

# POWER GRID CORP OF INDIA



On a constrained growth path

- PAT up 25% on back of commissioning of projects worth ~INR 40 bn**  
 Power Grid Corporation of India's (PGCIL) Q2FY11 earnings grew 25% Y-o-Y on back of commissioning projects worth ~INR 40 bn. Earnings were also driven by higher short-term open access income (up 159%) at INR 639 mn. While the consultancy division posted a PBT of INR 435 mn (up 60% Y-o-Y), telecom business recorded PBT of INR 94 mn (INR 96 mn in Q2FY10).
- Capex target of INR 125 bn for FY11 and ~ INR 170 bn for FY12**  
 Despite paucity of cash, PGCIL intends to incur a capex of INR 125 bn in FY11 and INR ~170 bn in FY12. As the 30% equity corpus for this capex is not sufficient, the company is scheduled to tap equity markets in Q3FY11. The company also targets commissioning projects worth INR 90-100 bn in FY11 and ~ INR 60-70 bn in FY12, of which, projects worth ~INR 51 bn have already been commissioned in H1FY11. We have, hence, considered 10% equity dilution at INR 100/share.
- XII plan capex target at ~ INR 1 tn +**  
 The management guided for a XII plan capex of more than INR 1 tn as the government has entrusted the responsibility of building the dedicated transmission corridor for ~48 GW of private sector generation projects and 4-6 incremental UMPPs to PGCIL. The management is reasonably confident that the entire capex spend would continue to earn the company regulated returns.
- Plan to enhance telecom and consultancy revenues**  
 The management is expecting to build on the robust transmission business expertise by garnering consultancy business both in India and abroad. Similarly, the company plans to leverage its transmission assets by providing telecom services. Earnings from these might not be more than 10-15% of the overall earnings, but could enhance RoEs due to its zero capital intensity.
- Outlook and valuations: Limited earnings growth; maintain 'HOLD'**  
 Earnings growth could continue to be robust, but is contingent on equity dilution and timely execution of associated generation projects in the XII plan. Moreover, with peak RoE at ~17% and other businesses yet to scale up, we believe there is limited upside from CMP of INR 104, as the stock is trading at 2.2x FY11E and 2x FY12E BV on a diluted basis. We maintain '**HOLD**' recommendation on the stock and rate it '**Sector Performer**' on relative return basis.

## Financials (Standalone)

Year to March	Q2FY11	Q2FY10	% Change	Q4FY10	% Change	FY10	FY11E
Revenues (INR mn)	21,266	17,486	21.6	22,305	(4.7)	71,275	97,981
Total expen. (INR mn)	3,409	2,762	23.4	4,100	(16.9)	12,581	14,166
EBITDA (INR mn)	17,858	14,723	21.3	18,205	(1.9)	58,694	83,815
Net profit (INR mn)	6,139	4,920	24.8	6,173	(0.5)	21,409	24,260
EBITDA margins (%)	84.0	84.2		81.6		82.3	85.5
NPM (%)	28.9	28.1		27.7		30.0	24.8
Diluted EPS (INR)						4.8	5.2
Diluted P/E (x)						21.4	19.8
ROAE (%)						13.4	12.8

October 20, 2010

Reuters: PGRD.BO Bloomberg: PWGR IN

### EDELWEISS 4D RATINGS

Absolute Rating	<b>HOLD</b>
Rating Relative to Sector	<b>Performer</b>
Risk Rating Relative to Sector	<b>Low</b>
Sector Relative to Market	<b>Underweight</b>

Note:  
Please refer last page of the report for rating explanation

### MARKET DATA

CMP	:	INR 104
52-week range (INR)	:	121 / 95
Share in issue (mn)	:	4,208.8
M cap (INR bn/USD mn)	:	443 /10,018
Avg. Daily Vol. BSE/NSE ('000):	:	2,182.4

### SHARE HOLDING PATTERN (%)

Promoters*	:	86.4
MFs, FIs & Banks	:	5.7
FIIIs	:	1.6
Others	:	6.3
* Promoters pledged shares (% of share in issue)	:	NIL

### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Power Index
1 month	0.1	2.4	(0.4)
3 months	6.3	11.9	2.9
12 months	(4.5)	17.2	(1.4)

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## Financial snapshot (Standalone)

(INR mn)

Year to March	Q2FY11	Q2FY10	% Change	Q4FY10	% Change	FY10	FY11E	FY12E
Total operating income	21,266	17,486	21.6	22,305	(4.7)	71,275	97,981	113,143
Total expenses	3,409	2,762	23.4	4,100	(16.9)	12,581	14,166	16,093
Transmission expense	1,481	1,067	38.8	1,998	(25.9)	5,314	6,375	7,522
Gross profit	19,786	16,419	20.5	20,307	(2.6)	65,961	91,606	105,621
Other expenses	1,928	1,695	13.7	2,102	(8.3)	7,267	7,791	8,570
Salaries and wages	1,928	1,695	13.7	2,102	(8.3)	7,267	7,791	8,570
EBITDA	17,858	14,723	21.3	18,205	(1.9)	58,694	83,815	97,051
Other income	963	751	28.3	(1,229)	(178.4)	3,761	2,138	2,497
PBDIT	18,821	15,474	21.6	16,976	10.9	62,455	85,953	99,548
Depreciation	5,456	5,819	(6.2)	3,949	38.2	19,797	25,479	29,719
Interest	4,017	4,162	(3.5)	3,319	21.0	15,432	30,149	35,795
PBT	9,348	5,493	70.2	9,709	(3.7)	27,226	30,326	34,034
Tax(including deferred tax)	2,799	885	216.2	3,271	(14.4)	5,854	6,065	6,807
PAT (reported)	6,514	4,600	41.6	5,465	19.2	20,409	24,260	27,228
Prev yr sales/write back	(284)	(210)		1,038	-	-	-	-
Forex (gains)/loss	(91)	(48)		22	-	(35)	-	-
Prior period items/tax	-	329		(611)	-	(25)	-	-
Tax adjustments	-	249		-	-	1,060	-	-
Adj PAT	6,139	4,920	24.8	6,173	(0.5)	21,409	24,260	27,228
Number of shares (mn)	4,209	4,209	-	4,209	-	4,209	4,630	4,630
EPS(INR)	1	4.7		5.9		5.1	5.2	5.9
P/E(x)	18	22.2		17.7		20.4	19.8	17.7
ROAE (%)						13.4	12.8	11.8

## as % of net revenues

COGS	7.0	6.1		9.0		7.5	6.5	6.6
Other expenses	9.1	9.7		9.4		10.2	8.0	7.6
Total expenses	16.0	15.8		18.4		17.7	14.5	14.2
Gross profit	93.0	93.9		91.0		92.5	93.5	93.4
EBITDA	84.0	84.2		81.6		82.3	85.5	85.8
Net profit	28.9	28.1		27.7		30.0	24.8	24.1
Tax rate	29.9	16.1		33.7		21.5	20.0	20.0

- **Company Description**

PGCIL commenced operations in 1992 by consolidating transmission assets of NTPC, NHPC, NEEPC, NPCIL, Tehri Hydro Development Corporation, and Neyveli Lignite. In 1994, the assets and communication systems of regional load dispatch centre (RLDC) were also transferred to the company with an objective to enhance grid management. Due to the central transmission utility status, PGCIL is mandated to undertake and operate inter-state transmission systems efficiently, provide for open access, and undertake various functions of RLDC. Recently, under the Rajiv Gandhi Grameen Vidyutikaran Yojana, PGCIL is mandated to implement the electrification of rural households in association with the Rural Electrification Corporation, SEBs, and the respective state governments.

- **Investment Theme**

**Growth visibility:** The company plans to invest INR 550 bn in the Eleventh Five Year Plan for its various transmission projects. Of these close to 60% are for strengthening the overall grid capacity and the balance 40% is generation linked. The 12<sup>th</sup> Plan target for capex is touted to be INR 1 tn with a similar mix. Hence, there is a certain visibility on the capex program and in turn earnings growth. The company has been consistently delivering 20-25% profit growth every quarter driven by its capex.

**Reversal in the current trend of capex and telecom earnings:** If the company is able to scale up internal accruals through superior earnings from telecom which would in turn invested in power business then the overall earnings growth could be significant.

- **Key Risks**

**Telecom a drag:** The company's strategy of leveraging its transmission towers also as telecom towers has not fructified so far. In addition, it seems to be a drag on earnings.

**Funding issues:** PGCIL is constrained by its limited retained earnings in undertaking significant capex programme under the 70:30 debt/equity norm. While the company could raise the threshold to 80% debt and 20% equity to meet its XI Plan target but earnings will continue to be on the actual equity deployed.

**Slow pace of capex – dependant on generation capacity growth:** Power Grid capex is dependant heavily (40-50% of total capex) on the capacity addition of its associated generation projects. Any delay in these generation assets will cascade to a delay in Power grids project execution slowing its pace of growth. Escalation in project costs, delay in commissioning of generation projects, and long gestation periods could impact profitability, if delays are not compensated through tariffs.

## Financial Statements

<b>Income statement</b>					<b>(INR mn)</b>
Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	46,148	65,798	71,275	97,981	113,143
Direct costs	3,469	4,578	5,314	6,375	7,522
Employee costs	5,190	6,439	7,267	7,791	8,570
Other expenses	2,622	0	0	0	0
Total operating expenses	11,281	11,017	12,581	14,166	16,093
EBITDA	34,867	54,781	58,694	83,815	97,051
Depreciation and amortisation	9,597	10,940	19,797	25,479	29,719
EBIT	25,271	43,841	38,897	58,337	67,332
Interest expenses	12,633	25,321	15,432	30,149	35,795
Other income	4,666	4,491	3,761	2,138	2,497
Income from provisions written back	513	704		0	0
Expenditure from provisions	1,082	(470)	(963)	0	0
Profit before tax	17,872	21,838	26,263	30,326	34,034
Provision for tax	2,821	4,932	5,854	6,065	6,807
Core profit	15,051	16,906	20,409	24,260	27,228
Extraordinary items	(568)	234	999	0	0
Profit before minority interest	14,483	17,140	21,409	24,260	27,228
Profit after minority interest	14,483	17,140	21,409	24,260	27,228
Shares outstanding	4,209	4,209	4,209	4,630	4,630
EPS (INR) basic	3.6	4.0	4.8	5.2	5.9
Diluted shares (mn)	4,209	4,209	4,209	4,630	4,630
EPS (INR) fully diluted	3.6	4.0	4.8	5.2	5.9
Dividend per share	1.0	1.2	1.2	1.3	1.5
Dividend payout (%)	35.1	35.1	29.2	29.2	29.2

### Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating expenses	24.4	16.7	17.7	14.5	14.2
Depreciation and amortization	20.8	16.6	27.8	26.0	26.3
Interest expenditure	27.4	38.5	21.7	30.8	31.6
EBITDA margins	75.6	83.3	82.3	85.5	85.8
Net profit margins	32.6	25.7	28.6	24.8	24.1

### Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	23.9	42.6	8.3	37.5	15.5
EBITDA	12.8	57.1	7.1	42.8	15.8
PBT	30.6	22.2	20.3	15.5	12.2
Net profit	34.8	12.3	20.7	18.9	12.2
EPS	34.8	12.3	20.7	8.1	12.2

**Balance sheet****(INR mn)**

As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	42,088	42,088	42,088	46,297	46,297
Reserves & surplus	91,602	104,148	117,331	174,260	195,412
Shareholders funds	133,690	146,236	159,419	220,557	241,709
Secured loans	175,521	252,883	313,458	378,854	454,600
Unsecured loans	47,114	31,772	30,710	30,710	30,710
Borrowings	222,635	284,654	344,168	409,564	485,310
Others	19,465	29,180	31,160	23,549	36,990
<b>Sources of funds</b>	<b>375,790</b>	<b>460,070</b>	<b>534,747</b>	<b>653,671</b>	<b>764,009</b>
Gross block	354,170	403,193	434,727	526,727	594,727
Depreciation	81,582	91,909	114,114	129,016	146,399
Net block	272,588	311,284	320,613	397,711	448,328
Capital work in progress	87,530	132,860	204,222	240,764	322,764
Total fixed assets	360,118	444,144	524,835	638,475	771,093
Investments	17,808	15,928	14,532	14,532	14,532
Inventories	2,189	2,976	3,449	3,979	4,367
Sundry debtors	6,329	13,736	22,149	25,554	28,042
Cash and equivalents	17,693	24,289	32,776	43,152	17,308
Loans and advances	23,143	42,129	37,935	33,332	39,242
Total current assets	49,354	83,129	96,309	106,018	88,958
Sundry creditors and others	42,581	61,234	76,346	76,346	76,346
Provisions	8,909	21,898	24,583	29,008	34,229
Total CL & provisions	51,490	83,132	100,929	105,354	110,575
Net current assets	(2,136)	(3)	(4,620)	664	(21,617)
Net deferred tax	0	0	0	0	1
<b>Uses of funds</b>	<b>375,790</b>	<b>460,070</b>	<b>534,747</b>	<b>653,671</b>	<b>764,009</b>
Book value per share (BV)(INR)	32	35	38	48	52

**Free cash flow****(INR mn)**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	14,483	17,140	21,409	24,260	27,228
Depreciation	9,597	10,940	19,797	25,479	29,719
Others	(5)	8,548	(18,169)	1,510	1,102
Gross cash flow	24,074	36,628	23,037	51,249	58,050
Less: Changes in W. C.	5,394	(4,462)	(13,105)	(5,092)	3,564
Operating cash flow	18,680	41,090	36,142	56,341	54,486
Less: Capex	57,150	94,353	102,896	128,543	150,000
<b>Free cash flow</b>	<b>(38,470)</b>	<b>(53,263)</b>	<b>(66,754)</b>	<b>(72,201)</b>	<b>(95,514)</b>

**Cash flow metrics**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	18,680	41,090	36,142	56,341	54,486
Financing cash flow	44,195	56,110	53,683	100,412	67,808
Investing cash flow	(57,150)	(91,568)	(101,034)	(126,681)	(148,138)
Net cash flow	5,725	5,633	(11,209)	30,073	(25,844)
Capex	(57,150)	(94,353)	(102,896)	(128,543)	(150,000)
Dividends paid	(4,343)	(5,051)	(4,984)	(6,065)	(6,807)

**Profitability & liquidity ratios**

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	12.4	12.1	13.4	12.8	11.8
ROACE (%)	7.7	10.9	8.1	10.1	9.7
Current ratio	1.0	1.0	1.0	1.0	0.8
Debtors (days)	44	56	92	89	86
Average fixed assets t/o (x)	0.2	0.2	0.2	0.3	0.3
Average working capital t/o (x)	(6.0)	(61.5)	(30.8)	(49.5)	(10.8)
Average capital employed t/o (x)	0.1	0.2	0.1	0.2	0.2
Debt / Equity	1.7	1.9	2.2	1.9	2.0
Debt/EBITDA	6.4	5.2	5.9	4.9	5.0
Adjusted debt/Equity	1.8	2.1	2.3	1.9	2.0

**Operating ratios**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover	0.1	0.2	0.1	0.2	0.2
Average fixed assets t/o (x)	0.2	0.2	0.2	0.3	0.3
Equity turnover	0.4	0.5	0.5	0.5	0.5

**Du pont analysis**

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	32.6	25.7	28.6	24.8	24.1
Total assets turnover	0.1	0.2	0.1	0.2	0.2
Leverage multiplier	2.9	3.0	3.3	3.1	3.1
ROAE (%)	12.4	12.1	13.4	12.8	11.8

**Valuation parameters**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	3.6	4.0	4.8	5.2	5.9
Y-o-Y growth (%)	34.8	12.3	20.7	8.1	12.2
CEPS (INR)	5.9	6.6	9.6	10.7	12.3
Diluted P/E (x)	29.1	25.9	21.4	19.8	17.7
Price/BV(x)	3.3	3.0	2.7	2.2	2.0
EV/Sales (x)	13.5	10.4	10.3	8.5	8.3
EV/EBITDA (x)	17.9	12.5	12.5	9.9	9.6
Dividend yield (%)	1.0	1.2	1.1	1.3	1.4



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Adani Enterprises	HOLD	SU	M	CESC	BUY	SO	H
GMR Infrastructure	HOLD	SP	H	GVK Power and Infra	HOLD	SO	H
Lanco Infratech	HOLD	SO	H	Marg	BUY	SO	H
Navabharat Ventures	BUY	SO	H	NTPC	HOLD	SP	L
Power Grid Corp of India	HOLD	SP	L	PTC India	BUY	SO	L
Reliance Infrastructure	BUY	SO	M	Tata Power Co	BUY	SO	M

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
Sector Underperformer (SU)	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
Underweight (UW)	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss  
Ideas create, values protect



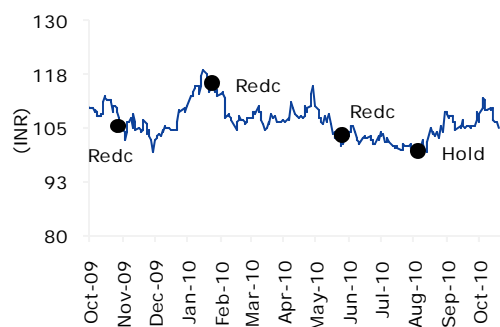
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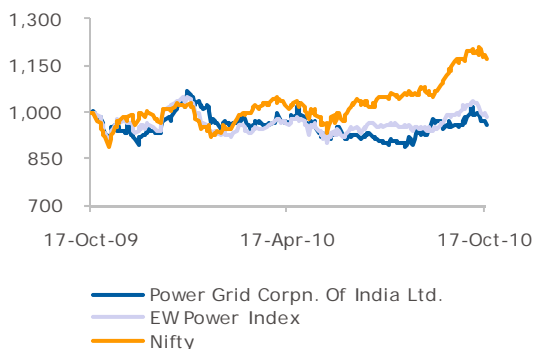
**Coverage group(s) of stocks by primary analyst(s): Power**

Adani Enterprises, CESC, GMR Infrastructure, GVK Power and Infra, Lanco Infratech, Marg, NTPC, Navabharat Ventures, PTC India, Power Grid Corp of India, Reliance Infrastructure, Tata Power Co

**Power Grid Corp of India**



**EW Indices**



**Distribution of Ratings / Market Cap**

**Edelweiss Research Coverage Universe**

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

**Recent Research**

Date	Company	Title	Price (INR)	Recos
13-Oct-10	<b>Lanco Infratech</b>	Strong project pipeline; <i>Event Update</i>	70	Hold
14-Sep-10	<b>Marg</b>	Charting a new course to script growth; <i>Initiating Coverage</i>	220	Buy
13-Sep-10	<b>Navabharat Ventures</b>	Move over commodity play to asset ownership and stable earnings; <i>Ini. Cov.</i>	393	Buy

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