

POWER FINANCE CORPORATION

Delivering on expectations

India Equity Research | Banking and Financial Services



Power Finance Corporation (PFC) reported steady Q2FY18 performance with earnings beat supported by lower provisions. While one fresh account (East Coast Energy – ~INR12bn) slipped into NPLs, upgrade of MP Genco loans (INR110bn) led to >30% QoQ decline in GNPLs (to INR215bn at 8.33% from 12.5%). Moreover, even while there was no fresh restructuring, restructured book rose to INR590bn (up 8% QoQ) as upgrade of MP Genco Loans (INR56bn) partially happened to restructured book. Encouragingly, Q2FY18 marks the quarter where upgrades have started crystalising with further upgrades (INR70bn from NPL, INR13bn from restructured book) expected in Q3FY18. Meanwhile, operating performance was soft as: a) NII declined >5% YoY, a derivative of lower NIMs (down 25bps to 4.2%) and softer <10% loan growth. Given quarterly earnings volatility, we are not revising our FY18/19 estimates. At CMP, the stock trades at 0.8x FY19E P/BV for RoE of 16-18%, rendering favourable risk-reward. Maintain 'BUY'.

One fresh NPLs; upgrades starting to play out as guided

Q2FY18 performance holds PFC in good stead—GNPL stood at INR215bn (down >30% QoQ) with state GNPL at INR123bn (upgrade of 1 account) and rise in private sector GNPL to INR92bn (INR81.4bn in Q1FY18, 1 new slippage). Further, restructured book rose to 22.9% (21.6% in Q1FY18) with private at INR172bn (INR181bn in Q1FY18) and public at INR418bn (INR365bn in Q1FY18, upgrade of 1 NPL account). Management expects further upgrades in ensuing quarters, which in our view is a key monitorable.

Business momentum softer; lower sanctions key monitorable

Loan book growth was soft at <10%. This, along with softer NIMs (down 25bps on lower yields, vindication of our stance), led to softer core. Furthermore, sanctions fell to INR130bn and this being harbinger of potential asset growth is key monitorable. Having said that, superior NIMs (even though lending may be under pressure funding cost benefit will persist as liabilities come for re-pricing) will help PFC sustain revenue traction.

Outlook and valuations: Recovery holds key; maintain 'BUY'

Given that large part of stress pertains to state utilities, where recovery is just a matter of time, it is not justifiable to adjust net worth for entire unprovided NPLs as LGD in case of state utilities will be negligible. We are valuing the stock on BV, but given exposure to single sector, valuations may be capped. Also, key monitorable will be incremental stress in private sector. We maintain 'BUY/SO' with TP of INR173.

Financials

(INR mn)

Year to March	Q2FY18	Q2FY17	Growth (%)	Q1FY18	Growth (%)	FY17	FY18E	FY19E
Net revenue	27,460	29,420	(6.7)	27,730	(1.0)	1,08,781	1,08,401	1,13,336
Net profit	18,870	18,740	0.7	14,290	32.1	21,028	67,649	69,445
Dil. EPS (INR) *	7.0	6.9	1.4	5.4	29.5	8.7	25.9	26.6
Book value (INR)						136.0	154.4	173.3
Price/book (x)						1.0	0.9	0.8
Price/Earnings (x)						16.4	5.5	5.3

*excluding extraordinaries

EDELWEISS 4D RATINGS	
Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: PWFC.BO, B: POWF IN)

CMP	: INR 142
Target Price	: INR 173
52-week range (INR)	: 169 / 103
Share in issue (mn)	: 2,640.1
M cap (INR bn/USD mn)	: 375 / 5,811
Avg. Daily Vol.BSE/NSE('000)	: 6,332.7

SHARE HOLDING PATTERN (%)

	Current	Q1FY18	Q4FY17
Promoters *	66.3	66.3	66.3
MF's, FI's & BK's	12.6	12.6	12.7
FII's	15.4	15.7	15.5
Others	5.7	5.4	5.5
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Banks and Financial Services Index
1 month	14.3	6.0	7.4
3 months	12.7	4.4	4.3
12 months	23.1	23.2	32.7

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Table 1: Key takeaways from Q2FY18 earnings

(INR mn)	Q2FY18	Q2FY17	YoY (%)	Q1FY18	QoQ (%)	Comments
Interest income	69,840	69,190	0.9	68,970	1.3	
Interest expense	42,630	40,520	5.2	41,330	3.1	
Net interest income	27,210	28,670	(5.1)	27,640	(1.6)	Core revenue softer, a derivative of lower NIMs (down 25bps to 4.2%) and softer <10% loan growth
Non-interest income	250	750	(66.7)	90	177.8	
Net revenues	27,460	29,420	(6.7)	27,730	(1.0)	
Operating expenses	560	420	33.3	2,040	(72.5)	
Operating profit	26,900	29,000	(7.2)	25,690	4.7	
Provisions	1,220	3,010	(59.5)	4,130	(70.5)	Lower provisions (writeback due to upgrade of MP Genco Loans) lead to earnings beat.
Profit before tax	25,680	25,990	(1.2)	21,560	NA	
Tax expense	7,146	7,705	(7.3)	7,249	(1.4)	
Core profit after tax	18,534	18,285	1.4	14,311	29.5	
Extra-ordinary items	336	455	NA	(21)	NA	
Profit after tax	18,870	18,740	0.7	14,290	32.1	
EPS (INR)	7.1	7.1	0.7	5.4	32.1	
Key Metrics						
Loan Assets	25,35,178	23,60,650	7.4	24,71,390	2.6	Loan book growth supported by transmission segment.
Disbursements	1,38,200	1,45,100	(4.8)	1,28,490	7.6	
Sanctions	1,30,470	3,65,920	(64.3)	5,09,220	(74.4)	Sanctions fell to INR130bn and this being harbinger of potential asset growth is key monitorable.
GNPA	2,15,030	75,850	183.5	3,14,980	(31.7)	While one fresh account (East Coast Energy – INR12bn) slipped into NPLs, upgrade of MP Genco Loans (INR110bn) led to >30% QoQ decline in GNPLs (to INR215bn)
NNPA	1,69,700	57,060	197.4	2,58,920	(34.5)	
GNPA (%)	8.3	3.2		12.5		
NNPA (%)	6.7	2.4		10.5		
NIM (reported, %)	4.2	4.9		4.4		NIMs dip following lower lending yields.

Table 2: Sanctions dipped sharply, a key monitorable

(INR bn)	Q217	Q317	Q417	Q118	Q218
Generation	282	65	96	395	28
Transmission	15	56	92	12	25
Distribution	12	27	9	41	12
Others	57	173	75	61	66

Table 3: Disbursements aided by generation & others (transitional finance) segment

(INR bn)	Q217	Q317	Q417	Q118	Q218
Generation	86	42	97	59	79
Transmission	9	7	13	7	6
Distribution	3	6	5	2	5
Others	46	67	168	60	48

Source: Company, Edelweiss research

Table 4: NIMs dip following pressure on lending rates

(%)	Q217	Q317	Q417	Q118	Q218
Yield on assets	11.8	11.6	9.3	11.1	10.8
Cost of funds	8.4	8.4	8.4	8.3	8.2
Net interest margin	4.9	4.7	2.6	4.4	4.2

*Source: Company***Table 5: GNPLs dip sharply on upgrade of one account, further upgrades expected**

(%)	Q217	Q317	Q417	Q118	Q218
Gross NPLs	3.2	3.1	12.5	12.5	8.3
Net NPLs	2.4	2.3	10.6	10.5	6.7
Prov cov	24.8	26.4	17.4	17.8	21.1

Source: Company

Financial snapshot

(INR mn)

Year to March	Q2FY18	Q2FY17	% change	Q1FY18	% change	YTD18	FY18E	FY19E
Interest income	69,840	69,190	0.9	68,970	1.3	138,810	277,522	291,039
Interest exp	42,630	40,520	5.2	41,330	3.1	83,960	172,709	181,491
Net int. inc. (INR mn)	27,210	28,670	(5.1)	27,640	(1.6)	54,850	104,812	109,549
Other income	250	750	(66.7)	90	177.8	340	3,589	3,787
Net revenues	27,460	29,420	(6.7)	27,730	(1.0)	55,190	108,401	113,336
Operating expenses	560	420	33.3	2,040	(72.5)	2,600	3,707	4,038
Pre prov op profit(ppop)	26,900	29,000	(7.2)	25,690	4.7	52,590	104,694	109,298
Provisions	1,220	3,010	(59.5)	4,130	(70.5)	5,350	8,414	10,488
Profit before tax	25,680	25,990	(1.2)	21,560	19.1	47,240	96,280	98,810
Tax	7,146	7,705	(7.3)	7,249	(1.4)	14,395	27,921	28,655
Core profit	18,534	18,285	1.4	14,311	29.5	32,845	68,359	70,155
Extraordinary items	480	650	(26.2)	(30)	NA	450	(710)	(710)
PAT	18,870	18,740	0.7	14,290	32.1	33,160	67,649	69,445
Diluted EPS (INR)	7.0	6.9	1.4	5.4	29.5	12.4	25.9	26.6
Tax Rate	27.8	29.6		33.6		30.5	29.0	29.0
Cost/income (%)	2.0	1.4		7.4		4.7	3.4	3.6
B/V per share (INR)							154.4	173.3
Adj book value / share							103.4	137.1
Price/ Book (x)							0.9	0.8
Price/ Adj. book (x)							1.4	1.0
Price/ Earnings							5.5	5.3

Company Description

PFC is a specialised institution in power sector financing, providing fund and non fund-based support for development of power projects in India. The company's project financing activities are primarily focused on the thermal and hydro-energy generation areas. In addition, it finances renovation and modernisation of power projects, projects related to transmission and distribution of power, and shunt capacitor projects. It has also initiated financing of projects based on renewable energy sources such as bio mass and wind power generation. PFC's clientele comprises state power utilities, central power utilities, private power utilities, joint sector power utilities, and power equipment manufacturers. Of total loan assets of INR2.6tn, as on September, 2017, ~66% of advances were extended to state power utilities, ~8% to central power utilities, ~16% to private power utilities, and ~9% to joint sector power utilities.

Investment Theme

Given that large part of stress pertains to state utilities, where recovery is just a matter of time, it is not justifiable to adjust net worth for entire unprovided NPLs as LGD in case of state utilities will be negligible. We are valuing the stock on BV, but given exposure to single sector, valuations may be capped. Also, key monitorable will be incremental stress in private sector. We maintain **'BUY/SO'**.

Key Risks

The power financing space is becoming increasingly competitive with commercial banks and financial institutions providing innumerable power finance products and services.

PFC's ability to borrow from banks may be restricted with RBI guidelines limiting the exposure of a bank in NBFCs to 10% of its capital funds (against 25% previously).

PFC's gross NPA even after the current rise is at low levels. Any major slippage or ineffective recoveries can raise its NPAs significantly, adversely affecting its profitability and future growth.

Financial Statements

Key Assumptions

Year to March	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.9	6.6	6.8	7.4
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)	65.5	67.1	65.0	66.0
Sector				
Credit growth	9.3	9.0	12.0	14.0
Bank's base rate (%)	9.5	9.0	9.0	9.0
Wholesale borr. cost (%)	8.5	8.5	8.5	8.5
G-sec yield	7.5	6.5	6.5	6.5
Company				
Op. metric assumpt. (%)				
Yield on advances	12.0	11.0	10.5	10.1
Cost of funds	8.4	8.6	8.1	7.5
Net interest margins	4.9	4.4	4.2	3.9
Dividend income	33	68	29	29
Employee cost growth	10.0	10.0	12.0	12.0
Tax rate (%)	32.5	58.4	29.0	29.0
Balance sheet assumption (%)				
Disbursement growth	5.1	40.2	(6.0)	13.4
Disb. to sanction ratio	56.1	64.4	55.0	56.7
Repayment/prepay. rate	10.0	13.1	9.0	9.0
Gross NPLs	3.1	12.5	9.0	6.0
Prov Cov	19.4	17.4	20.5	26.0
Net NPLs	2.5	10.6	7.3	4.5

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Interest income	275,617	278,865	277,522	291,039
Interest expended	163,054	173,379	172,709	181,491
Net interest income	112,564	105,486	104,812	109,549
Non interest income	1,380	1,590	1,735	1,770
Income from operations	113,944	107,076	106,547	111,318
Other income	1,619.23	1,704.67	1,853.66	2,017.55
Net revenues	115,563	108,781	108,401	113,336
Operating expense	3,117	3,416	3,707	4,038
- Employee exp	2,826	3,110	3,401	3,736
- Depn /amortisation	62	77	76	73
- Other opex	230	230	230	230
Preprovision profit	112,446	105,365	104,694	109,298
Provisions	17,239	50,460	8,414	10,488
Loan loss provisions	17,239	50,460	8,414	10,488
Profit Before Tax	95,207	54,904	96,280	98,810
Less: Provision for Tax	30,968	32,057	27,921	28,655
Profit After Tax	64,239	22,848	68,359	70,155
Extraordinaries	(3,104)	(1,820)	(710)	(710)
Reported Profit	61,135	21,028	67,649	69,445
Shares o /s (mn)	2,640	2,640	2,640	2,640
Basic EPS (INR)	24.3	8.7	25.9	26.6
Diluted shares o/s (mn)	2,640	2,640	2,640	2,640
Adj. Diluted EPS (INR)	24.3	8.7	25.9	26.6
Dividend per share (DPS)	7.0	5.0	6.5	6.6
Dividend Payout Ratio(%)	33.4	67.6	29.2	29.2

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	16.6	(5.9)	(0.3)	4.6
NII growth	15.3	(6.3)	(0.6)	4.5
Opex growth	28.6	9.6	8.5	8.9
PPP growth	16.3	(6.3)	(0.6)	4.4
Adjusted Profit	2.3	(64.4)	199.2	2.6

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Yield on assets	12.1	11.7	11.0	10.2
Cost of funds	8.4	8.6	8.1	7.5
Net interest margins	4.9	4.4	4.2	3.9
Spread	3.7	3.1	2.9	2.7
Cost-income	2.7	3.1	3.4	3.6
Tax rate	32.5	58.4	29.0	29.0

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	13,200	13,200	13,200	13,200	
Reserves & Surplus	319,844	320,207	364,401	409,696	
Shareholders' funds	333,045	333,408	377,601	422,896	
Short term borrowings	300,726	303,883	335,612	385,668	
Long term borrowings	1,704,114	1,722,003	1,901,804	2,185,455	
Total Borrowings	2,004,840	2,025,886	2,237,416	2,571,123	
Long Term Liabilities	12,716	21,870	19,351	21,250	
Def. Tax Liability (net)	3,021	1,052	1,052	1,052	
Sources of funds	2,353,622	2,382,216	2,635,421	3,016,321	
Gross Block	1,106	1,176	1,226	1,276	
Net Block	640	633	607	584	
Intangible Assets	1	(16)	(32)	(49)	
Total Fixed Assets	641	617	575	536	
Non current investments	26,244	35,202	45,011	54,821	
Cash and Equivalents	1,320	36,448	18,686	15,644	
Loans & Advances	2,389,200	2,455,254	2,690,771	3,078,636	
Current assets (ex cash)	44,278	47,846	51,758	56,048	
Other assets	6,384	3,683	2,784	1,883	
Other Current Liab	114,446	196,834	174,163	191,246	
Total Current Liab	114,446	196,834	174,163	191,246	
Net Curr Assets-ex cash	(70,167)	(148,988)	(122,405)	(135,198)	
Uses of funds	2,353,622	2,382,216	2,635,421	3,016,321	
BVPS (INR)	132.7	136.0	154.4	173.3	

Sanctions and disbursements		FY16	FY17	FY18E	FY19E
Year to March					
Sanctions (INR mn)	847,890	1,036,480	1,140,128	1,254,141	
Disbursements (INR mn)	475,830	667,120	626,948	710,757	
Disb. to sanction ratio	56.1	64.4	55.0	56.7	
Disbursements growth (%)	5.1	40.2	(6.0)	13.4	
Sanctions growth (%)	36.0	22.2	10.0	10.0	

RoE decomposition (%)		FY16	FY17	FY18E	FY19E
Year to March					
Net int. income/assets	4.9	4.4	4.2	3.9	
Non int. income/assets	0.1	0.1	0.1	0.1	
Net revenues/assets	5.1	4.6	4.3	4.0	
Operating expense/assets	0.1	0.1	0.1	0.1	
Provisions/assets	0.8	2.1	0.3	0.4	
Taxes/assets	1.4	1.3	1.1	1.0	
Total costs/assets	2.2	3.6	1.6	1.5	
ROA	2.8	1.0	2.7	2.5	
Equity/assets	14.7	14.9	15.2	15.2	
ROAE (%)	19.1	6.4	17.8	16.2	

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)	24.3	8.7	25.9	26.6	
Y-o-Y growth (%)	2.3	(64.4)	199.2	2.6	
BV per share (INR)	132.7	136.0	154.4	173.3	
Adj. BV per share (INR)	116.6	68.8	103.4	137.1	
Diluted P/E (x)	5.8	16.4	5.5	5.3	
P/B (x)	1.1	1.0	0.9	0.8	
Price/ Adj. BV (x)	1.2	2.1	1.4	1.0	
Dividend Yield (%)	4.9	3.5	4.6	4.7	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Power Finance Corp	5,811	5.5	5.3	0.9	0.8	17.8	16.2
Capital First	1,116	22.2	16.6	2.9	2.5	13.6	16.1
Dewan Housing Finance	3,234	18.1	15.4	2.4	2.2	14.2	15.1
HDFC	43,859	35.0	30.1	6.5	5.9	19.4	20.5
Indiabulls Housing Finance	8,017	15.1	12.5	3.9	3.4	27.3	29.2
LIC Housing Finance	4,759	16.2	13.9	2.4	2.1	17.4	18.0
Mahindra & Mahindra Financial Services	3,828	40.9	24.8	3.0	2.8	8.5	11.7
Manappuram General Finance	1,332	10.5	9.2	2.4	2.1	24.5	24.3
Muthoot Finance	3,078	13.8	12.1	2.6	2.3	20.5	20.1
Reliance Capital	2,303	11.9	9.6	0.9	0.8	7.5	8.7
Repco Home Finance	595	18.3	15.0	2.9	2.5	17.0	17.8
Rural Electrification Corporation	5,507	6.3	5.6	0.9	0.8	16.0	15.8
Shriram City Union Finance	2,297	18.3	12.8	2.6	2.2	15.1	18.7
Shriram Transport Finance	4,572	17.4	10.6	2.3	2.0	14.2	20.1
Median	-	16.8	12.7	2.5	2.2	16.5	17.9
AVERAGE	-	17.8	13.8	2.6	2.3	16.7	18.0

Source: Edelweiss research

Additional Data

Directors Data

Rajeev Sharma	Chairman & Managing Director	D. Ravi	Director (Commercial)
Chinmoy Gangopadhyay	Director (Projects)	Arun Kumar Verma	Director (Govt. Nominee)
Sitaram Pareek	Independent Director		

Auditors - M.K. Aggarwal & Co.

Holding - Top 10

	Perc. Holding		Perc. Holding
Life Insurance Corporation of India	8.09	Morgan Stanley	2.64
HDFC Asset Management	2.20	R Shares Infra	1.38
Benchmark Asset Management	0.98	Vanguard Group	0.83
BlackRock	0.81	Grantham Mayo Van Otterloo & Co.	0.68
Dimensional Fund Advisors	0.59	UTI Asset Management	0.31

**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
Allahabad Bank	HOLD	SU	M	Axis Bank	HOLD	SP	M
Bajaj Finserv	HOLD	SP	L	Bank of Baroda	BUY	SP	M
Bharat Financial Inclusion	BUY	SO	M	Capital First	BUY	SO	M
DCB Bank	HOLD	SP	M	Dewan Housing Finance	BUY	SO	M
Equitas Holdings Ltd.	BUY	SO	M	Federal Bank	BUY	SP	L
HDFC	HOLD	SP	L	HDFC Bank	BUY	SO	L
ICICI Bank	BUY	SO	L	IDFC Bank	HOLD	SP	L
Indiabulls Housing Finance	BUY	SP	M	IndusInd Bank	BUY	SP	L
Karnataka Bank	BUY	SP	M	Kotak Mahindra Bank	HOLD	SP	M
L&T FINANCE HOLDINGS LTD	BUY	SO	M	LIC Housing Finance	BUY	SP	M
Magma Fincorp	BUY	SP	M	Mahindra & Mahindra Financial Services	HOLD	SP	M
Manappuram General Finance	BUY	SO	H	Max Financial Services	BUY	SO	L
Multi Commodity Exchange of India	BUY	SP	M	Muthoot Finance	BUY	SO	M
Oriental Bank Of Commerce	HOLD	SP	L	Power Finance Corp	BUY	SO	M
Punjab National Bank	BUY	SP	M	Reliance Capital	BUY	SP	M
Repco Home Finance	BUY	SO	M	Rural Electrification Corporation	BUY	SO	M
Shriram City Union Finance	BUY	SO	M	Shriram Transport Finance	BUY	SO	L
South Indian Bank	BUY	SP	M	State Bank of India	BUY	SP	L
Union Bank Of India	HOLD	SP	M	Yes Bank	BUY	SO	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

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Coverage group(s) of stocks by primary analyst(s): Banking and Financial Services

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Recent Research

Date	Company	Title	Price (INR)	Recos
03-Nov-17	Shriram City Union Finance	Steady quarter; higher write-offs dent profitability; <i>Result Update</i>	2,247	Buy
01-Nov-17	Shriram Transport Finance	Operationally strong; cyclical tailwinds on horizon; <i>Result Update</i>	1,197	Buy
31-Oct-17	Capital First	Yet another strong quarter; <i>Result Update</i>	755	Buy

Distribution of Ratings / Market Cap

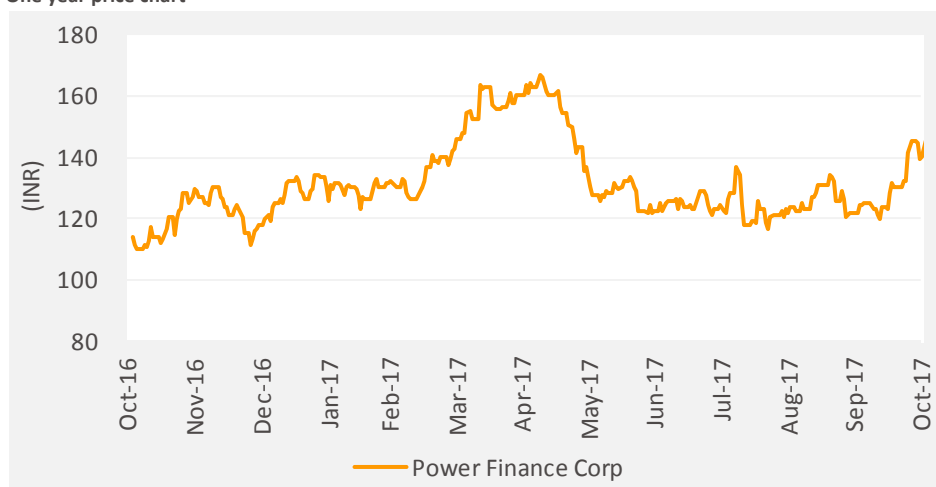
Edelweiss Research Coverage Universe

	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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