

RESULT UPDATE

MID CAP

Share Data

Reuters code	CESEC.BO
Bloomberg code	CESEC IN
Market cap. (US\$ mn)	985
6M avg. daily turnover (US\$ mn)	3.0
Issued shares (mn)	125
Target price (Rs)	384

Performance (%)	1M	3M	12M
Absolute	(4)	14	113
Relative	(1)	7	11

Valuation ratios

Yr to 31 Mar	FY10E	FY11E
EPS (Rs.)	32.8	35.7
+/- (%)	0.5	9.0
PER (x)	11.0	10.1
Adj PBV (x)	1.8	1.8
Dividend/Yield (%)	1.4	1.5
EV/Sales (x)	2.1	2.5
EV/EBITDA (x)	9.2	9.2

Major shareholders (%)

Promoters	52
FII's	17
MF's	15
BFSI's	4
Public & Others	12

Financial highlights

(Rs. mn)	2Q FY10	2QFY09	YoY (%)	FY09	FY10	YoY (%)	FY11	YoY (%)
Net Sales	9,640	7,640	26.2	30,701	32,457	5.7	33,900	4.44
EBITDA	2,250	1,960	14.8	6,512	7,242	11.2	9,022	24.58
EBITDA Margin (%)	23.3	25.7	-	21.2	22.3	-	26.6	19.28
Other Income	210	220	(4.5)	1,295	1,302	0.5	1,070	(17.83)
Interest	(460)	(350)	31.4	(1,410)	(1,795)	27.4	(2,639)	47.00
Depreciation	(490)	(430)	14.0	(1,749)	(2,274)	30.0	(2,571)	13.04
PBT	1,510	1,400	7.9	4,649	4,475	(3.7)	4,882	9.12
Tax	(250)	(160)	56.3	(552)	(537)	(2.7)	(586)	9.12
Reported PAT	1,260	1,240	1.6	4,097	3,938	(3.9)	4,297	9.12
Adjustments: extra-ordinary items	-	-	-	(400)	-	-	-	-
Adjusted PAT	1,260	1,240	1.6	3,697	3,938	6.5	4,297	9.12

CESEC

Upgrade to Outperformer

Price: Rs 373

BSE Index: 16,283

29 October 2009

2QFY10 Result – Lacklustre results but capacity expansion gathers pace

Highlights

- Due to lack of new capacities turning operational the results are lack luster with marginal (2%) rise in PAT.
- PAF of current plants are at 98%. The Budge-Budge 250 MW addition has commissioned but due to lack of transmission linkage it is still not adding to revenues. The transmission link will be completed by December 2009, post which the plant will work at full capacity.

B&K's view

The recent acceleration in project execution is heartening. While Budge-Budge 250 MW unit will attain full capacity by January 2010, the 600 MW Chandrapur will complete financial closure in 10-15 days. The Haldia project has been delayed due to land acquisition problems of the last 40 acres, which is a pre-condition to financial closure.

The retail venture – Spencer's continues to bleed but losses have reduced (range of Rs 170-200 mn per month as per our expectations). We have factored both these plants to be operational by FY14 but take a 20% discount to their fair value for our valuation (to factor risks of pending financial closure in Haldia and equipment ordering for both).

We expect earnings growth to be 9-10%, over FY10-12, driven by the Budge-Budge expansion and Kolkata distribution capex. We have also assumed additional equity outlay of Rs 10 bn in Spencer's over two years. Our DCF based value after netting of the fresh equity outlay in Spencer's gives a value of Rs 384/share (implied P/BV of 1.9X FY10 adjusted book value). We maintain Outperformer.

Outlook

- The financial closure of 600 MW Chandrapur Project (Dhariwal Infrastructure) in Maharashtra is expecting financial closure in the next 10-15 days with D:E of 70:30. The project cost is Rs 28.5 bn and is expected to come by FY14. The clearances for land and fuel are in place. Possible suppliers for equipment orders may be BHEL/Dong Fang.
- The financial closure for the 600 MW Haldia Project is dependent on land acquisition, of which 40 acres is yet to be acquired. The completion of the project as well as the acquisitions is expected by end of this fiscal.
- Losses continue at the Spencer's although at levels lower than last year. However, the break-even is about 1 to 1.5 years. A deal with private equity players is possible for 20% stake sale.

Valuation

We have factored in the Chandrapur and Haldia project for valuing CESC, considering the recent progress in execution. The actual construction for both is expected to begin in early FY11. We have assumed 20% RoE for both projects (due to lack of data on costing and sales mix). However considering the risks of delay due to pending equipment ordering (both plants) and financial closure (Haldia) we take 20% discount to our DCF value in the SOTP.

We value the Kolkata power generation and distribution business (including Budge-Budge 250 MW expansion), at Rs 400/share. From this we deduct the expected equity outflow into Spencer's and the real estate businesses estimated at Rs 110bn over the next two years. The SOTP value stands at Rs 384/share implying 1.9x FY10 adjusted book value.

Risk to our estimates and valuation

- Higher than expected loss in Spencer's/equity investment in real and/or further delays in Haldia and Chandrapur projects will impact our estimates.
- Better than expected RoEs will add to our valuation.

Adjusted Book Value

(Rs bn)	FY09	FY10E
Net Worth Rs bn	48.8	53.4
Less: Revaluation Reserve Rs bn	14.9	14.9
Less: Equity infusion into Retail & Real estate Rs bn	7.9	12.9
Adj Net Worth Rs bn	26.0	25.6
Adj BV (Rs /Sh)	207.4	204.2

SOTP

	(Rs mn)	VPS (Rs /Sh)
DCF: Existing Kolkata Generation & Distribution	50,274.4	400
Less: Expected Fund infusion into Spencer's & Real Estate over FY11 & FY12	11,200.0	89
Chandrapur	6,591.1	42
Haldia	5,221.6	33
SOTP	–	386
Adj Book value FY10	–	204
Implied P/BV (X)	–	1.9

Income Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11
Net sales	28,097	30,701	32,751	34,207
<i>Growth (%)</i>	<i>11.6</i>	<i>9.3</i>	<i>6.7</i>	<i>4.4</i>
Operating expenses	(22,227)	(24,189)	(25,306)	(24,968)
Operating profit	5,871	6,512	7,445	9,239
EBITDA	5,871	6,512	7,445	9,239
<i>Growth (%)</i>	<i>(3.9)</i>	<i>10.9</i>	<i>14.3</i>	<i>24.1</i>
Depreciation	(1,685)	(1,749)	(2,274)	(2,571)
Other income	1,206	1,295	1,302	1,070
EBIT	5,392	6,058	6,473	7,738
Interest paid	(1,363)	(1,410)	(1,795)	(2,639)
Pre-tax profit	4,029	4,649	4,677	5,099
(before non-recurring items)				
Non-recurring items	0	(156)	0	0
Pre-tax profit	4,029	4,493	4,677	5,099
(after non-recurring items)				
Tax (current + deferred)	(476)	(552)	(561)	(612)
Net profit	3,554	3,941	4,116	4,487
Adjusted net profit	3,317	4,097	4,116	4,487
<i>Growth (%)</i>	<i>10.3</i>	<i>23.5</i>	<i>0.5</i>	<i>9.0</i>

Balance Sheet

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11
Current assets	19,330	28,845	21,713	14,557
Investments	5,697	3,104	6,604	7,204
Net fixed assets	58,292	68,824	81,955	103,743
Other non-current assets	287	422	422	422
Total assets	83,605	101,196	110,695	125,926
Current liabilities	12,137	16,876	17,155	17,106
Total Debt	16,288	23,981	28,450	40,010
Other non-current liabilities	9,401	11,588	12,928	12,928
Total liabilities	37,826	52,446	58,533	70,044
Share capital	1,256	1,256	1,256	1,256
Reserves & surplus	44,609	47,573	50,985	54,705
Less: Misc. expenditure	(86)	(79)	(79)	(79)
Shareholders' funds	45,779	48,750	52,162	55,882
Total equity & liabilities	83,605	101,196	110,695	125,926

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10	FY11
Pre-tax profit	4,029	4,493	4,677	5,099
Depreciation	3,544	2,922	934	2,571
Chg in working capital	2,313	57	1,268	2,786
Total tax paid	(248)	(687)	(561)	(612)
Cash flow from oper. (a)	9,639	6,784	6,318	9,844
Capital expenditure	(6,278)	(13,454)	(14,065)	(24,358)
Chg in investments	(3,283)	2,593	(3,500)	(600)
Cash flow from inv. (b)	(9,561)	(10,862)	(17,565)	(24,958)
Free cash flow (a+b)	77	(4,077)	(11,247)	(15,115)
Equity raised/(repaid)	6,889	3,064	0	0
Chg in minorities	(237)	0	0	0
Debt raised/(repaid)	(1,695)	7,693	4,469	11,560
Dividend (incl. tax)	585	701	704	767
Other financing activities	0	(477)	0	0
Cash flow from fin. (c)	5,542	10,981	5,173	12,327
Net chg in cash (a+b+c)	5,620	6,903	(6,074)	(2,787)

Key Ratios

Yr end 31 Mar (%)	FY08	FY09	FY10	FY11
EPS (Rs)	26.4	32.6	32.8	35.7
EPS growth	(25.4)	23.5	0.5	9.0
EBITDA margin	20.9	21.2	22.7	27.0
EBIT margin	19.2	19.7	19.8	22.6
RoCE	8.0	7.8	7.3	7.6
Net debt/Equity	14.0	23.5	44.9	70.3

Valuations

Yr end 31 Mar (x)	FY08	FY09	FY10	FY11
PER	13.6	11.0	11.0	10.1
PCE	9.0	7.7	7.1	6.4
Adj Price/Book	1.7	1.7	1.8	1.8
Yield (%)	1.1	1.4	1.4	1.5
EV/Net sales	1.8	1.8	2.1	2.5
EV/EBITDA	8.8	8.7	9.2	9.2

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY08	FY09	FY10	FY11
Net margin (%)	11.8	13.3	12.6	13.1
Asset turnover	0.4	0.3	0.3	0.3
Leverage factor	1.9	2.0	2.1	2.2
RoE (%)	8.5	8.6	8.2	8.3

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 2. **OUTPERFORMER:** 0 to +25%
 3. **UNDERPERFORMER:** 0 to -25%
 4. **SELL:** Potential downside of < -25% (absolute returns)
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