Power Grid Corp of India PGRD.NS PWGR IN

POWER & UTILITIES

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Solid 3QFY12; capitalisation broadly on track

First Look

February 9, 2012

Rating Remains	**Buy**
Target price Remains	INR 120
Closing price February 8, 2012	INR 108

3QFY12 – Sales, EBITDA in line, net profit 12% above forecast

At Rs8.1bn, PWGR's 3QFY12 net profit was 12% and 10% above our and consensus forecasts, respectively; while revenues / EBITDA were in line with our forecast (2%/4% above consensus), the positive surprise at the bottom line was on account of lower-than-expected 'net' interest outgo, and an exchange fluctuation 'gain' (elaborated below). If we were to normalise for the net exchange 'gain', 3QFY12 adjusted net profit would be Rs781mn – still 8% and 6% above our and consensus forecasts, respectively.

9MFY12 capitalisation at Rs63bn; our FY12F target (Rs88bn) appears in sight

We understand that incremental capitalisation in 3QFY12 stood at ~Rs22bn, expectedly lower than the Rs32.5bn capitalisation in 3QFY12. As 9MFY12 capitalisation stood at Rs63bn, while our FY12F capitalisation (Rs88bn) appears very much achievable, management's long-standing FY12 capitalisation target of Rs100bn may just be a stretch – we expect more colour on this at the 10 Feb analysts' meeting.

Transmission revenues up 10.4% q-q, a tad above our forecast

At Rs22.5bn, 3QFY12 transmission revenues posted a 10.4% q-q rise (up 18% y-y), which was largely expected as capitalisation in 2QFY12 was back-ended and Phase-I of the Mundra UMPP transmission system was capitalised on 1 Oct, 2011. However, overall revenues were a tad below our forecast (but 2% above consensus) as revenue from short-term open access (STOA) and telecom business lines came in over 20% below expectations. We note that rebate to customers during the quarter stood at 0.6% of transmission revenues, sharply lower than ~1.3% in 1HFY12, potentially indicating lengthening of the revenue recovery period (debtor days).

Positive surprise on lower 'net' interest outgo, f/x fluctuation 'gain'

At Rs3.6bn, 3QFY12 net interest expense (excluding rebate to customers and exchange fluctuation gain/loss) was ~7% below our forecast. Notably, despite the magnitude of INR/USD depreciation in 3QFY12 being similar to 2QFY12, PWGR posted an exchange fluctuation gain of Rs110mn (vs. our forecast exchange fluctuation loss of ~Rs600mn) on account of: (1) reassessment of f/x loss recoverable from beneficiaries on the back of a Dec 2011 clarification from the regulator (CERC) given to a regulated return generating company, and (2) PWGR adopting Rule 46A provision (notified by the government on 29 Dec, 2011), which allows capitalisation of exchange variation loss on account of settlement/restatement of long-term monetary liabilities related to depreciable capital assets. Had PWGR not adopted the Rule 46A provision (which is now the default policy going forward), net profit would have been lower by Rs314mn, implying an adjusted net profit of Rs781mn (still, 8% and 6% above our and consensus forecasts, respectively).

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 1: PWGR – 3QFY12 earnings – Actual vs. Consensus

Net Profit was higher than our and consensus forecasts by 12% and 10%, respectively

PWGR - 3QFY12 (INR mn)	Actual	Nomura Estimate	Actual vs. Est.	Cons. Estimate	Actual vs. Cons.
Sales	24,666	24,869	-0.8%	24,221	1.8%
EBITDA	21,027	20,995	0.2%	20,286	3.7%
Net Profit	8,123	7,244	12.1%	7,388	10.0%
Reported Profit	8,092	7,244	11.7%	7,388	9.5%

Note: Consensus = Bloomberg mean estimates

Source: Company data, Bloomberg, Nomura research

Fig. 2: PWGR – 3QFY12 earnings snapshot

Transmission revenue growth was in line; positive surprise on lower 'net' interest outgo, f/x fluctuation 'gain'

Quarterly Results (Rs mn)	3QFY11 Dec-10	4QFY11 Mar-11	1QFY12 Jun-11	2QFY12 Sep-11	3QFY12 Dec-11	q-q (%)	y-y (%)	3QFY12F Dec-11	Act vs Est
Revenues	**20,521**	**22,076**	**21,575**	**22,644**	**24,666**	**8.9%**	**20.2%**	**24,869**	**-0.8%**
Transmission	19,073	20,045	19,991	20,416	22,542	10.4%	18.2%	22,336	0.9%
Consultancy	559	915	561	696	734	5.5%	31.3%	750	-2.1%
STOA	469	558	569	1,031	854	-17.2%	82.2%	1,083	-21.1%
Telecom Income	421	558	454	501	536	7.1%	27.5%	700	-23.4%
Staff cost	(1,883)	(1,649)	(2,110)	(1,922)	(1,998)	3.9%	6.1%	(2,000)	-0.1%
Other O&M expenses	(1,364)	(1,889)	(1,461)	(1,743)	(1,642)	-5.8%	20.4%	(1,874)	-12.4%
EBITDA	**17,274**	**18,538**	**18,005**	**18,978**	**21,027**	**10.8%**	**21.7%**	**20,995**	**0.2%**
- Margin (%)	84.2%	84.0%	83.5%	83.8%	85.2%			84.4%	
Depreciation	(5,709)	(5,805)	(5,790)	(5,966)	(6,792)	13.8%	19.0%	(6,711)	1.2%
EBIT	**11,565**	**12,733**	**12,214**	**13,012**	**14,234**	**9.4%**	**23.1%**	**14,284**	**-0.4%**
Interest expense	(3,851)	(4,772)	(4,190)	(5,277)	(4,595)	-12.9%	19.3%	(5,862)	-21.6%
Other income	931	3,711	1,432	1,942	1,096	-43.6%	17.7%	1,400	-21.7%
Rebate to customers	(200)	(450)	(256)	(280)	(139)	-50.2%	-30.3%	(290)	-52.1%
- % of Transmision rev.	1.0%	2.2%	1.3%	1.4%	0.6%			1.3%	
Profit before tax	**8,445**	**11,221**	**9,201**	**9,398**	**10,596**	**12.7%**	**25.5%**	**9,531**	**11.2%**
Tax	(2,487)	(3,762)	(2,676)	(2,331)	(2,472)	6.0%	-0.6%	(2,288)	8.1%
Net Profit	**5,959**	**7,459**	**6,525**	**7,066**	**8,123**	**15.0%**	**36.3%**	**7,244**	**12.1%**
Extraordinary items	(40)	45	528	21	(31)			-	
Reported PAT	**5,919**	**7,504**	**7,053**	**7,087**	**8,092**	**14.2%**	**36.7%**	**7,244**	**11.7%**

Note: If we were to normalise for the net exchange 'gain', 3QFY12 adjusted net profit would be Rs781mn – still 8%/6% above our/consensus forecast.
Source: Company data, Nomura estimates

We await management's commentary at 10 Feb analysts' meeting

At PWGR's upcoming analysts' meeting in Mumbai (on Friday, 10 Feb), we particularly await management's commentary regarding: (1) capitalisation/ capex outlook (and its broad build-up) for FY12/FY13 and the XIIth Plan; (2) debtor days, payment realisation from SEBs, and (3) revenue growth and profitability prospects of ancillary business lines.

Maintain BUY, we believe long-term mid-teen EPS growth prospects remain intact

PWGR remains our top pick in the power utilities space; prospects of mid-teen FY11-17F EPS CAGR remain intact, in our view. On our FY13F earnings forecast, the stock trades at 14.4x P/E and 2.0x P/BV, implying a 15%/10% discount to its three-year average rolling one-year forward multiples, and a 7% premium to NTPC on its FY13F P/BV multiple (in line on P/E).

Appendix A-1

Analyst Certification

I, Anirudh Gangahar, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

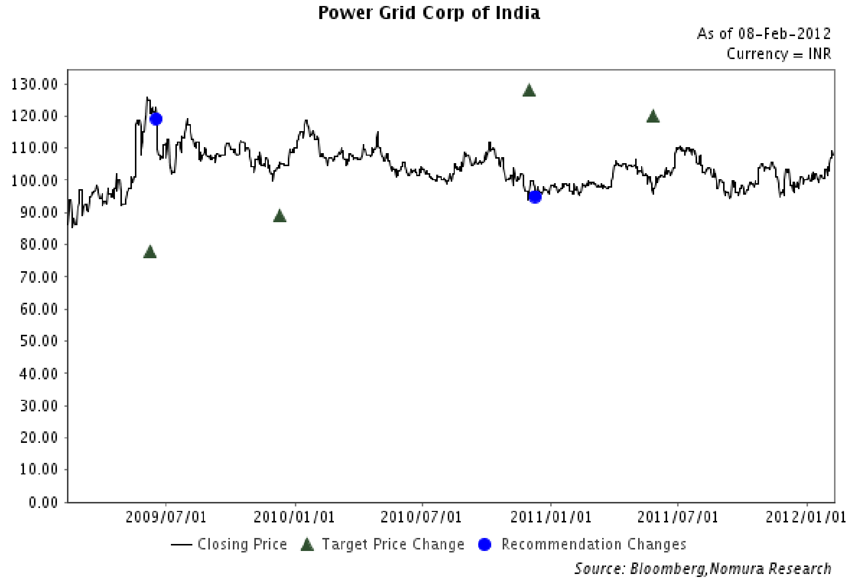
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Power Grid Corp of India	PWGR IN	INR 108	08-Feb-2012	Buy	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Power Grid Corp of India	Reduce	01-Dec-2010

Power Grid Corp of India (PWGR IN) **INR 108 (08-Feb-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
26-May-11		120.00	95.55
01-Dec-10	Buy		96.85
01-Dec-10		128.00	96.85
09-Dec-09		89.00	104.00
08-Jun-09	Reduce		120.95
08-Jun-09		78.00	120.95

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We use a residual income model to arrive at our target price of INR120. Key assumptions of our model are 1) Cost of equity - 12.5%; 2) Terminal RoE - 17%; and 3) Terminal growth rate - 3%.

Risks that may impede the achievement of the target price 1) lower-than-expected capitalization of transmission assets due to execution delays (scalability, vendor ramp-up, turnkey workforce) and/or impediments in securing Right-of-Way (RoW) / forest clearance; 2) sharp push-back in generation-capacity addition delaying capitalization of related transmission assets; and 3) overhang of a potential equity dilution in FY2014/15 in case annual capex exceeds our forecast by 15-20%.

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STOCKS

A rating of '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of '**Neutral'**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of '**Reduce'**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of '**Suspended'**, indicates that the rating, target price and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including, but not limited to, when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.
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SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

STOCKS

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A Target Price, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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