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Analysis	✓
Meeting Note	
News Impact	

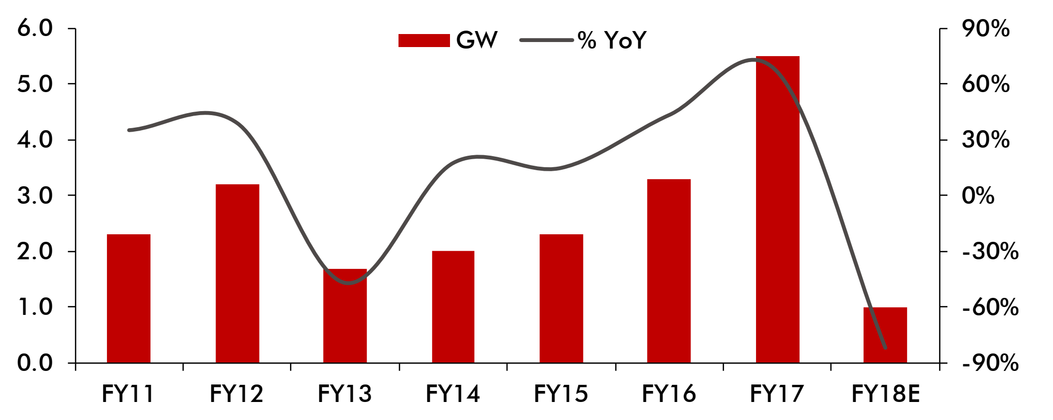
India Wind Power - Staging a comeback!

FY18 is proving to be a forgettable year for wind power with new capacity (1GW) expected to decline ~80% YoY. This is due to significantly low tariff in the wind auctions of Feb 2017 vs feed-in-tariff (FIT) regime. Hence, discoms postponed purchases to buy from auction-based plants. IPPs' interest in the auctions has been strong despite the low tariffs; our checks indicate >15% equity IRR despite the lower tariffs given significant decline in interest rate due to upfront PPAs, higher offtake visibility and new-age turbines that generate >30% PLF. We prefer IPPs (not many listed options but IPOs will come in 2HCY18); Tata Power is our top pick with installed renewable capacity of 2.1GW. Global renewables companies with similar size as Tata Power's trade at 1.5x FY19 P/B despite 6% RoE. Therefore, Tata Power's renewables portfolio should trade at much higher valuations given current RoE of 10%; we value it at Rs25/share (1x FY18E P/B) in our SOTP value of Rs129.

FY18 is a forgettable year for Indian wind power

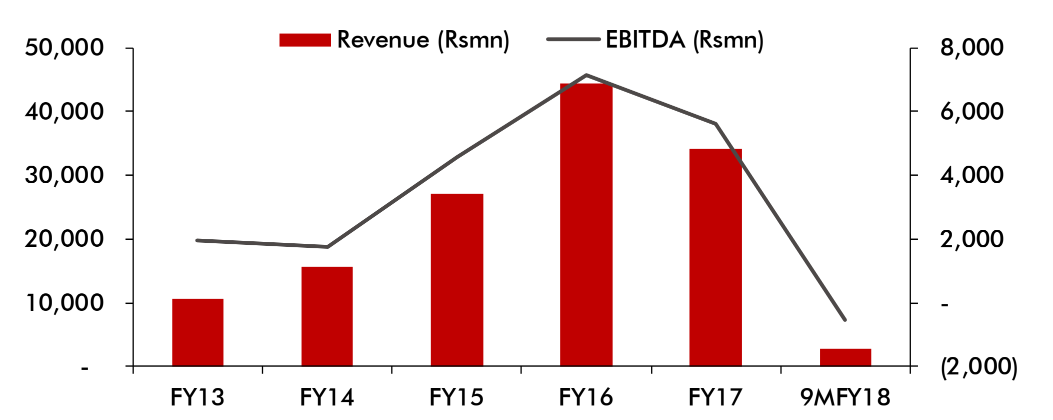
FY18 is likely to see ~80% YoY decline in new wind capacity as discoms almost stopped signing PPAs post Feb 2017 when tariff for projects to be set up in Tamil Nadu and Gujarat was discovered at Rs3.46/unit vis-a-vis the prevailing (FY17) state feed-in-tariff of Rs4.16/unit and Rs3.82/unit in Tamil Nadu and Maharashtra respectively. So, OEMs like Inox Wind faced a lot of cancellations in order books and resultantly Inox's 9MFY18 revenue declined to Rs2.7bn from Rs34bn in FY17.

Exhibit 1: FY18 will be a forgettable year for new wind capacity addition in India…



Source: Industry, Ambit Capital research

Exhibit 2: …and so is the case for Inox Wind



Source: Industry, Ambit Capital research

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CY19 will see inflection given strong auction pipeline

As against average per annum commissioning of 2.9GW over FY11-17, FY19 can witness a significant increase to ~5GW given the strong pipeline of 5.3GW built in the recent wind auctions (both State and Solar Energy Corporation of India, or SECI) in the last 12 months; auctions for another 2.5GW are likely in Mar 2018. Participation of IPPs is also strong, with the likes of Sembcorp, Renew Power, Torrent Power, Adani Green and Inox Wind emerging as the major winners in the SECI wind auctions.

Exhibit 3: Details of wind auctions held and pipeline

Auction flow	Month	Volume (MW)
SECI 1	February'17	1,050
Tamil Nadu	August'17	500
SECI 2	October'17	1,000
NTPC	November'17	250
Gujarat	December'17	500
SECI 3	February'18	2,000
Total (A)		**5,300**
SECI 4	March'18	2,000
Maharashtra	March'18	500
Gujarat	April'18 (500MW+500MW)	1,000
Total (B)		**3,500**
Grand Total (A+B)		**8,800**

Source: Industry, Ambit Capital research

Exhibit 4: Details of companies (IPPs) which emerged winners in the SECI-based wind auction

Companies	Auction 1	Auction 2	Auction 3	Total
Sembcorp Green Infra	250	250	300	800
Inox Wind	250	250	200	700
Renew Power	-	250	400	650
Torrent Power	-	-	500	500
Adani Green Energy	50	50	250	350
Alfanar	-	-	300	300
Ostro Energy	250	-	-	250
Mytrah	250	-	-	250
Orange Sironj	-	200	-	200
Betam Wind (Engie)		-	50	50
Total	**1,050**	**1,000**	**2,000**	**4,050**

Source: Industry, Ambit Capital research

The Power & New & Renewable Energy minister recently said that the Government is targeting wind auctions of 10GW each in FY19 and FY20. The key reasons why IPPs are keen to participate in the wind auctions are:

- **Upfront PPAs:** Unlike in the FIT regime, where construction of the wind project happened upfront and signing of the PPA after construction, in the wind auction scheme PPA signing is upfront (i.e. before start of construction) and that too for a long period of 25 years.

  An upfront PPA significantly reduces risks for projects, many of which were stranded after construction due to lack of PPAs. Banks significantly reduced interest rates to below 10% for funding these renewable projects. Both Tata Power and Sembcorp are paying interest rate less than 10%; investors have also lowered their return expectations given lower risks involved in the business. Alongside, as PPAs being signed upfront there is no longer dependence on regulatory incentives. Also, there is much better assurance of grid-connectivity with the central transmission utility (CTU) now.

Exhibit 5: Funding cost for Tata Power's renewable business is <10% as per our estimate

Rs mn unless specified	FY18E
Revenue	19,606
O&M expenses	824
EBITDA	18,782
Depreciation	4,004
EBIT	14,778
Interest	**7,878**
PBT	6,900
Tax (80IA tax benefit)	1,035
PAT	5,865
Outstanding debt	**80,929**

Source: Ambit Capital

- **Competitive tariff increases probability of discoms buying power:** Tariffs discovered in the auctions conducted so far have been very attractive (<Rs3/unit). This is even cheaper compared to tariffs from conventional sources like coal. NTPC's average tariff in 1QFY18/2QFY18/3QFY18 was higher, at Rs3.3/unit/Rs3.2/unit/Rs3.2/unit. This could be the reason why even incumbents like Sembcorp, Renew and Torrent Power are participating in bidding given higher probability of discoms buying power.

Exhibit 6: Wind tariff in auction are now cheaper…

Auction flow	Tariff (Rs/unit)	Month
SECI 1	3.46	February'17
Tamil Nadu	3.42	August'17
SECI 2	2.64	October'17
Gujarat	2.43	December'17
SECI 3	2.44	February'18
Maharashtra	2.85	March'18

Source: Industry, Ambit Capital research

Exhibit 7: …than NTPC's average tariff of Rs3.2/unit in 9MFY18

NTPC's average tariff	Tariff (Rs/unit)
1QFY18	3.3
2QFY18	3.2
3QFY18	3.2

Source: NTPC, Ambit Capital research

- **Discoms under SECI-backed PPAs are under obligation to offtake power:** Discoms have to give payment security to the IPP through a letter of credit equivalent to one month average billing and make a contribution to the payment security fund to support payment for at least three months of receivables. SECI has a right to invoke the letter of credit in the event the discoms delay payment or arbitrarily back down. This would put pressure on discoms to offtake power; both Tata Power's renewable portfolio and Sembcorp Green Infra (SGIL) renewable company report >15% PLF as most of their PPAs are SECI-backed and consequently report ~10% ROE.

Exhibit 8: Tata Power's renewable business should report 10% RoE in FY18…

Particulars	FY18E
Capacity (MW)	2,153
Revenue	19,606
EBITDA	18,782
PAT	5,865
Networth	58,345
ROE	**10.1%**

Source: Ambit Capital research

Exhibit 9: … so would SGIL

Particulars	Six months ended September 30, 2017
Capacity (MW)	927
Revenue	6,191
EBITDA	5,414
PAT	916
Networth	21,371
ROE (annualized)	**8.57%**

Source: DRHP, Ambit Capital research

Low wind tariff does not mean low RoE

Wind tariff as shown in the exhibit above has stopped declining since the Dec 2017 auctions. After a low of Rs2.43/unit in the Gujarat auctions in Dec 2017, the tariff discovered in the SECI auction in Feb 2018 was Rs2.44/unit; this increased to Rs2.85/unit in the Maharashtra state auctions in March.

There is a perception that RoE at such low tariff will be abysmal and possibly a few companies may also be incurring losses. However, this is not true given the main contributors to the decline in tariff is lower interest rates and rising PLF. As per our IRR model, project IRRs in the recently concluded wind auctions is 17.5% assuming 20% PLF and 10% interest rate. Cost of debt since the change in business model to auction-based bidding reduced to 9.5% from ~12% in the FIT regime. Quality of wind turbines has also significantly improved; Suzlon recently came up with a new S128 turbine which is available in variants of 2.6MW to 2.8MW and offers hub height of up to 140 metres. It has the largest-ever single rotor blade measuring 63 meters, offering 33% more swept area and generates 32% more power than the S111 turbine. Suzlon's S111 2.1MW turbine achieved 42% PLF in the first 12 months of operation at the Jamanwada site in Gujarat.

Exhibit 10: Sensitivity analysis (equity IRR to interest rate and PLFs) – wind IPPs should report >15% equity IRR despite lower tariff given lower interest cost and higher PLF

	Interest rate							
PLF	8.5%	9.0%	9.5%	10.0%	10.5%	11.0%	11.5%	12.0%
15%	11.1%	10.8%	10.5%	10.2%	10.0%	9.7%	9.4%	9.1%
20%	18.6%	18.3%	17.9%	17.5%	17.2%	16.8%	16.5%	16.1%
25%	26.3%	25.9%	25.4%	25.0%	24.6%	24.2%	23.7%	23.3%

Source: Ambit Capital research

CY18 to see several renewable IPOs; global renewable companies are trading at very attractive valuations

CY18 is likely to see the IPO of SGIL (filed DRHP recently) which has an installed renewables capacity of ~0.9GW with 0.8GW under construction. Tata Power may also come up with an IPO of Tata Power Renewables Energy (TPREL) in CY19; recently Tata Power did a restructuring whereby they carved out renewable assets into TPREL to make it a vehicle owning all the renewables assets. In a notice to the shareholders it mentioned that the rationale for the restructuring is to have a separate vehicle for renewable assets so as to allow fund raise through a private placement or an IPO.

Valuations of global renewables companies of similar size as TPREL and SGIL are very attractive despite single-digit RoE; even TPREL and SGIL have RoE of ~9%. Global renewables companies trade at 1.5x FY19 P/B despite average FY19 RoE of 6% as seen in the exhibit below.

If we apply the multiple (1.5x P/B) to TPREL's renewable portfolio, the valuation of the renewable business is Rs90bn vs the target valuation of Rs69bn of our SOTP-based TP of Rs129/share. Arguably, therefore, the valuation for TPREL should be higher than that of global peers given higher RoE of 10% and higher growth offered by the Indian renewables industry (the Government targets 175GW by FY22 vs 50GW now).

Exhibit 11: Global renewables companies with similar size trade at 1.5x FY19 P/B despite 6% RoE

Company	**Country**	**Capacity (MW)**	**Mcap (US$ mn)**	**P/B (x)**		**P/E (x)**		**RoE (%)**			**CAGR (FY17-19) (%)**	
				FY18	**FY19**	**FY18**	**FY19**	**FY17**	**FY18**	**FY19**	**Revenue**	**EPS**
Infigen Energy	Australia	557	533	1.2	1.1	20.5	14.2	8.5	3.5	8.0	9.4	4.3
Tilt Renewables	Australia	583	470	2.0	2.0	N.A	15.8	3.5	2.5	6.7	8.9	13.9
TerraForm Power	US	2,606	1,771	1.3	1.2	N.A	N.A	(33.0)	(3.0)	(0.9)	11.8	N.A
Pattern Energy	US	2,942	2,103	1.8	1.8	44.5	31.2	(1.7)	6.1	8.4	20.9	N.A
Average				**1.6**	**1.5**	**32.5**	**20.4**	**(5.7)**	**2.3**	**5.6**	**12.7**	**9.1**

Source: Bloomberg

Exhibit 12: Relative valuations of Indian utilities

Company	CMP	Mcap (US$ mn)	P/B (x)		P/E (x)		RoE (%)			CAGR (FY17-19) (%)	
			FY18	FY19	FY18	FY19	FY17	FY18	FY19	Revenue	EPS
CESC	966	1,971	1.2	1.1	12.6	10.4	6.5	10.6	11.5	11.1	33.4
KSK	10	68	NA	NA	NA	NA	-25.8	-39.5	-50.2	5.3	NA
JSPL	229	3,232	0.7	0.7	NA	20.4	-7.3	-3.1	3.6	33.5	NA
JP Power	7	600	NA	NA	NA	NA	-14.9	-9.8	-3.4	34.8	NA
NHPC	27	4,242	0.9	0.9	9.8	9.1	10.0	9.5	10.1	17.0	4.0
Adani Power	27	1,616	5.9	11.1	NA	NA	-118.0	-81.0	-85.6	4.8	NA
Torrent Power	251	1,855	1.6	1.5	13.3	10.8	6.4	12.6	14.1	6.2	61.2
NTPC	169	21,465	1.4	1.3	12.7	10.5	11.3	11.8	12.2	11.0	11.1
JSW Energy	78	1,974	1.2	1.1	17.4	14.5	6.3	6.9	7.7	6.7	18.3
Tata Power	80	3,340	1.3	1.1	15.4	9.9	10.1	8.6	12.1	-10.0	22.7
Sector median			**1.2**	**1.1**	**13.0**	**10.5**	**6.3**	**7.8**	**8.9**	**8.8**	**20.5**
Divergence with Tata Power			**4%**	**-2%**	**19%**	**-6%**	**3.8**	**0.8**	**3.2**	**-18.8**	**2.2**

Source: Bloomberg, Ambit Capital research

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