

# POWER GRID CORP OF INDIA

## Healthy capex driving growth

India Equity Research | Power



Power Grid Corporation of India's (PGCIL) Q1FY18 operating performance came in line with estimate with 17% revenue growth. Though H1 is normally slow with respect to capitalisation of assets, the company reported 44% growth (capitalization of INR35bn) in the same in Q1FY18. We believe, PGCIL can sustain high capitalisation /capex ratio at more than 1.25x (FY17: 1.27x) over the next 2-3 years led by stepped-up focus on commissioning. We maintain our investment thesis: (a) regulated equity will post 20% plus CAGR over FY17-19E even on a higher base; and (b) unlike the generation segment, core RoE is not contingent on utilization / power demand growth in the system. Having said that, key monitorable is RoE that PGCIL can earn in the intensely competitive TCB projects. Maintain 'BUY'.

### Consultancy and telecom: Robust performance sustained

Revenue of the consultancy business surged 74% YoY and that of telecom business also jumped a healthy 28% YoY. PGCIL bagged 12 and 38 new orders in consultancy and telecom, respectively, in Q1FY18. Management continues to be positive on the expanding telecom and consultancy businesses. Core regulated income at INR17bn (up 8% YoY) on core regulated equity of INR464bn (up 20% YoY) implied annualised RoE of 14.7% (down 160bps) for Q1FY18. Capitalisation at INR35bn was robust (up 44% YoY).

### Capex guidance intact

Management continued to guide for healthy capex of INR250bn in FY18. Guidance of INR810bn capex over the next 3.5 years implies annualised capex of ~INR250bn for the next 3-4 years. We have also estimated FY18 and FY19 capex at INR250bn each, which translates into capitalisation/capex ratio of 1.26x and 1.3x, respectively.

### Outlook and valuations: Positive; maintain 'BUY'

Strong capex visibility, reasonable capitalization/capex ratio of 1.3x and steady regulated RoE of 15.5-16.0% render PGCIL a good cash proxy with steady returns. However, increasing proportion of TCB based biddings needs to be monitored closely. We increase our SOTP based target price to INR 252 (INR225 earlier) factoring in lower risk free rate at ~7% versus 8% earlier. This implies an exit multiple of 2.1x. Maintain 'BUY/SP'.

Financials (Standalone)						(INR mn)		
Year to March	Q1FY18	Q1FY17	% Change	Q4FY17	% Change	FY17	FY18E	FY19E
Revenues	71,810	61,199	17.3	67,120	7.0	257,165	306,809	347,076
EBITDA	62,000	54,196	14.4	56,185	10.3	226,015	272,544	309,385
Adj. net profit	20,521	18,018	13.9	19,164	7.1	74,502	91,925	107,540
Dil. EPS (INR)	3.9	3.4	13.9	3.7		14.4	17.6	20.6
P/BV						2.3	2.1	2.1
ROAE (%)						16.3	17.4	18.1

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Low
Sector Relative to Market	Underweight

#### MARKET DATA (R: PGRD.BO, B: PWGR IN)

CMP	: INR 222
Target Price	: INR 252
52-week range (INR)	: 226 / 167
Share in issue (mn)	: 5,231.6
M cap (INR bn/USD mn)	: 1,160 / 18,224
Avg. Daily Vol.BSE/NSE('000)	: 5,332.3

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	57.9	57.9	57.9
MF's, FI's & BK's	9.7	8.6	8.3
FII's	25.7	26.6	26.8
Others	6.8	6.9	7.1
* Promoters pledged shares (% of share in issue)	NIL		

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Power Index
1 month	5.3	5.9	4.4
3 months	7.7	8.2	0.3
12 months	24.0	16.9	13.0

#### Swarnim Maheshwari

+91 22 4040 7418  
swarnim.maheshwari@edelweissfin.com

#### Viren Dargar

+91 (22) 6620 3195  
viren.dargar@edelweissfin.com

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**Table 1: SOTP valuation**

	Value	Comments	Multiple	Comments	Value	Per share
Regulated equity	664,470	FY19E req equity	1.86	(RoE-g)/(CoE-g)	1,233,381	235
CWIP equity	24,220	FY19E CWIP	1.00	Equity value	24,220	5
Investments	9,832	FY19E Invst	1.00	At book value	9,832	2
Value of telecom business	8,000	Current equity	1.00	BV	8,000	2
Value of consultancy business	3,095	FY19E earnings	15.0	12x P/E	46,430	9
<b>Total</b>					<b>1,321,863</b>	<b>252</b>

Source: Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Total operating Income	71,810	61,199	17.3	67,120	7.0	257,165	306,809	347,076
Transmission expense	5,774	4,288	34.7	5,561	3.8	17,379	19,117	21,028
Gross profit	66,036	56,911	16.0	61,560	7.3	239,787	287,692	326,048
Salaries and other exp.	4,036	2,714	48.7	5,374	(24.9)	13,771	15,148	16,663
Total expenditure	9,810	7,002	40.1	10,935	(10.3)	31,150	34,265	37,692
EBITDA	62,000	54,196	14.4	56,185	10.3	226,015	272,544	309,385
Depreciation	21,311	17,573	21.3	20,633	3.3	76,628	98,232	113,037
EBIT	40,689	36,624	11.1	35,552	14.4	149,387	174,312	196,348
Other income	2,085	1,394	49.5	3,424	(39.1)	8,649	7,740	11,626
Interest	17,624	15,178	16.1	15,558	13.3	63,038	65,073	71,124
Add: Exceptional items	695	(4)	(17,056.1)	829	(16.2)	-	-	-
Profit before tax	25,845	22,836	13.2	24,247	6.6	94,998	116,978	136,850
Provision for taxes	5,324	4,819	10.5	5,083	4.7	20,496	25,054	29,310
Reported net profit	20,521	18,018	13.9	19,164	7.1	74,502	91,925	107,540
Adjustments								
Adjusted Profit	20,521	18,018	13.9	19,164	7.1	74,502	91,925	107,540
Diluted shares (mn)	5,232	5,232		5,232		5,232	5,232	5,232
Adjusted Diluted EPS	3.9	3.4	13.9	3.7	7.1	14.2	17.6	20.6
Diluted P/E (x)	-	-		-		15.5	12.6	10.8
ROAE (%)	-	-		-		16.3	17.4	-

## As % of net revenues

COGS	8.0	7.0		8.3		6.8	6.2	6.1
Gross profit	92.0	93.0		91.7		93.2	93.8	93.9
Other expenses	5.6	4.4		8.0		5.4	4.9	4.8
Total expenses	13.7	11.4		16.3		12.1	11.2	10.9
EBITDA	86.3	88.6		83.7		87.9	88.8	89.1
Adjusted net profit	28.6	29.4		28.6		29.0	30.0	31.0
Tax rate	20.6	21.1		21.0		21.6	21.4	21.4

### Company Description

PGCIL commenced operations in 1992 by consolidating transmission assets of NTPC, NHPC, NEEPC, NPCIL, Tehri Hydro Development Corporation, and Neyveli Lignite. In 1994, the assets and communication systems of regional load dispatch centre (RLDC) were also transferred to the company with an objective to enhance grid management. Due to the central transmission utility status, PGCIL is mandated to undertake and operate inter-state transmission systems efficiently, provide for open access, and undertake various functions of RLDC. Recently, under the Rajiv Gandhi Grameen Vidyutikaran Yojana, PGCIL is mandated to implement the electrification of rural households in association with the Rural Electrification Corporation, SEBs, and the respective state governments.

### Investment Theme

**Growth visibility:** The company has met its Eleventh Five Year capex Plan of INR 550 bn for its various transmission projects. Of these close to 60% are for strengthening the overall grid capacity and the balance 40% is generation linked. The 12th Plan target for capex is touted to be INR 1 tn. Hence, there is a certain visibility on the capex program and in turn earnings growth. The company has been consistently delivering 20-25% profit growth every quarter driven by its capex.

**Reversal in the current trend of capex and telecom earnings:** If the company is able to scale up internal accruals through superior earnings from telecom which would in turn invested in power business then the overall earnings growth could be significant.

### Key Risks

**Telecom scale up:** The company's strategy of leveraging its transmission towers also as telecom towers has not scaled up so far.

**Funding issues:** PGCIL is constrained by its limited retained earnings in undertaking significant capex programme under the 70:30 debt/equity norm. While the company could raise the threshold to 75% debt and 25% equity to meet its XII Plan target but earnings will continue to be on the actual equity deployed.

**Slow pace of capex – dependant on generation capacity growth:** Power Grid capex is dependant heavily (40-50% of total capex) on the capacity addition of its associated generation projects. Any delay in these generation assets will cascade to a delay in PGCIL's project execution slowing its pace of growth. Escalation in project costs, delay in commissioning of generation projects, and long gestation periods could impact profitability, if delays are not compensated through tariffs.

## Financial Statements

### Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
<b>Macro</b>				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
<b>Company</b>				
Capex (INR mn)	225,840	245,000	250,000	250,000
Commissioning (INR mn)	317,880	310,000	315,000	315,000
Closing Reg. Eqty(INRmn)	382,470	475,470	569,970	664,470
RoE on Reg. Eqty (%)	16	15	16	16
Telecom Revenue (INR mn)	4,359	5,040	5,544	6,098
Telecom EBIT (INR mn)	1,626	2,540	2,218	1,525
Consulting Rev.(INRmn)	4,733	5,820	6,111	6,417
Consulting EBIT (INRmn)	3,406	4,084	4,400	4,620
Avg. Interest rate (%)	4.9	5.7	5.5	5.5
Depreciation rate (%)	4.6	4.7	4.7	4.7
Tax rate (%)	20.9	21.4	21.4	21.4
Dividend payout (%)	20.1	30.3	30.3	30.3
OI as %age of cash (%)	11.7	20.2	12.0	10.0
Net borrowings (INR mn)	1,058,504	1,094,723	1,142,590	1,211,200
Debtor days	43	42	42	42
Inventory days	14	13	13	13
Payable days	47	49	49	49

### Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	208,022	257,865	306,809	347,076
Direct costs	14,761	17,379	19,117	21,028
Employee costs	9,805	13,771	15,148	16,663
Total operating expenses	24,567	31,150	34,265	37,692
EBITDA	183,455	226,715	272,544	309,385
Depreciation	61,828	76,628	98,232	113,037
EBIT	121,627	150,087	174,312	196,348
Add: Other income	4,789.6	8,649.2	7,739.71	11,625.93
Less: Interest Expense	50,230	63,038	65,073	71,124
Profit Before Tax	76,187	95,698	116,978	136,850
Less: Provision for Tax	15,920	20,496	25,054	29,310
Reported Profit	60,267	75,202	91,925	107,540
Adjusted Profit	60,267	75,202	91,925	107,540
Shares o /s (mn)	5,232	5,232	5,232	5,232
Adjusted Basic EPS	11.5	14.4	17.6	20.6
Diluted shares o/s (mn)	5,232	5,232	5,232	5,232
Adjusted Diluted EPS	11.5	14.4	17.6	20.6
Adjusted Cash EPS	23.4	29.1	36.3	42.2
Dividend per share (DPS)	2.3	4.4	5.3	6.2
Dividend Payout Ratio(%)	23.1	34.8	34.8	34.8

### Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	11.8	12.1	11.2	10.9
Depreciation	29.7	29.7	32.0	32.6
Interest Expense	24.1	24.4	21.2	20.5
EBITDA margins	88.2	87.9	88.8	89.1
Net Profit margins	29.0	29.2	30.0	31.0

### Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	21.4	24.0	19.0	13.1
EBITDA	24.4	23.6	20.2	13.5
PBT	21.1	25.6	22.2	17.0
Adjusted Profit	17.7	24.8	22.2	17.0
EPS	17.7	24.8	22.2	17.0

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	52,316	52,316	52,316	52,316	
Reserves & Surplus	375,024	445,757	505,690	575,805	
Shareholders' funds	427,340	498,073	558,006	628,121	
Short term borrowings	20,000	15,000	15,000	15,000	
Long term borrowings	1,063,398	1,113,154	1,223,154	1,333,155	
Total Borrowings	1,083,398	1,128,154	1,238,154	1,348,155	
Long Term Liabilities	19,884	13,648	13,648	13,648	
Def. Tax Liability (net)	24,894	25,505	25,505	25,505	
Deferred revenue	57,239	48,824	48,824	48,824	
<b>Sources of funds</b>	<b>1,612,754</b>	<b>1,714,203</b>	<b>1,884,137</b>	<b>2,064,253</b>	
Gross Block	1,500,520	1,775,034	2,090,034	2,405,034	
Net Block	1,144,640	1,342,526	1,559,294	1,761,258	
Capital work in progress	437,202	422,317	307,202	242,202	
Intangible Assets	7,837	12,554	12,554	12,554	
Total Fixed Assets	1,589,679	1,777,396	1,879,050	2,016,013	
Non current investments	7,713	13,556	11,694	9,832	
Cash and Equivalents	24,894	33,431	95,564	136,954	
Inventories	8,237	9,070	10,820	12,240	
Sundry Debtors	27,380	32,211	38,883	41,542	
Loans & Advances	56,702	77,815	77,815	77,815	
Other Current Assets	69,685	3,316	3,316	3,317	
Current Assets (ex cash)	162,004	122,412	130,835	134,914	
Trade payable	3,139	4,140	4,554	5,009	
Other Current Liab	168,397	228,452	228,452	228,452	
Total Current Liab	171,536	232,591	233,005	233,461	
Net Curr Assets-ex cash	(9,532)	(110,180)	(102,170)	(98,547)	
<b>Uses of funds</b>	<b>1,612,754</b>	<b>1,714,203</b>	<b>1,884,137</b>	<b>2,064,253</b>	
BVPS (INR)	81.7	95.2	106.7	120.1	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	60,267	75,202	91,925	107,540	
Add: Depreciation	61,828	76,628	98,232	113,037	
Interest (Net of Tax)	39,734	49,537	51,136	55,891	
Deferred tax	172	612	-	-	
Others	(26,901)	(94,703)	(51,136)	(55,890)	
Less: Changes in WC	(25,223)	100,648	(8,009)	(3,624)	
Operating cash flow	109,877	207,924	182,147	216,954	
Less: Capex	225,837	260,969	199,885	250,000	
<b>Free Cash Flow</b>	<b>(115,961)</b>	<b>(53,045)</b>	<b>(17,738)</b>	<b>(33,046)</b>	

## Peer comparison valuation

Name	Market cap (USD mn)	EV / EBITDA (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Power Grid Corp of India	18,224	8.4	7.7	2.1	1.8	17.4	18.1
CESC	1,979	9.5	8.6	1.5	1.4	5.0	5.5
NTPC	22,254	10.0	9.0	1.4	1.3	11.6	12.6
Tata Power Co	3,509	9.2	9.2	1.6	1.6	7.0	8.8
Median	-	9.4	8.8	1.6	1.5	9.3	10.7
AVERAGE	-	9.3	8.6	1.7	1.5	10.3	11.3

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		109,877	207,924	182,147	216,954
Investing cash flow		(224,642)	(266,480)	(198,023)	(248,138)
Financing cash flow		119,054	272,072	78,009	72,575
Net cash Flow		4,289	213,516	62,133	41,390
Capex		(225,837)	(260,969)	(199,885)	(250,000)
Dividend paid		(12,085)	(22,757)	(27,818)	(32,544)

## Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	14.9	16.3	17.4	18.1
ROACE (%)	8.6	9.8	10.3	10.7
Inventory Days	191	182	190	200
Debtors Days	43	42	42	42
Payable Days	87	76	83	83
Cash Conversion Cycle	146	147	149	159
Current Ratio	1.1	0.7	1.0	1.2
Gross Debt/EBITDA	5.9	5.0	4.5	4.4
Gross Debt/Equity	2.5	2.3	2.2	2.1
Adjusted Debt/Equity	2.5	2.3	2.2	2.1
Interest Coverage Ratio	2.4	2.4	2.7	2.8

## Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	0.1	0.2	0.2	0.2
Fixed Asset Turnover	0.2	0.2	0.2	0.2
Equity Turnover	0.5	0.5	0.5	0.5

## Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	11.5	14.4	17.6	20.6
Y-o-Y growth (%)	17.7	24.8	22.2	17.0
Adjusted Cash EPS (INR)	23.4	29.1	36.3	42.2
Diluted P/E (x)	19.3	15.4	12.6	10.8
P/B (x)	2.7	2.3	2.1	1.8
EV / Sales (x)	10.6	8.7	7.5	6.8
EV / EBITDA (x)	12.1	9.9	8.4	7.7
Dividend Yield (%)	1.0	2.0	2.4	2.8

## Additional Data

### Directors Data

Shri I.S.Jha	Chairman & Managing Director	Shri R. T. Agarwal	Director (Finance)
Shri Ravi P. Singh	Director (Personnel)	Shri R. P. Sasmal	Director (Operations)
Dr. Pradeep Kumar	Govt. Nominee	Shri Jagdish I. Patel	Director (Independent)
Shri R K Gupta	Independent Director	Dr K Ramalingam	Independent Director
Shri Ajay Kumar Mittal	Independent Director	Shri R Krishnamoorthy	Independent Director
Shri Mahesh Shah	Independent Director	Smt. Jyoti Arora	Govt. Nominee

Auditors - M/s. S. K. Mehta & Co.,M/s. Chatterjee & Co.,M/s. Sagar & Associates

*\*as per last annual report*

### Holding – Top 10

	Perc. Holding		Perc. Holding
Capital Group Companies Inc	5.69	Comgest S A	3.68
Life Insurance Corp Of India	2.32	Hdfc Asset Management Co Ltd	1.98
Icici Prudential Asset Mgmt Co	1.68	Icici Prudential Life Insurance	1.23
Fil Limited	1.16	Vanguard Group	1.08
T Rowe Price Group Inc	0.93	Vontobel Holding Ag	0.79

*\*as per last available data*

### Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

*\*in last one year*

### Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

*\*in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Adani Power	HOLD	SU	H	CESC	BUY	None	None
JSW Energy	HOLD	SP	M	NTPC	BUY	SP	L
Power Grid Corp of India	BUY	SO	L	PTC India	BUY	None	None
Tata Power Co	BUY	SP	M				

## ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

## RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

## RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

## SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



**Edelweiss Securities Limited**, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.

Board: (91-22) 4009 4400, Email: [research@edelweissfin.com](mailto:research@edelweissfin.com)

Aditya Narain

Head of Research

[aditya.narain@edelweissfin.com](mailto:aditya.narain@edelweissfin.com)

### Coverage group(s) of stocks by primary analyst(s): Power

Adani Power, CESC, JSW Energy, NTPC, PTC India, Power Grid Corp of India, Tata Power Co

#### Recent Research

Date	Company	Title	Price (INR)	Recos
01-Aug-17	NTPC	Off the beaten track; Result Update	165	Buy
31-May-17	Power Grid Corporation of India	Steady quarter; Capex outlook intact; Result Update	208	Buy
29-May-17	NTPC	One-offs mar Q4; commissioning key; Result Update	156	Buy

#### Distribution of Ratings / Market Cap

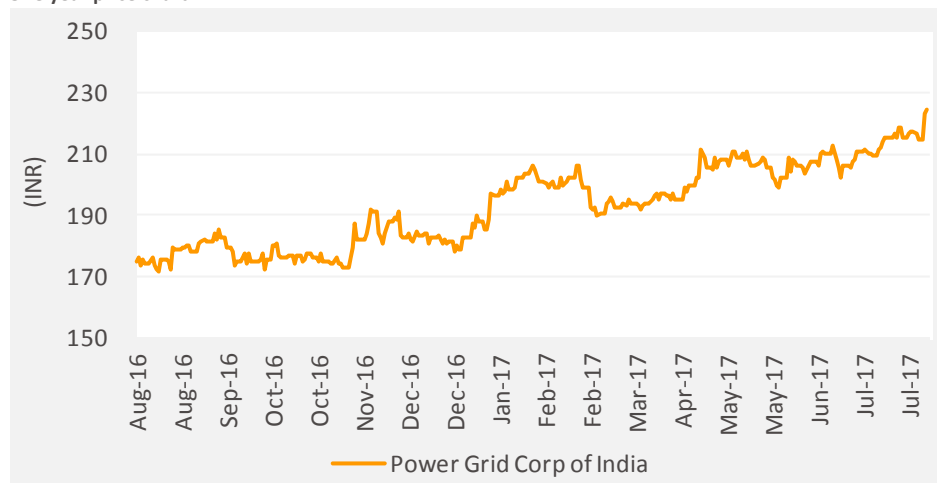
##### Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

#### Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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