

Nat Resources & Energy
Electric Utilities
 Equity – India

Power Grid Corp of India (PWGR)

Overweight

Target price (INR)	130.00
Share price (INR)	108.80
Potential return (%)	19.5

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	7.3	5.1	13.5
Relative^ (%)	-4.2	3.0	12.7

Index^	BOMBAY SE IDX
RIC	PGRD.BO
Bloomberg	PWGR IN
Market cap (USDm)	9,323
Market cap (INRm)	457,922
Enterprise value (INRm)	794400
Free float (%)	31

Note: (V) = volatile (please see disclosure appendix)

13 February 2012

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OW: Foot on the pedal

- ▶ **Capacity addition on fast track; company accelerates both capital expenditure and capacity addition for FY12**
- ▶ **PGCIL expects 12th Plan (FY13-17) capital expenditure of INR1trn to be front loaded as 56% tenders already awarded**
- ▶ **Likely to beat most estimates by >5% over next two years, 22-25% CAGR growth in regulated equity base with limited downside; reiterate OW and INR130 TP**

Higher than expected capacity addition likely stock driver. PGCIL's capacity addition for FY12 reached INR83bn and capital expenditure reached INR103bn as of 9 February. The current monthly run rate indicates that the company is likely to beat our expectations for FY12 on both capacity addition at INR100bn and capital expenditure at INR135bn.

Capex and capacity addition likely to be aggressive for FY13-14. Management targets to reach capital expenditure of INR175bn for FY12 and INR200bn for FY13, way ahead of the INR120bn achieved in FY11. Given a 24-30-month project gestation, we believe this will result in accelerated capacity addition for FY13-14 as the company already has cINR280bn under capital works in progress.

Capex for 12th Plan (FY13-17) likely to be front loaded. The company, which has INR1trn in projects for the 12th Plan, has already been awarded contracts worth INR560bn, with the work on these projects having either commenced or expected to commence soon. Hence we foresee front loading of the 12th Plan capex over the next three years. PGCIL is likely to issue contracts for most of the remaining INR440bn over the next two years.

Regulated equity base likely to increase fast. The company's regulated equity base of INR141bn at end 1HFY12 is likely to increase to INR232-240bn by end FY14. This drives our expectation of net profit growing in excess of a 15.5% CAGR over FY12-14 from a high base in FY11. We do not see any significant downside risks to these earnings estimates, given the assured return model (15.5% post-tax ROE) once the asset is operational. We conservatively maintain our earnings despite a strong showing by the company in 3QFY12 (9% more than our estimate).

Reiterate OW rating and TP of INR130 using DCF (COE of 11.8% and terminal growth of 3%). Our target implies 2.3x FY13e PB vs the current FY12e PB of 2.0x, and 17.2x FY13e PE vs the current FY12e PE of 15.0x. Key downside risk includes longer-than-expected delays in project commissioning impacting earnings.

Financials & valuation

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRM)				
Revenue	71,275	84,143	99,497	117,374
EBITDA	57,731	69,466	81,755	96,342
Depreciation & amortisation	-19,797	-22,255	-26,396	-31,523
Operating profit/EBIT	37,934	47,211	55,360	64,819
Net interest	-15,432	-17,118	-18,916	-20,983
PBT	26,263	37,126	41,251	47,521
HSBC PBT	26,263	37,126	41,251	47,521
Taxation	-5,854	-10,886	-10,748	-12,449
Net profit	20,409	26,240	30,503	35,072
HSBC net profit	20,409	26,240	30,503	35,072

Cash flow summary (INRM)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Cash flow from operations	52,853	51,981	60,261	69,506
Capex	-100,527	-120,000	-135,000	-135,000
Cash flow from investment	-98,016	-118,250	-133,250	-133,250
Dividends	-5,909	-9,480	-10,834	-12,188
Change in net debt	51,026	37,869	83,823	75,932
FCF equity	-55,685	-75,052	-79,546	-69,178

Balance sheet summary (INRM)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Intangible fixed assets	0	0	0	0
Tangible fixed assets	524,834	622,579	731,184	834,661
Current assets	96,273	124,517	113,752	106,046
Cash & others	32,776	56,487	40,256	26,336
Total assets	635,675	759,914	856,003	950,024
Operating liabilities	100,471	108,490	117,319	126,445
Gross debt	344,168	405,747	473,339	535,350
Net debt	311,392	349,260	433,083	509,014
Shareholders funds	159,419	214,059	233,728	256,612
Invested capital	487,861	582,119	687,361	787,926

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	25.3	18.1	18.2	18.0
EBITDA	27.8	20.3	17.7	17.8
Operating profit	10.9	24.5	17.3	17.1
PBT	17.8	41.4	11.1	15.2
HSBC EPS	20.6	22.4	11.0	15.0

Ratios (%)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Revenue/IC (x)	0.2	0.2	0.2	0.2
ROIC	6.5	6.2	6.4	6.5
ROE	13.4	14.1	13.6	14.3
ROA	5.5	5.5	5.5	5.6
EBITDA margin	81.0	82.6	82.2	82.1
Operating profit margin	53.2	56.1	55.6	55.2
EBITDA/net interest (x)	3.7	4.1	4.3	4.6
Net debt/equity	195.3	163.2	185.3	198.4
Net debt/EBITDA (x)	5.4	5.0	5.3	5.3
CF from operations/net debt	17.0	14.9	13.9	13.7

Per share data (INR)

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EPS reported (fully diluted)	4.85	5.94	6.59	7.58
HSBC EPS (fully diluted)	4.85	5.94	6.59	7.58
DPS	1.50	1.75	2.00	2.25
Book value	37.88	46.24	50.48	55.43

Key forecast drivers

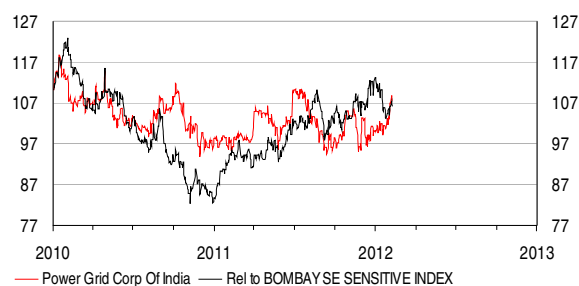
Year to	03/2010a	03/2011e	03/2012e	03/2013e
Capex (INRbn)	101	120	135	135
Capitalisation (INRbn)	29	75	100	117
Regulated Equity (INRbn)	106	129	158	193

Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
EV/sales	10.6	9.4	8.8	8.2
EV/EBITDA	13.1	11.4	10.8	9.9
EV/IC	1.5	1.4	1.3	1.2
PE*	22.4	18.3	16.5	14.4
P/Book value	2.9	2.4	2.2	2.0
FCF yield (%)	-12.6	-16.9	-17.8	-15.4
Dividend yield (%)	1.4	1.6	1.8	2.1

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 09 Feb 2012

3Q review – Strong performance continues

Adjusted net profit at INR7.88bn (up 32% y-o-y) was above our estimate (of INR7.20bn) and consensus by 9% and 7%, respectively. **At the operational level**, transmission income in 3Q at INR22.54bn (up 18% y-o-y) was ahead of our forecast by 7%. As we envisaged in our 2Q review, transmission income is growing rapidly with the commissioning of more assets.

In terms of other operations, consultancy and telecom income came back strongly and posted y-o-y growth of 31% and 27%, respectively, while short-term open access income continues to surprise on the upside. It grew to 3.5% of revenue in 1Q-3Q FY12 (up 58% y-o-y) from c2.5% of revenue in FY11. This is likely to boost earnings as it directly contributes to the bottom line with no significant cost.

Reported net profit at INR8.12bn was higher due to the capitalization of a Foreign Exchange Rate Variation (FERV) loss of INR313.7m in 3Q. Note that the company is on a cost-plus model and any actual increase in the borrowing cost, even accounting for foreign exchange variations, is passed on to customers as and when it arises.

Exhibit 1: PGCIL standalone 3Q quarterly results summary

INRm	Q3FY12	yoy%	HSBC	Act v/s HSBC	BBG Cons.	Act v/s Cons.	Q3FY11
Revenue	24,666	20%	22,890	8%	24,221	2%	20,521
EBITDA	21,027	22%	19,251	9%	20,286	4%	17,274
Margin %	85.2%	107	84.1%	115	83.8%	149	84.2%
PBT (adjusted)	10,282	22%	9,731	6%	10,351	-1%	8,445
Net profit (adjusted)	7,883	32%	7,201	9%	7,388	7%	5,959
PBT (reported)	10,596	25%	9,731	9%	10,351	2%	8,445
Net profit (reported)	8,123	36%	7,201	13%	7,347	11%	5,959
Segmental Revenue							
Transmission	22,542	18%	20,980	7%			19,073
Consultancy	734	31%	604	22%			559
Telecom	536	27%	463	16%			421
Short Term Open Access	854	82%	844	1%			469

Source: Company data, HSBC estimates, Consensus from Bloomberg

Investor focus on capex and capacity addition

We expect Power Grid to complete its 11th Five-year Plan ending FY12 with total capex of INR510bn (versus a target of INR550bn). To date, total capex has amounted to INR480bn, and we expect the remaining INR30bn to be spent in the next 50 days. However management has reiterated that it would be able to achieve the entire INR70bn remaining capex for the current plan. Overall capex incurred in this plan period will represent a significant c177% increase over the last plan period.

We do not expect any slowdown in capex post the plan period (contrary to market concerns). We forecast PGCIL to incur capex of cINR275bn and for capacity to expand by cINR240bn in FY13-14 similar to FY12. This is likely to be driven by: 1) projects under construction worth cINR452bn and 2) INR580bn worth of ordering for high capacity power transmission corridors (HCPTC) projects expected to start in 2HFY12. We remain conservative, factoring in capex of INR800bn for the 12th Plan period (FY13-17) against the company's guidance of INR1,000-1,200bn. PGCIL has already obtained investment approvals worth cINR700bn from the Board relating to 12th Plan projects, of which INR560bn in projects have already been awarded.

Exhibit 2: PGCIL capex and capacity addition to continue to remain strong over next 2-3 years

INRbn	FY10	FY11	1HFY12	2HFY12e	FY13e	FY14e
Capex	101	121	46	89	135	140
Capacity addition	29	73	41	59	115	125

Source: Company data, HSBC estimates

Exhibit 3: PGCIL: Some of the large expansion projects under construction

Project	Nature of the project	Target COD	Project cost (INRm)	Cost incurred as at 1HFY11	% spent
Transmission System for development of pooling station in Northern Part of West Bengal and transfer of power from Bhutan to Northern Region / Western Region North East / Northern Western Interconnector – I Project	Generation-linked	January, 2015	44,046	0	0%
Northern Region System Strengthening – XXI	Generation-linked	August, 2013	111,302	14,355	13%
Transmission System associated with Sasan UMPP	Grid-Strengthening	April, 2013	16,776	11	0%
Transmission System associated with Pallatana and Bongaigaon power station	Generation-linked	December, 2012	58,850	13,283	23%
Transmission System associated with Vindhyachal – IV and Rihand – III Projects	Generation-linked	December, 2012	21,440	853	4%
Eastern Region Scheme – III Strengthening	Generation-linked	November, 2012	46,730	120	0%
Transmission System associated with Mundra UMPP	Grid-strengthening	November, 2012	12,728	318	2%
Common Scheme for 765 kV Pooling Station with DVC and Maithon RB Project	Generation-linked	October, 2012	46,820	9,208	20%
Supplementary Transmission System associated with DVC and Maithon Project	Generation-linked	August, 2012	70,753	25,018	35%
System Strengthening in Northern Region for Sasan and Mundra UMPPs	Generation-linked	August, 2012	23,610	12,991	55%
765 kV System for Central Part of Northern Grid – PART – III	Grid strengthening	August, 2012	10,850	1,101	10%
Transmission System associated with Kundankulam – Atomic Power Project	Grid-strengthening	May, 2012	10,751	1,142	11%
Transmission System associated with Kaiga 3 and 4	Generation-linked	March, 2012	21,591	16,140	75%
765 kV System for Central Part of Northern Grid – PART – I	Generation-linked	March, 2012	10,072	7,603	75%
765 kV System for Central Part of Northern Grid – PART – II	Grid-strengthening	February, 2012	13,473	4,468	33%
Western Region Strengthening Scheme – II	Grid-strengthening	January, 2012	17,364	1,509	9%
Strengthening of East-West Transmission corridor	Grid-strengthening	March, 2011	35,690	26,465	74%
Western Region Strengthening Scheme – IX	Grid-strengthening	Dec, 2010	7,409	6,207	84%
Southern Region Strengthening Scheme – X	Grid-strengthening	March, 2011	1,410	522	37%
Western Region Strengthening Scheme – X	Grid-strengthening	April, 2012	2,240	317	14%
Northern Region Strengthening Scheme – XIII	Grid-strengthening	Feb, 2012	7,130	688	10%
Transmission System associated with Korba III generation project	Grid-strengthening	Nov, 2011	3,240	173	5%
Transmission System associated for Parbati III Hydro project	Generation-linked	March, 2011	2,763	1,581	57%
Transmission System associated for Mouda generation project	Generation-linked	Jun, 2011	6,163	4,019	65%
Sub Total	Generation-linked	Oct, 2012	2,800	99	4%
Others			605,999	148,190	24%
Add: Capex incurred in 2HFY11 (Oct 2010-March 2011)			211,513	87,825	42%
Add: Capex incurred in 1HFY12 (April 2011- Sep 2011)				83,175	
Grand Total					
Balance capex to be incurred			817,512	365,300	45%
			452,212		

Source: Company data

Exhibit 4: Summary of high-capacity transmission systems to be built for various independent power producers by PGCIL

Project - Transmission system associated with	Capacity (MW)	LTOA (MW) - Total	Project Cost (INRbn)
Phase - I generation projects in Orissa	10,090	6,080	87,520
IPP projects in Jharkhand	4,540	4,084	57,090
IPP projects in Sikkim	2,358	2,358	13,040
IPP projects in Bilaspur complex, Chhattisgarh and IPPs in Madhya Pradesh	4,370	4,160	12,430
IPP projects in Chhattisgarh	15,485	15,185	288,240
IPP projects in Krishnapatnam area, AP	4,600	3,072	20,650
IPP projects in Tuticorin area, Tamil Nadu	2,600	2,045	23,570
IPP projects in Srikakulam area, AP	3,960	3,760	29,860
IPP projects in southern region for transfer of power to other regions	11,526	9,182	48,210
Total	59,529	49,926	580,610

Source: Company data, Note: As per company, estimated cost of corridors is expected to be INR750bn which includes transmission system for Ultra Mega power projects not included in the table above

Reiterate Overweight rating with a TP of INR130

We use DCF to value Power Grid and apply a cost of equity of 11.8% and terminal growth rate of 3% to derive our target price of INR130 per share.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for Indian stocks of 11%. Our target price implies a potential return of 19.5%, above the Neutral band; therefore, we are reiterating our Overweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Our target price implies a FY13e PB of 2.3x versus the current FY12e PB of 2.2x, and an FY13e PE of 17.2x versus the current FY12e PE of 16.5x.

Risks

Key downside risks include longer-than-expected delays in commissioning of projects. Other risks include a potential default by SEB and a reduction in regulated returns, although both look highly improbable in the immediate future.

Exhibit 5: PGCL: Valuation summary

Particulars	INRm	INR/Share
Equity value - Core	550,726	119
Add: Cash & bank	40,256	9
Add: Investments	11,032	2
Equity value - Total	602,014	130

Source: HSBC estimates

Disclosure appendix

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Neutral (Hold)	36%	(21% of these provided with Investment Banking Services)
Underweight (Sell)	12%	(14% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Power Grid Corp Of India (PGRD.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	14 January 2011
Target Price	Value	Date
Price 1	130.00	14 January 2011

Source: HSBC

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