

CESC

Lack of tariff true up impacts earnings

India Equity Research | Power



Edelweiss
Ideas create, values protect

CESC reported Q3FY13 PAT of INR1bn, lower than our estimated INR1.6bn on account of lower than expected weakness in demand and pending tariff true up. While a steady performance by Spencers should reduce losses going ahead, pending clarity on FDI in retail and the recent Firstsource acquisition, the stock is expected to trade at a discount to our INR337/share TP. Maintain 'HOLD'.

Weak demand, delay in tariff revision dents profit

CESC's Q3FY13 PAT of INR1bn was lower than our estimate of INR1.6bn on account of lack of tariff true up and lower than expected demand in a seasonally weak quarter. Power sale of 1,961MUs (vis-à-vis 2BUs in Q3FY12) was flat YoY due to the extended winter which led to drop in PLFs to 81% from 86.5%. Further the petition for FY13 tariff revision which has been delayed is still awaiting an order from the West Bengal Electricity Regulatory Commission (WBERC) to recover the revised fixed costs (involve approval of capex servicing and O&M costs).

Power projects on track; other investments on the rise

The Dhariwal plant is expected to achieve CoD in Q1FY14 and secure an FSA (against LoA of 2.7MT) from SECL by entering into a medium term PPA. The Haldia project is also on schedule with the entire 600MW likely to be absorbed by the regulated Kolkata distribution business. CESC is now the majority shareholder (57% stake for a total investment of INR4.5bn) in FirstSource post the open offer and is expected to clock FY13 PAT of INR1.3bn. Spencers' same stores sales have increased from Rs.1124/sq ft in YTD 9MFY12 to Rs. 1303/sqft in YTD 9MFY13. While the FY13 cash loss is expected to be ~INR750mn, the management remains confident of cash breakeven by CY13 end.

Outlook and valuations: Unrelated diversification; maintain 'HOLD'

While tariff hike is expected in Q4, we remain concerned over the unrelated diversification through Firstsource acquisition and continued, albeit lower, loss funding in Spencers leading to diversion of cash flows from the stable regulated power business. Hence we expect the stock to trade at a discount to our revised SOTP based fair value of INR337/share (INR307 earlier). Introduce FY15E and maintain our 'HOLD/SU' rating/recommendation on the stock.

Financials (Standalone)

(INR mn)

Year to March	Q3FY13	Q3FY12	% Change	Q2FY13	% Change	FY12	FY13E	FY14E
Revenues	10,220	10,190	0.3	13,240	(22.8)	46,805	54,431	59,394
EBITDA	2,660	2,130	24.9	3,110	(14.5)	11,573	12,358	12,780
Net profit	1,010	740	36.5	1,360	(25.7)	5,543	5,566	5,726
Dilu. EPS (INR)						44.1	44.3	45.6
Diluted P/E (x)						7.2	7.2	7.0
Price/BV(x)						0.8	0.7	0.7
ROAE (%)						9.6	8.9	8.5

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Equalweight

MARKET DATA (R: CESC.BO, B: CESC IN)

CMP	: INR 318
Target Price	: INR 337
52-week range (INR)	: 347 / 243
Share in issue (mn)	: 124.9
M cap (INR bn/USD mn)	: 40/ 738
Avg. Daily Vol.BSE/NSE('000)	: 434.4

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	52.5	52.5	52.5
MF's, FI's & BK's	18.4	17.0	17.4
FII's	15.2	17.2	17.0
Others	13.9	13.3	13.2
* Promoters pledged shares (% of share in issue)			5.7

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Power Index
1 month	3.0	(0.5)	3.7
3 months	14.9	4.2	2.8
12 months	13.7	10.1	(7.6)

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Financial snapshot

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	YTD13	FY13E	FY14E
Total operating income	10,400	10,320	0.8	13,440	(22.6)	38,040	54,431	59,394
Cost of goods sold	5,070	5,510	(8.0)	7,450	(31.9)	20,990	30,170	34,059
Gross profit	5,330	4,810	10.8	5,990	(11.0)	17,050	24,261	25,335
Salaries,wages, other payments	1,300	1,060	22.6	1,390	(6.5)	3,990	5,369	5,745
Other expenses	1,370	1,620	(15.4)	1,490	(8.1)	4,390	6,535	6,810
Total expenditure	7,740	8,190	(5.5)	10,330	(25.1)	29,370	42,074	46,614
EBITDA	2,660	2,130	24.9	3,110	(14.5)	8,670	12,358	12,780
Other income	240	200	20.0	240	0.0	690	558	657
PBDIT	2,900	2,330	24.5	3,350	(13.4)	9,360	12,916	13,436
Depreciation	770	750	2.7	760	1.3	2,300	3,035	3,190
Interest	860	660	30.3	890	(3.4)	2,530	2,890	3,054
Profit before tax	1,270	920	38.0	1,700	(25.3)	4,530	6,991	7,192
Tax	260	180	44.4	340	(23.5)	910	1,426	1,467
Core profit	1,010	740	36.5	1,360	(25.7)	3,620	5,566	5,726
Adjustments								
Adjusted net profit	1,010	740	36.5	1,360	(25.7)	3,620	5,566	5,726
No. of shares (mn)	126	126		126		126	126	126
Diluted EPS (INR)	-	-		-		28.7	44.3	45.6

As % of net revenues

COGS	48.8	53.4		55.4		55.2	55.4	57.3
Gross profit	51.3	46.6		44.6		44.8	44.6	42.7
Other expenditure	13.2	15.7		11.1		11.5	12.0	11.5
Total expenses	74.4	79.4		76.9		77.2	77.3	78.5
EBITDA	25.6	20.6		23.1		22.8	22.7	21.5
Reported net profit	9.7	7.2		10.1		9.5	10.2	9.6
Tax rate	20.5	19.6		20.0		20.1	20.4	20.4

Table 1: SOTP valuations

Segment	Value (INR mn)	Multiple times	Method	Stake (%)	Target value (INR mn)	Value/ share (INR)	Comments
Regulated equity	29,912	1.2	(RoE-g)/(CoE-g)	100.0	35,351	281	As per the tariff orders, FY14E book
Cash & Liquid Investments	(938)	1.0	At book value	100.0	(938)	(7)	After funding Spencers losses/Firstsource acquisition
Dhariwal project	4,599	0.8	NPV	100.0	3,449	27	
Haldia	4,481	1.0	NPV	100.0	4,481	36	
Total						337	

Source: Edelweiss research

Company Description

CESC is an RP-Sanjiv Goenka Group company. It started operations in 1899 and since then the company has been offering power to consumers in its Kolkata license area which has expanded from 5.64 sq miles to 567 sq km over the years. The number of consumers has grown from 6,000 to 2.5 mn over time. CESC has total installed capacity of 1,225 MW from four generating units at Budge Budge (750 MW), Southern (135 MW), Titagarh (240 MW) and New Cossipore (100 MW).

Investment Theme

CESC has a huge expansion plan and intends to increase its capacity to more than 1,825 MW, in its license area. The company has been allotted 110 MT of coal block using which it plans setup a power plant. CESC is also seeking growth opportunities in other parts of India in the power space by developing 600 MW power plant in Maharashtra and is also looking at opportunities to develop ~3,000 MW in Bihar, Jharkhand and Orissa. The company has merged Spencer's retail with itself and plans to unlock value at appropriate time. CESC has also bid for the Patna and Muzaffarpur distribution franchisee business.

Key Risks

Regulated returns

Our earnings estimates assume incentives on account of PLF and other normative parameters under regulatory norm; if the company fails to earn the same, then RoE would be lower and, hence, impact valuations.

Delay in projects

Escalation in project costs, delay in commissioning of generation projects, and long gestation periods could impact profitability, if delays are not compensated through tariffs.

Further cash outflow in Spencers

We have factored INR 1.2 bn of cash outflow in Spencer's over FY13 and FY14. However, equity infusion at a greater than anticipated level, due to higher losses, or due to delay in divestment, pose risk to our estimates.

Unrelated diversification

The company in the past has made investments into unrelated businesses (outside of core business of power GTD) with no synergetic benefits which might dilute management bandwidth and hence poses a key risk.

Financial Statements

Key Assumptions

Year to March	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.8
USD/INR (Avg)	47.9	54.5	54.0	52.0
Sector				
Merchant prices (INR/kWh)	4.0	4.0	4.0	4.0
New Castle 6700 Kcal (USD/t FoB)	117	95	90	90
Melawan 5400 Kcal (USD/t FoB)	89	74	70	70
Company				
Closing Regulated Equity (INR mn)	25,992	27,973	29,912	30,062
RoE on Regulated Equity (%)	19	19	18	18
Investment in Spencers (INR mn)	1,063.4	800.0	400.0	0.0
PLF (%)	88.0	93.8	93.8	93.8
Net sale of energy (mn kwh)	8,271	8,767	9,293	9,851
Tariff (INR/kwh)	5.6	6.2	6.3	6.4
Fuel cost (INR/kwh)	2.0	2.2	2.3	2.3
Employee Exp. Growth(%)	(18.9)	14.0	7.0	10.0
SG&A Exp. As %age of T Exp.	22.7	20.0	20.0	20.0
Power purchase cost (INR mn)	6,361	9,401	12,563	15,915
Investment into sub. (INR mn)	489	4,380	1,878	-
Average Interest rate (%)	9.1	9.0	8.8	8.8
Average Depreciation rate (%)	2.4	2.4	2.4	2.4
Net borrowings (INR mn)	10,840	9,170	7,408	(1,750)
Capex (INR mn)	6,455	6,678	6,466	500
Debtor days	76	73	73	73
Inventory days	23	23	23	23
Payable days	30	30	30	30
Cash conversion cycle (days)	69	66	66	66

Income statement

(INR mn)

Year to March	FY12	FY13E	FY14E	FY15E
Income from operations	46,805	54,431	59,394	63,812
Direct costs	23,980	30,170	34,059	37,411
Employee costs	4,710	5,369	5,745	6,319
Other Expenses	6,543	6,535	6,810	6,954
Total operating expenses	35,233	42,074	46,614	50,684
EBITDA	11,573	12,358	12,780	13,128
Depreciation and amortisation	2,895	3,035	3,190	3,272
EBIT	8,678	9,323	9,590	9,855
Other income	1,013	558	657	1,082
Interest expenses	2,758	2,890	3,054	3,093
Profit before tax	6,933	6,991	7,192	7,845
Provision for tax	1,390	1,426	1,467	1,600
Net profit	5,543	5,566	5,726	6,245
Profit After Tax	5,543	5,566	5,726	6,245
Basic EPS (INR)	44.1	44.3	45.6	49.7
Shares outstanding (mn)	126	126	126	126
Diluted EPS (INR)	44.1	44.3	45.6	49.7
Dividend per share (INR)	5.0	5.0	5.2	5.6
Dividend payout (%)	11.3	11.3	11.3	11.3

Common size metrics

Year to March	FY12	FY13E	FY14E	FY15E
Operating expenses	75.3	77.3	78.5	79.4
Depreciation	6.2	5.6	5.4	5.1
Interest expenditure	5.9	5.3	5.1	4.8
EBITDA margins	24.7	22.7	21.5	20.6
Net profit margins	11.8	10.2	9.6	9.8

Growth ratios (%)

Year to March	FY12	FY13E	FY14E	FY15E
Revenues	18.8	16.3	9.1	7.4
EBITDA	15.6	6.8	3.4	2.7
PBT	12.9	0.8	2.9	9.1
Net profit	13.5	0.4	2.9	9.1
EPS	13.5	0.4	2.9	9.1

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13E	FY14E	FY15E	
Equity capital	1,256	1,256	1,256	1,256	
Reserves & surplus	58,862	63,690	68,656	74,073	
Shareholders funds	60,118	64,946	69,912	75,329	
Short term debt	4,328	2,000	2,000	2,000	
Long term debt	26,442	31,444	33,971	32,321	
Borrowings	30,770	33,444	35,971	34,321	
Deferred revenue	16,169	16,169	16,169	16,169	
Sources of funds	107,057	114,559	122,052	125,819	
Tangible assets	75,851	79,419	82,695	79,923	
Intangible assets	1,299	1,299	1,299	1,299	
CWIP (incl. intangible)	3,765	3,840	3,840	3,840	
Total net fixed assets	80,915	84,558	87,834	85,062	
Non current investments	10,482	14,862	16,739	16,739	
Current Investments	850	850	850	850	
Cash and equivalents	8,598	8,562	10,973	18,481	
Inventories	2,947	3,427	3,740	4,018	
Sundry debtors	9,770	10,886	11,879	12,762	
Loans and advances	12,910	14,410	15,410	15,410	
Other current assets	802	802	802	802	
Total current assets (ex cash)	26,429	29,525	31,830	32,992	
Trade payable	2,910	3,475	3,850	4,187	
Others current liabilities	17,307	20,323	22,324	24,118	
Total current liabilities &	20,217	23,798	26,175	28,305	
Net current assets (ex cash)	6,212	5,727	5,656	4,687	
Uses of funds	107,057	114,559	122,052	125,819	
Book value per share (INR)	386.6	425.1	464.6	507.7	

Free cash flow		(INR mn)			
Year to March	FY12	FY13E	FY14E	FY15E	
Net profit	5,543	5,566	5,726	6,245	
Depreciation	2,895	3,035	3,190	3,272	
Others	1,384	-	-	-	
Gross cash flow	9,822	8,601	8,915	9,517	
Less: Changes in WC	2,442	(484)	(72)	(969)	
Operating cash flow	7,380	9,085	8,987	10,486	
Less: Capex	6,455	6,678	6,466	500	
Free cash flow	924	2,407	2,521	9,986	

Peer comparison valuation

Name	Market cap (USD mn)	EV/EBITDA (X)		Price/BV (X)		ROAE (%)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
CESC	736	5.2	5.0	0.7	0.7	8.9	8.5
NTPC	22,509	10.1	7.5	1.6	1.4	11.9	15.3
Power Grid Corp of India	9,676	10.7	9.5	2.0	1.8	14.8	15.5
Tata Power Co	4,250	9.0	6.4	1.5	1.4	8.1	11.3
Median	-	9.6	6.9	1.5	1.4	10.4	13.3
AVERAGE	-	8.7	7.1	1.5	1.3	10.9	12.6

Source: Edelweiss research

Cash flow metrics		FY12	FY13E	FY14E	FY15E
Year to March					
Operating cash flow		7,380	9,085	8,987	10,486
Investing cash flow		(8,153)	(11,058)	(8,344)	(500)
Financing cash flow		870	1,937	1,767	(2,478)
Net cash flow		96	(36)	2,411	7,508
Capex		(6,455)	(6,678)	(6,466)	(500)
Dividends paid		(579)	(738)	(759)	(828)

Profitability & efficiency ratios

Year to March	FY12	FY13E	FY14E	FY15E
ROAE (%)	9.6	8.9	8.5	8.6
ROACE (%)	9.4	9.6	9.4	9.3
Debtors days	60	69	70	70
Current ratio	1.7	1.6	1.6	1.8
Debt/EBITDA	2.7	2.7	2.8	2.6
Fixed asset turnover (x)	0.6	0.7	0.7	0.8
Average working capital turnover	3.5	3.7	3.8	3.2
Average capital employed	0.5	0.5	0.5	0.5
Debt/Equity	0.5	0.5	0.5	0.5
Adjusted debt/equity	0.5	0.5	0.5	0.5

Operating ratios

Year to March	FY12	FY13E	FY14E	FY15E
Total asset turnover	0.5	0.5	0.5	0.5
Fixed asset turnover	0.6	0.7	0.7	0.8
Equity turnover	0.8	0.9	0.9	0.9

Valuation parameters

Year to March	FY12	FY13E	FY14E	FY15E
Diluted EPS (INR)	44.1	44.3	45.6	49.7
Y-o-Y growth (%)	13.5	0.4	2.9	9.1
CEPS (INR)	67.2	68.5	71.0	75.8
Diluted PE (x)	7.2	7.2	7.0	6.4
Price/BV (x)	0.8	0.7	0.7	0.6
EV/Sales (x)	1.1	0.9	0.8	0.6
EV/EBITDA (x)	5.3	5.2	5.0	4.2
Dividend yield (%)	1.6	1.6	1.6	1.8

Additional Data

Directors Data

Mr R P Goenka	Chairman, Promoter Non Executive	Mr S Goenka	Vice Chairman, Promoter Non Executive
Mr P K Khaitan	Non Independent	Mr B M Khaitan	Independent
Mr S K V Srinivasan	Independent (Nominee of IDBI Bank Ltd)	Mr S N Menon	Independent
Mr O P Vaish	Independent	Mr S Banaerjee	Managing Director, Executive

Auditors - Lovelock & Lewes

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
HDFC Asset Management Co Ltd	8.08	Goldman Sachs Inv Maur Ltd	2.79
BNK Capital Markets Ltd	2.41	M And G Asian Fund	2.23
SBI Funds Management	2.10	Adapt Investments Ltd	2.00
Sundaram Asset Management Co Ltd	1.83	Matthews International Capital	1.57
UTI Asset Management Co Ltd	1.55	DSP Blackrock Investment Manager	1.06

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
26 Oct 2012	Hdfc Mutual Fund A/C Hdfc Top 200 Fund	Buy	700000	286.24

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Adani Enterprises	BUY	SP	M	Adani Ports and Special Economic Zone	BUY	SO	M
Adani Power	REDUCE	SU	M	CESC	HOLD	SU	H
Essar Ports	BUY	None	None	GMR Infrastructure	BUY	SO	H
Gujarat Pipavav Port	REDUCE	None	None	GVK Power and Infra	HOLD	SU	H
JSW Energy	HOLD	SP	H	Lanco Infratech	BUY	SU	H
Marg	BUY	None	None	Navabharat Ventures	BUY	None	None
NTPC	HOLD	SU	L	Power Grid Corp of India	BUY	SO	L
PTC India	BUY	None	None	Reliance Infrastructure	BUY	SO	M
Tata Power Co	BUY	SO	L				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Power

Adani Power, Adani Enterprises, Adani Ports and Special Economic Zone, CESC, Essar Ports, GMR Infrastructure, Gujarat Pipavav Port, GVK Power and Infra, JSW Energy, Lanco Infratech, Marg, Navabharat Ventures, NTPC, PTC India, Power Grid Corp of India, Reliance Infrastructure, Tata Power Co

Recent Research

Date	Company	Title	Price (INR)	Recos
12-Feb-13	Tata Power	All round performance; <i>Result Update</i>	98	Buy
07-Feb-13	Power	Road to recovery; <i>Sector Update</i>		
07-Feb-13	NTPC	Subscribe to OFS; <i>Company Update</i>	152	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

DISCLAIMER

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