

POWER GRID CORP. OF INDIA



Higher RoEs, efficiency gains offset capex slippage

- PAT in line aided by telecom and other segments, despite lag in capex**
 Power Grid Corporation of India's (PGCIL) full year earnings grew 26%, despite commissioning of projects worth only INR 36 bn in FY10 (versus estimated INR 65 bn), driven by:
 - Higher income generated through short-term open access
 - The telecom division showing a full year PBT of INR 69 mn (profits for the first time) versus last year's losses of INR 321 mn, aided by inter-segmental transfer 43% Y-o-Y rise in consultancy division profits, while the load dispatch centers recorded profit growth of 350% Y-o-Y.
- Capex target of INR 125 bn for FY11**
 Despite paucity of cash, PGCIL incurred a capex of INR 105 bn in FY10, which we believe was funded on ~80:20 debt:equity basis. Further, the company is targeting FY11 capex of INR 125 bn and commission projects worth INR 70 bn.
- Equity dilution likely in FY11**
 PGCIL has been funding its capex with lower equity compared with the normative 30% level. Hence, given the current debt/equity of 2.2x and limited cash balance, the company is looking at raising INR 35-40 bn in FY11 (also part of GoI's disinvestment target), which should be adequate to fund its capex programme in FY11 and FY12.
- Outlook and valuations: Limited earnings growth; maintain 'REDUCE'**
 With ~INR 250 bn of capex achieved so far, ~80% of the targeted INR 550 bn capex target for the Eleventh Plan seems possible provided the company raises equity in FY11. While earnings growth is contingent on equity dilution and the telecom business is yet to scale up, we find the stock expensive at CMP of INR 103 (at 2.5x FY11E and 2.2x, FY12E BV). We maintain '**REDUCE**' on the stock given its rich valuation and rate it '**Sector Underperformer**' on relative returns.

May 26, 2010

Reuters: PGRD.BO Bloomberg: PWGR IN

EDELWEISS 4D RATINGS

Absolute Rating	REDUCE
Rating Relative to Sector	Underperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

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

MARKET DATA

CMP	:	INR 103
52-week range (INR)	:	129 / 95
Share in issue (mn)	:	4,208.8
M cap (INR bn/USD mn)	:	434 / 9,159
Avg. Daily Vol. BSE/NSE ('000)	:	3,706.0

SHARE HOLDING PATTERN (%)

Promoters*	:	86.4
MFs, FIs & Banks	:	5.6
FIIIs	:	1.5
Others	:	6.5
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Power Index
1 month	(8.0)	(9.4)	(7.6)
3 months	(5.2)	(1.1)	(2.2)
12 months	(12.8)	13.4	(9.4)

Financials (Standalone)

Year to March	Q410	Q409	% Change	Q310	% Change	FY10	FY11E
Revenues (INR mn)	22,305	23,167	(3.7)	15,254	46.2	71,275	91,607
Total expen. (INR mn)	4,100	6,101	(32.8)	2,787	47.1	12,581	14,166
EBITDA (INR mn)	18,205	19,254	(5.4)	12,467	46.0	58,694	77,441
Net profit (INR mn)	7,047	5,554	26.9	4,496	56.8	21,674	20,737
EBITDA margins (%)	81.6	83.1		81.7		82.3	84.5
NPM (%)	31.6	24.0		29.5		30.4	22.6
Diluted EPS (INR)						5.1	4.9
Diluted P/E (x)						20.3	20.9
ROAE (%)						14.0	12.4

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Financial snapshot (Standalone)

(INR mn)

Year to March	Q410	Q409	% Change	Q310	% Change	FY10	FY11E	FY12E
Total operating income	22,305	23,167	(3.7)	15,254	46.2	71,275	91,607	104,760
Total expenses	4,100	6,101	(32.8)	2,787	47.1	12,581	14,166	16,093
Transmission expense	1,998	1,726	15.8	1,278	56.4	5,314	6,375	7,522
Gross profit	20,307	21,441	(5.3)	13,976	45.3	65,961	85,232	97,237
Other expenses	2,102	2,188	(3.9)	1,510	39.3	7,267	7,791	8,570
Salaries and wages	2,102	2,188	(3.9)	1,510	39.3	7,267	7,791	8,570
EBITDA	18,205	19,254	(5.4)	12,467	46.0	58,694	77,441	88,667
Other income	(1,229)	683	(279.9)	2,246	(154.7)	3,761	2,570	2,930
PBDIT	16,976	19,937	(14.9)	14,713	15.4	62,455	80,011	91,597
Depreciation	3,949	2,811	40.5	5,360	(26.3)	19,797	25,020	29,181
Interest	3,319	6,654	(50.1)	4,118	(19.4)	15,432	29,070	32,034
PBT	9,709	10,471	(7.3)	5,236	85.4	27,226	25,921	30,382
Tax(including deferred tax)	3,271	3,637	(10.1)	361	805.6	5,854	5,184	6,076
PAT (reported)	5,465	6,154	(11.2)	4,878	12.0	20,409	20,737	24,305
Prev yr sales/write back	828	-	-	-	-	-	-	-
Forex (gains)/loss	(26)	(600)	(95.7)	45	-	(35)	-	-
Prior period items/tax	(611)	-	-	257	-	(25)	-	-
Tax adjustments	1,132	-	-	(425)	(366.4)	1,325	-	-
Adj PAT	7,047	5,554	26.9	4,496	56.8	21,674	20,737	24,305
Number of shares (mn)	4,209	4,209	-	4,209	-	4,209	4,209	4,209
EPS(INR)	6.7	5.3	-	4.3	-	5.1	4.9	5.8
P/E(x)	15.4	19.5	-	24.1	-	20.0	20.9	17.8

As % of net revenues

COGS	9.0	7.4	-	8.4	-	7.5	7.0	7.2
Other expenses	9.4	9.4	-	9.9	-	10.2	8.5	8.2
Total expenses	18.4	26.3	-	18.3	-	17.7	15.5	15.4
Gross profit	91.0	92.6	-	91.6	-	92.5	93.0	92.8
EBITDA	81.6	83.1	-	81.7	-	82.3	84.5	84.6
Net profit	31.6	24.0	-	29.5	-	30.4	22.6	23.2
Tax rate	33.7	34.7	-	6.9	-	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

Delays: Escalation in project costs, delay in commissioning of generation projects, and long gestation periods could impact profitability, if delays are not compensated through tariffs.

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.

■ Key Risks

- **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. Hence, there is a certain visibility on the capex program.
- **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.

Financial Statements

Income statement					(INR mn)
Year to March	FY08	FY09	FY10	FY11E	FY12E
Income from operations	46,148	65,798	71,275	91,607	104,760
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	77,441	88,667
Depreciation and amortisation	9,597	10,940	19,797	25,020	29,181
EBIT	25,271	43,841	38,897	52,421	59,486
Interest expenses	12,633	25,321	15,432	29,070	32,034
Other income	4,666	4,491	3,761	2,570	2,930
Income from provisions written back	513	704	0	0	0
Expenditure from provisions	1,082	(470)	0	0	0
Profit before tax	17,872	21,838	27,226	25,921	30,382
Provision for tax	2,821	4,932	5,854	5,184	6,076
Core profit	15,051	16,906	21,372	20,737	24,305
Extraordinary items	(568)	0	(963)	0	0
Profit before minority interest	14,483	16,906	20,409	20,737	24,305
Profit after minority interest	14,483	16,906	20,409	20,737	24,305
Shares outstanding	4,209	4,209	4,209	4,209	4,209
EPS (INR) basic	3.6	4.0	5.1	4.9	5.8
Diluted shares (mn)	4,209	4,209	4,209	4,209	4,209
EPS (INR) fully diluted	3.6	4.0	5.1	4.9	5.8
Dividend per share	1.0	1.2	1.2	1.2	1.4
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	15.5	15.4
Depreciation and amortization	20.8	16.6	27.8	27.3	27.9
Interest expenditure	27.4	38.5	21.7	31.7	30.6
EBITDA margins	75.6	83.3	82.3	84.5	84.6
Net profit margins	32.6	25.7	30.0	22.6	23.2

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	23.9	42.6	8.3	28.5	14.4
EBITDA	12.8	57.1	7.1	31.9	14.5
PBT	30.6	22.2	24.7	(4.8)	17.2
Net profit	34.8	12.3	26.4	(3.0)	17.2
EPS	34.8	12.3	26.4	(3.0)	17.2

Balance sheet**(INR mn)**

As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	42,088	42,088	42,088	42,088	42,088
Reserves & surplus	91,602	104,148	117,331	133,864	152,922
Shareholders funds	133,690	146,236	159,419	175,953	195,011
Secured loans	175,521	252,883	313,458	351,874	387,547
Unsecured loans	47,114	31,772	30,710	30,710	30,710
Borrowings	222,635	284,654	344,168	382,584	418,257
Others	19,465	29,180	31,160	23,169	36,370
Sources of funds	375,790	460,070	534,747	581,706	649,638
Gross block	354,170	403,193	434,727	509,418	591,764
Depreciation	81,582	91,909	114,114	128,748	145,816
Net block	272,588	311,284	320,613	380,670	445,948
Capital work in progress	87,530	132,860	204,222	164,691	172,346
Total fixed assets	360,118	444,144	524,835	545,361	618,293
Investments	17,808	15,928	14,532	14,532	14,532
Inventories	2,189	2,976	3,449	3,912	4,294
Sundry debtors	6,329	13,736	22,149	25,125	27,577
Cash and equivalents	17,693	24,289	32,776	64,892	56,378
Loans and advances	23,143	42,129	37,935	33,237	39,138
Total current assets	49,354	83,129	96,309	127,166	127,387
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)	21,812	16,812
Net deferred tax	0	0	0	0	1
Uses of funds	375,790	460,070	534,747	581,706	649,638
Book value per share (BV)(INR)	32	35	38	42	46

Free cash flow**(INR mn)**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	14,483	16,906	20,409	20,737	24,305
Depreciation	9,597	10,940	19,797	25,020	29,181
Others	(5)	8,782	(17,169)	1,320	1,086
Gross cash flow	24,074	36,628	23,037	47,077	54,574
Less: Changes in W. C.	5,394	(4,462)	(13,105)	(5,683)	3,513
Operating cash flow	18,680	41,090	36,142	52,760	51,061
Less: Capex	57,150	94,353	102,896	35,161	90,000
Free cash flow	(38,470)	(53,263)	(66,754)	17,599	(38,939)

Cash flow metrices

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	18,680	41,090	36,142	52,760	51,061
Financing cash flow	44,195	56,110	53,683	32,351	28,563
Investing cash flow	(57,150)	(91,568)	(101,034)	(33,299)	(88,138)
Net cash flow	5,725	5,633	(11,209)	51,812	(8,514)
Capex	(57,150)	(94,353)	(102,896)	(35,161)	(90,000)
Dividends paid	(4,343)	(5,051)	(4,984)	(5,184)	(6,076)

Profitability & liquidity ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%)	12.4	12.1	14.0	12.4	13.1
ROACE (%)	7.7	10.9	8.1	9.6	9.9
Current ratio	1.0	1.0	1.0	1.2	1.2
Debtors (days)	44	56	92	94	92
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)	10.7	5.4
Average capital employed t/o (x)	0.1	0.2	0.1	0.2	0.2
Debt / Equity	1.7	1.9	2.2	2.2	2.1
Debt/EBITDA	6.4	5.2	5.9	4.9	4.7
Adjusted debt/Equity	1.8	2.1	2.3	2.2	2.1

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	0.6

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP margin (%)	32.6	25.7	30.0	22.6	23.2
Total assets turnover	0.1	0.2	0.1	0.2	0.2
Leverage multiplier	2.9	3.0	3.3	3.3	3.3
ROAE (%)	12.4	12.1	14.0	12.4	13.1

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
Diluted EPS (INR)	3.6	4.0	5.1	4.9	5.8
Y-o-Y growth (%)	34.8	12.3	26.4	(3.0)	17.2
CEPS (INR)	5.9	6.6	9.8	10.9	12.7
Diluted P/E (x)	28.8	25.6	20.3	20.9	17.8
Price/BV(x)	3.2	3.0	2.7	2.5	2.2
EV/Sales (x)	13.4	10.3	10.2	8.0	7.5
EV/EBITDA (x)	17.8	12.4	12.4	9.5	8.8
Dividend yield (%)	1.0	1.2	1.1	1.2	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	NTPC	HOLD	SP	L
Power Grid Corp of India	REDUCE	SU	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
	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
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

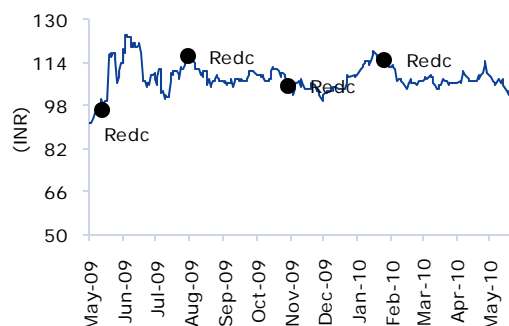
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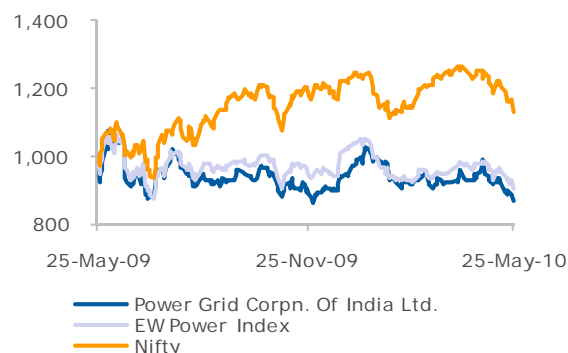
Coverage group(s) of stocks by primary analyst(s): Power

Adani Enterprises, CESC, GMR Infrastructure, GVK Power and Infra, Lanco Infratech, NTPC, 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*	101	56	9	169
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	103	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recos
25-May-10	Tata Power	Strong performance; Result Updae	1,244	Buy
21-May-10	PTC India	Power tolling, PPA volumes and margins to bear fruit by FY13; Initiating Coverage	103	Buy
18-May-10	NTPC	Efficient operator; Result Update	205	Hold

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