

## Solid 3QFY12; cap'n broadly on track (Erratum)

### First Look

February 9, 2012

<b>Rating</b> Remains	<b>Buy</b>
<b>Target price</b> Remains	INR 120
<b>Closing price</b> February 8, 2012	INR 108

#### 3QFY12 – Sales, EBITDA in line, net profit 12% above forecast

At Rs8.1bn, PWGR's 3QFY12 net profit was 12% and 10% above our and consensus forecasts, respectively; while revenues / EBITDA were in line with our forecast (2%/4% above consensus), the positive surprise at the bottom line was on lower-than-expected 'net' interest outgo, and an exchange fluctuation 'gain' (see below). If we were to normalise for the net exchange 'gain', 3QFY12 adjusted net profit would be Rs7.8bn, still 8% and 6% above our and consensus forecasts, respectively.

#### 9MFY12 capitalisation at Rs63bn; our FY12F target (Rs88bn) appears in sight

We understand that incremental capitalisation in 3QFY12 stood at ~Rs22bn, expectedly lower than the Rs32.5bn capitalisation in 3QFY12. As 9MFY12 capitalisation stood at Rs63bn, while our FY12F capitalisation (Rs88bn) appears very much achievable, management's long-standing FY12 capitalisation target of Rs100bn may just be a stretch – we expect more colour on this at the 10 Feb analysts' meeting.

#### Transmission revenues up 10.4% q-q, a tad above our forecast

At Rs22.5bn, 3QFY12 transmission revenues were up 10.4% q-q (up 18% y-y), largely expected as capitalisation in 2QFY12 was back-ended and Phase-I of the Mundra UMPP transmission system was capitalised on 1 Oct, 2011. But overall revenues were a tad below our forecast (but 2% above consensus) as revenue from short-term open access (STOA) and telecom business lines were over 20% below expectations. We note that rebate to customers during the quarter was 0.6% of transmission revenues, sharply lower than ~1.3% in 1HFY12, potentially indicating lengthening of the revenue recovery period (debtor days).

#### Positive surprise on lower 'net' interest outgo, f/x fluctuation 'gain'

At Rs3.6bn, 3QFY12 net interest expense (excluding rebate to customers and exchange fluctuation gain/loss) was ~7% below our forecast. Notably, despite the magnitude of INR/USD depreciation in 3QFY12 being similar to 2QFY12, PWGR posted an exchange fluctuation gain of Rs110mn (vs. our forecast exchange fluctuation loss of ~Rs600mn), on: (1) reassessment of f/x loss recoverable from beneficiaries on the back of a Dec 2011 clarification from the regulator (CERC) given to a regulated return generating company, and (2) PWGR adopting Rule 46A provision (notified by the government on 29 Dec, 2011), which allows capitalisation of exchange variation loss on account of settlement/restatement of long-term monetary liabilities related to depreciable capital assets. Had PWGR not adopted the Rule 46A provision (which is now the default policy going forward), net profit would have been lower by Rs314mn, implying an adjusted net profit of Rs7.8bn (still, 8% and 6% above our and consensus forecasts, respectively).

*This note replaces an earlier published note which erroneously indicated 3QFY12 adjusted net profit as Rs781mn instead of Rs 7.8bn. We apologise for any confusion this may have caused our readers.*

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

**Fig. 1: PWGR – 3QFY12 earnings – Actual vs. Consensus**

Net Profit was higher than our and consensus forecasts by 12% and 10%, respectively

PWGR - 3QFY12 (INR mn)	Nomura		Actual	Cons.	Actual
	Actual	Estimate	vs. Est.	Estimate	vs. Cons.
Sales	24,666	24,869	-0.8%	24,221	1.8%
EBITDA	21,027	20,995	0.2%	20,286	3.7%
Net Profit	8,123	7,244	12.1%	7,388	10.0%
Reported Profit	8,092	7,244	11.7%	7,388	9.5%

Note: Consensus = Bloomberg mean estimates

Source: Company data, Bloomberg, Nomura research

**Fig. 2: PWGR – 3QFY12 earnings snapshot**

Transmission revenue growth was in line; positive surprise on lower 'net' interest outgo, f/x fluctuation 'gain'

Quarterly Results (Rs mn)	3QFY11 Dec-10	4QFY11 Mar-11	1QFY12 Jun-11	2QFY12 Sep-11	3QFY12 Dec-11	q-q (%)	y-y (%)	3QFY12F Dec-11	Act vs Est
<b>Revenues</b>	<b>20,521</b>	<b>22,076</b>	<b>21,575</b>	<b>22,644</b>	<b>24,666</b>	<b>8.9%</b>	<b>20.2%</b>	<b>24,869</b>	<b>-0.8%</b>
Transmission	19,073	20,045	19,991	20,416	22,542	10.4%	18.2%	22,336	0.9%
Consultancy	559	915	561	696	734	5.5%	31.3%	750	-2.1%
STOA	469	558	569	1,031	854	-17.2%	82.2%	1,083	-21.1%
Telecom Income	421	558	454	501	536	7.1%	27.5%	700	-23.4%
Staff cost	(1,883)	(1,649)	(2,110)	(1,922)	(1,998)	3.9%	6.1%	(2,000)	-0.1%
Other O&M expenses	(1,364)	(1,889)	(1,461)	(1,743)	(1,642)	-5.8%	20.4%	(1,874)	-12.4%
<b>EBITDA</b>	<b>17,274</b>	<b>18,538</b>	<b>18,005</b>	<b>18,978</b>	<b>21,027</b>	<b>10.8%</b>	<b>21.7%</b>	<b>20,995</b>	<b>0.2%</b>
- Margin (%)	84.2%	84.0%	83.5%	83.8%	85.2%			84.4%	
Depreciation	(5,709)	(5,805)	(5,790)	(5,966)	(6,792)	13.8%	19.0%	(6,711)	1.2%
<b>EBIT</b>	<b>11,565</b>	<b>12,733</b>	<b>12,214</b>	<b>13,012</b>	<b>14,234</b>	<b>9.4%</b>	<b>23.1%</b>	<b>14,284</b>	<b>-0.4%</b>
Interest expense	(3,851)	(4,772)	(4,190)	(5,277)	(4,595)	-12.9%	19.3%	(5,862)	-21.6%
Other income	931	3,711	1,432	1,942	1,096	-43.6%	17.7%	1,400	-21.7%
Rebate to customers	(200)	(450)	(256)	(280)	(139)	-50.2%	-30.3%	(290)	-52.1%
- % of Transmission rev.	1.0%	2.2%	1.3%	1.4%	0.6%			1.3%	
<b>Profit before tax</b>	<b>8,445</b>	<b>11,221</b>	<b>9,201</b>	<b>9,398</b>	<b>10,596</b>	<b>12.7%</b>	<b>25.5%</b>	<b>9,531</b>	<b>11.2%</b>
Tax	(2,487)	(3,762)	(2,676)	(2,331)	(2,472)	6.0%	-0.6%	(2,288)	8.1%
<b>Net Profit</b>	<b>5,959</b>	<b>7,459</b>	<b>6,525</b>	<b>7,066</b>	<b>8,123</b>	<b>15.0%</b>	<b>36.3%</b>	<b>7,244</b>	<b>12.1%</b>
Extraordinary items	(40)	45	528	21	(31)			-	
<b>Reported PAT</b>	<b>5,919</b>	<b>7,504</b>	<b>7,053</b>	<b>7,087</b>	<b>8,092</b>	<b>14.2%</b>	<b>36.7%</b>	<b>7,244</b>	<b>11.7%</b>

Note: If we were to normalise for the net exchange 'gain', 3QFY12 adjusted net profit would be Rs7.8bn – still 8%/6% above our/consensus forecast.

Source: Company data, Nomura estimates

### We await management's commentary at 10 Feb analysts' meeting

At PWGR's upcoming analysts' meeting in Mumbai (on Friday, 10 Feb), we particularly await management's commentary regarding: (1) capitalisation/ capex outlook (and its broad build-up) for FY12/FY13 and the XIIth Plan; (2) debtor days, payment realisation from SEBs, and (3) revenue growth and profitability prospects of ancillary business lines.

### Maintain BUY, we believe long-term mid-teen EPS growth prospects remain intact

PWGR remains our top pick in the power utilities space; prospects of mid-teen FY11-17F EPS CAGR remain intact, in our view. On our FY13F earnings forecast, the stock trades at 14.4x P/E and 2.0x P/BV, implying a 15%/10% discount to its three-year average rolling one-year forward multiples, and a 7% premium to NTPC on its FY13F P/BV multiple (in line on P/E).

# Appendix A-1

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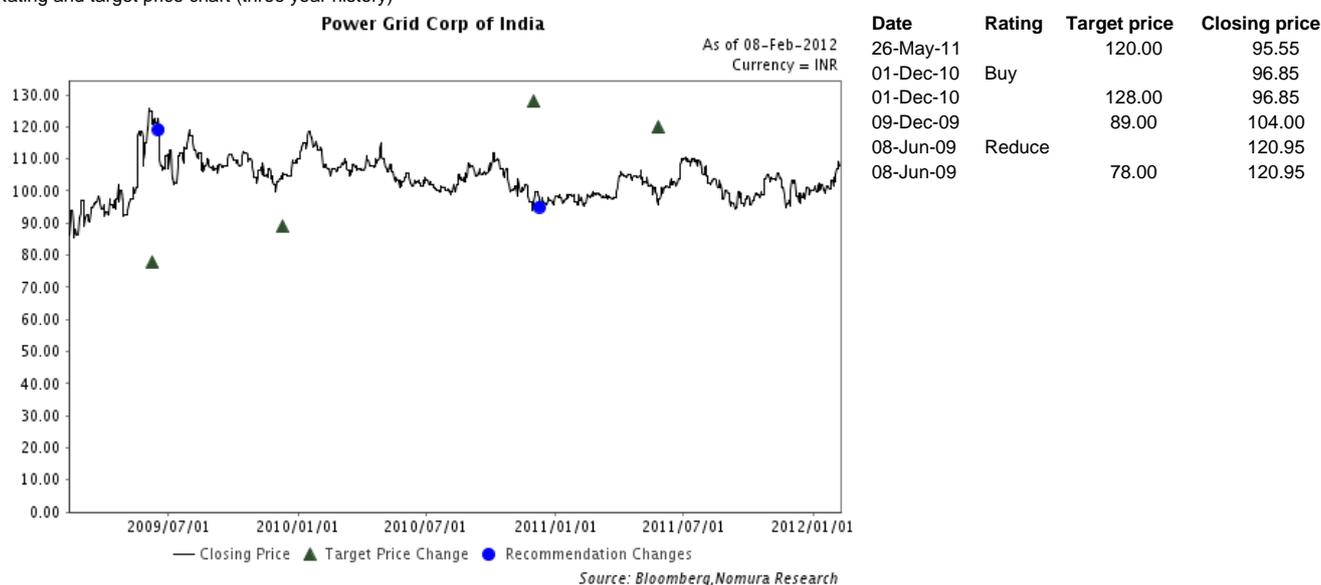
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Power Grid Corp of India	PWGR IN	INR 108	08-Feb-2012	Buy	Not rated	

## Previous Rating

Issuer name	Previous Rating	Date of change
Power Grid Corp of India	Reduce	01-Dec-2010

## Power Grid Corp of India (PWGR IN) INR 108 (08-Feb-2012) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We use a residual income model to arrive at our target price of INR120. Key assumptions of our model are 1) Cost of equity - 12.5%; 2) Terminal RoE - 17%; and 3) Terminal growth rate - 3%.

**Risks that may impede the achievement of the target price** 1) lower-than-expected capitalization of transmission assets due to execution delays (scalability, vendor ramp-up, turnkey workforce) and/or impediments in securing Right-of-Way (RoW) / forest clearance; 2) sharp push-back in generation-capacity addition delaying capitalization of related transmission assets; and 3) overhang of a potential equity dilution in FY2014/15 in case annual capex exceeds our forecast by 15-20%.

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