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Power Sector Update

CERC Power Tariff FY2020-24 Regulation

Central Electricity Regulatory Commission (CERC) has finally released the final regulations on the Power Tariff Regulation for FY2020-24. Final regulations favor promoting the economical drivers in the sector and has put to rest all the fears like regulated ROE being reduced for the sector by 1% amongst others. These regulations shall come into force on April 1, 2019, and unless reviewed earlier or extended by the commission, shall remain in force for a period of five years from FY2020-24. These regulations will be positive for the power sector and will benefit NTPC as the main concerns that the draft paper raised have been put to rest by the final regulation. Thus, while we are cautious on the power sector given the various concerns**, we maintain our BUY on NTPC as the stock provides a good opportunity; given its profitability is better insulated to industry dynamics. In addition, the stock at current valuations discount most of the concerns.**

CERC Power Tariff Regulation FY2020-24

Salient features for power Generators

- **Base ROE for Power generators remained same:** According to the regulation, return on equity (ROE) shall continue to be computed at the base rate of 15.50% for thermal generating station, transmission system including communication system and run-of river hydro generating station, and at the base rate of 16.50% for the storage type hydro generating stations including pumped storage hydro generating stations and run-of river generating station with pondage. This was against the draft paper, which indicated that RoE cut might be limited to 1% and that there will be different ROE for transmission vs. generation assets.

  The base rate of return on equity as allowed by the Commission under Regulation 30 of these regulations shall be grossed up with the effective tax rate of the respective financial year. For this purpose, the effective tax rate shall be considered on the basis of actual tax paid in respect of the financial year in line with the provisions of the relevant Finance Acts by the concerned generating company or the transmission licensee, as the case may be.

  The actual tax paid on income from other businesses including deferred tax liability (i.e. income from business other than business of generation or transmission, as the case may be) shall be excluded for the calculation of effective tax rate.

  Additionally, to enhance the productivity of the assets plants will have to ensure ramp rates of 1% per minute else, they will lose RoE of 0.25%. A higher than 1% ramp rate will earn 0.25% additional RoE, subject to a cap of additional 1%.

- **2-level structure for Power Tariff continues:** There is no change in the computation of the Capacity Charges (ROE, Interest on loan capital, Depreciation, Interest on working capital and O&M expenses) and Energy charges (Landed Fuel Cost of primary fuel Cost of secondary fuel oil consumption; and Cost of limestone or any other reagent, as applicable).

- Useful life for Hydro power plant has been increased to 40 years (from 35 years earlier).

- **Capacity Charges linked to a PAF of 85%, with some modification:** Full recovery of Capacity charges as long as PAF>85%; Recovery of capacity charge on seasonal basis and introduction of peak and off peak capacity charge. The capacity charge shall be recovered under two segments of the year, i.e. High Demand Season (period of three months) and Low Demand Season (period of remaining nine months), and within each season in two parts viz., Capacity Charge for Peak Hours of the month and Capacity Charge for Off-peak Hours of the month as follows. Availability will also be monitored for peak hours (4-hour) and non-peak hours (20-hour) of each day. Any gap in availability during high demand and peak periods will not be allowed to be recouped by higher availability during low demand and non-peak season. The recovery of fixed charge, which is based on availability of plants, has thus become stringent. The provisions under this regulation shall come into force with effect from FY2021.

  Till the Regulations comes into effect , the capacity charge for a thermal generating station determined under these regulations shall be recovered in accordance with the provisions contained in Regulations of the Central Electricity Regulatory Commission (Terms and Conditions of Tariff) Regulations, 2014, subject to the condition that the NAPAF and NAPLF shall be taken as specified under these regulations.

- **Debt: Equity for a power project still at 70:30:** For a project declared under commercial operation on or after April 1, 2019, the debt-equity ratio would be considered as 70:30 as on COD (Date of commercial operations). If the equity actually deployed is more than 30% of the capital cost, equity in excess of 30% shall be treated as normative loan provided that:
  - where equity actually deployed is less than 30% of the capital cost, actual equity shall be considered for determination of tariff:
  - The equity invested in foreign currency shall be designated in Indian rupees on the date of each investment:
  - Any grant obtained for the execution of the project shall not be considered as a part of capital structure for the purpose of debt: equity ratio.
  - provided that in case of a generating station or a transmission system including communication system which has completed its useful life as on or after 1.4.2019, if the equity actually deployed as on 1.4.2019 is more than 30% of the capital cost, equity in excess of 30% shall not be taken into account for tariff computation.

  The repayment for each of the year of the tariff period 2019-24 shall be deemed equal to the depreciation allowed for the corresponding year/period. In case of de-capitalization of assets, the repayment shall be adjusted by taking into account cumulative repayment on a pro rata basis and the adjustment should not exceed cumulative depreciation recovered upto the date of de-capitalisation of such asset. The rate of interest shall be the weighted average rate of interest calculated on the basis of the actual loan portfolio after providing appropriate accounting adjustment for interest capitalized.

Bank Rate for interest on working capital means the base rate of interest as specified by the State Bank of India from time to time or any replacement thereof for the time being in effect plus 350 basis points.

- **Working Capital norms Stringent:** Working capital receivable – 45 days, O&M - 1 month, cost of coal - 10 days for pithead, 20 days for non-pithead. This was against Working capital receivable - 2 months, O&M - 1 month, cost of coal - 15 days for pithead, 30 days for non-pithead.

- Financial gains to be shared because of controllable parameters (SHR, aux and secondary fuel oil cons) to be in 50:50 ratio between generator and consumers compared with 60:40 earlier.
- Sharing of gains related to restructuring of loans to be in the ratio of 50:50 between generators & consumers V/s 1:2 earlier.
- Depreciation charges would be charged on straight Line Method at specified rates higher for 12 years and at lower rate thereafter.

- **O&M expenses hike in line with draft:** Basic O&M expenses increased by 9-10% over FY2019, which is positive. Annual inflation in O&M allowance was, however, cut from the ~6.3% earlier to 3.5% mostly in line with the draft paper. The water charges and capital spares for thermal generating stations shall be allowed separately.

- The Special Allowance admissible to a generating station shall be @`9.5 lakh per MW per year for the tariff period 2019-24.
- Normative Annual Plant Availability Factor (NAPAF) all thermal generating stations, except those covered under specific provisions is 85%.

- **Gross Station Heat tweaked in a minor way :** Gross Station Heat Rate Existing Coal-based Thermal Generating Stations, other than those covered under clauses (ii) and (iii) is : for 200/210/250 MW Sets and 500 MW Sets (Sub-critical) sets 2430kCal/kWh and 2390 kCal/kWh respectively. For the generating stations having combination of 200/210/250 MW sets and 500 MW and above sets, the normative gross station heat rate shall be the weighted average gross station heat rate of the combinations. This is minor positive than earlier provisions.

- Auxiliary Energy Consumption for Thermal plants for 300/330/350/500 MW and above is ~8.0%.

- **Gross Calorie Value (GCV) Allowance:** CERC has provided the allowance of loss of 85kCal/GCV between unloading and firing point. Note that NTPC faced 5-6% under recovery on fuel due to from firing point to unloading point. The regulation is expected to remove entire under recovery because of fuel cost. This will enhance the net profit of the company by `800cr.

- Incentive linked to PLF> 85percentage; peak hours - 65 paise/Kwh & off peak hours - 50 paise/Kwh.

- **Older plants to continue to function:** In respect of a thermal generating station that has completed 25 years of operation from the date of commercial operation, the generating company and the beneficiary may agree on an arrangement, including provisions for target availability and incentive, where in addition to the energy charge, capacity charges determined under these regulations shall also be recovered based on scheduled generation. (2) The beneficiary shall have the first right of refusal and upon its refusal to enter into an arrangement as above, the generating company shall be free to sell the electricity generated from such station in a manner as it deems fit.

Thus, in case of plants that have completed their useful life and where regulated equity was more than 30% of project cost; will be reset to 30%. This affects NTPC for some of its old plants. However, the provision is significantly better than the draft tariff regulations, which had called for a write-off of regulated equity of old plants to ~5%. Though overall positive, it will be marginally negative as NTPC has some plants operating at 50:50 Debt: Equity.

Outlook

Overall, the regulations have not played out the fears that the draft mentioned and hence provided a relief to the sector; which is already plaguing with many concerns on the supply front; like oversupply of over, stressed assets, lack of fuel availability etc. Thus, with this regulation out, now the investment picture for investors and power companies is clear at least until FY2024. Currently we have a very cautious view on the space and have been recommending only NTPC as a good value pick, which has all the right levers to deliver returns to shareholders in the next 3-4 years. **Thus, with this regulation, the concern over reduction in the ROE and shutting down the older power plants which would have effected NTPC have been allied and the regulation in our estimate will enhance the EPS by 3-4% in FY2020. Hence, we reinforce our buy recommendation with a price target of `194.**

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DISCLAIMER

Disclosure of Interest Statement	**NTPC India**
1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period): *Buy (> 15%)* *Accumulate (5% to 15%)* *Neutral (-5 to 5%)* *Reduce (-5% to -15%)* *Sell (< -15)*