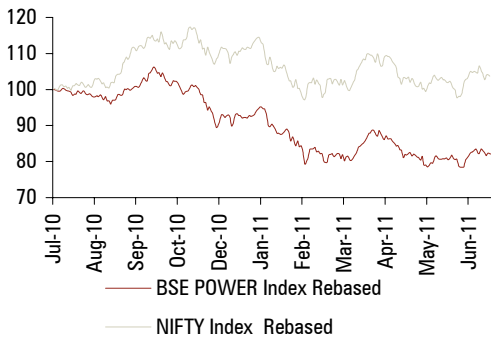


Power sector update

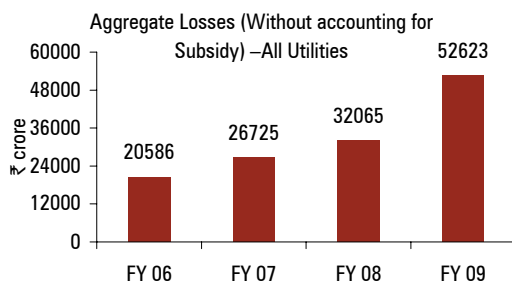
Sector View

Neutral

BSE Power Index underperforms Nifty by 21% since last year

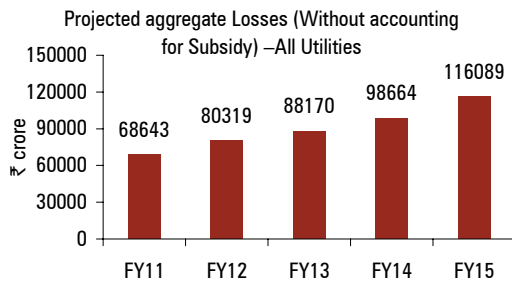


SEB Losses have been increasing



Source : PFC, ICICIdirect.com Research

Lack of reforms (tariff increase, distribution on PPP basis) can further widen losses



Source: Thirteenth finance commission, ICICIdirect.com Research

States with maximum losses (without subsidy)

State	Amount (₹ crore)
Tamil Nadu SEB	8964
Andra Pradesh discoms	7936
Rajasthan discoms	7655
UP discoms	5822
Haryana discoms	4121

Source : PFC, ICICIdirect.com Research

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SEB reforms at last, implementation the key...

The State Power Ministers' Conference on "Distribution Sector Reforms" organised in New Delhi on July 14, 2011 has underlined the need for urgent steps to arrest and reverse the growing losses in power distribution (which are outlined below). According to the 13th Finance Commission, SEB's losses are pegged at ~ ₹ 70,000 crore in FY11 (from ₹ 52,623 crore in FY09). Our take on the proposed reforms is that in the near term no immediate material impact will be seen on utilities (although sentimentally positive). In the long term, however, it is the need of the hour as utilities (NTPC, Lanco Infratech under our coverage universe) had to be backed by SEBs. If implemented, it could curtail losses of SEBs, improve their financial situation (to buy power from IPPs), open up franchise routes to more cities and capex by state SEBs triggering a possible re-rating of the entire power and power ancillary space, i.e. IPPs (NTPC, Lanco Infratech), distribution companies (Tata Power, CESC), T&D equipment (KEC, Kalpataru, Jyoti Structure) and NBFCs (REC).

The conference agreed upon a set of measures to bring down the distribution losses. These are as follows:

1. The state governments would ensure that the accounts of the utilities are audited up to 2009-10 and also ensure that the accounts of a financial year are audited by September of the next financial year, henceforth. Computerisation of accounts would be undertaken on priority, if not done already
 2. The states would ensure that the distribution utilities file their annual tariff revision petition every year, by December-January of the preceding financial year to the state regulators as stipulated by the national tariff policy
 3. The annual tariff revision petition would be filed before the SERC, keeping in view the increase of the power purchase cost (which accounts for nearly 70-80% of the cost of supply) and states will ensure that the difference between ARR and ACS is not only bridged but is positive to generate internal surpluses that can be used for network expansion and maintenance
 4. The state governments would ensure automatic pass through in tariff for any increase in fuel cost by incorporating the same in the regulations, as provided in Section 62(4) of Electricity Act, 2003. (State governments can issue directions to SERCs under Section 108 of the Electricity Act, 2003)
- Our take:** Measures 2, 3 and 4 would clearly pave the way for tariff hikes bringing down the losses of SEBs. It would also ensure that increase in fuel cost (by Coal India or imported coal) would not affect the profitability of IPPs (who would supply to SEBs)
5. The state governments would not only clear all the outstanding subsidies to the utilities but ensure advance payment of subsidy as per the Section 65 of the Electricity Act, 2003 in future

6. The eligibility criteria for inclusion of towns with population of 30,000 (10,000 for special category states) under R-APDRP assistance should be reduced to 15,000 (5,000 for special category states). All district headquarter towns in special category states should also be covered under R-APDRP, irrespective of their population
7. The state governments would ensure payment of all outstanding dues from various departments of state government and institutions to the distribution utilities or release payments from the state budget directly
8. The state governments would consider converting loans due from the state governments to distribution utilities as state government equity will ensure capital infusion and improvement in net worth of utility
9. The state governments would take effective steps to reduce AT&C losses to less than 15% by administrative measures, curbing pilferage of electricity and by setting up special police stations and special courts to deal exclusively with power theft related cases, if not done already
10. States would immediately initiate steps to appoint distribution franchises in urban areas through competitive bidding

Our take: Measures 9 and 10 would ensure capex by SEBs (distribution) - meaning potential orders to companies in T&D space as well opportunity for companies to enter lucrative distribution (regulated return of 15.5% + incentives for reducing losses in excess of target set SERC)

11. States would immediately invite bids for meeting the uncovered generation capacity gap vis-à-vis the requirement in their states by the end of the XIIth Plan. The process will be completed by March, 2012
12. States would create a unit in their states for integrated planning of generation, transmission and distribution to meet the future requirement of their states

ICICIdirect.com Coverage universe (Power)

				Sales (₹ cr)	EPS (₹)	PE (x)	EV/E (x)	PB (x)	RoNW (%)	RoCE (%)	
NTPC											
Idirect Code	NTPC	CMP	189	FY11	54874.0	11.0	17.1	12.9	2.1	13.4	12.6
		Target	202	FY12E	56349.0	11.4	16.6	10.3	2.0	13.2	11.2
Mcap(₹ cr)	155,839.3	% Upside	6.9	FY13E	61012.7	13.2	14.3	8.9	1.8	13.2	11.2
Lanco Infratech											
Idirect Code	LANINF	CMP	23	FY11	7783.8	1.9	12.2	11.0	1.2	12.7	6.8
		Target	43	FY12E	10815.9	1.9	11.8	8.1	1.2	11.9	6.6
Mcap(₹ cr)	5,462.7	% Upside	87.8	FY13E	12171.2	2.2	10.6	7.6	1.1	10.6	6.5
Neyveli Lignite											
Idirect Code	NEYLIG	CMP	101	FY11	3949.1	7.7	13.1	12.9	1.5	11.7	5.4
		Target	110	FY12E	4348.6	5.8	17.5	11.8	1.4	7.9	4.9
Mcap(₹ cr)	17,003.6	% Upside	8.9	FY13E	6541.4	6.7	15.0	10.1	1.3	8.8	5.3
PTC											
Idirect Code	POWTRA	CMP	82	FY11	9,063.2	4.7	17.3	14.1	1.1	6.2	6.3
		Target	121	FY12E	10,744.2	5.4	15.2	14.9	1.0	6.7	6.7
Mcap(₹ cr)	3,293.8	% Upside	47.6	FY13E	19,116.6	7.5	11.0	9.3	0.9	8.5	8.7
NHPC											
Idirect Code	NHPC	CMP	24.9	FY11	4046.6	1.7	14.4	13.0	1.2	8.7	6.5
		Target	26	FY12E	4143.7	1.8	13.8	12.9	1.1	8.5	5.7
Mcap(₹ cr)	30,628.8	% Upside	4.4	FY13E	6218.4	2.2	11.2	8.9	1.1	10.0	8.2
JP Power											
Idirect Code	JAIHYD	CMP	46	FY11	840.7	0.8	58.4	20.9	2.7	7.5	4.7
		Target	59	FY12E	2127.9	1.0	46.4	4.9	2.3	20.2	14.5
Mcap(₹ cr)	9640.1	% Upside	28.3	FY13E	3599.4	5.3	8.6	4.9	1.0	9.8	5.4
Tata Power											
Idirect Code	TATPOW	CMP	1260	FY11	19450.8	88.0	14.3	11.4	2.2	15.9	11.1
		Target	1383	FY12E	23628.2	99.6	12.7	10.5	1.9	15.6	9.6
Mcap(₹ cr)	29862.0	% Upside	9.8	FY13E	28931.6	108.4	11.6	8.2	1.7	14.8	11.3

Source: ICICIdirect.com Research

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Buy: Between 10% and 15%/20% for large caps / midcaps, respectively;

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Sell: -10% or more;

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