

FPO NOTE**POWER FINANCE CORPORATION LTD (PFC)**

May 10, 2011

Issue band : (Rs)193.00 - 203.00

SUBSCRIBE**SAHIL SHAH**

sahil.shah@edelweissfa.com

ADITYA SUNDARAM

aditya.sundaram@edelweissfa.com

Issue Details

Issue Size to public	22.93 cr shares
Face Value (Rs)	Rs 10
Bid opens	10th May
Bid closes	13th May
Issue band (Rs)	193.00 - 203.00
Issue Type	Book Building
Retail investors getting a 5% discount.	

Lead Managers

DSP Merrill Lynch Ltd
Goldman Sachs (India)Securities Pvt Ltd
ICICI securities Ltd
JM Financial Consultants Ltd

Registrar

Karvy Computershare Private Ltd

Issue Structure

	Equity Shares
Total Shares Offered to Public	229,553,340
Offer for sale	57,388,355
Fresh issue	172,165,005
QIB Portion	114,628,937
Non Institutional Portion	34,391,682
Retail Portion	80,247,257

No of Issued, subscribed and paid up shares before the issue	1,147,766,700
No of Issued, subscribed and paid up shares after the issue	1,319,931,705

Promoter and Promoter Group holding (Pre Issue)	89.78%
Promoter and Promoter Group holding (Post Issue)	73.72%

Background & Business

Power Finance Corporation Limited (PFC) is a Navratna Public Sector Unit, established in 1986 by Government of India as an institution dedicated to funding and developing the power sector in India. Until 1996, PFC lent exclusively to public sector entities. Since 1996, it has expanded its customer profile to include private sector power utilities and projects. PFC aims to promote a balanced and integrated development of the power sector by providing finance to low-cost, efficient, and reliable projects. As on March 31, 2010, PFC had total advances of Rs.799 billion, mainly long-term loans. The company's primary sources of funds include equity capital, internal resources and domestic and foreign borrowings, with long-term domestic and short-term borrowing receiving a very good rating from CRISIL and ICRA.

The company is also involved in various GOI programs for the power sector, including acting as the nodal agency for the UMPP program and the R-APDRP and as a bid process coordinator for the ITP scheme.

Objects of the Issue

The primary objective of the FPO is to use the proceeds for two main purposes (A) augment the capital base to ensure compliance with requisite capital adequacy norms and to meet future capital requirements (B) to use the funds from the FPO to finance existing loans, as well as future lending activities and (C) general corporate purposes.

The FPO will provide for disinvestment a further 5 % stake by the government in addition to the initial 10% disinvestment during PFC IPO in 2007.

Valuation

PFC is a pioneer power project finance provider in India and has robust growth potential from the growing power sector. Government support to PFC has helped it to maintain their cost of funds at a competitive/lower level. PFC' has considerable exposure to the generation segment as against REC's considerable exposure in T&D. Over past 5 years company loan book, income and profit have increased by 22%, 27% and 22% CAGR respectively with 0.03% NPA ,capital adequacy of 18.3% and 3 year average ROE of 14%. PFC's infrastructure finance company (IFC) status will help expand the resource base and improve the borrowing profile, while lowering costs.

At Rs 203 (Rs 193 for retail investors @ 5% discount) the stock trades at 1.4x its FY11 E Bookvalue (post issue) of Rs 144 per share. We recommend investors to **subscribe** to the issue from long term horizon.

Investment Positives

Huge lending potential

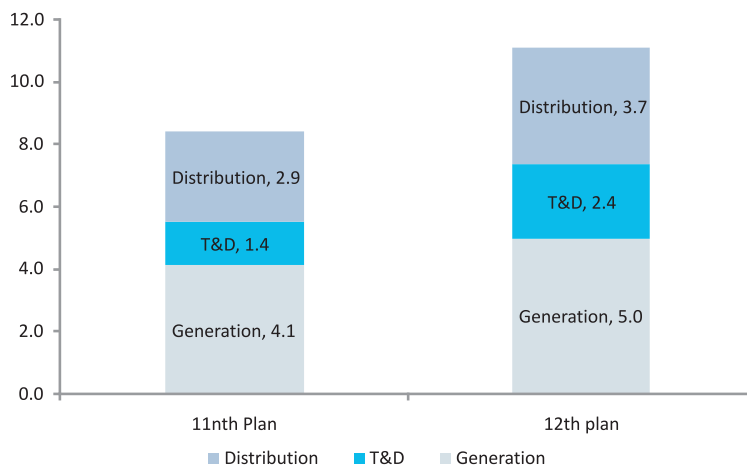
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The Indian Power sector has grown leaps and bounds as compared to historical reference but has still failed to keep pace with the growth of the economy of the country. There is a definitive trend in which power demand far outweighs the supply in India. The low per capita consumption of electricity in India is less than the world average per capita consumption of electricity which reflects the huge potential for investment in energy sector in India. With Peak power deficits of western region ,northern region and southern region being 14.7%,8.8% and 6.3% respectively which are relatively high the GOI has intensified setup for power generating outfit with a view of huge capacity addition benefiting PFC.

Tentative capacity addition of approximately 100,000 MW has been envisaged for the 12th Plan. The total fund requirement to achieve the above targeted capacity addition is estimated at Rs 11,00,000 crores. The company is likely to witness significant growth in loan sanctions and disbursement in next five years there by driving its top-line & bottom-line. PFC is expected to fund 15 to 20 per cent of the total funding requirement for the power sector under the Eleventh Five-Year plan.

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Plan capital outlay (INR bn)



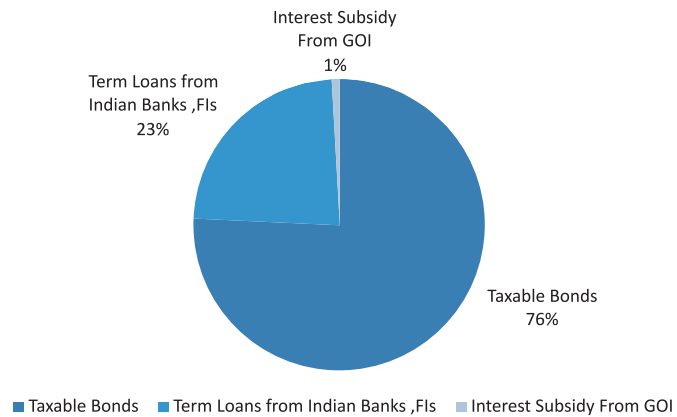
Source : RHP, Company

CRISIL and ICRA have currently granted the highest credit ratings of "AAA" and "LAAA", respectively, for long-term domestic borrowings and "P1+" and "A1+", respectively, for the short-term borrowings.

Access to various cost-competitive sources of funds

The company has low cost of funding through various tax benefits on the bonds it issues and their by lends at cheaper rates than other banking or NBFC institutions. Primary sources of funds include equity capital, internal resources and domestic and foreign borrowings. CRISIL and ICRA have currently granted the highest credit ratings of "AAA" and "LAAA", respectively, for long-term domestic borrowings and "P1+" and "A1+", respectively, for the short-term borrowings.

Source of funds on rupee loans



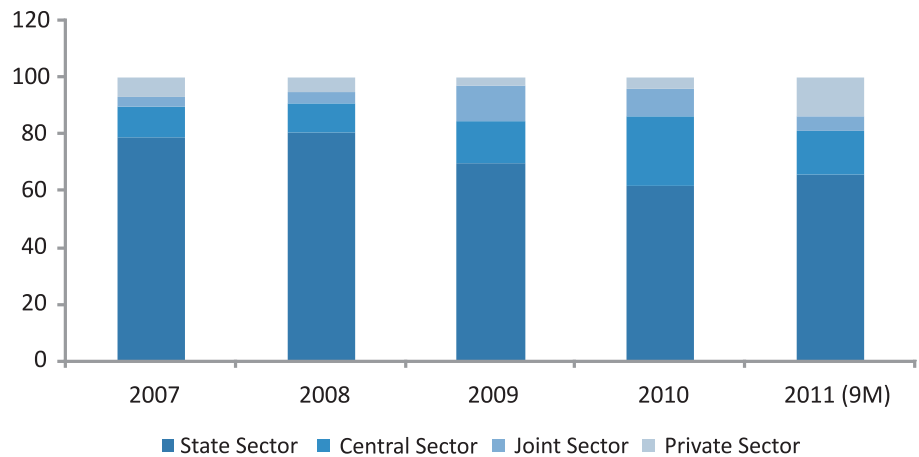
Source : RHP, Company

PFC's NPA are insignificant and are valued at Rs 13.2 cr as of 31st December forming 0.01% of total loans.

Broaden loan asset base, borrower profile thereby reducing risk

PFC's customers, mostly state power utilities (SPUs), continue to have weak financial profiles. Nevertheless, PFC has strong asset protection mechanisms, such as state government guarantees for loans, trust and retention accounts (for borrowers in the private sector), and default escrow accounts (for SPUs). This has resulted in high collection efficiency for PFC. Loans are secured through hypothecation or mortgage based on various contracts thus reducing risk of default. Borrowers are also stipulated to possess insurance against damages due to natural calamities. The company's NPA are insignificant and are valued at Rs 13.2 cr as of 31st December forming 0.01% of total loans.

Loan Disbursement by sectors



Source : RHP, Company

Concerns:

- Delays in the implementation of policies and initiatives by GOI.
- Environmental protection regulations applicable to power sector projects (no-go areas).
- Change in borrower credit ratings affecting their ability to finance projects.
- Adverse fluctuation in interest rates and currency rates.
- SEB losses are at 1% of GDP. Any risk arising from deterioration of financial health of SEB's will increase risk of NPAs.

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Income statement (Standalone)

Rs. Crs	2008	2009	2010	2011	CAGR
Operating income	5034	6586	8082	10160	26%
Operating expense	3243	4574	5047	6612	27%
Operating profit	1792	2016	3037	3548	26%
PBT	1787	1997	3031	3543	26%
Tax and other Adj	475	537	802	924	
PAT	1312	1460	2229	2619	26%
EPS (Pre Issue)	11.4	12.7	19.4	22.8	26%
Book Value (Pre Issue)	94.0	102.0	116.2	134.3	13%

Source : RHP, Company

Rs. Crs

Q4 FY10	Q4FY09	YOY	Q3FY10	QoQ
2617	2080	26%	2576	2%
1803	1371	32%	1678	7%
821	737	11%	903	-9%
819	736	11%	901	-9%
213	135	57%	243	-12%
607	601	1%	659	-8%
5.3	5.2		5.7	

Balance Sheet**Rs. Crs**

	2008	2009	2010	2011
Sharecapital	1148	1148	1148	1148
Reserves & Surplus	9637	10559	12184	14264
Networth	10784	11707	13332	15412
Loan Fund	40648	52160	67108	85599
Total Liability	51432	63867	80440	101010
Loans	51568	64429	79856	99571
Net block	77	75	73	77
Investment	66	36	31	54
Current assets	3071	3729	4900	7114
Current liabilities	3334	4346	4375	5723
Net deferred tax	-15	-55	-47	-83
Total assets	51432	63867	80440	101010
ROE	12.7%	13.0%	17.8%	18.2%
CAR Tier I	17.2%	16.1%	17.0%	-
CAR (Tier I+ Tier II)	17.2%	17.2%	18.2%	-

Source : RHP, Company

Avinash Gorakshakar	Head Research	avinash.gorakshakar@edelweissfa.com
Sahil shah	Research Analyst	sahil.shah@edelweissfa.com

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