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<b>Price band</b>	<b>Rs44-Rs52</b>
<b>Sensex</b>	<b>15,590</b>

IPO DetailsSector	Power
Issue size (mn shares)	560
Issue size (Rs bn)	Rs26.4-Rs29.1
Equity capital (Rs bn)	42.09
Face Value	Rs10
Market Cap (Rs bn)	185-219
Issue date	Sept 10-13

### Shareholding pattern (%)#

Gol	86.4%
Public	13.6%
# Post IPO	

### Mehul Mukati

Research Analyst  
Power & Power Equipments  
mehul.mukati@emkayshare.com  
+91 22 6612 1250

# PowerGrid Corporation of India Ltd.

IPO Note

## High voltage growth

### Synopsis

PGCIL owns and operates the inter-state transmission network and the national electricity grid. The cost plus 14% return on equity model ensures high revenue and profit visibility. The regulations also allow for incremental return on equity based on benchmarked transmission network availability. PGCIL is valued at 18x its FY07 fully diluted EPS of Rs2.9 at the higher end of the price band, and at 15x at the lower end of the price band. The P/BV (fully diluted basis) is 1.7x to 2.0x at the lower and upper ends of the price bands respectively.

**We recommend investors to subscribe to the issue with a long term perspective.**

### Key Investment Argument

#### High revenue visibility with assured return on equity

PGCIL has high revenue visibility on account of the long term (5 years to 25 years) bulk power transmission agreements. These agreements are based on the tariff determined by the regulator on a cost plus 14% return on equity basis. This also ensures that, in the long term, the company's profitability is maintained.

The present CERC norms assure PGCIL a cost plus 14% return on its equity investments in operational transmission assets. The cost plus return mechanism allows PGCIL to recover all project costs including interest on debt, exchange rate variations on interest payments and debt repayments, and income tax.

#### Incentives to improve return on equity

The CERC norms allow for a higher RoE through an incentive based mechanism. PGCIL can improve its RoE by 1% for every 1% improvement in availability of its transmission capacity. The benchmark is 95% for HVDC transmission lines and 98% for alternating current (AC) transmission lines. In the past four years PGCIL has maintained an average availability of 99.2% to 99.7% thereby increasing its return on equity proportionately.

#### Increased revenues from non-regulated business

PGCIL's non-regulated businesses, consultancy and telecom networks generated 8% (Rs3.03 bn) of its revenues and 6% (Rs1.54 bn) of its profits before interest and taxes in FY07. PGCIL's 19,000km broadband network covering 60 metro's contributes only 2% to the revenues, and less than 1% to the PBIT. Its key clients in this segment include, apart from all the leading telecom players in the country, many of the government organizations. While this business, thus having the potential to be a larger business, especially since its broadband network piggy-back's its transmission network.

The consultancy division is the main revenue generator in the non-core business of the company. This division contributes 6% of the total revenues and PBIT of the company. Increasing focus on transmission by state transmission utilities and private players is likely to give a boost to the revenues and profitability from this division.

### Experience and expertise minimizes operational risk

The company's vast experience in implementing, operating and maintaining large transmission projects is unparalleled in India. No other organization has the depth of implementing the vast array of extra-high voltage (EHV) transmission projects of upto 500kV HVDC systems and 800kV AC systems. PGCIL is also in talks with a number of international players to absorb the 800kV HVDC technology. PGCIL has experience of implementing, operating and maintaining the transmission networks in varied geological, ecological and seismic conditions. This gives it immense benefits in terms of its knowledge base and ability to implement new projects in a timely manner under varied conditions.

### National grid is an essential link in the country's development

62% of the generation capacity addition of 78,577MW planned in the 11th five year plan is already under construction. We believe that this will have a trickle down effect on investments in the transmission segment and would benefit PGCIL. The total investments planned in the transmission space during the 11th five year plan are to the tune of Rs1,400 bn. Rs750 bn is planned to be invested in the inter-state transmission network and the balance Rs650 bn in the intra-state transmission network.

The inter-regional transmission capacity stood at 14,100MW as at the end of the 10th five year plan (31 March 2007). The target is to increase this 1.6x to 37,150MW in the next five years (11th five year plan). PGCIL is likely to invest Rs550 bn in the next five years to ensure that the increased generation capacity is effectively utilized without any shortcomings in the transmission segment.

### Details of projects under construction

Project	Nature of the project	Expected Comm Date	Project costs as on 31-07-07	Length (ckm)	Transformation Capacity (MVA)	Amt spent as on 31-07-07
Bina-Nagda transmission line	Grid Strengthening	March 2008	3,878	662		2,944
Western Region System Strengthening Scheme – I	Grid Strengthening	November 2007	2,065	296	315	1,490
Rajasthan Atomic Power Project – 5 & 6 transmission system	Gen linked (nuclear)	March 2008	5,098	525	1,575	3,680
Sipat Stage – I transmission system	Gen linked (thermal)	December 2007*	23,311	2,150	4,130	19,515
Southern Region System Strengthening - VI	Grid Strengthening	December 2007	1,137	148	315	833
Northern Region System Strengthening Scheme – III	Grid Strengthening	March 2008	2,657	188	1,260	1,853
Kaiga – 3 & 4 transmission system	Gen linked (nuclear)	December 2007	5,883	826	1,575	4,097
Teesta – V HEP transmission system	Gen linked (hydro)	November 2007	2,516	240	315	1,784
Upgradation of Talcher-Kolar HVDC Bipole Link	Grid Strengthening	December 2007	1,183		500MW	532
National Load Despatch Centre (NLDC)	Load dispatch	May 2008	450			17
Sipat Stage II transmission system (supplementary)	Grid Strengthening	June 2008	8,315	1,173	630	1,577
Kudankulam Atomic Power Plant transmission system	Gen linked (nuclear)	November 2008	17,793	2,096	1,890	7,660
Neyveli Lignite Corp II transmission system	Gen linked (thermal)	December 2007	7,781	998	2,520	3,385
Barh Generation Project transmission system	Gen linked (thermal)	September 2009	37,795	2,388	2500MW	8,234
Northern Region System Strengthening Scheme – V	Grid Strengthening	June 2009	7,213	1,332		1,027
<b>Total</b>			<b>127,075</b>	<b>13,022</b>		<b>58,628</b>

\* Part commissioned

### Uses of the funds to be raised

The funds raised, between Rs24.64 bn to Rs29.12 bn at the lower and higher ends of the price bands are to be utilized to fund the equity component of PGCIL's projects. At the end of FY07 the company has 48 projects under implementation, including 15 that have been identified and detailed. These 48 projects have a approved capital expenditure of Rs277 bn, of which 30% (Rs83.1 bn) would be the equity contribution. These projects would result in an increase in the transmission capacity by 31,015 ckm and 30,365MVA, from 61,875 ckm and 61,307MVA respectively at the end of Q1FY08.

### Key risks and concerns

Implementation delays: As per CERC norms, PGCIL return on equity is recovered only from operational transmission assets. Hence delays in implementation could have an adverse impact on the profitability of the company.

Weak history of its key customers, the SEB's: PGCIL's key customers are state utilities, many of which are not profitable. Any deterioration in the financial health of these customers could have a negative impact on the company. We however believe that this is unlikely as PGCIL maintains, under the one-time settlement scheme, bank guarantees and letters of credit to the extent of 105% of the past 12 months billings.

### Valuation

The IPO of 560 mn shares at Rs52, the higher end of the price band, would enable the company to garner Rs29.12 bn. These funds would be used to finance the equity component of the identified transmission projects. PGCIL is valued at 18x its FY07 fully diluted EPS of Rs2.9 at the higher end of the price band, and at 15x at the lower end of the price band. The P/BV is 1.7x to 2.0x at the lower and upper ends of the price bands respectively.

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### About the company - company background

PGCIL was set up in 1989 with a paid up capital of Rs3.5 bn to operate the transmission assets of NTPC, NHPC, NEEPCO and NLC. The company took over these assets in 1992 making it a monopoly player in the inter-regional transmission segment. PGCIL task is to plan, build, operate and maintain the national and inter-regional transmission networks. It is also entrusted with the responsibility of managing and operating the national load dispatch centre and the five regional load dispatch centers which monitor of the national electricity transmission grid on a real-time basis. In 1998, the government notified PGCIL as a Category I Mini Ratna, and in 2001 it was given the role of advisor-consultant for the Accelerated Power Development and Reforms Programme (APDRP).

## Profit &amp; Loss Statement

Mar ending (Rs mn)	FY04	FY05	FY06	FY07
Net Sales	22,630	25,131	31,453	35,899
Growth %	5.7	11.0	25.2	14.1
Trans & admin exp	1,850	1,973	2,224	2,918
As a % to Net Sales	8.2	7.9	7.1	8.1
Employee expenses	2,353	2,272	2,568	3,389
As a % to Net Sales	10.4	9.0	8.2	9.4
Provisions	180	656	1,328	27
As a % to Net Sales	0.8	2.6	4.2	0.1
Def revenue exp	138	93	89	82
As a % to Net Sales	0.6	0.4	0.3	0.2
Total Exp	4,521	4,994	6,208	6,416
EBIDTA (Core)	18,110	20,137	25,245	29,483
EBIDTA (%)	80.0	80.1	80.3	82.1
Other Income	5,427	3,182	4,090	4,925
Depreciation	6,064	6,423	7,443	8,276
EBIT	17,473	16,896	21,892	26,131
Interest	9,910	8,087	9,475	11,404
PBT	7,563	8,809	12,417	14,727
Tax	-339	1,228	1,601	2,526
ETR (%)	-4.5	13.9	12.9	17.2
PAT	7,902	7,581	10,817	12,201
EOI	2,329	717	-1,303	-1,324
Adj PAT	10,232	8,298	9,514	10,877

Source : Company, Emkay Research

## Balance Sheet

Mar ending (Rs mn)	FY04	FY05	FY06	FY07
Equity Capital	30,741	32,041	36,234	38,262
Reserves & Surplus	52,198	56,440	62,494	68,760
Networth	82,939	88,480	98,729	107,022
Total Debts	122,664	133,880	150,261	193,255
Grant-in-aid	2,975	2,902	2,730	2,644
Adv against depreciation	3,953	6,103	8,222	12,012
Net deferred liab	1,974	2,427	3,125	4,193
<b>Capital Employed</b>	<b>214,505</b>	<b>233,793</b>	<b>263,067</b>	<b>319,127</b>
Gross Block	198,743	218,841	248,883	290,146
Less Depreciation	-49,895	-56,285	-63,720	-71,986
CWIP	38,901	50,390	64,156	94,554
Net Fixed Assets	187,749	212,946	249,319	312,715
Investments	19,979	20,292	21,394	19,670
Inventory	1,969	1,843	1,802	1,841
Debtors	4,777	5,713	4,403	4,904
Cash and Bank	7,754	6,040	5,890	11,968
Loans & Advances	16,637	15,040	17,495	16,383
Total Curr. Assets	31,138	28,636	29,591	35,096
Current Liabilities	20,710	24,653	31,762	40,021
Provisions	3,651	3,428	5,475	8,334
Total Curr. Liabilities	24,361	28,081	37,237	48,355
Net Current Assets	6,777	555	-7,645	-13,258
<b>Total Assets</b>	<b>214,505</b>	<b>233,793</b>	<b>263,067</b>	<b>319,127</b>

Source : Company, Emkay Research

## Cash Flow

Mar ending (Rs mn)	FY04	FY05	FY06	FY07
PBT	7,563	8,809	12,417	14,727
Depreciation	6,064	6,423	7,443	8,276
Net Chg in WC	2,507	-6,222	-8,200	-5,613
Others	4,977	10,515	12,583	20,905
Cash from Operations	21,111	19,525	24,243	38,295
Capex	-22,972	-31,588	-43,807	-71,662
Net Investments made	1,142	313	1,102	-1,724
Other Investing Activities	0	0	0	0
Cash from Investing	-21,830	-31,275	-42,705	-73,386
Change in Share capital	0	1,300	4,194	2,028
Change in Debts	7,854	11,144	16,208	42,909
Div. & Div Tax	-564	-2,408	-2,089	-3,768
Others	0	0	0	0
Cash from Financing	7,290	10,035	18,313	41,168
Total Cash Generated	6,571	-1,715	-149	6,078
Cash Opening Balance	1,184	7,754	6,040	5,890
Cash Closing Balance	7,754	6,040	5,890	11,968

Source : Company, Emkay Research

## Ratios

Mar ending (Rs mn)	FY04	FY05	FY06	FY07
EBIDTA - Core (%)	80.0	80.1	80.3	82.1
EBIT (%)	77.2	67.2	69.6	72.8
NPM (%)	28.2	26.8	30.4	29.9
Adj ROCE (%)	8.9	9.0	10.2	10.1
Adj ROE (%)	10.3	8.9	11.6	11.9
Adj EPS (Rs)	3.4	2.6	2.7	2.9
Cash EPS (Rs)	5.4	4.7	4.7	5.1
Book Value (Rs)	26.7	28.0	27.5	28.3
DPS (Rs)	0.4	0.6	0.8	1.0
Payout (%)	13.8	25.2	36.3	39.4
Debt Equity (x)	1.5	1.5	1.5	1.8
PE (x)	20.0	21.7	17.2	16.1
P/BV (x)	1.9	1.9	1.9	1.8
EV/Sales (x)	11.5	11.2	10.2	10.4
EV/EBITDA Core (x)	14.3	14.0	12.7	12.7
Div Yield (%)	0.8	1.1	1.6	1.9

Source : Company, Emkay Research

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Emkay Share and Stock Brokers Ltd.,  
Paragon Center, Ground Floor, C-6  
Pandurang Budhkar Marg, Worli, Mumbai – 400 013. , Tel no. 66121212. Fax: 66121299