Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 26.49

Updated Oct 08, 2022

Medium Risk

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

Source: Morningstar

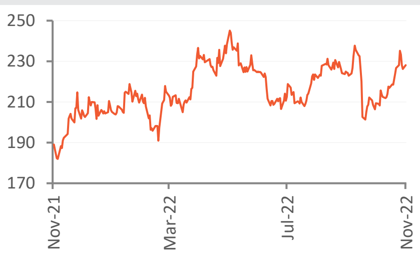
Company details

Market cap:	Rs. 1,59,040 cr
52-week high/low:	Rs. 248/180
NSE volume: (No of shares)	129.8 lakh
BSE code:	532898
NSE code:	POWERGRID
Free float: (No of shares)	339 cr

Shareholding (%)

Promoters	51.3
FII	31.7
DII	13.8
Others	3.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.9	2.8	-4.3	20.6
Relative to Sensex	3.8	-1.1	-15.9	19.5

Sharekhan Research, Bloomberg

Power Grid Corporation of India Ltd

Steady earnings growth; a play on healthy dividend yield

Power	Sharekhan code: POWERGRID

Reco/View: Buy	↔	CMP: **Rs. 228**	Price Target: **Rs. 265**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2FY23 standalone PAT grew by 9.4% y-o-y to Rs. 3,651 crore (in-line) led by lower tax rate of 9.4% and higher interest from subsidiaries/JVs offsetting muted asset capitalisation and lower surcharge income.
- Standalone/consolidated asset capitalisation was muted at Rs. 1,697 crore/Rs. 3,133 crore; down 81%/76% y-o-y. However, we expect capitalization to pick-up in H2FY23 given full year guidance of Rs. 13,000 crore. Receivables rose by 16% q-o-q to Rs. 6,777 crore.
- The company raised asset capitalisation guidance to Rs. 13,000 crore (versus Rs. 11,000 crore earlier) and expects capex to pick-up to Rs. 12,500 crore in FY25 versus ~Rs. 8,800 crore for FY23. Power Grid has projects worth Rs. 45,700 crore that provides decent earnings growth visibility. The company maintained its asset monetisation target at Rs. 6600 crore for FY23 and would increase dividend payment in absence of significant capex.
- We maintain a Buy on Power Grid with an unchanged PT of Rs. 265 as valuation of 1.7x/1.5x FY24E/FY25E P/BV seems attractive given expectation of 11% PAT CAGR over FY22-25E, RoE of 18-19% and a dividend yield of ~6-7%.

Power Grid Corporation of India Limited's (Power Grid's) standalone Q2FY23 PAT increased by 9.4% y-o-y to Rs. 3,651 crore (in-line with our estimate of Rs. 3,626 crore) as muted asset capitalization of just Rs. 365 crore (versus Rs. 4699 crore in Q2FY22) and lower surcharge income (Rs. 15 crore in Q2FY23 versus Rs. 89 crore in Q2FY22) was offset by a sharply lower effective income tax rate of 9.4% (versus assumption of 22%). Dividend/interest income from subsidiaries/JVs stood at Rs. 118 crore (versus Rs. 142 crore in Q2FY22)/Rs. 270 crore (versus Rs. 204 crore in Q2FY22) and interest on differential tariffs at Rs. 150 crore versus negative Rs. 1 crore in Q2FY22.

Key positives

- Upped asset capital guidance to Rs. 13000 crore versus earlier guidance of Rs. 11,000 crore.
- OCF/FCF increased sharply by 37%/52% y-o-y to Rs. 12,526 crore/Rs. 11,611 crore in H1FY23.
- Declared interim dividend of Rs. 5/share, which implies 2% dividend yield on CMP.

Key negatives

- Consolidated asset capitalisation was muted at Rs. 3,133 crore in Q2FY23 versus Rs. 13,275 crore in Q2FY22.
- Outstanding receivables increased to Rs. 6,777 crore in Q2FY23 versus Rs. 5,856 crore in Q1FY23.

Management Commentary

- FY23 asset capitalisation/capex guidance of Rs. 13,000 crore/Rs. 8,800 crore versus earlier guidance of Rs. 11000 crore/Rs. 8,000 crore. However, guidance is lower as compared to Rs. 20,695 crore/Rs. 9,060 crore done in FY22. Management expects capex to pick up in FY2025 to Rs. 12,000-12,500 crore.
- Khavda project's further phases are expected soon and several projects would be up for bidding in Rajasthan. The combined bidding opportunity is expected at Rs. 24,000 crore.
- Maintained monetization target of Rs. 6,600 for FY23; however, there are discussion going on with regards to mode and timing of monetization as Power Grid is no hurry for the same.
- Work in hand worth Rs. 45,700 crore (**ongoing projects –** Rs. 8,200 crore, **New projects –** Rs. 23,500 crore and **TBCB projects –** Rs. 14,000 crore). Estimated ISTS investment of Rs. 1.45 lakh crore by FY27 and Power Grid targets 40-45% market share in the same.
- Apart from 1 cr smart meters (already initiated procurement process) on its own, Power Grid aims to submit bids for >4 cr smart meters through its JVs and would have share of ~2 cr smart meter through JVs.

Revision in estimates – We have fine-tined our FY23 and FY24 earnings estimate. We have also introduced our FY25 earnings estimate in this report.

Our Call

Valuation – Maintain Buy on Power Grid with an unchanged PT of Rs. 265: Power Grid has a robust project pipeline worth Rs. 45,700 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-FY2025E along with RoE of ~18.8% in FY25E. We maintain a Buy on Power Grid with an unchanged PT of Rs. 265, as valuation of 1.7x/1.5x 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 a low FY23 capex of Rs. 8,800 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	FY22	FY23E	FY24E	FY25E
Revenue	41,616	45,570	49,899	54,390
OPM (%)	87.9	87.0	86.2	86.0
Adjusted PAT	13,504	14,226	15,905	18,502
y-o-y growth (%)	3.0	5.4	11.8	16.3
Ajusted EPS (Rs.)	19.4	20.4	22.8	26.5
P/E (x)	11.8	11.2	10.0	8.6
Price/ Book (x)	2.1	1.9	1.7	1.5
EV/EBITDA (x)	7.9	6.7	6.0	5.3
RoCE (%)	11.2	11.5	12.1	12.7
RoE (%)	18.5	17.9	18.2	18.8

Source: Company; Sharekhan estimates

Stock Update

Result Update

In-line PAT growth of 9.4% y-o-y as lower tax rate offsets weak asset capitalization

Standalone Q2FY23 revenues grew by 7.3% y-o-y to Rs. 10,656 crore, which was 6.5% below our estimate of Rs. 11,392 crore. The revenues from transmission business were up by 7.4% y-o-y to Rs. 10,412 crore. OPM at 84.1% (down 441 bps y-o-y) was 39 bps below our estimate of 84.5%. Consequently, operating profit at Rs. 8,958 crore (up 2% y-o-y) was 6.9% below our estimate of Rs. 9,622 crore. Standalone PAT at Rs. 3,651 crore, up 9.4% y-o-y was broadly in line with our estimate of Rs. 3,626 crore as muted asset capitalization of just Rs. 365 crore (versus Rs. 4699 crore in Q2FY22) and lower surcharge income (Rs. 15 crore in Q2FY23 versus Rs. 89 crore in Q2FY22) was offset by sharply lower effective income tax rate of 9.4% (versus assumption of 22%). Dividend/interest income from subsidiaries/JVs stood at Rs. 118 crore (versus Rs. 142 crore in Q2FY22)/Rs. 270 crore (versus Rs. 204 crore in Q2FY22) and interest on differential tariffs at Rs. 150 crore versus negative Rs. 1 crore in Q2FY22.

Q2FY23 analyst meet highlights

- **Strong growth outlook:** The robust forecast for sectoral growth has led to an estimated investment of up to Rs. 1.4 lakh crores in ISTS expansion plan till FY27 as per the CTUIL Rolling Plan 2027-28(Interim Report). The company targets to get 40-50% of this estimated investment and expects a further Rs. 1.4 lakh crore of investment from FY27 to FY30.
- **Capitalisation & capex guidance:** The management revised upwards its capitalization guidance for FY23 from Rs. 11,000 crores to Rs. 13,000 crores. It also revised upwards its capex guidance for FY23 from Rs. 8,000 crore to Rs. 8,800 crore. In Q2FY23, on a standalone basis, the company completed capex of Rs. 1,153 crores and capitalised assets worth Rs. 365 crore.
- **Monetisation target:** Asset monetisation target for FY23 was maintained at Rs. 6,600 crore. The target is low as company exceeded its target last year and monetized some portion of FY23 in FY22. The company will prefer to monetize the TBCB assets over RTM assets as the process is easier.
- **Work in hand & business outlook:** Work in hand is worth Rs. 45,700 crore (Ongoing projects – Rs.8,200 crore, New projects – Rs.23,500 crore and TBCB projects – Rs. 14,000 crore).
- **Outstanding Dues:** Outstanding dues from debtors as on September 30, 2022 was at Rs. 6,777 crores and increased by 16% q-o-q. Major dues are from J&K, Tamil Nadu, UP and Maharashtra. The company had a billing realisation rate of 88% for Q2FY23.
- **Solar power generation:** PGCIL is committed to source 50% of its electricity consumption from non-fossil fuel sources by 2025. The bids will be opened shortly for the company's first commercial Solar PV Project of 85 MW at Nagda.
- **Strong Telecom Performance:** Revenues from telecom business at Rs. 187 crore increased by 11% y-o-y. The company received orders worth Rs. 265 crores from Govt Departments, PSUs, Private Entities, Global OTTs, ISPs, etc. PGCIL signed OPGW leasing agreement with JKPDD and PTCUL, to explore business in new cities. Company successfully tested broadcasting of FM radio on its transmission tower.
- **Others:** 1) Studies are still ongoing for the Leh-Ladakh project and the first capex is at least 1 year away, 2) IRR on new TBCB projects is ~11-12%, 3) Two tenders which have come for battery storage are yet to be finalized, 4) The cost of a single meter in a simple household is about Rs. 7,000-7,500, 5) The company will increase its dividend payout if there is no attractive investment opportunity.

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY(%)	Q1FY23	QoQ(%)
Revenue	**10,656**	**9,931**	**7.3**	**10,446**	**2.0**
Total Expenditure	1,698	1,144	48.4	1,644	3.2
Operating profit	**8,958**	**8,787**	**2.0**	**8,802**	**1.8**
Other income	535	541	(1.2)	571	(6.3)
Depreciation	3,219	3,143	2.4	3,203	0.5
Interest	2,206	1,959	12.6	1,982	11.3
Reported PBT	**4,068**	**4,225**	**(3.7)**	**4,188**	**(2.9)**
Tax	**383**	**549**	**(30.3)**	**502**	**(23.8)**
Regulatory Deferral A/c	-34	-338	NA	80	NA
Reported PAT	**3,651**	**3,338**	**9.4**	**3,766**	**(3.0)**
Reported EPS	5.2	4.8	9.4	5.4	(3.0)
Ratios (%)			**bps**		**bps**
OPM	84.1	88.5	(441.0)	84.3	-19
NPM	34.3	33.6	64.8	36.0	-179
Tax rate	9.4	13.0	(358.6)	12.0	-259

Source: Company, Sharekhan Research

Segmental performance (standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY(%)	Q1FY23	QoQ(%)
Revenue					
Transmission	10,412	9,698	7.4	10,216	1.9
Consultancy	139	188	(25.9)	233	(40.4)
Telecom	205	191	7.6	190	7.7
Intersegment	-19	-17	9.7	-19	(0.7)
Net Revenue	**10,737**	**10,059**	**6.7**	**10,620**	**1.1**
EBIT					
Transmission	5,662	5,187	9.2	5,677	(0.3)
Consultancy	40	94	(57.7)	118	(66.3)
Telecom	77	80	(4.1)	75	2.9
Overall EBIT	**5,779**	**5,362**	**7.8**	**5,870**	**(1.6)**
EBIT margin (%)			**bps**		**bps**
Transmission	54.4	53.5	89	55.6	-119
Consultancy	28.7	50.2	-2,155	50.7	-2,203
Telecom	37.6	42.1	-455	39.3	-176
Overall EBIT	**53.8**	**53.3**	**52**	**55.3**	**-145**

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.

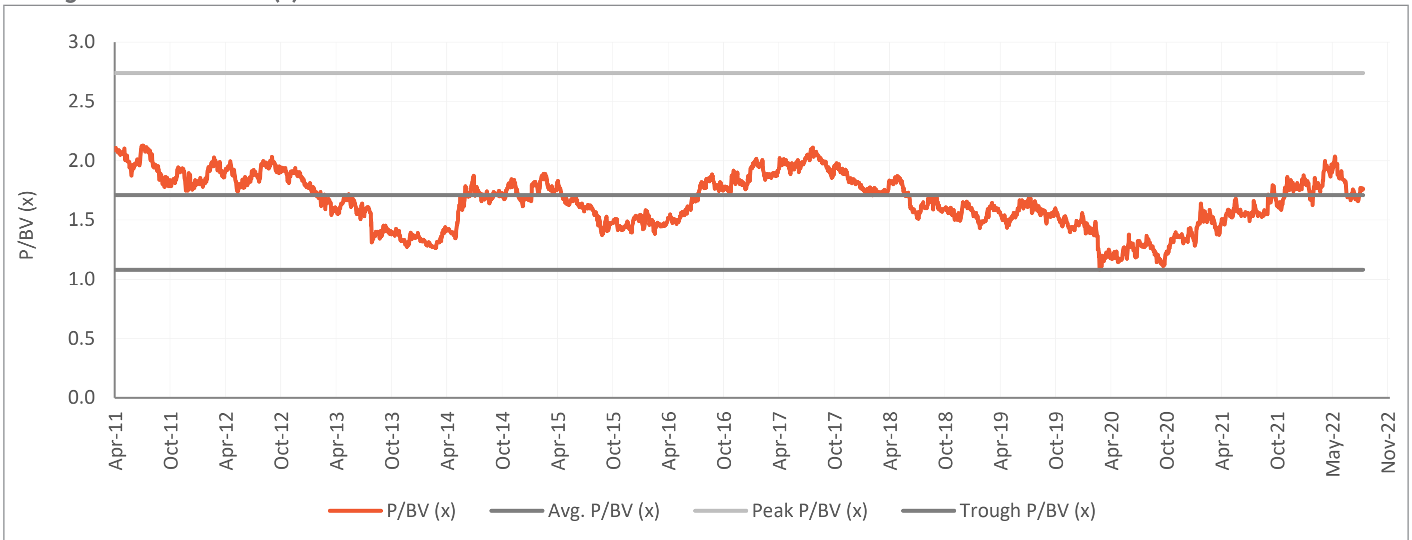
■ **Company Outlook – Earnings visibility led by robust capitalization in last one year**

Robust capitalization in the past 12 months and work-in-hand pipeline of ~Rs. 45,700 crore provide healthy earnings growth visibility (we expect a 11% PAT CAGR over FY2022-FY2025E). Capex/capitalisation guidance of Rs. 8,800 crore/Rs. 13,000 crore each for FY2023 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. 45,700 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-FY2025E along with RoE of ~18.8% in FY25E. We maintain a Buy on Power Grid with an unchanged PT of Rs. 265, as valuation of 1.7x/1.5x 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 a low FY23 capex of Rs. 8,800 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. 53,300 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)

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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

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