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CESC Limited

Steady Q4; Subsidiaries' turnaround to drive re-rating

Power	Sharekhan code: CESC	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 770**	
Price Target: **Rs. 905**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

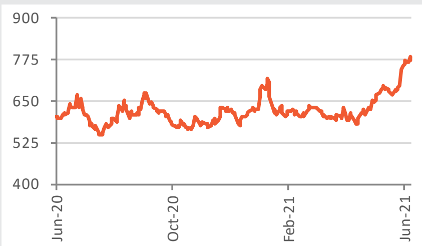
Company details

Market cap:	Rs. 9,624 cr
52-week high/low:	Rs. 801 / 539
NSE volume: (No of shares)	6.0 lakh
BSE code:	500084
NSE code:	CESC
Free float: (No of shares)	6.6 cr

Shareholding (%)

Promoters	50
FII	15
DII	24
Others	12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12	26	25	28
Relative to Sensex	-2	-5	-13	3

Sharekhan Research, Bloomberg

Summary

- Q4FY21 results were strong with consolidated PAT rising 15.6% y-o-y to Rs. 423 crore, on improved performance of subsidiaries and 8% y-o-y growth in standalone PAT to Rs. 270 crore (volume growth of 5.8% y-o-y and lower tax rate).
- Subsidiaries performed well - Dhariwal Infra clocked PAT of Rs. 31 crore; for Haldia/ Noida Power PAT grew by 12%/63% y-o-y. Rajasthan DF saw loss shrink to Rs. 4 crore and Malegaon DF PAT of Rs. 31 crore (vs. loss of Rs. 18 crore in Q4FY20). Management guided for 5% y-o-y fall in Q1FY22 power sales volume and normalized standalone PAT of ~Rs. 920 for FY22.
- Sustained profitable operations at Dhariwal Infrastructure, potential turnaround of the Rajasthan/Malegaon DF in FY2022 led by lower T&D loss, and consolidation of power distribution business under one SPV could act as a key re-rating trigger.
- We maintain our Buy rating on CESC with a revised SoTP-based PT of Rs. 905. The stock trades at attractive valuation of 0.9x its FY2023E P/BV and offers healthy dividend yield of 6%.

CESC Limited's (CESC) Q4FY2021 consolidated PAT increased by 15.6% y-o-y to Rs. 423 crore, led by improvement in performance of subsidiaries and decent 8% y-o-y growth in standalone PAT to Rs. 270 crore (4.7% above our estimate of Rs. 258 crore). The recovery in the standalone business was led by recovery in power sales volume (up 5.8% y-o-y to 2,229 million units), efficient cost management (employee cost down by 26% y-o-y), and lower effective tax rate of only 5.6% (versus 18.3% in Q4FY2020). In terms of subsidiaries, Dhariwal Infrastructure witnessed sustained profitable operations with PAT of Rs. 31 crore (versus only Rs. 4 crore in Q4FY2020 post adjustment of one-time income of Rs. 50 crore related to clean energy surcharge), while Haldia Energy/Noida Power reported 12%/63% y-o-y rise in profit to Rs. 76 crore/Rs. 31 crore in Q4FY2021. The Rajasthan distribution franchisee (DF) lowered net loss to Rs. 4 crore (versus net loss of Rs. 9 crore in Q4FY2020) and Malegaon DF performance surprised positively with PAT of Rs. 31 crore (versus loss of Rs. 18 crore in Q4FY2020) led by reduction in transmission & distribution (T&D) loss. However, Crescent Power reported net loss of Rs. 3 crore versus PAT of Rs. 24 crore in Q4FY2020. Management indicated that there is no major impact on power demand (expect for commercial power demand) in standalone operations due to lockdown in April-May 2021 and has guided for standalone PAT to reach normalised level of ~Rs. 920 crore in FY2022 and a likely tariff order could further add to earnings as capex of Rs. 1,000 crore is yet be approved by the power regulator. Management also expects turnaround at Dhariwal Infrastructure to sustain given considerable improvement in PLF for Chandrapur plant (80.4% in FY2021 versus 64.1% in FY2020), while Rajasthan/Malegaon DFs are on track to achieve PAT breakeven or report marginal profit in FY2022E. Consistent improvement in performance of subsidiaries and steady performance of standalone business bode well for improvement in consolidated earnings over FY2022E-FY2023E and would lead to gradual re-rating of CESC. We like CESC's business model as regulated RoE provides earnings visibility and the company is available at attractive valuation of 0.9x FY2023E P/BV and offers healthy dividend yield of 6%. Hence, we maintain our Buy rating on CESC with a revised SoTP-based PT of Rs. 905.

Key positives

- Dhariwal Infrastructure reported PAT of Rs. 106 crore in FY2021 versus net loss of Rs. 10 crore in FY2020.
- Standalone power sales volume increased by 5.8% y-o-y to 2,229 million units.

Key negatives

- Crescent Power reported net loss of Rs. 3 crore versus PAT of Rs. 24 crore in Q4FY2020.

Our Call

Valuation - Maintain Buy on CESC with a revised SoTP-based PT of Rs. 905: We see scope for gradual re-rating in CESC, led by steady earnings from the standalone business, sustained profitable operations at Dhariwal Infrastructure, and potential turnaround of the Rajasthan/Malegaon distribution franchisee in FY2022E. The consolidation of entire power distribution business (excluding Kolkata business) under one SPV is a step in the right direction and is expected to drive operational efficiencies going forward. We like the business model of CESC as regulated RoE provides earnings visibility and valuation is also attractive at 0.9x FY2023E P/BV along with a healthy dividend yield of 6%. Hence, we maintain our Buy rating on CESC with a revised SoTP-based PT of Rs. 905 (increase in PT reflects higher value for Dhariwal Infrastructure, standalone business, and increase in stake in Noida Power to 72.73%).

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	FY20	FY21	FY22E	FY23E
Revenues	7,836	6,921	8,129	8,739
OPM (%)	18.3	17.0	18.8	18.5
PAT	918	814	968	1,103
% y-o-y growth	*(2.0)*	*(11.3)*	*19.0*	*13.9*
EPS (Rs.)	68.9	61.1	72.7	82.8
P/E (x)	11.2	12.6	10.6	9.3
Price/ Book (x)	1.0	1.0	1.0	0.9
EV/EBITDA (x)	9.8	13.3	9.3	8.3
RoCE (%)	8.0	6.2	7.7	8.2
RoE (%)	9.3	8.1	9.4	10.0

Source: Company; Sharekhan estimates

Strong 16% y-o-y rise in consolidated PAT; Decent standalone performance

CESC's Q4FY2021 consolidated PAT increased by 15.6% y-o-y to Rs. 423 crore, led by improvement in performance of subsidiaries and decent 8% y-o-y growth in standalone PAT to Rs. 270 crore (4.7% above our estimate of Rs. 258 crore) led by volume recovery (up 5.8% y-o-y to 2,229 million units), efficient cost management (employee cost down by 26% y-o-y), and lower effective tax rate of only 5.6% (versus 18.3% in Q4FY2020). In terms of subsidiaries, Dhariwal Infrastructure witnessed sustained profitable operations with PAT of Rs. 31 crore (versus only Rs. 4 crore in Q4FY2020 post adjustment of one-time income of Rs. 50 crore related to clean energy surcharge), while Haldia Energy/Noida Power reported 12%/63% y-o-y rise in profit to Rs. 76 crore/Rs. 31 crore in Q4FY2021. Rajasthan DF lowered net loss to Rs. 4 crore (versus net loss of Rs. 9 crore in Q4FY2020) and Malegaon DF performance surprised positively with PAT of Rs. 31 crore (versus loss of Rs. 18 crore in Q4FY2020). However, Crescent Power reported net loss of Rs. 3 crore versus PAT of Rs. 24 crore in Q4FY2020.

Key takeaways from management discussion

- **Power demand scenario in Kolkata and PAT –** Management has indicated that power demand in Kolkata was largely normal in April 2021 but witnessed some impact on power demand from commercial customers in May 2021. Overall, the situation is much better compared to last year and has guided for a 5% y-o-y decline in its power sales volume in Q1FY2022.
- **Standalone PAT guidance –** Management expects earnings to largely normalise in the current fiscal and guided for PAT of Rs. 920 crore.
- **Reorganisation of power distribution business completed –** The company has brought all of its power distribution business under one special purpose vehicle (SPV) and has increased stake in Noida Power to 72.73% (from 49.6%).
- **Receivables situation –** The company's receivables has declined to Rs. 1,394 crore as of March 2021 versus Rs. 1,800 crore as of December 2020 and Rs. 2,071 crore as of September 2020. Management has guided that receivable would normalise of Rs. 1,000 crore in the next two quarters.
- **Dhariwal Infrastructure –** The company has successfully achieved turnaround of Dhariwal Infrastructure with PAT of Rs. 106 crore in FY2021 versus net loss of Rs. 10 crore in FY2020. Management expects that turnaround is sustainable and has guided to maintain profit in FY2022 despite lower utilisation at Chandrapur plant in Q1FY2022.
- **Distribution franchisee business outlook –** The company has substantially reduced losses at Rajasthan DF to Rs. 15 crore in FY2021 versus net loss of Rs. 38 crore in FY2020. Management expects Rajasthan and Malegaon DFs to breakeven or report marginal profits in FY2022.
- T&D loss declined to 8.35% in FY2021 as compared to 8.9% in FY2020.

Result table (Standalone) Rs cr

Particulars	Q4FY21	Q4FY20	Y-o-Y %	Q3FY21	Q-o-Q %
Revenue	1,688	1,583	6.6	1,659	1.7
Gross Profit	751	680	10.4	723	3.9
EBITDA	310	251	23.5	299	3.7
Other Income	104	49	112.2	28	271.4
Depreciation	117	121	(3.3)	116	0.9
Finance Cost	128	170	(24.7)	117	9.4
PBT	286	306	(6.5)	208	37.5
Total Tax	16	56	(71.4)	26	(38.5)
Reported PAT	**270**	**250**	**8.0**	**182**	**48.4**
EPS (Rs.)	20.3	18.8	8.0	13.7	48.4
Margin (%)			**BPS**		**BPS**
Gross Margin	44.5	43.0	153	43.6	91
EBITDA Margin	18.4	15.9	251	18.0	34
PAT Margin	16.0	15.8	20	11.0	502
Tax Rate	5.6	18.3	-1,271	12.5	-691

Source: Company; Sharekhan Research

Financial performance of key subsidiaries Rs cr

Particulars	Revenues		PAT	
	Q4FY21	Q4FY20	Q4FY21	Q4FY20
Haldia Energy Ltd	481	518	76	68
Dhariwal Infrastructure Ltd	419	383	31	4
Crescent Power	59	93	-3	24
Noida Power	456	388	31	19
Kota/Bharatpur/Bikaner	321	398	-4	-9
Malegaon	151	23	31	-18

Source: Company; Sharekhan Research; Note: We have adjusted Q4FY20 PAT of Dhariwal Infrastructure for exceptional income of Rs.50 crore

Improving performance of key subsidiaries Rs cr

Particulars	Q1FY20	Q2FY20	Q3FY20	Q4FY20	FY20	Q1FY21	Q2FY21	Q3FY21	Q4FY21	FY21
Haldia Energy	76	91	83	68	**318**	85	110	90	76	**361**
Dhariwal Infrastructure	-24	25	-15	4	**-10**	24	23	28	31	**106**
Crescent Power	3	17	-18	24	**26**	12	7	6	-3	**22**
Noida Power	27	65	29	19	**140**	17	30	23	31	**101**
RJ distribution franchisee	-53	-3	27	-9	**-38**	-33	1	21	-4	**-15**
Malegaon distrinbution	0	0	0	-20	**-20**	-31	-9	-14	31	**-23**

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector view - Regulated tariff model provides earnings visibility for power generation companies**

India's power sector is regulated by the Central Electricity Regulatory Commission (CERC) through an availability-based earnings model (fixed RoE on power generation assets) and, thus, the regulated tariff model provides strong earnings visibility for power-generation companies such as CESC. Improved power demand (except for April-May 2021 given lockdown but the situation is better compared last year) would result in a higher PLF for power-generation companies and improve PLF incentive income. Additionally, receivables of power-generation companies are likely to reduce in FY2022 as an economic recovery would result in timely receipt of dues from customers.

■ **Company outlook - Recovery in standalone business and turnaround of subsidiaries to improve consolidated earnings**

Power demand in CESC's standalone business has not seen any major impacted expect from the commercial segment and, thus, management is quite optimistic that FY2022 would see normalised profit levels. Recovery in earnings from standalone operations, reduction of losses at distribution franchisee led by lower T&D losses, and higher utilisation at Dhariwal Infrastructure are expected to improve consolidated earnings of CESC over FY2022E-FY2023E.

■ **Valuation - Maintain Buy on CESC with a revised SoTP-based PT of Rs. 905**

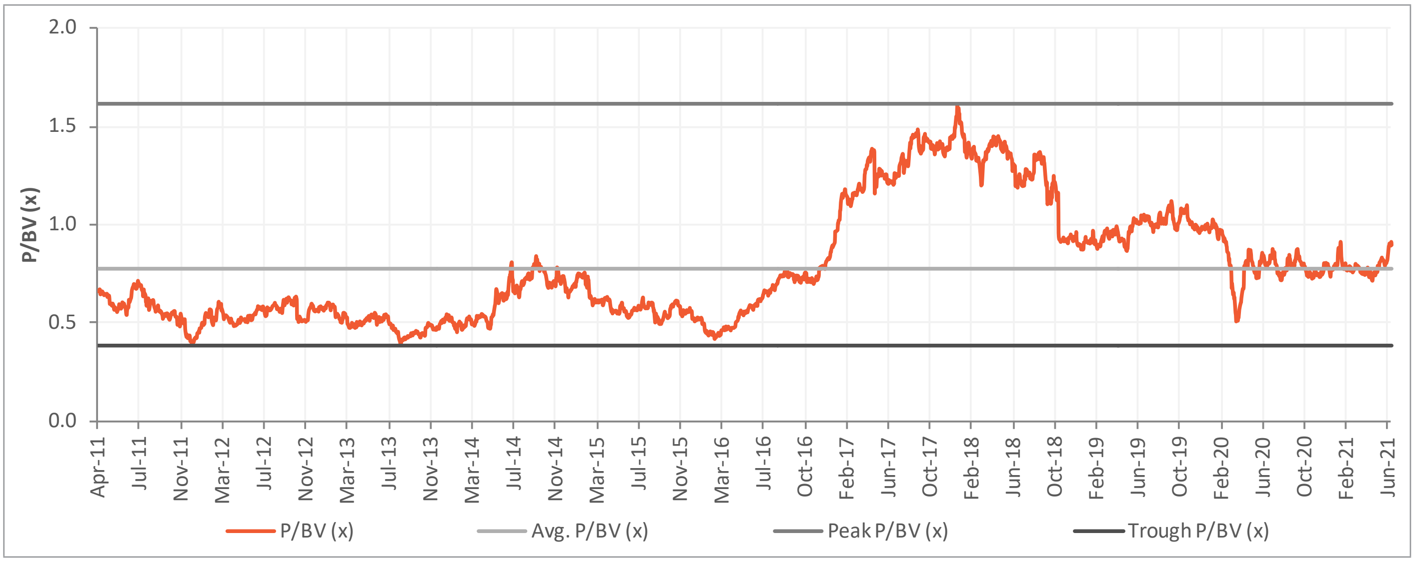
We see scope for gradual re-rating in CESC, led by steady earnings from the standalone business, sustained profitable operations at Dhariwal Infrastructure, and potential turnaround of the Rajasthan/Malegaon distribution franchisee in FY2022E. The consolidation of entire power distribution business (excluding Kolkata business) under one SPV is a step in the right direction and is expected to drive operational efficiencies going forward. We like the business model of CESC as regulated RoE provides earnings visibility and valuation is also attractive at 0.9x FY2023E P/BV along with a healthy dividend yield of 6%. Hence, we maintain our Buy rating on CESC with a revised SoTP-based PT of Rs. 905 (increase in PT reflects higher value for Dhariwal Infrastructure, standalone business, and increase in stake in Noida Power to 72.73%).

SoTP-based PT of Rs. 905

Particulars	Value (Rs/share)	Methodology
Standalone business	580	7x FY23E EPS
Haldia	130	1.5x regulated equity of ~Rs1150 crore
Dhariwal	113	1.5x regulated equity of ~Rs1000 crore
Crescent Power	7	6.5x FY21 PAT for 67.8% stake
Noida	44	2x regulated equity of ~Rs400 crore for 72.73% stake
DF	31	1x Investments
Price target	**905**	

Source: Sharekhan Research

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

CESC started operations in 1899. The company 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 has a distribution license within 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 DF make 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 DF 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 Trustee Company Ltd.	9.0
2	HDFC Asset Management Co. Ltd.	9.0
3	Massachusetts Financial Services Co.	5.8
4	ICICI Prudential Asset Management Co. Ltd	4.0
5	BNK Capital Markets Ltd.	2.2
6	Life Insurance Corp. of India	2.1
7	Nippon Life India Asset Management Ltd.	2.0
8	STEL Holdings Ltd.	1.9
9	Vanguard Group Inc/The	1.8
10	UTI Asset Management Co. Ltd.	1.7

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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