

**BUY**

TP: Rs 131 | ▲ 29%

**TATA POWER**

Power

18 May 2021

## Pressing all the right levers; initiate with BUY

We expect Tata Power (TPWR) to derive ~80% of forecast FY22 EBITDA and 55% of its valuation from the fast-growing segments of power distribution (#1 player), renewables (among top 10), solar EPC (#1) and rooftop solar solutions (#1). The company has made good progress on debt reduction in FY21 and we expect deleveraging to continue in FY22 as fresh investments flow into the renewables business. Merger of the lossmaking CGPL plant into the parent company is likely to save costs. Initiate with BUY, Mar'22 TP Rs 131.

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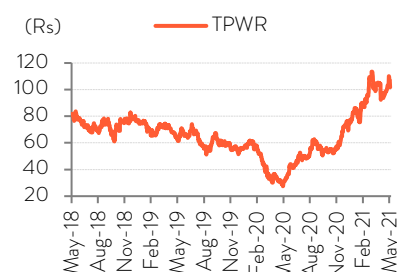
**Aligning to growing segments:** TPWR is a leader in the fast-growing segments of power distribution, solar EPC and rooftop solar solutions, besides being among the top 10 ranked renewable developers in India. We estimate that these growth segments will contribute ~55% to group valuation and 80% to FY22 EBITDA (vs. 50% in FY16) – a sharp departure from the last decade when coal mining and coal-based generation dominated the earnings mix. Over FY21-FY23, we model for a robust 12%/37% EBITDA CAGR in the distribution/renewable segments.

Ticker/Price	TPWR IN/Rs 102
Market cap	US\$ 4.4bn
Shares o/s	3,195mn
3M ADV	US\$ 79.7mn
52wk high/low	Rs 115/Rs 30
Promoter/FPI/DII	47%/12%/21%

Source: NSE

**Debt reduction to continue:** A combination of asset sales and equity injection totalling Rs 73bn by the parent company in FY21 has cut TPWR's net debt by ~22% to Rs 354bn in FY21. Management aims to reduce net gearing further to 1x in FY22 by bringing in new investors or listing the renewables business. This business is also likely to attract a higher multiple, similar to listed peers. Plans to merge the lossmaking CGPL plant into the parent will help cut costs as well.

## STOCK PERFORMANCE



Source: NSE

**Initiate with BUY:** Our Mar'22 SOTP-based TP of Rs 131 implies 10.7x FY22E EV/EBITDA, a ~35% premium to mean – justified by our 49% EPS CAGR forecast for FY21-FY23, aided by growth in the renewables and distribution segments. Key stock price drivers include fresh investments in renewables, parent company restructuring, and new renewable and distribution contracts.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21P	FY22E	FY23E
Total revenue (Rs mn)	2,98,811	2,91,364	3,24,681	4,49,889	5,05,017
EBITDA (Rs mn)	68,484	77,541	75,387	76,270	93,558
Adj. net profit (Rs mn)	5,652	10,305	11,119	14,623	24,794
Adj. EPS (Rs)	2.1	3.8	3.5	4.6	7.8
Adj. EPS growth (%)	(57.6)	82.3	(8.6)	31.5	69.6
Adj. ROAE (%)	0.7	1.2	1.2	1.5	2.4
Adj. P/E (x)	48.6	26.7	29.2	22.2	13.1
EV/EBITDA (x)	10.5	9.6	10.2	9.5	7.5

Source: Company, BOBCAPS Research | P – Provisional

## Investment rationale

### Mix shift to renewables and distribution to spur earnings

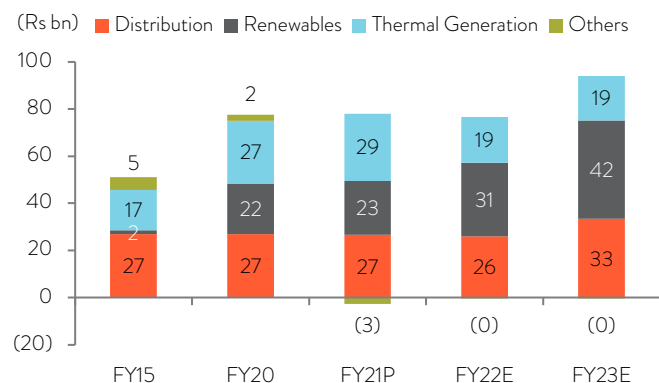
**#1 in private electricity distribution, #1 in solar EPC, #1 in rooftop solar, and top 10 renewable generator**

TPWR is India's largest private sector power distribution company with decades of experience in providing electricity to Mumbai and Delhi. In addition, the company acquired distribution rights for the state of Odisha in FY21, which is now the largest private distribution business by area and power sales.

TPWR also has a presence across the solar value chain consisting of solar module production, solar EPC (#1 player) and rooftop solutions (#1), in addition to being among the top 10 solar power generators with a target to increase its capacity six-fold over FY21-FY25. We expect the ongoing business shift towards renewables and distribution from thermal generation and coal to spur earnings growth, with the two focus businesses forecast to contribute >80% of EBITDA (vs. 50% in FY16) and 55% of valuations by FY22.

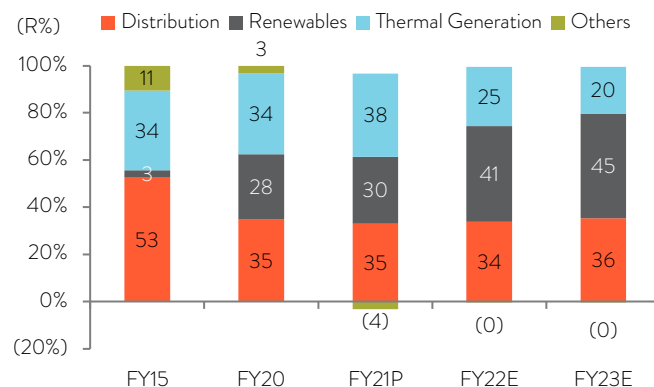
Our FY21-FY23 EBITDA CAGR forecasts for the distribution/renewable businesses stand at a robust 12%/37% despite flattish group EBITDA for FY22E as higher coal prices weigh on CGPL's profits.

**FIG 1 – EBITDA MIX TRANSITIONING AWAY FROM COAL...**



Source: Company, BOBCAPS Research

**FIG 2 – ...WITH SHARE OF DISTRIBUTION AND RENEWABLE SEGMENTS SET TO RISE**



Source: Company, BOBCAPS Research

### Profitable distribution franchise

Delhi, Mumbai and Odisha operate under a regulated returns model where the company earns a return on regulated equity that increases with capex. Incentives can be earned by improving AT&C losses at a faster rate than the past trajectory. TPWR also owns distribution franchisees in Ajmer (Rajasthan) where its earnings depend on reduction in AT&C losses.

### Leader in solar space and among the top renewable generators

TPWR runs a 2.1GW solar and wind generation capacity which management expects to continue investing in. The company is the largest solar EPC player in India with a Rs 87bn order backlog as of Mar'21 and has 1,100MW of solar module and cell capacity. It is also a market leader in the solar rooftop business as well as a producer of solar electricity-based groundwater pumps.

### 7GW of thermal capacity, stakes in Indonesian coal mines

The company operates 7GW of mostly thermal generation capacity with all of its plants tied to PPAs. However, its largest generation asset – Coastal Gujarat Power (CGPL) – is unable to fully recover its cost of imported coal. This apart, TPWR owns a 26-30% stake in Indonesian mining assets that also serve as its suppliers. The company plans to progressively move out of coal mining and avoid further thermal plant addition.

**FIG 3 – TPWR'S POWER ASSETS**

Generation				Transmission		Distribution		
Plant	Capacity (MW)	Remaining Life (years)	PPA (%)	Project	Circuit km	Area	Consumption (mn units)	Remaining Life (years)
Coastal Gujarat Power	4,150	17	100	Power Links	1,166	<b>Distribution PPA (Regulated Return)</b>		
Maithon Power (MPL)	1,050	16	100	Mumbai Transmission	1,200	North & North East Delhi	9,051	8
Tromba Power	930	16	100			Mumbai	4,573	19
Jojobera Power	240	16	100			Odisha	19,584	25
Industrial Energy / Jojobera Power Unit 1&4	375	16	100			<b>Distribution Franchisee</b>		
Haldia Power	120	16	100			Ajmer	465	16
Tata Power Hydro	447	16	100			<b>Coal Business (26-30% stake)</b>		
Solar	1,641	21	100			Indonesian Coal Mines		
Wind	504	19	100			- Production (mn tonnes)	72.9	
Under Development	1,247	25	100			Shipping Business	Bulk Transport	
Adjaristsqali Georgia LLC	187	NA	100					
<b>New Growth Segments</b>								
Solar EPC (Rs bn)	120							
Solar module capacity (MW)	1,100							
Solar cell capacity (MW)	1,100							
Rooftop solar annual installations (MW)	66							
						Traditional	Green Energy	Distribution

Source: Company, BOBCAPS Research

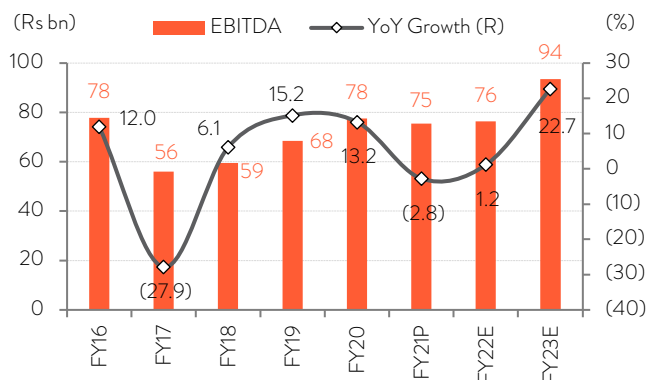
### Growth expected to revive as renewables share grows

TPWR had a relatively weak performance over FY16-FY21P marked by flat EBITDA growth (~-1% CAGR), arising from a combination of stable distribution income, volatile generation revenue and growing renewables income. The CGPL plant has been the biggest source of volatility due to fluctuations in Indonesian coal prices.

In renewables, organic expansion and acquisition resulted in 7.4x growth in segment EBITDA during FY16-FY21P, climbing from a low base of ~4% of group EBITDA to over 30% share in FY21P. We expect an increasing contribution from the distribution and renewables segments along with deleveraging (from asset sales and new investments in renewables) to drive a strong earnings recovery.

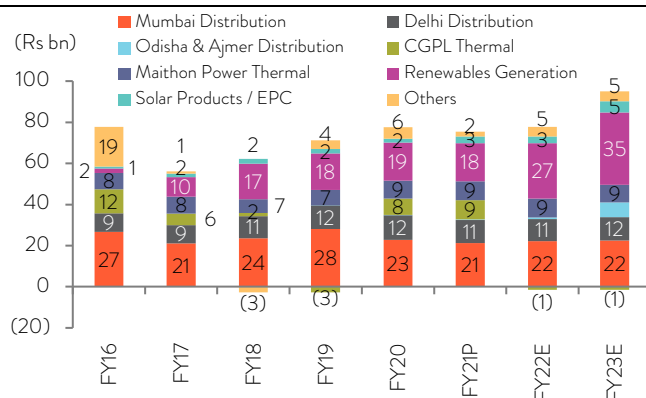
Apart from capacity expansion in renewables, we expect the Odisha discom to be another growth catalyst, particularly from FY23 onward as AT&C losses should decline meaningfully in the four distribution areas. We model for a sharp drop in CGPL EBITDA from Rs 9.2bn in FY21P to an EBITDA loss of Rs 1.4bn in FY22E due to our estimates of higher average coal prices in the forecast period versus FY21. However, the drag on TPWR's net income from CGPL should ease as the latter's debt has reduced, implying lower interest costs.

**FIG 4 – TPWR'S EBITDA IMPROVING SINCE FY17...**



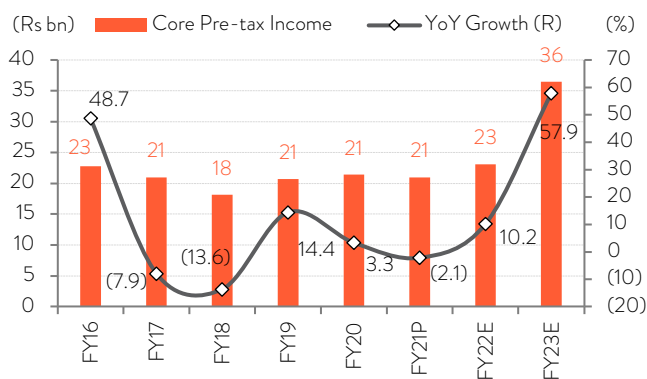
Source: Company, BOBCAPS Research

**FIG 5 – ...LED BY RENEWABLES**



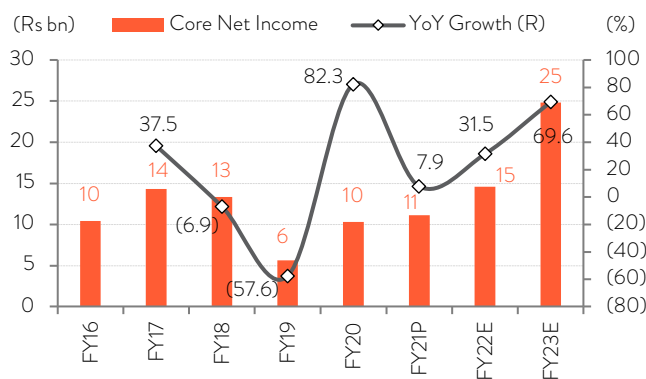
Source: Company, BOBCAPS Research

**FIG 6 – PRE-TAX INCOME PICKING UP**

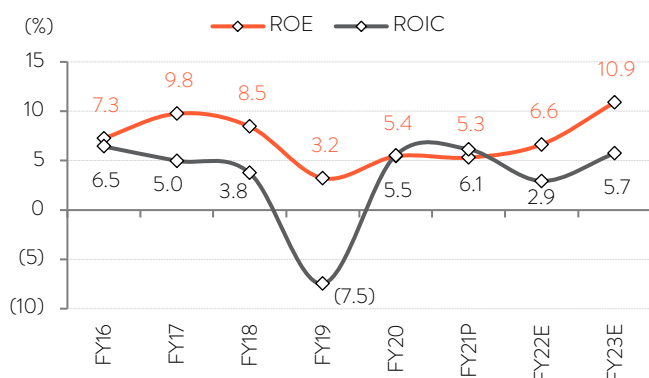


Source: Company, BOBCAPS Research

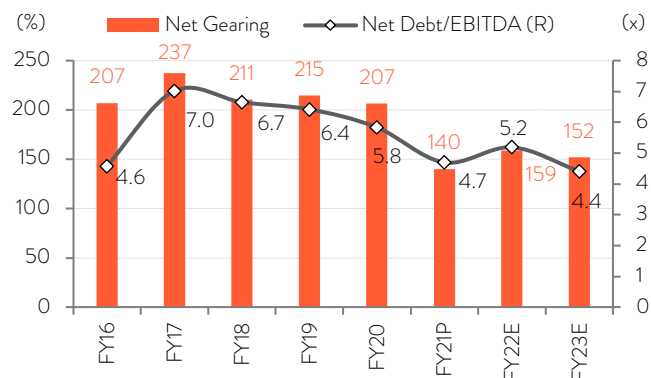
**FIG 7 – NET INCOME VOLATILE DUE TO TAX SHIFTS**



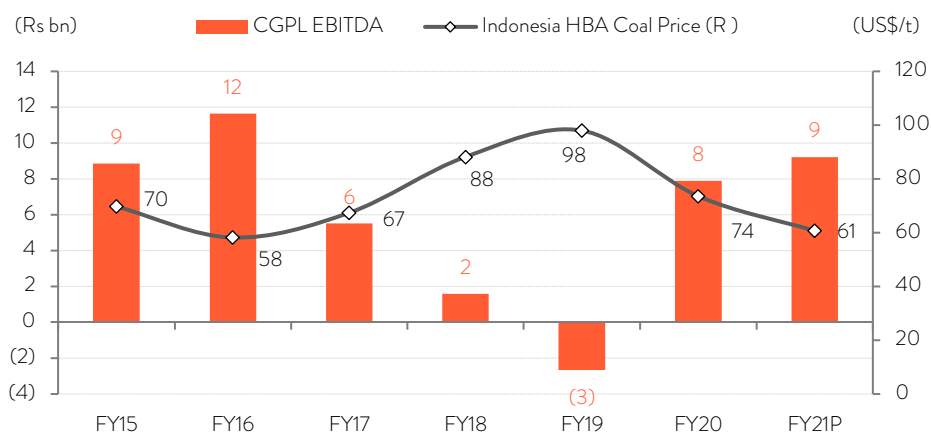
Source: Company, BOBCAPS Research

**FIG 8 – ROE SHOULD CONTINUE TO MOVE UP**

Source: Company, BOBCAPS Research

**FIG 9 – NET GEARING ALSO IMPROVING**

Source: Company, BOBCAPS Research

**FIG 10 – CGPL EBITDA VS. COAL PRICE**

Source: Company, BOBCAPS Research

**FIG 11 – TPWR – EBITDA ESTIMATES**

(Rs bn)	FY20	FY21E	FY22E	FY23E
<b>By Entity</b>				
Mumbai Distribution + Others (Standalone)	22.7	21.2	22.1	22.4
Coastal Gujarat Power Limited (CGPL)	7.9	9.2	(1.4)	(1.5)
Maithon Power (MPL)	8.7	9.2	9.1	8.6
Delhi Discom (TPDDL)	12.2	11.4	10.9	11.5
Power Trading (TPTCL)	0.6	0.5	0.5	0.5
Tata Power Solar (TPSL)	1.9	3.3	3.2	5.5
Tata Power Renewable (TPREL)	7.8	8.0	15.5	23.8
Walwhan Renewables Energy Limited	10.7	10.5	11.4	11.4
TERPL (Shipping Company)	4.0	4.1	4.2	4.2
Odisha Discoms	-	(0.1)	0.3	6.5
Ajmer Distribution	0.1	0.4	0.5	0.5
Others	1.0	(2.4)	-	-
<b>Total</b>	<b>77.5</b>	<b>75.4</b>	<b>76.3</b>	<b>93.6</b>
<b>By Business</b>				
Distribution	26.9	26.6	26.0	33.4
Renewables	21.6	22.9	31.2	41.8
Generation	26.6	28.5	19.4	18.8
Others	2.5	(2.7)	(0.3)	(0.4)
<b>Total</b>	<b>77.5</b>	<b>75.4</b>	<b>76.3</b>	<b>93.6</b>

Source: Company, BOBCAPS Research

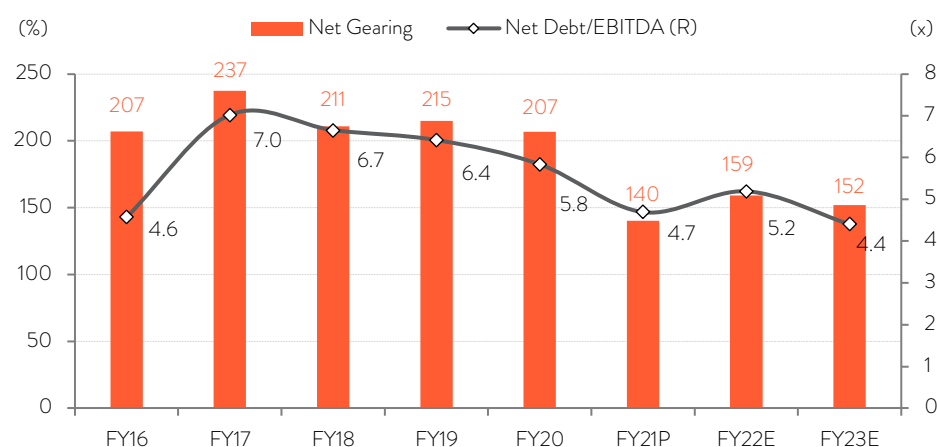
**Net gearing ratio targeted to halve to ~1x from over 2x, spurring change in risk profile**

## Debt reduction to continue; restructuring will save costs

TPWR's net gearing has come down appreciably following the sale of Rs 47bn in non-core assets and a Rs 26bn equity injection from the parent group in FY21. In addition, management is working on options to bring in new investors or list its renewables business – we believe this will help the company reach its targeted net gearing ratio of ~1x from 1.4x as of FY21P. Note that our estimates for FY22-FY23 do not include any external investments.

Lower leverage would materially change TPWR's risk profile and bolster its investments to expand the renewables and distribution segments. The company is also seeking regulatory approval to merge the lossmaking CGPL plant with the parent which will help reduce its own tax liability via set-off against accumulated losses.

**FIG 12 – DEBT PROFILE**



Source: Company, BOBCAPS Research

## Valuation methodology

### Expect 49% EPS CAGR

We estimate an EPS CAGR of 49% for TPWR over FY21-FY23 driven by growth in the renewables and distribution businesses. Group EBITDA is likely to be flat in FY22E as higher coal prices compared to FY21 would raise losses at CGPL. Pre-tax income will still grow as interest cost declines due to deleveraging. In FY23E, we expect a significant 23% increase in EBITDA from stronger renewable energy capacity additions and a drop in Odisha discom AT&C losses.

**FIG 13 – TPWR – EARNINGS ESTIMATES**

(Rs bn)	FY15	FY16	FY17	FY18	FY19	FY20	FY21P	FY22E	FY23E
Revenue	337.3	374.8	275.9	293.3	298.8	291.4	324.7	449.9	505.0
Gross Profit	121.9	151.0	93.9	101.1	103.4	117.3	119.0	139.0	164.7
EBITDA	69.4	77.7	56.1	59.5	68.5	77.5	75.4	76.3	93.6
EBIT	47.7	54.0	36.5	35.5	44.6	51.2	47.9	44.7	58.8
Core Pre-tax Income	15.3	22.8	21.0	18.1	20.7	21.4	21.0	23.1	36.5
Reported Net Income	1.7	8.7	9.0	24.8	23.6	10.2	11.3	15.1	24.8
Perpetual Securities Annual Pay-out*	(1.1)	(1.1)	(1.1)	(1.1)	(1.7)	(1.7)	(1.7)	(0.4)	-
Core Net Income	(0.1)	10.4	14.3	13.3	5.7	10.3	11.1	14.6	24.8
Average Number of Shares (bn)	2.7	2.7	2.7	2.7	2.7	2.7	3.2	3.2	3.2
EPS (Rs/sh)	(0.0)	3.8	5.3	4.9	2.1	3.8	3.5	4.6	7.8
<b>Growth YoY (%)</b>									
Revenue	-	11.1	(26.4)	6.3	1.9	(2.5)	11.4	38.6	12.3
Gross Profit	-	23.9	(37.8)	7.7	2.3	13.4	1.5	16.8	18.5
EBITDA	-	12.0	(27.9)	6.1	15.2	13.2	(2.8)	1.2	22.7
EBIT	-	13.2	(32.3)	(2.8)	25.5	14.9	(6.4)	(6.8)	31.5
Core Pre-tax Income	-	48.7	(7.9)	(13.6)	14.4	3.3	(2.1)	10.2	57.9
Reported Net Income	-	420.4	2.7	176.2	(4.9)	(56.8)	10.8	33.5	64.7
Core Net Income	-	(11,103.6)	37.5	(6.9)	(57.6)	82.3	7.9	31.5	69.6
EPS	-	(11,103.6)	37.5	(6.9)	(57.6)	82.3	(8.6)	31.5	69.6

Source: Company, BOBCAPS Research | \*Company has announced that it is paying back the Rs 15bn perpetual security in FY21P

Our earnings forecast factors in the plant load factor for generation/renewables, AT&C losses for the distribution business and growth in the renewable energy portfolio. We have not assumed any cash injection from the anticipated renewables deal or tax savings from the planned CGPL restructuring.

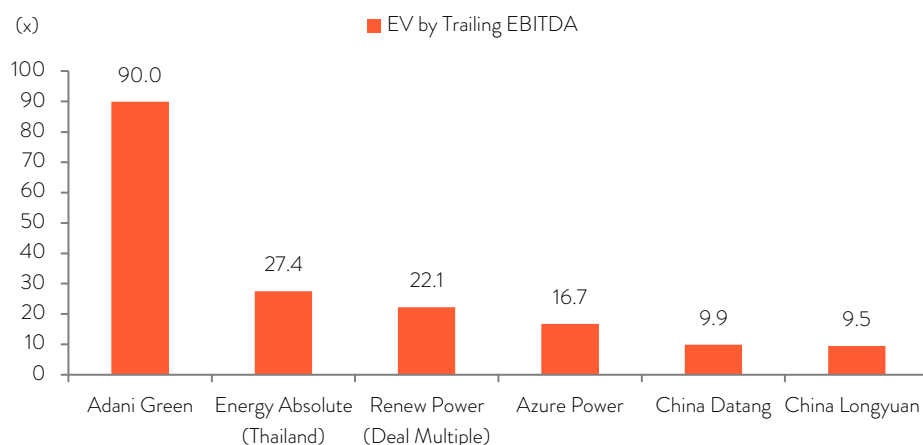
## Premium valuations justified

TPWR currently trades at 9.5x FY22E EV/EBITDA, one standard deviation above its 10-year mean. In our view, the stock merits premium valuations given:

**Deleveraging, distribution growth and new renewable plants to spur earnings**

- **Robust earnings growth:** Our 49% EPS CAGR forecast for TPWR over FY21-FY23E is premised on deleveraging, capex-fuelled growth in the distribution business (leading to higher regulated income), a drop in AT&C losses and commercial operations of new renewables plants.
- **New investments in renewables:** The anticipated deal in renewables will bring new investors into the business and is likely to be at a premium to group valuations considering the value being accorded to pure-play renewable energy companies in India. There are only three pure-play listed Indian companies in the segment, of which one is listed in India and the other two in the US (Azure Power and Renew Power listed after being acquired by a US-based special purpose acquisition company or SPAC).

**FIG 14 – REGIONAL RENEWABLE COMPANY MULTIPLES**



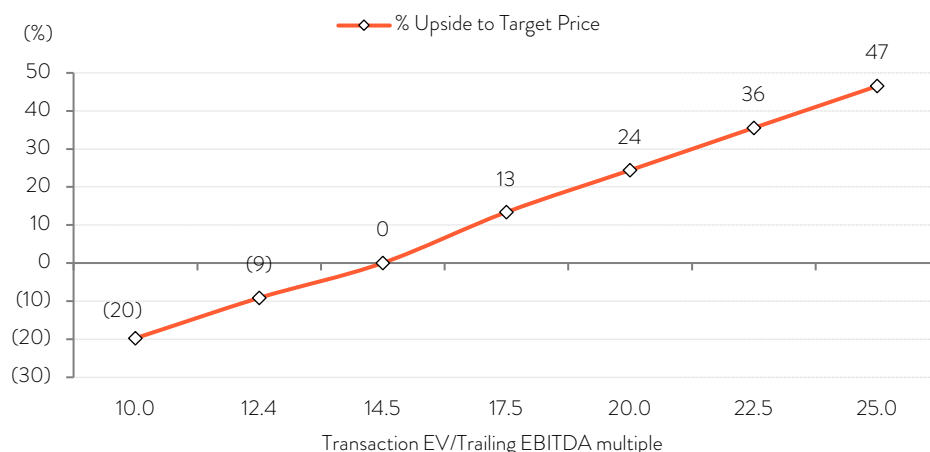
Source: Bloomberg | Note: Renew Power's multiple is based on the transaction multiple converted for trailing EBITDA

**FIG 15 – ILLUSTRATIVE UPSIDE AT HIGHER MULTIPLES\***

Renewable Business (Rs bn)	EV	Net Debt FY21E	Equity Value	FY21E EBITDA	EV/Trailing EBITDA (x)
Tata Power Renewables	184	60	124	8	23.0
Walwhan Renewables Energy	84	44	39	10	8.0
<b>Total</b>	<b>267</b>	<b>104</b>	<b>163</b>	<b>18</b>	<b>14.5</b>
<b>Valuation Sensitivity to deal multiples</b>					
<b>Updated Value</b>	<b>369</b>	<b>104</b>	<b>265</b>	<b>18</b>	<b>20.0</b>
% Change			102		
<b>% Upside to target price</b>			<b>24.4</b>		

Source: BOBCAPS Research | \*Based only on the renewable generation business. IPO or deal with potential investors may include solar EPC, solar pumps and solar module manufacturing



**FIG 16 – UPSIDE TO TARGET PRICE FROM DEAL MULTIPLES**

Source: BOBCAPS Research

- **Historical multiples not comparable:** TPWR's past multiples are not comparable as the business mix has shifted towards growing segments. Also, for a large part of the last decade, the market was concerned about the large losses made by CGPL. Apart from the proposed reorganisation, we expect CGPL's losses to reduce with the restructuring of debt, helping it achieve cash breakeven.

Stock trades at premium to 10Y mean – justified by expected earnings growth, deleveraging, renewable deal and restructuring

Also, emerging business mix geared for higher growth

**FIG 17 – TPWR – KEY EARNINGS DRIVERS**

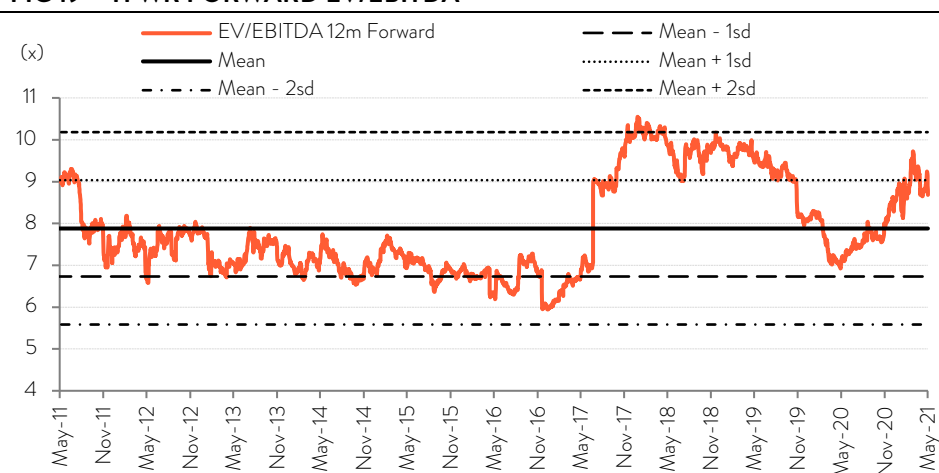
Drivers	FY20	FY21E	FY22E	FY23E
<b>AT&amp;C Losses (%)</b>				
Delhi Discom	7.9	7.9	7.5	7.3
Tata Power Mumbai	0.4	0.4	0.4	0.4
Odisha WESCO	28.6	28.6	26.0	24.5
Odisha Southco	36.3	36.3	35.0	34.0
Odisha CESU	30.4	30.4	28.0	26.0
Odisha NESCO	25.3	25.3	25.0	23.0
Ajmer	10.0	10.0	9.0	8.0
Renewables – New capacity (MW)	404	3	1,247	1,500
Renewables tariff for new projects (Rs/unit)	3.0	2.5	2.5	2.4
Renewables PLF for new projects (%)	22.0	22.0	24.0	25.0
Tata Power solar new EPC external order (MW)	NA	NA	750	1,000
Rooftop installations completed during the year (MW)	66.0	50.0	100.0	150.0
Tata Power solar product sales revenue (% YoY)	32.0	NA	10.0	10.0
USDINR Average Conversion Rate	70.9	74.2	75.0	75.0
Imported Coal Price - Indonesia HBA (US\$/t)	73.6	60.7	75.0	75.0

Source: Company, BOBCAPS Research

**FIG 18 – TPWR – BOBCAPS ESTIMATES VS. CONSENSUS**

(Rs bn)	BOBCAPS		Consensus		BOBCAPS vs. Consensus (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	450	505	378	405	19.1	24.5
EBITDA	76	94	82	88	(7.2)	6.1
EBIT	45	59	59	62	(24.7)	(4.6)
Pretax Income	23	36	22	27	5.0	35.2
Net Income	15	25	19	22	(21.2)	13.8
EPS (Rs)	4.6	7.8	6.1	7.1	(24.8)	9.5

Source: Bloomberg, BOBCAPS Research

**FIG 19 – TPWR FORWARD EV/EBITDA**

Source: Bloomberg

**Target price of Rs 131 carries  
29% upside**

### Initiate with BUY, TP Rs 131

Our Mar'22 target price of Rs 131 for TPWR 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% based on a risk-free rate of 6.12% as per the 10-year India bond yield as of end-Mar'21, (2) beta of 1.32 based on the last two-year weekly returns as of end-Mar'21, and (3) cost of debt of 8.5% factoring in the company's current debt cost. Our TP of Rs 131 implies 10.7x EV/EBITDA on FY22E, a ~24% premium to mean which is justified by a robust earnings outlook and expected project wins in growth segments. Initiate with BUY. Key stock price drivers include fresh investments in renewables, parent company restructuring, and new renewable and distribution contracts.