TNSEB: Tariff hike, past arrears approval key to financial restructuring

FAC allowed as pass through on quarterly basis, ST power purchase to come down sizably

- **Tamil Nadu Electricity Regulatory Commission (TNERC) has allowed 37% tariff hike for Tamil Nadu Generation and Distribution Company (TANGEDCO), which would address recurring under recovery. Also, the approval of Fuel adjustment charge (FAC) would mean that any deviation in power purchase cost/fuel cost is recovered on quarterly basis. Three key aspects of Tariff Order are: 1) FY13 would see addition of ~2GW of LT power, 2) Power purchase cost on aggregate basis to come down from INR4/unit in FY12 to INR3.2/unit in FY13, a reduction of 22% and 3) ST power purchase of 2BUs is allowed only as a flexibility for DISCOM to manage demand and at INR4/unit only.**
- **DISCOMs need prior approval before increasing quantum or price on ST power procurement. Additionally, State government has given in-principal approval to arrears of FY11/12, further improving credibility for the DISCOMs.**

TN tariff hike, in-principal approval by state government for past arrears – key milestone in the sector: TNERC has allowed tariff hike of INR78.8b (increase of 37%), in response to a tariff petition filed by TANGEDCO in November 2011. Last tariff revision was in August 2010 (after a gap of 7 years). Tariff hike (estimate was INR80b) and timeline (before March 2012) are both in-line with earlier understanding. Current tariff is effective from April 2012. Most importantly, state government has granted in-principal approval to absorb past arrears of FY11/FY12 estimated at INR196b (petition was filed for INR248b). This, in our view, is the most important event in the sector, more so given the apprehensions on political will.

LT availability of power to improve in FY13, driving overall cost down; ST power requirement estimated to be low: In FY13, TANGEDCO will have 1,875MW of long term power available from various projects getting commissioned. Earlier, TN was procuring ~1.5-2.0GW of power on spot basis, to meet the demand. The availability of LT power will lower the requirement of ST power. TNERC has allowed ~2BUs of ST power purchases in FY13 (vs an average of ~10BU in last 2 years) to provide flexibility to TANGEDCO in managing demand, while cost is approved at INR4/unit. TO stipulates prior approval of commission for any deviation in quantity / price for ST power. This would thus lower the overall power purchase cost for TANGEDCO to INR3.2/unit in FY13E, from INR4/unit in FY12, a reduction of 22%.

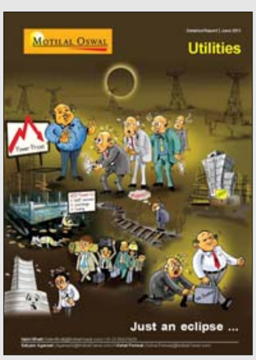
FY12 to be tipping point for SEB losses, UP remains last in the league: During past 18 months, 24 states have revised tariff. In Odhisa, the HC has refused to interfere with the decisions relating to electricity tariff hike in response to a PIL seeking review of ~40% tariff hike affected for FY12. This is yet another landmark judgment

SEB Finances: FY12 to be tipping point

Detailed Sector Report

Just an eclipse ......

brighter days ahead!



May-11

Meeting with TANGEDCO/TNERC

Roadmap exists to achieve financial viability

Jun11

SEB Finances: Set to improve

FY12 to be tipping point for SEB losses

Sep-11

Rajasthan tariff hike

Up by 23%; a progressive step

Sep-11

SEB FY10 financial analysis

Incremental losses coming down

Oct-11

Reports released date

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post the ruling by Delhi HC in case of tariff hike for Delhi, opposed/stayed by state government. The recent round of tariff bidding means that all top loss making states have increased tariff except for Uttar Pradesh, where it was pending given State elections. The revision of tariff for UPDICOMs would thus remains the next key trigger to watch out for. Thus, the ball is set rolling by DISCOMs in favour of disciplined efforts to manage cost, file tariff petition and hike tariffs. We continue to believe that FY12 was the tipping point in terms of the deterioration in SEB finances.

PFC/REC and PTC India specific beneficiary of improved scenario for DISCOMs, apart from sector incumbents at large: PFC and REC have seen sizable de-rating given the issues on health of DISCOMs, given exposure to large loss making states like Rajasthan (hiked tariff by 23% in Sept-11), TN (37% now), UP (pending), etc. Similarly, PTC India had corrected sizably due to issues of higher debtor, ST borrowing to fund debtors increase and higher exposure to state like TN and UP (INR10b of debtors out of INR23b). Management of PTC India have taken several steps to mitigate the impact, including discontinuation of trade with the states, no counter guarantee, etc. and thus problem is unlikely to mount further. Current tariff hike /assurance of past arrears by State government improved visibility on the recovery of the dues.

Tariff hike by States in FY11 (%)

State	Issued Date	Tariff Hike
Gujarat	Apr-10	1.5-3.5
Uttar Pradesh	Apr-10	14
Punjab	Apr-10	8
Uttarakhand	Apr-10	3
West Bengal	Apr-10	11
J&K	Apr-10	12
Jharkhand	May-10	11
Himachal	Jun-10	10
Madhya Pradesh	Jun-10	11
Tamil Nadu	Aug-10	11
Andhra Pradesh	Aug-10	4
Maharashtra	Sep-10	3
Haryana	Oct-10	17
Karnataka	Dec-10	6
Mizoram	Jan-11	11
Manipur	Feb-11	15
Andhra Pradesh	Mar-11	19
Orissa	Mar-11	20
Chhattisgarh	Mar-11	14

Tariff hike by States in FY12 (%)

State	Issued Date	Tariff Hike
Bihar	May-11	19
Haryana	May-11	10-15
Nagaland	Jun-11	34
Himachal	Jun-11	9
Jharkhand	Jul-11	18
Madhya Pradesh	Jul-11	6
Delhi	Aug-11	21
Punjab	Sep-11	9
Rajasthan	Sep-11	24
Gujarat	Sep-11	4
J&K	Oct-11	17
Maharashtra	Oct-11	10
Karnataka	Oct-11	7
Andhra Pradesh	Dec-11	14
TN	Mar-12	37
Bihar	Mar-12	12
Madhya Pradesh	Mar-12	7

Comparative valuations

	Rating	Mkt Cap	CMP	EPS (INR)		EPS Gr. (%)		RoE (%)		P/BV (x)		P/E (x)		EV/EBITDA (x)	
		(INR b)	(INR)	FY12	FY13	FY12	FY13	FY12	FY13	FY12	FY13	FY12	FY13	FY12	FY13
CPSUs															
NTPC	Buy	1,429	168	9.9	11.1	2.6	11.7	11.6	12.1	2.0	1.8	17.5	15.7	12.9	12.0
PGCIL	Buy	515	109	6.8	7.9	23.1	17.0	14.0	14.9	2.2	2.0	16.5	14.1	11.6	10.2
Coal India *	Buy	2,101	341	24.5	28.3	41.4	15.7	28.3	26.3	4.7	3.6	13.2	11.4	8.3	6.5
NHPC	Neutral	258	20	1.5	2.0	-7.4	34.2	5.9	7.7	0.9	0.9	14.4	10.7	9.4	8.7
Private Sector															
Tata Power	Neutral	256	100	8.3	8.3	12.4	-0.4	9.5	7.1	2.2	2.1	13.0	13.1	17.5	17.3
Adani Power	Neutral	179	69	1.4	5.1	-42.1	277.2	5.1	17.2	2.7	2.3	54.9	14.5	35.6	11.1
JSW Energy	Neutral	96	63	1.3	2.8	-74.3	114.5	-0.1	7.9	1.7	1.6	44.2	20.6	14.3	7.9
Lanco Infra	Buy	53	19	0.6	1.7	-76.9	162.8	3.3	8.6	1.2	1.1	34.8	13.2	11.6	10.2
Reliance Infra	Buy	174	613	61.4	59.9	51.9	-2.5	10.0	8.2	0.9	0.9	10.6	10.9	2.3	3.0
CESC	Buy	38	275	40.5	44.2	4.2	9.2	10.7	10.6	0.8	0.7	7.5	6.9	4.6	4.5
PTC	Buy	18	67	6.2	7.4	9.1	20.1	4.7	4.8	0.8	0.8	9.8	8.1	9.3	9.1

* RoE adjusted for OB reserves provisions

Source: MOSL

TANGEDCO tariff hike approved, important event for the sector

- In Nov-11, TANGEDCO had filed a tariff petition with TNERC, while last tariff revision was in August 2010 (after a gap of 7 years). The current tariff petition was very important as it would set a practice for regular tariff petition every year.
- TNERC has approved tariff hike of INR78.8b, in-line with estimated INR80b and in time bound manner (before Mar-12), as per our earlier understanding based on discussion with authorities. Tariff hike is effective from April-12 and applicable for the FY12-13E.
- In our earlier discussion with TANGEDCO and TNERC in July 2011, we were informed that the tariff petition would be filed by end of October/November, given prevailing State election, Panchayats election, and tariffs will be approved by February/March 2012. Given the increase of bus fares, milk prices, by State government which again impacted the masses, there was increased comfort on approval of 37% tariff hike proposed by TANGEDCO. The current approval is thus most important event for the sector, given TN was highest loss making state in FY09 and 2nd highest in FY10.

Proposed tariff hike to arrest on-going under recovery, past arrears to be absorbed by government...

- Based on the TO approved by the commission, the total under recovery for TANGEDCO for FY13 is estimated at INR78.8b and is fully allowed through a tariff hike (37%). This would ensure that there is no addition to under recoveries on an on-going basis.
- In its tariff petition, TANGEDCO had requested for creation of regulated assets to the tune of INR247.6b, pertaining to FY11-13E based on its assessment of cost and tariff hike proposed. However, commission has taken a very important step to solicit advise of State government on treatment of such regulated asset. TNERC made a plea to state government if the losses can be absorbed by State government, so that consumers are not burdened with such losses. In continuation of its drive to put State corporations in financial shape (earlier bus and milk prices were hiked), TN government has given in-principal approval to absorb the past arrears.
- Arrears for TANGEDCO of INR196b (as approved by Commission) would be amortized over the period of 5 years, starting from the year 2013-14 onwards. However, the exact details and mechanism will be worked out in conjunction with tariff revision and TANGEDCO's improvement due to internal savings.

TNERC letter to State government on Regulated Assets

The Regulatory Asset which is being discussed in this letter is relating to the post unbundling period. The amount involved being Rs.25,000/- crores and if the same is amortized by way of tariff hike the impact on the consumer would be huge resulting in a tariff shock to almost all the consumers for the next five years. Such a tariff hike would take the tariff to abnormal levels and may become unbearable and may also impact competitive nature of the industry. Under these circumstances, the Commission desires to know if the Government is willing to meet the amortization requirement of the Regulatory Asset. The views of the Government would enable the Commission to address the issue of Regulatory Asset appropriately.

It is, therefore, requested that the Government may communicate their views *as to whether the entire Regulatory Asset or part of it could be absorbed by the Government there by not passing on the entire burden on the electricity consumers of Tamil Nadu*.

TN government response to the TNERC letter

It is to be informed that the Government has in-principle agreed with the request for amortization and exact details and mechanism will be worked out in conjunction with tariff revision and TANGEDCO's improvement due to internal savings

- Commission has also observed that there was no proper classification between capital and revenue expenditure and equity infusion and debt drawl in these categories are not properly maintained. In its assessment, commission has thus highlighted that while debt was certainly used for meeting revenue gap, even equity infusion was largely used towards revenue gap. Capex was almost nearly funded through debt. Given this, the RoE is not allowed in its calculation of fixed charge.
- Infact, TNERC had also contemplated not allowing the interest cost on debt taken for meeting revenue expenditure (as debt recovery for capex incurred is only allowed as per regulation / for meeting working capital). However, it has allowed the entire interest cost on the ground that such disallowance would add to the existing problems of DISCOMs, not address/help incremental funding requirement, and at the end burden the consumer at large. Commission has however stated that provisional allowance of such interest would be dealt with properly once the report of B K Chaturvedi committee is out and the treatment of past liabilities in accordance with the same is worked out.

Synopsis of tariff approval (INR B)

ARR Requirement	FY11	FY12	FY13
Fixed Charges	45.1	61.6	65.1
Generation expenses	53.6	65.8	89.4
Power purchase cost	175.6	178.0	116.8
Trans Charges / Other	17.9	19.2	30.8
Total ARR	**292.3**	**324.6**	**301.9**
Less: Other revenue	8.7	9.7	8.6
Revenue requirement	283.6	314.9	293.4
Existing revenue	183.6	180.8	214.7
Revenue Gap	**100.2**	**134.1**	**78.6**
Past year revenue gap	54.2	141.5	
Cumulative arrears guaranteed by State		**195.7**	
Recoverable through current tariff hike			**78.6**

Source: TNERC

RoE not included as equity went to meet revenue gap

Fixed cost recovery	FY11	FY12	FY13
O&M Expenses	26.2	27.3	28.8
Depreciation	2.3	2.5	2.9
Int on LT loan	16.5	31.5	33.6
Other Debits	0.3	0.3	0.3
RoE	-	-	-
Total	**45.3**	**61.6**	**65.1**

Source: TNERC

LT power availability to increase, cost of power procurement expected to come down by 22% in FY13

- TO highlights sizable improvement in the operating performance of TANGEDCO as ~2GW of capacity (listed below) is added to its long term power purchase portfolio. This is expected to lower the overall cost of power purchase for TANGEDCO.
- Also, commission has highlighted that while ST power requirement is nearly NIL, it has allowed 2BUs of ST power procurement to provide flexibility to DISCOM to managed demand. ST power rate is considered at only INR4/unit and any deviation in quantity and price would be only with prior consent of commission.
- Owing to this, the power purchase cost for TANGEDCO is expected to come down from INR4/unit in FY12 (up from INR3.8/unit in FY11) to INR3.2/unit, a reduction of 22%.

Blended power purchase cost

	FY11	FY12	FY13
Units (MUs)	45,950	43,973	36,876
Cost (INR Cr)	17,556	17,800	11,675
Rate	**3.8**	**4.0**	**3.2**
Gr. % YoY		6	-22

Sizable addition to LT portfolio in FY13 (MW)

Projects	CoD expected	Installed Capacity	TANGEDCO's Share
NLC TS Expn U1	31/3/12	250	98
NLC TS Expn U2	15/9/12	250	98
Kudankulam U1	15/5/12	1,000	393
Kudankulam U2	15/2/13	1,000	394
Simhadri U3	16/9/11	500	81
Simhadri U4	31/3/12	500	81
NTPC-TNEB U1	31/3/12	500	295
NTPC-TNEB U2	15/2/13	500	295
MAPS	31/5/12	500	142
Total		**5,000**	**1,875**

Power purchase basket - ST power only for support!

MUs	FY11	FY12	FY13
Own Generation	23,233	25,680	33,908
% of total	**33.6**	36.9	**43.1**
IPP	6,945	5,982	7,020
% of total	10.0	8.6	8.9
Captive	6,833	6,965	7,258
% of total	9.9	10.0	9.2
Central	21,633	21,625	28,402
% of total	**31.3**	31.0	**36.1**
Traders	10,540	9,400	2,000
% of total	**15.2**	13.5	**2.5**
Total	**69,184**	**69,652**	**78,588**

Source: TNERC

Tariff proposal in-line with our past understanding/interaction, Bihar too has announced a tariff hike

- Our view of turnaround of TANGEDCO was based on 1) Tariff hike to ensure no under recovery on on-going basis, and 2) Financial support by State government through bonds/equity infusion/underwriting past arrears. The current tariff framework is thus in-line with our earlier understanding, based on our discussion with TNERC/TANGEDCO.
- Bihar has also announced a tariff hike ~12% and thus, the ball is set rolling by DISCOMs in favour of disciplined efforts to manage cost, file tariff petition and tariff hikes. The tariff hike of UP (post recent elections) would be the next key trigger to watch out for.

Buy PFC, REC and PTC India

- Earlier, Rajasthan hiked tariff by 23% (Sept-11), and TN has now got a tariff hike (Mar-12), which together accounted for 35%+ of total commercial losses. Totally 24 States have revised tariffs in past 18 months.
- We continue to believe that FY12 was the tipping point in terms of the deterioration in SEB finances, and things have started improving. The improvement is being driven by i) higher tariffs coupled with ii) lower power procurement costs. Power

purchase costs will decline due to lower merchant tariffs and large capacity additions in state / central sector.

- Concern on PFC/REC for their sizable exposure to Rajasthan (8.8% of loans for PFC and 11% for REC) was addressed partly with tariff hike and partly owing to government's underwriting towards past arrears, while concern over exposure to TN will also get addressed with current tariff hike/assurance towards past arrears. This coupled with improved cashflow position for major DISCOMs are expected to be key trigger re-rating, in our view.
- Similarly, PTC India has seen sizable correction due to issues of higher debtor, ST borrowing to fund debtors increase and higher exposure to state like TN and UP (INR10b of debtors out of INR23b). Management of PTC India have taken several steps to mitigate the impact, including discontinuation of trade with the states, no counter guarantee, etc. and thus problem is unlikely to mount further. Current tariff hike /assurance of past arrears by State government improves visibility on the recovery of the dues.

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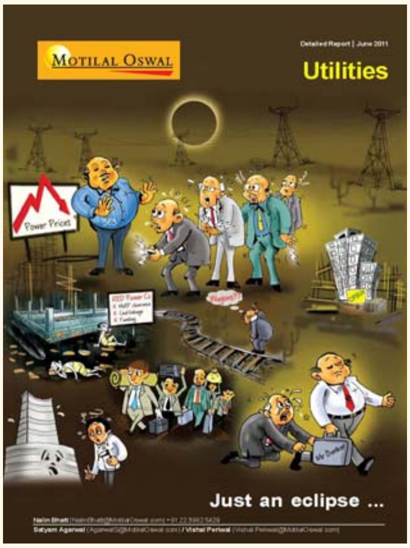

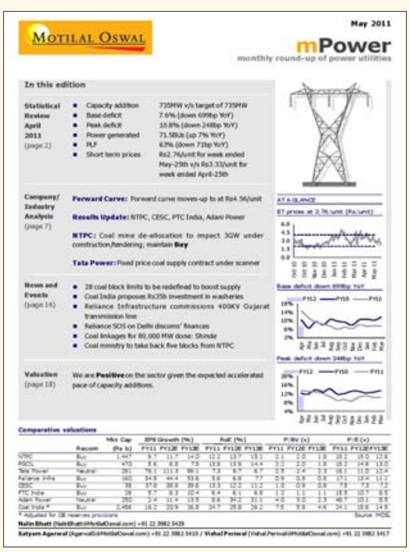

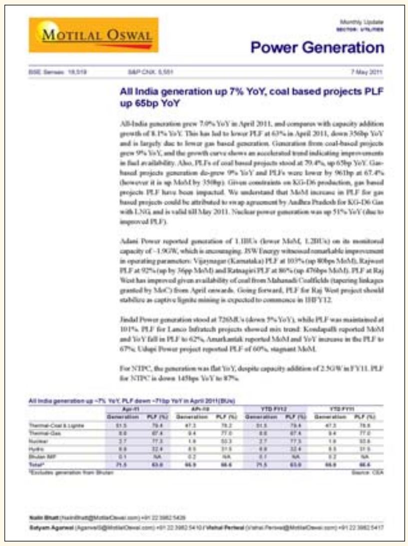

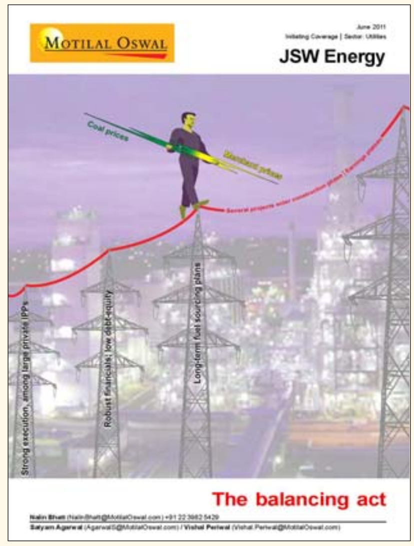

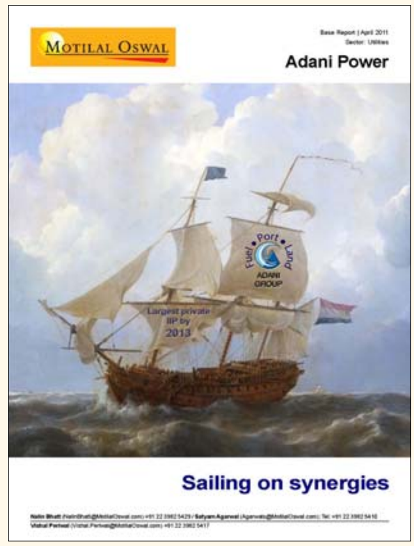

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