

**Nat Resources & Energy**  
**Electric Utilities**  
 Equity – India

## Overweight

Target price (INR) **1198.00**  
 Share price (INR) **1029.75**  
 Potential total return (%) **16.3**

Performance	1M	3M	12M
Absolute (%)	50.4	53.9	85.0
Relative^ (%)	30.0	27.7	28.2

Index^ BOMBAY SE IDX

RIC TTPW.BO  
 Bloomberg TPWR IN

Market cap (USDm) 5,406  
 Market cap (INRm) 213,974

Enterprise value (INRm) 240283  
 Free float (%) 67.72

**5 October 2007**

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# Tata Power

Generation capacity to be expanded five times in five years

- ▶ **We believe in Tata Power's ability to expand its generation capacity over next 5 years. We now expect it to implement 10.3GW by FY2013 against our earlier estimate of 9.4GW**
- ▶ **Backward integration in coal mines should help in reducing fuel costs. We reduce our fuel cost estimates by 14% and 13% for FY2012 and FY2013 respectively**
- ▶ **Given the higher visibility over capacity expansion, we raise our target price from INR843 to INR1198 per share and maintain our Overweight rating**

## Expansion in full gear...

Tata Power management in its recent presentation in September 2007 stated that they expect power generation capacity to grow five times in the next five years. The company is already implementing projects of 5,763MW and another 4,700 MW is planned and we now therefore expect 10,313MW to be installed by FY13 against our earlier estimate of 9.413MW.

Thanks to its integration across the chain, in addition to its acquisition of a strategic stake in Indonesian coal mines, the Ministry of Coal has allocated coal mines in India to the company, which should reduce its fuel costs substantially. We expect the coal mines to be operational by the end of FY11 and hence we reduce our fuel cost estimates by 14% and 13% for FY12 and FY13 respectively.

### Our capacity and fuel cost estimates for FY12 and FY13

Estimates	Capacity (MW)		Fuel cost (INRm)	
	FY12e	FY13e	FY12e	FY13e
Old estimate	9,413	9,413	97,146	100,177
New estimate	9,713	10,313	83,747	87,234

Source: HSBC estimates

Given the higher visibility regarding the implementation of the power projects and backward integration in coal production, our cash flow estimates for FY12 and FY13 increase substantially. We therefore raise our DCF valuation from INR871 to INR1559. We move from FY08 to FY09 as the base year for our sum-of the parts valuation, which is raised from INR817 to INR837. As our target price is the average of both methods, we assign a new target price of INR1198 per share and maintain an Overweight rating.

## Financials & valuation

### Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
<b>Profit &amp; loss summary (INRm)</b>				
Revenue	64,773	74,039	82,311	89,571
EBITDA	10,911	13,341	23,511	30,610
Depreciation & amortisation	-4,148	-4,166	-5,042	-6,441
Operating profit/EBIT	6,763	9,175	18,469	24,170
Net interest	-2,833	-4,603	-7,229	-7,586
PBT	6,795	12,994	21,868	28,115
HSBC PBT	6,795	12,994	21,868	28,115
Taxation	991	-1,671	-3,182	-3,792
Net profit	7,368	11,197	18,519	24,134
HSBC net profit	7,368	11,197	18,519	24,134

### Cash flow summary (INRm)

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Cash flow from operations	11,734	6,046	9,123	18,907
Capex	-11,085	-44,266	-67,017	-60,134
Cash flow from investment	-13,480	-86,566	-61,017	-54,134
Dividends	1,677	-2,764	-4,572	-5,958
Change in net debt	6,269	66,382	41,078	32,405
FCF equity	-5,870	-38,225	-57,900	-41,233

### Balance sheet summary (INRm)

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Intangible fixed assets	0	0	0	0
Tangible fixed assets	63,001	96,093	160,570	216,961
Current assets	43,317	49,029	37,243	44,728
Cash & others	14,024	18,247	3,049	8,227
Total assets	137,214	223,017	269,709	327,584
Operating liabilities	21,958	22,374	21,543	22,579
Gross debt	51,784	122,389	148,269	185,852
Net debt	37,760	104,142	145,220	177,625
Shareholders funds	54,103	68,034	87,906	105,280
Invested capital	70,336	104,500	173,221	230,882

### Ratio, growth and per share analysis

Year to	03/2007a	03/2008e	03/2009e	03/2010e
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#### Y-o-y % change

Revenue	13.7	14.3	11.2	8.8
EBITDA	9.9	22.3	76.2	30.2
Operating profit	4.5	35.7	101.3	30.9
PBT	-23.3	91.2	68.3	28.6
HSBC EPS	8.0	44.7	57.5	22.3

#### Ratios (%)

Revenue/IC (x)	1.0	0.8	0.6	0.4
ROIC	11.9	9.1	11.4	10.3
ROE	14.3	18.3	23.8	25.0
ROA	8.7	8.5	10.1	10.3
EBITDA margin	16.8	18.0	28.6	34.2
Operating profit margin	10.4	12.4	22.4	27.0
EBITDA/net interest (x)	3.9	2.9	3.3	4.0
Net debt/equity	66.7	146.4	158.4	161.9
Net debt/EBITDA (x)	3.5	7.8	6.2	5.8
CF from operations/net debt	31.1	5.8	6.3	10.6

#### Per share data (INR)

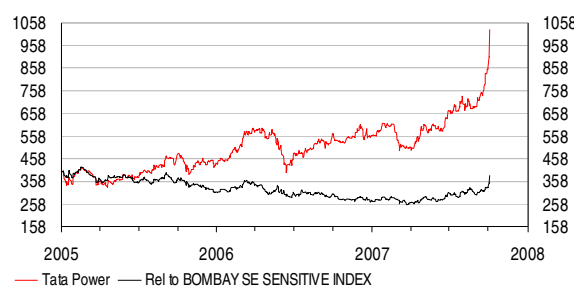
EPS reported (fully diluted)	37.23	53.89	84.89	103.85
HSBC EPS (fully diluted)	37.23	53.89	84.89	103.85
DPS	9.50	13.30	20.95	25.63
NAV	273.41	327.44	402.94	453.00

### Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	3.4	3.2	3.5	3.6
EV/EBITDA	20.2	18.0	12.2	10.6
EV/IC	3.1	2.3	1.7	1.4
PE*	27.7	19.1	12.1	9.9
P/NAV	3.8	3.1	2.6	2.3
FCF yield (%)	-3.2	-28.1	-40.7	-27.8
Dividend yield (%)	0.9	1.3	2.0	2.5

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative



Source: HSBC

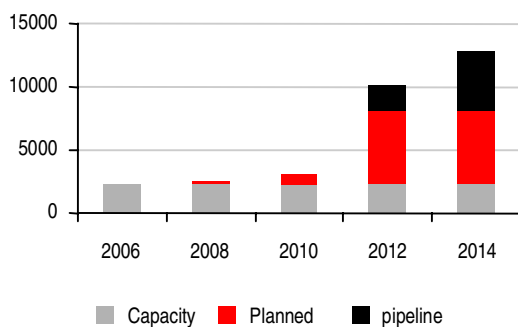
Note: price at close of 03 Oct 2007

## Capacity expansion in full swing

### Raising capacity expansion in FY12 and FY13

The management presentation to investors showed capacity expansion is expected to be 12.8GW by FY14, and we raise our capacity expansion estimates in FY12 and FY13 by 3% and 10% respectively. We expect the company to have 10.3GW capacity operational by FY13. The company has indicated 2,700MW group captive capacity to be developed for Tata Steel by its subsidiary Integrated Energy Ltd, where it holds a 74% stake. In addition, the company announced that it is in discussion with the Government of Maharashtra for setting up the 2,400MW coastal Maharashtra power project. Management gave a clear indication that they want to have 5 times capacity in 5 years.

Tata Power's power generation capacity expansion by FY14 (as presented by company in NY road show)



Source: HSBC, Company

### Fund raising can't be ruled out

Management clearly indicated in its presentation that they may raise funds if required. As per their presentation, they need USD1.4bn for all these expansions by FY12 and they'll get USD600m through internal accruals and USD310m by preferential allotment to Tata Sons (parent). We feel the internal accrual figure (FY08-12) indicated by company is very conservative. Our assessment shows that their internal accrual over FY07-11e should be in the range of USD2.8bn. We do not expect the company to raise funds at least for next 12 months.

## Valuation and rating

### Price target increased from INR 843 to INR1198

The stock has had a decent run of 50.4% appreciation over the last month and is now trading at 12.1x FY09e earnings, which is substantially lower than the Indian utilities average of 20.1x. We believe it is attractive given its high growth potential compared with the Asian utilities universe. On the back of higher visibility of the implementation of its power projects, we forecast its net profit to grow at 58% CAGR over the next five years.

Given the higher visibility over the implementation of its power projects and backward integration in coal production, our cash flow estimates in FY12 and FY13 increase substantially. As illustrated on page 1, we have increased our installed capacity estimates by 3% and 10% in FY12 and FY13 respectively and reduced our cost of coal forecast by 14% and 13% for FY12 and FY13 respectively, hence our net profit

estimate for FY12 and FY13 goes up by 27% and 43% respectively. Hence we raise our DCF valuation from INR871 to INR1559. As we move on from FY08 to FY09 as the base year for our sum-of the parts valuation, we raise our S-o-P valuation from INR817 to INR837.

**Our Revenue and net profit estimates for FY12 and FY13**

Estimates	Revenue INRm		Net Profit INRm	
	FY12e	FY13e	FY12e	FY13e
Old	218,276	230,325	56,231	60,173
New	224,280	251,187	71,536	86,168

Source: HSBC estimates

Our revised target price of INR1198 per share is the average of our two valuation methods: a DCF analysis which comes to INR1559 using a cost of equity of 12.7% using beta of 0.91 and a terminal growth rate of 5.0% and a sum of the parts valuation at INR837. Our target price of INR1198 is equivalent to 14.1x FY08e earnings.

**Sum of parts valuations:**

Business segment	HSBC assumptions	Fair value (INRm)	Fair value per share (INR)
Generation business MW Mar09	2,913		
Value per (INRm/MW)	45.00		
Relative value of generation capacity		131,085	601
Financial investment (Book Value) Mar09 (INRm)	76,733		
Price book multiple	1.80		
Relative value of associates businesses		138,119	633
Potential value of TTSL @20% premium to Temasek deal (INRm)	180,000		
Average market value of TTML (INRm)	4,500		
Relative value of telecom businesses		21,173	97
Earnings of T & D networks (Mar09)	2,743		
1-yr forward PE for Asian utilities	15.0		
Relative value of T&D network		41,142	189
Net debt as at Mar 09		(148,997)	-683
<b>Fair value of equity</b>		<b>120,208</b>	<b>837</b>

Source: HSBC estimates

## Risks

### Projects under implementation may get delayed

We have considered Tata Power's mega projects like Mundra UMPP, Maithan merchant power plant and other projects for Tata Steel in our projection. Any delay in the execution of these projects may affect its profitability adversely. Although the company has finalised its fuel linkages through backward integration, any sudden rise in international coal prices or disruption of coal supply from its mines in Indonesia may affect its profitability in the long term.

# Disclosure appendix

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Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

\*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

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Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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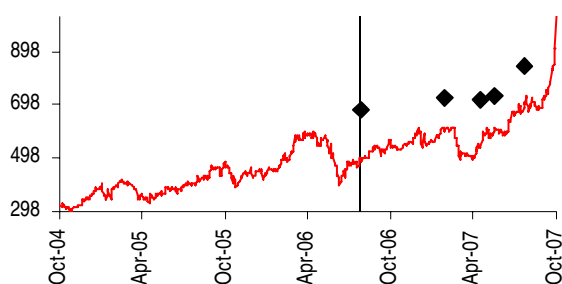
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**As of 04 October 2007, the distribution of all ratings published is as follows:**

<b>Overweight (Buy)</b>	50%	(26% of these provided with Investment Banking Services)
<b>Neutral (Hold)</b>	32%	(23% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	18%	(16% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Tata Power Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	28 July 2006
Target Price	Value	Date
Price 1	679.10	28 July 2006
Price 2	724.00	30 January 2007
Price 3	714.00	20 April 2007
Price 4	732.00	23 May 2007
Price 5	843.00	26 July 2007

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
TATA POWER	TTPW.NS	1029.75	03-Oct-2007	2, 5

Source: HSBC

- 1 HSBC\* has managed or co-managed a public offering of securities for this company within the past 12 months.
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