

Power Finance Corporation

SECTOR: NBFC



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Issue Snapshot	
Issue Open	10-May-11
Issue Close	13-May-11
Price Band (INR)	193 - 203
>for Retail@5% Discount	183.4 - 192.9
Issue Size (INR bn)	44.3 – 46.6
Market Cap (INR bn)	254.7 – 267.9

Issue Size (No of Shares)	229,553,340
Fresh Issue	172,165,005
Issue for Sale	57,388,335
QIB	114,638,937
Non-Institutional	34,391,682
Retail	80,247,257
Employee Reservation	275,464
Face Value (INR)	10.0
Book Value as of FY11 (INR)	134.3

Equity	
Pre Issue (INR mn)	1,1477.7
Post Issue (INR mn)	1,3199.3

Shareholding Pattern	Pre Issue (%)	Post Issue (%)
Promoter Group (GOI)	89.8%	73.7%
MF/FII & Others	6.7%	14.5%
Public	3.6%	11.8%
Total	100%	100%
Total Shares	1,147,766,700	1,319,931,705

Key Data	
BSE Code	532810
NSE Code	PFC
Sensex	18529.0
CMP	211.0
52 Week H/L	383.0/205.8
2 Wk Avg. Qty. BSE (mn)	0.172

Objects of the Fresh Issue		
Sr. No.	Particulars	INR mn
1	To augment capital base to ensure compliance with requisite capital adequacy norms and to meet future capital requirements	[*]
2	General Corporate Purposes	[*]

Power Finance Corporation (PFC) was set up in July 1986 as a financial institution is engaged in funding power generation, transmission and distribution projects and services various clients including Central, State as well Private sector. Apart from being a nodal agency for UMPPs, PFC offers services across finance intermediation to consultancy.

Investment Summary

Strong Loan Book growth

PFC's loan book has grown at a CAGR of 24.5% in last 3 years. And is likely to see a CAGR of 25%+ in its loan book over a period of next 2 years backed by robust investment opportunities of INR 10bn in the power sector. With investments to the tune of INR 4bn expected in Generation Sector and the private sector participation increasing in this segment, we expect PFC to retain its market share of >20% in the total funding requirements of this segment.

Steady margins to sustain

PFC has demonstrated one of the most steady stream of Net Interest Income of 3.5%+ in last three years, growing gradually though, implying that it has been able to pass down the re-priced liabilities to its asset side of balance sheet. Going forward, with a steady improvement in yields on loans, coupled with slight savings in total cost of funds, we believe PFC should be able to maintain steady NIMs above 3.7%.

Asset quality to remain healthy

Despite having concentration risks in its portfolio, PFC has been able to manage a robust asset quality, mainly attributable to factors like Escrow Account mechanism which enables PFC to reserve a right to direct borrower's banker to remit the dues to PFC in case of any defaults by its clients.

Borrowings Mix – to change in favour of foreign borrowings

With the grant of IFC status, PFC would be able to access low cost domestic borrowings in the form of Infrastructure Bonds. Also, with an access to ECB under Automatic Route upto 50% of its networth, restricted to USD 500mn per year, these funds effectively would be 300-400bps lower than domestic funds. However, currency fluctuations do pose a risk to its open positions, since PFC does not prefer to hedge its foreign currency borrowings.

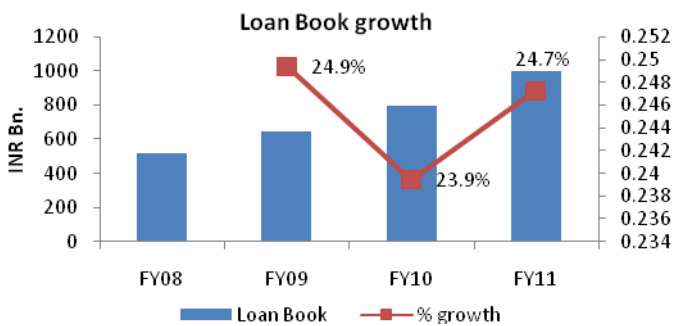
Outlook & Valuation

PFC is likely to witness a healthy traction in its NII, backed by macro opportunities in power funding in India. Healthy pipeline for sanctions lends much required visibility to the business growth. Also, grant of IFC status lends many new avenues for cheaper borrowings. We recommend **Subscribe** to the issue at upper band available at 1.21x post Issue FY12E BV of INR 174.5. The offer price is at a discount of 3.8% from CMP of INR 211.

Investment Rationale

Strong Loan Book growth

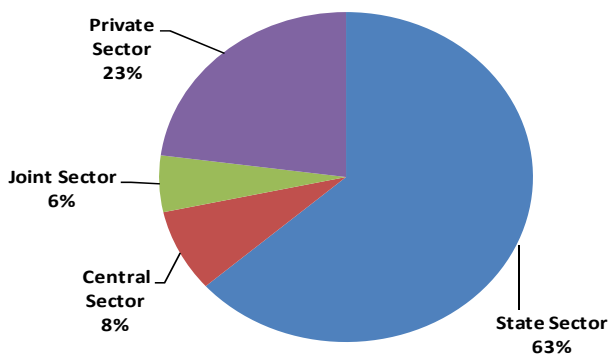
PFC is likely to see a CAGR of 25%+ in its loan book over a period of 2 years from FY11 to FY12E backed by robust investment opportunities of INR 10bn in the power sector. With investments to the tune of INR 4bn expected in Generation Sector and the private sector participation increasing in this segment, we expect PFC to retain its market share of >20% in the total funding requirements of this segment.



Source: SPA Research

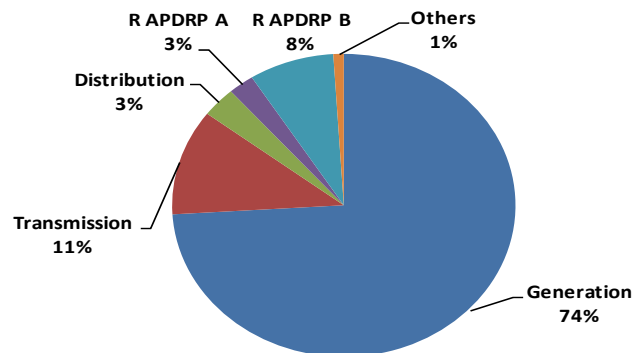
PFC has a healthy pipeline of outstanding sanctions, with power generation segment likely to dominate the share of outstanding sanctions giving the much needed visibility to the likely disbursements and the resultant loan book growth. With huge investments expected in Generation Sector and the private sector participation increasing in this segment; the share of Private Sector in its total sanctions and disbursements likely to witness continues growth.

Outstanding Sanctions - Sector wise



Source: SPA Research

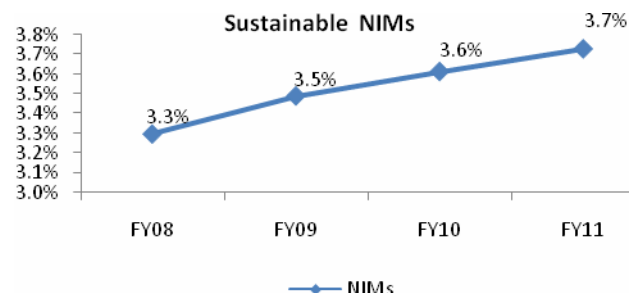
Outstanding Sanctions- Segmentwise



Source: SPA Research

Steady margins to sustain

PFC has demonstrated one of the most steady stream of Net Interest Income of 3.5%+ in last three years, growing gradually though, implying that it has been able to pass down the re-priced liabilities to its asset side of balance sheet. Going forward, with a steady improvement in yields on loans, coupled with slight savings in total cost of funds, we believe PFC should be able to maintain steady NIMs above 3.7%.

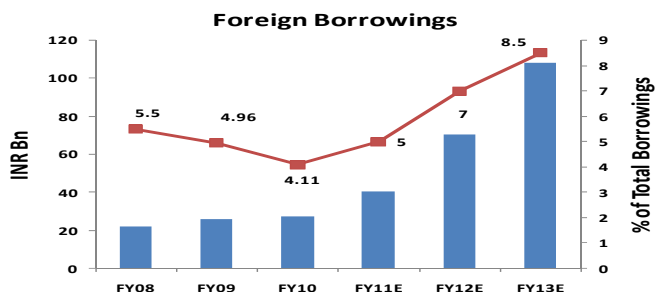


Source: SPA Research

Borrowings Mix – to change in favour of foreign borrowings

With the grant of IFC status, PFC would be able to access low cost domestic borrowings in the form of Infrastructure Bonds. IFCs enjoy other benefits including a lower risk weight on their bank borrowings (from a flat 100.0% to as low as 20.0% for AAA-rated borrowers), higher permissible bank borrowing (up to 20.0% of the bank's net worth as against 15% for an NBFC that is not an IFC), access to external commercial borrowings (up to 50.0% of owned funds on an automatic basis) and relaxation in their single party and group exposure norms.

These benefits should enable a highly rated IFC to raise more funds, of longer tenors and at lower costs, and in turn lend more to infrastructure companies. Further, the risk weights attached to borrowings portfolios from banks are now linked to the credit ratings of the instruments. PFC enjoys highest credit ratings for its instruments, and hence enjoys cost of borrowings at lower rates. Also, with an access to ECB under Automatic Route upto 50% of its networth, restricted to USD 500mn per year, these funds effectively would be 300-400bps lower than domestic funds.

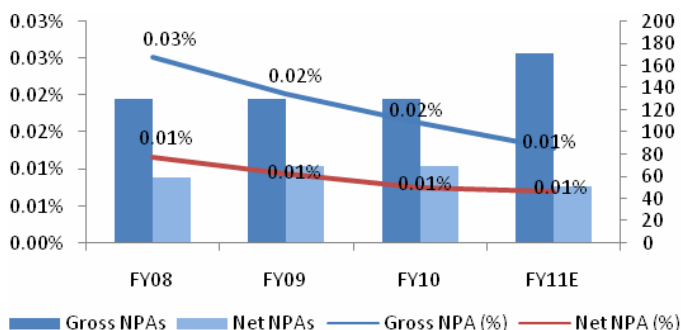


Source: SPA Research

However, currency fluctuations do pose a risk to its open positions, since PFC does not prefer to hedge its foreign currency borrowings.

Asset quality to remain healthy

Despite having concentration risks in its portfolio, PFC has been able to manage a robust asset quality, mainly attributable to factors like Escrow Account mechanism which enables PFC to reserve a right to direct borrower's banker to remit the dues to PFC in case of any defaults by its clients.



Source: SPA Research

SEB health concerns remain overdone and Power Financiers remain confident of their loan book exposures and qualities top these SEBs. However, any further defaults from any of these government bodies could put our Asset quality assumptions to upside risks.

Investment Concerns

Currency Fluctuation

PFC follows a strategy of open positions on all its foreign currency borrowings and does not use a hedge cover, which makes its liability side open to currency volatility. Un-hedged borrowings are effectively cheaper as compared to domestic debt borrowings; however adverse movements in currency can affect PFC adversely, also since we expect the share of overall borrowings to increase in its mix of total resources.

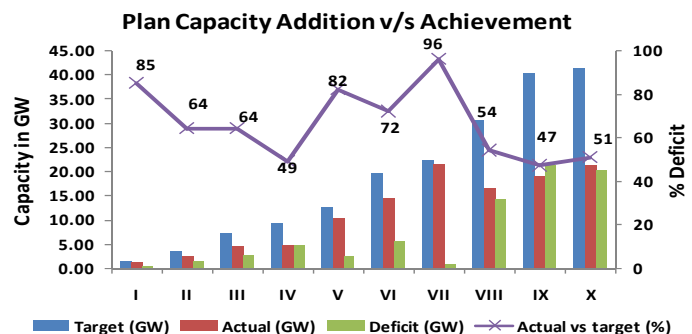
Rising Interest costs

PFC remains a wholesale funded NBFC and hence is prone to pressure on NIMs in a rising interest rate scenario that is likely to persist going forward. However, with reset clauses built in their loan book at every 3 years, and more access to cheap funds due to grant of IFC status will help PFC mitigate the interest rate risk to a considerable extent.

Industry Scenario

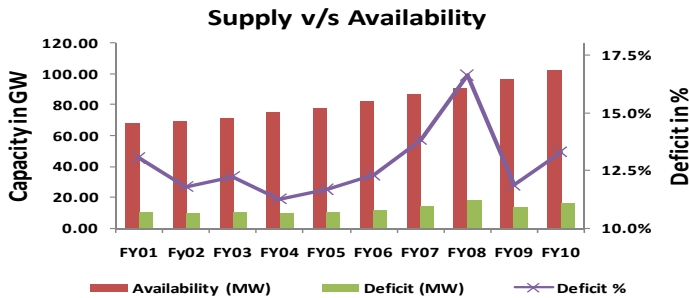
The entire value chain of the power sector is dominated by the central and state sector utilities. In the generation space, the share of central and state utilities stands at 49.8 GW and 76.6 GW, respectively; and that of private sector stands at 25.8 GW of the overall capacity of 152 GW. Of the 78.7 GW planned capacity additions during the 11th five-year-plan, central and state utilities together are estimated to add nearly 63.7 GW.

India has historically failed to meet its power sector targets by a significant margin and with tremendous opportunities ahead; the power sector continues to be affected by the shortfall both on generation as well as T&D side.

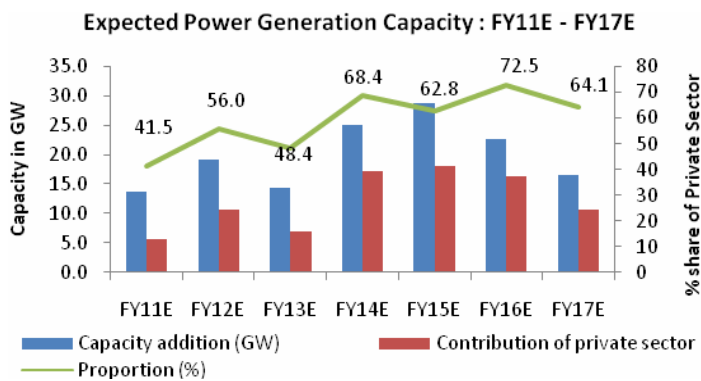


Source: CEA, SPA Research

The situation looks more precarious with the huge gaps in supply and availability of power in the country and the resultant peak deficit over the last decade.



Source: Planning Commission, SPA Research

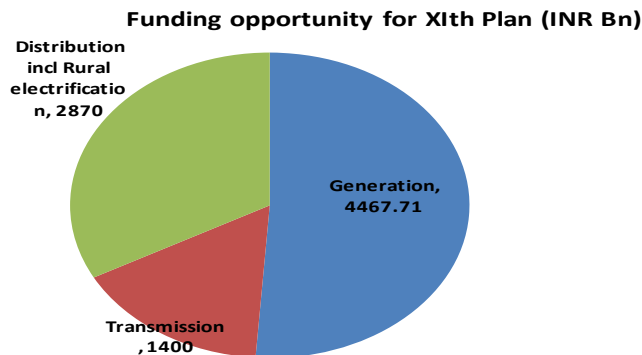


Source: Planning Commission, SPA Research

This furthers our strong vision for the forthcoming growth that the sector is likely to witness over the next two 5 year plans.

Funding opportunities in Power Sector

Based on the robust target of capacity addition for the XIth plan, it throws up a total funding opportunity of INR10bn to take care of the planned capacity additions, Generation segment having the highest projected funding requirement at INR 4bn.



Source: Planning Commission, SPA Research

Company Background - PFC

Power Finance Corporation (PFC) was set up in July 1986 as a financial institution (FI) dedicated to power sector financing and committed to the integrated development of the power and associated sectors. The corporation was notified as a public financial institution in 1990 under Companies Act, 1956. Being conferred with the status of Nav-Ratna PSU by Government of India in 2007, it was registered as a Non Banking Financial Company by RBI.

PFC is providing large range of financial products and services like project term loan, lease financing, direct discounting of bills, short term loan, and consultancy services for various power projects in generation, transmission, distribution sector as well as for renovation & modernization of existing power projects.

PFC is the nodal agency for the Ultra Mega Power Projects (UMPP), along with Ministry of Power and Central Electricity Authority, is working to facilitate development of UMPP with the capacity of about 4000 MW each under Tariff based competitive bidding route. Being large in size, these projects will meet the power needs of number of states through transmission of power on regional and national grids. PFC's clients are State Electricity Boards, State Power Utilities, State Electricity/Power Departments, Other State Departments (like Irrigation Department) engaged in the development of power projects, Central Power Utilities, Joint Sector Power Utilities, Equipment Manufacturers and Private Sector Power Utilities

Reported Results

Particulars (INR Mn)	Q4FY10	Q4FY11	YoY (%)	FY11	FY10	YoY (%)
Income From Operations	20,799.4	26,173.5	25.8	101,284.9	80,021.0	26.6
Interest and Other Financing Charges	13,579.6	17,906.3	31.9	64,924.7	50,576.4	28.4
Net Interest Income	7,219.8	8,267.2	14.5	36,360.2	29,444.5	23.5
Exchange Gain/(Loss)	(289.5)	(173.1)	-40.2	263.8	(1,038.4)	-125.4
Employee Cost	314.2	177.7	-43.4	676.2	717.0	-5.7
Depreciation/Amortization	8.9	13.9	56.4	50.5	38.1	32.5
Other Expenditure	100.5	115.2	14.6	257.5	340.6	-24.4
Total Expenditure	134.1	133.7	-0.3	1,248.0	57.3	2079.0
Other Income	276.7	60.7	-78.1	320.7	747.5	-57.1
PBT	7,362.5	8,194.2	11.3	35,432.9	30,134.8	17.6
Tax Expense	1,354.7	2,126.7	57.0	9,244.9	6,562.3	40.9
PAT	6,007.7	6,067.5	1.0	26,187.9	23,572.5	11.1

Source: Company, SPA Research

Peer Comparison

Particulars (INR mn)	CMP (INR)	Market Cap	Interest Income		PAT		EPS (INR)		BVS (INR)		P/E (x)		P/BVS (x)	
			FY11	FY11	FY11	FY12E	FY11	FY12E	FY11	FY12E	FY11	FY12E		
PFC@203*	203.0	267,946.1	94,621.0	26,187.9	19.8	24.7	143.2	167.6	10.3	8.3	1.4	1.2		
PFC@193*	193.0	254,746.8	94,621.0	26,187.9	19.8	24.3	141.9	166.3	9.7	7.9	1.4	1.2		
REC	222.0	219,215.9	81,002.0	25,081.5	25.4	30.0	128.8	148.9	8.7	7.4	1.7	1.5		
IDFC	135.8	198,441.1	49,167.4	12,816.5	8.7	10.9	71.2	82.1	15.5	12.4	1.9	1.7		

Source: Bloomberg, SPA Research

*post issue

Financials
Income Statement

Year End March (INR Mn.)	FY09	FY10	FY11E	FY12E*	FY13E
Interest Income	63,388	78,523	100,879	145,987	183,382
Interest Expenses	40,893	49,653	63,776	99,096	122,758
NII	22,495	28,870	37,103	46,891	60,624
<i>growth (%)</i>	<i>32.2</i>	<i>28.3</i>	<i>28.5</i>	<i>26.4</i>	<i>29.3</i>
Other Income	2,608	3,261	2,263	2,460	2,860
Total Income	25,103	32,131	39,366	49,351	63,484
Operating Costs	5,012	1,009	2,098	2,322	2,734
Pre Provisioning Profits	20,092	31,122	37,268	47,029	60,750
Provision	37	491	538	767	4,502
PBT	20,055	30,631	36,730	46,261	56,247
Extraordinary Items	0	0	0	0	0
PBT (Adjusted)	20,055	30,631	36,730	46,261	56,247
Tax	258	6,676	8,356	12,291	15,027
<i>Tax rate %</i>	<i>1.3</i>	<i>21.8</i>	<i>22.8</i>	<i>26.6</i>	<i>26.7</i>
PAT	19,797	23,955	28,373	33,971	41,221

Balance Sheet

Year End March (INR Mn.)	FY09	FY10	FY11E	FY12E*	FY13E
Share Capital	1,478	1,478	11,478	13,199	3,773
Share Warrants & Outstandings	-	61	75	75	75
Total Reserves	103,698	121,438	149,811	217,010	297,378
Shareholder's Funds	115,176	132,977	161,364	230,284	311,225
Borrowings	530,691	677,719	820,459	1,012,893	1,277,331
Current Liabilities & Provisions	36,574	37,925	55,098	62,637	67,626
Total Liabilities	682,440	848,620	1,036,920	1,305,813	1,656,182
Loan Assets	644,290	798,558	1,007,448	1,260,680	1,576,799
Fixed Assets	752	746	705	886	903
Investments	351	300	411	411	410
Current Assets	37,047	49,017	28,356	43,837	45,851
Total Assets	682,440	848,620	1,036,920	1,305,813	1,623,962

KEY DATA	FY09	FY10	FY11E	FY12E*	FY13E
EPS	17.25	20.87	24.72	24.67	29.93
BV	100.35	115.86	140.59	174.47	211.38
Dividend per share					
P/E (x)	12.23	10.11	8.54	8.55	7.05
P/ BV (x)	2.10	1.82	1.50	1.21	1.00

GROWTH RATIOS (%)	FY09	FY10	FY11E	FY12E*	FY13E
Borrowings	27	28	21	23	26
Advances	25	24	26	25	25
Total Assets	27	26	21	30	25
NII	32	28	29	26	29
Other Income	1	25	-31	9	16
Operating Profit	13	55	20	26	29
Net Profit	64	21	18	20	21

PROFITABILITY (%)	FY09	FY10	FY11E	FY12E*	FY13E
Yield on Assets	9.84	9.83	10.01	11.58	11.63
Cost of Funds	7.71	7.33	7.77	9.78	9.61
NIMs	3.49	3.62	3.68	3.72	3.84
Spread	2.13	2.51	2.24	1.80	2.02
RoAE	19.00	19.31	19.28	17.35	16.19
RoAA	3.22	3.13	3.01	2.90	2.81
Cost/ Income	22.28	3.50	5.65	4.95	4.51
Opex/ Avg Assets	0.82	0.13	0.22	0.20	0.18

ASSET QUALITY	FY09	FY10	FY11E	FY12E*	FY13E
Gross NPA	0.02	0.02	0.01	0.01	0.01
Net NPA	0.01	0.01	0.01	0.01	0.00

CAPITAL ADEQUACY	FY09	FY10	FY11E	FY12E*	FY13E
Tier I	16.24	15.11	14.70	19.41	18.42
CAR	17.49	16.36	15.95	20.66	19.67

* Calculations based on post FPO diluted equity from FY12E onwards.

Source: Company, SPA Research

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 Broking relationship with company covered - No

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