SELL
TP: Rs 181 | ∨ 20%

TATA POWER | Power | 03 December 2021

Stock rally too high, too fast

- **TPWR's ~70% run-up in two months stems from power demand growth, international coal price rally and possible renewables business IPO**
- **Power consumption growth is back in single digits, China is working to cool coal prices and renewables listing upside looks capped post rally**
- **Downgrade from BUY to SELL but raise TP to Rs 181 (from Rs 161) driven largely by rollover of our DCF valuation to Mar'24**

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Rallied 70% in two months: Tata Power's (TPWR) stock has outperformed peers CESC, Torrent Power (TPW) and NTPC by 50-60% in the last two months. In our view, the run-up was fuelled by power consumption growth in August, an international coal price rally, possible listing of the renewables business at a premium and setup of 1,000 EV charging stations with a target to reach 10,000.

Drivers for the rally now weakening: From a double-digit surge in Aug'21, India's power consumption growth is now back to single digits and likely to align with GDP growth, per historical trends. The upswing in August was due to weak rainfall in large parts of the country. International coal prices have also started falling after China – the biggest consumer of thermal coal – initiated steps to cool prices off. TPWR's renewables fund raising plan is on, but the rally has erased the valuation discount to Indian renewable peers listed in the US. Lastly, EV charging will continue to grow, but the business may take years to have a meaningful impact.

Downgrade to SELL: TPWR's unprecedented 70% rally since October has taken the stock higher than our revised SOTP-based TP of Rs 181 (vs. Rs 161 earlier). The target price increase is driven by rollover of our DCF valuation of the various businesses that is used to arrive at an SOTP value. We change our FY22-FY24 net income estimates by +19%/-10%/-1% to incorporate the expected increase in earnings of coal associates and stronger performance of the solar products division as well as a downward revision in renewable generation rollout plan.

Distribution delicensing a key upside risk: While stretched valuations and challenges in EPC are negative factors, delicensing of distribution could spark another stock rally as TPWR is India's largest power distributor with experience in running large-scale operations. Delicensing will enable the company to start offering power supply at limited upfront investment in larger cities with a focus on commercial and industrial customers. Other upside risks include IPO / investments into the renewables business at a large premium and steady rollout of EV charging and other new-age businesses.

Key changes

Target	Rating
▲	▼

Ticker/Price	TPWR IN/Rs 226
Market cap	US$ 9.6bn
Free float	53%
3M ADV	US$ 219.9mn
52wk high/low	Rs 268/Rs 66
Promoter/FPI/DII	47%/11%/20%

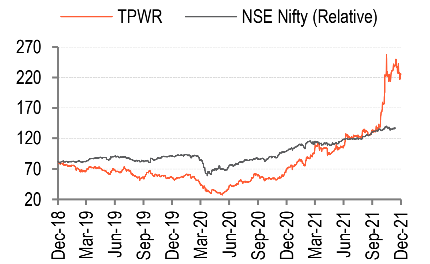
Source: NSE | Price as of 3 Dec 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	324,681	435,227	511,255
EBITDA (Rs mn)	75,387	74,125	95,246
Adj. net profit (Rs mn)	11,119	19,305	24,913
Adj. EPS (Rs)	3.5	6.0	7.8
Consensus EPS (Rs)	3.5	6.5	7.6
Adj. ROAE (%)	5.3	8.6	10.7
Adj. P/E (x)	64.8	37.3	28.9
EV/EBITDA (x)	15.5	15.2	11.5
Adj. EPS growth (%)	(8.6)	73.6	29.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



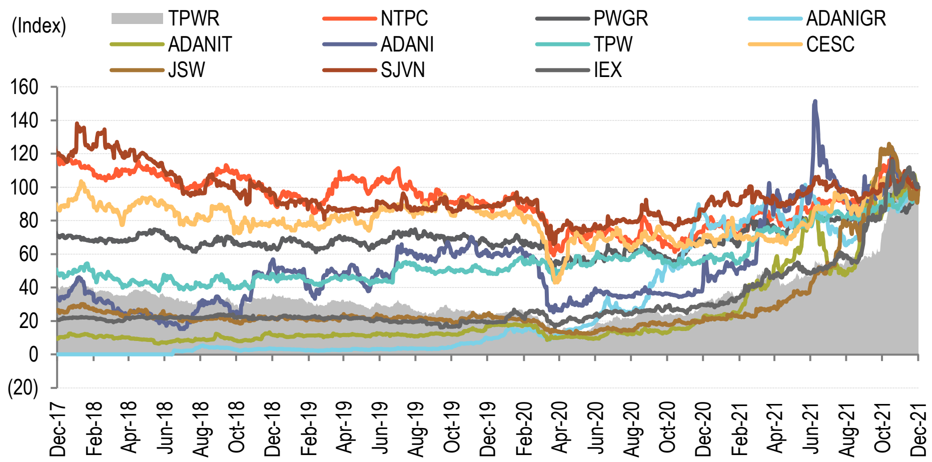
Source: NSE

Stellar rally but drivers losing steam

TPWR has rallied 69% in the last two months vs. -6% to +29% for peers among the top 10 listed power stocks. Consequently, the company now trades at a 100% premium to its five-year mean P/E and is the most expensive stock in our power coverage. It also now trades at a premium or close to the P/E of many renewable power generators in China, Europe and the US.

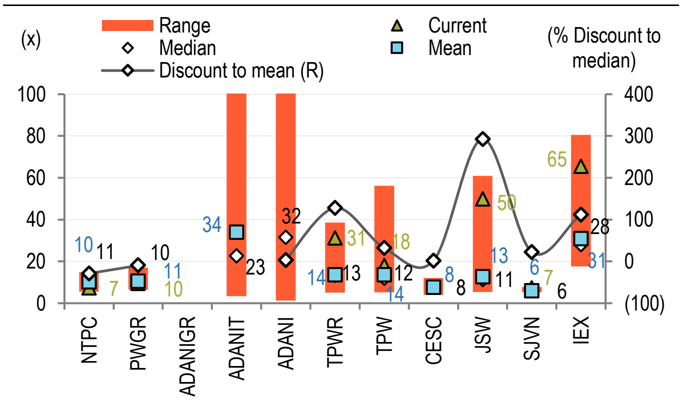
In our view, the rally has been fuelled by (1) power demand growth, (2) higher coal prices, (3) the proposed renewables transaction, and (4) EV charging rollout. However, we believe that power demand growth and international coal price increases are both moderating. Further, EV charger rollout will take a few years to have a meaningful impact on earnings.

Fig 1 – Stock has run up significantly in last two months



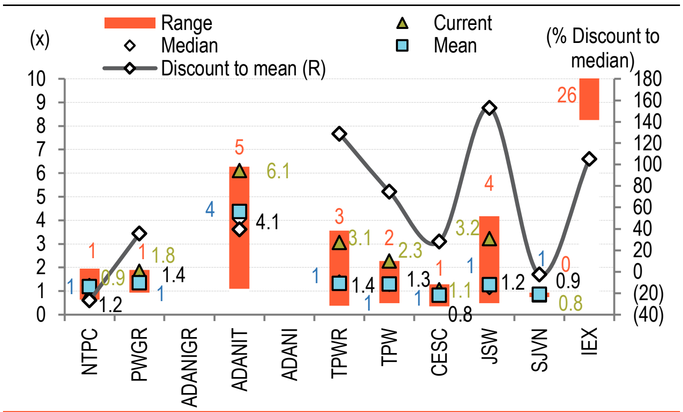
Source: Bloomberg

Fig 2 – P/E 1Y fwd: Stock trading at a premium to peers



Source: Bloomberg

Fig 3 – P/B 1Y fwd: Stock trading at a premium here too



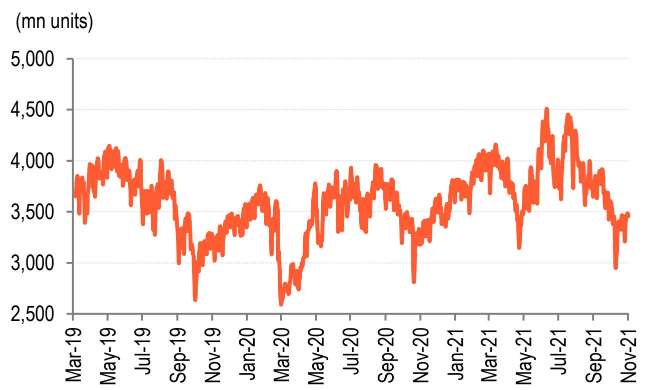
Source: Bloomberg

Driver 1: Power demand moderating

The rally in power stocks began due to robust demand for electricity in August as weaker rains led to higher temperatures in large parts of the country, in turn pushing up demand for cooling. In our view, this rally is now weakening. India's electricity consumption growth is already back to low single digits and should align to GDP growth, per historical trends.

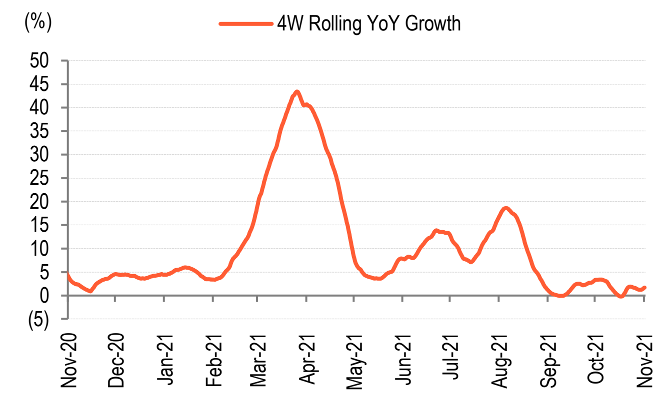
However, short-term volatility due to weather-related issues cannot be ruled out. A more sustainable demand push can come from growth in the manufacturing sector, leading to a rise in its contribution to GDP. This has been seen in countries such as Vietnam, but such a change may take time to materialise.

Fig 4 – Power consumption peaked in August due to delayed monsoons



Source: POSOCO

Fig 5 – YoY growth has moderated now



Source: POSOCO

Driver 2: International coal prices now correcting

TPWR has stakes in Indonesian coal mining companies which have benefited from the unprecedented rise in coal prices. Indonesian benchmark coal prices skyrocketed 54% during Apr-Dec'21 due to supply-side issues arising from Chinese mine closures and the ban on import of Australian coal to China.

Per Reuters, China's NDRC (National Development & Reform Commission) issued a statement on 29 Nov 2021 saying that "after the recent abnormal rise in coal prices, it is time to improve the coal prices mechanism". NDRC has started directing coal miners to reduce prices and some miners have accordingly begun lowering rates. Coal storage is expected to have reached an all-time high by end-November. Note that the rise in coal prices has led to large losses at coal generation utilities as government-led adjustments to their sales price are infrequent.

Given that China consumes a majority of coal, prices are likely to be impacted by cuts in its domestic prices. Both Henry Hub (international benchmark) and Shaanxi coal have corrected. Indonesian benchmark coal export prices are driven by international rates but with a lag. We thus expect prices to come down.

Fig 6 – Henry Hub and Shaanxi coal prices have corrected post NDRC statement; Indonesian prices (driven by global prices with a lag) should fall in coming months

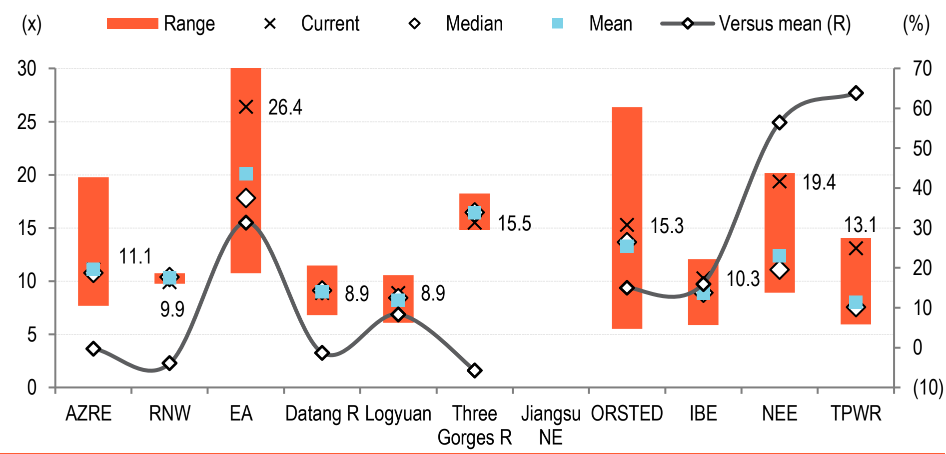
Source: Bloomberg

Driver 3: Renewables IPO impact has diminished

We expect TPWR's renewables business to perform well, but the recent rally has already brought its valuation close to that of many listed renewable companies. Unadjusted consensus one-year forward EV/EBITDA (which includes the valuation of associates in the numerator even as EBITDA doesn't include their contribution) is higher than US-listed Indian peers Azure Power (AZRE) and ReNew Energy (RNW). In contrast, pre-rally, TPWR's unadjusted EV/EBITDA was at a discount to these players.

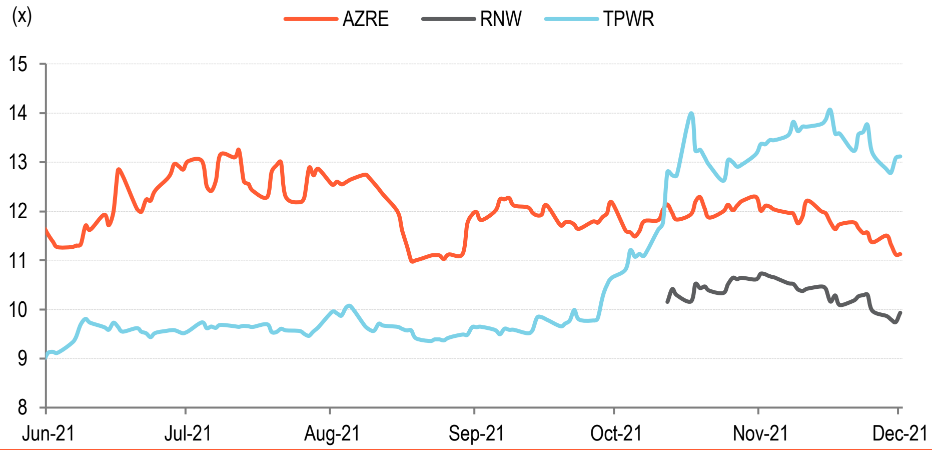
While TPWR could still trade at a premium to peers due to its presence across the solar value chain, its large expansion target and Tata brand, we believe potential upsides from listing of the renewables business have diminished due to this rally.

Fig 7 – TPWR's unadjusted EV/EBITDA higher than Indian renewable peers



Source: Bloomberg

Fig 8 – EV/EBITDA higher than listed renewable players



Source: Bloomberg

Driver 4: EV charging may not make a meaningful impact

In late October, TPWR completed the installation of 1,000 EV charging stations across cities. Assuming an average per-charge capacity of 25KW (based on the mix of chargers as per news flow), each charger will be able to sell 600 units (kWH) of power working at 100% capacity for 24 hours. Thus, at Re 1 per unit EBITDA, each charger will earn Rs 0.22mn per year. Even with 10,000 chargers – which is TPWR's next target – the business will earn just Rs 2.2bn or 3% of the company's FY21 consolidated EBITDA.

Valuation methodology

We revise our FY22/FY23/FY24 earnings estimates for TPWR by +19%/-10%/-1% due to higher forecasts for the solar products division following the better-than-expected H2FY22 performance. We have also increased estimates for the Odisha discom as results beat expectations and raised our earnings forecast for coal mining associates following the recent spike in coal prices. At the same time, we make a downward revision in renewable generation rollout which we now expect will occur at a later date.

Our TP which is derived from the DCF value of individual businesses thus rises to Rs 181 from Rs 161 previously – this implies 9.9x adj. EV/EBITDA on FY23E, a premium to mean which is justified by a robust earnings outlook and expected project wins in growth segments. That said, we downgrade TPWR to SELL from BUY based on the following:

- **Strong rally prices in the likely upside from renewables IPO.** Our valuation of the renewables business at 11.6x FY23E EV/EBITDA is in line with other listed players – ReNew Power (RNW US) and Azure Power (AZRE US).
- **Coal price increase is cyclical and not structural.** The increases in coal price is positive for associate company earnings and valuations, but long-term demand for coal is likely to reduce amid the shift toward green energy, which would limit the increase in international coal prices. Current prices should correct once supply issues are resolved and Chinese government initiatives kick in.
- **New businesses will take time to contribute meaningfully to earnings.** We like TPWR's efforts to enter new areas such as EV charging, smart grids and energy management. However, these businesses may take time to generate meaningful profits. Building in a high contribution from them would be premature, in our view.

Fig 9 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	435	511	548	469	522	557	(7.2)	(2.1)	(1.6)
EBITDA	74	95	121	75	95	123	(1.6)	0.2	(1.4)
EBIT	42	59	82	43	60	84	(3.5)	(1.1)	(3.3)
Pretax Income	18	11	9	12	12	7	49.0	(9.3)	42.5
Net Income	32	38	58	28	41	59	15.2	(6.5)	(2.4)
EPS (Rs)	19	25	43	16	28	43	19.0	(10.2)	(1.1)

Source: Bloomberg, BOBCAPS Research

Fig 10 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Delhi Discom - AT&C Losses (%)	6.5	6.0	5.5	5.0
Tata Power Mumbai - AT&C Losses (%)	0.4	0.4	0.4	0.4
Odisha WESCO AT&C Losses (%)	27.0	23.0	20.5	15.5
Odisha Southco AT&C Losses (%)	32.2	28.0	27.5	22.5
Odisha CESU AT&C Losses (%)	29.5	27.0	25.0	20.0
Odisha NESCO AT&C Losses (%)	25.3	21.0	20.0	15.0
Ajmer AT&C Losses (%)	10.0	8.0	7.0	6.0
Renewables- New Capacity (MW)	56	1,247	1,500	1,500
Renewables Tariff for New projects (Rs/unit)	2.5	2.5	2.4	2.3
Renewables New Projects PLF (%)	22.0	24.0	24.0	24.0
Tata Power Solar New EPC External Order (MW)	NA	1,000	1,250	1,500
Rooftop Installations Completed during the year (MW)	175.0	300.0	400.0	500.0
Solar Pump Sale (units)	12,982	30,000	40,000	50,000
USDINR Average Conversion Rate	74.2	75.0	75.0	75.0
Coal Price - Imported (US$/t) - Indonesia HBA	60.7	75.0	75.0	60.0

Source: Company, BOBCAPS Research

Our TP is based on an SOTP valuation, arrived at via a DCF assessment of various assets. Our valuation model discounts cash flows from the company's projects till the end of respective PPAs, assuming no extension only for generation plants. For distribution assets under the regulated return model, we have assumed extension of the concession period by 25 years post-expiry.

Key DCF assumptions include (1) cost of equity of 15.2% (vs. 15.0% previously) based on a risk-free rate of 6.22% (versus 6.051% previously) as per the 10-year India bond yield as of end-Sep'21, (2) beta of 1.31 (unchanged) based on the last two-year weekly returns as of end-Sep'21, and (3) cost of debt of 8.0% (unchanged).

Fig 11 – SOTP valuation

Segment (Rs mn)	EV	Net Debt FY23E	Equity Value	% Share	Contribution to Group Equity Value	EBITDA FY23E	EV/EBITDA FY23E(x)
Standalone	1,06,445	1,76,926	(70,481)	100	(70,481)	23,218	4.6
Coastal Gujarat Power (CGPL)	1,05,154	91,704	13,451	100	13,451	1,475	71.3
Maithon Power (MPL)	38,734	10,730	28,003	74	20,723	7,790	5.0
Delhi Discom (TPDDL)	85,075	26,953	58,122	51	29,642	10,997	7.7
Power Trading (TPTCL)	5,300	-	5,300	100	5,300	530	7.0
Tata Power Solar	1,25,794	7,837	1,17,958	100	1,17,958	7,218	17.4
Tata Power Renewables	2,43,577	1,74,142	69,436	100	69,436	19,460	12.5
Walwhan Renewables Energy	71,676	26,049	45,627	100	45,627	11,438	6.3
TERPL (Shipping Company)	36,096	7,398	28,698	100	28,698	4,173	8.7
Odisha Distribution	1,25,439	1,644	1,23,795	51	63,135	8,377	15.0
Ajmer	3,253	655	2,598	100	2,598	569	5.7
Sub-Total (A)	**9,46,544**	**5,24,037**	**4,22,507**		**3,26,086**	**95,246**	**9.9**
Elimination (B)	-	(1,05,435)	1,05,435	100	1,05,435	-	9.9
Majority Owned (C= A+B)	**9,46,544**	**4,18,602**	**5,27,941**		**4,31,521**	**95,246**	**9.9**

Segment (Rs mn)	EV	Net Debt FY23E	Equity Value	% Share	Contribution to Group Equity Value	EBITDA FY23E	EV/EBITDA FY23E(x)
Associates & JVs							
KPC			2,21,217	30	66,365		
PT Baramulti Suksessarana & PT Antang			44,243	26	11,503		
PT Nusa Tambang Pratama, Indonesia (Coal Infrastructure)			6,390	30	1,917		
Power Link (not consolidated)	5,231	(1,212)	6,443	51	3,286		
Industrial Energy (not consolidated)	6,180	6,526	(346)	74	(256)		
Tata Projects				48	15,566		
Adjaristsqali Georgia LLC				40	1,383		
Other associates					32,674		
Associates Valuation (D)					**1,32,438**		
Consolidated Total (E = C+D)					**5,63,959**		
Number of shares (F)					3,195		
Value per Share (G = F/E)					176		
Target Price (Rs) (H= G rounded to nearest 1)					**181**		

Source: BOBCAPS Research

Fig 12 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS CAGR FY21-24E (%)	P/E		EV/EBITDA		Net Debt/ EBITDA (x) FY22E
					FY22E	FY23E	FY22E	FY23E	
Power Grid	PWGR IN	HOLD	196	0.32	7.4	7.1	6.2	5.8	3.37
NTPC	NTPC IN	HOLD	111	7.39	6.9	6.1	7.3	6.7	4.85
Tata Power	TPWR IN	BUY	141	53.73	30.5	16.2	11.1	8.5	5.59
Torrent Power	TPW IN	HOLD	461	12.87	15.0	14.0	7.7	6.8	1.62
CESC	CESC IN	HOLD	751	1.55	7.4	7.0	5.7	5.6	3.30

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates include:

- passage of the Electricity (Amendment) Act 2021 in the upcoming session of parliament, which will result in delicensing of distribution and open up a large market for TPWR;
- IPO/investment in the renewables business at a heavy premium; and
- steady expansion of EV charging infrastructure and other new-age businesses.

Sector recommendation snapshot

Company	Ticker	Market Cap (US$ bn)	Price (Rs)	Target (Rs)	Rating
CESC	CESC IN	1.6	89	91	HOLD
NTPC	NTPC IN	16.7	127	111	HOLD
Power Grid Corp	PWGR IN	19.1	206	201	HOLD
Tata Power	TPWR IN	9.6	226	181	SELL
Torrent Power	TPW IN	3.6	565	461	HOLD

Source: BOBCAPS Research, NSE | Price as of 3 Dec 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**291,364**	**324,681**	**435,227**	**511,255**	**548,266**
EBITDA	77,541	75,387	74,125	95,246	121,488
Depreciation	(26,336)	(27,449)	(32,406)	(36,301)	(39,965)
EBIT	51,206	47,938	41,719	58,944	81,523
Net interest inc./(exp.)	(43,557)	(38,390)	(33,595)	(34,541)	(35,670)
Other inc./(exp.)	4,246	2,678	2,678	2,678	2,678
Exceptional items	(1,841)	(1,555)	2,950	0	0
EBT	19,579	19,405	32,202	38,399	57,857
Income taxes	(6,415)	(5,019)	(6,184)	(8,898)	(9,544)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	6,535	5,621	15,113	6,730	3,576
Reported net profit	**10,174**	**11,274**	**22,683**	**24,913**	**42,563**
Adjustments	131	(155)	(3,378)	0	0
Adjusted net profit	**10,305**	**11,119**	**19,305**	**24,913**	**42,563**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	50,954	71,201	95,443	112,115	120,232
Other current liabilities	50,954	73,902	98,144	114,817	122,933
Provisions	4,074	8,396	8,396	8,396	8,396
Debt funds	480,997	420,186	420,898	444,165	453,104
Other liabilities	67,226	125,734	129,070	133,657	139,407
Equity capital	2,705	3,196	3,196	3,196	3,196
Reserves & surplus	192,955	220,027	222,329	238,170	270,768
Shareholders' fund	195,660	223,223	225,525	241,365	273,963
Total liab. and equities	**897,482**	**988,512**	**1,019,105**	**1,079,472**	**1,134,876**
Cash and cash eq.	28,267	66,122	21,761	25,563	27,413
Accounts receivables	44,259	50,010	67,037	78,747	84,448
Inventories	17,524	18,848	25,265	29,679	31,827
Other current assets	30,165	28,731	28,731	28,731	28,731
Investments	13,025	23,059	23,059	23,059	23,059
Net fixed assets	446,626	487,489	537,475	602,355	660,665
CWIP	37,865	0	0	0	0
Intangible assets	30,038	31,404	31,404	31,404	31,404
Deferred tax assets, net	4,162	1,840	1,840	1,840	1,840
Other assets	245,551	281,009	282,532	258,094	245,488
Total assets	**897,482**	**988,512**	**1,019,105**	**1,079,472**	**1,134,876**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**73,753**	**84,580**	**71,689**	**86,896**	**112,211**
Capital expenditures	(22,258)	(33,358)	(82,393)	(101,181)	(98,275)
Change in investments	0	12,652	0	0	0
Other investing cash flows	(3,766)	7,310	0	0	0
Cash flow from investing	**(26,024)**	**(13,396)**	**(82,393)**	**(101,181)**	**(98,275)**
Equities issued/Others	201	29,961	(15,000)	0	0
Debt raised/repaid	(1,070)	(63,252)	713	23,267	8,939
Interest expenses	(40,025)	(37,314)	(33,626)	(34,585)	(35,874)
Dividends paid	(5,992)	(5,263)	(4,953)	(9,073)	(9,965)
Other financing cash flows	42,677	77,420	52,866	20,391	36,900
Cash flow from financing	**(4,209)**	**1,552**	**0**	**0**	**0**
Chg in cash & cash eq.	**17,228**	**15,227**	**(44,361)**	**3,801**	**1,851**
Closing cash & cash eq.	**28,267**	**66,122**	**21,761**	**25,563**	**27,413**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	3.8	3.5	7.1	7.8	13.3
Adjusted EPS	3.8	3.5	6.0	7.8	13.3
Dividend per share	1.6	1.6	2.8	3.1	5.3
Book value per share	72.3	69.9	70.6	75.5	85.7

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	3.9	3.6	2.6	2.1	2.1
EV/EBITDA	14.7	15.5	15.2	11.5	9.3
Adjusted P/E	59.3	64.8	37.3	28.9	16.9
P/BV	3.1	3.2	3.2	3.0	2.6

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	48.1	53.0	66.0	64.9	73.6
Interest burden (PBT/EBIT)	41.8	43.7	70.1	65.1	71.0
EBIT margin (EBIT/Revenue)	17.6	14.8	9.6	11.5	14.9
Asset turnover (Rev./Avg TA)	33.5	34.4	43.4	48.7	49.5
Leverage (Avg TA/Avg Equity)	4.6	4.5	4.5	4.5	4.3
Adjusted ROAE	5.4	5.3	8.6	10.7	16.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(2.5)	11.4	34.0	17.5	7.2
EBITDA	13.2	(2.8)	(1.7)	28.5	27.6
Adjusted EPS	82.3	(8.6)	73.6	29.1	70.8
Profitability & Return ratios (%)					
EBITDA margin	26.6	23.2	17.0	18.6	22.2
EBIT margin	17.6	14.8	9.6	11.5	14.9
Adjusted profit margin	3.5	3.4	4.4	4.9	7.8
Adjusted ROAE	5.4	5.3	8.6	10.7	16.5
ROCE	8.7	7.4	6.1	8.3	10.9
Working capital days (days)					
Receivables	55	56	56	56	56
Inventory	22	21	21	21	21
Payables	64	80	80	80	80
Ratios (x)					
Gross asset turnover	0.5	0.5	0.6	0.6	0.6
Current ratio	0.4	0.5	0.4	0.5	0.5
Net interest coverage ratio	1.2	1.2	1.2	1.7	2.3
Adjusted debt/equity	2.5	1.9	1.9	1.8	1.7

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

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

BUY – Expected return >+15%

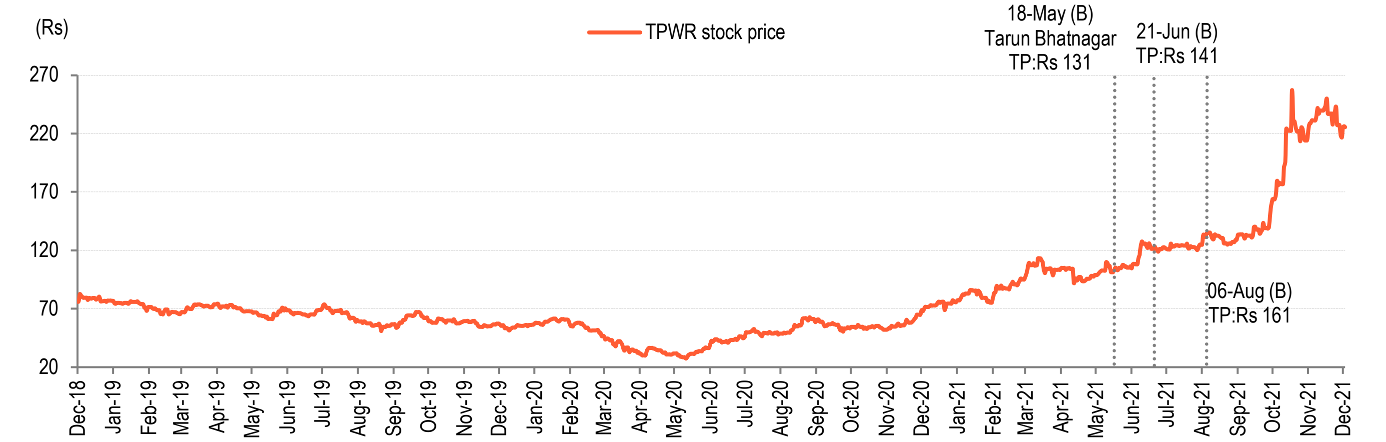
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): TATA POWER (TPWR IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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