



BUY

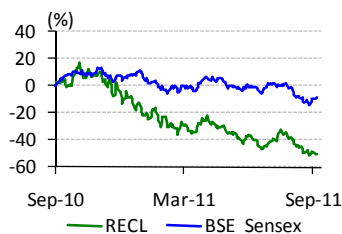
Company Update

Analyst

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Price Rs175
Target Rs274
BSE Index 17,065

Historical Chart Graph



Performance	1m	3m	6m
Absolute (%)	-13.0	-21.3	-30.2
Relative (%)	-10.5	-12.9	-22.7

Stock Information

Ticker code	RECL
Market cap (US\$bn)	3.8
52-week high (Rs)	410
52-week low (Rs)	163
Shares issued (m)	988
6m avg d.vol (US\$m)	13.9
Free float (%)	35
Major shareholders (%)	
Gov't of India	66.8
FII's	19.0

Statutory Auditor

Bansal & Co
 K G Somani & Co

Key Indicators (FY12F)

ROE (%)	22.1
ROA (%)	3.2
NIM (%)	4.3
Loan Growth (%)	20.0

Rural Electrification Corp(RECL)

Rise in NPL an aberration, Concerns overdone

Investors have been selling the RECL stock for the past 6 months due to its high exposure to central and state power projects. In recent times, gov't power utilities have been going thru liquidity pressure. Thus, despite assurances, doubts persist on their repayment capacity. RECL clarified that though a small NPL had appeared on its book for the first time in Q1, all of its funded projects including the big loan given to Tamil Nadu state utility are safe. Y-T-D the RECL stock is down 44%, which reduces its P/BV to 1.2x vs. avg of 1.8x since its listing in 2008. We like RECL due to cheap P/BV multiple and attractive ROE of 22%. **BUY**

Healthy loan growth of 24% for Q1, Maintain FY12F target of 20%

RECL continues to lend to gov't projects, which form 89% of total loans with several projects having achieved fuel linkage and land acquisitions and have strong viability. To reduce skew towards gov't power projects RECL doubled loans to private corporates during Q1.

Q1 NIM unchanged due to loan re-pricing, low cost of funds

For Q1 RECL maintained NIM of 4.3% because its yield on loans to gov't utilities increased 50bp and that from private companies was up 100bp. RECL's avg borrowing cost of 8% (+21bp) is still cheap due to low-cost sources such as tax-free bonds (58% of total) and foreign borrowings (11% of total).

New borrowings of Rs225bn from local debt, Rs75bn from overseas debt

RECL is aggressively increasing its foreign borrowings to keep overall cost of debt at 8%. Recently it mobilized US\$300m from an overseas bond issue and another US\$250m thru another bond issue this month. It is also planning a US\$1bn, convertible bond at a coupon of 2% soon.

Stock is oversold at 52 week low, Our TP of Rs274 based on P/BV of 1.8x

We believe, the negative perception of many more defaults in power utility sector is exaggerated because state gov't have guaranteed payment for their utilities. An increase in electricity tariff by many utilities is likely to avert a crisis in the near term.

Year End March 31	FY09	FY10	FY11	FY12F	FY13F
Revenue (Rs bn)	20.5	28.5	36.8	44.1	50.5
Recurring Net Profit (Rs bn)	12.7	20.2	25.8	30.7	35.1
Recurring EPS(Rs)	14.8	21.9	26.2	31.1	35.5
Growth (%)	41.0	47.7	19.5	18.8	14.1
ROE (%)	22.0	23.4	21.6	22.1	21.6
Gross NPL (%)	0.1	0.0	0.0	0.1	0.1
PER (x)	11.8	8.0	6.7	5.6	4.9
P/BV (x)	2.4	1.5	1.3	1.2	1.0

SEE APPENDIX I FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

FY12F - Gross NPL to be contained at 0.1% of loans

Recently, due to the increased losses of state power utilities and high prices of coal, the asset quality of power sector financiers has come under scanner. We believe, RECL is well placed to protect its asset quality from any major deterioration.

Sudden rise in NPL is not an indicator of more in pipeline

RECL's gross NPL moved up to 0.31% for Q1FY12 from nil last year due to default by Maheswar Hydel power project in the state of Madhya Pradesh (MP). RECL has an exposure of Rs2.5bn, in this project. RECL made a provision of Rs0.25bn in Q1 due to this. It is hopeful of this project starting production in FY13 because 1) it is already 85% complete, 2) its promoters are trying to bring in additional equity of Rs11bn and 3) the project is guaranteed by the MP gov't.

Exposure to Tamil Nadu utility at 8% of total loans is safe

RECL's exposure to power utilities in the state of Tamil Nadu is Rs70bn. RECL clarified that the possibility of default is unlikely because 1) the state utility came out with a bond issue of Rs50bn with guarantee from Government of Tamil Nadu, 2) after Oct, the tariff would be increased and 3) state gov't is clearing pending subsidy payment to the utilities.

Exposure to a weakened gas power project in AP is small

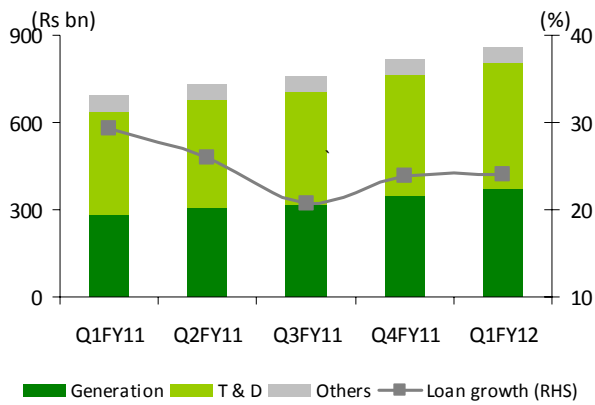
RECL stated that there was a delay in payment for one or two quarters in case of a gas-based power project in the state of Andhra Pradesh. Its exposure of Rs2.2bn is 0.3% of total loans. However, there is no default so far in case of this project.

Asset quality (Rs bn)

Particulars	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Gross NPL	0.2	0.2	0.2	0.2	2.7
Net NPL	0.02	0.02	0.02	0.02	2.3
Provisions	0.2	0.2	0.2	0.2	0.4

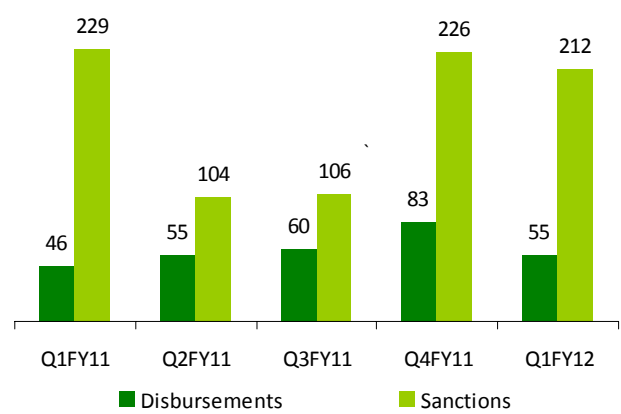
Source: Company data

Loans



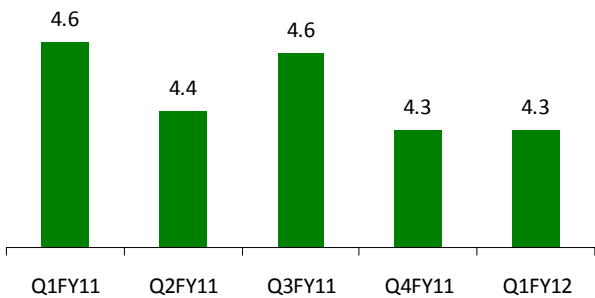
Source: Company data

Sanctions and disbursements (Rs bn)



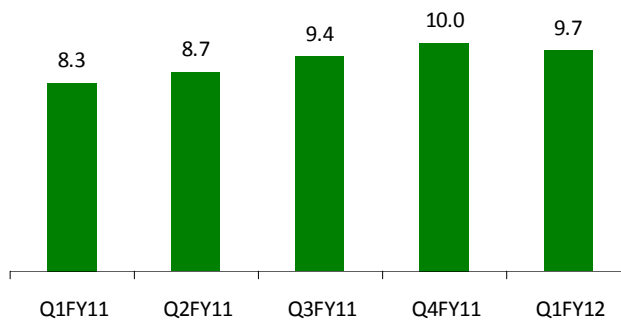
Source: Company data

NIM (%)



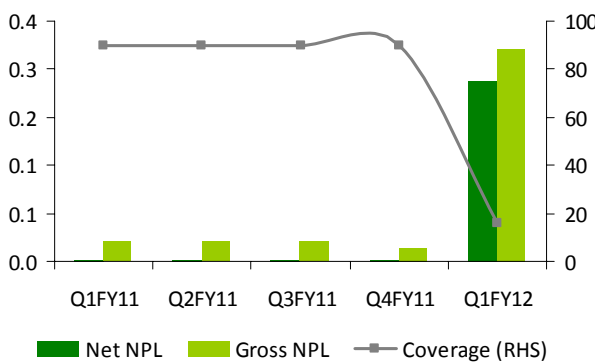
Source: Company data

Revenue (Rs bn)



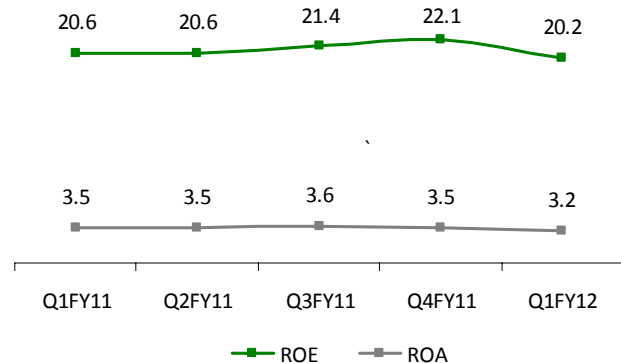
Source: Company data

Net NPL, Gross NPL and loan loss coverage (%)



Source: Company data

ROE & ROA (%)



Source: Company data

Company description:

RECL promoted by gov't of India (which holds 66.8%) is engaged in the financing and promotion of rural electrification projects. They provide assistance to state, central and private sector power utilities.

Investment thesis:

We forecast strong ROE of 22.1% and ROA of 3.2% for FY12F due to AUM growth of 20% and stable NIM of 4.3%

QUARTERLY FINANCIALS (Yr to Mar)

PROFIT & LOSS (Rs bn)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Interest income	18.8	19.9	20.9	21.6	23.1
Interest expenses	11.0	12.1	12.4	13.0	14.0
Net interest income	7.8	7.8	8.5	8.5	9.1
Non interest income	0.5	0.9	0.9	1.5	0.6
Operating Income	8.3	8.7	9.4	10.0	9.7
Operating expenses	0.3	0.4	0.4	0.6	0.5
Pre provision profits	7.9	8.4	9.0	9.5	9.2
Provisions	-	0.0	-	0.0	0.3
Profit before tax	7.9	8.4	9.0	9.5	9.0
Tax	2.1	2.2	2.4	2.5	2.3
Net profit	5.9	6.2	6.6	7.0	6.6
EPS (Rs)	5.9	6.3	6.7	7.1	6.7
Fully diluted shares (m)	987.5	987.5	987.5	987.5	987.5

Ratios (%)	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12
Gross NPL	0.03	0.03	0.03	0.02	0.31
Net NPL	0.00	0.00	0.00	0.00	0.26
Cost-income ratio	4.1	4.4	4.1	5.6	5.1
Effective Tax rate	26.0	26.0	26.3	26.0	26.1
Loan loss coverage	90.0	90.0	90.0	90.0	15.9

Source: Company data

CONSOLIDATED YEARLY FINANCIALS (Yr to Mar)					
PROFIT & LOSS (Rsm)	FY09	FY10	FY11	FY12F	FY13F
Interest income	47,946	65,383	82,583	103,541	126,052
Interest expenses	28,874	38,961	48,510	62,616	79,255
Net interest income	19,073	26,423	34,073	40,925	46,797
Processing fees	134	425	530	636	769
Other income	1,285	1,667	2,209	2,532	2,957
Operating Income	20,492	28,515	36,812	44,093	50,524
Operating expenses	1,238	1,704	1,818	2,155	2,597
Pre provision profits	19,254	26,811	34,994	41,938	47,927
Provisions	34	2	2	365	473
Operating profits	19,220	26,809	34,991	41,573	47,454
Non-operating items	-	-	-	-	-
Profit before tax	19,220	26,809	34,991	41,573	47,454
Income tax	6,488	6,585	9,143	10,862	12,399
Prior period items	4	1	-	-	-
Net profit	12,735	20,225	25,849	30,711	35,055
EPS (Rs)	14.8	21.9	26.2	31.1	35.5
EPS, diluted (Rs)	14.8	21.9	26.2	31.1	35.5
Key Assumptions	FY09	FY10	FY11	FY12F	FY13F
AUM (Rs bn)	507	660	817	984	1,189
Generation (Rs bn)	175	240	346	415	503
% growth	73	37	44	20	21
Transmission and distribution (Rs bn)	293	367	418	505	612
% growth	20	25	14	21	21
AUM growth (%)	31	30	24	20	21
NIM (bps)	403	434	443	429	397
Provision (% of average loans)	0.0	0.0	0.0	0.0	0.0
Non interest income growth (%)	496.3	47.4	30.9	15.7	17.6
RATIOS (%)	FY09	FY10	FY11	FY12F	FY13F
Profitability indicators					
ROA	2.6	3.3	3.3	3.2	2.9
ROE	22.0	23.4	21.6	22.1	21.6
Net profit growth	41.0	47.7	19.5	18.8	14.1
PPOP growth	42.0	39.2	30.5	19.8	14.3
Core earnings growth (NII + fees)	30.9	39.8	28.9	20.1	14.5
Non-interest income / total income (%)	6.9	7.3	7.4	7.2	7.4
Cost / income (%)	6.0	6.0	4.9	4.9	5.1
Interest margins					
Net interest Spread (%)	3.9	4.3	4.4	4.5	4.4
Gross yield (%)	10.3	10.9	10.9	11.2	11.3
Funding cost (%)	6.4	6.6	6.5	6.8	6.9
Borrowing cost(%)	7.3	7.7	7.7	8.0	8.1
Balance sheet					
Borrowings growth (%)	31.1	24.5	25.1	25.0	25.0
Net loans / borrowings (%)	114.3	118.8	117.3	112.9	109.6
Borrowings / liabs (%)	92.3	95.7	95.0	95.2	95.5
Total CAR (%)	13.4	16.1	19.1	17.2	16.2
Tier 1 CAR (%)	13.4	16.1	19.1	17.2	16.2
Asset-to-equity gearing	8.9	6.3	6.7	7.1	7.5
Asset quality					
Gross NPLs (Rs bn)	0.7	0.2	0.2	0.7	1.4
Net NPLs (Rs bn)	0.2	0.0	0.0	0.1	0.3
Gross NPL / loans (%)	0.1	0.0	0.0	0.1	0.1
LLR / NPL (%)	69.5	90.0	90.0	78.5	75.2
Others					
Effective tax rate	33.8	24.6	26.1	26.1	26.1
BALANCE SHEET (Rsm)	FY09	FY10	FY11	FY12F	FY13F
Bank balances	18,883	13,942	28,668	61,930	100,190
Investments (net)	10,048	9,098	8,123	9,748	11,698
Loans	514,293	664,706	821,501	988,737	1,199,308
Loan loss reserves	479	180	180	545	1,018
Loans (net)	513,814	664,526	821,321	988,193	1,198,290
Fixed and other current assets	5,980	8,206	7,238	8,623	10,347
Total assets	548,725	695,772	865,350	1,068,493	1,320,525
Secured loans	376,137	462,447	462,674	578,343	722,929
Unsecured loans	73,223	97,035	237,364	296,705	370,881
Total borrowings	449,360	559,482	700,038	875,048	1,093,810
Current liabilities and provisions	37,434	25,247	37,037	43,707	51,747
Total Liabilities	486,793	584,730	737,076	918,755	1,145,557
Shareholders' equity	61,932	111,043	128,274	149,738	174,968
BVPS	72	120	130	152	177
ABVPS	72	120	130	152	177

Source: Company data, KESI estimates

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Our recommendation is based on the following expected price performance within 12 months:

- +15% and above: BUY
- 15% to +15%: HOLD
- 15% or worse: SELL

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AND
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