

# POWER

## Supreme Court: Clears the way for PPA renegotiation

India Equity Research | Power

The Supreme Court today gave its nod to Mundra-Adani Power (APL), CGPL-Tata Power (TPWR) and EPGL to approach CERC for amending their existing PPAs of ~8GW. This paves the way for renegotiation of PPAs, thereby allowing them to pass on the under-recoveries in fuel cost (INR0.80-0.90/unit). At this juncture, we retain our earnings and recommendations on APL (HOLD) & TPWR (BUY) and would revisit the same post clarity on the judgment's legal implications and CERC's final decision (expected in two months). We view this as a huge positive for resolution of the three assets and also for the beleaguered power sector as it can revive the sector's sentiments. Once approved and amended by CERC, target prices of APL and TPWR could swing positively by 25-30%. However, CERC's amendment could be challenged again in a court of law and is therefore a key monitorable.

### Burden to be shared by all stakeholders: Power committee

In July 2018, Gujarat government had constituted a High Power Committee (HPC) for addressing the challenges faced by APL Mundra, CGPL and EPGL. The committee's key recommendations include: a) full pass through of fuel cost on landed cost basis with a ceiling on imported coal price up to USD120/tonne; b) extension of PPA tenure by 10 years at the option of procurers; and c) lenders will have to take a haircut (~INR90bn) on existing loan, benefit of which will be passed on to consumers in the form of lower energy charge. All the proposed changes will be applicable prospectively. Another caveat is that power producers have to pass on the profit from Indonesian coal mining operations to discoms to the extent of coal supplied for operation of the Indian plants.

### How this ruling is different from the earlier one

The SC's ruling today based on the HPC's aforementioned recommendations **pertains to amendment of existing PPAs**. The SC's ruling in April 2017 related to **the change in the Indonesian coal regime and whether that invokes 'Change in Law' or 'force majeure' condition under the existing PPA structure or not**. The apex court had overruled the CERC/APTEL's ruling, which granted power producers compensatory tariff (on higher fuel costs) under the 'force majeure' conditions of the PPA. In the wake of SC ruling today, power producers and discoms would approach the CERC to seek amendments to their existing PPAs, which is likely to allow pass-through of fuel under-recoveries on the basis of the formula suggested by the HPC.

### Outlook: Big relief for TPWR and APL on Mundra plants

We perceive this as a big positive for the power sector, highlighting the government's commitment towards salvaging stressed power assets. TPWR and APL will of course be key beneficiaries of the outcome. In our SOTP-based valuation, we ascribe negative value of INR34 and INR5 to CGPL - TPWR ('BUY' with TP of INR87) and Mundra(I-III) - APL ('HOLD' with TP of INR25), respectively. Clarity is awaited on the road ahead and whether the judgment will be re appealed in the court post CERC's order.

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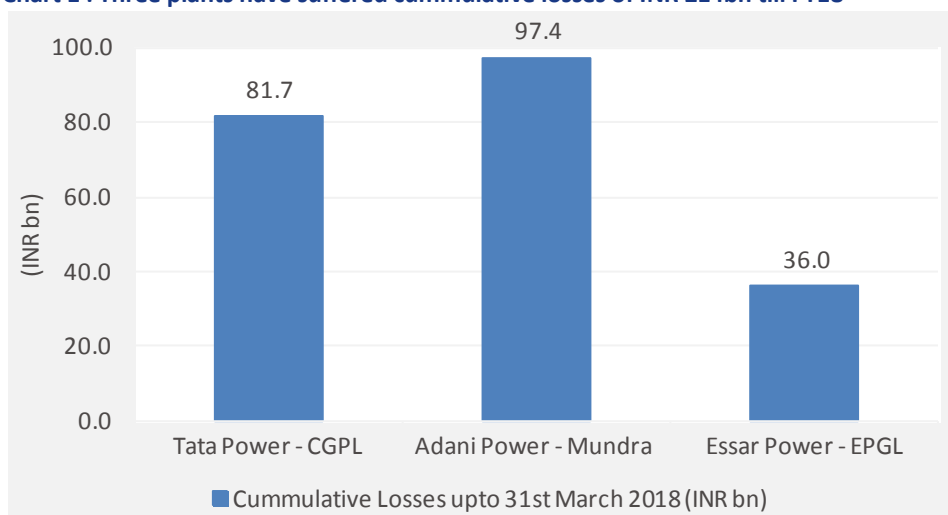
October 29, 2018

**Background of the case :**

- The three projects designed to run on imported coal were rendered economically unviable post change in coal pricing mechanism by the government of Indonesia effected in September 2011.
- The projects continued to supply electricity at PPA tariff in the INR1.3-2.0/kwh range against indicative fuel costs upwards of INR2.0/kwh on account of increase in Indonesian coal prices. Thus, they incurred significant fuel cost under-recovery since 2011.
- The CERC and APTEL granted relief under the ‘force majeure’ conditions of the PPA, granting compensatory tariff for under-recovery due to higher fuel cost.
- However, the Supreme Court overruled APTEL’s judgement in April 2017, clarifying that change in Indonesian regulations did not construe ‘Change in Law’ or ‘Force Majeure’ condition as per the existing PPA.
- Gujarat government intervened by constituting a HPC on July 3, which submitted a resolution mechanism for the three TPPs. HPC concluded that salvaging the projects is in the interest of consumers.

The committee consisted of Mr. R K Agrawal (former Justice Supreme Court), Mr. S S Mundra ( former Dy. Governor –RBI) and Mr. Pramod Kumar Deo (former Chairman-CERC).

**Chart 1 : Three plants have suffered cummulative losses of INR 214bn till FY18**



Source: Edelweiss research

**Table 1 : Gujarat draws about 4GW of power from the three power plants**

Company	Capacity (MW)	Configuration	Concerned states (PPA tie up - MW)				
			Gujarat	Haryana	Maharashtra	Punjab	Rajasthan
Tata Power - CGPL	4,000	(5x800)	1,805	380	760	475	380
Adani Power - Mundra	4,620	(4x330 + 5x660)	2,000	1,424			
Essar Power - EPGL	1,200	(2x600)	1,000				

Source: Industry, HPC Draft report, Edelweiss research

**Table 2 : Capacity charge for the plants ranges from INR 0.9-1.1/kwh**

Company	Capacity (MW)	PPA (MW)	Procurers	Capacity Charge (INR/kwh)
Tata Power - CGPL	4,150	3,800	Multiple States	0.90
Adani Power - Mundra	4,640	1,000	GUVNL	1.14
		1,000	GUVNL	1.00
		1,424	Haryana	1.08
Essar Power - EPGL	36.0	1,000	GUVNL	1.06

Source: Industry, HPC Draft report, Edelweiss research

**Table 3 : Under recovery on account of fuel cost is to the tune of INR0.7-0.9/kwh**

Company	PPA Variable cost (INR/kwh)	Tariff after actual cost pass through (INR/kwh)	Under-recovery (INR/kwh)
CGPL	1.60	2.37	0.77
APL-Phase III	1.62	2.58	0.96
APL-Phase I & II	1.85	2.67	0.82
EPGL	1.99	2.70	0.71

Source: Industry, HPC Draft report, Edelweiss research

#### Recommendations of HPC:

The recommendations of HPC are based on the principle of balancing of equities. The committee has proposed a resolution mechanism noting that the projects are instrumental in fulfilling the demand from procurer states. It further notes resolution will be in 'consumer interest' highlighting that procurement from alternate sources could be costlier than resolving the assets. HPC proposes for the burden of hardships to be borne by all the stakeholders (lenders, developers, consumers) to resolve the stressed plants. Some key recommendations are :

- Fuel costs to be made fully pass through on landed cost basis with projects not bearing any loss on account of fuel prices. However, the HPC proposes a ceiling on imported coal cost up to 120USD/MT beyond which the entire fuel risk will be borne by the generator. Ceiling price to be reviewed every five years.
- Reduction of capacity charge of INR0.2/kwh by reducing the project debt by lenders. The amount will be treated as a discount and is to be reduced from energy charge for purpose of merit order dispatch and billing. Proposed debt reduction – CGPL (INR42 bn), APML- (INR 32bn) and EPGL-(INR11bn).
- **The proposed plan to be applied prospectively:** Cut-off date for implementing the restructuring plan is set at October 1, 2018, and proposed recommendations will be applied prospectively. Past losses incurred by developers up to cut-off date will not be compensated.
- The state may relinquish tied up capacity to facilitate resolution in case the scheme recommended is not acceptable to any state.
- **Extension of PPA tenure by 10 years:** Procurers have the option to extend PPA on the same terms for further 10 years. Capital costs, if necessary, on renovation and modernisation applicable as per regulatory norms will be a pass through.
- **Tie up of free capacity:** Additional untied capacity to be offered to procurers at the capacity charge equal to levelised capacity charge in existing PPA without any discount.

- **Sharing of profit from Indonesian mines:** Developers to pass on 100% profit sharing from coal mining business in Indonesia attributable to coal supplied to their respective Indian plants.

#### Implications for Tata Power/APL:

TPWR and APL have suffered extensive losses on account of the Mundra plants' operations and any favourable outcome for the plants is a key positive for the companies. In our SOTP-based valuation, we ascribe negative value of INR34 and INR5 to CGPL-TPWR ('BUY' with TP of INR87) and Mundra(I-III) -APL ('HOLD' with TP of INR25), respectively.

HPC also recommends sharing of profits from Indonesian coal mining operations. TPWR, which has 30% stake in KPC/Bumi coal mines in Indonesia, will have to pass the profit from coal mining operations for coal supplied to CGPL. APL's coal mining operations are housed in Adani Enterprises and do not impact the former directly. While more clarity is awaited on the future action path on the ruling and CERC final tariff order, successful resolution of Mundra plants can be a key trigger for the stocks. At this juncture, we retain our earnings and recommendations on APL (HOLD) & TPWR (BUY) and would revisit the same post clarity on the judgment's legal implications and CERC's final decision (expected in two months).

**Table 4 : Tata Power SOTP**

Businesses	Method	Earnings / BV Equity/Reserves	RoE	CoE	Multiple	Valuation (INR mn)	Tata Share (%)	Tata Share (INR mn)	Per share (INR)
Regulated utility	P/B	40,222	18.0%	13.0%	1.61	64,748	100	64,748	24
Delhi Distribution	P/B	13,495	16.0%	13.0%	1.37	18,432	51	9,400	3
Power Links	P/B	4,848	16.0%	13.0%	1.37	6,622	51	3,377	1
Renewable/Overseas projects	P/B	10,875	16.0%	13.0%	1.37	14,854	100	14,854	5
Jobbera	P/B	5,000	19.0%	13.0%	1.70	8,500	100	8,500	3
Mundra UMPP	NPV				1.00	-91,264	100	(91,264)	(34)
DVC (Maithon)	P/B	14,320	18.0%	13.0%	1.25	17,900	74	13,246	5
Tata Steel IPP	P/B	7,881	18.0%	13.0%	1.45	11,428	74	8,457	3
KPC & Bumi	NPV at WACC of 7%					351,117	30.0%	<b>105,335</b>	<b>39</b>
Welspun Renewable	P/B	35,000	6.6%	13.0%	1.20	42,000	100	42,000	16
<b>Quoted investments</b>									
Total	At book value					18,409			7
Net Cash	BV							20,521	8
<b>Total</b>								<b>233,638</b>	<b>87</b>

Source: Edelweiss research

**Table 5 : Adani Power SOTP**

Unit	MW	Stake	NPV @ Ke 13% (INR mn)	INR / share
Mundra I & II	1,320	100%	(198)	(0)
Mundra III	1,320	100%	(17,594)	(5)
Mundra IV	1,980	100%	13,267	3
Tirora	1,980	100%	22,696	6
Tirora II	1,320	100%	23,915	8
Kawai	1,320	100%	26,706	7
Udupi	1,200	100%	15,553	4
<b>Total</b>	<b>10,440</b>		<b>84,345</b>	<b>25</b>

Source: Edelweiss research

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Adani Power, Adani Transmission, CESC, India Grid Trust, JSW Energy, NTPC, PTC India, Power Grid Corp of India, Tata Power Co, Adani Ports & SEZ, Gujarat Pipavav Port

#### Recent Research

Date	Company	Title	Price (INR)	Recos
22-Oct-18	<b>Power</b>	Winds of change in beleaguered power sector; <i>Sector Update</i>		
22-Oct-18	<b>NTPC</b>	Changing industry dynamics – NTPC in a sweet spot; <i>Visit Note</i>	165	Buy
08-Oct-18	<b>Power and Ports</b>	Power demand healthy; macro challenges add woes; <i>Sector Update</i>		

#### Distribution of Ratings / Market Cap

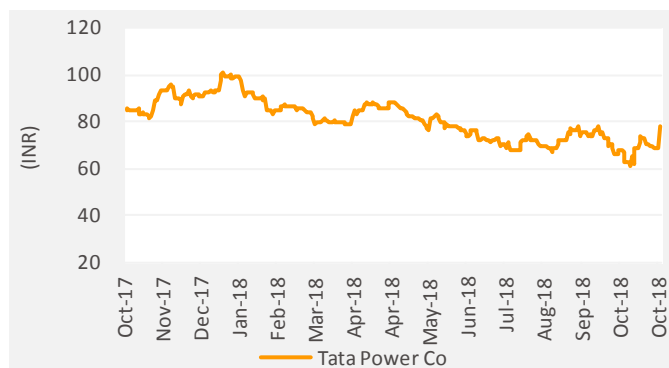
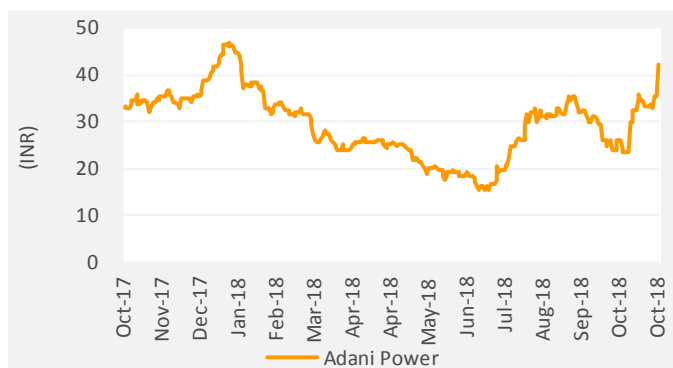
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	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

#### One year price chart



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