

SELL
TP: INR 210.00
▼ 4.7%

Rural Electrification

RECL IN

PAT in line; sanctions robust led by T&D

RECL's Q2FY13 NII and PAT were in line at Rs 12.8bn and Rs 9.5bn. Business growth was strong with disbursements/loan book growing by 25%/24% YoY. Sanctions have remained strong in H1FY13 at Rs 483bn led by the T&D segment. NIMs improved further by 23bps QoQ to 4.76%. Asset quality was stable with no slippages in Q2FY13. While earnings growth remains strong for REC we remain cautious given concerns on power projects. Valuations are not cheap at 1.15x FY14E BV – Maintain SELL.

- ➔ **Sanctions robust in H1FY13:** While sanctions in the generation segment have remained muted in the past five quarters as project announcements have come down, sanctions in the T&D space have picked up since Q4FY12 (Fig 4). Out of total sanctions of Rs 483bn in H1FY13, Rs 322bn was towards T&D projects. Loan book was healthy at 23% YoY. Generation/T&D projects constitute 45%/49% of the total loan book. The share of private projects has risen to 12% (from 6.6% in Q2FY10).
- ➔ **Interest spreads improved further:** Interest spreads have improved further to 3.5% as access to cheap foreign currency borrowings and tax-free bonds have kept borrowings costs low at ~8.4% (incremental cost at ~8.7%). Yield on advances has also improved by ~34bps QoQ to 11.86%.
- ➔ **Asset quality stable:** GNPLs/NNPLs stood stable at Rs 4.9bn/Rs 4.3bn. But we are concerned on asset quality given REC's highly leveraged balance sheet of large corporates, and worries on fuel availability and increasing exposure to private developers.
- ➔ **Maintain SELL:** REC has performed well YTD due to expectations of reforms in the power sector. At current valuation of 1.15x FY14E BV and 5x FY14E EPS, the stock trades at a significant premium to PSU banks despite the single product nature of the business. Maintain SELL with a revised September'13 TP of Rs 210.

Financial Highlights

Y/E 31 Mar	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income (INR mln)	33,723	39,249	48,734	57,459	64,230
Net revenues (INR mln)	36,443	41,315	51,229	60,187	67,269
Pre-provision profits (INR mln)	34,801	38,988	48,944	57,478	64,061
Adj. PAT (INR mln)	25,732	28,708	35,014	41,120	45,830
Adj. EPS (INR)	26.1	29.1	35.5	41.6	46.4
ROE (%)	21.6	20.7	22.7	23.4	22.8
ROA (%)	3.4	3.0	3.0	3.0	2.8
Gross NPA (%)	0.0	0.5	0.5	0.5	0.5
CAR (%)	19.1	17.0	15.1	14.7	14.3
P/BV (x)	2.0	1.4	1.3	1.2	1.0
P/E (x)	9.7	7.1	6.2	5.3	4.7

Source: Company, Bloomberg, RCML Research

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PRICE CLOSE (02 Nov 12)

INR 220.35

MARKET CAP

INR 217,587 mln
USD 4,044 mln

SHARES O/S

987.5 mln

FREE FLOAT

33.2%

3M AVG DAILY VOLUME./VALUE

2.4 mln/ USD 9.6 mln

52 WK HIGH

INR 248.65

52 WK LOW

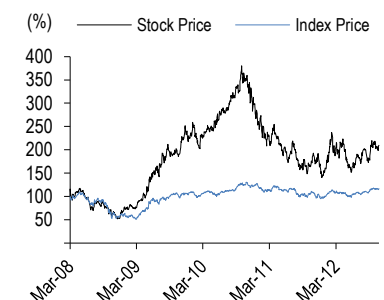
INR 147.60




Fig 1 - Actual vs. estimates

	Actual	Estimate	% Variance
NII	12,802	12,427	3.0
PBT	12,954	12,477	3.8
PAT	9,544	9,381	1.7

Source: Company, RCML Research

Fig 2 - Quarterly performance

(Rs mn)	Q2FY13	Q2FY12	% Chg YoY	Q1FY13	% Chg QoQ
Interest Income	32,405	25,145	28.9	29,970	8.1
Interest expenses	19,603	15,649	25.3	18,310	7.1
NII	12,802	9,497	34.8	11,660	9.8
Other operating income	514	176	191.9	710	(27.6)
Other income	219	379	(42.4)	240	(8.9)
Net revenues	13,534	10,052	34.6	12,610	7.3
Operating costs	580	456	27.3	460	26.1
PPOP	12,954	9,596	35.0	12,150	6.6
Provisions	-	-			
PBT	12,954	9,596	35.0	12,150	6.6
MTM profit / (loss)	(140)	(1,256)	(88.8)	(370)	(62.2)
PBT after extraordinary	12,814	8,341	53.6	11,780	8.8
Tax	3,270	2,112	54.8	3,000	9.0
- Current tax	3,270	2,135	53.2	3,000	9.0
- Deferred tax	-	(23)			
PAT	9,544	6,229	53.2	8,780	8.7
Tax rate (%)	25.2	22.0		24.7	
Cost/income (%)	4.3	4.5		3.6	
NIMs (calc)	4.73	4.38		4.45	
Disbursements	76,290	61,210	24.6	68,640	11.1
Loan book	1,119,000	903,330	23.9	1,066,320	4.9
Gross NPA	4,900	2,700		4,900	-
Gross NPA (%)	0.44	0.30		0.46	
Net NPA	4,260	2,270		4,260	-
Net NPA (%)	0.38	0.25		0.40	
Provision coverage ratio (%)	13.1	15.9		13.1	

Source: Company, RCML Research

Fig 3 - Disbursements growth healthy

(Rs bn)	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Generation	20	20	18	25	32	28	22	36	30	30	27	36	24	34
T&D	12	22	23	32	12	20	25	39	19	25	25	49	26	39
Short term loans	4	12	19	3	2	8	13	8	6	6	12	14	19	4
RGGVY	0	1	-	-	-	-	-	-	-	-	-	-	-	-
Total	36	55	60	60	46	55	60	83	55	61	63	99	69	76

Source: Company, RCML Research



Fig 4 - Sanctions driven by strong traction in the T&D segment

(Rs bn)	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Generation	112	79	43	6	112	48	63	181	152	29	41	10	91	46
T&D	34	68	47	24	112	45	33	35	50	63	37	81	106	217
Short term loans	6	17	16	3	5	11	10	10	11	15	11	10	21	3
Total	151	163	106	33	229	104	106	226	212	108	88	101	218	265

Source: Company, RCML Research

Fig 5 - Outstanding loan composition based on ownership of entity – share of private developers increasing

(Rs bn)	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
State	453	486	529	556	595	627	633	681	707	743	776	850	896	930
Central PSUs	49	55	58	61	51	54	55	59	59	59	59	57	56	55
Private	34	38	41	43	46	48	69	78	92	101	114	107	115	135
Total	535	579	628	660	692	729	757	817	858	904	950	1,014	1,067	1,120

Source: Company, RCML Research

Fig 6 - Outstanding loan composition based on the product category

(Rs bn)	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Generation	190	219	224	240	285	307	315	346	373	400	428	452	472	502
T&D	308	317	345	367	353	373	392	418	431	451	467	499	516	548
Others	37	43	59	53	53	50	51	53	54	54	55	63	79	70
Total	535	579	628	660	692	729	757	817	858	904	950	1,014	1,067	1,120
YoY growth (%)	33	32	30	30	29	26	21	24	24	24	25	24	24	24

Source: Company, RCML Research

Fig 7 - NIMs continue to improve due to access to low-cost borrowings

	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Yield on asset	11.1	11.0	11.0	11.2	11.1	11.2	11.2	11.0	11.0	11.5	11.4	11.4	11.5	11.9
Cost of funds	7.6	7.7	7.7	7.8	7.8	8.0	7.8	7.8	7.9	8.3	8.4	8.1	8.1	8.4
NIMs (R)	4.4	4.3	4.2	4.5	4.6	4.4	4.6	4.3	4.3	4.5	4.3	4.3	4.5	4.8

Source: Company, RCML Research

Fig 8 - NPA trends

	FY10				FY11				FY12				FY13	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Gross NPA	320	210	200	200	200	200	200	200	2700	2700	4930	4900	4900	4900
Net NPA	20	20	20	20	20	20	20	20	2270	2270	4260	4260	4260	4260
Provisions	300	190	180	180	180	180	180	180	430	430	670	640	640	640
Gross NPA as a % of loans outstanding	0.06	0.04	0.03	0.03	0.03	0.03	0.03	0.03	0.31	0.30	0.52	0.48	0.46	0.44
Net NPA as a % of loans outstanding	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.26	0.25	0.45	0.42	0.40	0.38

Source: Company, RCML Research



Disbursements

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Disbursements	245,190	278,323	308,968	322,408	372,897
Growth (%)	19.3	13.5	11.0	4.3	15.7
AUM/Sanctions	821,321	1,005,483	1,223,768	1,435,239	1,677,642
Growth (%)	23.6	22.4	21.7	17.3	16.9

Per Share Data

Y/E 31 Mar (INR)	FY11A	FY12A	FY13E	FY14E	FY15E
Reported EPS	26.0	28.5	35.5	41.6	46.4
Adjusted EPS	26.1	29.1	35.5	41.6	46.4
DPS	7.5	8.6	10.6	12.5	13.9
Book value	129.5	145.8	166.1	190.0	216.7
Adjusted book value	0.0	0.0	0.0	0.0	0.0

Valuation Ratios

Y/E 31 Mar (x)	FY11A	FY12A	FY13E	FY14E	FY15E
P/E	9.7	7.1	6.2	5.3	4.7
P/BV	2.0	1.4	1.3	1.2	1.0
P/ABV	n.a.	n.a.	n.a.	n.a.	n.a.

Financial Ratios

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
Spread Analysis					
Interest spreads	3.6	3.2	3.2	3.2	3.0
Yield on advances	10.9	11.1	11.3	11.3	11.3
Yield on assets	11.0	10.9	11.0	10.9	10.7
Cost of funds	7.4	7.6	7.8	7.7	7.7
NIMs	4.5	4.2	4.2	4.1	3.9
Operating Ratios					
Operating cost to income	4.5	5.6	4.5	4.5	4.8
Operating expenses / Avg assets	0.2	0.2	0.2	0.2	0.2
Asset Quality and Capital					
Gross NPA	0.0	0.5	0.5	0.5	0.5
Net NPA	0.0	0.4	0.4	0.3	0.3
CAR	19.1	17.0	15.1	14.7	14.3
Growth Ratios					
Net interest income	28.4	16.4	24.2	17.9	11.8
Non-interest income	59.5	(24.0)	20.7	9.3	11.4
Pre-provisioning profit	31.3	12.0	25.5	17.4	11.5
Net profit	10.6	11.6	22.0	17.4	11.5
Assets	25.1	22.1	21.2	18.8	18.8
Advances	23.6	22.4	21.7	17.3	16.9
Book value	15.4	12.6	13.9	14.4	14.1
EPS	10.6	11.6	22.0	17.4	11.5

DuPont Analysis

Y/E 31 Mar (%)	FY11A	FY12A	FY13E	FY14E	FY15E
Net interest income / Assets	4.5	4.2	4.2	4.1	3.9
Non-interest income / Assets	0.4	0.2	0.2	0.2	0.2
Operating expenses / Assets	0.2	0.2	0.2	0.2	0.2
Provisions / Assets	0.0	0.1	0.1	0.1	0.1
Taxes / Assets	1.2	1.0	1.1	1.1	1.0
ROA	3.4	3.0	3.0	3.0	2.8
Equity / Assets	15.9	14.5	13.3	12.6	12.1
ROAE	21.6	20.7	22.7	23.4	22.8



Income Statement

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Interest income	82,233	101,569	127,205	151,508	177,200
Interest expense	(48,510)	(62,320)	(78,471)	(94,049)	(112,970)
Net interest income	33,723	39,249	48,734	57,459	64,230
Non-interest income	2,719	2,066	2,495	2,728	3,039
Net revenue	36,443	41,315	51,229	60,187	67,269
Operating expenses	(1,642)	(2,327)	(2,285)	(2,708)	(3,208)
Pre-provisioning profits	34,801	38,988	48,944	57,478	64,061
Provisions & contingencies	(2)	(520)	(979)	(1,150)	(1,281)
PBT	34,799	38,468	47,965	56,329	62,780
Extraordinaries	(32)	(530)	0	0	0
Income tax	(9,067)	(9,760)	(12,950)	(15,209)	(16,951)
Reported PAT	25,699	28,178	35,014	41,120	45,830
Adj. net profit	25,732	28,708	35,014	41,120	45,830

Balance Sheet

Y/E 31 Mar (INR mln)	FY11A	FY12A	FY13E	FY14E	FY15E
Advances	821,321	1,005,483	1,223,768	1,435,239	1,677,642
Investments	8,124	7,307	6,607	6,607	6,607
Current assets	61,445	75,626	88,890	125,833	178,735
Net block (inc CWIP)	881	733	811	887	960
Goodwill	0	0	0	0	0
Other assets	0	0	0	0	0
Total Assets	891,771	1,089,149	1,320,076	1,568,565	1,863,944
Share capital	9,875	9,875	9,875	9,875	9,875
Options/warrants/others	0	0	0	0	0
Reserves & surplus	118,012	134,122	154,140	177,696	204,117
Net worth	127,886	143,996	164,015	187,570	213,991
Total borrowings	700,038	902,056	1,106,988	1,325,813	1,588,714
Current liabilities	31,310	2,289	2,747	3,297	3,956
Provisions	32,664	40,807	46,326	51,886	57,283
Deferred tax liabilities	(128)	0	0	0	0
Other liabilities	0	0	0	0	0
Total Equity & Liabilities	891,771	1,089,149	1,320,076	1,568,565	1,863,944

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