Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

CESC Ltd

Muted Q3; subsidiaries' turnaround to create value

Power	Sharekhan code: CESC
Reco/View: Buy ↔	CMP: Rs. 92 / Price Target: Rs. 105 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q3FY22 consolidated PAT remained flat y-o-y at Rs. 329 crore as benefit of higher short-term power rates at Dhariwal (PAT up 79% y-o-y) and steady standalone performance was offset by a sharp 90% y-o-y decline in profit from Rajasthan DF.
- Standalone power generation grew by 2.7% y-o-y to 1,242 million units but power sales volumes was muted with growth of 0.7% y-o-y to 2,173 million units as demand from schools was still below pre-COVID levels.
- Improvement in financial performance of Rajasthan/Malegaon DFs in FY23 would boost consolidated earnings. Potential higher profit/RoI (target of Rs. 100 crore PAT and RoI of 12% over next 4 years) at Chandigarh discoms to create value.
- We maintain a Buy rating on CESC with an unchanged SoTP-based PT of Rs. 105 as valuation seems attractive at 1.1x its FY2023E P/BV and stock offers a healthy dividend yield of 5-6%.

CESC reported flat y-o-y consolidated PAT of Rs.329 crore as a 1.8x y-o-y rise in profit from Dhariwal Infrastructure to Rs. 50 crore given the benefit of increase in merchant power tariff (benefit of Rs. 15-20 crore) and steady standalone earnings (PAT up 1.1% y-o-y to Rs. 184 crore, broadly in-line but power sales volume growth of just 0.7% y-o-y to 2173 MU disappointed) was offset by sharp 90% decline in profits from Rajasthan DF to Rs. 2 crore as power demand in Kota still remains below pre-COVID level. In addition, profit at Haldia Energy declined by 8% y-o-y to Rs. 83 crore reflecting lower PLF of 80% (versus 83.6% in Q3FY21) while net loss from Malegaon DF declined to Rs. 12 crore versus Rs. 14 crore in Q3FY21. Other subsidiaries like Crescent Power/Noida Power posed good performance with 29%/17% y-o-y rise in PAT to Rs. 7 crore/Rs. 23 crore.

Key positives

- Dhariwal Infrastructure reported robust 79% y-o-y increase in PAT to Rs. 50 crore in Q3FY22.
- Declared interim dividend of Rs. 4.5/share, which implies yield of 5% on CMP.

Key negatives

- Rajasthan DFs reported lower profit of Rs. 2 crore versus Rs. 21 crore.

Management Commentary

- The management expects Rajasthan and Malegaon DFs to report minor loss in FY2022 but guided that the two DFs to become profitable in FY23 with better demand and focus to lower T&D loss. The company expects Q4FY22 to be better for the Rajasthan DF.
- Standalone performance would be better in Q4FY22 as adjustment with respect to regulatory aspects would be visible and thus expect to report higher y-o-y standalone earnings in FY22 despite marginal 2% y-o-y growth in PAT in 9MFY22.
- The management expect Letter of Intent for the Chandigarh discom to be received in Q4FY22 and targets to increase PAT from the discom to ~Rs. 100 crore over the next four years as compared to Rs. 35 crore currently.
- Dhariwal Infrastructure has participated with a 210 MW bid in a medium term power purchase tender floated by the Railway Energy Management Company Limited for three years. This could result in additional ~Rs30 crore of profit on annualized basis to Dhariwal Infrastructure.

Revision in estimates – We have fine-tuned our FY22 earnings estimates to factor lower power sales volume and maintain our FY23-24 earnings estimates.

Our Call

Valuation - Maintain Buy with an unchanged SoTP-based PT of Rs. 105: 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 DF in FY2023E. We like CESC's business as regulated RoE provides earnings visibility and valuations are also attractive at 1.1x its FY2023E P/BV along with a healthy dividend yield of ~5-6%. Hence, we maintain a Buy on CESC with an unchanged SoTP-based PT of Rs. 105.

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	FY21	FY22E	FY23E	FY24E
Revenue	6,921	8,129	8,739	9,446
OPM (%)	17.0	18.8	18.5	18.5
PAT	814	927	1,089	1,181
% y-o-y growth	(11.3)	13.9	17.4	8.5
EPS (Rs.)	6.1	7.0	8.2	8.9
P/E (x)	15.0	13.1	11.2	10.3
Price/ Book (x)	1.2	1.2	1.1	1.0
EV/EBITDA (x)	14.9	10.6	9.5	8.3
RoCE (%)	6.2	7.4	8.2	8.4
RoE (%)	8.1	9.0	9.9	10.0

Source: Company; Sharekhan estimates

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 61.43
Updated Jan 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

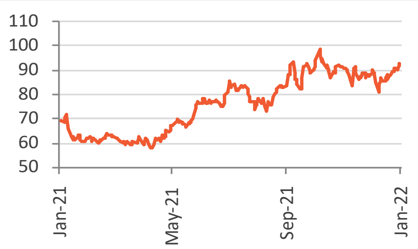
Company details

Market cap:	Rs. 11,525 cr
52-week high/low:	Rs. 102/58
NSE volume: (No of shares)	32.6 lakh
BSE code:	500084
NSE code:	CESC
Free float: (No of shares)	63.5 cr

Shareholding (%)

Promoters	52
FII	13
DII	22
Others	12

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.0	-6.2	8.2	32.8
Relative to Sensex	-3.4	-5.3	-7.5	9.3

Sharekhan Research, Bloomberg

Muted quarter as strong performance of Dhariwal Infrastructure gets offset by lower profit of RJDF

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Results (Standalone) Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Revenue	**1,662**	**1,659**	**0.2**	**2,091**	**(20.5)**
Total expenditure	1,450	1,360	6.6	1,672	(13.3)
Operating profit	**212**	**299**	**(29.1)**	**419**	**(49.4)**
Other Income	58	28	107.1	32	81.3
Depreciation	117	116	0.9	116	0.9
Finance Cost	123	117	5.1	124	(0.8)
PBT	231	208	11.1	306	(24.5)
Tax	47	26	80.8	71	(33.8)
Reported PAT	**184**	**182**	**1.1**	**235**	**(21.7)**
EPS (Rs.)	13.8	13.7	1.1	17.7	(21.7)
Margin			**YoY (bps)**		**QoQ (bps)**
OPM (%)	12.8	18.0	-527	20.0	-728
NPM (%)	11.1	11.0	10	11.2	-17
Tax Rate (%)	20.3	12.5	785	23.2	-286

Source: Company, Sharekhan Research

Financial performance of key subsidiaries Rs cr

Particulars	Revenue		PAT	
	Q3FY22	Q3FY21	Q3FY22	Q3FY21
Haldia Energy	581	571	83	90
Dhariwal Infrastructure	378	379	50	28
Crescent Power	61	63	9	7
Noida Power	464	414	27	23
Kota/Bharatpur/Bikaner	348	333	2	21
Malegaon	131	122	-12	-14

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 the lockdown, but situation is better as compared to last year) would drive up PLFs 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 - Steady performance by standalone biz, turnaround of subsidiaries to improve consolidated earnings

CESC is quite optimistic that FY2022 would see normalised profit, given recovery in power demand in the standalone business. Recovery in earnings from standalone operations, reduction of losses at distribution franchisees 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 an unchanged SoTP-based PT of Rs. 105

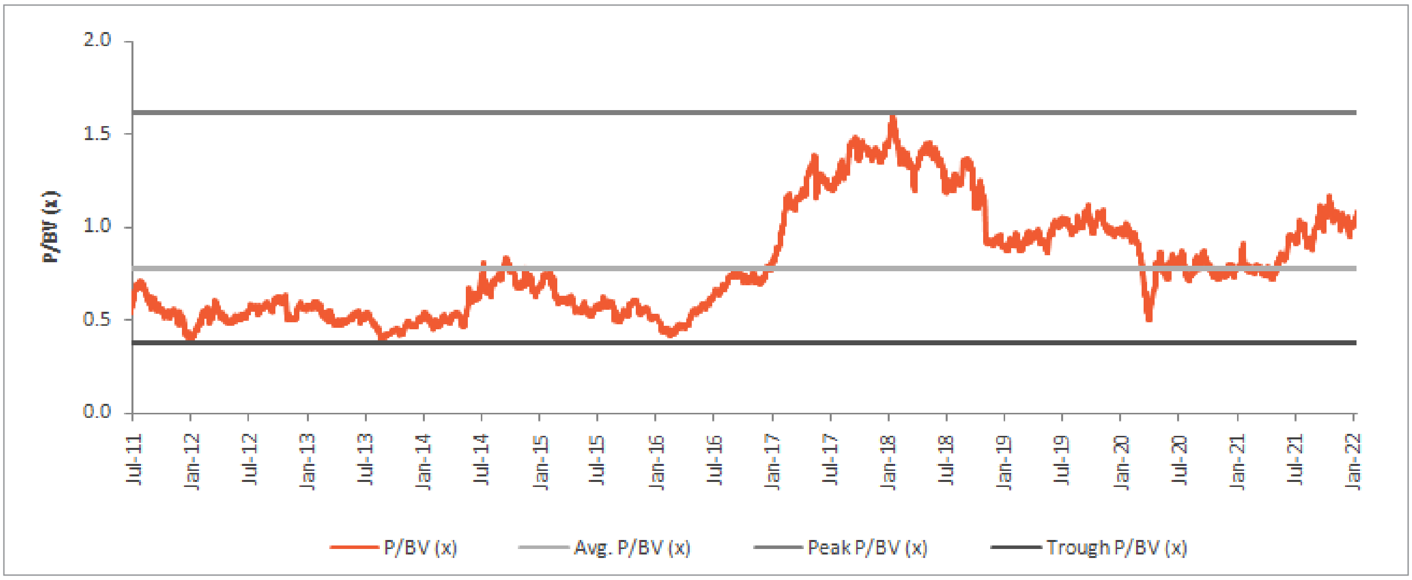
We see scope for gradual re-rating in CESC, led by steady earnings from the standalone business, sustained profitable operations at Dhariwal Infrastructure and potential turnaround of the Rajasthan/Malegaon DF in FY2023E. We like CESC's business as regulated RoE provides earnings visibility and valuations are also attractive at 1.1x its FY2023E P/BV along with a healthy dividend yield of ~5-6%. Hence, we maintain a Buy on CESC with an unchanged SoTP-based PT of Rs. 105.

SoTP-based PT of Rs. 105

Particulars	Value (Rs./share)	Methodology
Standalone business	66	8x its FY2023E EPS
Haldia	13	1.5x regulated equity of ~Rs. 1,150 crore
Dhariwal	16	2.1x regulated equity of ~Rs. 1,000 crore
Crescent Power	1	6.5x its FY2021 PAT for 67.8% stake
Noida	4	2x regulated equity of ~Rs. 400 crore for 72.73% stake
DF	5	1.5x Investments
Price target	**105**	

Source: Company, 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co. Ltd	7.7
2	ICICI Prudential India Opp	4.0
3	ICICI Prudential Asset Management Co. Ltd	3.7
4	Massachusetts Financial Services Co.	2.3
5	Life Insurance Corp of India	2.1
6	UTI Asset Management Co. Ltd	1.9
7	Vanguard Group Inc/The	1.9
8	Aditya Birla Sun Life Trustee Co. Pvt Ltd	1.3
9	Aditya Birla Sun Life Asset Management Co. Ltd	1.2
10	DSP Investment Managers Pvt. Ltd	1.0

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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