

## Equities

16 November 2011 | 13 pages

# Power Grid Corporation of India (PGRD.BO)

## Top Pick With a Target Price of Rs121

- Company Update
- Target Price Change
- Estimate Change

- **Top India electric utility pick** — We expect PGCIL to deliver 15% EPS growth in FY11-14E with an average RoE of 14%. The company remains, in our view, the safest play in the Indian electric utilities sector, which has been riddled with coal shortages, falling merchant prices and deteriorating SEB finances. The above risks could impede PGCIL's growth due to delayed capacity additions. However, we adequately factor in the risk (XIth Plan capex of Rs504bn v/s target of Rs550bn and XIIth Plan capex of Rs700bn v/s tentative target of Rs1000bn).
- **Target price increased to Rs121 from Rs118** — We revise EPS by 0-2% for FY12E-15E and roll forward our target P/BV of 2.2x to Mar13E (from Dec12E).
- **Solid 2Q FY12 PAT growth** — PGCIL's 2Q FY12 recurring PAT was Rs7.1bn, +18% yoy (CIRA: Rs7.1bn), driven by sales of Rs22.6bn (+10% yoy) and an EBITDA margin of 83.8%. Adjusted for forex, PAT growth is higher at 32% yoy. PGCIL delivered PAT of Rs14.1bn in 1H FY12, +18%, and is on track to meet our target of Rs29.2bn.
- **Improvement in receivable days** — PGCIL's 1H FY12 receivable days came off to 105 from 133 days a year back, a significant improvement. Management expects debtor days to decline to 1 month by Mar 12.
- **Capitalization update** — Capitalized Rs40.6bn in 1HFY12 and Rs51bn till Oct11 and on track to meet CIRA FY12E of Rs90bn (below management estimate of Rs110bn).
- **XIIth Plan capex** — The capex plan for XIIth Plan (Rs750bn on 11 high capacity power transmission corridors) of Rs1,000bn. According to management, coal shortages will not affect future capex because even if a plant operates at low PLFs, it would need a transmission line. Much of the XIIth Plan capex is for transmission corridors, which have multiple beneficiaries. Even if 1 or 2 beneficiaries do not complete projects, it would not matter because other beneficiaries would need the transmission line.

<b>Buy</b>	<b>1</b>
Price (16 Nov 11)	Rs103.30
Target price	Rs121.00
	from Rs118.00
Expected share price return	17.1%
Expected dividend yield	1.9%
<b>Expected total return</b>	<b>19.1%</b>
Market Cap	Rs478,251M
	US\$9,446M

### Price Performance (RIC: PGRD.BO, BB: PWGR IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2010A	20,672	4.91	7.6	21.0	2.7	13.5	1.5
2011A	25,437	5.49	11.9	18.8	2.2	13.6	1.7
2012E	29,256	6.32	15.0	16.3	2.1	13.1	1.9
2013E	33,777	7.30	15.5	14.2	1.9	13.9	1.9
2014E	38,803	8.38	14.9	12.3	1.7	14.4	1.9

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
<b>Valuation Ratios</b>					
P/E adjusted (x)	21.0	18.8	16.3	14.2	12.3
EV/EBITDA adjusted (x)	12.6	11.7	10.8	10.0	9.3
P/BV (x)	2.7	2.2	2.1	1.9	1.7
Dividend yield (%)	1.5	1.7	1.9	1.9	1.9
<b>Per Share Data (Rs)</b>					
EPS adjusted	4.91	5.49	6.32	7.30	8.38
EPS reported	4.85	5.83	6.32	7.30	8.38
BVPS	37.87	46.15	50.14	55.10	61.16
DPS	1.50	1.75	2.00	2.00	2.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	71,275	81,862	96,743	112,610	128,374
Operating expenses	-32,138	-35,309	-41,278	-47,961	-54,743
<b>EBIT</b>	<b>39,136</b>	<b>46,553</b>	<b>55,465</b>	<b>64,649</b>	<b>73,632</b>
Net interest expense	-15,432	-17,339	-20,366	-23,293	-26,025
Non-operating/exceptionals	3,522	7,053	4,089	4,237	4,414
<b>Pre-tax profit</b>	<b>27,226</b>	<b>36,266</b>	<b>39,188</b>	<b>45,592</b>	<b>52,021</b>
Tax	-6,554	-10,830	-9,932	-11,816	-13,217
Extraord./Min.Int./Pref.div.	-263	1,532	0	0	0
<b>Reported net income</b>	<b>20,409</b>	<b>26,969</b>	<b>29,256</b>	<b>33,777</b>	<b>38,803</b>
Adjusted earnings	20,672	25,437	29,256	33,777	38,803
Adjusted EBITDA	58,933	68,547	81,255	94,671	107,885
<b>Growth Rates (%)</b>					
Sales	8.3	14.9	18.2	16.4	14.0
EBIT adjusted	-11.6	19.0	19.1	16.6	13.9
EBITDA adjusted	6.7	16.3	18.5	16.5	14.0
EPS adjusted	7.6	11.9	15.0	15.5	14.9
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>55,537</b>	<b>47,109</b>	<b>61,686</b>	<b>70,204</b>	<b>79,490</b>
Depreciation/amortization	19,797	21,994	25,791	30,022	34,254
Net working capital	13,141	-5,910	5,139	4,406	4,433
<b>Investing cash flow</b>	<b>-99,091</b>	<b>-134,763</b>	<b>-130,038</b>	<b>-118,690</b>	<b>-128,691</b>
Capital expenditure	-100,487	-135,645	-130,000	-120,000	-130,000
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>52,041</b>	<b>91,678</b>	<b>55,912</b>	<b>49,459</b>	<b>47,437</b>
Borrowings	59,514	64,660	66,783	60,331	58,309
Dividends paid	-7,370	-9,426	-10,772	-10,772	-10,772
<b>Change in cash</b>	<b>8,488</b>	<b>4,024</b>	<b>-12,441</b>	<b>974</b>	<b>-1,764</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>635,640</b>	<b>757,308</b>	<b>857,537</b>	<b>956,047</b>	<b>1,057,544</b>
Cash & cash equivalent	32,776	36,801	24,341	25,315	23,552
Accounts receivable	22,149	31,621	37,369	43,498	49,587
Net fixed assets	524,834	638,486	742,695	832,673	928,419
<b>Total liabilities</b>	<b>476,256</b>	<b>543,662</b>	<b>625,425</b>	<b>700,930</b>	<b>774,396</b>
Accounts payable	10,606	18,368	21,707	25,267	28,804
Total Debt	344,168	408,828	475,611	535,942	594,251
<b>Shareholders' funds</b>	<b>159,383</b>	<b>213,646</b>	<b>232,112</b>	<b>255,117</b>	<b>283,148</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	82.7	83.7	84.0	84.1	84.0
ROE adjusted	13.5	13.6	13.1	13.9	14.4
ROIC adjusted	7.3	6.6	6.9	7.1	7.2
Net debt to equity	195.4	174.1	194.4	200.2	201.6
Total debt to capital	68.3	65.7	67.2	67.7	67.7

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## Maintain Buy – Target price increased to Rs121

- We expect PGCIL to deliver 15% EPS growth over FY11-14E with an average RoE of 14%. The company remains, in our view, the safest play in the Indian Electric Utilities universe, which has been riddled with coal shortages, falling merchant prices and deteriorating SEB finances.
- The above factors could impede PGCIL's growth capex due to delayed capacity additions. However, we believe we have factored in the above risks adequately in our estimates as we assume XIth Plan capex of Rs504bn (vs. target of Rs550bn) and XIIth Plan capex of Rs700bn (vs. tentative target of Rs1,000bn).
- We increase our target price to Rs120 (from Rs118) to factor in our EPS revisions and rolled forward of target P/BV of 2.2x for Mar13E (Dec12E earlier)

Figure 1. PGCIL — 1-Year Forward Rolling P/BV Bands

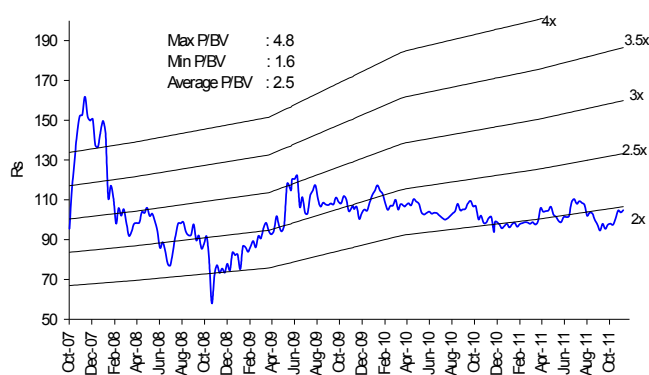
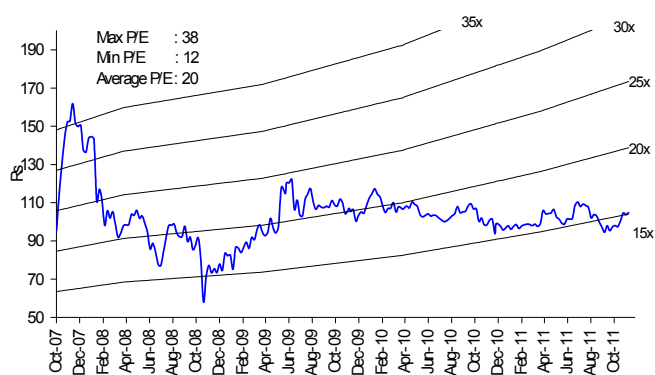


Figure 2. PGCIL — 1-Year Forward Rolling P/E Bands



Source: DataCentral and Citi Investment Research and Analysis

Source: DataCentral and Citi Investment Research and Analysis

## EPS revisions

Figure 3. PGCIL — Revision Table

	FY12E	FY13E	FY14E	FY15E
<b>Recurring PAT</b>				
Old	29,237	33,507	38,263	43,261
New	29,237	33,777	38,803	44,071
Change	0.0%	0.8%	1.4%	1.9%
<b>EPS</b>				
Old	6.32	7.24	8.26	9.34
New	6.32	7.30	8.38	9.52
Change	0.0%	0.8%	1.4%	1.9%
<b>BV</b>				
Old	50.1	55.0	61.0	68.0
New	50.1	55.1	61.2	68.4
Change	0.0%	0.1%	0.3%	0.5%
<b>RoE</b>				
Old	13.1%	13.8%	14.2%	14.5%
New	13.1%	13.9%	14.4%	14.7%
bps	0	10	17	21

Source: Citi Investment Research and Analysis estimates

Figure 4. PGCIL EPS — CIRA vs. Consensus

	FY12E	FY13E	FY14E	FY15E
<b>PAT</b>				
Consensus	30,152	35,423	41,483	47,332
CIRA	29,237	33,777	38,803	44,071
Difference	-3.0%	-4.6%	-6.5%	-6.9%
<b>EPS</b>				
Consensus	6.5	7.6	8.7	10.0
CIRA	6.3	7.3	8.4	9.5
Difference	-2.7%	-4.3%	-4.1%	-4.8%
<b>BV</b>				
Consensus	50.6	55.7	62.3	67.0
CIRA	50.1	55.1	61.2	68.4
Difference	-0.9%	-1.1%	-1.8%	2.0%
<b>RoE</b>				
Consensus	13.2%	14.2%	15.0%	15.6%
CIRA	13.1%	13.9%	14.4%	14.7%
Difference	(13)	(30)	(56)	(94)

Source: Bloomberg and Citi Investment Research and Analysis estimates

### Solid recurring PAT growth

- PGCIL's 2Q FY12 recurring PAT at Rs7.1bn, up 18% yoy, was in line with CIRA's estimate of Rs7.1bn. This was driven by sales of Rs22.6bn, up 10% yoy (v/s CIRA at Rs23bn), and an EBITDA margin of 83.8% (inline with that of CIRA).
- Adjusted for forex fluctuations PAT growth is higher at 32% yoy. The company delivered recurring PAT of Rs14.1bn in 1H FY12, up 18% yoy, and is on track to meet our estimate of Rs29.2bn for FY12E.

Figure 5. PGCIL — 2Q FY12E Results Review

Rsmn	1QFY11	1QFY12	Growth	2QFY11	2QFY12	Growth
Transmission Assets CoD	13,560	8,000	-41.0%	39,320	26.68	-100.0%
<b>Sales</b>	<b>18,667</b>	<b>22,025</b>	<b>18.0%</b>	<b>20,566</b>	<b>22,644</b>	<b>10.1%</b>
<b>EBITDA</b>	<b>15,486</b>	<b>18,455</b>	<b>19.2%</b>	<b>17,158</b>	<b>18,978</b>	<b>10.6%</b>
<b>Margins %</b>	<b>83.0%</b>	<b>83.8%</b>		<b>83.4%</b>	<b>83.8%</b>	
Depreciation	5,024	5,790		5,456	5,966	
<b>EBIT</b>	<b>10,462</b>	<b>12,664</b>		<b>11,702</b>	<b>13,012</b>	<b>11.2%</b>
Total Interest and Finance Charges	4,049	4,446		4,017	5,556	
Total Other Income	1,506	1,432		963	1,942	
<b>PBT</b>	<b>7,919</b>	<b>9,651</b>	<b>21.9%</b>	<b>8,648</b>	<b>9,398</b>	<b>8.7%</b>
Total Tax	1,960	2,586		2,660	2,331	
Effective Tax Rate %	24.8%	26.8%		30.8%	24.8%	
<b>Recurring PAT</b>	<b>5,959</b>	<b>7,065</b>	<b>18.6%</b>	<b>5,988</b>	<b>7,066</b>	<b>18.0%</b>
<b>Recurring PAT (Ex Forex)</b>	<b>6,090</b>	<b>7,065</b>	<b>16.0%</b>	<b>5,858</b>	<b>7,750</b>	<b>32.3%</b>
Prior Period - Others	12	(13)		(35)	21	
Exceptional	1,325	0		700	0	
Tax Adjustment	(264)	0		(139)	0	
<b>Reported PAT</b>	<b>7,032</b>	<b>7,053</b>	<b>0.3%</b>	<b>6,514</b>	<b>7,087</b>	<b>8.8%</b>

Source: Company and Citi Investment Research and Analysis

### Significant improvement in receivable days

- PGCIL's 1H FY12 receivable days came off to 105 from 133 a year back, which is a significant improvement.
- Over the past 6 months, CERC has allowed provisional billing, which has resulted in higher billing for a lot of customers in 1H FY12. Management expects debtor days will come down to 1 month by Mar12. Due to this there is very little unbilled revenue in receivables as of now and 99% of sales has been billed.
- There is Rs2.15bn of receivables from Tamil Nadu, and TNSEB has promised payment by Dec11 as it is in the process of getting a Rs60bn financial restructuring package.

Figure 6. PGCIL — Balance Sheet Review

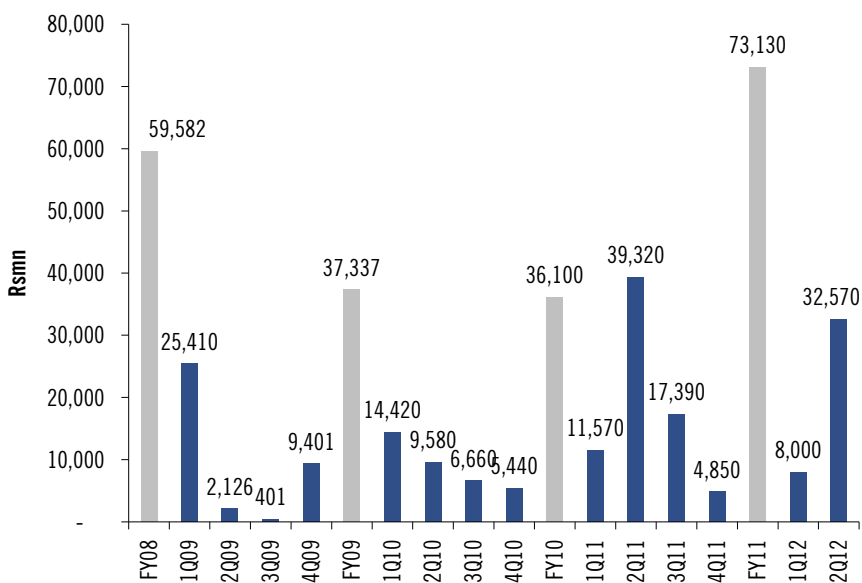
	FY10	FY11	1H FY11	1H FY12
Sales	71,275	81,862	39,233	44,668
Receivables	22,149	31,621	28,650	25,622
Days of sales	113	141	133	105
Unbilled revenues	15,823	21,527		
Sales (Ex Unbilled Revenues)	55,452	60,335		
Receivable (Ex Unbilled revenues)	6,326	10,094		
Days of sales	42	61		
Net Fixed Assets	524,834	638,486	563,377	678,059
Capex			28,063	27,817

Source: Company and Citi Investment Research and Analysis

### Capex and capitalization update

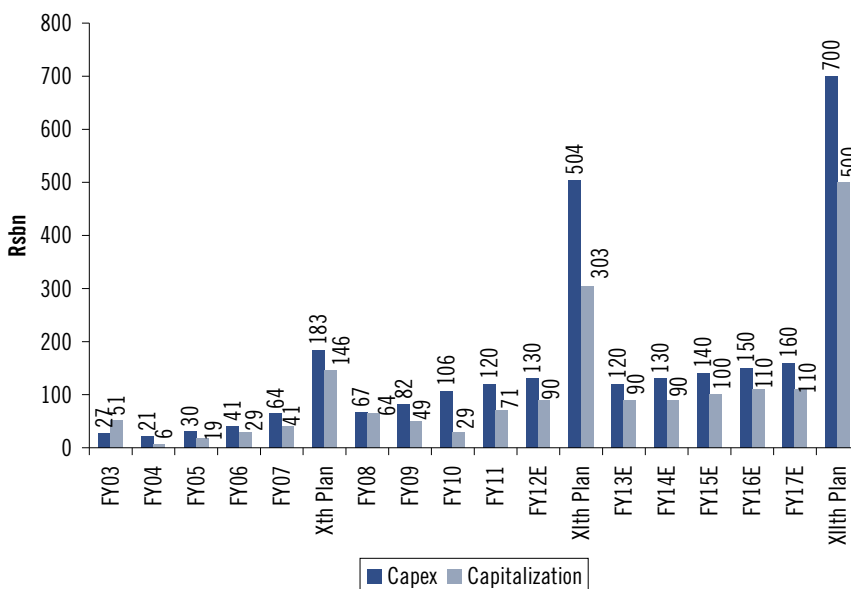
- PGCIL capitalized Rs40.57bn of assets in 1H FY12 and Rs51bn till Oct11 and is on track to meet our FY12E estimate of Rs90bn (below management's estimate of Rs110bn).
- PGCIL's capex was Rs421bn at Sep 11 and Rs430bn by Oct 11. The company reiterated its capex guidance of Rs550bn in the XIth Plan. We remain conservative with our estimate of Rs504bn.
- PGCIL plans capex of Rs1,000bn in the XIIth Plan, of which Rs750bn is on 11 high capacity power transmission corridors which have been approved by beneficiaries and CERC.
- According to management, coal shortages will not affect future capex because even if a power plant operates at 50-60% or lower PLF, it will need the full transmission line.
- Moreover, much of the XIIth plan capex is on high capacity power transmission corridors that have multiple beneficiaries. Even if one or two beneficiaries are not able to complete their power projects, it will not matter because other beneficiaries will need the transmission line.

Figure 7. PGCIL Quarterly Capitalization



Source: Citi Investment Research and Analysis

Figure 8. PGCIL Yearly Capex and Capitalization



Source: Company and Citi Investment Research and Analysis estimates

### Regulatory precedent during 2Q FY11 – Significant positive

- According to CERC regulations, transmission assets can be declared commercial even in case of delays in generation capacity, if the transmission project has been completed.

- In 2Q FY11, PGCIL received in-principle approval for the Kudankulam nuclear plant where transmission capacity was declared commercial in April 2009, despite generation capacity not being operational.
- This precedent will enable PGCIL to approach the regulator in other such instances, and transmission returns being impacted due to delays in generation projects will be minimized.

#### **Using this regulatory precedent in NTPC's Koldam hydel project**

- During FY11 the 400 KV Koldam-Nalagarh line along with line bays at Nalagarh end are ready for use of evacuation of power from Koldam project of NTPC from April 1, 2010. Accordingly the asset has been capitalized and expenditure of Rs221m (including depreciation of Rs97m) has been charged to the profit and loss account.
- Koldam is yet to be commissioned and the CERC regulation provides for approval of transmission line commissioning prior to power plant commissioning. A petition has been filed by PGCIL before CERC for approval of transmission from April 1, 2010. Pending approval, no revenue has been recognized during FY11.

#### **Mundra UMPP transmission system update**

- According to PGCIL it has completed the installation as per schedule and it cannot be held responsible for the delay in commissioning of the generation project. According to PGCIL If there are delays on part of the generator it will have to be compensated suitably by the beneficiary states. Cost of Mundra UMPP transmission system is Rs50bn, of which PGCIL capitalized Rs7bn in Oct 11 relating to 770ckm line.
- Tata Power maintains that it had to resort to application of chemical coating for the preservation of the installed power equipment in May11 while awaiting completion of the transmission line by the central transmission utility. Tata Power says it will take another 4 months to commission unit 1 of Mundra UMPP.

# Power Grid Corporation of India

## Company description

PGCIL (61.42% owned by the Government of India) is India's Central Transmission Utility (CTU) mandated to establish and operate regional and national grids to facilitate transfer of power within and across regions. It commenced operations in April 1992 and carries about 45% of India's generated electricity. As on 31 March 2008, it had a transmission network of about 66,807 circuit kms with 111 substations, and system availability of above 99.65%. PGCIL also plays an active role in distribution sector reforms initiated by government. Recently, PGCIL diversified to provide broadband telecom services and consultancy for T&D projects in India and abroad.

## Investment strategy

We rate PGCIL a Buy to factor in (1) its scarcity value, as it is the only listed play on the regulated transmission business in India vis-a-vis plenty of generation companies to choose from and (2) EPS CAGR of 15% over FY11-14E with average RoE of 14%. PGCIL plans Rs550bn of capex during the XIth Five Year Plan (FY08-12). Management suggested that capex during the next plan could be as high as Rs1000bn. Under the regulatory regime, PGCIL's sales and earnings growth is largely driven by capex and capex that it capitalizes and brings into its gross block. The capex is incrementally funded through a 70:30 debt: equity mix. Capitalization again depends on commissioning transmission lines.

## Valuation

DCF is normally preferred when valuing an electric utility company that has regulated earnings and cash flow streams. However, for a company like PGCIL, which we estimate will be FCF negative until at least FY12E and might continue to be FCF negative beyond FY12E depending on the scale of the capex it undertakes in the XIIth Plan (FY13E -FY17E), the DCF approach could either overestimate or underestimate the value of the company based on the terminal year cash-flow assumptions.

The entire value would be dependent on the steady state case assumed when growth capex stops and the company does only maintenance capex and generates substantial amounts of cash. The DCF value would also be extremely sensitive to the maintenance capex assumption in the terminal year. We therefore believe P/BV valuation methodology is more appropriate.

Our target price of Rs121 is set at 2.2x P/BV for Mar13E, a ~12% discount to the historical average P/BV of 2.5x since listing given the sector's generic risks of coal shortage, falling merchant prices and deteriorating SEB finances.

## Risks

Key downside risks to our target price include: 1) Creditworthiness of the State Power Utilities; 2) Changes in the regulatory environment; 3) Increased competition; and 4) Project-related risks. Key upside risks are: 1) Faster-than-expected project execution leading to earlier capitalization of capex; 2) Higher-than-expected short-term open access revenues due to a spurt in power trading, and 3) Higher-than-expected revenues and profitability in consulting and telecoms businesses.



## Appendix A-1

### Analyst Certification

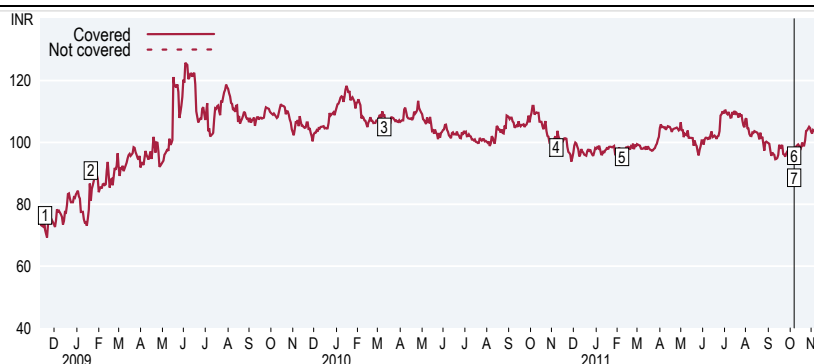
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### IMPORTANT DISCLOSURES

#### Power Grid Corporation of India (PGRD.BO)

##### Ratings and Target Price History Fundamental Research

Analyst: Venkatesh Balasubramaniam



Date	Rating	Target Price	Closing Price
1 17-Nov-08	3L	*69.00	75.60
2 21-Jan-09	3L	*89.00	81.10
3 10-Mar-10	*2L	*116.00	109.05

Date	Rating	Target Price	Closing Price
4 8-Nov-10	*1L	*117.00	98.35
5 8-Feb-11	1L	*118.00	95.70
6 7-Oct-11	Stock rating system changed		

Date	Rating	Target Price	Closing Price
7 7-Oct-11	*1	118.00	97.25

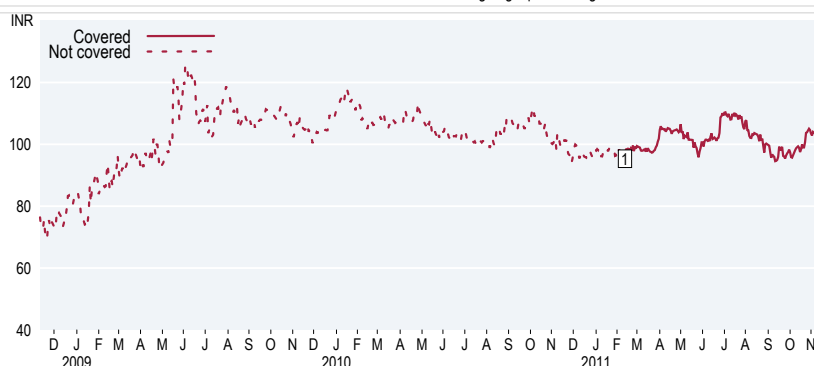
\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

#### Power Grid Corporation of India (PGRD.BO)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam



Date	Rating	Target Price	Closing Price
1 11-Feb-11	*ADD MP	-	96.25

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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