.

• **Net realization is down by 3% in 1HFY11:** After considering 1) incremental sales from Sewa II of Rs 700 mn; 2) Incremental AAD of Rs

NHPC

Neutral

Large Cap

Market Data

Bloomberg code	NHPC IN
Sensex	20,032
Price (₹)	31
Target Price (₹)	30
Target return	(4)%
Equity shares o/s (mn)	12,301
Market Cap (\$ mn)	8,637
Market Cap (₹ bn)	384
3M Avg Daily T/O (\$ mn)	8
52 Wk H/L (₹)	37 / 28
FII Limit	24

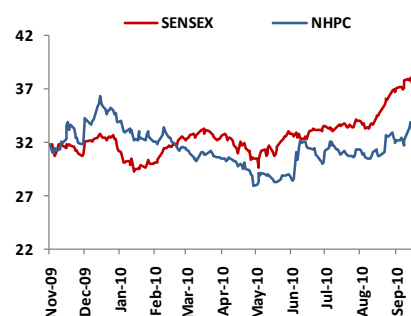
Stock performance

(%)	Absolute	Relative
1 Month	(3.4)	(3.3)
6 Months	5.0	(10.9)
12 Months	2.9	(18.7)

Shareholding pattern

		FII's	DII's
Promoter	86.4	1.6	
Pub. & Oth.	9.1		2.9

Sensex Relative chart



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700mn; 3) Incremental UI charge of Rs 70 mn 4) Impact of increased tariffs of Dulhasti/Chamera/Teesta projects; and 5) Lower tariff realization of ~440 mn of Uri I project due to decrease in depreciation (plant ageing more than 12 years); Net average realization has decreased to Rs 2 /kWh in 1HFY11, which is below our estimates.

Valuations and Recommendation: At CMP of Rs 31, NHPC trades at a P/B of 1.5x FY12E. We revise our rating to “Neutral” from “Overweight” and downgrade our target price by 9% to Rs 30.

Key financial highlights (Standalone)

Rs mn	2QFY10	2QFY11	YoY%	1HFY10	1HFY11	YoY%	FY10	FY11E	YoY%	FY12E	YoY%
Net Sales	11,954	12,403	4	22,557	22,600	0.2	34,024	38,112	12	44,383	16
EBITDA	10,529	10,592	1	19,876	19,096	(4)	25,158	28,810	15	33,357	16
EBITDA Margin (%)	88	85	(300bps)	88	84	(400bps)	74	76	200bps	75	(100bps)
Depreciation	2,567	2,677	4	5,156	5,281	2	10,333	8,387	(19)	9,316	11
EBIT	8,722	9,627	10	15,939	17,363	9	20,427	27,476	35	31,140	13
Interest	1,232	1,091	(11)	2,452	2,133	(13)	4,571	5,654	24	6,237	10
PBT	7,490	8,536	14	13,487	15,230	13	15,856	21,822	38	24,903	14
Tax	1,324	1,635	24	2,300	2,955	28	3,116	3,928	26	4,513	15
RPAT	6,166	6,901	12	11,187	12,275	10	12,740	17,894	40	20,390	14
EPS	0.50	0.56	12	1.0	1.0	5	1.0	1.5	40	1.7	14

IFIN Revised Estimates: NHPC Capacity Addition of 4,292 MW till FY14 – Standalone

Plant Name	State	Plant type	FY10	FY11E	FY12E	FY13E	FY14E
Sewa II	J&K	ROR		120			
Total for FY11E				120			
Uri - II (Unit – I to IV)	J&K	Pondage		Unit I&II (120 MW)	→ 240		
Chamera – III (Unit – I to III)	HP	Pondage		Unit 1 (77 MW)	→ 231		
Parbati – III	HP	ROR		-	520		
Teesta Low Dam – III	WB	Pondage		Full (132 MW)	→ 132		
Nimoo Bazgo	J&K	ROR		-	45		
Chutak	J&K	ROR		-	44		
Total for FY12E				329 MW	→ 1,212		
Parbati II	HP	ROR			-	800	
Teesta Low Dam – IV	WB	ROR			Full (160 MW)	→ 160	
Total for FY13E						960	
Subansiri (Lower)	Ar.P	ROR				Full (2000 MW)	→ 2,000
Total for FY14E							2,000
Opening Balance			3,655	3,655	3,955	5,167	6,127
Additions			-	120	1,212	960	2,000
Grand Total			3,655	3,955	5,167	6,127	8,127

Valuation

We have valued NHPC using Discounted Cash Flow with designated values to its core business (NHPC – Standalone) as of FY12E. We value the core business using a discounted cash flow to equity holders with a WACC of 10.61% and cost of equity of 11.6 % till FY 2025E. In our view, the stable earnings model of the business could best be valued using the discounted cash flow method and accordingly present value (PV) of Rs. 30 per share is derived by discounting the Free Cash Flows (FCF) for the forecast period. We have not valued on consolidated basis as EPS contribution from its 51% subsidiary – NHDC; shall remain negligible at ~Rs0.07/share, until capacity growth takes place for NHDC.

DCF Assumptions:

WACC		DCF Value	
Risk free rate	8.0%	Perpetual growth	4%
Beta	0.8	PV of forecast period i.e. FY25E (Rs bn)	117
Risk Premium	5.0%	PV of terminal value (Rs bn)	343
Cost of Equity	11.6%	Firm Value (Rs bn)	461
Cost of Debt (post Tax)	9%	Less: Net Debt (Rs bn)	88
Debt : Equity	0.6	Equity Value (Rs bn)	373
WACC	10.6%	Per share (Rs.)	30

Our revised price target of Rs 30 represents a P/B multiple of 1.5x FY11E and FY12E. At CMP (Rs 31), the stock is trading at a P/B multiple of 1.6x FY11E and 1.5x FY12E NAV (Net Asset Value). On account of recent developments and changed business scenario, **we revise our rating to “Neutral” from “Overweight”.**

Income Statement (Rs mn)				
Year end 31 March	FY09	FY10	FY11E	FY12E
Net Sales	26,889	34,024	38,112	44,383
Expenditure	10,060	9,997	10,886	12,768
Operating Profit	16,828	24,027	27,227	31,615
Other Operating Income	490	1,131	1,583	1,741
EBITDA	17,318	25,158	28,810	33,357
Other Income	5,032	5,601	7,053	7,099
Depreciation	5,175	10,333	8,387	9,316
EBIT	17,175	20,427	27,476	31,140
Interest	5,052	4,571	5,654	6,237
PBT (before non-recurring)	12,123	15,856	21,822	24,903
Non Recurring	333	-	-	-
Tax on non recurring	-	-	-	-
PBT (after non-recurring)	12,456	15,856	21,822	24,903
Total Tax	1,157	3,116	3,928	4,513
Minority interest	-	-	-	-
Share of Profit of Assoc	-	-	-	-
Reported PAT	11,298	12,740	17,894	20,390
Adjusted PAT	10,966	12,740	17,894	20,390
Prior period items	-	(8,165)	-	-
Net Income	11,298	20,905	17,894	20,390

Cash Flow Statement (Rs mn)				
Year end 31 March	FY09	FY10	FY11E	FY12E
Oper.profit before w.cap. change	20,313	30,663	32,906	37,795
Change in current assets	(5,897)	(11,334)	(6,589)	2,438
Change in current liabilities	7,615	(12,556)	18,278	8,096
Others activities	(895)	31,339	(9,799)	(8)
Cash flow from operation (a)	21,136	38,112	34,797	48,321
Capital expenditure	(39,790)	(34,764)	(65,529)	(43,451)
Investments	2,556	(16,005)	3,076	2,861
Dividend received	516	96	96	-
Interest received	1,853	-	2,861	2,660
Others	327	-	591	327
Cash flow from investing (b)	(34,538)	(50,673)	(58,905)	(37,603)
Free cash Flow (a+b)	(13,401)	(12,561)	(24,109)	10,718
Equity capital + share premium	(20)	40,667	-	-
Debt	22,777	16,342	24,659	2,143
Interest paid	(5,052)	(4,571)	(5,654)	(6,237)
Dividend paid	(3,717)	(7,889)	(8,395)	(9,058)
Others	(20)	23	-	-
Cash flow from financing (c)	13,989	44,549	10,610	(13,152)
Net change in cash (a+b+c)	587	31,989	(13,498)	(2,434)
Cash and equivalents at the end	19,000	50,988	37,476	35,042

Key ratios				
Year end 31 March	FY09	FY10	FY11E	FY12E
Growth rates (%)				
Net sales	20.7	26.5	12.0	16.5
EBITDA	3.0	45.3	14.5	15.8
APAT	8.1	16.2	40.5	13.9
Margins (%)				
EBITDA	64.4	73.9	75.6	75.2
EBIT	63.9	60.0	72.1	70.2
PBT	46.3	46.6	57.3	56.1
APAT	40.8	37.4	47.0	45.9
Valuation ratios (x)				
EPS (Rs)	1.0	1.0	1.5	1.7
EPS Growth (%)	8.0	5.6	40.5	13.9
PER (x)	32.6	30.9	21.3	18.7
Price / Cash EPS (P/CEPS) (x)	21.7	12.6	14.5	12.8
Price /Book Value (P/BV) (x)	2.0	1.7	1.6	1.5
EV/Net Sales (x)	18.0	13.8	13.3	11.5
EV/EBITDA (x)	28.0	18.6	17.6	15.3
DuPont				
ROE (%)	6.3	6.2	7.5	8.2
Net Margin (%)	40.8	37.4	47.0	45.9
Asset Turnover (x)	0.1	0.1	0.1	0.1
Leverage (x)	1.9	1.9	1.9	2.0
Other key ratios				
ROCE (%)	5.7	5.8	6.8	7.2
Net Debt / Equity (x)	0.6	0.4	0.5	0.5
Dividend Payout (%)	33.9	61.9	46.9	44.4

Balance Sheet (Rs mn)				
Year end 31 March	FY09	FY10	FY11E	FY12E
Share Capital	111,825	123,007	123,007	123,007
Reserves & Surplus	66,916	109,725	119,223	130,555
Shareholder's funds	178,741	232,732	242,231	253,562
Long term debt	122,340	84,972	163,341	165,484
Short term debt	-	53,710	-	-
Total Debt	122,340	138,682	163,341	165,484
Creditors	-	-	-	-
Other current liab & provn	33,852	44,178	55,962	66,311
Other non-current liabilities	13,295	15,765	16,388	18,641
Total Liabilities	348,228	431,358	477,923	503,999
F.Assets (net) incl. Cap WIP	280,360	304,200	360,749	394,558
Investments	27,936	43,941	40,865	38,004
Cash & Bank	19,000	50,974	37,476	35,042
Inventory	567	443	1,552	1,888
Debtors	2,947	11,402	13,106	10,652
Other current assets	17,396	20,399	24,175	23,855
Total current assets	39,909	83,218	76,309	71,437
Other non-current assets	23	-	-	-
Total Assets	348,228	431,358	477,923	503,998
Key Balance Sheet parameters (Rs mn)				
Capital Employed	314,376	387,180	421,961	437,687
Net Current Assets	6,058	39,040	20,347	5,126
Book Value (Net Worth)	178,741	232,732	242,231	253,562
Net Working Capital	(12,942)	(11,934)	(17,129)	(29,916)

Prior reports released on NHPC:

Initiating Coverage	10.06.10	OVERWEIGHT	28	33
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Key ratings:

Rating	LARGE CAP	MID CAP	SMALL CAP
	Market Cap > Rs 100 bn	Market Cap Rs 25 – Rs 100 bn	Market Cap < Rs 25 bn
BUY (B)	> 20%		>30%
Overweight (OW)	5% to +20%		10% to +30%
Neutral (N)	-5% to +5%		-10% to +10%
Underweight (UW)	-5% to -20%		-10% to -30%
SELL (S)	< (20)%		< (30)%
Not Rated (NR)	Not initiated coverage on the stock / Not enough assurance to give a rating on the stock		

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