Torrent Power – Annual Report analysis

CMP	Rs. 247	Absolute	Add
Target	Rs. 262	Relative	Outperform

Rating: ▼ Target price: ▼ EPS: ▼

Another year of robust performance; but downgrade to 'Add' on gas supply concerns

Torrent Power reported a strong year with consolidated revenues of Rs. 65.3bn (12% yoy increase), EBITDA of Rs. 18.0bn (4.4% yoy increase) and PAT of Rs. 10.6bn (26% yoy increase). Based on our analysis of the company's FY11 annual report we note that:

- **PLFs drop yoy:** Company level PLFs dropped yoy to 83% in FY11 (vs. 88% in FY10) with PLFs of Sabarmati & Vatva dropping to 83% (vs. 93% in FY10) due to higher shutdowns and Sugen's PLF dropping to 83% (vs. 86% in FY10).
- **Units supplied increases:** Total units supplied including power purchases grew 20% yoy to 16,983mn units (vs. 14,145mn in FY10) due to a) higher generation of 11,397mn units (vs. 9,349mn in FY10 as Sugen was commissioned mid-FY10) & b) higher purchases of 5,586mn units (vs. 4,751mn in FY10) due commencement of Agra franchise.
- **Bhiwandi flat, Agra to be the next leg of growth:** AT&C losses at Bhiwandi stood at 18% (vs. 19.3% in FY10) while it was 53.6% in Agra (distribution commenced from April 1, 2010). We note that the AT&C losses at Bhiwandi have been substantially controlled and further reductions will be marginal, while at Agra we believe that Torrent will do a Bhiwandi and hence we foresee good growth opportunity from this circle over the next two-three years.
- **Robust growth in top line:** Top line grew 12% yoy due to addition of Agra circle, 6% growth in demand from Ahmedabad & Surat circle and 3% growth in Bhiwandi circle. ~2,400mn units have been sold in merchant market at an estimated avg. realization of ~5.0/ unit while the blended avg. realization was Rs. 4.5/ unit (vs. same 4.5/ unit in FY10).
- **Fuel cost increases:** Per unit fuel cost increased to Rs. 2.0/ units (vs. 1.8/ unit in FY10) due to increase in coal costs and increased gas requirement in the year due to higher generation.

We like Torrent's unique integrated business model in the current scenario, where multiple structural headwinds exist. Healthy financials (DER <0.6x), high RoE profile (22% in FY11) and strong operating cash flows make the company the best utility within our coverage. However, we think the drop in production at KG-D6 has affected the company and will likely result in lower PLFs of ~80% for FY12, limiting merchant power opportunity (~300MW). Hence we cut our earnings estimates for FY12E and FY13E. Further, there is no clarity on the gas supply scenario for the new plants coming up in FY13 and FY14. Based on these concerns, we downgrade our rating on the stock from 'Buy' to 'Add', with a target price of Rs. 262/ share at 2.0x FY13E book value (earlier Rs. 301). Our SoTP valuation pegs the stock's value at Rs. 255/ share, giving us comfort on this valuation range.

Financial summary

Year	Revenues (Rs. mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	BV (Rs.)	P/BV(x)
FY11	65,034	17,370	10,658	102	2.4
FY12E	69,724	20,990	9,931	115	2.1
FY13E	75,096	22,675	10,678	131	1.9

Company Update

Date	July 7, 2011
Market Data	
SENSEX	18777
Nifty	5639
Bloomberg	TPW IN
Shares o/s	472mn
Market Cap	Rs. 116bn
52-wk High-Low	Rs. 367-183
3m Avg. Daily Vol	Rs. 13mn
Index member	BSEPowr
Latest shareholding (%)	
Promoters	52.8
Institutions	26.5
Public	20.8

Stock performance (%)

	1m	3m	12m
Torrent	3%	-5%	-32%
Sensex	2%	-3%	6%
BSEPowr	2%	-6%	-17%

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Key takeaways

CMP	Rs. 247	Absolute	Add
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Topic	Summary
PLFs	▪ Company level PLFs dropped yoy (to 83% in FY11 vs. 88% in FY10) due to lower power demand during 2HFY11, longer maintenance shutdowns, merit order enforcement at Sabarmati plant as well as lower gas supply from KG-D6 to the Sugen plant. ▪ Accordingly PLFs of Sugen was 83% in FY11 (vs. 86% in FY10) and of Sabarmati & Vatva was 83% in FY11 (vs. 93% in FY10). ▪ It is noteworthy that PLFs of Sugen in the first 2 months of 1QFY12 has been 90%.
Power Generated and supplied	▪ Total units generated (gross) grew by 10% to 11,832mn units (vs. 10,723 mn in FY10), while units dispatched/ supplied from the generating stations (net of AUX) stood at 11,397mn in FY11 (vs. 9,394mn in FY10). ▪ Total power supplied grew by 20% to 16,983mn units (vs. 14,145mn in FY10) which includes power dispatched from power stations and power purchases. Power purchases grew 18% yoy to 5,586mn units in FY11 (vs. 4,751mn in FY10) primarily due to purchases for Agra.
Power Demand and AT&C losses	▪ Demand from Ahmedabad & Surat grew by 6% yoy while the AT&C losses in this circle was nearly flat yoy at 7.2% (vs. 7.6% in FY10). ▪ AT&C losses at Bhiwandi for FY11 stood at 18% (vs. 19.3% in FY10). We note that the AT&C losses have been substantially controlled thus far and hence further reductions in the coming years will be marginal. ▪ Distribution to Agra commenced in FY11 which has a high AT&C loss of 53.6% with a demand for ~2,100mn units per annum. We believe that Torrent will do a Bhiwandi at Agra and hence we foresee good growth opportunity from this circle over the next two-three years. ▪ Consequently the total units billed/ sold increased yoy by 13% to 14,512mn units (8,527mn in Ahmedabad & Surat, 2,511mn in Bhiwandi, 980mn in Agra and 2,494 to merchant). In FY10 this number was 12,895mn units and the 13% increase yoy is due to the distribution to Agra.
Revenues and Cost	▪ The top line grew 12% yoy, lesser than the 20% growth in total units supplied, largely due to high AT&C losses at Agra. ▪ Total merchant sales was flat yoy at ~2,400mn units with an average per unit realization of Rs. 5.0/unit, while the blended realization for the company also remained flat yoy at Rs. 4.5/ unit. We expect the company to sell ~2,500mn units in merchant power for FY12E at ~Rs. 4.5/ unit. ▪ Fuel cost increased 24% yoy partly due to generation increasing by 10% and partly due to significant increase in cost/ tonne of imported coal during the year. ▪ Accordingly blended per unit cost of generating power increased to Rs. 2.0/ unit in FY11 (vs. 1.8/ unit in FY10). Aggregate power purchase cost also increased yoy due to buying power for Agra from UPPCL.
Pipeline Projects and Cash Flows	▪ Company has obtained all necessary clearances for the pipeline projects of Sugen Expansion (382.5MW) and first two units of Dahej (800MW) including environmental clearance. Equipments have been ordered and construction activity has started on these two plants. ▪ We expect the 382.5MW to be commissioned in 3QFY14 and the 800MW by the beginning of FY14. The Company has incurred ~Rs. 13bn CAPEX in FY11 for these two plants hence there was a decrease in cash balance (Rs. 9,263mn at the end of FY11 vs. Rs. 11,714mn in FY10).

Operational Performance

- **PLFs lower yoy due to lower demand:** Company level PLFs for the year FY11 was down yoy to 82.6% (vs. 88.2% in FY10) due to lower demand in FY11 from the distribution circles of Ahmedabad and due to longer planned maintenance/ shut-down and application of merit-order dispatch route (at the Sabarmati plant).
  - PLFs were especially lower in 3QFY11 and 4Q (~75%) due to lower demand during the winter months.
  - Total units generated increased by 10% yoy due to full-year operation of the Sugen plant vis-à-vis half a year in FY10.
- **Bhiwandi AT&C loss reduction flattish:** Sales in the Bhiwandi distribution circle was flattish yoy with total units sold in FY11 at 2,511mn units (vs. 2,449mn in FY10). Reduction in AT&C losses during FY11 has been higher than in FY10 (AT&C loss of 18% in FY11 vs. 19.3% in FY10 vs. 19.5% in FY09). Since AT&C losses have been substantially controlled we think further reductions will be marginal.
- **Distribution to Agra circle commences:** Distribution license for supplying power to the urban area of Agra commenced from April 1, 2010. The franchise agreement is for a period of 20 years awarded to Torrent Power by UPPCL (Uttar Pradesh Power Co.). The circle has 0.27mn customer-base with total electricity requirement of ~2,100mn units in FY11. With the aggregate technical and commercial (AT&C) losses at 53.6% for FY11 sales to this circle was only 980mn units. We note that there is a huge potential for Torrent Power to reduce the AT&C losses further and hence increase the contribution from Agra to the overall profits over the next few years. Based on the CAPEX requirement of the company for its existing T&D infrastructure and the CAPEX incurred for the pipeline projects we think the company has invested ~Rs. 2bn at the Agra circle.

Operational Performance			
Total Supply, mn units	**2010**	**2011**	**yoy, %**
Sabarmati & Vatva plants (500 MW)	3,785	3,327	-12%
PLF, %	*93%*	*83%*	
Sugen plant* (1147.5 MW)	5,609	8,070	44%
PLF, %	*86%*	*83%*	
Power from purchases	4,751	5,586	18%
Total (1)	**14,145**	**16,983**	**20%**
*Sugen was fully operational only in August 2009			
Units sold to distribution circles, mn units	**2010**	**2011**	**yoy, %**
Ahmedabad & Surat	8,045	8,527	6%
Bhiwandi	2,449	2,511	3%
Agra	-	980	NM
Sub Total (a)	**10,494**	**12,018**	**15%**
Total units supplied including to merchant (b)	**12,895**	**14,512**	**13%**
Units sold to merchant (a)-(b)	**2,401**	**2,494**	**4%**
AT&C Losses, %	**2010**	**2011**	**yoy, %**
Ahmedabad & Surat	7.6%	7.2%	-5%
Bhiwandi	19.3%	18.0%	-7%
Agra	-	53.6%	NM
Units supplied to distribution circles, mn units	**2010**	**2011**	**yoy, %**
Ahmedabad & Surat	8,709	9,192	6%
Bhiwandi	3,036	3,060	1%
Agra	-	2,114	NM
Sub Total (2)	**11,744**	**14,366**	**22%**
Units available for merchant sales & inter-state (1)-(2)	**2,401**	**2,617**	**9%**
Total	**14,145**	**16,983**	**20%**

Source: Company

Torrent Power – Annual Report analysis

Operational Performance

CMP	Rs. 247	Absolute	Add
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- **Total power purchase increases due to commencement of distribution to Agra:** Total power purchases increased to 5,586mn units in FY11 (vs. 4,751mn in FY10) due to the commencement of distribution in Agra.
- For Bhiwandi, as per the franchise agreement, Torrent buys power from MSEDCL (Maharashtra State Electricity Distribution Co.) at a bulk-supply rate of Rs. 2.13/ unit. Accordingly Torrent Power bought 2,530mn units from MSEDCL in FY10 (Source: MERC). For FY11 we estimate that ~2,594mn units have been bought. Any excess power requirement is met through external power purchases.
- For Agra, based on our channel checks we estimate a similar arrangement with UPPCL to buy power at a bulk-supply rate of Rs. 2.5/ unit. On this assumption, the entire power requirement for the Agra circle of 2,114mn units is most likely bought from UPPCL.
- Apart from power purchased from MSEDCL and UPPCL purchases from external sources (merchant market) stands at 878mn units for FY11 (vs. 2,221 in FY10). The yoy fall is primarily due to the higher generation from Sugen as it was operational only for half-a-year in FY10 whereas it has been operational for the full year in FY11.
- The per unit rate at which power has been procured from the external market for FY11 is higher at Rs. 4.5/unit vs. 3.85/ unit in FY10 (this purchase includes units procured through the Renewable Purchase Obligation mechanism to an extent of 5% of total supply).

Purchase of power

	2010	2011
Total units of power purchase, mn units (1)	**4,751**	**5,586**
Total cost of power purchase, Rs. mn (a)	**13,950**	**14,759**
From MSEDCL for Bhiwandi		
units, mn units (2)	2,530	2,594
per unit cost, Rs./ unit	2.13	2.13
Sub Total (b)	**5,389**	**5,525**
From UPPCL for Agra		
units, mn units (3)	0	2,114
per unit cost, Rs./ unit (assumption)	0.00	2.50
Sub Total (c)	**0**	**5,285**
From merchant market		
units, mn units (1)-(2)-(3)	2,221	878
Total cost (a)-(b)-(c	8,562	3,949
Merchant power rate & rate of RPO power, Rs./ unit	**3.85**	**4.50**

Source: Company, Spark Capital Research

SPARK CAPITAL
enhancing value

Torrent Power – Annual Report analysis

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Financial Performance

- **Revenues higher yoy due to increase in generation:** Total revenues grew 12% yoy primarily due to the increase in units generated and due to the addition of revenues from Agra circle. The blended per unit realization for the company stood at Rs. 4.5/unit, which is flat vis-à-vis FY10.
- **We have tried to break-up the revenues according to sales to different circles. Assuming an average 4.5/ unit tariff for Ahmedabad & Surat and Rs. 4.0/ unit for Bhiwandi and Agra we arrive at a merchant realization of Rs. 5.2/ unit for FY11 (Rs. 5.1 in FY10).**
- **Other Income** increased yoy by 196% due to a write-back of excess provision in previous years to the tune of Rs. 1,956mn. We estimate this as the tariff adjustments pertaining to the period 2009-2011 due to increased estimation of Aggregate Revenue Requirement.

P&L (Stand Alone)

Rs. mn	2010	2011	yoy, %
Revenues			
Total Revenues from sale of power (1)	**58,232**	**65,356**	**12%**
Total units supplied	**12,895**	**14,512**	**13%**
Blended realization per unit, Rs./ unit	4.5	4.5	
Reconciliation of Revenues			
Sales to Ahmedabad and Surat, mn units	8,045	8,527	
tariff, Rs./ unit (assumption)	4.50	4.50	
Revenues from Ahmedabad & Surat	**36,203**	**38,372**	**6%**
Sales to Bhiwandi	2,449	2,511	
tariff, Rs./ unit (assumption)	4.00	4.00	
Revenues from Bhiwandi	**9,796**	**10,044**	**3%**
Sales to Agra	-	980	
tariff, Rs./ unit (assumption)	-	4.00	
Revenues from Agra	**-**	**3,920**	**NM**
Revenues, Sub Total (2)	45,999	52,336	
Revenues from sale of power to merchant (1)-(2)	**12,234**	**13,021**	**6%**
merchant units, mn units	2,401	2,494	
per unit merchant realization, Rs./ unit	5.1	5.2	

Source: Company, Spark Capital Research

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Torrent Power – Annual Report analysis

Financial Performance

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- **Fuel costs increase due to increased gas requirement for Sugen and higher coal costs:** Total fuel cost grew 24% yoy primarily due to 10% increase in gross generation and due to an estimated increase in imported fuel cost by 50%.

P&L (Stand Alone)			
Rs. mn	**2010**	**2011**	**yoy, %**
Costs			
Total Cost of Fuel	**18,868**	**23,475**	**24%**
Gross Generation	**10,723**	**11,832**	**10%**
Blended cost per unit, Rs./ unit	1.8	2.0	13%
Reconciliation of Fuel Costs			
Generation from Sabarmati 400MW, mn units	3,324	2,889	-13%
Generation from Vatva Gas Station 100MW, mn units	769	726	-6%
Generation from Sugen, 1147.5MW	6,630	8,217	24%
Coal			
Domestic Coal, %	72%	70%	
Imported Coal, %	28%	30%	
Domestic Coal calorific Value, kCal/ kg	5,236	4,573	
Imported Coal calorific Value, kCal/ kg	4,929	5,167	
Domestic Coal price, Rs./ tonne	2,700	3,000	11%
Imported Coal price, Rs./ tonne	3,000	4,500	50%
SHR, kCal/ unit	2,800	2,800	
Domestic Coal Required, mn tonnes	1.28	1.24	
Imported Coal Required, mn tonnes	0.53	0.47	
Domestic Coal Cost, Rs. mn	3,456	3,715	7%
Imported Coal Cost, Rs. mn	1,586	2,114	33%
Total Coal Cost	**5,042**	**5,828**	16%
Gas			
Gas Calorific value, kCal/ mmBTU	224	224	
SHR, kCal/ unit	1,854	1,854	
Gas cost, Rs./ mmBTU	226	239	6%
Gas requirement, mmBTU	61.1	73.9	21%
Total Gas Cost	**13,826**	**17,647**	28%
Total Cost	**18,868**	**23,475**	24%

Source: Tariff Orders, Company, Spark Capital Research

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Torrent Power – Annual Report analysis

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Financial Performance

- **Cash Flows – CAPEX for DGEN and UNOSUGEN: Company's investing cash flows increased yoy as it has incurred CAPEX for its pipeline projects (UNOSUGEN, 382.5MW and DGEN 1,200MW) to the tune of ~Rs. 9,000mn. The cash position of the company continues to remain healthy which stands at Rs. 9,263mn**

Cash Flows (Stand Alone)			
Rs. mn	**2010**	**2011**	**yoy, %**
Cash Flows from Operating Activities	16,662	17,081	3%
Cash Flows from Investing Activities	(5,474)	(14,604)	-67%
Cash Flows from Financing Activities	(4,199)	(5,574)	33%
Net Cash Flow	**6,989**	**(3,097)**	**-144%**
Ending Cash Balance	**11,714**	**9,263**	**-21%**

Source: Company

Pipeline Projects

- **Thermal capacity ramp-up to the tune of ~1,200MW by FY14:** UNOSUGEN (382.5MW) as well as DGEN (first 800MW) are under construction with all clearances in place (equipment orders have been placed and construction at the sites have begun). Torrent is factoring in both plants to be operational by FY14, of these capacities about 665MW is ear-marked for generating power to the Ahmedabad and Surat license areas, while the rest is kept open. We believe the management will focus on the completion of these power projects before stepping up execution on other expansion plans.
- **Wind Project to meet the RPO requirements: The Company has signed an agreement with Enercon Ltd. to set-up a 44MW wind project at Jamnagar, Gujarat, to meet the Renewable Purchase Obligation requirement in the future.**

Torrent Power – Annual Report analysis

Key parameters and Estimate Revisions

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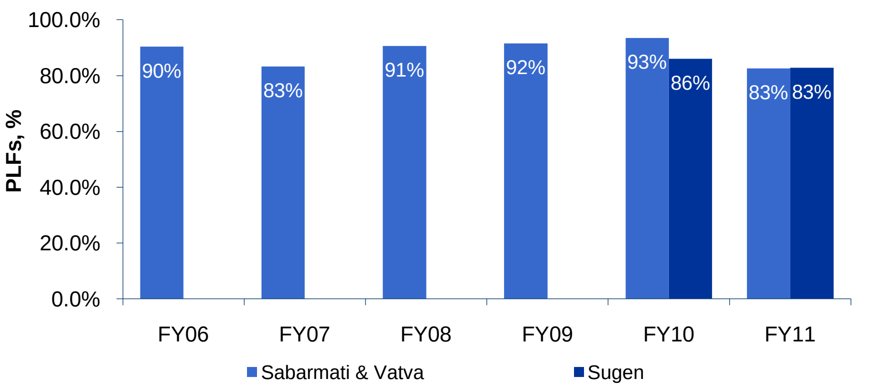
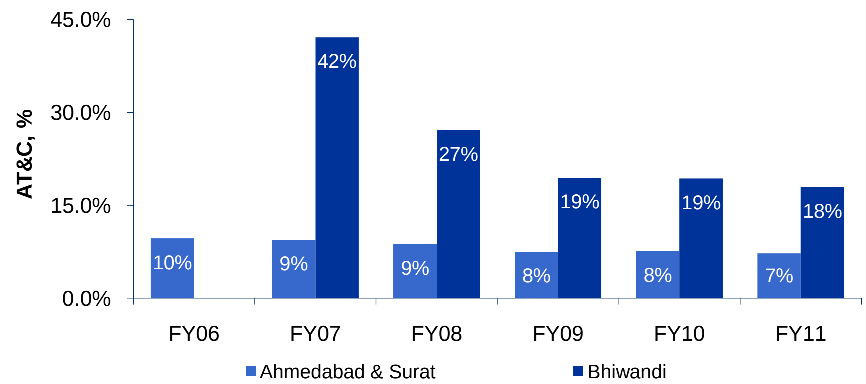
PLFs, %



Source: Company

AT&C Losses, %



Source: Company

Key estimate revision

	FY12E			FY13E		
	Old	New	Change	Old	New	Change
Revenue	69,724	67,022	-3.9%	75,096	73,595	-2.0%
EBITDA	20,990	19,645	-6.4%	22,675	21,979	-3.1%
Margin (%)	30%	29%		30%	30%	
PAT	10,836	9,931	-8.4%	11,294	10,678	-5.5%
Margin (%)	16%	15%		15%	15%	
EPS	22.9	21.0	-8.1%	23.9	22.6	-5.3%

All figures in Rs. mn, except EPS, which is in Rs.

1 year forward P/BV

Source: Bloomberg

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Torrent Power – Annual Report analysis

SoTP Valuation

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SoTP valuation for Torrent Power

	Torrent's stake	CoE	Equity value (Rs. mn)	Value to Torrent (Rs. mn)	Per share value	%
Generation Assets						
Sabarmati & Vatva (500MW)	100%	13%	7,180	7,180	15.2	6%
Sugen (1,147.5MW + 382.5MW)	100%	13%	42,949	42,949	91.0	36%
Distribution Assets						
Ahmedabad	100%	13%	36,587	36,587	77.5	30%
Surat	100%	13%	12,740	12,740	27.0	11%
Bhiwandi	100%	14%	11,560	11,560	24.5	10%
Agra	100%	Investment Value	2,000	2,000	4.2	2%
Projects in Pipeline						
Dahej (first 800MW)	100%	Investment Value	7,300	7,300	15.5	6%
Total					**254.9**	**100%**

Torrent Power – Annual Report analysis

Financial Summary

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Abridged Financial Statements (Consolidated)

Rs. mn	FY10	FY11	FY12E	FY13E
Profit & Loss				
Revenues	58,253	65,357	67,022	73,595
EBITDA	17,063	17,693	19,645	21,979
Other Income	1,323	3,914	1,471	1,664
Depreciation	3,527	3,927	4,062	4,856
EBIT	14,859	17,680	17,054	18,786
PBT	11,878	14,288	12,812	13,517
PAT	8,360	10,658	9,931	10,678
Balance Sheet				
Net Worth	39,854	48,023	54,234	61,892
Total debt	33,263	35,729	60,547	123,199
Deferred Tax	2,593	3,589	3,589	3,560
Service Line & Security Deposits	4,277	4,742	5,440	6,054
Total Networth & Liabilities	**79,986**	**92,084**	**123,810**	**194,705**
Gross Fixed assets	78,094	85,449	95,986	174,783
Net fixed assets	67,482	70,410	75,386	149,326
CWIP	3,062	14,109	53,253	56,482
Investments	2,152	1,748	1,748	1,748
Inventories	1,442	2,817	2,016	2,135
Sundry Debtors	5,432	6,094	6,974	7,612
Cash and bank balances	11,963	9,789	(1,958)	(8,711)
Loans & Advances	6,883	1,031	1,119	1,250
Current liabilities	18,430	13,916	14,727	15,136
Net current assets	7,290	5,816	(6,577)	(12,851)
Deferred Tax/ Misc. Expenses	-	-	-	-
Total Assets	**79,986**	**92,083**	**123,810**	**194,705**
Cash Flows				
Cash flows from Operations	17,246	19,452	19,578	20,909
Cash flows from Investing	(7,230)	(18,079)	(49,681)	(82,025)
Cash flows from Financing	(2,741)	(2,602)	17,556	54,363

Key metrics

	FY10	FY11	FY12E	FY13E
Capacities / Generation				
Operational (MW)	1,648	1,648	1,648	1,648
Pipeline (MW)	1,583	1,583	1,583	1,583
Units Sold (Mn kWhr)	12,895	14,512	13,578	14,060
Revenue per unit (Rs.)	4.5	4.5	4.9	5.2
Opex per unit (Rs.)	3.2	3.3	3.5	3.7
PBT per unit (Rs.)	0.9	1.0	0.9	1.0
Performance ratios				
RoA (%)	10.5%	11.6%	8.0%	5.5%
RoE (%)	21.0%	22.2%	18.3%	17.3%
RoCE (%)	18.6%	19.2%	13.8%	9.6%
Total Assets Turnover (x)	0.7	0.7	0.5	0.4
Fixed Assets Turnover (x)	0.7	0.8	0.7	0.4
Working capital Turnover (x)	8.0	11.2	(10.2)	(5.7)
Financial stability ratios				
Net Debt to Equity (x)	0.8	0.7	1.1	2.0
Current ratio (x)	1.4	1.4	0.6	0.2
Working capital days	45	32	(35)	(63)
Inventory & Debtor days	42	49	48	48
Creditor days	114	77	79	74
Interest cover (x)	5.0	5.2	4.0	3.6
Valuation metrics				
Fully Diluted shares (mn)	472.4	472.4	472.4	472.4
Fully diluted M. Cap (Rs.mn)		105,828		
Fully Diluted EPS (Rs.)	17.7	22.6	21.0	22.6
P/E (x)	13.8	10.9	11.7	10.8
EV (Rs.mn)		131,768		
EV/ EBITDA (x)	7.7	7.4	6.7	6.0
BV/ share (Rs.)	84	102	115	131
Price to BV (x)	2.9	2.4	2.1	1.9

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Absolute Rating Interpretation	
BUY	Stock expected to provide positive returns of > 15% over a 1-year horizon
ADD	Stock expected to provide positive returns of <=15% over a 1-year horizon
REDUCE	Stock expected to fall <=15% over a 1-year horizon
SELL	Stock expected to fall >15% over a 1-year horizon

Relative Rating Interpretation	
OUTPERFORM	Stock expected to outperform sector index /sector peers in our coverage
UNDERPERFORM	Stock expected to underperform sector index/ sector peers in our coverage

Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
01-Jun-11	248	301	BUY	OPF
06-May-11	249	301	BUY	OPF
08-Apr-11	262	305	BUY	OPF
21-Feb-11	229	305	BUY	OPF
25-Jan-11	235	305	BUY	OPF

Analyst Certification

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