

Rural Electrification Corporation

Rs267
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs264bn; US\$5.6bn

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Result: Q4FY10

Comment: Strong performance

Revision: Upgrading earnings estimates by 4.7% for FY11E and 6% for FY12E

Key valuation metrics

Year to March 31 (Rs m)	NII	yoy chg (%)	Net profit	yoy chg (%)	EPS (Rs)	Book value (Rs/share)	P/ BV (x)	PER (x)	RoE (%)
FY07	7,883	36.1	6,603	3.6	8.5	51.4	5.3	32.0	16.1
FY08	12,974	64.6	8,601	30.3	10.5	62.5	4.3	25.8	18.3
FY09	17,679	36.3	12,722	47.9	14.8	72.1	3.8	18.2	22.0
FY10	25,200	42.5	20,009	57.3	21.7	112.2	2.4	12.5	23.2
FY11E	32,639	29.5	25,193	25.9	25.5	127.9	2.1	10.6	21.3
FY12E	41,572	27.4	31,777	26.1	32.2	152.0	1.8	8.4	23.0

Highlights of Q4FY10 results

Rural Electrification Corporation 'REC' reported a Q4FY10 net profit of Rs5.6bn, (growth of ~45% yoy) ahead of our estimates of Rs4.9bn. The outperformance was led by traction in net interest income, in turn driven by expansion in margins and healthy loan growth.

- **Strong NII, margins expand qoq:** REC witnessed stellar 49% yoy expansion in NII to Rs7.2bn compared Rs6.8bn our estimates. Reported NIMs came in at 4.45% expanding by 30bp qoq, aided by increase in yield of loans (20bp qoq increase). Costs of borrowings were largely stable at 7.75%, registering a qoq increase of 4bp. REC aims to maintain its spreads at ~3.3% (10bp higher qoq) over FY11 by swapping its fixed rate liabilities (3-yr tenor) with G-sec indexed floating rates. (Exhibit 1)
- **Advances growth healthy...led by strong disbursements:** Growth in advances remained healthy at 30% yoy, similar to the levels seen in Q3FY10. Disbursements increased by 35% yoy to Rs60bn, though were flat qoq. Transmission and distribution accounted for ~53% of the total disbursements in Q4FY10, witnessing 58% yoy growth. Generations constituted for 42% of total disbursements for Q4FY10. (Exhibit 3)
- **Strong sanctions pipeline:** While sanctions in Q4FY10 were significantly lower qoq (~Rs33bn as against Rs106bn in Q3FY10), REC is looking at a strong outstanding pipeline of ~Rs1trn. We would not view the slower rate of sanctions in Q4FY10 as a negative as the existing level of approvals provides significant cushion on disbursements over FY11. The management aims to disburse 80% of the total sanctions in FY10 in near term. (Exhibit 2)
- **Seeking IFC status from RBI:** REC has applied for IFC status with the RBI and expects to get an approval for the same in the near future. This would entail maintaining the CRAR at 15% (as against 10% norm presently) but will

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allow REC to raise 50% of their owned fund through automatic ECB route. The IFC status would also enable REC to increase exposure limits to individual borrowers.

- **Robust operating profit:** Operating profit was robust at 32% yoy growth to Rs7.5bn . Other income grew by 39% qoq to Rs737m compared to Rs707m our estimate. Expenses increased by 12% qoq to Rs380mn in line with our estimate of Rs373mn. For FY10, REC earned ~Rs585mn on RGGVY, ~Rs179 in commissions and ~Rs77mn in lead fee income in FY10. The management aims to double the amount on lead fee income on back of higher disbursements to the private sector in FY11.
- **Asset quality maintained:** Gross NPAs remained negligible at 0.03% (stable qoq and yoy). Exposure to large generation projects in government sector has helped REC maintain robust asset quality. Exposure to private sector is low at ~6% and the lender's provisioning expenses remain nil.
- **Adequately capitalized:** REC has raised ~Rs26bn (~13% of post-issue equity) through an FPO in Q4FY10. Post the recent capital issuance, REC is comfortably capitalized with CRAR ratio of 16% (mostly tier I capital) which would increase to ~21% if RBI formally reduces risk weights on power sector loan projects guaranteed by the state government from 100% to 20%.

Valuations & View

REC reported strong performance in Q4FY10 driven by robust loan growth and 30bp qoq expansion in margins. NII growth was strong at 49% yoy (ahead of estimates) as business volumes remained robust (disbursement up 35% yoy). Furthermore, with healthy sanctions pipeline we expect disbursements to remain strong in the near term driving future loan growth. We remain convinced of REC's earnings outlook owing to the huge unaddressed infrastructure financing requirement, further supported by recent policy actions. To factor in stronger disbursements and stable NIMs, we are upgrading our by 4.7% for FY11 and by 6% for FY12. We expect 31% CAGR in REC's disbursements over FY10-12. Led by strong operating performance, RoA is likely to remain elevated at average of ~3% over the next couple of years. We see a 26% CAGR in REC's earnings over FY10-12 with an average RoE of ~22%. Stock currently trades at 2.1x FY11E and 1.8x FY12E adjusted book value. Reiterate Outperformer with a 18-month price target of Rs380 (~2.5x FY12E book).

Quarterly results

(Rs m)	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	FY10	FY11E	FY12E	Comments
Interest Income	13,370	14,490	15,324	16,532	17,959	64,310	84,572	110,463	
Interest expense	8,552	8,740	9,413	10,279	10,790	39,110	51,934	68,891	
NII	4,819	5,750	5,911	6,254	7,169	25,200	32,639	41,572	Above estimates as margins expand
<i>yoy growth (%)</i>	19.7	41.6	36.0	40.2	48.8	42.5	29.5	27.4	
Other Income	1,101	600	905	530	737	2,770	3,262	3,751	Increased by 39% qoq
<i>yoy growth (%)</i>	271.9	82.7	84.3	27.2	-33.0	4.0	17.8	15.0	
Net revenue	5,919	6,350	6,816	6,783	7,906	27,970	35,901	45,323	
<i>yoy growth (%)</i>	37.0	44.7	40.9	39.1	33.6	37.5	28.4	26.2	
Operating expenses	208	300	351	450	380	1,481	1,806	2,307	
<i>yoy growth (%)</i>	-60.1	25.0	-10.7	60.7	83.1	32.6	22.0	27.7	
Operating profit	5,712	6,050	6,466	6,333	7,526	26,489	34,095	43,016	Buoyant on excellent top-line performance
<i>yoy growth (%)</i>	50.3	45.8	45.4	37.8	31.8	37.8	28.7	26.2	
Provision	24	-	1	-	-	-	50	75	Asset quality remains strong
PBT	5,688	6,050	6,465	6,333	7,526	26,489	34,045	42,941	
<i>yoy growth (%)</i>	50.1	46.2	39.0	33.6	32.3	37.9	28.5	26.1	
Tax	1,808	1,340	1,521	1,705	1,917	6,480	8,852	11,165	
PAT	3,880	4,710	4,944	4,629	5,608	20,009	25,193	31,777	Ahead of estimates due to strong NII
<i>yoy growth (%)</i>	2.4	13.8	60.1	45.3	44.5	57.3	25.9	26.1	
Ratios (%)									
Int. Spread (%) -reported	3.16	3.52	3.35	3.26	3.36				
NIMs (calculated)	3.53	4.17	4.14	4.06	4.40	3.95	3.98	3.92	qoq expansion in margins as loan yields improve
Operating exp/avg assets	0.15	0.22	0.25	0.29	0.23	0.23	0.22	0.22	
Employee exp/avg assets	0.13	-	0.20	0.24	0.17	0.18	0.17	0.17	
Cost/Income	3.51	4.72	5.14	6.63	4.81	5.29	5.03	5.09	
Tot prov/ avg assets	0.02	-	0.00	-	-	-	0.01	0.01	
PBT/avg assets	4.2	4.4	4.5	4.1	4.6	4.2	4.2	4.0	
PAT/ avg assets	2.8	3.4	3.5	3.0	3.4	3.1	3.1	3.0	
RoNW	25.0	29.3	26.8	22.6	23.2	23.2	21.3	23.0	
Tax/PBT	31.8	22.1	23.5	26.9	25.5	24.4	26.0	26.0	
Balance Sheet (Rs bn)									
Loan Book	513.8	547.5	586.7	636.3	664.5				Advances growth healthy driven by strong disbursements
<i>yoy growth (%)</i>	30.7	33.9	34.3	29.2	29.3				
Sanctions	69.7	151.4	163.4	105.9	32.7				
<i>yoy growth (%)</i>	1.4	25.7	7.8	69.3	(53.1)				Strong sanctions pipeline; outstanding sanctions of ~Rs1trn
Disbursements	44.5	36.2	55.1	60.2	59.9				
<i>yoy growth (%)</i>	0.0	35.1	15.6	14.3	34.6				Driven by transmission and distribution projects

* On average quarterly balances

Exhibit 1: Margins expand

(%)	Q4FY09	Q3FY10	Q4FY10	qoq bps Change	yoy bps change
Reported					
Yield on Loan	11.79	10.96	11.16	20	(63)
Cost of Borrowing	8.63	7.71	7.75	4	(88)
Interest Spread	3.16	3.26	3.36	10	20
NIMs	4.25	4.15	4.45	30	20
Calculated NIMs	3.53	4.06	4.40	33	87

Exhibit 2: Disbursements and sanctions

Rs bn	Q4FY09	Q3FY10	Q4FY10	% of total
Disbursements				
Generation	20	18	25	42
Transmission & Distribution	20	23	32	53
Short-term loan	2	19	3	5
Total	42	60	60	100
Sanctions				
Generation	22	43	6	18
Transmission & Distribution	47	47	24	73
Short-term loan	1	16	3	9
Total	70	106	33	100

Exhibit 3: Advances- traction led by strong disbursements

Rs bn	Q4FY09	Q3FY10	Q4FY10	%of total
By Type				
Generation	175	224	240	36
Transmission & Distribution	293	345	367	56
Others	39	59	53	8
Total	507	628	660	100
By Borrowers				
State	486	529	556	84
Central PSUs	55	58	61	9
Private	38	41	43	6
Total	579	628	660	100

Exhibit 4: Outstanding borrowings

Rs bn	Q4FY09	Q3FY10	Q4FY10	% of total
Capital Gains	144	117	99	18
Taxable Bonds	182	288	309	55
Banks	95	97	106	19
Foreign	15	19	21	4
Commercial Paper	12	26	25	4
Total	449	546	559	100
Average cost of borrowings	7.70	7.71	7.75	

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