Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

CESC Ltd

Decent Q3; valuations attractive

Power	Sharekhan code: CESC		
Reco/View: Buy ↔	CMP: Rs. 77	Price Target: Rs. 95 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

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 33.86
Updated Feb 08, 2023

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 9,595 cr
52-week high/low:	Rs. 88 / 68
NSE volume: (No of shares)	21.3 lakh
BSE code:	500084
NSE code:	CESC
Free float: (No of shares)	63.5 cr

Shareholding (%)

Promoters	52
FII	13
DII	22
Others	13

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.0	4.2	-4.7	-2.9
Relative to Sensex	4.4	5.4	-5.9	-8.3

Sharekhan Research, Bloomberg

Summary

- Q3FY23 consolidated PAT declined by 3% y-o-y to Rs. 319 crore as a sharp fall in earnings from Haldia and continued losses at Rajasthan DF offset steady standalone PAT and strong growth from Noida/Crescent Power.
- Standalone PAT grew by 1% y-o-y to Rs. 186 crore (18% above our estimate) reflecting low single digit growth in power sales volumes.
- Dhariwal Infrastructure's 9MFY23 revenue/PAT was up 29%/52% y-o-y to Rs. 1444 crore/Rs. 166 crore as a rise in power demand and new medium-term PPA led to continued strong PLF.
- We maintain a Buy on CESC with an unchanged PT of Rs. 95 crore, given attractive valuation of 0.9x FY24E P/BV and dividend yield of ~5-6%. Turnaround of power distribution businesses could create value.

Q3FY23 consolidated revenue, operating profit and PAT stood at Rs. 3,460 crore (up 11% y-o-y), Rs. 827 crore (flat q-o-q) and Rs. 319 crore (down 3% y-o-y) respectively. The y-o-y earnings degrowth was due to sharp 14% y-o-y decline in Haldia PAT to Rs. 71 crore and net loss of Rs. 11 crore at Rajasthan DF, which offsets steady standalone earnings and robust 104% PAT growth at Noida Power to Rs. 55 crore and turnaround of Crescent Power (PAT of Rs. 7 crore versus net loss of Rs. 4 crore in Q3FY22). Dhariwal Infrastructure's PAT grew by 2% y-o-y to Rs. 51 crore. Standalone performance was steady with 1% y-o-y growth in PAT to Rs. 186 crore (18% above our estimate of Rs. 158 crore) and reflects a 2.6% y-o-y increase power sales volume to 2,201 million units.

Key positives

- Noida Power reported robust 104% y-o-y PAT growth in Q3FY23.
- Steady standalone PAT of Rs. 186 crore was 18% above our estimate.

Key negatives

- Rajasthan DF's net loss at Rs. 11 crore versus PAT of Rs. 2 crore in Q3FY22.
- Haldia's PAT declined by 14% y-o-y.

Revision in estimates – We have lowered our FY23/FY24/FY25 earnings estimate to factor higher interest and depreciation costs.

Our Call

Valuation – Maintain Buy with an unchanged SoTP-based PT of Rs. 95: CESC is a play on the investment and turnaround of the power distribution business, while earnings are expected to gradually improve with a further rise in utilisation at Dhariwal Infrastructure and the potential turnaround of Rajasthan/Malegaon DFs in FY24E, 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 5-6%. Hence, we maintain a Buy on CESC with an unchanged SoTP-based PT of Rs. 95.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	7,294	8,087	8,684	9,120
OPM (%)	15.3	17.0	17.5	18.5
PAT	816	811	959	1,082
% y-o-y growth	0.2	(0.6)	18.3	12.8
EPS (Rs.)	6.2	6.1	7.2	8.2
P/E (x)	12.6	12.7	10.7	9.5
P/B (x)	1.0	1.0	0.9	0.9
EV/EBITDA (x)	15.6	11.2	9.7	8.3
RoCE (%)	6.7	6.7	7.8	8.3
RoE (%)	8.2	7.9	8.9	9.4

Source: Company; Sharekhan estimates

Subdued consolidated performance, steady standalone PAT

Q3FY23 consolidated revenue, operating profit and PAT stood at Rs. 3,460 crore (up 11% y-o-y), Rs. 827 crore (flat q-o-q) and Rs. 319 crore (down 3% y-o-y) respectively. The y-o-y earnings degrowth was due to sharp 14% y-o-y decline in Haldia PAT to Rs. 71 crore and net loss of Rs. 11 crore at Rajasthan DF, which offsets steady standalone earnings and robust 104% PAT growth at Noida Power to Rs. 55 crore and turnaround of Crescent Power (PAT of Rs. 7 crore versus net loss of Rs. 4 crore in Q3FY22). Dhariwal Infrastructure's PAT grew by 2% y-o-y to Rs. 51 crore. Standalone performance was steady with 1% y-o-y growth in PAT to Rs. 186 crore (18% above our estimate of Rs. 158 crore) and reflects a 2.6% y-o-y increase power sales volume to 2,201 million units.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenue	**1,939**	**1,863**	**4.1**	**2,473**	**(21.6)**
Total expenditure	1,483	1,450	2.3	1,943	(23.7)
Operating profit	**456**	**413**	**10.4**	**530**	**(14.0)**
Other Income	56	58	(3.4)	48	16.7
Depreciation	119	117	1.7	119	0.0
Finance Cost	156	123	26.8	148	5.4
PBT	237	231	2.6	311	(23.8)
Tax	51	47	8.5	68	(25.0)
Reported PAT	**186**	**184**	**1.1**	**243**	**(23.5)**
EPS (Rs.)	14.0	13.8	1.1	18.3	(23.5)
Margin (%)			**bps**		**bps**
OPM (%)	23.5	22.2	135	21.4	209
NPM (%)	10.9	11.1	-18	10.7	15
Tax Rate (%)	21.5	20.3	117	21.9	-35

Source: Company; Sharekhan Research

Financial performance of key subsidiaries Rs cr

Particulars	Revenue		PAT	
	Q3FY23	Q3FY22	Q3FY23	Q3FY22
Haldia Energy	627	581	71	83
Dhariwal Infrastructure	511	378	51	50
Crescent Power	54	-32	7	-4
Noida Power	495	464	55	27
Kota/Bharatpur/Bikaner	384	348	-11	2
Malegaon	164	131	-19	28

Source: Company; Sharekhan Research

Results (Consolidated) **Rs cr**

Particulars	Q3FY23	Q3FY22	Y-o-Y %	Q2FY23	Q-o-Q %
Revenue	**3,460**	**3,108**	**11.3%**	**4,270**	**-19.0%**
Expenses	2,633	2,281	15.4%	3,423	-23.1%
Operating profit	**827**	**827**	**0.0%**	**847**	**-2.4%**
Other income	95	126	-24.6%	64	48.4%
Depreciation	219	221	-0.9%	221	-0.9%
EBIT	703	732	-4.0%	690	1.9%
Interest	289	273	5.9%	274	5.5%
PBT	**414**	**459**	**-9.8%**	**416**	**-0.5%**
Share in Profit of associate and joint venture	0	0	#DIV/0!	0	#DIV/0!
PBT before regulatory income	414	459	-9.8%	416	-0.5%
PBT	414	459	-9.8%	416	-0.5%
Tax	78	119	-34.5%	97	-19.6%
PAT	**336**	**340**	**-1.2%**	**319**	**5.3%**
Minority interest	17	11	54.5%	14	21.4%
PAT post MI	**319**	**329**	**-3.0%**	**305**	**4.6%**
EPS	2.4	2.5	-3.0%	2.3	4.6%
Margin (%)			**bps**		**bps**
OPM	23.9	26.6	-271	19.8	407
NPM	9.2	10.6	-137	7.1	208
Tax rate	18.8	25.9	-709	23.3	-448

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Regulated tariff model provides earnings visibility for power-generation companies.**

The 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, yet the situation is better than last year) would drive up PLFs for power-generation companies and better PLF incentive income. Additionally, receivables of power-generation companies are likely to reduce in FY2022 as an economic recovery would result in the timely receipt of dues from customers.

■ **Company Outlook – Steady performance by standalone biz, the turnaround of subsidiaries to improve consolidated earnings**

A recovery in earnings from standalone operations given strong power demand, lower losses at distribution franchisees led by lower T&D losses and higher utilisation at Dhariwal Infrastructure are expected to improve CESC's consolidated earnings over FY2024E-FY2025E.

■ **Valuation – Maintain Buy with an unchanged SoTP-based PT of Rs. 95**

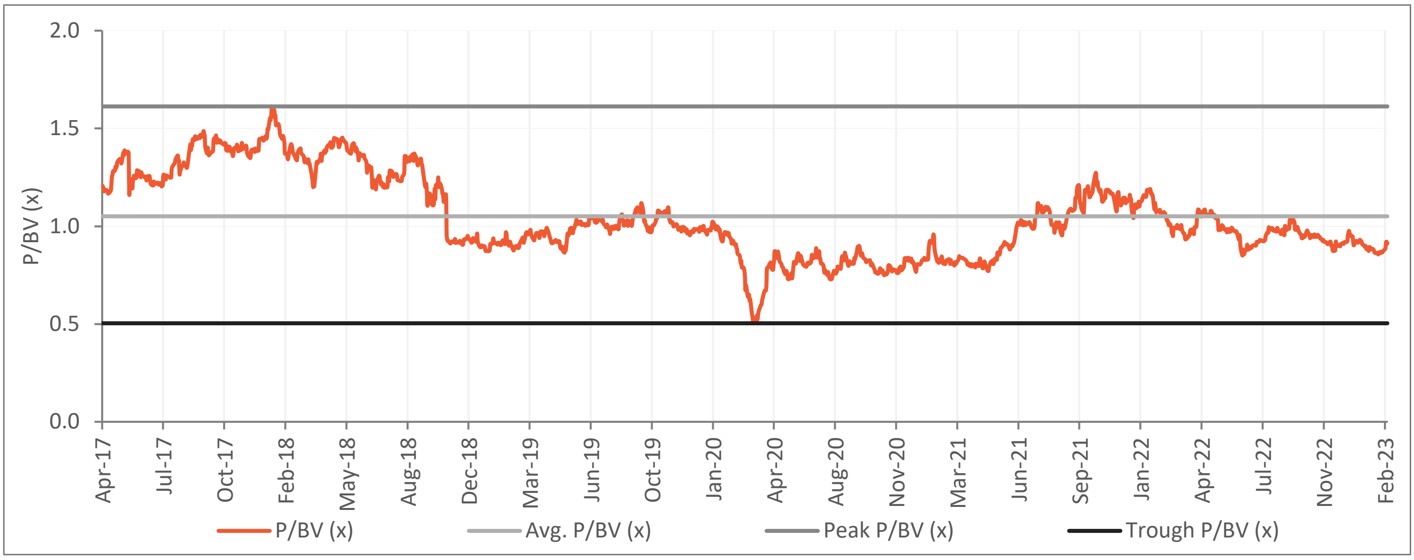
CESC is a play on the investment and turnaround of the power distribution business, while earnings are expected to gradually improve with a further rise in utilisation at Dhariwal Infrastructure and the potential turnaround of Rajasthan/Malegaon DFs in FY24E, while the standalone business is largely stable given regulated RoE model. Valuation is attractive at 0.9x its FY2024E P/BV, and the stock offers a healthy dividend yield of 5-6%. Hence, we maintain a Buy on CESC with an unchanged SoTP-based PT of Rs. 95.

SoTP-based PT of Rs. 95

Particulars	Value (Rs. /share)	Methodology
Standalone business	58	8x FY24E EPS
Haldia	15	1.7x regulated equity of ~Rs. 1150 crore
Dhariwal	15	2x regulated equity of ~Rs. 1,000 crore
Crescent Power	1	6.5x FY22 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: 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 electricity distributor 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 franchisees 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 contributions 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 appealing.

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
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 (old data)

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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