

6 February 2013

Rural Electrification Corp.

*Stable growth, higher NIM; Buy*Rating: **Buy**

Target Price: ₹289

Share Price: ₹249

Key takeaways

Robust loan growth, higher disbursements. Rural Electrification Corp.'s (REC) loan book grew 25% yoy (6.0% qoq), to ₹1,187bn, led by healthy disbursements growth of 64% yoy (37% qoq) to ₹104bn. Sanctions pipeline in the quarter improved 46% yoy to ₹128bn, driven by higher sanctions in the transmission and distribution space. Share of state governments in overall loan book has increased 80bps yoy to 82.6%.

Higher NIM on better yields, productivity up. Reported NIM grew 26bps qoq, led by 24bps rise in yield on earning assets to 12.14%, further aided by 4bps qoq fall in cost of funds to 8.36%. A dynamic borrowing mix, coupled with easing liquidity, could further benefit NIM. Productivity further improved with cost-income at 3.5% against 6.8% a year ago.

Asset quality stable; medium-term risks persist. REC's asset quality remained stable, with no addition to delinquencies in the quarter. While NPA coverage increased to 18%, it remains lower than other NBFCs. The SEB restructuring package augurs well for the company's financial health. However, increasing incremental share of private sector projects may pose asset quality concerns in the medium term. As a result, we have built higher provision of 22bps over FY13-15 against 6bps in FY12.

Our take. We increase our PAT estimates 3.4% and 5.6% for FY14 and FY15, respectively, on higher NIM assumptions. We raise our target price to ₹289 from ₹270 and value the NBFC at 1.4x FY14e BV on higher RoEs (earlier 1.3x FY14). With strong niche expertise and domain knowledge, we believe risk-reward favors REC at current valuations of 1.2x FY14 BV. We re-iterate Buy. At our Mar'14 target, the stock would trade at PABV of 1.4x FY14e and 1.2x FY15. Our target is based on two-stage DDM (CoE: 14.6%; beta: 0.9; Rf: 8%). **Risks.** Slowdown in the power sector, regulatory hurdles.

Key data	RECL IN / RURL.BO
52-week high / low	₹268/₹142
Sensex / Nifty	19660/5957
3-m average volume	US\$7.8m
Market cap	₹240bn/US\$4.6bn
Shares outstanding	987.5m

Shareholding pattern (%)	Dec-12	Sep-12	Jun-12
Promoters	66.8	66.8	66.8
- of which, Pledged	-	-	-
Free Float	33.2	33.2	33.2
- Foreign Institutions	21.2	20.7	20.1
- Domestic Institutions	6.0	6.1	6.1
- Public	5.9	6.4	7.0

Estimates revision (%)	FY13e	FY14e	FY15e
NII	6.9	3.2	4.8
PAT	11.4	3.4	5.6
ROE (bps)	216	20	53

Financials (YE: Mar)	FY13e	FY14e
Net interest income (₹m)	52,560	61,327
Net profit (₹m)	38,364	42,909
EPS (₹)	38.9	43.5
Growth (%)	36.2	11.8
PE (x)	5.7	5.1
PABV (x)	1.2	1.0
RoE (%)	23.6	22.0
RoA (%)	3.2	3.0
Dividend yield (%)	3.2	3.4
Net NPA (%)	0.5	0.2

Source: Anand Rathi Research

Quarterly results (YE: Mar)	3QFY12	3QFY13	% yoy	9MFY12	9MFY13	% yoy
Net interest income (₹m)	10,052	14,084	40.1	28,645	38,539	34.5
Non-interest income *(₹m)	1,357	508	(62.6)	1,256	1,685	34
Operating expenses (₹m)	779	507	(34.9)	1,704	1,547	(9.2)
Cost-to-income (%)	6.8	3.5	(335)bps	5.7	3.8	(185)bps
Pre-provisioning profit (₹m)	10,629	14,085	32.5	28,197	38,677	37.2
Provisions (₹m)	241	250	3.8	491	250	(49.1)
PBT (₹m)	10,389	13,835	33.2	27,706	38,427	38.7
Tax (₹m)	2,693	3,568	32.5	7,149	9,855	37.9
PAT(₹m)	7,695	10,267	33.4	20,558	28,572	39.0
EPS (₹)	7.8	10.4	33.4	19.3	28.9	49.6

Source: Company, Anand Rathi Research *Includes forex gain and loss

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net interest income	34,059	39,588	52,560	61,327	71,612
NII growth (%)	34.4	16.2	32.8	16.7	16.8
Non-interest inc	2,384	1,715	2,200	1,925	2,342
Total income	36,443	41,303	54,760	63,252	73,954
Total Inc growth (%)	29.6	13.3	32.6	15.5	16.9
Op. expenses	1,645	2,326	2,478	2,883	3,354
Operating profit	34,797	38,977	52,282	60,370	70,600
Op profit growth (%)	31.3	12.0	34.1	15.5	16.9
Provisions	2	1,048	1,130	3,158	3,297
PBT	34,795	37,929	51,152	57,212	67,303
Tax	9,096	9,758	12,788	14,303	18,172
PAT	25,699	28,170	38,364	42,909	49,131
PAT growth (%)	28.4	9.6	36.2	11.8	14.5
FDEPS (₹/share)	26.0	28.5	38.9	43.5	49.8
DPS (₹/share)	6.5	6.5	7.0	7.5	8.5

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	9,875	9,875	9,875	9,875	9,875
Reserves & surplus	118,012	137,575	167,851	202,095	241,406
Borrowings	700,397	900,565	1,072,386	1,323,554	1,582,581
Current liab. & prov.	36,844	39,272	47,126	56,551	68,427
Minority Interest	(128)	(101)	(101)	(101)	573
Total liabilities	864,999	1,087,185	1,297,137	1,591,974	1,902,861
Advances	817,360	1,014,029	1,246,960	1,498,928	1,798,388
Investments	8,368	7,576	8,333	9,167	10,175
Cash & bank bal	28,319	53,115	33,528	74,218	83,475
Fixed & other assets	10,952	12,465	8,316	9,661	10,824
Total assets	864,999	1,087,185	1,297,137	1,591,974	1,902,861
No. of shares (m)	987	987	987	987	987
Borrowings growth (%)	25.2	28.6	19.1	23.4	19.6
Advances growth (%)	23.0	24.1	23.0	20.2	20.0

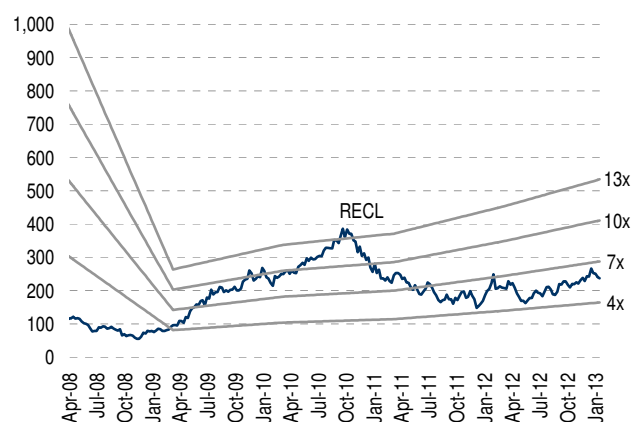
Source: Company, Anand Rathi Research

Fig 3 – Key ratios

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
NIM (%)	4.5	4.1	4.5	4.3	4.1
Other inc / total inc (%)	6.5	4.2	4.0	3.0	3.2
Cost-income (%)	4.5	5.6	4.5	4.6	4.5
Provision coverage (%)	90.0	13.5	23.8	64.8	107.6
Dividend payout (%)	33.5	30.6	21.1	20.2	20.0
Credit-deposit (%)	85.7	88.8	86.0	88.3	88.0
Investment-deposit (%)	-	-	-	-	-
Gross NPA (%)	0.0	0.5	0.6	0.5	0.4
Net NPA (%)	0.0	0.4	0.5	0.2	(0.0)
BV (₹)	129.4	149.2	179.9	214.6	255.1
Adj BV (₹)	123.3	137.0	165.1	201.7	244.0
CAR (%)	19.1	17.0	16.5	16.2	15.6
RoE (%)	21.5	20.5	23.6	22.0	21.2
RoA (%)	3.3	2.9	3.2	3.0	2.8
Dividend yield (%)	2.6	2.6	2.8	3.0	3.4

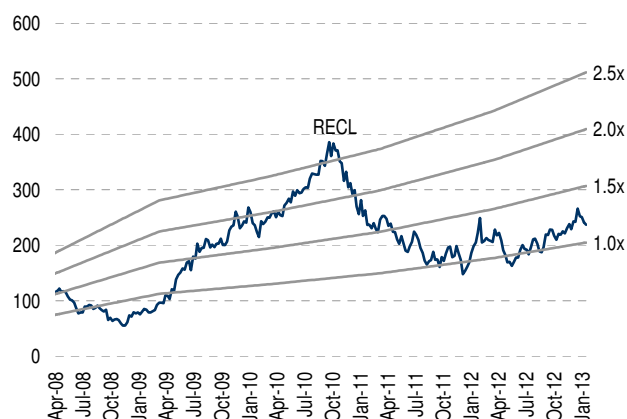
Source: Company, Anand Rathi Research

Fig 4 – PE band



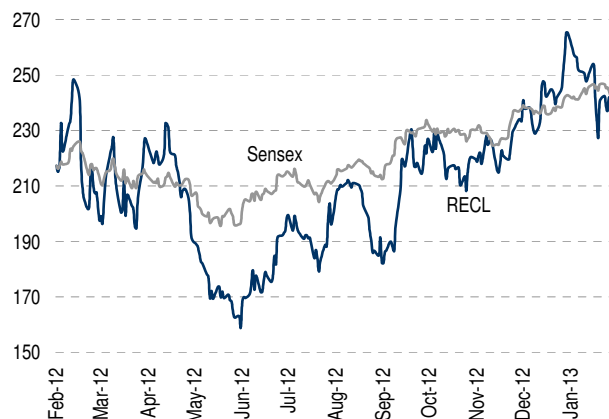
Source: Bloomberg, Anand Rathi Research

Fig 5 – Price-to-book band



Source: Bloomberg, Anand Rathi Research

Fig 6 – REC vs. Sensex



Source: Bloomberg

Result highlights

Fig 7 – 3QFY13 results

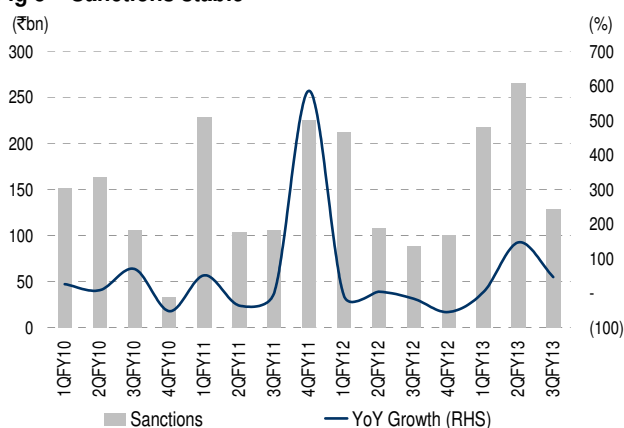
(₹m)	3QFY13	3QFY12	% Chg	9MFY13	9MFY12	% Chg
Net interest income	14,084	10,052	40.1	38,539	28,645	34.5
Non-interest income	508	1,357	(62.6)	1,685	1,256	34.1
Operating costs (%)	507	779	(34.9)	1,547	1,704	(9.2)
Pre-provisioning profits	14,085	10,629	32.5	38,677	28,197	37.2
PAT	10,267	7,695	33.4	28,572	20,558	39.0
	3QFY13	3QFY12	YoY	2QFY13	QoQ	
Loan book	1,186,900	949,580	25.0	1,119,650	6.0	
Borrowings	1,017,490	810,530	25.5	954,520	6.6	
Borrowings-Loans (%)	85.7	85.4	37bps	85.3	48bps	
Sanctions	128,660	88,120	46.0	265,490	(51.5)	
Disbursements	104,250	63,420	64.4	76,290	36.6	
Gross NPA	4,900	4,930	(0.6)	4,900	-	
Gross NPA	4,010	4,260	(5.9)	4,260	(5.9)	
Gross NPA %	0.4	0.5	(11)bps	0.4	(3)bps	
Net NPA %	0.3	0.4	(11)bps	0.4	(4)bps	
NPA coverage %	18.2	13.6	457bps	13.1	510bps	

Source: Company,

Robust loan growth, stable disbursements

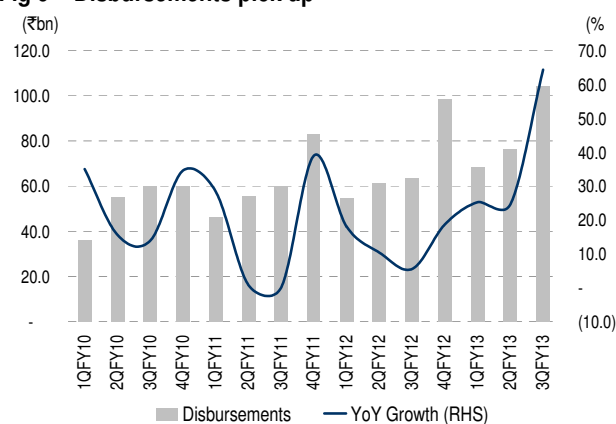
Loan book grew 25% yoy (6.0% qoq), to ₹1,187bn, led by healthy disbursements growth of 64% yoy (37% qoq) to ₹104bn. Sanctions pipeline in the quarter improved 46% yoy to ₹128bn, driven by higher sanctions in the transmission and distribution space. Share of state governments in overall loan book has increased 80bps yoy to 82.6%.

Fig 8 – Sanctions stable



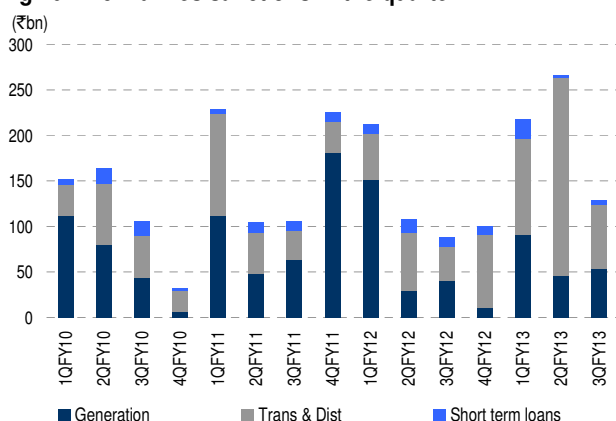
Source: Company, Anand Rathi Research

Fig 9 – Disbursements pick up



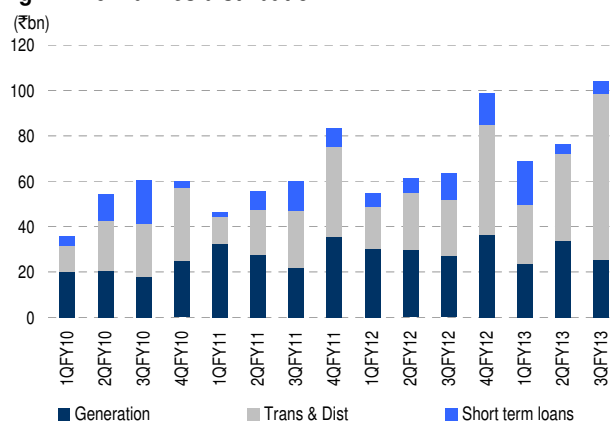
Source: Company, Anand Rathi Research

Fig 10 – T&D drives sanctions in the quarter



Source: Company, Anand Rathi Research

Fig 11 –T&D drives distribution

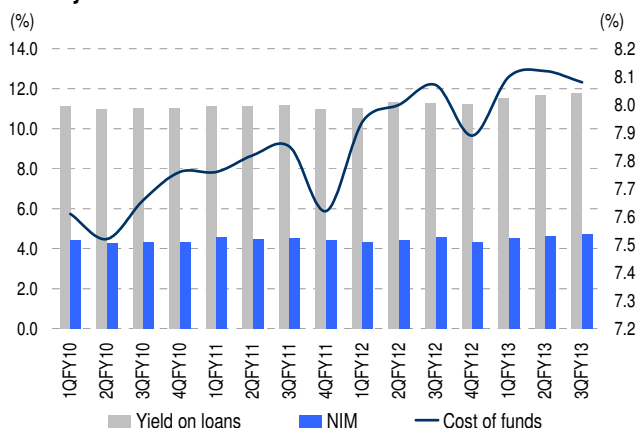


Source: Company, Anand Rathi Research

Higher NIM on better yields; better productivity

Reported NIM improved 26bps qoq led by 24bps increase in yield on earning assets to 12.14%, further aided by 4bps qoq fall in cost of funds to 8.36%. REC plans to further diversify its borrowing mix by issuing additional lower cost tax free bonds in the fourth quarter by issue of ECBs and a large Medium Term Notes issue in foreign currency. This, combined with easing liquidity conditions, provides further impetus for NIM expansion. A dynamic borrowing mix, coupled with easing liquidity, could benefit NIM positively. Productivity further improved with cost-income at 3.5% compared with 6.8% a year ago.

Fig 12 – Trend in yields and costs

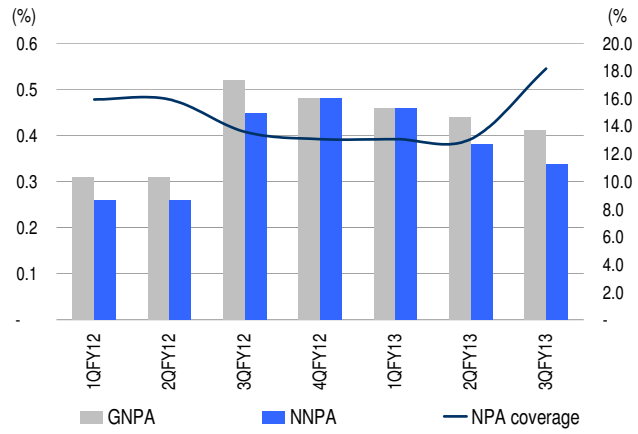


Source : Company

Asset quality stable; medium-term risks persist

Asset quality remained stable, with no addition to delinquencies this quarter. While, NPA coverage rose to 18%, it remains lower than other NBFCs. The SEB restructuring package augurs well for REC’s financial health. Management expects one account to turn standard in 4QFY13. Further, with likely improvement in cash flows for SEBs, financial stress on related private sector entities could reduce. However, we believe the increasing incremental share of private sector projects will continue to pose asset quality concerns in the medium term. The management has decided to proactively build an 8bps standard asset provisioning over FY13-15. We have built higher provision of 22bps in FY13-15.

Fig 13 – Stable asset quality, but NPA coverage below peers

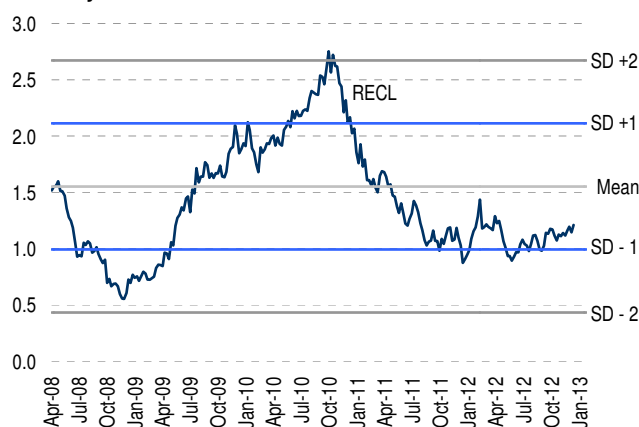


Source: Company

Valuations

We increase our PAT estimates 3.4% and 5.6% for FY14 and FY15, respectively, on higher NIM assumptions. We raise our target price to ₹289 from ₹270 and value the NBFC at 1.4x FY14 on higher RoEs (earlier 1.3x FY14). With strong niche expertise and domain knowledge, we believe risk-reward favors REC at current valuations of 1.2x FY14 BV. We re-iterate Buy. At our Mar'14 target, the stock would trade at PABV of 1.4x FY14e and 1.2x FY15. Our target is based on two-stage DDM (CoE: 14.6%; beta: 0.9; Rf: 8%). **Risks.** Slowdown in the power sector, regulatory hurdles.

Fig 14 – Past one-year-forward P/BV



Source: Bloomberg, Anand Rathi Research

Risks

- Slowdown in power sector could hit loan growth
- Regulatory hurdles could slow earnings growth.

Financials

We expect 21.0% CAGR in REC's loan book over FY12-15, with a 20.4% CAGR in net profit.

Fig 15 – Income Statement

Year-end: March (₹m)	FY11	FY12	FY13e	FY14e	FY15e
Interest income	82,569	103,376	131,164	156,637	185,610
Interest expended	48,510	63,788	78,604	95,310	113,998
Net interest income	34,059	39,588	52,560	61,327	71,612
Growth (%)	34.4	16.2	32.8	16.7	16.8
Non-interest income	2,384	1,715	2,200	1,925	2,342
Total income	36,443	41,303	54,760	63,252	73,954
Non-interest income / total income (%)	6.5	4.2	4.0	3.0	3.2
Operating expenses	1,645	2,326	2,478	2,883	3,354
Employee expenses	1,275	1,710	1,795	2,082	2,416
Other expenses	371	616	683	800	939
Pre-provisioning profit	34,797	38,977	52,282	60,370	70,600
Growth (%)	31.3	12.0	34.1	15.5	16.9
Provisions	2	1,048	1,130	3,158	3,297
Profit before tax	34,795	37,929	51,152	57,212	67,303
Taxes	9,096	9,758	12,788	14,303	18,172
Tax rate (%)	26.1	25.7	25.0	25.0	27.0
Profit after tax	25,699	28,170	38,364	42,909	49,131
Growth (%)	28.4	9.6	36.2	11.8	14.5
Number of shares	987	987	987	987	987
Earnings per share	26.0	28.5	38.9	43.5	49.8

Source : Company, Anand Rathi Research

Fig 16 – Balance Sheet

Year-end: March (₹m)	FY11	FY12	FY13e	FY14e	FY15e
Share capital	9,875	9,875	9,875	9,875	9,875
Reserves and surpluses	118,012	137,575	167,851	202,095	241,406
Net worth	127,886	147,449	177,726	211,970	251,280
Borrowings	700,397	900,565	1,072,386	1,323,554	1,582,581
Minority Interest	(128)	(101)	(101)	(101)	573
Total loans	36,844	39,272	47,126	56,551	68,427
Total liabilities	864,999	1,087,185	1,297,137	1,591,974	1,902,861
Advances	817,360	1,014,029	1,246,960	1,498,928	1,798,388
Investments	8,368	7,576	8,333	9,167	10,175
Cash & bank balances	28,319	53,115	33,528	74,218	83,475
Fixed & other assets	7,310	8,167	8,316	9,661	10,824
Total assets	861,357	1,082,887	1,297,137	1,591,974	1,902,861

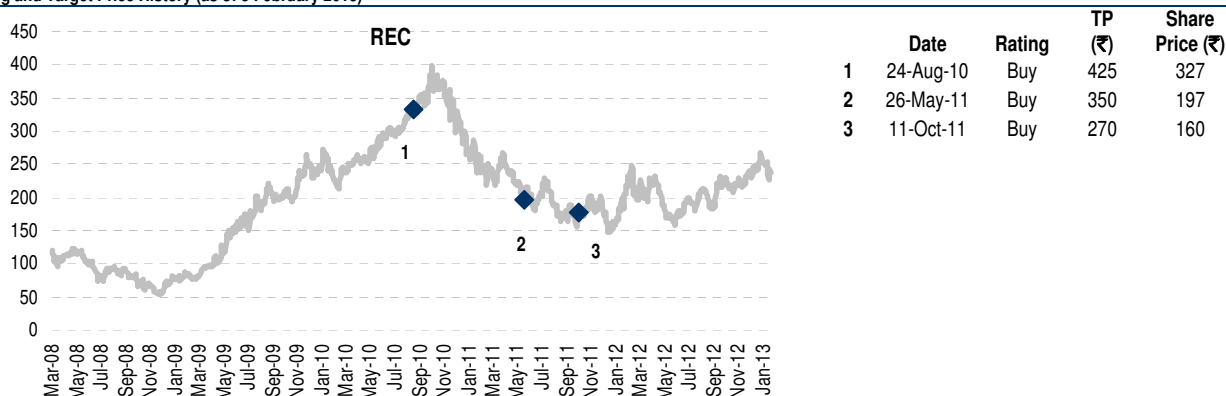
Source : Company, Anand Rathi Research

Appendix

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