

18 March 2024

India | Equity Research | Sector Update

Power

Tariff regulation FY24-FY29: A benign regime

CERC has finalised the tariff regulations for FY24-FY29. The regulator has largely maintained the RoE for existing thermal, hydro and transmission assets while incentivising new hydro assets with 17% RoE and reduced the RoE for new transmission assets to 15%. There are no material changes in the final order versus the draft order, except a few: 1) Thermal – incentive of INR 0.55/unit for off peak (vs. 50p/unit for off – peak earlier). 2) Transmission – minor changes in O&M expenses. 3) Hydro – relaxed normative availability norms for certain plants. The new regulations are beneficial for thermal gencos owing to higher renovation and maintenance cost, higher incentive for off-peak supply, and hydro gencos for higher RoE on new assets, but slightly negative for NLC TPS-II as normative PAF has been increased to 70% (vs. 50% in draft).

Tariff regulations for FY24-FY29 finalised

CERC has finalised the tariff regulations for FY24–FY29. These regulations are applicable to all cost plus generation and transmission assets. This is the sixth tariff regulations (prior regulations – 2001, 2004, 2009, 2014, 2019) and one of the most benign till date. All previous regulations had tried to tighten operational and financial norms, impacting the sector negatively.

No material changes in final order compared to draft order

From the draft regulations revealed in early-Jan'24, the regulator has now introduced the final order with only a few tweaks, mainly: 1) Thermal – incentive of INR 0.75/unit for peak supply and INR 0.55/unit for off-peak (vs. 50p/unit for off-peak earlier). 2) Transmission – minor changes in the O&M expenses for AC and HVDC lines. 3) Hydro – relaxed normative availability norms for a few plants and reduced O&M expense.

Key aspects of the regulations

Key aspects of the new regulations include: 1) Thermal RoE at 15.5% for existing and new thermal assets. 2) Hydro RoE at 16.5% and 17% for existing and new hydro assets, respectively. 3) Transmission RoE at 15.5% and 15% for existing and new transmission assets, respectively.

Positive development across the board

Tariff regulations have historically been an overhang on the sector in anticipation of incremental tightening of operational and performance norms. However, the new regulations have abstained from any significant tightening; it also incentivises new hydro assets with a higher RoE and reduces RoE on new transmission assets (large chunk of new transmission assets are being executed through bid-based mechanism).

View

The new regulations are beneficial for thermal generation companies owing to the higher R&M allowed for older plants, higher incentives for coal-based power plants and removal of seasonal availability norms. It is also a positive for hydro generation companies given higher RoE for new hydro assets. That said, regulations may have a slightly negative bearing on transmission companies owing to the lower RoE ascribed to new transmission assets and O&M costs. Separately, NLC TPS-II normative PAF has been hiked to 70% (vs. 50% in the draft).

Mohit Kumar

kumar.mohit@icicisecurities.com
+91 22 6807 7419

Nikhil Abhyankar

nikhil.abhyankar@icicisecurities.com

Exhibit 1: Tariff regulations for thermal assets

| Particulars | Final regulations 2019 | Draft Regulations 2024 | Final regulations 2024 |
|---|---|---|---|
| Capacity Charge | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense) |
| Energy charges | Recovery of fuel cost (primary fuel cost and secondary fuel oil cost) | Recovery of fuel cost (primary fuel cost and secondary fuel oil cost) | Recovery of fuel cost (primary fuel cost and secondary fuel oil cost) |
| Return on equity | 15.5% (with no additional return on early completion) | 15.5% (with no additional return on early completion) | 15.5% (with no additional return on early completion) |
| Tax on RoE | Income tax grossed up but recoverable on actuals | Income tax grossed up but recoverable on actuals | Income tax grossed up but recoverable on actuals |
| Interest on loan | Gross normative loan @ 70% with depreciation = repayment | Gross normative loan @ 70% with depreciation = repayment | Gross normative loan @ 70% with depreciation = repayment |
| Depreciation | Straight Line Method at specified rates; higher for 12 years and at lower rate thereafter | Straight Line Method at specified rates; higher for 12 years and at lower rate thereafter | Straight Line Method at specified rates; higher for 12 years and at lower rate thereafter |
| Interest on working capital | State Bank of India MCLR + 300 bps | State Bank of India MCLR + 325 bps | State Bank of India MCLR + 325 bps |
| Base O&M expense | Increased by 8-10% over FY19 | Increased by 6-7% over FY23 | Increased by 6-7% over FY23 |
| Escalation in O&M expense | O&M expenses escalated at 3.5% | O&M expenses escalated at 5.86% | O&M expenses escalated at 5.86% |
| Normative PAF | 85% on seasonal basis (two seasons) | 85% on annual basis | 85% on annual basis |
| Payment of capacity charge (CC) | Full recovery of CC as long as PAF>83%; Recovery of capacity charge on seasonal basis and Introduction of peak and off peak capacity charge | Full recovery of CC as long as PAF>83%; Recovery of capacity charge on seasonal basis and Introduction of peak and off peak capacity charge | Full recovery of CC as long as PAF>83%; Recovery of capacity charge on seasonal basis and Introduction of peak and off peak capacity charge |
| Incentive | Incentive linked to PLF> 85%; peak hours - 65 paise/Kwh & off peak hours - 50 paise/Kwh | Incentive linked to PLF> 85%; peak hours - 75 paise/Kwh & off peak hours - 50 paise/Kwh | Incentive linked to PLF> 85%; peak hours - 75 paise/Kwh & off peak hours - 55 paise/Kwh |
| Interest on working capital | Working capital receivable - 45 days, O&M - 1 month, cost of coal - 10 days for pithead, 20 days for non-pithead | Working capital receivable - 45 days, O&M - 1 month, cost of coal - 10 days for pithead, 20 days for non-pithead | Working capital receivable - 45 days, O&M - 1 month, cost of coal - 10 days for pithead, 20 days for non-pithead |
| Financial gains to be shared on account of controllable parameters (SHR, aux and secondary fuel oil cons) | 50:50 between generator and consumer | 50:50 between generator and consumer | 50:50 between generator and consumer |
| Blending of coal | Prior permission if energy charge >30% of base charge or >20% of previous month, whichever is lower | | |
| Reduction of equity for older power plants | No provision for reduction in equity | | |
| Water charges | Additional recovery separately | Additional recovery separately | Additional recovery separately |
| Security expenses | Additional recovery separately | Additional recovery separately | Additional recovery separately |
| GSHR of existing station | 200/210/250MW sets - 2430 Kcal/Kwh and 500MW sets - 2390Kcal/kwh | 200/210/250MW sets - 2400 Kcal/Kwh and 500MW sets - 2375Kcal/kwh | 200/210/250MW sets - 2415 Kcal/Kwh and 500MW sets - 2375Kcal/kwh |
| GSHR of new station | 1.05* Design heat rate | 1.05* Design heat rate | 1.05* Design heat rate |
| SFO consumption | 0.5 ml/Kwh | 0.5 ml/Kwh | 0.5 ml/Kwh |
| Aux energy cons for 300/330/500MW & above | 8.00% | Steam driven boiler feed pumps - 5.25%; Electrically driven boiler feed pumps 8% | Steam driven boiler feed pumps - 5.25%; Electrically driven boiler feed pumps 8% |
| Sharing of gains related to restructuring of loans | 50:50 with consumer | 50:50 with consumer | 50:50 with consumer |
| Late payment surcharge | 1.50% per month (applicable from 45 days) | As per LPS Rules Mar-22 | As per LPS Rules Mar-22 |

Source: CERC tariff regulations

Exhibit 2: Tariff regulation for transmission assets

| Particulars | Final regulations 2019 | Draft Regulations 2024 | Final Regulations 2024 |
|--|---|---|---|
| Capacity Charge | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) |
| AC System | Recovery of capacity charge at 98% availability | Recovery of capacity charge at 98% availability | Recovery of capacity charge at 98% availability |
| DC System | Recovery of capacity charge at 95% availability | Recovery of capacity charge at 95% availability | Recovery of capacity charge at 95% availability |
| Return on equity | 15.5% pre-tax with grossing up (with additional return of 0.5% on timely completion) | 15.5% pre-tax with grossing up (with additional return of 0.5% on timely completion); New projects at 15% | 15.5% pre-tax with grossing up (with additional return of 0.5% on timely completion); New projects at 15% |
| O&M expenses | 8-10% increase in base O&M expenses | 8-10% increase in base O&M expenses | 8-10% increase in base O&M expenses |
| Security expenses | Additional recovery separately | Additional recovery separately | Additional recovery separately |
| Interest on working capital | Working capital receivable - 2 months, O&M - 1 month and Maintenance Spared @15% of O&M | | |
| Incentive | | | |
| HVDC | Over and above benchmark of 98.5% | Over and above benchmark of 98.5% | Over and above benchmark of 98.5% |
| HVAC | Over and above benchmark of 96% | Over and above benchmark of 96% | Over and above benchmark of 96% |
| Sharing of gains related to restructuring of loans | 50:50 with consumer | 50:50 with consumer | 50:50 with consumer |
| Late payment surcharge | 1.50% per month (applicable from 45 days) | As per LPS Rules Mar-22 | As per LPS Rules Mar-22 |

Source: CERC tariff regulations

Exhibit 3: Tariff regulations for Hydro assets

| Particulars | Final regulations 2019 | Draft Regulations 2024 | Final Regulations 2024 |
|--|---|---|---|
| Annual fixed cost (AFC) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) | Recovery of annual fixed cost (RoE, interest, depreciation, interest on working capital, O&M expense, cost of secondary fuel) |
| Capacity Charge | 50% AFC recoverable on normative availability | 50% AFC recoverable on normative availability | 50% AFC recoverable on normative availability |
| Energy Charge | 50% AFC recoverable on generation of design energy | 50% AFC recoverable on generation of design energy | 50% AFC recoverable on generation of design energy |
| Return on equity | 16.5% for hydro station with pondage otherwise 15.5% | 16.5% for hydro station with pondage otherwise 15.5%; 17% for new projects | 16.5% for hydro station with pondage otherwise 15.5%; 17% for new projects |
| Water expenses | Recovery separately | Recovery separately | Recovery separately |
| Security expenses | Additional recovery separately | Additional recovery separately | Additional recovery separately |
| Interest on working capital | Working capital receivable - 2 months, O&M - 1 month and Maintenance Spared @15% of O&M | Working capital receivable - 2 months, O&M - 1 month and Maintenance Spared @15% of O&M | Working capital receivable - 2 months, O&M - 1 month and Maintenance Spared @15% of O&M |
| Incentive | | | |
| Over recovery on PAF Higher than Design energy | Over and above benchmark plant wise Over and above design energy; energy charge @120ps/kwh > design energy | Over and above benchmark plant wise Over and above design energy; energy charge @120ps/kwh > design energy | Over and above benchmark plant wise Over and above design energy; energy charge @120ps/kwh > design energy |
| Sharing of gains related to aux | 50:50 with consumer | 50:50 with consumer | 50:50 with consumer |
| Sharing of gains related to restructuring of loans | 50:50 with consumer | 50:50 with consumer | 50:50 with consumer |
| Late payment surcharge | 1.50% per month (applicable from 45 days) | 1.50% per month (applicable from 45 days) | 1.50% per month (applicable from 45 days) |

Source: CERC tariff regulations

"In case of industry/sector reports or a report containing multiple stocks, the rating/recommendation for a particular stock may be based on the last released stock specific report for that company."

This report may be distributed in Singapore by ICICI Securities, Inc. (Singapore branch). Any recipients of this report in Singapore should contact ICICI Securities, Inc. (Singapore branch) in respect of any matters arising from, or in connection with, this report. The contact details of ICICI Securities, Inc. (Singapore branch) are as follows: Address: 10 Collyer Quay, #40-92 Ocean Financial Tower, Singapore - 049315, Tel: +65 6232 2451 and email: navneet_babbar@icicisecuritiesinc.com, Rishi_agrawal@icicisecuritiesinc.com.

"In case of eligible investors based in Japan, charges for brokerage services on execution of transactions do not in substance constitute charge for research reports and no charges are levied for providing research reports to such investors."

New I-Sec investment ratings (all ratings based on absolute return; All ratings and target price refers to 12-month performance horizon, unless mentioned otherwise)
BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

ANALYST CERTIFICATION

I/We, Mohit Kumar, MBA; Nikhil Abhyankar, Masters in Finance; authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of the ICICI Securities Inc. It is also confirmed that above mentioned Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months and do not serve as an officer, director or employee of the companies mentioned in the report.

Terms & conditions and other disclosures:

ICICI Securities Limited (ICICI Securities) is a full-service, integrated investment banking and is, inter alia, engaged in the business of stock brokering and distribution of financial products. Registered Office Address: ICICI Venture House, Appasaheb Marathe Marg, Prabhadevi, Mumbai - 400 025. CIN: L67120MH1995PLC086241, Tel: (91 22) 6807 7100. ICICI Securities is Sebi registered stock broker, merchant banker, investment adviser, portfolio manager, Research Analyst and Alternative Investment Fund. ICICI Securities is registered with Insurance Regulatory Development Authority of India Limited (IRDAI) as a composite corporate agent and with PFRDA as a Point of Presence. ICICI Securities Limited Research Analyst SEBI Registration Number – INH000000990. ICICI Securities Limited SEBI Registration is INZ000183631 for stock broker. ICICI Securities AIF Trust's SEBI Registration number is IN/AIF3/23-24/1292 ICICI Securities is a subsidiary of ICICI Bank which is India's largest private sector bank and has its various subsidiaries engaged in businesses of housing finance, asset management, life insurance, general insurance, venture capital fund management, etc. ("associates"), the details in respect of which are available on www.icicibank.com.

ICICI Securities is one of the leading merchant bankers/ underwriters of securities and participate in virtually all securities trading markets in India. We and our associates might have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. ICICI Securities and its analysts, persons reporting to analysts and their relatives are generally prohibited from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

Recommendation in reports based on technical and derivative analysis centre on studying charts of a stock's price movement, outstanding positions, trading volume etc as opposed to focusing on a company's fundamentals and, as such, may not match with the recommendation in fundamental reports. Investors may visit icidirect.com to view the Fundamental and Technical Research Reports.

Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

ICICI Securities Limited has two independent equity research groups: Institutional Research and Retail Research. This report has been prepared by the Institutional Research. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, and target price of the Retail Research.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on a reasonable basis, ICICI Securities is under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities might be acting in an advisory capacity to this company, or in certain other circumstances. This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and shall not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return on investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities accepts no liabilities whatsoever for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

ICICI Securities or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction.

ICICI Securities or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the companies mentioned in the report in the past twelve months.

ICICI Securities encourages independence in research report preparation and strives to minimize conflict in preparation of research report. ICICI Securities or its associates or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither ICICI Securities nor Research Analysts and their relatives have any material conflict of interest at the time of publication of this report.

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

ICICI Securities or its subsidiaries collectively or Research Analysts or their relatives do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

Since associates of ICICI Securities and ICICI Securities as a entity are engaged in various financial service businesses, they might have financial interests or actual/ beneficial ownership of one percent or more or other material conflict of interest in various companies including the subject company/companies mentioned in this report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Neither the Research Analysts nor ICICI Securities have been engaged in market making activity for the companies mentioned in the report.

We submit that no material disciplinary action has been taken on ICICI Securities by any Regulatory Authority impacting Equity Research Analysis activities.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

This report has not been prepared by ICICI Securities, Inc. However, ICICI Securities, Inc. has reviewed the report and, in so far as it includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.

Investment in securities market are subject to market risks. Read all the related documents carefully before investing.

Registration granted by SEBI and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors. None of the research recommendations promise or guarantee any assured, minimum or risk free return to the investors.

Name of the Compliance officer (Research Analyst): Mr. Atul Agrawal, Contact number: 022-40701000, **E-mail Address** : complianceofficer@icicisecurities.com

For any queries or grievances: Mr. Prabodh Avadhoot Email address: headservicequality@icicidirect.com Contact Number: 18601231122
