

CERC's forward curve price can be misleading

May 18, 2011

Price Performance

APL

(%)	1M	3M	6M	12M
Absolute	(3)	(2)	(17)	(6)
Rel. to Nifty	3	(8)	(9)	(12)

JSW Energy

(%)	1M	3M	6M	12M
Absolute	(12)	1	(40)	(41)
Rel. to Nifty	(6)	(4)	(35)	(45)

Lanco

(%)	1M	3M	6M	12M
Absolute	(23)	(15)	(45)	(45)
Rel. to Nifty	(18)	(20)	(40)	(49)

RPL

(%)	1M	3M	6M	12M
Absolute	(13)	3	(36)	(21)
Rel. to Nifty	(7)	(3)	(30)	(26)

JPVL

(%)	1M	3M	6M	12M
Absolute	(5)	30	(26)	(31)
Rel. to Nifty	1	22	(19)	(36)

KSK

(%)	1M	3M	6M	12M
Absolute	8	3	(30)	(37)
Rel. to Nifty	15	(3)	(23)	(41)

NBVL

(%)	1M	3M	6M	12M
Absolute	(18)	(13)	(32)	(45)
Rel. to Nifty	(13)	(18)	(25)	(48)

NTPC

(%)	1M	3M	6M	12M
Absolute	(7)	3	(9)	(15)
Rel. to Nifty	(1)	(3)	(0)	(21)

GIPCL

(%)	1M	3M	6M	12M
Absolute	(10)	(6)	(28)	(29)
Rel. to Nifty	(4)	(11)	(21)	(33)

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- In CERC's Apr 11 report on power trading, it has predicted - July and Aug 11 (monsoon period), bilateral merchant tariffs of Rs4.56/unit, higher than Jun 11 prediction of Rs4.08/unit.
- +31% revision from last report in Mar11. We believe these predictions can be misleading as contracts in Apr11 are mostly 1 month delivery & at best representative of May11
- No reason for higher tariffs in Jul/Aug 11 vs. Jun11 as (1) it's a period just after elections, (2) monsoon est. normal, (3) lots of MWs coming up in Q1/Q212E & (4) demand not encouraging (2% gr.) even in Mar-Apr11 (pre-election month).
- Foresee bilateral merchant prices heading towards avg. Rs3.5-3.7/unit in FY12E & Rs3.0-3.2/unit in FY13E from about Rs4.7/unit in FY11P; Use any upswings to reduce weights

Apr11 report has upped Jul/Aug11 bilateral tariff prediction to Rs4.56/unit (+31%)

CERC's monthly (latest - April 2011) report on power trading, predicts that during July and August 2011 (monsoon period), the bilateral merchant power prices would be Rs4.56/unit, higher than June 2011 (start of monsoon) prices of Rs4.08/unit. This is a significant upward revision (+31%) from there last report in March 2011 in which they had predicted July 2011 prices of Rs3.49/unit.

But report also says most of the contracts entered in Apr11 are one month contracts

However, important to note is that report also says most of the contracts entered in April 2011 are one month contracts (refer to page 5, para 1) out of total 78 contracts. Further only 5 contracts are above three month contracts from which the prediction for August month would have been derived.

Thus, these contracts are at best representative of May11 prices and not beyond

Since most of the contracts are 1 month delivery meaning delivery max upto May11. Therefore, at best these contracts are representative of May month prices (prediction of Rs4.67/unit). Predictions for the period June and July 11 are based on very few contracts and can be misleading. Further, since prediction for August 11 is based on only 5 contracts - which again can be misleading.

Also there isn't too much to look into Apr11's huge contract volumes

CERC has reported that volumes contracted in Apr11 went up significantly to 9.3bn units vs 1.4bn units contracted in Mar11. However, we believe that since most of these contracts were for one month (delivery max up to May 2011), these were driven by state elections (5 states in April and May). We expect contract volumes to come back to normal levels from May11 reporting.

Also our analysis of CERC's all prediction reports indicates actual prices always have been lower

Our analysis of the forward curve predictions from August 2010 to April 2011 (refer table on next page) shows that (1) actual prices have always been lower (1% to 17%) than predictions, (2) normally the predictions comes down as we approach nearer to a particular month, (3) the yoy trend in prices is downwards only – infact even in Mar11 (pre-election month), bilateral merchant prices were down 13% yoy despite the fact that there was no seasonal or abnormal (monsoon or elections) impact in Mar10 and (4) and (4) July and August prices are based on very few contracts.

Do not see any reason why July and August 2011 prices should be higher than June 2011

We believe that there is no reason as of now for bilateral prices in July and August 2011 to be higher than June 2011 prices as (1) it is a period just after state elections (normally relatively lower demand), (2) monsoon estimates are normal, (3) lot of capacities are coming up especially merchant in Q1 and Q2FY12E and (4) the demand numbers are not that encouraging even in Mar-Apr11 (pre-election months) – energy demand growth of just 2% and deficit of 7.5%.

We believe that merchant power prices are headed towards Rs3.2/unit in FY13E; use any upswings to reduce weights

FY11P bilateral merchant prices stood at Rs4.7/unit mainly driven by prices in first 6 months. Our analysis of (1) electricity demand, (2) supplies scheduled, (3) state distribution company losses - we believe that merchant power prices including bilateral are headed towards Rs3.5-3.7/unit (average) in FY12E and Rs3.0-3.2/unit in FY13E. Our estimate of sustainable merchant power prices stands at Rs2.7/unit (tariff at which discom's losses do not increase) beyond FY13E. We continue to prefer NTPC and Power grid over private players and recommend any upswings in stock prices to be used to reduce weights.

Forward curve predictions, actual bilateral prices and deviation from predictions

Month	Predictions (months back)				Actual	yoy %	Deviation From		
	4	3	2	1			Avg Predictions	1st Est.	1 month back
Sep-10				5.20	4.73	0.0%	-9.1%	-9.1%	-9.1%
Oct-10			4.29	4.62	4.00	-21.1%	-10.2%	-6.7%	-13.4%
Nov-10		4.28	4.65	4.21	3.91	-26.6%	-10.8%	-8.6%	-7.2%
Dec-10		4.75	4.40	4.30	3.95	-20.8%	-11.9%	-16.8%	-8.1%
Jan-11		4.38	4.38	4.25	4.00	-24.0%	-7.7%	-8.7%	-5.9%
Feb-11	4.37	4.37	4.27	4.29	4.24	-16.0%	-2.0%	-3.0%	-1.2%
Mar-11	4.35	4.32	4.36	4.41	4.30	-13.0%	-1.4%	-1.1%	-2.5%
Apr-11	4.59	4.60	4.68	4.68					
May-11	4.81	4.85	4.83	4.67					
Jun-11	4.04	4.05	4.08						
Jul-11	3.49	4.56							
Aug-11	4.58								

Observations – (1) actual prices always lower than predictions, (2) predictions comes down as we approach nearer to a particular month, (3) yoy trend in prices is downwards only and (4) July and August prices are based on very few contracts

Source: CERC, Emkay Research

Mute electricity demand growth even in Mar-Apr11 (pre-election months)

Month	Energy Demand (Mn units)	Y-o-Y Growth	Energy Deficit
Mar-10	76,787	10.3%	-11.9%
Apr-10	75,259	10.7%	-14.6%
May-10	74,363	8.6%	-11.5%
Jun-10	70,972	2.1%	-9.5%
Jul-10	70,620	3.3%	-8.5%
Aug-10	70,378	-4.0%	-7.3%
Sep-10	67,756	-1.8%	-5.4%
Oct-10	73,277	5.1%	-6.8%
Nov-10	64,193	2.0%	-6.3%
Dec-10	71,249	3.8%	-8.1%
Jan-11	75,489	7.4%	-7.9%
Feb-11	69,501	6.0%	-7.8%
Mar-11	79,510	3.5%	-7.5%
Apr-11	74,843	-0.6%	-7.6%

Source: CEA

Even the peak demand growth is not encouraging

Month	Peak Demand (MW)	Y-o-Y Growth	Demand Deficit
Mar-10	119,166	8.8%	-12.7%
Apr-10	119,437	7.6%	-14.3%
May-10	117,171	8.6%	-12.1%
Jun-10	116,706	4.5%	-12.5%
Jul-10	114,015	4.1%	-12.5%
Aug-10	114,844	-1.2%	-10.8%
Sep-10	117,076	1.7%	-8.7%
Oct-10	117,479	1.8%	-8.7%
Nov-10	112,900	2.9%	-7.5%
Dec-10	117,355	4.4%	-10.7%
Jan-11	120,575	7.2%	-10.3%
Feb-11	120,536	5.4%	-10.2%
Mar-11	122,287	2.6%	-9.8%
Apr-11	124,333	4.1%	-10.8%

Source: CEA

Valuation Table – Power Utilities

Companies	Rating	Target	PE (x)		P/BV (x)		EV/EBITDA (x)		RoE (%)	
			FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
APL	REDUCE	103	10.5	6.7	2.7	1.9	11.1	6.9	30.7	35.4
JSW Energy	REDUCE	78	9.1	11.4	1.6	1.4	9.5	11.7	20.0	13.3
RPL	ACCUMULATE	157	50.3	15.0	1.8	1.6	45.4	14.4	3.7	11.3
Lanco	BUY	56	8.8	6.8	1.2	1.0	7.7	6.8	19.0	20.7
JPVL	HOLD	47	25.5	20.9	2.1	1.8	11.9	12.4	11.0	9.3
KSK Energy	HOLD	110	12.2	9.8	1.4	1.2	13.8	11.7	12.6	14.0
NBVL	ACCUMULATE	328	5.0	5.0	0.8	0.7	4.7	5.2	17.8	14.9
NTPC	BUY	204	14.8	13.2	1.9	1.8	11.5	10.6	13.3	13.8
PGCIL	NOT RATED	101	15.4	12.9	1.8	1.7	12.1	10.2	12.3	13.5
GIPCL	HOLD	101	8.0	7.7	0.9	0.8	5.0	4.9	11.2	10.9

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