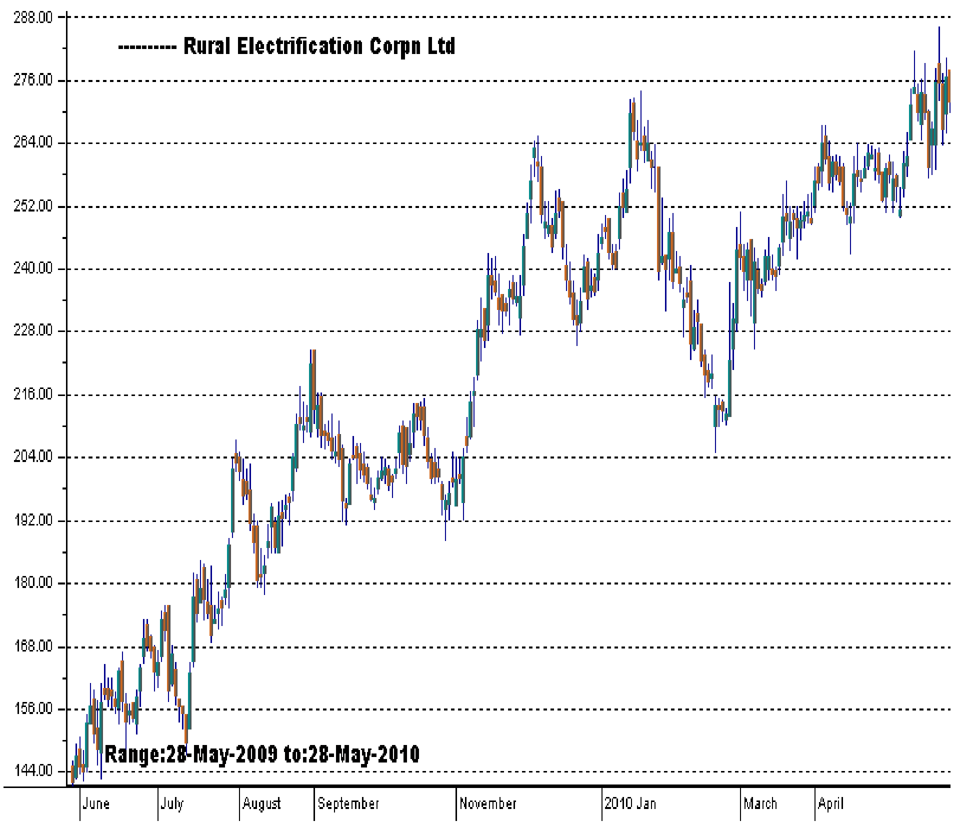
Research@bonanzaonline.com

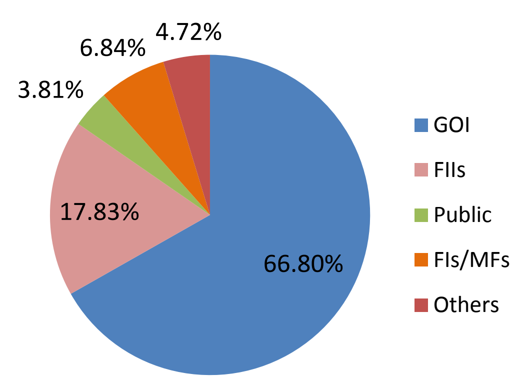
28th May 2010

Rural Electrification Crop. **Hold** **CMP: - Rs 276**



Key Data	
Face Value:	10
52 week High:	287
52Week Low:	141.3
NSE Code:	REC
AverageVol. (Monthly) (BSE+NSE)	70,143,860

Shr holding pattern



Company back ground:

Rural Electrification Corporation (REC), a public sector enterprise is engaged in financing and promoting transmission, distribution and generation projects across the country. Its financial products include long-term loans, short-term loans, bridge loans and debt refinancing. It has 17 units across the country with corporate office in New Delhi. It was conferred with prestigious Nav Ratna status in 2008. REC had issued IPO in Mar2008 and in Feb 2010 it had issued FPO. REC has four Subsidiary Companies namely REC Transmission Projects Company Limited (RECTPCL), REC Power Distribution Company Limited (RECPDCL), North Karanpura Transmission Company Limited (NKTCL)(a wholly owned subsidiary of

RECTPCL), Talcher II Transmission Company Limited (TTCL) (a wholly owned subsidiary of RECTPCL)

Investment rational:

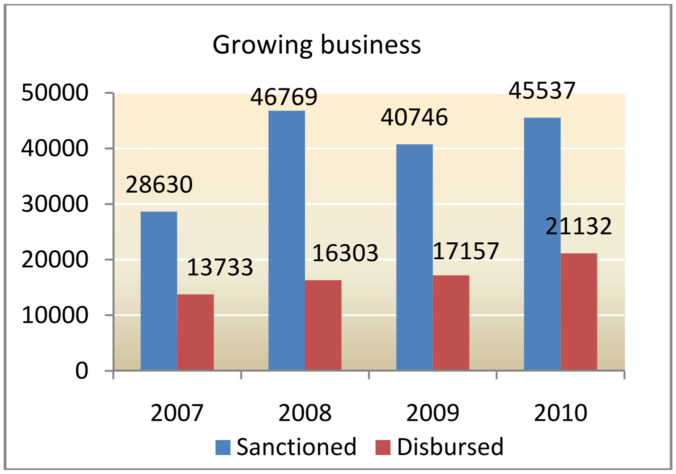
Better Q4 FY10 financial performance:

- REC had reported a impressive 45%y-o-y growth in net profit Q4FY10
- Net sales grew by 34% y-o-y and stood at Rs 1796 cr in Q4FY10.
- Net interst income (NII) registered sturdy 51% y-o-y growth to Rs 727cr in Q4FY10 as against Rs482 cr in Q4 FY09. For FY10 NII grew at 42.5%y-o-y to Rs 2520 cr.
- Net interest margin for Q4 FY10 stood at 3.35% where NIM for FY10 is 4.3% as against 3.96% in FY09
- Sanction and disbursement grew by 12% & 23% for FY10 respectively.
- Management is expecting a 30% growth in disbursement and loan asset with 25% growth in bottom-line.

Government initiative towards infrastructure sector (Power, Electricity) shows strong visibility of Business growth:

To achieve GDP growth of 9 to 10% the government has proposed a $1trillion infra investment during 12th five year plan, out of which major chunk is expected for power sector value chain to meet the target of energy generation capacity of 1470-1525 bn kwh by the 2017. REC, which plays a strategic role in financing power projects would find business growth to meet the debt requirement of the power sector. REC with long experience in power financing is expected to disburse around Rs 590 bn during eleventh five year plan (as projected by Working Group of Power) and is more optimistic to raise its business acquiring a sizable share in funding the power projects in the coming years.

Growing business with outstanding sanctions of Rs~1000bn in its kitty: With superior domain knowledge, and financing expertise REC enjoys a strategic advantage to bag the financing opportunities in the power sector . There is a significant growth in REC's sanction and disbursement during these years. Its sanctions and disbursements have grown at a CAGR of ~29% and ~28% respectively over a period FY05-FY10. With the better macro economic environment and the proposed capex plan of the government during 12th five-year plan, REC would further boost its disbursement. REC has a huge sanction of Rs 1000 bn in pipeline. Management is expecting a 30% y-o-y growth in loan book for FY11.

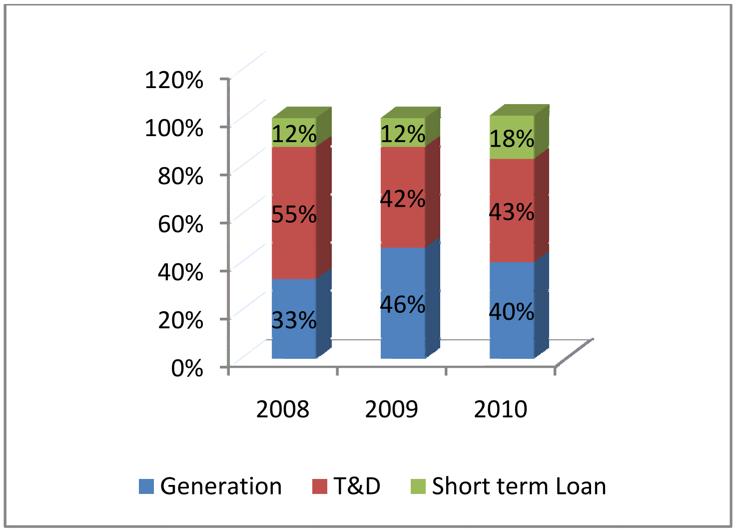


Applied for IFC status (Infra Financing Corporation): Recently REC has approached RBI for IFC status. If that status get approved then exposure limits of REC towards state utilities, group projects and individuals would be increased to 100%,50% an 25% of its net worth respectively.IFC status would also increase the ECB limits through automatic route.

Expanding lending portfolios financing the entire power value chain: REC was established with an objective to finance and promote rural electrification projects all over the country. But over the years REC has expanded its financing activities to different segments of power sector including generation, Transmission & Distribution (T&D) business. Recently REC has extended its financing activities to power linked projects such as coal and other mining activities, fuel supply arrangement for power sector and other power-related infrastructure. The company acts as a nodal agency for Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY), a GoI initiative to provide electricity to the entire rural India.

Recent capital infusion strengthened the Balance sheet. During Feb 2010 REC had came out with FPO (where there was dilution of govt shares also) and raised capital to meet its capital requirements. Currently CAR of REC is ~16% against the required 10%.

Re- mix of lending portfolio to avoid slippage: Traditionally, REC had a large amount of its loan portfolio towards the T&D segment which resulted higher NPAs due to huge losses in this segment. From 2001onwards REC had revised its lending port folio entering into generation segments to contain the slippage in assets. Although generation segment has longer gestation period compared to T&D segment but flexibility in financing and measures undertaken to avoid slippage made this segment attractive.



Demand-supply mismatch creates a opportunities for investment: The existing power deficit in the country, as well as increasing demand on the back of growing economic activities will necessitate large-scale capacity addition in the coming years. Power working group has projected a capacity addition of 82200MW for 12th plan period (2012-17) based on a scenario of 9% GDP growth rate ,which could increase to 107500MW under GDP growth of 10%. Realizing these future requirements govt has embarked upon investment of ~400bn USD over the 10 year period (2007-17). In this context REC having more than 16% market share, would be a major beneficiary of this huge investments.

Capacity addition required during 12th plan period				
GDP %	Electricity generation required (Bn kwh)	Peak demand (MW)	installed capacity (MW)	capacity addition required (MW)
8%	1415	215700	280300	70800
9%	1470	224600	291700	82200
10%	1525	232300	302300	107500

Better asset quality with less NPA: There is a significant improvement in asset quality since 2007 onwards on the back of escrow mechanism coupled with restructuring of loans, better appraisal and collection procedures. GNPA of REC which was Rs322 cr during FY08 reduced to Rs 20 cr by 31st March'2010 and that is only 0.03% of the loan outstanding in FY10.

Improved rating: REC enjoys international credit rating equivalent to sovereign rating of India from International Credit Rating Agencies Moody's and FITCH which is "Baa3" and "BBB-" respectively. This helps REC to raise funds at a competitive rate.

Peer Analysis:

Looking at the peer set REC appears cheaper at 13.6x P E.

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FY10/ Rs in Cr	PFC	REC	IDFC
Net sales	8002	6431	3570
PAT	2355	2001	1013
EPS	20.5	20.3	7.8
CMP	288	276	155
market cap	32344	26893	20065
P/BV (X)	2.4	2.5	3.0
P/E(X)	14.0	13.6	19.9
BV	120.8	112.2	52.5

Risk & concerns:

The weak financial health of SEBs remains an area of concern even as they undergo the reform process.

Recommendation:

The huge opportunities for business growth from government's proposed capex plan in the coming years would be driving force towards the betterment of REC. If REC achieved the IFC status it would increase its exposure limits towards different section of borrowers and simultaneously it would avail of the fiscal benefit related to infra financing. At CMP Rs 276 the stock is trading at forward earning multiple of 10.9x of FY11E and 2.1x of FY11E BV.Stock is reasonably priced and offers value for long term investors.

Financials :

Rs Crore	*Q4F09*	*Q4FY10*	*%y-o-y*	*Q3FY10*	*%q-o-q*	*FY09*	*FY10*	*FY11E*
Net sales	1337	1796	34.32%	1653	8.63%	4665	6431	8103
other income	110	74	-33.03%	53	39.13%	266	277	299
Total income	1447	1870	29.20%	1706	9.58%	4931	6708	8402
Interest expense	855	1068	24.95%	1028	3.95%	2897	3911	4967
Operating Expense	23	48	108.39%	34	42.50%	114	147	169
Total Expense	878	1117	27.14%	1062	5.18%	3011	4058	5137
PBT	569	753	32.36%	645	16.82%	1920	2649	3265
prov.forTax	181	192	6.06%	170	12.48%	648	648	765
Net profit	388	561	44.62%	474	18.37%	1272	2001	2500
NII (Rs)	482	727	50.95%	625	16.31%	1768	2520	3136
GNPA	69	20		20		69	20	20
GNPA%	0.136	0.030		0.032		0.136	0.030	0.030
NNPA	21	2		2		17	2	0
NNPA%	0.041	0.003		0.003		0.041	0.003	0.0
CAR %							16	16
Equity(FV Rs 10)	859	987		987		859	987	987

EPS (Rs)	4.52	5.68		4.80		14.81	20.27	25.32
CMP (Rs)	276	276		276		276	276	276
BV (Rs)						72	112	130
P/BV(x)						3.8	2.5	2.1
P/E(x)						18.63	13.62	10.90

Key parameters(FY10)	*Q1*	*Q2*	*Q3*	*Q4*
NIM%	*4.42*	*4.25*	*4.15*	*4.45*
yield on loan%	*11.13*	*11.01*	*10.96*	*11.16*
Cost of borrowing%	*7.61*	*7.66*	*7.7*	*7.8*
Interest spread%	*3.52*	*3.35*	*3.26*	*3.36*
Int.coverage ratio%	*1.69*	*1.69*	*1.63*	*1.7*
GNPA%	*0.06*	*0.036*	*0.032*	*0.03*
NNPA%	*0.004*	*0.003*	*0.003*	*0.003*
ROE%	*29.38*	*26.79*	*23.1*	*23.17*
*EPS**	*5.49*	*5.76*	*5.52*	*5.68*
*BV**	*77.58*	*83.34*	*88.86*	*112.2*
P/BV	*3.5576*	*3.3117*	*3.106*	*2.46*

**In Q4FY10 REC issued FPO*

Balance Sheet			*(Rs Crore)*
Particulars	**FY09**	**FY10E**	**FY11E**
*sh.holders fund**	6190	11080	12876
Borrowing	44936	55948	72732
Deferred tax lib	957	-7	485
Total Liabilities	52083	67021	86093
Net fixed assets	81	90	104
Loan assets	51381	66452	85723
Investments	1005	910	1092
Current Assets(Net)	-384	-431	-825
Total Assets	52083	67021	86093

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