

PFC & RECBSE SENSEX
18,618S&P CNX
5,600**CMP/TP (INR): PFC 213/290; REC 220/310****Buy**

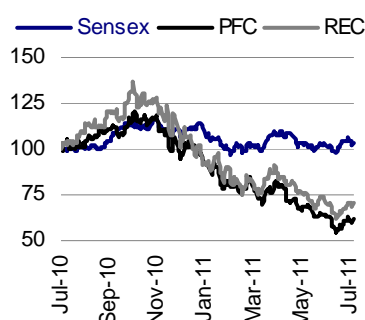
Bloomberg	PFC	RECL
Equity Shares (m)	1147.8	987.5
52-Week High	383	410
52-Week Low	169	179
M.Cap. (INR b)	244.7	217.4
M.Cap. (USD b)	5.5	4.9
1,6,12 Relative Performance (%)		
PFC	5/-21/-37	
REC	5/-15/-30	

PFC: Valuation summary

Y/E March	2011	2012E	2013E
NII (INR b)	33.8	40.8	48.9
OP (INR b)	35.4	42.6	50.7
NP (INR b)	26.2	31.5	37.5
EPS (INR)	22.8	23.8	28.4
EPS Gr. (%)	11.1	4.5	19.1
P/E (x)	9.3	8.9	7.5
BV/Sh. (INR)	135.0	160.7	180.9
P/BV (x)	1.6	1.3	1.2
RoE (%)	18.4	17.1	16.6
RoA (%)	2.9	2.8	2.7

RECL: Valuation summary

Y/E March	2011	2012E	2013E
NII (INR b)	33.1	38.6	45.4
OP (INR b)	34.8	39.6	46.6
NP (INR b)	25.7	29.3	34.5
EPS (INR)	26.0	29.7	34.9
EPS Gr. (%)	28.1	14.2	17.7
P/E (x)	8.5	7.4	6.3
BV/Sh. (INR)	129.4	149.1	172.3
P/BV (x)	1.7	1.5	1.3
RoE (%)	21.5	21.3	21.7
RoA (%)	3.4	3.2	3.1

Stock performance (1 year)**State governments resolve to bring down SEB losses****Positive for power financiers; Buy PFC and REC**

- In a conference on "Distribution Sector Reforms", state governments have unanimously resolved to bring down commercial losses and ensure financial sustainability of DISCOMs.
- They intend to implement concrete measures like computerization of accounts, annual tariff petition filing/tariff revisions, and conversion of loans into perpetual bonds/equity, among others.
- We believe this is a positive development for power financiers, and reiterate our Buy rating on PFC and REC.

Positive development for power financiers

PFC and REC have corrected ~45% from the peak amidst concerns relating to the deteriorating financial health of SEBs. In this backdrop, media reports of possible restructuring of the Madhya Pradesh SEB loans from the state government and developments in the recent conference on "Distribution Sector Reforms" are enthusing.

At the conference, the state governments unanimously resolved to bring down commercial losses and ensure financial sustainability of DISCOMs. (We have presented the details on page 2). This is positive for power financiers like PFC, which has 65% exposure to SEBs, and REC, which has 83% exposure to SEBs.

SEB financials alarming, but the worst seems to be behind

In an Update, "Just an Eclipse...Brighter Days Ahead" (dated June 2011), our Utilities team had opined that FY11 would be the peak of SEB losses. With decline in ST power cost and improvement in availability of LT power, there would be a reduction in SEBs' power purchase cost. This combined with gradual tariff increase would lead to an improvement in SEB finances.

Post their meetings with Tamil Nadu State Electricity Regulatory Commission (TNERC) and Tamil Nadu Generation and Distribution Company (TANGEDCO), they have come away reassured about impending improvement in TANGEDCO's financials. They have noted that there is a concrete roadmap to achieve financial viability for TANGEDCO and a clear consensus amongst authorities on restoring the financial health of the power sector.

Reiterate our positive view on PFC and REC

PFC (see our Detailed Report dated 9 May 2011) and REC (see our Detailed Report dated 25 May 2011) are our preferred bets to play the theme of 'improvement in SEB finances'. These companies either have an escrow mechanism or state government guarantees for a large part of their funding to SEBs. Valuations are attractive. We reiterate **Buy** on PFC/REC with a target price **INR290/INR310**.

Conference on "Distribution Sector Reforms": Highlights

In the State Power Ministers' Conference on "Distribution Sector Reforms", the state governments/Planning Commission/Ministry of Power underlined the need for urgent steps to arrest and reverse the growing losses in power distribution. Chaired by Union Minister of Power, Mr Sushil Kumar Shinde, the Conference brought together State Power Ministers from across the country.

The Conference emphasized that the target of bringing down distribution losses to 15% is achievable if the states devise a utility-wise turnaround plan and closely monitor it at the highest level. In their respective presentations, the states highlighted the administrative and financial measures taken by them to address the issue of electricity pilferage.

Key takeaways from the Power Ministry's press release

- The state governments would ensure that the accounts of the utilities are audited up to the year 2009-10 and also ensure that the accounts of a financial year are audited by September of the next financial year, henceforth. Computerization of accounts would be undertaken on priority, if not done already.
- The states would ensure that the distribution utilities file their Annual Tariff Revision Petition every year by December/January of the preceding financial year with the State Regulators as stipulated by the National Tariff Policy.
- The Annual Tariff Revision Petition would be filed before the SERC, keeping in view the increase in power purchase cost (which accounts for 70-80% of the cost of supply) and states would ensure that the difference between ARR and ACS is not only bridged but is positive to generate internal surpluses, which can be used for network expansion and maintenance.
- The state governments would ensure automatic pass-through in tariff for any increase in fuel cost by incorporating the same in the regulations, as provided in Section 62(4) of the Electricity Act, 2003. (State governments can issue directions to SERCs under Section 108 of the Electricity Act, 2003).
- The state governments would not only clear all the outstanding subsidies to the utilities, but ensure advance payment of subsidy as per Section 65 of the Electricity Act, 2003 in future.
- The eligibility criteria for inclusion of towns under R-APDRP assistance with population of 30,000 (10,000 for special category states) should be reduced to 15,000 (5,000 for special category states). All district headquarter towns in special category states should also be covered under R-APDRP, irrespective of their population.
- The state governments would ensure payment of all outstanding dues from various departments and institutions to the distribution utilities or release payments from the state budget directly.
- The state governments would consider converting their loans to the distribution utilities to state government equity to ensure capital infusion and improvement in net worth of the utilities.
- The state governments would take effective steps to reduce AT&C losses to less than 15% by administrative measures, curbing pilferage of electricity and by setting up special police stations and special courts to deal exclusively with power theft related cases, if not done already.

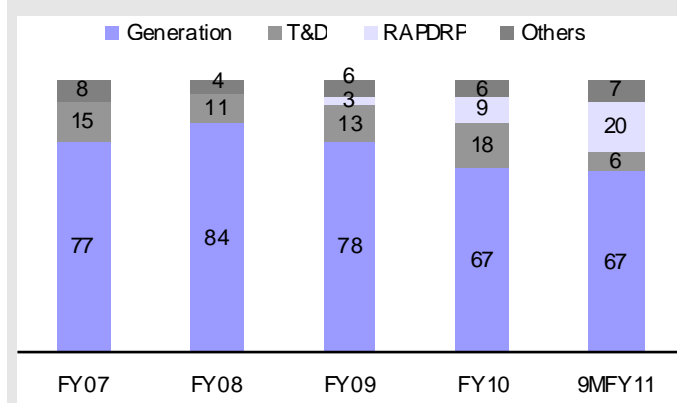
- States would immediately initiate steps to appoint distribution franchisees in urban areas through competitive bidding.
- States would immediately invite bids for meeting the uncovered generation capacity gap vis-à-vis the requirement in their states by the end of 12th Plan. The process will be completed by March 2012.
- States would create a unit in their states for integrated planning of generation, transmission and distribution to meet the future requirement of their states.



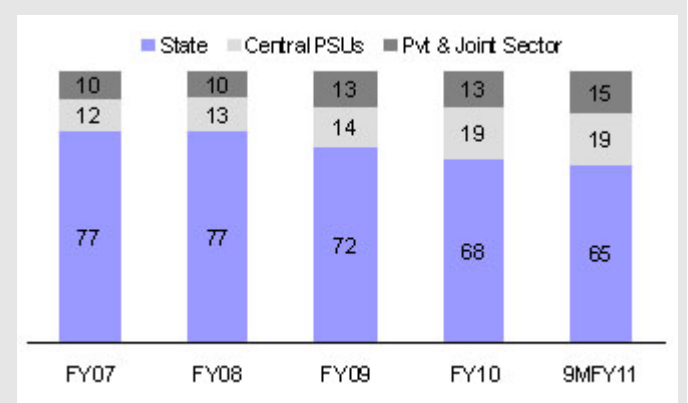
Highlights from our recent Detailed Report on PFC

PFC is well placed to leverage the strong demand for financing in the power sector, with its leadership position and strong domain knowledge. Well matched asset-liability profile has been cushioning PFC against interest rate risks; however, rising competition and bulk borrowing rates are likely to impact spreads. We model PAT CAGR of 18% over FY11-13, supported by lean cost structure and minimal credit cost. Heightened concerns over SEB losses and expected slowdown in loan growth (due to environment clearance issues) have led to a sharp correction from the peak. We believe current valuations are attractive.

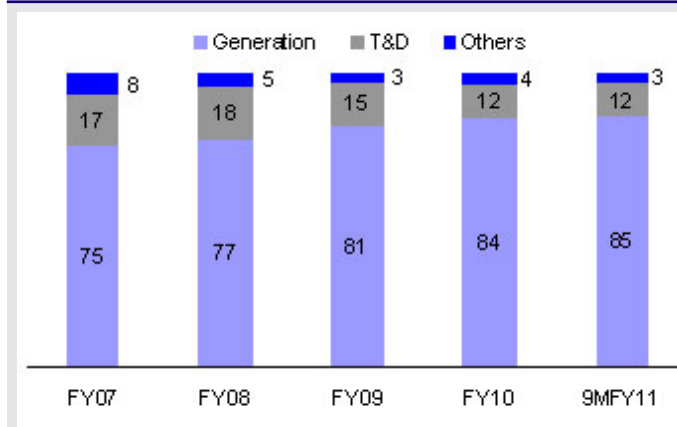
Generation accounts for lion’s share of sanctions (%)



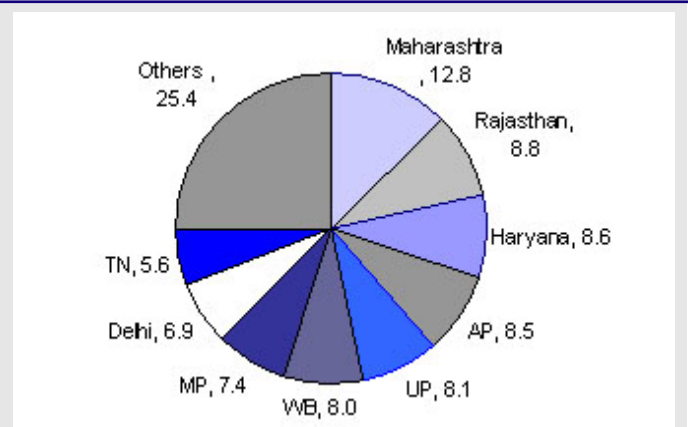
Composition of loans- borrower wise (%)



Outstanding loan book (%)



State-wise loan book exposure (%)



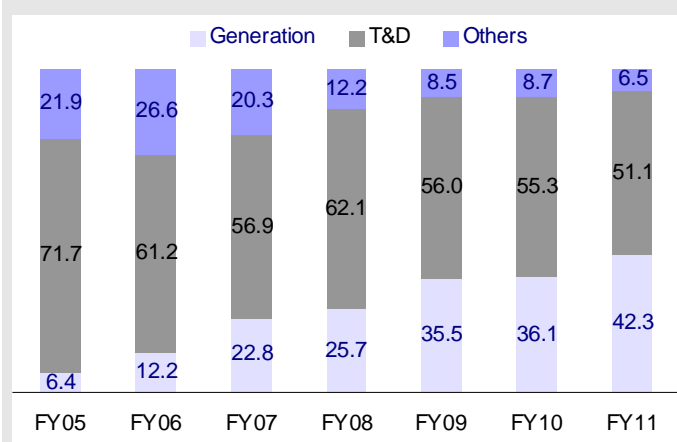
Source: Company/MOSL



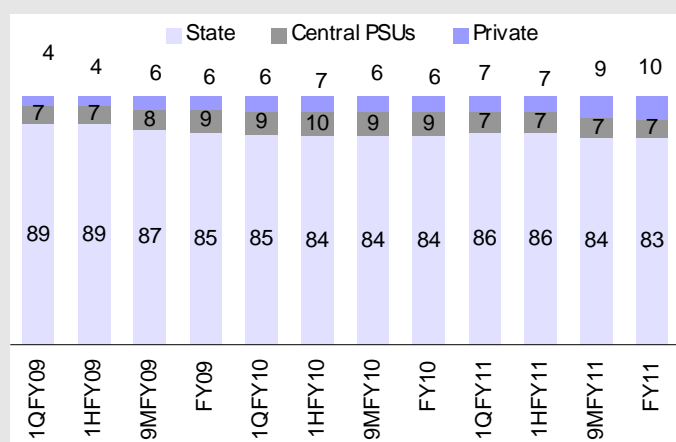
Highlights from our recent Detailed Report on REC

We expect REC's loan growth to remain strong at 22% over FY11-13E due to a strong pipeline of sanction; however, NIMs may come off from peaks. Rising SEB losses are driving up REC's risk quotient, given its high exposure to T&D. However the government's thrust on power sector reforms, protection through an escrow mechanism and SEB initiatives to ease the strain on cash flows provide some comfort. The REC stock price has corrected 50% from its peak. We believe current valuations are attractive at 1.1x FY13E BV.

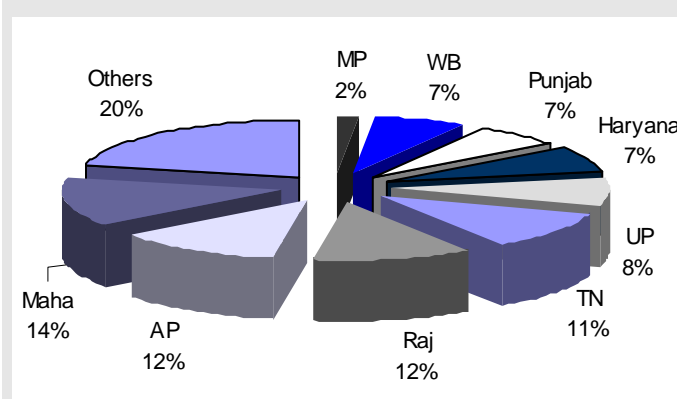
Loan book composition segment wise (%)



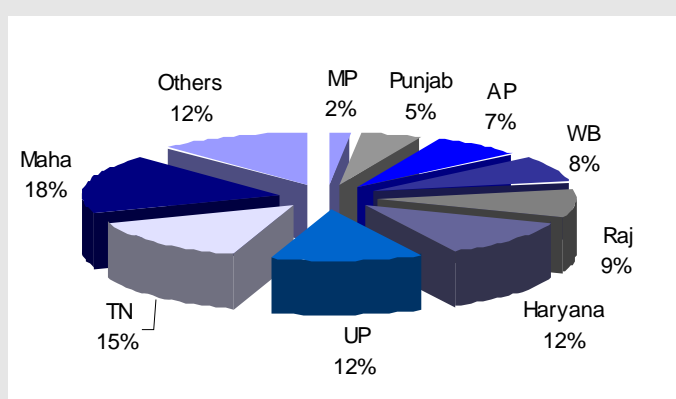
Composition of loans- borrower wise (%)



State-wise loan book exposure - as on FY10 (%)



State-wise disbursement exposure - as on FY10 (%)



Source: Company/MOSL

Power Finance Corporation: Financials and Valuation

Income Statement					(INR Million)	
Y/E March	2008	2009	2010	2011	2012E	2013E
Interest on loans	47,808	63,388	78,523	98,685	127,744	157,908
Interest exp and other charges	31,624	42,464	50,599	64,925	86,913	109,053
Net Financing income	16,184	20,924	27,924	33,760	40,831	48,854
Change (%)	27.6	29.3	33.5	20.9	20.9	19.6
Other operating income	2,485	2,186	1,498	2,600	2,725	2,852
Exchg Gain/(loss) on Forex loans	-201	-2,522	1,038	-264	-200	-100
Other Income	108	262	748	321	350	375
Net Income	18,575	20,849	31,208	36,417	43,707	51,981
Change (%)	27.4	12.2	49.7	16.7	20.0	18.9
Employee Cost	498	424	717	677	745	838
Administrative Exp	312	444	341	258	290	326
Depreciation	45	41	38	51	60	75
Operating Income	17,720	19,941	30,113	35,432	42,612	50,742
Change (%)	26.1	12.5	51.0	17.7	20.3	19.1
Total Provisions	-105	37	-21	0	100	100
% to operating income	-0.6	0.2	-0.1	0.0	0.2	0.2
PBT	17,825	19,905	30,134	35,432	42,512	50,642
Prior period Adjustments	52	0	1	0	0	0
PBT (post prior period adj)	17,877	19,905	30,135	35,432	42,512	50,642
Tax (Incl Deferred tax)	5,809	5,038	6,562	9,245	11,053	13,167
Tax Rate (%)	32.5	25.3	21.8	26.1	26.0	26.0
PAT	12,068	14,867	23,573	26,187	31,459	37,475
Change (%)	36.4	23.2	58.6	11.1	20.1	19.1
Extra ordinary item	0	4,832	0	0	0	0
Reported PAT	12,068	19,700	23,573	26,187	31,459	37,475
PAT (Incl DTL)	13,044	15,303	23,487	26,547	31,459	37,475
Change (%)	23.5	17.3	53.5	13.0	18.5	19.1
Proposed Dividend	4,017	4,591	5,165	5,739	7,920	9,240

Balance Sheet					(INR Million)	
Y/E March	2008	2009	2010	2011	2012E	2013E
Capital	11,478	11,478	11,478	11,478	13,199	13,199
Reserves & Surplus	81,821	103,601	121,130	142,640	198,061	224,726
Net Worth	93,299	115,078	132,608	154,118	211,261	237,926
Deferred Tax Liability	12,403	555	470	830	830	830
Networth (incl DTL)	105,701	115,633	133,077	154,948	212,090	238,755
Interest subsidy from Gol	10,668	9,089	6,635	4,519	3,841	3,265
Borrowings	406,478	521,602	671,084	855,986	1,017,527	1,272,122
Change (%)	21.0	28.3	28.7	27.6	18.9	25.0
Total Liabilities	522,847	646,324	810,796	1,015,452	1,233,458	1,514,142
Investments	656	359	314	539	647	776
Change (%)	11.4	-45.3	-12.4	71.4	20.0	20.0
Loans	515,683	644,290	798,558	995,707	1,225,936	1,496,614
Change (%)	17.5	24.9	23.9	24.7	23.1	22.1
Net Fixed Assets	770	752	745	767	771	716
Net Current Assets	5,738	924	11,180	18,439	6,104	16,036
Total Assets	522,847	646,324	810,796	1,015,452	1,233,458	1,514,142

ASSUMPTIONS	(%)					
Disbursements Growth	15.3	29.9	22.6	32.2	20.0	20.0
Borrowings Growth	21.0	28.3	28.7	27.6	18.9	25.0
Loans Growth	17.5	24.9	23.9	24.7	23.1	22.1
Investments Growth	11.4	-45.3	-12.4	71.4	20.0	20.0
Dividend	3.5	4.0	4.5	5.0	6.0	7.0

E: MOSL Estimates

Power Finance Corporation: Financials and Valuation

Ratios

Y/E March	2008	2009	2010	2011	2012E	2013E
Spreads Analysis (%)						
Avg. Yield - on Financing portfolio	10.0	10.9	10.9	11.0	11.5	11.6
Avg Cost of funds	8.5	9.2	8.5	8.5	9.3	9.5
Interest Spread	1.5	1.8	2.4	2.5	2.2	2.1
Net Interest Margin	3.4	3.6	3.9	3.8	3.7	3.6
Profitability Ratios (%)						
RoE	12.8	18.2	18.9	18.4	17.1	16.6
RoA	2.7	3.4	3.2	2.9	2.8	2.7
Efficiency Ratios (%)						
Int. Expended/Int.Earned	66.1	67.0	64.4	65.8	68.0	69.1
Other operating Inc./Net Income	13.4	10.5	4.8	7.1	6.2	5.5
Other Income/Net Income	0.6	1.3	2.4	0.9	0.8	0.7
Op. Exps./Net Income	4.6	4.4	3.5	2.7	2.5	2.4
Empl. Cost/Op. Exps.	58.3	46.6	65.4	68.7	68.0	67.6
Asset-Liability Profile (%)						
Loans/Borrowings Ratio	126.9	123.5	119.0	116.3	120.5	117.6
Invest./Borrowings Ratio	0.2	0.1	0.0	0.1	0.1	0.1
Net NPAs to Adv.	0.0	0.0	0.0	0.0	0.0	0.0
Debt/Equity Ratio	4.4	4.5	5.1	5.6	4.8	5.3

Valuations

	2008	2009	2010	2011	2012E	2013E
Book Value (Rs)	92.1	100.7	115.9	135.0	160.7	180.9
BV Growth (%)	8.6	9.4	15.1	16.4	19.0	12.6
Price-ABV (x)	2.3	2.1	1.8	1.6	1.3	1.2
OPS (Rs)	15.4	17.4	26.2	30.9	32.3	38.4
OPS Growth (%)	26.1	12.5	51.0	17.7	4.6	19.1
Price-OP (x)	13.8	12.3	8.1	6.9	6.6	5.5
EPS (Rs)	10.5	17.2	20.5	22.8	23.8	28.4
EPS Growth (%)	36.4	63.2	19.7	11.1	4.5	19.1
Price-Earnings (x)	20.3	12.4	10.4	9.3	8.9	7.5
Dividend	3.5	4.0	4.5	5.0	6.0	7.0
Dividend Yield (%)	1.6	1.9	2.1	2.3	2.8	3.3

E: MOSL Estimates

Rural Electrification Corp: Financials and Valuation

Income Statement					(INR Million)	
Y/E March	2008	2009	2010	2011	2012E	2013E
Interest on Loans	33,605	46,649	64,309	81,088	104,308	127,351
Interest Exp and Other Charges	20,637	28,873	38,961	48,001	65,729	81,933
Net Financing Income	12,969	17,776	25,348	33,087	38,579	45,418
Change (%)	60.4	37.1	42.6	30.5	16.6	17.7
Other Operating Income	177	922	1,189	1,481	1,810	2,166
Other Income	1,594	1,741	1,578	2,384	1,592	1,652
Net Income	14,740	20,439	28,115	36,951	41,981	49,236
Change (%)	32.6	38.7	37.6	31.4	13.6	17.3
Employee Cost	923	872	1,171	1,275	1,402	1,542
Administrative Exp	182	224	277	369	406	446
Other Operating Exp.	105	112	172	539	564	604
Operating Income	13,530	19,231	26,495	34,768	39,609	46,643
Change (%)	32.1	42.1	37.8	31.2	13.9	17.8
Total Provisions	400	34	2	2	20	50
% to Operating Income	3.0	0.2	0.0	0.0	0.1	0.1
PBT	13,130	19,197	26,493	34,766	39,589	46,593
Prior Period Adjustments	-6	4	-1	0	0	0
PBT(post prior period adj)	13,124	19,201	26,492	34,766	39,589	46,593
Tax (Incl Deferred tax)	4,523	6,480	6,478	9,067	10,293	12,114
Tax Rate (%)	34.4	33.8	24.5	26.1	26.0	26.0
PAT	8,601	12,721	20,014	25,699	29,296	34,479
Change (%)	30.3	47.9	57.3	28.4	14.0	17.7
Proposed Dividend	2,576	3,864	6,032	7,406	8,393	9,875

Balance Sheet

Y/E March	2008	2009	2010	2011	2012E	2013E
Capital	8,587	8,587	9,875	9,875	9,875	9,875
Reserves & Surplus	53,261	62,881	100,855	117,884	137,360	160,285
Net Worth	61,848	71,468	110,730	127,758	147,234	170,160
Borrowings	342,828	449,360	559,482	700,038	864,206	1,057,924
Change (%)	13.2	31.1	24.5	25.1	23.5	22.4
Total Liabilities	404,676	520,827	670,212	827,797	1,011,440	1,228,084
Investments	11,474	10,049	9,099	8,124	8,531	8,957
Change (%)	-3.9	-12.4	-9.5	-10.7	5.0	5.0
Loans	393,165	513,814	664,526	821,321	1,008,408	1,223,034
Change (%)	22.5	30.7	29.3	23.6	22.8	21.3
Net Fixed Assets	779	809	899	880	891	901
Net current assets	-742	-3,845	-4,312	-2,528	-6,389	-4,807
Total Assets	404,676	520,827	670,212	827,797	1,011,440	1,228,084

E: MOSL Estimates

Rural Electrification Corp: Financials and Valuation

Ratios

Y/E March	2008	2009	2010	2011	2012E	2013E
Spreads Analysis (%)						
Avg. Yield - on Financing Portfolio	9.4	10.3	10.9	10.9	11.4	11.4
Avg Cost of Funds	6.4	7.3	7.7	7.6	8.4	8.5
Interest Spread	3.1	3.0	3.2	3.3	3.0	2.9
Net Interest Margin	3.6	3.9	4.3	4.5	4.2	4.1
Profitability Ratios (%)						
RoE	17.1	21.2	22.0	21.5	21.3	21.7
RoA	2.5	3.1	3.4	3.42	3.19	3.08
Efficiency Ratios (%)						
Int. Expended/Int.Earned	61.4	61.9	60.6	59.2	63.0	64.3
Other operating Inc./Net Income	1.2	4.5	4.2	4.0	4.3	4.4
Other Income/Net Income	10.8	8.5	5.6	6.5	3.8	3.4
Op. Exps./Net Income	8.2	5.9	5.8	5.9	5.7	5.3
Empl. Cost/Op. Exps.	76.3	72.2	72.3	58.4	59.1	59.5
Asset-Liability Profile (%)						
Loans/Borrowings Ratio	114.7	114.3	118.8	117.3	116.7	115.6
Invest./Borrowings Ratio	3.3	2.2	1.6	1.2	1.0	0.8
Net NPAs to Adv.	0.6	0.0	0.0	0.0	0.0	0.0
Debt/Equity Ratio	5.5	6.3	5.1	5.5	5.9	6.2

Valuations

	2008	2009	2010	2011	2012E	2013E
Book Value (INR)	72.0	83.2	112.1	129.4	149.1	172.3
BV Growth (%)	18.3	15.6	34.7	15.4	15.2	15.6
Price-BV (x)	3.1	2.6	2.0	1.7	1.5	1.3
OPS (INR)	15.8	22.4	26.8	35.2	40.1	47.2
OPS Growth (%)	86.3	42.1	19.8	31.2	13.9	17.8
Price-OP (x)	14.0	9.8	8.2	6.3	5.5	4.7
EPS (INR)	10.9	16.4	20.3	26.0	29.7	34.9
EPS Growth (%)	9.8	50.6	23.3	28.1	14.2	17.7
Price-Earnings (x)	20.2	13.4	10.9	8.5	7.4	6.3
Dividend	3.0	4.5	6.5	7.5	8.5	10.0
Dividend Yield (%)	1.4	2.0	3.0	3.4	3.9	4.5

E: MOSL Estimates

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Motilal Oswal
Bharti Airtel



Out of turbulence

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The balancing act

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Sweetening the world

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Motilal Oswal
Power Finance Corporation



Emerging from the woods

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Sailing on synergies

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AI's in place

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Motilal Oswal
Coal India



Lord of the mines

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Siemens



The right steps

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