Initiating Coverage
Power Finance Corporation Ltd.

31-December-2020

RETAIL RESEARCH

Power Finance Corporation Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
NBFC	Rs.114.25	Buy at LTP and add on dips to Rs.102-104 band	Rs.125	Rs.138	2 quarters

HDFC Scrip Code	POWFINEQNR
BSE Code	532810
NSE Code	PFC
Bloomberg	POWF
CMP Dec 31, 2020	114.25
Equity Capital (RsCr)	2,640
Face Value (Rs)	10
Equity Share O/S (Cr)	264
Market Cap (Rs Cr)	30,162.94
Book Value (Rs)	171
Avg. 52 Wk Volumes	8630644
52 Week High	133.3
52 Week Low	74.2

Share holding Pattern % (Sep, 2020)	
Promoters	55.99
Institutions	37.48
Non Institutions	6.53
Total	100.0

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Our Take:

Power Finance Corporation Limited (PFC) is the largest government-owned (~56% stake) NBFC, that provides funding to the Indian power sector. The concentrated efforts of the Government towards ensuring continuous, uninterrupted and reliable supply of electricity are expected to boost demand for funds for capex and that would ultimately help in growth of power finance companies particularly PFC which is a strategic partner with GOI and is one of the leader in this segment funding ~40% of overall power sector capex. Also in some cases like UMPP (Ultra Mega Power projects) GOI has mandated PFC as the nodal agency for implementation for the scheme.

There are several growth opportunities for the sector lying ahead that will affect the business of the company significantly in the positive manner i.e. proposed amendments to Electricity Act & National Tariff Policy and Rs.25trn capex pipeline for National Infrastructure in the period of FY20-25. Renewable segment provides new growth opportunities for the company. Keeping in view the Government thrust in clean energy sources, PFC is also focusing more and more on finance to clean/renewable energy projects.

Valuations & Recommendation:

Despite a difficult environment mainly on account of mounting AT&C losses due to operational inefficiencies of Discoms and reducing collections due to Covid-19, the company has delivered decent growth in H1FY21. There might be near term volatility in the performance of the company due to uncertainty prevailing in the SEBs. The Rs.90,000 Cr liquidity package by Government under the Aatmanirbhar Bharat was a big boost for the power sector. The Company and its subsidiary REC shall be the only lenders to provide the financial support under this package.

We have envisaged 11.4% CAGR for NII and 22.9% CAGR for Adjusted Net Profit over FY20-22E. With incremental unlocking of the economy the demand for power (and hence realisations for SEBs and then the capex by them) will improve from FY22E. Balance sheet expansion, steady RoE of >14%, FY20 dividend yield of ~8% (that could fall a little post the latest RBI prescription), more than offsets slow stress resolution. We have estimated 10.3% CAGR for loan book over FY20-22E. Asset quality and recovery from NCLT accounts will be the key things to watch out.

We feel that investors can buy PFC at the LTP and add on dips to Rs.102-104 band (0.48xFY22E ABV +Rs.26.7 REC holding value after 50% discount). We feel the Base case fair value is Rs.125 (0.62x Mar-22E ABV + Rs.26.7 REC holding value after 50% discount) and the Bull case fair value of Rs.138 (0.7x Mar-22E ABV + Rs.26.7 REC holding value after 50% discount) over the next 2 quarters.

Financial Summary

Particulars (RsCr)	Q2FY21	Q2FY20	YoY-%	Q1FY21	QoQ-%	FY19	FY20	FY21E	FY22E
NII	3365	2550	32.0	3073	9.5	9445.1	10097.2	11551.7	12534.7
PPOP	3449	2119	62.8	2479	39.1	8943.2	9183.1	12032.2	12890.7
PAT	2085	1157	80.2	1700	22.6	6952.7	5654.9	7607.1	8537.7
EPS (Rs)						26.3	21.4	28.8	32.3
ABV (Rs)						109.7	121.4	136.2	159.1
P/E (x)						4.3	5.3	4.0	3.5
P/ABV (x)						1.0	0.9	0.8	0.7
RoAA (%)						2.2	1.6	2.0	2.1

(Source: Company, HDFC sec)

Recent Developments

Q2FY21 highlights:

Net profit rose by 80% YoY /23% QoQ to Rs.2,085 Cr, while NII was up by 32% YoY/9.5% QoQ. The company reported forex gain of Rs.124 Cr (vs loss of ~Rs230 Cr in Q1FY21). Stage-3 assets were flat at Rs.26,527 Cr. Currently, total 25 projects are under stress of which 17 projects are being resolved under NCLT of which 64% has been provisioned , while 8 projects are being resolved outside NCLT where 44% has been provisioned. Total of the 8 mentioned projects comprise 75% of stage 3 assets. RKM Powergen worth Rs. 5200 Cr is close to resolution. All the banks except 1 have agreed for a resolution. Scheme-wise as on H1FY21, Generation, Distribution and Transmission share of disbursements stood at 45%/48% and 7% respectively while government sector contributed major chunk of 88% while private sector share in disbursement stood at 12% for the same period. According to RBI's recent circular citing dividend pay-out norms, PFC is eligible to pay out 25% dividend compared to its current policy of 30% of net profit or 5% of net worth, whichever is higher.

COVID-19 pandemic worsened the woes of power players across the country, especially the distribution companies. The situation aggravated during the lockdown as power demand from commercial and industrial segment weakened, resulting in lower revenue realization for distribution companies, as these big consumers either remained shut or only operated partially, thereby leading to lower realizations. To ease out stress on cash flows, Government of India had announced reforms linked allocation of ~90,000 crore for cash-strapped distribution companies under the Aatmanirbhar Bharat Abhiyan. This financial package was welcome news for power producers and has given a significant boost to power sector reforms. The Company and its subsidiary REC shall be the only lenders to provide the financial support under the Aatmanirbhar Bharat liquidity package of ~Rs.90,000 crores.

As on September 30, 2020, on a standalone basis, tier-I CAR was 14.1% and overall CAR 18.18% compared to 12.5% and 17.0%, respectively, as on March 31, 2020. As Government is the promoter of the company, capitalization is expected to remain adequate over the medium term as raising capital is relatively easy. Credit rating agencies are showing confidence in the rating as it has a highest long term rating of AAA; this also helps the company in raising money at a lower cost. As per ALM as on September 30, 2020, there are no cumulative mismatches up to 5 years. Also the tenure of repayment schedules of the loans of PFC is of highly long gestation period which provides as a cushion in any short term adverse economic situation. Historically state discoms, over a period of time have been able to honor their obligations.

Long term Triggers

Government's continued push and reformist agenda to provide support

Power sector is one of the most important drivers for economic growth and socio-economic development of a nation. Therefore, GoI is actively committed to ensuring electricity access to each household. In this direction, the Government has been taking plethora of initiatives. With an aim to provide electricity distribution infrastructure in the rural areas, GOI launched the "Deendayal Upadhyaya Gram Jyoti Yojana (DDUGJY). Further, supplementing the DDUGJY scheme, the Government introduced the scheme named Pradhan Mantri Sahaj Bijli Har Ghar Yojana (Saubhagya) to provide energy access to all by last mile connectivity by providing electricity connections to all remaining un-electrified households in rural as well as urban area. As on date, around 99% of the households have been electrified. The Saubhagya scheme is expected to create an additional power demand of about 28,000 MW.

The concentrated efforts of the Government towards ensuring continuous, uninterrupted and reliable supply of electricity are expected to boost demand for funds for capex in generation, distribution and transmission of power and that would ultimately help in growth the business of the company as it is one of the leaders in the country in this segment and in some cases GOI has mandated PFC as the nodal agency for implementation for the scheme.

Growth opportunity is significant

There are several growth opportunities for the sector lying ahead that will affect the business of the company significantly in the positive manner. The proposed amendment in the Electricity Act is aimed at addressing issues that are adversely impacting the financial viability and therefore the investments in the sector. Establishment of Electricity Contract Enforcement Authority to enforce the performance of contracts like PPAs/ FSAs/ TSAs related to generation and transmission of power could help in addressing the issue of renegotiation of PPAs by DISCOMs, which is leading to lot of uncertainties in the sector. Proposed amendments in the National Tariff Policy such as capping of losses at 15% for determination of tariff, higher penalties for non-compliance to RPOs, restrictions on creation of new regulatory assets etc. will also help in making the sector more efficient. National Infrastructure pipeline has outlined Rs.25trn capex for the period FY20-25 for power sector. This is a 41% jump from the Rs17.7trn capex done in the sector between FY13-FY19. PFC is a dominant player in the power finance space with almost no competition from banks (given their reluctance to lend to the sector).

Plays a strategic role in the GoI's initiatives for power sector development

PFC is not a mere financial intermediary but plays a strategic role in the GoI's initiatives for the development of the power sector in India. PFC works closely with GoI, State Governments, and power sector utilities across the value chain for the development and implementation of structural and procedural policies & reforms measure for the power sector. At present PFC is the strategic partner with GoI for various power sector programs, including acting as the nodal agency for the Ultra Mega Power Projects (UMPPs), Integrated Power Development Scheme (IPDS) and as a bid process coordinator through its wholly owned subsidiary PFC Consulting Limited for the Independent Transmission Projects (ITPs).

Renewable segment - A new growth opportunity

The renewable segment has also seen its share of positive news where the tariffs have stabilized and this provides huge opportunities to invest in clean sources of energy. This also gives strong tailwinds to India’s ambitious green energy target. Government is also pursuing innovative models in distributed solar power generation in line with its goal of transitioning towards clean fuels.
Government is making efforts to find specific solutions to incentivize every state for improving performance. It is also focusing on indigenous production in various sectors and it is critical that share of power sector equipment manufactured in India should increase going forward. We believe that various Government initiatives like ‘Make In India’ & ‘Digital India’ will go a long way towards building an ecosystem for manufacturing wafers, ingots, cells and modules within the country. This will help the Indian Power Sector being self-reliant and self-sustainable.

Keeping in view the Government thrust in clean energy sources, PFC is also focusing more and more on finance to clean/renewable energy projects. In FY20, PFC issued sanctions of Rs.8,642 crore to Hydro Generation (>25MW) and disbursed Rs.5,846 crore. Further, PFC sanctioned Rs.10,231 crore to renewable energy projects and disbursed an amount of Rs.6,150 crore during the same period. Being a leading lender in the country in the segment, the Company is well positioned to get benefit out of it.

NPA fears overdone.

As of Q2FY21, Stage- 3 assets remained flat though two projects with exposure of Rs1700 cr claimed the Supreme Court (SC) standstill benefit (being categorised in stage-2). However PFC, as a matter of prudence, created provision on these assets. Detailed analysis suggests limited downside risk to stress accretion and that will be more than offset by resolutions in advanced stages.

What could go wrong?

- The borrowers are from power sector and their credit risk profile is weak because of their poor financials. PSUs, especially discoms, are an inherently weak asset class. Even the private sector power players have increasingly become more vulnerable to asset quality risks owing to issues such as lack of fuel availability, inability to pass on fuel price increases, and absence of long-term power purchase agreements for assured power offtake.
- To implement and execute any reform measures is difficult for this sector as broad-based political consensus is necessary. Even the much needed tariff increases to ensure sustained improvement in the performance might also take a lot of time to approve and implement.
- Due to the lockdown, there has been a general fall in the demand for electricity in the country and the revenue realization of the distribution utilities has been adversely impacted. As a result, the credit worthiness of the borrowers has deteriorated. This might lead to fresh slippages in the future.
- Any delay in the recovery, higher than expected haircuts or sharp rise in the slippage could impact the profitability and business growth prospects.
- A higher-than-expected deterioration in the asset quality could result in the erosion of the Tier I capital. Fresh formation of bad loans could keep provision high and return ratio compressed for a longer time.

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- Recent pandemic led economic recession has created a considerable amount of stress in the fiscal situation. So government in the current scenario might not be in the position to keep infusing capital in the value chain at the same rate.
- PFC's independent power producer (IPP) portfolio remains impacted by concerns regarding fuel availability, disputed and competitive power sale tariffs, absence of power purchase agreements (PPAs), environmental clearance and land acquisition issues.
- PFC has hedged 72% of foreign currency borrowing for 5 years maturity. However, its overseas borrowings more than 5 years remain unhedged. Movement in INR-USD rate could keep earnings volatile.
- Potential merger of PFC & REC and the likely structure remains over hang.
- Outstanding assets portfolio of PFC has shown significant growth in renewables (mainly wind and solar) over last 3-4 years. Any adverse development on the renewables segment resulting in liquidity issues can impact asset quality and collections of PFC.
- PFC being quasi sovereign finds it cheap to borrow over various time buckets due to its high credit rating. Any indication by the GoI that it is not willing to back the company could result in higher costs of borrowing for the company.
- Currently receivables from the Discoms/SEBs are directly or indirectly guaranteed by the respective state Govts. In case the State Govts show unwillingness or are unable to fund the losses of these entities, then PFC could see a rise in NPAs even from the PSU sector. In Oct'20, the pending dues of power distribution companies (discoms) to power generation companies (gencos) rose 1% mom to Rs1.26tn but was up 35% yoy. Discoms in key states – Rajasthan, Tamil Nadu, Uttar Pradesh, Karnataka, Maharashtra, J&K and Telangana – account for 79% of the total overdue to gencos.
- In a followup announcement post the recent MPC meet, the RBi has announced guidelines regarding the distribution of dividends by NBFCs from FY21 onward. The regulations are placed mainly on three parameters; capital adequacy, net NPA ratio (for deposit-taking NBFCs and systematically important non deposit-taking NBFCs) and leverage ratio (for non-systemically important, non-deposit taking NBFCs). Both REC and PFC have a historic dividend payout of ~45%. As per new norms, they will be eligible for a ~25% dividend payout. A cut in the dividend payout would lead to a fall in dividend yield and remove one key attraction to buy these PSUs.

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Company Profile:

Power Finance Corporation Limited (PFC) is the largest government-owned (~56% stake) NBFC that provides funding to the Indian power sector. It is also the nodal agency for Ultra Mega Power Projects (UMPPs), Integrated Power Development Scheme (IPDS) and Independent Transmission Projects (ITPs). 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.

The product portfolio of PFC includes financial products and services like rupee term loan, short-term loan, equipment lease financing and transitional financing services, etc, for various power projects in generation, transmission and distribution sector. PFC's clients mainly include central power utilities, state power utilities, private power sector utilities (including independent power producers), joint sector power utilities and power equipment manufacturers.

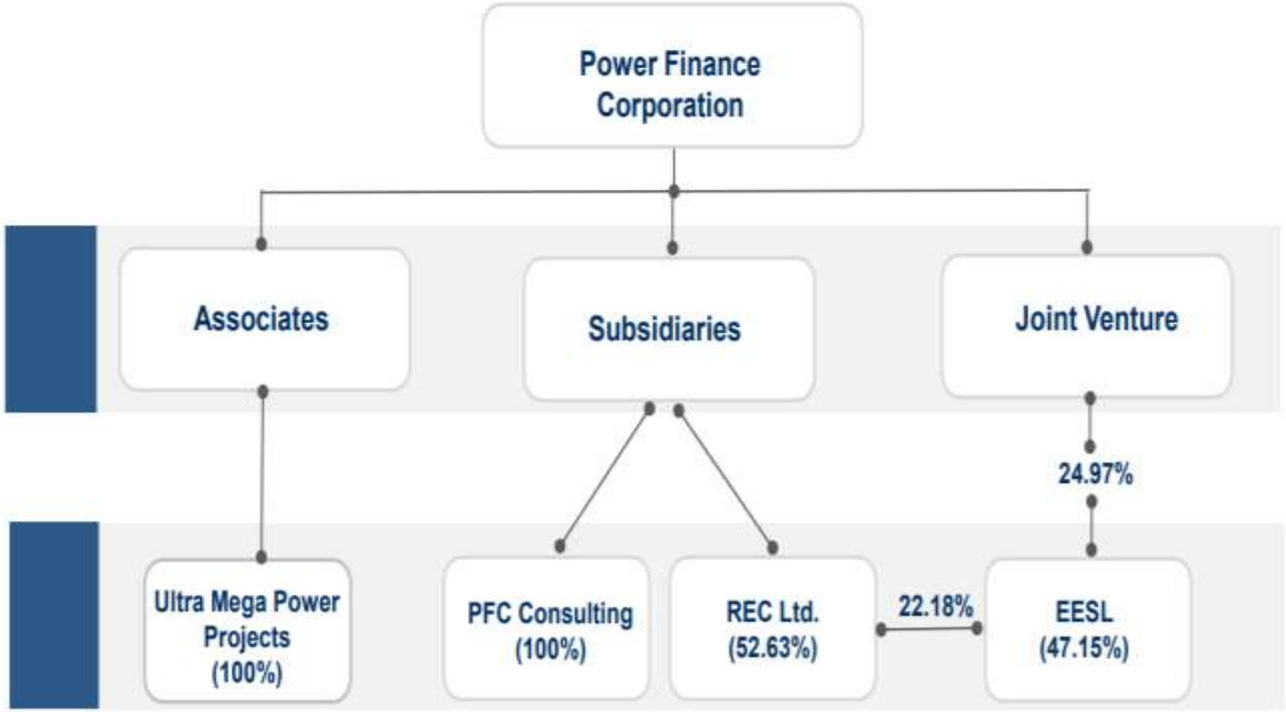
It was set up in the year 1986 as a Financial Institution dedicated to power sector financing. Until 1996, PFC lent exclusively to the public sector entities. Since 1996, it has expanded its customer profile to include private sector power utilities and projects. In the year 2010, RBI had classified the company as 'Infrastructure Finance Company (NBFC-ND-IFC)'.

In March 2019, Power Finance Corporation announced the acquisition of the GoI's 52.63% paid-up share capital in Rural Electrification Corporation (REC) at acquisition cost of about Rs 14,500 crore @Rs.139.50 per share.

SOTP Valuation:

	Base Case	Bull Case	Rationale
PFC–Standalone	98.6	111.3	0.62x / 0.70 Mar-22E ABV of Rs 159
REC Value	26.7	26.7	50% Holding Co. Discount to current Mcap
Total SOTP Value	**125.3**	**138.0**	

Power Finance Corporation Ltd.



1. EESL – Energy Efficiency Service Ltd.

2. 47.15% stake in EESL is consolidated stake of PFC (24.97%) & REC (22.18%)

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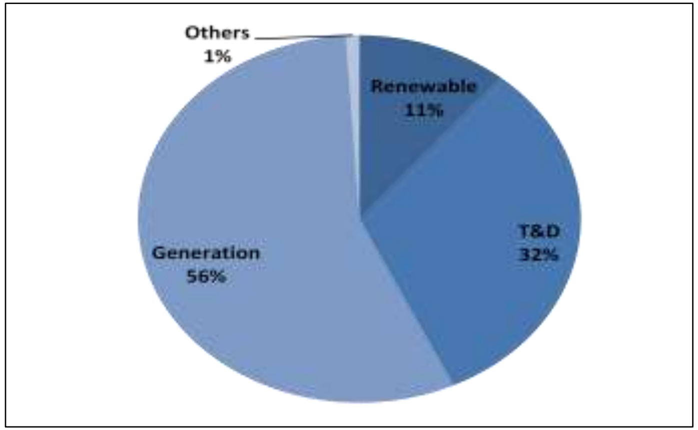
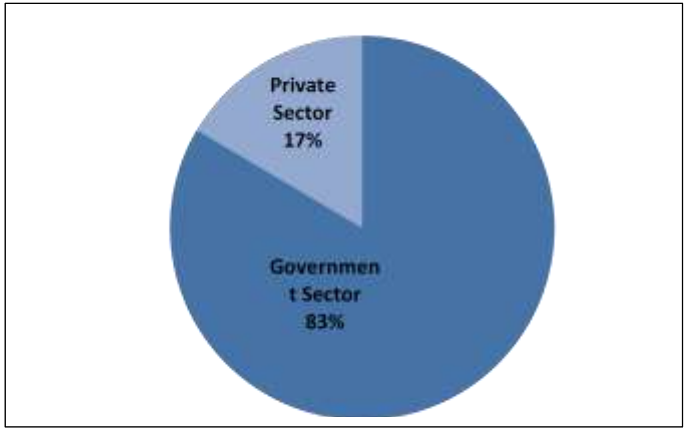
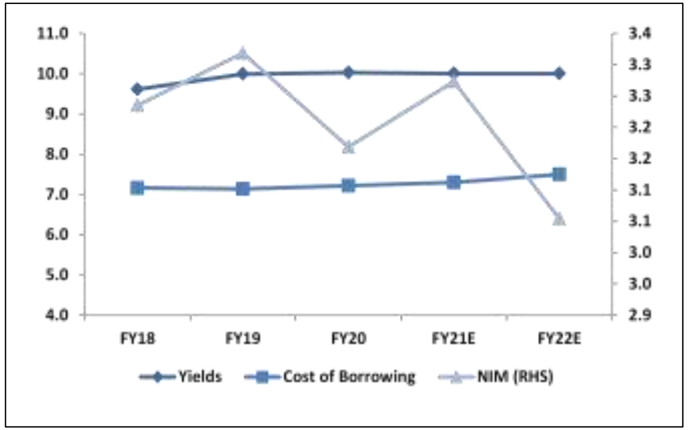
Loan Assets Scheme Wise (%)



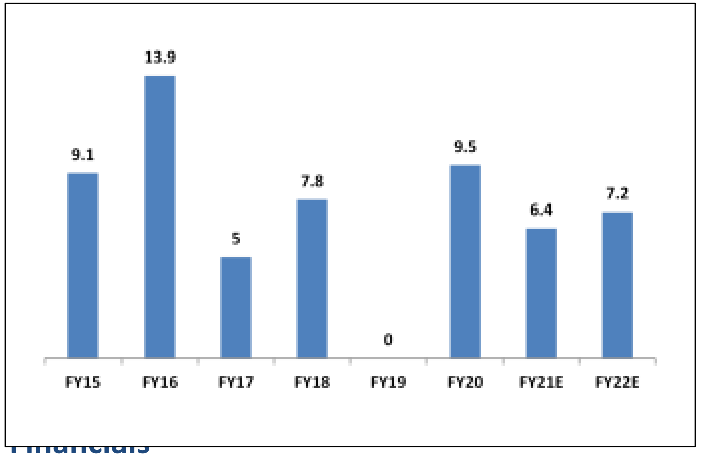
Loan Assets Sector Wise (%)



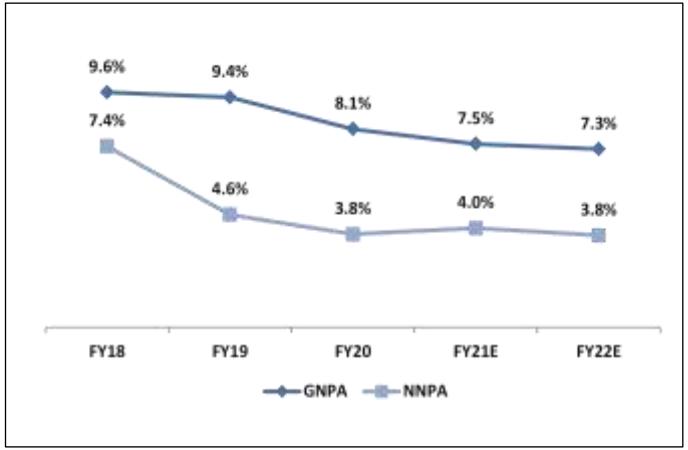
NIM Trend



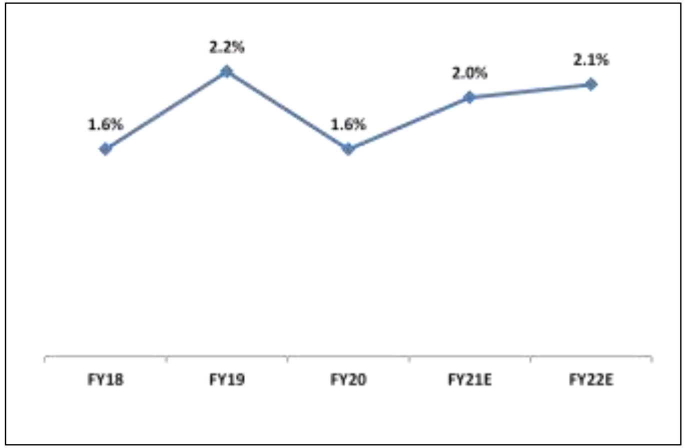
Dividend Per Share



NPA Trend



Return Ratio



Power Finance Corporation Ltd.

INCOME STATEMENT

(Rs Cr)	FY19	FY20	FY21E	FY22E
Interest Income	28433	31950	35048	38667
Interest Expenses	18988	21853	23497	26132
Net Interest Income	**9445**	**10097**	**11552**	**12535**
Non-interest income	333	1420	1577	1701
Operating Income	**9778**	**11517**	**13129**	**14236**
Operating Expenses	834	2334	1097	1345
PPP	8943	9183	12032	12891
Prov & Cont	-871	991	1752	1353
Profit Before Tax	9815	8192	10280	11537
Tax	2862	2537	2673	3000
PAT	**6953**	**5655**	**7607**	**8538**

BALANCE SHEET

(Rs Cr)	FY19	FY20	FY21E	FY22E
Share Capital	2640	2640	2640	2640
Reserves & Surplus	40648	42524	48257	54735
Shareholder funds	**43288**	**45164**	**50897**	**57375**
Borrowings	295239	310275	333472	372795
Other Liab & Prov.	6199	6348	6475	6592
SOURCES OF FUNDS	**344726**	**361787**	**390844**	**436762**
Fixed Assets	28	68	70	78
Investment	16586	16473	17976	20730
Cash & Bank Balance	14201	199	1063	2974
Advances	303210	334113	366856	406476
Other Assets	10700	10935	4879	6504
TOTAL ASSETS	**344726**	**361787**	**390844**	**436762**

(Source: Company, HDFC sec Research)

Power Finance Corporation Ltd.

Key Ratios:

	FY19	FY20	FY21E	FY22E
Return Ratios				
Calc. Yield on adv	10.0%	10.0%	10.0%	10.0%
Calc. Cost of borr	7.1%	7.2%	7.3%	7.4%
NIM	3.3%	3.2%	3.3%	3.2%
RoAE	17.3%	12.8%	15.8%	15.8%
RoAA	2.2%	1.6%	2.0%	2.1%
Asset Quality Ratios				
GNPA	9.4%	8.1%	7.5%	7.3%
NNPA	4.6%	3.8%	4.1%	3.8%
PCR	51%	53%	46%	48%
Growth Ratios				
Advances	14.0%	10.2%	9.8%	10.8%
Borrowings	24.7%	5.1%	7.5%	11.8%
NII	9.7%	6.9%	14.4%	8.5%
PPP	8.6%	2.7%	31.0%	7.1%
PAT	58.5%	-18.7%	34.5%	12.2%

Key Ratios:

	FY19	FY20	FY21E	FY22E
Valuation Ratios				
EPS	26.3	21.4	28.8	32.3
P/E	4.3	5.3	4.0	3.5
Adj. BVPS	109.7	121.4	136.2	159.1
P/ABV	1.0	0.9	0.8	0.7
DPS	0.0	9.5	7.1	7.8
Div. Yield	0.0	8.3	6.2	6.8
Other Ratios				
Cost-Income	8.5	20.3	8.4	9.5
Leverage	7.0	7.4	7.2	7.1

One Year Price Chart

Disclosure:

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Any holding in stock –No

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