

POWER

09 June 2021

Stay selective – sustained rally requires reforms

- Sector rally in June driven by expected recovery in power demand as Covid-19 restrictions ease but this is not sufficient for the rally to sustain
- Recent regulatory proposals seek to reduce discoms' cost of power but addressing pricing, collection and infrastructure is a bigger challenge
- Recommend that investors be selective. We like TPWR due to possible external investments in renewables, deleveraging and restructuring

Tarun Bhatnagar
researchreport@bobcaps.in

Power sector rally fuelled by expected demand recovery: Stocks in our coverage have rallied by 5.2-10.7% in June vs. a 1% gain for the Nifty. An expected rise in power demand after the removal of Covid-related restrictions could have fuelled the rally. A similar run-up after the first wave of the pandemic did not sustain despite a strong revival in power demand (Fig 1).

Regulatory proposals to reduce discom costs: The Ministry of Power (MoP) recently proposed the following to reduce discoms' power purchase costs:

1) Market Based Economic Dispatch (MBED): Thermal power purchase can be undertaken through a centralised pool of power plants vs. current purchases that are limited to each discom's PPA – this will maximise procurement from cheaper plants and save Rs 120bn or Rs 0.09/unit per MoP's estimates.

2) Market Based Procurement of Renewables: Per [The Economic Times](#), the government is evaluating a proposal to sell power from new renewable projects on power exchanges. The differential between market-discovered prices and bid prices will be paid by the party that has called the bid (like SECI) every month. Current projects will have an option to shift to this system. Discoms could buy power from the exchange rather than entering into long-term PPAs. Also, SECI's renewable projects awaiting PPAs from discoms can proceed towards construction.

3) Trading of Renewable Energy Certificates (REC): MoP proposes to restart REC trading and raise their validity to 15 years for new projects and till the PPA ends for existing projects vs. 3 years earlier. Discoms will be able to meet renewable portfolio obligations (RPO) without signing a PPA with generators by buying RECs.

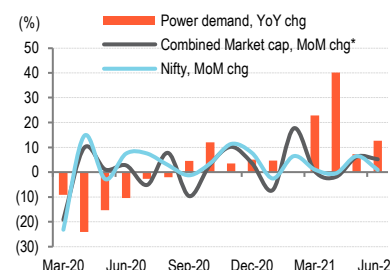
Discom reforms key for sustainable rally: While these developments will address the cost side of discom operations to some extent, the pricing, collection and last-mile infrastructure will need remedying to bring about sustainable change and raise investor confidence in the sector. TPWR is our top pick as it is aligning towards renewables and, as the No. 1 private power distributor, it will play a growing role in distribution once the sector opens up. Stock catalysts include new external investments in the renewable business, disinvestment of non-core assets and group restructuring to save costs.

Recommendation snapshot

Ticker	Price	Target	Rating
NTPC IN	116	111	REDUCE
PWGR IN	234	261	ADD
TPWR IN	117	131	BUY

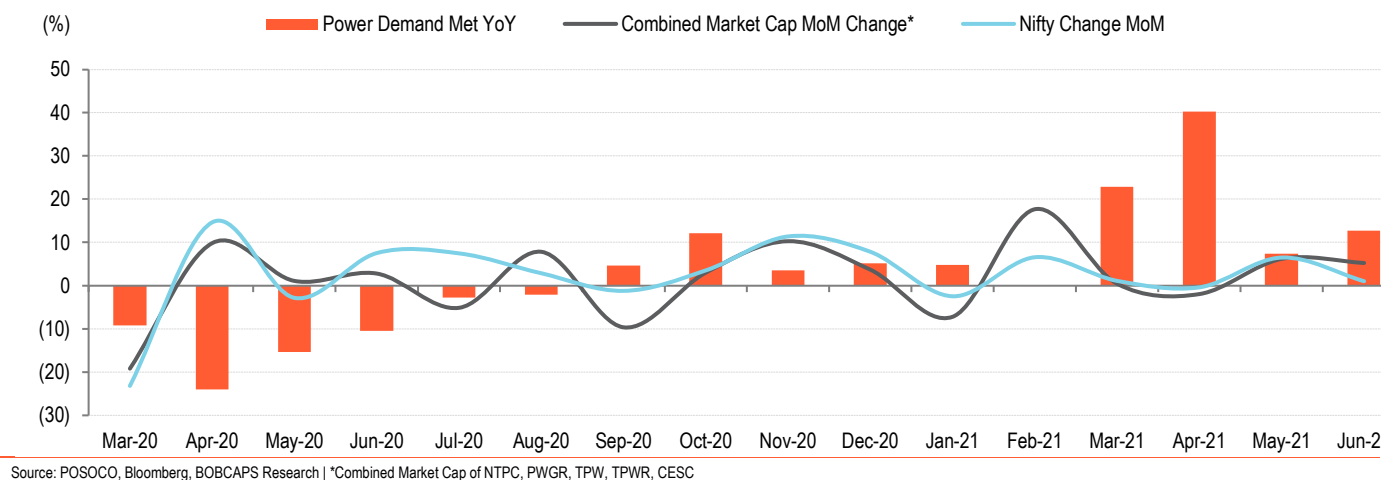
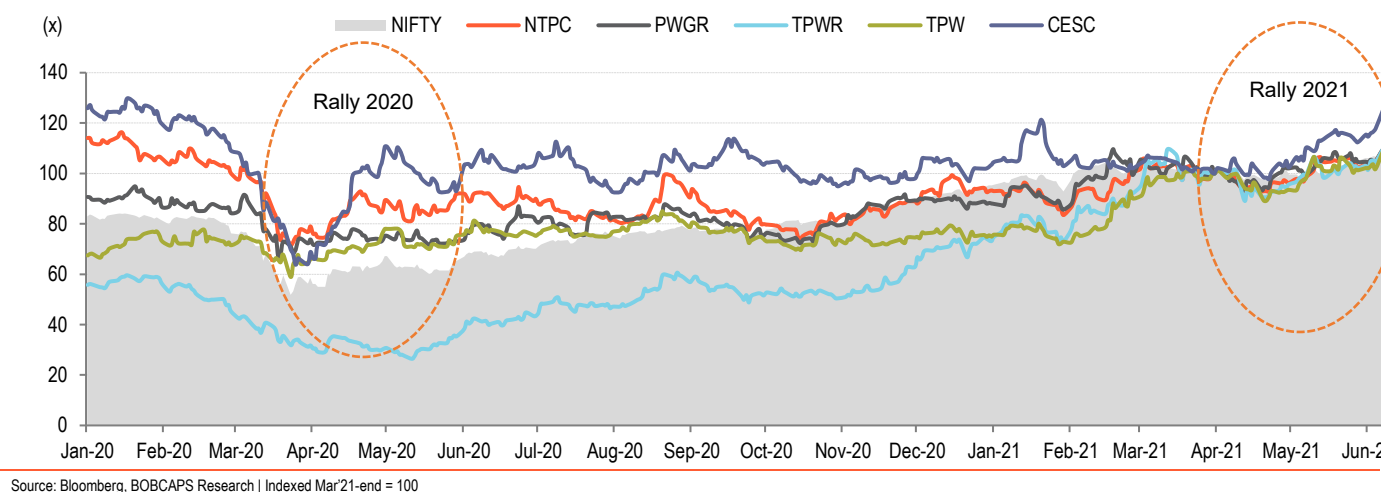
Price & Target in Rupees | Price as of 8 Jun 2021

Power stock rallies short-lived



Source: POSOCO, Bloomberg, BOBCAPS Research | *Combined Market Cap of NTPC, PWGR, TPW, TPWR, CESC



Fig 1 – Power stocks' monthly performance vs. power demand – Rallies have been short-lived

Fig 2 – Stock Performance (Repasted chart – Changed text in left text box)


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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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