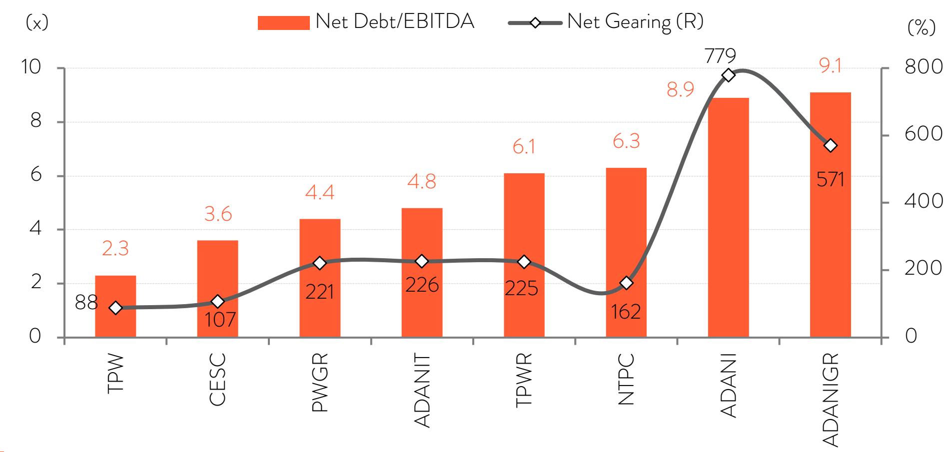
Recent distribution wins

In Feb'21, TPW won the bids for power distribution concessions in the union territories of Dadra & Nagar Haveli and Daman & Diu, overcoming competitors such as Tata Power (TPWR) and Adani Transmission (ADANITR). The process has, however, been held up following the admission of a public interest litigation against privatisation in court.

Bidding for Chandigarh is under process while other union territories such as Puducherry and Jammu & Kashmir are expected to invite bids in coming quarters. TPW has one of the strongest balance sheets in the sector, which will enable it to fund growth.

FIG 9 – TPW HAS ONE OF THE STRONGEST BALANCE SHEETS IN THE SECTOR



Source: Bloomberg | ADANI – Adani Power

Overhang from contract expiry and tariff resetting

Ahmedabad concession expiring in Mar'25

TPW's five-year distribution tariff in Ahmedabad is due for a reset by the Gujarat Electricity Regulatory Commission (GERC) in FY22, besides which the company will complete the 25 years allowed under the current contract on 31 Mar 2025. The key variable driving distribution company earnings is the return on regulated equity, which is currently set at 14%. Given that the CERC's regulated equity return norms for generation and transmission were kept flat at 15.5% for FY19-FY23 (decided before GERC's last tariff setting for Ahmedabad), it is less likely that GERC will reduce the returns.

Apart from the tariff reset overhang, TPW's 33-year-old coal generation plant Amgen may not be able to meet sulphur dioxide (SOx) emission norms due to a dearth of space to set up the prescribed flue gas desulfurisation (FGD) plant.

Gas plant operations face challenges

Gas plant earnings will depend on incentives and gas prices

In 2019, TPW's UnoSugen gas plant signed PPAs with discom customers for 72% of its generation capacity. This contract is subject to a total tariff ceiling of Rs 5.61/unit and a variable tariff ceiling of Rs 4.416/unit. Therefore, at higher gas prices, the plant's profitability will decline. TPW procures ~75% of its gas requirements through LNG imports, has an agreement with IOCL for 20% and procures the balance 5% from Reliance Industries.

The DGen plant has not been able to sign a PPA since it was completed in 2014. As a result, the company had to write off Rs 10bn of the plant cost in FY20.

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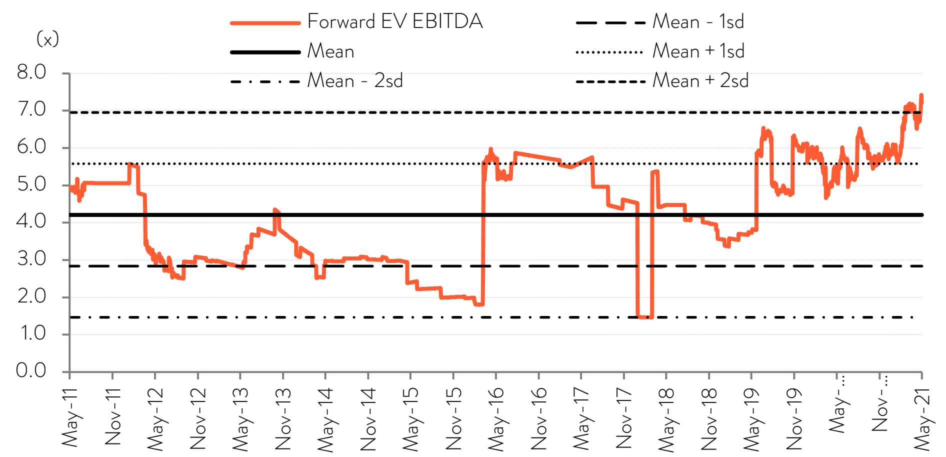
Valuation methodology

Valuation elevated relative to history

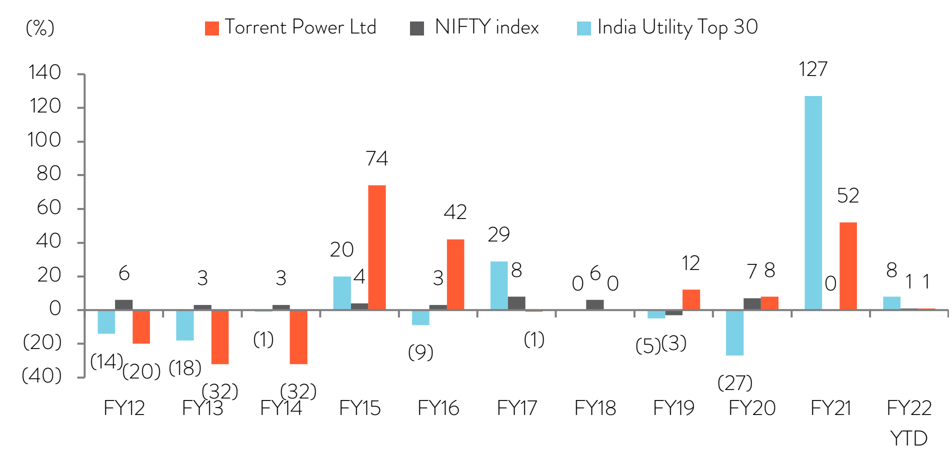
The stock is trading at a 70% premium to its 10-year mean forward EV/EBITDA and at 30% premium to its 10-year mean forward P/BV. TPW posted a stable stock performance over FY15-FY20 but rallied sharply in FY21 largely due to new renewable order wins and its recent winning bids for Dadra & Nagar Haveli and Daman & Diu.

FIG 10 – 12M FORWARD EV/EBITDA



Source: Bloomberg

FIG 11 – ANNUAL STOCK RETURNS YOY



Source: Bloomberg

Initiate with ADD, TP Rs 461

Expect 15% EPS CAGR for FY21-FY23 led by lower AT&C losses and new plants

We estimate a 15% EPS CAGR for TPW over FY21-FY23 as AT&C losses normalise from the higher levels seen in FY21 due to Covid-19 and as commercial operations begin at new renewable plants. Our estimates are in line with consensus and are based on the plant load factor for generation, AT&C losses for the distribution business and growth in the renewables portfolio.

FIG 12 – KEY EARNINGS DRIVERS

(%)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
PLF (%)								
Sugen	35.8	47.5	65.3	62.3	59.9	63.3	63.3	63.3
Unsugen	34.6	27.3	33.3	33.4	40.7	54.4	54.4	54.4
Amgen	65.0	74.6	71.4	87.8	72.9	36.9	65.0	65.0
Dgen	25.7	-	-	-	6.5	6.0	-	-
Solar	19.0	17.9	17.3	17.6	17.1	17.5	17.5	17.5
Wind	21.6	22.2	27.3	30.1	29.0	25.8	29.0	29.0
AT&C Losses (%)								
Ahmedabad -	7.2	6.8	6.3	5.6	5.0	5.3	4.5	4.5
Surat	3.9	3.9	3.6	3.4	3.4	3.6	3.4	3.4
Dahej	0.8	0.5	0.4	0.4	0.3	0.3	0.3	0.3
Bhiwandi	22.4	21.7	17.6	15.1	11.9	14.2	12.0	10.0
Agra	29.3	24.7	19.2	14.2	12.5	13.0	12.5	10.0
SMK	-	-	-	-	47.0	47.0	40.0	35.0

Source: BOBCAPS Research, Company

FIG 13 – TPW – BOBCAPS ESTIMATES VS. CONSENSUS

(Rs bn)	BOBCAPS			Consensus			BOBCAPS vs. Consensus (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	132	136	140	134	145	151	(2.0)	(6.2)	(7.7)
EBITDA	34	37	41	34	38	40	0.3	(0.7)	4.5
EBIT	20	22	24	22	24	25	(6.8)	(8.8)	(6.6)
Pretax Income	15	18	20	15	18	20	(0.7)	2.7	0.2
Net Income	12	15	16	12	14	15	3.0	9.6	8.2
EPS (Rs)	25.3	31.4	33.7	24.7	29.2	31.9	2.5	7.6	5.6

Source: BOBCAPS Research, Bloomberg

We have a Mar'22 target price of Rs 461 for TPW based on an SOTP valuation, arrived at via a DCF assessment of various assets. Our model discounts the cash flows of the company's projects till the current PPA lasts, assuming no extension only for generation plants. For distribution assets under the regulated return model, we have assumed extension of the concession period by another 25 years post-expiry.

Key DCF assumptions include (1) cost of equity of 9.4% based on a risk-free rate of 6.12% as per the 10-year India bond yield as of end-Mar'21, (2) market risk premium of 6.85% based on NYU Stern estimates, (3) beta of 0.48 as per the last two-year weekly returns as of end-Mar'21, and (4) cost of debt of 8.5% factoring in the company's current debt cost.

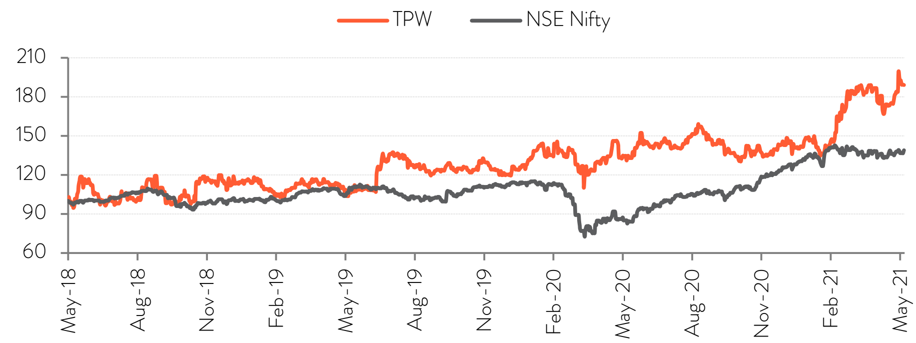
Our Mar'22 TP of Rs 461 implies 7.2x FY22E EV/EBITDA and translates to an upside of 8%. We initiate coverage with an ADD rating.

FIG 14 – SOTP VALUATION

Segment (Rs mn)	EV	Net Debt FY22E	Equity Value	% Share	Contribution to Group Equity Value	EBITDA FY22E	EV/EBITDA (x)
Generation							
Sugen	18,978	5,914	13,064	100	13,064	3,253	5.8
Amgen	592	4,145	(3,553)	100	(3,553)	2,263	0.3
Unosugen	19,079	6,074	13,005	100	13,005	2,597	7.3
Dgen	(2,899)	37,904	(40,803)	100	(40,803)	(300)	9.7
Merchant Market	630	-	630	100	630	72	8.7
Sub-Total	**36,380**	**54,038**	**(18,287)**		**(18,287)**	**7,812**	**4.7**
Renewables	**57,640**	**22,976**	**34,665**	**100**	**34,665**	**6,542**	**8.8**
Distribution							
Ahmedabad / Gandhinagar	88,459	33,190	55,269	100	55,269	9,256	9.6
Surat	24,508	2,778	21,730	100	21,730	2,278	10.8
Dahej	1,557	343	1,215	100	1,215	187	8.3
Bhiwandi	25,459	1,494	23,965	100	23,965	6,909	3.7
Agra	8,654	7,423	1,230	100	1,230	1,489	5.8
Dholera	1,693	1,892	(198)	100	(198)	231	7.3
Shil, Mumbra and Kalwa (SMK)	309	3,326	(3,017)	100	(3,017)	(913)	(0.3)
Sub-Total	**1,50,640**	**50,446**	**1,00,194**		**1,00,194**	**19,438**	**7.7**
Transmission	2,684	252	2,432	67	1,620	400	6.7
Elimination / Corporate Costs	22,797	(78,779)	1,01,576	100	1,01,576	3,151	7.2
Consolidated	**2,67,457**	**48,933**	**2,18,147**		**2,19,767**	**37,343**	**7.2**
Number of Share (mn)					481		
Price (Rs/sh)					457		
Target Price (Rs/sh) – rounded to nearest 1					**461**		

Source: BOBCAPS Research

FIG 15 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Upside risks include new distribution or renewable project wins, PPAs for the DGen plant and government incentives for gas power plants.
- Downside risks include negative news flow on tariff resetting for Ahmedabad and a sharp rise in gas price which could impact earnings of the UnoSugen plant as it has a ceiling beyond which passthrough on gas cost is disallowed.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	**1,31,510**	**1,36,406**	**1,31,604**	**1,35,773**	**1,39,616**
EBITDA	31,995	35,561	34,224	37,343	41,334
Depreciation	(12,265)	(13,043)	(14,062)	(15,177)	(17,583)
EBIT	19,730	22,518	20,162	22,166	23,750
Net interest income/(expenses)	(8,230)	(8,726)	(6,032)	(4,465)	(4,729)
Other income/(expenses)	1,137	956	650	650	650
Exceptional items	0	(10,000)	0	0	0
EBT	12,636	4,748	14,780	18,351	19,671
Income taxes	(3,598)	7,040	(2,582)	(3,206)	(3,437)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	(49)	(47)	(47)	(47)	(47)
Reported net profit	**8,989**	**11,742**	**12,150**	**15,097**	**16,187**
Adjustments	0	10,000	0	0	0
Adjusted net profit	**8,989**	**21,742**	**12,150**	**15,097**	**16,187**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	8,098	10,379	10,014	11,159	11,475
Other current liabilities	8,522	13,078	12,713	13,858	14,174
Provisions	832	1,030	1,030	1,030	1,030
Debt funds	88,765	77,996	63,069	54,107	69,262
Other liabilities	28,203	19,668	19,716	19,763	19,810
Equity capital	4,806	4,806	4,806	4,806	4,806
Reserves & surplus	84,896	86,729	95,671	1,06,345	1,17,034
Shareholders' fund	89,702	91,535	1,00,477	1,11,151	1,21,840
Total liabilities and equities	**2,45,540**	**2,36,230**	**2,29,928**	**2,32,832**	**2,59,040**
Cash and cash eq.	9,549	8,879	3,367	5,174	5,180
Accounts receivables	12,297	12,798	16,225	12,647	13,005
Inventories	6,270	5,982	5,772	5,580	5,738
Other current assets	17,735	20,578	20,578	20,578	20,578
Investments	2,876	1,160	1,160	1,160	1,160
Net fixed assets	1,79,666	1,75,543	1,71,616	1,76,564	2,02,332
CWIP	35,927	5,674	0	0	0
Intangible assets	173	150	150	150	150
Deferred tax assets, net	36	199	199	199	199
Other assets	(18,987)	5,269	10,862	10,780	10,699
Total assets	**2,45,540**	**2,36,230**	**2,29,928**	**2,32,832**	**2,59,040**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	21,255	24,784	26,212	30,274	33,770
Interest expenses	9,076	8,643	5,845	4,330	4,593
Non-cash adjustments	(1,355)	1,669	(416)	(467)	(467)
Changes in working capital	28,975	35,096	31,642	34,137	37,897
Other operating cash flows	(33,704)	(33,839)	(35,224)	(29,221)	(38,097)
Cash flow from operations	**24,246**	**36,354**	**28,059**	**39,052**	**37,697**
Capital expenditures	(19,887)	(13,337)	(10,053)	(20,043)	(43,270)
Change in investments	0	0	0	0	0
Other investing cash flows	834	1,100	0	0	0
Cash flow from investing	**(19,053)**	**(12,237)**	**(10,053)**	**(20,043)**	**(43,270)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	4,185	(8,535)	(14,927)	(8,962)	15,156
Interest expenses	(9,076)	(8,643)	(5,845)	(4,330)	(4,593)
Dividends paid	(2,925)	(9,683)	(3,208)	(4,424)	(5,497)
Other financing cash flows	9,466	28,662	23,980	17,716	(5,065)
Cash flow from financing	**1,650**	**1,800**	**0**	**0**	**0**
Changes in cash and cash eq.	**(204)**	**(249)**	**(5,511)**	**1,807**	**6**
Closing cash and cash eq.	**9,549**	**8,879**	**3,367**	**5,174**	**5,180**

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	18.7	24.4	25.3	31.4	33.7
Adjusted EPS	18.7	45.2	25.3	31.4	33.7
Dividend per share	5.0	11.6	7.6	9.4	10.1
Book value per share	186.6	190.5	209.1	231.3	253.5

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.1	2.1	2.1	2.0	1.9
EV/EBITDA	8.8	8.0	8.2	7.2	6.3
Adjusted P/E	22.9	9.5	16.9	13.6	12.7
P/BV	2.3	2.2	2.0	1.9	1.7

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	71.1	147.4	82.2	82.3	82.3
Interest burden (PBT/EBIT)	64.0	65.5	73.3	82.8	82.8
EBIT margin (EBIT/Revenue)	15.0	16.5	15.3	16.3	17.0
Asset turnover (Revenue/Avg TA)	55.8	56.6	56.5	58.7	56.8
Leverage (Avg TA/Avg Equity)	2.8	2.7	2.4	2.2	2.1
Adjusted ROAE	10.8	24.0	12.7	14.3	13.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	14.2	3.7	(3.5)	3.2	2.8
EBITDA	2.6	11.1	(3.8)	9.1	10.7
Adjusted EPS	(4.6)	141.9	(44.1)	24.3	7.2
Profitability & Return ratios (%)					
EBITDA margin	24.3	26.1	26.0	27.5	29.6
EBIT margin	15.0	16.5	15.3	16.3	17.0
Adjusted profit margin	6.8	15.9	9.2	11.1	11.6
Adjusted ROAE	3.8	9.0	5.2	6.5	6.6
ROCE	9.8	11.5	10.8	12.0	12.0
Working capital days (days)					
Receivables	34	34	45	34	34
Inventory	17	16	16	15	15
Payables	22	28	28	30	30
Ratios (x)					
Gross asset turnover	0.6	0.6	0.5	0.5	0.5
Current ratio	1.1	1.0	1.0	0.9	0.9
Net interest coverage ratio	2.4	2.6	3.3	5.0	5.0
Adjusted debt/equity	1.0	0.9	0.6	0.5	0.6

Source: Company, BOBCAPS Research

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ADD
TP: Rs 721 | ⮝ 7%

CESC | Power | 18 May 2021

Steady business but limited avenues for growth; initiate with ADD

CESC has decades of power distribution experience in Kolkata and Greater Noida and also operates four small franchises. However, it has no ongoing growth initiatives and hence we expect flat EPS for FY21-FY23. Distribution is its only focus area – any new contract wins will be a stock trigger, but opportunities are limited and at least three other peers have similar experience with stronger financial muscle. Current low valuations at 5.7x FY22E EV/EBITDA and dividend yield of 6.8% should provide downward support. Initiate with ADD, Mar'22 TP Rs 721.

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Among India's top private electricity distributors: CESC is India's fourth largest private electricity distributor with 1% volume share as of FY20. The company supplies electricity to the city of Kolkata under the regulated return model and has low AT&C losses at 7.9%. It owns 73% stake in Greater Noida distribution, also under regulated returns, with relatively low AT&C of 8.2% and a strong growth profile, besides franchisee assets. Its 600MW Haldia generation asset provides good earnings support, but the Dhariwal Infrastructure plant has only 50% capacity under PPA. CESC has no plans to build new generation plants.

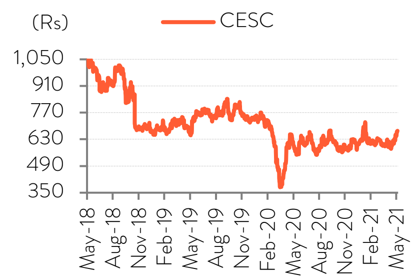
Distribution opportunities few and far between: Barring the upcoming Chandigarh privatisation, fresh opportunities for growth look limited over the near term and may improve only with passage of the Electricity (Amendment) Bill 2020. In addition, ADANIT, TPWR and TPW pose stiff competition for new privatisation bids. We note that CESC has not had much success winning distribution bids since it bagged the Malegaon franchise in 2019.

Initiate with ADD: At 5.7x FY22E EV/EBITDA, the stock is trading at 17% discount to the 10Y mean. Our Mar'22 TP of Rs 721 implies an FY22E EV/EBITDA of 5.9x – 15% discount to the 10Y mean. Key positive stock drivers include new distribution wins and passage of the Electricity Act.

Ticker/Price	CESC IN/Rs 674
Market cap	US$ 1.2bn
Shares o/s	133mn
3M ADV	US$ 3.6mn
52wk high/low	Rs 731/Rs 534
Promoter/FPI/DII	50%/15%/24%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	1,06,641	1,10,146	1,08,682	1,33,427	1,36,885
EBITDA (Rs mn)	37,080	35,355	34,163	36,634	37,382
Adj. net profit (Rs mn)	11,840	13,021	13,616	13,104	14,108
Adj. EPS (Rs)	89.3	98.2	102.7	98.9	106.4
Adj. EPS growth (%)	43.1	10.0	4.6	(3.8)	7.7
Adj. ROAE (%)	3.6	3.8	3.9	3.6	3.9
Adj. P/E (x)	7.5	6.9	6.6	6.8	6.3
EV/EBITDA (x)	5.7	5.9	6.0	5.6	5.6

Source: Company, BOBCAPS Research