

24 October 2011

Produced by: The Royal Bank of Scotland N.V., (India) Office

Buy

Target price
Rs110.00

Price
Rs99.00

Equity | India | Utilities

Flashnote

Power Grid

Capitalisation gaining momentum

PWGR's 2QFY12 adjusted profit at Rs7.8bn (up 31% yoy) was higher than our estimate of Rs7.3bn, primarily on higher other income. In the quarter, PWGR capitalised ~Rs32bn worth of assets, taking 1HFY12 capatilisation at ~Rs40bn, in line to achieve our estimate of Rs80bn for FY12. Buy.

Better than expected earnings on higher other income

- PWGR's 2QFY12 results were better than our estimate primarily on higher other income vs estimate.
- In 2QFY12, PWGR adjusted sales at Rs22.7bn (up 6.7% yoy) and adjusted EBITDA at Rs19.2bn (up 7.6% yoy) were in line with our estimate of Rs22.9bn and Rs19.2bn, respectively.
- However, adjusted profit at Rs7.8bn (up 31% yoy) was higher than our estimate of Rs7.3bn, largely due to higher other income at Rs1.94bn (up 102% yoy).
- Other income was higher due to dividend income from JVs received in the quarter at ~Rs200m (dividend income was booked in 1Q in FY11 vs 2Q in FY12) and ~Rs400m interest received on bills arrears from various SEBs.
- Broad break-up of other income: 1) interest from banks Rs780m, 2) interest on bills arrears from various SEBs Rs400m, 3) interest on bonds Rs250m, 4) lease income Rs120m, 5) dividend income Rs200m, 6) miscellaneous income Rs192m.
- Note that 2QFY12 revenue and PBT did not include the contribution from POSOCO assets (included in 2QFY11 revenue at Rs815m and PBT at Rs186m), which has been transferred to 100% subsidiary in October 2010. Hence, ULDC/RLDC revenue and PBT is not comparable yoy.
- Also, O&M expenditure includes system operating charges of Rs195m for 1HFY12 (Rs50m

(Continued on page 2)

Key quarterly financials

Quarterly (Rs mn)	2QFY12	2QFY11	YoY (%)	1HFY12A	1HFY11A	YoY (%)
Net sales	22,644	21,266	6.5	44,668	41,258	8.3
EBIDTA	18,978	17,858	6.3	37,433	34,669	8.0
EBIDTA margin (%)	84	84.0	-16 bps	83.8	84.0	-23 bps
Other income	1,942	963	101.6	3,374	2,469	36.7
Depreciation	(5,966)	(5,456)	9.4	(11,757)	(10,480)	12.2
Interest	(5,556)	(4,017)	38.3	(10,002)	(8,066)	24.0
PBT	9,398	9,348	0.5	19,049	18,592	2.5
Tax rate (%)	24.8	25.8	-100 bps	25.8	27.0	-121 bps
Reported PAT	7,087	6,514	8.8	14,140	13,546	4.4
Recurring PAT	7,799	5,961	30.8	13,779	11,875	16.0
Segmental financials						
Revenue (incl other income)	2QFY12	2QFY11	YoY (%)	1HFY12A	1HFY11A	YoY (%)
Transmission	22,958	19,939	15.1	45,005	39,222	14.7
Telecom	510	463	10.2	972	918	5.9
ULDC	400	1,042	(61.6)	767	2,079	(63.1)
Consultancy	725	794	(8.7)	1,271	1,531	(17.0)
PBT margin (%)						
Transmission	39.6	42.6	-299 bps	40.6	43.9	-335 bps
Telecom	3.9	20.3	-1648 bps	13.7	7.9	581 bps
ULDC	-11.5	28.4	-3988 bps	11.6	22.0	-1037 bps
Consultancy	49.4	54.9	-546 bps	44.9	52.7	-784 bps

Source: Company, RBS

Important disclosures can be found in the Disclosures Appendix.

Analyst

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for 2QFY12) for which revenue has not been booked pending finalisation by the regulator.

Strong capitalisation in the quarter

- In the quarter, PWGR capitalised ~Rs32bn worth of assets, taking 1HFY12 capitalisation at ~Rs40bn (down 24% YoY).
- Note that PWGR capitalised Rs73bn worth of assets in FY11, with very strong capitalisation contribution in 1HFY11 at 72% of total. Hence, lower capitalisation yoy in 1HFY12 is not a cause for concern.
- We project PWGR will capitalise Rs80bn in FY12 and capitalisation, so far, gives us confidence that our projection should be achieved.

Analyst meet today (Monday 24 October 2011)

- PWGR will hold an analyst meet today (Monday 24 October 2011) to discuss 2QFY12 financial results and growth plans. We shall come out with an update post the meet.

We prefer PWGR to other Indian utilities; maintain Buy

- We prefer PWGR to other Indian utilities as: 1) it is partially insulated from coal shortage issues faced by power generators; 2) low risk to our earnings CAGR of 14% over FY11-14F; 3) it factors in no tax arbitrage profits (NTPC and NHPC do) and so there is no downside risk from this; and 4) we think the stock should outperform given its earnings quality, strong momentum and sustainable ROE. At P/BV of 1.8x FY13F BV, valuations look reasonable to us.

Income statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Revenue	71275	83887	97508	112467	127905
Cost of sales	-12341	-13315	-16576	-19119	-21744
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	58933	70572	80932	93347	106161
DDA & Impairment (ex gw)	-19797	-21994	-23085	-26695	-30518
EBITA	39136	48578	57847	66652	75643
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	39136	48578	57847	66652	75643
Net interest	-15432	-17339	-20905	-23505	-26044
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	2559	7009	6247	6534	7116
Reported PTP	26263	38247	43188	49681	56715
Taxation	-5854	-11278	-12735	-14650	-16724
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	-0.00	0.00
Reported net profit	20409	26969	30453	35031	39991
Normalised Items Excl. GW	0.00	0.00	0.00	0.00	0.00
Normalised net profit	20409	26969	30453	35031	39991

Source: Company data, RBS forecasts

year to Mar

Balance sheet

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
Cash & market secs (1)	32776	36801	52414	63173	72656
Other current assets	63497	68371	71969	77387	88010
Tangible fixed assets	524834	638486	725401	808705	888187
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	14568	13675	11813	9951	8089
Total assets	635675	757332	861597	959216	1056942
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	76346	71138	97508	112467	127905
Long term debt (3)	313458	363251	416653	471560	522457
Oth non-current liab	86453	109273	114016	119052	124508
Total liabilities	476256	543662	628178	703079	774870
Total equity (incl min)	159419	213670	233419	256137	282072
Total liab & sh equity	635675	757332	861597	959216	1056942
Net debt	311392	372027	409816	453964	495378

Source: Company data, RBS forecasts

year ended Mar

Cash flow statement

Rsm	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA	58933	70572	80932	93347	106161
Change in working capital	13141	-5910	27515	14577	10272
Net interest (pd) / rec	-15432	-17339	-20905	-23505	-26044
Taxes paid	-5854	-11278	-12735	-14650	-16724
Other oper cash items	1010	4368	0.00	0.00	0.00
Cash flow from ops (1)	51797	40412	74806	69770	73664
Capex (2)	-100191	-133519	-110000	-110000	-110000
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	5155	7591	8109	8396	8978
Cash flow from invest (3)	-95036	-125929	-101891	-101604	-101022
Incr / (decr) in equity	0.00	4209	0.00	0.00	0.00
Incr / (decr) in debt	59514	64660	53402	54907	50897
Ordinary dividend paid	-7370	-9426	-10704	-12313	-14056
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-417.1	29697	0.00	0.00	0.00
Cash flow from fin (5)	51726	89140	42699	42594	36840
Forex & disc ops (6)	0.00	401.0	0.00	-0.00	-0.01
Inc/(decr) cash (1+3+5+6)	8488	4024	15613	10760	9483
Equity FCF (1+2+4)	-48394	-93107	-35194	-40230	-36336

Lines in bold can be derived from the immediately preceding lines.
Source: Company data, RBS forecasts

year to Mar

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 23 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	864 (11)	564 (3)
Hold	420 (7)	226 (4)
Sell	89 (6)	50 (0)
Total (IB%)	1373 (9)	840 (3)

Source: RBS

Trading recommendations (as at 23 Oct 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	0 (0)	0 (0)
Trading Sell	1 (0)	1 (0)
Total (IB%)	1 (0)	1 (0)

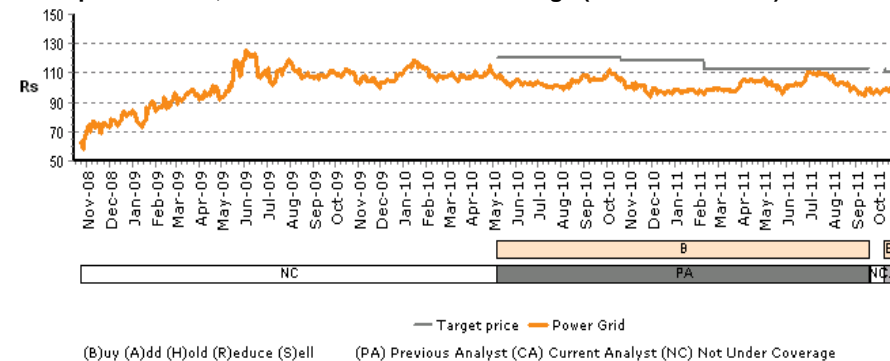
Source: RBS

Valuation and risks to target price

Power Grid (RIC: PGRD.BO, Rec: Buy, CP: Rs99.00, TP: Rs110.00): Our SOTP target price is derived from the average of (1) a target P/B for core equity based on the Gordon growth model and (2) a target P/B for balance sheet book. Risks include: 1) delays in capitalisation vs our assumptions could lower core book and intrinsic values of the company; and 2) delays/default by even a single state electricity board (SEB) would increase risk aversion, thereby affecting the stock's fair value.

Power Grid coverage data (PGRD.BO, PWGR IN)

Stock performance, recommendations and coverage (as at 23 Oct 2011)



Harish Bihani started covering this stock on 10 Oct 11. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

Price perf (at Close 21 Oct 2011)

	(1M)	(3M)	(12M)
Price (Rs)	99.25	108.0	105.6
Absolute (%)	-0.3	-8.3	-6.2
Rel market (%)	1.4	0.7	13.2
Rel sector (%)	3.5	6.4	28.1

Source: Bloomberg
Market: Sensex
Sector: Electricity

Regulatory disclosures

None

Global disclaimer

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