Power Finance Corporation - BUY

CMP Rs235, Target Rs299

Sector: NBFC	
Sensex:	16,192
CMP (Rs):	235
Target price (Rs):	299
Upside (%):	27.3
52 Week h/l (Rs):	285 / 125
Market cap (Rscr) :	26,978
6m Avg vol ('000Nos):	800
No of o/s shares (mn):	1,148
FV (Rs):	10
Bloomberg code:	POWF IB
Reuters code:	PWFC.BO
BSE code:	532810
NSE code:	PFC

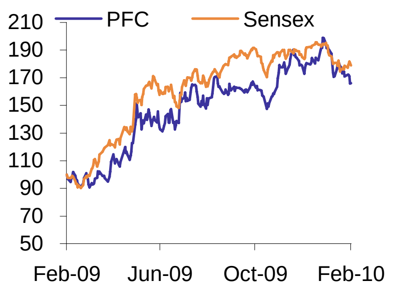
Prices as on 19 Feb, 2010

Shareholding pattern	
December '09	**(%)**
Promoters	89.8
Institutions	7.1
Non promoter corp hold	1.4
Public & others	1.7

Performance rel. to sensex

(%)	1m	3m	1yr
PFC	(4.9)	(2.9)	(8.9)
REC	(11.8)	(3.5)	101.2
IDFC	1.6	(8.6)	97.4
SREI	(20.6)	(12.9)	1.9

Share price trend



Power Finance Corporation (PFC) with prominent market share (20%+) in power financing business is expected to be the key beneficiary of the hefty capex plan as articulated in the XIth Five Year Plan. The company has witnessed robust 32% CAGR in sanctions over FY05-FY09. With an improving investment appetite, we expect PFC to capitalise on the growth opportunity. Predominant exposure towards generation segment, increasing proportion of disbursement towards private sector and near zero levels of NPA would drive a sturdy 21% CAGR in balance sheet and 22% CAGR in loan book over FY09-11E. Recommend BUY.

Impetus towards power generation

The XIth Five Year Plan has articulated for a capacity addition of 78,700MW entailing capital investment of Rs10.3tn over the plan period. Investment towards generation segment is pegged at Rs4.1tn. PFC has a predominant towards generation segment at 84% of its loan book, 86% of which is state and central government entities. High generation exposure translates into a huge growth opportunity for the company.

Interest spreads to narrow down in coming period

The benign interest rate regime in the past one year enabled PFC to report 50bps yoy improvement in spreads during Q3 FY10. With rising interest rates, PFC, being 100% wholesale funded, is likely to witness moderation in interest spreads in coming period. The high sovereign rating, however, is likely to enable the company to borrow at competitive rates thereby maintaining healthy NIM. Further, the Navratna accredited PFC is also a nodal agency for various government schemes, which acts as a solid source of fee income.

Valuation points towards re-rating

The stock has underperformed its peers and Bankex in the past 1-3 months. With pick-up in power financing activity from revival in private and public investments, we expect material re-rating in PFC's valuations over next 1-year. The stock has historically traded in a broad range of 1.4x-2.6x 1-yr fwd BV. With improving return ratios (RoE and RoA), we expect valuations to attain a higher range. We assign a FY12 P/BV multiple of 1.8x and arrive at 1-year price target of Rs299. Recommend BUY.

Valuation summary

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Total operating income	24,943	30,490	36,632	45,992
yoy growth (%)	28.2	22.2	20.1	25.5
Operating profit (pre-provision)	19,927	26,534	31,884	40,086
Net profit	19,700	21,057	24,802	31,015
yoy growth (%)	63.2	6.9	17.8	25.1
EPS (Rs)	17.2	18.3	21.6	27.0
BVPS (Rs)	100.3	117.9	139.2	166.2
P/E (x)	13.7	12.8	10.9	8.7
P/BV (x)	2.3	2.0	1.7	1.4
ROE (%)	18.9	16.8	16.8	17.7
ROA (%)	3.2	2.8	2.7	2.8
Dividend yield (%)	1.7	1.9	2.1	2.6

Source: Company, India Infoline Research

Rich presence in power financing business

Dominant market share at 20%+

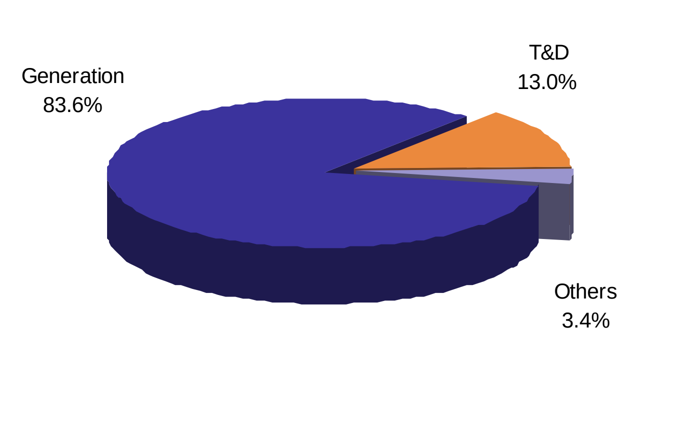
84% loan book is towards generation segment

86% of exposure is towards government entities (Central and state)

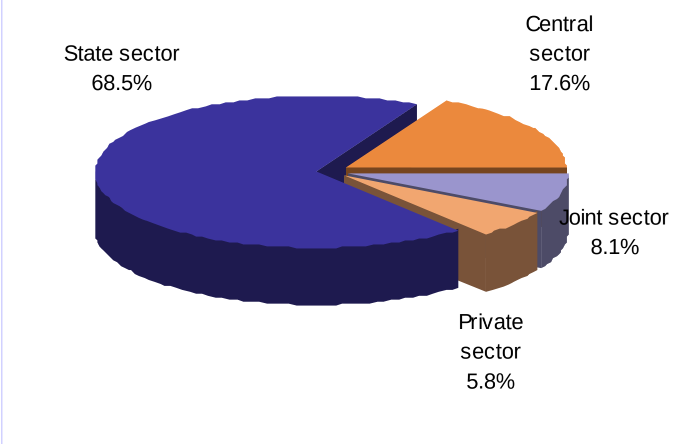
Rich presence with dominant market share at 20%+

Power Finance Corporation (PFC) has gained rich presence in power financing business over last 20 years. With dominant market share of ~20%+, we expect the company to be one of the key beneficiaries of the huge capex plan articulated in the XIth Five Year Plan. The plan envisages for energy capacity addition at 78,700MW with a total investment of Rs10.3tn. Of this, investment towards generation segment is pegged at Rs4.1tn. PFC, predominantly has a huge exposure towards generation segment. Over 84% of its loan book is towards the generation segment with 86% exposure towards state and central government. While exposure towards private sector has remained low at 6%, with huge sanctions in place particularly towards the private sector, we expect gradual shift in loan portfolio.

Large exposure towards generation segment



... and towards government entities



Source: Company, India Infoline Research

32% CAGR in sanctions over FY05-09

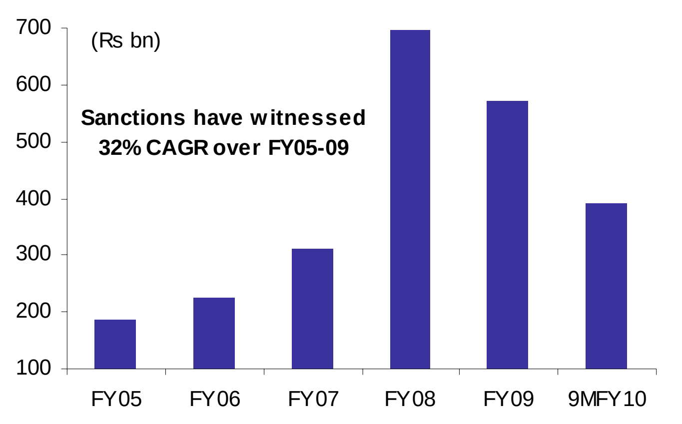
Disbursements reported 22% CAGR

Loan book to witness 22% CAGR over FY09-11E

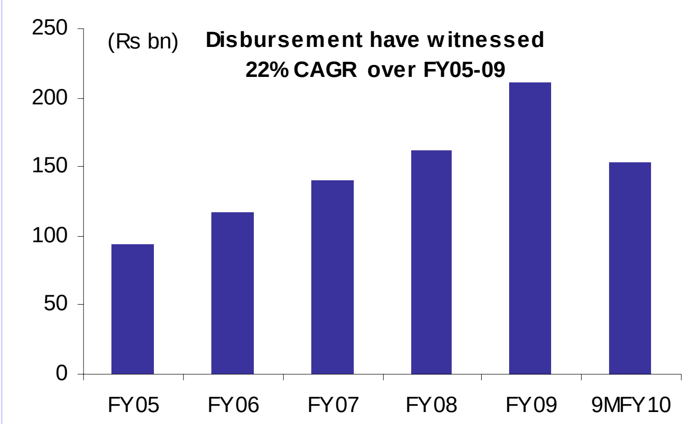
Sanctions have remained healthy

PFC has witnessed strong 32.4% CAGR in sanctions over FY05-09. This is relatively higher as compared with 22.3% CAGR in disbursements during the said period. With impetus given towards energy generation and huge capex plans as articulated in the XIth Five Year Plan, we expect the company to capitalise on this growth opportunity. Further with pre-dominant exposure towards generation segment (XIth Five Year Plan has envisaged a capex plan of Rs4.1tn), we expect 22% CAGR in loan book over FY09-11E.

Trend in sanctions



... and in disbursements



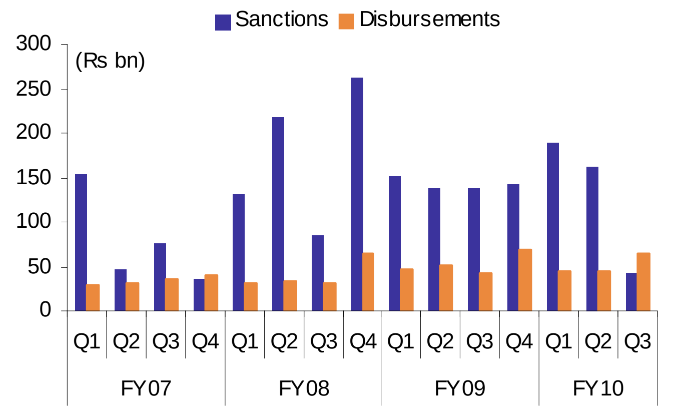
Source: Company, India Infoline Research

... disbursements, however yet to gather pace

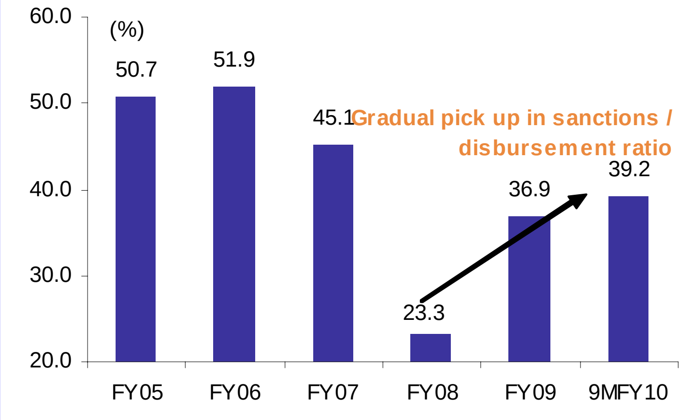
Expect gradual pick-up in disbursements

As against a cumulative sanction of Rs2.3tn over FY05-9m FY10, disbursements, however, have remained low at R878bn or 36% of the cumulative sanctions. While global downturn during 2008-09 resulted in significant moderation in disbursements, with improving economic environment, we expect gradual pick-up in coming period.

Incremental sanctions and disbursements



Trend in sanctions/disbursements ratio



Source: Company, India Infoline Research

Increasing concentration towards private sector

Sanctions towards private sector has increased to 28% as at 9m FY10

Over the past few quarters, PFC has started increasing its exposure towards private sector. With strong emergence of private investment across the value chain, especially generation segment, we expect the company to benefit in the coming period. As against mere 9% of loans sanctions towards private sector as at Q1 FY08, the exposure to this segment has gradually increased to 28% as at 9m FY10.

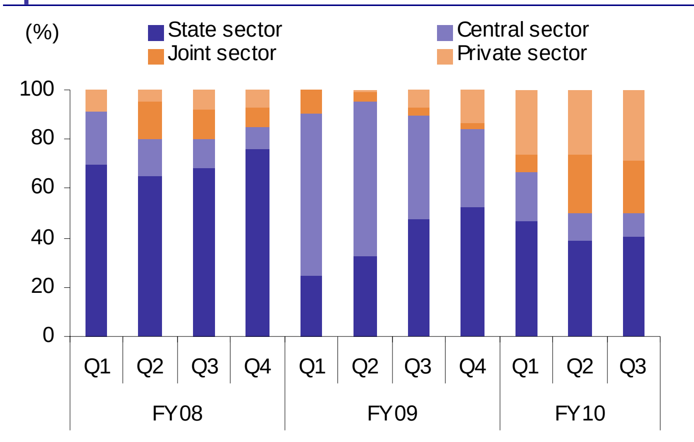
.... Has in-turn helped maintain healthy Spreads

The increasing proportion of lending towards private sector has enabled PFC to lend at higher rate as compared with lending towards government sector. This in turn has enabled the company to maintain healthy spreads irrespective of divergent movement in cost-of-funds.

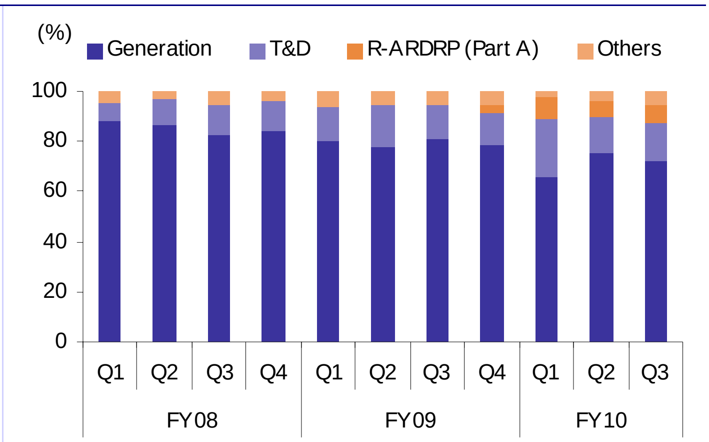
Sanctions towards generation segment have declined to 72% of total

While the company was pre-dominantly engaged in lending towards generation segment, the share of sanctions towards this segment has declined to 72% as against 88% as at Q1 FY08. This however is relatively higher as compared with 61% in case of REC. (H1 FY10).

Increasing exposure towards private sector



albeit declining share in generation segment



Source: Company, India Infoline Research

Disbursements, albeit have remained concentrated towards government entities

Disbursements towards private sector have remained muted

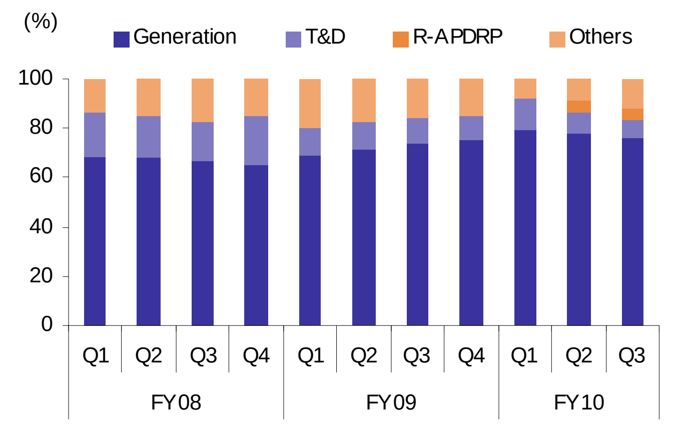
While disbursements have remained low over the past few quarters, with improving risk-appetite we expect disbursements to gradually pick-up in coming period. Lending towards private sector which had attained the peak of 9% as at Q1 FY08 has moderated to ~4% levels as at 9m-FY10. We expect huge disbursements towards private sector (especially towards UMPP) in coming period with uptick in capex plans.

According to the MoU between PFC and the Government of India, it has targeted for a disbursement of Rs230bn in FY10. Of this, PFC has already disbursed Rs154bn of loans until 9M FY10. We expect the company to meet its targeted plan.

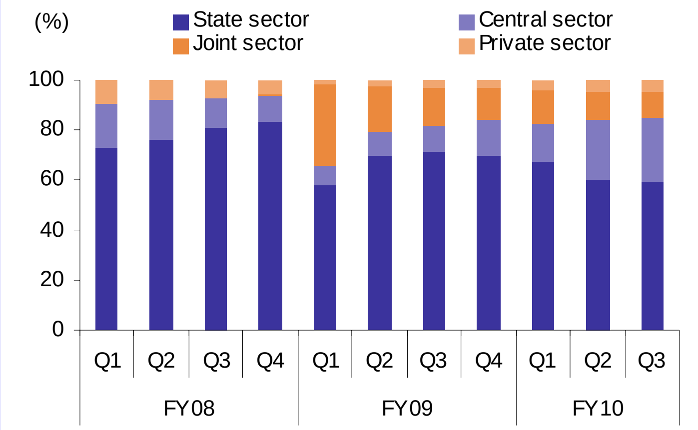
Lending to generation segment constituted 76% of total loans

Lending to generation segment constituted 76% of total loans disbursed as at 9m FY10.

Disbursement skewed towards generation segment



Private sector investment yet to gather pace



Source: Company, India Infoline Research

Prudent lending and exposure norms

Provisioning norms prohibit exposure upto 80% of project cost for government project

...and upto 50% for private project

PFC has been following prudent exposure norms. Lending towards government backed projects is restricted upto 80% of project cost. In case of private sector this is tad lower at 50% of project cost. Further, the internal norms enable it to take exposure upto 100% of its networth towards government entities and upto 150% of its networth by a special board approval. In case of private sector, exposure is restricted at 15% of networth for a single company and 25% for the group.

High sovereign rating enable borrow at competitive rates

Domestic bonds constitute over 73% of total borrowings

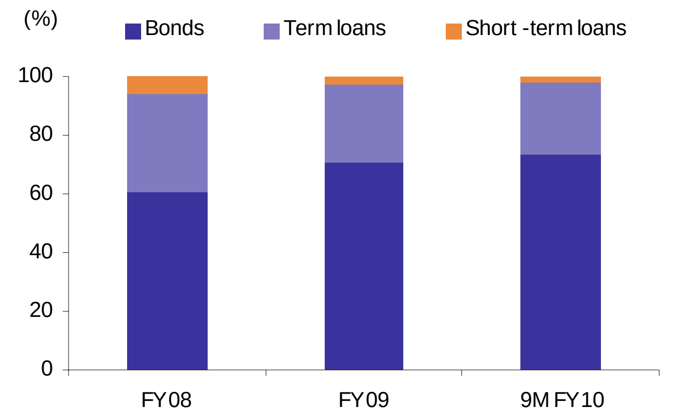
Foreign currency borrowings constitute mere 5% of total borrowings

… 52% of which is hedged

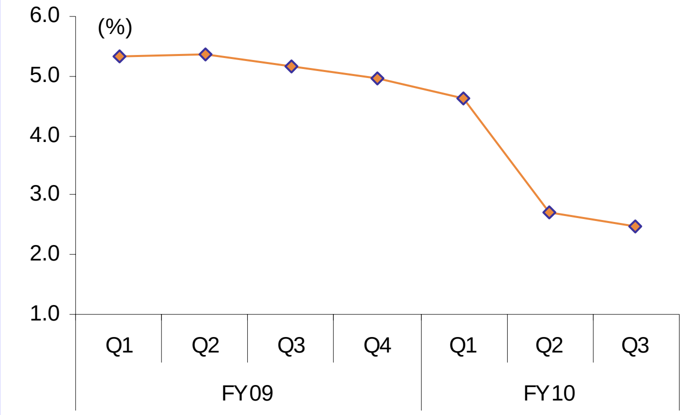
Funding largely through bonds

Unlike REC, which is permitted to raise funds through issue of tax-free window (issue of 54EC bonds), PFC traditionally has being resorting to raising funds via bond issuance and term loans including short term loans. Despite tight liquidity conditions, the company raised over Rs215bn of bonds during FY09. Over the years, borrowings through domestic bonds window have increased from 61% as at FY08 to 73% (9mFY10). The high sovereign ratings have enabled PFC to issue bonds at relatively lower rates. Foreign currency borrowings constituted mere 5% (2.5% as at 9m FY10) of total borrowings. With over 52% of the book being hedged, (plain vanilla forward rate agreement), over 48% of the book is exposed to currency risk. PFC plans to raise US$300m in Q4 FY10. Further, line of credit with Asian Development Bank, KfW and MoU with EX-IM bank of United States act as a major source of fund.

Borrowings largely via domestic bonds



Foreign currency borrowing minimal at 5%

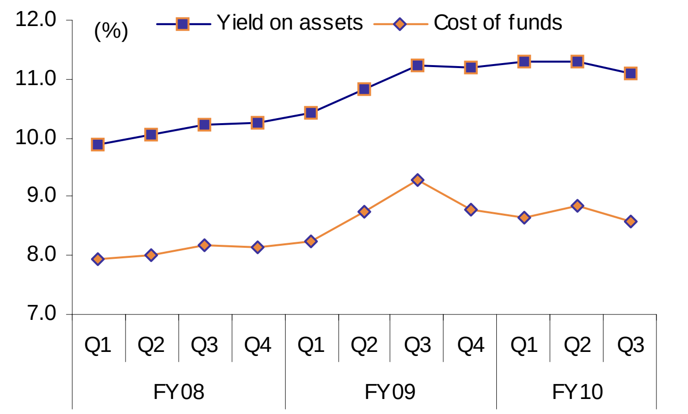


Source: Company, India Infoline Research

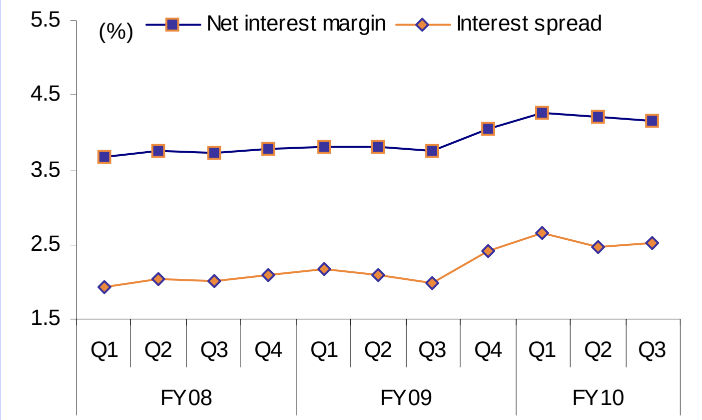
… will impact interest spreads in coming period

The current benign interest rate regime enabled PFC to report 50bps YoY improvement in spreads during Q3 FY10. Being 100% wholesale funded with rising interest scenario, PFC is likely to witness moderation in interest spreads in coming period. We expect spreads to widen by 23bps to 2.35% during FY10E and gradually decline by 20-25bps over FY10-12E.NIMs too are expected to remain in a narrow range of 3.9-4.0% levels over FY10-12E. ALM mismatch has remained favorable with over 77% of the liability being fixed in nature as against 87% of the asset which have a periodic reset clause of 3-10 years.

Trend in yield on assets and cost of funds



… spreads to widen during FY10E



Source: Company, India Infoline Research

Asset quality remains the best amongst the sector

86% of loan book is towards government entities

Recovery rate has remained high at 96-98% for last 10-year

PFC has been able to content its NPA at zero levels. This is condemnable given significant exposure towards SEBs/SPUs (86% of loan book is towards state and central government). A host of measures viz escrow mechanism, primary security have enabled the company to maintain healthy asset quality. The recovery rate has remained at elevated levels of 96-98% for the past 10 years.

Provisioning norms too have remained stringent. Being NBFC, PFC is exempt from RBI prudential norms for NPA recognition. The internal norms however consider 180-days for recognizing NPA. Also, NPA are recognized on a loan wise basis for state entities as against the standard norm of identifying NPA borrower-wise. We expect minimal accretion to NPL in coming period.

… returns ratios, however, have witnessed wild swings

Net profit (excluding extra-ordinary item grew 23% yoy)

Expect 14% CAGR in net profit over FY09-11E

RoE to remain at steady levels of 17-18%

PFC reported healthy 63% yoy growth in its net profit during FY09. However, excluding extra-ordinary item towards reversal of earlier year's deferred tax liability of Rs4.8bn, net profit grew by 23% yoy. While we expect PFC to report modest 7% yoy growth in its net profit during FY10E (due to high base effect of FY09), the net profit is set to witness 14% CAGR over FY09-11E. RoE has remained in the wide range of 14-19% during FY07-09. Going forward, with adequate capital, visible growth and near zero NPA, we expect RoE to remain at steady levels of 17-18% over FY10-12E. RoA is expected to remain at 2.8% levels on back of 21% CAGR in total assets.

Adequate capital for a brisk growth

Minimum CAR at 12%

Strong GoI holding provides adequate cushion towards additional capital

According to RBI regulations, PFC (and also REC) is required to maintain minimum capital adequacy at 12%. PFC, however, is well capitalised with CAR at 17.6% (9m FY10). Post equity dilution in February 2007, PFC has been resorting to traditional source of funding viz borrowings (via bonds, term loans) for capital requirement. Further, the planned capital infusion of US$300m is likely to support balance growth in coming period. The strong GoI holding at 90% provide adequate cushion towards additional capital.

Nodal agency for host of government schemes

Nodal agency for implementation of UMPP project

With a view to meet the targeted capacity addition and bridge the power deficit, the GoI has initiated the concept of Ultra Mega Power projects (UMPP). It has appointed PFC as the nodal agency for the implementation of the project and has targeted for a capacity addition of 4,000MW for each UMPP. Accordingly, PFC incorporated 11 wholly owned subsidiaries, of which 9 were to facilitate the development and construction of large capacity power projects based on international competitive bidding. Further, two subsidiaries were formed for the development of large transmission projects.

Located 14UMPP's

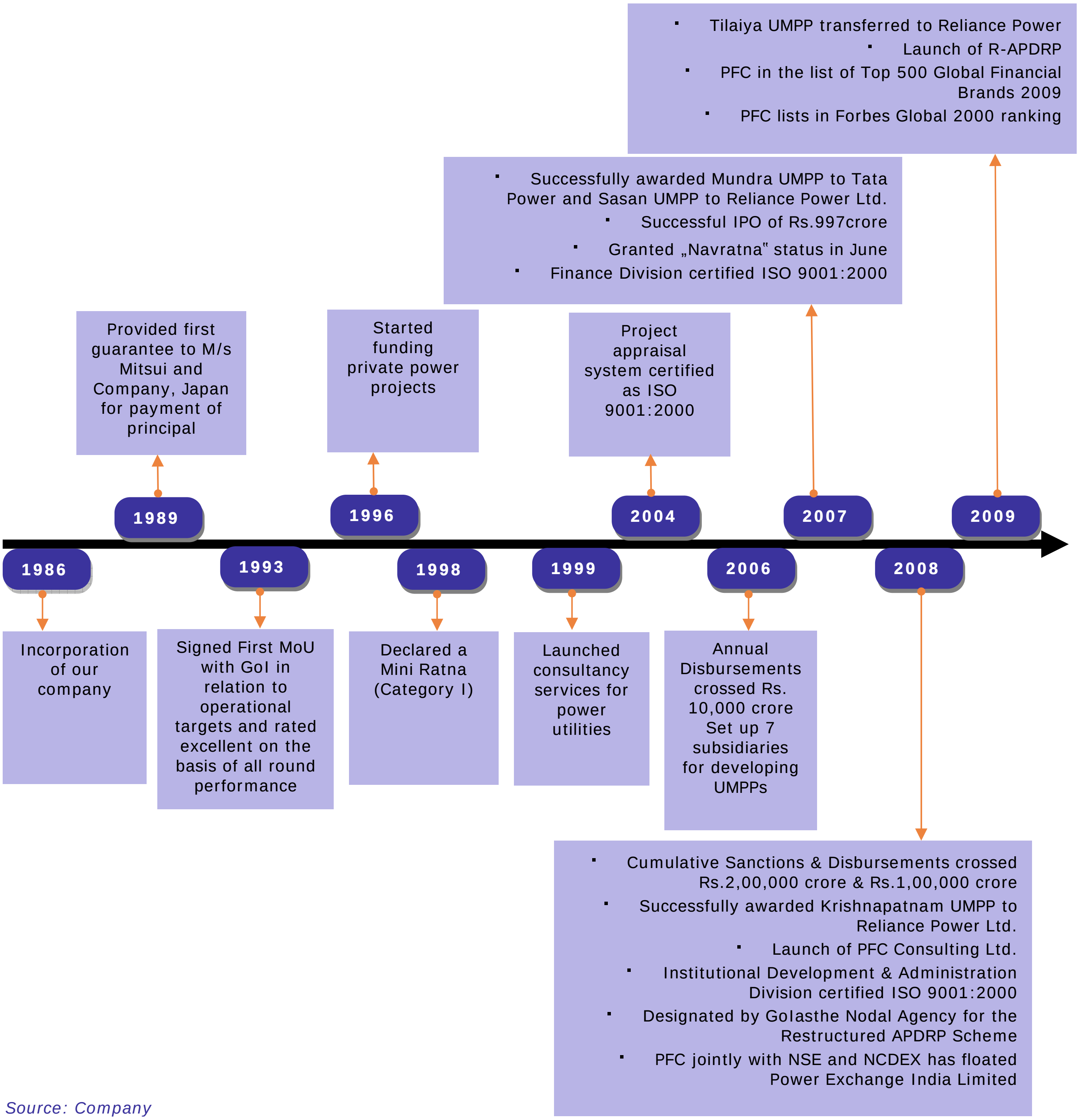
PFC has located 14 such UMPPs – Sasan, (Madhya Pradesh) Mundra (Gujarat), Akaltara (Chhattisgarh), Munge (Karnataka/Maharashtra) Krishnapatnam (Andhra Pradesh), Tilaiya (Jharkhand), Cheyyur (Tamil Nadu), Bedabahal (Orissa), 2 additional UMPPs in Orissa, 2nd UMPPs in Andhra Pradesh, Tamil Nadu and Gujarat.

PFC has already handed letter of intent for 4 UMPP's and further three more are expected to be transferred in another 6-months. The fee income generated through this business will be booked in wholly-owned subsidiary, PFC consulting, set up in March 2008 to promote, organize and carry on consultancy in power sector.

Nodal agency for R-APDRP in addition to existing to APDRP and RGGVY

PFC has also been appointed as a nodal agency for implementation of R-APDRP scheme in addition to existing APDPR scheme, RGGVY scheme (in consortium with REC). The R-APDRP scheme introduced in 11th Five Year Plan has placed focuses on actual, demonstrable performance in terms of sustained loss reduction.

Key achievements



Source: Company

New business ventures…

Plans to foray into new business ventures

With huge equity funding requirement, PFC plans to foray into equity financing business of power projects. It also intends to provide equity syndication services and further expands its business-mix in the areas of financing of development/expansion of fuel supply sources and its distribution and equipment manufacturing.

Valuation points towards re-rating

Improving risk-appetite to prove beneficial

22% CAGR in loan over FY09-11E

With improving risk-appetite, we expect PFC to capitalise on the growth opportunity. The impetus given towards energy generation and huge capex plan embarked in XIth Five Year Plan is likely to prove beneficial for PFC which has a dominant market share in power financing business. We expect the company to witness sturdy 22% CAGR in loan book over FY09-11E.

21% CAGR in balance sheet over FY09-11E

Hefty 32% CAGR in sanctions over FY05-FY09 provides strong growth visibility in coming years. With dominant exposure towards generation segment, increasing proportion of disbursement towards private sector, zero levels of NPA, we expect PFC to report 21% CAGR in balance sheet over FY09-11E.

Interest spreads to narrow down to 2.2-2.3% over FY10-12E.

High sovereign rating to enable borrow at competitive rate

While interest spreads grew 50bps yoy (Q3 FY10), with rising interest rates in coming period, spreads are likely to narrow down to 2.2-2.35% over FY10-12E. The high sovereign ratings, however is likely to enable PFC to borrow at a relatively competitive rate thereby maintaining healthy NIM.

Nodal agency for various government schemes

Further, the Navratna accredited PFC is also a nodal agency for various government schemes, thereby acting as solid source of fee income in coming period.

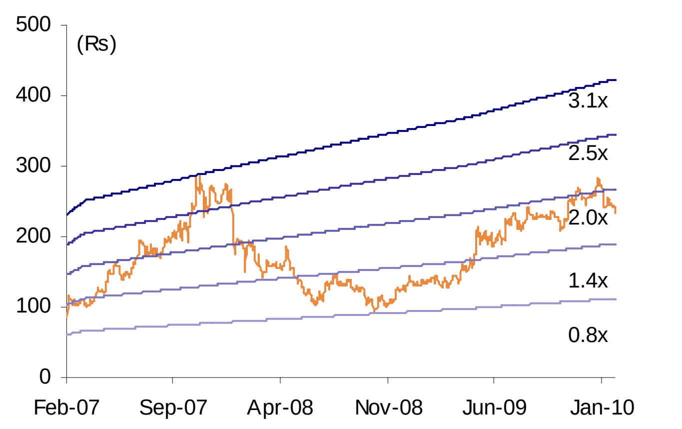
The stock has under-performed its peers and Bankex in the past 1-3 months. We expect significant re-rating in next 1-year with pick-up in power financing activity and private investment capex.

Traded in a broad range of 1.4x-2.6x 1-year forward BV.

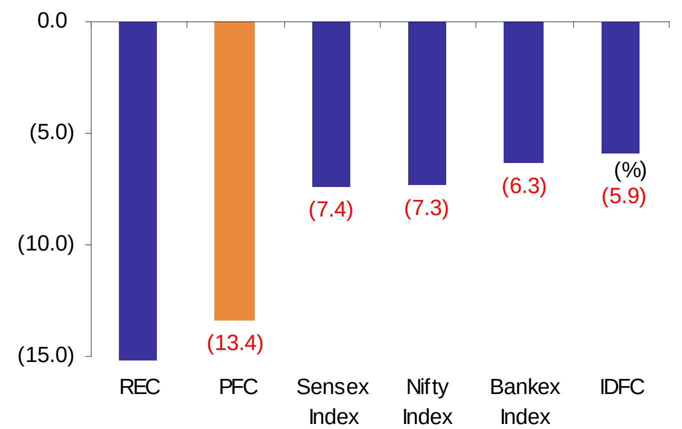
Assign 1.8x FY12P/B.

The stock has historically traded in a broad range of 1.4x-2.6x 1-yr fwd BV. With improving returns ratios (RoE and RoA), we expect the valuations to re-rate. We assign a FY12 P/BV multiple of 1.8x and arrive at a price target of Rs299. Recommend BUY.

1-year forward PB



PFC vis-à-vis peers... 1month performance



Source: Bloomberg, Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Interest inc	63,388	77,250	95,252	119,718
Interest exp	(40,893)	(49,057)	(61,576)	(77,530)
Net int inc	**22,495**	**28,193**	**33,676**	**42,188**
Non-int inc	2,448	2,297	2,957	3,804
Total op inc	**24,943**	**30,490**	**36,632**	**45,992**
Total op exp.	(5,016)	(3,956)	(4,749)	(5,905)
Op profit (pre-prov)	**19,927**	**26,534**	**31,884**	**40,086**
Total prov.	(29)	(213)	(87)	(324)
Profit before tax	**19,898**	**26,322**	**31,797**	**39,763**
Taxes	(198)	(5,264)	(6,995)	(8,748)
Net profit	**19,700**	**21,057**	**24,802**	**31,015**

Balance sheet

Y/e 31 Mar (Rs m)	FY09	FY10E	FY11E	FY12E
Total cash & equ.	3,922	3,751	3,528	2,825
Investments	359	394	446	513
Loan assets	644,290	773,148	958,703	1,198,379
Int-earn. assets	**648,571**	**777,293**	**962,677**	**1,201,717**
Fixed assets	752	796	861	932
Other assets	32,765	36,710	34,103	34,480
Total assets	**682,088**	**814,799**	**997,642**	**1,237,128**
Net worth	**115,080**	**135,357**	**159,804**	**190,714**
Sec. borrow. (bonds)	354,792	425,626	527,627	664,649
Unsec. borrow.	166,810	200,312	245,893	304,088
Int-bear liabs	**521,602**	**625,938**	**773,520**	**968,737**
Non-int-bear liabs	45,406	53,504	64,319	77,677
Total liabilities	**567,007**	**679,442**	**837,838**	**1,046,414**
Equity + Total liabi.	**682,088**	**814,799**	**997,642**	**1,237,128**

Key ratios

Y/e 31 Mar	FY09	FY10E	FY11E	FY12E
Growth matrix (%)				
Net interest income	32.2	25.3	19.4	25.3
Total op income	28.2	22.2	20.1	25.5
Op profit (pre-prov)	10.8	33.2	20.2	25.7
Net profit	63.2	6.9	17.8	25.1
Loan assets	24.9	20.0	24.0	25.0
Borrowings	28.3	20.0	23.6	25.2
Total assets	24.7	19.5	22.4	24.0
Profitability Ratios (%)				
NIM	3.9	4.0	3.9	3.9
Non-int inc/Total inc	9.8	7.5	8.1	8.3
Return on Avg Equity	18.9	16.8	16.8	17.7
Return on Avg Assets	3.2	2.8	2.7	2.8
Per share ratios (Rs)				
EPS	17.2	18.3	21.6	27.0
BVPS	100.3	117.9	139.2	166.2
DPS	4.0	4.5	5.0	6.0
Other key ratios (%)				
Credit/Borrowings	114.3	120.1	119.4	118.1
Cost/Income	6.0	5.2	4.7	4.2
CAR	13.3	16.8	15.0	13.8
Gross NPLs/Loans	0.02	0.04	0.04	0.06
Net NPLs/Net loans	0.01	0.00	0.00	0.00

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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