

VISIT NOTE

Tuesday, 22nd JUNE, 2010

CESC Limited. – Powering Ahead.....

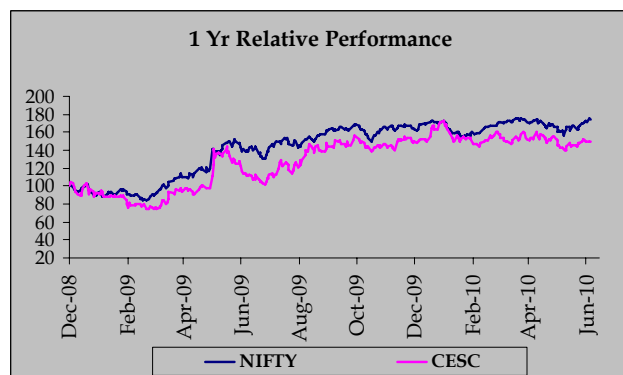
		BUY
CMP		387
Target Price		501
Time frame	9-12 months	
Upside		29%

Key Data	
CMP (Rs.)	387.00
Bloomberg Code	CESC IN
Bloomberg Industry	Electric - Integrated
Market-Cap (Rs. mn)	48350.19
Enterprise Value (Rs. mn)	59820.99
Shares O/S (mn)	124.94
52 Wk High/Low	452 / 260
Absolute Return 3m (%)	-2.10%
Absolute Return 12m (%)	32.0%

Source: Bloomberg

Shareholding Pattern	Mar-10	Dec-09	Sep-09
Promoter and Promoter Group	52.49%	52.49%	52.49%
Mutual Funds/UTI	15.34%	15.39%	14.72%
Financial Institutions/Banks	0.09%	0.08%	0.04%
Insurance Companies	2.49%	3.41%	4.31%
FII's	18.60%	17.65%	16.57%
Non Institutions/Public	10.95%	10.89%	11.79%
Others	0.04%	0.09%	0.08%

Source: NSE



Source: Bloomberg

We see a 30% upside in CESC Ltd over the next 10-12 months and hence initiate coverage and suggest an **“OVERWEIGHT”** within the Power sector.

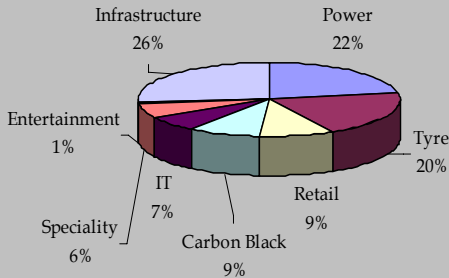
CESC’s installed capacity has increased 25% with the commissioning of the 250 MW Budge Budge unit in Q4FY10. There is traction in other expansion plans as well with the Chandrapur project (600MW) achieving financial closure and placing various equipment orders. **While the Budge Budge unit will add to the Company’s earnings in FY11, the Haldia and Chandrapur projects would significantly add to the Company’s bottomline from FY14 onwards.**

CESC’s retail business continues to be loss making at the EBITDA level and remains a drag on profit. However, the management maintains its intent to break even in the retail foray by FY11. While there is some improvement in the retail business (cash losses down from Rs. 3 bn FY09 to Rs. 2 bn in FY10), **we believe a strategic sale of Spencer would be ideal for CESC Ltd**, which in turn would lead to re-rating of the stock. Management have indicated to us that they are looking for a strategic partner to sell a significant stake in Spencer going ahead.

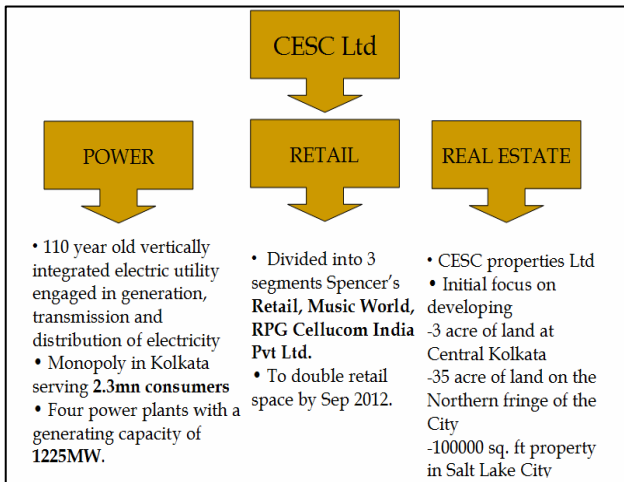
At the current market price of Rs.387, the stock is trading at 10.3 and 9.9 times its estimated FY11 and FY12 EPS of Rs.37.5 and Rs. 39.0 respectively. On an Enterprise value (EV)/EBITDA basis, the stock is trading at 6.4 times its estimated FY11 attributable EV/ EBITDA and at 6.1 times its estimated FY12 attributable EV/ EBITDA; while on price/book value basis, the stock is trading at 1 times its estimated FY11 book value and at 0.9 times its estimated FY12 book value.

We have valued the company using sum-of-the-parts (SOTP) method to arrive at a **target price of Rs 501**, implying a potential upside of 30% upside from current levels. We have valued the Power business based on average of EV/MW, P/BV method and P/E method (**at Rs 374/share**), the Haldia Phase I with FCFF method (**at Rs.43/share**), Chandrapur Project with FCFF method (**at Rs.62/share**), and the Real Estate business based on market value (**at Rs 22/share**).

RPG Enterprises FY09 Revenue Break Up



Source: Company



Source: Company

CESC Installed Capacity (MW)	
Generating Stations	Installed Capacity
Budge Budge	2 x 250 MW
Southern	2 x 67.5 MW
Titagarh	4 x 60 MW
Cossipore	100 MW
Budge Budge III*	250 MW
Current Installed Capacity	1225 MW

* Started operations in Q4FY10

Source: Company

Company Description

CESC Limited is a RPG group company, one of India's leading industrial houses. Starting as India's first fully integrated electrical utility, CESC has been generating and distributing electrical power in Kolkata and Howrah since 1897. The company has operations spanning the entire power value chain: right from mining coal, generating power, transmission and distribution of power. Besides, CESC through its subsidiaries also operates in the Retail and Real Estate Businesses.

Power Business

The company is the sole distributor of electricity within an area of 567 sq km of Kolkata and Howrah serving 2.3 million consumers which includes domestic, industrial and commercial users. The peak power demand in the licence area is now approximately 1460 MW, which is met through CESC's internal generation capacities as well as through power purchased from the state and national grid. Almost 88% of the customers electricity requirement is met from its own generating plants, rest 12% of electricity is purchased from third parties. The company has a 26% stake in Integrated Coal Mines that meets ~55% of its coal requirement; the balance is either bought from Coal India or is imported.

Generation

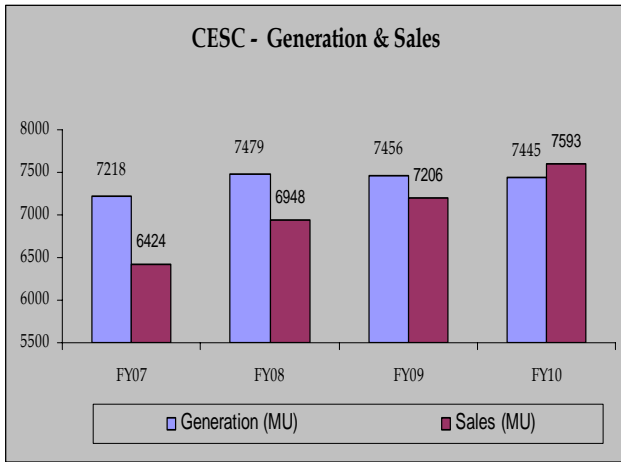
The Company has four coal based generating stations – three pulverised fuel stations at Budge Budge, Southern and Titagarh and the oldest, New Cossipore, which was commissioned in 1949. The combined generating capacity of these four plants is 975 MW. CESC recently started its Budge Budge Phase III (250 MW), which has enhanced the company's total capacity to 1225 MW.

Budge Budge

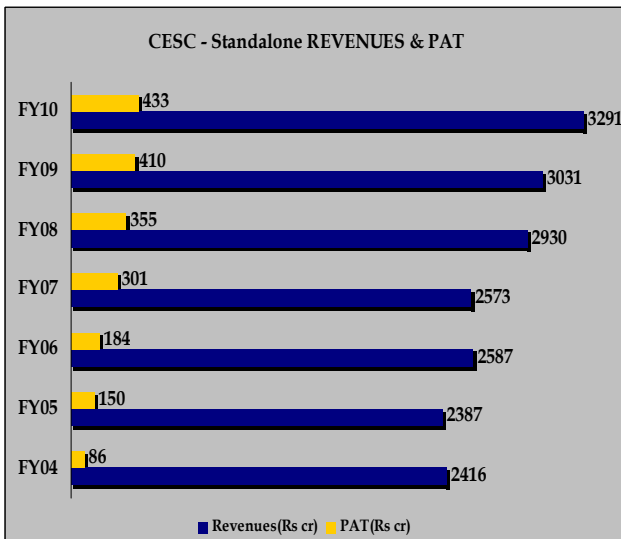
Budge Budge, CESC's twelve year old generating station, has an installed capacity of 2 X 250 MW, while a third 250 MW unit has started operations in Q4FY10. The Budge Budge plant has earned several distinctions. It not only continued to operate at its full capacity for two consecutive years but also featured in the list of top ten thermal power stations in the country.

Southern

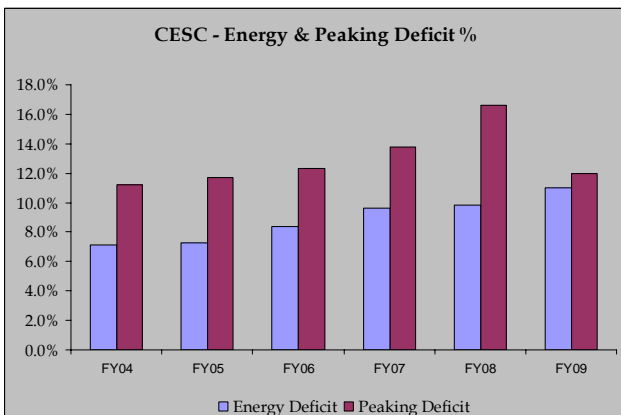
Southern is the Company's eighteen year old power generating station, having being commissioned in 1991-92. In spite of its relative age, the generating station is at peak performance and is also featured amongst the most efficient operating power plants in the country. In FY09, Southern generated 1119 MU of power at a PLF of 94.62%; this in spite of having to shut down for some time one of its units to undertake critical component repairs.



Source: Company



Source: Company



Source: Company

Titagarh

Titagarh is twenty seven years old, having been commissioned in 1982-83. Usually, thermal power generating plants have an effective working life of around thirty years; beyond this, plant efficiencies become increasingly difficult to maintain. Titagarh, however, continues to deliver nearly 92% PLF, while generating over 1900 MU of power.

New Cossipore

New Cossipore was commissioned in 1949 – nearly six decades ago. This sixty year old plant delivered 445 MU of power in 2008-09 during peak demand periods. The management expects this plant to run for at least another two years.

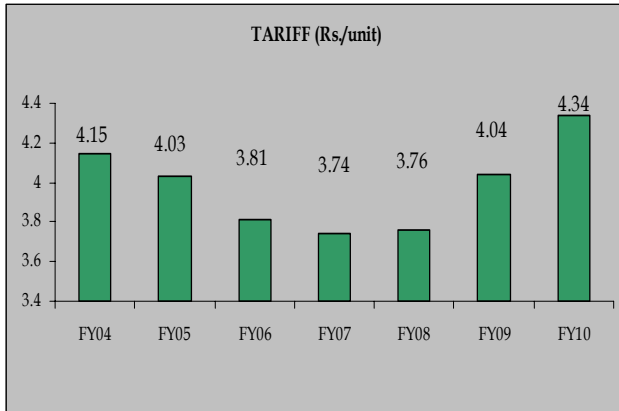
Transmission and Distribution

CESC also owns and operates the Transmission & Distribution system through which it supplies electricity to consumers.

The transmission system comprises of 474 km circuit of transmission lines linking the Company's generating and receiving stations with 85 distribution stations; 3,837 km circuit of HT lines further links distribution stations with LT substations, large industrial consumers and 9,867 km circuit of LT lines connecting the LT substations to LT consumers. It is in process of setting up a number of power stations in various states.

CESC recently completed the setting up of its first 220kV / 132 kV substation – the Eastern Metropolitan substation, situated on the Eastern Metropolitan Bypass. With this, CESC is ready to receive power from the third unit of Budge Budge generating station. The substation will ultimately have four 160 MVA 220/132/33 kV transformers, which will, on one hand, step down power to 132 kV level for onward transmission to various load centres and, on the other hand, meet the local area load through the 33 kV network. This marks the vital step towards upgrading the voltage to 220 kV; till now, the generating stations and load centre substations have been inter-connected at 132 kV. The substation will also be capable of state and central grid inter connectivity for better operational flexibility, reliability and stability of supply. The Company has also commissioned a voice, data and protection network for the entire transmission system using Synchronous Digital Hierarchy (SDH) equipment.

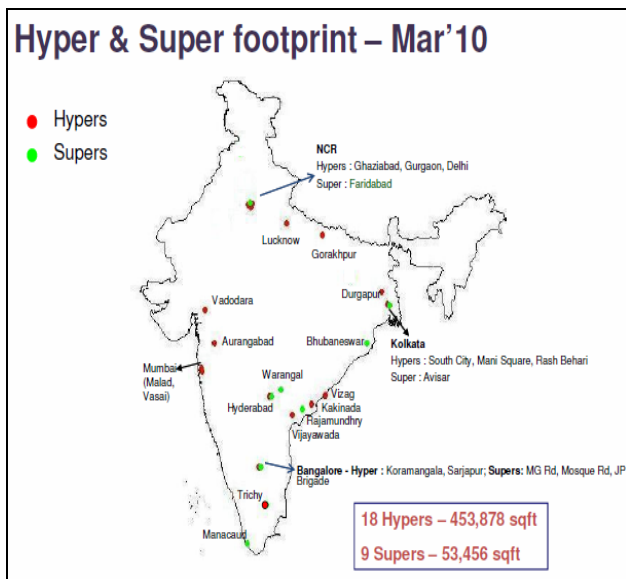
The distribution infrastructure comprises about 15,000 circuit kilometres of cable, 5,000 distribution transformers and a large number of switchgears. Investments are made on an ongoing basis to make the network stronger and more reliable; large sums have been invested recently in the distribution infrastructure.



Source: Company

SPENCERS FOOTPRINT - MARCH 2010			
	No. of cities	Total Area ("000)	Total malls
Regions			
EAST	3	131	17
WEST	5	220	49
NORTH	9	182	35
SOUTH 1	17	181	69
SOUTH 2	8	189	44
TOTAL	42	903	214

Source: Company



Source: Company

Retail Business

The company has three divisions under the Retail segment i.e., Spencer's Retail, Music World, Books & Beyond and RPG Cellucom India Private Ltd. Spencer's Retail Ltd. (SRL) is in the business of operating and managing a large chain of retail stores across India and became CESC's subsidiary, after Pathik Foods, the holding company for the retailing business was merged with CESC effective from April 2007. CESC currently holds a 94.7% stake in SRL. SRL currently operates 214 stores under the Spencer's brand in 42 cities with retail space of approximately 903 thousand square feet. SRL offers a range of products that cater to the entire family - fresh products, foods and grocery, home care products, apparel and accessories, non-food FMCG products, consumer durables, lifestyle products, footwear and many more. Music World Retail Limited (MWRL), a wholly owned subsidiary of Spencer's Retail Limited, is into the music and books retailing business, with a pan-Indian presence with 68 stores of 'Music World' & 'Books & Beyond'. Au Bon Pain Cafe India Limited (ABPCIL) is a subsidiary of Spencer's Retail Limited; the company is in the process of setting up a retail chain of cafe stores. ABPCIL has signed a master franchisee agreement with ABP Corporation, USA for setting up and operating ABP cafes in India.

Real Estate Business

CESC being a 110-year-old utility has a huge unexplored land bank and to take advantage of the opportunities in the real estate sector by venturing into the development of property, CESC has floated a new 100% subsidiary, CESC Properties Ltd, in April 2007. Besides this, CESC has sizeable real estate at its plants at Mulajore (35 acres) and New Cossipore (23 acres). The company has acquired another 5.5 acres, comprising 3.5 acres at Haldia and 2 acres at Howrah, for commercial and residential development.

As of now, the company has identified three properties for conversion into mall, residential apartment and industrial parks.

Investment Rationale

✓ Huge Expansion on cards

CESC is into huge expansion spree as it plans to increase its capacity by 5180 MW in coming 5-6 years, which will increase its total capacity to 6405 MW from present 1225 MW. The estimated capex for the expansion is around Rs. 249 billion and the financing is expected on 75:25 debt-equity ratio.

While the Chandrapur and Haldia projects are in advanced stage of commissioning and there is clear visibility on the date of commissioning, the other projects are in conceptualization

CESC - Expansion Plans				
Location	Purpose	Size	Cost (Rs. Mn)	Commissioning
Haldia Phase I West Bengal	License Area	600 MW	30000	Mar-14
Chandrapur Maharashtra	Merchant	2 x 300 MW	28000	Mar-14
Dumka Jharkhand	Merchant	1000 MW	50000	N.A.
Dhenkanal Orissa	Merchant	2 x 660 MW	62000	N.A.
Pirpainty Bihar	Merchant	1000 MW	47000	N.A.
Baligarh West Bengal	Merchant	660 MW	32000	N.A.
		5180 MW	249000	

Source : Company

CESC - Growth Plans	
Location	Current Status
Chandrapur Maharashtra	- 450 Acres of land in possession - Coal Linkage Obtained - Environmental Clearance in place - Financial Closure Achieved - BTG/BOP vendors tied up
Haldia Phase I West Bengal	- Over 80% land acquired - Expected Zero Date Sept 2010.
Dumka Jharkhand	- 110 MT coal block allocated - MOU signed with Govt. of Jharkhand
Dhenkanal Orissa	- MOU signed - 450 acres land already acquired - Awaiting coal linkage
Pirpainty Bihar	- MOU signed with Bihar Govt.

Source :Company

phase and there may be several modifications and changes in their scopes. Also, there is no clear visibility on the CODs for these projects.

600 MW Coal Based Project at Chandrapur, Maharashtra

CESC has the required 450 acres of land under a 95 year lease from MIDC. It has received the requisite clearances and coal linkage for 100% of the requirement from South Eastern Coalfields Limited (SECL) for this project. It has also achieved Financial Closure and placed orders for BTG and BoP with Shanghai Electric and Punj Lloyd respectively. We have assumed the Project to attain COD by March 2014 vis-à-vis a management expectation of March 2013.

600 MW Coal Based Project at Haldia, West Bengal

The 600 MW project at Haldia has the requisite clearances and coal linkage for 70% of the requirement from Mahanadi Coalfields Limited (MCL). It has also acquired nearly 400 acres of land and has encountered a land acquisition issue for the final parcel of around 40 acres of land. The land has been acquired by Haldia Development Authority and is proposed to be handed over to CESC soon. We have assumed the Haldia project to get commissioned by March 2014.

Other Projects

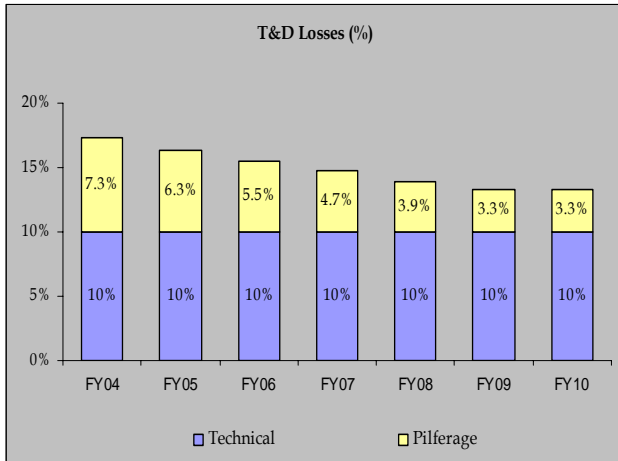
- CESC has signed MoU for a 110 MT coal block with the Government of Jharkhand for the Dumka project and has initiated the land acquisition process.
- It has signed MoU and acquired 450 acres of land for Dhenkannal Project in Orissa. It awaits the coal linkage for the same.
- It has also signed an MoU with the Bihar Government for the Pirpainty Project and is in the process of acquiring the land and obtaining the coal linkage for the same.

.....Foraying into Merchant power

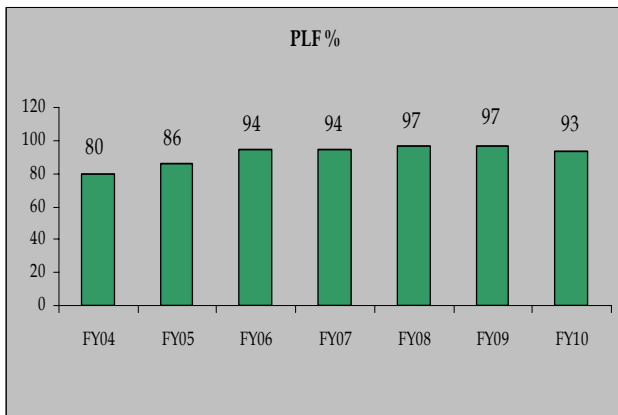
With these CESC is foraying into dedicated merchant power business where profitability is much higher as compared to the regulated business as merchant power plant generates electricity for sale in the open wholesale power market. They sell power to more than one buyer based on demand. Here, the returns are better in terms of profit. We believe that after the commissioning of the above merchant power plants, the topline and the bottomline of the company will increase significantly and the Company will not be limited to the regulated area of Kolkata and Howrah only.

.....And Diversifying into Hydro Power Generation

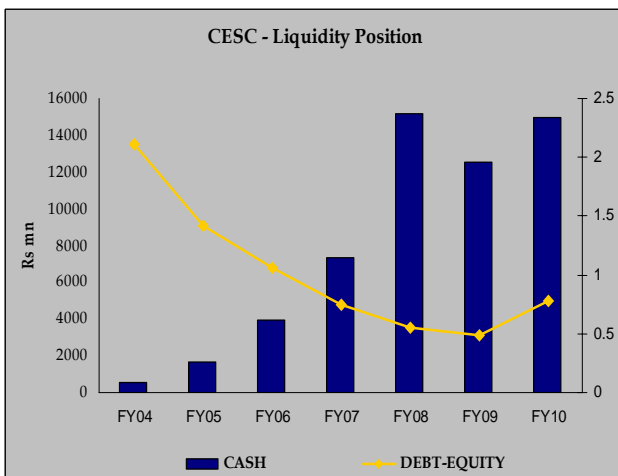
CESC Ltd has been awarded a 140 MW hydro power project by the Himachal Pradesh government at Lara-Sumta. The project is expected to come on stream by FY2014. The



Source :Company



Source :Company



Source: Company

expected cost of the project would be around Rs7000 million. At present environment and 'four seasons' studies are being carried out for the project. Apart from the current allotted project, the company is keen on taking more of such kind of projects. The next focus area for hydro projects will be North-East region.

✓ Improving Operational Efficiency

CESC has been improving its operating efficiency parameters on a consistent basis to emerge as a competitive electric utility. This has been done through a mix of increasing the plant load factor (PLF), and reducing auxiliary consumption, transmission and distribution (T&D) losses, and power pilferage. CESC has been able to improve its PLF over the years from 80% in FY04 to 97% in FY09. Simultaneously, the company has also been able to decrease its auxiliary power consumption from ~9.1% in FY04 to around 7% in FY09. Improvement in both these parameters has eventually led to generation and dispatch of more units from the same installed capacity, enabling CESC to meet the peak demand with minimal power purchase. Pilferage has been reduced by over 65% in the last 6 years. T&D losses too have been reduced significantly from 25% levels in FY01 to 13.9% in FY08 and further to 13.3% in FY10.

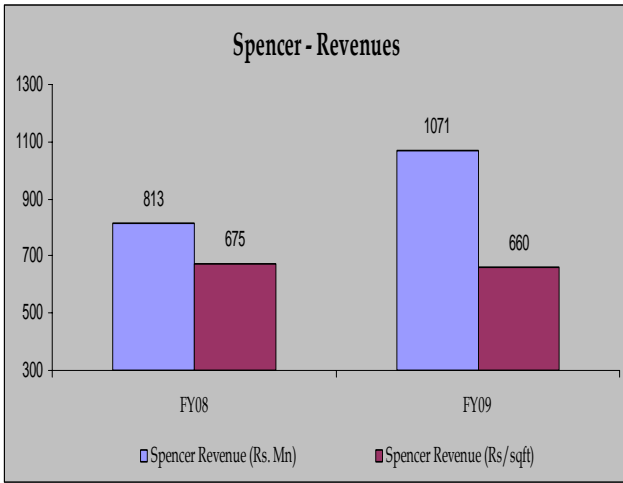
The company is upgrading the 132 kV transmission line to 220 kV as well as the current distribution network, with a capex of Rs 4500 mn over the next three years. CESC is also setting up a coal washery, which will reduce the ash content in the coal procured from its captive mines. These will improve the company's operational efficiency further going ahead.

✓ Lower Power Purchase going forward

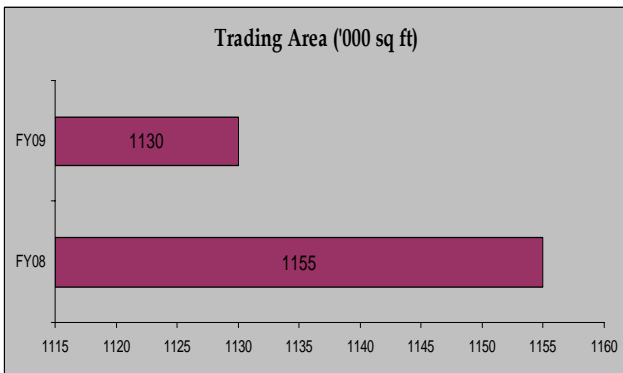
With the commissioning of the Budge Budge unit, we expect the company's dependence on purchased power to reduce further; and by the time the Haldia Phase I is commissioned, CESC's own generation will be self-sufficient for its license area. Thus the Company will benefit from an increase in its margins due to lower power purchase and coal cost on account of higher generation capacity and improved heat rates.

✓ Huge liquid cash position to provide financial stability

CESC has over Rs12.5 bn in cash and its leverage ratio stands at 0.49x (standalone levels in FY09), which clearly indicates that the company can easily raise further debt. The future capex can be easily funded through the surplus cash generated from the power business.



Source: Company



Source: Company

✓ **Spencer showing signs of turning around**

Spencer retail grew aggressively in FY08 and FY09 and this led to high rental and salary overheads. Due to the meltdown, the retail chain was caught on the wrong foot with high overheads while the realizations per sq. ft. reduced. The unit reported losses of Rs. 3350 mn in FY09 and this included losses of Rs. 800 mn on account of shutdown of unprofitable stores.

The annual losses have been reduced to around Rs. 2000 million in FY10. This is reflected in the higher sales per sq. ft. of Rs. 795/sq. ft. from Rs. 695/sq. ft. and the right sizing of operations. It has achieved cost cutting of Rs. 100 million per month through closure of unprofitable stores, rent renegotiations and organizational delayering. **Management expects the retail division to break-even at company level by the end of FY2011.**

In the past the management was aggressively pushing increase in trading area, however, after suffering huge losses, the management has decided to shut the loss making spaces and planned a strategy of 'Same Store More Volume'. Going forward the major focus of the company would be on in-house apparels and staples. The company plans to expand in the form of 'HYPERs' in 13 cities across the country, which will entail a capex of around Rs15,000 million. In the said expansion, all equity will be funded by the parent company i.e. CESC.

✓ **Real estate business – Adding value to the company**

The company has floated a 100% subsidiary, CESC Properties, in April 2007. CESC Properties has prime real estate of 3 acres in Park Street, Kolkata and is constructing an international standard premium shopping mall for Rs. 2000 million. It has planned a retail area of 4,00,000 sq. ft. and a 900+ car parking. It has appointed RTKL as the architect and has placed an order for turnkey project with L&T. The construction has started and mall is expected to start operations by FY13. Besides this, it has 35 acres land on northern Fringe of Calcutta and 100000 sq. ft. in Salt Lake City. According to the mandate by regulator, CESC Properties is required to share one third of its gains from its Real Estate business with its utility consumers.

The gradual turnaround of Spencers and the leasing of the retail mall in Park Street will make the retail and real estate subsidiaries EPS accretive in FY14.

CESC Q4FY10 Standalone Income Statement

(in mn)	Q4FY10	Q4FY09	% Change YoY	
Net Sales	7540.00	7410.00	1.8%	
Operating Costs				
Fuel Cost	2650.00	2240.00	18.3%	
Power Purchase	880.00	620.00	41.9%	
Personnel Cost	870.00	730.00	19.2%	
Other Operating Expenses	1300.00	2300.00	-43.5%	
Total Operating Expenses	5700.00	5890.00	-3.2%	
EBITDA	1840.00	1520.00	21.1%	
Depreciation and Amortization	520.00	420.00	23.8%	
EBIT	1320.00	1100.00	20.0%	
Other Income	360.00	340.00	5.9%	
Interest Expenses	470.00	370.00	27.0%	
PBT	1210.00	1070.00	13.1%	
Tax Expenses	210.00	130.00	61.5%	
Net Profit	1000.00	940.00	6.4%	
Exceptional Items	0.00	0.00		
EBITDA%	24.4%	20.5%		
EBIT%	17.5%	14.8%		
Net Income %	13.3%	12.7%		
Operating Data	Q4FY10	Q4FY09	FY10	FY09
Units Sold (MU)	1668	1668	7508	7590
Gross Units Generated (MU)	1949	1883	7901	7836
Units Purchased (MU)	169	160	1404	1775
Tariff (Rs./unit)	4.52	4.44	4.04	4.34
Fuel Cost (Rs./Kwh)	1.36	1.19	1.19	1.37
Purchase Cost (Rs./Kwh)	5.21	3.88	2.93	3.59

Source: Company, GSL Research

Q4FY10 Financial Performance - Standalone
Financial Highlights

CESC's Top-line grew by a marginal 1.8% yoy during the quarter to Rs. 7540 mn. The sales volumes increased were flat YoY at 1,668 MU. However, generation increased 3.5% YoY to 1949 MU following the commissioning of unit 3 at Budge Budge.

On the operating front, the company clocked a 21.1% growth in EBITDA to Rs. 1840 mn. EBITDA margins improved by 390bp yoy to 24.4% during Q4FY10, aided by a substantial reduction in other expenses. Interest and Depreciation charges grew 27% and 24% YoY respectively with the new unit at Budge Budge going commercial. The net profit rose by 6.4% yoy to Rs1000 mn during the quarter.

CESC's interest costs were up 27% YoY. As per the management, this was on account of:

- 1) capitalisation of capex on distribution operations; and
 - 2) borrowings on projects where financial closure is underway
- Hence, profit for the quarter, though up 6% YoY, fell short of consensus estimates.

Operational Highlights for FY10

CESC's total power generation during FY2010 stood at 7,836 MU compared to 7,901 MU in FY09, a decline of 0.8% as compared to FY2009. The overall PLF stood at 92.8% in FY10 compared to 97.3% in FY09. The power purchased by the company increased by 26.4% during FY10 to 1,775 MU compared to 1404 MU in FY09. Going forward, we expect reduced dependence on imported power to meet growing demand from Kolkata license area as the Company is likely to see higher internal generation.

T&D losses during the year remained flat at 13.3%. CESC took a 20-day maintenance shutdown in its Budge-Budge-I, II (500MW) and Southern (135MW) units. This, clubbed with lower PLFs in these stations, resulted in a generation loss of 14% YoY during 4QFY10. This was offset by generation at Budge-Budge-III unit (250MW), and hence CESC's aggregate power demand was met without significant power imports. However, as unit III was not declared commercial, CESC did not book its revenues during 4QFY10.

CESC Standalone Power Valuation	
EV/MW Valuation	
Installed Capacity (MW)	1225
Capital Cost per MW (mn)	55
Implied EV in mn	67375.0
Add: Cash	14939.2
Less: Debt	37856.1
Implied Market Cap in mn	44458.1
Share O/S in mn	124.9
Per share Value	355.8
P/BV Valuation	
FY11E Book Value	48789.3
Average P/B Multiple	2.4
Historical Discount	60%
P/BV Multiple	1.0
Market Cap in mn	47341.6
Share O/S in mn	124.9
Per share Value	378.9
P/EPS Valuation	
FY11E EPS	37.5
Average P/E Multiple	18.8
Historical Discount	45%
P/E Multiple	10.4
Per share Value	387.7
Standalone Power Valuation	374.2

Source: GSL Research

Haldia Phase I Valuation	
Basis	FCFF
WACC	15%
Debt/Equity	75:25
Tariff Rate	Rs. 3/Kwh
Date of commencement	FY14
Stake	100%
Equity Value	5400.0
Per share Value	43.2
Chandrapur Power Plant Valuation	
Basis	FCFF
WACC	12%
Debt/Equity	75:25
Tariff Rate	Rs. 3/Kwh
Date of commencement	FY14
Stake	100%
Equity Value	7800.0
Per share Value	62.4

Source: GSL Research

Outlook and Valuation

In view of the company's diverse nature of the businesses, we have used the sum of- the-parts (SOTP) methodology to arrive at the fair valuation of the company.

Standalone Power Business

We have valued the core business of CESC using the average of EV/MW, P/BV method and P/E method, to arrive at a fair value per share of Rs. 374/share.

On an EV/MW basis, we assign a value of Rs 55 mn per MW to CESC on its FY10 current capacity of 1225 MW. **We have arrived at a value per share of Rs. 356/share as shown in the adjoining table.**

On P/BV basis, CESC stock has been trading at roughly 0.8-1.0x 1 yr forward Book Value. This is at a steep discount (~60%) to its peers. However, going forward this discount will narrow down and hence **we value the company at 1.0x FY11 BVPS to arrive at a fair price of Rs. 379.**

On relative valuation basis, CESC is trading at a lucrative valuation of 10.3x its FY11 Expected EPS of Rs.37.5. Peer companies like Tata Power, NTPC, GIPCL, Torrent Power and Neyveli Lignite are trading at a 1 Yr forward P/E of 31.5x, 17.2x, 10.9x, 14.8x and 19.6x respectively. **Valuing CESC at a 45% discount to the average peer set gives us a value of Rs. 388/share.**

600 MW Haldia Phase II and 600 MW Chandrapur Power Plant

On the basis of the assumptions mentioned in the adjoining table, we have valued the Haldia project at Rs. 43.2/share and the Chandrapur project at Rs. 62.4/share on a NPV basis. On account of financial closure achieved for the Chandrapur plant, we have assigned a lower WACC to the Chandrapur plant compared to Haldia where still 20% of land is yet to be acquired.

Real Estate Division Valuation

Since the property division is still at a nascent stage, we have considered the value of the land which the company is currently holding and we arrive at the Net Asset Value (NAV) of Rs. 21 per share.

Retail Division Valuation

Even though Spencer has been successful in bringing its losses down, the unit has not broke even at the Company EBITDA level. Management expects the retail division to break-even at company level by the end of FY2011. Hence we have not given any valuation to the retail unit of Spencer.

Valuation of Real Estate Business						
	Park Circus	Mulajore	Haldia	Howrah	New Cossipore	Total
Area (acre)	3	35	3.5	2	23	66.5
Development Area (acre)	2.2	25.2	2.5	1.4	16.6	47.9
Rate (mn/acre)	500	20	100	20	50	
Value Total	1100	504	250	28	830	2712
Value /share	8.8	4.0	2.0	0.2	6.6	21.7

Source: GSL Research

CESC SOTP Valuation		
Business	Basis	Value/ share
Existing Power Business	Average of EV/MW, P/FY11 BVPS and P/FY11 EPS	374.2
Haldia Phase	FCFF with WACC of 15%	43.2
Chandrapur, Maharashtra	FCFF with WACC of 12%	62.4
Real Estate Division	NAV	21.7
	Total	501.5

Source: GSL Research

Recommendation

We remain positive on the domestic power sector given the strong demand supply gap and high peak demand, allowing strong growth opportunity for industry players like CESC to tap this huge opportunity on account of their vast experience. With increased reforms in the sector for generation, transmission as well as distribution, the opportunities are getting manifold. We believe CESC has the right experience and infrastructure to tap this opportunity going ahead. Apart from CESC's regulated power business, the ability to sell surplus power from generation assets after meeting the requirements of the distribution business gives CESC the benefit from high merchant rates as well. Also, it has sizeable holdings in the retail and real estate sectors.

In terms of valuation, CESC is one of the cheapest available stocks among the domestic power utilities. The stock is trading at a significant discount to its power players primarily on account of concerns over Spencer's operations and delay in execution over some of its key projects. Also, as all the power plants of the company are thermal based concerns over rising input prices (coal prices) and environmental regulatory issues are also lingering. However, we are confident of the fact that the management is working in the right direction to sort these issues in the near term. We believe the discount should narrow down as CESC takes aggressive steps to expand its current capacity, make Spencer's profitable and diversify into non renewable sources of energy generation

We have valued the company using sum-of-the-parts (SOTP) method to arrive at a target price of Rs 501, implying a potential upside of 30% upside from current levels. We have valued the Power business based on average of EV/MW, P/BV method and P/E method (at Rs 374/share), the Haldia Phase I with FCFF method (at Rs.43/share), Chandrapur Project with FCFF method (at Rs.62/share), and the Real Estate business based on market value (at Rs 22/share).

At the current market price of Rs.387, the stock is trading at 10.3 and 9.9 times its estimated FY11 and FY12 EPS of Rs.37.5 and Rs. 39.0 respectively. On an Enterprise value (EV)/EBITDA basis, the stock is trading at 6.4 times its estimated FY11 attributable EV/ EBITDA and at 6.1 times its estimated FY12 attributable EV/ EBITDA; while on price/book value basis, the stock is trading at 1 times its estimated FY11 book value and at 0.9 times its estimated FY12 book value

We therefore recommend a "BUY" on CESC with a price target of Rs 501, an upside of 30% from the current levels, over a period of 12 months.

Investment Concerns:

- ✓ Delay in setting up power plant
- ✓ Delay in Spencer's profitability
- ✓ Availability of assured coal supply from within the country will remain a critical issue.
- ✓ Low growth in domestic coal mining has increased dependence on imported coal.
- ✓ The power sector faces challenges such as difficulties in debt collection, procedural delays and need more improved co-ordination between various Governmental agencies.
- ✓ The pace of opening up of the distribution sector to private sector participation is slow.
- ✓ Any slow down in the retail business will hamper the growth of the company.
- ✓ As the company is only into thermal power generation it can also face some environmental issues going ahead

Key Triggers:

- ✓ Announcements for achievement of Milestones related to Chandrapur and Haldia Projects;
- ✓ Easing of FDI limits for investment in retail business;
- ✓ Divestment of stake in Spencers;
- ✓ Improvement in EPS contribution from Spencers;
- ✓ Announcements related to Real Estate Projects;
- ✓ Announcements related to new power projects

CESC Standalone FINANCIALS

(All figures in INR mn)	FY09	FY10	FY11 E	FY12E		FY09	FY10E	FY11E	FY12E	
INCOME STATEMENT						BALANCE SHEET				
Net Sales	30310.0	32910.0	35548.2	38944.4		Cash	12510.3	14939.2	16891.0	19387.9
Operating Expenditure						Receivables	3888.7	2704.9	2921.8	3200.9
Fuel Cost	9440.0	10710.0	12723.5	12907.9		Inventories	2119.6	2303.7	2488.4	2726.1
Cost of Power Purchase	4120.0	6370.0	2800.0	4505.6		Loans and Advances	10326.7	10326.7	10326.7	10326.7
Personnel Cost	3280.0	3610.0	3889.2	4260.8		Deferred Payments	422.2	422.2	422.2	422.2
Other Operating Expenditure	7350.0	4680.0	6851.2	7505.7		Total Current Assets	29267.5	30696.7	33050.0	36063.8
Total Operating Expenditure	24190.0	25370.0	26263.9	29180.0		Gross Fixed Assets	94288.7	112788.7	118288.7	123788.7
EBITDA	6120.0	7540.0	9284.4	9764.4		Less: Depreciation	38260.9	40240.9	42370.1	44598.3
Depreciation & Amortization	1700.0	1980.0	2129.2	2228.2		Net Fixed Assets	56027.8	72547.8	75918.6	79190.4
EBIT	4420.0	5560.0	7155.2	7536.2		Capital WIP	12796.3	10000	10000	10000
Interest Charges	1400.0	1780.0	2938.7	3227.4		Investments	3104.3	3104.3	3104.3	3104.3
Other Income	1630.0	1440.0	1421.9	1557.8		Misc. Expenses	78.6	78.6	78.6	78.6
PBT	4650.0	5220.0	5638.4	5866.6		Total Assets	101274.5	116427.4	122151.5	128437.1
Taxes	550.0	890.0	958.5	997.3						
Net Income	4100.0	4330.0	4679.9	4869.3		Current Liabilities & Provisions	16876.4	18324.1	19793.0	21684.0
Shares O/S in mn	124.9	124.9	124.9	124.9		Total Debt	23981.1	37856.1	41981.1	46106.1
Basic & Diluted EPS	32.8	34.7	37.5	39.0		Equity Capital	1256.0	1256.0	1256.0	1256.0
						Reserves and Surplus	47572.9	47403.2	47533.3	47802.9
						Customer Security Deposit	8211.8	8211.8	8211.8	8211.8
						Advance against Depreciation	3376.3	3376.3	3376.3	3376.3
						Total Equity and Liabilities	101274.5	116427.4	122151.5	128437.1
Key Parameters & Assumptions										
Installed Capacity (MW)	975	1225	1225	1225		Capex Funding (Debt/Equity)		75:25	75:25	75:25
Plant Load Factor%	97.30%	92.80%	90.00%	90.00%		Capex	12499.8	18500	5500	5500
Total Generation (Mn units)	7901	7836	9220	9220		Cost of Debt	6%	5%	7%	7%
Power Purchase (Mn units)	1404	1775	800	1280		Depreciation as % of Prior Gross Block	1.8%	1.8%	1.8%	1.8%
Auxiliary Consumption	6.9%	8.9%	7.0%	7.0%		Debtors Collection Period	42	30	30	30
T&D Losses	13.3%	13.3%	13.3%	13.3%		Inventory as a % of Sales	7%	7%	7%	7%
Total Units Sold	7508	7590	8079	8466						
Tariff Rate	4.04	4.34	4.40	4.60						
Fuel Cost (Rs./Kwh)	1.19	1.37	1.38	1.40						
Purchase Cost (Rs./Kwh)	2.93	3.59	3.50	3.52						
Personnel Cost as a % of Sales	10.8%	11.1%	10.9%	10.9%						
Other Expenditure as a % of Sales	24.3%	14.3%	19.3%	19.3%						
EBITDA%	20.2%	22.9%	26.1%	25.1%						
Other Income as a % of Sales	5.4%	4.4%	4.0%	4.0%						
Tax as a % of PBT	11.8%	17.0%	17.0%	17.0%						
Dividend Per Share	4.0	4.0	4.4	4.8						

Source: Company, GSL Research

Research Analysts: Prashant Kamdar; E Mail Id: prashant.kamdar@guinessonline.net
Pinaki Banerjee; E Mail Id: pinaki.banerjee@guinessonline.net

Contact No. 033-3001-5555, Extn.5569

Disclaimer

This Document has been prepared by the Research Team of Guinness Securities Ltd. and it is only meant for the use of the recipients only & it is strictly restricted for circulation without prior permission. Every care has been taken while preparing this document, however as the information contained herein is obtained from sources believed to be reliable hence we do not represent it, as accurate and it should not be relied upon as such. We do not take any responsibility for our research recommendation. Investors are advised to use their own judgment while taking any investment decision.

Registered Office: Suite No. C-1, Madhukunj, Laram Centre CHS Ltd., M.A. Road of S.V. Road, Opp. Andheri Railway Station, Andheri (West), Mumbai – 400 058 (w.e.f. 15th May, 2010)
 Corporate Office: Guinness House, 18, Deshapriya Park Road, Kolkata-700 026. Ph: 3001-5555. Fax: 91 33 3001 5566.
 Email: research@guinessonline.net, Website: www.16anna.com