

Strategy

June 12, 2024

NTPC and PWGR are neither growth nor value stocks

We see NTPC and PWGR as two great examples of (1) the narrative nature of the Indian market and (2) use of wrong valuation methodologies to justify narratives. The market is super bullish on the electricity sector narrative, but overlooking that these companies' (1) earnings are linked to stock of assets, which will grow slowly and (2) valuations are super expensive.

Agree with the part about the need for new assets, but not with the narrative

We do not agree with the way investors are valuing NTPC and PWGR stocks, even as we agree with the view of new capacity creation in the power sector. One fundamental difference is that NTPC and PWGR are 'stock' stocks and their earnings growth depends on the growth in the stock of assets, unlike 'flow' stocks, where earnings growth depends on growth in revenues and profitability. We are keeping aside other relevant issues of (1) questionable terminal value of NTPC's thermal assets and (2) gradual shift in their business models to competitive low-RoE versus the current assured high-RoE businesses.

Growth is linked to asset or regulated equity

We expect fairly muted earnings growth of NTPC and PWGR (see Exhibit 1), as (1) their earnings growth is linked to the growth in their regulated equity base, which will depend on the addition of new assets and (2) their asset base will grow slowly over the next few years; see Exhibits 2-3 for gross block, new assets capitalization and regulated equity base for the past few years and FY2024-26E. It is obvious that capitalization of new assets cannot be very high relative to the total stock of assets.

Valuations are super expensive

In our view, the fair values of NTPC and PWGR are a lot lower than their current market prices. Their valuations (NTPC at 16X FY2025E EPS and PWGR at 18X FY2025E EPS) may look optically cheap relative to the market or other capital goods stocks and electricity plays, but the multiples are not low in the context of (1) low growth in earnings, as discussed above and (2) limited terminal value in the case of NTPC for most of its current asset base (thermal). In fact, valuations are quite stiff in the context of (1) P/B (NTPC trades at 2X FY2025E BV and PWGR at 3.2X FY2025E BV) and (2) adjusted P/B (removing cash and investments from market cap. and using regulated equity instead of reported equity), the most appropriate valuation methodology (see Exhibit 4). We note that end-FY2024 regulated equity of NTPC and PWGR stood at Rs89/share and Rs83/share, respectively.

Reverse valuation exercise highlights the extent of over-valuation

Our reverse valuation exercises for NTPC and PWGR (see Exhibits 5-6) show that (1) NTPC's stock price is discounting about 50-70 GW of new thermal capacity versus its end-FY2024 thermal capacity of 59 GW and (2) PWGR's stock price is discounting Rs2.6 tn of the additional asset base versus its end-FY2024 gross block of Rs2.8 tn. The implied assumptions are quite unrealistic.

Key estimates summary

	2024	2025E	2026E
Nifty estimates			
Earnings growth (%)	20.5	9.3	14.1
Nifty EPS (Rs)	993	1,092	1,248
Nifty P/E (X)	23.4	21.3	18.6
Macro data			
Real GDP (%)	8.2	6.9	6.5
Avg CPI inflation (%)	5.4	4.4	4.2

Source: Company data, Kotak Institutional Equities estimates

Quick Numbers

NTPC's regulated equity base to increase 6% over FY2025-27E

PWGR's regulated equity base to increase 19% over FY2025-27E

NTPC has already added 50-70 GW of new thermal capacity, according to the market

PWGR has already doubled its asset base, according to the market

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We expect fairly muted earnings growth of both NTPC and PWGR; growth in FY2025E, largely driven by higher other income

Exhibit 1: Earnings growth of NTPC and PWGR, March fiscal year-ends, 2019-27E

	2019	2020	2021	2022	2023	2024	2025E	2026E	2027E
NTPC									
Net profits (Rs bn)	126	116	161	167	169	208	223	244	262
EPS growth (%)	19.9	(8.2)	39.2	3.3	1.4	23.1	7.1	9.6	7.1
PWGR									
Net profits (Rs bn)	99	109	129	134	155	156	167	179	188
EPS growth (%)	22.9	10.1	18.3	4.1	15.4	0.6	6.9	7.3	5.1

Notes:

(a) The strong growth in FY2024 EPS for NTPC reflects large regulatory account deferral income and higher other income.

Source: Companies, Kotak Institutional Equities estimates

We assume capitalization of Rs963 bn over FY2025-27E versus end-FY2024 gross block of Rs3.7 tn

Exhibit 2: Key assumptions of NTPC, March fiscal year-ends, 2020-27E

	2021	2022	2023	2024	2025E	2026E	2027E
Capex (Rs bn)	357	291	275	337	340	226	296
Capitalization (Rs bn)	367	355	294	353	392	182	389
Gross block (Rs bn)	2,735	3,090	3,384	3,737	4,009	4,071	4,260
Regulated equity (Rs bn)	663	709	776	877	909	909	928
Growth rate (%)							
Capex		(18)	(6)	23	1	(33)	31
Capitalization		(3)	(17)	20	11	(54)	113
Regulated equity	7	7	10	13	4	—	2

Notes:

(a) We model gradual ramp up in thermal capacity and steady ramp up in renewable capacity.

(b) Our projections for capex and capitalization consider projects currently under construction only. Management believes it will likely maintain a capex run-rate of Rs350-400 bn on the basis of new projects for coal and renewable power that it will win/tender out.

Source: Companies, Kotak Institutional Equities estimates

We assume capitalization of Rs630 bn over FY2025-27E versus end-FY2024 gross block of Rs2.6 tn on standalone basis

Exhibit 3: Key assumptions of Power Grid, March fiscal year-ends, 2020-27E

	2021	2022	2023	2024	2025E	2026E	2027E
Capex (Rs bn)	117	91	92	125	219	229	260
Standalone	86	44	53	63	191	208	230
TBCB	31	46	40	62	27	21	30
Capitalization (Rs bn)	216	207	74	76	161	204	230
Standalone	196	151	45	40	127	180	200
TBCB	20	56	29	36	34	24	30
Gross block (Rs bn)	2,415	2,627	2,701	2,760	2,963	3,164	3,404
Standalone	2,343	2,500	2,558	2,588	2,733	2,913	3,113
TBCB	72	128	143	172	232	256	286
Regulated equity (Rs bn)	696	743	761	775	813	867	927
Growth rate (%)							
Capex	(24)	(22)	2	36	75	5	13
Capitalization	18	(4)	(64)	3	111	27	13
Regulated equity	9	7	2	2	5	7	7

Source: Companies, Kotak Institutional Equities estimates

NTPC and PWGR trade at expensive valuations on a regulated equity base

Exhibit 4: Valuations of NTPC and PWGR on a regulated equity base, March fiscal year-end, 2025E (X)

	NTPC	PWGR
Current market cap. (Rs bn)	3,601	3,019
FY2025E cash and investments (Rs bn)	186	155
FY2025E value of subsidiaries (Rs bn)	379	–
Implied value of regulated business (Rs bn)	3,036	2,865
FY2025E regulated equity (Rs bn)	909	967
Adjusted P/B on regulated book (X)	3.3	3.0

Source: Companies, Kotak Institutional Equities estimates

NTPC has already added 50-70 GW of incremental thermal capacity, according to the market

Exhibit 5: Implied capacity of NTPC, March fiscal year-end, 2025E (GW)

	P/B for regulated equity (X)		
	1.25	1.5	1.75
Current market cap. (Rs bn)	3,601	3,601	3,601
FY2025E cash and investments (Rs bn)	186	186	186
FY2025E value of subsidiaries	379	413	482
FY2025E regulated equity (Rs bn)	909	909	909
Value of extant assets @ 1.25, 1.5 or 1.75X regulated equity	1,136	1,364	1,591
Fair value of extant business, cash and investments	1,701	1,962	2,259
Implied market capitalization of new capacities (Rs bn)	1,900	1,638	1,342
Cost/GW of new thermal capacity (Rs bn)	70	70	70
Implied new thermal capacity @ 70:30 debt/equity (GW)	72	52	37

Source: Company, Kotak Institutional Equities estimates

PWGR has already doubled its asset base, according to the market

Exhibit 6: Implied regulated equity of PWGR, March fiscal year-end, 2025E (GW)

	P/B for regulated equity (X)		
	1.4	1.6	1.8
Current market cap. (Rs bn)	3,019	3,019	3,019
FY2025E cash and investments (Rs bn)	155	155	155
FY2025E regulated equity (Rs bn)	967	967	967
Value of extant assets @ 1.4, 1.6 or 1.8X regulated equity	1,354	1,548	1,741
Fair value of extant business, cash and investments	1,509	1,702	1,896
Implied market capitalization of new assets (Rs bn)	1,510	1,317	1,123
Implied incremental regulated equity base (Rs bn)	1,079	823	624
Implied incremental asset base (Rs bn)	3,596	2,744	2,081

Source: Company, Kotak Institutional Equities estimates

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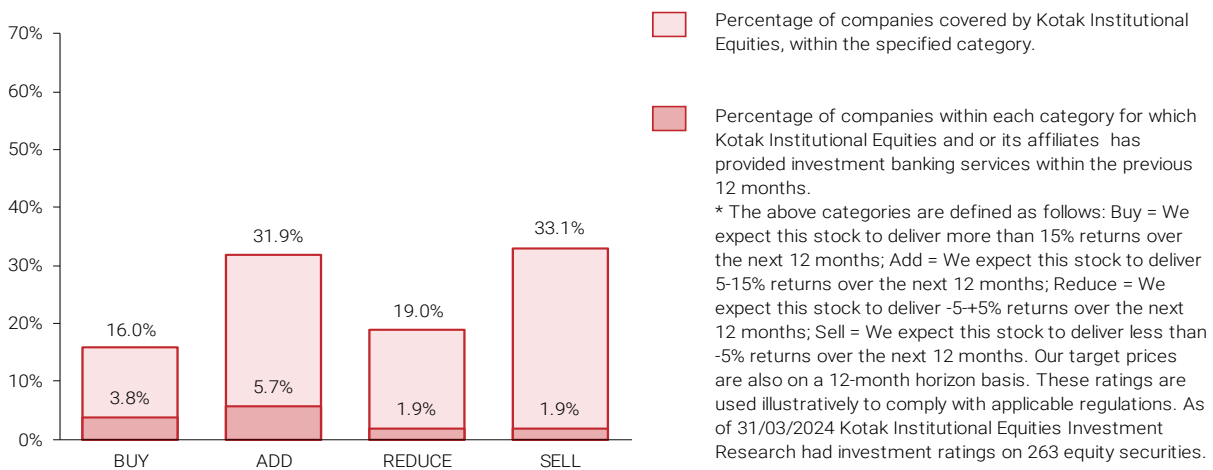
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