PTC India – BUY

15 July 2011

Management meeting

IIFL Institutional Equities

Play on possible financial revival of SEBs

Company update

We expect 26% CAGR in PTC's core power trading volumes over FY11-13; this is lower than the management's guidance, owing to delay in project commissioning and fuel shortage, which affects power generation. We lower our FY12-13 earnings forecasts by 13-15%. At ~1x FY13ii BV, we think the stock discounts the multiple headwinds in the power sector adequately. News flow on revival of financial health of SEBs (which would improve the long-term growth outlook for the sector) is a near-term catalyst for the stock. We retain BUY.

Project delays + fuel shortage = lower growth: So far, PTC has exceeded street's expectations on volume growth, with short-term transactions and supplies from captive power plants. While these segments would continue to see double-digit growth, delays in execution and fuel shortages should impact PTC's long-term trading volumes over FY12-13ii. We build in delays of 12-15 months for large projects and lower our volume forecasts by 15-25% over FY12-13. PTC would still register 26% volume CAGR through FY11-13ii. We see no risk to its trading margins, which are already marginal.

Going slow on diversification: We like the management's cautious approach on diversification initiatives, given the heightened risks in the sector. Over the past three years, PTC has not committed any significant capital except for PTC Financial Services (PFS), a dedicated power NBFC. That said, huge cash and equivalents (Rs9.6bn, 40% of market cap) have dragged reported RoE to lower single digits.

Lower earnings forecasts, retain BUY: We cut our FY12-13 standalone EPS forecasts by 13-15% to reflect lower volume growth. We also build in flat trading margins and assume that PTC would not earn any income via surcharge in FY12-13. At CMP (netting out cash and equivalents and the value of holdings in PFS, after 25% holding co discount), PTC's trades at 3x FY12ii EBITDA; on FY12ii reported BV, it trades at 1.05x. We retain BUY on PTC, which offers a thematic play on the power-sector value chain. News flow on financial revival of SEBs bodes well for a near–term re-rating.

CMP	**Rs82**
12-mth TP (Rs)	***105 (28%)***
Market cap (US$ m)	**542**
Bloomberg	**PTCIN IN**
Sector	**Utilities**

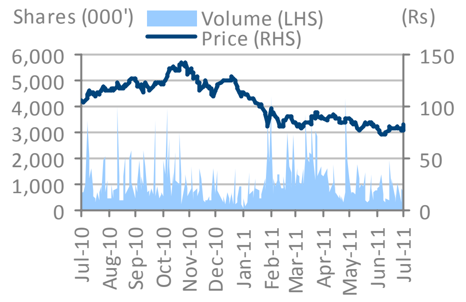
Price performance (%)

	1M	3M	1Y
PTC India	2.6	-9.8	-22.8
Rel. to Sensex	**0.9**	**-4.3**	**-26.6**

Shareholding pattern (%)

Promoters	16.3
FIIs	16.9
DIIs	46.8
Others	20.0
52Wk High/Low (Rs)	150/68
Shares o/s (m)	295
Daily volume (US$ m)	2
Dividend yield FY12ii (%)	2.8
Free float (%)	84.0

Stock performance



Financial summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11A	FY12ii	FY13ii
Revenues (Rs m)	63,624	75,696	90,756	112,682	146,694
EBITDA Margins (%)	0.6%	0.9%	1.5%	1.2%	1.3%
Pre-Exceptional PAT (Rs m)	978	989	1,346	1,359	1,857
Reported PAT (Rs m)	908	941	1,392	1,359	1,857
EPS (Rs)	4.3	3.4	4.6	4.6	6.3
Growth (%)	133.2	-21.9	35.8	1.0	36.7
IIFL vs consensus (%)				-10.9	-11.3
PER (x)	19.1	24.4	18.0	17.8	13.0
ROE (%)	5.9	4.5	6.2	5.9	7.7
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
EV/EBITDA (x)	29.9	17.2	10.6	11.5	8.7
Price/Book (x)	1.21	1.15	1.08	1.05	1.01

Source: Company, IIFL Research. Priced as on 14 July 2011

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Project delay + fuel shortage = lower near-term growth

Despite erratic power purchases from SEBs, PTC reported volume growth of 34% in FY11, which was ahead of consensus expectation. However, PTC is unlikely to surprise positively going ahead, and volume growth could be well below street estimates. But we do not expect a decline in trading volumes.

So far, PTC's volume growth has been driven by: 1) spot/short-term transactions; 2) captive power plants; and 3) power exchanges. While these three sources would continue to register healthy volume growth, we had earlier anticipated sharper growth in long-term trading contracts that PTC has entered into. However, due to delays in commissioning of projects, ramp-up in long-term contracts would be pushed back by 12-15 months, in our view.

PTC has signed power off-take contracts of 6,000MW, which are long term in nature (at least 25 years). On a back-to-back basis, it has already signed power sales contracts with SEB's aggregating 4,500MW and the rest would be signed close to projects commissioning.

Figure 1: Key projects to be commissioned over FY12-13

Project	MW	CoD
Jaypee Karcham Wangtoo HEP	704	FY12
Malana-II HEP	100	FY12
Torrent Power	100	FY12
Simhapuri tolling project	200	FY12
Meenakshi Power	160	FY12
Teesta III HEP	1056	FY13
GMR Energy	323	FY13
KVK Nilachal	500	FY13
Ind Bharat	560	FY13
RKM Powergen	700	FY13

Source: Company

Figure 1 provides details of the projects (including the date of commissioning) for which PTC has signed a PPA. We believe the new projects (particularly hydro) face a risk of delayed commissioning, although the management expects them to be on schedule and achieve full load during the monsoon season. We also expect delays in commissioning of thermal plants, for which PTC has a PPA. Moreover, the PLFs of these new units would be affected due to fuel shortages.

In addition, changes in the coal export law in Indonesia have alleviated concerns on tolling projects (360MW capacity) that are due for commissioning in FY12. While PTC has no direct investments in these projects, risk to coal contracts would imply a risk of delays in commissioning of power projects as well (which in turn would impact volumes). We believe these factors present a risk to PTC's guidance of trading 50BU in FY13.

Figure 2: 12.6GW of PPAs provide clarity over long-term volume growth

MW	Hydro	Thermal	Total
FY12	886	468	1,354
FY13	1,297	3,316	4,613
FY14	-	6,285	6,285
FY15	-	400	400
Total	**2,183**	**10,469**	**12,652**

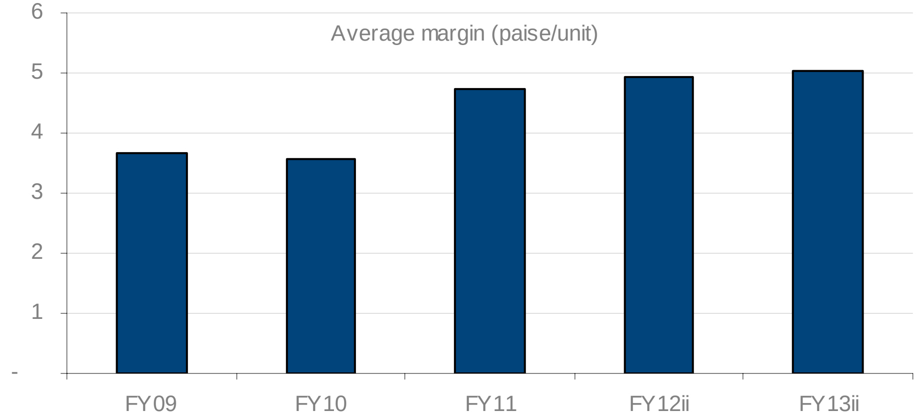
Source: Company

Tolling Projects: PTC India is developing two projects—Simhapuri (200MW) and Meenakshi (160W)—in Andhra Pradesh under power tolling arrangements. Under the tolling model, the company would supply coal to the developer for generation in return for ownership of a share of power produced. For these two projects, PTC has contracted 1.4m tonnes of Indonesian coal.

Low risk to already thin margins

In recent times, PTC has been recording much higher blended margins (figure 3). This has been driven by the surcharge imposed on delayed payments from SEBs. Stripping out the surcharge and a late payment fee charged to the state-owned discoms, PTC's margins are close to the regulated number. The management indicated that such cases are rare, and in the recent past, payments were affected by procedural issues in the states that had elections. However, recovery from such states is 100%.

Figure 3: Given the increased share of long-term trades, we see low risk to margins



Source: Company, IIFL Research

According to the revised trading margin regulation of CERC, long-term trades are out of regulatory purview, and hence, a higher share of such trades bodes well for PTC's margin expansion. In short-term transactions PTC earns 4-7paise/unit, while for a long-term trades, margins can well exceed 7paise/unit (as these are bilaterally-negotiated contracts). Thus, trading margins form a small portion of overall trades (1.5-2.5% of trade value); given the risk involved in the trade, we see limited scope for undercutting from the industry impacting the already wafer-thin margins of power trading.

PFS, now a listed entity, has ambitious plans

Through a recent IPO, PTC listed its NBFC subsidiary, PTC Financial Services (PFS). PFS raised Rs3.5bn through the IPO and post its listing, PTC holds a 60% stake in the entity. PFS is a dedicated power-sector NBFC and it has flexibility to take equity stake in a power project. Since incorporation in September 2006, the company has sanctioned loans aggregating ~Rs35bn and it disbursed ~Rs7bn.

Figure 4: List of key equity investments by PFS

Equity Investments	Capacity (MW)	Outstanding (FY11) (Rsm)	Investment Status
Indian Energy Exchange *	NA	57.7	Operational since June 2008.
			PFS currently holds 21.12% in the company after divesting its part stake in the co.
			Another portion of divestment In FY 2011-12
Ind-Barath Powergencom	189.0	556.3	The project has been commissioned. PFS has put option exercisable in August 2011.
Ind- Barath Energy (Utkal)	700.0	1,050.0	Financial closure has been achieved. All clearances have been received and project is on track to be implemented by March 2012.
Meenakshi Private Energy	900.0	1,003.4	Phase I (300MW) project is expected to be commissioned in December 2011
			Phase II (600 MW) project is on track after financial closures and expected to be commissioned in March 2013.
East Coast Energy Private Limited	1,320.0	1,250.0	After Financial Closure project was on track. Govt. order on recent environment issue is awaited. Exercise is underway for swap of shares to the holding company awaiting FIPB approval.
RS Wind Energy India	99.5	539.4	All the Machines of phase – I (41.25MW) have been commissioned.
	NA	71.8	In as subsidiary for WTG manufacturing facility
Others	10.0	57.6	
Total		4,586.2	

Source: Company, IIFL Research

PFS is targeting loan growth of 50% in FY12 and it expects to sustain this in FY13-14, although on a lower base. The company also plans to launch a power fund, which would invest in equity of smaller/mid-size power projects. Modalities of the fund are being worked out.

The management also indicated that PFS is considering booking profit in a couple of unlisted projects that are nearing completion. Exit from projects at a profit should strengthen PFS' growth visibility and arrest the underperformance of the stock since listing.

Figure 5: PFS is likely to sell its investments in profitable venture

PTC India Fin may exit Ind-Barath project

It had divested 5% in IEX last year at a premium of ₹ 108 a share

Mumbai: PTC India Financial Services, a unit of power trading firm PTC India , plans to sell its investment in a power project by Ind-Barath, besides selling part of its stake in Indian Energy Exchange (IEX) this fiscal, a top official said. Tweet

"As per contractual terms, buyback of shares by Ind-Barath in a thermal power project based in south India may take place," Ashok Haldia, director on the board of the power sector lender told Reuters in a telephonic interview on Friday.

"We invested about ₹ 55 crores in August, 2008 (in Ind-Barath project), and the exit is likely to be in August or September."

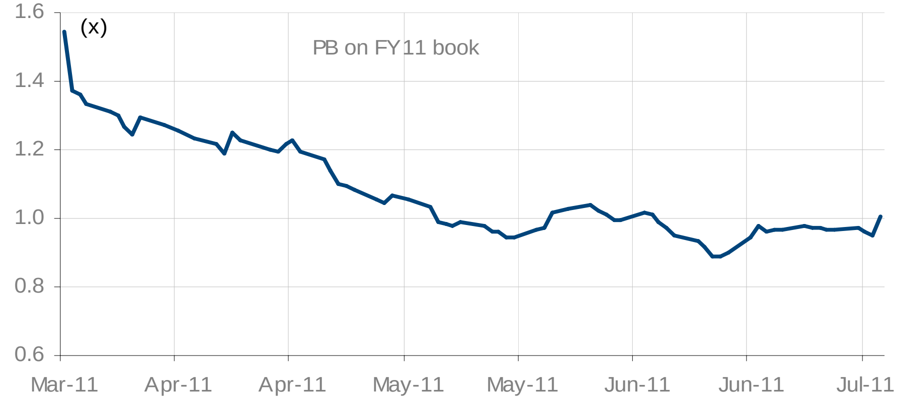
The New Delhi-based financial services firm, in which Macquarie holds 3.46 % stake and HSBC owns 3.68%, expects to earn a post-tax return of 23.75% per annum on exiting the Ind-Barath project, he added.

The firm may also divest part of its 21% holding in IEX this year, Haldia said, but declined to reveal the quantum or timing of the proposed divestment.

It had divested 5% in IEX last year at a premium of ₹ 108 a share, he said.

Source: Livemint

Figure 6: PFS valuation has contracted sharply since listing (Mar-11)



Source: Company, IIFL Research

Cautious on diversification initiatives

PTC raised Rs17bn in equity through two rounds of fund-raising (Rs12bn in FY08 and Rs5bn in FY10) to fund its diversification initiatives. Of this, it has invested Rs8bn so far in six SPVs, including Rs4.5bn in PFS.

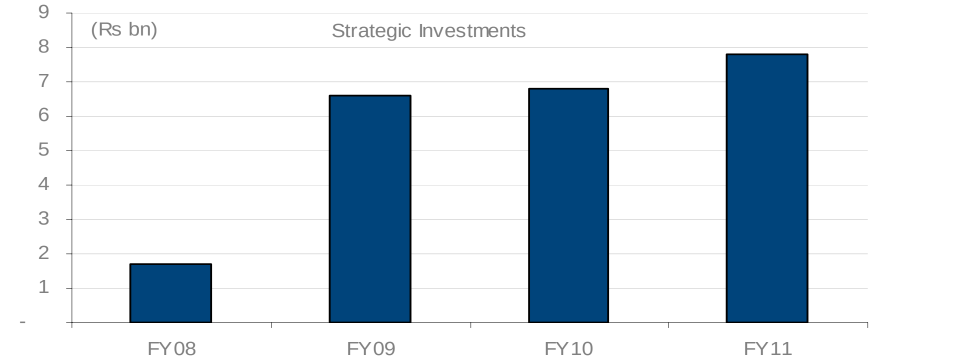
We notice that PTC appears to be going a bit slow on its diversification initiatives, as it has not stepped up investments in non-core areas for the past two years. While we like the management's cautious approach in evaluating new projects, high cash on books and low resulting yields drag down reported earnings growth and RoE.

Figure 7: PTC has invested Rs 7.8bn in various subsidiaries until date

Company	Amount approved by board (Rs m)	Investments as of end-FY11 (Rs m)
PTC Financial Services (PFS)	4,460	4,460
PTC Energy	2,000	410
Athena Energy	1,500	1,290
Teesta Urja	1,490	1,410
Krishna Godavari Power Utilities	400	195
Total	**9,850**	**7,765**

Source: Company, IIFL Research

Figure 8: PTC has been cautious in making new investments



Source: Company, IIFL Research

Reduce earnings estimates by 13-15%

We lower our earnings forecasts for PTC's core power trading business (ex-PFS) by 13-15% through FY12-13ii, to reflect delays in projects, which would impact volume growth. We cut our volume growth estimates by 17%-27% for FY12-13ii. Large treasury income (cash = ~40% of market cap) lowers the impact of fall in core income.

Valuations reflect low earnings growth, retain BUY

PTC trades at 1.1x FY12ii BV and 1x FY13ii BV. Moreover, netting out: 1) the valuation of PFS (at CMP, it trades at 1x FY11 BV; we build in holding co. discount of 25%); and 2) cash on books, PTC's core power trading business trades at 3x FY12ii EBITDA.

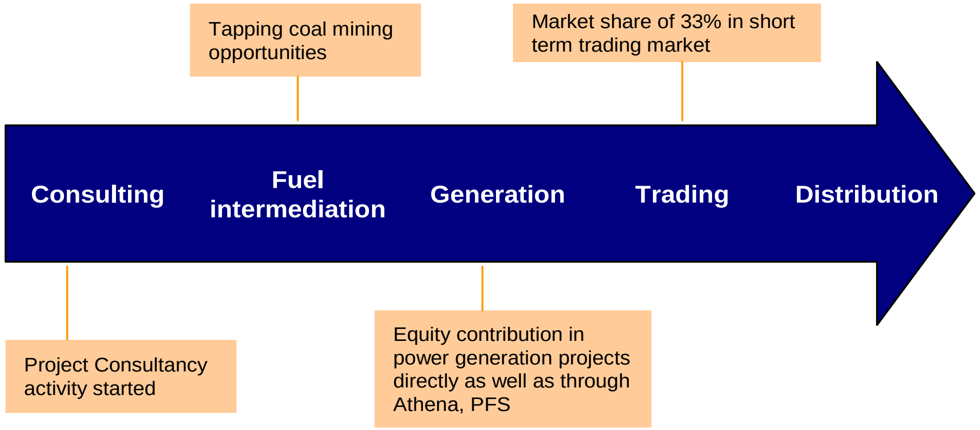
We believe the stock's recent underperformance (down 36% YTD vs 9% decline for Sensex), which was led by concerns on defaults by SEBs, has adequately de-rated it. At CMP, we think the valuations reflect lower-than-expected trading volumes and earnings adequately; though defaults by SEBs are not priced in. We assign a very low probability to this event. Any news flow on revival of SEBs, which improves the long-term prospects of the sector, would re-rate the stock in the near term. We think the risk-reward is favourable. We retain BUY.

Figure 9: SOTP valuation

Description	Rs mn	$mn	Rs/shr	Comment
Core Business	11,000	239	37	8x FY12 EBITDA
PFS Valuation @ CMP (60% holding)	4,590	100	16	25% holding co discount
Theesta Urja	2,250	49	8	
KG Power	1,000	22	3	
Athena	300	7	1	
SPV	20	0	0	
PTC Energy	2,000	43	7	
Liquid Investments	9,628	209	33	
Fair Value	30,788	669	105	

Source: IIFL Research

Figure 10:PTC offers a thematic play on the overall power sector



Source: Company, IIFL Research

Assumptions

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Trading volumes (MU)	13,825	18,236	24,481	30,071	38,615
Trading Margins (paise/unit)	3.7	3.6	4.7	4.9	5.0

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue	63,624	75,696	90,756	112,682	146,694
EBITDA	369	713	1,368	1,375	1,834
EBIT	**306**	**658**	**1,318**	**1,322**	**1,780**
Interest income	933	722	615	630	707
Interest expense	36	13	11	11	11
Exceptional items	-70	-48	46	0	0
Profit before tax	**1,204**	**1,366**	**1,922**	**1,941**	**2,476**
Taxes	226	377	576	582	619
Net profit	**908**	**941**	**1,392**	**1,359**	**1,857**

Cash flow summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Profit before tax	1,204	1,366	1,922	1,941	2,476
Depr. & amortization	62	55	50	53	54
Tax paid	182	382	592	582	619
Working capital Δ	-939	-1,188	-2,690	-1,956	-1,077
Operating cashflow	145	-148	-1,309	-544	834
Capital expenditure	6	5	5	10	10
Free cash flow	**139**	**-154**	**-1,314**	**-554**	**824**
Equity raised	118	5,063	638	0	0
Investments	5,290	-766	-1,767	-500	-500
Dividends paid	413	412	684	691	944
Other items	-113	-43	61	0	0
Net change in cash	**5,020**	**3,688**	**-3,066**	**-1,745**	**-620**

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Cash & equivalents	6,256	9,944	6,878	5,132	4,512
Sundry debtors	3,546	5,310	10,439	13,107	17,030
Other current assets	194	512	330	415	539
Fixed assets	**475**	**426**	**380**	**337**	**293**
Other term assets	7,994	8,760	10,527	11,027	11,527
Total assets	**18,465**	**24,952**	**28,554**	**30,018**	**33,901**
Sundry creditors	2,562	3,466	6,123	6,919	9,890
Other current liabs	442	434	33	33	33
Net worth	**15,460**	**21,052**	**22,397**	**23,065**	**23,978**
Total liabs & equity	**18,465**	**24,952**	**28,554**	**30,018**	**33,901**

Ratio analysis

Y/e 31 Mar	FY09A	FY10A	FY11ii	FY12ii	FY13ii
Revenue growth (%)	67.9	19.0	19.9	24.2	30.2
Op Ebitda growth (%)	75.2	93.4	91.9	0.5	33.4
Op Ebit growth (%)	54.9	114.6	100.4	0.3	34.7
Op Ebitda margin (%)	0.6	0.9	1.5	1.2	1.3
Op Ebit margin (%)	0.5	0.9	1.5	1.2	1.2
Net profit margin (%)	1.5	1.3	1.5	1.2	1.3
Dividend payout (%)	42.2%	41.7%	50.9%	50.9%	50.9%
Tax rate (%)	18.8%	27.6%	30.0%	30.0%	25.0%
Net debt/equity (%)	-40.5	-47.2	-30.7	-22.3	-18.8
Return on equity (%)	5.9	4.5	6.2	5.9	7.7
Return on assets (%)	5.3	4.0	4.7	4.5	5.5

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.
