27th October, 2010

Key Data	INR
CMP	366
Target Price	407
Bloomberg Code	RECL IN
Reuters Code	RURL.BO
BSE Code	532955
NSE Code	RECLTD
Face Value (₹)	10
Market Cap (₹ Bn)	362
52 Week High (₹)	410
52 Week Low (₹)	188
Avg. Daily Volume (6m)	2581708
F & O	
Market Lot	1000
Turnover (INR Mn)	780

Shareholding	%
Promoters	66.8
Mutual Funds / Bank/ FI	3.3
Foreign Institutional Investors	20.4
Insurance Companies	1.8
Bodies corporate/Individuals/others	7.7
Total	100.0

Rural Electrification Corporation Ltd

Rural Electrification Corporation (REC) reported PAT of ₹6.1 billion, up by 25% on YoY basis. Healthy loan growth enabled strong growth in NII of 32%. Asset quality performance appears on track as indicated by low NPAs.

KEY HIGHLIGHTS FOR 2Q FY11:

- REC's disbursements grew by mere 0.8% YoY in 2QFY11 to ₹55 billion while sanctions declined by 36% to ₹104 billion in 2QFY11.
- Healthy loan growth of 25% enabled strong growth in Net Interest Income (NII) of 32%. Asset quality performance remains strong as indicated by low NPAs at 0.003%.
- During the 2QFY11, REC reported margins of 4.39% lower by 20 bps compared to the 1QFY11. With the general increase in the interest rates the cost of funds have increased more than the yields during the quarter.
- REC maintains a capital adequacy is at 21% (entire Tier I) against the requirement of 15%. Management is comfortable with taking leverage up to 9x from the current 5.9x and does not see any need for capital raising in the next 18 months.

Valuation and Recommendation

Considering the sanctions outstanding we expect REC to register strong growth in disbursements. T&D disbursement though muted during this quarter the management expects this to pick up in 2HFY11 and FY12. Further with increasing cost of funds, we believe margins may be under pressure. We expect REC to register a 28% growth in its loan book during FY10-12. We expect earnings CAGR of REC to be 25% for FY10-12 and the net interest income (NII) CAGR at 26%. We maintain our **"ACCUMULATE"** recommendation on REC and we increase our price target to ₹407. (2.7x PBV of ₹150.8 for FY12E).

Analyst
Deepti Chauhan
research@acm.co.in
Tel: +91-22 2858 3408

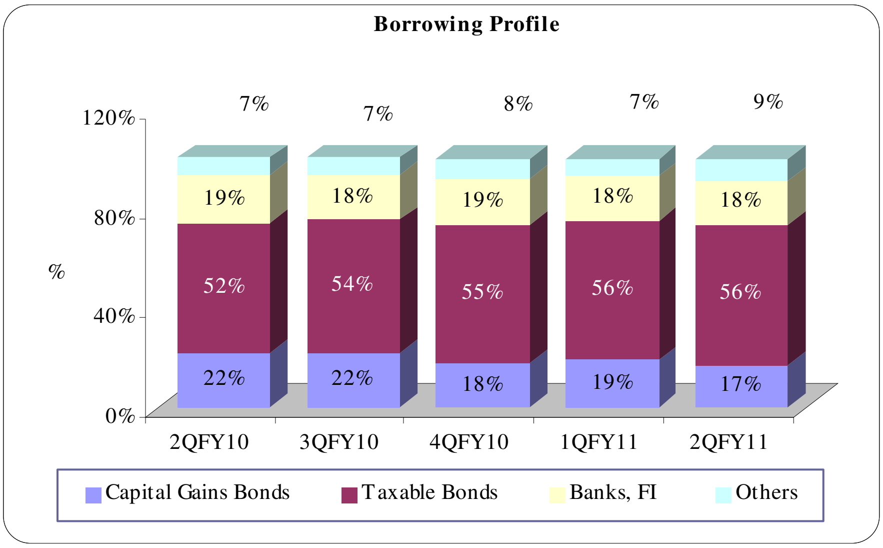
Disbursement

REC's disbursements grew by mere 0.8% YoY in 2QFY11 to ₹55 billion while sanctions declined by 36% to ₹104 billion in 2QFY11. A large part of disbursements have been to the generation segment (50%) mainly due to large sanctions done in this segment in the past. .The growth was pulled down by decline in disbursals to T&D projects. Management attributed this decline to temporary slippages in a few T&D projects and expects demand to rebound strongly in 2H11 and FY12E.

Loan Book

The loan book of REC has registered a 25% growth in 2QFY11. Although the T&D loans dominate the loan book, however the share of this segment is declining with strong demand being witnessed by REC from the generation sector. Further as the management increased it exposure towards the private sector, the share of private sector has also increased. Loan amounting to ₹100 billion (15% of the loan book) are coming up for repricing in FY11 (of which ₹30 billion has already been repriced in 1HFY11) and management expect the same to be repriced at higher yields. We expect REC's loan book to grow at a 28% CAGR during FY10-12.

Borrowing profile



Source: Company

REC raised INR72 billion of funds during 2QFY11 of which 30% have been raised from banks and financial institutions with average cost of funds being 8.13%, 28% through taxable bonds carrying an average cost of 7.82%, 27% of funds have been raised in from of foreign currency loan carrying an average cost of 6.95%. With the interest rates hikes, the average cost of borrowings has gone up. This has resulted in average cost of funds increasing from 7.66% in 2QFY10 to 7.96% in 2QFY11 versus 7.76% in 1QFY11. However going forward the management intends to maintain lower cost. The company has loans of ₹70 billion is expected to be repriced whereas borrowings of ₹40 billion are expected to be repriced. Further the company would access more foreign borrowings, as the cost of these funds is 100bps lower than the domestic funds.

Asset quality remains strong

REC's asset quality remains robust with net NPAs below 1%. Gross NPA has reduced from 0.04% in 2QFY10 to 0.03% in 2QFY11. While Net NPA has been maintained at 0.003%.

Net Interest Margins decline

During the 2QFY11, REC reported margins of 4.39% lower by 20 bps compared to the 1QFY11. With the general increase in the interest rates the cost of funds have increased more than the yields during the quarter. However going forward the company intends to maintain its margins at around 3.25-3.30%. This it intends to do by repricing and sourcing low cost foreign borrowings.

IFC status

The company has received IFC status in September. This will enables REC to increase its private sector exposure by 5% points. REC's current exposure limit to a single private company is 20% of its net worth and to a single private group 35%. However the company will have to maintain a CAR of 15% (as against the current requirement of 10%). At present the capital adequacy is at 21% (entire Tier I).

Valuation and Recommendation

Considering the sanctions outstanding we expect REC to register strong growth in disbursements. T&D disbursement though muted during this quarter the management expects this to pick up in 2HFY11 and FY12. Further with increasing cost of funds, we believe margins may be under pressure. We expect REC to register a 28% growth in its loan book during FY10-12. We expect earnings CAGR of REC to be 25% for FY10-12 and the net interest income (NII) CAGR at 26%. We maintain our "ACCUMULATE" recommendation on REC and we increase our price target to ₹407. (2.7x PBV of ₹150.8 for FY12E).

Interim Results (₹ Mn)	2QFY11	2QFY10	% Chng	1HFY11	1HFY10	% Chng
Interest Income	19876.7	15324.4		38647.4	29,817.9	
Interest expended	12075.6	9413.1		23087.9	18,148.1	
Net Interest Income	**7801.1**	**5911.3**	**32.0**	**15559.5**	**11669.8**	**33.3**
Other Income	944.5	905.1		1461.5	1500.6	
Operating Income	8745.6	6816.4		17021	13170.4	
Operating Expenses	385.9	351.6		728.7	652.7	
Profit before Taxes	8359.7	6464.8		16292.3	12517.7	
Provisions for taxes	2177.6	1521.6		4236.6	2855.9	
Net Profit	**6182.1**	**4943.2**	**25.1**	**12055.7**	**9661.8**	**24.8**
Equity Share capital	9874.6	8586.6		9874.6	8586.6	
EPS	6.3	5.8		12.2	11.3	
Source: Company						

Earnings Summary				₹ Mn
Particulars	FY09	FY10	FY11E	FY12E
Interest Income	46649.3	64308.5	84040.8	109503.0
Interest expended	28873.5	38960.7	52023.4	69576.5
Net Interest Income	**17775.8**	**25347.8**	**32017.4**	**39926.5**
Fee Income	832.5	1010.6	1248.0	1547.5
Other Income	1830.9	1756.9	2150.6	2560.5
Operating Income	20439.2	28115.3	35416.0	44034.5
Operating Expenses	1207.8	1620.1	2049.5	2636.6
Pre Provisioning Profits	19231.4	26495.2	33366.5	41397.8
Provisions & contingencies	34.2	2.2	38.2	41.7
Profit before Taxes and Prior period items	19197.2	26493.0	33328.4	41356.2
Prior period items	3.9	-1.1	0.0	0.0
Profit before Taxes	19201.0	26491.9	33328.4	41356.2
Provisions for taxes	6480.3	6477.8	8337.2	10344.1
Net Profit	**12720.7**	**20014.1**	**24991.2**	**31012.0**
Source: Company, ACMIIL research				

Sources and Application of Funds				₹ Mn
Particulars	**FY09**	**FY10**	**FY11E**	**FY12E**
Liabilities				
Capital	8586.6	9874.6	9874.6	9874.6
Reserves & Surplus	53314.2	100925.4	118198.8	139053.1
Networth	61900.8	110800.0	128073.4	148927.7
Borrowings	449359.6	559480.0	723484.0	933541.8
Deferred Tax Liability	9566.9	-73.7	-68.6	-63.5
Total	**520827.2**	**670206.3**	**851488.8**	**1082406.1**
Assets				
Fixed assets	809.0	896.2	1044.7	1220.9
Investments	10048.6	9100.0	9098.6	9098.6
Loans	513814.5	664520.0	847657.1	1080613.2
Net Current Assets	-3844.9	-4310.0	-6311.6	-8526.5
Total	**520827.2**	**670206.2**	**851488.8**	**1082406.1**
Source: Company, ACMIIL research				

Key Ratios	FY09	FY10	FY11E	FY12E
Spreads				
Cost of Borrowings	7.4%	7.8%	8.1%	8.4%
Yield on Advances	10.5%	11.0%	11.2%	11.4%
Net Interest Income	3.1%	3.3%	3.0%	3.0%
Net interest margins	4.0%	4.3%	4.2%	4.1%
Profitability ratios				
Return On Average Assets (ROAA)	2.7%	3.4%	3.3%	3.2%
Return On Average Net worth (ROANW)	22.0%	23.2%	20.9%	22.4%
Balance sheet ratios				
Loan to borrowings ratio (%)	114.3	118.8	117.2	115.8
Debt/Equity Ratio (Times)	7.3	5.0	5.6	6.3
Growth Ratios				
Borrowings	31.1%	24.5%	29.3%	29.0%
Loans	30.7%	29.3%	27.6%	27.5%
NII Growth	35.9%	41.7%	26.3%	24.7%
Book value	15.3%	56.1%	15.6%	16.3%
EPS	47.9%	36.8%	7.4%	24.1%
Valuation ratios				
EPS (Rs.)	14.8	20.3	25.3	31.4
Book value (Rs.)	71.8	112.2	129.7	150.8
P/E (X)	24.8	15.6	14.5	11.7
P/BV (X)	5.1	3.3	2.8	2.4
Source: Company, ACMIIL research				

Notes

Institutional Sales:

Ravindra Nath, Tel: +91 22 2858 3400
Kirti Bagri, Tel: +91 22 2858 3731
Himanshu Varia, Tel: +91 22 2858 3732
Email: instsales@acm.co.in

Institutional Dealing:

Email: instdealing@acm.co.in

iNVESTMENTZ.com
INVESTOR FIRST