



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 Aug 08, 2023

33.86

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 16,096 cr
52-week high/low:	Rs. 128/62
NSE volume: (No of shares)	72.3 lakh
BSE code:	500084
NSE code:	CESC
Free float: (No of shares)	63.5 cr

Shareholding (%)

Promoters	52
FII	13
DII	20
Others	15

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	24.5	34.5	66.3	53.9
Relative to Sensex	15.7	27.6	53.4	38.1

Sharekhan Research, Bloomberg

CESC Ltd

Aggressive RE plan a right strategy

Power

Sharekhan code: CESC

Reco/View: Buy



CMP: Rs. 121

Price Target: Rs. 150



Upgrade



Maintain



Downgrade

Summary

- CESC is pursuing an aggressive RE growth strategy with a plan of 3GW (capex of ~Rs12-13k cr) in the next 4-5 years. It will use RE for captive requirement for its Kolkata/Nodia circles as well as IPPs. This makes a good value proposition given the lower RE cost, strong growth prospects, and likely improvement in ESG rating.
- Potential turnaround of the distribution business of Rajasthan (expected in FY24), Malegaon, and Chandigarh (yet to become operational) would create long-term value for investors.
- Noida Power has strong financials with EBITDA of Rs. 255 crore, RoE much higher than the regulated return of 15%, and cash of Rs. 724 crore. Noida is also witnessing strong growth of 12-15% and, thus, we see better value for Noida Power.
- We maintain Buy rating on CESC with a revised PT of Rs. 150. Valuation of 1.3x its FY2026E P/BV is attractive, given discount to peers; and the stock offers a healthy dividend yield of 3-4%. RE investment and turnaround of power distribution businesses could create value.

CESC's aggressive plan to transition to RE is a step in the right direction as it would provide a strong growth opportunity, improve earnings quality, and ESG rating in the long term. Investment in RE and potential turnaround of the distribution business of Rajasthan (expected in FY2024) would create value for shareholders. Valuation of 1.3x its FY2026E P/BV is attractive given discount to peers, and the stock offers a healthy dividend yield of 3-4%. We maintain our Buy rating on CESC with a revised price target (PT) of Rs. 150.

- **RE focus to result in better earnings quality apart from fueling long-term growth prospects:** CESC had recently indicated its plan to set-up up to 3GW of renewable power generation capacity over next 4-5 years and the same would significantly improve the share of RE power capacity portfolio going forward. We believe RE capacity addition plan comes on the backdrop of the Power Ministry mandate to meet RE purchase obligation of its power distribution business. The shift towards RE assets is the right step as apart from fueling growth it would also help alleviate ESG concern and could act as a key re-rating catalyst for CESC.
- **Consistent improvement in performance of subsidiaries:** CESC has been successful in the turnaround of its subsidiary Dhariwal Infrastructure with consistent track record of strong PAT growth of 29%/78%/28% on a y-o-y basis to Rs. 137 crore/Rs. 244 crore/Rs. 147 crore in FY2022/FY2023/H1FY2024. Moreover, CESC's RJ DF has seen significant improvement with PAT of Rs. 15 crore in H1FY2024 versus net loss of Rs. 18 crore in H1FY2023. Bharatpur/Bikaner DF are PAT positive, while Kota DF has minor loss. We expect RJ DF to turnaround fully as power demand is expected to remain strong and the company is focused to further reduce T&D losses.
- **Noida Power – Strong financial, high growth:** Noida Power has strong financials with EBITDA of Rs. 255 crore in FY2023, RoE much higher than the regulated return of 15%, and cash of Rs. 724 crore. Noida is also witnessing strong growth of 12-15% and, thus, we see better value for Noida Power.

Our Call

Valuation - Maintain Buy with a revised SoTP-based PT of Rs. 150: CESC is a play on RE capex revival and turnaround of the power distribution businesses and earnings are expected to gradually improve over the coming years. Valuation is attractive at 1.3x its FY2026E P/BV, and the stock offers a healthy dividend yield of 3-4%. Hence, we maintain Buy on CESC with a revised SoTP-based PT of Rs. 150 (higher PT reflects rollover of valuation for the standalone business to FY2026 earnings and higher value for Noida Power).

Key Risks

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

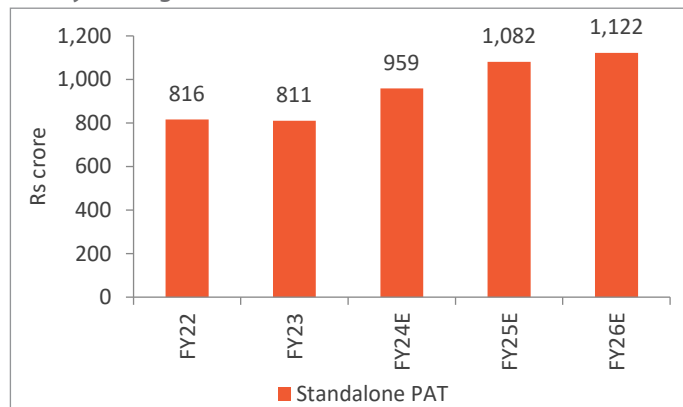
Valuation (Standalone)

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	7,294	8,087	8,684	9,120	9,434
OPM (%)	15.3	17.0	17.5	18.5	18.5
PAT	816	811	959	1,082	1,122
% y-o-y growth	0.2	(0.6)	18.3	12.8	3.7
EPS (Rs.)	6.2	6.1	7.2	8.2	8.5
P/E (x)	19.8	20.0	16.9	15.0	14.4
P/B (x)	1.6	1.5	1.4	1.4	1.3
EV/EBITDA (x)	20.9	15.5	13.6	11.8	11.0
RoCE (%)	6.7	6.7	7.8	8.3	8.2
RoE (%)	8.2	7.9	8.9	9.4	9.1

Source: Company; Sharekhan estimates

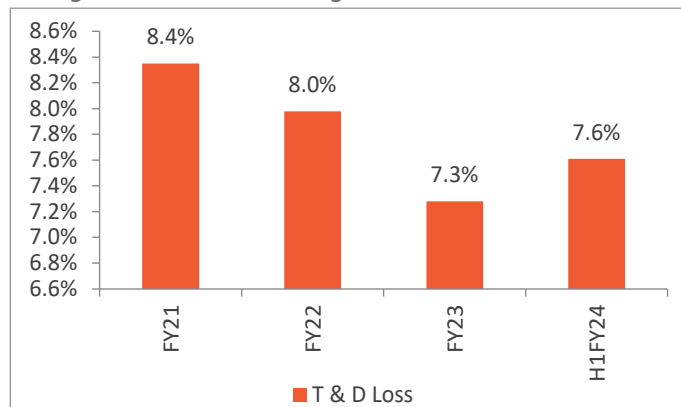
Financials in charts

Steady earnings contribution from the standalone business



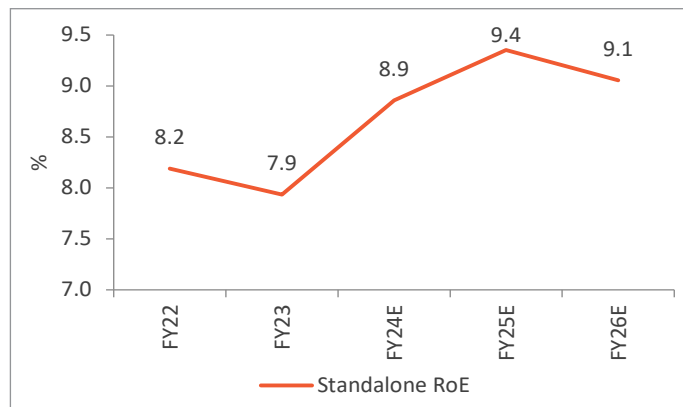
Source: Company, Sharekhan Research

Strong track record of reducing T&D loss



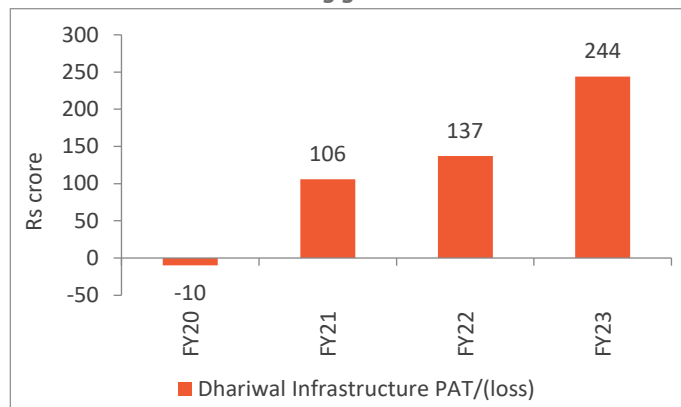
Source: Company, Sharekhan Research

RoE trend



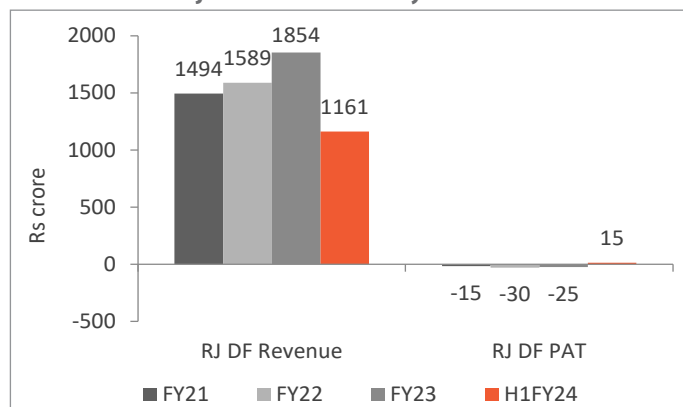
Source: Company, Sharekhan Research

Dhariwal Infrastructure strong growth continues



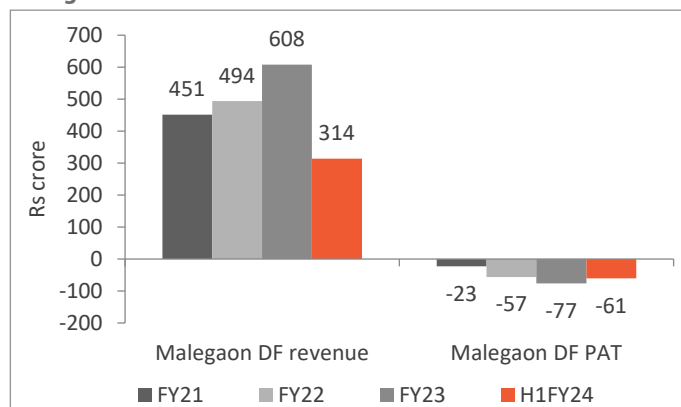
Source: Company, Sharekhan Research

Turnaround of Rajasthan DF underway



Source: Company, Sharekhan Research

Malegaon DF continue to witness loss



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - The regulated tariff model provides earnings visibility for power-generation companies

The Central Electricity Regulatory Commission (CERC) regulates India's power sector through an availability-based earnings model (i.e., fixed RoE on power-generation assets). Thus, the regulated tariff model provides strong earnings visibility for power-generation companies like CESC. Better 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

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 and potential turnaround of Rajasthan/ Malegaon DF are expected to improve the consolidated earnings of CESC over FY2024E-FY2026E.

■ Valuation - Maintain Buy with a revised SoTP-based PT of Rs. 150

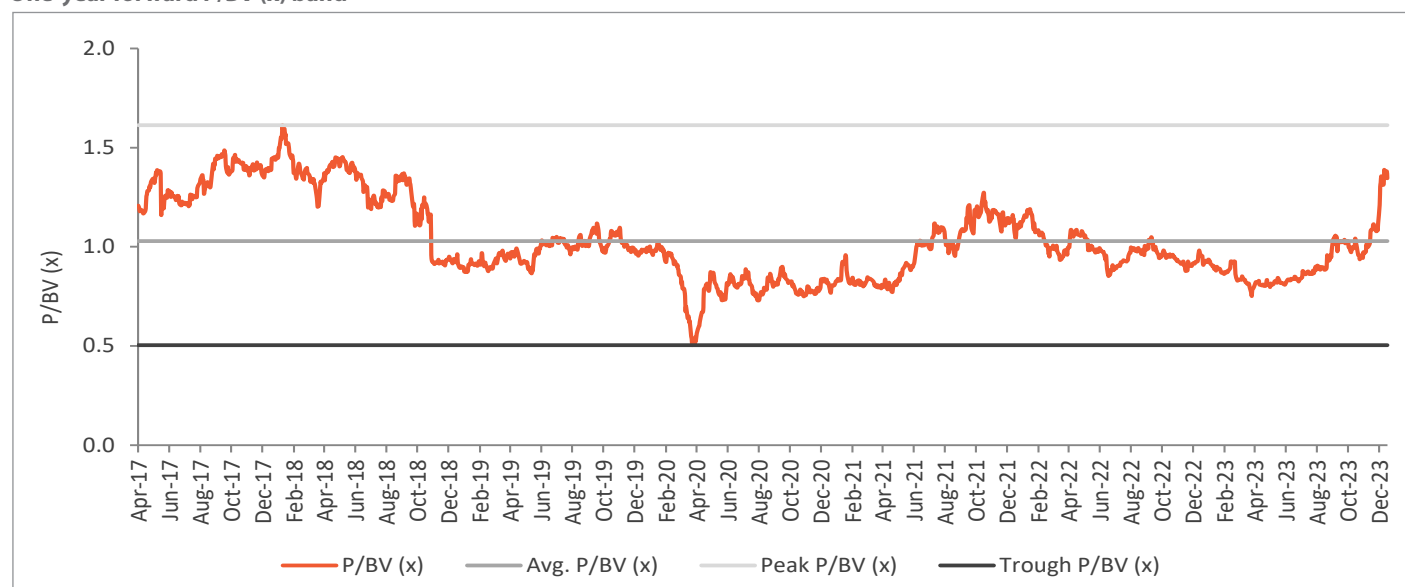
CESC is a play on RE capex revival and turnaround of the power distribution businesses and earnings are expected to gradually improve over the coming years. Valuation is attractive at 1.3x its FY2026E P/BV, and the stock offers a healthy dividend yield of 3-4%. Hence, we maintain Buy on CESC with a revised SoTP-based PT of Rs. 150 (higher PT reflects rollover of valuation for the standalone business to FY2026 earnings and higher value for Noida Power).

SoTP-based PT of Rs. 150

Particulars	Value (Rs/share)	Methodology
Standalone business	77	9x FY26E EPS
Haldia Energy	17	2x regulated equity of ~Rs1150 crore
Dhariwal Infrastructure	15	2x regulated equity of ~Rs1000 crore
Crescent Power	1	6.5x FY23 PAT for 67.8% stake
Noida Power	17	9x FY23 EBITDA for 72.73% stake
DF	5	1.5x Investments
Cash and cash equivalent	18	
Price target (Rs.)	150	

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 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 a 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 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 makes 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
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	SBI Funds Management Ltd	5.75
2	HDFC Asset Management Co Ltd	4.14
3	Life Insurance Corp of India	3.41
4	ICICI Prudential Asset Management	2.82
5	Massachusetts Financial Services C	2.34
6	ICICI PRUDENTIAL INDIA OPP	2.25
7	Sprott Resource Lending Corp	2.19
8	UTI Asset Management Co Ltd	1.65
9	Vanguard Group Inc/The	1.92
10	BlackRock Inc	1.09

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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