

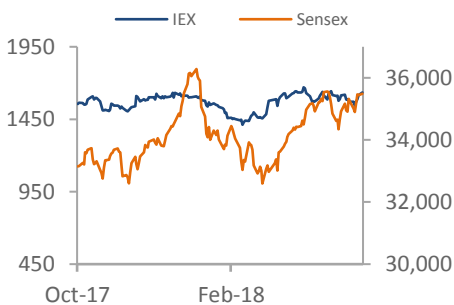
Sector	Power
Recommendation	BUY
Upside	20%

Stock Data	
Sensex	35,483
52 Week h/l (₹)	1,678 / 1,402
Market cap (₹ Cr)	4,959
BSE code	540750
NSE code	IEX
FV (₹)	10
Div yield (%)	1.4

Shareholding Pattern			
	Sep-17	Dec-17	Mar-18
Promoters	-	-	-
DII+FII	34	40	43
Individuals	66	60	57

Source: ACE Equity

Share Price Trend



Prices as on 11/06/2018

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Indian Energy Exchange (IEX) executed ~97% of total power exchange volumes in FY18. IEX would see trading volumes rise at 14.9% CAGR over FY18-20E due to (1) 5% CAGR in power demand over FY18-20E, and (2) market share of IEX rising from 3.8% (FY18E) to 4.6% (FY20E). Thus, we forecast EPS CAGR of 16.8% over FY18-20E, with IEX maintaining its ROE at 40%+ over FY19-20E. We recommend BUY with target price of ₹1,956 (33x FY20E EPS).

Increasing preference for short term markets: Power distribution companies (discoms) are expected to increase sourcing from the short term market. Factors behind this shift are: (1) short prices are lower on average than existing PPAs, (2) variability in power supply due to rise in power generation from renewable sources, and (3) reduced network congestion due to expansion of transmission capacity (refer exhibit 1).

Shift of short term volumes to power exchanges: IEX would benefit from migration to short term market over FY19-22E. This migration has been due to transparent price discovery on IEX. Due to price discovery mechanisms, differences in inter-regional power prices have reduced by ₹1.1 per unit over FY14-18 (refer exhibit 4).

Exchanges dominate trading in developed markets: Power exchanges in India had a market share of 3.8% in FY18E. This is much lower than that in developed countries, where the market share ranges between 30-50%. This highlights the long term growth trajectory for power exchanges, as Indian power markets converge with global standards.

Outlook & Valuation: We are positive on IEX due to (a) growing share of the short term power market and exchanges, and (b) unique business model with superior return ratios (refer exhibit 6) and negative working capital. We value the stock at 33x FY20E EPS, which we feel reflects IEX's long term growth opportunities and its unique business model. Further, strong cash flows would allow for healthy distribution to shareholders via buybacks and dividends.

Financial Summary

Standalone ₹Cr.	FY17	FY18	FY19E	FY20E
Revenue	204	230	273	311
YoY growth (%)	16.5	13.0	18.4	14.0
EBITDA Margin (%)	70.3	80.2	80.6	80.8
PAT	114	132	168	180
EPS (₹)	35.7	41.8	53.4	57.0
ROCE (%)	58.7	62.1	65.7	58.1
ROE (%)	47.7	46.9	53.0	43.6
P/E (x)	43.6	37.6	29.4	27.6

Source: IIFL Research

Balance Sheet

Standalone ₹Cr.	FY17	FY18	FY19E	FY20E
Assets				
Fixed Assets	6	8	8	8
Investments	71	78	78	78
Other Non-current assets	32	115	105	95
Current Assets	444	374	501	679
Total Assets	554	575	692	860
Liabilities				
Shareholders Funds	278	284	351	472
Current Liabilities	272	272	321	366
Other Liabilities	4	19	20	22
Total Liabilities	554	575	692	860

Company Overview

Indian Energy Exchange (IEX), a professionally managed company, manages the largest power exchange in the country (~97% of volumes in exchange segment). The company offers physical trading in electricity in the Day Ahead Market (DAM) and Term Ahead Market (TAM) segments. The company also conducts trading in Renewable Energy Certificates (REC) and Energy Savings Certificates (ES-certs).

The company has signed an MoU with Japan Electric Power Exchange (JEPX) for the purpose of information sharing, training and mutually beneficial commercial initiatives. IEX is also exploring setting up an exchange for the purpose of physical trading of natural gas.

Increasing preference towards short term markets

The share of the short term power market has moved from 9.4% (FY15) to 10.6% (in FY18). CRISIL estimates this share will eventually reach 21.1% by FY22E. This migration would be encouraged by structural reasons such as: (1) additions to transmission network, and (2) lower short term prices than pricing through long term mechanisms. Further, prices on IEX remained below recent bidding for long term PPAs (above Rs3.6 per unit).

Exhibit 1: Congestion down as transmission network grows

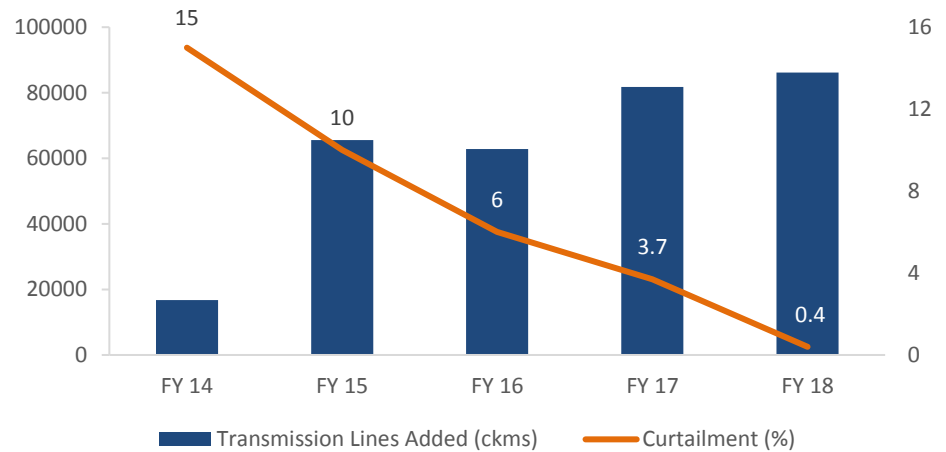
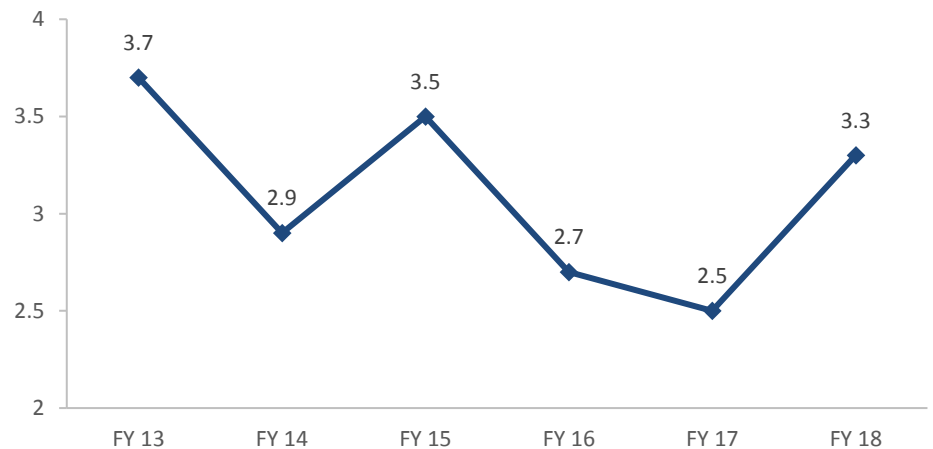


Exhibit 2: Prices remained below ₹3.6 per unit in FY14-18

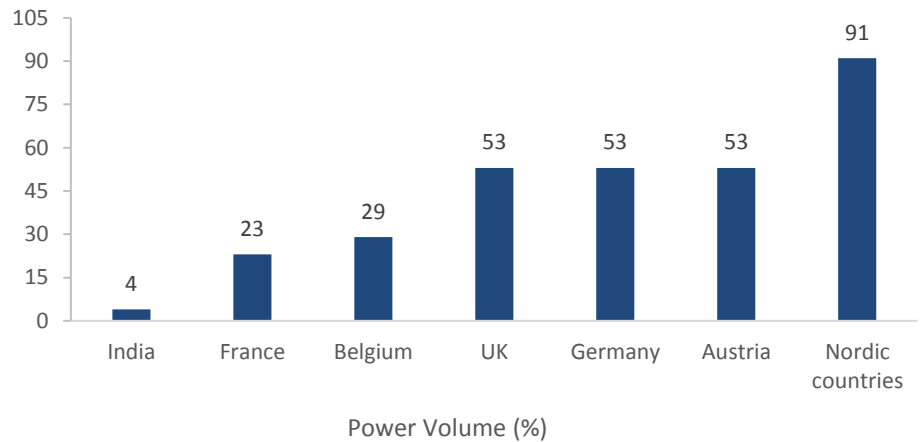


Source: Company Data, CEA, CRISIL, IIFL research

Power exchanges still at nascent stage

Power regulators have decided to move the industry towards market driven pricing of electricity. At present, power exchanges account for ~4% of total power traded. This is much lower than international power markets, where the share of power exchanges stand between 30-50%. This highlights the long growth trajectory for IEX, as the Indian power industry eventually converges to global standards.

Exhibit 3: Domestic power exchanges at a nascent stage

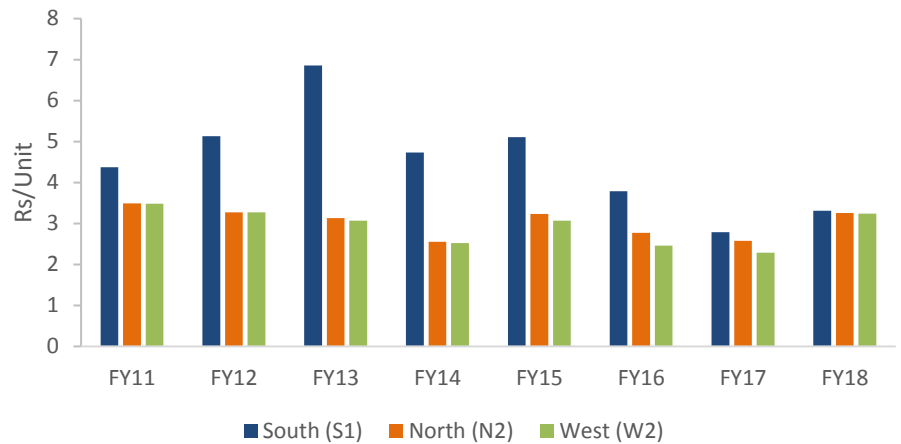


Source: Company Data, CRISIL

Migration of power volumes to exchanges

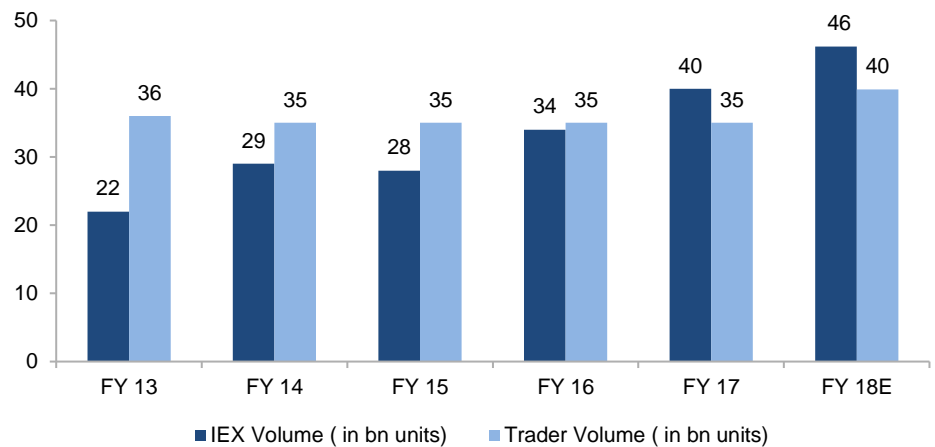
IEX has transparent pricing mechanism with bidding and sales details published publicly. Transmission capacity has also improved significantly. Trading volumes curtailed in FY18 stood at 0.43% of traded volumes against 3.7% in FY17. Transparent pricing and reduction of curtailment has enabled discovery of “one nation, one price” on 264 trading days in FY18. The price differential for North (N2) vs. South (S1) has also reduced from ₹3.7 (FY13) per unit to ₹0.1 per unit in FY18. For this reason, IEX has emerged as a better alternative to other participants in the short term power market.

Exhibit 4: Lesser inter-regional price difference leads to ...



Power volumes to continue migration to exchanges due to transparent and market driven price discovery

Exhibit 5: ... gains for IEX volumes vs. power traders



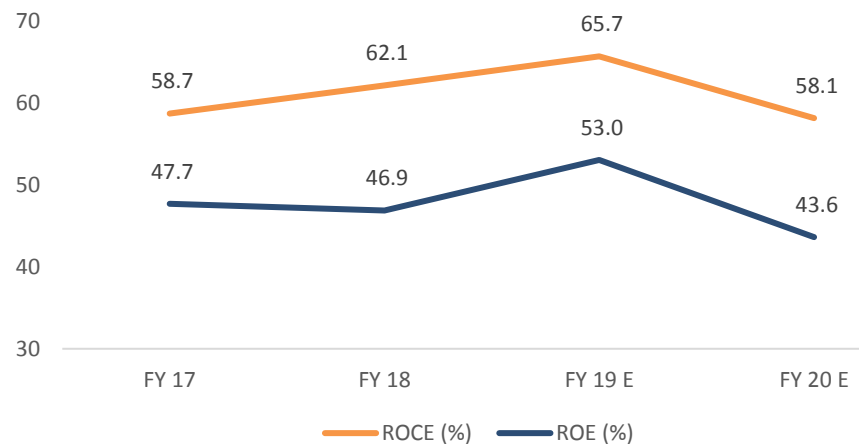
Source: Company Data, CERC, IIFL Research

Superior return ratios and cash generation

IEX boasts of high return ratios owing to the unique nature of the company's operations. Due to the negative working capital and non-capex growth, the company is able to generate large cash flows. Thus, the ROCE is likely to come in lower in FY20E (58%) vs. FY19E (65.7%). The company has stated that they would maintain a policy of paying out 50% of net profits to shareholders in the form of dividends.

On April 24, 2018, the company decided against going ahead with a share buyback. However, the management has stated that a buyback after October 23, 2018 could be considered. This delay would allow anchor investors to participate in the buyback process as well. However, the management is also considering setting up a gas exchange. The final decision would be based on maximizing shareholder value.

Exhibit 6: Superior return ratios over FY17-20E

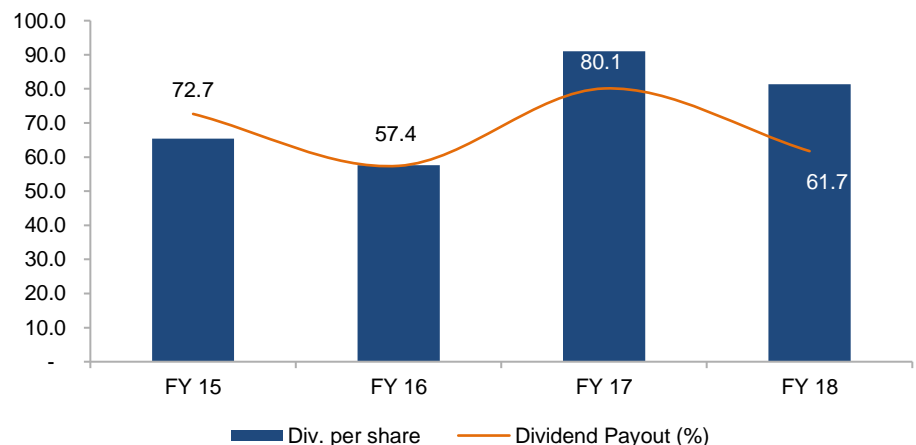


Source: Company Data, IIFL Research

RoCE = EBIT / Average capital employed

RoE = PAT / Average Net worth

Exhibit 7: Dividend Payout remains above 50% (FY15-18)



Source: Company data, IIFL Research

Numerous avenues for growth

IEX has numerous revenue growth opportunities going forward. In case of some opportunities (like cross border trade), IEX would see greater volumes on existing products. However, there is scope for introduction of new products, such as derivatives, for the power market. The company is also exploring setting up a gas trading exchange. This is a good strategic fit given the operational similarities in physical gas and electricity trading.

Exhibit 8: Sources of future growth

Opportunities	Description	Status
Cross Border Trade	Allows grid connected countries like Bhutan, Nepal and Bangladesh to trade power on the Term Ahead Market	Agreements between India and buyer nations pending
Futures and Forwards	Use of forwards and other derivatives to hedge exposure to volatile power prices	Awaiting action from regulator
Intraday & ancillary market	Intraday regulations & ancillary service market will help IEX gain share of Unscheduled Interchange volumes	Awaiting action from regulator
Gas Exchange	The petroleum ministry has announced that they are planning to setup a physical gas trading exchange by October 2018	Regulatory framework still under development

Source: Company Data, PNGRB

Key Risks:

- ✧ CERC has not regulated the trading fees for power exchanges in order to encourage participants in the segment. However, if CERC changes its stance, it could reduce the revenues of the company.
- ✧ Reduced production from stressed power generation assets would result in reduced sale on short term markets, which would impact trading volumes on IEX.
- ✧ If coal stocks remain low, then thermal plants would be unable to increase generation volumes. This would lead to higher settlement prices on IEX, which would reduce interest from buyers.

Recommendation Parameters for Fundamental/Technical Reports:

- Buy – Absolute return of over +10%
- Accumulate – Absolute return between 0% to +10%
- Reduce – Absolute return between 0% to -10%
- Sell – Absolute return below -10%

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