POWER

18 March 2024

CERC final tariff norms: Maintaining policy continuity

- **CERC retains most of the norms specified in the draft tariff regulations in letter and spirit, ensuring stability of policy**
- **The norms make hydro projects more attractive, and boost storage capacity for renewable RTC power via higher regulated returns**
- **PSU utilities offer valuation comfort. We maintain BUY on NTPC and PWGR, while TPW remains at HOLD**

Vinod Chari | Swati Jhunjhunwala
Arshia Khosla
research@bobcaps.in

Final tariff norms maintain policy continuity: The final tariff norms released by the Central Electricity Regulatory Commission (CERC) for FY25-FY29 have retained most of the norms set in the draft policy released earlier. It ensures the stability of existing power assets by keeping their regulated returns unchanged.

No change in regulated returns: There are no changes to the key regulated return on equity compared to the ones suggested in the draft norms. The tariff guidelines maintain 15.5% ROE for thermal generation stations over FY25-FY29, in line with current norms (FY19-FY24). CERC has increased the attractiveness of hydro-based power by hiking ROE by 50bps to 17% for storage-based hydro plants as well as pumped storage hydro plants (PSHP). We believe this is aimed at storage capacity as PSHP is a viable solution to make renewable power available round the clock (RTC). On the transmission side, CERC has marginally reduced regulated ROE by 50bps to 15%.

Impact on stocks same as that of the draft: We expect the new proposals to have little impact on our coverage universe as the regulated ROE on NTPC and TPW's generating assets remain the same, whereas PWGR could see a marginal negative impact as the bulk of its new capex is earmarked for tariff-based competitive bidding (TBCB). The proposals are incrementally positive for NTPC as it plans to add ~8GW of PSHP over the next 5-7 years due to the better ROE profile of PSHPs. The norms are positive for hydropower companies like NHPC (Not Rated) and SJVN (Not Rated).

NTPC and PWGR are our picks: Given their stature and track records, we believe that NTPC and PWGR should enjoy valuations closer to their private sector peers, which trade at a ~50% premium to the price to book multiple (on a TTM basis). The valuation comfort in PSU stocks leads us to retain our BUY ratings on NTPC (TP Rs 370) trading at a P/B of 1.8x of Dec'25 book and PWGR (TP Rs 320), trading at a P/B of 2.2x of Dec'25 book – our top picks in the utilities space. We continue to maintain our HOLD rating on TPW, given that it is trading close to our TP of Rs 1,140.

Recommendation snapshot

Ticker	Price	Target	Rating
NTPC IN	316	370	BUY
PWGR IN	266	320	BUY
TPW IN	1,156	1,140	HOLD

Price & Target in Rupees | Price as of 15 Mar 2024

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Fig 1 – CERC norms on ROE – Stable for generation, boost for new hydro projects

Basis	Old	New
ROE on existing thermal, transmission and run-of-river hydro projects	15.50%	15.50%
ROE on existing storage type hydro generating stations, PSPs and run-of-river hydro project with pondage	16.50%	16.50%
ROE on new thermal and run-of-river hydro projects	15.50%	15.50%
ROE on new transmission projects commissioned	15.50%	15.00%
ROE on new storage type hydro generating stations, PSPs and run-of-river hydro project with pondage	16.50%	17.00%
ROE on additional capitalisation after cut-off date beyond the original scope	Weighted average rate of interest on actual loan portfolio	1Y MCLR of SBI + 350bps (ceiling of 14%)
ROE reduction upon failure to achieve required ramp rate	0.25%	0.25%
Additional ROE allowed upon incremental ramp rate over required ramp rate achieved	0.25% per 1% ramp (ceiling 1%)	0.125% per 0.5% ramp (ceiling 1%)
Ramp rate required	1% per minute	1% per minute (coal or lignite fired plants), 3% per minute (gas power plants), 10% per minute (hydro power plants)

Source: CERC, BOBCAPS Research | PSP: Pump Storage Plant

Fig 2 – Working capital – Most conditions have been retained

Basis	Old	New
Cost of coal or lignite (pit-head)	10 days	10 days
Cost of coal or lignite (non-pit-head)	20 days	20 days
Cost of limestone	10 days (pit-head) and 20 days (non-pit-head)	15 days
Advance payment towards cost of coal or lignite and limestone	30 days	30 days
Cost of secondary fuel	2 months	2 months
Maintenance spares	20% of O&M expenses	20% of O&M expenses
Receivables	45 days of capacity charge and energy charge	45 days of capacity charge and energy charge
O&M expenses	1 month	1 month
Emission control system of coal or lignite-based thermal generating stations:		
Cost of limestone or reagent	-	20 days
Advance payment towards cost of reagent	-	30 days
Receivables	-	45 days of supplementary capacity and energy charges
O&M expenses	-	1 month
Maintenance spares	-	20% of O&M expenses
For open-cycle gas turbine/combined cycle thermal generating stations:		
Fuel cost	30 days	15 days
Liquid fuel cost	15 days	15 days
Maintenance spares	30% of O&M expenses	30% of O&M expenses
Receivables	45 days of capacity charge and energy charge	45 days of capacity charge and energy charge
O&M expenses	1 month	1 month
For hydro generating station including pumped storage stations and transmission systems:		
Receivables	45 days of annual fixed cost	45 days of annual fixed cost
Maintenance spares	15% of O&M expenses	15% of O&M expenses
O&M expenses	1 month	1 month

Source: CERC, BOBCAPS Research

Fig 3 – O&M expenses – Escalation of expenses a positive

Basis	Old	New
Emission control systems in coal or lignite-based thermal generating station	-	2% of admitted capex, to be escalated at 5.25% annually
Escalation rate to be applied on hydro projects with less than 3 years of operation	4.77%	5.47%
Communication system in transmission systems	2%	2%

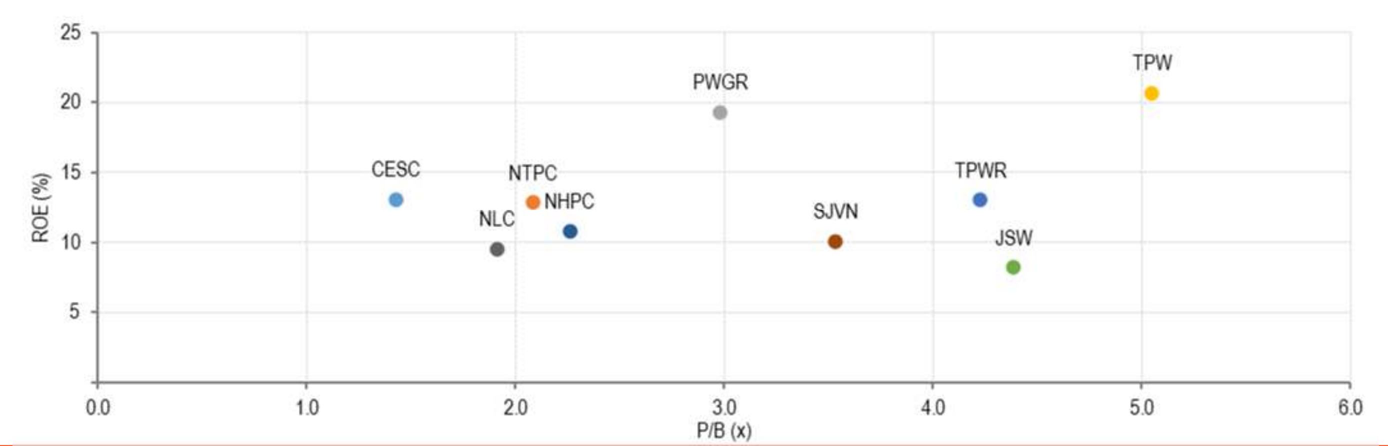
Source: CERC, BOBCAPS Research

Fig 4 – Input prices of coal and lignite from integrated mines have been included

Basis	Old	New
Input price of coal and lignite from integrated mines	Not in scope	In scope
ROE for the integrated mine	-	14%
Salvage value of asset	-	5%
O&M expenses escalation	-	5.25% annually
Working capital coverage:		
Input cost of coal stock	-	7 days of production
Consumption of stores and spares	-	15% (coal mine) and 20% (lignite mine)
O&M expenses	-	1 month

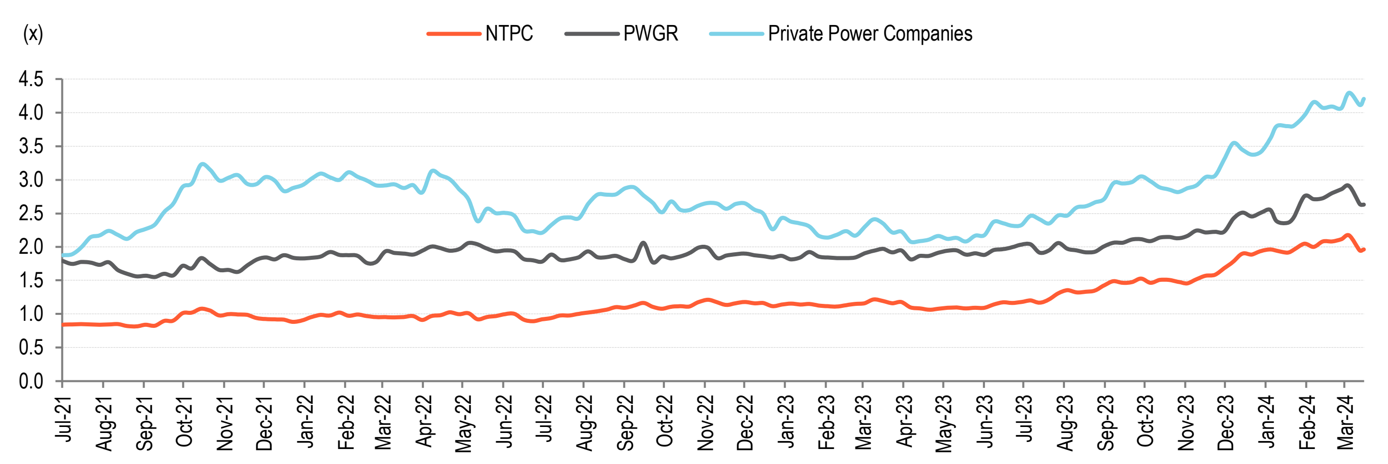
Source: CERC, BOBCAPS Research

Fig 5 – PSU companies trading at lower P/B despite higher ROEs



Source: Bloomberg, BOBCAPS Research

Fig 6 – P/B: Gap between private and public sector utilities expected to narrow



Source: Bloomberg, BOBCAPS Research

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**
SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**
Brand Name: **BOBCAPS**
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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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