Power Finance Corporation

IPO Fact Sheet

Issue details

Issue opens	:	January 31, 2007
Issue closes	:	February 6, 2007
Issue size	:	Rs856-997 crore
Offer size	:	117,316,700 equity shares of Rs10 each for cash constituting 10% of the fully diluted post-issue paid-up capital of the company.
Price band	:	Rs73-85
Reservation for employees	:	up to 2,500,000 equity shares
Net issue to public	:	up to 114,816,700 equity shares of which
QIB portion	:	at least 57,408,350 equity shares (50%)
Non-institutional portion	:	up to 17,222,505 equity shares (15%)
Retail portion	:	up to 40,185,845 equity shares (35%)

Objects of the issue

The issue proceeds of Rs856-997 crore would be utilised by Power Finance Corporation towards augmenting the capital base to meet its future capital requirements arising out of the growth in its business and for other general corporate purposes.

Shareholding pattern

Shareholders	Pre-issue	Post-issue
GOI	100%	89.78%
Public (including employees)	Nil	10.22%

About the company

Power Finance Corporation Ltd (PFCL), incorporated in July 1986, is a public sector financial institution and a non-banking financial company (NBFC) providing fund and non-fund-based services to clients involved in all aspects of the generation, transmission and distribution and related activities in the power sector in India. It primarily deals with the state power utilities, central power sector utilities, power departments, private power sector utilities etc.

Investment positives

Key beneficiary of investments in the power sector

The company was founded with the sole objective of extending finance to and promoting Indian power projects and related activities. This has helped the company to develop extensive power sector knowledge and the capacity to appraise and extend financial assistance for a wide variety of projects. During the Ninth Five-Year Plan period (fiscal 1998 to fiscal 2002) its disbursements stood at 11.4% of the total expenditure in the power sector for that period, which increased to 22.9% during the Tenth Five-Year Plan period (fiscal 2003 to fiscal 2007). Its disbursements grew at a compounded annual growth rate (CAGR) of 22.6% from FY2002 to FY2006. The company continues to remain the key beneficiary of the power sector projects. The government of India's (GoI) mission of "Power for all by 2012" estimates that India's installed generation capacity should be 200,000MW by the end of its Eleventh Five-Year Plan in 2012 compared to 127,423MW as on September 30, 2006. This will require huge amount of funds for investment in the power sector and PFCL being exclusively involved in financing power projects will stand to benefit.

...established relationship with government

The company occupies a key position in the government's plans for the growth and development of the Indian power sector. It has played and will continue to play a key role in the implementation of government policies and programmes including the implementation of the Electricity Act. It has established strong relationships with the GoI and acts as a nodal agency to implement various policies and programmes of the GoI which keeps it at the forefront of most power sector related projects and activities. The company is acting as the nodal agency for the ultra mega power projects. In recognition of its performance and consistent achievement of targets it received the ***Mini Ratna*** status from the government within 10 years of starting operations in 1998, which provides it greater operational flexibility.

...and established client relationships

Most of the companies engaged in power generation, distribution and transmission are owned by the central or state governments. The private participation in the power sector is also on the rise. Being a public sector enterprise and having a long standing relationship with most of the state run power entities and private players, does provide the company an advantage over its competitors.

Healthy asset quality

Despite the significant exposure to state power utilities (which have been making cash losses) the company's asset quality remains healthy primarily on account of its recovery mechanism. The primary security like charge on assets, irrevocable state government guarantees and payment of obligations through default escrow accounts helps the company to lower its non-performing assets (NPA) to a great extent. Gross NPAs and net NPAs stood at 0.23% and 0.16% as on September 2006 respectively.

Enjoys highest credit ratings

The company enjoys the highest credit ratings of "AAA" and "LAAA" for its long-term domestic borrowings and "P1+" and "A1+" for its short-term borrowings from the domestic credit rating agencies CRISIL and ICRA, respectively. The international credit rating agencies Moody's and Standard & Poor's have given it the long-term foreign currency issuer ratings of Baa3 & BB+, respectively, which are at par with the sovereign ratings for India. Highest credit ratings help the company to keep its borrowing costs down.

Competitive cost of funds

The cost of funds stood at 7.07% in FY2006 and 7.31% (annualised) in the six months ended September 30, 2006. Due to the status as a government company, PFCL is exempt from the provisions of the RBI Act relating to the maintenance of liquid assets, the creation of reserve funds and directions relating to the acceptance of public deposits and prudential norms. It is also exempt from holding a significant portion of its funds in relatively low yielding assets, including government and other approved securities and cash reserves. Coupled with highest credit ratings its cost of funds is expected to remain competitive.

Financials remain healthy and earnings growth expected to improve

The company's financials remain healthy; however the past growth in the earnings was low. The operating income and the profit after tax (PAT) grew at a CAGR of only 9.5% and 10.1% respectively from FY2002 to FY2006. The earnings have shown a very low growth as its yield on assets has declined due to re-pricing and pre-payment of loans. The same has been arrested as the company has now inserted a reset clause every 3 years for fixed rate loans, which was earlier not available to the company and has also limited pre-payment options. Its staff costs to the total operating expenses is comparatively much lower than the industry standards and does provide some cushion at the operating profit levels in a rising interest rate scenario. The yields have improved to 9.08% (annualised) as on September 2006 compared to 8.9% in March 2006. The NIM is expected to stabilise going forward with improved yields negating the rise in the cost of funds and the loan growth expected to continue (CAGR of 21.2% during FY2002 to FY2006) the company's earnings are expected to improve going forward.

Future plans and other investment holdings

The company intends to set up a venture capital fund, India Power Fund to invest in power sector projects for which the company has committed Rs200 crore. The company is in the process of incorporating this fund and expects the same to be operational in the near future. It also plans to increase its fee-based advisory business. PFCL is one of the promoters of Power Trading Corporation (PTC) India, which is in electricity trading. It has an 8% equity stake in PTC and as of September 30, 2006 it has invested a total of Rs12 crore in the company.

Investment concerns

RBI's norms on systematically important NBFCs

The company is currently exempt from Reserve Bank of India's (RBI) prudential norms governing NBFCs. However, the RBI in its notification dated December 12, 2006 has amended the regulatory framework governing NBFCs to address the concerns arising from certain divergent regulatory requirements for banks and NBFCs. Under the amendment, the RBI has proposed to bring all deposit taking and systematically important companies (NBFCs with an asset base of Rs100 crore or more) under the provisions of the NBFCs prudential norms. However, the date from which government owned NBFCs are to fully comply with these guidelines will be decided later. Hence, the company needs to prepare a road map for compliance with various elements of the NBFC regulations, in consultation with the GoI and submit the same to the RBI by March 31, 2007.

Concentration risks

The company exclusively focuses on power projects, related activities and intends to continue to be a sector specific public financial institution with a focus on the Indian power sector. The power projects involve project specific and general risks, again its exposure to a single borrower and borrower groups remain significantly high. Any negative trends or financial difficulties in the Indian power sector could adversely affect its business and financial performance.

Tax benefits withdrawn U/s 10 (23G)

The withdrawal of tax benefit U/s 10 (23G) of the Income Tax Act 1961, related to the interest income on infrastructure lending from FY2007 onwards has resulted in higher effective tax rates of 20.6% for the company during H1FY007 compared to an average effective tax rate of 17-18% reported for the earlier years.

Valuations

We have compared the valuations for PFCL with a host of public and private sector companies engaged in banking and infrastructure finance. The interest in infrastructure finance remains very high and PFCL would continue to benefit from the government's focus on the power sector. At the higher end of the price band of Rs85 the stock would trade at 12.2x its H1FY2007 annualised fully diluted earnings per share of Rs7 and 1.2x post-issue book value, which appears to be a fair valuation.

Comparative valuation

	PFCL*	PFCL**	IDFC	IDBI	SREI	BOB
CMP	85.0	85.0	105.0	101.0	52.0	251.0
EPS	7.8	7.0	4.9	7.7	5.8	28.5
BV	66.7	68.6	26.5	87.5	32.0	230.6
RoA	2.0	2.0	3.3	0.6	2.5	1.0
RoNW	11.7	10.2	20.0	8.8	18.0	12.4
P/BV (x)	1.3	1.2	4.0	1.2	1.6	1.1
P/E (x)	10.9	12.2	21.6	13.2	8.9	8.8

* on pre-issue capital; ** on post-issue capital
EPS calculations are annualised, for PFCL based on HIFY07 and others on 9MFY2007 numbers

Key ratios (%)

Key ratios	FY04	FY05	FY06	H1FY07*
NIM	6.0	4.5	3.4	3.4
Cost of funds	7.9	7.3	7.1	7.3
Yield on funds	11.9	10.0	8.9	9.1
GNPA	0.5	0.7	0.3	0.2
NNPA	0.4	0.5	0.2	0.2
RoANW before EO	16.3	12.9	13.1	12.0
RoANW after EO	18.5	16.2	15.0	11.7

* annualised

Balance Sheet

Rs (cr)

Particulars	FY04	FY05	FY06	H1FY07
Net block	85.3	81.3	84.7	88.3
Investment	12.0	14.1	16.5	16.0
Loans	24,827.3	29,520.1	35,602.5	38,562.9
Current assets	1,748.8	1,530.1	1,786.7	1,418.0
Total assets	**26,673.5**	**31,145.5**	**37,490.4**	**40,085.2**
Equity capital	1,030.5	1,030.5	1,030.5	1,030.5
Reserves & surpluses	4,489.3	4,967.0	5,475.1	5,845.8
Net worth	5,519.8	5,997.5	6,505.5	6,876.3
Loan funds	17,748.0	21,648.2	26,924.8	29,144.5
Interest subsidy fund from GOI	1,102.8	1,155.9	1,200.3	1,039.7
Current liabilities	2,302.8	2,343.9	2,859.7	3,024.7
Total liabilities	**26,673.5**	**31,145.5**	**37,490.4**	**40,085.2**

Earnings table

Rs (cr)

Particulars	FY04	FY05	FY06	H1FY07
Interest income	2,694.2	2,713.2	2,917.6	1,688.2
Interest expense	1,346.5	1,502.6	1,793.6	1,062.5
Net interest income	1,347.7	1,210.7	1,124.1	625.8
Other income	131.8	128.3	106.6	48.8
Net income	1,479.4	1,339.0	1,230.7	674.6
Operating expenses	155.1	150.8	130.8	60.2
Operating profit	1,324.3	1,188.2	1,099.8	614.3
Provisions	0.6	23.2	-14.2	6.3
PBT & EO	1,323.8	1,165.0	1,114.0	608.0
Tax	423.7	388.8	264.6	195.9
PAT before EO	900.1	776.2	849.4	412.1
EO	148.2	237.0	152.1	-13.7
Tax on EO	29.8	42.5	26.2	-2.8
PAT	1,018.5	970.6	975.2	401.3

The views expressed in this report are our views only and have been arrived at after a thorough analysis of the public offering details. The note is advisory in nature, but is not a Recommendation under our "Stock Idea" category. It may/may not be considered as a "Stock Idea" by our analysts at a later date.