Investment rationale

Among India's top electricity distributors

CESC is India's fourth largest private electricity distributor and has 1% share in the Indian distribution market by volume of power sold (~3bn units as of FY20). The company has been providing power to the city of Kolkata for over three decades (under the present management group) and has ~16 years of experience supplying power to Greater Noida, with a strong record of reducing AT&C losses in all its circles. In CY16, it began supplying electricity under a franchisee model to three cities of Rajasthan and from CY19 to Malegaon, Maharashtra.

Distribution in both Kolkata and Greater Noida is under the regulated model where the company earns a return on regulated equity – currently 16.5% and 15.0% respectively– that increases with capex. Incentives can be earned by improving AT&C losses at a faster rate than the past trajectory. CESC's distribution franchisees earn income solely on the basis of reduction in losses, which currently range between 17% and 40%.

The company also owns 2.4GW of generation capacity (less than 1% of India's total) across six plants – three of which are part of the Kolkata distribution circle with 14-20 years of remaining PPA life. Of the remaining three, Haldia Power has a PPA for 100% capacity and earns a return on regulated equity, currently set at 15.5%, and the Chandrapur plant has agreements for ~50% of its capacity. Crescent Power is a merchant plant that trades power on the electricity exchanges.

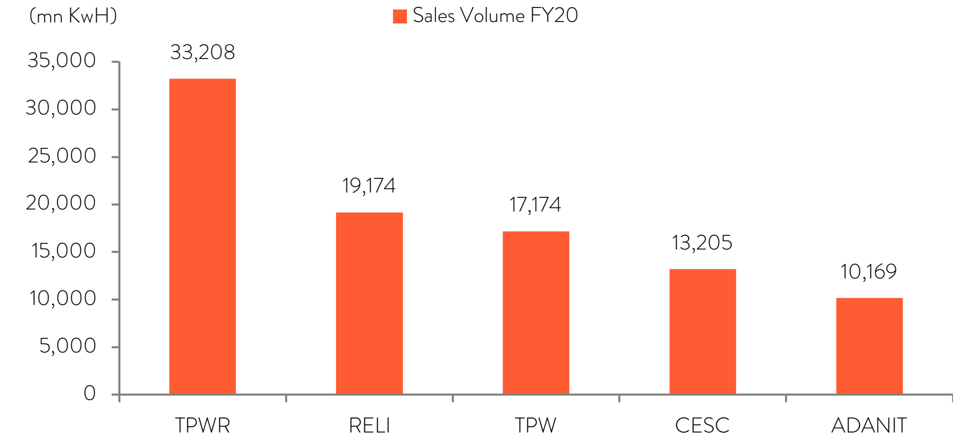
FIG 1 – CESC'S POWER ASSETS

Generation				Distribution		
Plant	**Capacity (MW)**	**Remaining life (years)**	**PPA (%)**	**Area**	**Consumption (mn units)**	**Remaining life (years)**
Budge Budge	750	16	100	**Distribution PPA (regulated return)**		
Southern Thermal Power Station	135	16	100	Kolkata	9,700	17
Titagarh Thermal Power Station	240	16	100	Noida Power Company	1,850	8
Haldia Power	600	19	100	**Distribution franchisee**		
Chandrapur TPP	600	18	50	Kota	1,016	15
Crescent Power	40	14	0	Bikaner	639	16
Solar	18	20	100	Malegaon	497	18
Wind	156	20	100	Bharatpur	220	16

Source: Company

Traditional | Green Energy | Distribution

FIG 2 – PRIVATE DISTRIBUTION PLAYERS IN INDIA

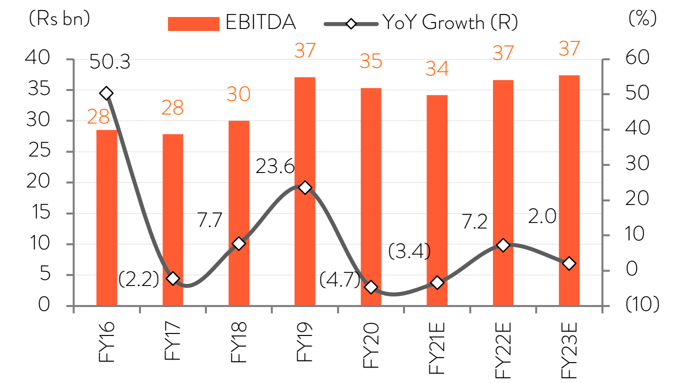


Source: Company | RELI – Reliance Infrastructure | Note: For TPWR, volumes include pre-acquisition volumes of the four Odisha circles

Decent EBITDA CAGR of 13% over FY15-FY20

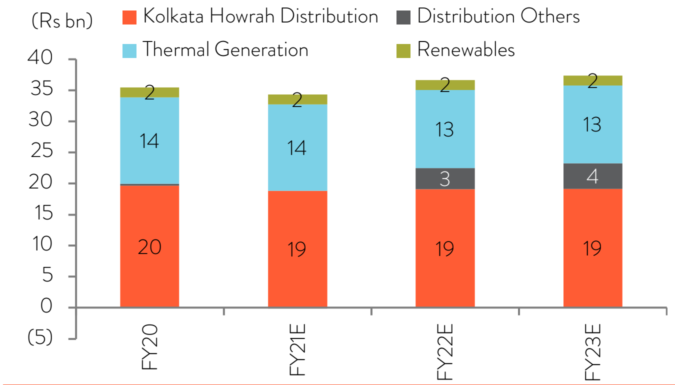
CESC's EBITDA has increased at a healthy 13.3% over FY15-FY20. Note that financials also include the loss-making retail division till FY18 after which it was hived off into a separate company, leading to an improvement in ROE. Distribution makes up 57% of consolidated EBITDA (FY20), generation 39% and renewables 5%. We expect the share of distribution to rise to 62% by FY23 as generation falls to 34%, due to growth in business as well as consolidation of Noida Power Company following the company gaining a minority share.

FIG 3 – EBITDA HAS FLATTENED OUT SINCE FY19



Source: Company, BOBCAPS Research

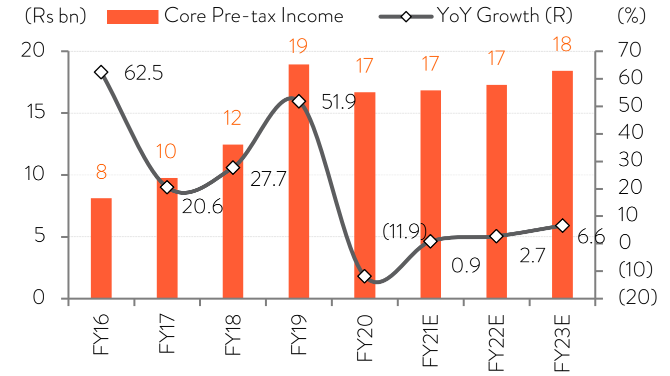
FIG 4 – EBITDA MIX SHIFTING TO DISTRIBUTION



Source: Company, BOBCAPS Research

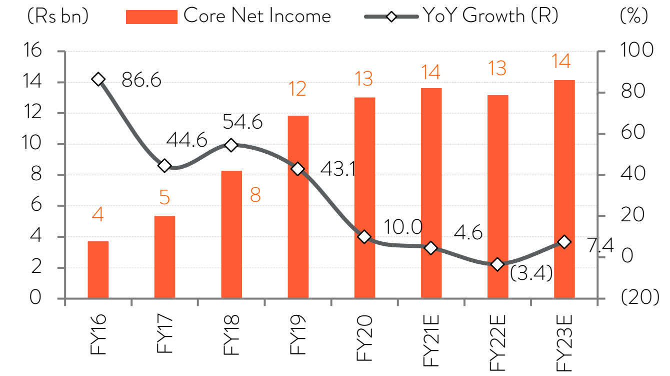
BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIG 5 – PRE-TAX INCOME



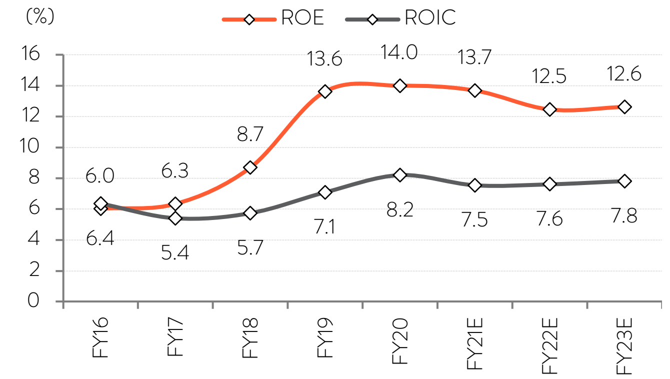
Source: Company, BOBCAPS Research

FIG 6 – NET INCOME EXPECTED TO BE FLAT



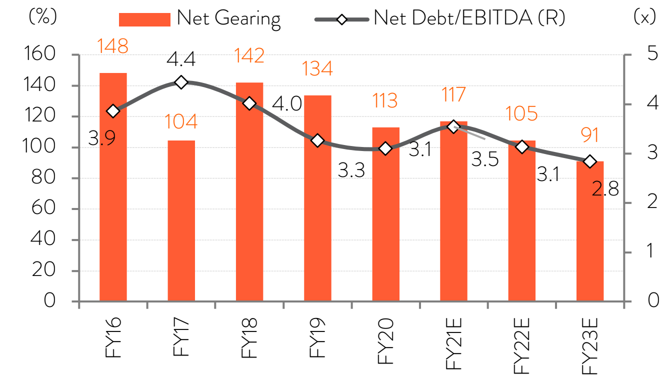
Source: Company, BOBCAPS Research

FIG 7 – RETURN RATIOS HAVE BEEN MODEST



Source: Company, BOBCAPS Research

FIG 8 – BALANCE SHEET STRONG



Source: Company, BOBCAPS Research

Distribution opportunities few and far between

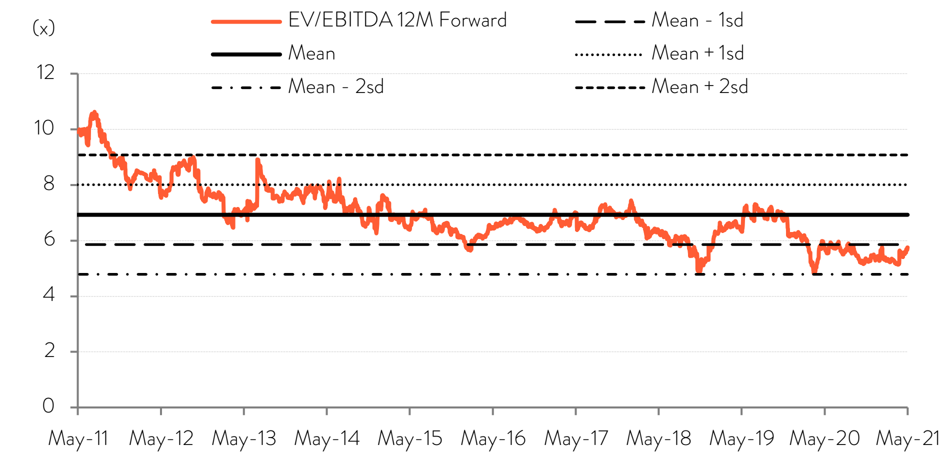
Competition in power distribution is intense and at least three major rivals – Tata Power (TPWR), Adani Transmission (ADANIT) and Torrent Power (TPW) – have comparable experience in running large distribution businesses and curbing AT&C losses. CESC has not had much success in winning distribution bids since it secured the Malegaon franchise in 2019 given that the opportunities available have been limited and these are primarily in the larger privatisation space. The union territories of Chandigarh, Puducherry and Jammu & Kashmir could be next on the anvil for privatisation.

The company's power generation division is steady with over 15 years of asset life still remaining. The primary upside in this business hinges on its ability to address the 300MW of idle capacity (12.5% of total) at its generation plants through PPAs. In our view, signing long-term agreements is likely to be difficult given the cheaper power available from renewables and low utilisation of existing coal plants.

Trading at trough valuation due to meagre growth initiatives

At 5.7x FY22E EV/EBITDA, CESC is trading at a 17% discount to 10-year mean valuation multiples. In our view, this underperformance is largely due to a lack of major growth initiatives undertaken by the company. We believe prospects will improve only if India's distribution segment is opened up rapidly, affording CESC the opportunity to win new concessions. Without new wins, CESC will find it increasingly difficult to compete against larger peers.

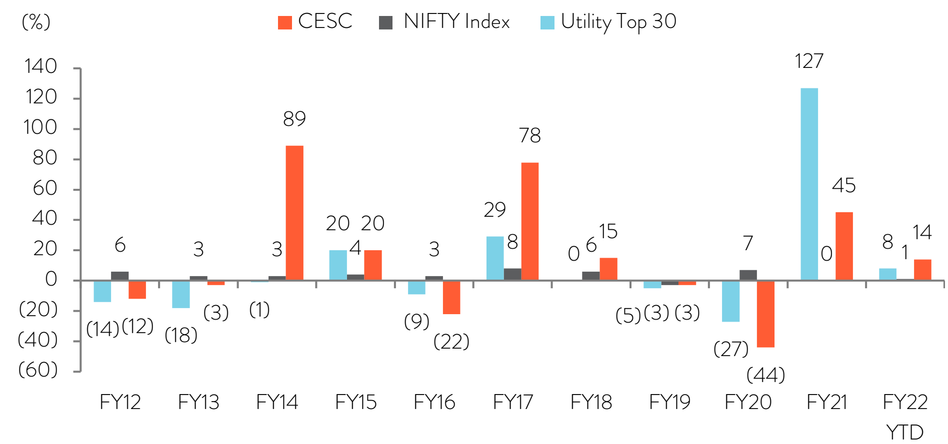
FIG 9 – EV/EBITDA 12M FORWARD



Source: BOBCAPS Research, Bloomberg

Stock returns have been modest since FY19 with a selloff in FY20

FIG 10 – ANNUAL STOCK RETURNS YOY



Source: BOBCAPS Research, Bloomberg

Valuation methodology

Expect EPS to remain flattish

We estimate flat EPS over FY21-FY23 driven by a fall in Dhariwal Infrastructure plant earnings after the temporary PPA ends in Jan'21, which should be offset by growth in distribution franchisee earnings. We are lower than consensus on net income primarily due to differing tax rate assumptions (our estimate at ~25%). In addition, our revenue assumptions could be higher as we have consolidated Greater Noida's financials after the company's announcement of taking a majority stake in the business at 73% from less than 50%.

FIG 11 – CESC – KEY EARNINGS DRIVERS

Drivers	FY20	FY21E	FY22E	FY23E
AT&C Losses (%)				
Kolkata	7.9	7.5	7.5	7.5
Noida Power Company	8.2	8.2	7.5	7.5
Kota	20.4	20.0	19.0	18.0
Bharatpur	17.0	16.0	15.0	14.0
Bikaner	18.0	17.0	16.0	15.0
Malegaon	44.8	44.8	40.0	35.0
Consumption (% YoY)				
Kolkata	2.0	(5.0)	10.0	2.0
Noida Power Company	2.0	(5.0)	10.0	5.0
Kota	2.0	-	5.0	2.0
Bharatpur	1.0	-	5.0	2.0
Bikaner	1.0	-	5.0	2.0
Malegaon	1.0	-	5.0	2.0
Availability Factor (%)				
Haldia Power	96.9	90.0	90.0	90.0
Dhariwal Infrastructure	70.0	80.0	60.0	60.0
Crescent Power	67.0	70.0	70.0	70.0

Source: BOBCAPS Research, Company

FIG 12 – CESC – BOBCAPS ESTIMATES VS. CONSENSUS

(Rs bn)	BOBCAPS			Consensus			BOBCAPS vs. Consensus (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	109	133	137	113	119	125	(4.1)	12.2	9.9
EBITDA	34	37	37	32	33	34	7.2	12.7	10.2
EBIT	26	27	28	23	25	26	11.7	10.7	7.9
Pretax Income	17	17	18	15	17	18	12.4	3.0	(0.0)
Net Income	14	13	14	13	14	15	6.6	(4.0)	(6.2)
EPS (Rs)	102.7	99.3	106.7	95.9	102.9	112.5	7.1	(3.5)	(5.2)

Source: BOBCAPS Research, Bloomberg

Initiate with ADD, TP Rs 721

We value CESC at a Mar'22 target price of Rs 721 based on an SOTP valuation, arrived at via a DCF assessment of various assets. Our valuation model discounts cash flows from the company's generation projects till the end of respective PPAs, assuming no extension. For distribution licenses in Kolkata and Greater Noida, we have assumed extension for another 25 years after the current concessions end. For renewable projects, we have factored in the remaining life based on the standard 25-year PPAs.

Key DCF assumptions include (1) cost of equity of 11.9% based on a risk-free rate of 6.12% as per the 10-year India bond yield as of end-Mar'21, (2) beta of 0.84 based on the last two-year weekly returns as of end-Mar'21, and (3) cost of debt of 9% factoring in the company's current debt cost.

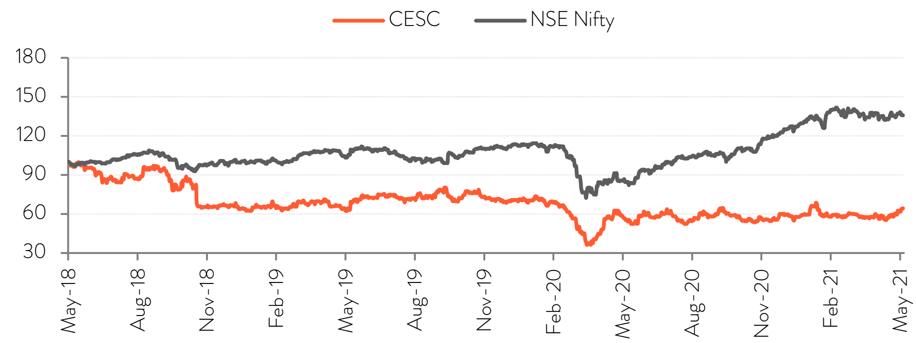
The stock is currently trading at 5.7x FY22E EV/EBITDA, a 17% discount to the 10-year mean. Our Mar'22 TP of Rs 721 implies 5.9x FY22E EV/EBITDA or a 15% discount to the mean. Initiate coverage with ADD.

FIG 13 – SOTP VALUATION

Segment (Rs mn)	EV	Net Debt FY22E	Equity Value	% Share	Contribution to Group Equity Value	EBITDA FY22E	EV/EBITDA (x)
Distribution							
Kolkata & Howrah	82,467	32,172	50,295	100	50,295	18,767	4.4
Noida	20,269	2,348	17,921	73	13,034	2,998	6.8
Kota	1,319	2,125	(807)	100	(807)	(199)	(6.6)
Bikaner	314	587	(273)	100	(273)	0	2,016.6
Bharatpur	1,598	224	1,374	100	1,374	181	8.8
Malegaon	325	8,768	(8,443)	100	(8,443)	388	0.8
Subtotal (A)	**1,06,291**	**46,224**	**60,067**		**55,180**	**19,138**	**5.6**
Renewables (B)	**12,927**	**6,312**	**6,615**	**100**	**6,615**	**1,593**	**8.1**
Generation							
Haldia Power	56,096	25,340	30,756	100	30,756	8,759	6.4
Dhariwal Infrastructure	20,494	26,913	(6,418)	100	(6,418)	3,589	5.7
Crescent Power	147	1,292	(1,145)	68	(777)	230	0.6
Subtotal (C)	**76,737**	**53,545**	**23,192**		**23,561**	**12,578**	**6.1**
Others (D)	19,565	8,873	10,692	100	10,692	3,326	5.9
Consolidated (E= A+B+C+D)	**2,15,520**	**1,14,954**	**1,00,566**		**96,047**	**36,634**	**5.9**
Number of shares (mn) (F)					133		
Value (Rs/sh) (G = E divided by F)					725		
Target Price (Rs) (H= F – rounded to nearest 1)					**721**		

Source: BOBCAPS Research

FIG 14 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Upside risks include the company winning new distribution concessions and Dhariwal Infrastructure winning a long-term PPA.
- Downside risks include regulatory changes such as a reduction in rate of regulatory returns and delays in proposed regulatory changes including the Electricity Act 2021.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	**1,06,641**	**1,10,146**	**1,08,682**	**1,33,427**	**1,36,885**
EBITDA	37,080	35,355	34,163	36,634	37,382
Depreciation	(7,638)	(7,814)	(8,258)	(9,197)	(9,402)
EBIT	29,442	27,541	25,905	27,436	27,980
Net interest income/(expenses)	(12,757)	(13,194)	(11,400)	(11,822)	(11,206)
Other income/(expenses)	1,553	1,645	1,626	1,626	1,626
Exceptional items	0	0	0	0	0
EBT	18,931	16,686	16,835	17,240	18,400
Income taxes	(6,950)	(3,627)	(3,235)	(3,717)	(3,851)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	552	655	720	(419)	(441)
Reported net profit	**11,840**	**13,021**	**13,616**	**13,104**	**14,108**
Adjustments	0	0	0	0	0
Adjusted net profit	**11,840**	**13,021**	**13,616**	**13,104**	**14,108**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	16,350	6,568	6,481	7,957	8,163
Other current liabilities	16,350	6,568	6,481	7,957	8,163
Provisions	3,443	4,247	4,247	4,247	4,247
Debt funds	1,26,123	1,21,816	1,32,082	1,29,534	1,19,326
Other liabilities	79,174	84,963	84,947	85,366	85,807
Equity capital	1,332	1,332	1,332	1,332	1,332
Reserves & surplus	88,406	94,942	1,01,385	1,07,229	1,13,772
Shareholders' fund	89,738	96,274	1,02,718	1,08,562	1,15,104
Total liabilities and equities	**3,34,697**	**3,43,721**	**3,60,327**	**3,65,517**	**3,62,499**
Cash and cash eq.	5,026	12,129	10,868	13,343	13,689
Accounts receivables	17,389	18,818	29,776	29,244	22,502
Inventories	5,130	150	148	182	187
Other current assets	19,679	18,934	18,934	18,934	18,934
Investments	1,985	1,631	1,631	1,631	1,631
Net fixed assets	2,34,346	2,33,767	2,35,721	2,39,185	2,42,680
CWIP	0	0	0	0	0
Intangible assets	1,579	1,472	1,472	1,472	1,472
Deferred tax assets, net	1,579	1,472	1,472	1,472	1,472
Other assets	47,984	55,347	60,303	60,054	59,932
Total assets	**3,34,697**	**3,43,721**	**3,60,327**	**3,65,517**	**3,62,499**

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	19,478	20,835	21,874	22,302	23,510
Interest expenses	13,336	13,306	10,360	10,806	10,246
Non-cash adjustments	3,117	939	(1,306)	(191)	(225)
Changes in working capital	35,930	35,079	30,929	32,917	33,531
Other operating cash flows	(48,921)	(40,125)	(41,972)	(30,944)	(26,587)
Cash flow from operations	**22,939**	**30,033**	**19,886**	**34,891**	**40,476**
Capital expenditures	(8,378)	(7,464)	(10,090)	(12,539)	(12,776)
Change in investments	0	0	(4,500)	0	0
Other investing cash flows	998	5,393	0	0	0
Cash flow from investing	**(7,381)**	**(2,072)**	**(14,590)**	**(12,539)**	**(12,776)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(3,111)	(4,892)	10,266	(2,548)	(10,208)
Interest expenses	(13,336)	(13,306)	(10,360)	(10,806)	(10,246)
Dividends paid	(2,790)	(3,188)	(7,173)	(7,260)	(7,565)
Other financing cash flows	21,101	21,471	7,267	20,615	28,020
Cash flow from financing	**1,865**	**86**	**0**	**0**	**0**
Changes in cash and cash eq.	**(1,303)**	**7,103**	**(1,260)**	**2,474**	**346**
Closing cash and cash eq.	**5,026**	**12,129**	**10,868**	**13,343**	**13,689**

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	89.3	98.2	102.7	98.9	106.4
Adjusted EPS	89.3	98.2	102.7	98.9	106.4
Dividend per share	17.5	20.0	45.0	45.5	47.5
Book value per share	677.0	726.3	774.9	819.0	868.3

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.0	1.9	1.9	1.5	1.5
EV/EBITDA	5.7	5.9	6.0	5.6	5.6
Adjusted P/E	7.5	6.9	6.6	6.8	6.3
P/BV	1.0	0.9	0.9	0.8	0.8

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	62.5	78.0	80.9	76.0	76.7
Interest burden (PBT/EBIT)	64.3	60.6	65.0	62.8	65.8
EBIT margin (EBIT/Revenue)	27.6	25.0	23.8	20.6	20.4
Asset turnover (Revenue/Avg TA)	32.1	32.5	30.9	36.8	37.6
Leverage (Avg TA/Avg Equity)	3.8	3.6	3.5	3.4	3.3
Adjusted ROAE	13.6	14.0	13.7	12.4	12.6

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

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	3.8	3.3	(1.3)	22.8	2.6
EBITDA	23.6	(4.7)	(3.4)	7.2	2.0
Adjusted EPS	43.1	10.0	4.6	(3.8)	7.7
Profitability & Return ratios (%)					
EBITDA margin	34.8	32.1	31.4	27.5	27.3
EBIT margin	27.6	25.0	23.8	20.6	20.4
Adjusted profit margin	11.1	11.8	12.5	9.8	10.3
Adjusted ROAE	3.6	3.8	3.9	3.6	3.9
ROCE	10.8	10.0	9.1	9.3	9.4
Working capital days (days)					
Receivables	60	62	100	80	60
Inventory	18	0	0	0	0
Payables	56	22	22	22	22
Ratios (x)					
Gross asset turnover			10.8	8.2	4.7
Current ratio	0.7	0.8	0.9	0.9	0.8
Net interest coverage ratio	2.3	2.1	2.3	2.3	2.5
Adjusted debt/equity	1.4	1.3	1.3	1.2	1.0

Source: Company, BOBCAPS Research