

Indian Energy Exchange

Powering up for the future of electricity trading

Indian Energy Exchange (IEX) is the dominant exchange in India for trading electricity in the country. It has a market share of over ~98% of the volumes in the power exchange industry.

Low market penetration allows for significant growth potential: As on FY17, 3.6% of electricity generation in India was traded on power exchanges. This is much lower than global power exchanges, which typically have 30-70% of traded volumes. This leaves the power market lots of room to grow.

Migration of electricity markets to exchanges: Electricity on IEX trades at a lower price than the bilateral price (₹2.5 per kWh on IEX Vs ₹3.5 per kWh bilateral price in FY17). The price difference has ranged between ₹0.8 to ₹1.4 per kWh over the past four years. The consistently lower pricing that IEX offers results in power procurement cost optimization for distribution companies and large consumers.

Capacity addition in Renewable Energy Sources (RES): Under the Central Electricity Authority's (CEA) 13th plan, 100 gW of capacity addition is to take place in the Renewable Energy segment. This would bring the total of solar and wind energy capacity installed to 100 and 60 gW respectively. Due to seasonality and variability in the generation of solar and wind energy, these new power generators would depend on the power exchanges to provide access to short-term electricity markets.

Enforcement of Renewable Purchase Obligation (RPO) to provide boost to trading in REC segment: the central government has targeted 17% share of renewable power by 2019. However, many states are still laggards in regards to their RPO targets. In order to address this deficit, trading of Renewable Energy Certificates (REC) is likely to see increased participation.

High Dividend Payout: The company has a policy to payout more than 50% of net profits as dividend. Due to strong cash generation, the company is likely to maintain the dividend payout similar to the payout (80%) in FY17.

Outlook & Valuation: IEX is likely to continue its current growth trajectory as the short-term electricity market would continue its migration away from other platforms and to the exchanges. The company is also likely to sustain its position as the dominant market player. The company is also likely to benefit from long-term industry trends as the Indian power market moves towards global standards. The company has an ROE of 30.8% Vs 7.4% for Multi-commodity Exchange (MCX), based on FY18 annualized earnings. At the upper end of the price band, the pre issue P/E multiples works out be 40.9x of FY2018 annualized EPS or IEX, Vs 51.5x of FY2018 annualized EPS for MCX. **We recommend 'SUBSCRIBE' on the issue for a mid-to-long term period.**

Key Financial

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Net Sales	153	145	175	204
% chg	26%	-5%	21%	17%
Net Profit	92	90	100	114
% chg	9.9	-2.1	11.5	13.2
EBITDA (%)	74.8%	71.9%	71.5%	70.3%
EPS (Rs)	30.3	29.7	33.1	37.5
P/E (x)	54	56	50	44
P/BV (x)	20	21	18	18
RoE (%)	53	55	54	63
RoCE (%)	44	42	45	51
EV/EBITDA	41	44	37	31

SUBSCRIBE

Issue Open: Oct 9, 2017

Issue Close: Oct 11, 2017

Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹3.03cr

Offer for Sale: **0.60cr Shares

Fresh issue: -

Post Eq. Paid up Capital: ₹3.03cr

Issue size (amount): *₹998cr -**1000 cr

Price Band: ₹1645-1650

Lot Size: 9 shares and in multiple thereafter

Post-issue implied mkt. cap: *₹4984cr
**₹5000cr

Promoters holding Pre-Issue: -

Promoters holding Post-Issue: -

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Patte

Promoters	0%
Others	100%

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Company background

Indian Energy Exchange (IEX) is the largest power trading exchange in India. For the past five years, it has more than 90% market share of the exchange-traded volumes of electricity in India. The balance of the exchange-traded volumes are transacted on the Power Exchange India Ltd (PXIL), which is its main competitor. The company has 4 products that it offers: Day Ahead Market (DAM), Term Ahead Market (TAM), Renewable Energy Certificate (REC). The company also soon began trading in Energy Savings Certificates (ESCCerts) from 26 Sept. 2017. The company's primary revenue is from earning transaction charges of ₹20 per mWh on the traded volume on the exchange. The company also earns a good amount of interest on interest free deposits collected from exchange members.

IEX primary focus is on the short-term electricity market. At present, the short-term electricity market is 10.3% of the total traded volumes of the electricity market. Of the short-term market, 34.5% is traded on power exchanges. The short-term trading market consists of Inter-state trading Licenses, Power exchanges, Deviation Settlement Mechanism (DSM), and Direct Bilateral. Market share of volumes traded on exchanges has gone from 10.9% in FY10 to 34.5% in FY17 (in the short-term electricity market).

Exhibit 1: Business Volumes by product category for IEX

	FY 13	FY 14	FY 15	FY 16	FY 17
DAM (in kWh)	22,346	28,923	28,124	33,956	39,783
TAM (in kWh)	481	345	222	330	744
REC (in mln units)	1.99	1.32	1.55	3.14	4.62

Source: Company, Angel Research, RHP

The company is a professionally managed entity with no promoter group or subsidiaries. In August 2016, the company received three ISO Certifications - ISO 9001:2008 for quality management, ISO 27001:2013 for information security management and ISO 14001:2004 for environment management. The Council of Power utilities recognized IEX as the 'Leader in Power Market Development' in 2015 and was awarded the 'Exchange of the Year' Award by Power Business View in 2014.

As of August 31, 2017, the company had over 5,900 participants registered on their exchange of which over 3,200 participants were active. Over 4,300 registered participants were eligible to trade electricity contracts and over 4,000 registered participants were eligible to trade RECs. The trading participants registered to trade electricity contracts are located across 29 states and 5 union territories, and include 50 distribution companies, over 400 electricity generators and over 3,900 open access consumers. The activities of the company are subject to regulation from Central Regulatory Electricity Commission (CERC).

Exhibit 2: Market share of IEX in exchange traded electricity

	FY 13	FY 14	FY 15	FY 16	FY 17
IEX	95.0%	91.5%	92.1%	93.7%	94.8%
PXIL	5.0%	8.5%	7.9%	6.3%	5.2%

Source: Company, Angel Research, RHP

Issue Details

This IPO is an OFS and with no issue of fresh shares. The issue constitutes of an OFS worth ₹1000cr. The OFS would offer exit to the institutional investors in IEX. The two largest sellers are Multiples Private Equity and Tata Power. Multiples Private Equity and Tata Power currently hold 13.3% and 4.34% of the pre-Offer Equity Share capital of the company respectively.

Exhibit 3: Pre and Post-IPO shareholding pattern

	No of shares (Pre-issue)	%	No of shares (Post-issue)	%
Promoter	-	-	-	-
Public	3,03,28,624	100%	3,03,28,624	100%
	3,03,28,624	100%	3,03,28,624	100%

Source: RHP, Angel Research

Objects of the offer

- To get the benefits of listing the equity shares on the stock exchange
- To carry out sale of upto 6,065,009 Equity Shares of existing shareholders

Key Management Personnel

Dinesh K. Mehrotra is the Chairman of the company. He has worked for LIC for over 35 years and last held the position of Chairman of the company. He also holds directorships across multiple boards such as Tata Steel and UTI Asset Management. He has been with the company for over two years.

Satyanarayan Goel is the Managing Director and CEO of the company. He has over 38 years of experience working in the power sector. He was previously the Director of Marketing and Operations at PTC and was associated with NTPC for over 29 years. He is responsible for the company's overall business operations.

Rohit Bajaj is the Vice President, Business Development. He has over 23 years of experience in the energy domain. He was previously the Head of Business at NETS Ltd.

Investment Rationale

Low market penetration allows for significant growth potential

As on FY17, only 3.6% of power generated in India was traded on exchanges. This is much lower than global power markets, where exchange volumes account for 30-70% of the volume of power generated. As Indian energy markets develop and mature, the participation on electricity exchanges is going to converge with global level.

Exhibit 4: Market share of Power exchanges by country

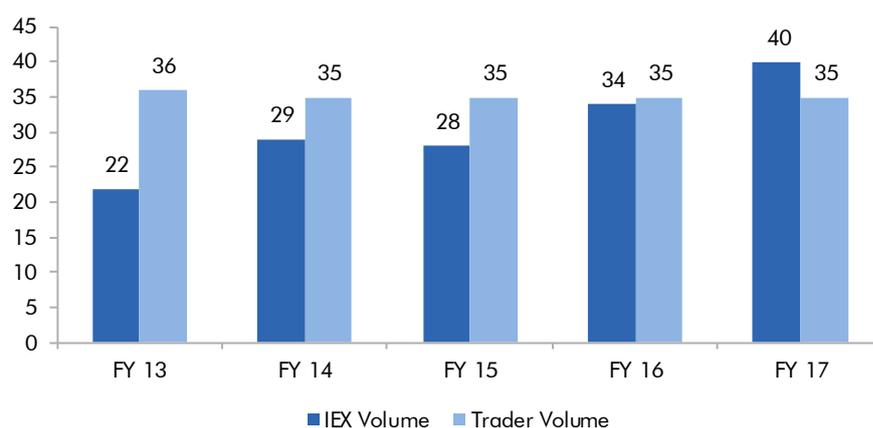
India	France	Belgium	UK	Germany	Austria	Nordic countries
3%	23%	29%	53%	53%	53%	91%

Source: Company, Angel Research, RHP

Migration of short-term energy market towards exchanges

IEX is the leading power exchange and a leader in volumes in the short-term power market. It has a dominant market share in the DAM, TAM and REC segment of the market. The company has steadily gained market share against other participants in the short-term market. IEX has gained market share due to its superior execution, cost optimization and transparent price discovery.

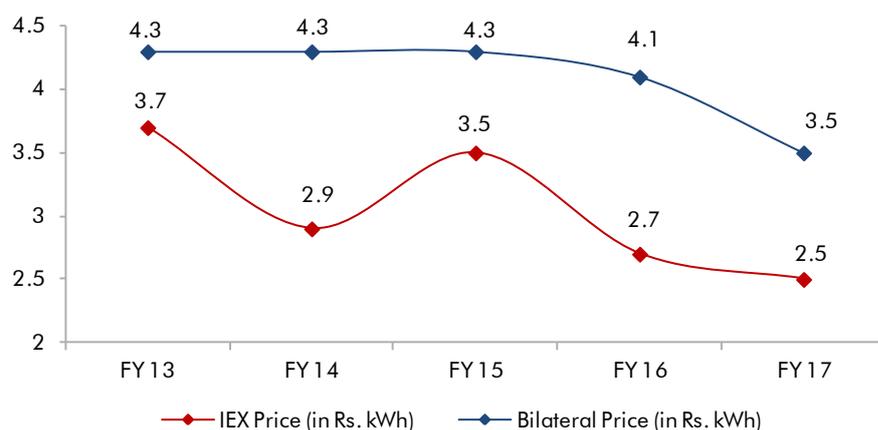
Exhibit 5: IEX volumes Vs Trader volumes in DAM & TAM segment



Source: Company, Angel Research, RHP

This superior price discovery has resulted in IEX prices being consistently lower than dealer prices. This trend is likely to remain as markets get deeper with better participation and improved transmission infrastructure.

Exhibit 6: Avg. prices discovered on IEX Vs dealer market



Source: Company, Angel Research, RHP

Capacity addition in Renewable Energy Sources

By 2022, the capacity of the renewable energy segment is expected to reach 170gW from a present capacity of 58.3gW. Of this capacity, 100 gW is solar energy while 60 gW is wind energy. Wind and solar energy generators are highly dependent on local conditions such as the weather (in case of both) and time of day (in case of solar).

Due to these reasons, it is likely that power generators from this segment would rely on the short-term power market.

Enforcement of Renewable Purchase Obligation

The central government has attempted to encourage the use of renewable energy. The government aims to encourage this by using Renewable Purchase Obligations. Renewable Purchase Obligations ("RPOs"), put simply, is the minimum percentages of total power that electricity distribution companies and other obligated entities like captive and open access consumers need to purchase from renewable energy sources.

The ministry of power has set an ambitious RPO target of 17.0% by 2019. Of this, 6.75% should come from solar and the balance from non-solar renewable sources such as wind, biomass etc.

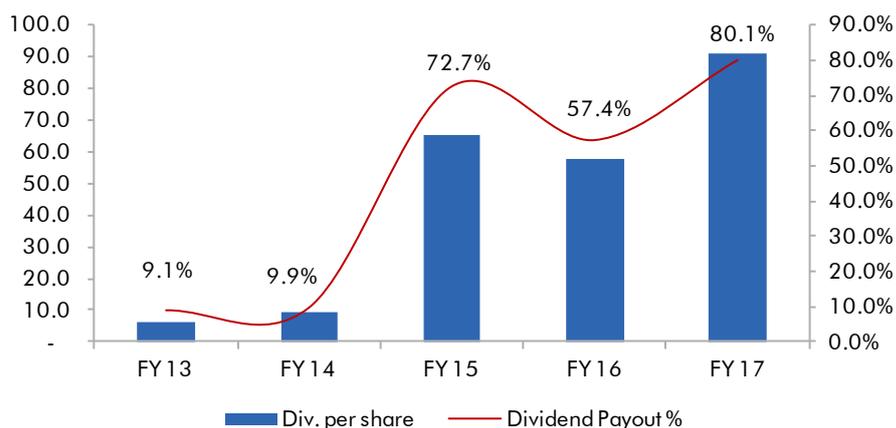
However, the State Regulatory Commissions are free to set year-wise RPO targets in their respective states as well as targets for solar and non-solar sources separately. However, few states have been able to meet their RPO targets.

Historically, distribution licensees have not been interested in purchasing electricity generated from renewable energy sources, due to power generation costs as well as a lack of local availability. Renewable energy certificates (“RECs”) were introduced to address this mismatch so that states can meet their renewable purchase obligations, by purchasing REC of producers from other states.

As the power ministry has still reiterated its initial target, states will now have to increase their participation. Thus, it is likely that the participation is likely to increase in the REC market.

High Dividend Payout: Since FY15, the company has maintained a dividend payout of over 50%. The company has stated that it will follow a policy to keep its dividend payout at 50% of net profits. Given the extremely low levels of capital required to run the business, it is quite likely that the company would keep dividend payout as per its historical levels.

Exhibit 7: High Dividend Payout



Source: Company, Angel Research

Outlook & Valuation

IEX is likely to continue its current growth trajectory as the short-term electricity market would continue its migration away from other platforms and to the exchanges. The company is also likely to sustain its position as the dominant market player. The company is also likely to benefit from long-term industry trends as the Indian power market moves towards global standards. The company has an ROE of 30.8% Vs 7.4% for Multi-commodity Exchange (MCX), based on FY18 annualized earnings. At the upper end of the price band, the pre issue P/E multiples works out be 40.9x of FY2018 annualized EPS or IEX, Vs 51.5x of FY2018 annualized EPS for MCX. **We recommend 'SUBSCRIBE' on the issue for a mid-to-long term period.**

Key risks

Regulatory control on pricing

At present, the company is charging a transaction charge of ₹20 per mWh of electricity traded on its platform. The power industry regulator CERC sets this pricing and hence the company's revenue is vulnerable to any regulation that stipulates a reduction in the transaction charges.

Competition from other exchanges

IEX faces competition from two other platforms – PXIL and the DEEP portal (created by the Power ministry). At present, these exchanges do not pose a significant threat to IEX. However, this industry is still in the early phases of its development and the situation remains quite dynamic. This is a possible outcome as platforms like DEEP have the support of the central government. Also, there are no regulatory barriers that prevent other competitors from entering the industry.

Exhibit 8: Consolidated Income Statement

Y/E March (₹ cr)	FY14	FY15	FY16	FY17
Total operating income	153	145	175	204
% chg	25.9	(5.1)	20.9	16.5
Total Expenditure	38	41	50	61
Personnel	8	12	14	16
Others Expenses	30	29	36	45
EBITDA	114	104	125	143
% chg	8.0	(8.8)	20.3	14.5
(% of Net Sales)	74.8	71.9	71.5	70.3
Depreciation & Amortisation	3	3	3	3
EBIT	111	101	122	140
% chg	11.5	(9.3)	20.4	14.8
(% of Net Sales)	73.1	69.9	69.6	68.6
Interest & other Charges	0	0	0	0
Other Income	21	32	25	34
(% of Sales)	16.1	23.8	17.1	19.3
Share in profit of Associates	-	-	-	-
Recurring PBT	133	133	147	173
% chg	20.6	(0.3)	10.7	18.1
Tax	40.9	42.5	46.3	59.6
PAT (reported)	92	90	100	114
% chg	9.9	(2.1)	11.5	13.2
(% of Net Sales)	60.3	62.2	57.3	55.7
Basic & Fully Diluted EPS (Rs)	30.3	29.7	33.1	37.5
% chg	38.7	(2.1)	5.3	13.2

Exhibit 9: Consolidated Balance Sheet

Y/E March (₹ cr)	FY14	FY15	FY16	FY17
SOURCES OF FUNDS				
Equity Share Capital	30	30	30	30
Reserves & Surplus	223	210	241	245
Shareholders Funds	253	240	271	275
Minority Interest	-	-	-	-
Total Loans	3	-	-	-
Other Liab & Prov	2	1	0	-
Total Liabilities	369	406	424	552
APPLICATION OF FUNDS				
Net Block	10	14	11	9
Capital Work-in-Progress	-	-	-	0
Investments	65	44	39	39
Current Assets	294	348	373	502
Inventories	-	-	-	-
Sundry Debtors	0	0	1	0
Cash	289	338	363	498
Loans & Advances	2	2	2	2
Other Assets	2	8	7	3
Current liabilities	111	165	153	277
Net Current Assets	182	183	220	225
Other Non Current Asset	-	-	0	2
Total Assets	369	406	424	552

Exhibit 10: Consolidated Cash Flow Statement

Y/E March (₹cr)	FY14	FY15	FY16	FY17
Profit before tax	133	133	147	173
Depreciation	3	3	3	3
Change in Working Capital	4	30	9	123
Interest / Dividend (Net)	(18)	(17)	(25)	(10)
Direct taxes paid	(42)	(42)	(46)	(61)
Others	(3)	(15)	(0)	(22)
Cash Flow from Operations	76	92	89	206
(Inc.)/ Dec. in Fixed Assets	(1)	(7)	(2)	(1)
(Inc.)/ Dec. in Investments	(89)	30	(21)	(19)
Cash Flow from Investing	(90)	24	(23)	(21)
Issue of Equity	0	0	0	0
Inc./(Dec.) in loans	3	(3)	0	0
Others	(11)	(103)	(70)	(110)
Cash Flow from Financing	(8)	(106)	(70)	(110)
Inc./(Dec.) in Cash	(22)	9	(4)	76
Opening Cash balances	22	0	10	6
Closing Cash balances	0	10	6	82

Exhibit 11: Key Ratios

Y/E March	FY14	FY15	FY16	FY17
Valuation Ratio (x)				
P/E (on FDEPS)	54.4	55.5	49.8	44.0
P/CEPS	52.8	53.8	48.2	42.7
P/BV	19.8	20.8	18.5	18.2
Dividend yield (%)	0.2	1.3	1.2	1.8
EV/Sales	30.5	31.9	26.3	21.9
EV/EBITDA	40.7	44.4	36.7	31.1
EV / Total Assets	12.6	11.4	10.9	8.1
Per Share Data (Rs)				
EPS (Basic)	30.3	29.7	33.1	37.5
EPS (fully diluted)	27.6	27.0	31.5	35.7
Cash EPS	31.2	30.7	34.2	38.6
DPS	3.0	21.6	19.0	30.0
Book Value	83.5	79.2	89.4	90.8
Returns (%)				
ROCE	43.6	42.2	44.9	50.8
ROE	52.5	55.2	54.1	63.0
Turnover ratios (x)				
Asset Turnover (Gross Block)	8.9	6.3	7.3	8.3
Receivables (days)	1	1	2	0
Payables (days)	69	87	123	308
Returns (%)	(68)	(86)	(121)	(307)

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