

## Rural Electrification Corporation

### Strong quarter

Rural Electrification Corporation's (REC) Q2FY10 results were in line with our estimates. NII grew 36% YoY to Rs 5.9bn, driven by a 32% growth in loan book and stable net interest margins. The company booked a fee income of Rs 240mn from loans sanctioned under RGGVY scheme. Asset quality remained robust with non-performing loans maintained at zero levels. Tax rate was lower at 24% (as against 37% in Q2FY09) due to a tax write-back of Rs 124 mn and no provision for deferred tax liability. As a result, PAT grew 69% YoY to Rs 4.9bn.

**Strong business growth:** During the quarter, REC sanctioned loans of Rs 163bn, taking its total outstanding sanctions to Rs 0.8tn. Generation and T&D segments constituted 48% and 41% of total sanctions made during the quarter. The company disbursed loans of Rs 55bn, increasing its total disbursements in the current fiscal to Rs 91bn. We believe that disbursements will grow at 19% CAGR over FY09-11E on strong, continued demand from the power segment. We expect REC's loan book to grow by 25% CAGR during this period.

**NIMs at 4.25%:** With abundant liquidity in the system, REC's cost of borrowings remained low at 7.7% and interest spread healthy at 3.3%. 54EC bonds worth Rs 42bn matured during the quarter and replaced it with market borrowings at ~1.5% higher rate. For the full year, 54EC bonds will be lower by ~Rs 50bn (net of fresh issue); however, re-pricing of assets will help cushion this impact. The company will re-price its loan portfolio of Rs 74bn and Rs 120bn in FY10 and FY11 respectively at a higher rate. This will enable REC in sustaining its margins in a rising interest rate scenario.

**To raise capital for future growth:** REC has secured government approval for a follow-on offer to issue fresh equity shares amounting to 15% of total outstanding equity shares. The government is also expected to dilute 5% of its stake in REC. Moreover, the risk weight on government guaranteed loan assets reduced from 100% to 20%. As a result, its CAR has improved to 15% from 12%. After raising equity capital, its CAR will further improve to ~20%.

**Revising Estimates – maintain Hold:** We are revising our FY10 and FY11 PAT estimates by 6% and 4% respectively to factor in equity dilution (at Rs 190/share) and better interest margins. At the CMP of Rs 200, the stock trades at 1.8x FY10E ABV and 1.6x FY11ABV (after the dilution). The stock has underperformed the Bankex in the past three months due to stretched valuations. We, however, expect the stock to continue trading at a premium to PSU banks but absolute returns will be muted in the near-term. We maintain our Hold rating with a target price of Rs 221 (based on 1.8 FY11E ABV).

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 200	Rs 221	HOLD	MEDIUM

BSE	NSE	BLOOMBERG
532995	RECLTD	RECL IN

#### Company data

Market cap (Rs bn / US\$ bn)	172 / 3.6
Outstanding equity shares (mn)	859
Free float (%)	18.2
Dividend yield (%)	2.2
52-week high/low (Rs)	225 / 54
3-month average daily volume	1,665,751

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
REC	200	(0.7)	(1.3)	94.0
Sensex	15,896	(7.2)	3.3	39.4

#### Valuation matrix

(x)	FY08	FY09	FY10E	FY11E
P/BV @ CMP	2.8	2.4	1.8	1.61
P/BV @ Target	3.1	2.6	2.0	1.78
P/E @ CMP	20.0	13.5	10.7	9.4

#### Financial highlights

(Rs mn)	FY08	FY09	FY10E	FY11E
NII	14,447	19,081	24,312	28,712
Growth (%)	36.2	32.1	27.4	18.1
PPP	13,530	18,856	24,292	28,704
Growth (%)	32.1	39.4	28.8	18.2
FDEPS (Rs)	10.0	14.8	18.6	21.3
Growth (%)	30.3	47.9	44.5	14.4

#### Profitability and return ratios

(%)	FY08	FY09	FY10E	FY11E
Net interest margin	3.8	4.1	4.1	4.0
Non-int inc/Total inc	1.4	4.4	4.9	4.7
Cost/Inc ratio	10.4	3.8	4.8	5.1
RONW	18.3	22.0	22.8	19.9
ROA	2.3	2.8	3.1	2.9
Net NPA	0.6	0.0	0.0	0.0





## Result highlights

**Fig 1 - Actual vs estimated performance**

(Rs mn)	Actual	Estimate	% Variance
NII	6,816	6,981	(2.4)
PPP	6,466	6,681	(3.2)
PAT	4,944	4,877	1.4

Source: Company, RHH

**Fig 2 - Quarterly performance**

(Rs mn)	Q2FY10	Q2FY09	% Chg YoY	Q1FY10	% Chg QoQ
Interest income	15,324	11,040	38.8	14,494	5.7
Interest expenses	9,413	6,690	40.7	8,735	7.8
Net interest income	5,911	4,350	35.9	5,759	2.7
Other operating income	512	130	293.6	115	344.2
Other income	393	350	12.4	480	(18.1)
Total income	6,816	4,830	41.1	6,354	7.3
Operating costs	351	390	(10.1)	300	16.9
PPOP	6,466	4,440	45.6	6,054	6.8
Provisions	1	(200)	(100.5)	1	(30.8)
PBT	6,465	4,640	39.3	6,053	6.8
Tax	1,521	1,720	(11.6)	1,335	14.0
PAT	4,944	2,920	69.3	4,718	4.8
EPS (Rs)	5.8	3.4	69.3	5.5	4.8
Tax rate (%)	23.5	37.1		22.1	
Cost/income (%)	5.2	3.9		4.7	
NIMs (%)	4.3	4.2		4.4	
Loan book (Rs bn)	579	437	32.5	535	8.2
Disbursements (Rs bn)	55	48	15.6	36	52.1
Sanctions (Rs bn)	163	152	7.8	151	7.9
Gross NPA (Rs mn)	320	2,480	(87.1)	320	-
Net NPA (Rs mn)	20	1,860	(98.9)	20	-

Source: Company, RHH

**Fig 3 - Revised estimates**

Key parameters (Rs mn)	FY10E			FY11E		
	Old	New	% Chg	Old	New	% Chg
NII	23,424	24,312	3.8	27,913	28,712	2.9
PPOP	23,085	24,292	5.2	27,542	28,704	4.2
PAT	17,271	18,378	6.4	20,191	21,020	4.1
ABV (Rs)	97.0	109.8	13.2	112.8	124.0	9.9

Source: RHH

Results in line with estimates

NII up 36% due to 32% growth in loan book and stable NIM

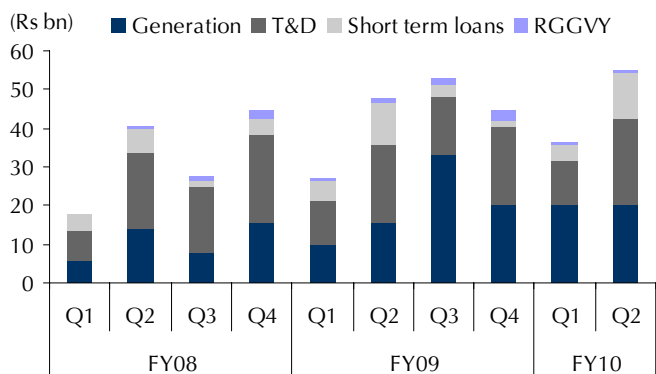
Effective tax rate lower at 23% due to a tax refund of Rs 124mn

Sanctions remained strong at Rs 163bn

Estimates revised to factor in equity dilution and stable margins

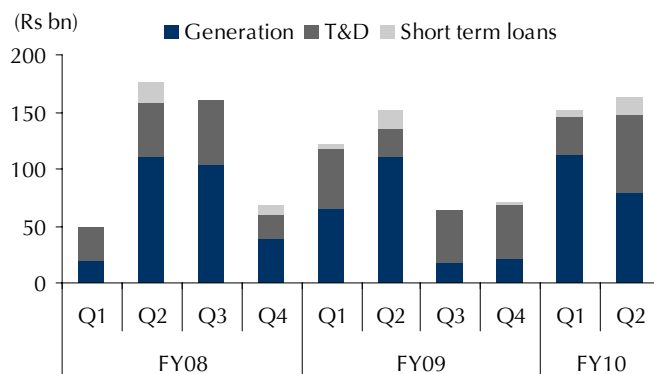


**Fig 4 - Disbursement grew by 16% YoY**



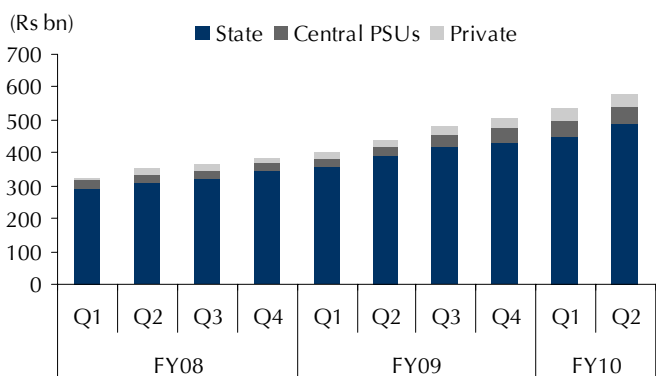
Source: RHH, Company

**Fig 5 - Sanctions in generation as well as T&D remained strong**



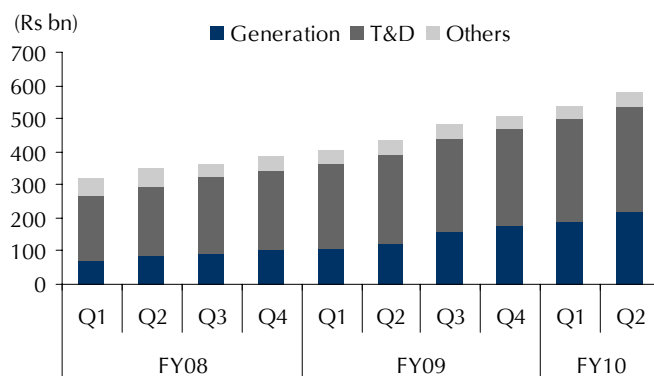
Source: RHH, Company

**Fig 6 - Borrower-wise loan composition**



Source: RHH, Company

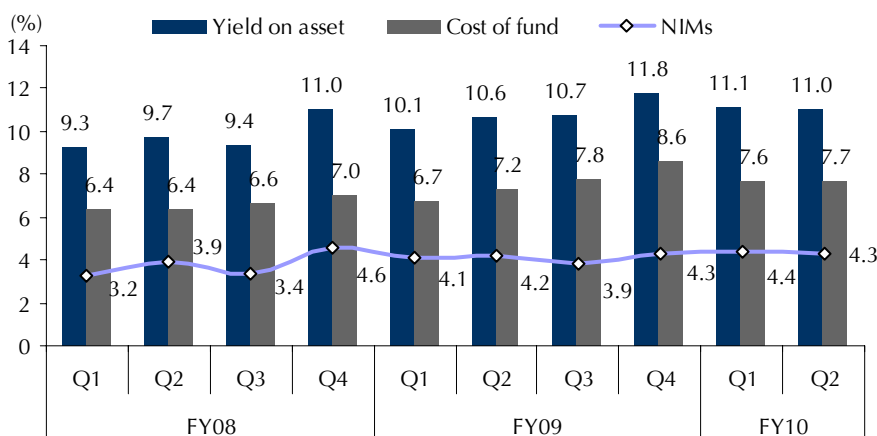
**Fig 7 - T&D constitutes 55% of total loan book**



Source: RHH, Company

**Fig 8 - NIM maintained at 4.25%**

Margins maintained at 4.25%



Source: Company

**Fig 9 - Comparative valuation – PFC and REC**

Company	Price	Market Cap (Rs mn)	P/BV (x)			RoE (%)	
	(Rs)		FY09E	FY10E	FY11E	FY09E	FY10E
PFC	221	253,656	2.2	1.9	1.7	18.0	17.9
REC*	200	171,732	2.4	1.8	1.6	22.8	19.9

Source: RHH, Company

\* Adding reserves created for deferred tax liability in net worth and assuming equity dilution at Rs 190 per share



## Standalone financials

### Profit and Loss statement

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Interest earned	35,174	47,993	63,101	79,658
Interest expended	20,728	28,911	38,789	50,945
<b>Net interest income</b>	<b>14,447</b>	<b>19,081</b>	<b>24,312</b>	<b>28,712</b>
Non-interest income	202	887	1,246	1,430
Operating expenses	1,119	1,111	1,266	1,439
Pre-provisioning profits	13,530	18,856	24,292	28,704
Provisions	400	(350)	(28)	105
PBT	13,130	19,206	24,320	28,599
Tax	4,523	6,485	5,942	7,579
Net profit	8,607	12,721	18,378	21,020
Extraordinaries (net of tax)	6	-	-	-
<b>Reported PAT</b>	<b>8,601</b>	<b>12,721</b>	<b>18,378</b>	<b>21,020</b>

### Balance sheet

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Cash and Bank balances	12,530	16,763	21,404	24,260
Loans and Advances	6,204	9,926	11,415	13,127
Other current assets	4,991	7,033	9,267	11,721
Investments	11,474	10,074	9,224	8,374
Advances	393,165	513,810	654,316	803,646
Net Block (inc CWIP)	779	785	840	915
<b>Total assets</b>	<b>429,144</b>	<b>558,391</b>	<b>706,466</b>	<b>862,043</b>
Share Capital	8,587	8,587	9,875	9,875
Reserves & surplus	45,090	53,592	88,942	103,007
Net Worth	53,677	62,179	98,817	112,882
Secured Loans	294,220	382,979	439,908	549,971
Unsecured Loans	48,608	65,533	106,529	124,044
Current Liabilities	14,866	21,269	28,907	39,026
Provisions	9,602	16,858	22,732	26,547
Deferred Tax liability	8,171	9,573	9,573	9,573
<b>Total liabilities</b>	<b>429,144</b>	<b>558,391</b>	<b>706,466</b>	<b>862,043</b>

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
Sanctions	467,698	412,743	515,929	598,478
Growth (%)	63.4	(11.8)	25.0	16.0
Disbursements (Excl. RGGVY)	125,520	165,677	204,801	234,163
Growth (%)	21.1	32.0	23.6	14.3

### Per share data

Y/E March	FY08	FY09	FY10E	FY11E
Shares outstanding (mn)	858.7	858.7	987.5	987.5
FDEPS (Rs)	10.0	14.8	18.6	21.3
DPS (Rs)	3.0	4.4	5.6	6.4
Book value (Rs)	62.5	72.4	100.1	114.3
Adjusted book value (Rs)*	72.0	83.6	109.8	124.0

\* Adj. for reserves created for deferred tax liability

### Key ratios

Y/E March (Rs mn)	FY08	FY09	FY10E	FY11E
<b>Valuation ratios (x)</b>				
P/E	20.0	13.5	10.7	9.4
P/BV	3.2	2.8	2.0	1.7
P/ABV	2.8	2.4	1.8	1.6
<b>Return ratios (%)</b>				
Interest spread	3.1	3.4	3.3	3.1
Net interest margin	3.8	4.1	4.1	4.0
Yield on assets	9.4	10.3	10.5	10.7
Cost of funds	6.2	7.0	7.4	7.9
Non-int Inc/ Total income	1.4	4.4	4.9	4.7
Opex cost/ Total income	10.4	3.8	4.8	5.1
<b>ROE calculation (%)</b>				
Net interest income/assets	3.8	4.1	4.1	4.0
Non interest income/assets	0.1	0.2	0.2	0.2
Net revenues/Assets	3.9	4.3	4.4	4.2
Operating expense/Assets	0.4	0.2	0.2	0.2
Taxes/Assets	1.2	1.4	1.0	1.0
ROA	2.3	2.8	3.1	2.9
Equity/Assets	12.4	12.5	13.7	14.6
ROAE	18.3	22.0	22.8	19.9
<b>Growth ratios (%)</b>				
Net interest income	36.2	32.1	27.4	18.1
Non-interest Income	(28.8)	338.7	40.5	14.7
Total income	34.5	36.3	28.0	17.9
Pre-provisioning profit	32.1	39.4	28.8	18.2
Net profit	31.0	47.8	44.5	14.4
EPS	18.4	47.9	25.6	14.4
Adj. Book value	18.3	16.0	31.4	13.0
<b>Asset quality (%)</b>				
Gross NPA	0.8	0.1	0.1	0.1
Net NPA	0.6	0.0	0.0	0.0



### Quarterly trend

Particulars	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
NII (Rs mn)	4,060	4,350	4,450	4,819	5,759
YoY growth (%)	58.6	33.0	46.9	19.9	41.8
QoQ growth (%)	1.0	7.1	2.3	8.3	19.5
Total income (Rs mn)	4,380	4,830	4,870	5,919	6,354
YoY growth (%)	37.3	26.8	46.7	37.0	45.1
QoQ growth (%)	1.4	10.3	0.8	21.5	7.3
PPP (Rs mn)	4,140	4,440	4,590	5,712	6,054
YoY growth (%)	36.6	24.7	46.2	50.7	46.2
QoQ growth (%)	9.2	7.2	3.4	24.4	6.0
Adj net profit (Rs mn)	2,730	2,920	3,190	3,880	4,718
YoY growth (%)	58.7	28.1	41.8	65.1	72.8
QoQ growth (%)	16.2	7.0	9.2	21.6	21.6

### Company profile

Rural Electrical Corporation (REC) is one of India's leading public financial institutions in power infrastructure. It is involved in the financing and promotion of transmission, distribution and generation projects across India. REC is also the nodal agency for the government's RGGVY scheme (Rajiv Gandhi Gramin Vidyut Yozna) where it administers grants and provides loans for electrification of villages. The company has been awarded navratna status by the government of India for its operational efficiency and financial strength.

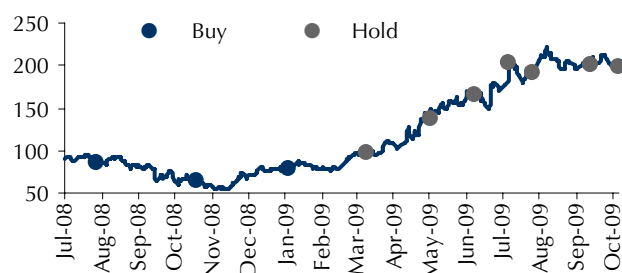
### Shareholding pattern

(%)	Mar-09	Jun-09	Oct-09
Promoters	81.8	81.8	81.8
FIs	3.4	4.6	5.9
Banks & FIs	8.3	8.0	6.2
Public	6.5	5.6	6.1

### Recommendation history

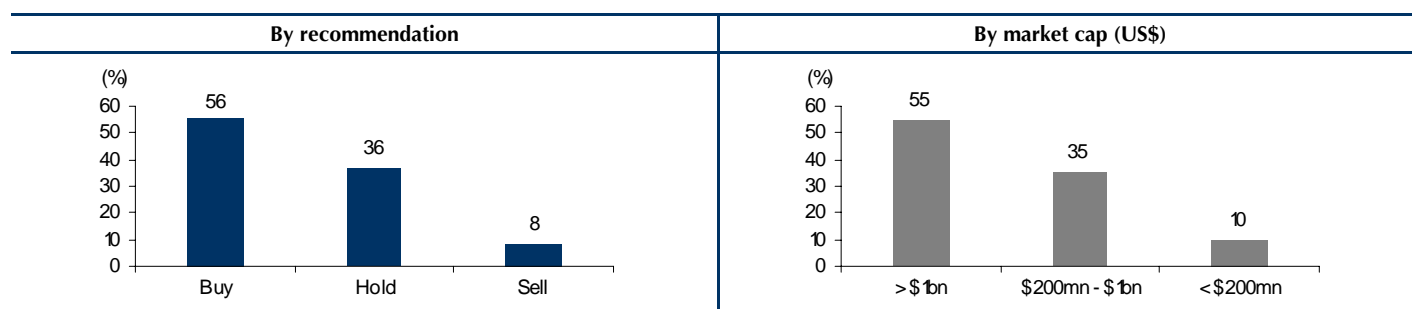
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	86	120	Buy
14-Nov-08	Company Update	64	90	Buy
29-Jan-09	Results Review	78	100	Buy
6-Apr-09	Quarterly Preview	96	100	Hold
26-May-09	Results Review	138	135	Hold
2-Jul-09	Quarterly Preview	163	165	Hold
30-Jul-09	Results Review	202	195	Hold
19-Aug-09	Company Update	192	195	Hold
6-Oct-09	Quarterly Preview	200	221	Hold
30-Oct-09	Results Review	200	221	Hold

### Stock performance





### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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