



GEOJIT BNP PARIBAS

New Issue Recommendation

Report Date	February 18, 2010	
Company Name	Rural Electrification Corporation (REC)	
Base Price / Recommendation	Rs. 203/-	Subscribe

Sector	Power Finance		<p>Investment Rationale</p> <ul style="list-style-type: none"> ➤ REC, a Navratna PSU, finances all the segments across the power value chain – generation (incl. UMPP), transmission & distribution. ➤ India's power deficiency, huge investment required to support the energy demand and government's ambitious plans of increasing power generation capacity significantly in 11th as well as 12th Five Year Plan period will directly benefit REC in terms of high business volumes for next few years. ➤ Strong financials as well as operational performance. Its loan sanctions & disbursements have grown @ CAGR of 25.7% and 23.2% respectively between FY 2005-2009. ➤ Focusing on fee based income from its subsidiaries. Company also gets consistent fee income from Rajiv Gandhi Gramin Vidyutikaran Yojna (RGGVY). <p>Investment Concerns</p> <ul style="list-style-type: none"> ➤ Inherently weak asset profile because of poor financial position of main customers viz., State Electricity Boards (SEBs) and State Power Utilities (SPUs), accounting for > 90% of loan book ➤ Concentration on single sector (power) and high exposure to few customers <p>Recommendation</p> <ul style="list-style-type: none"> ➤ At base price of Rs. 203/-, the share is trading at 9.2 times FY 2010 expected consolidated EPS of Rs. 22/- and 8.1 times FY 2011 expected consolidated EPS of Rs. 25/- on fully diluted equity of Rs. 987.46 crore. Price to expected consolidated & fully diluted book value works out to be 2.11 for FY 2010 and 1.68 times for FY 2011. ➤ Considering the immense future growth potential, we recommend to SUBSCRIBE the issue.
BSE Sensex	16428.91		
Issue Details			
Issue Size	Rs. 3,486.16 crore		
Shares offered to Public	171,382,000 shares		
Shares reserved for Retail Investors	59,983,700 shares		
Face Value	Rs. 10/-		
Funds to be raised	Rs. 2,415 crore		
Issue opens on	Feb. 19, 2010		
Issue closes on	Feb. 23, 2010		
<i>Retail investors & HNIs will be allotted shares at floor price.</i>			
Utilisation of Issue Proceeds			
To augment capital base to meet future capital requirements arising out of growth in business.			
Shareholding Pattern			
	Pre Issue	Post Issue	
President of India	81.8%	66.8%	
Others	12.6%	11.0%	
Public	5.6%	22.2%	
	100.0%	100.0%	
Eq. Capital (Rs. Cr.)	858.66	987.46	

	FY 2008	FY 2009	% Inc.	H1 FY 10
Income from Operations	3,380.46	4,754.93	40.7%	3,044.48
EBITDA	1,166.22	1,741.41	49.3%	1,162.04
EBITDA (%)	34.5%	36.6%	6.2%	38.2%
P.B.T. before extra ordinary items	1,325.46	1,908.42	44.0%	1,253.55
Net Profit	958.68	1,386.47	44.6%	928.89
Equity Capital (Rs 10/-)	858.66	858.66		858.66
Fully Diluted Equity Capital (Rs 10/-)	987.46	987.46		987.46
Annualised EPS (Rs)	11.25	16.05		21.64
Annualised EPS on fully diluted equity (Rs)	9.78	13.96		18.82
Book Value (Rs)	72.88	83.79		126.15
RONW (%)	15.3%	19.3%		15.2%
ROCE (%)	2.9%	3.3%		3.9%

About REC

- REC provides financial assistance to state electricity boards (SEBs) and rural electricity cooperatives. It has given financial support to major projects, including Ultra Mega Power Projects (UMPPs) for eg., company is part-financing Reliance Power's coal-based 4,000 MW UMPP, the largest in India, at Sasan, Madhya Pradesh.
- It is also the nodal agency for RGGVY, which aims at electrifying 115,000 villages across India. 90% of project's funding is through government grants and remaining 10% by REC as loan. Company gets consistent fee income (1% of project) from RGGVY. With an outlay of ~ Rs. 36,000 crore for RGGVY projects, REC will earn ~ Rs. 360 crore as fee based income.
- While most of its lending is to central and state electricity bodies, REC has gradually increased its lending portfolio to include private players as well. It has been appointed as "nodal agency" for 2 UMPP projects for which company is expected to earn Rs 15 crore each as fees for getting clearances & other formalities completed for the projects.
- Earlier company used to focus on T&D, but now as a part of strategic move, REC has started focusing on generation projects (which have better payment track record compared to T&D) as well. It has also started financing independent power generation projects (IPPs) and provides short-term finance for purchase of T&D equipments. This amplifies REC's key developmental role in channeling finance to rural electrification sector.

	FY 07	FY 08	FY 09	H1 FY10
Transmission & Distribution	58.4%	63.2%	56.8%	54.7%
Power Generation	23.4%	26.1%	36.0%	37.8%
Others incl. short term loans, debt refinancing, & bridge loans	18.2 %	10.60%	7.2 %	7.5%

- REC has diversified resource profile, though its borrowings are primarily wholesale. Its funding sources are capital market instruments, such as taxable bonds, infrastructure bonds, & capital gains bonds under Section 54EC of the Income-tax Act (accounts for 73% of total borrowings in FY 2009) and loans from other banks, LIC, etc. Company has also accessing funds thru foreign currency borrowings (3% of borrowings in FY 2009).

Investment Rationale

- India is a power deficit country, with significant base and peak load deficits. This is because of limited installed generating capacity, high T&D losses, long gestation periods for projects, capital intensity of new capacities and continuous rising demand fuelled by buoyant economic growth. Hence, Government of India has set out ambitious target for generating capacity additions of 78,577 MW for 11th five year Plan (2007 to 2012) and ~ 82,200 MW in 12th five year Plan (2012 to 2017). This entails overall requirement of funds > Rs.10,000 billion during 11th plan and Rs. 11,000 billion in 12th plan, ensuring significantly higher business volumes for next few years.
- Apart from growing fund based income, REC is also focusing on fee based income. Company has 2 subsidiaries – REC Transmission Projects (for bringing in private sector in construction of transmission lines) & REC Power Distribution Company (providing consultancy for power projects). Both these companies help it earn fee based income.
- Strong financial as well as operational performance. Its loan sanctions & disbursements have grown @ CAGR of 25.7% and 23.2% respectively between FY 2005-2009.

Investment Concerns

- Inherently weak asset profile because of poor financial position of main customers viz., State Electricity Boards (SEBs) and State Power Utilities (SPUs), accounting for > 90% of its loan book. However, REC has tried to cushion itself thru state government guarantees, default escrow mechanism, hypothecation of assets, etc
- Concentration on single sector (i.e. power) and high exposure to few customers. REC is making efforts at de-risking its customer profile by diversifying into thru lending to private power utilities.

Recommendation

- At base price of Rs. 203/-, share is trading at 9.2 times FY 2010 expected consolidated EPS of Rs. 22/- and 8.1 times FY 2011 expected consolidated EPS of Rs. 25/- on fully diluted equity of Rs. 987.5 crore. Price to expected consolidated & fully diluted book value works out to be 2.1 for FY 2010 and 1.7 times for FY 2011.
- Considering the immense future growth potential, we recommend to **SUBSCRIBE** the issue.

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