Utilities

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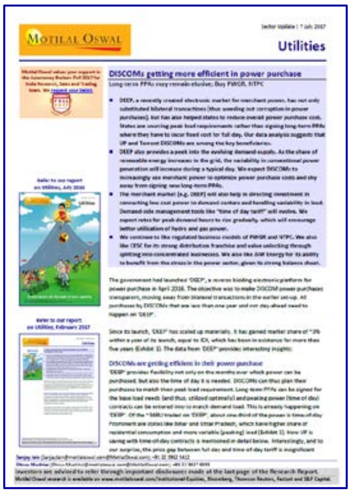
Sector Update | 19 September 2017

Utilities

Merchant power price spike – a nine-day wonder



Sector Update | 7 July 2017

Utilities

DISCOMs getting more efficient in power purchase

Seven things we learned at a conference on power distribution

We attended a conference on the power distribution sector organized by 'Powerline' on November 15-16, 2017. Our key takeaways:

1. **Dr Arun Kumar Verma, Joint Secretary, Ministry of Power highlighted increasing focus on strengthening distribution infrastructure, metering and improving financial health of DISCOMs.**
2. **Distribution network is getting strengthened on improved central funding.**
3. **Madhya Pradesh (MP), Maharashtra, Rajasthan and Andhra Pradesh (AP) have started supplying power round the clock. However, this has not boosted overall demand. Peak load has declined in MP after feeder separation. Metering and feeder-wise monitoring impacts consumption by freeloaders. These states also mentioned that they have sufficient long-term PPAs to meet demand growth over the next 2-3 years.**
4. **DISCOMs continue to discourage open access. However, they are wooing back industrial customers with lower tariff.**
5. **Political will has improved to tackle AT&C losses in some states.**
6. **There was little discussion on privatization of DISCOMs and carriage & content, as states are less enthusiastic about them.**
7. **The business model of distribution companies and the regulatory framework will have to evolve from content providers to solution providers. Home automation, energy services, load management will be some of the new service areas.**

We continue to like Power Grid and NTPC, being regulated, and offering strong earnings growth potential and good visibility. We also like CESC, as we see potential for value unlocking through demerger.

Emphasis on metering; carriage and content still some time away

Dr Arun Kumar Verma, Joint Secretary, Ministry of Power spoke about the increasing focus on distribution segment, metering, and carriage and content. The last critical link in power sector reforms in India is the distribution segment.

- The focus on DISCOMs' finances was never as intense as it is now. DISCOMs' losses are expected to decline by INR110b-120b in FY18 from ~INR430b in FY17. AT&C losses are expected to reduce from ~22% in FY16 to ~19% in FY19.
- There is now a lot of emphasis on large scale metering (EESL recently called bids for 50m meters). Flat rate billing (unmetered connections) is inefficient and leaves scope for leakages.
- Carriage and content requires getting all states on board, but the states are still not forthcoming. Proper functioning of carriage and content will also require a lot more investment in carriage (network).

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Distribution network getting strengthened on improved central funding

- There was general consensus at the conference that schemes like IPDS and DDUGJY have helped in improving the last-mile distribution network. It has become easier to get funds from the central government.
- Backend IT infrastructure is also getting attended to. Investment will continue in areas like distribution transformer metering, LT to HT line conversion, and feeder separation.

Power supply has improved in some states…

- Officials from the Madhya Pradesh (MP), Maharashtra, Rajasthan, and Andhra Pradesh (AP) DISCOMs mentioned that their DISCOMs are already supplying power round the clock to non-agriculture consumers.
- Agriculture too is getting supply for a good 8-10 hours every day. Supply disruption, if any, is due to technical faults and will decline over time, as the network is upgraded.

…but has not boosted demand in these states

- Large portion of the untapped demand in these states is already captured.
- Connecting the un-electrified households through schemes like Saubhagya would give some demand push, but the opportunity is small, in our view.

Improving compliance impacts demand

- Mr Kele mentioned that the peak demand declined by ~30% for MP DISCOM after feeder separation. Load management improved due to better control over agriculture supply.
- Mr RG Gupta of Jaipur (Rajasthan) DISCOM expects agriculture segment consumption to decline if all connections are metered and monitored. As compliance improves, consumption by freeloaders will take a hit.

These states have signed too many PPAs

These DISCOMs also mentioned that they have sufficient long-term PPAs to meet the demand growth over the next 2-3 years. We maintain our view that electricity demand growth is unlikely to exceed ~7% over the medium term and new long-term PPAs are unlikely, as the states have already signed enough PPAs.

Suggestions to tackle political and social menace in high-loss areas

Lack of political and social will have prevented DISCOMs from reducing AT&C losses, though key trouble areas are well understood. Many suggestions were made to handle this social menace to reduce AT&C losses.

- DISCOMs should publicize the high-loss areas, identifying them with the local political leaders.
- Linking Aadhar number and assigning credit score to bill payments can improve collection efficiency.

DISCOMs continue to discourage open access

DISCOMs continue to discourage open access to industrial customers, as they do not want to lose high-margin customers. Loss of revenue due to open access to high paying industrial customers was a common concern among officials from Rajasthan, Maharashtra and MP DISCOMs.

In the last couple of years, a number of states have introduced additional surcharge to discourage open access. The regulators also seem to be relatively supportive of this move. The increase in IEX short-term power prices and the additional surcharges have already made open access unviable for a lot of consumers. Even the group captive route (another form of open access) is being curbed. Maharashtra is working with Gujarat to stop the misuse of the group captive route.

However, they are wooing back industrial customers with lower tariff

DISCOMs are cognizant of their uneconomical tariff structure, particularly for industrial consumers, and of the need to bring them down. Industrial power tariffs in India are almost twice as high as in Europe.

- MP has started giving discounts to industrial consumers.
- Rajasthan is likely to reduce industrial tariffs next year.
- AP and Maharashtra are already providing selective relief.
- Punjab has recently announced a special relief.

Competitive tariffs can drive industrial demand and improve the financial health of DISCOMs.

Jaipur – a case of regulatory support, excellent execution and political will

Jaipur DISCOM (Rajasthan) has reduced its AT&C losses from 33% in FY16 to 20% in 1HFY18. It expects to reduce these further to ~15% in FY19. The gap between revenue and cost is expected to decline to 'nil' in FY18 from INR2.5/kWh in FY16. The DISCOM is expected to turn a profit of INR0.11/kWh in FY19. Such a significant turnaround has been possible by a combination of regulatory support, excellent execution, UDAY, and political will.

Regulatory support: Mr Vishvanath Hiremath, Chairman of the Rajasthan Electricity Regulatory Commission, has allowed significant tariff hikes in the last few years. He has tried to balance the need for tariff hikes and burden on consumer, pushed for timely filing of orders and data sanctity, ensured strict adherence to AT&C losses by DISCOMs, and amongst others, promoted consumer awareness through special cost allowances to DISCOMs.

Excellent execution: Mr RG Gupta, retired/former Chairman of the Rajasthan DISCOM, was recalled by the state government to improve the operations of Jaipur DISCOM. He has taken the following steps to improve the health of the DISCOM.

- Feeder responsibility: Each feeder is a profit center (there is a feeder-wise PL) and the person responsible is incentivized on achieving the targeted loss reduction. The feeder in-charge works engages with the panchayats for identifying high-loss areas. Each feeder acts as a mini DISCOM.
- DT (distribution transformer) metering is being done in urban areas.
- Increased vigilance.
- Use of technology for handling customer complaints, loss reporting.
- Franchise model for areas where losses are high.

Political will: Mr Gupta mentioned that the loss reduction in Jaipur DISCOM would not have been possible without political will. The chief secretary of the state is providing full support to ensure smooth functioning of the DISCOM and achieve the targeted goals.

Privatization – moving slow

There was little discussion on upcoming privatization opportunities. Odisha is looking for privatization in some of its circles, likely through the distribution franchisee route. Jaipur DISCOM is open for a franchisee or PPP model if it is not able to reduce losses.

It was highlighted that engaging and communicating with consumers is a must before a company gets aggressive in targeting the loss areas. For instance, replacing old meters with new/efficient meters (and thus, better energy accounting) results in higher bills, leading to backlash from consumers against private companies.

DISCOM model will evolve into service provider model

- The business model of distribution companies and the regulatory framework will have to evolve from content providers to solution providers, said Mr Sanjay Banga from Tata Power Delhi Distribution. Home automation, energy services, and load management will be some of the new service areas.
- The current regulatory framework does not allow distribution companies to own roofs. Hence, DISCOMs are unable to get into solar generation.
- Mr Kele from MP DISCOM mentioned that solar roof-top is already seeing a lot of traction in Indore.
- In its recent earnings conference call, Ujaas Energy, mentioned that though DISCOMs have started allowing net metering, the approval process is still lengthy. If net-metering smoothens, we believe there is immense scope for solar roof-tops in India, given the cross-subsidizing tariff structure.

Sector valuation

	Rating	CMP (INR)	TP (INR)	Up/ (dw) %	MCAP USD m	EPS			P/E (x)		P/B(x)		RoE (%)	
						FY17E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Powergrid	Buy	209	261	25	17,039	14.0	17.4	20.4	12.0	10.2	1.9	1.7	17.0	17.4
NTPC	Buy	180	211	17	23,153	12.0	13.4	15.7	13.4	11.5	1.4	1.3	11.0	11.9
JSW Energy	Sell	81	49	-39	2,067	3.9	3.4	2.7	23.8	29.9	1.3	1.2	5.3	4.2
CESC	Buy	1,016	1,360	34	2,090	51.9	89.1	102.1	11.3	9.9	1.2	1.0	10.7	11.1
Tata Power	Sell	92	72	-22	3,868	7.4	7.3	7.5	12.6	12.2	1.9	1.7	16.0	14.6
Coal India	Buy	278	335	20	27,395	14.9	17.5	20.7	15.9	13.5	6.7	6.4	43.4	48.9

Source: MOSL, Company

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