

CESC Ltd.

₹ 258

**Re'tail'ing the truth !!!****Buy**

Gateway to Prosperity

December 02, 2011

**Company Background**

CESC (previously Calcutta Electric Supply Corporation) is part of the RPG Group which has a strong presence in the fields of power generation, transmission network. Incorporated in 1978, the company began its operations way back in 1899 & manages power generation and distribution in state of West Bengal. It is a part of RP Goeka group- a \$ 3 bn group which has interests across business sectors - Power & Natural Resources, Infrastructure, Carbon Black, Retail and Media & Entertainment.

CESC is the sole distributor of electricity within an area of 567 sq km of Kolkata and Howrah serving 2.5 million consumers which includes domestic, industrial and commercial users. It owns and operates four thermal power plants generating 1225 MW of power. More than 80% its electricity requirement is met from its own generating plants whilst balance electricity is being purchased from third parties. About 50% of the coal requirement is sourced from captive mines. CESC also owns and operates the Transmission & Distribution system through which it supplies electricity to consumers. CESC has also exposure to retail business through its multi retailer subsidiary company Spencer. CESC has a large unexploited land bank. CESC floated a wholly owned subsidiary "CESC Properties Ltd" to develop real estate projects.

**Financial Performance**

CESC's sales stood at ₹ 12.41 bn for the Q2FY12. Its sales grew by 12% YoY and 5% QoQ. Sales growth can be attributed to an 8% hike in the tariff rate. On a QoQ basis, the volume of the power sold grew by 4% despite a 1% lower generation as power purchase was higher than in Q1FY12. Performance at Spencer level has remained strong, driven by higher revenue. Sales of Spencer's has also increased during the first half of FY 12 - 13% higher yoy. Spencer closed 16 Daily / Express stores during the quarter. As on Sept 2011, it operated 195 Stores v/s 208 stores.

However, surge in other expenses restricted the profit growth. The other expenses mainly contained interest on security deposit and cost adjustment, and were primarily responsible for the profit decline in both the comparable quarters. At the same time, the fuel cost per unit went up from ₹ 1.75 in Q2FY2011 to ₹ 1.89 in Q2FY2012. Consequently, the company reported operating profit at ₹ 2.60 bn - a decline of 18% YoY and of 3% QoQ. The company's OPM fall was mainly because of lower realization. The net profit of the company stood at ₹ 1.14 bn.

**Investment Rationale****➔ Core Business Expanding**

CESC is one of the oldest utility companies in India. CESC has current installed capacity of 1.2GW. It is currently constructing 1.2GW of power projects- 600MW each at Chandrapur and Haldia. The company has acquired the required land and received all statutory and regulatory clearances including environmental clearances. Bo the the projects are running smoothly & are expected to be operational by 2015. The company plans to sell 50% of the

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**Info Codes**

Reuters	CESC.BO
Bloomberg	CESC@IN
NSE	CESC
BSE	500084

**Market Data**

52 Wk Range (₹)	: 385 / 234
Shares in Issue (mn)	: 125
Mkt. Cap (₹ bn)	: 32.10
BSE 2 Wk Avg Vol	: 56314

**Share Holding Pattern (%)**

Promoters	: 52.48
DII's	: 16.99
FII's	: 18.32
Others	: 12.16

**Investment Theme**

CESC has a strong presence in West Bengal in Power generation distribution business. During its presence in the region for more than 100 years the company has made the region load shedding free with fault free electricity supply. The company has plans to double its power generation capacities to 2.3 GW by 2015. It has captive mines to supply the expansion plans. The company's retail adventure through Spencer's has been showing signs of breakeven and would be boosted significantly with the opening of FDI. Given the company's past collaboration with foreign investors & need of an investor to finance its capex plan, the company is expected to welcome the FDI in its operations. We remain bullish on CESC & recommend to buy stock.

**FDI to Flood Retail Soon !!!**

power from the project on long-term basis and the balance in the short-term market.

#### ➔ Safer Business Operations

CESC's existing operations are generating steady cash. In the current scenario, where almost all generators sell power to state distribution companies, CESC is better placed as it sells all of its power to its own distribution arm in Kolkata. This secures the generating arm from backing down, delayed payments, and longer debtor days which most of its generating peers are facing. It has been able to run operations at 92% PLF. Further its operations are under the tight control of regulatory framework of West Bengal Electricity Regulatory Commission. As per these norms, the generation company will be reimbursed all costs including taxes. It benefits from energy exports where it is entitled to retain 40% of the profit earned from sale of surplus power. CESC sells surplus power in the open market during off peak hours. The company is better placed in terms of fuel security as most of the coal required to fire its existing stations comes from captive mine, Coal India and imports. For its future projects, the company has already signed for domestic linkages.

#### ➔ Retail FDI to boost Spencer's

The retail business of CESC (Spencer's) has been a overhang on its profitability due to running losses for the last 5 years. These losses are being funded by the cash generated from its utility business. However, over the last 18-20 months the management has been able to reduce the losses. It has also achieved store level break even. We believe going forward the margins of Spencer's should improve and that could lift the burden.

With the nod to foreign direct investment in multibrand retail things may speed up. Group may induct foreign partners for back-end infrastructure of its retail venture Spencer's. CESC has huge capex plans which require equally massive financial funding. ₹ 350-crore capital expenditure was proposed for Spencer's for 2012-13 against ₹ 150 crore this year. The Group Chairman Sanjiv Goenka expected 50% of the retail to flow into back-end operations. This could help Spencer's break-even earlier.

#### ➔ Value unlocking in landbank

Being a fairly old company, CESC enjoys ownership of crucial & large landbank. CESC Properties, a 100% subsidiary of CESC, plans to develop a 0.4mn sq. ft. shopping mall in Central Kolkata. Going ahead, CESC Properties also plans to monetize its 35-acre land at Mulajore.

#### Key Financials

Year Ended 31 <sup>st</sup>	Mar 09	Mar 10	Mar 11
Revenue (₹ mn)	32794.3	35303.0	41689.7
<b>Rev. growth (%)</b>	<b>7.98</b>	<b>7.65</b>	<b>18.09</b>
EBITDA (₹ mn)	8835.2	10594.0	12319.4
Net profit (₹ mn)	4096.9	4333.0	4884.0
Shares outstanding (mn)	131.2	131.2	131.2
EPS (₹)	31.2	33.0	37.2
<b>EPS growth (%)</b>	<b>15.29</b>	<b>5.76</b>	<b>12.72</b>
P/E (x)	6.7	11.6	8.4
EV/ EBITDA	32.5	49.0	34.9
<b>ROCE (%)</b>	<b>8.14</b>	<b>7.31</b>	<b>7.43</b>

#### Indian Power Sector

India ranks 5th in the world in terms of total installed capacity. As the Indian economy continues to surge ahead, its power sector has been expanding concurrently to support the growth rate; yet it is one of the lowest in terms of per capita consumption of power. The demand for power is growing exponentially. India is planning to get an additional 60,000 MW of electricity from various hydro-power projects by the end of 2025. If India is to achieve double digit growth, it is imperative to rapidly expand its power infrastructure and the scope of growth of this sector is immense.

#### The Retail Sector

The modern retail sector currently accounts for around 5 per cent of the Indian retail market. The growth in the overall retail market is expected to be driven, largely by the explosion in the modern retail market. The main drivers of Indian modern retail growth can broadly be defined as economic growth, favourable population demographics and increased industry investment. Now the Government of India very recently opened up the retail sector almost completely for FDI. Foreign companies will be able to wholly own single-brand stores and majority-own multi-brand stores. The decision is likely to catalyse joint ventures between Indian and foreign organised retailers. This offers good prospects for large established Indian retailers. As many of them are cash starved & could easily solve the funding issues if 49% is sold to a foreign participants. Not only in financial term, but FDI would boost the operational performance as well long with bringing latest products & technology from overseas market. Overall this is a liberalisation era for Indian Retail Industry.

## Financial Statements

### Income Statement

(₹ mn)

Year end	Mar 09	Mar 10	% Chg	Mar 11	% Chg
Total Sales + Excise	30524.4	33695.9	10.39	40499.0	20.19
Other Income	2269.9	1607.1	(29.20)	1190.7	(25.91)
Change in Stocks	0.0	0.0	-	0.0	-
Raw Material Con.	11799.5	12778.1	8.29	15269.3	19.50
Employee Exp.	3702.4	4260.2	15.07	4818.2	13.10
Indirect Taxes	78.0	100.2	28.46	82.7	(17.47)
Other Exp.	8379.2	7570.5	(9.65)	9200.1	21.53
Operating Exp.	23959.1	24709.0	3.13	29370.3	18.86
Operating Profit	6565.3	8986.9	36.88	11128.7	23.83
Total Interest	2430.3	3309.9	36.19	3496.0	5.62
Gross Profit	6404.9	7284.1	13.73	8823.4	21.13
Net Dep.	1756.2	2063.6	17.50	2680.9	29.91
Total Taxation	551.8	887.5	60.84	1258.5	41.80
Net Profit/Loss	4096.9	4333.0	5.76	4884.0	12.72

### 4 Years Balance Sheet

(₹ mn)

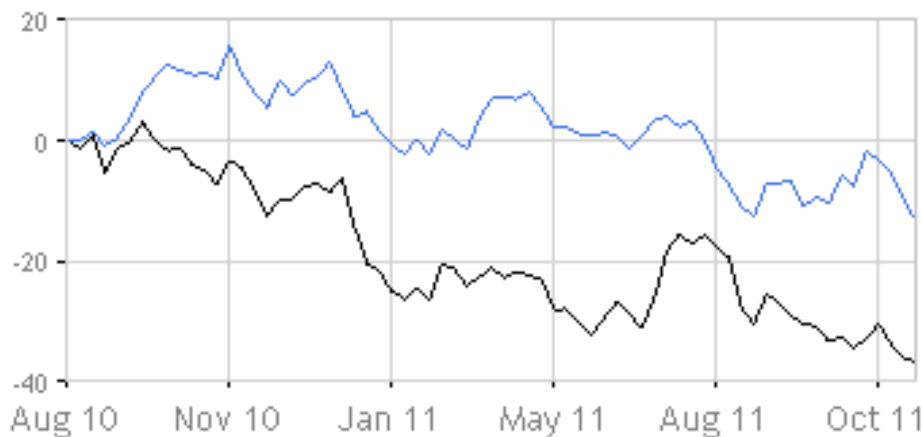
Balance Sheet as on 31 <sup>st</sup>	Mar 08	Mar 09	Mar 10	Mar 11
<b>SOURCES OF FUNDS</b>	<b>47988.9</b>	<b>58141.5</b>	<b>66348.0</b>	<b>73208.6</b>
Equity Share capital	1256.0	1256.0	1256.0	1256.0
Share Application Money	0.0	0.0	0.0	0.0
Preference Share Capital	0.0	0.0	0.0	0.0
Reserves & Surplus	28465.6	32667.4	36974.9	41786.8
Loan Funds	15106.1	22361.1	27490.4	28395.1
Unsecured Loans	3161.2	1857.0	626.7	1770.7
<b>USES OF FUNDS</b>	<b>47988.9</b>	<b>58141.5</b>	<b>66348.0</b>	<b>73208.6</b>
Gross Block	87435.3	94288.7	113638.4	119687.3
Less : Revaluation Reserves	16143.2	14905.5	13737.1	12649.6
Less : Accumulated Depreciation	35339.2	38260.9	41311.3	44901.8
Net Block	35952.9	41122.3	58590.0	62135.9
Capital Work in Progress	6195.5	12796.3	2782.6	2722.4
Investments	8196.5	11550.6	14994.8	20464.3
Current Assets	19296.1	23040.5	23485.7	23237.3
Less : Current Liabilities	21737.9	30446.8	33576.5	35415.5
Total Net Current Assets	(2441.8)	(7406.3)	(10090.8)	(12178.2)
Misc. Expenses not written	85.8	78.6	71.4	64.2
<b>NOTE</b>				
Bk Val Unquoted Investments	3208.2	9237.1	12481.3	18150.8
Mkt Val. Quoted Investments	4991.3	2318.1	2500.0	2300.0
Contingent Liabilities	8371.7	2898.9	1409.1	1227.5
Dividend (%)	40	40	40	40

## Quarterly Income Sheets

(₹ mn)

Quarter Ended	Dec 10	Mar 11	Jun 11	Sep 11
Net Sales	9390.0	8750.0	11830.0	12410.0
Cost Of Sales	6750.0	6290.0	9160.0	9640.0
Operating Profit	2640.0	2460.0	2670.0	2770.0
Recurring Income	220.0	200.0	130.0	290.0
Adjusted PBDIT	2860.0	2660.0	2800.0	3060.0
Financial Expenses	800.0	580.0	700.0	920.0
Depreciation	690.0	670.0	710.0	720.0
Other Write Offs	0.0	0.0	0.0	0.0
Adjusted PBT	1370.0	1410.0	1390.0	1420.0
Tax Charges	270.0	290.0	280.0	280.0
Adjusted PAT	1100.0	1120.0	1110.0	1140.0
Non Recurring Items	0.0	0.0	0.0	0.0
Other Non Cash Adjust	0.0	0.0	0.0	0.0
Net Profit	1100.0	1120.0	1110.0	1140.0

## 52 Week Index Relative Percentage Appreciation



CESC vs SENSEX

## Risks Associated

➔ **Highly Regulated Environment**

CESC is in power generation & transmission business. The sector is heavily subjected to regulations by government. Any adverse policies by government could affect company's performance. The rate revisions if delayed further would continue to put pressure on margins.

➔ **Coal shortage could spoil the play**

CESC has planned to double its generation capacity by 2015. The rising cost of financing as well delays in power equipments delivery could affect its target. Further though company has captive mines, it requires coal from auction as well. The lower availability of coal if sustained could harm company's expansion plans.

➔ **Spencer's still an overhang**

Retail business Spencer's have been making losses for past few years. The losses have been paid from the cash generated from power business. So Retail has been an overhang on company's overall balance sheet. If macro environment becomes more shaky, then the break even period could extend further.

## In a Nutshell

CESC is part of the RPG Group which has a strong presence in the fields of power generation, transmission network. Incorporated in 1978, the company began its operations way back in 1899 & manages power generation and distribution in state of West Bengal. During its presence in the region for more than 100 years the company has made the region load shedding free with fault free electricity supply. The company has plans to double its power generation capacities to 2.3 GW by 2015. It has captive mines to supply its expansion plans. The delay in tariff revisions affected company's revenues this quarter. The company would be recovering it in coming quarters. CESC has gathered a significant landbank over past 100 years. The company has been developing it. That would add to its revenues. CESC's retail adventure through Spencer's has been showing signs of breakeven. It would be boosted significantly with the opening of FDI. Given the company's past collaboration with foreign investors & need of an investor to finance its capex plan, the company is expected to welcome the FDI in its operations. The FDI will not only bring a foreign partner but get cash to the company which can be used to fund its expansion plans. We remain bullish on CESC & recommend to buy this stock.

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## Rating Interpretation

<b>Buy</b>	: Expected to appreciate 20% or more over 12-months	<b>Reduce</b>	: Expected to depreciate up to 10% over 12-months
<b>Accumulate</b>	: Expected to appreciate 10% to 20% over 12-months	<b>Sell</b>	: Expected to depreciate 10% or more over 12-months
<b>Trade Buy</b>	: Expected to appreciate more than 10% over 45-days	<b>Trade Sell</b>	: Expected to depreciate more than 10% over 45-days

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