

INITIAL COVERAGE REPORT

Power Grid Corporation of India Ltd.

Buy

Share Data

Market Cap	Rs. 383.4 bn
Price	Rs. 91.1
BSE Sensex	13,570.31
Reuters	PGRD.BO
Avg. Volume (52 Week)	4.5 mn
52-Week High/Low	Rs.161.8/73.05
Shares Outstanding	4208.8 mn

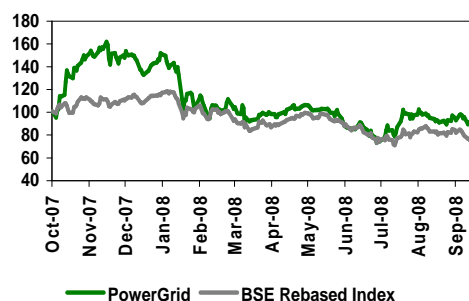
Valuation Ratios (Consolidated)

Year to 31 March	2009E	2010E
EPS (Rs.)	4.2	4.9
+/- (%)	21.2%	17.8%
PER (x)	21.8x	18.5x

Shareholding Pattern (%)

Promoters	86
FII's	3
Institutions	2
Public & Others	8

Relative Performance



Huge investment opportunities lie ahead

Power Grid is a Central Transmission Utility engaged in inter-state and inter-regional power transmission business. Over a period of 16 years, it has emerged as one of the largest and best managed transmission utilities in the world. Currently it is operating around 67,000 ckt. kms. of transmission lines along with 111 sub-stations and transmits about 40%-45% of the power generated in India. The Company has around 45 projects in hand, which would drive revenues and earnings in the medium term.

The Company has monopoly in this business over the past 16 years. However, with the introduction of the competitive bidding mode in 2011, private players are expected to enter the market. Power Grid's asset base of over Rs. 350 bn and 16 years of expertise in this field would pose a formidable challenge to its competitors. Diversification into consultancy and telecom has started generating additional income, which is expected to grow significantly in the coming years.

The Government of India's significant expansion plan to meet the power needs of the country completely is likely to open new vistas for Power Grid, which should keep the revenues and earnings steady in the long run.

Key Figures

Year to March	FY06	FY07	FY08	FY09E	FY10E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY08-10E)
Net Sales	31,453	35,899	46,148	54,796	66,981	20.5%
EBITDA	25,245	29,483	37,451	43,289	52,915	18.9%
Adj. Net Profit	10,089	12,294	14,485	17,559	20,680	19.5%

Margins(%)

EBITDA	80.3%	82.1%	81.2%	79.0%	79.0%
NPM	32.1%	34.2%	31.4%	32.0%	30.9%
ROE	10.6%	11.7%	11.7%	12.0%	12.5%

Per Share Data (Rs.)

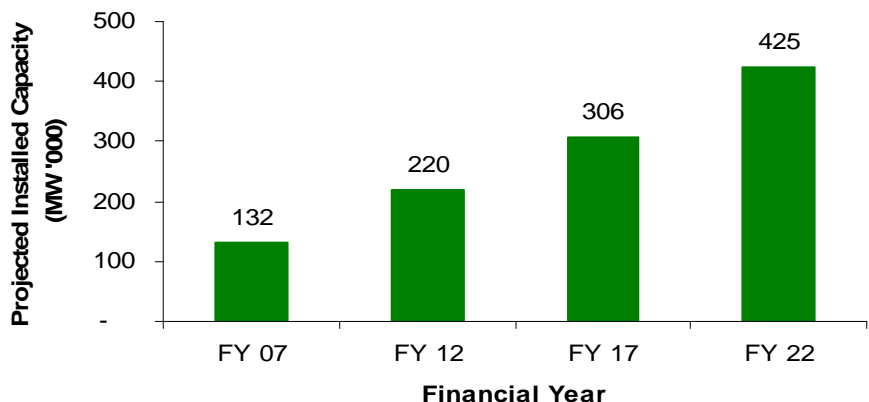
Normalised EPS	2.8	3.2	3.4	4.2	4.9
PER (x)	32.4x	28.1x	26.5x	21.8x	18.5x

- We estimate net sales and net profit to grow at a CAGR of 20.5% and 19.5%, respectively by 2010 on the back of significant investment opportunities available for the Company.
- At the current market price, the stock is trading at a price-to-book (P/B) multiple of 2.7x. Based on our valuation, the target P/B multiple of the stock is 3.29x giving us a fair value price of Rs. 110, implying a potential upside of 21% from the current market price of Rs. 91. We, therefore, initiate coverage with a BUY rating.

Investment rationale

Gol expansion plans to keep the growth in revenues and earnings to remain steady

Gol has envisaged meeting the power needs of the country completely by the end of the XIth five-year plan. At the end of the Xth five-year plan, India's power generation systems had an installed capacity of about 132,329 MW. Gol has planned for a capacity addition of 100,000 MW to meet its mission of "power for all" by the end of the XIth five-year plan.



Source: Power Grid's IPO Prospectus

PowerGrid to infuse Rs. 550 bn in the XIth five-year plan

The government of India has also developed a national electricity policy with an aim to accelerate the development of power sector through the generation of additional power. The Ministry of Power is developing nine ultra mega power projects (UMPPs) each having the capacity of about 4,000 MW. The contracts for the construction of the transmission lines associated with these projects are likely to be bagged by Power Grid. The policy also advocates establishing an infrastructure for transmission services for which it

has budgeted an expenditure of Rs. 750 bn, out of which Power Grid will infuse Rs. 550 bn and the rest would be mobilised through the private sector in the form of joint ventures with Power Grid or 100% investment by the private sector. The inter-state transmission system (ISTS) capacity is expected to increase from 17,000 MW to 37,000 MW by 2012. Power Grid would be responsible for the most of this increase and is expected to earn steady revenues from the projects.

Return on equity likely to improve

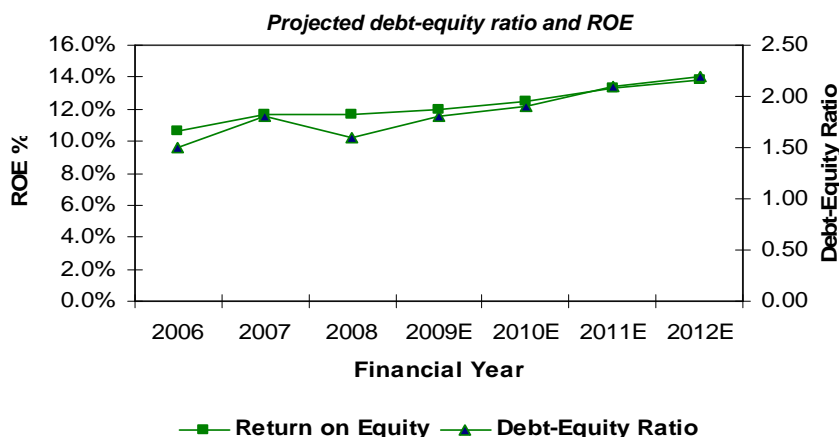
We expect the ROE of Power Grid to improve from the current level of 11.7% to 13.8% by the end of 2012, driven by the following factors:

Higher debt-equity ratio

Central Electricity Regulatory Commission (CERC) requires the debt-equity ratio of 2.33 for the purpose of tariff determination, whereas the current debt-equity ratio of Power Grid is 1.61. The excess equity is assumed as an interest bearing debt by CERC, thus bringing down the effective ROE. As a result, Power Grid has not been able to achieve the maximum ROE of 14% allowed by CERC for structuring the tariffs.

However, the Company has proposed to invest Rs. 550 bn in the XIth five-year plan, out of which Rs. 375 bn is expected to be raised through debt. This would result in an increase in the debt-equity ratio over the period and would consequently impact the ROE of the Company positively.

ROE is likely to improve on the back of higher debt-equity ratio, operational efficiency and incremental income from telecom & consultancy.



Average system availability was at 99.65% for the fiscal 2007-08.

Significant investment has been made in laying down the infrastructure for the telecom network.

Improved operational efficiency

Power Grid has maintained an average system availability of over 99% since fiscal 2002, while in the last fiscal it was 99.7%. For each percentage point of increase in annual availability beyond the target availability of 98% set by CERC, Power Grid is entitled to an incentive of 1% of equity. This incentive income scheme has helped the Company in improving its ROE in the past. For example, in the last fiscal, although the debt-equity ratio fell from 1.8 to 1.6, the ROE remained at 11.7% mainly because of the incentive income earned on the back of high operational efficiency. Power Grid is determined in maintaining the current levels of system availability in future by investing in modern technologies.

Incremental revenues from telecom segment

Power Grid has made huge investments in installing about 20,000 kms of telecom network. Revenues from the telecom segment increased by 62% in FY'08 to Rs. 1,250 mn; however, the Company reported a net loss of Rs. 179 mn. Losses were principally on account of higher financial charges and depreciation as the business required significant investment. Considering the facts that the infrastructure needed for the business has been laid down and Power Grid is planning to enter into the telecom market, the income from this segment is expected to grow manifold in the coming years. Although the telecom industry already consists of large private players, even if Power Grid is able to capture a small portion of the market, it can generate huge revenues from it.

The Company leases its bandwidth to major telecom players and big corporate houses. Moreover, it is also planning to tap the customers in the entertainment and broadcasting industry. Telecom, being an unregulated and highly leveraged business, is expected to boost the ROE of Power Grid in the coming years.

Consultancy income from government funded projects and international projects

Since 1995, Power Grid has diversified into consultancy business, providing transmission-related consultancy services to more than 90 clients in over 225 domestic and international projects. Power Grid's expertise and

Government funded nation building schemes to drive growth in consultancy segment.

experience in this field has enabled the Company to generate a steady flow of revenues from consultancy services. In the last fiscal, this segment contributed 5% to the total revenues, whereas it contributed 8% to the total profits. With better margins we expect that it will add to the overall profitability of the Company.

Power Grid has been playing a major role in the Govt. of India's nation building schemes such as Accelerated Power Development and Reforms Programme (APDRP) and Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) towards bringing qualitative improvement in the distribution sector. Consultancy fees at a fixed rate (2%, 5%, 12% of the total project cost, depending upon the work) has been granted to Power Grid under these schemes.

Power Grid has been assigned projects worth Rs. 94 bn under RGGVY, out of which 25% of the work has been done and the rest is expected to be completed by 2012. Under APDRP, Power Grid has completed about 81% of the work assigned to it and the rest is expected to be completed by 2010. The total cost of the projects assigned to Power Grid under APDRP is Rs. 773 bn. Power Grid is also expected to bag more consultancy assignments in other nations, as it has been doing in the past.

These consultancy projects on an average provide an operating margin of 60%-65% to Power Grid with nominal investment required to be made. Thus, incremental consultancy income can give a huge boost to the ROE of Power Grid.

Competition – a mixed bag of challenges and opportunities

Power Grid has been in the power transmission business for the last 16 years, without any serious competition primarily due to the regulated nature of the business. However, Gol would be shifting to the competitive bidding mode in 2011 for granting rights to build transmission lines for power projects. With the opening up of the sector, ROEs are unlikely to remain capped by regulations. Power Grid's huge asset base and expertise should give the Company an edge over its competitors and can potentially help the Company to increase its ROEs in the future.

However, the increased competition is also expected to pose a challenge to Power Grid in terms of retaining talent, reducing its costs, further improving its efficiency.

Thus, increased competition may turn out to be a boon or a curse for Power Grid depending upon how it adapts to the competitive bidding mode.

Key Risks

Adverse changes in tariff regulations

In 2004, CERC reduced the prescribed ROE from 16% to 14% for the purpose of tariff determination, which is subjected to change in 2009. If CERC reduces the prescribed ROE further, it would affect the Company's revenues adversely and thus our estimates.

The prescribed ROE for transmission companies in other developed countries has historically been in the range of 9%-12%. Eventually, CERC might bring the regulated ROEs in line with those of other developed nations. But as per the draft of the terms and regulations of tariff determination issued by CERC recently, the ROE cap is expected to remain at 14% for the next 5 years.

Delays in commissioning of projects

The power transmission business is subject to delays in the commissioning of projects, which may arise due to many factors such as delays in granting of approval, land acquisition disputes, environmental disputes.

When the power generating projects, to which the transmission project of the Company is linked, get delayed, the return on investment in the project gets postponed, and when the transmission project is delayed by some reason, Power Grid has to indemnify the generating company up to a certain limit. This adversely affects the ROE.

For our valuation purpose, we have factored in an average delay of 1 year for projects that are under implementation. However, if projects get delayed more often and longer, it would adversely affect our estimates.

Defaults by “State Power Utilities” (SPUs)

SPUs have had weak credit histories in the past. Income from SPUs accounts for 80% of the revenues of the Company. Currently, the Company collects 100% of its revenues from the SPUs on timely basis, but if the situation deteriorates again in future, it may affect the company adversely.

Outlook

We have estimated the ROE of Power Grid to improve from the current level of 11.7% to 13.8% by 2012 on the back of significant expansion plans along with a higher debt-equity ratio and improving operational efficiencies.

The growth in the consultancy segment, on the back of the government funded schemes, is also expected to give a boost to the ROE of the Company. The telecom segment, for which the infrastructure has been laid down, should start generating additional income for the Company.

However, restricting the delays in commissioning of projects remains a challenge for Power Grid. The competitive bidding mode is to kick off in 2011. If Power Grid is unable to cope up with the challenges posed by private players, our projections can be adversely affected.

Valuation

At the current market price of Rs. 91.10, the Company is trading at a price-to-book multiple of 2.73x. Our valuation model gives us a target price to book multiple of 3.29x and a estimated fair value of Rs. 110. We have assumed a discount rate of 9.25%. Our target price shows an upside of 21% from the current price. We therefore initiate coverage with a BUY rating.

Sensitivity Analysis

		Terminal ROE				
		12.8%	13.3%	13.8%	14.3%	14.8%
Discount rate	8.25%	114	129	145	163	184
	8.75%	100	112	126	142	160
	9.25%	87	98	110	124	139
	9.75%	76	85	96	108	122
	10.25%	66	74	84	94	106

Company background

Power Grid is the Central Transmission Utility of India, which started its operations 16 years ago in 1992. The Company is engaged in construction, operation & maintenance of inter-regional and inter-state transmission systems. It was a wholly owned government company till September 2007, when the Company went public with an IPO of 573.9 mn equity shares of the face value of Rs. 10 each. The Company received an overwhelming response from the market with the issue being oversubscribed by 64.5 times. The Company has a gross asset base of Rs. 350 bn and transmission capacity of more than 73,000 MVA. To remain financially sound, the Company has diversified into consultancy and telecom services, which have started generating valuable income for the Company.

However, the Company is highly regulated because of the nature of business it is into. Central Electricity Regulatory Commission (CERC) regulates the tariff determination process for Power Grid by listing out the expenses that the Company can pass on to the consumers and specifying a prescribed ROE for structuring the tariffs. CERC also gives incentive income to Power Grid if the operational efficiency of the Company is above 95%. Power Grid's operational efficiency has been above 99% in the past 5 years, which has helped the Company gain valuable incentive income.

The Company has a near monopoly in its area of operations. Due to the investment size, long gestation periods and the regulated nature of the projects it deals in, the private sector has so far not entered into its market on a large scale.

Power Grid has been conferred with the National Award five times for meritorious performance in the transmission sector for system availability and project completion. CRISIL has given a bond rating of AAA to Power Grid. It has also been designated a Mini-Ratna Category-I public sector undertaking since 1998.

Disclaimer

This report is not for public distribution and is only for private circulation and use. The Report should not be reproduced or redistributed to any other person or person(s) in any form. No action is solicited on the basis of the contents of this report.

This material is for the general information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be considered as an offer to sell or the solicitation of an offer to buy any stock or derivative in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Indiabulls Securities Limited. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. You are advised to independently evaluate the investments and strategies discussed herein and also seek the advice of your financial adviser.

Past performance is not a guide for future performance. The value of, and income from investments may vary because of changes in the macro and micro economic conditions. Past performance is not necessarily a guide to future performance.

This report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Any opinions expressed here in reflect judgments at this date and are subject to change without notice. Indiabulls Securities Limited (ISL) and any/all of its group companies or directors or employees reserves its right to suspend the publication of this Report and are not under any obligation to tell you when opinions or information in this report change. In addition, ISL has no obligation to continue to publish reports on all the stocks currently under its coverage or to notify you in the event it terminates its coverage. Neither Indiabulls Securities Limited nor any of its affiliates, associates, directors or employees shall in any way be responsible for any loss or damage that may arise to any person from any error in the information contained in this report.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject stock and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. No part of this material may be duplicated in any form and/or redistributed without Indiabulls Securities Limited prior written consent.

The information given herein should be treated as only factor, while making investment decision. The report does not provide individually tailor-made investment advice. Indiabulls Securities Limited recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. Indiabulls Securities Limited shall not be responsible for any transaction conducted based on the information given in this report, which is in violation of rules and regulations of National Stock Exchange or Bombay Stock Exchange.