



Incorporating **FRK**, the Global FIG Specialist

INDIA

POWF IN Outperform
Price 1 Dec 10 Rs337.90

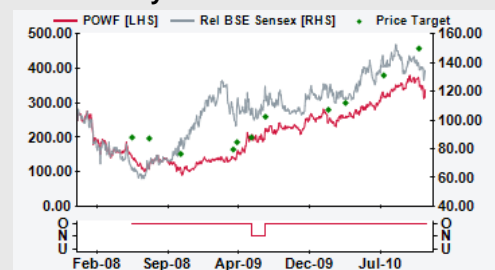
12-month target Rs 458.00
Upside/Downside % 35.5
Valuation Rs 458.00

GICS sector Diversified Financials
Market cap Rsm 387,909
30-day avg turnover US\$m 0.5
Market cap US\$m 8,454
Number shares on issue m 1,148

Investment fundamentals

Year end 31 Mar		2010A	2011E	2012E	2013E
Net interest Inc	m	28,850	35,787	47,537	60,444
Non interest Inc	m	2,797	2,417	2,221	2,552
Underlying profit	m	30,114	36,516	47,902	60,955
PBT	m	30,135	36,516	47,902	60,955
PBT growth	%	22.3	21.2	31.2	27.2
Reported profit	m	23,572	27,387	35,927	45,716
EPS rep	Rs	20.54	23.86	28.46	36.21
EPS rep growth	%	20.2	16.2	19.3	27.2
PER rep	x	16.5	14.2	11.9	9.3
Total DPS	Rs	3.10	3.40	3.40	3.40
Total div yield	%	0.9	1.0	1.0	1.0
ROA	%	3.1	2.8	2.9	2.9
ROE	%	19.0	19.2	19.1	19.1
Equity to assets	x	15.6	14.0	15.8	14.3
P/BV	x	2.9	2.5	1.9	1.7

POWF IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, December 2010
(all figures in INR unless noted)

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2 December 2010

Power Finance

Chugging along nicely

Event

- We had a discussion with Power Finance management to get an update on the company. We maintain our OP on the stock with TP of Rs458.

Impact

- Follow on issue likely in April/May 2011.** A note for a divestment+ fresh equity issuance has been circulated to various ministries. The latter will then come back with their suggestions which would be included and then a final note will be put before the cabinet for approval. Once approvals come it would take about three months for the issue to come before the market. As such it is likely to come in April or May of 2011.
- Cost of bonds remains under control...** Cost of long tenor bonds does not seem to have jumped significantly. The latest bond issuance has been done at coupon of 8.8% that is within the range of 8.7–8.9% done by the company in the recent past. Management is seeing cost of funds spiking more in the short term paper market. The proportion of borrowings with duration less than 1 year is negligible for PFC.
- ..even as pricing power remains.** The company has increased its lending rates by 25bp in September, the beneficial impact of which will likely flow through margins in 3Q11. Management does not see major competition in its focus market- that of state power utilities which has enabled it to go through with the lending rate increase.
- Confident about asset quality.** Management does not see any worrying signs on repayment of loans. It believes the escrow mechanism is working well (borrower's sales receipts go to an escrow account with PFC having first right on them). Regarding AT&C losses, it believes that the progress under APDRP is likely to accelerate the loss reduction which has already come down from ~33% a few years back to ~28% currently. Material loss reduction under the scheme would however be visible only 2–3 years later.
- On an issue of bank license, management clarified that no decision has been made yet on the appointment of a strategic consultant. This consultant was supposed to suggest various strategic options to the management.

Earnings and target price revision

- No change.

Price catalyst

- 12-month price target: Rs458.00 based on a Gordon Growth methodology.
- Catalyst: pick up in loan growth in 2H11; more clarity on FPO

Action and recommendation

- We retain our OP on PFC with its strong earnings visibility, excellent return ratios and attractive valuations. We advice investors to accumulate the stock ahead of the FPO.

Valuations

We value the PFC using a two stage Gordon Growth model. where $P/BV = RoE * \left\{ \frac{p(1+g) * (1 - (1+g)^n / (1+r)^n)}{r - gn} + \frac{pn(1+g)^n}{(r-gn)(1+r)^n} \right\}$, where g=growth rate for the first n (high-growth period) years, p=payout ratio in the first n years, gn=perpetual growth rate, and pn=perpetual payout ratio.

Fig 1 2 stage GGM

RoE	19.5%
g (initial growth)	15%
r (CoE)	13.0%
gn (perpetual growth rate)	4%
n (initial growth period, yrs)	10
P/BV	2.58x
Target Price (rounded off)	458

Source: Macquarie Research, December 2010

Fig 2 Valuation Comps- IDFC, PFC, REC

	EPS growth			P/E			P/BV			RoE (%)		
	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
IDFC	41.4	10.0	12.7	23.1	21.0	18.6	3.5	2.6	2.3	16.1	14.1	12.9
PFC	20.2	16.2	19.3	16.4	14.1	11.9	2.9	2.5	1.9	19.0	19.2	19.1
REC	46.2	17.4	25.5	16.0	13.6	10.9	3.1	2.7	2.3	23.2	21.0	22.5

Source: Macquarie Research, December 2010

Fig 3 Stock details

	Ticker	Target (Rs)	CMP (Rs)	Upside	Reco
IDFC	IDFC IN	200	189	6%	N
PFC	POWF IN	458	337	36%	OP
REC	RECL IN	460	347	33%	OP

Source: FactSet, Macquarie Research, December 2010

Power Finance (POWF IN, Outperform, Target Price: Rs458.00)

Quarterly Results					Profit & Loss						
	2Q/11A	3Q/11E	4Q/11E	1Q/12E		2010A	2011E	2012E	2013E		
Net Interest Income	m	9,414	9,492	8,160	12,150	Net Interest Income	m	28,850	35,787	47,537	60,444
+ Loan Fees	m	76	513	1,198	568	+ Loan Fees	m	1,760	1,917	2,221	2,552
+ Trading Income	m	515	0	656	0	+ Trading Income	m	1,038	500	0	0
+ Insurance Income	m	0	0	0	0	+ Insurance Income	m	0	0	0	0
+ Other Income	m	0	0	0	0	+ Other Income	m	0	0	0	0
Non Interest Income	m	591	513	1,855	568	Non Interest Income	m	2,797	2,417	2,221	2,552
Total Operating Inc	m	10,004	10,005	10,015	12,717	Total Operating Inc	m	31,647	38,203	49,758	62,996
+ Staff expenses	m	210	197	286	209	+ Staff expenses	m	676	744	818	900
+ Other expenses	m	163	250	473	265	+ Other expenses	m	857	943	1,037	1,141
Total Operating Exp	m	373	448	759	474	Total Operating Exp	m	1,534	1,687	1,856	2,041
Pre-Provision Profit	m	9,631	9,558	9,256	12,243	Pre-Provision Profit	m	30,114	36,516	47,902	60,955
Loan Provisions	m	0	0	0	0	Loan Provisions	m	-21	0	0	0
Post Provision Profit	m	9,631	9,558	9,256	12,243	Post Provision Profit	m	30,135	36,516	47,902	60,955
Other Profit	m	0	0	0	0	Other Profit	m	0	0	0	0
- Amortisation	m	0	0	0	0	- Amortisation	m	0	0	0	0
- Non Recurring Items	m	0	0	0	0	- Non Recurring Items	m	0	0	0	0
- Associates	m	0	0	0	0	- Associates	m	0	0	0	0
Pre-Tax Profit	m	9,631	9,558	9,256	12,243	Pre-Tax Profit	m	30,135	36,516	47,902	60,955
- Taxation	m	2,623	2,423	2,015	3,061	- Taxation	m	6,562	9,129	11,976	15,239
Net Profit After Tax	m	7,009	7,135	7,241	9,182	Net Profit After Tax	m	23,572	27,387	35,927	45,716
- Minority Interests	m	0	0	0	0	- Minority Interests	m	0	0	0	0
Reported Profit	m	7,009	7,135	7,241	9,182	Reported Profit	m	23,572	27,387	35,927	45,716
Adjusted Profit	m	7,009	7,135	7,241	9,182	Adjusted Profit	m	23,572	27,387	35,927	45,716
Attributable Profit	m	7,009	7,135	7,241	9,182	Attributable Profit	m	23,572	27,387	35,927	45,716
EPS (rep)		6.11	6.22	6.31	7.27	EPS (rep)		20.54	23.86	28.46	36.21
EPS growth pcp (rep)	%	27.2	14.1	25.2	39.1	EPS growth yoy (rep)	%	20.2	16.2	19.3	27.2
EPS (adj)		6.11	6.22	6.31	7.27	EPS (adj)		20.54	23.86	28.46	36.21
EPS growth pcp (adj)	%	27.2	14.1	25.2	39.1	EPS growth yoy (adj)	%	59.6	16.2	19.3	27.2
DPS		0.85	0.85	0.85	0.85	DPS		3.10	3.40	3.40	3.40
Payout ratio	%					Payout ratio	%	15.1	14.2	11.9	9.4
Book Value p.s (wgted)						Book Value p.s (wgted)		115.5	133.4	176.1	203.2
Tangible Book Value p.s (wgted)						Tangible Book Value p.s (wgted)		115.5	133.4	176.1	203.2
Weighted average shares	m					Weighted average shares	m	1,148	1,148	1,263	1,263
Key Ratios					Key Ratios						
	2Q/11A	3Q/11E	4Q/11E	1Q/12E		2010A	2011E	2012E	2013E		
Interest Spread	%	2.79	2.73	1.95	2.60	Interest Spread	%	4.83	4.55	4.38	4.56
Net Interest Margin	%	4.09	4.13	3.14	4.06	Net Interest Margin	%	7.22	6.88	7.04	6.98
Non Int Inc / Total Inc	%	5.9	5.1	18.5	4.5	Non Int Inc / Total Inc	%	8.8	5.7	4.5	4.1
Cost to Income	%	3.7	4.5	7.6	3.7	Cost to Income	%	4.8	4.4	3.7	3.2
Cost to Assets	%	0.07	0.08	0.14	0.07	Cost to Assets	%	0.18	0.15	0.13	0.11
Provisions / Loans	%	0.00	0.00	0.00	0.00	Provisions / Loans	%	-0.00	0.00	0.00	0.00
Tax Rate	%	27.2	25.3	21.8	25.0	Tax Rate	%	21.8	25.0	25.0	25.0
Loan Deposit Ratio (LDR)	%	nmf	nmf	nmf	nmf	Loan Deposit Ratio (LDR)	%	nmf	nmf	nmf	nmf
NPLs	%	0.00	0.00	0.00	0.00	NPLs	%	0.00	0.00	0.00	0.00
Reserve Cover	%	nmf	nmf	nmf	nmf	Reserve Cover	%	nmf	nmf	nmf	nmf
Tier 1 Capital Ratio	%	nmf	nmf	nmf	nmf	Tier 1 Capital Ratio	%	nmf	nmf	nmf	nmf
Total Capital Ratio	%	nmf	nmf	nmf	nmf	Total Capital Ratio	%	nmf	nmf	nmf	nmf
Equity to Assets	%	14.0	14.0	14.0	15.8	Equity to Assets	%	15.6	14.0	15.8	14.3
ROA (ave)	%	1.45	1.47	1.49	1.47	ROA (ave)	%	3.08	2.82	2.88	2.86
ROE (ave)	%	9.8	10.0	10.1	9.8	ROE (ave)	%	19.0	19.2	19.1	19.1
ROTE (ave)	%	9.8	10.0	10.1	9.8	ROTE (ave)	%	19.0	19.2	19.1	19.1
Growth rates					Growth rates						
						2010A	2011E	2012E	2013E		
Income Growth	%					Income Growth	%	52.4	20.7	30.2	26.6
Cost Growth	%					Cost Growth	%	68.1	10.0	10.0	10.0
Pre-Prov Profit Growth	%					Pre-Prov Profit Growth	%	51.7	21.3	31.2	27.2
PBT Growth	%					PBT Growth	%	22.3	21.2	31.2	27.2
Loan Growth	%					Loan Growth	%	23.9	30.2	29.9	28.1
Ave Int Earning Assets	%					Ave Int Earning Assets	%	23.9	30.3	29.9	28.1
Valuation data					Valuation data						
						2010A	2011E	2012E	2013E		
P/E (rep)	x					P/E (rep)	x	16.5	14.2	11.9	9.3
P/E (adj)	x					P/E (adj)	x	16.5	14.2	11.9	9.3
P/B (wgted)	x					P/B (wgted)	x	2.9	2.5	1.9	1.7
P/TB (wgted)	x					P/TB (wgted)	x	2.9	2.5	1.9	1.7
Dividend yield	%					Dividend yield	%	0.9	1.0	1.0	1.0
Balance Sheet					Balance Sheet						
						2010A	2011E	2012E	2013E		
Cash & Equivalent	m					Cash & Equivalent	m	13,943	13,804	13,667	13,533
Net Loans to Customer	m					Net Loans to Customer	m	798,558	1,040,086	1,350,604	1,730,672
Other Interest Earning Assets	m					Other Interest Earning Assets	m	314	632	769	935
Other Assets	m					Other Assets	m	34,957	37,467	40,240	42,846
Total Assets	m					Total Assets	m	847,772	1,091,990	1,405,280	1,787,986
Customer Deposits	m					Customer Deposits	m	0	0	0	0
Other Int Bearing Liab	m					Other Int Bearing Liab	m	671,084	875,760	1,117,795	1,464,046
Other Liabilities	m					Other Liabilities	m	44,080	63,103	65,203	67,408
Total Liabilities	m					Total Liabilities	m	715,164	938,863	1,182,998	1,531,454
Ordinary Equity	m					Ordinary Equity	m	19,989	19,989	62,228	62,228
Retained Earnings	m					Retained Earnings	m	0	0	0	0
Reserves	m					Reserves	m	112,619	133,138	160,054	194,305
Minority Interests	m					Minority Interests	m	0	0	0	0
Total S/H's Funds	m					Total S/H's Funds	m	132,608	153,126	222,282	256,532

All figures in INR unless noted.

Source: Company data, Macquarie Research, December 2010

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 September 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.06%	64.41%	55.07%	46.58%	66.99%	50.00%	(for US coverage by MCUSA, 13.73% of stocks covered are investment banking clients)
Neutral	34.15%	17.31%	36.23%	48.40%	28.71%	36.81%	(for US coverage by MCUSA, 11.76% of stocks covered are investment banking clients)
Underperform	14.79%	18.28%	8.70%	5.02%	4.31%	13.19%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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