6 September 2018

Update | Sector: Utilities

NHPC

BSE SENSEX	S&P CNX
38,243	11,537

CMP: INR25 TP: INR33 (+30%) Buy

Core PAT up 19%; one-offs impacted reported PAT

Lower under-recoveries and capital cost approval to boost earnings

Stock Info

Bloomberg	NHPC IN
Equity Shares (m)	10,259
M.Cap.(INRb)/(USDb)	260.1 / 3.6
52-Week Range (INR)	35 / 22
1, 6, 12 Rel. Per (%)	4/-20/-32
12M Avg Val (INR M)	199
Free float (%)	26.4

Financials Snapshot (INR b)

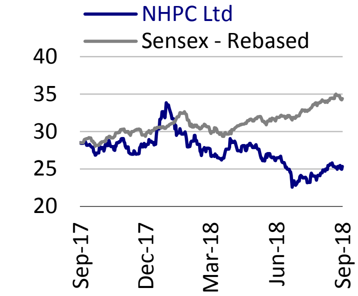
Y/E Mar	2018	2019E	2020E
Net Sales	77.5	92.9	107.9
EBITDA	42.0	53.4	65.7
PAT	25.0	25.2	31.0
EPS (INR)	2.4	2.5	3.0
Gr. (%)	-17.3	0.5	23.3
BV/Sh (INR)	29.3	30.1	31.2
RoE (%)	8.5	8.3	9.9
RoCE (%)	5.6	6.4	8.2
P/E (x)	10.4	10.3	8.4
P/BV (x)	0.9	0.8	0.8

Shareholding pattern (%)

As On	Jun-18	Mar-18	Jun-17
Promoter	73.6	74.0	74.5
DII	11.2	10.9	11.1
FII	4.5	4.3	3.8
Others	10.7	10.8	10.6

FII Includes depository receipts

Stock Performance (1-year)



Earnings impacted by shutdowns and reversals

NHPC's consolidated PAT declined ~17% YoY to INR25b in FY18. It was impacted by: (a) INR3.8b (pre-tax) impact of shutdown at TLDP III & IV plant and prior-period's revenue reversal at Parbati-III U-IV plant; (b) lower other income due to lower treasury and lower late-payment surcharge income; and (c) lower generation at subsidiary NHDC. Highlights from the FY18 annual report:

- Stripping out the other income, prior-period items, one-offs and shutdown impact, the standalone (S/A) generation PAT grew by a healthy 19% YoY (Exhibit 1) even as regulated equity remained unchanged.
- The improvement in underlying earnings is estimated to be driven by lower O&M under-recovery and other savings. Core (i.e. generation business) RoE on regulated equity increased ~200bp YoY to ~15%.
- We calculate O&M under-recovery reduced on lower cost (Exhibit 2) and with a normative annual increase in O&M allowance. Cost declined on retirement of employees (by 658 to 7,351), offsetting the wage hike, and by controlling repairs and other administrative costs.
- Standalone (S/A) debtor days continue to improve, down to 67 days in FY18 from 75 days in FY17, and with a peak of 141 days in FY13, releasing INR5.8b. But INR5.4b payment to a contractor under arbitration offset this benefit.
- The derived S/A capex (through balance sheet route) stood at ~INR26b in FY18, flat YoY. Cash capex was INR15.3b while the rest was allocation of cost through P&L.
- Capex was funded ~30% through debt against normative 70% (Exhibit 3). NHPC is funding Subhansiri Lower project through equity, as the project is on hold. It should continue doing so until the project is cleared, when it should also be able to recoup the excess equity.
- S/A Capital work in progress (CWIP) (including regulatory assets) @30% was 24% of its networth in FY18, increasing ~100bp YoY.
- Subsidiary NHDC's (51% stake) PAT declined 49% YoY to INR4.8b in FY18 due to a 72% YoY decline in generation, which impacted incentive income.

Lower O&M under-recovery, project cost approval should boost earnings

- We expect O&M under-recoveries to continue declining on retirements. We expect a sharper reduction in under-recoveries in FY20, which is the beginning of the next tariff control period, as the regulator resets the normative O&M allowance to actual. We expect under-recoveries to decline from ~INR5b in FY18 to ~INR2.5b by FY20E—and we are building it into estimates.

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- Five projects are facing revenue under-recoveries as the regulator has provisionally considered a lower capital cost—until the costs are approved by the Central Electricity Authority (CEA)/ PIB/ Ministry of Power (MoP), and the Cabinet Committee on Economic Affairs (CCEA). In a recent relaxation, the regulator provisionally allowed tariff on actual capital costs subject to the approval of any one of the above government agencies (instead of all four earlier). NHPC already has approval of CEA for all the five projects and is in the process of filing tariff petitions. The differential capital cost is estimated at ~INR25b, which will boost annual revenue and earnings by ~INR4b. We expect this benefit to accrue from FY20 onwards. NHPC will also benefit from accumulated under-recoveries of ~INR6.9b at the end of FY18.

Contribution from new projects a few years away

- Kishanganga 330MW plant was commercialized in May-2018, which has boosted S/A regulated equity by ~16% to INR130b. But the regulator has provisionally approved the tariff at 85% of the capital cost, pending the revised capital cost approval by the government. The approval could take a few years—until then, the project will remain a PAT break-even to marginally positive.
- Amongst under-construction projects, Parbati-II (800MW) project is delayed till end-CY21 due to difficult geological conditions. The Subhasiri Lower (2,000MW) is stuck due to litigations, though management expects a positive resolution soon.

Valuations attractive at 0.8x BV, attractive dividend yield

- While earnings contribution from new projects is at least a couple of years away, we expect consolidated PAT to increase by ~24% to ~INR31b by FY20E driven by lower O&M under-recoveries and differential capital cost approval (for which visibility has improved after recent change in procedures).
- Steady progress at Parbati-II, positive development for Subhasiri Lower project and capital cost approval for Kishanganga over the period should improve earnings growth visibility thereafter.
- We have cut consolidated PAT estimate by ~10% to INR25.2b for FY19E. Lower water flow in northern India can drive risk to earnings in the near-term.
- NHPC has low regulatory risk with high growth potential due to the large untapped water energy potential in India. We expect many regulatory tailwinds, as the government will need to invigorate investment in hydro power to handle volatility in solar energy.
- The stock is attractively trading at ~0.8x FY20E P/BV with a dividend yield of ~5-6%. The DCF based TP is revised to INR33/sh. Maintain Buy.

Exhibit 1: Adj. generation PAT and core RoE for standalone

INR m	FY15	FY16	FY17	FY18
Reported PBT	**27,701**	**31,805**	**34,746**	**35,257**
Less: Other income	8,613	9,921	14,587	14,910
Reported generation PBT	**19,088**	**21,884**	**20,159**	**20,347**
Less: Prior period sales	1,414	3,311	2,987	2,324
Less: Consultancy revenue	470	305	521	633
Less: Bad debts and provisions	-1,431	-3,888	-1,075	-514
Less: Other one-offs				-3,820
Adj. generation PBT	**18,635**	**22,157**	**17,727**	**21,724**
RoE (pre-tax)	21,902	22,017	22,452	23,261
Incentives	4,792	5,958	5,974	6,428
Working capital incentive*	1,930	2,079	2,098	2,054
O&M under-recovery*	-4,051	-4,884	-6,828	-5,282
Capital cost under-recovery *	-982	-3,017	-3,802	-4,446
Others	-4,958	4	-2,167	-291
Adj. generation PAT	**14,008**	**16,928**	**14,262**	**16,997**
Core generation RoE on reg. Equity - %	14.2	16.3	13.1	15.2
Core generation RoE on reg. equity & WC - %	11.3	12.8	10.6	12.6
Reg. Equity	102,040	105,450	111,770	112,500
Working capital	30,293	26,796	26,074	20,028
Receivables	24,971	15,544	14,929	12,815
Inventories	827	840	916	958
Unbilled revenue	6,025	11,633	11,699	7,970
Trade Payables	1,530	1,221	1,471	1,716
Reg. Equity + working capital (equity funded)	132,333	132,246	137,844	132,528

*MOSL estimates on best effort basis

Source: MOSL, Company

Exhibit 2: O&M cost for standalone – INR m

S/A INR m	FY15	FY16	FY17	FY18
Employee cost (net of regulatory assets)	10,195	10,521	12,824	12,576
Repairs	1,850	2,593	2,940	2,702
Stores and spares	304	198	253	246
Others (net of regulatory assets)	4,103	4,391	4,694	4,646
Derived O&M cost	**16,452**	**17,703**	**20,711**	**20,171**

Source: MOSL, Company

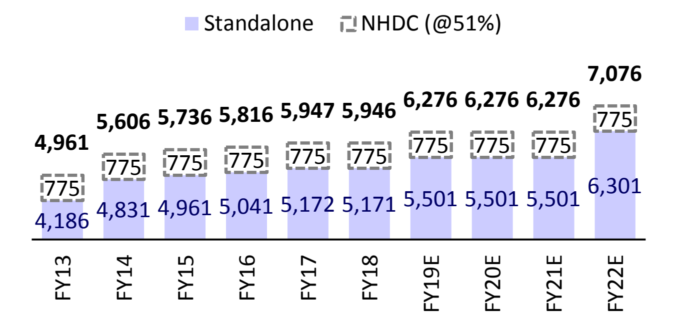
Exhibit 3: Funding of capex for standalone – INR m

INR m	FY17	FY18
a. Increase in gross debt	-7,115	-6,247
b. Repayment (=depreciation)	13,884	14,059
New loans = a + b	6,769	7,812
Capex (derived from B/S)	25,536	25,874
New loans % of capex	27	30

Source: MOSL, Company

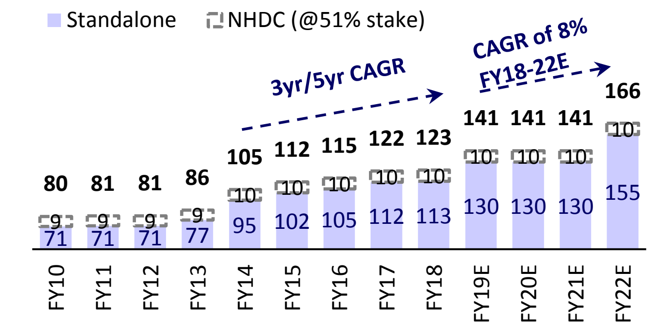
Story in charts

Exhibit 4: Installed capacity - MW



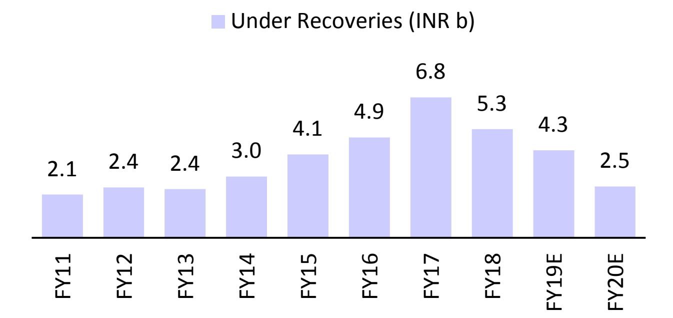
Source: MOSL, Company

Exhibit 5: Regulated equity - INR b



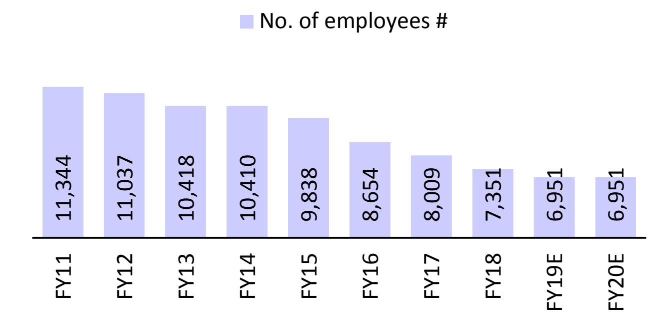
Source: MOSL, Company

Exhibit 6: O&M under-recoveries to decline…



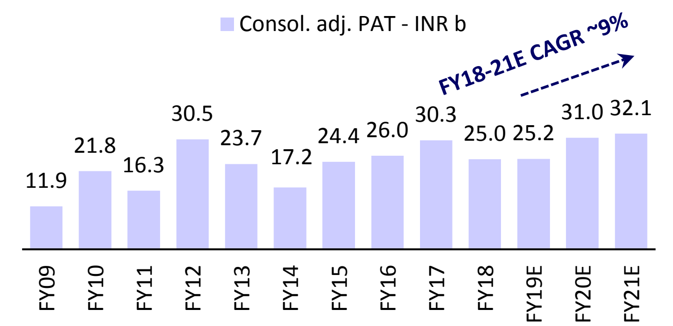
Source: MOSL, Company

Exhibit 7: …on natural attrition



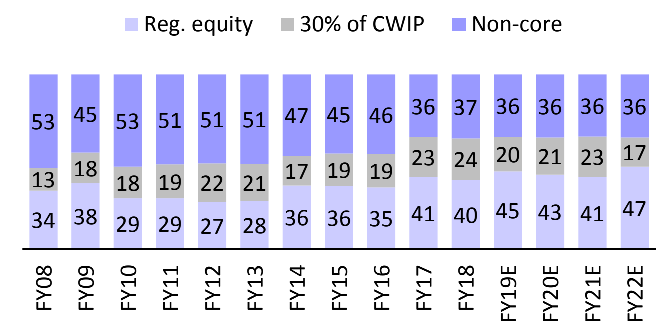
Source: MOSL, Company

Exhibit 8: PAT to grow at CAGR of ~9% over FY18-21E



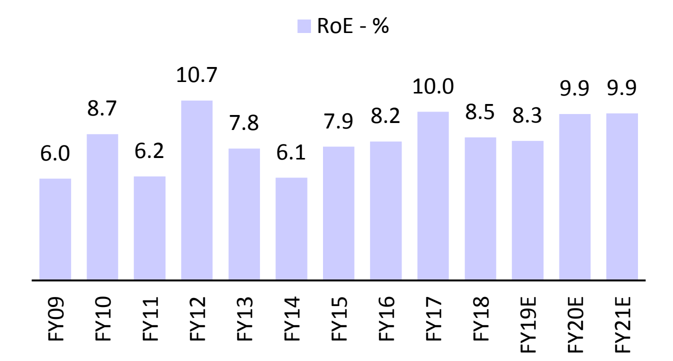
Source: MOSL, Company

Exhibit 9: Net worth in non-core activities to decline - %



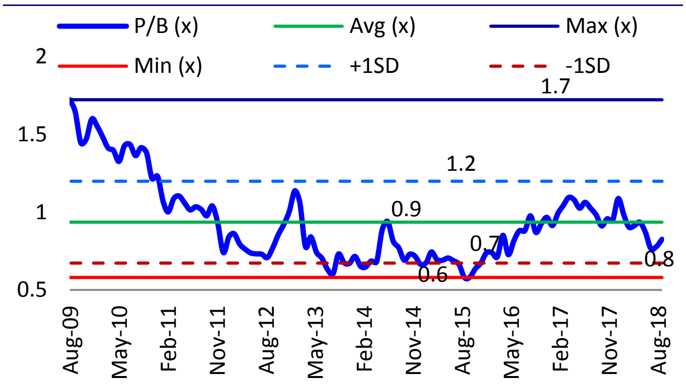
Source: MOSL, Company

Exhibit 10: RoE - %



Source: MOSL, Company

Exhibit 11: Valuation attractive



Source: MOSL, Company

Financials and Valuations

Income Statement								(INR Million)
Y/E Mar	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019E**	**2020E**
Net Sales	**64,062**	**74,159**	**82,441**	**83,540**	**86,231**	**77,512**	**92,928**	**107,873**
Change (%)	-7.4	15.8	11.2	1.3	3.2	-10.1	19.9	16.1
EBITDA	**42,730**	**43,833**	**57,382**	**53,727**	**55,621**	**49,380**	**59,069**	**68,916**
EBITDA Margin (%)	66.7	59.1	69.6	64.3	64.5	63.7	63.6	63.9
Depreciation	12,411	14,994	17,153	14,320	14,618	14,791	17,189	17,189
EBIT	**30,319**	**28,839**	**40,230**	**39,407**	**41,004**	**34,589**	**41,879**	**51,727**
Interest	5,962	11,802	12,728	11,182	10,734	9,226	11,435	13,357
Other Income	12,152	13,221	9,132	10,924	15,038	11,014	7,624	7,011
Extraordinary items	2,441	-4,972	550	0	0	0	0	0
PBT	**38,949**	**25,286**	**37,184**	**39,149**	**45,307**	**36,376**	**38,068**	**45,381**
Tax	10,223	8,954	9,203	10,003	10,531	8,629	9,371	10,947
Tax Rate (%)	26.2	35.4	24.8	25.5	23.2	23.7	24.6	24.1
Min. Int. & Assoc. Share	2,552	4,144	3,067	3,130	4,482	2,709	3,541	3,414
Reported PAT	**26,174**	**12,188**	**24,914**	**26,017**	**30,294**	**25,039**	**25,156**	**31,020**
Adjusted PAT	**23,733**	**17,160**	**24,364**	**26,017**	**30,294**	**25,039**	**25,156**	**31,020**
Change (%)	-22.3	-27.7	42.0	6.8	16.4	-17.3	0.5	23.3

Balance Sheet								(INR Million)
Y/E Mar	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019E**	**2020E**
Share Capital	123,007	110,707	110,707	110,707	102,593	102,593	102,593	102,593
Reserves	180,743	171,753	196,868	205,720	187,555	197,586	206,122	217,444
Net Worth	**303,750**	**282,460**	**307,575**	**316,427**	**290,148**	**300,179**	**308,715**	**320,037**
Minority Interest	23,102	30,657	33,257	31,681	33,822	29,349	28,366	27,255
Advance Against Depreciation	0	0	0	0	0	0	0	0
Debt	188,059	193,090	187,245	199,382	192,267	186,021	184,713	180,074
Deferred Tax	6,241	9,344	9,886	15,136	16,653	17,109	17,109	17,109
Total Capital Employed	**521,152**	**515,551**	**537,963**	**562,627**	**532,891**	**532,658**	**538,902**	**544,475**
Gross Fixed Assets	329,392	404,868	405,761	342,331	353,055	255,977	315,448	315,448
Less: Acc Depreciation	94,019	108,975	126,600	116,191	130,784	44,204	61,394	78,583
Net Fixed Assets	**235,373**	**295,892**	**279,161**	**226,140**	**222,271**	**211,772**	**254,055**	**236,865**
Capital WIP	199,618	149,240	163,775	167,416	175,876	190,871	153,209	172,895
Investments	0	0	7,633	5,999	10,200	11,248	11,247	11,246
Current Assets	**188,370**	**168,879**	**163,551**	**228,446**	**193,424**	**189,985**	**191,611**	**194,688**
Inventory	642	798	906	928	1,008	1,047	1,047	1,047
Debtors	22,401	24,224	29,052	19,045	18,540	13,460	15,519	17,969
Cash & Bank	94,235	74,162	71,975	72,847	34,725	33,191	27,273	24,844
Loans & Adv, Others	71,092	69,695	61,618	135,626	139,152	142,287	147,772	150,828
Curr Liabs & Provns	**102,209**	**98,461**	**76,158**	**65,375**	**68,881**	**71,219**	**71,219**	**71,219**
Net Current Assets	**86,160**	**70,419**	**87,393**	**163,071**	**124,544**	**118,767**	**120,392**	**123,469**
Total Assets	**521,152**	**515,551**	**537,963**	**562,627**	**532,891**	**532,658**	**538,902**	**544,475**

Financials and Valuations

Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Basic (INR)								
EPS	**1.9**	**1.6**	**2.2**	**2.4**	**3.0**	**2.4**	**2.5**	**3.0**
Cash EPS	2.9	2.9	3.8	3.6	4.4	3.9	4.1	4.7
Book Value	24.7	25.5	27.8	28.6	28.3	29.3	30.1	31.2
DPS	0.6	0.3	0.6	1.3	2.5	1.2	1.4	1.6
Payout (incl. Div. Tax.)	36.4	22.6	32.8	67.6	98.9	55.1	66.1	63.5
Valuation(x)								
P/E	11.5	14.9	11.0	10.7	9.9	10.4	10.3	8.4
Cash P/E	7.5	8.0	6.4	6.9	6.7	6.5	6.1	5.4
Price / Book Value	0.9	0.9	0.9	0.9	1.0	0.9	0.8	0.8
EV/Sales	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EV/EBITDA	9.1	9.3	8.0	9.1	10.2	10.5	8.3	6.7
Dividend Yield (%)	2.7	1.3	2.5	5.2	8.4	4.8	5.3	6.3
Profitability Ratios (%)								
RoE	7.8	6.1	7.9	8.2	10.0	8.5	8.3	9.9
RoCE	6.2	6.4	6.5	6.2	7.0	5.6	6.4	8.2
Adjusted RoE	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Turnover Ratios (%)								
Asset Turnover (x)	0.1	0.1	0.2	0.1	0.2	0.1	0.2	0.2
Debtors (No. of Days)	128	119	129	83	78	63	61	61
Inventory (No. of Days)	4	4	4	4	4	5	4	4
Leverage Ratios (%)								
Net Debt/Equity (x)	0.3	0.4	0.3	0.4	0.5	0.5	0.5	0.4

Cash Flow Statement **(INR Million)**

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Adjusted EBITDA	42,730	43,833	57,382	53,727	55,621	49,380	59,069	68,916
Non cash opr. exp (inc)	1,341	-35,311	-26,357	-36,000	-19,022	3,490	0	0
(Inc)/Dec in Wkg. Cap.	-11,507	1,909	-5,631	11,134	35,873	6,409	-2,058	-2,450
Tax Paid	-7,736	-7,942	-8,092	-8,718	-10,808	-8,301	-9,371	-10,947
Other operating activities	0	0	0	0	0	0	0	0
CF from Op. Activity	**24,828**	**2,489**	**17,302**	**20,143**	**61,664**	**50,978**	**47,639**	**55,519**
(Inc)/Dec in FA & CWIP	-23,989	-22,499	-17,260	-21,470	-15,870	-15,673	-21,809	-19,686
Free cash flows	**839**	**-20,010**	**42**	**-1,326**	**45,794**	**35,306**	**25,830**	**35,833**
(Pur)/Sale of Invt	0	0	0	0	0	0	0	0
Others	10,694	11,746	9,580	14,007	-2,775	1,790	2,139	3,955
CF from Inv. Activity	**-13,296**	**-10,754**	**-7,680**	**-7,462**	**-18,645**	**-13,883**	**-19,670**	**-15,731**
Inc/(Dec) in Net Worth	625	-23,679	0	0	-26,259	0	0	0
Inc / (Dec) in Debt	11,179	4,494	-196	-6,184	-8,364	43,550	-1,308	-4,639
Interest Paid	-15,320	-16,195	-16,544	-15,020	-13,912	-11,440	-11,435	-13,357
Divd Paid (incl Tax) & Others	-8,293	23,571	4,931	9,395	-32,607	-70,739	-21,144	-24,222
CF from Fin. Activity	**-11,809**	**-11,809**	**-11,809**	**-11,809**	**-81,141**	**-38,629**	**-33,886**	**-42,217**
Inc/(Dec) in Cash	**-276**	**-20,074**	**-2,187**	**872**	**-38,122**	**-1,534**	**-5,918**	**-2,429**
Add: Opening Balance	94,512	94,235	74,162	71,975	72,847	34,725	33,191	27,273
Closing Balance	**94,235**	**74,162**	**71,975**	**72,847**	**34,725**	**33,191**	**27,273**	**24,844**

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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