POWERHOUSE FINANCE CORP. (PFC) FPO note – "SUBSCRIBE" 11th May,2011

Issue at a Glance

Issue Summary	
Total Issue of Shares (Cr)	22.95
Fresh Issue by the company (Cr)	17.22
Offer for Sale(Cr)	5.73
QIB Investors (Cr)	11.46
Non -Institutional Investors (Cr)	3.44
Retail Investors (Cr)	8.02
Employee (Cr)	0.03
Issue opens on	10th May, 2011
Issue closes on	13th May, 2011
Price Band (Rs.)	193-203*
Lot size (No. of shares) and multiple	28
Face Value (Rs)	10
Issue Size (Rs in Cr.)	4430.38- 4659.93
Equity Shares outstanding prior to the Issue (Cr)	114.78
Equity Shares outstanding after the Issue (Cr)	132.00

*5% Discount on issue price for retail investors and employees.

Shareholding Pattern

	Pre-Issue (%)	Post- Issue (%)
Promoters and Promoter Group Holdings	89.78	73.72
Public (incl. Institutions & Employees)	10.22	26.28
Total Share Capital	100	100

Grading "As this is an FPO Grading is not required"

Issue Objectives

Offer for Sale

- **PFC is coming out with an FPO of 22.95 Cr shares of which 5.73 Cr Shares is the part of divestment by "Government of India" (GoI) for which PFC will not receive any proceeds. And the remaining portion i.e. 17.22 Cr of Shares is the fresh issue.**

Object of the Fresh Issue

- **Augment its capital base to ensure compliance with requisite capital adequacy norms and to meet its future capital requirements arising out of growth in its business.**

Company Background

Power Finance Corporation Ltd is **a leading financial institution in India** focused on the power sector, which was established as an integral part of, and continues to play a **strategic role in, the Government of India's (GoI's) initiatives for the development of the power sector in India**. For the development and implementation of policies and structural and procedural reforms for the power sector it works closely with GoI instrumentalities, State governments and power sector utilities, other power sector intermediaries and private sector clients in India.

Comprehensive range of financial products and related advisory and other services from project conceptualization to the post-commissioning stage are provided to its clients in the power sector, including for **generation (conventional and renewable), transmission and distribution projects as well as for related renovation and modernization projects**. It also provides various fund based and financial assistance, including project finance, short term loans, buyer's line of credit and debt refinancing schemes, as well as non-fund based assistance including default payment guarantees and letters of comfort along with fee based technical advisory and consultancy services for power sector projects. Strategically it has expanded its focus areas to include projects that represent forward and backward linkages to the core power sector projects, including procurement of capital equipment for the power sector, fuel sources for power generation projects and related infrastructure development and also intend to fund power trading initiatives. **Equity capital, internal resources and domestic and foreign borrowings are the primary sources of funds of PFCL**. **Currently it enjoys the highest credit ratings for its long-term domestic and short term borrowings from CRISIL and ICRA respectively.**

It is registered with the RBI as a non-deposit taking systemically important Non Banking Financial Company (NBFC) and was classified as an Infrastructure Finance Company (IFC) in July 2010.

Overview of Power Industry

India has continuously experienced shortages in energy and peak power requirements. According to the Central Electricity Authority's ("CEA") monthly review of the power sector ("CEA Monthly Review") published in March 2011, the total energy deficit and peak power deficit for March 2011 was approximately 7.5% and10.3%, respectively. The shortages in energy and peak power have been primarily due to the sluggish progress in capacity addition. The Indian economy is based on planning through successive five year plans ("Five Year Plans") that set its targets for economic development in various sectors, including the power sector. During the 9th Five Year Plan (1997-2002) ("9th Plan"), capacity addition achieved was 19,015 MW, which was 47.5% of the 40,245 MW targeted under the 9th Plan. During the course of the 10th Five Year Plan (2002 to 2007) ("10th Plan"), capacity addition achieved was 21,180 MW, which was 51.6% of the 41,110 MW targeted under the 10th Plan. The current revised capacity target for the 11th Five Year Plan (2007-2012) ("11th Plan") is 78,700 MW. As of March 31, 2011, capacity addition achieved over the 11th Plan has been 56.7% of the target addition or 44,622.90 MW. The total installed power generation capacity in India was 173,626.40 MW as of March 31, 2011.

Power Demand in India

Rapid growth of the economy places a heavy demand on electric power. Reforms in the power sector, to make it efficient and more competitive, have been under way for several years and while there has been some progress, shortage of power and lack of access continues to be a major constraint on economic growth. The persistent shortages of electricity both for peak power and energy indicate the need for improving performance of the power sector in the country **(Source: Planning Commission of India.)**

Although power generation capacity has increased substantially in recent years, it has not kept pace with the continued growth of the Indian economy, despite low per capita electricity consumption. The low per capita consumption of electricity in India compared to the world average presents significant potential for sustainable growth in the demand for electric power in India. The total energy consumption in India is estimated to grow to approximately 1,280 million tonnes of oil equivalent ("Mtoe") by Fiscal 2030. This implies growth of 3.5% CAGR in India's energy requirement over the next 25-30 years, reflecting the huge potential for investments in the energy sector in India.

Current Capacity

India’s total installed capacity of 173,626.40 MW as on March 31, 2011, the installed capacity of central power sector utilities, state sector entities and private sector companies accounted for approximately 31.3%, 47.5% and 21.2%, respectively. The following table sets forth a summary of India's energy generation capacity as of March 31, 2011 in terms of fuel source and ownership:

Sector	Thermal	Nuclear	Hydro	Renewable energy sources	Total
Central	40,747.23	4,780.00	8,885.40	-	54,412.63
State	52186.73	-	27,257.00	3,008.85	82,452.58
Private	19890.52	-	1,425.00	15,445.67	36,761.19
Total	1,12,824.48	4,780.00	37,567.40	18,454.52	1,73,626.40

Demand-Supply Imbalance in India

The Indian power sector has historically been beset by energy shortages which have been rising over the years. In fiscal 2010, peak energy deficit was 12.7% and total energy deficit was 10.1%. The demand for electricity has consistently exceeded the supply, and the demand-supply gap has been widening. The deficits in electric energy and peak power requirements vary across different regions in India.

The peak deficit was 14.7 % in the western region of the country, followed by 8.8% in the northern region of the country in March 2011. This can be contrasted to the lowest regional deficit in March 2011 of 6.3% in southern India (*Source: CEA Monthly (March 2011)*).

The larger deficit in the former regions is a result of the slow development progress of additional power generation capacity in these areas respectively.

Indian Power Deficit

Fiscal	2008	2009	2010
Deficit (%)	9.9	11.1	10.1

Indian Peak Deficit

Fiscal	2008	2009	2010
Deficit (%)	16.6	12.0	12.7

Future Capacity Additions

The aim for the 11th Plan is to achieve a capacity addition of 15,000 MW from renewable fuels. The total fund requirement to achieve the 11th Plan target was estimated as Rs10, 316.00 billion. This included total estimated funding of Rs 4,108.96 billion for generation projects (including nuclear projects) of which Rs 1,237.92 billion was envisaged for the public sector, Rs 2,020.67 billion for the central sector and Rs 850.37 billion for the private sector, respectively. This also includes an estimated Rs 1,400.00 billion for transmission system development (with Rs 750.00 billion envisaged for the central sector and Rs 650.00 billion for the public sector, respectively). Total fund requirement for the distribution sector (including rural electrification) during the 11th Plan was estimated at Rs 2,870.00 billion, which was only for the public sector.

12th Five Year Plan (2012-2017) (the "12th Plan")

A tentative capacity addition of approximately 100,000 MW has been envisaged for the 12th Plan. This comprises an estimated 74,000 MW thermal power, 20,000 MW hydro power, 3,400 MW nuclear power and 2,500 MW from lignite, respectively The total fund requirement to achieve the above targeted capacity addition is estimated at Rs 11,000.00 billion, with an estimated Rs 4,950.00 billion being required for generation projects, an estimated Rs 2,400.00 billion being required for transmission projects and an estimated Rs 3,710.00 billion being required for distribution projects

PFC Competitive Strengths

- **Comprehensive financial assistance platform focused on the Indian power sector:-**It provide a comprehensive range of financial products and related advisory and other services from project conceptualization to the post-commissioning stage, to its clients in the power sector, including for generation (conventional and renewable), transmission and distribution projects as well as for related renovation and modernization projects.

- **Strategic role in GoI initiatives and established relationships with power sector participants: -** PFC was established as an integral part of, and has played a strategic role in, the GoI's initiatives for the promotion and development of the power sector in India for more than two decades. It also involved in various GoI programs for the power sector, including acting as the nodal agency for the UMPP and the R-APDRP and as a bid process coordinator for the ITP scheme. As a result, it has developed strong relationships with the Central and State governments, various regulatory authorities, significant power sector organizations, Central and State power utilities, private sector project developers, as well as other intermediaries in the power sector.

- **Operational flexibility to capitalize on both fundraising and lending opportunities:-**It is registered with the RBI as an NBFC and has also been classified as an IFC. NBFC and IFC classification leads to flexibility in operations than some of their competitors and effectively capitalize on available financing opportunities. As an NBFC, it is governed by regulations and policies that are generally less stringent than those applicable to commercial banks. PFC was classified as an IFC, which is a distinct category of NBFCs that are primarily engaged in infrastructure financing. IFC status enables them to increase their lending exposures to individual entities, corporations and groups, compared to other NBFCs that are not IFCs. IFC status helps them to raise credit at a cheaper rate.

- **Favorable credit rating and access to various cost-competitive sources of funds: -** PFC primary sources of funds include equity capital, internal resources and domestic and foreign borrowings. CRISIL and ICRA have granted us the highest credit ratings of "AAA" and "LAAA", respectively, for there long term domestic borrowings and "P1+" and "A1+", respectively, for its short-term borrowings. International credit rating agencies Moody's, Fitch and Standard & Poor's have provided the long-term foreign currency issuer ratings of "Baa3", "BBB-" and "BBB-", respectively, which are at par with the sovereign ratings for India. This financial strength and its favorable credit ratings enable them to access various cost competitive funding options.

- **Comprehensive credit appraisal and risk management policies and procedures**

- **Track record of consistent financial performance and growth**

PFC Business Strategy

1. **Continue to leverage its industry expertise and relationships to capitalize on the expected growth in the Indian power sector.**
2. The Indian power sector has historically has been characterized by power shortages and relatively low per capita consumption. PFC intends to leverage its industry expertise and ability to develop, supervise and implement structured financial assistance packages based on specific operational and financial performance standards to assist otherwise financially weak State Power Utilities ("SPUs") and Public sector projects to improve their financial position.

3. **Strategically expand its business and service offerings**

❖ **Consultancy and other fee-based services**:- It intend to increase its focus on fee-based and consultancy services to SPU's, power distribution licenses, IPPs, public sector undertakings and SERCs. It also provides services for various GoI Programs for the power sector in India.

❖ **Debt Syndication: -** It has acted as the lead financial institution for several projects, and has carried out syndication activities for various projects. It s technical expertise and industry experience, its project appraisal capabilities and its relationship with commercial banks and other financial institutions enable them to ensure timely financial closure for such projects.

❖ **Equity investments:-** PFC aims to leverage its power sector experience and relationships, existing client base, its financial strength and lending capability to invest in power sector projects. In addition, it may consider equity syndication opportunities for power sector projects, which they expect will also increase its fee-based income.

❖ **Other Initiatives: -** Company is currently in the preliminary stages of evaluating the possibility of establishing or acquiring a bank and is in the process of appointing a consultant in connection with such initiative.

4. **Broader its loans and assets portfolio.**

❖ **Private sector projects**
❖ **Hydro Projects and renewable energy: -** It intends to focus on providing financial assistance to hydro projects to facilitate an optimal mix of thermal and hydro projects in its loan asset portfolio.
❖ **Forward and backward linkages to core power sector projects: -** Company has strategically expanded its focus areas to include projects that represent forward and backward linkages to the core sector projects including capital equipment for the power sector, fuel sources for power generation projects and related infrastructure development as well as power trading initiatives.
❖ **Capital equipment manufactures**
❖ **Fuel sources and related infrastructure development**
❖ **Power Trading**

5. **Continue to develop strategic partnerships and evaluate new business opportunities.**

It has investments in PTC which is involved in power trading. They have also invested in National Power Exchange Ltd (NPEL) and Power Exchange India Ltd (PEIL) to encourage power trading initiatives in India.

Risks & Concerns

1. **Significant concentration of outstanding loans to certain borrowers, particularly public sector power utilities, many of which are historically loss-making, and if these loans become non-performing the quality of its asset portfolio may be adversely affected.**

2. **PFC has not obtained sufficient security or collateral in connection with their loans.**

3. **It has huge contingent liabilities and in the event it materializes could adversely affect its business.**

4. **Risks related to power sector projects, particularly power generation projects, could materially and adversely affect its business, financial condition and results of operations.**

5. **Volatility in the interest rates affects its lending operations and may result in drop in its net interest income and net interest margin and adversely affect its return on assets and profitability.**

6. **Volatility in foreign exchange and un-hedged foreign currency could adversely affect its financial conditions and results of operations.**

Financials

Consolidated Summary Statement of P & L

(Rs in Cr)

Particulars	31-Mar-09	Mar 31, 2010	9M 31 Dec, 2010
Total Operating Income	6566.08	8102.96	7470.66
Other Income	23.64	23.6	16.38
Total Income	6589.73	8126.58	7487.04
Total Expenditure	4574.2	5059.28	4835.25
Operating Profit	6451.92	7982.80	7345.24
Depreciation	3.84	3.39	3.17
PBT	**2011.68**	**3063.89**	**2648.62**
Tax	542.09	813.81	701.61
Net Profit	**1469.59**	**2250.08**	**1947.01**
Basic EPS (Rs)	**12.80**	**19.60**	**16.96**
Diluted EPS (Rs)	**11.13**	**17.05**	**14.75**

Consolidated Summary Statement of Balance Sheet

(in Rs Cr)

Particulars	31 Mar, 2009	31 Mar, 2010	9M 31 Dec,2010
Gross Block	97.38	93.54	99.07
Less: Depreciation	22.2	20.47	23.23
Capital Work in progress	0	1.73	2.08
Total Fixed Assets	**75.18**	**74.8**	**77.92**
Investments	**35.07**	**30.03**	**27.81**
Total Current Assets, Loans and Advances	**68303.61**	**84947.11**	**97551.09**
Total Liabilities and Provisions	**56586.87**	**71584.56**	**82240.85**
Net Assets	**11716.74**	**13362.55**	**15310.24**
Net Worth Represented by:			
Share Capital (including Share Application)	1147.77	1147.77	1147.77
Reserves and Surplus	9848.83	11369.68	13211.78
Reserve for Bad & Doubtful Debts	720.15	845.11	950.69
Net Worth	**11716.74**	**13362.55**	**15310.24**

Key Indicators	Q3 FY11	Q3 FY10	9M FY11	9M FY10	FY10
Disbursements (Cr)	7802	6493	22270	15355	25808
Sanctions (Cr)	17800	4247	61077	38976	65466
Net outstanding Sanctions (Cr)	170821	125207	170821	125207	141813
Loan Assets (Cr)	92118	72441	92118	72441	79856
Yield on Assets*	11.08%	11.08%	11.19%	11.19%	10.73%
Cost of funds*	8.35%	8.57%	8.42%	8.54%	8.14%
Interest Spread*	2.73%	2.51%	2.76%	2.65%	2.59%
Net Interest Margin*	4.09%	4.17%	4.12%	4.20%	3.98%
Return on Average Net worth*	18.81%	18.51%	20.06%	20.15%	20.31%
Return on Average Net worth* (before exchange gain/loss)	19.32%	17.86%	20.38%	19.39%	19.55%
Debt Equity Ratio	5.41	4.74	5.43	4.85	5.22
Leverage (Average assets/Average net worth)	6.81	6.21	6.81	6.24	6.59
Capital Adequacy Ratio	17.31%	17.63%	17.31%	17.63%	18.20%
EPS (Weighted Average)*	22.96	19.65	23.37	20.41	20.54
EPS (Weighted average)* (before exchange gain/loss)	23.60	18.91	23.69	19.73	19.85
Book Value per Share	124.78	108.50	124.78	108.50	108.20
Book Value Per Share (before exchange gain/ loss)	124.94	108.31	125.02	107.99	107.51

Peer Comparison

Name of the Company	Face Value In Rs per Share	EPS (TTM)	NAV	P/BV	P/E Ratio
Power Finance Corp Ltd	10	22.82	134.28	1.43x-1.51x	8.45x-8.89x*
Rural Electrification Corp Ltd	10	25.22	124.41	1.79x	8.84x

*8.45 at the lower Price band and 8.89 at the upper Price band

Valuation & Outlook

P/B ratio is currently at 1.51x multiples on the higher band of IPO price & 1.43x on lower end of IPO price. The Book value of PFC is Rs 134.28 as on 31 Mar, 2011.

Investment Rationale

- **PFC is a NAVRATNE PSU which provides financial resources to the power and associated sectors and act as a catalyst in financial, technical and managerial areas to ensure optimum utilization of resources.**
- **PFC has a significant portion of loans in portfolio with 3 and 10 year re-sets of interest rates, which lends stability to yields.**
- **The secured nature of the company's loan book with negligible non-performing assets and the low cost-income ratio are key positives.**
- **The total demand for India is expected to cross 950,000 MW by 2030.**
- **With expected GDP of 9% above in years to come the demand for power is likely to be robust. Being the leader in the sector company is expected to how excellent results in future.**
- **Capital Adequacy of the company will rise to 19% from 15.94 % after the FPO.**

We recommend long term Investors to "Subscribe" the issue

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