Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Tata Power Company Ltd

Multiple catalysts to power growth

Power Utilities	Sharekhan code: TATAPOWER
Reco/View: Buy ↔	CMP: Rs. 274
Price Target: Rs. 315 ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 40.47

Updated Feb 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

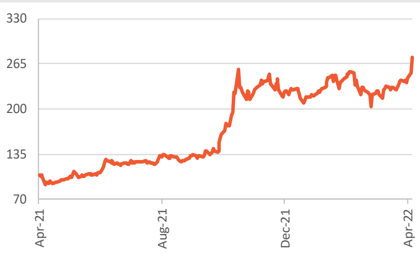
Company details

Market cap:	Rs. 87,424 cr
52-week high/low:	Rs. 275 / 90
NSE volume: (No of shares)	514.0 lakh
BSE code:	500400
NSE code:	TATAPOWER
Free float: (No of shares)	169.8 cr

Shareholding (%)

Promoters	46.9
FII	10.8
DII	15.6
Others	26.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	27	20	56	161
Relative to Sensex	13	19	54	139

Sharekhan Research, Bloomberg

Summary

- NCLT approval for merger of loss-making CGPL with Tata Power (standalone) would help save future tax outgo given massive accumulated losses at CGPL. We see an earnings upside of 10% from CGPL merger. Moreover, a potential agreement with states (already in talks with Gujarat) for full pass-through of fuel cost would result in significant earnings upgrades and aid Tata Power's valuation.
- Media reports indicate that Tata Power is looking to raise $700 million by inducting strategic investors into its renewable energy business. Likely monetisation of RE business portfolio would unlock value and also deleverage balance sheet.
- Earnings growth would have multiple catalysts like expansion of RE business (rooftop solar, solar EPC and RE generation capacity expansion), ramp-up of Odisha distribution business, new capex in power transmission and thus we expect a robust 36% PAT CAGR over FY21-24E. Likely tariff revision for Mundra UMPP could support earnings upgrades going forward.
- We maintain a Buy on Tata Power with a revised PT of Rs. 315.

Tata Power Company Limited's (TPCL) has multiple levers for earnings upgrades and better valuation, which are only partially captured in its stock price. Major catalysts include – 1) a potential tariff negotiation for Mundra UMPP for full pass-through of fuel cost, 2) full benefit of CGPL merger with Tata Power standalone would help reduce tax outgo as Tata Power would be able to offset massive accumulated loss at CGPL and 3) ramp-up and reduction in T&D loss at Odisha discoms. Potential monetisation of RE business would unlock value and aid balance sheet deleveraging. We expect robust 36% PAT CAGR over FY21-24E with likely improvement in RoE to 11.7%. We retain a Buy rating with revised PT of Rs. 315.

- **CGPL merger with Tata Power Standalone – Brings tax benefits and aids earnings upgrades:** Recently, the NCLT (Mumbai bench) has approved Scheme of Arrangement between Coastal Gujarat Power Limited (CGPL) and Tata Power for the merger of CGPL with Tata Power Standalone with effect from April 01, 2021. The merger would simplify the group holding structure and aid future growth, through fiscal consolidation and strengthening of balance sheet. The merger will provide a massive tax benefit to the parent given ~Rs14,000 crore accumulated loss at Mundra UMPP in the last 11 years due to adverse coal price and currency movements. Potential lower tax outgo and better refinancing terms would result in earnings upgrades of 10% over FY23-24 for Tata Power. Additionally, Tata Power is in talks with Gujarat government (~1,805 MW PPA – 45% of total capacity of Mundra UMPP) for full pass through of fuel cost at its Mundra UMPP and any success on this front would significantly add to its PAT and valuation.
- **Monetisation of RE portfolio – to unlock value and support balance sheet deleveraging:** Media reports are indicating BlackRock and Mubadala (UAE sovereign Fund) may invest $500 million and $200 million respectively in Tata Power's renewable energy (RE) business. Induction of strategic investor would help unlock value from RE business (media articles indicate a valuation of $5 billion) and help in balance sheet deleveraging. Potential value unlocking from RE business is a catalyst for Tata Power.
- **Robust earnings growth outlook:** We expect Tata Power's PAT to clock 36% PAT CAGR over FY21-24E led by sustained growth and strong execution at solar EPC (robust order book of Rs. 11,076 crore as of December 2021), focus to shift towards RE projects (target to increase the RE portfolio to 15 GW by 2025 and 25 GW by 2030 from 4 GW currently), ramp-up of Odisha discoms, new investment in power transmission and tax benefit from CGPL merger with the parent.

Our Call

Valuation – We maintain Buy rating on TPCL with a revised PT of Rs. 315: TPCL's focus on business restructuring (CGPL merger), focus on high growth RE business and entry in to power transmission) and balance sheet deleveraging plan would play a crucial role for sustained earnings growth and improved earnings quality (expect RoE to improve to 11.7% in FY24E versus only 6.1% in FY21). In addition, management's business restructuring plans to increase share of high growth RE business would drive sustained improvement in ESG scores and RE portfolio monetisation to help unlock value. Hence, we maintain a Buy on Tata Power with a revised PT of Rs.315. At CMP, the stock is trading at 3.3x/3x FY23E/FY24E P/BV.

Key Risks

1) Slower-than-expected ramp-up of RE portfolio and expansion in distribution business, 2) Lower-than-expected profitability in Solar EPC business, 3) Delay in plan to monetise RE asset and 4) volatility in international coal prices and tariff risk for Mundra UMPP.

Valuation (Consolidated) Rs cr

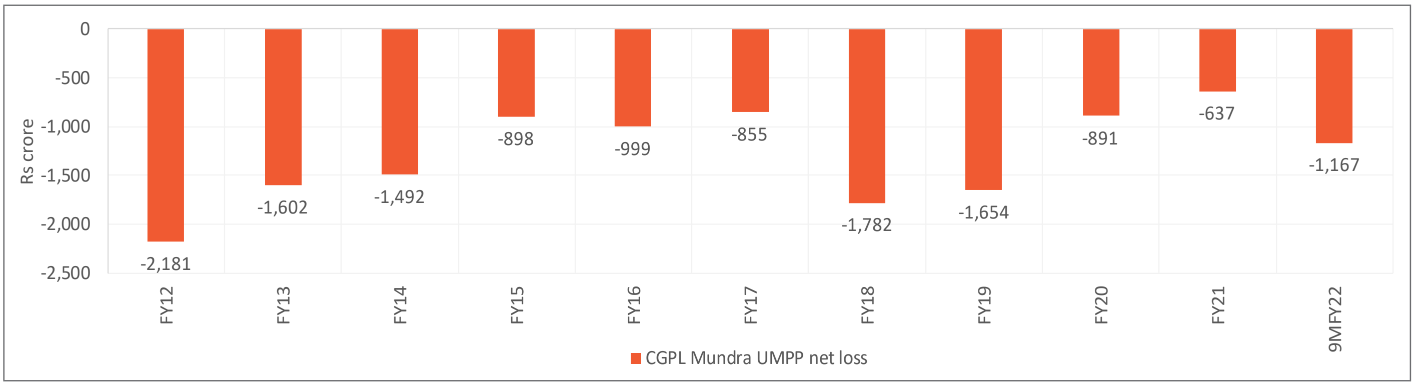
Particulars	FY21	FY22E	FY23E	FY24E
Revenue	32,468	43,634	47,567	51,905
OPM (%)	21.3	22.3	23.8	24.4
Adjusted PAT	1,283	2,220	2,877	3,243
% YoY growth	*6.8*	*73.0*	*29.6*	*12.7*
Adjusted EPS (Rs.)	4.0	6.9	9.0	10.1
P/E (x)	68.1	39.4	30.4	27.0
P/B (x)	3.9	3.6	3.3	3.0
EV/EBITDA (x)	17.3	12.7	10.8	9.5
RoNW (%)	6.1	9.6	11.4	11.7
RoCE (%)	6.1	8.9	10.4	11.3

Source: Company; Sharekhan estimates

Merger of CGPL with parent – potential earnings benefit of 10%

Recently, the NCLT has approved the merger of Coastal Gujarat Power Ltd (CGPL – wholly owned subsidiary of Tata Power) with Tata Power standalone with effect from April 01, 2021. The merger will simplify group holding structure and aid future growth, through fiscal consolidation and strengthening of balance sheet. CGPL operates the 4,000 MW Mundra plant, which is an imported coal-based power plant. The merger will provide massive tax benefit to Tata Power given more than ~Rs. 14,000 crore accumulated loss at Mundra UMPP over FY12 to 9MFY22. The merger would add 10% of the Tata Power's PAT as it would be able offset accumulated loss against future profit.

CGPL losses



Source: Company; Sharekhan Research

Potential tariff revision for Mundra UMPP to drive significant earnings upgrade

CGPL's Mundra UMPP operated at just 25% PLF in FY22 versus 73% in FY21 due to high fuel cost under-recovery and lower PAF also led to penalties and thus impacting cost absorption. However, recent power shortage in India amid low coal supplies led to few states (Gujarat and Rajasthan) allowed fuel cost pass through for Mundra UMPP and the same is reflected in significant sequential reduction in net loss to Rs.458 crore in Q3FY22.

Tata Power is in talks with the Gujarat state government (~1805 MW PPA – 45% of total capacity) for full pass through of fuel cost at its Mundra UMPP and intends to work with others states like Rajasthan for full fuel cost pass through. Potential success in full fuel cost pass through on total Mundra UMPP and moderation in the international coal price would reduce loss and could make Mundra UMPP profitable at higher PLF. We thus believe that likely tariff revision for Mundra UMPP could significantly ass to earnings and valuation of Tata Power.

Monetisation of RE portfolio – could help in value unlocking and balance sheet deleveraging

Tata Power has been looking for options to monetise its renewable energy assets and the same would fulfill twin objective of value unlocking and deleverage its balance sheet. Recent media reports hint that BlackRock and Mubadala (UAE sovereign Fund) may invest $500 million and $200 million respectively in Tata Power's renewable energy (RE) business. Induction of strategic investor would help unlock value from RE business (media articles stating valuation of $5 billion) and help in balance sheet de-leveraging.

Tata Power's Debt Profile Rs cr

PARTICULARS	CONSOLIDATED				
	Q3 FY22			Q2 FY22	Q3 FY21
	Rupee	Forex	Total	Total	Total
Long term	27,606	740	28,346	26,900	29,081
Short term	9,381	1,457	10,838	11,337	9,360
Current Maturity of LT	5,804	2,375	8,179	7,275	4,012
Total Debt	**42,792**	**4,571**	**47,363**	**45,512**	**42,454**
Less: Cash			6,370	5,077	3,991
Less: Debt against dividend in Coal SPVs			1,457	976	1,593
Net External Debt			**39,536**	**39,459**	**36,870**
Equity			**24,996**	**24,425**	**24,445**
Net Debt to Equity			**1.58**	**1.62**	**1.51**

Source: Company data

Outlook and Valuation

■ **Sector view – Regulated tariffs provide earnings visibility; reforms to strengthen balance sheets of power companies**

India's power sector is regulated by the CERC with an availability-based earnings model (fixed RoE on power generation assets) and, thus, the regulated tariff model provides strong earnings visibility for power-generation, transmission & distribution companies. Moreover, the government's power sector package of over Rs. 3 lakh crore announced in the Union Budget 2021 would help power discoms clear dues of power generation and transmission companies. This would reduce receivables of the power sector and strengthen companies' balance sheets.

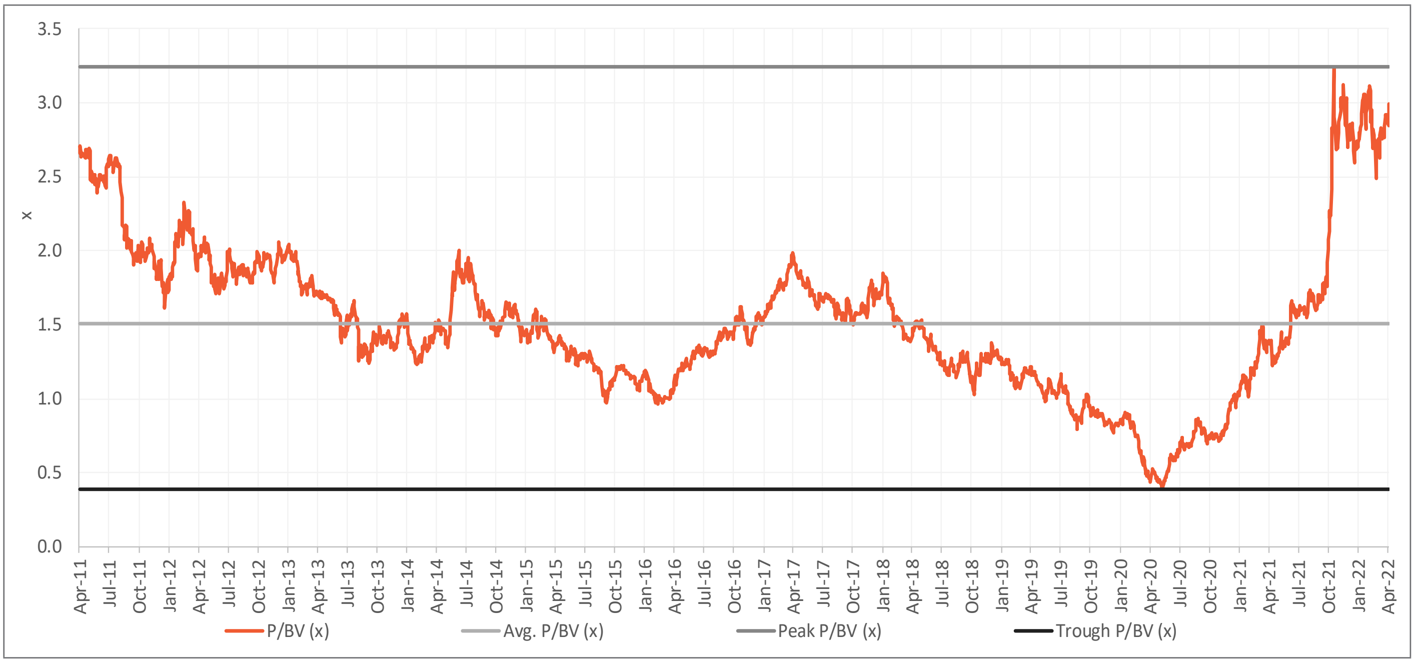
■ **Company outlook – Focus on distribution and RE business to drive robust earnings growth**

Tata Power has a well-planned strategy to shift towards clean energy and targets to treble PAT to over Rs. 3,600 crore and double RoE to 12% by FY2025 (versus 6% in FY2021). We believe that growth would be driven largely by distribution and the renewable energy (RE) business. We expect PAT to clock a CAGR of 36% over FY2021-FY2024E with a sharp improvement in RoE to 11.7% by FY2024E.

■ **Valuation – We maintain Buy rating on TPCL with a revised PT of Rs. 315**

TPCL's focus on business restructuring (CGPL merger), focus on high growth RE business and entry in to power transmission) and balance sheet deleveraging plan would play a crucial role for sustained earnings growth and improved earnings quality (expect RoE to improve to 11.7% in FY24E versus only 6.1% in FY21). In addition, management's business restructuring plans to increase share of high growth RE business would drive sustained improvement in ESG scores and RE portfolio monetisation to help unlock value. Hence, we maintain a Buy on Tata Power with a revised PT of Rs.315. At CMP, the stock is trading at 3.3x/3x FY23E/FY24E P/BV.

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

Tata Power is India's largest integrated private power company with presence in power generation (capacity of 12808 MW with 69% from thermal and 31% from renewables), transmission, distribution (largest private sector player with a customer base of 11.7 million), trading and Solar EPC (largest solar EPC player in India).

Investment theme

Tata Power's core earnings are resilient even in demand down cycle as it gets regulated returns on power generation and distribution assets. The company's focus to shift from a B2G to B2C model would drive robust earnings growth (to be driven by RE and distribution business) over the next 4-5 years and materially improve its RoE to ~9.4% by FY2024E (from just 6.1% in FY2021). Monetisation of renewable assets and potential improvement in ESG rating could re-rate the company while focus on debt reduction would strengthen balance sheet.

Key Risks

- Slower-than-expected ramp-up of RE portfolio and expansion in distribution business.
- Lower-than-expected profitability in Solar EPC business. Continued losses at Mundra UMPP in case of high imported coal prices.
- Delay in plan to monetise RE assets.
- Volatility in international coal prices

Additional Data

Key management personnel

Mr. Natarajan Chandrasekaran	Chairman
Dr. Praveer Sinha	Managing Director and CEO
Ramesh Subramanyam	CEO and Managing Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5
2	Vanguard Group Inc.	2
3	ICICI Prudential Asset Management Co. Ltd	1.7
4	BlackRock Inc.	1.4
5	Matthews International Capital Management	1.3
6	General Insurance Corp. of India	1.2
7	Franklin Resources Inc	0.8
8	L&T Mutual Fund	0.5
9	Kotak Mahindra Asset Management Ltd	0.5
10	Dimensional Fund Advisors LP	0.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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