

Industry	LTP	Base Case Fair Value	Bull Case Fair Value	BUY Range	Time Horizon
Power Exchange	Rs.186.10	Rs.203	Rs.218	Buy in the Rs.177-180 band and add on dips to 158-162 band	2 quarters

HDFC Scrip Code	INDENEEQNR
BSE Code	540750
NSE Code	IEX
Bloomberg	IEX
CMP Jun 26, 2020	186.1
Equity Capital (Rs cr)	29.96
Face Value (Rs)	1
Equity Share O/S (cr)	29.96
Market Cap (Rs crs)	5575
Book Value (Rs)	20
Avg. 52 Wk Volumes	823636
52 Week High	203.4
52 Week Low	111.05

Share holding Pattern % (Mar 31, 20)	
Promoters	-
Institutions	63.3
Non Institutions	36.33
Others	0.41
Total	100.0

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Our Take:

After over a decade of existence, IEX has created near monopolistic market with 95% market share for itself, in India's short term power exchange market. Also this market is at a very nascent stage with only around 4% of India's power produced transacted through exchanges compared to 30% in developed economies, but the trend is changing with preference towards short term contracts. With its large customer network and advance technology infrastructure, the company has created barriers to entry for new entrants. IEX is expanding its pie via adding new products to its portfolio. Recently, it has added Real-Time Market (RTM) product enabling consumers to buy power just an hour before delivery and IEX is planning to add many more such products in near future. Launch of Gas exchange - India's first ever digital trading platform for natural gas seems very promising because of government's commensurate intentions and huge untapped potential market. Due to strong financials, debt free status and high return ratios it can command a higher multiple.

Valuations & Recommendation:

Newer product launches and rising preference for short term contracts will improve volumes for the company. We have envisaged 12% CAGR in revenue and 10% CAGR in net profit over FY20-22E. Return ratios are estimated to remain well above the 35% mark. Due to negligible capex requirement, the dividend payout ratio of the company is expected to remain stable at 40%.

We feel the Base case fair value of the stock is Rs.203 (27.8x FY22E EPS) and the Bull case fair value is Rs.218 (30.0x FY22E EPS). For margin of safety and enough upside, investors could buy the stock in the Rs.177-180 band (24.5x FY22E EPS) and add on dips to Rs.158-162 band (22.0x FY22E EPS). At the CMP the stock trades at about 25.5x FY22E EPS.

Financial Summary:

(Rs cr)	4QFY20	4QFY19	YoY (%)	3QFY20	QoQ (%)	FY19	FY20	FY21E	FY22E
Net Revenue	80	68	18	69	16	254	257	280	325
EBITDA	63	56	13	57	11	203	204	212	250
RPAT	46	38	20	42	9	165	178	182	217
EPS						5.5	6.0	6.1	7.3
RoE						50.4	46.7	41.0	39.1
P/E						33.8	31.0	30.5	25.5
P/BV						15.5	14.3	10.9	9.3
EV/EBITDA						27.8	27.6	26.7	22.6

(Source: Company, HDFC sec Research)

Recent Triggers:

IEX is expanding its pie via adding new products to its portfolio. Recently, it has added Real-time market (RTM). This is expected to reduce the delivery time from current 3.5 hours to just 60 minutes. The company is also planning to launch products like Cross Border Trade, Longer Duration Contracts, Green TAM (Term Ahead Market), Exchange based Ancillary Market and Banking contracts in near future. This is expected to give a fillip to the volumes and ultimately the revenues of the company going ahead.

The Government of India has set a policy target of increasing the share of natural gas in India's energy basket from current 6.5% to 15% by 2030. World average proportion of gas in the energy mix is currently at 23.5%. To undertake such an increase in share of natural gas in India, it is imperative to drive investments in the overall gas economy value chain – including domestic production, re-gasification of imported LNG, transportation (pipelines) and end-use consumption (industrial, commercial and residential applications). The required investments, in turn, calls for a market-based mechanism for gas pricing and allocation that can generate effective price, demand and supply signals. A market-based mechanism is possible if there is a transparent and neutral natural gas trading platform.

Recently, IEX through its wholly owned subsidiary Indian Gas Exchange (IGX) has launched India's first ever digital trading platform for natural gas. It will enable market participants of trade in standardized gas contracts. India's spot gas market is 25–30% of overall market and it is 2.5x of electricity market. This is dominated by traders, so the potential is huge. For the first full year of operation, IEX is targeting to capture 2–3% of spot gas market share.

Even in the challenging environment the company reported good set of numbers in Q4FY20 with 18% YoY growth in revenue and 20% YoY growth in PAT. Despite ~20% decline in power demand during April and May 2020 (lockdown period), IEX registered electricity volume growth of ~19%. This is attributable to lower spot prices resulting in higher participation, mainly from discoms.

Long term Triggers:

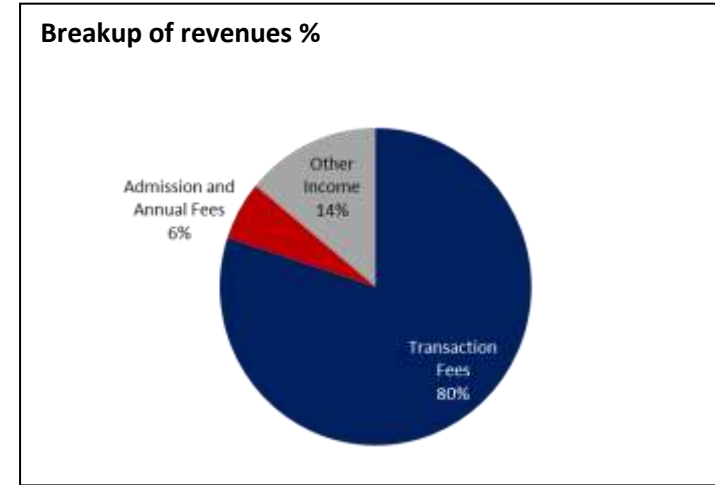
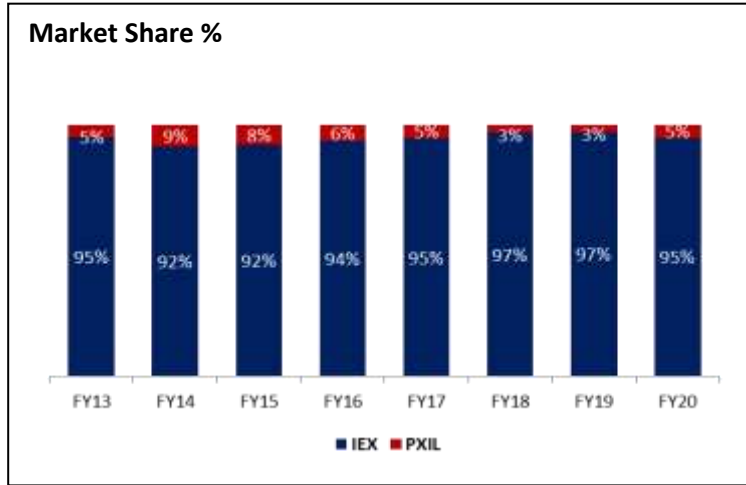
Since establishment of power exchanges in the country, there has been a duopoly between IEX and PXIL wherein IEX has dominated the space. Of the total volumes traded on exchanges as of Q4FY20, IEX contributes 95% market share. Stemming from the significant operational track record and by achieving international quality certifications, IEX enjoys the early mover advantage and strong brand recognition. Also with the large customer network and advance technology infrastructure the company has created artificial barriers to entry for new entrants.

IEX have achieved deep penetration of the market for trading of electricity over exchanges. The company has customer base of 4000+ Industries, 56+ Discoms, 100+ ESCert Entities, 500+ Generators and 1600+ RE Generators & Obligated entities. These participants are located in 29 states and five union territories in India. These include companies across segments like, textiles, metals, chemicals, automobiles, food processing, cement, ceramics, plastics, housing and commercial real estate, consumer goods and IT. The diversity of participant base leads to increased liquidity of electricity contracts and other electricity products on the exchange, both in terms of demand and supply.

IEX is zero debt company and it does not carry any credit risk because it executes trades once it receives margin from customers. This has resulted in negative working capital cycle. The company has strong margin profile with EBITDA margin at ~80% and APAT margin at ~70% at the end of March-20. The return profile of the company is also excellent with ROE at ~47% and ROCE at ~43.6% in FY20. Due to negligible capex requirement the dividend payout ratio of the company has remained well above 40% in the past few years (except for FY19, when company has announced buy back of shares). We expect the trend will continue going forward.

What could go wrong:

- Any unfavorable change in rules and regulatory policies can have a negative impact on earnings outlook of the company.
- Currently India has only two power exchanges and IEX have dominant position with market share of 95%. Rival's margin reduction to capture higher market share or even license grant to any new player could create higher competitive intensity. Regulatory proceedings/compliances for a proposed third exchange by a consortium of PTC, BSE and ICICI Bank are underway.
- The COVID-19 outbreak and consequent lock-downs have created high volatility in the demand for power. Though the volumes have remained resilient for the last two months, a weaker than expected economic recovery can pose challenges. Also higher power prices could impact the buyer's decision (shift to higher offtake through long-term PPAs) and lower power prices could impact sellers' decision.
- Reduced production from stressed power generation assets would result in reduced sale on short term markets, which would impact trading volumes on IEX.
- IEX has recently invested in new venture – Gas Exchange. Volume and revenue generation capabilities in this venture and its timing will be a key monitorable. It has and will spend a lot of money on recruitment and technology, returns from which may take time to materialize.
- Any reduction in trading margins from the current Rs0.04 per unit by a regulatory action can result in impact on revenues and profits.

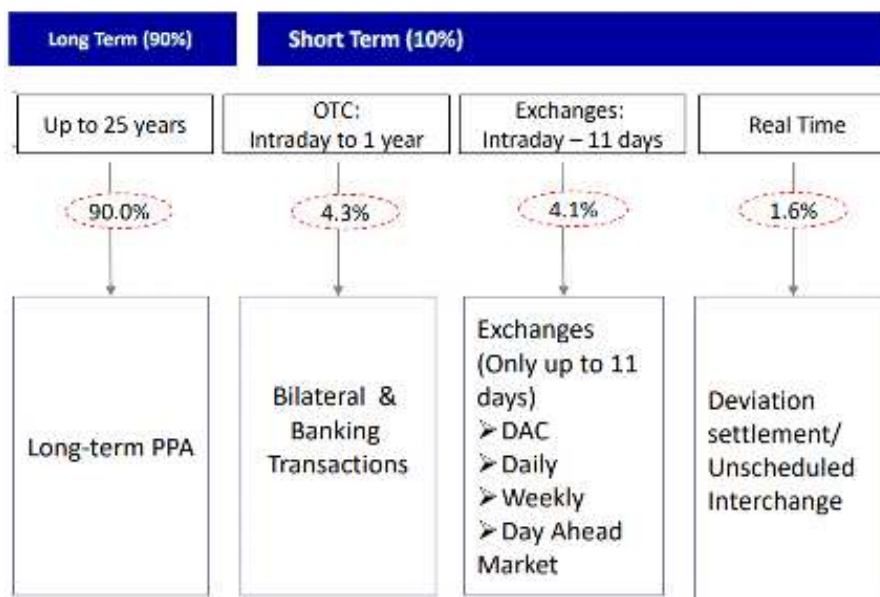


Industry Overview:

Several favorable policy and initiatives adopted by the government have helped the Indian Power Industry reach new heights. Initiatives like ‘Power for All’, ‘24x7 power supply’, smart cities, rising industrialization and growing urbanization are expected to drive the power demand going forward. The headroom is large as the annual per capita electricity consumption is at around 1,200 units compared with global average of 3,125 units. This indicates that as India would grow, this gap could be effectively addressed.

Initially, the structure for the bulk power market was characterized by long term contracts between generation plants owned by central and state governments, independent power producers, captive-generators with surplus capacity and distribution utilities or SEBs. Power purchase agreements were signed by these players for long-term of 25 years. However, long-term contracts had their own limitations, and could not address some of the key requirements of an efficient power market. Hourly consumption over a long term without forecasting errors was difficult to predict, leading to shortages of power in one region while surplus power was available in the another region. Also, long term contracts were cost plus in nature, therefore did not lead to competition in the sector.

Now the preference has been shifting towards short term contracts. These are for the period of less than 1 year and currently it contributes only 10% of total market. Short term contacts include category of OTC, Exchanges and real time contracts. Presently, only around 4% of India’s power produced is transacted through exchanges and the corresponding figure is in excess of 30% in a number of developed economies indicating the extent of headroom available for growth for the company.



About the company:

Incorporated in 2007, Indian Energy Exchange Ltd (IEX) is the first and largest energy exchange in India providing a nationwide, automated trading platform for physical delivery of electricity, Renewable Energy Certificates and Energy Saving Certificates. IEX is India's largest exchange with 95% market share in electricity products trading category. IEX Exchange is an online trading platform which is accessible to registered participants. It promotes efficient price discovery and the opportunity to trade in a variety of electricity products. In addition to trade execution, IEX also offers settlement services, including electronic trade confirmation, access to clearing services and risk management functionality. IEX makes Rs.0.04/unit (Rs.0.02/unit from each party) of power traded on its platform and Rs.20 per REC.

IEX was originally promoted by Financial technologies. It had 33.5% stake in the company in March 2013, which it divested gradually and completely before March 2016. Dalmia Power Ventures and TVS Shriram Growth fund bought a part of this stake and the rest was picked up by domestic/foreign institutions. As on March 2020, there are no official promoters, TVS Shriram Growth Fund holds 10.02% stake, Dalmia Power Ventures holds another 10%.

IEX appointed Rajiv Srivastava as an Additional Director on the Board of the Company and designated him as a Whole-time Director of the company. Srivastava took over as the Managing Director & CEO of the Company, effective from July 21, 2019, in place of S N Goel whose term is expiring on July 20, 2019. Rajiv Srivastava is a Mechanical Engineer from BITs - Pilani and MBA from FMS, Delhi. Srivastava was working as Chief Operating Officer (COO) and Head of Sales Strategy & Operations for HP Inc- Asia Pacific & Japan Region and leading all of HP's end-to-end sales strategy, sales enablement, and key growth

initiatives as well as services and solution in the region. He has about 34 years of experience at senior level at companies like HP India, Hewlett Packard, Microsoft India, Yamaha Motorcycles Limited & NSL.

The products offered by IEX for trading include:

1. **DAM (Day-ahead-market)** - Launched in June, 2008, in this segment, participants transact electricity on 15-minutes block basis, a day prior to the delivery of electricity. Both buyers and sellers submit their anonymous bids electronically during the market bid session and matching of bids is done on double sided auction mechanism with uniform market clearing price. The DAM constitutes the majority of the energy contracts (78% of revenues) that are traded on IEX.
2. **TAM (Term-ahead-market)** - Launched in September 2009, contracts under TAM cover a range for buying/selling electricity for duration up to 11 days (currently 7% of revenues). It enables participants to purchase electricity for the same day through intra-day contracts, for the next day through day-ahead contingency, on daily basis for rolling seven days through daily contracts, and on weekly basis through weekly contracts to manage their electricity portfolio for different durations.
3. **RECs (Renewable energy certificates)** - Launched in February 2011, REC market facilitates transaction in environmental attributes- both solar and non-solar. The Renewable Energy (RE) generator can opt to get RECs against green attributes of their generation. IEX enables sale of such environmental attributes, separately from the electricity generated from renewable resources, in accordance with the regulations issued by the CERC. RECs are traded on the last Wednesday of every month.
4. **Energy Saving Certificates** - ESCerts are the tradable certificates under the Perform, Achieve, Trade (PAT) Scheme of Bureau of Energy Efficiency (BEE), a market-based mechanism to incentivise energy efficiency in large energy-intensive industries. (Consumers achieving reductions above their targets receive ESCerts, which can be traded on any power exchange. Consumers that don't achieve respective targets in accordance with the PAT scheme must buy ESCerts to offset their shortfall.) IEX became the first and only Power Exchange to commence trading in ESCerts on 26 September 2017.
5. **RTM (Real Time Market)** - IEX recently launched this product on 1st June, 2020. It will have every half an hour sessions during the day with delivery of power within an hour of the closure of the bid session.

Financials
Income Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Net Revenue	230	254	257	280	325
Growth (%)	16.0	10.3	1.2	9.0	16.0
Operating Expenses	46	51	53	68	75
EBITDA	185	203	204	212	250
Growth (%)	28.9	9.7	0.8	3.5	18.1
EBITDA Margin (%)	80.2	79.8	79.6	75.6	77.0
Depreciation	10.3	10.4	15.2	16.0	17.0
EBIT	175	192	189	196	233
Other Income	26	40	40	38	45
Interest	0.2	0.7	1.6	0.2	0.5
PBT	200	232	228	233	278
Tax	68.3	66.7	49.9	51.4	61.1
RPAT	132	165	178	182	217
EPS	4.5	5.5	6.0	6.1	7.3

Balance Sheet

(Rs cr)	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share Capital	30.2	30.2	29.8	29.8	29.8
Reserves	254	340	360	468	580
Shareholders' Funds	284	370	390	498	610
Net Deferred Taxes	15	24	24	22	20
Long Term Provisions & Others	4	6	19	18	15
Total Source of Funds	302	400	434	538	645
APPLICATION OF FUNDS					
Net Block	119	111	119	119	120
Capital Work-in-Progress	1	1	1	0	0
Non-Current Investments	78	202	209	235	245
Long Term Loans & Advances	4	3	1	0	1
Total Non Current Assets	201	318	330	354	365
Current Investments	191	272	307	350	410
Inventories	0	0	0	0	0
Trade Receivables	0	46	0	0	0
Short term Loans & Advances	0	0	2	2	2
Cash & Equivalents	114	68	27	62	91
Other Current Assets	68	1	2	2	2
Total Current Assets	374	387	338	416	505
Trade Payables	85	134	76	90	100
Other Current Liab & Provisions	187	171	158	143	125
Total Current Liabilities	272	305	234	233	225
Net Current Assets	102	82	104	183	280
Total Application of Funds	303	401	434	538	645

(Source: Company, HDFC sec Research)

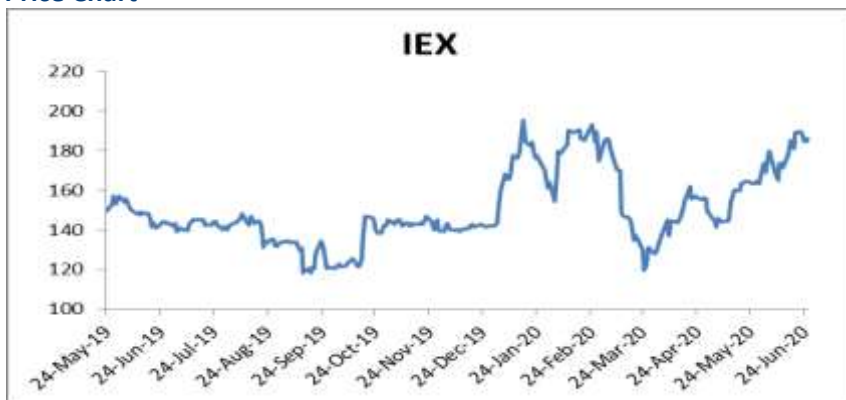
Cash Flow Statement

(Rs Cr)	FY18	FY19	FY20	FY21E	FY22E
Reported PBT	200	232	228	233	278
Non-operating & EO items	-116	-40	-40	-38	-45
Interest Expenses	0	1	2	0	1
Depreciation	10	10	15	16	17
Working Capital Change	87	-28	-38	-17	-24
Tax Paid	-68	-67	-50	-51	-61
OPERATING CASH FLOW (a)	113	108	116	143	165
Capex	-121	-2	-23	-16	-18
Free Cash Flow	-8	106	93	127	147
Investments	19	-124	-4	-26	-10
Non-operating income	26	40	40	38	45
INVESTING CASH FLOW (b)	-75	-86	13	-4	17
Debt Issuance / (Repaid)	15	11	14	-4	-5
Interest Expenses	0	-1	-2	0	-1
FCFE	7	117	106	123	141
Share Capital Issuance	0	0	0	0	0
Dividend	-66	0	-75	-75	-104
FINANCING CASH FLOW (c)	-51	11	-63	-79	-110
NET CASH FLOW (a+b+c)	-14	32	67	61	72

(Source: Company, HDFC sec Research)

Key Ratios

	FY18	FY19	FY20	FY21E	FY22E
Profitability (%)					
EBITDA Margin	80.2	79.8	79.6	75.6	77.0
EBIT Margin	75.8	75.7	73.6	69.8	71.7
APAT Margin	57.1	65.0	69.2	65.0	66.6
RoE	46.9	50.4	46.7	41.0	39.1
RoCE	57.7	48.1	43.6	36.4	36.2
Solvency Ratio					
D/E	0.0	0.0	0.0	0.0	0.0
PER SHARE DATA					
EPS	4.5	5.5	6.0	6.1	7.3
BV	94	12	13	17	20
Dividend	22.0	0.0	2.5	2.5	3.5
VALUATION					
P/E	41.3	33.8	31.0	30.5	25.5
Dividend Yield	11.6	0.0	1.3	1.3	1.9
P/BV	2.0	15.5	14.3	10.9	9.3
EV/EBITDA	30.5	27.8	27.6	26.7	22.6
EV / Revenues	24.5	22.2	22.0	20.1	17.4

Price Chart


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