# Morgan Stanley downgrades major thermal power players

## Except Tata Power, others in the sector 'likely to see disruption from renewables'

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In its recently released report, 'Renewable Energy: What Cheap, Clean Energy Means for Global Utilities', , Morgan Stanley downgraded its industry view of India Utilities to 'In-Line' from 'Attractive' as renewable energy is bringing major disruption to India's thermal power sector.

### Pressure on earnings

"We believe we are amidst a first phase of disruption (renewables at grid parity), and that over the next 12-18 months the earnings and multiples of merchant players (JSWE) and utilities with PPAs in place (NTPC and APWR) are likely to come under pressure," the report notes.

The second phase of disruption, it adds, will likely commence as battery storage costs reach grid parity. In this phase, there is risk of coal-based contracts being renegotiated.

The third and final phase, according to Morgan Stanley, will come after existing long-term contracts and PPAs expire, which is in the range of 15-20 years.

As the cost of solar power has fallen significantly in India, with some of the recent auctions seeing tariff bids as low as ₹2,44 a unit — cheaper than any other form of power generation — India has emerged the fastest-growing solar market in the world through 2020.

Although the government's ambitious target to achieve 160 GWT solar and wind capacity by 2022 might not be realistic (Morgan Stanley projects 32GW of solar and 11GW of incremental wind capacity likely to be commissioned by 2022), this is still three times more than the current solar installed base (of 12.3GW with around 5GW added in the last fiscal year alone).

### Fall in solar power tariff

While experts generally attribute fall in solar power tariffs to high competitiveness in the market, sharply declining cost of inputs (solar modules mainly) as well as cost of financing (with most players being able to raise funds outside India) are other reasons, to mention a few.

"While industry players and experts still debate around the sustainability of the recent solar bids and the underlying assumption, it is clear that over the next few years, the State electricity boards will think hard before signing even short- or medium-term (3-10 years) coal-based PPAs given that solar has achieved grid parity and PPAs using domestic coal always face inflation risk," Morgan Stanely notes.

### Upgrades

According to Morgan Stanley, two large power sector players in India are positively exposed to the growth of cheap renewables.

Morgan Stanley upgraded Tata Power from 'Equal-weight' to 'Overweight' pointing out that the company is relatively well-positioned for the rapid growth in low-cost solar power as, among peers, it generates the largest percentage of its power from renewable energy (after it acquired 1,140MW Welspun Renewable Portfolio) and its strategy is heavily focussed on shifting towards clean energy with upside potential to reach 40 per cent by 2025.

"We believe renewables build-out will be a key growth driver for the stock in the coming years," the report notes.

Morgan Stanley has maintained 'Overweight' on Power Grid Corporation pointing out the company's wires-only business model that allows it to avoid downside risk to coal-fired plant margins.

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### Downgrades

Morgan Stanley downgraded NTPC to 'Equal-weight' from 'Overweight' and Adani Power to 'Underweight' from 'Equal-weight', while it assumed coverage of BHEL with an 'Underweight' rating and stayed its 'Underweight' rating on JSW Energy.

"Although NTPC is a regulated utility (and, therefore, somewhat sheltered from falling power prices) with a generation business (the third-largest coal-based utility), we think the company will disappoint on commissioning new coal plants, premised on our belief that economics favour future solar additions versus coal, implying risk to earnings growth," the report notes.

According to Morgan Stanely, NTPC offers low pipeline visibility for solar as it does not make regulated returns on solar projects (all solar projects are awarded through competitive bidding) while NTPC's conservative management team may not bid competitively enough — potentially missing out on the huge upside opportunity from the renewables expansion in India.

As for Adani Power, Morgan Stanley says the merchant portion (9 per cent) of Adani's coal-fired power plant fleet will be exposed to the risk of falling power prices as cheap solar power becomes a significant source of power.

### JSW, most exposed

Among merchant power generators, JSW is most exposed to competitive pressures and load factors at several of JSW's plants will continue to face pressure.

Another report, issued by India Ratings and Research, maintains 'Negative' outlook towards thermal power sector stating that India's private thermal projects are staring at muted power demand, which is the effects of non-remunerative tariffs partly due to aggressive bids and some adverse perception due to falling renewable tariff.