



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 Updated Apr 08, 2022 34.35

High Risk

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

Source: Morningstar

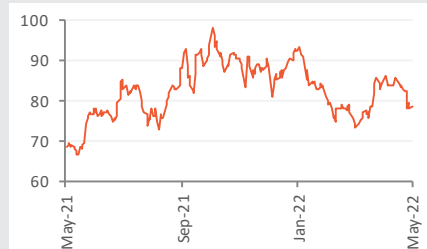
Company details

Market cap:	Rs. 9,826 cr
52-week high/low:	Rs. 102/66
NSE volume: (No of shares)	9.2 lakh
BSE code:	500084
NSE code:	CESC
Free float: (No of shares)	63.5 cr

Shareholding (%)

Promoters	52
FII	14
DII	21
Others	13

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.6	-0.6	-11.8	14.8
Relative to Sensex	2.6	7.9	-0.1	7.9

Sharekhan Research, Bloomberg

CESC Ltd

Decent Q4; Play on the power distribution theme

Power	Sharekhan code: CESC		
Reco/View: Buy	↔	CMP: Rs. 79	Price Target: Rs. 95
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Q4FY2022 consolidated PAT was flat y-o-y at Rs. 424 crore as strong performance of Noida Power gets offset by higher loss at distribution franchise (DF) business amid impact on demand due to COVID-19 third wave.
- Standalone PAT was steady at Rs. 259 y-o-y (down 4.1% q-o-q) despite weak power sales volume of 2,100 MU (down 5.8% y-o-y) beating our estimate of Rs. 215 crore on higher regulatory income and lower tax rate. Haldia/Dhariwal PAT declined by 21%/10% on weak demand and high base of Q4FY2021, especially for Dhariwal.
- Dhariwal Infra signed a 210 MW medium-term PPA with Central Railway for three years, which would further aid the profitability of Dhariwal Infra (FY2022 PAT of Rs. 137 crore versus Rs. 106 crore in FY2021). RJ losses to reduce in FY2022 but breakeven timeline extends due to weak demand in Kota.
- The recent sharp fall in the stock price provides a good entry opportunity and potential scale-up of power distribution (recently won Chandigarh discom) could create long-term value for investors. Hence, we maintain a Buy on CESC with a revised PT of Rs. 95 (lower valuation for standalone and DF valuation), given attractive valuation of 0.9x its FY2024E P/BV and dividend yield of ~6%.

CESC reported flat y-o-y consolidated PAT of Rs. 424 crore as strong profitability in Noida Power (PAT up 2.3x y-o-y to Rs. 77 crore) was offset by increased losses at Rajasthan/Malegaon DFs, while standalone business performance was steady with PAT of Rs. 259 crore, down 4% y-o-y on lower power sales volume of 2,100 million units (down 5.8% y-o-y) due to impact of COVID-19 in January/February 2022. Rajasthan DF net loss increased to Rs. 11 crore (versus Rs. 4 crore in Q4FY2021) because of weak power demand in Kota (still below pre-COVID level), while Bharatpur and Bikaner remain profitable. Profit at Haldia and Dhariwal declined by 21%/ 10% y-o-y to Rs. 60 crore/Rs. 28 crore, respectively, primarily due to lower plant PF of 64.4%/80.5% (versus 69.6%/85% in Q4FY2021), given weak power demand and high base for Dhariwal (had benefit of one-off clean energy surcharge income) in Q4FY2021.

Key positives

- Noida Power has shown strong performance with 2.3x y-o-y rise in PAT.
- Dhariwal Infra signed a 210 MW medium-term PPA with Central Railways for three years.

Key negatives

- Losses widened at Rajasthan DF to Rs. 11 crore as demand still remains below pre-COVID level in Kota circle.

Management Commentary

- Management has guided that losses in Rajasthan DF to halve in FY2023, supported by recovery in power demand and lower T&D losses.
- Standalone PAT growth guidance of 10% as management expects decent power sales volume recovery and does not see any major Covid-related demand destruction in the current fiscal.
- 210 MW tender won by Dhariwal Infrastructure, which would help improve its earnings as it gives visibility on higher PLF. Management has guided 15-20% earnings growth at Dhariwal Infrastructure in FY2023.
- Management stated that CESC is yet to receive the handover of Chandigarh Discom and expects the same in Q1FY2023.
- Completed sale of Surya Vidyut at consideration of Rs. 305 crore.

Revision in estimates – We have lowered our FY2023-FY2024 standalone earnings estimates to factor lower tariff for Kolkata distribution business.

Our Call

Valuation - Maintain Buy with a revised SoTP-based PT of Rs. 95: CESC is a play on investment and turnaround of power distribution business and we expect earnings to gradually improve with further improvement in utilisation at Dhariwal Infrastructure and potential turnaround of Rajasthan/Malegaon DF in FY2024E, while the standalone business is largely stable, given regulated RoE model. Valuation is attractive at 0.9x its FY2024E P/BV and the stock offers a healthy dividend yield of ~6%. Hence, we maintain Buy on CESC with a revised SoTP-based PT of Rs. 95 (reflects lower valuation for standalone business and Rajasthan DF as turnaround timeline extends).

Key Risks

Sustained losses in the distribution franchisee for an extended period and lower utilisation of Chandrapur plant.

Valuation (Standalone)

Particulars	FY21	FY22	FY23E	FY24E
Revenue	6,921	7,294	8,226	8,849
OPM (%)	17.0	15.3	17.0	17.5
PAT	814	816	930	1,039
% y-o-y growth	(11.3)	0.2	14.0	11.7
EPS (Rs.)	6.1	6.2	7.0	7.8
P/E (x)	12.8	12.8	11.2	10.0
P/B (x)	1.0	1.0	1.0	0.9
EV/EBITDA (x)	13.4	15.8	11.0	9.4
RoCE (%)	6.2	6.7	6.8	7.9
RoE (%)	8.1	8.2	9.0	9.5

Source: Company; Sharekhan estimates

Steady Q4 performance despite weak power demand amid the third Covid wave

CESC reported flat y-o-y consolidated PAT of Rs. 424 crore as strong profitability in Noida Power (PAT up 2.3x y-o-y to Rs. 555 crore) was offset by increased losses at the power distribution business and increased losses at Rajasthan/Malegaon DF, while standalone business performance was steady with PAT of Rs. 259 crore, down 4% y-o-y on lower volumes. Rajasthan DF losses increased because of weak power demand in Kota, while Bharatpur and Bikaner have turned profitable. Profits at Haldia and Dhariwal declined annually by 21% and 10% to Rs. 60 crore and Rs. 28 crore, respectively, primarily due to lower plant PF, given weak demand.

Results (Standalone)

					Rs cr
Particulars	Q4FY22	Q4FY21	y-o-y (%)	Q3FY22	q-o-q (%)
Revenue	1,935	1,805	7.2	1,863	3.9
Total expenditure	1,434	1,378	4.1	1,450	(1.1)
Operating profit	501	427	17.3	413	21.3
Other income	81	104	(22.1)	58	39.7
Depreciation	120	117	2.6	117	2.6
Interest	130	128	1.6	123	5.7
PBT	332	286	16.1	231	43.7
Tax	73	16	356.3	47	55.3
Reported PAT	259	270	(4.1)	184	40.8
O/S equity shares (crore)	133	133		133	
Reported EPS (Rs.)	2.0	2.0	(4.1)	1.4	40.8
Margin (%)			Bps		Bps
OPM	25.9	23.7	223	22.2	372
NPM	13.4	15.0	-157	9.9	351
Tax rate	22.0	5.6	1,639	20.3	164

Source: Company, Sharekhan Research

Financial performance of key subsidiaries

					Rs cr
Particulars	Revenue		PAT		
	Q4FY22	Q4FY21	Q4FY22	Q4FY21	
Haldia Energy	481	481	60	76	
Dhariwal Infrastructure	534	419	28	31	
Crescent Power	50	59	-3	-3	
Noida Power	555	456	71	31	
Kota/Bharatpur/Bikaner	344	321	-11	-4	
Malegaon	128	151	-16	31	

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 business, turnaround of subsidiaries to improve consolidated earnings

CESC is quite optimistic that FY2023 would see better earnings, given recovery in power demand in the standalone business. Earnings recovery 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 FY2023E-FY2024E.

■ Valuation – Maintain Buy on CESC with a revised SoTP-based PT of Rs. 95

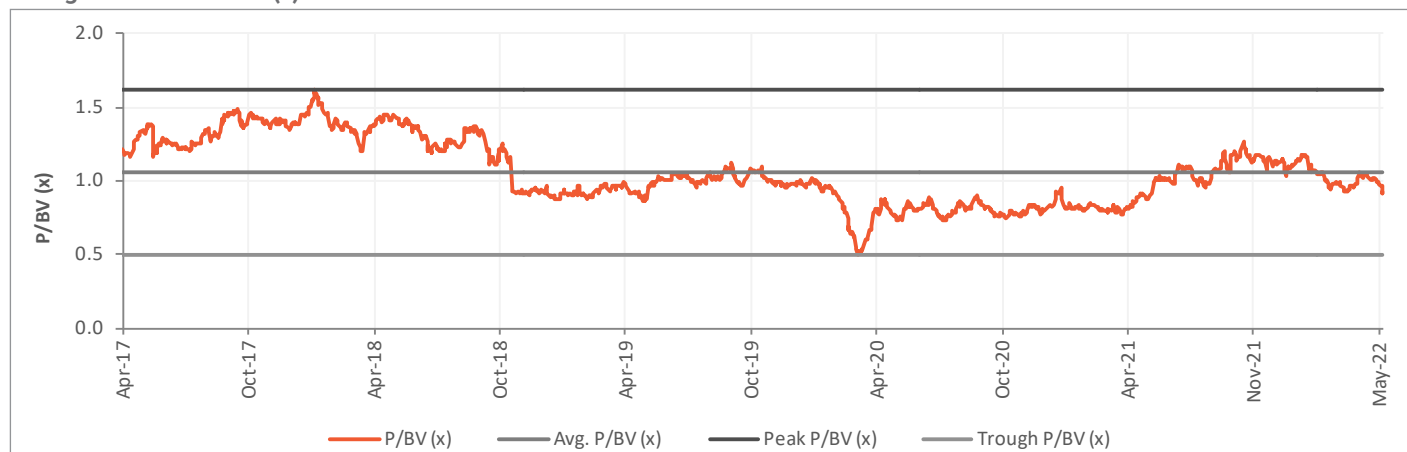
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SoTP-based PT of Rs. 95

Particulars	Value (Rs/share)	Methodology
Standalone business	56	8x FY23E EPS
Haldia	15	1.7x regulated equity of ~Rs. 1,150 crore
Dhariwal	17	2.3x regulated equity of ~Rs. 1,000 crore
Crescent Power	1	6.5x FY2021 PAT for 67.8% stake
Noida	4	2x regulated equity of ~Rs. 400 crore for 72.73% stake
DF	2	0.6x Investments
Price target	95	

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.

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	6.68
2	ICICI Prudential India OPP	3.74
3	ICICI Prudential Asset Management Co Ltd/ India	3.04
4	Life Insurance Corp of India	3.03
5	Massachusetts Financial Services	2.34
6	UTI Asset Management Co Ltd	2.12
7	Vanguard Group Inc	1.57
8	Aditya Birla Sun Life Trustee Co Pvt Ltd	1.24
9	Aditya Birla Sun Life Asset Management Co Ltd	1.24
10	FIL Ltd	0.93

Source: Bloomberg

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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 deteriorating 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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