

RURAL ELECTRIFICATION CORP

BANKS & FINANCIAL SERVICES

17 AUG 2017

Quarterly Update

BUY

Target Price: Rs 200

Subdued Q1 but growth revives

Q1FY18 was subdued marked by 15 bps QoQ decline in margin to 4.4% and marginal deterioration in asset quality. GNPA's increased ~19 bps QoQ at 2.6% and coverage ratio remained flat at ~34%. PAT was lower than expected at Rs 13 bn (down 8.4% YoY) due to lower NII (down ~9% YoY) and higher provisions. On positive front, loan growth revived (up 10% YoY).

As indicated earlier, the management expects FY18 loan growth to be ~15% driven by renewables. It expects to clock Rs 100-120 bn of renewable loan sanctions and ~Rs 50 bn of disbursements in FY18. Lending to private sector will be under watch, as CAG recently has flagged lack of proper due diligence by PFC and REC on loans given to private power producers over FY14-16; however, the management has refuted these claims.

CMP : Rs 165
Potential Upside : 21%

MARKET DATA

No. of Shares : 1,975 mn
Free Float : 41%
Market Cap : Rs 326 bn
52-week High / Low : Rs 224 / Rs 109
Avg. Daily vol. (6mth) : 9.3 mn shares
Bloomberg Code : RECL IB Equity
Promoters Holding : 59%
FII / DII : 23% / 9%

Key highlights: (a) Loan growth revived to 10% YoY primarily contributed by T&D segment (52.9% of loans; up 9% YoY), while generation (44.5% of loans) and short term loan segment (~1% of loans) witnessed a run-off sequentially. Renewable segment – a key focus area for growth – too remained largely flat QoQ; (b) Disbursement growth remained muted at ~9.3% YoY, while traction in sanctions remained strong at 113% YoY (on favorable base) giving comfort on the loan growth in ensuing quarters; (c) Margin declined 15 bps QoQ to ~4.4% due to larger decrease in yields (down 30 bps QoQ to 11.1%) vs. cost (down 15 bps QoQ to 8%); and (d) O/S restructured book improved marginally QoQ at Rs 230.8 bn (11.1% of loans vs. 11.6% in Q4), out of which ~53% is from the private sector

Maintain BUY with a revised TP of Rs 200 vs. Rs 240 earlier: On larger share of T&D assets, REC has better growth visibility and credit quality than its peers. However, on continued pressure on NIM and concerns over asset quality, we revise the target multiple to 1.1x from earlier 1.3x, valuing REC at Rs 200 (upside of ~21% from CMP). At CMP of Rs 165, REC trades at 1x/0.9x FY18E/19E P/ABV of Rs 160/Rs 180.

Financial summary (Standalone)

Y/E March	FY16	FY17	FY18E	FY19E
PAT (Rs mn)	56,277	62,458	62,933	70,862
EPS (Rs)	28	32	32	36
EPS chg (%)	7.0	11.0	0.8	12.6
Book value (Rs)	135	156	173	193
Adj. BV (Rs)	124	145	160	180
PE (x)	5.8	5.2	5.2	4.6
P/ABV (x)	1.3	1.1	1.0	0.9
RoE (%)	22.6	21.8	19.4	19.6
RoA (%)	2.9	3.0	2.8	2.8
Net NPA (%)	1.6	1.6	1.6	1.5

Source: Company, Axis Capital

Key drivers

(%)	Q3'17	Q4'17	Q1'18	Q3FY18
Disbursement (% YoY)	(3)	72	9	23
YTD-NIM (%)	4.5	4.5	4.4	3.8
GNPA (%)	2.3	2.4	2.6	34.1

Price performance

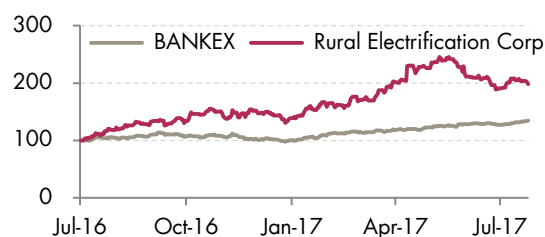
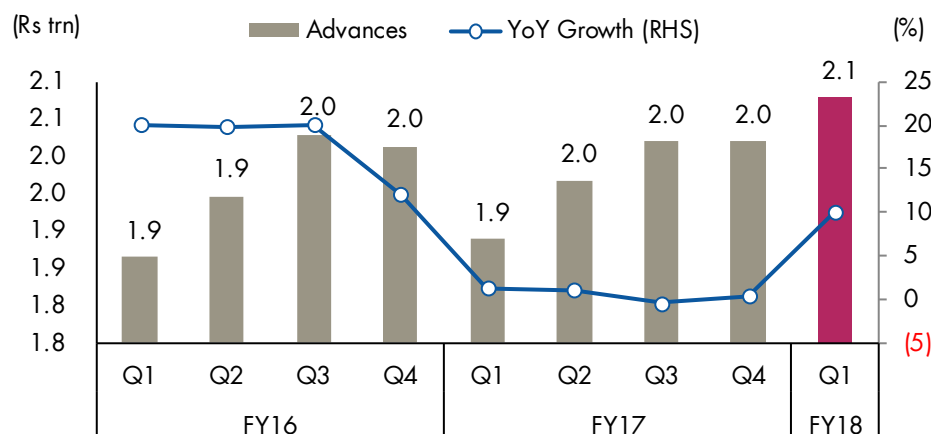
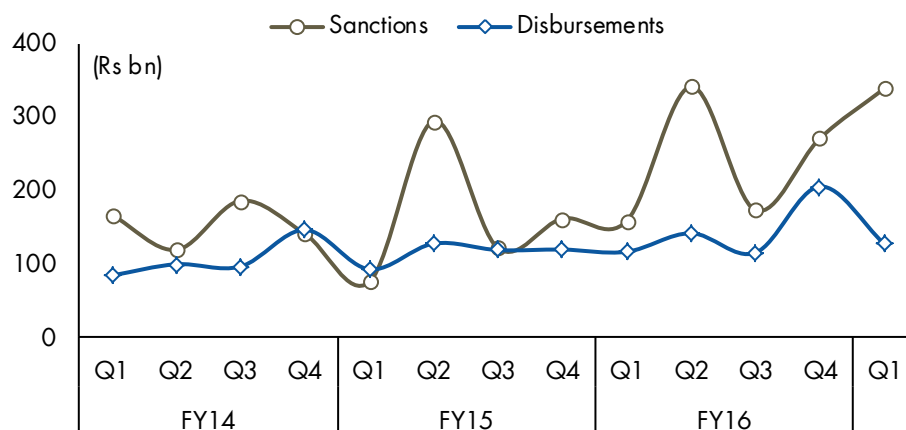


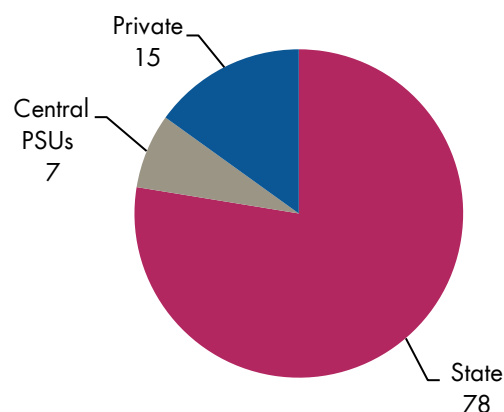
Exhibit 1: Advances growth revived to 10% YoY on favorable base


Source: Company, Axis Capital

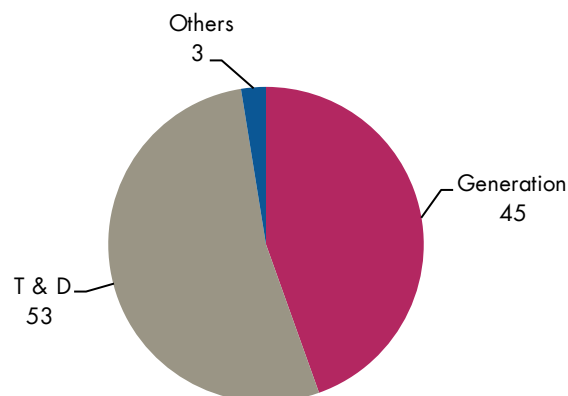
Exhibit 2: Sanctions have been consistently higher than disbursements over many quarters


~Rs 250 bn of borrowings and ~Rs 280 bn of advances are expected to re-price in FY18

Source: Company, Axis Capital

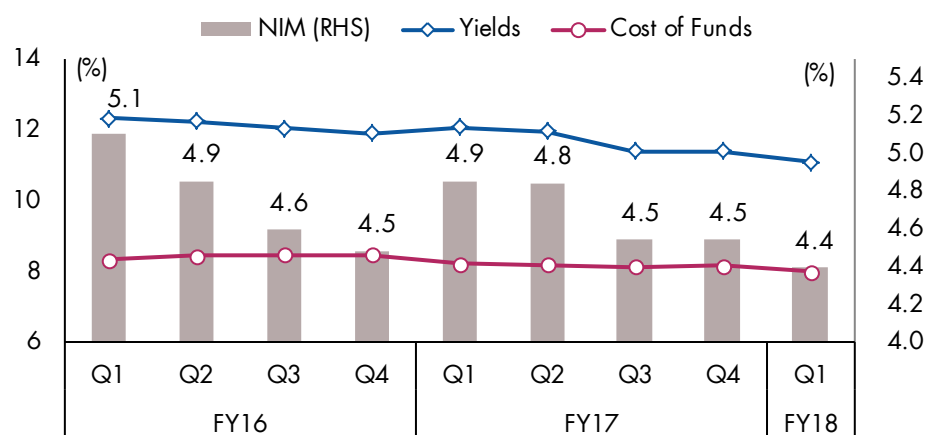
Exhibit 3: Loan mix – Public vs. Private


Source: Company, Axis Capital

Exhibit 4: Loan mix – Generation vs. T&D


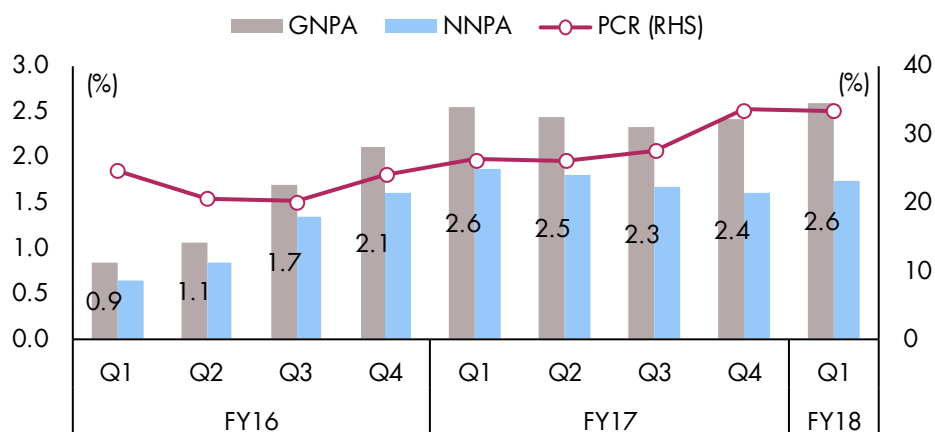
Source: Company, Axis Capital

Exhibit 5: NIM declined 15 bps QoQ to 4.39%



Source: Company, Axis Capital

Exhibit 6: GNPA's deteriorated QoQ (GNPA up ~19 bps QoQ)



Source: Company, Axis Capital

Exhibit 7: Results update

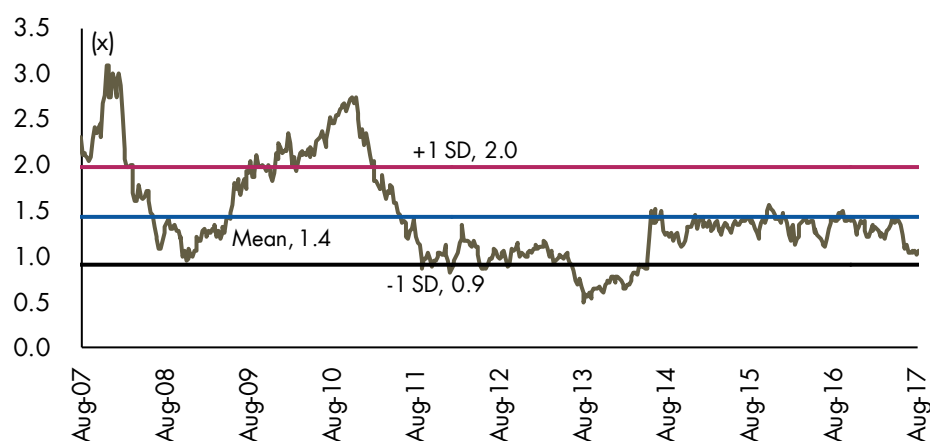
(Rs mn)	Quarter ended				12 months ended			
	Jun-17	Jun-16	% Chg	Mar-17	% Chg	FY18E	FY17	% Chg
Interest income	54,632	58,895	(7)	57,174	(4)	243,058	229,360	6
Interest expended	33,425	35,534	(6)	34,225	(2)	140,827	129,095	9
Net interest income	21,207	23,362	(9)	22,949	(8)	102,232	100,265	2
Non-interest income	1,989	1,612	23	2,609	(24)	9,838	11,594	(15)
Net Income	23,196	24,974	(7)	25,558	(9)	112,070	111,859	0
Operating expenses	874	888	(2)	532	64	11,888	12,173	(2)
Operating profit	22,322	24,086	(7)	25,026	(11)	100,182	99,685	0
Provision & Contingencies	3,425	3,565	(4)	6,162	(44)	12,082	11,078	9
PBT	18,897	20,521	(8)	18,864	0	88,099	88,607	(1)
Tax	5,886	6,319	(7)	5,682	4	25,166	26,149	(4)
Adjusted PAT	13,011	14,202	(8)	13,192	(1)	62,933	62,458	1
Margins (%)								
Yield on advances	11.1	12.1	(100) bps	11.4	(30) bps	11.3	11.4	(17) bps
Cost of funds	8.0	8.2	(23) bps	8.1	(15) bps	7.8	7.7	17 bps
Interest spread	3.1	3.9	(77) bps	3.3	(15) bps	3.1	3.5	(33) bps
Net interest margins	4.4	4.9	(46) bps	4.54	(15) bps	4.6	4.9	(25) bps
Asset quality								
Gross NPAs (Rs mn)	54,120	48,160	12	48,730	11	62,842	48,730	29
Gross NPAs (%)	2.6	2.6	5 bps	2.4	19 bps	2.7	2.4	28 bps
Net NPAs (Rs mn)	35,910	35,500	1	32,340	11	37,705	32,340	17
Net NPAs (%)	1.7	1.9	(15) bps	1.6	13 bps	1.6	1.6	2 bps
Provisioning coverage (%)	34	26	736 bps	34	1 bps	40	34	637 bps
Balance sheet (Rs. bn)								
Loan book	2,078	1,888	10	2,019	3	2,307	2,019	15
Disbursements	128	117	9	206	(38)	696	580	20
Cost-to-income (%)	3.8	3.6	0.2	2.1	169 bps	10.6	10.9	(0) bps
Tax rate (%)	31.1	30.8	0.4	30.1	103 bps	28.6	29.5	(1) bps

Source: Company, Axis Capital

Note: Ratios are on calculated basis and may differ from actuals.

Note: FY17 numbers are provisional as we await the annual report for granular details

Exhibit 8: 10 years P/ABV movement



Source: Bloomberg, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Interest earned	235	229	243	272
Interest expended	(134)	(129)	(141)	(158)
Net interest income	100	100	102	115
Non interest income	3	12	10	10
Net income	103	112	112	125
Operating expenses	(12)	(12)	(12)	(13)
Staff expenses	(1)	(2)	(2)	(2)
Other operating expenses	(11)	(10)	(10)	(11)
Operating profit	91	100	100	112
Provisions & contingencies	(11)	(11)	(12)	(13)
Pre-tax profit	80	89	88	99
Tax expense	(24)	(26)	(25)	(28)
Profit after tax	56	62	63	71
Extraordinary item	-	-	-	-
Minority interest/Associates	-	-	-	-
Adj. PAT	56	62	63	71

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Total assets	2,064	2,092	2,376	2,730
Cash & Balances with RBI	34	59	37	23
Investments	25	27	28	29
Advances	2,003	2,004	2,307	2,674
Fixed assets	2	2	2	2
Other assets	1	1	1	1
Total liabilities	2,064	2,092	2,376	2,730
Equity capital	10	20	20	20
Preference capital	-	-	-	-
Reserves & surplus	256	288	322	362
Networth	266	308	342	382
Borrowings	1,691	1,675	1,917	2,224
Deposits	-	-	-	-
Other liabilities & prov.	86	84	86	88

Source: Company, Axis Capital

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
Per share data				
FDEPS (Rs.)	28	32	32	36
BV (Rs.)	135	156	173	193
Adj. BV (Rs.)	124	145	160	180
DPS (Rs.)	9	10	10	11
Dividend payout (%)	30	31	31	29
Yields & Margins (%)				
Yield on advances	12.3	11.4	11.3	10.9
Cost of deposit	-	-	-	-
Net interest margin	5.2	4.9	4.6	4.5
Asset quality (%)				
Gross NPAs	2.1	2.4	2.7	2.7
Net NPAs	1.6	1.6	1.6	1.5
Credit cost	0.3	0.3	0.4	0.3
Provisioning coverage	23.9	33.6	40.0	45.0
Capital (%)				
CAR	19.0	18.7	16.8	15.6
Efficiency (%)				
ROA	2.9	3.0	2.8	2.8
ROE	22.6	21.8	19.4	19.6
CASA	-	-	-	-
Effective tax rate	30	30	29	29
Growth (%)				
Net interest income	16	-	2	12
Fee income	-	-	-	-
Operating expenses	56	2	(2)	9
Profit after tax	7	11	1	13
Advances	11	-	15	16
Deposits	-	-	-	-
Total assets	13	1	14	15

Source: Company, Axis Capital

Note: FY17 numbers are provisional as we await the annual report for granular details

Note: Ratios are on calculated basis and may differ from actuals.

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