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Company update

Utilities

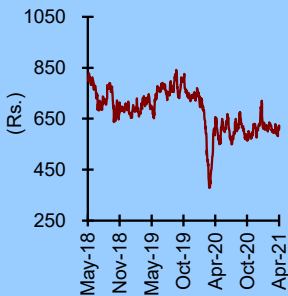
Target price: Rs883

Shareholding pattern

	Sep '20	Dec '20	Mar '21
Promoters	49.9	49.9	49.9
Institutional investors	41.7	40.9	38.6
MFs and other	21.6	21.4	19.5
FIs/Bank	3.3	3.3	3.8
FII	16.7	16.2	15.3
Others	8.4	9.2	11.5

Source: www.nseindia.com

Price chart



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INDIA

CESC

ICICI Securities

BUY

Maintained

Rs608

Next rerating candidate?

With the overhang of West Bengal elections now over, we expect the West Bengal Electricity Regulatory Commission (WBERC) to expedite the issuance of tariff order for CESC's Kolkata discom, which has been pending for the past three years (MoP's recent directive on timely tariff determination and full cost reflectiveness of tariff will help). Although, on consolidated basis, CESC's earnings have improved on better performance by subsidiaries, profits from the Kolkata business have remained stagnant as regulated equity growth has not been approved. With the expected issue of tariff order, approval of capex incurred in the past three years and future capex, we expect the ambiguity in earnings and valuation to diminish and CESC may be the next utility stock to rerate. Maintain BUY with the target price unchanged at Rs883/share.

- **Issuance of Kolkata distribution tariff order to provide much needed boost:** As the elections in West Bengal culminate, we expect the state regulatory commission to move forward to issue the tariff order for the Kolkata distribution area (as well as other circles). The tariff order has been pending for the past three years and has resulted in no growth in CESC's regulated equity and subsequently earnings. However, on a consolidated basis, the company has witnessed growth as subsidiaries have fared much better. With the expected issue of tariff order for subsequent years, approval of capex incurred in the past three years and future capex, we expect the ambiguity in earnings and valuation to diminish. Although future earnings may not change meaningfully as we expect some cut in T&D incentives, which will be offset by increase in regulated equity base, the overhang of returns on future capex gets addressed.
- **MoP's directive on timely tariff determination and full cost reflectiveness of tariff may also push WBERC to expedite the tariff order:** The MoP has issued directives to state electricity commissions to ensure timely determination of tariff orders and full cost reflectiveness of tariffs for ensuring sustainability of the sector and also in consumers' interest. The directive reminded CERC and SERCs to abide by the provisions of the Electricity Act and ensure recovery of full cost of power supply plus a reasonable return and ensure that there is no creation of regulatory assets under business as usual situation. It has directed that annual performance review, annual revenue requirements, tariff determination, and true-up of past expenses have to be conducted on a yearly and timely basis. All tariff orders have to be issued before 1st April of the year. Status of compliance of these provisions has to be sent to the MoP by 31st May every year. Based on these directives and compliance requirements, we expect the WBERC to expedite the issue of the pending tariff orders for CESC.
- **Valuations lag peers – next rerating candidate?** We maintain our BUY rating and target price of Rs883/sh on CESC. We estimate an improvement in profit from Kolkata distribution business and better-than-estimated recovery in DF businesses. The stock, which is currently trading at FY23E P/E of 5.7x, P/BV of 0.7x and dividend yield of 8.2%, by far lags its peers, viz. private utilities including Torrent Power and JSW Energy. We estimate this gap to partially shrink on passage of the tariff order and improvement in profit of the standalone entity as well as subsidiaries. However, valuations may reach levels similar to peers only when CESC shows growth intent and action in next-gen business segments, including renewables.

Market Cap	Rs80.6bn/US\$1.1bn	Year to March (con)	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	CESC.BO/CESC IN	Revenue (Rs mn)	116,772	114,852	118,607	123,104
Shares Outstanding (mn)	132.6	Net Income (Rs mn)	13,059	12,679	13,311	14,111
52-week Range (Rs)	730/534	EPS (Rs)	98.0	95.2	99.9	105.9
Free Float (%)	50.1	% Chg YoY	9.0	(2.9)	5.0	6.0
FII (%)	15.3	P/E (x)	6.2	6.4	6.1	5.7
Daily Volume (US\$'000)	4,384	CEPS (Rs)	156.7	157.3	163.6	170.9
Absolute Return 3m (%)	(0.4)	EV/E (x)	6.2	6.2	5.8	5.5
Absolute Return 12m (%)	(7.3)	Dividend Yield	3.3	7.4	7.7	8.2
Sensex Return 3m (%)	5.6	RoCE (%)	10.2	9.8	9.9	10.2
Sensex Return 12m (%)	46.3	RoE (%)	13.6	12.3	12.1	12.0

Please refer to important disclosures at the end of this report

Other key recent events

To consolidate ex-Kolkata distribution businesses into a single entity

CESC's Board has approved a proposal for consolidation of all distribution business investments (ex-Kolkata distribution) into Eminent Electricity Distribution, a wholly-owned subsidiary.

Reorganises stake in Noida Power under Eminent Electricity Distribution

CESC has reorganised its holding in Noida Power (NPCL), an associate company. It has acquired 23.18% stake (13.9mn shares) through Eminent Electricity Distribution. This stake was previously held by STEL Holdings Limited (5%) and Shaft Investments Private Limited (18.18%), two group companies. The balance 27.27% is held by Greater Noida Industrial Development Authority.

For the 23.18% stake, CESC has paid Rs4.5bn (at Rs325/share) at an EV of Rs19.5bn, implying 7.1x FY20 EBITDA of Rs2.7bn. NPCL's revenue for FY20 was Rs17.3bn and it posted a profit of Rs1.4bn, recording 12.5% growth in sales volumes and 17.2% growth in billed revenues. Volumes are likely to grow at 10% annually going forward.

ESG ratings upgraded to 'BBB' by MSCI

CESC's approach towards improving its ESG profile paid dividends as the MSCI upgraded its ESG rating to 'BBB' in its latest update. This is the highest rating achieved by a power utility in India.

Table 1: MSCI rating comparison – Indian power utilities

Company	CESC	Power Grid	Tata Power	NTPC	JSW Energy
MSCI rating	BBB	BBB	BB	CCC	BB

Source: xx

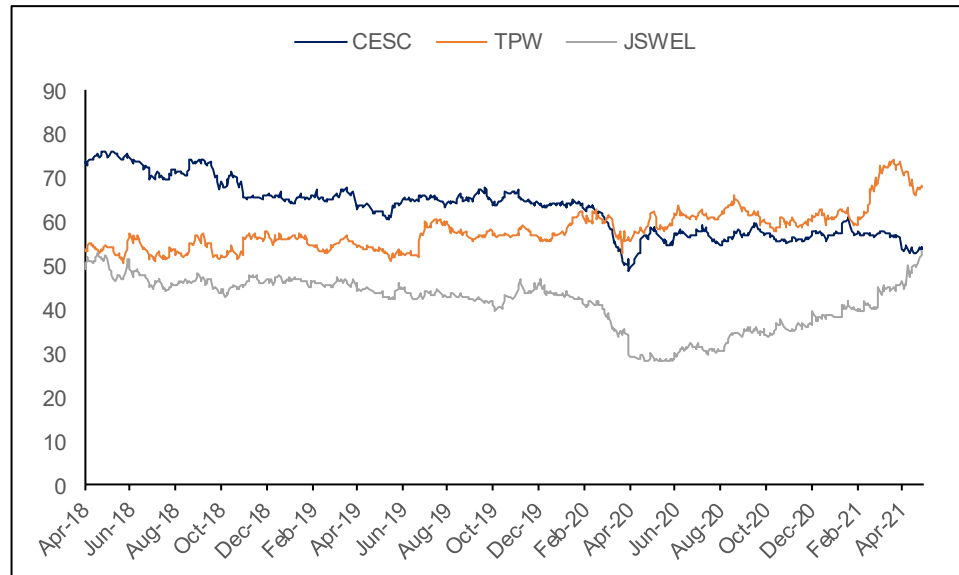
Rs45/share interim dividend announced

Company announced an interim dividend of Rs45/share, which translates into 47% payout at FY21E EPS of Rs95. At CMP, the dividend yield is 7.4%. If the payout ratio of 50% is maintained going forward, the dividend yield averages 7.5% over FY21E-FY23E.

Peer comparison – CESC’s valuation lags peers

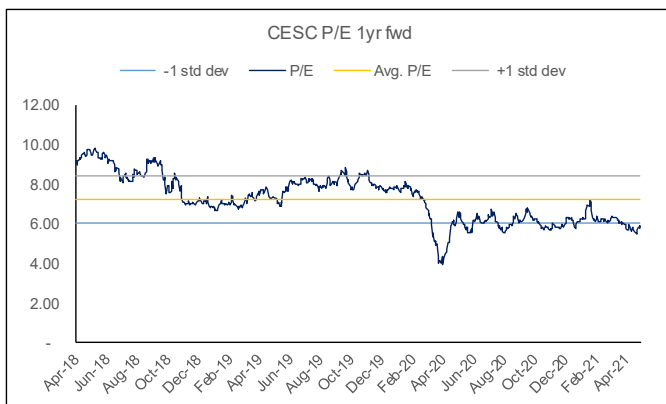
Chart 1: EV/MW comparison – CESC is now lower than both Torrent Power and JSWE

(Rs mn per MW)



Source: Company, Bloomberg, I-Sec research

Chart 2: CESC 1-year forward P/E trend



Source: Company, Bloomberg, I-Sec research

Chart 3: CESC 1-year forward P/B trend

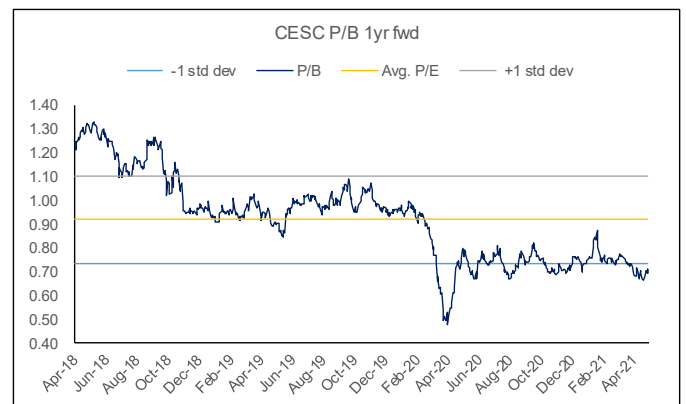
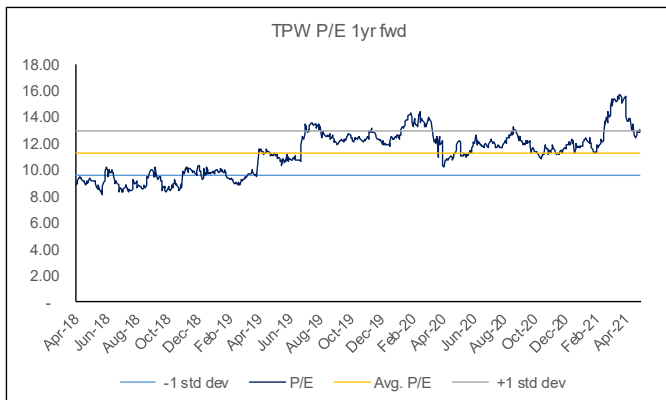


Chart 4: Torrent Power 1-year forward P/E trend



Source: Company, Bloomberg, I-Sec research

Chart 5: Torrent Power 1-year forward P/B trend

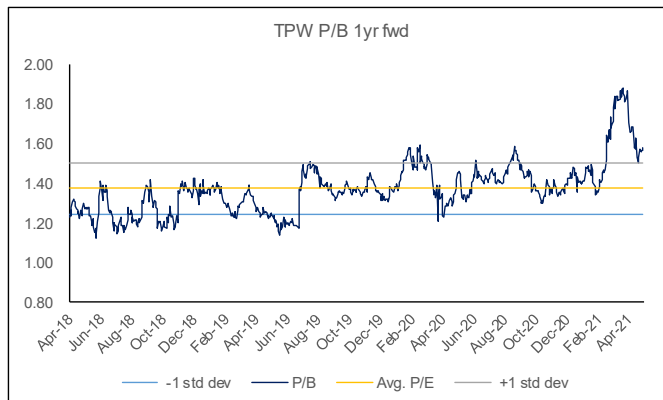
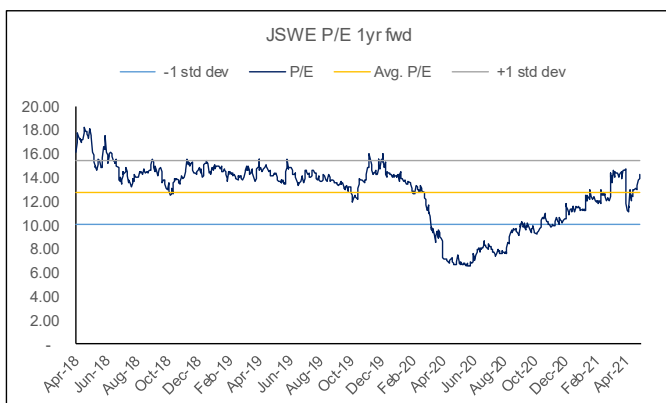
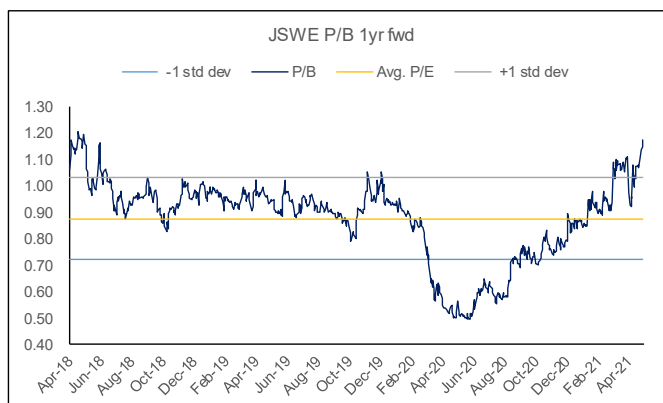


Chart 6: JSW Energy 1-year forward P/E trend



Source: Company, Bloomberg, I-Sec research

Chart 7: JSW Energy 1-year forward P/B trend



Valuation and key risks

We maintain our **BUY** rating and target price of Rs883/sh on CESC. We estimate an improvement in profits from the Kolkata distribution business and better-than-estimated recovery in DF businesses. The stock is currently trading at FY23E P/E of 5.7x, P/BV of 0.7x and dividend yield of 8.2%.

Table 2: Valuation table

Particulars	Equity (regulated; Rs mn)	Valuation method	Multiple	Value (Rs mn)	Per share
Kolkata generation	12,616	P/BV	0.70	8,831	66
Haldia	12,000	P/BV	1.80	21,600	162
Dhariwal	10,050	P/BV	0.70	7,035	53
Renewables	2,519	P/BV	1.00	2,519	19
Crescent Power	500	P/E	10.0	3,050	23
Kolkata License Area (distribution)	34,671	P/BV	2.00	69,343	521
Noida Power Co	3,185	P/BV	1.4	4,427	33
Distribution Franchisee		DCF		811	6
Total					883

Source: Company data, I-Sec research

Key downside risks: 1) Higher than anticipated coal cost and under-recovery at Sarisatolli coal block; and 2) delay in locking PPAs for the remaining capacity at Chandrapur plant.

Brief overview of the company

Table 3: Brief overview of businesses of the company

Business	Capacity and other operational details	Operational since	Remarks
Kolkata Distribution area			
- Coal Mining	FY14 rated capacity of 3.5mtpa and coal reserve of 83mnte; Mining lease area: 670ha	2002	Captive coal block located at Saristoli, Raniganj, WB. Supplies coal to BBGS
- Power generation	1,125MW (BBGS: 750MW; SGS: 135MW; TGS: 240MW)	BBGS: 1997	Integrated generation for Kolkata Distribution. Fuel sourcing through CIL linkage, e-auction and own mines. FY20 generation was 5,798MU at 88% PLF for BBGS, while SGS and TGS seldom operate as they are very old plants.
- Licensed Distribution	567 sq. km area; 3.3mn consumers; >21,866ckm of network; Peak load of 2,337MW; T&D loss: 8.9%;	Past 120 years	Power sales (FY20) – 10,282MU (LT 68%, HT 32%) FY20 revenues at Rs79bn; Tariff is Rs7.31/unit; assured post-tax equity return of 16.5%; procures 88% power from own sources
Independent Power plants			
- Haldia TPP	600MW FY20 Generation 4,430MU, PLF: 84.1%	2015	Has a 100% long-term PPA with Kolkata discom. Sources coal through CIL linkage and e-auction.
- Chandrapur TPP	Two units of 300MW each; FY20 PLF: 43% for unit-I & 80% for unit-II	2014	Has 100MW LT PPA with TANGEDCO, 187MW LT PPA with NPCL and 185MW MT PPA with Mahagenco. Fuel sourcing through CIL linkage, e-auction.
- Crescent Power	40MW	2009	AFBC plant uses shale and coal washery rejects from captive mines. Operates in the merchant power market.
Distribution			
Licensed distribution		Handover date	
- Noida distribution	335 sq. km area; 0.1mn consumers; Peak load of 450MW T&D loss: 8.3%;	1993	Power sales (FY20) – 2,081MU FY20 revenue of Rs17bn; Assured post-tax equity return of 15.5%; FY20 PAT was Rs1.4bn
Franchised distribution		Handover date	
- Kota	176 sq. km area; 0.26mn consumers; Peak load of 297MW T&D loss: 20.4%;	Sep'16	Power sales (FY20) – 1,016MU; FY20 revenues at Rs8.7bn and avg. billing rate of Rs8.32/kWh
- Bharatpur	50 sq. km area; 0.07mn consumers; Peak load of 61MW T&D loss: 12.3%;	Dec'16	Power sales (FY20) – 253MU; FY20 revenues at Rs2.1bn and avg. billing rate of Rs8.24/kWh
- Bikaner	155 sq. km area; 0.18mn consumers; Peak load of 170MW T&D loss: 14.4%;	May'17	Power sales (FY20) – 690MU; FY20 revenues at Rs5.5bn and avg. billing rate of Rs7.7/kWh
- Malegaon	25 sq. km area; 0.1mn consumers; Peak load of 150MW T&D loss: 49.6%;	Mar'20	Power sales (FY20) – 555MU; FY20 revenue billing of Rs3.6bn and collection efficiency of 99%; Min. capex p.a.: 1 st -5 th year.: Rs200mn, 6 th -20 th year: Rs30mn
Renewables			
Wind			
- Dangri, Rajasthan	24MW	FY13	Has two long-term PPAs with JVVNL and AVVNL. In FY20, it generated 24.8MU of electricity
- Surendargarh, Gujarat	26MW	Dec'14	Has long-term PPA with GUVNL. In FY20, it generated 53.9MU of electricity
- Rojmal, Gujarat	70MW	FY18	Has long-term PPA with GUVNL. In FY20, it generated 144.5MU of electricity
- Madhya Pradesh	36MW	Mar'16	Has long-term PPA with MPPMCL. In FY20, it generated 46.2MU of electricity
Solar			
- Ramnathpuram, Tamil Nadu	18MW	Jan'16	Has long-term PPA with TANGEDCO. In FY20, it generated 27.7MU of electricity

Source: Company, I-Sec research

Financial summary (consolidated)

Table 4: Profit and Loss statement
(Rs mn, year ending March 31)

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Operating Income (Sales)	83,634	102,749	112,340	116,772	114,852	118,607	123,104
Operating Expenses	56,245	73,432	78,470	81,417	80,467	83,742	87,629
EBITDA	27,845	29,991	33,870	35,355	34,385	34,866	35,474
% margins	33.3	29.2	30.1	30.3	29.9	29.4	28.8
Depreciation & Amortisation	7,148	7,515	7,640	7,814	8,272	8,483	8,652
Gross Interest	13,724	13,030	13,250	13,574	12,762	12,280	11,814
Other Income	2,300	2,520	2,040	2,025	2,327	2,360	2,447
Recurring PBT	8,564	12,464	15,710	16,686	15,815	16,603	17,603
Less: Taxes	3,210	3,562	3,730	3,627	3,136	3,293	3,491
Net Income (Reported)	6,703	9,753	11,980	13,059	12,679	13,311	14,111
PAT (ex-discontinued ops)	5,149	8,902	11,980	13,059	12,679	13,311	14,111

Source: Company data, I-Sec research

Table 5: Balance sheet
(Rs mn, year ending March 31)

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Assets							
Total Current Assets	51,170	39,641	42,676	50,273	52,669	55,530	59,336
of which cash & cash eqv.	16,061	11,940	10,307	17,910	16,746	18,815	21,583
Total Current Liabilities & Provisions	24,860	24,637	26,016	28,208	28,392	28,466	28,652
Net Current Assets	26,311	15,004	16,660	22,065	24,277	27,064	30,684
Investments							
of which	11,095	11,737	11,855	6,853	6,853	6,853	6,853
Strategic/Group	4,224	6,673	6,724	6,703	6,703	6,703	6,703
Other Marketable	6,871	5,064	5,130	150	150	150	150
Net Fixed Assets	246,156	238,535	236,485	235,866	232,180	227,697	223,045
Capital Work-in-Progress	3,919	2,166	1,614	1,468	1,468	1,468	1,468
Other fixed assets	62,310	37,783	42,053	49,262	49,262	49,262	49,262
Total Assets	349,791	305,226	308,667	315,513	314,039	312,343	311,311
Liabilities							
Borrowings	155,942	145,778	144,721	139,909	131,596	122,701	114,071
Deposits from Customers	16,190	15,067	14,843	16,280	16,280	16,280	16,280
Equity Share Capital	1,332	1,332	1,332	1,332	1,332	1,332	1,332
Face Value per share (Rs)	10	10	10	10	10	10	10
Reserves & Surplus*	104,895	82,870	88,406	94,942	101,628	108,678	116,129
Less: Misc. Exp. #.	-	-	-	-	-	-	-
Net Worth	106,227	84,202	89,738	96,274	102,960	110,010	117,462
Minority interest	12,101	694	821	858	1,011	1,160	1,306
Other non-current liabilities	59,332	59,486	58,544	62,192	62,192	62,192	62,192
Total Liabilities	349,791	305,226	308,667	315,513	314,039	312,343	311,311

Source: Company data, I-Sec research

Table 6: Quarterly trend – standalone
(Rs mn, year ending March 31)

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Net sales	21,530	22,960	19,070	19,160	24,110	22,940	17,830	18,800	17,300	20,700	17,730
% growth (YoY)	8.2	9.5	7.4	-1.7	14.0	-0.1	-6.5	-8.1	-22.6	-9.8	-0.6
EBITDA	4,450	5,540	4,020	5,330	4,940	5,110	4,120	5,480	3,730	4,190	4,130
Margin (%)	21.1	24.5	21.1	26.1	20.5	22.3	23.1	29.1	21.6	20.2	23.3
Other income	200	280	450	720	230	230	290	490	340	140	280
Add: Extraordinaries	-	-	-	-	-	-	-	-	-	-	-
Net profit	1,820	2,770	1,730	3,090	2,170	2,170	1,760	2,500	1,340	2,280	1,820

Source: Company data, I-Sec research

Table 7: Cashflow statement*(Rs mn, year ending March 31)*

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Operating Cashflow	12,829	16,273	17,580	18,848	18,624	19,434	20,316
Working Capital Chgs	(918)	(6,336)	(3,565)	1,406	(3,374)	(719)	(852)
Capital Commitments	(15,527)	(10,317)	(8,397)	(9,688)	(4,586)	(4,000)	(4,000)
Free Cashflow	(3,616)	(380)	5,618	10,565	10,664	14,715	15,465
Cashflow from Investing Activities	2,300	2,651	1,973	7,005	2,327	2,360	2,447
Issue of Share Capital	158	22	-	-	-	-	-
Buyback of shares	-	-	-	-	-	-	-
Inc (Dec) in Borrowings	24,658	19,428	(1,056)	(4,813)	(8,313)	(8,895)	(8,629)
Dividend paid	(1,599)	(1,902)	(2,797)	(3,197)	(5,994)	(6,260)	(6,660)
Extraordinary Items	(20)	49	(30)	-	-	-	-
Chg. in Cash & Bank balance	12,445	3,152	(5,171)	4,190	(1,163)	2,068	2,768

Source: Company data, I-Sec research

Table 8: Key ratios*(Rs mn, year ending March 31)*

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Per Share Data (Rs)							
EPS(Basic Recurring)	38.6	66.8	89.9	98.0	95.2	99.9	105.9
Diluted Recurring EPS	38.6	66.8	89.9	98.0	95.2	99.9	105.9
Recurring Cash EPS	92.3	123.2	147.3	156.7	157.3	163.6	170.9
Dividend per share (DPS)	10.2	12.1	17.5	20.0	45.0	47.0	50.0
Book Value per share (BV)	797	632	674	723	773	826	882
Growth Ratios (%)							
Operating Income	NM	22.9	9.3	3.9	(1.6)	3.3	3.8
EBITDA	NM	7.7	12.9	4.4	(2.7)	1.4	1.7
Recurring Net Income	NM	72.9	34.6	9.0	(2.9)	5.0	6.0
Diluted Recurring EPS	NM	72.9	34.6	9.0	(2.9)	5.0	6.0
Diluted Recurring CEPS	NM	33.5	19.5	6.4	0.4	4.0	4.4
Valuation Ratios (x)							
P/E	15.7	9.1	6.8	6.2	6.4	6.1	5.7
P/CEPS	6.6	4.9	4.1	3.9	3.9	3.7	3.6
P/BV	0.8	1.0	0.9	0.8	0.8	0.7	0.7
EV / EBITDA	8.5	7.6	6.7	6.2	6.2	5.8	5.5
EV / Operating Income	2.8	2.2	2.0	1.9	1.9	1.7	1.6
EV / Operating FCF	18.5	13.9	12.8	11.7	11.4	10.5	9.6
Operating Ratios							
Raw Material/Sales (%)	41.3	47.3	49.2	48.9	47.8	47.8	48.0
SG&A/Sales (%)	10.4	9.4	9.2	9.3	9.9	10.2	10.4
Other Income / PBT (%)	24.8	21.1	13.6	12.7	14.8	14.3	14.0
Effective Tax Rate (%)	35.7	28.7	24.1	18.3	20.0	20.0	20.0
NWC / Total Assets (%)	7.5	4.9	5.4	7.0	7.7	8.7	9.9
Inventory Turnover (days)	36.7	20.6	22.8	22.5	23.4	22.8	22.5
Receivables (days)	67.7	54.3	56.5	58.8	70.6	70.6	70.6
Payables (days)	84.0	54.6	47.6	50.8	54.1	52.9	51.9
D/E Ratio (x)	1.3	1.6	1.5	1.3	1.1	0.9	0.8
Profitability Ratios (%)							
Recurring Net Income Margins	6.2	8.7	10.7	11.2	11.0	11.2	11.5
RoCE	5.3	7.9	9.4	10.2	9.8	9.9	10.2
RoNW	4.8	10.6	13.3	13.6	12.3	12.1	12.0
Dividend Payout Ratio	26.4	18.2	19.5	20.4	47.3	47.0	47.2
Dividend Yield	1.7	2.0	2.9	3.3	7.4	7.7	8.2
EBITDA Margins	33.3	29.2	30.1	30.3	29.9	29.4	28.8

Source: Company data, I-Sec research

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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

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