Public Power/India
Special Report

Indian Power – Outlook 2007

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Sector Coverage

- NTPC Limited ('BBB-'/Stable)
- National Hydroelectric Power Corp. (NHPC) ('BBB-'/'AAA(ind)'/'F1+(ind)'/Stable)
- Reliance Energy Limited ('AAA(ind)'/'F1+(ind)'/Stable)
- Power Finance Corporation Limited. ('BBB-'/Stable)
- PTC India Limited ('F1+(ind)')
- Rural Electrification Corporation Limited (REC). ('BBB-'/'AAA(ind)'/'F1+(ind)'/Stable)
- Indian Renewable Energy Development Agency Limited ('A+(ind)'/Stable)
- Tata Projects Limited ('AA-(ind)'/Stable)
- Jaiprakash Hydro-Power Limited ('A-(ind)'/Stable)
- JSW Energy Limited ('BBB+(ind)'/'F2+(ind)'/Negative)
- Malana Power Company Limited ('AAA(ind)(SO)'/Stable)

Outlook

The main reason for a historical lack of investor interest in the Indian power sector has been the slow pace of reform. While the improvement in the finances of state power utilities are largely below expectation, the structural changes brought about since 2001 may enable the implementation of large generation projects in 2007.

Since 2001, a large number of integrated state-owned utilities have unbundled into multiple generation and distribution entities, which together with a new electricity law (enacted in 2003) have enabled the development of a nascent but strengthening wholesale power market. This, together with interventions sponsored by the Government of India (GoI), resulted in a more prompt payment of bills by distribution companies that are mostly state-owned. This in turn resulted in a number of private investors planning merchant and captive (with excess capacity for sales to grid) power plants, and Fitch expects the bulk of these plants to be commissioned over 2008-2012.

On the funding side, with low demand risk on the back of huge unsatisfied demand, Indian lenders increasingly looked at tariff competitiveness to gauge the credit risk for these private generators instead of relying on power purchase agreements. While equity market participation in power utilities has been largely absent, except in the past 18 months, Fitch expects this to change significantly in 2007.

The most significant carry-over from 2006 is the Ultra-Mega Power Projects – seven projects, each of 4,000 megawatts (MW) capacity, being planned at the instance of the GoI. These projects appear a compelling investment given their capital efficiencies, hence the low cost of power produced and consequent low off-take and credit risk. However, given their likely cost of around USD3.0bn to USD3.6bn, these investments would not only challenge many Indian corporates sponsoring these projects but also Indian lenders – based on their existing single-asset and single-industry exposure norms. The projects may consequently require the involvement of export credit agencies and foreign lenders, and involve relatively widely distributed stock holdings, and some may have an early initial listing on the stock exchanges. The projects which have so far been put out to bidding have been bagged by an Indian corporate and a consortium led by an Indian corporate; the bidding is open to foreign companies. Fitch would assess the documentation and the extent of funding required for the SPV (expected to be established for UMPP) to assess the impact on the credit profile of any corporate sponsoring such projects.

Investors, however, would need to keep a close watch on the progress of reforms in the distribution utilities, which have been disappointing. Collectively, Indian utilities continue to incur cash losses because of operational inefficiencies and a skewed tariff structure. In Fitch's opinion, fundamental operating weakness would be difficult to mask by structural changes, and in the long-term, should the distribution utilities not achieve positive operating returns soon, their weakness may blunt the heightened private interest in the sector.