

February 26, 2010

Industry View
In-Line

India Utilities

India Budget: Marginally Negative for Merchant Plays

Quick Comment: The India budget was announced today, and the government has more than doubled the plan allocation for the power sector to Rs51.3 bn in F2011 from Rs22.3 bn in F2010 (excluding allocation for RGGVY). At the same time, the introduction of cess on coal, increase in MAT, and *ad valorem* duty on sale of electricity from a SEZ to a Domestic Tariff Area will negatively affect merchant profitability.

Highlights of the budget include:

- A proposal to **introduce a bidding process for allocating coal blocks for captive mining**, which we believe is a positive policy decision. This will help in providing a road map on allocation of captive coal blocks. However, aggressive bidding may cause coal prices to go up, thus pushing up power tariffs in the country.
- A proposal to **set up a Coal Regulatory Authority** in order to create a level playing field in the coal industry should help increase transparency, facilitate decision-making, improve efficiency and define the methodology for determining ROE for the industry.
- **Electricity supplied from a SEZ to a Domestic Tariff Area will attract a 16% *ad valorem* duty.** This is negative for Adani Power as far as merchant sales from the Mundra projects are considered (if the same is not sold within the SEZ). Assuming the company benefits from its co-developer status (i.e., it is 100% exempt from tax for 10 out of the first 15 years), we believe earnings for F2010 and F2011 may not be affected, but earnings for F2012 may be affected by about 10%, as the proportion of merchant sales will be high.

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- **Minimum Alternate Tax (MAT) to be increased from 15% earlier to 18%.** This is not likely to affect regulated utilities and the case I or II bids, as the tax component will be passed through in tariffs. However, the profitability of merchant plants may be adversely affected – we expect a 3-4% impact on our profitability estimates. The impact on Jindal Steel and Power and Adani Power may be higher than that for Lanco Infratech, Tata Power and Reliance Power.
- **Imposing a cess of Rs50/ton on domestic and imported coal as ‘clean energy cess’.** While this will not affect regulated utilities and case I or II bids, as coal costs will be passed through in the tariff, it will adversely affect profitability of merchant plants – we expect a 1% impact on our estimates. This will affect Adani Power, Lanco Infratech, Tata Power, Jindal Steel and Power and Reliance Power. However, this move will help promote cleaner forms of energy generation.
- **Setting up a National clean energy fund and increasing plan outlay to promote solar capacity of 20 GW by F2022.** This is positive, in our view, and should provide impetus to the renewable energy industry. The plan outlay for the Ministry of New and Renewable Energy has been increased by 61%, to Rs10 bn in F2011.

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Industry Coverage:India Utilities

Company (Ticker)	Rating (as of)	Price* (02/26/2010)
Parag Gupta		
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LANCO Infratech Ltd (LAIN.BO)	E (04/23/2007)	Rs45.9
NTPC (NTPC.BO)	E (04/23/2007)	Rs203
Reliance Infrastructure Limited (RLIN.BO)	O (01/23/2008)	Rs1,003.95
Tata Power Co (TTPW.BO)	E (11/30/2009)	Rs1,212.95

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