

Power Interrupted !



Power Grid Corp. of India Ltd.

SELL | CMP Rs. 94.0
Target Rs. 82.0

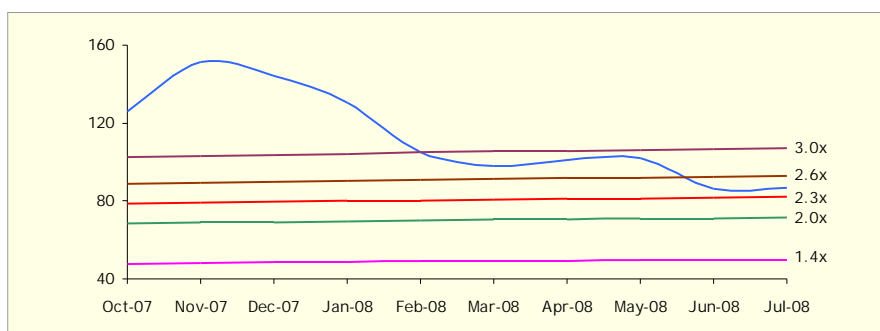
19th August 2008

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PGCIL can be best introduced as a large-cap stock with a near monopoly in a high growth & critical T&D segment. Given the hitherto regulatory protection & the sheer scale, PGCIL is unlikely to experience any meaningful competition in the foreseeable future. Another interesting facet to this monopoly play is the growth prospect on the backdrop of poor current power scenario & aggressive reforms. Moreover there is secured cost plus margins, which one may also refer as 'regulated' margins.

However, we initiate our coverage on this power major with a pessimistic stance. Briefly, we are not happy with the current valuations given the business model & the consequent impact on the financial performance. The business is highly capital intensive. Rs. 100 addition to the gross block of fixed assets would generate a mere Rs. 12.5 of revenues. PGCIL's key business is in earning a usage charge for the huge interstate electricity infrastructure that it owns. So, one sees that the ~entire business model of the company is asset driven. The poor asset turnover is decently compensated by the extremely high operating margins, which have consistently been over 80%. However, it is the huge depreciation (given the capital intensive business) and the huge interest costs (given the aggressive 70:30 leverage policy), that bring down the net margins to ~30%.

It is here that we realize that the business has poor ability to self finance its future growth. The company would grow (& meaningfully grow, given the huge base effect), only when subjected to huge capex; & as long as this persist, the return ratios would be lower than the stipulated 14-16%. The ROEs which have been historically observed in the range of 10-12% are unlikely to improve in the foreseeable future. Even in a steady state scenario in future, we see there are no strong levers to take the return ratios to better levels, say ~20% after considering the income from unregulated sources as well. In this context, we feel that, at 2.9x FY08 book value and at 2.5x FY10E book value, the stock is still richly valued.



The huge spike in this index scrip with monopoly play post its listing on bourses, has been followed by a continual correction in the P/BV for PGCIL. We feel there is clearly more room for correction from the current levels. We at best assign a 2x book value on forward basis, given the monopolistic positioning of the company. At 2x FY11E P/BV target multiple, we get our target price of Rs. 82 for PGCIL (13% downside from CMP). Here, it is not just the one-time 13% downside that we are suggesting. We believe that the case for PGCIL delivering any meaningful increase in PAT Y-o-Y is weak. So, the

scrip may make sense to some as a discount/value bet if it corrects further from these levels, but may still not entice investors who are looking at recurring earnings growth.

There are many more negative levers to the PGCIL story. These include :

- Increase in competition from private players upon introduction of competitive bidding as per National Tariff Policy;
- Poor returns from the unregulated yet competitive businesses;
- Delays at the end of PGCIL and also the generation utilities;
- Obliteration of Short-term open access charges;
- Increase in near-load centre generation capacity;
- Higher usage on non-conventional energy sources;
- Increase cost of new funds;
- Price variation clause to EPC contractors & subcontractors;
- CERC regulation uncertainty over pass through of foreign exchange variations & continuance of Advance against Depreciation;
- Sharing of revenues from unregulated businesses make it further unremunerative;
- Likelihood of short-fall in estimated accruals & consequent necessity for Equity dilution to meet Capex needs, a few years down the line;
- Increasing tax rates; etc..

However, our concern primarily stimulates from the model of the mainstay business of the company. With a decent 30% dividend payout, poor asset turnover, high depreciation & finance costs, there is very little ploughing back of profits, relative to the huge investment that goes into achieving some moderate growth.

PGCIL is often compared to EPC plays in the T&D space, which include companies like Jyoti Structures & KEC International & a few others. The companies are smaller companies, significantly dependent on PGCIL for its growth and also function in a more competitive environment, unlike the monopolistic PGCIL. However, these companies are much better in terms of high asset turnover, high growth rates (base effect play here) and much attractive ROEs. We disagree that the outlook for these EPC plays is any worse than PGCIL. We believe that in terms of growth outlook, both PGCIL & EPC companies are in the same boat. However, given the business economics, we prefer the EPC plays over PGCIL.

Comparative Valuations

Particulars	M.Cap	Sales	M/Cap to Sales	EBITDA	PAT	Fixed Assets T/o	ROE	ROCE	Debt/Equity
FY08	(Rs. Mn)	(Rs. Mn)	(x)	(%)	(%)	(Gross)	(%)	(%)	(x)
KEC International [#]	32,554.5	28,137.5	1.16	14.0	6.0	5.77	46.3	43.0	1.28
Jyoti Structures [#]	12,963.6	13,704.0	0.95	12.7	5.3	13.00	21.3	29.5	0.70
PGCIL [*]	395,631.0	46,148.2	8.57	91.3	31.4	0.13	10.5	9.0	1.60

Source: [#] Actuals / ^{*} PPFAS Estimate

One another differentiator between PGCIL & EPC players is in terms of working capital intensity & its impact on the cashflows. EPC players have a track record of high working capital intensity, given the long gestation period (18-24 months) of the projects. PGCIL on the other hand has had a trend of negative working capital, ergo reflecting strong operating cashflow generation.

Particulars	KEC International #	Jyoti Structures #	PGCIL*
Inventory T/o Days	26.64	20.92	20.00
Debtors T/o Days	185.50	132.86	50.00
Advances T/o Days	35.04	30.56	150.00
Creditors T/o Days	170.88	88.09	303.09
Net Working Cap T/o Days	76.30	127.78	(68.14)

Source: # Actuals / * PPFAS Estimate

However, talking business perspective, PGCIL has a higher execution time-frame (18-36 months) and also higher working capital intensity. The negative working capital for PGCIL is on account of very high creditor days, which we perceive is on account of capex liabilities. This number is significant, given the huge capex undertaken by PGCIL. Infact, it is this huge capex that makes the cash-flow based valuation for the company absolutely unappealing. We do not expect this to change in the foreseeable future.

Particulars	FY06	FY07	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E
CF - Optg. Activities	44,594.4	38,225.6	17,072.0	75,866.8	65,308.1	74,557.4	85,486.9	16,288.8	115,005.8	88,544.9
Change in FA	(58,291.8)	(71,659.1)	(57,189.8)	(92,646.8)	(111,855.5)	(130,729.7)	(150,358.9)	(27,773.2)	(50,004.2)	(42,484.3)
Free Cashflow	(13,697.4)	(33,433.5)	(40,117.8)	(16,780.0)	(46,547.4)	(56,172.3)	(64,872.0)	(11,484.4)	65,001.6	46,060.6

Source: PPFAS Research

The effective interest cost for the company appears to be low at ~6% as against the current weighted average cost of debt at 7.5-8%. This is primarily on account of capitalization of interest costs for the projects under construction. The impact of the rising interest rate scenario will get reflected with a lag in the case of PGCIL. It would be more evident as & when the CWIP & Capital Advances as a % of Gross block reduces.

Particulars	FY06	FY07	FY08E	FY09E	FY10E	FY11E
Gross Block	248,882.5	290,146.3	354,170.0	421,386.8	518,242.3	633,972.0
Capital WIP	36,356.8	60,688.5	53,050.0	80,000.0	95,000.0	110,000.0
Advances for CAPEX	27,651.8	33,715.4	34,520.0	33,000.0	33,000.0	33,000.0
As % of GB	25.7%	32.5%	24.7%	26.8%	24.7%	22.6%

Source: PPFAS Research

The stock is currently trading at 24.3x FY09E EPS of Rs. 3.9 & 2.7x P/BV (FY09E). We do not find the scrip favourable in terms of P/E, P/BV and also cash-flow based valuations. Here, it is not just the one-time 13% downside that we are suggesting. We believe that the Book Value would grow at a mere 8% CAGR, which we feel is unexciting, making PGCIL more a play on price multiples, rather than regular business growth. We recommend SELL.



Source: PPFAS Research

Power Grid Corp. Of India Ltd.

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Initiating Coverage

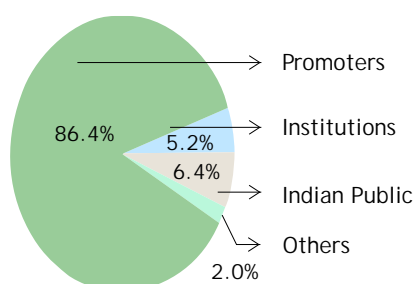
Stock Data

Bloomberg : PWGR.IN
Reuters : PGRD.BO
BSE Code : 532898
NSE Code : POWERGRID
BSE Group : A

Stock Codes

Benchmark : Nifty
52 Week High/Low: 167.45/70.60
Free Float : 14Mn
Mkt Cap : Rs. 412,887Mn
Face Value : Rs. 10.0

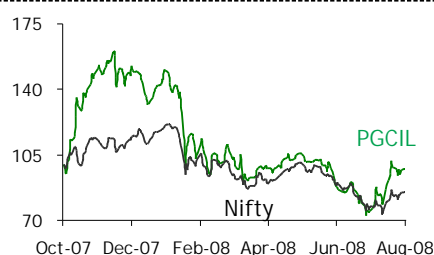
Shareholding Pattern (as on June 08)



Stock Returns

	1 Mth	3 Mths	6 Mths
PGCIL	30.50	-6.61	-14.31
Nifty	9.45	-14.56	-19.85

Price Comparison



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Huge capex to fuel top line growth

The macro economic environment is attracting significant investments in generation, entailing corresponding capex in transmission & distribution infrastructure. Accordingly, PGCIL has a planned capex of Rs. 550Bn through FY07-12, to be funded by as per Central Electricity Regulatory Commission (CERC) guidelines (debt:equity of 70:30). given the capex, we have estimated a top line CAGR growth of 19% over FY08-11E.

However, a substantial lag in transmission ROE

Power Grid starts to earn a 14% ROE only when a transmission project becomes operational. With Rs. 550Bn capex in FY07-12 to increase transmission capacity from 14.1 GW to 37.5 GW, we expect transmission business ROE to remain below 14%. However, we expect Power Grid's overall ROE to improve to 11.5% in FY10 from 10.5% currently on increasing financial leverage and improving profitability of its unregulated businesses.

Telecom & Consultancy Businesses - Non Satisfactory

We expect Power Grid's unregulated telecom & consultancy businesses to expand at a CAGR of 20% & 13%, respectively over FY08-11E. The contribution of these businesses to the topline of PGCIL would remain @ 6-7% over FY09-11E.

Valuations

Power Grid is a natural monopoly but without the pricing power of a monopoly as its returns & tariffs are regulated. The company is allowed a 14% ROE on transmission, but the effective ROE is lower at 10.5% due to huge capex plans & also the capital work in progress. PGCIL is currently trading at 24.3x & 21.6x our FY09E & FY10E earnings of Rs. 3.9 & Rs. 4.3 respectively. On a P/BV multiple, company is trading at 2.9x FY09E book value is high. Thus we recommend a 'SELL' on the scrip, with a price objective of Rs. 82 (13% downside) at which the scrip would trade at 2x FY11E P/BV.

Particulars (Rs. Mn)	FY06	FY07	FY08A	FY09E	FY10E	FY11E
Revenues	31,367.6	35,898.5	46,148.2	54,780.3	65,816.8	78,612.5
PAT	10,003.6	12,293.7	14,484.7	16,308.1	18,298.9	20,185.3
OPM (%)	80.2%	81.7%	81.2%	81.4%	81.8%	82.2%
EPS (Rs.)	2.8	3.2	3.4	3.9	4.3	4.8
P/E (x)	34.0	29.3	27.3	24.3	21.6	19.6
P/BV (x)	3.4	3.3	2.9	2.7	2.5	2.3
ROCE (%)	8.7%	8.6%	9.0%	8.6%	8.5%	8.4%
RONW (%)	10.0%	11.2%	10.5%	11.0%	11.5%	11.7%
Debt/Equity (x)	1.5	1.8	1.6	1.8	2.1	2.4

Brief Profile

Power Grid Corporation of India Ltd. (PGCIL) is India's principal electric power transmission company & has commenced operations in FY92 as part of an initiative of the Government of India to consolidate all the interstate and inter-regional electric power transmission assets of the country in a single entity. Accordingly, the transmission assets of all central sector electricity generation utilities that operated on an interstate or inter-regional basis were transferred to PGCIL. As on 01st May 2000, the Government granted coveted 'Navratna' status to PGCIL, giving the transmission major financial autonomy to take independent decision on investments up to Rs. 10Bn and provides a greater delegation of powers to undertake new projects without Government approval, subject to an investment ceiling set by the Government. PGCIL has received the highest annual performance rating from the Gol in each year since FY94, & the Prime Minister's award for performance for six out of the seven years to FY06. The company has certified for PAS 99:2006, which integrates the requirements of ISO 9001:2000 for quality, ISO 14001:2004 for environment management and OHSAS 18000:1999 for health and safety management systems.

Power Grid Capacity

Particulars	MW
Present	14,100
FY10E	21,150
FY12E	37,150
FY17E	65,000

PGCIL owns and operates most of India's interstate and inter-regional electric power transmission system. In that capacity, the company owned and operated 61,875 circuit kilometres (ckm) of electrical transmission lines and 115 electrical substations. Since its inception, it has completed 101 transmission projects and schemes. The average system availability maintained by PGCIL was over 99% since FY02. The transmission losses were in the range of 3%-4%, representing mainly technical losses. As the power is transmitted over high voltage, it generally does not involve commercial losses. Nevertheless, transmission losses are factored in the tariff. As a result, it does not impact the company.

The company plans to invest Rs. 550Bn on transmission infrastructure as part of the Rs. 1.4Tn plan funding to build a national power grid with an inter-regional power transfer capacity of 37,150 MW. A total of 45 projects are in the implementation stage for increasing the transmission lines by 30,536 ckm & transformer capacity by 29,420 MVA.

Telecom Business

The company has entered into telecommunication network business by laying overhead optic fibre network of 20,000 kms for telecom connectivity to major towns & cities. The network connects over 60 cities in India & leases bandwidth to clients like Bharat Sanchar Nigam, Videsh Sanchar Nigam, Tata Teleservices, Reliance Communications & Bharti Airtel.

Joint Ventures

PGCIL has formed three joint ventures with Tata Power, Torrent Power & Jaiprakash Hydro-Power for enhancement of public private partnerships in the development of new transmission lines & systems.

JVs with private players for development of new transmission lines & systems

49% share	26% share	21% share
Powerlinks Transmission Ltd	Torrent Powergrid Ltd	Jaypee Powergrid Ltd

Source: Company

Recent Developments

PGCIL has entered into a shareholder's agreement with Teesta Urja Ltd. to form a joint venture company named "Teestavalley Power Transmission Ltd." on 06th Aug 2008. Power Grid and Teesta Ltd. will have 26% & 74% respectively in the JV.

The objective of the company is to develop associated transmission systems for evacuation of power from 1,00 MW Teesta-III HEP in Sikkim. It also comprises of constructing a 400 kV D/C Teesta Mangan Transmission Line (~10 kms) and a 400 kV D/C Mangan-Kishanganj Transmission Line (~180 kms)

Subsidiary Companies

The company also two subsidiary companies, Parbati Koldam Transmission Company (PKTCL) & Byrnihat Transmission Company (BTCL), incorporated in September 2002 & March 2006 respectively.

Parbati Koldam Transmission Company (PKTCL)

Power Grid, has formed this company with the object of establishing 400kV D/C Bina-Nagda and 400kV D/C Nagda-Dehgam Transmission Lines through IPTC route on Build, Own, Operate & Transfer (BOOT) basis which could not materialize due to rejection of Transmission License to TNB-KPTL Consortium by CERC. In view of the same, PGCIL has decided that this Company may be utilized for taking up the implementation of Transmission Lines associated with Parbati and Koldam HEPs on JV route for which detailed agreements are to be executed.

Byrnihat Transmission Company (BTCL)

The company was incorporated on 23rd March, 2006 as a Project specific 'SHELL COMPANY' to take up the implementation of Misa Byrnihat Transmission Line on JV Route. It was decided that Misa - Byrnihat Transmission Project (the transmission link to Meghalaya) would be implemented through formation of a joint venture company between PGCIL and Meghalaya State Electricity Board (MeSEB) with the company as 89% equity partner and MeSEB as 11% equity partner.

Loan Agreement

The company has signed a loan agreement with Asian Development Bank (ADB), Manila for US\$ 400 million on March 28th 2008, and also the company has signed a loan agreement with "The World Bank" for USD 600 Mn.

According to a Central Electricity Report (CEA), India's inter-regional transmission capacity currently stands at 16,450 MW which is planned to be raised to 37,150 MW by FY12. Growth in the transmission system is characterised by physical growth in transmission networks as well as the introduction in higher voltages & new technologies to transmit bulk power. Future plans for transmission technology involve the operation of a +600kV, 4,000MW HVDC bi-pole line in FY11. Out of the total investment of Rs. 10.3Tn investment planned in India's power sector over the XIth five year plan, Rs. 1.4Tn will towards raising transmission capacities.

Introduction of transmission technologies

Particulars	Date
600kV, 4,000MW HVDC bi-pole	2011
765kV charged at (765kV)	2007
765kV charged at (400kV)	2000
500kV, HVDC bi-pole	1990
HVDC back-to-back	1989
400kV	1977
220kV	1960

Source: Central Electricity Authority (CEA)

Investment in transmission sector in the XIth five year Plan

Segment	Rs. Mn
Inter-state	7,500
Intra-state	6,500
TOTAL	14,000

Source: Central Electricity Authority (CEA)

For this a perspective transmission plan has been evolved & put into implementation by Power Grid for establishment of an integrated NATIONAL POWER GRID, in a phased manner, for strengthening the regional grids (five grids structured on geographical contiguity basis) & to support the generation capacity addition program of about 100,000 MW during the XIth plan. Inter-regional power transfer capacity is expected to be enhanced to 30,000 MW by FY12.

The total investment for setting up such a National Grid has been envisaged to be about Rs. 500Bn (70%), while the balance of Rs. 210Bn (30%) is envisaged to be mobilized by Private Participation.

Inter-regional transmission capacity

Particulars (MW)	FY02	FY05	FY07	FY10	FY12
765kV	-	-	1,100	2,200	9,200
HVDC bi-pole	-	2,000	2,500	2,500	6,500
HVDC back-to-back	2,000	3,000	3,000	3,000	3,000
HVDC mono-pole	200	200	200	200	200
400kV	1,000	2,400	7,800	11,400	16,400
220kV	1,850	1,850	1,850	1,850	1,850
TOTAL	5,050	9,450	16,450	21,150	37,150

Source: Central Electricity Authority (CEA)

Transmission Projects - to be executed on BOO basis

Particulars	Voltage	Length (km)	Completion	Total Order size (Rs. Mn)
Western Region Strengthening system (WRSS)	220kV, 400kV, 765kV	-	2009-10	200
Evacuation system for Maithon RB (1,000 MW)	220kV, 400kV, 765kV	1,453	2009-11	420
Evacuation system for Kodema (500 MW)				
Evacuation system for Mejia EXT (1,000 MW)				
Evacuation system for Simhadri EXT (1,000 MW)				
Evacuation system for North Karanpura (1,980 MW)	220kV, 400kV, 765kV	1,230	2011-12	680
Talcher augmentation system	400kV		2009-10	
Scheme for enabling import of NER/ER surplus by NR	400kV		2009-10	
SR-WR Synchronous Interconnector				
Kawas Navsari	400kV D/C			
Navsari Mumbai New Location	400kV D/C			
Evacuation system for Barh II (1,320 MW)				
Evacuation system for Nabinagar (1,000 MW)				
Evacuation system for Daripally integrated project (3,200 MW)				
Evacuation system for Lara integrated project (4,000 MW)				

Source: Power Finance Corp. (PFC) & Ministry of Power (MoP)

Derating Risk Increasing !

Energy plays a pivotal role in sustainable development of the economy. The Indian Power Sector, one of the major backbones of the Indian Economy is linearly related in terms of growth i.e., in pace with the growth of the economy. We are bullish on this sector due to a sense of urgency felt in ensuring that the corporate growth momentum does not slacken.

Power Grid Corporation of India Ltd. (PGCIL) is India's monopoly player in the Transmission & Distribution Sector (T&D) by transmitting almost 45% of the country's total power generated. Also because of PGCIL's established track record & technical expertise, the company has played as a consultant on numerous domestic & international T&D related projects. With an investment plan of Rs. 550Bn on transmission infrastructure as part of the Rs. 1.4Tn funding plan to build a National Power Grid with an inter-regional power transfer capacity of 37,150 MW, PGCIL is set to grow over a long term perspective.

However on a wide comparison, the current slow-down in global as well as the domestic economy has affected the growth momentum of all the sectors across the boards with no exceptions to the Power Sector as well. There are a lot of noticeable delays occurring in the new generating capacities, which in turn would also have its impact on the T&D space. Also, the Power space is a fully regulated business where the return on equity is capped @ 14-16%. PGCIL is bound to be affected by the overall slowdown & also the actuals for the company are much lower at ~10%.

While the growth owing to the power sector reforms is good, the increasing interest rates would eat into the profitability of the sector and PGCIL under analysis as well. The result being that the Net Growth stands moderated. PGCIL has also ventured into unregulated businesses viz., TELECOM & CONSULTANCY, which are considered high growth areas. Returns in telecom business are unregulated, but the actuals are even lower than the regulated T&D business, given the competitive scenario. Consultancy though large in absolute terms, it is fractional relative to the total size of the company.

The company is trading at 22x forward earnings, which is high, given the poor return ratios. We feel P/BV is a better parameter, considering the asset based business model. Also, the increasing interest cost is likely to be a key factor here as was the case in Q1FY09 & could even wipe out the incremental operational gains in Q2FY09 as well.

However, factoring the monopolistic positioning & decent growth visibility, we are comfortable with a 2x P/BV valuation for PGCIL, notwithstanding the poor ROE's. There is a low possibility of any significant growth in the foreseeable future and also the market fancy may dip.

Huge capex to fuel top line growth

PGCIL is India's principal electric power transmission company. It owns & operates most of India's ISTS. In that capacity, as at Jun'08 it has 68,172 circuit kilometres (ckt kms) of electrical transmission lines, 115 electrical substations & 75,012 MVA of transformation capacity. In FY08, the company transmitted approximately 741 billion units of electricity, representing approximately 45% of all the power generated in India.

The macro economic environment is attracting significant investments in generation, entailing corresponding capex in transmission & distribution infrastructure. Accordingly, PGCIL has a planned capex of Rs. 550Bn through FY07-12, to be funded by as per Central Electricity Regulatory Commission (CERC) guidelines (debt:equity of 70:30). Given the capex, we have estimated a top line CAGR growth of 19% over FY08-11E.

However, this would continue to depress the transmission ROE

Typically, PGCIL undertakes projects to extend its transmission infrastructure. New electricity generators are connected to its transmission system. As the company is paid ROE only after the commencement of service of a transmission project, delay in its transmission project or the related electricity generation project could block the company's equity. PGCIL may, thus, go without any returns on that equity during the course of the delay.

Power Grid starts to earn a 14% ROE only when a transmission project becomes operational. With Rs. 550Bn capex in FY07-12 to increase transmission capacity from 14.1 GW to 37.5 GW, we expect core transmission business ROE to remain below 14%. The company's monopoly business entails tightly regulated returns, with profits linked to incremental equity investments in operating assets. However, we expect Power Grid's overall ROE to improve to 11.5% in FY10 from 10.5% currently on increasing financial leverage and improving profitability of its unregulated businesses.

Telecom & Consultancy Businesses - Non Satisfactory

We expect Power Grid's unregulated telecom & consultancy businesses to expand at a CAGR of 20% & 13%, respectively over FY08-11E. The contribution of these businesses to the topline of PGCIL would remain @ 6-7% over FY09-11E.

Private Player Participation

The Ministry of Power (MoP) has envisaged to execute certain projects through competitive bidding on BOO basis (Some of them planned to be implemented by PGCIL earlier) wherein other players like REL, Tata Power, Torrent Power, etc., will also bid in competition with PGCIL. It runs with the risk of losing the projects under consideration to the private players.

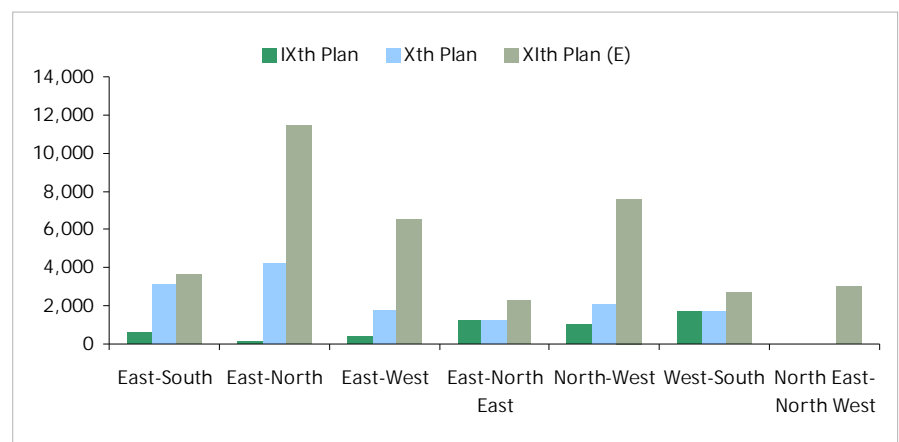
The transmission of electricity is typically defined as the bulk transfer of power over a long distance at a high voltage, generally 132 KV and above. A transmission and distribution ("T&D") system is typically comprised of transmission lines, sub-stations, switching stations, transformers and distribution lines. If the GoI intends to increase installed power generation capacity by 87,663 MW by 2012, it must also facilitate an expansion of the transmission network and inter-regional capacity to transmit power.

Global electricity sector investment is anticipated to reach USD 10 trillion by 2030. More than USD 5 trillion will be used to invest in transmission and distribution networks (Source: World Energy Outlook 2003). Average investment in T&D in India during the Tenth Plan was about 32% of investment in generation (Source: Eleventh Five Year Plan, Ministry of Power).

In India, the T&D system is a 3-tier structure comprising distribution networks, state grids, and regional grids. These distribution networks and state grids are principally owned and operated by SEBs or other state utilities, or state governments (through state electricity departments). At present there are five regional grids operating in India, in the Northern, Eastern, Western, Southern and Northeastern regions. Regional or interstate grids facilitate the transfer of power from a region with a surplus to one with a deficit. These regional grids also facilitate the scheduling of maintenance outages and coordination between power plants. Presently the Northern, Eastern, Western and North Eastern regions are operating in one synchronous mode with total installed capacity of 90,000 MW and the Southern region is interconnected with Western Region and Eastern Region through HVDC links.

With the strengthening of inter-regional connections by FY2012, the inter-regional capacity is predicted to grow from 14,100 MW to 37,150 MW.

Historical & planned
inter-regional
transmission capacity



Source: Ministry of Power (MoP) & Company

Earnings Statement								
YE March (Rs. Mn)	Q109	Q408	Q-Q(%)	Q108	Y-Y(%)	FY08	FY07	Y-Y(%)
Net Revenues	12,940.3	15,192.2	-14.8%	9,754.7	32.7%	46,148.2	35,898.5	28.6%
O&M Expenses	741.1	3,010.4	-75.4%	650.5	13.9%	3,468.5	2,917.7	18.9%
Gross Profit	12,199.2	12,181.8	0.1%	9,104.2	34.0%	42,679.7	32,980.8	29.4%
Staff Costs	1,515.9	2,026.4	-25.2%	1,065.0	42.3%	5,190.6	3,388.8	53.2%
Provisions Write Off	1.9	34.2	-94.4%	0.0	0.0%	38.3	109.4	-65.0%
Total Expenditure	1,517.8	2,060.6	-26.3%	1,065.0	42.5%	5,228.9	3,498.1	49.5%
Operating Profit	10,681.4	10,121.2	5.5%	8,039.2	32.9%	37,450.8	29,482.7	27.0%
Other Income	1,138.8	2,092.7	-45.6%	754.8	50.9%	4,667.1	5,073.0	-8.0%
EBITDA	11,820.2	12,213.9	-3.2%	8,794.0	34.4%	42,117.9	34,555.7	21.9%
Depreciation	2,637.9	2,550.8	3.4%	2,254.1	17.0%	9,596.5	8,275.8	16.0%
EBIT	9,182.3	9,663.1	-5.0%	6,539.9	40.4%	32,521.4	26,279.9	23.8%
Interest	5,639.9	6,868.8	-17.9%	1,127.7	400.1%	13,395.5	11,404.2	17.5%
Exceptional Items	5.9	0.0	0.0%	13.0	-54.6%	1,820.6	(92.8)	-2061.9%
PBT	3,536.5	2,794.3	26.6%	5,425.2	-34.8%	17,305.3	14,968.5	15.6%
Tax	479.6	386.4	24.1%	903.2	-46.9%	2,820.6	2,526.3	11.6%
PAT	3,056.9	2,407.9	27.0%	4,522.0	-32.4%	14,484.7	12,442.2	16.4%
Equity Capital	42,088.4	42,088.4	0.0%	42,088.4	0.0%	42,088.4	38,262.2	10.0%
EPS	0.7	0.6	27.0%	1.1	-32.4%	3.4	3.3	5.8%
Ratio Analysis								
Profitability								
YE March	Q109	Q408	Q-Q(bps)	Q108	Y-Y(bps)	FY08	FY07	Y-Y(bps)
OPM (%)	82.5%	66.6%	1,592.3	82.4%	13.0	81.2%	82.1%	(97.5)
EBITDA (%)	91.3%	80.4%	1,094.8	90.2%	119.3	91.3%	96.3%	(499.3)
EBIT (%)	71.0%	63.6%	735.3	67.0%	391.5	70.5%	73.2%	(273.4)
PAT (%)	23.6%	15.8%	777.4	46.4%	(2,273.4)	31.4%	34.7%	(327.2)
Operational Parameters								
YE March	Q109	Q408	Q-Q(bps)	Q108	Y-Y(bps)	FY08	FY07	Y-Y(bps)
O&M Expenses	5.7%	19.8%	(1,408.8)	6.7%	(94.2)	7.5%	8.1%	(61.2)
Staff Cost	11.7%	13.3%	(162.4)	10.9%	79.7	11.2%	9.4%	180.8
Effective Tax Rate	13.6%	13.8%	(26.7)	16.6%	(308.7)	16.3%	16.9%	(57.8)

Q1 FY09 Result Update

During Q1FY09 Rs. 24.8Bn of new transmission projects have been commissioned by the company. These projects were targeted for FY08 but there was a marginal delay in execution. In FY08 PGCIL commissioned Rs. 59.5Bn of transmission projects. This provided the company with 32.7% Y-Y boost to revenues & 32.9% Y-Y jump for EBITDA in Q1FY09.

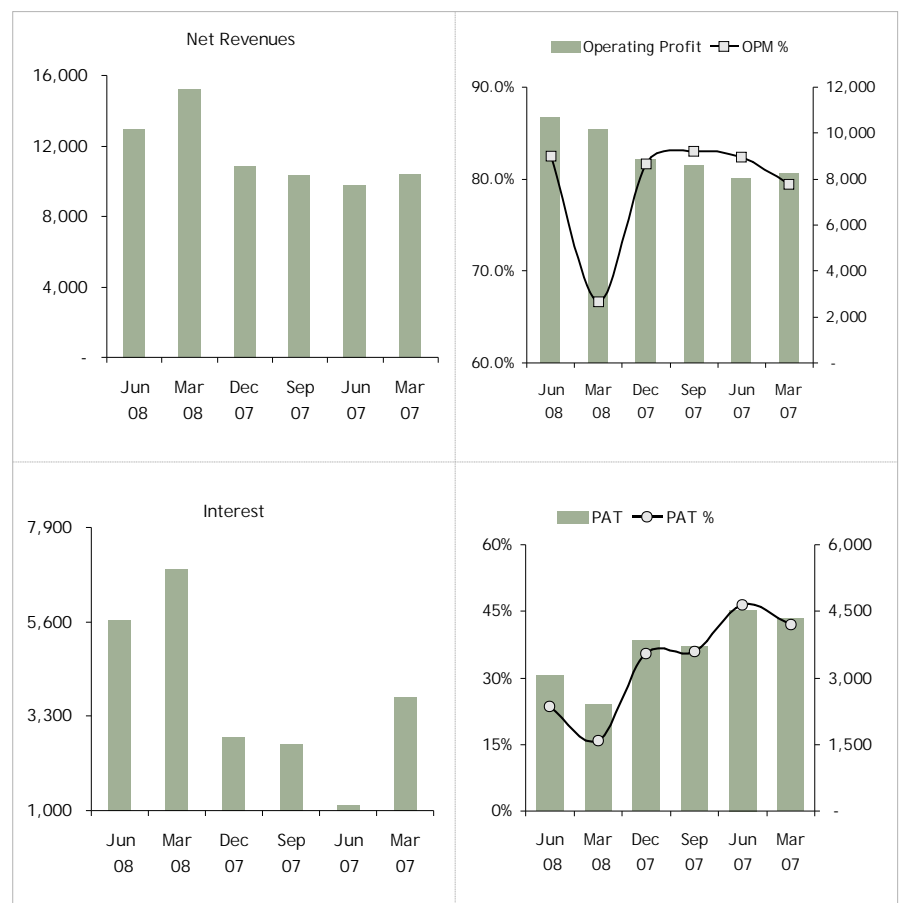
For the quarter ended Jun 30, 2008 Power Grid Corporation of India Ltd. (PGCIL) has posted 34% growth in Total Income from Rs. 14,079.1Mn to Rs. 10,509.5Mn for the quarter ended Jun 30, 2007. EBITDA margins for the company have remained flat @ 82.5% in Q1FY09 as against 82.4% in Q1FY08.

The company's O&M Expenses & staff costs have increased to Rs. 741.1Mn & Rs. 1,515.9Mn in Jun'08 as against Rs. 650.5Mn & Rs. 1,065Mn in Jun'07 respectively. As a percentage of sales O&M Expenses have decreased to 5.7% for the current quarter ended Jun'08 as compared to 6.7% for the corresponding quarter ended Jun'07. PGCIL's staff cost has increased from 10.9% in Q1FY08 to 11.7% in Q1FY09.

In Q1FY09 Power Grid has been hit due to substantial increase in its interest cost by 400% to Rs. 5,639.9Mn from Rs. 1,127.7Mn in Q1FY08, thereby having an impact on its net profit which decreased to Rs. 3,059.6Mn in Jun'08 from Rs. 4,522.0Mn in Jun'07, showing a decline of 32.4%. EPS for the reported quarter has also fallen to Rs. 0.7 as against Rs. 1.1 for the corresponding quarter last year.

Quarterly Charts

Q408 OPM% impacted
by wage revisions



Sharp increase in
interest expense

Source : PPFAS Research

Highly regulated environment

The power industry in India is regulated by the laws, rules & directives issued by the government & the regulatory authorities. CERC specifies the terms & conditions for the tariff structure & PGCIL is bound to follow it. The current tariff structure would remain same until FY09. Any change in policy can adversely affect the business of the company.

State Power Utilities - the major contributors to income

The state power utilities (SPUs) are the largest customers of PGCIL. They accounted for at least 79% of the income in the last four fiscal years (FY2005-08). The SPUs include certain state electricity boards (SEBs) & entities that have been created by the unbundling of the remaining SEBs. The SEBs have had weak credit histories. Although PGCIL currently collects nearly 100% of the receivables from SPUs, yet the risk of default still remains.

Escalation of projects costs

All transmission projects allotted by PGCIL contain a price variation clause. Any escalation in the contract cost due to price variation or due to change in design is borne by PGCIL.

Minimal Free Cash Flows

Though the company enjoys operating margins in excess of 80-85%, however due to the huge capex involved in the business, PGCIL is not able to generate free cash flows. The company is investing heavily in expanding the transmission infrastructure in the country & we believe that would continue to do so at least for the next 10 years, thereby not generating free cash flows.

Timing Mismatch

Transmission projects require a substantial capital outlay & time before any benefits or returns on investments are realised. Any timing mismatch between generation linked transmission projects & the completion by generating companies of new electricity generators could lead to delays in returns on equity.

Earnings Statement						
Particulars (Rs. Mn)	FY06	FY07	FY08	FY09E	FY10E	FY11E
Total Revenues	31,367.6	35,898.5	46,148.2	54,780.3	65,816.8	78,612.5
- Growth (%)		14.4%	28.6%	18.7%	20.1%	19.4%
Total Expenditure	6,208.0	6,564.3	8,697.4	10,189.1	11,978.7	13,993.0
Operating Profit	25,159.6	29,334.2	37,450.8	44,591.2	53,838.1	64,619.5
Other Income	4,089.7	5,073.0	4,667.1	2,612.3	2,652.0	2,548.6
EBITDA	29,249.3	34,407.2	42,117.9	47,203.4	56,490.1	67,168.1
- Growth (%)		17.6%	22.4%	12.1%	19.7%	18.9%
Depreciation	7,443.3	8,275.8	9,596.5	11,798.8	14,510.8	17,751.2
EBIT	21,806.1	26,131.4	32,521.4	35,404.6	41,979.3	49,416.9
Interest	9,474.5	11,404.2	13,395.5	15,735.6	19,912.4	25,075.5
PBT & adjustments	12,331.6	14,727.2	19,125.9	19,669.0	22,067.0	24,341.4
Prior period adjustments	727.4	(92.8)	1,820.6	0.0	0.0	0.0
PBT	11,604.2	14,820.0	17,305.3	19,669.0	22,067.0	24,341.4
Tax	1,600.6	2,526.3	2,820.6	3,360.9	3,768.1	4,156.1
PAT Before Adjustments	10,003.6	12,293.7	14,484.7	16,308.1	18,298.9	20,185.3
- Growth (%)		22.9%	17.8%	12.6%	12.2%	10.3%
Ratio Analysis						
Particulars	FY06	FY07	FY08E	FY09E	FY10E	FY11E
OPM (%)	80.2%	81.7%	81.2%	81.4%	81.8%	82.2%
EBITDA (%)	93.2%	95.8%	91.3%	86.2%	85.8%	85.4%
PBIT (%)	69.5%	72.8%	70.5%	64.6%	63.8%	62.9%
PAT (%)	31.9%	34.2%	31.4%	29.8%	27.8%	25.7%
Interest Cover (x)	2.3	2.3	2.4	2.2	2.1	2.0
EPS (Rs.)	2.8	3.2	3.4	3.9	4.3	4.8
P/E (x)	34.0	29.3	27.3	24.3	21.6	19.6
P/BV (x)	3.4	3.3	2.9	2.7	2.5	2.3
BVPS (Rs.)	27.5	28.6	32.8	35.2	37.9	41.0
Market Cap (Rs. Mn.)	340,603.5	359,664.6	395,631.0	395,631.0	395,631.0	395,631.0
M Cap/Sales (x)	10.9	10.0	8.6	7.2	6.0	5.0
EV (Rs. Mn.)	463,580.2	521,281.4	595,116.7	631,370.8	702,017.8	788,044.8
EV/EBITDA (x)	15.8	15.2	14.1	13.4	12.4	11.7
EV/Sales (x)	14.8	14.5	12.9	11.5	10.7	10.0
ROCE (%)	8.7%	8.6%	9.0%	8.6%	8.5%	8.4%
RONW (%)	10.0%	11.2%	10.5%	11.0%	11.5%	11.7%
Debt/Equity Ratio (x)	1.5	1.8	1.6	1.8	2.1	2.4
Inventory T/o Days	21.0	18.7	20.0	20.0	20.0	20.0
Debtors T/o Days	37.9	49.9	50.0	50.0	50.0	50.0
Advances T/o Days	171.5	151.6	150.0	150.0	150.0	150.0
Creditors T/o Days	344.8	406.9	235.3	453.4	493.3	509.8
Working Cap T/o Days	(106.7)	(134.8)	(25.8)	(224.5)	(274.7)	(293.0)
Fixed Assets T/o (Gross)	0.126	0.124	0.130	0.130	0.127	0.124
DPS (Rs.)	0.8	1.0	1.2	1.3	1.4	1.5
Dividend Payout (%)	30.3%	30.0%	34.9%	33.6%	32.2%	31.3%
Dividend Yield (%)	0.9%	1.0%	1.3%	1.4%	1.5%	1.6%

Balance Sheet						
Particulars (Rs. Mn)	FY06	FY07	FY08E	FY09E	FY10E	FY11E
Equity Capital	36,234.4	38,262.2	42,088.4	42,088.4	42,088.4	42,088.4
Reserves	63,785.5	71,386.6	96,079.2	106,036.6	117,496.1	130,353.6
Shareholders Funds	100,019.9	109,648.8	138,167.6	148,125.0	159,584.5	172,442.1
Borrowed Funds	150,261.3	193,255.0	222,201.2	262,259.9	331,873.2	417,925.6
Deferred Tax Liability	3,095.1	4,193.3	4,937.8	5,331.2	5,772.6	6,259.4
Adv. Against Depreciation	8,222.3	12,011.7	8,955.0	8,955.0	8,955.0	8,955.0
Total Liabilities	261,598.6	319,108.8	374,261.6	424,671.0	506,185.2	605,582.0
Fixed Assets	249,171.0	312,564.6	360,157.9	441,005.9	538,350.6	651,329.1
Investments	21,394.1	19,670.0	17,360.0	17,360.0	17,360.0	17,360.0
Current Assets						
Inventory	1,802.4	1,841.3	2,528.7	3,001.7	3,606.4	4,307.5
Sundry Debtors	3,256.0	4,904.8	6,321.7	7,504.1	9,016.0	10,768.8
Loans & Advances	14,737.5	14,912.6	18,965.0	22,512.4	27,048.0	32,306.5
Cash & Bank Balance	5,890.5	11,968.2	5,355.6	9,160.2	8,126.4	8,151.8
Other Current Assets	1,554.4	1,470.3	1,890.1	2,243.6	2,695.6	3,219.7
Current Liabilities						
Sundry Creditors	29,630.6	40,017.9	29,750.1	68,051.4	88,953.4	109,790.8
Provisions	6,784.0	8,333.7	8,570.5	10,068.7	11,067.6	12,073.9
Net Current Assets	(9,173.9)	(13,254.5)	(3,259.6)	(33,698.1)	(49,528.6)	(63,110.3)
Miscellaneous Expenditure	207.3	128.6	3.2	3.2	3.2	3.2
Total Assets	261,598.6	319,108.8	374,261.6	424,671.0	506,185.2	605,582.0
Cash Flow						
Particulars	FY06	FY07	FY08E	FY09E	FY10E	FY11E
Opening Cash & Bank	6,039.7	5,890.5	11,968.2	5,355.6	9,160.2	8,126.4
Profit after Tax	10,003.6	12,293.7	14,484.7	16,308.1	18,298.9	20,185.3
Less: Investment Income	(4,089.7)	(5,073.0)	(4,667.1)	(2,612.3)	(2,652.0)	(2,548.6)
Interest Paid	9,474.5	11,404.2	13,395.5	15,735.6	19,912.4	25,075.5
Miscellaneous Exp W/Off	(206.4)	78.7	125.4	0.0	0.0	0.0
Depreciation	7,443.3	8,275.8	9,596.5	11,798.8	14,510.8	17,751.2
Deferred Taxation	691.6	1,098.2	744.5	393.4	441.3	486.8
Others	11,698.1	(10.3)	0.0	0.0	(0.0)	0.0
Change in Working Cap	9,579.5	10,158.3	(16,607.5)	34,243.1	14,796.8	13,607.1
CF - Operating Activities	44,594.4	38,225.6	17,072.0	75,866.8	65,308.1	74,557.4
Change in Fixed Assets	(58,291.8)	(71,659.1)	(57,189.8)	(92,646.8)	(111,855.5)	(130,729.7)
Change in Investments	(1,102.0)	1,724.1	2,310.0	0.0	0.0	0.0
Investment Income	4,089.7	5,073.0	4,667.1	2,612.3	2,652.0	2,548.6
CF - Investing Activities	(55,304.1)	(64,862.0)	(50,212.7)	(90,034.5)	(109,203.5)	(128,181.0)
Increase in Equity	4,986.3	1,616.1	19,896.3	0.0	(0.0)	(0.0)
Changes in Borrowings	16,380.9	42,993.7	28,946.2	40,058.7	69,613.3	86,052.4
Changes in Adv. Depn	2,119.0	3,789.4	(3,056.7)	0.0	0.0	0.0
Interest Paid	(9,474.5)	(11,404.2)	(13,395.5)	(15,735.6)	(19,912.4)	(25,075.5)
Dividend Paid	(3,451.3)	(4,280.9)	(5,862.2)	(6,350.8)	(6,839.3)	(7,327.8)
CF - Financing Activities	10,560.5	32,714.1	26,528.0	17,972.4	42,861.6	53,649.1
Net Change in Cash	(149.2)	6,077.7	(6,612.6)	3,804.6	(1,033.7)	25.4
Closing Cash & Bank Bal	5,890.5	11,968.2	5,355.6	9,160.2	8,126.4	8,151.8

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Disclosure of Interest Statement

1. Analyst Ownership of the scrip
2. PPFAS ownership of the scrip
3. PMS ownership of the scrip

Power Grid Corp. of India Limited

NO
NO
NO

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