Power

Switch from Reliance Power to NTPC or CESC depending on your risk profile

Key points

Prefer NTPC, CESC: We have compared Reliance Power with NTPC and CESC on various parameters like operational efficiencies, progress on expansion, balance sheet strength, risk and prevailing valuations. Given the multiple concerns for the power generation companies (like coal linkage, execution delays, forex fluctuations etc.), we believe it is better to stick with companies with power generating assets (that provide free cash flows), assured returns and higher certainty of future earnings. Thus, it is better to switch from Reliance Power to NTPC (for conservative investors) or CESC (for more aggressive investors).

Reliance Power - execution delays and uncertainty of coal usage issues: We see rising execution delay risk on two of its major projects (with total capacities of 8000 MW). In these two projects the company was planning to divert surplus coal from captive coal mines to feed other projects. However, it appears that coal diversion is being questioned now which could dilute the perceived advantage it had of surplus coal. Moreover, due to unfavorable change in Indonesia's coal pricing, the Krishnapatnam (4000 MW) project is facing a viability challenge with the existing tariff rate. Hence, we see rising execution delay risk in Reliance Power.

NTPC - high return ratio with large generating assets: NTPC is the largest power generating utility in India and also one of the most efficient player. We like its large operational assets which are generating healthy cash to fund future growth. Moreover, having FSA with Coal India it has relatively high safety of coal supply. Also, assured high return on equity (RoE: 14%) which could be sustained despite capacity addition is difficult to ignore.

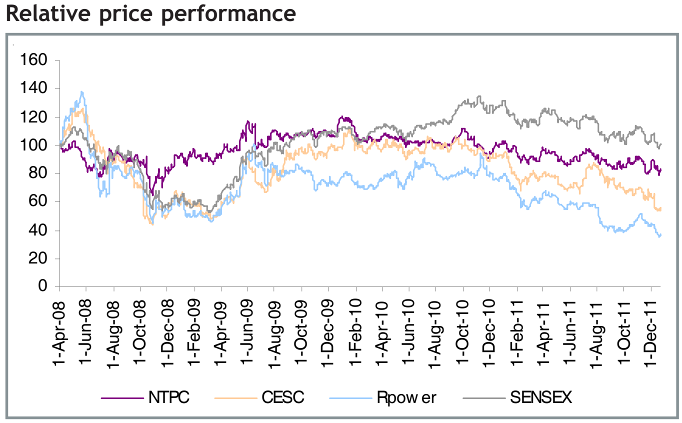
CESC - extremely attractive valuations; retail spin off is additional trigger: We believe CESC is one of the cheapest utility stocks available in the Indian market, despite being one of the most integrated utility. It has a coal supply tie up of around 80% and doesn't have any SEB related risk, having its own distribution business. We believe the discount in its valuation is overdone as the financial health of the retail business is improving since FY2011. Further, possible break even of the retail segment by FY2015 coupled with growing scale of the utility business would consequently reduce the impact of the retail business' drag on the overall balance sheet of the company.

Key risk to our argument

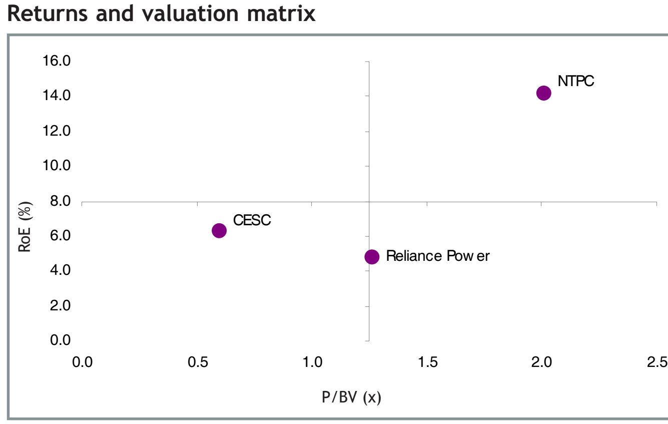
1. Apparent challenges ahead of Reliance Power easing off due to some structural change of business plan or favourable policy changes.

2. Any unfavourable changes which could cause delay in NTPC or CESC's project execution time line.

Relative price performance



Returns and valuation matrix



Comparative landscape

Comparative parameters	NTPC	CESC	Reliance Power
Operational Capacity	Very good (Currently above 31000 MW) and likely to add 8500 MW in next two years.	Current operational capacity is 1200 MW and adding another 1200 MW which is in advanced stage (to come by FY14 and FY15).	Poor (only 600 MW now and, expected additional 1200 MW in a year's time). Increasing concern of major projects could delay capacity addition time line.
Off take (PPA/open)	100% PPA	100% PPA; but new plants would have around 75% of PPA	Currently 100% sold through PPA but considering future projects it will be 89%
Coal Supply	FSA with Coal India for 90% of requirement	80% fuel supply assured, of which 50% from its invested company	78% captive but major two projects built on captive mines are facing execution delay due to respective issues
Earnings Growth visibility	Healthy (Decent growth likely with improving project execution rate off late)	High (Doubling capacity in next 3 years with very high certainty)	Dubious (execution hurdle for large projects); current status suggests lower profitability than previously expected. Long gestation
Balance sheet	Total debt to equity (DE) ratio stands at 0.7, however Cash and long term investments together are almost 50% of total debt. Further, we believe despite planned capacity addition of around 20,000 MW in next 5 years period, balance sheet would not be in stress.	DE is still comfortable. Further, reducing losses from retail segment are supportive to improve balance sheet. We expect retail business to break even in next 3 years period; which could improve balance sheet significantly.	DE ratio is very low now but not likely to remain as major capex has yet to come. The company plans huge capacity addition, which could need more than Rs60,000 crore of debt; likely to weigh on balance sheet in future.
Cash flow	Strong cash flow generation from operating assets (almost funding 50% of current capex).	Healthy cash flow generating from current assets but a part of the same is diverted to currently loss making retail segment.	Currently having negative cash flow from operations and having most of the projects in construction phase, it would take some time to generate cash from operations. Moreover, time of the same would be highly dependent on execution of the upcoming projects.
Share pledges	No	11% of total shares	No
Forex exposure	It has foreign loan of Rs10,700 crore	FCCB has been redeemed but having approval for ECB funding of Rs11,000 crore for Sasan and plans for around Rs500 crore of foreign funds for solar project	Foreign exposure of around $100 mn (Rs450 crore)
Returns (RoE)	14.2	6.3	4.4
Valuation (P/BV)	2x	0.5x	1.3x

What turned negative in Reliance Power

Reliance Power is having just 600 MW of operating capacity currently and expects to add 1200 MW in the next one year period. The company has an ambitious plan to add above 18000 MW in future. However, two major adverse developments viz unfavourable change in the price of Indonesian coal and questions on coal diversion from captive mines, are likely to delay or bring uncertainty in execution of two of its projects.

The company had been very aggressive in bidding for 4000 MW UMPP at Sasan, Madhya Pradesh at a tariff of Rs1.19/ unit. This was backed by pit head captive coal mine which could extract surplus coal after feeding the Sasan plant. Reliance Power was planning to divert the surplus coal to Chitrangi project, which was expected to add value to Chitrangi project. So, the low tariff of Sasan could be compensated to certain extent. However, competitors have raised the coal diversion issue to regulators and now it appears that power ministry is not going to permit this surplus coal diversion plan of Reliance Power. Hence, coal supply uncertainty is likely to rise and the value addition as expected through this would not be possible. The positive of surplus coal availability is now diluted.

Another UMPP project won by Reliance Power at Krishnapatnam is facing execution risk. Coal for the proejct was planned to be imported from Indonesia through coal concessions and bidding (tariff) was done with an estimated landed cost of such coal. However, recently Indonesia amended its coal pricing policy to link base price to international benchmark. Hence, the landed coal cost would be significantly high for Reliance Power compared to previous estimates; thereby raising questions of viability of the project with the same tariff. Hence, we expect there could be a delay in the execution of the Krishnapatnam project.

We believe what was perceived as a positive (surplus captive coal transfer) for the company is diluted now. As a result, the returns ratio of the company which is already too low now will take time to reach a respectable level.

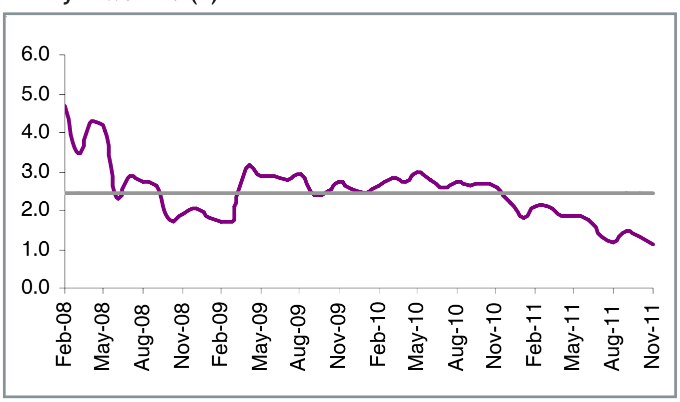
Prefer NTPC or CESC

NTPC's status for coal supply has remained as it is; on the contrary coal supply has improved as captive mines are expected to be reallocated soon. Further, a concern arising out of messy financial condition of SEBs leading to lower offtake from NTPC is likely to ease off soon with expected implementation of bail out plans recommended by the Shunglu committee.

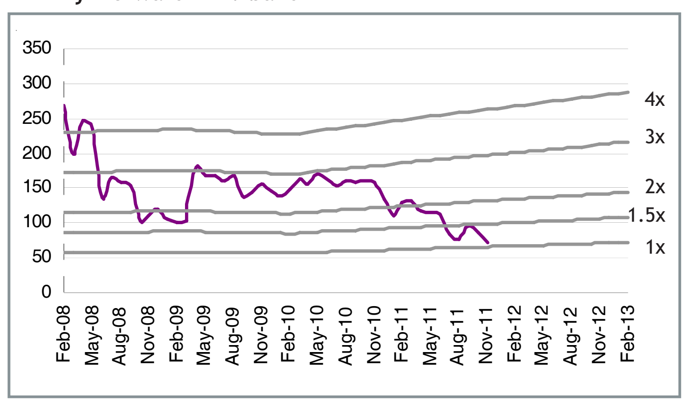
In case of CESC, the utility business is not having any concern now and the loss making retail business is also showing initial signs of recovery. Since FY2011, Spencers' is making store level profit and the company plans to breakeven in the next three years time. We believe the cheap valuation of the company is on account of the drag of its retail business but there is a silver lining in this.

Therefore, we recommend switching from Reliance Power to NTPC (for conservative investors) or CESC (for more aggressive investor).

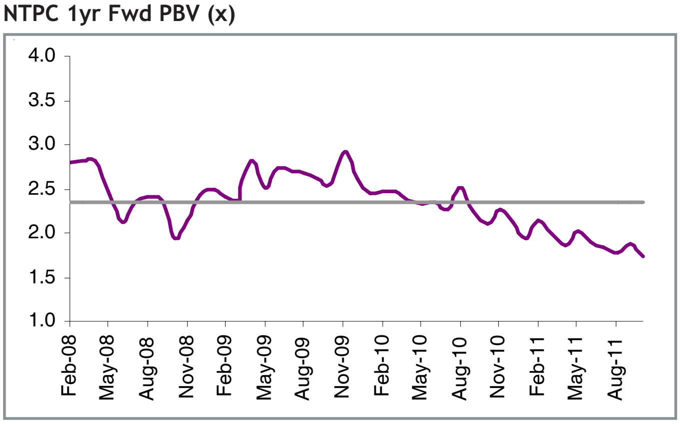
RPL 1yr Fwd PBV (x)



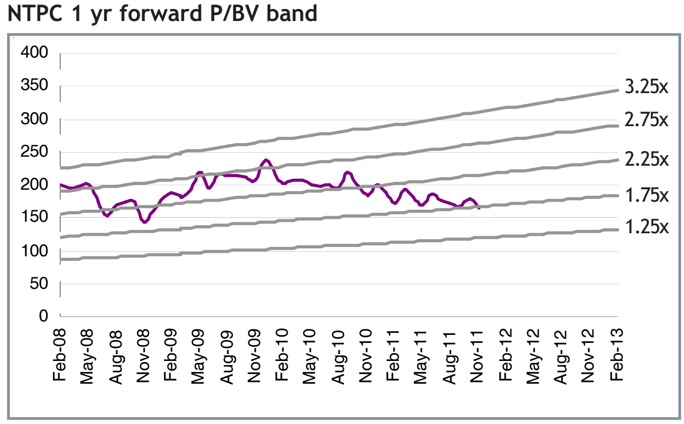
RPL 1 yr forward P/BV band



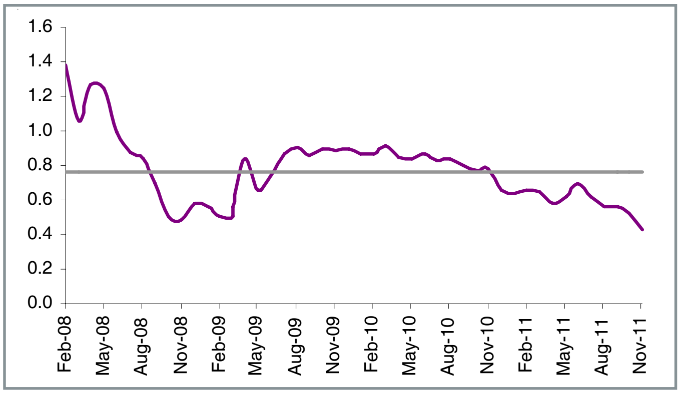
NTPC 1yr Fwd PBV (x)



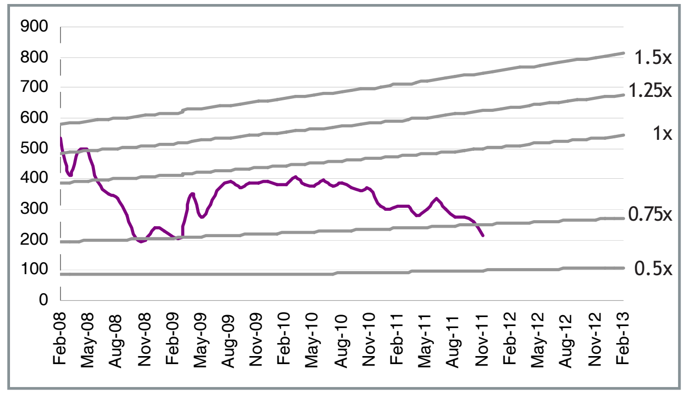
NTPC 1 yr forward P/BV band



CESC 1yr Fwd PBV (x)



CESC 1 yr forward P/BV band



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