

Company Focus

13 November 2007 | 24 pages

CESC (CESC.BO)

 Target price change
 Estimate change

Buy: Morphing Into a Conglomerate; Target Price Rs650

- Morphing into a conglomerate** — From a pure play electric utility, CESC is morphing into a conglomerate. After the first phase in which CESC achieved growth by improving operating efficiencies, it is now embarking on the second phase which involves: 1) giving its electric utility business a national footprint; 2) monetizing idle real estate assets; and 3) growing retail at rapid pace.
- Target priced raised to Rs650** — We are raising our target price to Rs650 from Rs359 earlier as we factor in: 1) an earnings revision; 2) valuing the power business at Rs553, a 5% discount to DCF value given improved visibility; 3) addition of real estate value of Rs17; and 4) addition of retail value Rs80 (15% discount to recent merger transaction valuation).
- Capacity addition targets of 4150MW** — CESC is working on 4150MW of capacity to expand its national footprint. This includes: 1) 250MW Budge Budge expansion; 2) 600MW Haldia Phase – I; 3) 1300MW Haldia Phase – II; 4) 1000MW Jharkand project; and 4) 1000MW Orissa project.
- Rapid growth in retailing** — Spencer's will double total tradable area over the next year and double it again in the subsequent year. Though the company is now making losses (losses of Rs468mn on sales of Rs5.2bn in FY07), it expects to turn profitable from FY09E/FY10E.
- Monetizing real estate** — CESC Properties will first monetize three acres of land in Central Kolkatta and follow up with 35 acres of land in Mulajore.

Buy/Low Risk	1L
Price (12 Nov 07)	Rs564.65
Target price	Rs650.00
	<i>from Rs359.00</i>
Expected share price return	15.1%
Expected dividend yield	0.7%
Expected total return	15.8%
Market Cap	Rs65,147M
	US\$1,665M

Price Performance (RIC: CESC.BO, BB: CESC IN)



Figure 1. CESC – Statistical Abstract

Year to	Net Profit	EPS	EPS Growth	P/E	P / BV	#Adj P/E	#Adj P/BV	ROE	Yield
31-Mar	Rsmn	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)
FY05A	1,507	20.25	56.1%	27.9	3.3	23.1	2.7	12.9%	0.4%
FY06A	1,844	21.87	8.0%	25.8	2.9	21.4	2.3	12.7%	0.4%
FY07A	3,007	35.68	63.1%	15.8	2.4	13.1	2.0	16.6%	0.6%
FY08E	3,266	28.30	-20.7%	20.0	2.1	16.5	1.8	12.9%	0.7%
FY09E	3,767	32.65	15.4%	17.3	1.9	14.3	1.6	11.7%	0.8%
FY10E	4,243	36.77	12.6%	15.4	1.7	12.7	1.4	11.9%	0.9%

Source: Citi Investment Research estimates; # Adjusted for value of real estate and retail businesses

See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	25.8	15.8	20.0	17.3	15.4
EV/EBITDA adjusted (x)	14.0	13.6	11.9	9.3	8.3
P/BV (x)	2.9	2.4	2.1	1.9	1.7
Dividend yield (%)	0.4	0.6	0.7	0.8	0.9
Per Share Data (Rs)					
EPS adjusted	21.87	35.68	28.30	32.65	36.77
EPS reported	21.06	35.68	28.30	32.65	36.77
BVPS	195.15	235.40	266.35	293.74	324.66
DPS	2.50	3.50	4.00	4.50	5.00
Profit & Loss (RsM)					
Net sales	25,159	24,843	26,547	28,886	31,828
Operating expenses	-21,728	-20,684	-22,388	-23,907	-26,009
EBIT	3,431	4,159	4,159	4,979	5,820
Net interest expense	-2,124	-1,679	-1,698	-1,698	-1,998
Non-operating/exceptionals	667	927	1,250	1,000	1,000
Pre-tax profit	1,975	3,407	3,711	4,281	4,821
Tax	-200	-400	-445	-514	-579
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	1,775	3,007	3,266	3,767	4,243
Adjusted earnings	1,844	3,007	3,266	3,767	4,243
Adjusted EBITDA	5,970	5,739	5,861	7,117	8,217
Growth Rates (%)					
Sales	8.4	-1.3	6.9	8.8	10.2
EBIT adjusted	-3.0	21.2	0.0	19.7	16.9
EBITDA adjusted	-7.5	-3.9	2.1	21.4	15.5
EPS adjusted	8.0	63.1	-20.7	15.4	12.6
Cash Flow (RsM)					
Operating cash flow	3,691	7,901	5,265	5,774	6,420
Depreciation/amortization	2,539	1,579	1,702	2,138	2,398
Net working capital	-622	3,315	297	-131	-221
Investing cash flow	-3,076	-4,614	-15,550	-8,080	-11,150
Capital expenditure	-3,077	-2,514	-3,970	-6,280	-9,150
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	563	194	6,074	1,627	3,662
Borrowings	-2,572	-1,117	-2,000	2,000	4,000
Dividends paid	-235	-345	-540	-608	-675
Change in cash	1,177	3,481	-4,211	-678	-1,069
Balance Sheet (RsM)					
Total assets	48,661	55,178	65,434	71,403	79,964
Cash & cash equivalent	2,829	7,314	3,104	2,425	1,357
Accounts receivable	5,224	4,151	4,436	4,827	5,319
Net fixed assets	36,406	37,340	39,608	43,750	50,502
Total liabilities	32,212	35,337	34,700	37,510	42,503
Accounts payable	6,761	8,967	9,417	9,833	10,327
Total Debt	19,100	17,983	15,983	17,983	21,983
Shareholders' funds	16,449	19,841	30,734	33,893	37,461
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	23.7	23.1	22.1	24.6	25.8
ROE adjusted	12.6	16.6	12.9	11.7	11.9
ROIC adjusted	8.5	10.0	9.9	10.9	11.2
Net debt to equity	98.9	53.8	41.9	45.9	55.1
Total debt to capital	53.7	47.5	34.2	34.7	37.0

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Investment Thesis and Valuations

An emerging conglomerate; we maintain our Buy rating

From a pure play electric utility CESC is morphing into a conglomerate with electric utility, retailing and real estate businesses. After the first phase where CESC achieved growth by improving operating efficiencies (higher PLFs and lower T&D losses), it is now embarking on the second phase which involves:

- Giving its electric utility business a national footprint;
- Monetizing the value inherent in its idle real estate assets; and
- Growing retailing at rapid pace and turning it profitable by FY09E/FY10E.

Figure 2. CESC – Strategy Matrix

	Utilities	Retail	Property
Capital Intensity	High	Low	Medium
Growth	Low	High	High

Source: CESC

Raising our target price to Rs650

We have hiked our target price to Rs650 from Rs359 earlier as:

- We move to DCF to value the power business on: 1) Increasing visibility of growth with the 250MW Budge Budge expansion and the 600MW Haldia Phase – I coming to fruition; 2) Regulatory uncertainty is a thing of the past; and 3) the power business should benefit clarity on incentive structure. Our power business value at Rs553 (P/E multiple of 16.9x FY09E in line with the power business value of Tata Power) is at a 5% discount to our DCF value.
- We value CESC Plaza at Rs11 using a DCF and value 35 acres of the Mulajore plant area at Rs20mn/acre.
- We also value CESC's 94% stake in Spencer's Retail at a 15% discount to the recent merger valuation giving us a value of Rs80/share

Further upside from target price would be possible once: 1) Haldia Phase I attains financial closure and the EPC contract is given to the equipment supplier; and 2) CESC takes a firm call on shutting down New Cossipore and decides to monetize the retail estate that would be freed up.

Figure 3. CESC – Sum of the Parts

Part	Methodology	Rsmn	US\$m	Rs/Share
Power Business	5% discount to DCF @16.9x FY09E P/E	63,835	1,596	553
CESC Plaza	DCF Value	1,254	31	11
Mulajore Plant 35 acre Land Bank	Valued @Rs20mn/acre	700	18	6
Retailing (94% Stake)	15% Discount to merger valuation	9,252	231	80
Total		75,042	1,876	650

Source: Citi Investment Research estimates

Figure 4. CESC – Earnings Revisions

March 31 (Rsmn)	FY08E	FY09E	FY10E
Sales			
Old	27,743	29,586	30,413
New	26,547	28,886	31,828
Change	-4.3%	-2.4%	4.7%
Recurring PAT			
Old	2,519	2,861	3,336
New	3,266	3,767	4,243
Change	29.6%	31.7%	27.2%
FD EPS			
Old	29.89	33.94	39.58
New	28.30	32.65	36.77
Change	-5.3%	-3.8%	-7.1%

Source: Citi Investment Research estimates

Revising earnings

We have revised our earnings estimates to factor in:

- Fuel cost and interest cost saving from FY08E onwards;
- PLF incentives from FY09E onwards; and
- New capex plans for the next three years.

As a consequence we have hiked our PAT estimates by 27-30% over FY08E-10E. However, because of a 37% dilution due to the merger of the retailing business we have cut our estimates by 4-7% over FY08-10E.

Power Business

Vertically integrated electric utility

CESC is vertically integrated electric utility engaged in generation, transmission and distribution of electricity to consumers in its licensed area, which covers Kolkata and Howrah. The company has four power plants with a generation capacity of 975MW servicing 2.2mn consumers in its 567 sqkm license area. CESC has a 26% stake in Integrated Coal Mining Ltd (ICML) (74% held by RPG group companies). ICML supplies ~2.5 mn MTPA of coal to CESC (52% of CESC's coal requirement) with the remaining sourced from Coal India and imported from Indonesia. Imported coal with 6% ash content is mixed with domestic coal with 42% ash content to bring it down to 37% ash content and fed into the power plants. CESC generated 7703 million units (MU) of power, bought 1032 MU of power and sold 6424 MU of power with a Transmission and Distribution (T&D) Loss of 14.7% in FY07

Figure 5. CESC – Generation Capacity

	Capacity (MW)	Commissioning Date
New Cossipore	100	1949
Titagarh	240	1983
Southern	135	1991
Budge Budge	500	1997
Total	975	

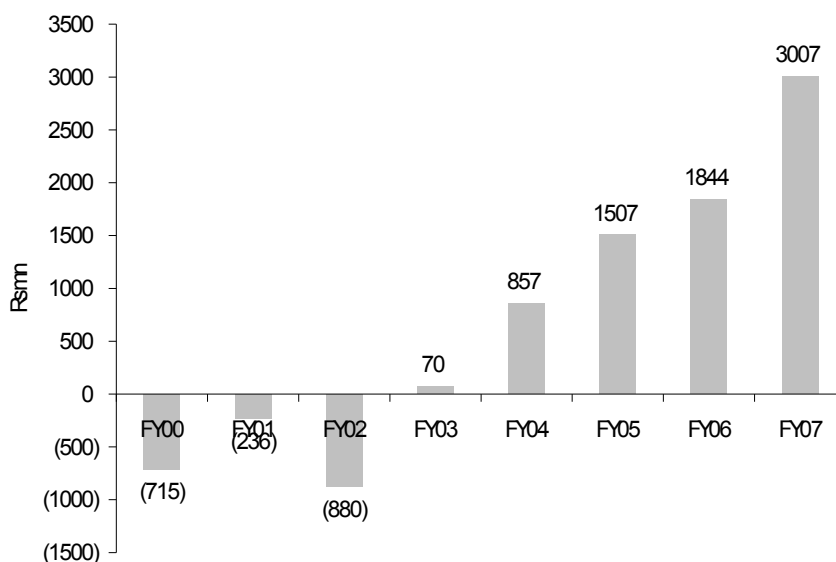
Source: CESC

Turned around from losses of Rs1.3bn in FY99 to profits of Rs3.0bn in FY07

Business turnaround continues

CESC had a torrid time between FY98 to FY02 incurring huge losses due to non-revision of its tariffs in line with increasing fuel and power purchase costs, non-allowance of capital costs of Budge Budge on time and cost over runs, high employee costs, high T&D losses and low PLF% of old power plants of Mulajore and New Cossipore. CESC had long legal battle with the regulator in the High Court and the Supreme Court. On October 2002 the Supreme Court permitted CESC to charge higher tariffs and recover ~ Rs5.2bn on arrears by tariff adjustments.

Figure 6. CESC – Remarkable Profit Turnaround

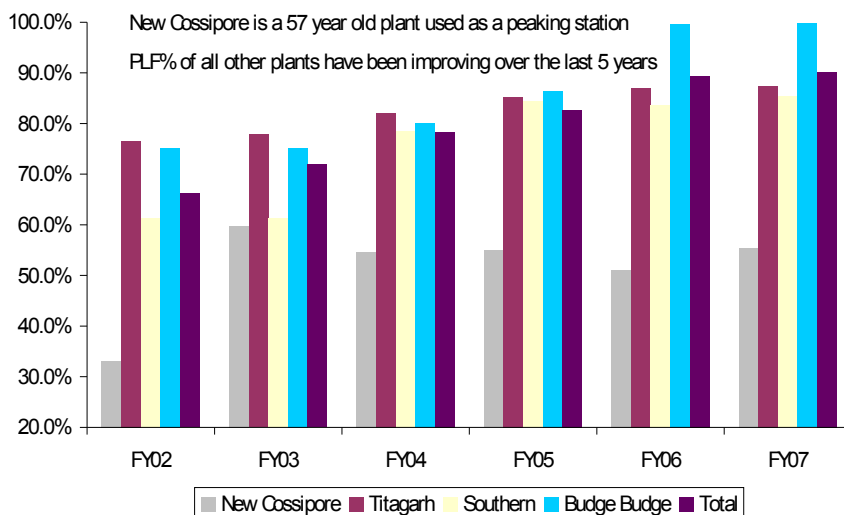


Source: CESC and Citi Investment Research

Aided by improving operating parameters

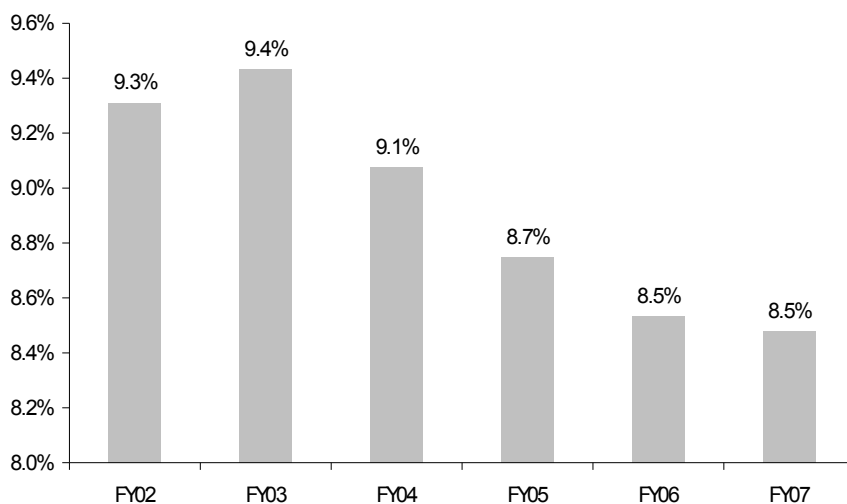
CESC has been improving its operating efficiency parameters consistently over the past six years to emerge as a more competitive electric utility. This was done through a mix of increasing Plant Load Factors (PLF%), reducing auxiliary consumption, T&D losses and pilferage, leading to control over the number of units purchased

Figure 7. CESC – Improving PLF% of Generating Stations



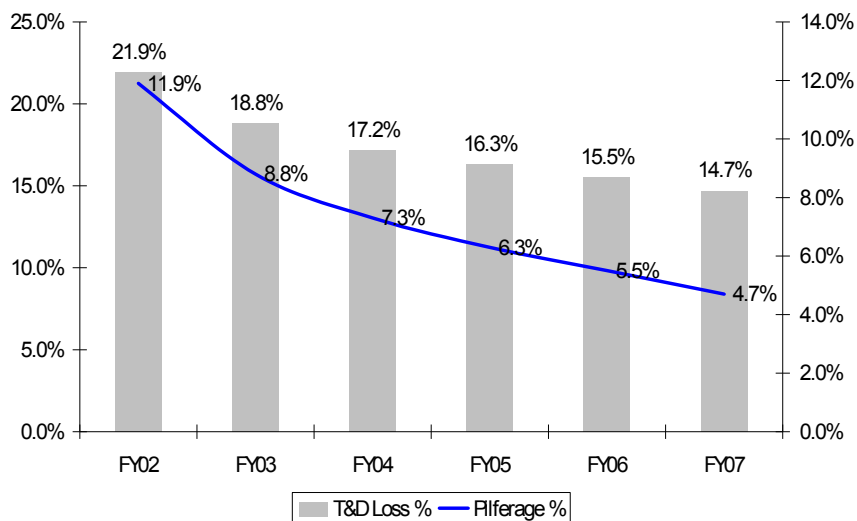
Source: CESC and Citi Investment Research

Figure 8. CESC – Reduction in Auxiliary Consumption



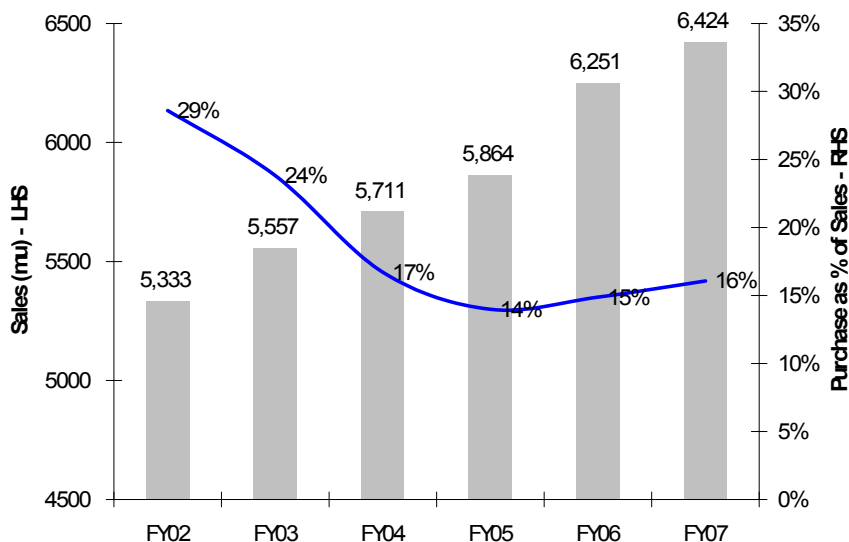
Source: CESC and Citi Investment Research

Figure 9. CESC – Reduction in T&D Losses and Pilferage



Source: CESC and Citi Investment Research

Figure 10. CESC – Controlling Power Purchase Despite Sales Growth



Source: CESC and Citi Investment Research

Planning for Rs51bn of capex

CESC would add 250MW at Budge Budge by September 2009 and 600MW Haldia Phase – I by FY12E. The coal linkages for both these projects are in place. Further, CESC expects to spend 1) Rs3.5bn in the next three years to enhance its transmission capacity and 2) Rs2bn of annual maintenance capex in the next five years

Figure 11. CESC – Current Capacity Expansion Projects

Project	Cost (Rsbn)	Date - Remarks
Budge Budge Project - 250MW	11.0	By FY10E - BHEL got EPC award - Construction work started - Coal linkage in place
Haldia Phase - I - 600MW	26.0	By FY12E - Exercise on to select Chinese EPC player - 200 acres of land acquired - Coal linkage in place - NOC for water obtained - Pre-feasibility studies done - Evacuation survey on
Interface to receive 700MW of peak power		- Project planning complete
Additional Transmission Capacity		- Equipment procurement process initiated
Network re-organization		- Work to commence shortly
Connectivity to National Grid	3.5	By FY10
Annual maintenance capex of Rs2bn for 5 years	10.0	FY08E- FY12E - Annual Planning done regularly
Total Project Cost	50.5	

Source: CESC and Citi Investment Research estimates

Growth strategy

CESC working additional portfolio of 3300MW of generation capacity to expand its national footprint

CESC is evaluating a number of projects to expand into an electric utility with a national foot print. This includes the 1300MW Haldia Phase – II project, 1000MW Jharkand project and the 1000MW Orissa project

Figure 12. CESC – Future Capacity Expansion Projects

Project	- Remarks
Haldia Phase II - 1300MW	- Land acquisition on - Coal linkage applied for - Pre - feasibility studies near completion
Jharkand - 1000MW	- MoU signed with Government - Coal linkage for 750MW available (110mn MTPA Mahuagarhi Block) - Trying to secure linkage for additional 250MW - Exercise on to select Chinese EPC contractor - Pre - feasibility studies near completion
Orissa -1000MW	- MoU signed with Government - Pre - feasibility studies near completion

Source: CESC and Citi Investment Research estimates

Regulatory uncertainty ends

- WBERC allows CESC 14% return on average equity base for the year, which is equal to Average (Opening Equity Base, Opening + 0.3 X Maintenance Capex) thus removing the uncertainty on future profits CESC. Further the WBERC also allows special appropriations for any contingencies or small adjustments for the costs under estimated in the previous year.
- CESC makes more than the allowed regulatory profit given: 1) fuel cost and interest cost savings which lags one year; and 2) retention of 40% of difference between sales realizations and variable cost of power exported. The remaining 60% is used to bring down tariffs for customers.
- WBERC has not allowed utilization-based incentives in FY08E but has indicated that this might be allowed from FY09E onwards.

Figure 13. CESC – Reconciliation Between Regulatory PAT and Actual PAT

	FY06T	FY07T	FY08T	FY09T	FY10T	FY11T	FY12T
Equity at the beginning		13,343	14,059	15,020	15,980	20,210	20,810
Equity Base Added In the Year 1)		2,609	2,550				
Capex In the Year		2,387	3,203	3,200	3,100	2,000	2,000
Equity Portion of Capex At 30% 2)		716	961	960	930	600	600
Minimum of 1) & 2)		716	961	960	930	600	600
Budge Budge Expansion Equity					3,300	0	0
Equity at the end		14,059	15,020	15,980	20,210	20,810	21,410
Average Equity Base In The Year		13,701	14,540	15,500	18,095	20,510	21,110
Paid Up Capital end FY04	667						
Less Value of Equity Shares Other Than Cash	(72)						
Share Premium Account	4,227						
Cash from rights issue	496						
Free Reserves	3,372						
Total	8,690						
Base PAT at 14%	1,217	1,918	2,036	2,170	2,533	2,871	2,955
Return	12.4%	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%
Special Appropriation	485	125	129	134	139	144	149
Regulatory Profit	1,563	2,043	2,164	2,304	2,672	3,015	3,104
Fuel Cost + Working Capital Interest Savings	0	700	800	900	1,000	1,100	1,200
Exports Benefits	251	256	333	279	427	443	352
PLF Incentives	0	0	0	212	213	235	257
Total Reported PAT	1,814	3,000	3,298	3,695	4,312	4,793	4,914

Source: WBERC, CESC and Citi Investment Research estimates

Real Estate Business

CESC being a 110 year old utility has a huge unexplored land bank and as a consequence it wants to use these idle assets for additional income generation and capital appreciation. As a consequence CESC floated 100% subsidiary CESC Properties Limited in April 2007.

CESC Plaza in Central Kolkatta

CESC Properties plans to develop a 0.4mn sqft mall and 900 car parks totaling 0.3mn sqft in Central Kolkatta. Work should start in October 2007 and be completed in 18 months. We expect annual rental income of Rs480mn in FY10E assuming a rate of Rs100/sqft/month. We expect the total cost of construction to be Rs1.5bn for this project. Further, we expect CESC to use ~ Rs80mn every year to reduce tariffs for its power consumers.

Figure 14. CESC – CESC Plaza in Central Kolkatta

Year End Mar31 (Rsmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY14E	FY14E	FY14E	FY14E	Terminal Year
Rental Income				480	504	529	556	583	613	643	675	709	
Cost of Construction		(497)	(993)										
For Reducing Tariffs				(80)	(80)	(80)	(84)	(84)	(84)	(88)	(88)	(88)	
Tax at 33%				(132)	(140)	(148)	(156)	(165)	(174)	(183)	(194)	(205)	
Cash Flow To Company	0	(497)	(993)	268	284	301	316	335	354	372	393	416	437
For Valuation Purpose	0	(497)	(993)	268	284	301	316	335	354	372	393	5,270	
Discounting Rate	14%												
Value as of Sep 2008	1,254												

Source: CESC and Citi Investment Research estimates

CESC Mulajore Plant Area

CESC has shut down the Mulajore plant and commenced a scrap sale. It has 43 acres of land that is 30km from Kolkatta on the river Ganges. Out of the 43 acres the company will retain eight acres and develop a 30-acre residential property and a five-acre industrial park. We value the 35 acres at Rs20mn/acre

Figure 15. CESC – Mulajore Plant Area

Parameter	Value	Units
Area	35	acres
Rate	20	Rsmn/acre
Land Bank Valuation	700	mn

Source: CESC and Citi Investment Research estimates

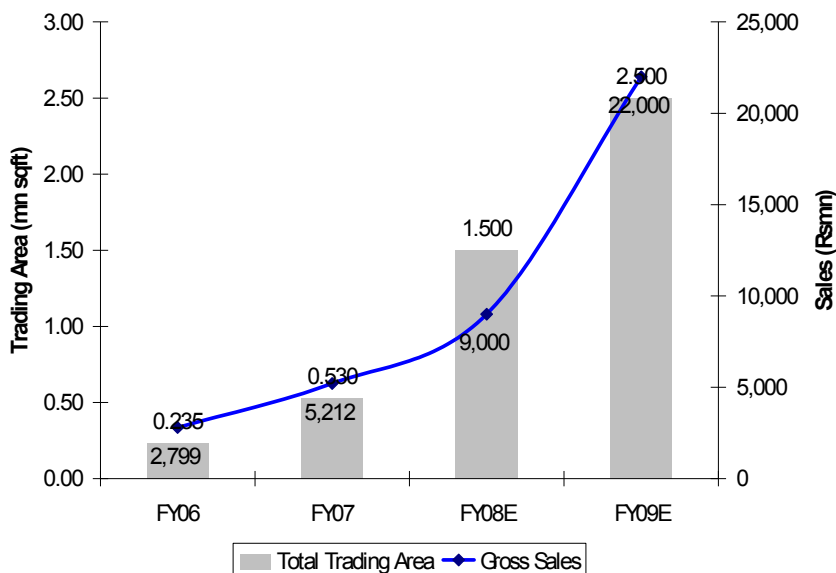
CESC New Cossipore Plant Area

CESC also plans to shut down its New Cossipore plant, which was set up in 1949 in FY10E when the Budge Budge expansion project is commissioned. This would free up 27 acres of land which is 6km from CESC's Calcutta office in Chowringee Square and could fetch rates as high as Rs100mn/acre. In the interest of conservatism we have not valued this property as the plant is yet to be shuttered. CESC Properties is also identifying surplus land and acquiring land afresh.

Retailing Business









- Pathik Foods the holding company for the retailing business has been merged with CESC effective April 17, 2007. Pathik Foods owns a 94% stake of Spencer's Retail while 6% is held by high net worth individuals. Music World is a division of Spencer Retail. During the course of the merger Spencer's Retail was valued at an enterprise value of Rs1.23bn and an equity value of Rs1.16bn. This merger also involved issuance of 31.1 mn fully paid-up equity shares of CESC to the promoters.
- Spencer's plans to double total tradable area over the next year and double it again in the subsequent year. Though the company is making losses (losses of Rs468mn on sales of Rs5.2bn) it expects to turn profitable from FY09E/FY10E onwards

Figure 16. Spencer's – Retail Growth Plans



Source: CESC and Citi Investment Research estimates

Figure 17. Spencer's – Retail Formats

	Area in Sqft	Assortment Mix
 Convenience store	3000 - 5000	Fruits & Vegetables, Beverages, Staples, Ready to eat, Processed Foods, Takeaways, Bakery, Home & Personal care, Fish, Meat, etc.,
 Convenience store	1400 - 1800	Store Next Door With essential SKU's from above
 Convenience store	10000-18000	Full offering of Daily's + Home, Brown Goods, Select Apparel
 Destination store	30000-75000	Full Offering of Super's + Full range HWP & Apparel, White Goods, Electronics & Electricals
Specialty Verticals    		

Source: CESC

Financial Statements

Figure 18. CESC – Operating Statistics

Year End Mar31	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E	FY10E
New Cossipore	190	130	100	100	100	100	100	100	100
Titagarh	240	240	240	240	240	240	240	240	240
Southern	135	135	135	135	135	135	135	135	135
Budge Budge	500	500	500	500	500	500	500	500	500
Budge Budge Expansion	0	0	0	0	0	0	0	0	250
Total Capacity (MW)	1065	1005	975	975	975	975	975	975	1225
New Cossipore	551	680	478	481	447	486	486	486	0
Titagarh	1610	1636	1727	1792	1830	1837	1850	1850	1850
Southern	725	725	928	998	990	1010	1017	1017	1017
Budge Budge	3289	3289	3507	3783	4363	4370	4336	4336	4336
Budge Budge Expansion	0	0	0	0	0	0	0	0	876
Total Generation	6176	6330	6687	7054	7630	7703	7689	7689	8079
New Cossipore	33.1%	59.7%	54.6%	54.9%	51.0%	55.5%	55.5%	55.5%	0.0%
Titagarh	76.6%	77.8%	82.1%	85.2%	87.0%	87.4%	88.0%	88.0%	88.0%
Southern	61.3%	61.3%	78.5%	84.4%	83.7%	85.4%	86.0%	86.0%	86.0%
Budge Budge	75.1%	75.1%	80.1%	86.4%	99.6%	99.8%	99.0%	99.0%	99.0%
Budge Budge Expansion									40%
Total PLF%	66.2%	71.9%	78.3%	82.6%	89.3%	90.2%	90.0%	90.0%	75.3%
Auxiliary Consumption	575	597	607	617	651	653	653	653	686
Auxiliary Consumption %	9.3%	9.4%	9.1%	8.7%	8.5%	8.5%	8.5%	8.5%	8.5%
Net Generation	5601	5733	6080	6437	6979	7050	7036	7036	7393
Power Purchase	1525	1323	954	820	930	1032	1300	1400	1500
Units to System	7126	7056	7034	7257	7909	8082	8336	8436	8893
Units consumed in Company	36	18	18	18	19	17	17	17	17
Units to WBSEB (Net)	198	89	89	68	70	72	72	72	72
Exports	0	0	7	160	418	458	505	410	611
Sales	5333	5557	5711	5864	6251	6424	6617	6815	7020
Growth %		4.2%	2.8%	2.7%	6.6%	2.8%	3.0%	3.0%	3.0%
T&D Loss %	21.9%	18.8%	17.2%	16.3%	15.5%	14.7%	14.6%	14.5%	14.4%
Pilferage %	11.9%	8.8%	7.3%	6.3%	5.5%	4.7%	4.6%	4.5%	4.4%

Source: CESC and Citi Investment Research estimates

Figure 19. CESC – Profit & Loss Statement

Year End Mar31 (Rsmn)	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E	FY10E	FY07-10E
Sale of Electrical Energy	20798	21853	23484	23212	25159	24843	26547	28886	31828	8.6%
Power Purchased	3279	3015	2913	2257	2518	2679	3641	4120	4665	
As % of sales	15.8%	13.8%	12.4%	9.7%	10.0%	10.8%	13.7%	14.3%	14.7%	
Rs/kwh	2.15	2.28	3.05	2.75	2.71	2.60	2.80	2.94	3.11	
Cost of Fuel	6149	6409	6638	7605	8396	8427	8440	8689	9210	
As % of sales	29.6%	29.3%	28.3%	32.8%	33.4%	33.9%	31.8%	30.1%	28.9%	
Rs/kwh	1.00	1.01	0.99	1.08	1.10	1.09	1.10	1.13	1.14	
Employee Cost +	2420	2945	3551	2823	2924	3078	3611	3791	4361	
As % of sales	11.6%	13.5%	15.1%	12.2%	11.6%	12.4%	13.6%	13.1%	13.7%	
Others	3130	2805	3692	4075	5351	4921	4994	5169	5374	
As % of sales	15.0%	12.8%	15.7%	17.6%	21.3%	19.8%	18.8%	17.9%	16.9%	
Total Expenditure	14978	15174	16793	16760	19189	19105	20686	21769	23611	
As % of sales	72.0%	69.4%	71.5%	72.2%	76.3%	76.9%	77.9%	75.4%	74.2%	
EBITDA	5820	6678	6691	6451	5970	5739	5861	7117	8217	12.7%
Margin %	28.0%	30.6%	28.5%	27.8%	23.7%	23.1%	22.1%	24.6%	25.8%	
Depreciation	3154	3227	2962	2915	2539	1579	1702	2138	2398	
EBIT	2665	3451	3729	3536	3431	4159	4159	4979	5820	
Margin %	12.8%	15.8%	15.9%	15.2%	13.6%	16.7%	15.7%	17.2%	18.3%	
Interest & Financial Charges +	4178	3955	3481	2560	2124	1679	1698	1698	1998	
Other Income +	633	581	681	659	736	927	1250	1000	1000	
PBT	(880)	76	929	1635	2044	3407	3711	4281	4821	
Margin %	-4.2%	0.3%	4.0%	7.0%	8.1%	13.7%	14.0%	14.8%	15.1%	
Tax	0	6	72	129	200	400	445	514	579	
Tax Rate	0.0%	7.9%	7.7%	7.9%	9.8%	11.7%	12.0%	12.0%	12.0%	
Recurring PAT	(880)	70	857	1507	1844	3007	3266	3767	4243	12.2%
Margin %	-4.2%	0.3%	3.7%	6.5%	7.3%	12.1%	12.3%	13.0%	13.3%	
Exceptional	0	0	0	-35	-69	0	0	0	0	
Reported PAT	(880)	70	857	1472	1775	3007	3266	3767	4243	12.2%

Source: CESC and Citi Investment Research estimates

Figure 20. CESC – Balance Sheet

Year End Mar31 (Rsmn)	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E	FY10E
Share Capital	578	578	661	744	823	843	1154	1154	1154
Forfeited Shares	6	6	6	7	7	7	7	7	7
Reserves & Surplus	8012	4361	10093	12082	15676	19084	29666	32826	36393
Misc Exp/Profit Loss	(4159)	(113)	(106)	(107)	(100)	(93)	(93)	(93)	(93)
Networth	4437	4832	10654	12725	16406	19841	30734	33893	37461
Preference Capital	33	33	0	0	0	0	0	0	0
Equity Warrants	0	0	0	0	43	0	0	0	0
Secured Loans	23886	24959	21796	17261	16644	15467	13467	15467	19467
Unsecured Loans	6873	4971	4297	4411	2456	2516	2516	2516	2516
Total Loan Funds	30759	29930	26093	21672	19100	17983	15983	17983	21983
Security Deposits	2498	3163	3732	4410	5596	6521	6968	7203	7540
DTL	0	0	0	0	0	0	0	0	0
AAD						1005	1005	1005	1005
TOTAL LIABILITIES	37727	37959	40479	38806	41144	45349	54689	60084	67988
Gross Block	62102	63114	60632	62054	82610	84696	87896	91096	105196
Revaluation Reserve	(13403)	(13108)	(2999)	(2560)	(20383)	(18218)	(18218)	(18218)	(18218)
Adjusted Gross Block	48698	50006	57634	59495	62227	66478	69678	72878	86978
Accumulated Depreciation	(15721)	(19189)	(21271)	(24597)	(27136)	(31795)	(33497)	(35635)	(38033)
Net Block	32977	30817	36363	34897	35091	34683	36181	37243	48945
CWIP	502	648	988	970	1314	2657	3427	6507	1557
Net Fixed Assets	33479	31465	37351	35867	36406	37340	39608	43750	50502
Investments	109	110	301	314	314	2414	13994	15794	17794
Inventories	867	1049	1228	1423	1713	1673	1820	1930	2091
Sundry Debtors	9454	9308	7489	5692	5224	4151	4436	4827	5319
Cash and Bank	656	666	527	1651	2829	7314	3104	2425	1357
Loans and Advances	2580	2499	1947	1341	1426	1770	1947	2142	2356
Deferred Payments	288	288	104	69	750	515	525	536	547
Total CA	13844	13810	11294	10177	11942	15424	11832	11860	11668
Current Liabilities	9270	7050	8053	6752	6761	8967	9417	9833	10327
Provisions	435	375	414	800	756	862	1328	1486	1648
Total CL	9705	7426	8467	7552	7517	9829	10745	11319	11976
NCA	4139	6384	2827	2625	4424	5595	1088	540	(307)
TOTAL ASSETS	37727	37959	40479	38806	41144	45349	54689	60084	67988

Source: CESC and Citi Investment Research estimates

Figure 21. CESC – Cash Flow Statement

Year End Mar31(Rsmn)	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E	FY10E
PAT	(880)	70	857	1472	1775	3007	3266	3767	4243
D&A	3154	3227	2962	2915	2539	1579	1702	2138	2398
Chg in Int Accr	2	0	0	0	0	0	0	0	0
Chg in Inventories	39	(182)	(179)	(195)	(290)	40	(147)	(110)	(161)
Chg in Debtors	(2787)	146	1819	1797	468	1073	(285)	(391)	(492)
Chg in L&A	(87)	81	552	606	(85)	(344)	(177)	(195)	(214)
Chg in Def Pay	151	0	184	34	(681)	235	(10)	(11)	(11)
Chg in CL	(68)	(2279)	1041	(915)	(35)	2311	916	575	656
Change in WC	(2750)	(2235)	3417	1327	(622)	3315	297	(131)	(221)
CFO	(475)	1063	7237	5715	3691	7901	5265	5774	6420
Capex	(941)	(1214)	(8848)	(1431)	(3077)	(2514)	(3970)	(6280)	(9150)
Change in Investment	24	1)	(191)	(13)	1	(2100)	(11580)	(1800)	(2000)
CFI	(917)	(1214)	(9039)	(1445)	(3076)	(4614)	(15550)	(8080)	(11150)
Change in AAD	0	0	0	0	0	1005	0	0	0
Change in Equity	0	0	83	83	79	20	311	0	0
Change in Reserves	1659	325	4881	727	2061	754	7857	0	0
Change in Pf Cap	4)	0	(33)	0	0	0	0	0	0
Chg in Equity Warrants	0	0	0	0	43	(43)	0	0	0
Change in Debt	890	(828)	(3837)	(4421)	(2572)	(1117)	(2000)	2000	4000
Chg in CC & SD	(1200)	665	569	677	1186	926	447	235	337
Dividend & Dividend Tax	0	0	0	(212)	(235)	(345)	(540)	(608)	(675)
CFD	1345	162	1663	(3145)	563	1199	6074	1627	3662
Inc/Dec in Cash	(47)	10	(139)	1125	1177	4486	(4211)	(678)	(1069)
Opening Cash	703	656	666	527	1651	2829	7314	3104	2425
Closing Cash	656	666	527	1651	2829	7314	3104	2425	1357

Source: CESC and Citi Investment Research estimates

CESC

Company description

CESC is a vertically integrated electric utility engaged in generation, transmission and distribution of electricity to consumers within its licensed area covering Kolkata and Howrah. It has four power plants with generation capacity of 975MW that services 2.1m consumers in its 567 sqm license area. CESC has a 26% stake in Integrated Coal Mining Ltd (ICML) (74% held by RPG group companies). ICML supplies 2.5m MTPA of coal to CESC (52% of CESC's coal requirement) with the remainder sourced from Coal India and through imported coal from Indonesia. Imported coal, which has 6% ash content, is mixed with domestic coal, which has 42% ash content, to produce 37% ash content. CESC generated 7703 million units (MU) of power, bought 1032 MU of power and sold 6424 MU of power with a Transmission and Distribution (T&D) Loss of 14.7% in FY07.

Investment strategy

From a pure play electric utility CESC is morphing into a conglomerate with electric utility, retailing and real estate businesses. After the first phase where CESC achieved growth by improving operating efficiencies from PLF and T&D losses, it is now embarking on the second phase which involves: 1) trying to give its electric utility business a national footprint; 2) monetizing the value inherent in its idle real estate assets; and 3) growing retailing at rapid pace and turning it profitable by FY09E/FY10E. We maintain our Buy rating.

Valuation

Our Rs650 target price is based on a sum of the parts. We use DCF to value the power business given: 1) increasing visibility of growth with the 250MW Budge Budge expansion and the 600MW Haldia Phase – I coming to fruition; 2) regulatory uncertainty being a thing of the past; and 3) improving clarity on incentive structure that the power business would benefit from. Our power business value at Rs553 (P/E multiple of 16.9x FY09E is in line with the power business value of Tata Power) is at a 5% discount to our DCF value. We value CESC Plaza at Rs11 using a DCF and value the 35 acres of the Mulajore plant area at Rs20mn/acre. We also value CESC's 94% stake in Spencer's Retail at a 15% discount to the recent merger valuation giving us a value of Rs80/share. Further upside from target price would be possible once: 1) Haldia Phase I attains financial closure and the EPC contract is given to the equipment supplier; and 2) CESC takes a firm call on shutting down New Cossipore and decides to monetize the retail estate that would be freed up.

Risks

We rate CESC Low Risk, which differs from the Medium Risk rating assigned by our quantitative risk-rating system that tracks 260-day historical share price volatility. Key risks to CESC's operations and our earnings forecasts could emanate from: 1) the State Electricity Boards (SEBs) are still loss-making and trifurcation-corporatization-privatization process has yet to be completed; 2) given that India has a significant deficit of power, the big question for the sector remains whether private generating companies can earn the expected returns with adequate payment security; 3) following passage of the Electricity Act, a number of High Tension (HT) industrial consumers have set up captive capacity and are not purchasing power from the grid. CESC has faced similar problems in its license area. If the speed of switching to captive power increases beyond our expectation, CESC's operations could be negatively affected; 4) despite CESC having access to substantial coal for its operations, future growth beyond the Budge Budge operations will depend on its ability to secure captive mining blocks in Orissa and Jharkand; 5) free power has been a bane for the Indian electric utilities sector in the past. Although CESC's license area is unlikely to face such problems, this remains an area of risk; and 6) CESC's future capacity expansion depends on various regulatory authorities' clearances for land, water, fuel and project plans.

Appendix A-1

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Analyst: Venkatesh Balasubramaniam (covered since September 21 2006)



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