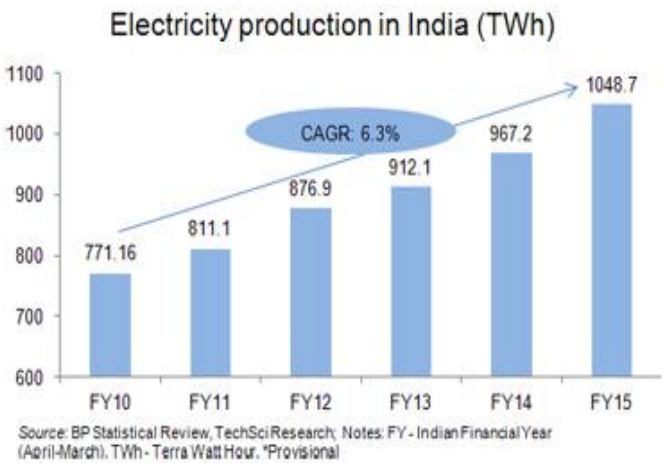
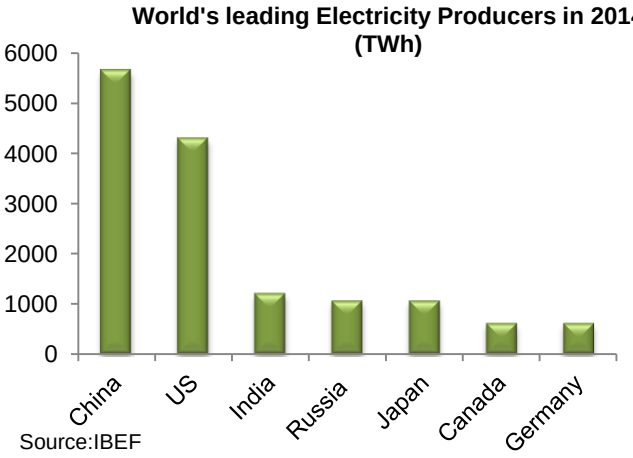
February 17, 2016

"India's power sector is at an inflection point, given the government's conviction that electricity is a critical enabler for economic growth."- *WEF report*

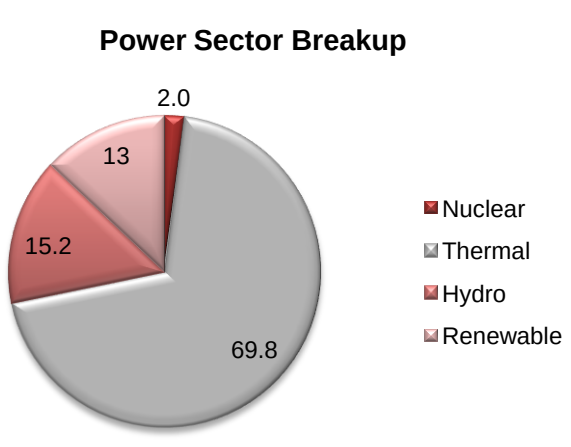
India is among the 3rd largest producer and 4th largest consumer of electricity in the world. Electricity production in India grew at 8.4% YoY to 1,048.7 TWh in FY15 and 5 year CAGR growth (FY10-15) stood at 6.3%.Although power generation has grown more than 100-fold since independence, growth in demand has also been higher due to increasing economic activity. According to the 12th Five Year Plan, India is targeting a total of 88.5 GW of power capacity addition by 2017, of which, 72.3 GW constitutes thermal power, 10.8 GW hydro and 5.3 GW nuclear. The demand for power sector should remain strong in future thanks to the government's initiatives to expand into the under penetrated rural areas, increasing urbanization and rising income levels in India is leading to higher per capita consumption. Also due to huge potential in renewable energy potential in country supply will also grow at rapid pace. Lower fossil fuel prices (Coal, petroleum and natural gas) due to big focus on green energy initiatives in western world, should benefit the Indian power companies and consumers going forward.

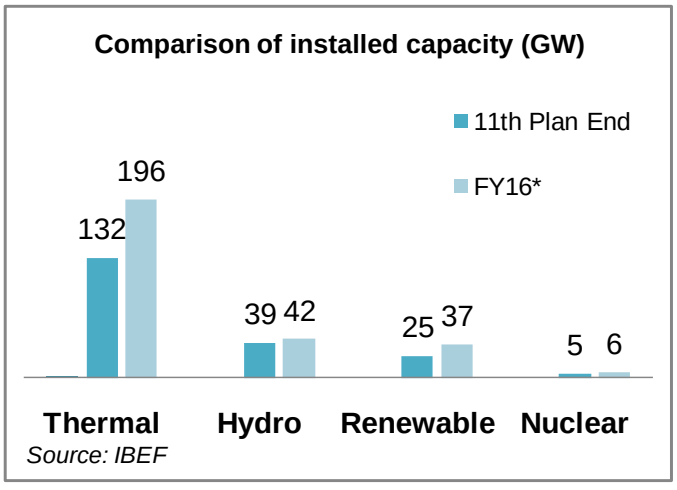




Sources of Power- Indian power generation is mainly achieved from thermal energy (69.8%), followed by hydro (15.2%), renewable (13%) and nuclear energy. Among the different sources of power in India, the CAGR in Comparison of installed capacity (GW) installed capacity over FY07–16* was

- 9.6% for thermal power
- 18.7% for renewable energy, the fastest among all sources of power
- 2.3 % for hydro power
- 4.5% for nuclear power





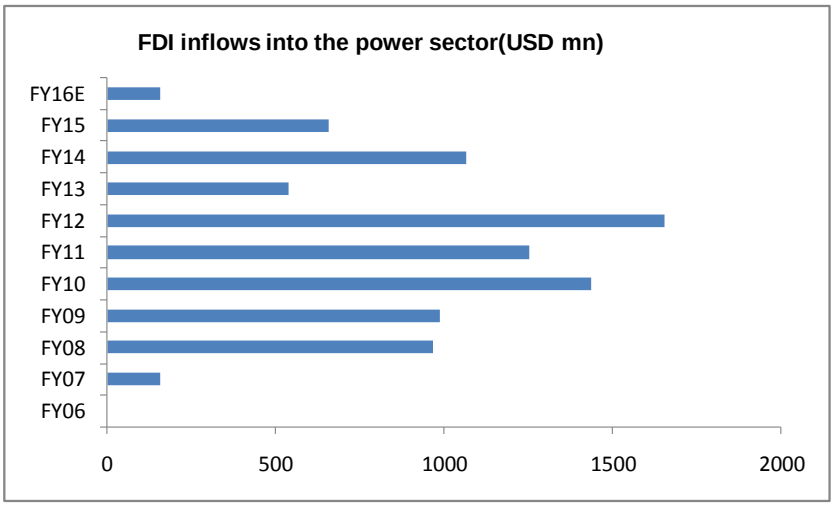
Majority of power generation takes place through thermal power plants which uses coal as its raw material. Lack of coal supply was a major hurdle in the power sector until some time back. The lack of coal supply had led to large supply deficits in the country in the past. However, the power deficit has narrowed from 10.1% in 2009-10 to 2.2% in 2015 year end, thanks to active efforts taken by the government to increase coal supply and easing the supply chain woes of coal transportation. Also big thrust of Indian Government on solar energy has helped bridge the power deficit. India Ratings and Research company expects the power deficit to remain low at 3-4%. Coal India's supply to power sector increased by 6.8% to 299.1mn tonnes during April-December 2015. .Average transmission and distribution losses (T&D) are around 25% of total power generation. India's T&D losses are almost 2.5x times the world average. The T&D losses are due to various reasons - energy sold at low voltage, improper distribution system, and sparsely distributed loads over large rural areas.

The government plans to achieve 1.5 bn tonnes of coal production by 2020. Of this, Coal India alone is targeting an output of 1 bn tonnes. Some of the major players in the power generation sector are NTPC, Power Grid, and Reliance Power etc.

Lower energy prices should help to increase the PLF factor:
India's gas power sector is suffering from low PLF factor and high T&D losses. This is due to many reasons: The State Electricity Boards (SEBs) are saddled with debts and they do not have more resources to purchase powers. However with gas prices coming down from 2015 onwards, the PLF factor is gradually picking up. The PLF factor was around 25% for September 2015 as compared to ~20% in 2014. We expect the PLF factor to improve further going forward as international energy prices are expected to remain low.

UDAY Scheme a pain reliever for distressed power companies?
The government recently introduced 'Ujwal Discom Assurance Yojana' (UDAY) scheme to rescue the SEBs. Under this scheme, 75% of the loans on the SEBs books will be transferred in the books of their respective state governments. SEBs are facing financial crisis and are making losses to around Rs 700 bn annually. Most SEBs do not have enough resources to purchase power from the generators, which is leading to lower PLFs in the generation plants. Transferring such huge amount of loans will provide some relief to the SEBs in terms of finance costs. However, their situation will improve substantially only if there are regular tariff hikes by the state government who may be reluctant to increase the power tariffs.

FDI inflows into the power sector are positive and should aid performance.
According to the IBEF data, total FDI inflows in the power sector touched USD9.9 bn during April 2000 to September 2015, accounting for 4 % of total FDI inflow in India. FDI inflows have been increasing post the government's decision to allow 100% FDI in power sector. The power consumption is estimated to increase from 1174.07 TWh in 2015 to 1,894.7 TWh in 2022.



Partial shift to Solar energy will help in lowering the power deficit.

The government aims to put generating capacity of 100 GW of solar power by 2022 from the 3.3GW at present. The tariff for solar power has fallen from Rs.18 per unit a few years ago to a record low of ~ Rs4.5 per unit. This should encourage the usage of solar power and hence lower the power deficit in India. However, India needs to have backup power plants when power from solar energy would be unavailable and delicate balance between base and peak load power plants is required.

Cost control initiatives, securing adequate supply and diversifying energy resources are healthy measures taken by the power companies.

The power companies are adopting various measures to boost their performance. Some of them are trying to curb fuel transport cost by switching to the nearby coal sources and are also developing captive coal fields to reduce price volatility. In addition to this, power companies are trying to source adequate supplies of fuel through domestic as well as international engagements. The increasing use of different power sources such as hydro, thermal and renewable energy will aid in maintaining low power deficit in the country. Many companies like Uttar Gujarat Vij Company, Tata Power and Essel have installed machine-to-machine (M2M) based smart metering systems in India to check the T&D losses.

Some of the global developments could support lower international gas prices for a longer term, thereby leading to recovery in losses and faster turnaround for gas based generation plants. The global developments are:

- Japan is restarting some of its nuclear power plants in order to reduced its dependence on LNG, thereby reducing global gas demand.
- USA, one of the world's largest producer gas, will soon start to exporting petroleum products especially natural gas, creating an excess supply in the world markets.
- Iran, with the world's second-largest gas reserves, out of the sanctions and it would be aggressively developing its petroleum industry in coming years leading to more supplies of Natural Gas.

If India can monetize this trend by locking in gas supplies at lower rates for future, power plants can improve their financial conditions faster. However, SEB problems and political intervention may be a hindrance to the power sector.

POLICIES ADOPTED DURING BUDGET FY15 & FY16 for power sector

- A Public Private Partnership (PPP) policy framework with Coal India Limited to be planned by the government to reduce dependency on imported coal.
- 100 percent FDI is allowed under automatic route for power sector except atomic energy.
- Low interest funds from National Clean Energy Fund (NCEF) to Indian Renewable Energy Development Agency Ltd (IREDA) would be provided for lending to viable renewable energy projects.
- The total plan outlay is estimated at USD10.05 billion for FY16 for the power sector.
- Tax benefits such as writing off R&D expenditure will be encouraged
- Spinning reserves have been created to meet peak load shortages and to achieve grid stability.
- Schemes like Deen Dayal Upadhyay Gram Jyoti Yojana(DDUGJY),Integrated Power Development Scheme (IPDS) and Ujwal DISCOM Assurance Yojana (UDAY) have been adopted to ensure power supply 24*7 across rural and urban areas.

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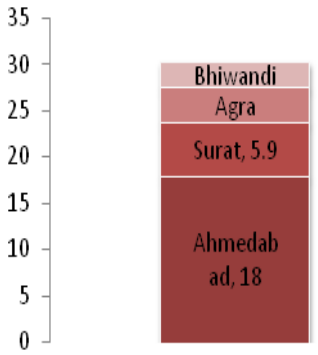
Torrent Power- Strong fundamentals, falling energy prices and favorable policies will drive growth

Torrent Power, integrated power utility of the Torrent Group, is one of the largest private sector players in India which generates, transmits and distributes power. It distributes power to around 3mn customers in Ahmedabad, Gandhinagar, Surat, Bhiwandi, Agra and Dahej SEZ. Torrent Power has around 3253MW capacity with a mix of coal, gas and renewable energy. The company has been successfully expanding its footprints and has one of the lowest T&D losses in India at 6.52% only.

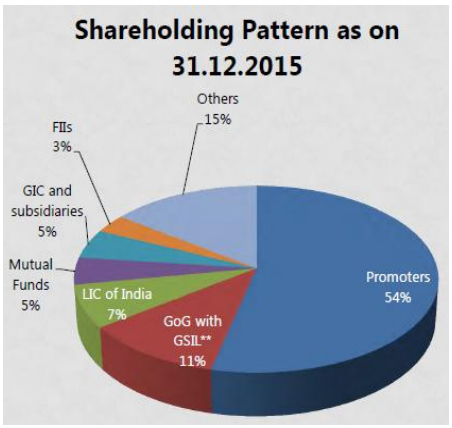
Market Cap	Rs 10453cr
CMP	Rs 216.5
52 Week High	Rs 246.9
52 Week Low	Rs 136.55

No of consumers (in lacs)



Healthy financials post the recent amalgamation: Torrent Power's Q3 revenues was up 19% YoY at Rs 3025 cr and net profit stood was Rs 372 cr vs Rs 68.8 cr last year. However, the results are not comparable as the company recently amalgamated its companies – Torrent Energy and Torrent Cables into one. Operating margin for the quarter stood at 23.95% as compared to 14.31% for the previous year period.

PLF and T&D losses are improving and one of the best among the power sectors: Torrent Power's PLF for SUGEN, UNOSUGEN and DGEN plants was 32.8%, 25% and 29% this quarter. The PLF will gradually push up further as the gas prices come down and supply bottlenecks get resolved. Recently, Petronet has contracted for a lower gas pricing with RasGas of Qatar. We expect this benefit to flow through to Torrent Power, thereby resulting in higher earnings. The transmission and distribution losses (T&D) have also improved at ~4.5% across Ahmedabad and Surat.

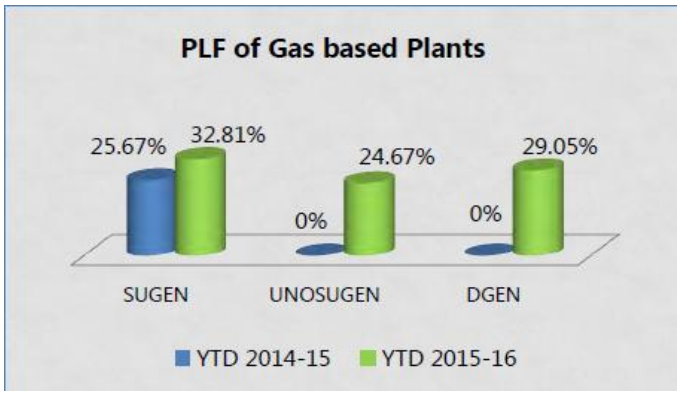


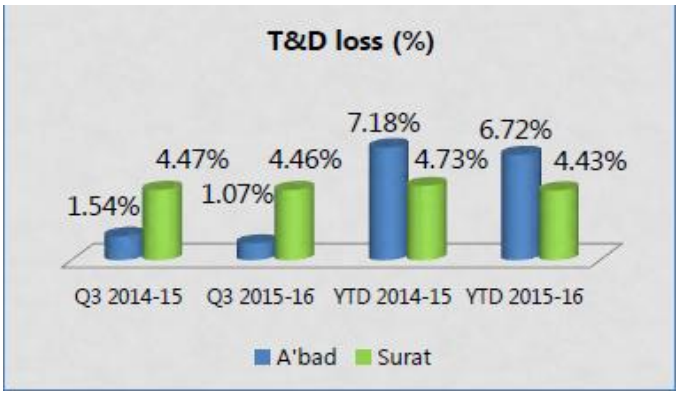
Expansion plans amid smart city launches and increasing domestic demand bode well: Torrent Power wants to expand its renewable energy portfolio from its current 101MW.The Company is also looking for Greenfields or Brownfield opportunities in the coal based generation space. The company has turned round its distribution franchise model in Bhiwandi and plans to extend it to other states. It also plans to expand its renewable energy portfolio as the demand for solar power is increasing.

We believe these expansion plans are net positive if implemented as there is huge unmet domestic demand due to power supply deficiency. The upcoming smart city plans offers great opportunities to power companies to gain market share and expand their business. Falling gas prices, lower interest rates, supporting government policies (as discussed above) all seems favorable for expansion plans at this moment.

According to the Bloomberg consensus, FY16E and FY17E EPS is much higher at 21 and 22 implying a forward P/E multiple of 10.5x in 2016 and 10.2x in 2017 respectively, much lower than the historical average of >20x times. So, with higher growth prospects and improving fundamentals the stocks appears at attractive valuations.

In Millions	2014	2015	2016E	2017E
Sales	86811	104225	116605	118509
Pre-tax Income	2749	7404	15169	15436
Profit	1053	3597	10519	11740
EPS	2	8	21	22
RoE	2	6	14	14
P/E	42	21	10.5	10.2





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