Institutional Equity Research

NTPC

Power | India

Company Update | September 03, 2018

CMP* (Rs)	170
Upside/ (Downside) (%)	25
Bloomberg Ticker	NTPC IN
Market Cap. (Rs bn)	1,408
Free Float (%)	37.7
Shares O/S (mn)	8,245

BUY

Target Price: Rs213

Better Days Ahead, Attractive Valuation; Maintain Buy

NTPC has underperformed vis-à-vis Sensex by 21% over the last 12 months owing to lower PLF, lower system demand and likely negative impact of proposed CERC regulations impacting its core RoE. Operating parameters of its power plants were under pressure with the PLF dropping by 400-500bps due to lower system demand and fuel issues. We believe CERC regulations and lower PLF have already been factored in at a current low valuation of 1.1x FY20E P/BV. **Expecting improvement in NTPC's business dynamics, we maintain our BUY recommendation on the stock and maintain our Target Price of Rs213, which implies P/B of 1.4x FY20E.**

Investment Rationale

- **Regulated Business Model – Protects from Rising Coal Prices:** NTPC operates under 100% regulated business model, which entitles it to pass on fuel cost to protect itself from rising coal prices. We consider NTPC as one of the best-placed companies in terms of fuel security, as most of its capacity off-take will continue to be through long-term PPAs. Despite rise in fuel security risk with the commissioning of incremental capacity, we believe NTPC is relatively better-placed considering: (1) 100% regulated business model; and (2) secure coal supplies via FSAs.
- **Significant Jump in Regulated Equity Expected:** We expect NTPC to add commercial capacity of 5GW each in FY19E/FY20E, which would lead to a significant jump in regulated equity from current level of Rs505bn. Currently, its pre-tax RoE of 18-19% is one of the highest due to better operational efficiency and higher incentives, while the new CERC regulations – if implemented – won't have any meaningful impact NTPC's RoE, in our view. NTPC's regulated equity stood at Rs509.2bn as of Mar'18, which it expects to increase to Rs850bn by FY22. Under-recoveries remained high at ~Rs4.9bn in 1QFY19 out of which Rs1.3bn was owing to coal shortage, while the rest is attributable to plant shutdown and maintenance activities. Total fixed cost under-recovery stood at Rs14.3bn in FY18 out of which Rs8bn was due to fuel unavailability. Highlighting that the coal mine issue at Kaniha plant are temporary, the Management expects full fixed charge recovery by FY19-end.
- **Strong Balance Sheet; Capacity Addition on Track:** NTPC's balance sheet is strong enough to fund ongoing capex plans. Thus, we expect funding for ensuing projects would not be a major issue for NTPC, which is likely to commercialise 5GW/annum over next two years. However, it expects slowdown in coal-based capacity addition to 2GW/annum thereafter.

Attractive Valuation

Looking ahead, we expect NTPC's business to improve on the back of higher capacity commercialisation, better fuel availability and likely improvement in demand led by UDAY scheme. We continue to consider NTPC as one of the best-placed companies in terms of fuel security, as most of its capacity off-take will continue to be through long-term PPAs. At CMP, the stock trades at P/B of 1.1x and P/E 10.3x based on FY20E, which is attractive in our view. We have used (P/B vs. RoE) to factor in near-term concerns on declining PLF. **We maintain our BUY recommendation on the stock with a Target Price of Rs213.**

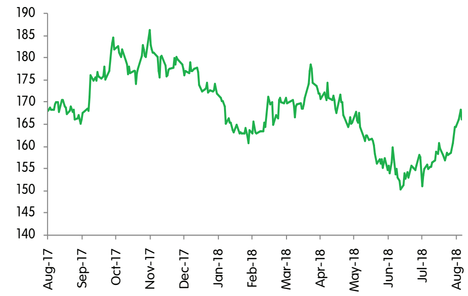
Key Financials (Rs mn)	FY17	FY18	FY19E	FY20E
Net Sales	786,853	841,529	936,400	1,040,533
Op. Profits	216,957	223,675	257,295	289,318
OPM (%)	27.6	26.6	27.8	27.8
YoY Gr. (%)	(11.7)	8.2	20.0	15.6
RoE (%)	9.8	9.9	10.9	11.3
ROCE (%)	8.6	7.7	8.2	8.5
PE (x)	15.5	14.3	11.9	10.3
P/B (x)	1.5	1.4	1.2	1.1

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	9.6	3.0	0.1
Relative to Nifty	6.7	(7.7)	(21.0)

Shareholding Pattern (%)	Mar'18	Jun'18
Promoter	62.3	61.7
Public	37.7	38.3

1 Year Stock Price Performance



*Note: * CMP as on Aug. 30, 2018*

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Investment Rationale

Regulated Business Model – Protects from Rising Coal Prices

Despite the instances of coal shortage in some plants, we believe NTPC is one of the best placed companies in terms of fuel security, as most of its capacity off-take will continue to be through long-term PPAs. CERC has released an approach paper for FY20-24 tariff regulations for regulated power utilities. This followed by draft regulations in Sept-Oct '18 and the final regulations are expected to be announced by Dec'18/Jan'19. The new regulations – if implemented – won't have any meaningful impact NTPC's RoE, in our view.

The paper clearly states that it does not intend to increase financial instability for existing and under construction power assets. Hence, RoE revision if any will only be for new plants commissioning post March 31, 2019. This is positive for NTPC.

We have assumed core RoE lower at 14.5% (presuming CERC 2019-22 approach gets implemented as it is) for NTPC's upcoming projects.

Long Term Fuel Security

NTPC has secured a single ACQ for all its coal stations resulting in optimum utilisation of coal leading to reduction in ECR, avoidance of loss of fixed charges due to coal shortage, more efficient operation of power plants, and higher marginal contribution from operations. Long term Fuel Supply Agreements (FSAs) have been signed with CIL and SCCL for supply of coal for a period of 20 years for total ACQ of ~169MTPA. 67% of coal-based capacity is linked by MGR/belt conveyor system to coal mines representing 10 out of 20 of its coal plants. ACQ materialisation stood at 96.20% in FY18 vs. 94.04% in FY17.

Coal availability remained a challenge in entire FY18. Coal PLF declined to 77.9% in 1QFY19 from 79.0% in 1QFY18, which led to disincentive on account of coal shortage. Whilst Plant Availability Factor (PAF) declined by 306bps to 85.9% for coal-based plants, it declined by 434bps YoY to 83.8% for gas-based stations. Under-recoveries remained high at ~Rs4.9bn in 1QFY19 out of which Rs1.3bn was on account of coal shortage and the remaining was on account of plant shutdown and maintenance activities. Notably, total fixed cost under-recovery stood at Rs14.3bn in FY18 out of which Rs8bn was due to fuel unavailability. Highlighting that the problems at Mouda and Solapur have largely been reduced, the Management expects full fixed charge recovery by FY19-end.

Exhibit 1: Status of Coal Mines

Coal block	GR (MMT)	Mining Capacity MMTPA	Status			
			EC	FC	Coal Controller Permission	Mining/MDO
Pakri Barwadih	1,574	18	Yes	Yes	Yes	Target to produce 6.3 MMT in FY19
Dulanga	196	7	Yes	Yes	Yes	Target to produce 1.5 MMT in FY19
Talaipalli	1,267	18	Yes	Yes	Yes	Target to produce coal by Nov'19
Chatti Bariatu	548	7	Yes	Yes	Yes	
Kerandari	285	6	Yes	St-I accorded	-	
Other Five Mines with GR of ~3.42 BT and Mining Capacity of ~55 MMTPA - under various phases of development.						

Source: Company, RSec Research

Coal Block

The NTPC – India's largest power producer in public sector – is likely to begin coal production from Talaipalli mine in Chhattisgarh's Raigarh district by 2019. Talaipalli mine has gross coal reserves of 1267mn metric tonnes (MMT) with excavation capacity of 18MMT/annum. The Government has allotted the state-owned firm 10 coal blocks to meet fuel requirements. Its first coal block, Pakri Barwadih (Jharkhand), has been in operation since Jun'17. NTPC is currently working on 5 coal blocks – including Pakri Barwadih, Chatti Bariatu, Kerandari, Talaipalli and Dulanga – with total geological reserves of 3.8bn tonne and mining capacity of 56MTPA. These mines have total geological reserves of ~7.15bn tonne , these blocks have production potential of 111MMTPA catering to requirement of 20,000MW.

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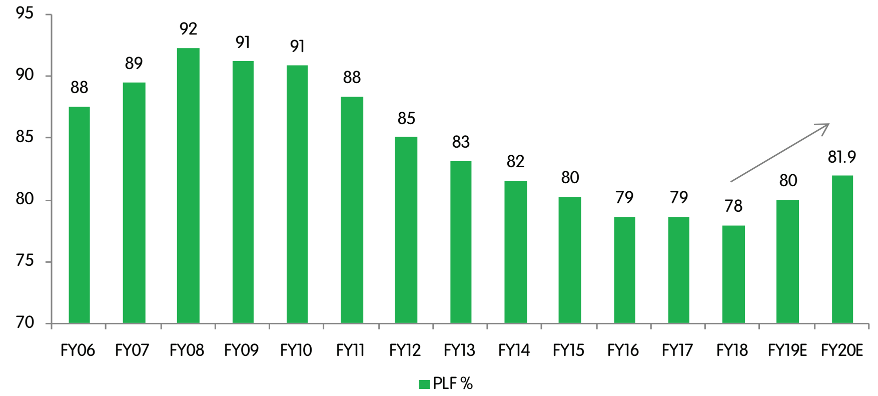
Exhibit 2: PLF (%)



Source: Company, RSec Research

Significant Jump in Regulated Equity Expected

Looking ahead, we expect NTPC to add commercial capacity of 5GW each in FY19E/FY20E, which would lead to a significant jump in regulated equity from current level of Rs509bn. Earlier, its pre-tax RoE of 18-19% was one of the highest due to operational efficiency and higher incentives. Regulated equity stood at Rs509.2bn as of Mar'18, which the Company expects to increase to Rs850bn by FY22. The Management highlighted that introduction of 'National Merit Order' dispatch system could prove to be beneficial, as the Company's total tariff of Rs3.23/kwh with fuel cost of Rs1.95/kwh is most competitive.

We expect NTPC's standalone commercial capacity to increase to 60GW by FY22, which would drive regulated equity to Rs785bn by FY22 from Rs506bn FY18.

Exhibit 3: Regulated Equity Trend (Rs bn)

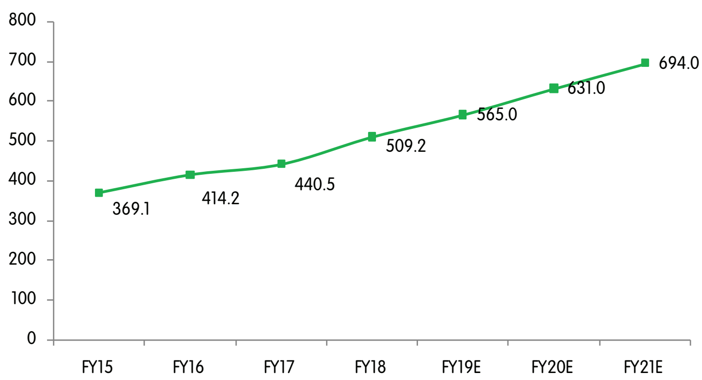
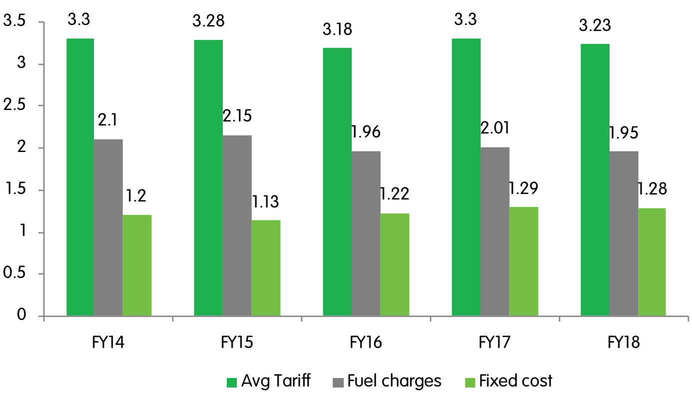


Exhibit 4: Cost of Power Per Unit (Rs/Unit)



Source: Company, RSec Research

Strong Balance Sheet; Capacity Addition on Track

NTPC's balance sheet is strong enough to fund ongoing capex plans, which would be funded from internal accruals and debt. Given the strength of operational performance and healthy balance sheet, we expect the funding for the ensuing projects would not be a major issue in comparison to the private players. Around 21GW of capacity is currently under construction with 14GW at standalone level. The Management highlighted that NTPC is likely to commercialise 5GW/annum over next two years. However, it expects slowdown in coal-based capacity addition of 2GW/annum thereafter with higher contribution from renewable assets.

Exhibit 5: Capacity addition program

Fuel Mix	In MW	Coal Technology	In MW	Group Mix	In MW	Target	In MW
Coal	20,260	Ultra Super Critical	5,320	NTPC	13,921	2018-19	4,740
Hydro	811	Super Critical	13,900	Domestic JVs	5,830	2019-20	5,950
		Sub Critical	1,040	International JV	1,320	After FY20	10,381
Total	**21,071**	**Total**	**20,260**	**Total**	**21,071**	**Total**	**21,071**

Source: Company, RSec Research

Exhibit 6: Current Installed Capacity

Fuel Mix	No. of Plants	Capacity (MW)	Share (%)
NTPC-owned			
Coal	21	40,355	75.22
Fuel Mix - Gas/Liquid Fuel	7	4,017	7.49
Hydro	1	800	1.49
Renewables	13	928	1.73
Sub-total	**42**	**46,100**	**85.93**
Owned by JVs & Subsidiaries			
Coal	8	5,584	10.40
Gas	1	1,967	3.67
Sub-total	9	7,551	14.07
Total	**51**	**53,651**	**100.00**

Source: Company, RSec Research

Recent Key Development

The Allahabad High Court has refused to grant interim relief to the firms facing the NCLT proceeding post 180-grace period granted by the RBI. As per the RBI's February 12 circular, ~60 companies which have turned defaulters – including power firms – will have to be taken to the NCLT by the lenders after the 180-day grace period. Almost three-fourth of stressed assets worth Rs3,800bn is from the power companies, which dragged the RBI to the Allahabad High Court.

Our View: This development is going to be very negative for the Indian power sector in terms of future investment in the sector, which witnessed a significant capacity expansion during last 6-7 years. However, this could be positive for the company like NTPC with strong balance sheet, low cost manufacturing and fuel linkages. Out of 40,130MW stressed assets identified by the Government, 8,460MW projects with no progress on ground, 10,430MW projects without any PPA, 11,000MW resolution is possible, while 7,620MW tied-up coal supply under "SHAKTI" scheme. Some large power generation projects belong to companies i.e. Jaiprakash Associates, Lanco, GMR, KSK and Essar Power etc. Sectoral stress can be attributed to factors beyond their control, in our view. Earlier, the Standing Committee on Energy was informed that there were 34 coal-based thermal power plants, which have been categorised as financially 'stressed'.

Notably, there is no single reason, which can be assigned as a cause for making all these power plants stressed, but some major issues have been identified and categorised as: (a) non-availability of regular fuel supply arrangements, (b) lack of power purchase agreement, (c) projects set up without linkage, (d) cancellation of coal blocks, (e) delay in project implementation leading to cost overrun, (f) inability of the promoter to infuse equity and working capital, (g) aggressive bidding by developers in PPA, and (h) lack of enough PPA by the states.

In case stressed power projects are taken to NCLT by the lenders, liquidation value will be significantly lower than the replacement cost. Given the projects facing key issues, getting buyers for these stressed assets would be very difficult, unless the underlying issues i.e. coal supply and power purchase agreements are addressed. In our view only financial engineering without resolving key structural issues cannot revive these projects. In fact at current capital cost, power produced will be very expensive to stand in merit order despatch.

NTPC is working closely with lenders to large power assets and assessing the right fit as challenges of fuel supply be it coal or natural gas continue to cause concern. Earlier in Nov'17, the Company floated a tender to acquire commissioned stressed coal-based power plants. At present, out of the 40GW stressed coal-based power generation capacity, ~12GW capacity worth ~Rs500bn commissioned after April 1, 2014 and is eligible under this tender. According to the tender document, the Company will shortlist the suitable operational domestic coal-based power assets located for possible acquisition after evaluating the offered projects. All power plants which have commercial date of operation (COD) from April 1, 2014 onwards are eligible under for acquisition by NTPC. NTPC's earning expansion could be possible in addition to strong capacity addition by value accretive acquisitions. The Company has already taken over Patratu power plant (Jharkhand) and Barauni power plant (Bihar) and resorted to buying out the stakes of its JV partners. We believe these measures will further boost its earnings growth.

Exhibit 7: Valuation based on P/B vs. RoE

	FY20E
Risk free rate (%)	7.5
Risk Premium (%)	5
Growth (%)	3
Beta	0.7
Cost of Equity (%)	11.0
(Core ROE-g)/(Cost of Equity-g) (x)	1.75
Regulated Equity (Rs mn)	631,207
A. Value of Regulated Equity	**1,104,613**
Regulated Equity in CWIP (Rs mn)	445,160
Core RoE/Cost of Equity (x)	1.0
B. Value of Regulated Equity in CWIP	**445,160**
C. Value of Cash & Investments (Rs mn)	**204,509**
Total Equity Value A+B+C (Rs mn)	1,754,283
Value Per Share (Rs)	**213**

Source: Company, RSec Research

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BUY

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Outlook & Valuation

NTPC has delivered a weak performance in FY18 owing to: (1) provision for wage revision, and (2) lower plant availability leading to disincentive on account of shortage of coal at Mauda, Kudgi, Solapur plants. Looking ahead, we expect its business to improve backed by higher capacity commercialisation, better fuel availability and likely improvement in demand owing to UDAY scheme. We continue to consider NTPC as one of the best placed companies in terms of fuel security, as most of its capacity off-take will continue to be through long-term PPAs. At CMP, the stock trades at P/B of 1.1x and P/E 10.3x based on FY20E, which is attractive in our view. We believe that capacity addition track record, assured RoE, robust balance-sheet and strong operational cash-flow continue to augur well for NTPC. We have used (P/B vs. RoE) to factor in near-term concerns on declining PLF. **We maintain our BUY recommendation on the stock with a Target Price of Rs213.**

Risks to the View

- Any significant delay in project execution.
- Lower coal availability

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Profit & Loss Statement

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
Revenues	**786,853**	**841,529**	**936,400**	**1,040,533**
Growth (%)	11.6	6.9	11.3	11.1
Operating Profit	**216,957**	**223,675**	**257,295**	**289,318**
Other Income	6,570	10,551	14,243	15,098
EBITDA	**223,526**	**234,225**	**271,538**	**304,415**
Growth (%)	19.4%	4.8%	15.9%	12.1%
Depreciation & Amortization	59,208	70,989	80,356	87,197
EBIT	**164,318**	**163,237**	**191,182**	**217,218**
Interest Charges (Net)	35,972	39,843	44,388	47,528
PBT (Before E/o items)	**128,346**	**123,394**	**146,794**	**169,691**
Tax provision	30,026	25,493	29,359	33,938
Minority interest	7,830	**0**	**0**	**0**
Pre-exceptional PAT	**90,491**	**97,901**	**117,435**	**135,753**
Extra-ordinary items	3,357	**5,530**	**0**	**0**
Net Profit	**93,848**	**103,431**	**117,435**	**135,753**
Growth (%)	(8.4)	10.2	13.5	15.6

Balance Sheet

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E
Equity Share Capital	82,455	82,455	82,455	82,455
Reserves & Surplus	879,858	935,323	1,052,758	1,188,511
Shareholders' Funds	962,313	1,017,778	1,135,213	1,270,966
Total Debt	1,025,870	1,173,626	1,297,149	1,360,453
Deferred Tax liability	15,600	24,086	24,086	24,086
Capital Employed	**2,003,783**	**2,215,491**	**2,456,449**	**2,655,505**
Fixed Assets	1,800,927	1,980,345	2,199,989	2,332,792
Cash & cash eq.	29,304	39,784	52,717	44,187
Net current assets	84,027	86,877	106,307	118,204
Investments	89,524	108,484	97,436	160,322
Total Assets	**2,003,783**	**2,215,491**	**2,456,449**	**2,655,505**

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Cash Flow Statement

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E
Pre-tax profit	128,346	123,394	146,794	169,691
Depreciation	59,208	70,989	80,356	87,197
Total tax paid	(30,026)	(25,493)	(29,359)	(33,938)
Chg in working capital	21,746	(2,850)	(19,430)	(11,897)
Other items	(4,472)	**5,530**	**0**	**0**
Cash from oper. (a)	**174,802**	**171,570**	**178,361**	**211,053**
Capital expenditure	(279,501)	(250,406)	(300,000)	(220,000)
Chg in investments	(6,592)	(18,961)	11,048	(62,886)
Cash from inv. (b)	**(286,094)**	**(269,367)**	**(288,952)**	**(282,886)**
Free cash flow (a+b)	**(111,291)**	**(97,797)**	**(110,591)**	**(71,833)**
Equity raised/(repaid)	5,788	(20,255)	31,463	36,371
Debt raised/(repaid)	131,275	147,756	123,523	63,303
Dividend (incl. tax)	(25,144)	(27,711)	(31,463)	(36,371)
Other items	(15,388)	8,486	0	0
Cash from fin. (c)	**96,531**	**108,276**	**123,523**	**63,303**
Net chg in cash (a+b+c)	**(14,760)**	**10,480**	**12,932**	**(8,529)**
Closing Cash balance	**29,304**	**39,784**	**52,717**	**44,187**

Key Ratios

Y/E Mar	FY17	FY18	FY19E	FY20E
OPM (%)	27.6	26.6	27.5	27.8
Net Margin (%)	11.5	11.6	12.5	13.0
Dividend Yield (%)	1.5	1.7	1.9	2.2
Net Debt/Equity (x)	1.0	1.1	1.1	1.0
ROACE (%)	8.6	7.7	8.2	8.5
ROANW (%)	9.8	9.9	10.9	11.3
EV/Sales (x)	3.1	3.0	2.8	2.6
EV/EBITDA (x)	11.1	11.3	10.3	9.4
PE (x)	15.5	14.3	11.9	10.3
Price/Book (x)	1.5	1.4	1.2	1.1

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Rating History

Date	Reco	CMP	TP
2-Aug-18	BUY	155	213
4-Jun-18	BUY	162	213
5-Feb-18	BUY	166	213
16-Nov-17	BUY	174	192
3-Aug-17	BUY	172	192
30-May-17	BUY	161	192
9-Feb-17	BUY	168	178
2-Nov-16	BUY	157	178

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%