Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Power Grid Corporation of India Ltd

Overhang gone; earnings outlook resilient

Power	Sharekhan code: POWERGRID

Reco/View: Buy	↔	CMP: Rs. 212	Price Target: Rs. 265	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 26.06

Updated July 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 1,47,984 cr
52-week high/low:	Rs. 248/180
NSE volume: (No of shares)	128.4 lakh
BSE code:	532898
NSE code:	POWERGRID
Free float: (No of shares)	339 cr

Shareholding (%)

Promoters	51.3
FII	30.3
DII	15.2
Others	3.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-7.6	2.7	-2.2	10.6
Relative to Sensex	-4.1	-5.8	-0.2	12.9

Sharekhan Research, Bloomberg

Summary

- Media reports indicate that the Power ministry has recently rejected the proposal for REC's takeover by Power Grid. This removes overhang of investment in unrelated business and focus shifts to Power Grid's strong earnings visibility given regulated RoE model. We maintain Buy on Power Grid with an unchanged PT of Rs. 265 as stock price correction of 15% from 52-week high and attractive valuation of 1.6x FY24E P/BV provides investment opportunity.
- Large investment opportunity of up to Rs. 1,24,148 crore in interstate power transmission system (ISTS) over FY23-27 given the capex for RE capacity expansion and sharp rise in works in hand to Rs. 52,000 crore (including Leh-Kaithal project worth Rs. 26,000 crore) provide scope for pick-up in Power Grid's capex from FY24 and could re-rate the stock.
- Exploring non-transmission opportunities (has set-up PowerGrid Energy Services) in power sector like energy management, smart meters, smart grid, energy storage would diversify earnings stream and create value in the long term.
- Asset monetization target of Rs. 6,600 crore for FY23 and no REC takeover plan would mean sustained high dividend payout of ~60% (based on FY22) and dividend yield of 6-7%.

Power ministry's rejection of REC takeover by Power Grid has removed a key overhang of capital allocation (estimated at Rs. ~Rs. 12,972 crore based on REC's current market capitalization) in unrelated business of power finance. With robust works in hand worth Rs. 52,000 crore and ISTS opportunity of Rs. 124,148 crore over FY23-27 is expected to drive up Power Grid's transmission capex from FY2024 and improve earnings growth outlook. The focus to invest in smart metering and distribution infrastructure to diversify the earnings stream while continued asset monetisation (target of Rs. 6,600 crore for FY23) would help sustain higher dividend payout and dividend yield of 6-7%. We maintain a Buy on Power Grid with an unchanged PT of Rs. 265.

- **RE capacity expansion to drive core transmission business –** The government's aim to expand India's renewable power capacity to ~500GW by 2030 (versus only 163 GW currently) will help Power Grid in playing a pivotal role for grid integration of various renewable energy zones in India by implementing high-capacity Green Energy Corridors. This would increase capex in transmission projects and generate new bids. The long-term growth outlook for the company is strong as the total work in hand for Q1FY23 was Rs. 52,000 crore versus Rs. 35,100 crore in Q1FY22. The CTUIL rolling plan envisages robust investment upto Rs. 1,24,148 crore in the ISTS over FY23-27. The management gave muted capex plan of Rs. 8,000 crore for FY23 but we expect strong pickup in capex spends from FY24 given large investment opportunity in power transmission led by capex for augment RE capacity.
- **Focus on non-transmission opportunities –** to help diversify earnings and create long-term value: Power Grid has established a wholly owned subsidiary PowerGrid Energy Services Limited to explore various non-transmission business opportunities like energy management, smart meters, smart grid, energy storage. The initiative in smart metering is gaining traction and the company has initiated procurement process for 1 crore smart meters to provide end-to-end solutions and signed an MoU with MGVCL & UGVCL, Gujarat state discoms to implement Advanced Metering Infrastructure (AMI) System for 66 lakh meters.
- **REC takeover overhang ends; strong case for sustained high dividend payouts –** Recently media reports indicated that Power Ministry has rejected a proposal wherein Power Grid Corporation was to buy Power Finance Corporation's (PFC) 52.6% stake in REC Limited. This has removed an overhang on Power Grid as the acquisition would have required Power Grid to pay ~Rs. 13,013 crore (based on REC's current market capitalization) in unrelated business of power finance. This coupled with the FY23 asset monetization target of Rs. 6,600 crore makes strong case for sustained higher dividend payout (Power Grid has consistently increase dividend payout to 60% in FY22 versus only 36% in FY18) and dividend yield of 6-7%.

Our Call

Valuation – Maintain Buy on Power Grid with an unchanged PT of Rs. 265: Power Grid has a robust project pipeline worth Rs. 26,000 crore (excluding the Leh-Kaithal project worth Rs. 26,000 crore) and has capitalised ~Rs. 20,695 crore in FY22, which provides earnings visibility for 2-3 years. We thus expect an 11% CAGR in PAT over FY2022-FY2024E and RoE of ~19% in FY24E. We maintain a Buy on Power Grid with an unchanged PT of Rs. 265, as valuation of 1.6x FY24E P/BV seems attractive considering decent growth outlook, healthy RoE and dividend yield of ~6-7%. Further, monetisation of transmission assets could help improve dividend payout given low FY23 capex guidance of Rs. 8,000 crore.

Key Risks

1) Slower-than-expected capitalisation of projects and 2) Inability to win new projects under tariff-based competitive bidding route.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	39,640	41,616	45,570	49,899
OPM (%)	88.3	87.9	87.0	87.0
Adjusted PAT	13,115	13,504	14,226	16,716
y-o-y growth (%)	18.6	3.0	5.4	17.5
Ajusted EPS (Rs.)	18.8	19.4	20.4	24.0
P/E (x)	11.3	11.0	10.4	8.9
Price/ Book (x)	2.1	1.9	1.8	1.6
EV/EBITDA (x)	7.8	7.6	6.4	5.7
RoCE (%)	11.1	11.2	11.5	12.2
RoE (%)	19.5	18.5	17.9	19.1

Source: Company; Sharekhan estimates

RE capacity expansion + uptick in work in hands to drive transmission capex

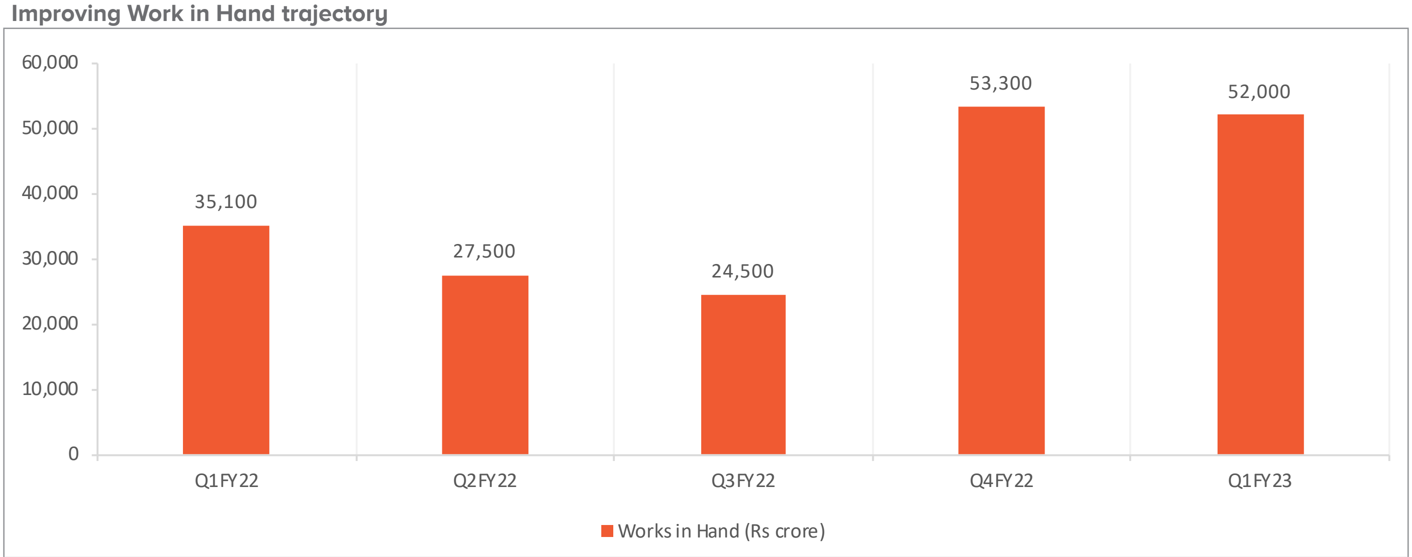
India's aim to expand its renewable power capacity to ~500 GW by 2030 (versus only 175 GW currently) provides enormous growth opportunities to expand both interstate and intra-state power transmission lines. Large investment opportunity of up to Rs. 1,24,148 crore (as per CTUIL's rolling plan) in Inter-State Transmission System (ISTS) over FY23-27 given capex for RE capacity expansion. Moreover, Power Grid's works in hand has also significantly improved to Rs. 52,000 crore (including Leh-Kaithal project worth Rs. 26,000 crore). ISTS opportunity and higher works in hand would address the concerns of lower capex plan as it provides scope for pick-up in Power Grid's capex from FY24.

Rolling Plan 2026-27 for Inter-State Transmission System by CTUIL Rs cr

Financial Years	Ckm addition	MVA addition	Estimated Cost (in Rs. crore)
FY23	10,009	49,365	27,673
FY24	6,099	52,820	19,079
FY25	9,355	84,695	29,904
FY26	4,404	23,330	20,525
FY27	2,028	6,630	26,967
Total	**31,895**	**2,16,840**	**1,24,148**

Source: Company, Sharekhan Research

Improving Work in Hand trajectory



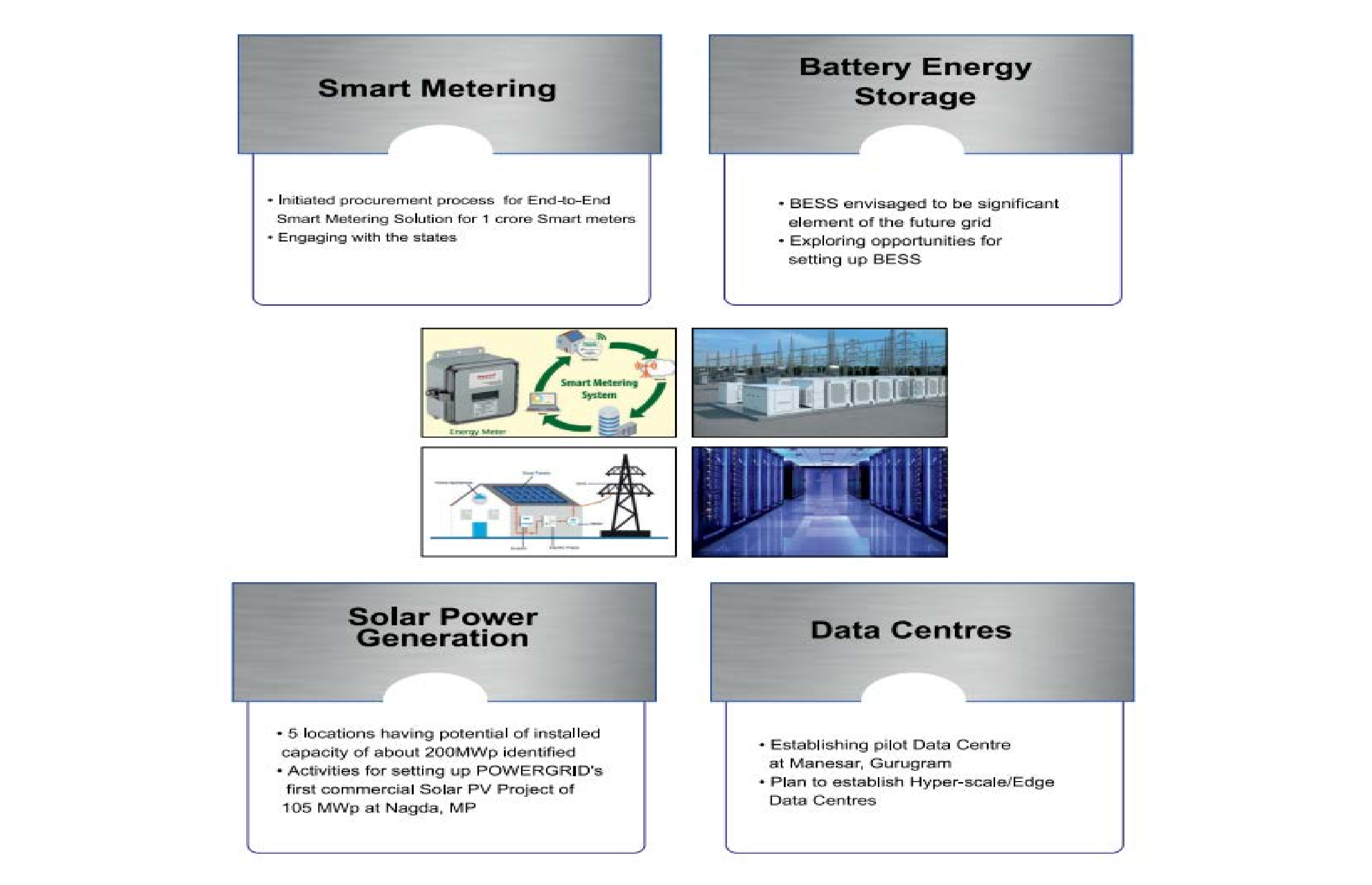
Source: PowerGrid; Sharekhan Research

Work in Hand - ₹ 52,000 crore

Ongoing Projects	New Projects	TBCB Projects
₹ 8,200 crore	₹ 28,000 crore	₹ 15,800 crore

Source: Company; Sharekhan Research

Focus on non-transmission businesses – to help diversify earnings stream

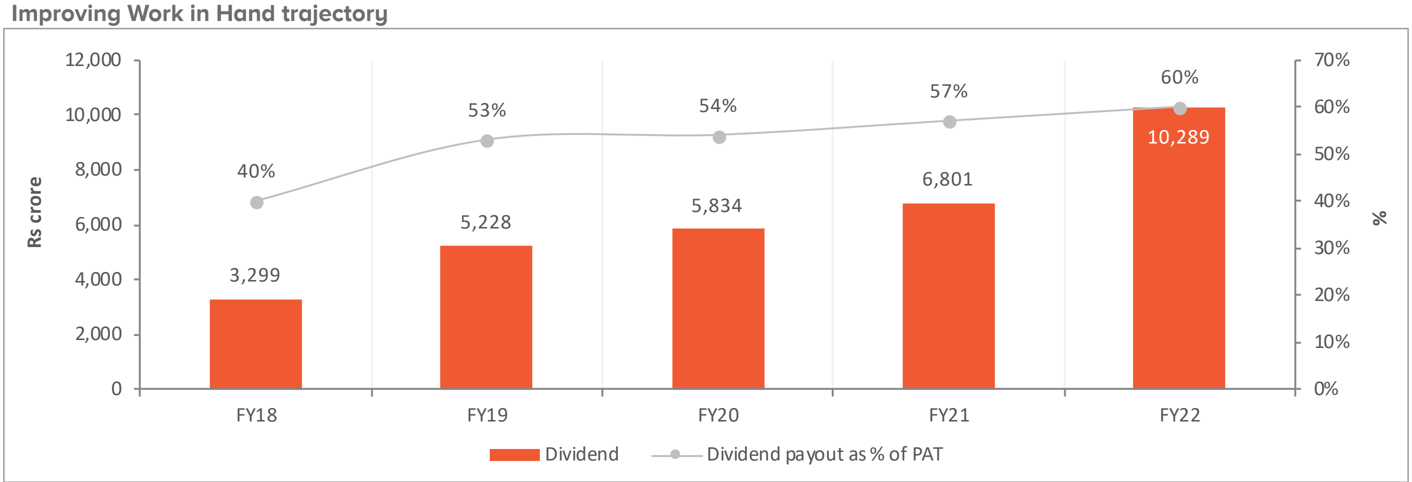


Source: Power Grid FY22 Annual Report

REC takeover overhang done away; strong case for sustained high dividend pay-out

Recently media reports indicated that Power Ministry has rejected a proposal wherein Power Grid Corporation was to buy Power Finance Corporation's (PFC) 52.6% stake in REC Limited. The has removed an overhang on Power Grid as the acquisition would have required Power Grid to pay ~Rs. 13,013 crore (based on REC's current market capitalization) in unrelated business. This coupled with FY23 asset monetization target of Rs. 6,600 crore makes strong case for sustained higher dividend payout (Power Grid has consistently increase dividend payout to 60% in FY22 versus only 36% in FY18) and dividend yield of 6-7%.

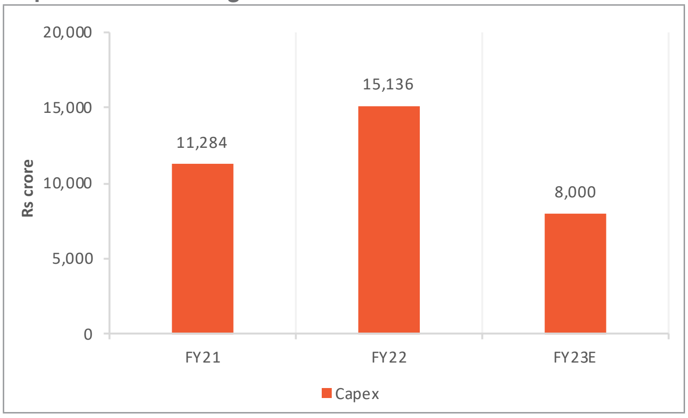
Improving Work in Hand trajectory



Source: PowerGrid; Sharekhan Research

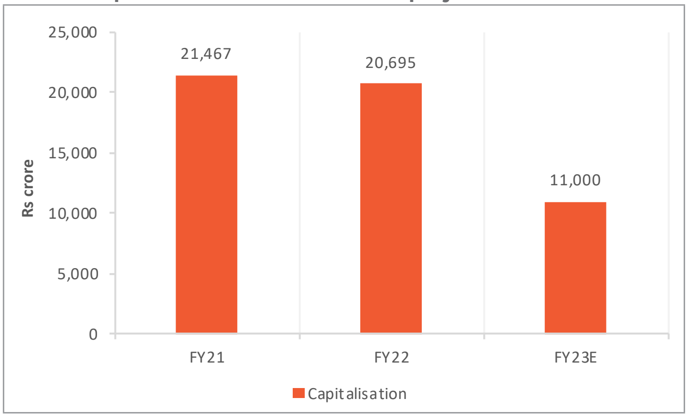
Financials in charts

Capex to remain rangebound



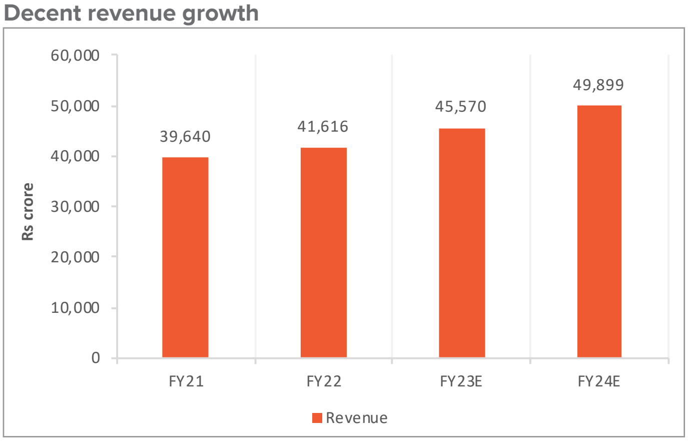
Source: Company, Sharekhan Research

Decent capitalisation outlook led RE projects



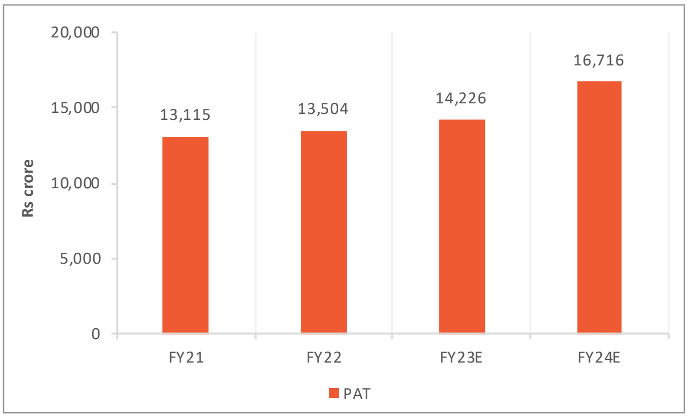
Source: Company, Sharekhan Research

Decent revenue growth



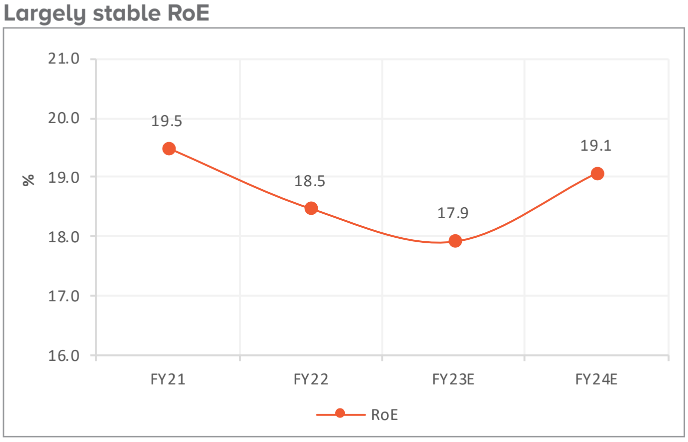
Source: Company, Sharekhan Research

PAT to clock CAGR of 11% over FY22-FY24E



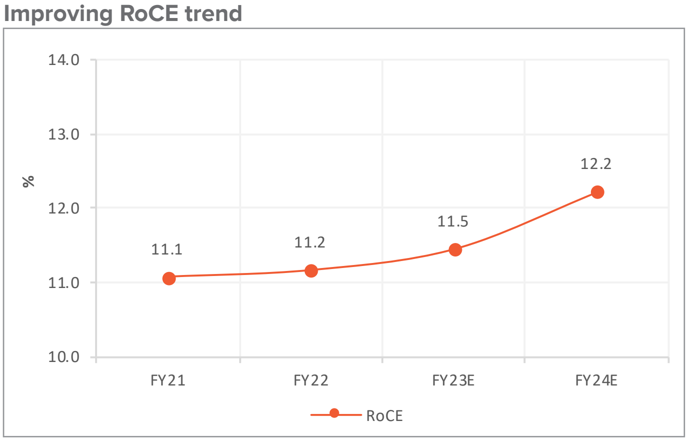
Source: Company, Sharekhan Research

Largely stable RoE



Source: Company, Sharekhan Research

Improving RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Regulated tariff model provides earnings visibility; Power sector reforms to strengthen balance sheet of power companies

India's power sector is regulated by the CERC with an availability-based earnings model (fixed RoE on power transmission assets). Thus, the regulated tariff model provides strong earnings visibility for power transmission companies. Moreover, the government's power sector package of over Rs. 3 lakh crore announced in the Union Budget would help power discoms clear dues of power generation and transmission companies. This would reduce the power sector's receivables and strengthen companies' balance sheets.

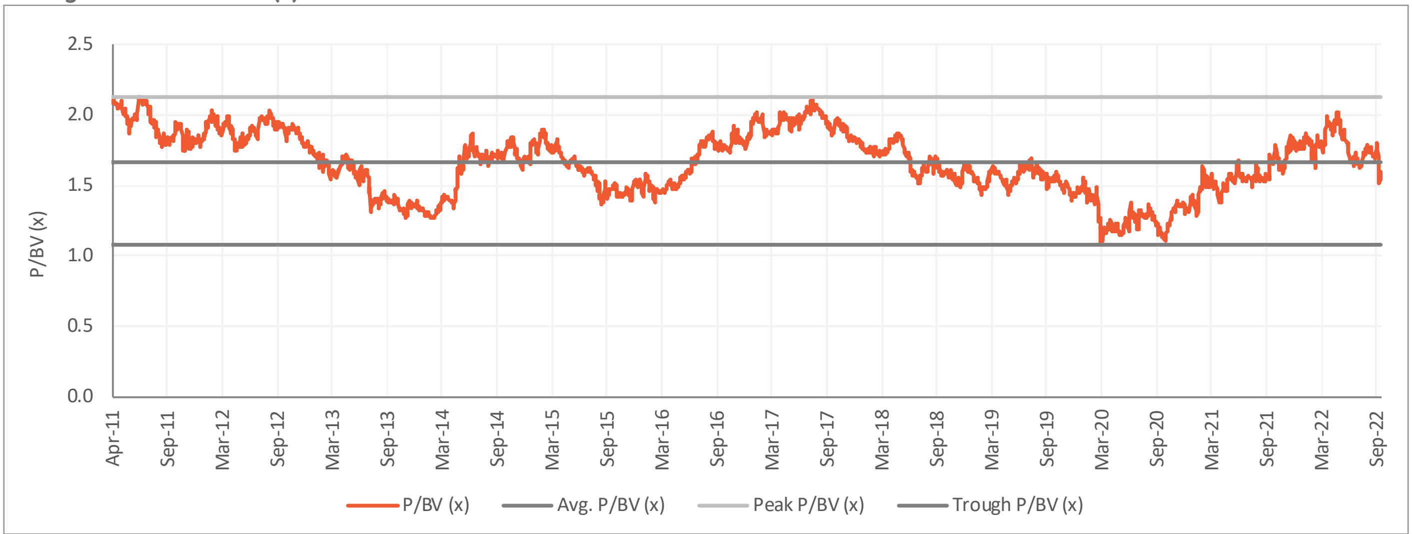
Company Outlook – Earnings visibility led by robust capitalization in last one year

Robust capitalization in the past 12 months and a work-in-hand pipeline of ~Rs. 52,000 crore provide healthy earnings growth visibility (we expect a 11% PAT CAGR over FY2021-FY2024E). Capex/capitalisation guidance of Rs. 8,000 crore/Rs. 11,000 crore each for FY2023 and FY2024 is lower than FY22 level but could pick up, given strong upcoming opportunities in the TBCB segment.

Valuation – Maintain Buy on Power Grid with an unchanged PT of Rs. 265

Power Grid has a robust project pipeline worth Rs. 26,000 crore (excluding the Leh-Kaithal project worth Rs. 26,000 crore) and has capitalised ~Rs. 20,695 crore in FY22, which provides earnings visibility for 2-3 years. We thus expect an 11% CAGR in PAT over FY2022-FY2024E along with RoE of ~19% in FY24E. We maintain a Buy on Power Grid with an unchanged PT of Rs. 265, as valuation of 1.6x FY24E P/BV seems attractive considering decent growth outlook, healthy RoE and dividend yield of ~7%. Further, monetisation of transmission assets could help improve dividend payout given low FY23 capex of Rs. 8,000 crore.

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

Power Grid is into the power transmission business with the responsibility for planning, implementation, operation, and maintenance of inter-state transmission system and operation of the National and Regional Load Dispatch Centres. The company's segments include transmission, telecom, and consultancy. The transmission segment includes extra-high voltage/high voltage (EHV/HV) networks and grid management. The company owns and operates over 1,70,724 circuit kilometers of EHV transmission lines. Power Grid has approximately 262 sub-stations. The company's Smart Grid enables real-time monitoring and control of power systems.

Investment theme

Power Grid is expected to maintain its strong growth momentum, given ~Rs. 52000 crore (including CWIP) worth of projects pending for capitalisation, which provides healthy earnings growth visibility over the next few years. Power Grid has a healthy RoE of 19% and is trading at an attractive valuation. Further asset monetisation over FY23E-FY25E and lower capex could result in higher dividend payout in coming years.

Key Risks

- Slower-than-expected capitalisation of projects.
- Inability to win new projects under the tariff-based competitive bidding route.

Additional Data

Key management personnel

K Sreekant	Chairman and Managing Director
M. Taj Mukarrum	Director – Finance
Abhay Choudhary	Director – Projects

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Capital Group Cos Inc	6.6
2	Life Insurance Corp of India	5.96
3	Capital Income Builder	2.6
4	Nippon Life India Asset Management	2.57
5	Vanguard Group Inc	2.43
6	Republic of Singapore	2.43
7	SBI Funds Management	2.21
8	FMR LLC	1.67
9	Blackrock Inc	1.48
10	ABRDN PLC	1.1

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.