

RURAL ELECTRIFICATION CORPORATION LTD

29 December 2017

Initiating Coverage (BUY)

CMP

INR 155

Target Price

INR 187

Stock Details

Industry	FINANCE
Bloomberg Code	RECL:IN
BSE Code	532955
Face Value (Rs.)	10.00
Market Cap. (Rs. mn)	306,504.5
52wk. Low/High (Adjusted) (Rs.)	120.10/223.80

Shareholding Pattern Sept '17

Promoter (%)	58.86
FII (%)	0.00
DII (%)	0.00
Public - Other (%)	41.14
No. of Share Outstanding (mn)	1974.91

Valuation Summary

	FY 16A	FY 17A	FY 18P	FY 19P
P/E (x)*	01.43	04.85	05.00	05.00
EV/EBITDA (x)	6.46	7.71	8.73	8.74
P/BV (x)	0.28	0.91	1.47	1.37

*TTM for Current Year

 Based on Market Price as on 1st Apr is taken for Each FY

Key Financial

Rs. Mn	FY 16A	FY 17A	FY 18P	FY 19P
Net Sales	240,129	239,452	268,186	295,004
EBITDA	224,294	227,572	250,494	275,002
Net Profit	56,918	63,134	65,496	73,759
EPS (Rs.)*	57.6	32.0	33.2	37.3

*Un adjusted

Key Ratios

	FY 16A	FY 17A	FY 18P	FY 19P
EBITDA Margin (%)	93.0	92.4	91.9	92.0
EBIT Margin (%)	93.0	92.2	91.8	91.8
Net Pro. Margin (%)	23.6	25.6	24.0	24.6
Debt/Equity (x)	4.80	4.45	6.72	5.54
RoNW (%)	21.2	20.2	23.4	29.9
RoCE (%)	3.5	3.6	3.6	4.2

One Year Price / Volume



We recommend 'BUY' on RURAL ELECTRIFICATION for a target of INR 187 - valuing the company at P/E 5x of FY19E Earning.

INVESTMENT RATIONALE:

- REC, being a specialized power financier, plays a strategic role in Gol's ongoing financing plans for development of the power sector.
- Superior domain knowledge, financing expertise and government support will enable it to leverage emerging financing opportunities.
- REC has been conservatively following RBI norms & has not sprung any negative surprise like peers with respect to stress in state utility projects.
- With large part of repayment under UDAY scheme already being effected, we see better growth visibility for FY18-19.
- Despite NIM pressure, as incremental spreads are lower with structural improvement across power value chain, it has potential to deliver ~15-16% RoE.
- Growth momentum sustained, NIMs pressure dents revenue

VALUATIONS AND VIEW:

REC has not sprung any negative surprise with respect to stress in state utility projects. However, key monitorable is its private sector exposure, though, in our view, significant recognition is unlikely over near term. Also, with UDAY scheme already being effected, we see better growth visibility for FY18-19. Despite NIM pressure, as incremental spreads are lower with structural improvement across power value chain, it has potential to deliver ~15-16% RoE, rendering favourable risk-reward. **We value the business at 5x FY19E EPS and recommend a BUY rating on the stock with a target price of INR 187 per share.**

RISK & CONCERNS:

- **Credit Risk:** Credit risk is a risk inherent in the financing industry and involves the risk of loss arising from the diminution in credit quality of a borrower and the risk that the borrower will default on contractual repayments under a loan or an advance. To mitigate the same, the Company follows systematic institutional and project appraisal process to assess the credit risk.
- **Market Risk:** Primary market risk exposures result primarily from fluctuations in interest rates and foreign currency exchange rates. In order to mitigate the interest rate risk, Company periodically reviews its lending rates based on prevailing market rates and our weighted average cost of borrowing.
- **Liquidity Risk:** Liquidity risk is the risk of potential inability to meet our liabilities as they become due. It manage its liquidity risk through a mix of strategies, including through forward-looking resource mobilization based on projected disbursements and maturing obligations.
- **Foreign Currency Risk:** The Company manages foreign currency risk associated with exchange rate and interest rate through various derivative instruments. For this, the Company has put in place a Hedging Policy to manage risk associated with foreign currency borrowings.

COMPANY BACKGROUND:

Rural Electrification Corporation (REC), incorporated in 1969, is a leading public institution primarily involved in the financing of T&D and generation projects across India. It was established by GoI for the purpose of developing the T&D infrastructure in rural India and currently acts as a nodal agency for RGGVY, a GoI initiative for rural electrification. Over the last decade, the company has diversified into urban areas and it plays a strategic role in GoI's plan to improve the transmission and distribution infrastructure of India. REC, along with Power Finance Corporation (PFC), is the nodal agency for APDRP, a GoI initiative to improve the financial viability of state power utilities. Loans to T&D projects constituted >51% of the total loan book.

Two subsidiaries – RECPDCL (REC Power Distribution Company Limited) and RECTPCL (REC Transmission Project Company Limited) work in tandem with us to realise our shared mission by providing consultancy services in Distribution and Transmission sectors.

INDUSTRY OVERVIEW:

Power is one of the most important drivers of growth in an economy. The power sector in the country has seen transformational growth in the last three years, in terms of both additional generation capacity and increasing consumption levels, on the back of several initiatives of the Government, massive investments towards modernization of transmission capacity and distribution networks, electrifying villages and extending power to all households. Decisive steps have been taken by the Government across other sectors as well, which have resulted in surplus power, fiscal discipline in utilities, sufficient coal availability and unprecedented growth in the clean energy market. In fact, India's coal imports have been on a declining trend from 217.78 million tonnes in financial year 2014-15, to 203.95 million tonnes in financial year 2015-16 to 190.95 million tonnes in financial year 2016-17. The Government has also been working on turning around debt-ridden DISCOMs and lowering of the operational costs of conventional power plants, while trying to achieve the country's climate change goal of becoming a low carbon economy. Huge strides have been made towards energy efficiency and solving the issues of stranded thermal power assets.

PEER COMPARISON

Company	CMP (Rs)	P/E*	Mcaps (Rs Cr)	Div Yld (%)	NP Qtr (Rs Cr)	Qtr Profit Var (%)	Sales Qtr (Rs Cr)	Qtr Sales Var (%)	CMP/BV
Havells India	409	41.5	25,569.1	1.47	153.0	11.75	1,506.0	13.20	8.28
Bajaj Fin.	166	20.3	97,551.4	0.20	556.9	36.58	3,086.2	32.14	5.24
Power Fin.Corp.	120	16.9	31,393.9	4.20	1,886.6	0.70	7,033.4	1.52	0.79
Shriram Trans.	1,457	22.2	31,648.5	0.29	479.1	23.59	2,978.9	9.79	2.59
Muthoot Finance	475	12.3	17,452.6	1.37	454.2	53.06	1,664.9	20.49	2.38
Reliance Capital	571	9.7	11,848.5	2.25	352.0	39.13	5,243.0	7.31	0.74
Cholaman.Inv.&Fn	1,285	24.6	20,189.4	0.43	228.2	36.07	1,312.7	11.99	4.24
Rural Elec.Corp.	155.2	5.0	30,650.4	6.39	1,214.7	(30.64)	5,492.8	(7.79)	0.91

*TTM

FINANCIAL OVERVIEW

Q4 FY17 Performance Highlight							
(in Million)	4Q FY16	1Q FY17	2Q FY17	3Q FY17	4Q FY17	YoY (%)	QoQ (%)
Revenue	59,568.20	56,463.50	57,939.70	55,715.60	54,928.10	-7.79%	-1.41%
Other Income	1517.3	3114	1843.5	906	1349		
Total Income	61,085.50	59,577.50	59,783.20	56,621.60	56,277.10	-7.87%	-0.61%
Expenditure	-2,345.70	-34,825.40	-40,895.80	-37,711.40	-38,038.40		
As a % of Sales	3.94%	61.68%	70.58%	67.69%	69.25%		
Interest	-34254.8	--	-34225.1	-33425.4	-34274.9	0.06%	2.54%
PBDT	24485	24752.1	18887.4	18910.2	18238.7		
As a % of Sales	41.10%	43.84%	32.60%	33.94%	33.20%		
Depreciation	-18.3	-13.2	-13.3	-13	-13		
PBT	24466.7	24738.9	18874.1	18897.2	18225.7	-25.51%	-3.55%
As a % of Sales	41.07%	43.81%	32.58%	33.92%	33.18%		
Tax	-6954	-7194.9	-5681.8	-5885.8	-6079.1	-12.58%	3.28%
Net Profit	17512.7	17544	13192.3	13011.4	12146.6	-30.64%	-6.65%
As a % of Sales	29.40%	31.07%	22.77%	23.35%	22.11%		
Equity	19749.2	19749.2	19749.2	19749.2	19749.2	0.00%	0.00%
EPS (Rs)	8.87	8.88	6.68	6.59	6.15	-30.67%	-6.68%
CEPS (Rs)	8.88	8.89	6.69	6.59	6.16		
OPM %	98.61	43.84	32.6	33.94	33.2		
NPM %	29.4	31.07	22.77	23.35	22.11		

Income Statement (Consolidated)

Y/E Mar (Rs mn)	FY 14A	FY 15A	FY 16A	FY 17A	FY 18E	FY 19P	FY 20P
Net Sales	171,222	203,840	240,129	239,452	268,186	295,004	318,605
Other Operating Income	1,067	1,659	1,171	7,408	4,802	4,562	5,511
Expenditure	5,730	11,494	16,809	18,885	22,016	24,082	26,122
EBITDA	166,559	194,005	224,491	227,975	250,972	275,484	297,994
Depreciation	45	83	197	403	479	482	485
EBIT	166,514	193,921	224,294	227,572	250,494	275,002	297,509
Interest Expenses	100,347	118,397	142,824	137,864	157,018	169,802	185,071
PBT	66,167	75,524	81,471	89,709	93,476	105,201	112,438
Tax	18,755	22,079	24,552	26,590	27,980	31,441	33,578
Extraordinary Items	-	1	-	15	-	-	-
Net Income Before Adjustment	47,412	53,446	56,918	63,134	65,496	73,759	78,860
Minority Int./Income from Assoc.	-	-	-	-	-	-	-
Adjusted PAT	47,412	53,446	56,918	63,134	65,496	73,759	78,860

Balance Sheet (Consolidated)

Y/E Mar (Rs mn)	FY 14A	FY 15A	FY 16A	FY 17A	FY 18E	FY 19P	FY 20P
Equity share capita	9,875	9,875	9,875	19,749	19,749	19,749	19,749
Reserves & surplus	198,156	240,851	279,059	316,956	202,904	250,390	301,159
Share Warrants	-	-	-	-	-	-	-
Misc Expenditure	-	-	-	-	-	-	-
Net worth	208,031	250,726	288,934	336,706	222,653	270,139	320,908
Share Application Money	-	-	-	-	-	-	-
Loan Funds	1,100,953	1,311,233	1,387,839	1,496,809	1,496,811	1,496,809	1,496,807
Net deferred tax liability	1,729	1,058	475	399	399	399	399
Other Long-term Liabilities	235	362	101	134	150	165	179
Long-term Provisions	4,423	10,074	12,955	18,495	20,714	22,785	24,608
Total Liabilities	1,315,371	1,573,453	1,690,304	1,852,545	1,740,728	1,790,300	1,842,903
Net block	835	1,198	3,321	5,204	4,932	4,658	4,359
Investment, Loan & Adv.	1,375,765	1,654,576	1,601,082	1,801,782	1,990,751	2,188,043	2,363,583
Total Current Assets	152,843	178,786	465,046	295,463	(86,323)	(233,635)	(356,276)
Current Liabilities & Provisions	214,072	261,107	379,146	249,907	168,633	168,769	168,764
Net Current Assets	(61,229)	(82,321)	85,900	45,556	(254,956)	(402,403)	(525,040)
Total Assets	1,315,371	1,573,453	1,690,304	1,852,545	1,740,728	1,790,300	1,842,903

Cash Flow (Consolidated)

Y/E Mar (Rs mn)	FY 17A	FY 18E	FY 19P	FY 20P
Operating Cash Flow	68,045	(49,059)	216,982	240,794
Cash Flow from Investments	(1,010)	(189,196)	(197,506)	(175,731)
Cash Flow from Financing	(39,468)	(173,292)	(194,730)	(212,299)
Net Changes in Cash	27,568	(411,548)	(175,254)	(147,236)
Opening Cash	18,236	45,803	(365,745)	(540,998)
Closing Cash Balance	45,803	(365,745)	(540,998)	(688,235)

Research Analyst Details

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