

November 2, 2012

Rating Remains	Buy
Target price Remains	INR 255
Closing price November 2, 2012	INR 220

Robust 2Q: flat NPLs, huge sanctions growth

Quick Note

Earnings vs estimates

Rural Electrification Corp (REC) reported a robust 18% PAT beat (INR9.54bn for 2QFY13 vs. our estimate of INR8.1bn) on better NIMs which expanded 23bps q-q. Loan book growth came in at a strong 6% q/q (24.5% y/y) while loan sanctions increased 22% q-q. REC didn't add any fresh NPLs during the quarter.

Key highlights:

- Interest spreads improved marginally to 3.46% for 2QFY13, compared to 3.42% in 1QFY13 as a 30bps increase in cost of funds was more than offset by 34bps sequential increase in loan yields which continue to see the benefit of upward repricing of 3-yr reset loans. In addition to higher spreads, NIMs benefited from the full impact of improved leverage (proportion of loans to borrowings). The company has guided towards maintaining its FY12 spreads of 3.3-3.4% for FY13.
- The company did not make any provisions during the quarter as REC didn't add anything to its NPLs during the quarter vs our expectation of INR4bn loan slipping in the quarter. GNPLs remained flat at INR4.9bn while GNPL ratio was 44bps.
- Q2FY13 sanctions were INR256bn (increase of 22% q-q and 147% y-y) driven by huge addition in T&D related sanctions which clocked INR217bn compared to INR106bn in the previous quarter. H1 sanctions put together amounted to 74% of the full year sanction guidance of INR650bn given in the previous quarter.
- Disbursals continued to be strong with 43% and 49% q-q increase in generation and T&D related disbursals.
- Encouragingly, short term loans declined by 11% q-q to constitute just 6% of overall loan book as of Q2FY13.
- Loan growth came in better than expected clocking a 6% sequential growth (24.5% y/y). The mix of private sector exposure in overall loan book increased 120bps to 12% for Q2FY13.
- Forex impact - forex translation assets (FCMITD account) declined to INR2.7bn (from INR4.8bn in Q1) amounting to 1.6% of their net worth.

We had increased our FY13 earnings estimates by 17% in our note published on Oct 19, 2012, "Gap estimate of "problem" SEBs".

Valuation: REC trades at 1.3x our avg FY13-14F ABV and 5.9x our avg FY13-14F EPS estimates. At our TP of INR255, REC would trade at 1.5x our avg FY13-14F ABV of INR172.4 and 6.9x EPS of INR37.1, for FY13F ROA of 3.1% and ROE of 23.4%.

Research analysts

India Banks

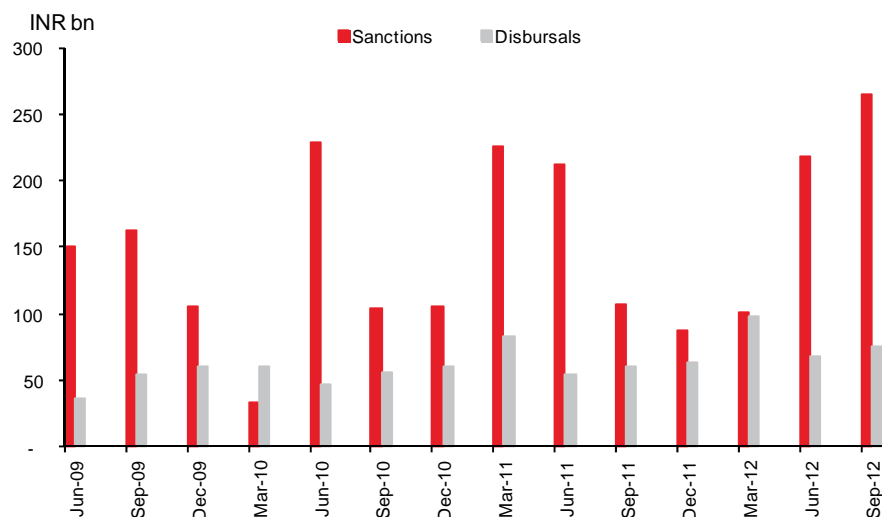
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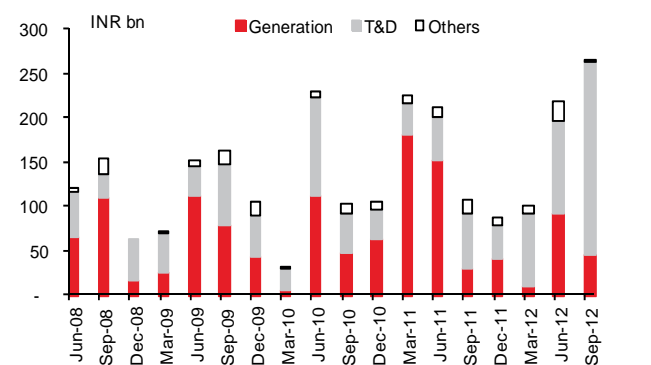
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 1: Sanctions & disburseals trend



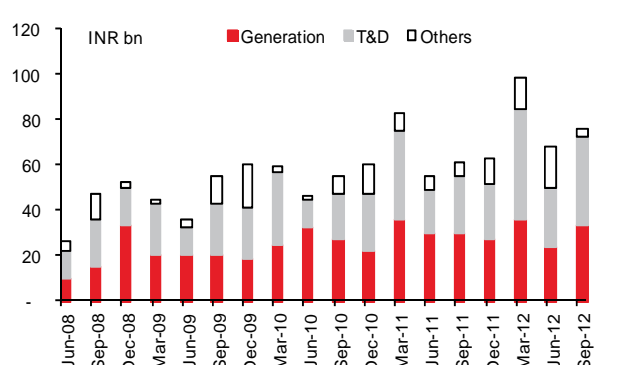
Source: Company data, Nomura research

Fig. 2: Sanctions beak-up



Source: Company data, Nomura research

Fig. 3: Disburseals beak-up



Source: Company data, Nomura research

Fig. 4: Earnings summary

Earnings summary (INRmn)	2QFY13	1QFY13	2QFY12	%y/y	%q/q	2QFY13F	%Variance
Interest Income	32,404.5	29,968.2	25,145.2	28.9	8.1	30,649.7	5.7
Interest expended	19,603.0	18,313.8	15,648.7	25.3	7.0	18,955.7	3.4
Net Interest Income	12,801.5	11,654.4	9,496.5	34.8	9.8	11,694.0	9.5
Non-interest income	592.5	584.6	(700.3)	NM	1.4	310.4	90.9
Total Net Income	13,394.0	12,239.0	8,796.2	52.3	9.4	12,004.3	11.6
Total Operating expenses	584.8	455.5	455.6	28.4	28.4	561.3	4.2
Employee expenses	435.8	354.2	302.4	44.1	23.0	417.3	4.4
Other Operating expenses	149.0	101.3	153.2	(2.7)	47.1	144.0	3.5
Operating Profit	12,809.2	11,783.5	8,340.6	53.6	8.7	11,443.0	11.9
Provisions	-	-	-	-	-	399.0	-
PBT	12,809.2	11,783.5	8,340.6	53.6	8.7	11,044.0	16.0
Tax	3,270.2	3,016.2	2,111.9	54.8	8.4	2,981.9	9.7
Net Profit	9,539.0	8,767.3	6,228.7	53.1	8.8	8,062.2	18.3
Extra-ordinary income/(expense)	-	-	-	-	-	-	-
Adjusted net profit	9,539.0	8,767.3	6,228.7	53.1	8.8	8,062.2	18.3
EPS	9.7	8.9	6.3	53.1	8.8	8.2	18.3

Source: Company data, Nomura estimates

Fig. 5: Key Ratios

Key Ratios	2QFY13	1QFY13	2QFY12	y/y bps	q/q bps	
Yield on funds, %	11.86	11.52	11.42	44	34	bps
Cost of funds, %	8.40	8.10	8.33	7	30	bps
Reported spread, %	3.46	3.42	3.09	37	4	bps
NIMs, %	4.76	4.53	4.47	29	23	bps
Cost to income ratio, %	4.37	3.72	5.18	(81)	64	bps

Source: Company data, Nomura research

Fig. 6: Asset Quality

Asset Quality (INRmn)	2QFY13	1QFY13	2QFY12	%y/y	%q/q	
Gross NPL	4,900	4,900	2,700	81.5	-	
Net NPL	4,260	4,260	2,270	87.7	-	
Gross NPL, %	0.44	0.46	0.30	14.1	(2.2)	bps
Net NPL, %	0.38	0.40	0.25	13.1	(1.9)	bps

Source: Company data, Nomura research

Fig. 7: Loans & Borrowings

Loans & Borrowings (INRmn)	2QFY13	1QFY13	2QFY12	%y/y	%q/q
Advances	1,119,650	1,066,320	909,363	23.1	5.0
Total Borrowings	950,920	895,810	756,810	25.6	6.2
Sanctions	265,490	217,890	107,680	146.6	21.8
Generation	46,310	91,300	29,260	58.3	(49.3)
T&D	216,680	105,690	63,120	243.3	105.0
Short-term loan	2,500	20,900	15,300	(83.7)	(88.0)
Disbursements	76,290	68,640	61,210	24.6	11.1
Generation	33,750	23,640	29,920	12.8	42.8
T&D	38,540	25,900	24,990	54.2	48.8
Short-term loan	4,000	19,100	6,300	(36.5)	(79.1)

Source: Company data, Nomura research

Appendix A-1

Analyst Certification

We, Abhishek Bhattacharya, Vijay Sarathi and Amit Nanavati, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Rural Electrification Corporation	RECL IN	INR 220	02-Nov-2012	Buy	Not rated	A6,A7,A13

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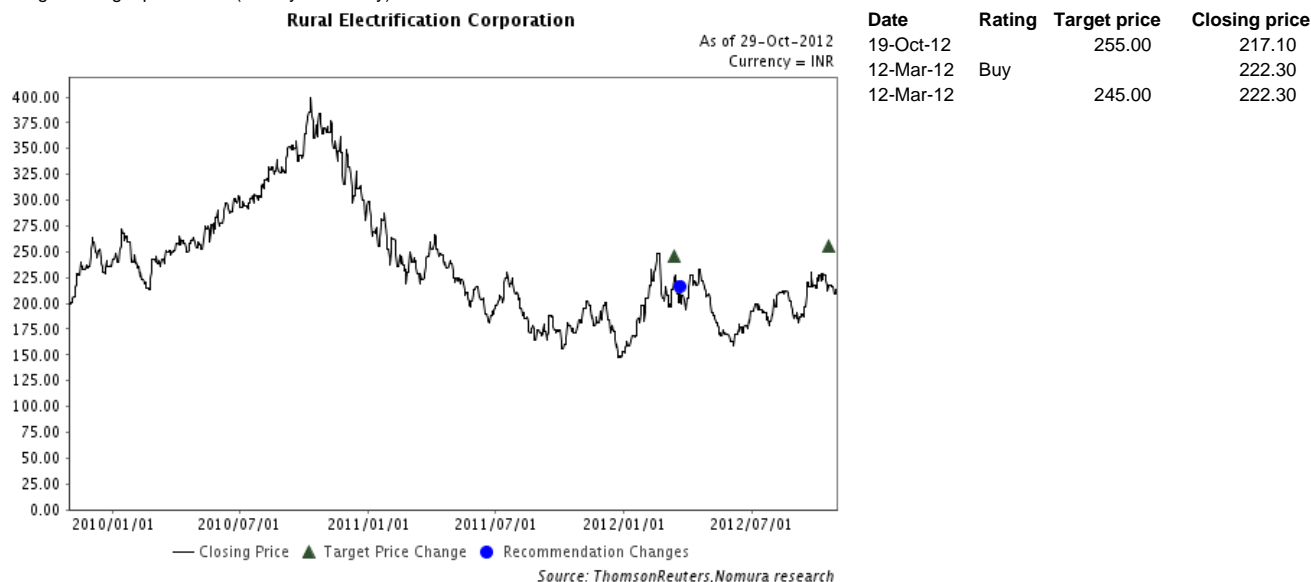
A13 A Nomura Group Company has a significant financial interest (non-equity) in the issuer.

Previous Rating

Issuer name	Previous Rating	Date of change
Rural Electrification Corporation	Not Rated	12-Mar-2012

Rural Electrification Corporation (RECL IN) INR 220 (02-Nov-2012) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We have arrived at our target price of INR255 using a three-stage residual-income valuation method using following assumptions: 1)18.8% CAGR in interest earning asset for FY12-FY15F, 2) 22.8% avg RoE for FY12-FY15F, 3) discount rate of 14.5% for FY12 to FY15F, 12.5% for FY15F to FY20F and terminal discount rate of 10%. At our TP of INR255, REC would trade at 1.5x our avg FY13-14F ABV of INR172.4 and 6.9x EPS of INR37.1, for FY13F ROA of 3.1% and ROE of 23.4%.

Risks that may impede the achievement of the target price Sharp deterioration in asset quality of private sector developers and non adherence to the trajectory recommended in the FRP by SEBs could impact the earnings outlook.

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STOCKS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

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