Sharekhan
by BNP PARIBAS

CESC Limited

Lower incentive income impacts Q1; valuation attractive

Sector: Power
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 615**	
Price Target: **Rs. 825**	↔

↑ Upgrade ↔ No change ↓ Downgrade

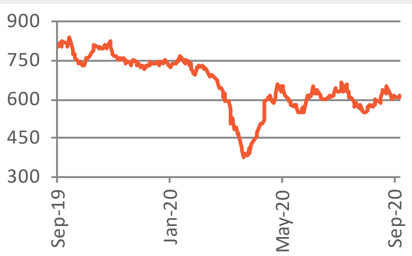
Company details

Market cap:	Rs. 7,687 cr
52-week high/low:	Rs. 855/366
NSE volume: (No of shares)	5.6 lakh
BSE code:	500084
NSE code:	CESC
Sharekhan code:	CESC
Free float: (No of shares)	6.6 cr

Shareholding (%)

Promoters	50
FII	18
DII	24
Others	8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8	-1	4	-23
Relative to Sensex	7	-14	-4	-26

Sharekhan Research, Bloomberg

CESC Limited's (CESC) Q1FY2021 standalone PAT declined by 38.2% y-o-y (down by 46.4% q-o-q) to Rs. 134 crore, below our estimate of Rs. 193 crore due to lower plant-load factor (PLF) based incentive income as volume slumped by 30.7% y-o-y to 2,118 million units and higher per unit cost of electricity purchased (up 15% y-o-y). However, the decline of 14.7% y-o-y in the consolidated PAT to Rs. 198 crore was much lower as compared to the decline in PAT for the standalone business due to: 1) better profitability of Dhariwal Infrastructure (PAT of Rs. 24 crore versus a net loss of Rs. 24 crore in Q1FY2020) and 2) reduction in losses at distribution franchisee (DF) to Rs. 33 crore versus Rs. 53 crore in Q1FY2020 and 3) improvement in PAT to Rs. 12 crore (versus only Rs. 3 crore in Q1FY2020) for Crescent Power. However, sequential performance was impacted across subsidiaries (ex-Haldia) due to weak power demand amid the lockdown, while the Malegaon DF reported a net loss of Rs. 33 crore in Q1FY2021, which was not there in Q1FY2020 as the operation in the DF started in March 2020. The performance of Haldia Energy was also decent with PAT up by 11.8% y-o-y to Rs. 85 crore. The management has indicated that major impact on earnings was in Q1FY2021 due to low PLF and earnings momentum is expected to improve from Q2FY2021 as its power plants are operating at PLF of 85-90%. Potential reduction in losses at the distribution franchisee to Rs. 15-20 crore (from net loss of Rs. 38 crore in FY2020) and a marginal profit for Dhariwal Infrastructure in FY2021E would improve consolidated earnings outlook and makes us constructive on CESC. The stock is also trading at an attractive valuation of 0.7x FY2022E P/BV and 7.9x its FY2022E EPS on a standalone basis. Hence, we maintain our Buy rating on CESC with unchanged SoTP-based PT of Rs. 825.

Key positives

- Dhariwal Infrastructure reported PAT of Rs. 24 crore versus a net loss of Rs. 24 crore in Q1FY2020.
- Loss at distribution franchisee reduced to Rs. 33 crore as compared to Rs. 53 crore in Q1FY2020.

Key negatives

- Standalone power sales volume declined by 30.7% y-o-y to 2,118 million units in Q1FY2021.

Our Call

Valuation - Maintain Buy on CESC with unchanged SoTP-based PT of Rs. 825: We have fine-tuned our earnings estimates for FY2021 and FY2022 as we expect an earnings recovery with improvement in power demand and have also introduced our FY2023 earnings estimates in this report. Steady earnings contribution from standalone business, turnaround of Dhariwal Infrastructure and Rajasthan distribution franchisee would improve CESC's consolidated financials over next couple of years. Potential singing of medium/long-term PPA in FY2022E for unit-1 of Dhariwal Infrastructure could act as a key re-rating trigger for CESC. The stock is also trading at an attractive valuation (of 0.7x FY2022E P/BV and 7.9x its FY2022E standalone EPS) and offers healthy dividend yield of 3.3%. Hence, we maintain our Buy rating on CESC with unchanged SoTP-based PT of Rs. 825.

Key Risks

Delay in signing of long-term PPA for the Chandrapur plant and sustained losses in the distribution franchisee for an extended period.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	7,754	7,836	7,663	8,798	9,483
OPM (%)	17.5	18.3	18.8	18.8	18.5
PAT	937	918	822	1,042	1,192
% y-o-y growth	8.4	(2.0)	(10.5)	26.8	14.4
EPS (Rs.)	70.3	68.9	61.7	78.2	89.5
P/E (x)	8.7	8.9	10.0	7.9	6.9
Price/ Book (x)	0.8	0.8	0.8	0.7	0.7
EV/EBITDA (x)	8.8	8.4	7.7	6.2	5.3
RoCE (%)	8.3	8.0	6.9	8.4	8.5
RoE (%)	9.8	9.3	8.0	9.6	10.2

Source: Company; Sharekhan estimates

Standalone numbers hit by lower PLF-based incentives income; subsidiaries post good show y-o-y: Standalone revenues declined by 32.8% y-o-y (flat q-o-q) to Rs. 1,585 crore, which was marginally above our expectation of Rs. 1,538 crore. The power sales volume declined sharply by 30.7% y-o-y to to 2,118 million units while the realisation at Rs. 7.5/unit (down 3% y-o-y). Operating profit declined by 48.4% y-o-y (down 9.2% q-o-q), below our estimate of Rs. 252 crore on the account of lower PLF incentive income (due to weak power sales volumes) and higher per unit cost of electricity purchased (up 15% y-o-y). Standalone PAT stood at Rs. 134 crore (down 38.2% y-o-y; down 46.4% q-o-q), below our estimate of Rs. 193 crore due to miss in the operating profit partially offset by lower effective tax rate.

However, the decline of 14.7% y-o-y in consolidated PAT to Rs. 198 crore was much lower than the decline in standalone PAT led by 1) better profitability at Dhariwal Infrastructure (PAT of Rs. 24 crore versus a net loss of Rs. 24 crore in Q1FY2020) and 2) reduction in losses at distribution franchisee (DF) to Rs. 33 crore as compared to Rs. 53 crore in Q1FY2020 and 3) improvement in PAT from Crescent Power to Rs. 12 crore (versus only Rs3 crore in Q1FY2020). However, the COVID-19 led lockdown impacted sequential performance across subsidiaries (ex-Haldia) due to weak power demand. Moreover, Malegaon DF reported net loss of Rs. 33 crore in Q1FY2021, which was not there in Q1FY2020 as the operation started in March 2020. The performance of Haldia Energy was also decent as PAT rose by 11.8% y-o-y to Rs85 crore.

Key takeaways from management discussion

- **Standalone PAT guidance –** The management maintained its guidance of 10% y-o-y decline in the standalone PAT for FY2021E as Q1FY2021 earnings was impacted by lower PLF-based incentive income (Rs. 60-65 crore quarterly run-rate). PLF for standalone power generation plants same has improved to 85-90% currently.
- **DF loss to reduce further in FY2021 –** The management has guided that the loss at distribution franchisees (DFs) is expected to reduce further to Rs. 15-20 crore in FY2021E (as compared to a net loss of Rs. 38 crore in FY2020 and versus earlier guidance for a Rs. 25-30 crore net loss). The improvement would be on the back of potential reduction in transmission and distribution (T&D) loss. Management has strong track record to reduce T&D loss in the power distribution and thus we remain confident of turnaround in distribution franchisee business, which could add significant value over next 2-3 years for CESC.
- **Dhariwal Infrastructure –** The company expects Dhariwal Infrastructure to report a marginal profit in FY2021E as compared to net loss of Rs. 10 crore in FY2020 and Rs. 93 crore in FY2019.
- **Dividend –** The management aims to maintain at the dividend at FY2020 level of Rs. 20/share, which implies a dividend yield of 3.3%.
- Power generation declined by 22.6% y-o-y to 1,329 million units in Q1FY2021 as compared to 1,718 million units in Q1FY2020. Power sales was impacted by lockdown and declined by 30.7% y-o-y to 2,118 million units in Q1FY2021.
- Transmission and distribution loss stood at 8.5% in Q1FY2021 versus 9% in Q1FY2020. Haldia and Chandrapur PLF was at 76.8% (versus 87.9% in Q1FY2020) and 75.8% (versus 70.8% in Q1FY2020), respectively in Q1FY2021.
- The management has guided for capex of Rs. 150 crore for the standalone business, Rs. 30-40 crore for Noida Power and Rs. 40-50 crore for DF.
- Cash & bank balance stood at Rs. 1,100-1,200 crore and debt was at Rs. 14,000 crore (flat q-o-q) as on June 2020.

Results (Standalone) Rs cr

Particulars	Q1FY21	Q1FY20	YoY(%)	Q4FY20	QoQ(%)
Revenue	**1,585**	**2,359**	**(32.8)**	**1,583**	**0.1**
Gross Profit	622	1,010	(38.4)	680	(8.5)
Operating profit	**228**	**442**	**(48.4)**	**251**	**(9.2)**
Other Income	34	23	47.8	49	(30.6)
Depreciation	117	109	7.3	121	(3.3)
Finance Cost	136	130	4.6	170	(20.0)
PBT	154	278	(44.6)	306	(49.7)
Tax	20	61	(67.2)	56	(64.3)
Reported PAT	**134**	**217**	**(38.2)**	**250**	**(46.4)**
EPS (Rs.)	10.1	16.3	(38.2)	18.8	(46.4)
Margins			**BPS**		**BPS**
Gross Margin (%)	39.2	42.8	-357	43.0	-371
OPM (%)	14.4	18.7	-435	15.9	-147
PAT Margin (%)	8.5	9.2	-74	15.8	-734
Tax Rate (%)	13.0	21.9	-896	18.3	-531

Source: Company; Sharekhan Research

Financial performance of key subsidiaries Rs cr

Particulars	Revenues		PAT	
	Q1FY21	Q1FY20	Q1FY21	Q1FY20
CESC Consolidated	2465	3257	200	231
Haldia Energy Ltd	540	575	85	76
Dhariwal Infrastructure Ltd	352	366	24	-24
Crescent Power	70	77	12	3
Noida Power	327	456	17	27
Kota/Bharatpur/Bikaner	376	434	-33	-53
Malegaon	52	0	-31	0

Source: Company

Outlook

Earnings to largely stabilise from Q2FY2021; turnaround of subsidiaries to boost performance: The PLF has recovered to 85-90% and lockdown norms in Kolkata (key area of operations) has been relaxed and thus we expect that earnings momentum should improve from Q2FY2021 onwards and full recovery in H2FY2021. Stable earnings from standalone operations, reduction of losses at distribution franchisee led by lower T&D losses and higher utilisation at Dhariwal is expected to improve consolidated earnings of CESC over FY2022E-FY2023E.

Valuation

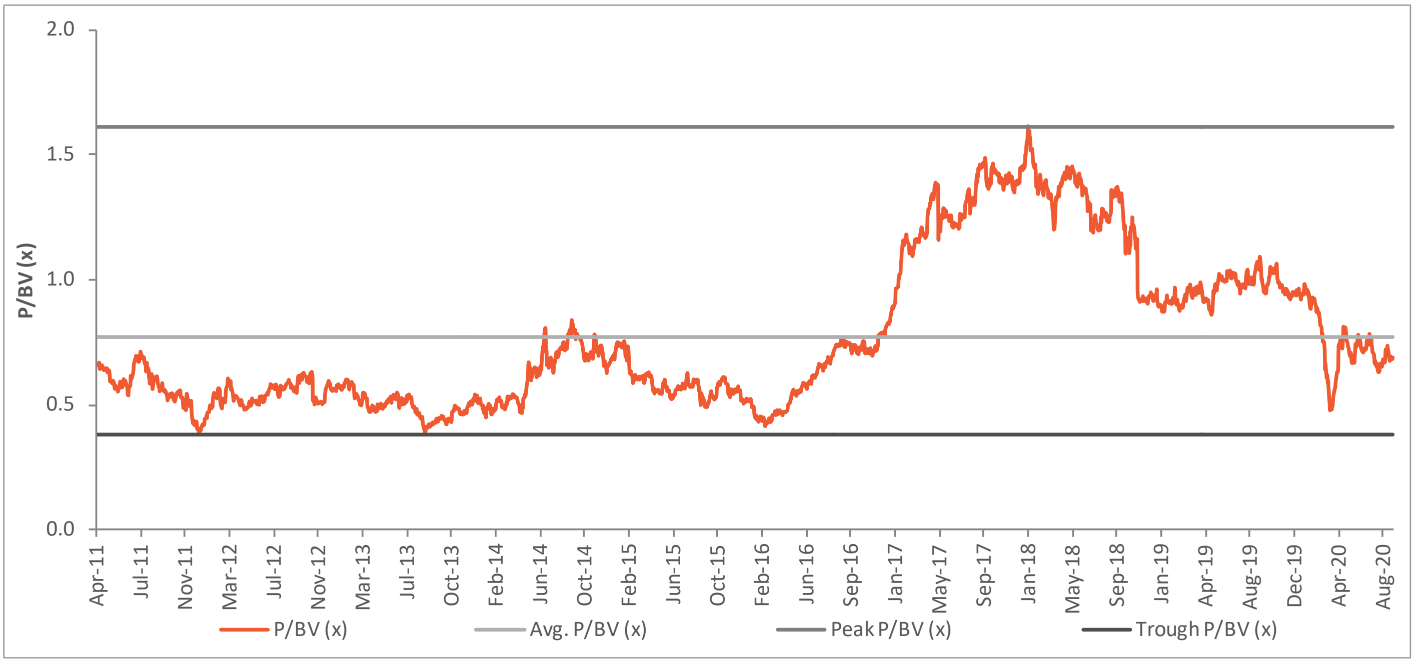
Maintain Buy on CESC with unchanged SoTP-based PT of Rs. 825: We have fine-tuned our earnings estimates for FY2021 and FY2022 as we expect an earnings recovery with improvement in power demand and have also introduced our FY2023 earnings estimates in this report. Steady earnings contribution from standalone business, turnaround of Dhariwal Infrastructure and Rajasthan distribution franchisee would improve CESC's consolidated financials over next couple of years. Potential singing of medium/long-term PPA in FY2022E for unit-1 of Dhariwal Infrastructure could act as a key re-rating trigger for CESC. The stock is also trading at an attractive valuation (of 0.7x FY2022E P/BV and 7.9x its FY2022E standalone EPS) and offers healthy dividend yield of 3.3%. Hence, we maintain our Buy rating on CESC with unchanged SoTP-based PT of Rs. 825.

SoTP-based PT of Rs. 825

Particulars	Value (Rs/share)	Methodology
Standalone business	550	7x FY22E EPS
Haldia	130	1.7x regulated equity of ~Rs1,150 crore
Dhariwal	75	1x regulated equity of ~Rs1,000 crore
Crescent Power	10	6.5x FY20 PAT for 67.8% stake
Noida	30	2.5x regulated equity of ~Rs400 crore for 49.6% stake
DF	30	1x Investments
Price target	**825**	

Source: Sharekhan Research

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

CESC Limited, started operations in 1899, is a fully integrated power utility company. The company is the sole distributor of electricity within an area of 567 sq. km of Kolkata and Howrah and serves 3.3 million consumers (including domestic, industrial and commercial users). The company owns and operates three thermal power plants with generation capacity of 1,125 MW for its Kolkata distribution business. Additionally, CESC has independent power plants at Haldia (600 MW) and Chandrapur (600 MW) along with renewable energy (174 MW wind projects). CESC have distribution licensee with in an area of 335 sq. km of Noida and serves 82,000 consumers. The company also has distribution franchisee in three cities of Rajasthan (Kota, Bikaner and Bharatpur – all are operational) and one city in Maharashtra (Malegaon – operations expected to start soon).

Investment theme

CESC has stable earnings contribution from standalone operations with regulated power generation and distribution businesses getting assured RoE of 15.5% on generation assets and 16.5% for distribution assets. Reducing loss at Dhariwal Infrastructure and Rajasthan distribution franchisee makes CESC an attractive investment proposition. CESC's valuation is also attractive.

Key Risks

- Delay in signing of long-term PPA for Chandrapur plant.
- Sustained losses in distribution franchisee for an extended period.

Additional Data

Key management personnel

Sanjiv Goenka	Chairman
Rajarshi Banerjee	Chief Financial Officer
Rabi Chowdhury	Managing Director – Generation
Debasish Banerjee	Managing Director – Distribution

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	9.3
2	Sun Life Financial Inc	5.9
3	Reliance Capital Trustee Co Ltd	3.2
4	ICICI Prudential Asset Management	2.3
5	BNK Capital Markets Ltd	2.2
6	Life Insurance Corp of India	2.1
7	Franklin Resources Inc	2.0
8	STEL Holdings Ltd	1.9
9	Vanguard Group Inc/The	1.6
10	Emirate of Abu Dhabi United Arab	1.5

Source: Bloomberg

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