

RETAIL EQUITY RESEARCH

Rural Electrification Corporation Ltd.
NBFC

BSE CODE: 532955

NSE CODE: RECLTD

Bloomberg CODE: RECL:IN

SENSEX: 33,176

19th March, 2018**BUY**

Rating as per Large Cap

12 month investment period

CMP Rs. 129 TARGET Rs. 145 RETURN 12% **Muted performance but attractive dividend yield...**

Rural Electrification Corporation Ltd. (RECL) is a public sector non-banking finance company (NBFC). The company primarily caters to the funding requirements of generation and T&D projects, especially in rural areas.

- Net interest income (NII) decreased by 7.4% YoY mainly due to 52 bps YoY decline in net interest margin (NIM) to 3.8% in Q3FY18.
- Asset quality deteriorated significantly as Gross/Net non-performing asset (NPA) ratio increased by 45/37 bps QoQ to 3.0%/2.0% in Q3FY18.
- We expect net profit to remain flat over FY17-20E due to higher base coupled with increasing provisions.
- We expect Gross/Net NPA to increase significantly to 4.2%/2.7% by FY19E given the high level of private restructured loan book (~5.6% of total loans).
- While uncertainty around asset quality is a major overhang, attractive dividend yield is ray of hope for investors. Hence, we upgrade rating to BUY on the stock with a revised downward TP of Rs145 (P/ABV of 0.8x for FY20E).

Growth momentum sustained on the back of generation segment

Loan growth was higher than our expectations at 11% YoY led by power generation sector (46% of total loans) which grew at a similar pace in Q3FY18. While loans to Joint sector (9% of total loans) and state sector (77% of total loans) grew by 22% YoY and 12% YoY, respectively, loans to private sector grew at a meagre pace of 1% YoY as the company continues to remain cautious given the higher stress in the sector. Sanctions and disbursements increased by a robust pace of 124% YoY and 25% YoY on the back of 340% YoY and 32% YoY growth in the generation sector, respectively. However, T&D sector's sanctions and disbursements declined by 5% YoY and 28% YoY, respectively. Going forward, we expect RECL's loan book to grow at a healthy CAGR of 12% over FY17-20E mainly led by higher growth in generation sector.

Weak NIM coupled with higher provisions dragged earnings

Net interest income (NII) decreased by 7.4% YoY (below our expectation) mainly due to 52 bps YoY decline in net interest margin (NIM) to 3.8% in Q3FY18. NIM remain suppressed owing to higher interest reversals along with repayments of high yield SEB loans. We expect NIM to hover around current levels over FY17-20E given the rising competition from the banks. Provisions increased by more than 13.0x YoY with sharp increase in asset quality stress. As a result, net profit declined by 26% YoY (below our expectation). Going forward, we expect net profit to remain broadly flat over FY17-20E due to higher base coupled with increasing provisions. Given the higher than expected interest reversals coupled with provisions, we revised downward our NII/net profit estimates by 3%/9% for FY19E and 10%/16% for FY18E.

Uncertainty over asset quality remains

Asset quality deteriorated significantly as Gross/Net non-performing asset (NPA) ratio increased by 45/37 bps QoQ to 3.0%/2.0% in Q3FY18 mainly led by slippages of Lanco Anpara where it has exposure of ~Rs1,250cr. However, gross restructured assets declined by 9% QoQ following upgrade in public sector unit (PSU). As per management, some more PSU restructured accounts are likely to get upgraded in future. However, given the uncertainty surrounding private restructured assets (Rs12,644cr), we expect the company's Gross/Net NPA ratios to increase significantly to 4.2%/2.7% by FY19E.

Outlook & Valuation

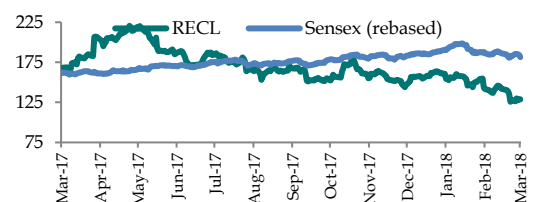
REC's profitability will continue to remain under pressure over FY17-20E as provisions are likely to remain high given the increasing stress in power sector and high level of private restructured loan book (~5.6% of loans). Further, increasing competition from banks will exert some pressure on business growth. Hence, we revise our target price downwards to Rs 145 and rollover our valuation to FY20E. We reduce our target multiple to 0.8x on FY20E ABV (earlier 1.0x on FY19E ABV) to capture uncertainties around private restructured assets. However, we upgrade our rating to BUY from Hold given the recent fall in stock price (↓24% in last six months) which factor most of the negatives. Moreover, the attractive dividend yield of ~7% will restrict any further fall in the stock price.

Company Data

Market Cap (cr)	Rs. 25,388		
Outstanding Shares (cr)	197.5		
Free Float	42%		
Dividend Yield	7.5%		
52 week high	Rs. 224		
52 week low	Rs. 123		
6m average volume (cr)	0.6		
Beta	1.0		
Face value	Rs. 10		
Shareholding (%)	Q1FY18	Q2FY18	Q3FY18
Promoters	58.9	58.9	58.9
FII's	23.2	24.4	23.6
MFs/Insti	9.0	7.5	8.9
Public	9.0	9.3	9.2
Others	-	-	-
Total	100.0	100.0	100.0

Price Performance	3 Month	6 Month	1 Year
Absolute Return	-12.4%	-23.3%	-20.6%
Absolute Sensex	-0.9%	2.8%	12.1%
Relative Return*	-11.5%	-26.1%	-32.8%

*over or under performance to benchmark index



Standalone (Rs.cr)	FY18E	FY19E	FY20E
Net Interest Income	8,313	9,287	10,493
Growth (%)	-9%	12%	13%
NIM (%)	3.9	3.9	3.9
Pre Pro Profit	8,729	9,780	11,084
Growth (%)	-12%	12%	13%
Net Profit	5,154	5,734	6,453
Growth (%)	-17%	11%	13%
EPS	26.1	29.0	32.7
Growth (%)	-17%	11%	13%
P/E	4.9	4.4	3.9
P/BV	0.7	0.6	0.6
P/ABV	0.8	0.8	0.7
RoE (%)	14.8	15.2	15.5
RoA (%)	2.3	2.3	2.3

Quarterly Financials (Standalone)

Profit & Loss Account

(Rs cr)	Q3FY18	Q3FY17	YoY Growth %	Q2FY18	QoQ Growth %
Interest Income	5,470	5,573	(1.8)	5,371	1.8
Interest Expense	3,434	3,373	1.8	3,427	0.2
Net Interest Income	2,036	2,200	(7.4)	1,944	4.8
Non-Interest Income	133	385	(65.5)	257	(48.3)
Total Net Income	2,169	2,585	(16.1)	2,200	(1.4)
Operating Expenses	88	95	(7.2)	67	31.7
Employee Cost	46	40	16.7	36	27.5
Other Operating Exp.	42	56	(24.3)	31	36.8
Total Income	5,603	5,958	(6.0)	5,628	(0.4)
Total Expenditure	3,523	3,469	1.6	3,495	0.8
Pre-Provisioning profit	2,080	2,489	(16.4)	2,133	(2.5)
Provisions	205	15	1239.3	310	(33.9)
Profit Before Tax	1,875	2,474	(24.2)	1,823	2.9
Tax	578	719	(19.6)	608	(4.9)
Net Profit	1,296	1,754	(26.1)	1,215	6.7
EPS - Diluted (Rs)	6.6	8.9	(26.1)	6.2	6.7

Business Performance (Rs cr)	Q3FY18	Q3FY17	YoY Growth %	Q2FY18	QoQ Growth %
Sanctions	38,885	17,346	124.2	22,300	74.4
Disbursements	12,892	11,559	11.5	13,751	(6.2)
Loans	224,014	201,937	10.9	215,845	3.8
Borrowings	182,342	167,612	8.8	175,626	3.8

Key Ratios (%)	Q3FY18	Q3FY17	YoY bps	Q2FY18	QoQ bps
Net Interest Margin	3.8	4.3	(52)	3.8	5
Cost of Borrowings	7.9	8.0	(16)	8.1	(27)
Yield on Funds	10.3	11.0	(74)	10.4	(14)
Cost to Income	4.1	3.7	39	3.1	103
Debt to Equity	5.0	5.0	(1)	5.0	(1)
Capital Adequacy	21.2	21.3	(8)	20.2	99
Tier I	18.6	18.6	3	17.6	97
Gross NPA	3.0	2.3	67	2.5	45
Net NPA	2.0	1.7	35	1.7	37
Provision Coverage	32.1	27.6	452	34.6	(254)
Credit Cost	0.4	0.0	36	0.6	(22)
RoE (Ann.)	14.8	22.8	(801)	14.5	27
RoA (Ann.)	2.4	3.4	(102)	2.3	8

Change in estimates

Year / Rs cr	Old estimates		New estimates		Change %	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Net Interest Income	9,244	9,608	8,313	9,287	-10.1	-3.3
Pre-Provisioning Profit	9,890	10,262	8,729	9,780	-11.7	-4.7
Net Profit	6,098	6,290	5,154	5,734	-15.5	-8.8
EPS (Rs)	30.9	31.8	26.1	29.0	-15.5	-8.7

Source: Company, Geojit Research

Standalone Financials

Profit & Loss Account

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
Interest Income	23,471	22,936	22,169	24,839	28,139
Interest Expense	14,283	13,775	13,856	15,551	17,646
Net Interest Income	9,188	9,160	8,313	9,287	10,493
% Change	11.7	(0.3)	(9.3)	11.7	13.0
Non-Interest Income	286	1,160	743	832	943
Net Income	9,473	10,320	9,055	10,119	11,436
Operating Expenses	338	352	326	339	352
Total Income	23,756	24,095	22,911	25,671	29,082
Total Expenditure	14,621	14,127	14,182	15,891	17,998
Pre-Provisioning Profit	9,135	9,969	8,729	9,780	11,084
% Change	11.0	9.1	(12.4)	12.0	13.3
Provisions	1,090	1,109	1,175	1,376	1,627
Profit Before Tax	8,045	8,859	7,554	8,404	9,457
Tax	2,418	2,615	2,400	2,670	3,004
Tax Rate (%)	30	30	32	32	32
Net Profit	5,628	6,244	5,154	5,734	6,453
% Change	7.0	11.0	(17.5)	11.2	12.5
No. of Shares (cr)	99	197	197	197	197
EPS (Rs)	28.5	31.6	26.1	29.0	32.7
% Change	7.0	11.0	(17.5)	11.2	12.5

Balance Sheet

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
Liabilities					
Capital	987	1,975	1,975	1,975	1,975
Reserves & Surplus	27,630	31,351	34,134	37,497	41,578
Borrowings	169,106	167,517	187,268	210,570	240,133
Provisions	2,147	2,043	2,366	2,661	3,034
Other Liabilities	6,482	6,351	7,887	9,502	11,559
Total Liabilities	206,353	209,236	233,630	262,204	298,279
Assets					
Fixed Assets	150	181	219	264	319
Investments	2,467	2,696	2,254	2,534	2,890
Advances	200,378	200,373	224,901	252,887	288,391
Other Assets	1,629	1,496	4,056	4,561	5,201
Cash & Bank Balances	1,729	4,490	2,200	1,959	1,478
Total Assets	206,353	209,236	233,630	262,204	298,279

Ratios

Y.E March (Rs cr)	FY16A	FY17A	FY18E	FY19E	FY20E
EPS	28.5	31.6	26.1	29.0	32.7
DPS	8.6	9.7	10.0	10.0	10.0
BV	144.9	168.7	182.8	199.9	220.5
ABV	128.6	152.4	154.9	164.6	182.0
Valuation (%)					
P/E	4.5	4.1	4.9	4.4	3.9
P/BV	0.9	0.8	0.7	0.6	0.6
P/ABV	1.0	0.8	0.8	0.8	0.7
Div. Yield	6.7	7.5	7.8	7.8	7.8
Spreads (%)					
Yield on Funds	12.3	11.4	10.4	10.4	10.4
Cost of Funds	8.9	8.2	7.8	7.7	7.7
Capital (%)					
CAR	20.4	21.2	20.7	20.3	19.9
Tier I	17.5	18.4	18.0	17.6	17.1
Tier II	2.9	2.8	2.8	2.8	2.8
Asset (%)					
GNPA	1.7	2.4	3.7	4.2	4.1
NNPA	1.6	1.6	2.4	2.7	2.6
PCR	6.4	33.6	34.4	35.2	36.0
Management (%)					
Debt/Equity	5.9	5.0	5.2	5.4	5.6
Cost/ Income	3.6	3.4	3.6	3.4	3.1
Earnings (%)					
NIM	4.8	4.5	3.9	3.9	3.9
ROE	21.0	20.2	14.8	15.2	15.5
ROA	2.9	3.0	2.3	2.3	2.3

Recommendation Summary (last 3 years)



Source: Bloomberg, Geojit Research

Dates	Rating	Target
05 December 2016	HOLD	135
17 February 2017	HOLD	165
28 June 2017	HOLD	180
19 March 2018	BUY	145

*Initiating Coverage

Investment Rating Criteria

Large Cap Stocks;		Mid Cap and Small Cap;			
Buy	-	Upside is 10% or more.	Buy	-	Upside is 15% or more.
Hold	-	Upside or downside is less than 10%.	Accumulate	-	Upside between 10% - 15%.
Reduce	-	Downside is 10% or more.	Hold	-	Absolute returns between 0% - 10%.
Neutral	-	Not Applicable	Reduce/Sell	-	Absolute returns less than 0%.
			Neutral	-	Not Applicable

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