TWO STEPS Board has approved issuance of pref shares to Tata Sons, plan for InvIT of renewable assets, which will help cut over 30% debt

Tata Power's Debt Reduction to Boost Profits, Street Mood

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ET Intelligence Group: Tata Power has taken two measures that will significantly reduce its debt, which will offer some comfort to investors.

The company's board has announced a preferential issue and proposed to create an infrastructure investment trust (InvIT) of its renewable business. Investors have welcomed the developments, with the stock gaining 15% in the past one week.

The board has approved the issuance of 49 crore shares to Tata Sons at ₹53 apiece, 4% higher than Tuesday's closing price of 50.9, aggregating to ₹2,600 crore. Although this will lead to an equity dilution of 18%, it will not affect earnings per share since the company will save on interest expenses. A major portion of the proceeds will be used to reduce debt by nearly 6%. The company had a debt of ₹44,000 crore in FY20. The savings on interest are likely to boost net profit by around 16%. The promoter holding will increase from 35% to 46% after the issue.

The proposed hiving off of the renewable business will offer a bigger boost to the balance sheet and sentiments of investors who have been less enthused with the high capex in renewable energy projects and uncertain return profiles. Analysts expect nearly ₹11,000 crore or 25% reduction of consolidated debt through the proposed InVIT. In addition, it will also help in unlocking value for investors.

Paring the Burden

Key indicators at Tata Power before and after deleveraging

	Pre	Post
Debt/Equity	2.2	1.5
Debt/EBIDTA	5.2	3.7
RoE (%)	7.1	8.6

Tata Power had undertaken a leveraged buyout of Welspun Renewables, which mainly owns wind and solar assets, for ₹10,000 crore in 2016.

In addition, monetisation of non-core assets in shipping, defence and overseas power assets will bring down debt further. These initiatives are expected to reduce debt by 40%.

The debt-Ebitda ratio may fall to less than four from 5.2 while the debt-equity ratio may shrink to 1.5 from 2.2 at the end of FY21. The stock is available at 10.5 times estimated FY21 earnings and 0.7 times the price-book value.