

HOLD

TP: Rs 91 | ▼ 0%

CESC

| Power

| 11 November 2021

Fairly priced but upside if distribution is delicensed

- Despite steady 8% YoY growth in Q2 pretax income, consolidated net income fell 11% due to lower tax rate in comparable quarter
- Distribution delicensing could open up large market for CESC – one of the few experienced players in this space
- Raise TP to Rs 91 (vs. Rs 75) on higher net income estimates but retain HOLD as current valuations capture business prospects

Tarun Bhatnagar | Someel Shah
researchreport@bobcaps.in

Pretax income up 8% YoY: CESC reported a Q2FY22 consolidated net income decline of 11% YoY due to a 146% increase in taxation from a higher effective tax rate (29%) versus a low base (13%). Note that the tax rate in regulated utilities can be volatile. Pretax income was up 8% YoY driven by a drop in interest cost and higher other income. Sequentially, net income rose 24% QoQ due to an 11% increase in EBIT and a 54% increase in other financial income.

Well positioned to benefit from opening up of electricity distribution: CESC is India's fourth largest private electricity distributor with ~1% volume share and decades of experience in supplying electricity to the city of Kolkata under the regulated return model and to Greater Noida, besides franchisee assets. The company has won the concession for power distribution in Chandigarh. Delicensing of distribution through the Electricity (Amendment) Bill 2021 will open up a huge opportunity to offer services pan India which will benefit CESC as it is among a handful of private companies engaged in distribution.

Estimates raised by 7-9%: We raise our FY22/FY23/FY24 net income estimates by 7%/7%/9% to factor in lower AT&C loss assumptions in franchisee distribution circles and reduced interest rates. We have also stripped the renewables business from our estimates following its sale to Torrent Power and excluded Chandigarh distribution as it has not been formally transferred to the company.

Retain HOLD, change TP to Rs 91: We raise our SOTP-based Sep'22 TP to Rs 91 from Rs 75 led by our higher PAT estimates and lower interest rate assumptions which reduce the WACC used to value CESC's different businesses. Our TP implies an FY22E EV/EBITDA of 6.1x, close to the 10-year mean. We retain HOLD as we believe that the current business prospects are already captured in the price. Passage of the Electricity Act could, however, raise growth prospects and, therefore, valuations. New distribution wins would act as another positive stock driver.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	CESC IN/Rs 91
Market cap	US\$ 1.6bn
Free float	48%
3M ADV	US\$ 5.5mn
52wk high/low	Rs 102/Rs 56
Promoter/FPI/DII	52%/13%/23%

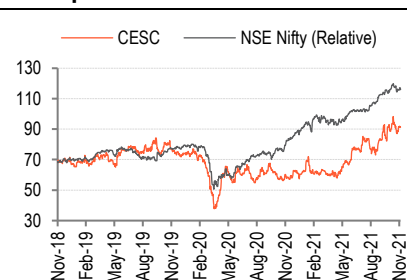
Source: NSE | Price as of 11 Nov 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	1,16,390	1,31,525	1,34,804
EBITDA (Rs mn)	36,100	35,762	35,998
Adj. net profit (Rs mn)	13,310	14,733	15,611
Adj. EPS (Rs)	10.0	11.1	11.8
Consensus EPS (Rs)	10.0	10.6	11.7
Adj. ROAE (%)	13.7	14.3	14.0
Adj. P/E (x)	9.1	8.2	7.8
EV/EBITDA (x)	6.6	6.4	6.2
Adj. EPS growth (%)	(89.8)	10.7	6.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q2FY22	Q2FY21	YoY (%)	Q1FY22	QoQ (%)	H1FY22	H1FY21	YoY (%)
Revenue (post indirect taxes)	34,940	33,510	4.3	32,160	8.6	67,100	59,650	12.5
Cost of Revenue	(18,790)	(17,820)	5.4	(17,210)	9.2	(36,000)	(32,220)	11.7
Gross Profit	16,150	15,690	2.9	14,950	8.0	31,100	27,430	13.4
Gross Margin (%)	46.2	46.8	(60bps)	46.5	(26bps)	46.3	46.0	36bps
Employee Benefits Expense	(2,870)	(3,000)	(4.3)	(2,860)	0.3	(5,730)	(5,840)	(1.9)
Other Expense	(4,140)	(3,810)	8.7	(4,410)	(6.1)	(8,550)	(6,540)	30.7
Other Income	260	450	(42.2)	1,010	(74.3)	1,270	2,340	(45.7)
EBITDA	9,400	9,330	0.8	8,690	8.2	18,090	17,390	4.0
EBITDA margin (%)	26.9	27.8	(94bps)	27.0	(11.8bps)	53.9	58.7	(475bps)
Depreciation & Amortization	(2,220)	(2,120)	4.7	(2,190)	1.4	(4,410)	(4,320)	2.1
EBIT	7,180	7,210	(0.4)	6,500	10.5	13,680	13,070	4.7
EBIT margin (%)	20.5	21.5	(97bps)	20.2	34bps	20.4	21.9	(152bps)
Interest Income	0	0	-	0	-	0	0	-
Interest Expense	(2,780)	(3,020)	(7.9)	(2,830)	(1.8)	(5,610)	(6,250)	(10.2)
Dividend	0	0	-	0	-	0	0	-
Other Financial Items	400	250	60.0	260	53.8	660	730	(9.6)
Forex	0	0	-	0	-	0	0	-
Total Financials	(2,380)	(2,770)	(14.1)	(2,570)	(7.4)	(4,950)	(5,520)	(10.3)
Income after financial items	4,800	4,440	8.1	3,930	22.1	8,730	7,550	15.6
Margin (%)	13.7	13.2	49bps	12.2	152bps	13.0	12.7	35bps
Associate Income	0	0	-	0	-	0	0	-
Pretax income	4,800	4,440	8.1	3,930	22.1	8,730	7,550	15.6
Total Non-Recurring	0	0	-	0	-	0	0	-
Reported Pretax	4,800	4,440	8.1	3,930	22.1	8,730	7,550	15.6
Taxation	(1,400)	(570)	145.6	(1,130)	23.9	(2,530)	(1,590)	59.1
% of pretax income before Associates	29	13	0.0	29	0.0	58	46	0.0
Net income before minorities	3,400	3,870	(12.1)	2,800	21.4	6,200	5,960	4.0
Minorities	(50)	(90)	(44.4)	(90)	(44.4)	(140)	(160)	(12.5)
Net income after minorities	3,350	3,780	(11.4)	2,710	23.6	6,060	5,800	4.5
Core net income	3,350	3,780	(11.4)	2,710	23.6	6,060	5,800	4.5
Net margin (%)	9.6	11.3	(169bps)	8.4	116bps	9.0	9.7	(69bps)

Source: Company, BOBCAPS Research

Valuation methodology

Raise earnings estimates

We raise our FY22/FY23/FY24 net income estimates by 7%/7%/9% to factor in lower AT&C loss assumptions in franchisee distribution circles and reduced interest rates. We have also stripped the renewables business from our estimates following its sale to Torrent Power and excluded Chandigarh distribution as it has not been formally transferred to the company.

Fig 2 – Key earning drivers

Drivers	FY20	FY21	FY22E	FY23E	2024E
AT&C Losses (%)					
Kolkata	7.9	7.5	7.5	7.5	7.5
Noida Power Company	8.2	8.2	7.5	7.5	7.5
Kota	20.4	20.0	19.0	17.0	15.0
Bharatpur	17.0	16.0	15.0	13.0	11.0
Bikaner	18.0	17.0	16.0	14.0	12.0
Malegaon	44.8	44.8	40.0	35.0	30.0
Consumption (% YoY)					
Kolkata	2.0	(5.0)	10.0	2.0	2.0
Noida Power Company	2.0	(5.0)	10.0	5.0	5.0
Kota	2.0	-	5.0	5.0	5.0
Bharatpur	1.0	-	5.0	5.0	5.0
Bikaner	1.0	-	5.0	5.0	5.0
Malegaon	1.0	-	5.0	5.0	5.0
Availability Factor (%)					
Haldia Power	96.9	90.0	90.0	90.0	90.0
Dhariwal Infrastructure	70.0	80.0	60.0	60.0	50.0
Crescent Power	67.0	70.0	70.0	70.0	70.0

Source: Company, BOBCAPS Research

Fig 3 – Revised estimates

(Rs bn)	New			Old			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	131.5	134.8	138.5	133.4	136.8	139.8	(1.4)	(1.5)	(1.0)
EBITDA	35.8	36.0	35.4	36.6	37.3	36.4	(2.2)	(3.6)	(2.8)
EBIT	26.8	27.1	26.2	27.4	27.9	26.8	(2.1)	(3.1)	(2.1)
Pretax Income	19.1	20.1	19.8	18.1	19.1	18.5	5.4	5.2	6.9
Net Income	14.7	15.6	15.2	13.8	14.6	13.9	7.1	6.8	8.9
EPS (Rs/sh)	11.1	11.8	11.5	104	110	105	(89.3)	(89.3)	(89.1)

Source: BOBCAPS Research

Fig 4 – Estimate vs. Consensus

(Rs bn)	BOBCAPS			Consensus			BOBCAPS vs. Consensus		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	131.5	134.8	138.5	127.4	133.7	138.3	3.2	0.8	0.1
EBITDA	35.8	36.0	35.4	35.9	37.0	37.6	(0.4)	(2.7)	(6.0)
EBIT	26.8	27.1	26.2	29.4	30.5	29.4	(8.7)	(11.4)	(10.7)
Pretax Income	19.1	20.1	19.8	17.7	19.7	20.4	8.1	2.0	(2.9)
Net Income	14.7	15.6	15.2	14.1	15.5	16.8	4.3	0.8	(9.9)
EPS (Rs/sh)	11.1	11.8	11.5	10.6	11.7	12.5	4.5	0.9	(8.6)

Source: Bloomberg, BOBCAPS Research

Retain HOLD, raise TP to Rs 91

We have a revised Sep'22 TP of Rs 91 (vs. Rs 75 earlier) for CESC based on an SOTP valuation, arrived at via a DCF assessment of various assets. Our TP implies an FY22E EV/EBITDA of 6.1x, close to the 10-year mean. We retain HOLD as current business prospects are already captured in the price, in our view. Passage of the Electricity Act could, however, raise growth prospects and, therefore, valuations. New distribution wins would act as another positive stock driver.

For our DCF valuation, we discount cash flows from the company's generation projects till the end of respective PPAs, assuming no extension. For distribution licenses in Kolkata and Greater Noida, we have assumed extension for a further 25 years after the current concessions end. For renewable projects, we have factored in the remaining life based on the standard 25-year PPAs.

Key DCF assumptions include (1) cost of equity of 12.0% (11.9% earlier) based on a risk-free rate of 6.22% (6.12% earlier) as per the 10-year India bond yield as of end-Sep'21, (2) beta of 0.84 (unchanged) based on the last two-year weekly returns as of end-Sep'21, and (3) cost of debt of 8% (9% earlier).

Fig 5 – SOTP valuation

Business (Rs mn)	EV	Net Debt FY22E	Equity Value	Shareholding (%)	Contribution to Group Valuation	EBITDA FY22E	EV/EBITDA (x)
Distribution							
Kolkata & Howrah	79,432	31,361	48,071	100	48,071	18,691	4.2
Noida	20,194	2,348	17,847	73	12,980	2,998	6.7
Kota	5,699	2,125	3,573	100	3,573	(199)	(28.7)
Bikaner	2,167	587	1,580	100	1,580	0	13,916.1
Bharatpur	2,665	224	2,441	100	2,441	181	14.7
Malegaon	6,141	8,768	(2,627)	100	(2,627)	388	15.8
Subtotal (A)	1,16,299	45,413	70,885	-	66,019	19,062	6.1
Generation							
Haldia Power	55,926	25,340	30,585	100	30,585	8,759	6.4
Dhariwal Infrastructure	21,222	26,913	(5,691)	100	(5,691)	3,589	5.9
Crescent Power	146	1,292	(1,146)	68	(777)	230	0.6
Subtotal (B)	77,294	53,545	23,749	-	24,117	12,578	6.1
Others (C)	25,223	(633)	25,856	100	25,856	4,122	6.1
Consolidated (D=A+B+C)	2,18,815	98,324	1,20,490	-	1,15,992	35,762	6.1

Business (Rs mn)	EV	Net Debt FY22E	Equity Value	Shareholding (%)	Contribution to Group Valuation	EBITDA FY22E	EV/EBITDA (x)
Other Associates	-	-	-	-	-	-	-
Total	-	-	-	-	1,15,992	-	-
Number of shares (mn) (E)	-	-	-	-	1,326	-	-
Value (Rs/sh) (F = D divided by E)	-	-	-	-	88	-	-
Target Price (Rs/sh) – rounded off to the nearest 1	-	-	-	-	91	-	-

Source: BOBCAPS Research

Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS CAGR FY21-24E (%)	P/E (x)		EV/EBITDA (x)		Net Debt/ EBITDA FY22E (x)
					FY22E	FY23E	FY22E	FY23E	
Power Grid	PWGR IN	HOLD	201	-7.26	9.8	9.4	7.2	6.8	3.42
NTPC	NTPC IN	HOLD	111	7.39	8.1	7.2	7.8	7.1	4.85
Torrent Power	TPW IN	HOLD	461	12.87	17.1	15.9	8.5	7.5	1.62
CESC	CESC IN	HOLD	91	4.49	8.2	7.8	6.4	6.2	3.12

Source: BOBCAPS Research

Key risks

- Upside risks include the company winning new distribution concessions and Dhariwal Infrastructure winning a long-term PPA.
- Downside risks include regulatory changes such as a reduction in rate of regulatory returns and delayed passage of the Electricity Act 2021.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
CESC	CESC IN	1.6	91	91	HOLD
NTPC	NTPC IN	18.2	137	111	HOLD
Power Grid Corp	PWGR IN	17.1	182	201	HOLD
Torrent Power	TPW IN	3.5	535	461	HOLD

Source: BOBCAPS Research, NSE | Price as of 11 Nov 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	1,10,146	1,16,390	1,31,525	1,34,804	1,38,460
EBITDA	35,355	36,100	35,762	35,998	35,354
Depreciation	(7,814)	(8,670)	(8,959)	(8,926)	(9,139)
EBIT	27,541	27,430	26,803	27,073	26,215
Net interest inc./(exp.)	(13,194)	(11,612)	(9,355)	(8,583)	(8,034)
Other inc./(exp.)	1,645	1,702	1,626	1,626	1,626
Exceptional items	0	0	0	0	0
EBT	16,686	17,520	19,073	20,115	19,807
Income taxes	(3,627)	(3,890)	(3,921)	(4,063)	(4,157)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	655	(320)	(419)	(441)	(465)
Reported net profit	13,021	13,310	14,733	15,611	15,185
Adjustments	0	0	0	0	0
Adjusted net profit	13,021	13,310	14,733	15,611	15,185

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	6,568	9,390	7,207	7,387	7,587
Other current liabilities	6,568	10,310	8,127	8,307	8,507
Provisions	4,247	4,760	4,760	4,760	4,760
Debt funds	1,21,816	1,24,650	1,11,477	1,01,584	97,698
Other liabilities	84,963	94,280	94,699	95,140	95,605
Equity capital	1,332	1,332	1,332	1,332	1,332
Reserves & surplus	94,942	97,398	1,05,550	1,14,327	1,22,634
Shareholders' fund	96,274	98,730	1,06,882	1,15,659	1,23,966
Total liab. and equities	3,43,721	3,58,620	3,51,834	3,51,339	3,56,425
Cash and cash eq.	12,129	20,270	13,152	13,480	13,846
Accounts receivables	18,818	23,150	27,026	22,160	22,761
Inventories	150	5,970	6,746	6,915	7,102
Other current assets	18,934	6,580	6,580	6,580	6,580
Investments	1,631	1,400	1,400	1,400	1,400
Net fixed assets	2,33,767	2,39,710	2,43,412	2,47,408	2,51,462
CWIP	0	0	0	0	0
Intangible assets	1,472	1,630	1,630	1,630	1,630
Deferred tax assets, net	1,472	0	0	0	0
Other assets	55,347	59,910	51,888	51,767	51,645
Total assets	3,43,721	3,58,620	3,51,834	3,51,339	3,56,425

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	30,033	28,180	25,006	36,812	30,609
Capital expenditures	(7,464)	(6,830)	(12,539)	(12,800)	(13,071)
Change in investments	0	(4,520)	7,900	0	0
Other investing cash flows	5,393	(4,000)	0	0	0
Cash flow from investing	(2,072)	(15,350)	(4,639)	(12,800)	(13,071)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(4,892)	210	(13,173)	(9,893)	(3,887)
Interest expenses	(13,306)	(11,780)	(8,524)	(7,616)	(7,081)
Dividends paid	(3,188)	(5,940)	(6,581)	(6,834)	(6,877)
Other financing cash flows	21,471	17,510	28,278	24,342	17,844
Cash flow from financing	86	0	0	0	0
Chg in cash & cash eq.	7,103	(4,230)	(7,118)	328	366
Closing cash & cash eq.	12,129	20,270	13,152	13,480	13,846

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	98.2	10.0	11.1	11.8	11.5
Adjusted EPS	98.2	10.0	11.1	11.8	11.5
Dividend per share	20.0	4.5	5.0	5.2	5.2
Book value per share	726.3	74.5	80.6	87.3	93.5

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	2.2	2.0	1.7	1.7	1.5
EV/EBITDA	6.8	6.6	6.4	6.2	6.1
Adjusted P/E	0.9	9.1	8.2	7.8	8.0
P/BV	0.1	1.2	1.1	1.0	1.0

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	78.0	76.0	77.2	77.6	76.7
Interest burden (PBT/EBIT)	60.6	63.9	71.2	74.3	75.6
EBIT margin (EBIT/Revenue)	25.0	23.6	20.4	20.1	18.9
Asset turnover (Rev./Avg TA)	32.5	33.1	37.0	38.3	39.1
Leverage (Avg TA/Avg Equity)	3.6	3.6	3.5	3.2	3.0
Adjusted ROAE	14.0	13.7	14.3	14.0	12.7

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	3.3	5.7	13.0	2.5	2.7
EBITDA	(4.7)	2.1	(0.9)	0.7	(1.8)
Adjusted EPS	10.0	(89.8)	10.7	6.0	(2.7)
Profitability & Return ratios (%)					
EBITDA margin	32.1	31.0	27.2	26.7	25.5
EBIT margin	25.0	23.6	20.4	20.1	18.9
Adjusted profit margin	11.8	11.4	11.2	11.6	11.0
Adjusted ROAE	14.0	13.7	14.3	14.0	12.7
ROCE	10.0	9.4	8.9	9.0	8.7
Working capital days (days)					
Receivables	62	73	75	60	60
Inventory	0	19	19	19	19
Payables	22	29	20	20	20
Ratios (x)					
Gross asset turnover		17.0	10.0	5.2	3.6
Current ratio	0.8	1.0	1.0	1.0	1.0
Net interest coverage ratio	2.1	2.4	2.9	3.2	3.3
Adjusted debt/equity	1.3	1.3	1.0	0.9	0.8

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): CESC (CESC IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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