Power Financiers

The Power Play

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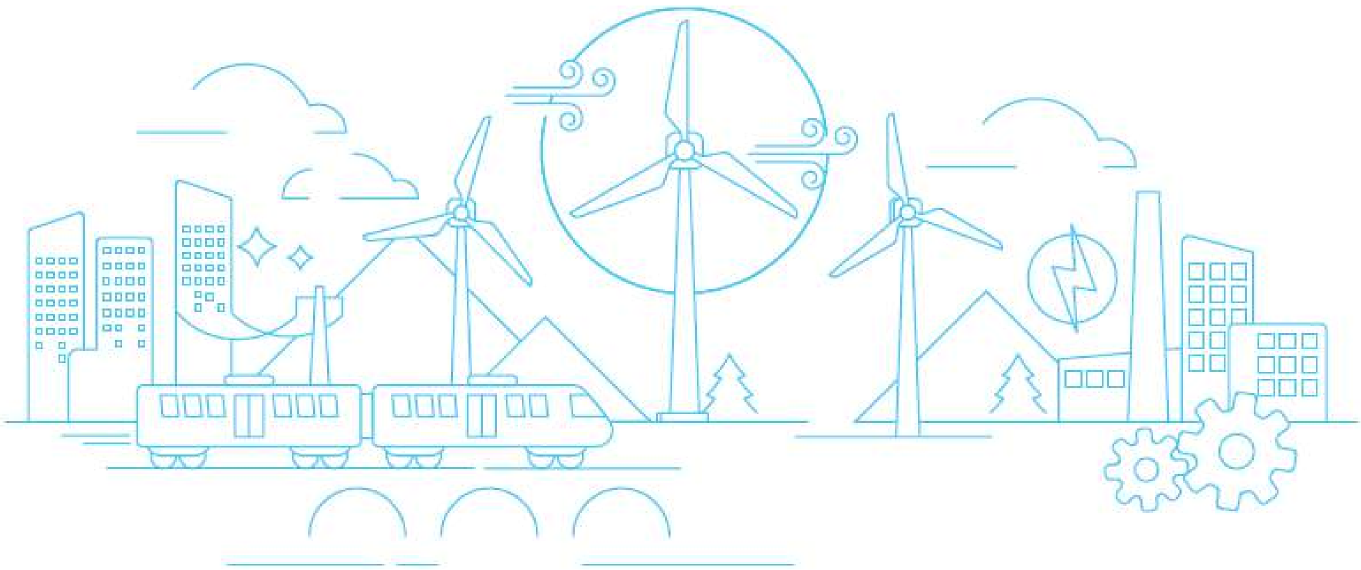
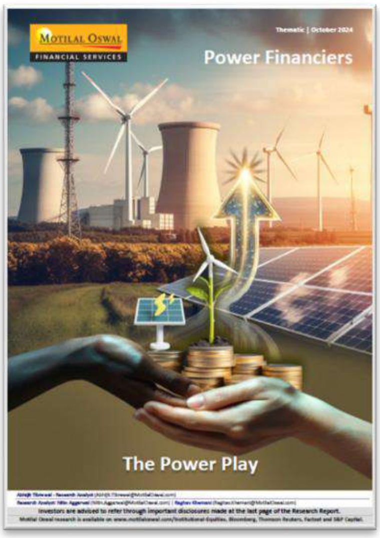
Content: Power Financiers: The Power Play



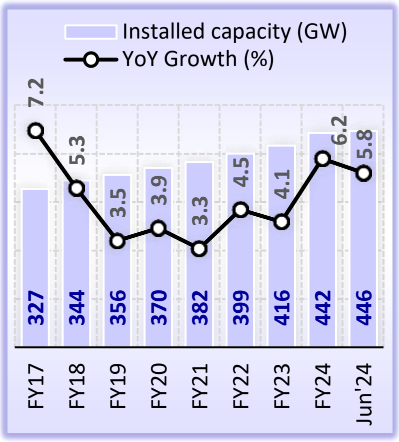
Power Financiers



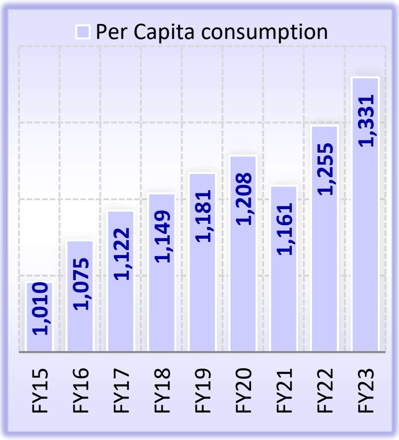
Initiating coverage on PFC and REC

Cos.	Mcap (INR b)	TP INR	Upside (%)
PFC	1,449	560	28
REC	1,317	630	26

Total installed power capacity exhibited a ~4% CAGR over FY18-FY24



Per capita power consumption (kwh)



The Power Play: Key to India's energy transition

PFC and REC fueling the nation's energy boom

- **Investment opportunity of INR42t and more:** An investment opportunity of INR42t (INR34t in firm capex + INR8t in optionality) is set to unfold in the Indian power sector over the next decade, with generation accounting for ~85% of this capex. The triple tailwinds driving this investment are: 1) power demand accelerating at a higher ~7% CAGR (~5% earlier), 2) the urgent need to upgrade/ replace aging power infrastructure as the electricity mix undergoes a shift (more RE all-day), and 3) the transition to cleaner sources of energy considering India's ambitious target of achieving 500GW of renewable energy (RES) capacity by 2030.
- **Power demand growth accelerating at 7% CAGR (vs. 5% earlier):** With a robust GDP growth outlook for India and the emergence of new demand drivers (electric vehicles, data centers, electrification of energy demand), we believe power consumption in India can compound at 7%+ over the next decade (currently 8-9%).
- **India's power sector is undergoing a significant transition from a phase of surplus to one of shortage**. This transition has been driven by a combination of factors, including increased power demand, underinvestment in dispatchable power sources (such as thermal and hydro), and the govt.'s focus on renewable energy. Consequently, there is a renewed emphasis on expanding power generation capacity, which in turn will drive loan book growth for lenders such as Power Finance Corporation (PFC) and Rural Electrification Corporation (REC).
- **India is projected to add ~250GW of new power generation capacity over the next five years, nearly three times the 86GW capacity added in the previous five years.** This expansion will involve substantial investments in renewable energy, along with essential supporting infrastructure such as thermal plants, battery storage, and pumped storage systems.
- The ability of PFC and REC, as state-owned NBFCs, to mobilize and manage substantial amounts of capital renders them indispensable to India's energy ambitions. **Under the National Infrastructure Pipeline (NIP), there is a total capex opportunity of INR29t:** ~INR18t under renewable generation, ~INR7t under T&D, and the remaining under conventional generation. Besides power projects, PFC and REC are also exploring financing opportunities in electric vehicles and charging infrastructure, bio-refinery projects, ethanol blending, solar panels, Flue Gas Desulfurization (FGD), smart metering, and city-gas distribution (CGD) projects. Further, their expansion into financing infrastructure & logistics projects is likely to serve as an additional driver of sustained, healthy loan growth.
- In previous cycles, the power sector was plagued by high levels of NPAs, mainly in thermal projects. However, the current cycle is markedly different, since a majority of loans extended by PFC and REC are now directed towards government entities or private renewable energy companies, both of which exhibit lower default risks. **The GNPA and NNPA ratios are at their multi-year lows, as the power sector has witnessed the resolution of various stressed assets over the past three years.**

- For PFC, we expect a loan book CAGR of ~15% and a PAT CAGR of ~12% over FY24-FY27. This is for an RoA/RoE of 2.9%/19% and a dividend yield of ~4.2% in FY27E. PFC (standalone) trades at 1.0x FY26E core P/ABV, and the risk rewards are attractive. **We initiate coverage on PFC with a BUY rating and a TP of INR560** (based on a target multiple of 1.2x Sep'26E P/ABV on the standalone business and ~INR211/share for its stake in REC with a holdco discount of 20%).
- For REC, we project a loan book CAGR of ~18% and a PAT CAGR of ~15% over FY24-FY27. This is for an RoA/RoE of 2.6%/21% and a dividend yield of ~4.7% in FY27E. REC trades at 1.4x FY26E P/ABV. **We initiate coverage on REC with a BUY rating and a TP of INR630** (based on a target multiple of 1.6x Sep'26E P/ABV).

Asset quality at its best in nearly a decade

- DISCOMs have historically been the weak link in India's power sector, suffering from poor financial health due to high debt levels, operational inefficiencies, and political interference. Interestingly, not every asset in the power sector is stressed, and various government schemes and reforms such as IPDS, UDAY, and LPS have actually reduced AT&C losses, improved the average realizable revenue - average cost of supply (ARR-ACS) gap, and reduced DISCOM's legacy dues outstanding towards power generation and transmission companies.
- PFC and REC are perceived as financial intermediaries that can raise borrowings at attractive interest rates for deployment in the power sector. While a part of this is true, it is also important to note that PFC and REC play an advisory role in various government initiatives in the power sector. These are also the nodal implementing agencies for various government schemes and packages, and both together have funded more than 40% of the power sector capex in the last five years.
- In the current power upcycle, many distressed power plants have been acquired by larger players, resulting in the resolution of multiple stressed projects. This trend is expected to continue, leading to further recoveries for lenders like PFC and REC. As the power sector recovers, there is potential for provision reversals, particularly in the case of loans to thermal power plants that are now generating positive cash flows. State-guaranteed loans now constitute 81% and 89% of the loan mix for PFC and REC (v/s 83% and 88% in FY19), respectively.

Diversification into infra and logistics to enable a strong sanction pipeline

- Beyond power generation, India's infrastructure sector, including roads, airports, and logistics, is set for significant expansion. PFC and REC have expanded their mandates to include infrastructure financing, opening new avenues for growth. The diversification into infrastructure projects, particularly those backed by government guarantees, will provide PFC and REC with lower-risk, high-reward opportunities.
- Disbursements in renewables and infrastructure projects are usually back-ended, suggesting that a healthy sanction pipeline will translate into healthy disbursement growth in the subsequent yields. We estimate a disbursement CAGR of 11% and 23% for PFC and REC, respectively, over FY24-FY27. However, we should remain wary of higher exposures to private infrastructure/logistics projects and promoter funding to entities in this segment.

POWER FINANCE CORPORATION

Financials Snapshot (INR b)

Y/E March	FY25E	FY26E	FY27E
NII	178	202	231
PPP	198	224	255
PAT	165	182	205
EPS (INR)	49.9	55.0	62.1
EPS Gr. (%)	15	10	13
BV/Sh. (INR)	275	313	357
ABV/Sh. (INR)	231	270	313
RoAA (%)	3.1	3.0	2.9
RoAE (%)	19.4	18.7	18.5
Div Payout (%)	30.0	30.0	30.0
Valuations			
P/E (x)	8.8	8.0	7.1
P/BV (x)	1.6	1.4	1.2
Core P/E (x)	5.4	4.9	4.4
Core P/BV (x)	1.1	1.0	0.8
Div. Yld (%)	3.4	3.8	4.2

REC

Financials Snapshot (INR b)

Y/E March	FY25E	FY26E	FY27E
NII	196	226	264
PPP	196	228	266
PAT	159	183	211
EPS (INR)	60.5	69.3	80.1
EPS Gr. (%)	14	15	16
BV/Shr (INR)	306	357	417
ABV/Shr (INR)	302	354	413
RoAA (%)	2.7	2.6	2.6
RoE (%)	21.3	20.9	20.7
Div. Payout (%)	29.8	29.6	29.3
Valuation			
P/E (x)	8.3	7.2	6.2
P/BV (x)	1.6	1.4	1.2
Div. Yield (%)	3.6	4.1	4.7

PFC & REC: Benefitting from the power sector's capex revival

- PFC and REC will both be beneficiaries of the revival in power sector capex. With our detailed project-level analysis of stressed assets, we believe that we are now in a phase of power upcycle, where we will see stressed asset resolutions continue, leading to further asset quality improvement. We do not see risks of incremental additions to the stress pool over the next two years, and this should keep credit costs benign at <5bp over FY25E-FY26E.
- For an RoA profile of 3.0%/2.6%, a RoE of ~19%/21%, and dividend yields of ~3.8%/4.1% in FY26E, we believe current valuations of 1.0x and 1.4x FY26E P/ABV for PFC (standalone) and REC, respectively, are attractive. Moreover, both PFC and REC's stock prices have corrected by ~25% from their recent highs, and now even provide a margin of safety in valuations. **While we have a BUY rating on both PFC and REC, we prefer REC over PFC, because of its better execution capability and a stronger RoE profile.**
- **Key downside risks for both PFC and REC:** 1) an increase in exposure to projects without PPA or to private infrastructure projects, 2) the RBI's stricter draft provisioning norms on project financing, 3) compression in spreads/NIM from high competitive intensity in renewable projects, and 4) deterioration in the health of DISCOM and potential haircuts in interest income.

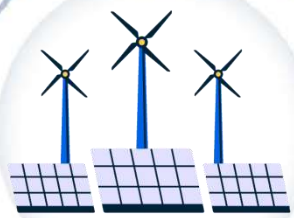
Valuation matrix: Comparison of PFC and REC with other NBFCs

Peers	CMP	MCap	RoA (%)		RoE (%)		P/E (x)		P/BV (x)	
	(INR)	(INR b)	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
PFC*	**439**	**1,449**	**3.1**	**3.0**	**19.4**	**18.7**	**5.4**	**4.9**	**1.1**	**1.0**
REC	**500**	**1,317**	**2.7**	**2.6**	**21.3**	**20.9**	**8.3**	**7.2**	**1.6**	**1.4**
Five-Star	790	231	8.1	7.6	18.7	18.8	21.5	17.8	3.7	3.1
LIC HF	607	334	1.6	1.6	14.7	13.8	6.8	6.5	0.9	0.8
PNB HF	934	243	2.3	2.5	11.5	13.0	13.3	10.5	1.4	1.3
Aavas	1,727	137	3.2	3.2	14.5	15.2	23.2	19.1	3.1	2.7
HomeFirst	1,239	110	3.5	3.4	16.4	17.5	29.2	23.5	4.5	3.8
CanFin	823	110	2.2	2.2	17.9	17.5	13.0	11.3	2.1	1.8
Repco	499	31	3.0	2.9	13.9	13.2	7.2	6.7	0.9	0.8
Cholamandalam	1,481	1,245	2.5	2.8	20.6	22.5	27.8	20.3	5.2	4.0
MMFS*	292	361	2.0	2.4	12.7	15.7	14.1	10.3	1.7	1.5
Shriram Finance	3,302	1,242	3.3	3.3	16.3	17.2	14.7	12.1	2.2	2.0
Indostar	284	35	1.3	1.6	5.1	7.1	22.6	16.1	1.1	1.1
Muthoot*	1,883	756	5.4	5.3	19.3	19.1	14.9	13.0	2.7	2.3
Manappuram	183	155	4.6	4.8	18.5	19.1	6.7	5.5	1.1	1.0
BAF	7,272	4,501	4.0	4.2	19.6	21.3	26.6	20.0	4.7	3.9
Poonawalla	380	295	4.6	4.3	14.8	16.4	22.5	17.8	3.1	2.7
ABCL	225	587	0.0	0.0	12.1	13.9	17.0	13.2	2.0	1.7
LTFH	168	420	2.5	2.6	11.5	13.1	14.8	11.8	1.6	1.5
PIEL	1,003	226	1.0	1.8	3.4	6.4	24.4	12.5	0.8	0.8
MAS Financial	275	50	2.9	3.0	14.5	14.7	16.3	12.6	2.0	1.7
IIFL Finance	436	185	2.1	3.3	9.6	14.9	16.5	9.0	1.4	1.3
CreditAccess	1,145	183	4.4	4.8	18.1	18.4	14.1	11.7	2.4	2.0
Fusion Micro	226	23	-0.1	4.5	-0.6	17.5	-	4.2	0.8	0.7
Spandana Sphoorty	541	39	0.7	3.8	2.5	13.0	42.6	7.4	1.0	0.9

Note: *standalone; Source: MOFSL, Company

STORY IN CHARTS

Strong investment pipeline in renewable energy sources (RES) projects

Electricity generation (Renewable)	Total RES Projects	Projected investment (INR t)
	450	18

RDSS scheme is aimed at:

- **A:** Reducing the AT&C losses to pan-India levels of 12-15%
- **B:** Reducing the ACS-ARR gap to zero by 2024-25 by improving the operational efficiencies and financial sustainability
- **C:** Improving the quality, reliability, and affordability of power supply to consumers through a financially sustainable and operationally efficient distribution sector

Strong investment pipeline in infrastructure projects

Infrastructure loans	Total Infrastructure Projects	Projected investment (INR t)
	5,153	49

STORY IN CHARTS

History of Central govt's debt relief measures for DISCOMs

2001-2003

- **Accelerated power development scheme:** Aimed at upgrading T&D network+ adding tamper-proof meters outlay of USD121m.
- **State Electricity Board bailout:** Central govt. converted 50% of outstanding debt to govt. bonds and 50% waived off; INR7b package.
- **Electricity Act, 2003:** Established CERC/SERCs
- **Accelerated Power Development Reforms package:** Aims to achieve 15% AT&C loss (50% at the time) through grants and incentives to states.

2008-2015

- **Restructured accelerated power development reforms package:** Central govt. to provide loans to states to improve T&D structure of high density load centers to reduce AT&C losses.
- **Financial restructuring package:** DISCOM loans restructured (USD19b outstanding to banks); 50% as govt-backed bonds and 50% into long-term loans, with lenient repayment terms and waiver of penal interests.
- **Ujwal DISCOM Assurance Yojana (UDAY):** States to take up 75% of DISCOM debt (USD52b at the time) and remainder loan to have low interest rates

2021-2023

- **Revamped distribution sector scheme:** Outlay of USD37b aimed at reducing India's AT&C losses to 12-15% and ACS-ARR gap to 0 through results-linked financial assistance outlay.
- **Electricity (late payment surcharge and related matters) Rules:** Scheme was introduced to reduce Genco receivables from DISCOMs. Late Payment Surge rules provided for an incremental surcharge with every additional month of default.
- **Electricity (amendment) Rules:** Quarterly monitoring of subsidies being released by states as billed by DISCOMs.

Power Finance Corporation : Investment Rationale

A Asset quality strength to sustain; stressed asset resolutions to continue

B Expect ~15% loan CAGR over the next three years

C High earnings predictability with PAT CAGR of ~12% over FY24-27E

Rural Electrification Corporation: Investment Rationale

01 Strong loan CAGR of ~18% likely over the next three years

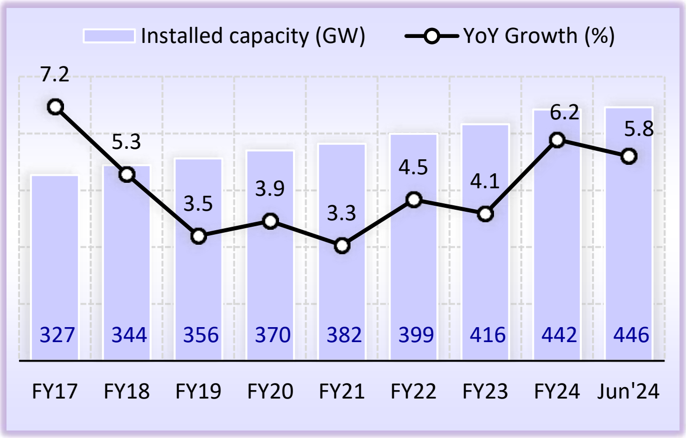
02 Spread compression from high competitive intensity can be mitigated with benign credit costs

03 New stressed asset formation will be minimal in this power upcycle; Asset quality outlook healthy

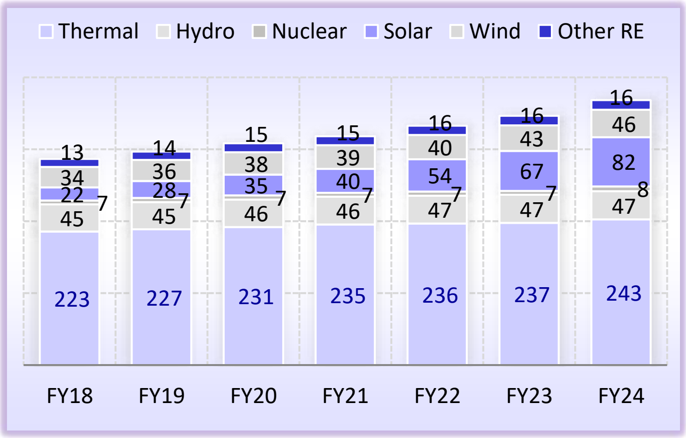
04 Healthy earnings trajectory with ~21% RoE over FY25-27E

STORY IN CHARTS

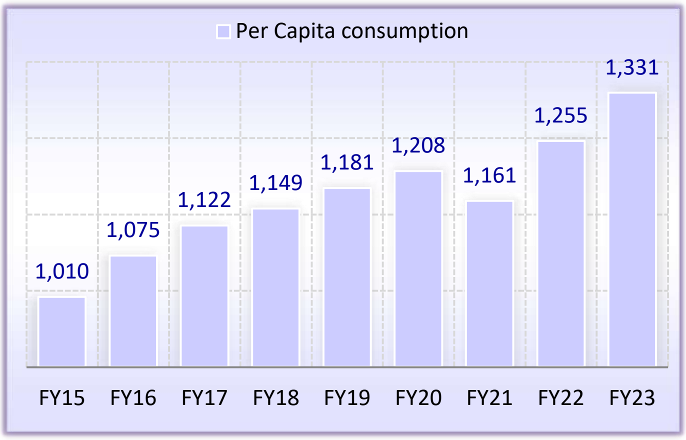
Total installed power capacity exhibited a ~4% CAGR over FY18-FY24



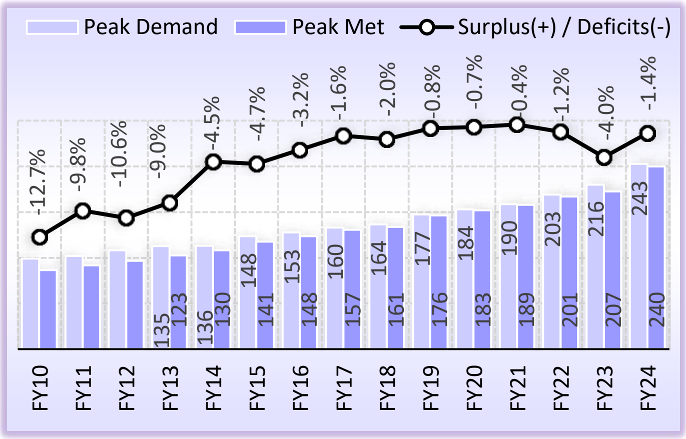
Thermal is still the largest conventional power source in India and fossil fuel contributes ~55% to the total installed power capacity (in GW)



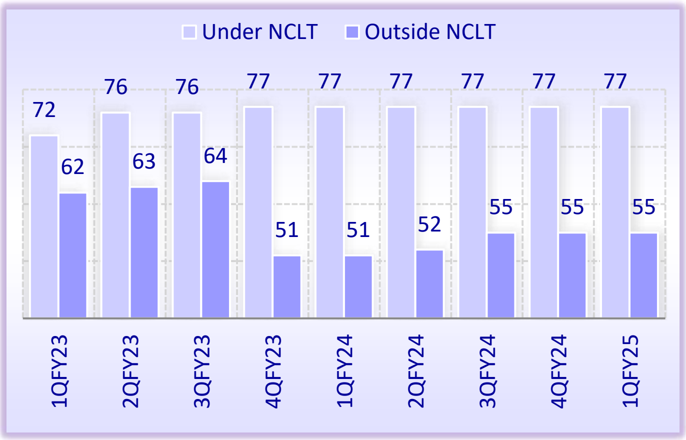
Per capita power consumption (kwh)



Peak power demand and met status (GWh)



PFC: Stressed loans being resolved in NCLT and outside NCLT with healthy provision covers (%)



REC: Healthy provision coverage on both NCLT and non-NCLT stressed exposures

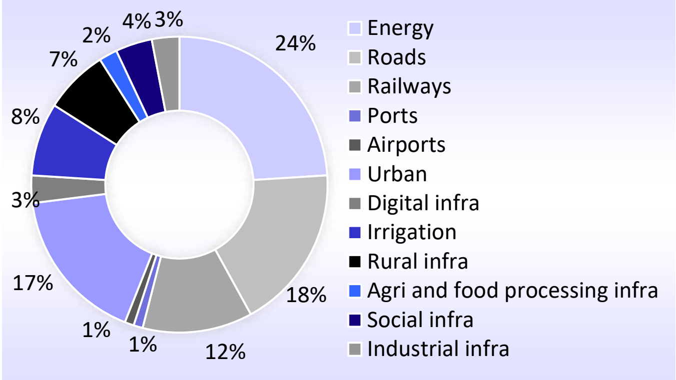
Resolution Status	INR b
Under NCLT	123
Outside NCLT	15
Total Stage III	**138**
Resolution Status	**No. of projects**
Under NCLT	12
Outside NCLT	4
Total Stage III	**16**
PCR on Stage 3	**%**
Under NCLT	71
Outside NCLT	49
PCR on total Stage III	**69**

Sizing the opportunity in the power finance sector

Power has ~23% share in the INR111t total capex under NIP over FY20-25

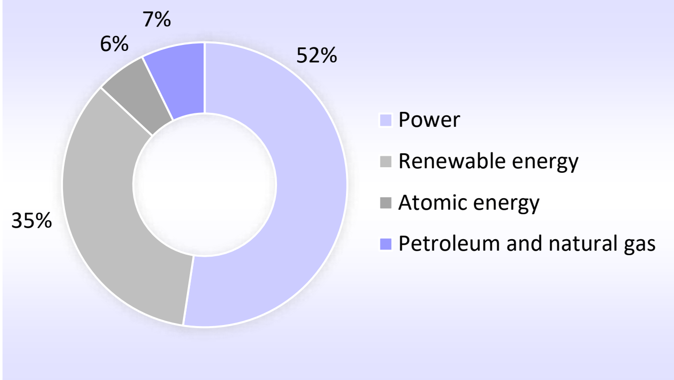
The power sector has always commanded a significant proportion of the overall domestic infrastructure spending. Conventionally, a large part of the domestic power financing was towards coal-based thermal projects. However, given the country's stated objectives to generate 500GW of non-fossil electricity capacity and reduce emissions by 1b tons by 2030, we believe the capex in renewable energy will continue to remain elevated over the next five years as well.

Exhibit 1: Sector wise breakup of capex of INR111t during FY20-25



Source: NIP

Exhibit 2: Power and renewable energy to command ~87% share in the estimated capex on Energy during FY20-25



Source: NIP

A large part of the opportunity in power financing lies in renewable energy

Until now, private investment has not found its way into thermal power because of the overcapacity, low plant load factor (PLF) and the government's clear focus on renewable energy projects. Besides, the environmental norms have become stricter, and given the constant scrutiny around ESG, investors remain wary of investing in conventional thermal power plants.

Thermal power projects of 28K MW are under construction by the central and state sector entities.

Moreover, ~28K MW of thermal power projects is under construction (at different stages) by the central and state sector entities. By end-Jun'24, investments worth INR1.8t had already gone into these projects, and additional investments of INR1.2t are likely over the next five years. Thermal power projects of 28K MW are under construction by the central and state sector entities.

Exhibit 3: Thermal capacity under construction as of Jun'24

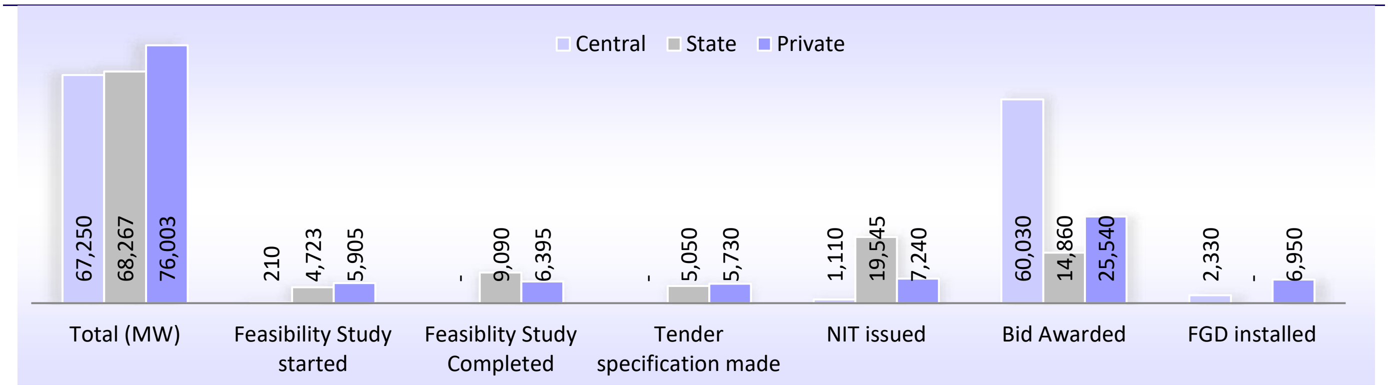
Project Name	Capacity Addition GW FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	Cumulative	State	Implementing agency	INR b Total project cost	Cost incurred till 30 Jun 24	Additional investment required
Centre												
Barh STPP St-I	0.66						0.7	Bihar	NTPC	224	224	-
Buxar TPP	1.32						1.3	Bihar	SJVN	104	96	8
Lara STPP St-II				0.8	0.8		1.6	Chhattisgarh	NTPC	155	9	146
North Karanpura STPP	0.66			0			0.7	Jharkhand	NTPC	162	155	7
Patratu STPP	0.8	1.6					2.4	Jharkhand	PVUNL	187	139	48
Singrauli STPP, St-III						1.6	1.6	Madhya Pradesh	NTPC	172	5	167
Talcher TPP St- III			0.66	0.66			1.3	Odisha	NTPC	118	16	103
NLC Talabira TPP					2	1	2.4	Odisha	NLC	272	10	263
Ghatampur TPP	1.98						2.0	Uttar Pradesh	NUPPL	194	174	20
Khurja SCTPP	1.32						1.3	Uttar Pradesh	THDC	111	107	3
State												
Jawaharpur STPP	0.66						0.7	Uttar Pradesh	UPRVUNL	146	126	20
Obra-C STPP	0.66						0.7	Uttar Pradesh	UPRVUNL	117	108	9
Panki TPS Extn.	0.66						0.7	Uttar Pradesh	UPRVUNL	67	57	10
Ennore SCTPP			1.32				1.3	Tamil Nadu	TANGEDCO	164	99	65
North Chennai TPP St-III	0.8						0.8	Tamil Nadu	TANGEDCO	102	90	12
Udangudi STPP St-I	1.32						1.3	Tamil Nadu	TANGEDCO	131	105	26
Bhusawal TPS	0.66						0.7	Maharashtra	MAHAGENCO	64	45	18
Sagardighi TPP St-III	0.66						0.7	West Bengal	WBPDCL	46	22	24
Yadadri TPS	3.2	0.8					4.0	Telangana	TSGENCO	345	271	75
DCRTPP Extn.						0.8	0.8	Haryana	HPGCL	69	0	69
Private												
Mahan STPP, Ph- II			0.8	0.8			1.6	Madhya Pradesh	Mahan Energen	124	10	115
Total	**15**	**2**	**3**	**2**	**2**	**3**	**28**			**3,075**	**1,869**	**1,207**

Source: CEA

FGD installation mandatory and can be a good opportunity

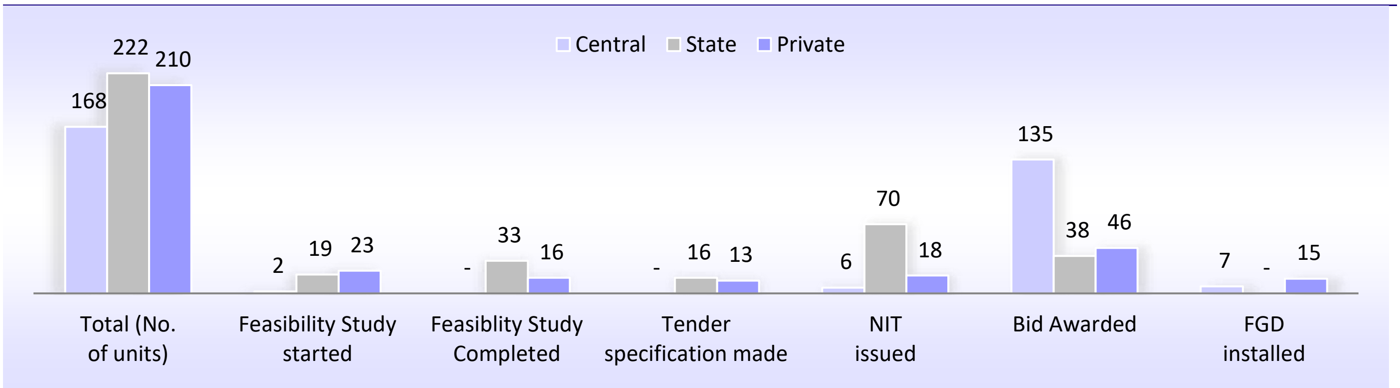
To curb sulfur-dioxide emissions, installation of FGD systems in existing and all new thermal power plants has been made mandatory. Our discussions with industry experts suggested that installation of FGD will entail a cost of INR5m per MW, implying a total investment of ~INR1t if it were to be fully and mandatorily installed across all thermal plants.

Exhibit 4: FGD installed capacity (MW)



Source: CEA; Note: Data as of Mar'23

Exhibit 5: Status of FGD installation (based on the no. of units)



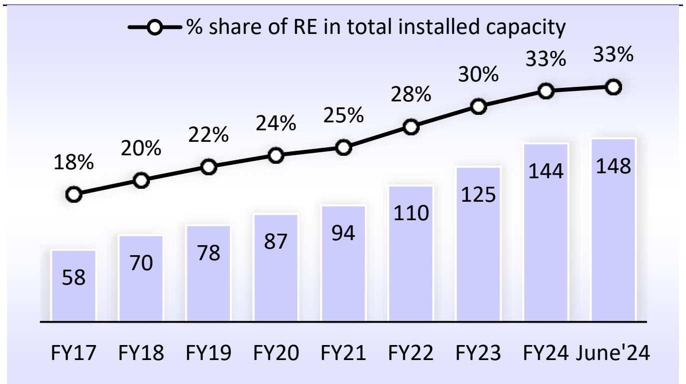
Source: CEA; Note: Data as of Mar'23

A process for in-principle approval to pass FGD costs on to the end-consumers through tariff increases is already in place for plants that have long-term power purchase contracts. To enable financing, a provisional tariff increase for each such contract should be approved upfront by regulators rather than just in-principle approvals.

Renewable power: Focus of the government and where the opportunity lies

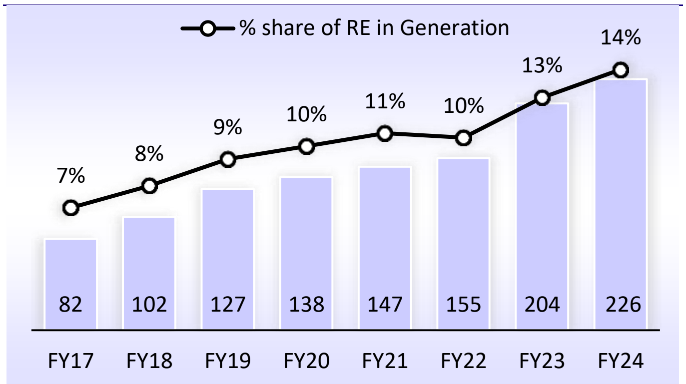
Under the 2015 Paris agreement, India committed to reduce its greenhouse gas emissions by 33-35% below the 2005 levels and to achieve 40% of installed electric power capacity from non-fossil sources by 2030. Renewable Energy Sources (RES) are sustainable even at lower power tariffs, and they are attractive means of meeting India's energy requirements.

Exhibit 6: Installed RES capacity (in GW)



Source: CEA, Note: Data is up to Jun'24

Exhibit 7: Proportion of generation from renewable sources



Source: CEA; Note: Data is up to Mar'24

Currently, India is committed to reaching 500GW of renewable energy capacity by 2030. As of Jun'24, the total installed renewable energy capacity had reached ~148GW, which was predominantly solar and wind, along with a relatively lower proportion of biomass and hydro. The next committed target is to achieve net zero carbon by 2070.

Exhibit 8: Strong investment pipeline in RES projects

Electricity generation (Renewable)	No. of projects
NIP Projects	271
Non-NIP Projects	135
Stressed Projects	44
Total RES Projects	**450**

Source: NIP, MOFSL

Exhibit 9: Estimated investment of ~USD215b in RES projects

Electricity generation (Renewable)	Projected investment (USD b)	Projected investment (INR t)
NIP Projects	187.8	15.8
Non-NIP Projects	26.8	2.2
Total RES Projects	**214.6**	**18.0**

Source: NIP, MOFSL

The NIP forecasts investment opportunities of ~INR18t in the renewable generation segment.

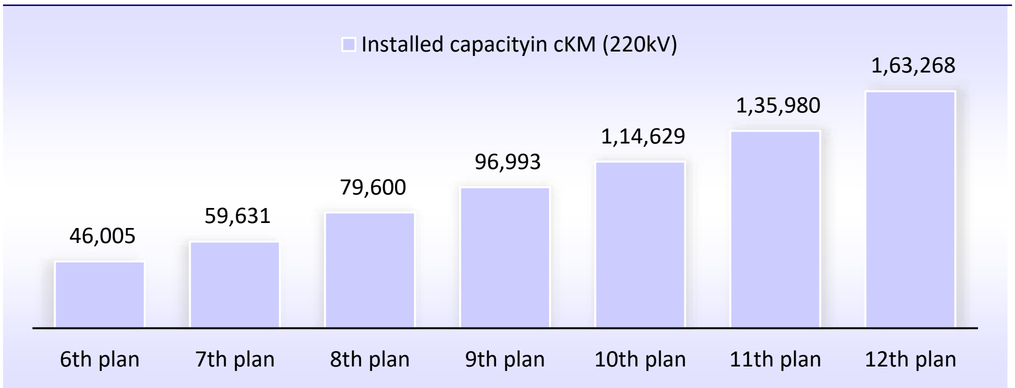
The NIP projects investment opportunities of ~INR18t in the renewable generation segment. Most of the large-ticket projects in RES generation are under NIP. Rajasthan, Uttar Pradesh, Gujarat, Madhya Pradesh, and Himachal Pradesh are the top five states where there are opportunities in the RES generation segment. These states contribute ~82% of the total number of such projects in the country as of Mar'24.

The NIP also identifies a list of 44 renewable energy projects that are stressed. Most of the stressed projects in this sub-sector are in the state of Telangana (contributing ~40% of the total number of stressed renewable energy projects as of Mar'24).

Transmission needs to scale up significantly to support the generation/load

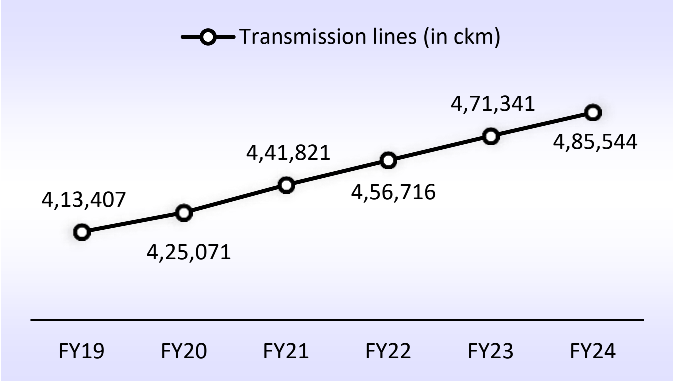
Transmission capacity depends on the growth in loan and the addition of installed generation capacity. Transmission infrastructure in India largely has participation from the central/state entities and very little (or insignificant) presence of the private sector.

Exhibit 10: Installed capacity of transmission lines in each of the five-year plans (all figures in circuit km; CKM)



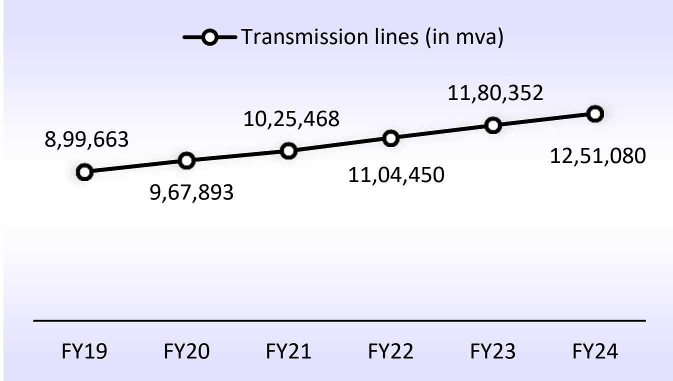
Source: Ministry of Power

Exhibit 11: Total transmission lines (220KV and above in CKM)



Source: National Power Portal and Ministry of power

Exhibit 12: Total transformation capacity (220KV and above in MVA)



Source: National Power Portal and Ministry of power

The NIP forecasts an investment of ~INR5.2t in electricity transmission spread across 217 NIP and 79 non-NIP projects.

Transmission capacity would need to grow to support the generation from the RES of electricity. The NIP forecasts an investment of ~INR5.2t in electricity transmission spread across 217 NIP and 79 non-NIP projects. **Typically, Pan-India, there are no stressed assets as of Mar'24 in the transmission segment vs. 58 and 78 such stressed projects in the distribution and generation segments, respectively**. The NIP forecasts an investment of ~INR5.2t in electricity transmission spread across 217 NIP and 79 non-NIP projects.

Moreover, to fulfill the government's vision to deliver 500GW of RES by 2030, transmission capex would need to be carried out to support this additional load.

Distribution improving through multiple reforms

Distribution is often perceived (and perhaps also is) as the weakest link in the power value chain. The government had in the past introduced various schemes, such as the Integrated Power Development Scheme (IPDS) and Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), to strengthen the urban and rural distribution networks.

Due to the pandemic and the consequent lockdown, liquidity problems traversed upstream in the power sector value chain due to the inability of DISCOMs to pay generation and transmission companies for the electricity purchased and transmitted. To tide over the liquidity crisis in the power sector, the GoI announced the Liquidity Infusion Scheme (LIS) in May'20 to help DISCOMs pay outstanding dues to CPSU GENCOs and TRANSCOs, Renewable Generators, and Independent Power Producers. Under the scheme, REC and PFC provided long-term concessional transition financing to the distribution utilities against an unconditional and irrevocable state government guarantee. The sanctioned loan under the scheme was disbursed in two tranches (50% each). **As of Dec'23, the total loan disbursed by PFC and REC together under the Scheme stood at INR1.12t for 16 states.**

In CY21, the Central government approved an RDSS scheme with an outlay of ~INR3t and estimated budgetary support from the central government worth ~INR976b over a period of five years.

NIP anticipates investments of ~INR5.1t in the distribution segment

In CY21, the central government approved a Revamped Distribution Sector Scheme (RDSS) – a reforms-based and results-linked scheme with an outlay of ~INR3t and estimated budgetary support from the central government worth ~INR976b over a period of five years (from FY22 to FY26). The scheme's objective is to improve the quality, reliability, and affordability of power supply to consumers through a financially sustainable and operationally efficient distribution sector. In CY21, the Central government approved an RDS scheme with an outlay of ~INR3t and estimated budgetary support from the central government worth ~INR976b over a period of five years.

The scheme aimed at:

- reducing the AT&C losses to Pan-India levels of 12-15% and
- reducing the ACS-ARR gap to zero by 2024-25 by improving the operational efficiencies and financial sustainability
- Improving the quality, reliability, and affordability of power supply to consumers through a financially sustainable and operationally efficient distribution sector.

Key interventions under the plan included:

- Providing support to DISCOMs to undertake activities for ensuring 100% system metering, implementing prepaid smart metering, energy accounting, and implementing infrastructure works for loss reduction, as well as for modernization and system augmentation aimed at improving the quality and reliability of power supply.
- Segregating feeders dedicated only for supply of power for agricultural purposes, which are proposed to be solarized under the KUSUM scheme, will be sanctioned on priority under the scheme.
- Along with their proposals, DISCOMs will also need to submit an action plan for strengthening their distribution system and improving performance by way of various reform measures. The action plan should contain targeted improvements in operational efficiency, financial viability, as well as the quality and reliability of power supply.

- The unique feature of the scheme is that its implementation is based on the action plan worked out for each state to address state-specific issues, rather than a "one-size-fits-all" approach.

Progress made under RDSS:

- Because of the reform measures taken under the scheme, AT&C losses have come down to ~15.4% (provisional) in FY23. The direct impact of this will be on reducing the ACS-ARR gap, which will ultimately benefit end consumers for getting quality supply.

DISCOMs' legacy dues amounting to ~INR883b have been paid by 13 States/UTs as of Nov'23. The remaining legacy dues as of Dec'23 stood at INR516.7b.

Statutory mechanism for timely payment to Generating companies

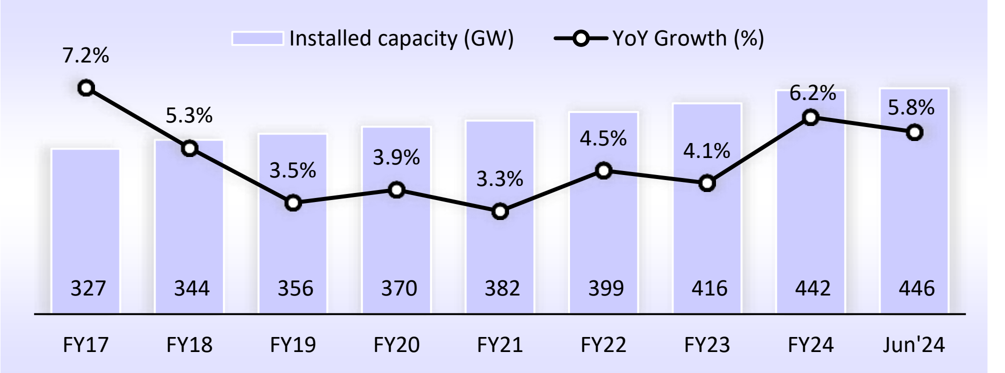
- **Electricity (late payment surcharge and related matters) Rules, 2022** provide relief to the DISCOMs as well as electricity consumers, and at the same time, generation companies are also getting the benefit of assured monthly payments, which will help the whole power sector to become financially viable.
- Provision has been made for a one-time scheme for liquidation of arrears, enabling DISCOMs to pay total outstanding dues including Late Payment Surcharge (LPS), as on the date of notification, in up to 48 monthly instalments. No LPS on past outstanding dues will be applicable in case of timely payment of these instalments. It will bring discipline in timely payment of dues.
- All current dues are being paid since August 2022 within a maximum timeframe of 75 days.
- DISCOMs' legacy dues, amounting to ~INR883b, have been paid by 13 States/ UTs as of Nov'23 (against total outstanding of ~INR1.4t as of Jun'22). The balance legacy dues stood at INR516.7b as of Dec'23.
- Based on the results achieved so far, it is expected that strict implementation of the LPS Rules will bring back the financial viability of the power sector in the country and would attract investments in the power sector. This rule has not only ensured that the outstanding dues have been liquidated, but it has also guaranteed that the current dues have been paid in time. It has played a vital role towards ensuring the financial discipline in DISCOMs.
- **A total of 13 states opted for loans from PFC/REC (total loans sanctioned under LPS stood at INR1.14t as of Dec'23).**

Overview of the power sector

India's power demand has been recording an impressive 6% CAGR from FY18 to FY24, with projections indicating a continuation of this trend as the economy expands. However, power generation capacity has lagged behind at 4% CAGR, leading to a scenario where demand could outstrip supply, particularly as the country adds more renewable energy capacity with lower plant load factors (PLFs) vs. thermal power.

Thermal is still the largest conventional power source in India, and fossil fuel contributes ~55% to the total installed power capacity.

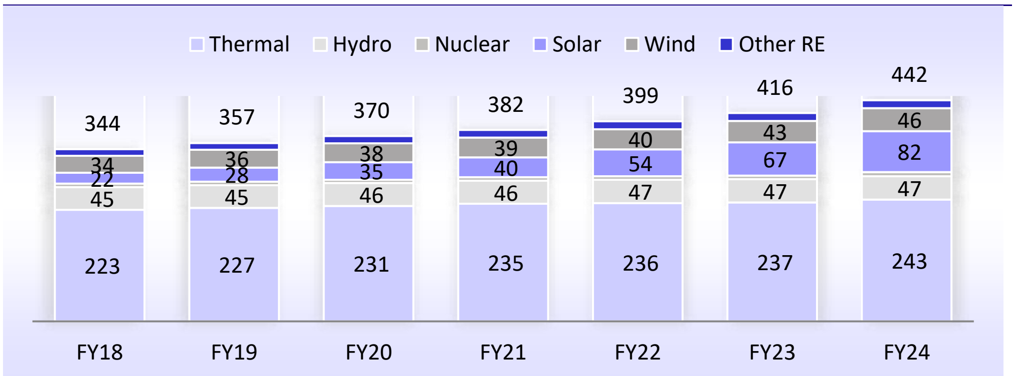
Exhibit 13: Total installed power capacity exhibited a ~4% CAGR over FY18-FY24



Source: CEA

The gap between growing demand and lagging capacity presents a significant opportunity for PFC and REC to finance new power generation projects, particularly in renewables, thereby ensuring stable and profitable loan growth.

Exhibit 14: Thermal is still the largest conventional power source in India and fossil fuel contributes ~55% to the total installed power capacity (In GW)

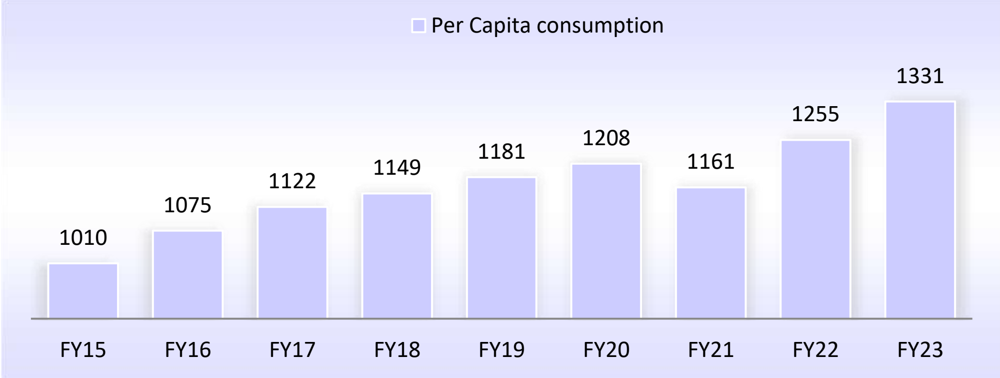


Source: CEA

As of now, India's per capita consumption of electricity is approximately one-third of the world average, and per capita emission of carbon dioxide is also one-third of the world average. In India's pursuit to become a developed country, its per capita consumption of electricity will definitely increase. Even if it were to cross the world average over the next two decades, it will entail a three-fold increase in the per capita consumption of electricity. Both PFC and REC will play a crucial role in financing the capex towards electricity generation to cater to those levels of electricity demand.

India's per capita consumption of electricity is approximately one-third of the world average.

Exhibit 15: Per capita power consumption (kwh)



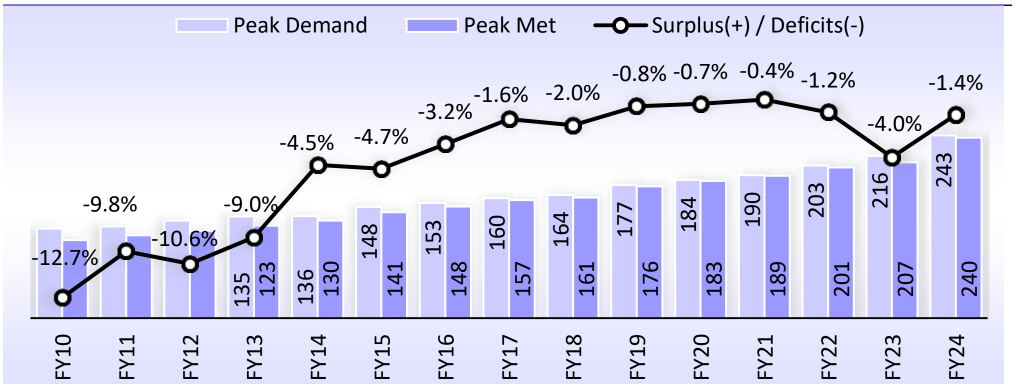
Source: CEA

India has seen a steady and robust increase in power demand driven by intense weather conditions in certain geographies, the emergence of new power use-cases such as data centers, and an intensified focus on manufacturing.

Until 2013, India's peak electricity demand used to be significantly higher than the peak met, resulting in a power deficit ranging between 9% and 13% over FY10-13. However, a surge in thermal capacity addition post-2012 allowed India to achieve sufficient power supply after 2014. What followed was the power deficit declining from ~5% in FY14 declining to <1% by FY20-FY21. This was driven by a surge in thermal capacity addition post-2012, which allowed the country to achieve sufficient power supply. This led to many thermal plants becoming distressed, lacking power purchase agreements and coal supply, ultimately halting new thermal capacity additions and shifting the focus to renewable energy.

Since FY23, however, India has again faced power shortages due to a combination of the lack of new dispatchable power supply (excluding renewables) and strong growth in power demand.

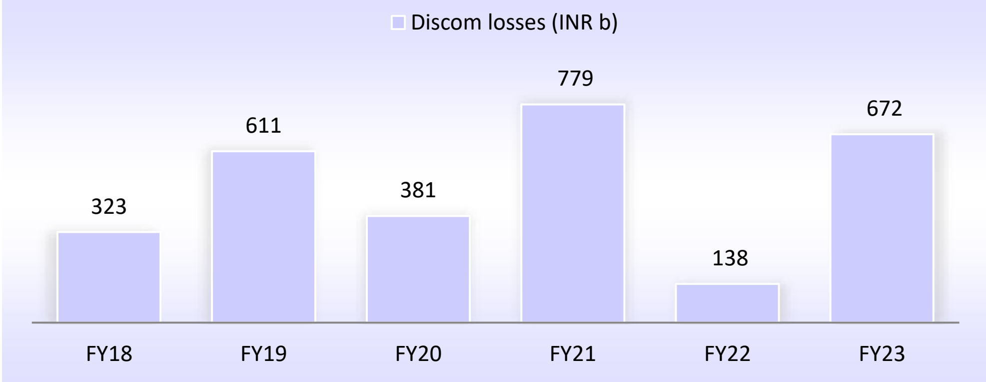
Exhibit 16: Peak power demand and met status (GWh)



Source: CEA

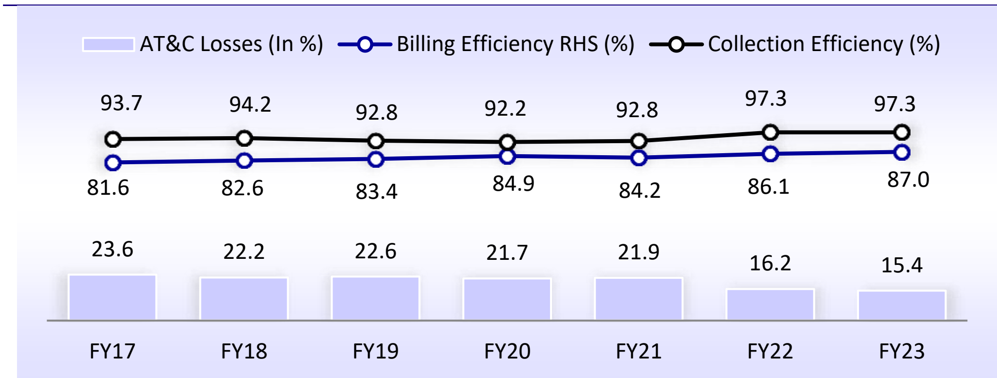
High AT&C losses + inadequate tariffs: Poor financial health of DISCOMs

Exhibit 17: DISCOM losses mounted again in FY23 after declining in FY22



Source: PFC (Report on performance of power utilities); Note: Losses are after tax with subsidy received

Exhibit 18: Collection and billing efficiency consistently improving



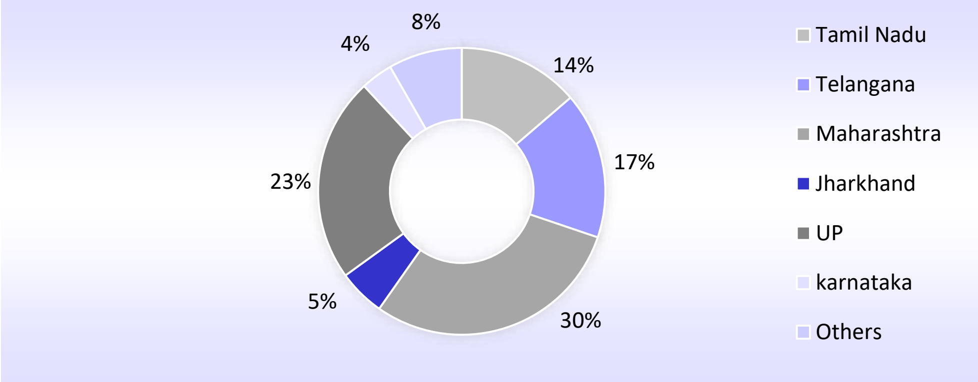
Source: PFC (Report on performance of power utilities); Note: Data is up to 31 Mar 23

Various reports on the domestic power sector from the credit rating agencies suggested that the DISCOM losses in FY21/FY22 could have increased up to INR900b/INR750b due to the adverse impact on the industrial segments in the first Covid lockdown in the early months of FY21.

DISCOM losses, excluding revenue grant under UDAY and regulatory income, were equal to ~INR672b in FY23.

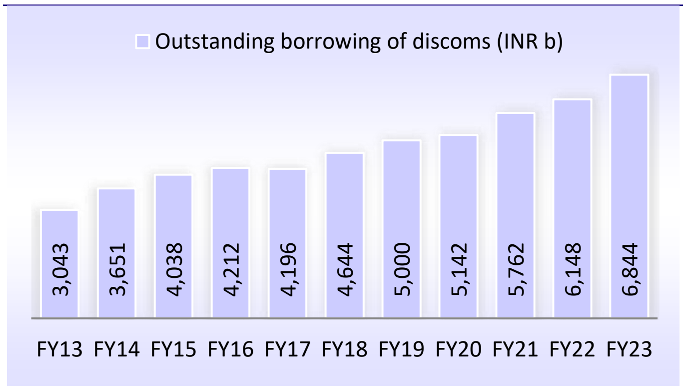
DISCOM losses, excluding revenue grant under UDAY and regulatory income, were equal to ~INR672b in FY23. Tamil Nadu, Telangana, Jharkhand, Maharashtra, Uttar Pradesh, and Karnataka were among the most distressed state distribution utilities, with a combined contribution of ~92% to the DISCOM losses (excluding revenue grant under UDAY and regulatory income) in FY23.

Exhibit 19: Share of respective state DISCOMs in the cumulative losses of DISCOMs



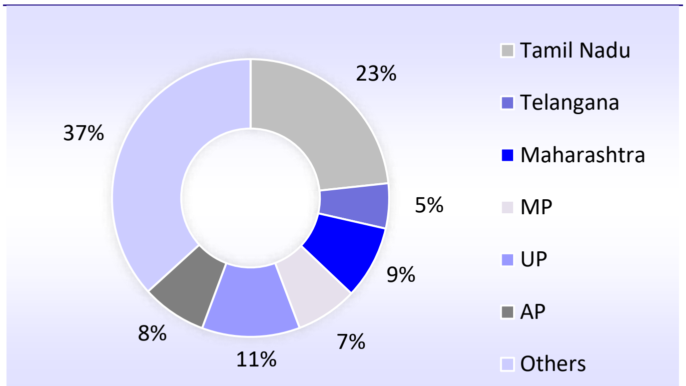
Source: PFC (Report on performance of power utilities) as of 31 Mar'23
Note: Losses are excluding revenue grant under UDAY and regulatory income

Exhibit 20: Outstanding borrowing of DISCOMs (INR b)



Source: PFC (report on performance of power utilities) as of Mar'23

Exhibit 21: DISCOMs' borrowing distribution



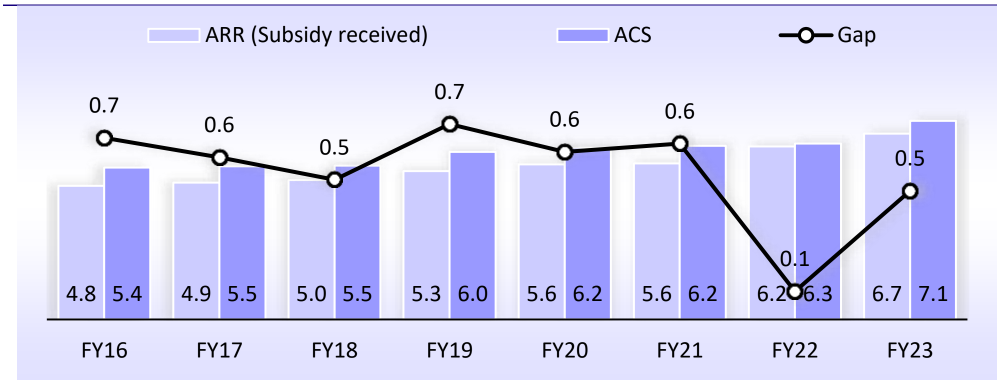
Source: PFC (report on performance of power utilities) as of Mar'23

Power sector reforms in India for the distribution segment

Some of the key recommendations made by the government or its agencies in the recent past included the following:

- Regular tariff revisions to fairly reflect the fixed and variable costs.
- Distribution franchise model where the private sector entities have no ownership over the distribution of grid assets but primarily manage the collections and the billing instead
- Distribution licensee model where the private sector entities are even owners of the distribution assets
- Smart metering that can help DISCOMs improve their billing efficiency. RDSS can be effectively leveraged to achieve full coverage using prepaid/smart meters.
- DISCOMs should be dissuaded from signing newer, more expensive long-term PPAs with thermal gencos, provided the markets can offer lower-cost power to the DISCOMs.

Exhibit 22: Reforms introduced by the govt. to reduce ACS-ARR GAP to Zero by FY25 (in INR/kWh)

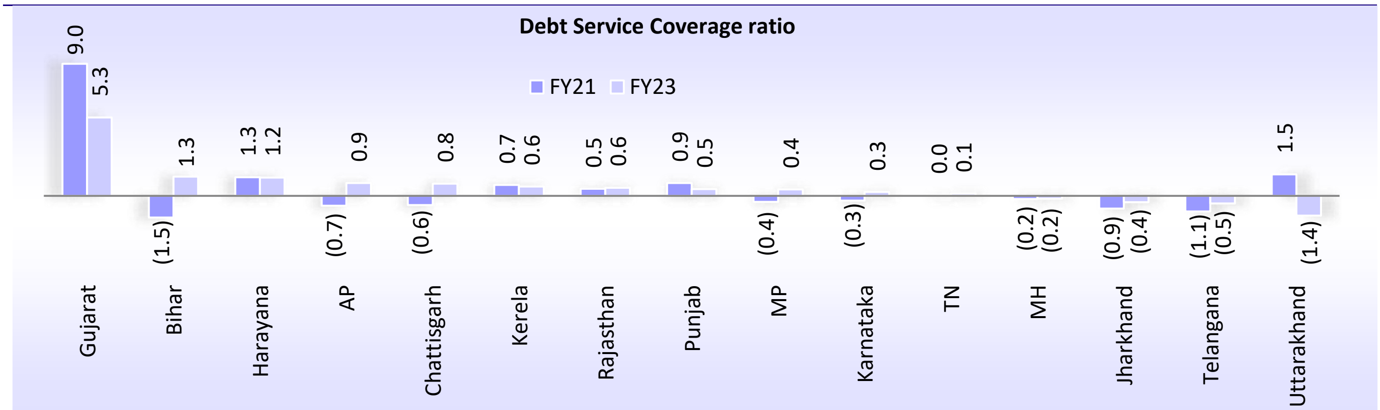


Source: PFC (Report on performance of power utilities) as of Mar'23

RDSS scheme is aimed at:

- reducing the AT&C losses to pan-India levels of 12-15% and
- reducing the ACS-ARR gap to zero by 2024-25 by improving the operational efficiencies and financial sustainability.

Exhibit 23: Debt service coverage ratio for states



PFC (Report on performance of power utilities):

- Debt servicing capabilities of state DISCOMs have seen a major improvement as compared to DSCR in 2021 (barring a few DISCOMs in Uttarakhand, Andhra Pradesh, and Chhattisgarh).

Exhibit 24: History of Central govt's debt relief measures for DISCOMs

2001-2003

- **Accelerated power development scheme:** Aimed at upgrading T&D network+ adding tamper-proof meters outlay of USD121m.
- **State Electricity Board bailout:** Central govt. converted 50% of outstanding debt to govt. bonds and 50% waived off; INR7b package.
- **Electricity Act, 2003:** Established CERC/SERCs
- **Accelerated Power Development Reforms package:** Aims to achieve 15% AT&C loss (50% at the time) through grants and incentives to states.

2008-2015

- **Restructured accelerated power development reforms package:** Central govt. to provide loans to states to improve T&D structure of high density load centers to reduce AT&C losses.
- **Financial restructuring package:** DISCOM loans restructured (USD19b outstanding to banks); 50% as govt-backed bonds and 50% into long-term loans, with lenient repayment terms and waiver of penal interests.
- **Ujwal DISCOM Assurance Yojana (UDAY):** States to take up 75% of DISCOM debt (USD52b at the time) and remainder loan to have low interest rates

2021-2023

- **Revamped distribution sector scheme:** Outlay of USD37b aimed at reducing India's AT&C losses to 12-15% and ACS-ARR gap to 0 through results-linked financial assistance outlay.
- **Electricity (late payment surcharge and related matters) Rules:** Scheme was introduced to reduce Genco receivables from DISCOMs. Late Payment Surge rules provided for an incremental surcharge with every additional month of default.
- **Electricity (Amendment) Rules:** Quarterly monitoring of subsidies being released by states as billed by DISCOMs

The NDA government has a strong focus on infrastructure, and with PFC/REC both mandated to finance both infrastructure/logistics projects, we will see a healthy sanction pipeline (presently) translating into stronger disbursements in the coming years. The loan sanction data published by REC suggests that the surge in loan sanctions has been aided by a combination of both renewables as well as infrastructure/logistics.

It is important to note that only those renewable plants that get commissioned before Jul'25 will be eligible for free inter-state transmission. This could result in a significant increase in renewable capacity additions in FY25 and translate into stronger disbursements (from existing pipelines) in FY25 and early FY26.

Exhibit 25: Strong investment pipeline in infrastructure projects

Infrastructure loans	No. of projects
NIP Projects	4,188
Non-NIP Projects	965
Total RES Projects	**5,153**

Source: NIP, MOFSL

Exhibit 26: Estimates investment of ~USD600b in infrastructure projects

Infrastructure loans	Projected investment (USD b)	Projected investment (INR t)
NIP Projects	542.9	45.5
Non-NIP Projects	39.8	3.3
Total RES Projects	**582.6**	**48.9**

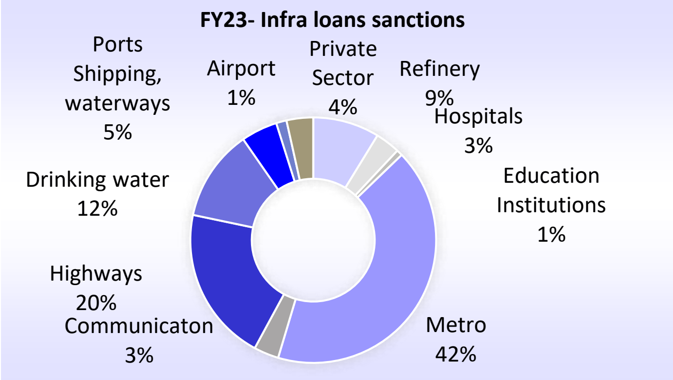
Source: NIP, MOFSL

Wholesale loans and infrastructure financing by NBFCs have been looked upon with much skepticism, particularly after the default of IL&FS

In FY24, REC sanctioned ~INR406b to non-power infrastructure sectors comprising roads & expressways, metro rail, airports, IT communication, social and commercial infrastructure (educational institution, hospitals), ports, and electro-mechanical (E&M) works in respect of various other sectors such as steel, refinery, etc.

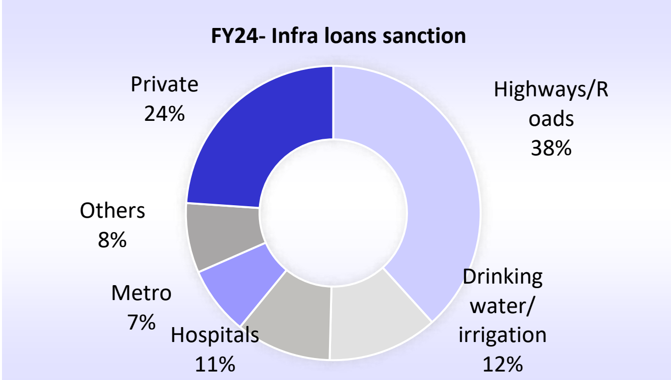
Infrastructure financing in India has evolved significantly over recent years. The previous reliance on public-private partnerships (PPP) led to failures due to developers/generators facing risks like traffic in road projects and revenue in power plants. Now, the government has shifted to models such as Hybrid Annuity Model (HAM) and Engineering, Procurement, and Construction (EPC), which reduce these risks. While this new approach is less risky, it is still a new area for PFC and REC, which have their core expertise in power sector financing. Their focus on government-backed infrastructure projects is prudent, but a shift towards significant lending to private infrastructure projects could pose risks and could be again met with skepticism from much of the investor fraternity.

Exhibit 27: REC infra and logistics loan sanctions for FY23



Source: Company, MOFSL

Exhibit 28: REC infra and logistics loans sanctions for FY24



Source: Company, MOFSL

The majority of the infra and logistics loans sanctioned by REC are to govt./ state projects, which account for ~75% (FY23: ~96%) of the total infra and logistics loans.

During FY24, REC sanctioned 38 infrastructure & logistics projects involving a total loan amount of ~INR406b in several large-scale infrastructure projects in areas such as development of highways/roads, metro rail systems, airports, hospitals, etc. The majority of the infra and logistics loans sanctioned by REC are to govt./ state projects, which account for ~75% (FY23: ~96%) of the total infra and logistics loans. However, increasing share of private loans can expose the loan book of power financiers to higher risk and ultimately elevated credit costs in the future.

COMPANIES COVERED

Power Finance Corporation: Powering progress!

REC: Charging ahead with renewable might

Power Finance Corporation

BSE SENSEX	S&P CNX
81,050	24,796

Stock Info

Bloomberg	POWF IN
Equity Shares (m)	3300
M.Cap.(INRb)/(USDb)	1447.6 / 17.2
52-Week Range (INR)	580 / 226
1, 6, 12 Rel. Per (%)	-19/-5/52
12M Avg Val (INR M)	7255
Free float (%)	44.0

Financials Snapshot (INR b)

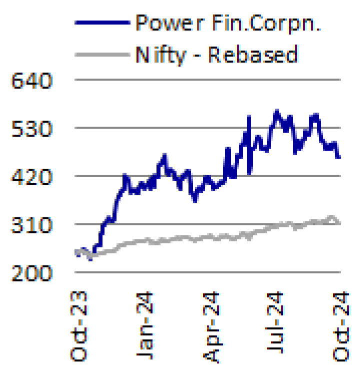
Y/E March	FY25E	FY26E	FY27E
NII	178	202	231
PPP	198	224	255
PAT	165	182	205
EPS (INR)	49.9	55.0	62.1
EPS Gr. (%)	15	10	13
BV/Sh. (INR)	275	313	357
ABV/Sh. (INR)	231	270	313
RoAA (%)	3.1	3.0	2.9
RoAE (%)	19.4	18.7	18.5
Div Payout (%)	30.0	30.0	30.0
Valuations			
P/E (x)	8.8	8.0	7.1
P/BV (x)	1.6	1.4	1.2
Core P/E (x)	5.4	4.9	4.4
Core P/BV (x)	1.1	1.0	0.8
Div. Yld (%)	3.4	3.8	4.2

Shareholding pattern (%)

As On	Jun-24	Mar-24	Jun-23
Promoter	56.0	56.0	56.0
DII	17.1	18.3	18.1
FII	17.9	17.2	17.5
Others	9.0	8.6	8.4

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR439 TP: INR560 (+28%) Buy

Powering progress!

Stressed asset resolutions will aid write-backs and keep credit costs benign

PFC is one of India's two major public sector pure-play power asset finance companies. With a presence across the value chain, PFC has a significant exposure to power generation (~48% of loans as of Jun'24, including ~13% in renewable energy or RE) and only ~19% of its loans are offered to private players. Given its strong focus on RE/infrastructure lending and intense competition from banks in this segment, PFC's spreads are likely to contract by ~20bp over the next two years. Our detailed project-level analysis suggests that asset quality will continue to improve from hereon, aided by stressed asset resolutions (particularly in thermal generation) and lower credit costs (including write-backs from recoveries) of <5bp over the next three years.

Asset quality risks have receded; stressed asset resolutions to continue

We tried to reconstitute PFC's stressed project portfolio and believe that PFC has demonstrated significant progress on stressed asset resolutions and is already at advanced stages of resolutions in projects with total exposure of ~INR40b. Most of the stressed projects are adequately provided for and recoveries in many projects will flow directly into the income statement. Based on our analysis, we estimate recoveries of ~INR15-20b over the next 12-18 months.

Expect ~15% loan CAGR over the next three years

- PFC and REC will always remain the implementing agencies for all incentives and schemes rolled out by the government of India (GoI) to influence every power sector reform. PFC clocked a ~24% CAGR in loan book over FY10-FY15, driven by strong capex in the thermal power segment. However, loan book growth slowed to a 7% CAGR during FY15-FY22 because of stress in thermal generation projects and the focus shifting toward RE projects and T&D.
- FY24 disbursements were dominated by DISCOM disbursements. Over the next five years, we anticipate a significant acceleration in generation capex, driven by investments in conventional generation and energy transition in India, which is aiding RE projects. A strong sanction pipeline in infrastructure will also lead to stronger disbursements in such infrastructure projects in the coming years. We expect a ~15% CAGR in loans for PFC over FY24-FY27.

Intense competition and declining interest rate cycle to weigh on margins

PFC delivered historical high spreads of 3.3% in FY22, which declined to 3.1%/2.8% in FY23/FY24. Historically, the spreads for PFC have been around 250-300bp. Spreads could compress further due to a) banks remaining aggressive and amenable to financing good-quality operational power projects, b) lower spreads in RE financing, which continues to see high competition, and c) a possible decline in the repo (interest) rate since a large proportion of assets are linked to a floating rate, while a large proportion of liabilities (particularly domestic debt market and foreign borrowings) are fixed rate. PFC had shared that a ~25bp decline in the interest rates (over a one-year period) would impact its profits by ~INR3.2b.

We estimate yield compression of ~20bp over the next three years, which will potentially result in a decline in NIM to ~3.5% in FY25/FY26E.

High earnings predictability from healthy loan growth and benign credit costs

PFC, being a specialized power financier, will be able to leverage its lending opportunities across conventional generation, renewables, and logistics to deliver a healthy 11% disbursement CAGR over FY24-FY27E. Considering the status of PFC's sanctioned loans (translating into disbursements in the subsequent years), we are confident that PFC's loan growth will remain healthy at ~15% CAGR over FY24-FY27E. PFC has no NPAs in state-backed projects. All 21 projects that are classified as NPAs are from the private sector. GNPA has declined to ~3.3% in FY24 from ~8.1% in FY20, and similarly, NNPA has declined to ~0.9% in FY24 from ~3.8% in FY20. Over the last five years, PFC has increased the PCR on its Stage 3 loan assets from ~51% in FY20 to ~74% in FY24. The company reported ~22% YoY PAT growth to ~INR145b in FY24. There is good visibility on a stable earnings growth trajectory for PFC, and we estimate an adjusted PAT CAGR of ~12% over FY24-FY27E with RoA/RoE of 2.9%/19% and a dividend yield of ~4.2% in FY27E.

Valuation and view

PFC (standalone) trades at 1.0x FY26E P/BV and 4.9x FY26E P/E. In our view, we are in the early phase of this current power uptrend and there is strong visibility on loan and earnings growth, given that stressed asset resolutions will continue (keeping credit costs at <5bp) for the next three years. **We initiate coverage on PFC with a BUY rating** and our SoTP (Sep'26E)-based TP of INR560 (based on 1.2x target multiple for the PFC standalone business and INR211/share for PFC's stake in REC after holdco discount of 20%).

Key risks

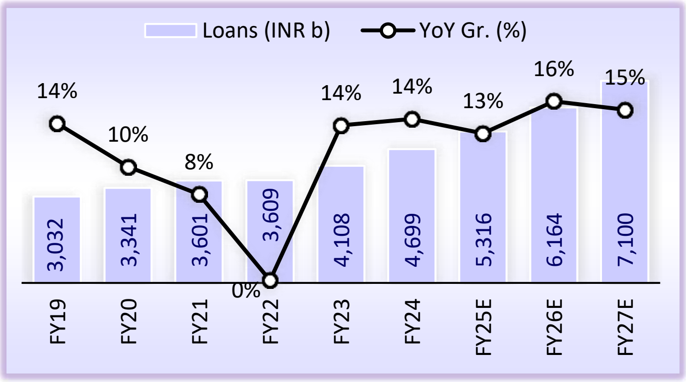
The key downside risks to our investment thesis include: 1) increasing exposure to the high-risk power projects without PPAs, such as merchant RE plants, pumped storage, and green hydrogen projects; 2) expanding exposure to private infrastructure projects that raises risks as these loans fall outside PFC's core business of lending to power projects; 3) the RBI's proposed stricter provisioning norms for project financing that increase the provisioning requirement to ~5.0% from ~0.4% and which would be gradually brought down subject to conditions; and 4) compression in spreads and margins due to intensified competition.

PFC: SOTP – Sep'26E

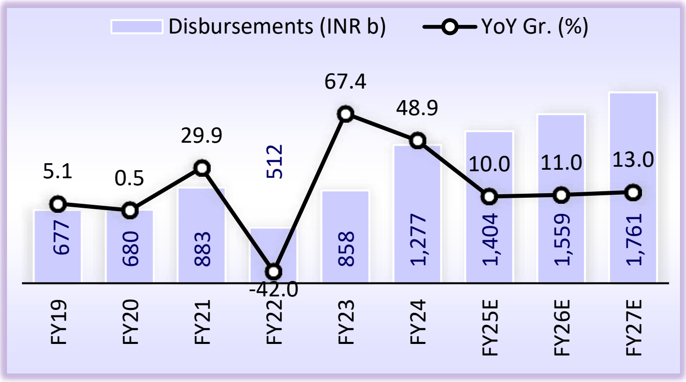
	Stake	Target Multiple	Value (INR B)	INR per share	% To Total	Rationale
PFC Standalone	100	1.2	1,153	350	62	1.2x Sep'26 PBV
REC Stake (Pre-Holdco)	53	1.6	873	**265**		1.6x Sep'26 PBV
Hold Co Discount (20%)			175			
REC Stake (Post-Holdco)			**698**	**210**	38	
Target Value			**1,852**	**560**	**100**	

STORY IN CHARTS

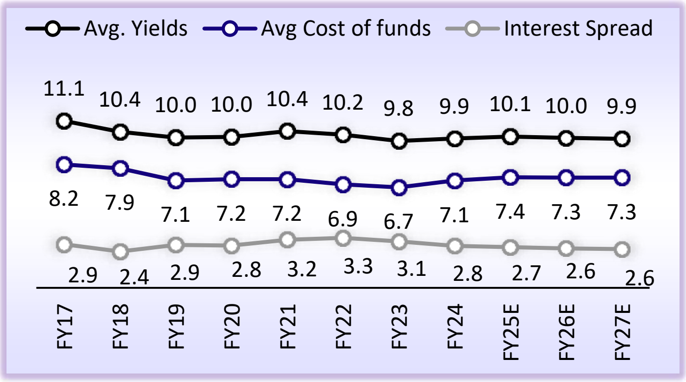
Loan book CAGR of 15%...



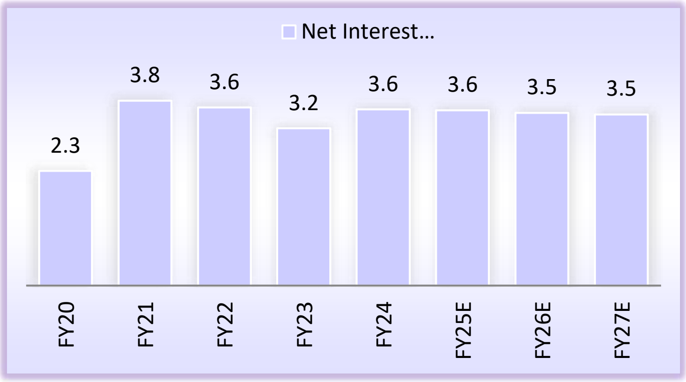
...supported by 11% disbursement CAGR



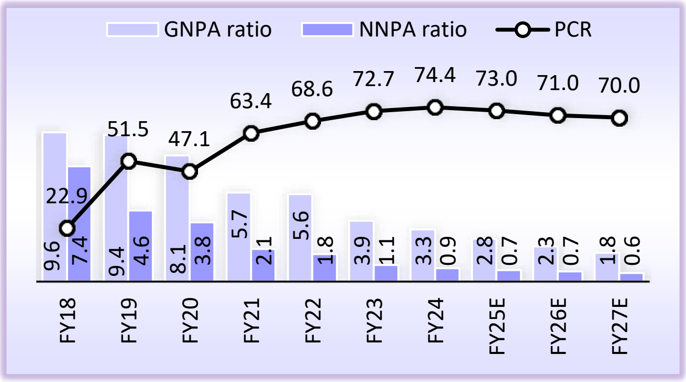
Compression in spreads is inevitable... (%)



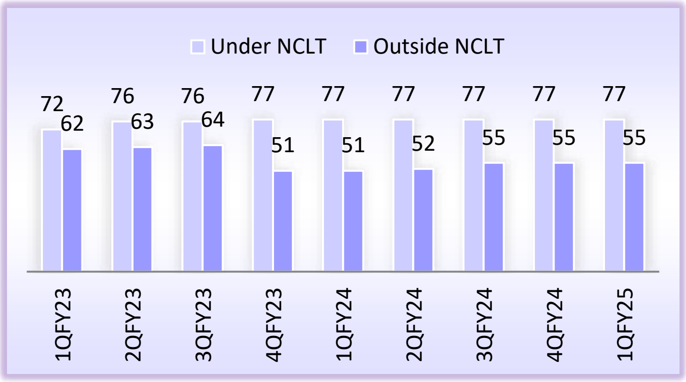
...leading to a minor pressure on NIM as well



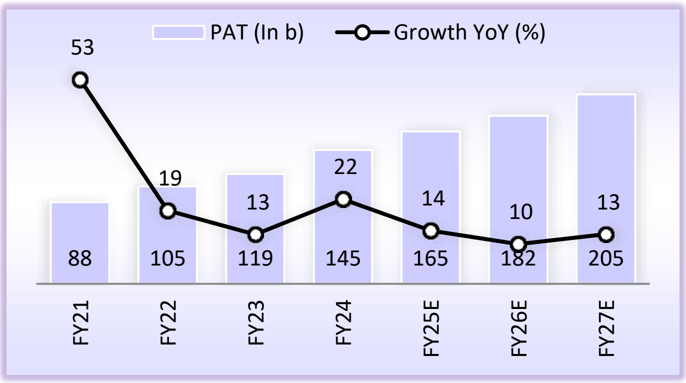
Resolutions will result in a further improvement in asset quality (%)



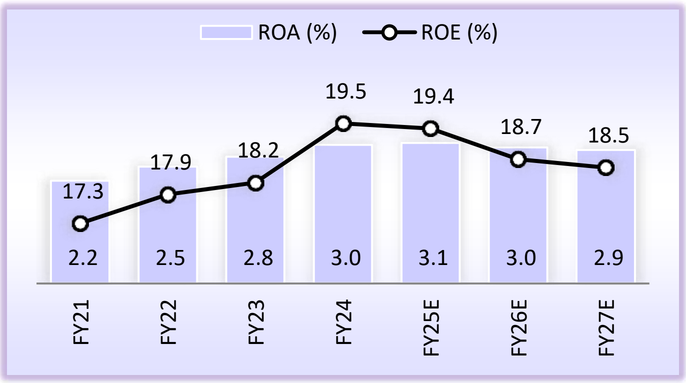
Stressed loans being resolved in NCLT and outside NCLT with healthy provision covers (%)



PAT CAGR of 12% over FY24-26E...



RoA/RoE of ~3%/19% in FY26



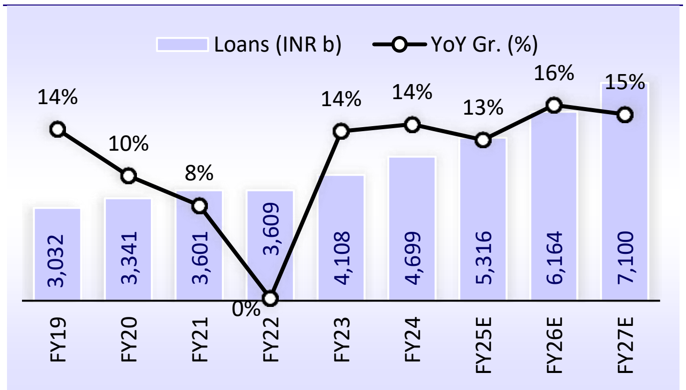
Investment proposition in PFC

- Loan growth to remain strong on the back of healthy sanction pipeline
- Margins reasonably healthy even after building in spread compression
- Diversified liability profile with greater hedging of foreign currency liabilities
- Significant improvement in asset quality with stressed asset resolutions
- Good visibility on earnings growth and franchise with healthy RoA/RoE

Disbursement/loan likely to clock CAGR of 11%/15% over FY24-27

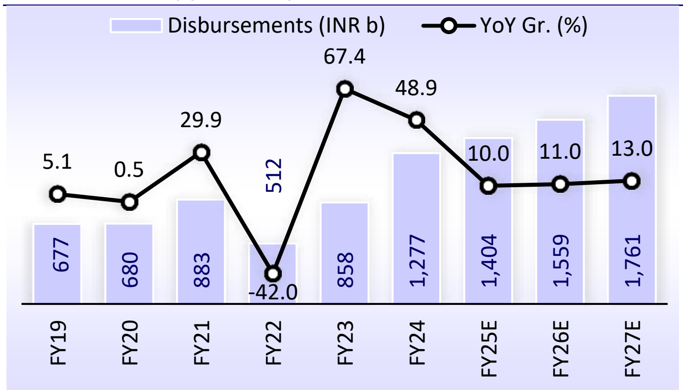
PFC is a mono-line and a specialized power and infrastructure lender. Given that, incrementally, a lot of the focus is on financing renewable energy and infrastructure projects, PFC has also started exploring newer business avenues actively. It has started financing electric vehicles/ EV charging infrastructure, smart metering projects, FGD installations, bio-refinery projects, ethanol blending and selectively even CGD projects.

Exhibit 29: Loan book CAGR of 15%...



Source: MOFSL, Company

Exhibit 30: ...supported by 11% disbursement CAGR

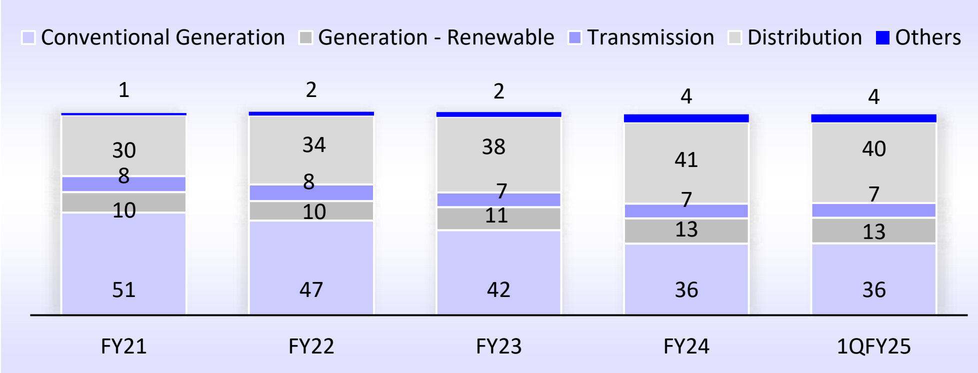


Source: MOFSL, Company

PFC being a specialized power financier will be able to leverage the lending opportunities across conventional generation, renewable and logistics to deliver a healthy 11% CAGR in disbursements over FY24-FY27E. We expect the run-off in the loan book (including pre-payments) to remain elevated at ~16% in FY25 and then moderate to ~13% in FY26/FY27. This should translate in a loan CAGR of ~15% over the next three fiscal years.

Exposure to generation (including conventional) and transmission will start picking up now

Exhibit 31: Sharp increase in exposure to distribution over the last four years driven by disbursements under the DISCOM liquidity infusion package and LPS scheme (%)

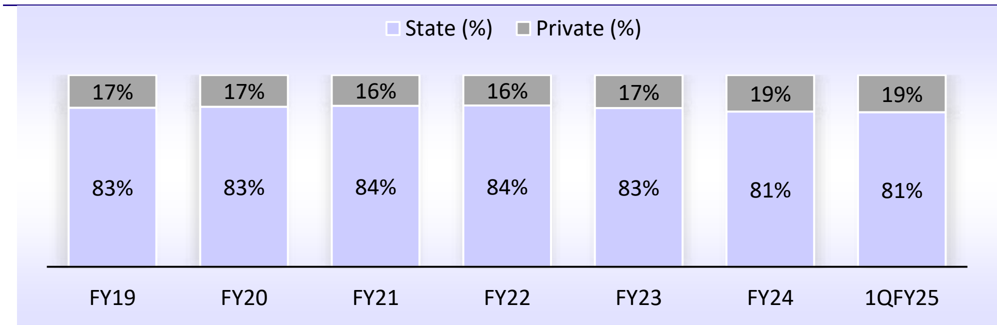


Source: MOFSL, Company

The proportion of conventional generation projects in the loan mix has declined to 36% as of Jun'24 from ~51% in Mar'21. This was both a function of the aversion of power lenders to conventional generation as well as the subsequent resolution of stressed thermal generation projects. Decline in conventional generation was complemented by higher proportion of loans in the renewable and distribution segments.

India had committed under the 2015 Paris agreement to reduce greenhouse gas emissions intensity by 33%-35% below 2005 levels, and to achieve 40% of installed electric power capacity from non-fossil sources by 2030. In 2015, India had embarked on an ambitious plan of installing 500 GW of renewable energy capacity by 2030. Against this target, total renewable capacity (including Hydro) as of Jul'24 was ~200GW. **Renewable energy now contributes 13% to PFC's loan mix and we expect this to increase to ~25% over the next five years.**

Exhibit 32: Marginal increase in exposure to private sector in the loan mix is predominantly from renewable projects



Source: MOFSL, Company

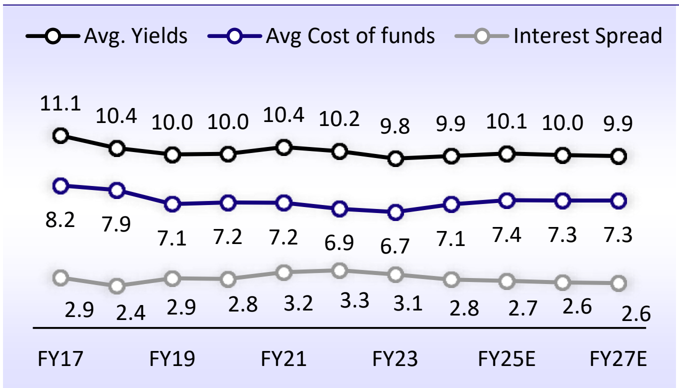
PFC and REC were the nodal implementation agencies for the DISCOM package announced by the GoI under the Atmanirbhar DISCOM Scheme and the Late Payment Surcharge (LPS) rules and reforms. Disbursements under the scheme are supported by state government guarantees and secured against DISCOMS' receivables in the form of electricity dues.

PFC has also been actively financing private sector projects in RE since it has a smaller execution timeline compared to thermal generation and has pre-agreed PPAs. Further, the risk of NPAs in RE projects is significantly low. This led to a minor increase in PFC's exposure to private sector enterprises over the last two years.

Margins healthy despite building in a ~20bp compression in spreads

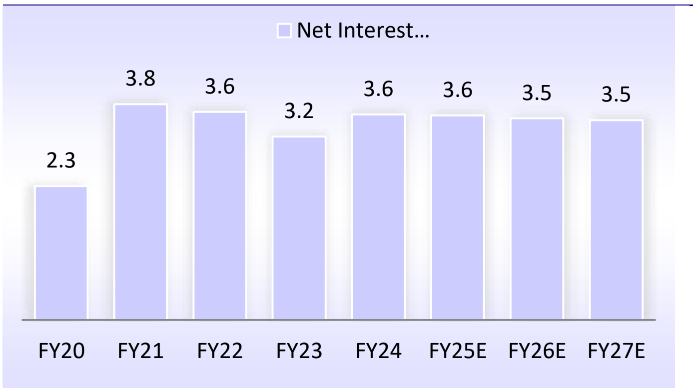
In 2015, prior to the introduction of the UDAY scheme, DISCOM debt had surged to INR4.3t, with banks having an exposure of ~INR1.6t at interest rates of 14-15%. Most of this debt was transferred to state governments, while the remaining portion was restructured, resulting in banks taking haircut and offering lower interest rates at the base rate plus 10bp (which amounted to ~400-500bp of haircut in interest rates). Because of this, banks and most other wholesale NBFCs have in the recent past avoided power financing, especially to financially stressed DISCOMS.

Exhibit 33: Compression in spreads is inevitable… (%)



Source: MOFSL, Company

Exhibit 34: …leading to a minor pressure on NIM as well



Source: MOFSL, Company

We did a scenario analysis around the yields and the spreads that PFC will be able to command as we believe the current yields are clearly unsustainable given the increasing proportion of renewable and infrastructure loans (which are more competitive segments) in the loan mix. Our belief that spreads will moderate is predicated on the following reasons: a) As the financial health of the state DISCOMS improve, they would expect PFC/REC to extend loans to them at interest rates that are comparable to the state government bond yields; and b) With low systemic credit growth, the banks will be looking to selectively re-finance operational and good-quality power projects of PFC/REC and c) Increasing proportion of renewables which is a highly competitive segment with relatively lower spreads.

Our scenario analysis suggests that even if spreads were to moderate to ~2.3% over the next two years, PFC would still be able to deliver NIM of ~3.2% and RoA/RoE of ~2.7%/17.4%. This combination of return profile, along with a dividend yield of ~4%, is better than many other PSU banks (albeit, at slightly cheaper valuations than PFC/REC).

Exhibit 35: Scenario analysis on spreads/margins assuming other items remain unchanged (%)

Scenario Analysis	Scenario 1	Scenario 2	Base Case
Yields	9.65	9.75	9.95
CoF	7.30	7.30	7.30
Spreads	2.30	2.40	2.60
Margin	3.20	3.30	3.50
RoA	2.7	2.8	3.0
RoE	17.4	17.8	18.7

Source: MOFSL, Company

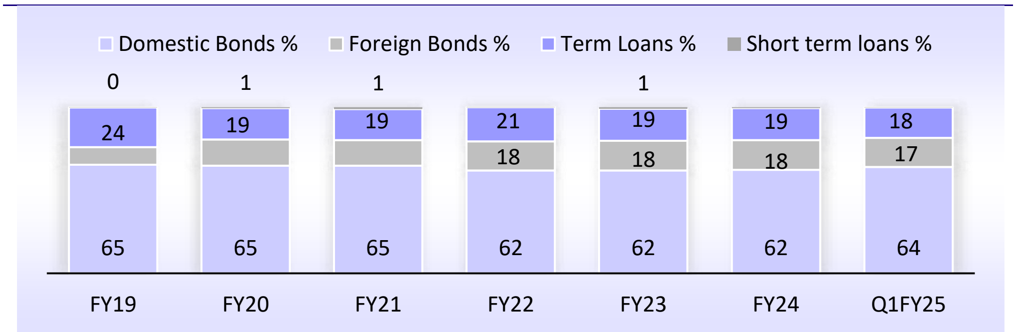
Under our base case, we estimate a yield of 9.95%, a spread of 2.6% and a margin of 3.5% in FY26E for PFC.

Diversified liability profile with better hedging of foreign currency liabilities

PFC has a diversified liability profile and a high share of domestic bonds and foreign-currency borrowings in its liability mix. Unlike other NBFCs/HFCs, PFC does not fully hedge its foreign currency borrowings. As of Jun'24, PFC enhanced its exchange risk hedge ratio to 95% for the portfolio with residual maturity of up to five years (up from 86% as of Mar'21). With this, PFC's earnings are relatively insulated from foreign exchange fluctuations.

Until 2023, a lot of RE projects leveraged USD bonds compared to INR term loans. After 2023, the spreads between 10Y Indian and US G-Sec bond yields narrowed and stood at <300bp as of Jun'24. USD borrowing rates have gone up faster than INR borrowing rates. After hedging costs, it is now cheaper for power/infrastructure projects to borrow in INR than in USD bonds.

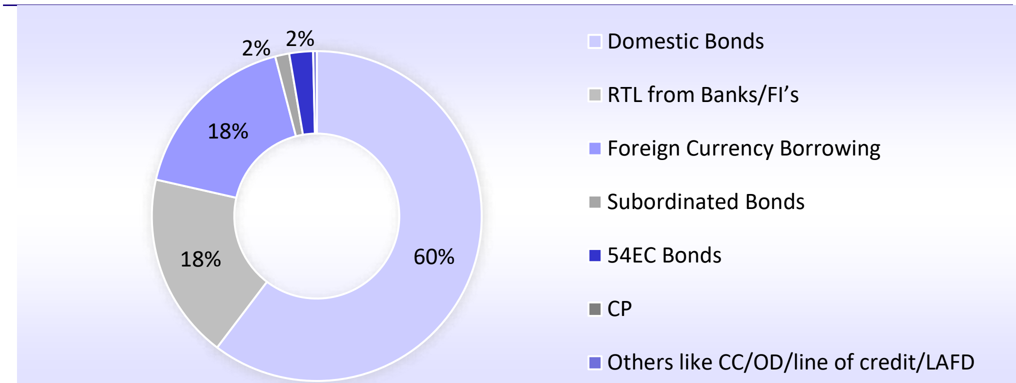
Exhibit 36: Liability mix has a fair share of foreign borrowings



Source: MOFSL, Company

The interest rate cut in the US will not change the attractiveness of INR term loans since, at some point, the interest rate cuts will happen in India as well. Quite a few power generators issued USD bonds when borrowing in USD was cheaper than borrowing in INR. When these maturing USD bonds are refinanced with INR term loans, it will offer another opportunity for loan growth for PFC/REC.

Exhibit 37: Liability mix is dominated by domestic bonds



Source: Company, MOFSL; Note: Data as on Jun'24

PFC has a credit rating of AAA for domestic borrowings and is rated BBB- for all external commercial borrowings. PFC has sovereign backing and much better access to longer-duration liabilities (~60% of its borrowings come from domestic bonds, most of which have a duration of 10 years), which enable PFC to keep a matched ALM profile.

Earlier, only REC was allowed to raise money via 54EC bonds, but later PFC also got approval from the Ministry of Power to raise liabilities through this route. 54EC bonds now constitute ~2% of the borrowing mix for PFC.

Exhibit 38: Credit rating of PFC

Debt type	CRISIL	ICRA	Fitch/Care	Moody's/IR&R
Domestic long-term instrument	AAA	AAA	AAA	AAA
Short term borrowing	A1+	A1+	A1+	
Foreign borrowing			BBB-/stable	Baa3(stable)

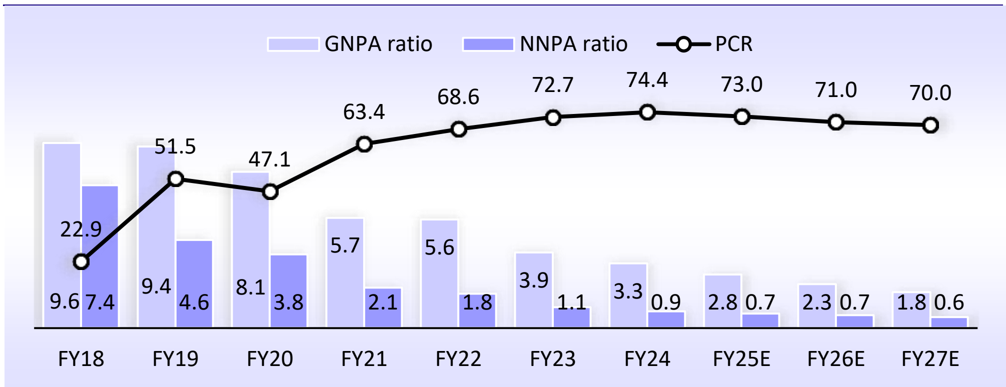
Source: MOFSL, Company; Data as of Mar'24

Stress asset resolutions have led to significant improvement in asset quality

Like most industry experts in the power sector, we also believe that the current power uptrend will last for several years, driven by investments in both conventional generation and RE capability. We do not want to underemphasize the investments in transmission, which will be required to support the new installed generation capacity coming up over the next five years.

We would not go so far as to say that there was no stress in the power sector or that all stressed assets would be resolved in the near future. However, it is important to highlight that asset quality risks in the current power uptrend have receded and we would continue to see the resolution of stressed assets, which became distressed in the last power down-cycle), over the next two years.

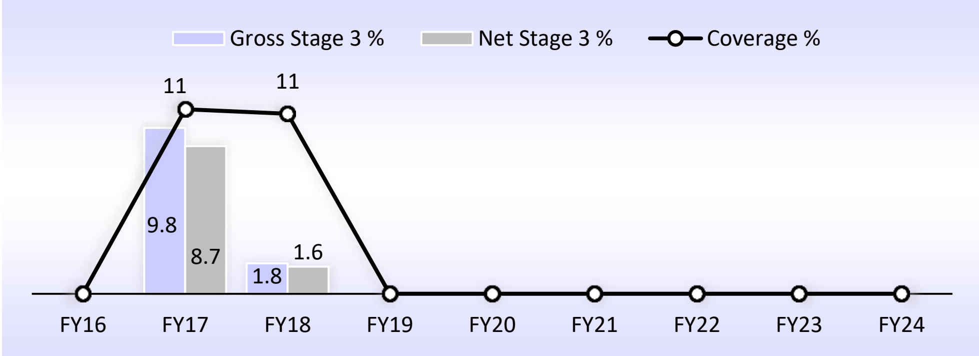
Exhibit 39: Resolutions will result in a further improvement in asset quality (%)



Source: MOFSL, Company

Even though there is always an overarching risk in exposures to state government entities, they have managed to remain standard because of the guarantees from state government and repayments just before they turn NPAs. However, our project-level analysis of PFC's private sector loans (primarily large ticket exposures) suggests that many of the erstwhile stressed projects are now at advanced stages of resolution and that the net slippages over the next two years should be negative. This should translate into an improvement in headline asset quality as well as keep net credit costs benign at <5bp over FY25-FY27E.

Exhibit 40: Nil NPAs in the public sector loan book of PFC



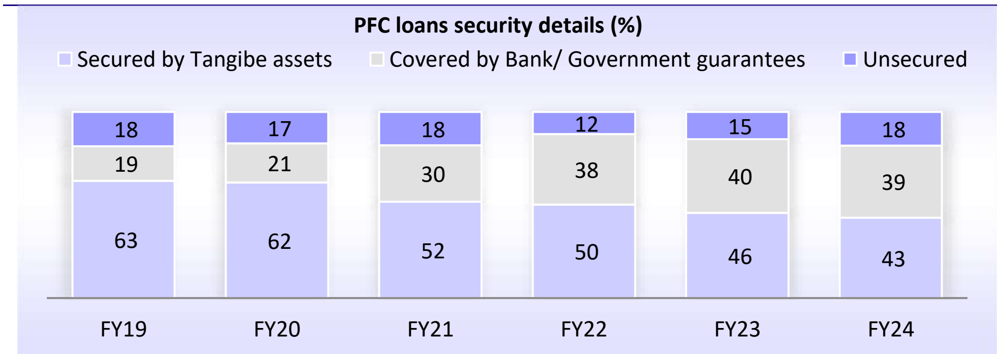
Source: MOFSL, Company

PFC has no NPAs in state-backed projects. All the 21 projects that are classified as NPAs are from the private sector. Resolutions in 13 NPA projects are being pursued under NCLT, and PFC is trying to achieve a resolution in the remaining eight NPA projects outside NCLT.

Among the stressed projects, three accounts with total outstanding of ~INR40b are at advanced stages of resolution.

- Among these three accounts, **Lanco Amarkantak** (600MW commissioned and 2x660MW expansions under Phase II), in which PFC has **total exposure of ~INR24b,** has received final NCLT approval to be acquired by Adani Power through the insolvency resolution process. PFC had made provisions of ~76% for this exposure and based on this resolution, there will be minor write-backs.
- In addition, there is also **TRN Energy with outstanding exposure of ~INR11.4b** (600MW commissioned). The resolution of TRN is being pursued outside NCLT, whereby the resolution plan has been formulated and approval from all the consortium lenders is awaited.
- The resolution of **KSK Mahanadi (6x600MW party commissioned project) with an outstanding exposure of ~INR33b** is being pursued in NCLT. While PFC has a ~55% provision cover on this exposure, it expects >100% recovery against this project based on the bids that have been received.

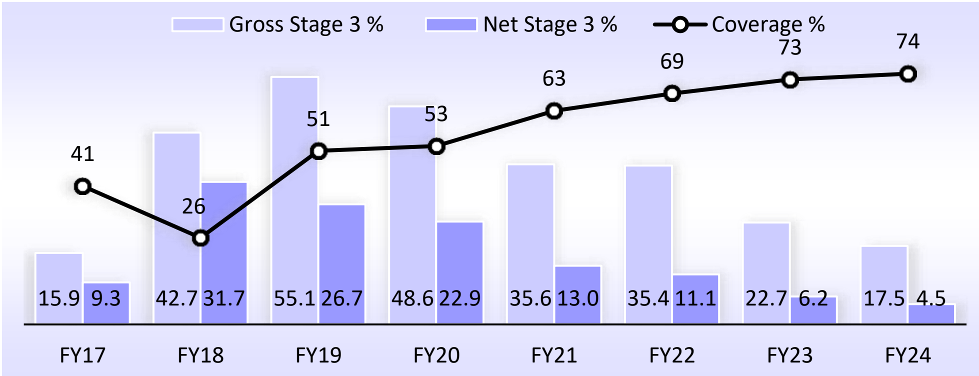
Exhibit 41: Only 18% of PFC's entire loan book is unsecured, 43% backed by tangible assets and 39% backed by bank/government guarantees



Source: MOFSL, Company

If we look at the security details of the loans extended by PFC, nearly ~40% of PFC's loan book is backed by state govt. guarantees/bank guarantees, ~43% by tangible assets and only 18% unsecured. Many of these unsecured loans are also eventually backed by state-guarantees. Until some of those loans are approved for state-guarantee, they are categorized as unsecured.

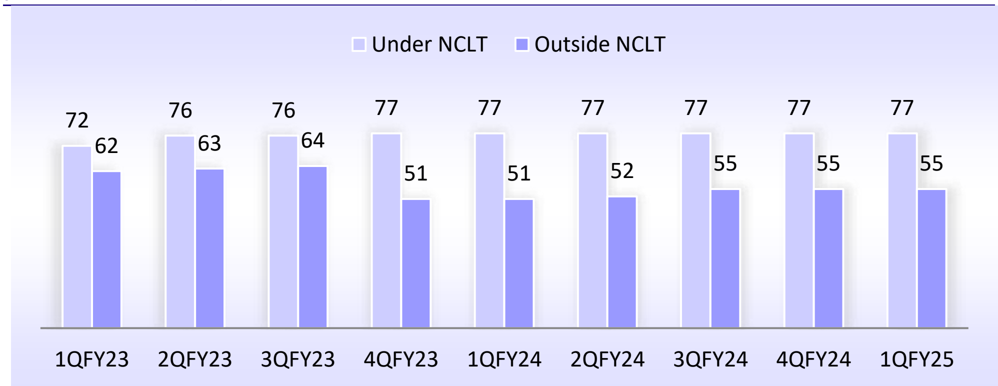
Exhibit 42: Private loan book of PFC has witnessed resolutions and improved PCR



Source: MOFSL, Company

Over the last five years, PFC has increased its provision coverage on its Stage 3 loan assets to ~74% (compared to ~51% as of FY19). It is working on the resolutions of stressed exposures both in NCLT as well as outside.

Exhibit 43: Stressed loans being resolved in NCLT and outside NCLT with healthy provision covers (%)



Source: MOFSL, Company

Exhibit 44: PFC – A snapshot of NPA exposure along with expected recovery and current status of resolutions

Sr No	Projects	State	Fuel	Outstanding (INR b)	NCLT	Stage of Resolution	Expected Recovery	COD Status	Comments
1	KSK Mahanadi	Chhattisgarh	Coal (domestic)	33	NCLT	Expected to get resolved in this fiscal	>100%	3 units commissioned (1800 MW)	❖ Expression of interest was seen with 26 active participants. Company has made provisions of ~55%
2	Lanco Amarkantak	Chhattisgarh	Coal (domestic)	24	NCLT	Advanced	~30%	2 units commissioned	❖ **NCLT approval received on 23rd August**. The company has made ~76% provision. Write-backs in the range of ~20%
3	Shri Maaheshwar	Madhya Pradesh	Hydel Power	16	NCLT			Not commissioned	❖ Discussions on resolutions going on and case is with COC. Company has made provisions of 100%
4	Sinnar Power Transmission	Delhi	Power transmission	1.6	NCLT	Expression of interest from 16 participants		Commissioned	❖ Made provisions of ~80%
5	India Power Corporation (Haldia)			10	NCLT			2 units commissioned (300 MW)	❖
6	Sinnar Thermal (Rattan India Nasik)	Maharashtra	Coal (domestic)	30	Outside NCLT		40%		❖ Made provisions of ~80%
7	Konaseema	Andhra Pradesh	Gas	4	Outside NCLT		<20%		❖ Under liquidation and made provisions of ~100%
8	IPCL Haldia	West Bengal	Imported coal	9.6	Outside NCLT				❖ Expression of Interest pending, once the same is completed all the bids will be finalized.
9	Shiga Energy	Sikkim	Hydro	5.2	Outside NCLT	Advanced	100%	Commissioned	❖ Approved the resolution plan and it is expecting that the other consortium members will be approving it soon. Expect marginal write-backs.
10	TRN Energy	Chhattisgarh	Coal (domestic)	11.4	Outside NCLT	Advanced	100%	Commissioned	❖ Resolution plan is finalized but the same is pending for approval by lenders. Expect marginal write-backs.
11	East Coast	Andhra Pradesh	Coal (domestic & imported)	11.25	NCLT		<20%		❖ Under liquidation and made provisions of ~100%
12	Jas Infra (coal)	Bihar	Coal (domestic)	2	NCLT		10%-20%		❖ Under liquidation and made provisions of ~100%
13	Ind Barath Madras	Tamil Nadu	Thermal Power	4.25	NCLT		20%		❖ Under liquidation and made provisions of ~100%
14	KVK Nilachal	Hyderabad	Coal (domestic)	4	NCLT		20%		❖ Under liquidation and made provisions of ~100%
15	EMP Power	Andhra Pradesh		0.16					❖ Under liquidation and made provisions of ~100%
16	Om Shakti	Rajasthan		0.04					❖ Under liquidation and made provisions of ~100%

Source: MOFSL, Company

Exhibit 45: PFC – Stressed loan projects that are in liquidation

Corporate	Outstanding amount (INR b)	Details
East Coast	11	❖ Under liquidation and made provisions of ~100%
Konaseema	4	❖ Under liquidation and made provisions of ~100%
Jas Infra (coal)	24	❖ Under liquidation and made provisions of ~100%
Ind Barath Madras	4.25	❖ Under liquidation and made provisions of ~100%
KVK Nilachal	4	❖ Under liquidation and made provisions of ~100%
Emp Power	0.16	❖ Under liquidation and made provisions of ~100%
Om Shakti	0.04	❖ Under liquidation and made provisions of ~100%

Source: MOFSL, Company

Exhibit 46: PFC – Stressed loan projects which are resolved

Name of the borrower	PFC's exposure (INR b)	Remarks	Year of Resolution
Mytrah Vayu Tungbhadra Private Limited	7	❖ Restructuring with change in ownership outside NCLT	FY24
Dans Energy Private Limited	4	❖ Restructuring without change in ownership outside NCLT	FY24
Suzlon Energy Ltd	2	❖ One Time Settlement	FY23
South-East UP Power Transmission Company Limited	23	❖ Resolution with change in ownership through NCLT	FY23
Jhabua Power Limited	8	❖ Resolution with change in ownership through NCLT	FY23
Ind Barath Energy Utkal Ltd. (IBUEL)	14	❖ Resolution with change in ownership through NCLT	FY23
Krishna Godavari Power Utilities Ltd.	1	❖ Restructuring with change in ownership through NCLT	FY22
GVK Ratle Hydro Electric Project Pvt. Ltd.	11	❖ One time settlement	FY22
Essar Power MP Ltd	13	❖ Restructuring with change in ownership through NCLT	FY22
Astonfield Solar (Gujarat) Pvt. Ltd.	0	❖ Restructuring with change in ownership through NCLT	FY22
RS India Wind Energy Private Limited	2	❖ One time settlement	FY22
Essar Power Transmission Corp. Ltd	4	❖ Restructuring without change in ownership	FY21
Suzlon Energy Limited	9	❖ Restructuring without change in ownership	FY20
RKM Powergen Pvt. Ltd.	51	❖ Restructuring without change in ownership	FY20
Ratnagiri Gas & Power Pvt. Ltd.	2	❖ Composite Resolution Plan including One time settlement	FY20
Jal Power Corporation Ltd.	4	❖ One time settlement	FY20

Source: MOFSL, Company

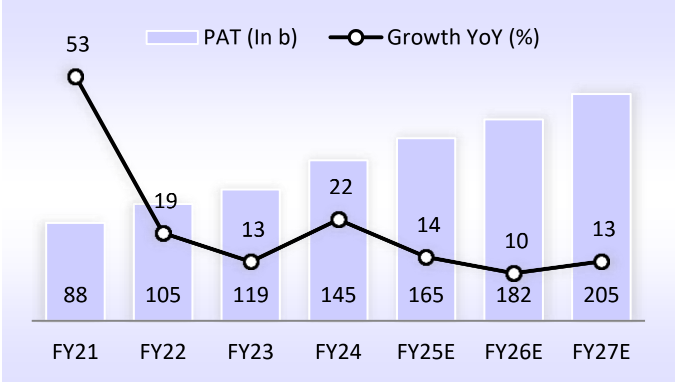
PFC has demonstrated its ability to achieve stressed project resolutions. As of Jun'24, PFC's gross Stage 3 stood at 3.4%, down from ~8% as of FY20. The company has also increased the provision cover on its Stage 3 loans, with the net Stage 3 declining to 0.9%. We believe that the provision coverage on Stage 3 loans is adequate. Moreover, on the 13 projects that are being resolved under NCLT, PFC now carries a PCR of 77%, while on the eight projects that are being resolved outside NCLT, it now carries a PCR of 55%.

Good visibility on earnings growth and franchise with healthy RoA/RoE

Considering the status of PFC's sanctioned loans (translating into disbursements in the subsequent years), we are confident that PFC's loan growth will remain healthy at ~15% CAGR over FY24-FY26E. While NIM could compress, we believe that it could be offset by better asset quality. Given our view on the power cycle, over the next at least two years, we do not see any new stressed asset formation. In the absence of any new stressed asset formation and the resolution of existing stressed projects, credit costs will remain benign with a stronger possibility of write-backs over the next two years.

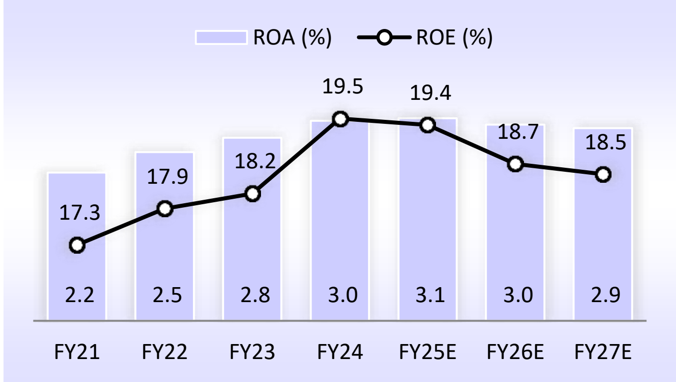
There is good visibility on a stable earnings growth trajectory for PFC and we estimate a PAT CAGR of ~12% over FY24-FY26. This will translate into an RoA/RoE of 3%/19% in FY26.

Exhibit 47: PAT CAGR of 12% over FY24-26E…



Source: MOFSL, Company

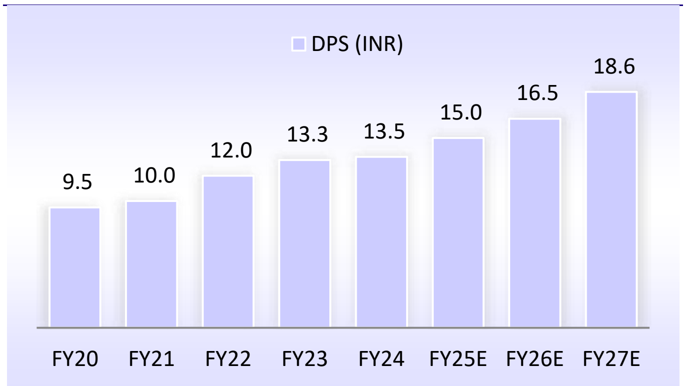
Exhibit 48: RoA/RoE of ~3%/19% in FY26



Source: MOFSL, Company

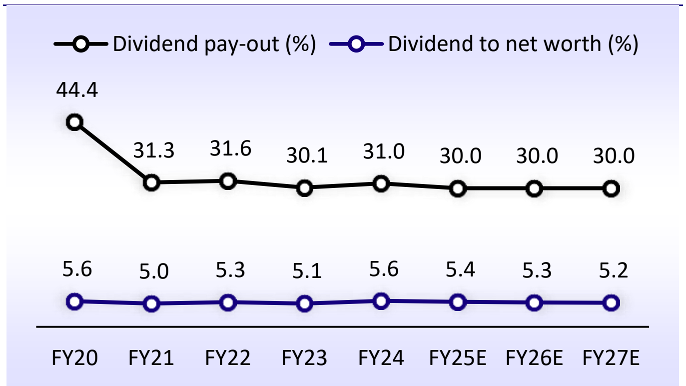
Back in May'16, the GoI had mandated every CPSE to pay a minimum annual dividend that is higher than either 30% of PAT or 5% of net worth. This was subject to the maximum dividend allowed to be paid out under the extant legal provisions.

Exhibit 49: Healthy payout of dividends…



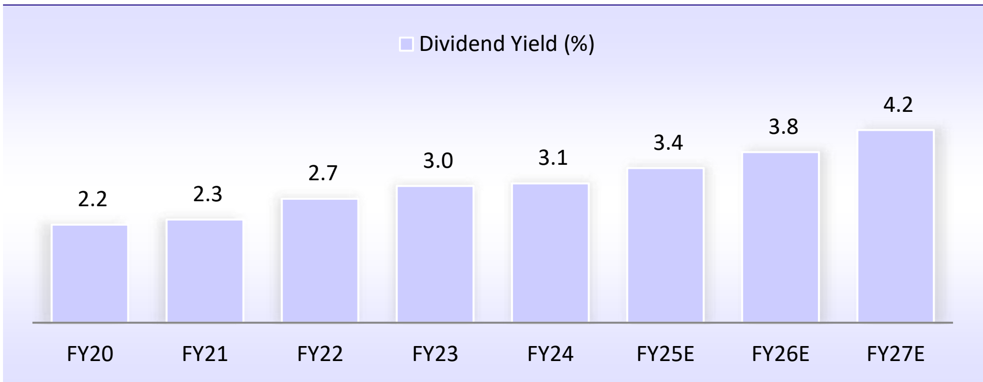
Source: MOFSL, Company

Exhibit 50: …driven by dividend policy that is higher of either 30% of PAT or 5% of the net worth



Source: MOFSL, Company

Exhibit 51: Dividend yield of ~3.8% in FY26



Source: MOFSL, Company

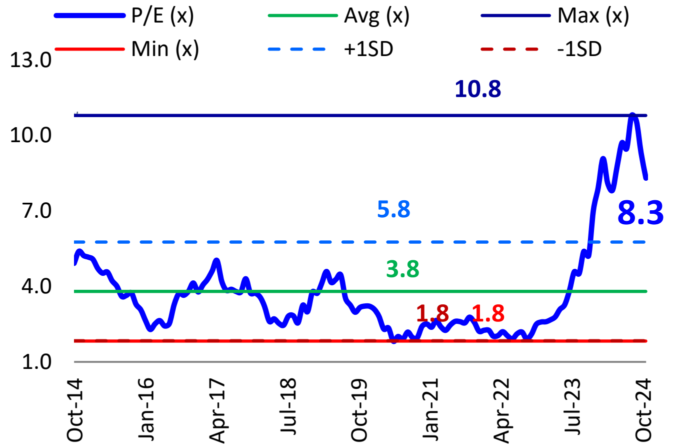
PFC: Valuation and View

We believe that given the niche nature of power financing and the fact that PFC/REC are the nodal implementation agencies for the power reforms initiated by the GoI, PFC will always remain relevant. Moreover, with opportunities in RE, EVs, and charging infrastructure, and the modernization of the existing thermal power plants, infrastructure and logistics, we believe PFC will be able to demonstrate a healthy loan growth with receding risks on asset quality.

We estimate a PAT CAGR of ~12% for PFC over FY24-FY26 with an RoA/RoE of 3.0%/19% and a dividend yield of ~3.8% in FY26. The stock trades at 1.0x FY26E standalone P/ABV and we believe that the risk-rewards are favorable in the current power uptrend. Moreover, PFC's stock price has corrected by ~25% from its recent highs, and now even provides a margin of safety in valuations.

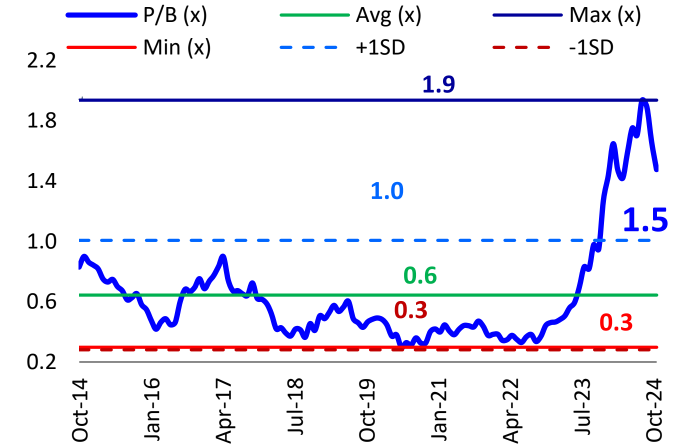
We initiate coverage on PFC with a BUY rating with our SoTP (Sep'26E)-based TP of INR560 (based on 1.2x target multiple for the standalone business and INR211/share for PFC's stake in REC after holdco discount of 20%).

Exhibit 52: PFC - One-year forward P/E



Source: MOFSL, Company

Exhibit 53: PFC - One-year forward P/B



Source: MOFSL, Company

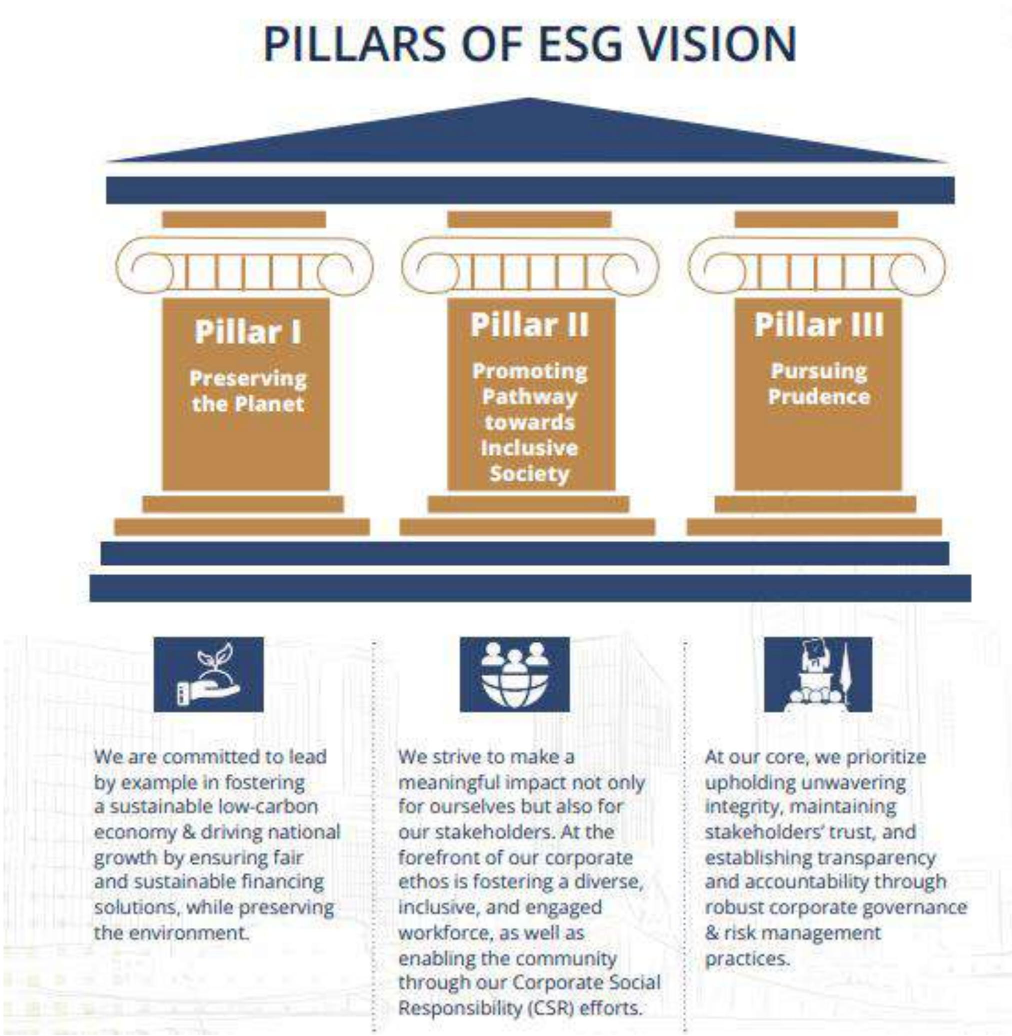
PFC: Key risks

- **Increase in exposure to projects without PPA:** Lending to power projects without PPAs was a significant reason behind the financial strain in the past. While power sector lenders have since made PPAs a prerequisite for loan disbursal, there are still concerns about renewed exposure to projects lacking these PPAs. High-risk areas include: merchant RE plants (NBFCs have started partial lending without PPAs), pumped storage plants (which require significant capital before securing PPAs), and green hydrogen projects (which lack a defined PPA structure and have high capex requirements).
- **Expanding exposure to private infrastructure loans:** Until recently, PFC primarily extended loans to government entities in the infrastructure sector, with minimal exposure to private firms. However, any future increase in lending to private infrastructure or industrial projects could pose significant risks. The company acknowledged sanctioning loans to Shapoorji Pallonji Group, which we believe could be secured by the Group's real estate cash flows and shares in Tata Sons. Private loans (particularly those to promoters) fall outside the core business of PFC.
- **RBI's draft stricter provisioning norms on project financing:** The RBI has proposed stricter lending norms for project financing, increasing provisioning requirements from 0.4% to 5%, with gradual reductions to 2.5% and 1% as projects become operational, subject to conditions. These changes apply across infrastructure, non-infrastructure, and commercial real estate projects for regulated financial entities. Additional guidelines, such as a minimum 10% exposure for consortium lending, are also included. While we see a low probability of these draft guidelines on project financing being implemented in their current form, it remains a risk to the overall sector.
- **Compression in spreads and margins:** We have highlighted earlier that the current yields are clearly not sustainable due to the following reasons: a) As the financial health of DISCOMs improves, states would expect PFC/REC to extend loans to them at interest rates that are comparable to the state government bond yields; b) With low systemic credit growth, banks will be looking to selectively re-finance operational and good-quality power projects of PFC/REC; and c) Increasing proportion of RE, which is a highly competitive segment with relatively lower spreads.
- **Asset quality stress from any further deterioration in health of private power projects or DISCOMS:** The government has initiated many reforms in the power sector, which should potentially improve the health of the sector. However, we cannot completely rule out any adverse impact on the provisioning and credit costs because of slippages in some of the large private sector accounts and the adverse effect on interest income from any DISCOM bailouts provided by the government.

PFC: ESG initiatives

- As of FY24, PFC is the largest RE sector financier in India, having supported 50GW of RE capacity in India, which is around ~25% of India's total non-fossil fuel based installed capacity (around 190.57GW as per CEA, March 2024). PFC has cumulatively disbursed over INR1t to the RE sector.
- To oversee the activities of CSR, PFC has in place a board level CSR & SD Committee of Directors headed by an independent director. For FY24, the board approved the CSR budget of INR2.15b.
- PFC's Board comprises seven directors, including three independent directors and one woman director.
- The members of the Board are appointed by the President of India through the administrative ministry, which, inter alia, fixes the remuneration of such whole-time directors through their respective appointment orders/pay fixation orders.

PFC: Pillars of ESG Vision



Source: Company, MOFSL

About PFC

A country's energy usage is an important measure to gauge its advancement and expansion and PFC plays a crucial role in the rise of India as a global player in the energy sector. PFC endeavors to maintain a robust evaluation and appraisal process, which in turn helps the company maintain a healthy loan book despite the hardships in the power sector.

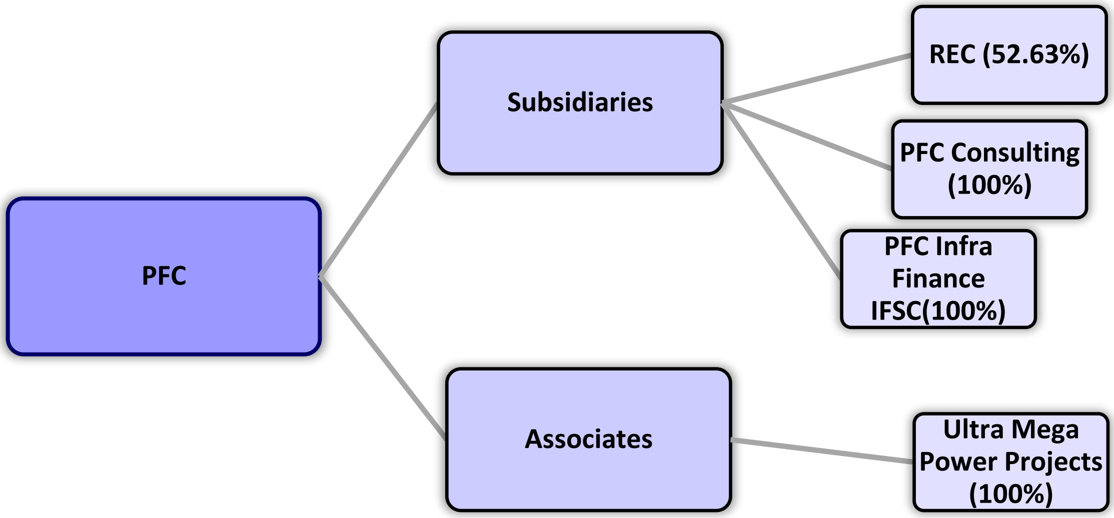
Description

- PFC is a power and infrastructure finance company under the administrative control of the Ministry of Power.
- PFC has been conferred with the title of Maharatna CPSE and is designated as a "Nodal Agency" for development of Integrated Power Development Scheme (IPDS), Ultra Mega Power Projects (UMPPs) and "Bid Process Coordinator" for Independent Transmission Projects (ITPs).
- PFC provides financial assistance to power projects in the field of generation, transmission and distribution and has also ventured into financing of development of coal mines and oil and gas pipelines.
- PFC's continued focus on expansion and diversification has led to its foray into the infrastructure and logistics sectors, wherein it caters to EV fleet, charging infrastructure, roads, ports, metro rail, smart cities, and other significant infrastructure projects.
- Further, it extends consultancy and advisory services in strategic, financial, regulatory and capacity building skills under one umbrella.
- In Mar'19, the Ministry of Power approved PFC to take over a ~52.6% stake of the Government of India (GoI) in REC.
- **PFC is currently led by Ms. Parminder Chopra, Chairman and Managing Director. She earlier held the role of Director (Finance) at PFC since Jul'20.**

Product portfolio

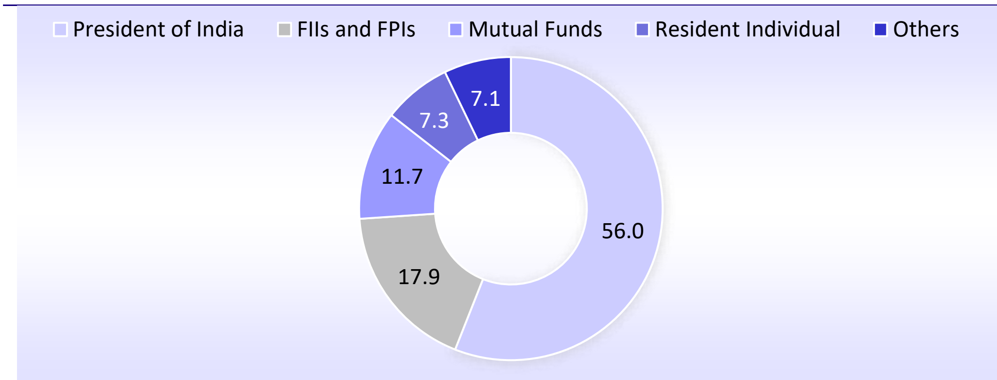
- **Fund based:** Project term loans (rupee and foreign currency), debt refinancing, lease financing for power wind projects and purchase of equipment, short-/ medium-term loans to equipment manufacturers, line of credit for import of coal, grants/interest-free loans for studies/ consultancies, credit facility for purchase of power through Power Exchange, etc.
- **Non-fund based:** Guarantee for performance of contract/ obligations w.r.t. fuel supply agreement, letter of comfort, policy for guarantee of credit enhancement, etc.

Exhibit 54: Group structure



- **PFC Infra Finance:** Subsidiary to provide financial solutions for infrastructure projects across multiple sectors.
- **PFC Projects:** Coastal Karnataka Power Limited (CKPL) was created to develop ultra-mega power projects in Karnataka, as mandated by the Government of India. It can also participate in bidding for lender-backed resolution plans through PFC.
- **PFC Consulting:** provides services like transaction advisory, project development, project management (e.g., RDSS), and policy support for the Ministry of Power.

Exhibit 55: Shareholding of PFC (%)



Source: MOFSL, Company; Data as on Jun'24

Exhibit 56: Top 10 shareholders of PFC

Sr no.	Shareholder	% holding
1	Republic of India	55.99%
2	Life Insurance Corp of India	2.14%
3	HDFC Asset Management Co Ltd	2.02%
4	Vanguard Group Inc	1.81%
5	Blackrock Inc	1.66%
6	Kotak Mahindra Asset Management Co Ltd	1.60%
7	Nippon Life India Asset Management Ltd	1.57%
8	DSP Investment Managers Pvt Ltd	1.25%
9	Capital Group Cos Inc	0.70%
10	Dimensional Fund Advisors LP	0.67%

Source: MOFSL, Bloomberg; Data as on 07-Oct-2024

PFC: Bull and Bear cases

Bull case

- ☑ In our bull case, we assume ~18% AUM CAGR, driven by a ~18% disbursement CAGR over FY24-FY27E.
- ☑ We expect spreads/margins to remain largely stable at ~2.8%/3.7% by FY27.
- ☑ We estimate NII and PPOP CAGR of ~19% and 17% respectively, over FY24-27 owing to strong loan growth and the company's ability to deliver operating efficiencies.
- ☑ We estimate cost ratios to improve over the next three years. Average credit costs of ~2bp-5bp can lead to ~16% PAT CAGR over FY24-FY27.

Bear case

- ☑ In our bear case, we assume ~12% AUM CAGR over FY24-FY27.
- ☑ We expect spreads to decline ~35bp and NIM to contract ~25bp by FY27.
- ☑ We estimate NII and PPOP CAGR of ~10% each over FY24-27.
- ☑ We project average credit costs of ~10-20bp to drive PAT CAGR of ~6% over FY24-FY27

Exhibit 57: PFC Bull case scenario

INR m	FY25E	FY26E	FY27E
AUM	55,36,398	66,33,683	79,49,560
YoY Growth (%)	15	20	20
NIM (%)	3.6	3.6	3.7
NII	1,80,464	2,12,913	2,60,367
PPoP	2,00,418	2,34,920	2,84,601
Credit Costs	(3,293)	431	7,355
PBT	2,03,712	2,34,490	2,77,245
PAT	1,66,025	1,91,109	2,25,955
Growth (%)	15	15	18
RoA (%)	3.1	3.0	3.0
RoE (%)	19.5	19.6	20.2
BV (INR)	275	316	364
PFC Target Multiple			**1.4**
PFC Standalone (INR)			**415**
REC stake post hold-co discount (INR)			**245**
PFC SOTP Target price (INR)			**660**
Upside (%)			**50%**

Source: MOFSL, Company

Exhibit 58: PFC Bear case scenario

INR m	FY25E	FY26E	FY27E
AUM	54,34,273	60,94,325	68,03,856
YoY Growth (%)	13	12	12
NIM (%)	3.6	3.4	3.3
NII	1,77,569	1,91,961	2,08,008
PPoP	1,97,523	2,13,969	2,32,241
Credit Costs	(4,192)	18,010	20,561
PBT	2,01,715	1,95,959	2,11,680
PAT	1,64,398	1,59,706	1,72,519
Growth (%)	14	-3	8
RoA (%)	3.1	2.7	2.6
RoE (%)	19.4	16.6	16.0
BV (INR)	275	309	345
PFC Target Multiple			**0.9**
PFC Standalone (INR)			**245**
REC stake post hold-co discount (INR)			**135**
PFC SOTP Target price (INR)			**380**
Downside (%)			**-13%**

Source: MOFSL, Company

PFC: SWOT analysis

Strength

- ☑ Improving asset quality with GS3 of <3.4% and NS3 of <1%.
- ☑ Healthy sanction pipeline will help the company achieve strong loan growth.

Weakness

- ☑ Expanding exposure to private infrastructure projects raises risks as these loans fall outside PFC's core business of lending to power projects.
- ☑ Increasing exposure to high risk power projects without PPAs, such as merchant RE plants, pumped storage, and green hydrogen projects.

Opportunity

- ☑ Significant acceleration in investments in renewable energy will help the company increase disbursements.
- ☑ The National Infrastructure Pipeline presents opportunity of ~INR35t across electricity generation and T&D, which will lead to strong loan growth of ~15% over FY24-27.

Threats

- ☑ Increasing competitiveness through active participation by banks in renewable financing might lead to margin compression.
- ☑ The RBI's draft circular on increasing provisioning requirements from ~0.4% to ~5.0%, which would be gradually brought down subject to conditions.

PFC: Board of Directors

Smt. Parminder Chopra
Chairman and MD

Smt. Parminder Chopra has assumed the charge w.e.f. 14th Aug'23. Previously, she held the additional charge of Chairman and Managing Director (CMD), w.e.f. 01.06.2023 and was Director (Finance), PFC since 01.07.2020. During her term as Director (Finance), she spearheaded the Finance division, leading to the highest net profit, highest net worth, and lowest NPA levels.

Shri Rajiv Ranjan Jha
Director (Projects)

Shri Rajiv Ranjan Jha has been working with PFC since Mar'97. He has overall 33 years of experience and had been holding the position of Executive Director (Projects), PFC since 27th May'19. He had earlier handled the entire loan portfolio in Consortium Lending with PFC as lead FI.

Shri Manoj Sharma
Director (Commercial)

Shri Manoj Sharma is a Chartered Accountant with a degree in law (LLB). He joined PFC in 1990 and was working as Executive Director (In Charge) of Commercial Division before assuming charge as Director (Commercial), PFC. He has more than 30 years of experience in the power sector.

Shri Sandeep Kumar
Director (Finance)

Shri Sandeep Kumar has assumed the charge of Director (Finance) at PFC w.e.f. 11 July 2024. Shri Sandeep Kumar has a distinguished career spanning over 34 years in the power and financial sectors. Throughout his tenure at PFC, he has held various positions within the finance function.

Shri Shashank Misra
Director (Govt. Nominee)

Shri Shashank Misra is an IAS officer and holds a B. Tech degree in Electrical Engineering from IIT Delhi. Presently, he is posted as Joint Secretory in the Ministry of Power, Government of India. Prior to joining the Ministry of Power, he served in the Dept. of Revenue, Ministry of Finance.

Shri Bhaskar Bhattacharya
Independent Director

Shri Bhaskar Bhattacharya is an honors graduate in Commerce and has a bachelor's degree in Law. He also holds a Post Graduate Diploma in Business Management. He has been acting as an Advocate for more than 24 years.
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Smt. Usha Sajeev Nair
Independent Director

Smt. Usha Sajeev Nair holds a graduate degree in Bachelors of Arts. She is a female entrepreneur engaged in her own business in Dadra and Nagar Haveli and Daman and Diu, providing employment and support to a number of families for quite some time now.

Shri Prasanna Tantri
Independent Director

Shri Prasanna Tantri holds a B. Com degree from Mangalore University and is a qualified Cost Accountant. . At present, he is an Associate Professor in the Finance area at the Indian School of Business and Executive Director of the Centre for Analytical Finance at ISB.

PFC: Financials and valuations

PFC: Income Statement (Standalone) (INR b)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Interest on loans	284	320	361	367	376	436	503	571	657
Interest exp & other charges	190	219	232	227	233	280	325	370	426
Net Interest Income	**94**	**101**	**130**	**140**	**144**	**156**	**178**	**202**	**231**
Change (%)	7.8	6.9	28.3	8.3	2.4	8.8	14.1	13.1	14.6
Other operating income	6	22	15	24	23	24	26	29	32
Exchg Gain/(loss) on Forex loans	-5	-26	2	-9	-20	2	1	1	1
Other Income	0	0	0	0	0	0	0	0	0
Net Income	**95**	**97**	**146**	**155**	**147**	**182**	**206**	**232**	**264**
Change (%)	-8.0	2.3	50.5	6.2	-5.0	23.7	12.8	12.6	14.0
Employee Cost	2	2	2	2	2	2	3	3	3
Administrative Exp	2	2	3	3	4	4	5	5	6
Depreciation	0	0	0	0	0	0	0	0	0
Operating Income	**91**	**93**	**141**	**149**	**141**	**176**	**198**	**224**	**255**
Change (%)	-8.7	2.3	51.5	6.0	-5.4	24.2	12.9	12.8	14.2
Total Provisions	**-9**	**10**	**35**	**22**	**-3**	**-2**	**-4**	**1**	**4**
% to operating income	-9.6	10.7	24.8	14.9	-2.1	-1.0	-1.9	0.3	1.5
PBT	**100**	**83**	**106**	**127**	**144**	**177**	**202**	**223**	**252**
Tax	29	25	18	22	26	33	37	41	47
Tax Rate (%)	28.7	30.5	16.6	17.3	17.8	18.4	18.5	18.5	18.5
Reported PAT	**71**	**58**	**88**	**105**	**119**	**145**	**165**	**182**	**205**
Adjusted PAT (Excluding REC Dividend)	**73**	**53**	**82**	**98**	**113**	**139**	**160**	**176**	**199**
Change (%)	12.4	-28.2	56.7	18.7	15.4	23.5	14.8	10.2	12.8

PFC Balance Sheet (Standalone) (INR b)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Capital	26	26	26	26	26	33	33	33	33
Reserves & Surplus	406	425	498	567	656	759	874	1,001	1,145
Net Worth	**433**	**452**	**524**	**594**	**682**	**792**	**907**	**1,034**	**1,178**
Deferred Tax Liability	0	0	0	0	0	0	0	0	0
Networth (incl DTL)	**433**	**452**	**524**	**594**	**682**	**792**	**907**	**1,034**	**1,178**
Interest subsidy from GoI	0	0	0	0	0	0	0	0	0
Borrowings	**2,952**	**3,103**	**3,330**	**3,274**	**3,704**	**4,164**	**4,679**	**5,403**	**6,207**
Change (%)	24.7	5.1	7.3	-1.7	13.1	12.4	12.4	15.5	14.9
Total Liabilities	**3,385**	**3,554**	**3,854**	**3,868**	**4,386**	**4,956**	**5,586**	**6,438**	**7,385**
Investments	166	165	160	161	173	202	222	234	245
Change (%)	558.2	-0.7	-3.0	0.7	7.6	16.9	10.0	5.0	5.0
Loans	**3,032**	**3,341**	**3,601**	**3,609**	**4,108**	**4,699**	**5,316**	**6,164**	**7,100**
Change (%)	14.0	10.2	7.8	0.2	13.8	14.4	13.1	15.9	15.2
Forex monetary reserves	0	0	0	0	0	0	0	0	0
Net Fixed Assets	0	1	1	1	1	1	1	1	1
Net Current Assets	142	2	48	40	16	2	46	46	51
Total Assets	**3,340**	**3,509**	**3,809**	**3,811**	**4,298**	**4,905**	**5,586**	**6,444**	**7,397**

E: MOFSL Estimates

PFC: Financials and valuations

PFC Loans and Disbursements	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Gross Loans (INR b)	3,147	3,449	3,708	3,731	4,225	4,815	5,473	6,320	7,260
YoY Growth (%)	13	10	7	1	13	14	14	15	15
Disbursements (INR b)	677	680	883	512	858	1,277	1,404	1,559	1,761
YoY Growth (%)	5	0	30	-42	67	49	10	11	13

PFC: Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Spreads Analysis (%)									
Avg. Yields	10.0	10.0	10.4	10.2	9.8	9.9	10.1	10.0	9.9
Avg Cost of Funds	7.1	7.2	7.2	6.9	6.7	7.1	7.4	7.3	7.3
Interest Spread	2.9	2.8	3.2	3.3	3.1	2.79	2.70	2.62	2.57
NIM	3.1	2.3	3.8	3.6	3.2	3.6	3.6	3.5	3.5
Profitability Ratios (%)									
RoE	17.3	12.8	17.3	17.9	18.2	19.5	19.4	18.7	18.53
RoA	2.2	1.6	2.2	2.5	2.8	3.0	3.1	3.0	2.9
Efficiency Ratios (%)									
Int. Expended/Int. Earned	66.8	68.4	64.2	61.8	61.8	64.2	64.6	64.7	64.8
Other operating Inc./Net Income	5.8	23.0	10.1	15.1	15.9	13.0	12.7	12.4	12.0
Other Income/Net Income	0.2	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.2
Op. Exps./Net Income	4.2	4.1	3.5	3.7	4.1	3.7	3.6	3.5	3.3
Empl. Cost/Op. Exps.	43.5	48.5	37.9	37.1	36.3	36.3	35.2	34.6	34.2
Asset-Liability Profile (%)									
Loans/Borrowings Ratio (x)	103	108	108	110	111	113	114	114	114
Assets/Networth (x)	7.7	7.8	7.3	6.4	6.3	6.2	6.2	6.2	6.3
Debt/Equity (x)	6.8	6.9	6.4	5.5	5.4	5.3	5.2	5.2	5.3
Asset Quality (%)									
Gross Stage 3	9.4	8.1	5.7	5.6	3.9	3.3	2.8	2.3	1.8
Net Stage 3	4.6	3.8	2.1	1.8	1.1	0.9	0.7	0.7	0.6
PCR	51.5	47.1	63.4	68.6	72.7	74.4	73.0	71.0	70.0
Credit costs	-0.31	0.31	1.01	0.62	-0.08	-0.04	-0.08	0.01	0.06

Valuations

Book Value (INR)	164	171	198	225	258	240	275	313	357
BV Growth (%)	17.1	4.3	16.0	13.3	14.9	-7.1	14.6	14.0	13.9
Price-BV (x)	**2.7**	**2.6**	**2.2**	**2.0**	**1.7**	**1.8**	**1.6**	**1.4**	**1.2**
Adjusted Book Value (INR)	150	116	144	170	203	196	231	270	313
ABV Growth (%)	24.8	-22.8	23.6	18.4	19.7	-3.6	17.8	16.7	16.1
Price-ABV (x)	**1.7**	**2.3**	**1.8**	**1.5**	**1.3**	**1.3**	**1.1**	**1.0**	**0.8**
EPS (INR)	26.3	21.4	32.0	38.0	44.0	43.5	49.9	55.0	62.1
EPS Growth (%)	4.2	-18.7	49.3	18.7	15.8	-1.0	14.6	10.3	12.8
Price-Earnings (x)	**16.7**	**20.5**	**13.7**	**11.6**	**10.0**	**10.1**	**8.8**	**8.0**	**7.1**
Core EPS (INR)	27.7	19.9	31.2	37.0	42.8	42.3	48.5	53.5	60.3
Adj Core EPS Growth (%)	12.4	-28.2	56.7	18.7	15.4	-1.2	14.8	10.2	12.8
Adj. Price-Core EPS (x)	**9.5**	**13.2**	**8.4**	**7.1**	**6.1**	**6.2**	**5.4**	**4.9**	**4.4**
DPS	0.0	9.5	10.0	12.0	13.3	13.5	15.0	16.5	18.6
Dividend Yield (%)	**0.0**	**2.2**	**2.3**	**2.7**	**3.0**	**3.1**	**3.4**	**3.8**	**4.2**

E: MOFSL Estimates

PFC: Du Pont Analysis %	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Interest income	9.1	9.0	9.6	9.3	9.0	9.2	9.4	9.3	9.3
Interest expenses	6.1	6.2	6.2	5.8	5.5	5.9	6.0	6.0	6.0
Net Interest Income	**3.0**	**2.9**	**3.4**	**3.6**	**3.4**	**3.3**	**3.3**	**3.3**	**3.3**
Other Operating Income	0.2	0.6	0.4	0.6	0.6	0.5	0.5	0.5	0.4
Other Income	-0.2	-0.7	0.0	-0.2	-0.5	0.0	0.0	0.0	0.0
Total Income	**3.0**	**2.7**	**3.9**	**3.9**	**3.5**	**3.8**	**3.8**	**3.8**	**3.8**
Operating expenses	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Operating profits	**2.9**	**2.6**	**3.7**	**3.8**	**3.4**	**3.7**	**3.7**	**3.6**	**3.6**
Provisions	-0.3	0.3	0.9	0.6	-0.1	0.0	-0.1	0.0	0.1
PBT	**3.2**	**2.4**	**2.8**	**3.2**	**3.4**	**3.7**	**3.8**	**3.6**	**3.6**
Taxation	0.9	0.7	0.5	0.6	0.6	0.7	0.7	0.7	0.7
RoA	**2.3**	**1.6**	**2.3**	**2.7**	**2.8**	**3.0**	**3.1**	**3.0**	**2.9**
Leverage (x)	7.8	8.0	7.7	7.0	6.6	6.4	6.3	6.3	6.4
RoE	**17.7**	**13.1**	**18.1**	**18.8**	**18.6**	**19.6**	**19.4**	**18.7**	**18.5**

E: MOFSL Estimates

REC

BSE SENSEX	S&P CNX
81,050	24,796

Stock Info

Bloomberg	RECL IN
Equity Shares (m)	2633
M.Cap.(INRb)/(USDb)	1317 / 15.7
52-Week Range (INR)	654 / 259
1, 6, 12 Rel. Per (%)	-17/-4/49
12M Avg Val (INR M)	7750
Free float (%)	47.4

Financials Snapshot (INR b)

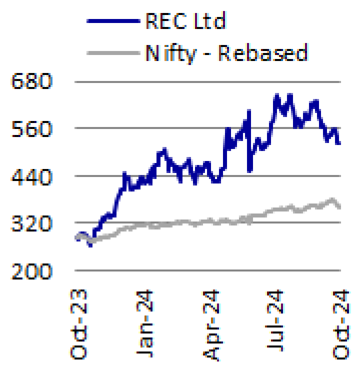
Y/E March	FY25E	FY26E	FY27E
NII	196	226	264
PPP	196	228	266
PAT	159	183	211
EPS (INR)	60.5	69.3	80.1
EPS Gr. (%)	14	15	16
BV/Shr (INR)	306	357	417
ABV/Shr (INR)	302	354	413
RoAA (%)	2.7	2.6	2.6
RoE (%)	21.3	20.9	20.7
Div. Payout (%)	29.8	29.6	29.3
Valuation			
P/E (x)	8.3	7.2	6.2
P/BV (x)	1.6	1.4	1.2
Div. Yield (%)	3.6	4.1	4.7

Shareholding pattern (%)

As On	Jun-24	Mar-24	Jun-23
Promoter	52.6	52.6	52.6
DII	14.7	15.5	12.1
FII	20.4	19.9	21.9
Others	12.2	12.0	13.4

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR500 TP: INR630 (+26%) Buy

Charging ahead with renewable might

Strong loan growth and benign credit costs render good visibility on earnings

- **REC is one of the two major public sector power and infrastructure asset finance companies. Present across the value chain, a major part of its exposure as of Jun'24 caters to distribution and generation (~41% and ~28%, respectively) and only ~11% of its loans are towards the private sector. REC has intensified its efforts in financing renewable energy and infrastructure/logistics projects, resulting in a marked increase in the proportion of these segments within its sanction mix.**
- **In the current power upcycle, which is propelled by investments in power generation and transmission, the loan growth for REC is likely to remain robust over the next few years. Our asset quality analysis indicates that, similar to PFC, REC will also continue to experience resolutions of its stressed assets. This trend is anticipated to lead to notably benign credit costs over the next two to three years.**

Strong loan CAGR of ~18% likely over the next three years

National Infrastructure Pipeline (NIP) forecasts an investment opportunity of ~INR35t across electricity generation (both renewable and non-renewable) as well as transmission and distribution (T&D). REC reported ~22% loan CAGR over FY10-FY15, driven by robust capex in the thermal power segments and its higher exposure to distribution utilities. However, this was followed by only 12% CAGR in the loan book during FY15-FY22 because of: a) subsequent stresses in thermal generation projects, b) losses incurred by distribution utilities, and c) shift in focus towards renewable energy projects.

During FY23-FY24, REC's disbursements remained strong, propelled by disbursements towards the RDSS, RBPF, and LPS schemes. **Over the next five years, REC aims to capture a market share of 30-35% in thermal generation projects and ~20% in renewable projects. Additionally, the contribution of renewables in the FY24 sanction mix improved to ~38% (from ~8% in FY23). These sanctions are likely to translate into stronger disbursement growth over the next three years. We expect ~18% loan CAGR for REC over FY24-FY27.**

Compression in spreads due to high competitive intensity

Renewables represent a highly competitive segment with significantly narrower spreads than conventional generation or distribution projects. As the proportion of renewables in the loan mix increases, we anticipate some compression in the spreads. Banks have also been aggressive and willing to finance high-quality operational power projects. We estimate a yield compression of ~30bp over the next two years, driven by a shift in the loan mix and heightened competitive intensity. Consequently, we estimate spreads to decline ~20bp over the next two years, resulting in ~10bp NIM compression to 3.5% by FY26. A significant portion of REC's liability mix is fixed, while a substantial part of its asset portfolio is floating. This disparity could exert additional downward pressure on spreads and NIM if there is a reduction in repo rates in the second half of FY25.

Assset quality strength to sustain in the current power upcycle

REC's GNPA has receded from its last peak of ~7% during FY18-FY19 to ~2.6% as of Jun'24, with a provision coverage ratio (PCR) of ~69%. This improvement in asset quality has been driven by the resolution of stressed assets, which has accelerated over the last three years.

Currently, REC has 16 exposures classified under Stage 3. For 12 of these exposures, it has maintained a provision coverage of ~71%, and these are being resolved under the National Company Law Tribunal (NCLT). All stressed exposures are related to the private sector, with none originating from the government sector. We anticipate that the resolution of stressed assets will continue over the next two years, as distressed assets are available at a fraction of the total investments required to establish a greenfield generation project.

For REC, the exposures to Nagai Power and Lanco Amarkantak are effectively resolved, as both have received NCLT approval in Jul'24 and Aug'24, respectively. **The company has indicated that it is in the advanced stages of resolution for Sinnar Power Nashik, Hiranmaye, KSK Mahanadi in Chattisgarh, TRN Energy, Bhadreshwar Corporate Power, and Konaseema Gas Power.**

Healthy earnings growth trajectory with ~21% RoE over FY25-27E

REC has delivered a loan CAGR of ~11% over FY21-FY24, and its loan book stood at ~INR5.3t as of Jun'24. We expect the company to report a loan CAGR of ~18% over FY24-27 and scale its loan book to ~INR8.4t by FY27. Given the ongoing resolutions of stressed thermal projects and investments in scaling up renewable energy sources, the new stressed asset formation will be minimal in the current power upcycle. The company posted an earnings CAGR of ~19% over FY21-FY24 and is projected to record an earnings CAGR of ~15% over FY24-FY27, along with an RoA/RoE of 2.6%/21% and dividend yield of ~4.7% in FY27.

Valuations and View

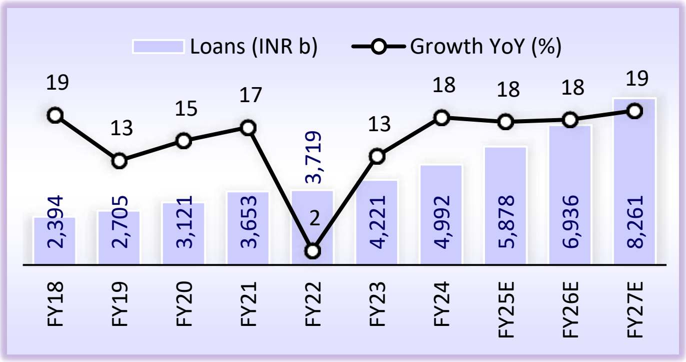
REC trades at 1.4x FY26E P/ABV, and we believe that the risk-rewards are attractive considering the strong visibility on loan growth, earnings growth, and healthy return ratios. All these factors support a very healthy outlook on asset quality. **We initiate coverage on REC with a BUY rating** and a TP of INR630 (premised on a target multiple of 1.6x Sep'26E P/ABV).

Key risks

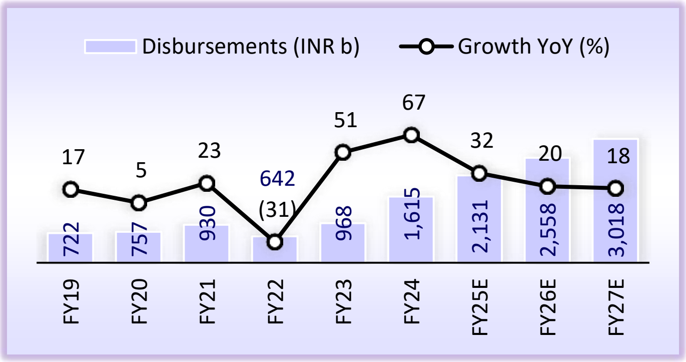
The key downside risks to our investment thesis include: 1) increasing exposure to the high-risk power projects without PPAs, such as merchant RE plants, pumped storage, and green hydrogen projects; 2) expanding exposure to private infrastructure projects that raises risks as these loans fall outside REC's core business of lending to power projects; 3) the RBI's proposed stricter provisioning norms for project financing that increase the provisioning requirement to ~5.0% from ~0.4% and which would be gradually brought down subject to conditions; and 4) compression in spreads and margins due to intensified competition.

STORY IN CHARTS

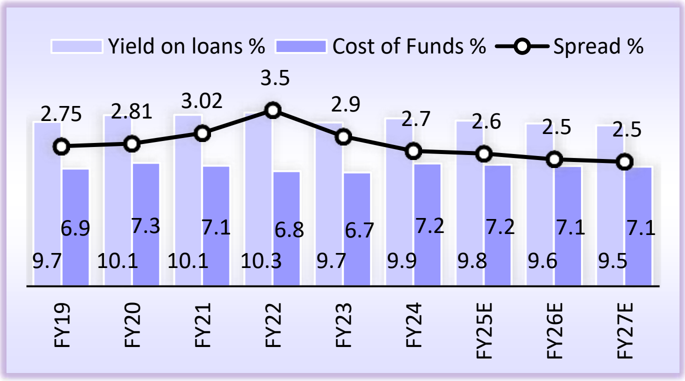
Loan book CAGR of 18% over FY24-27E…



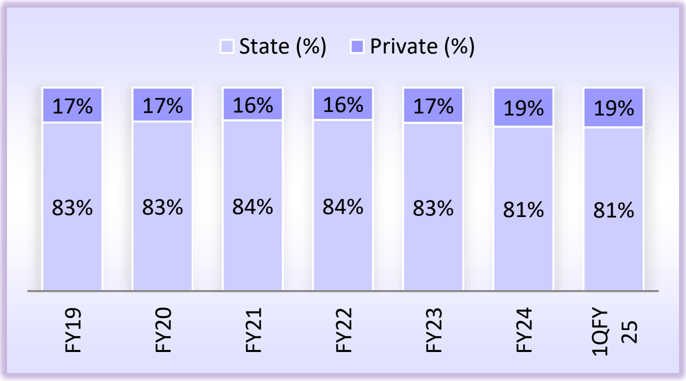
…supported by 23% disbursement CAGR



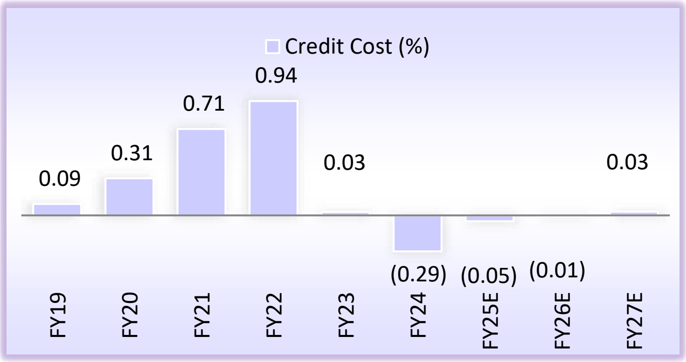
Intense competition and increase in renewables in the mix will lead to compression in spreads



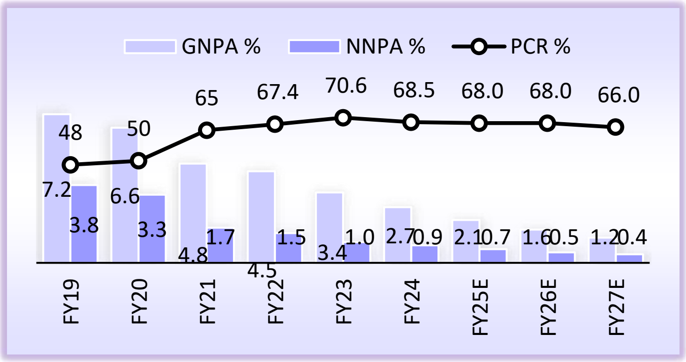
Exposure to private entities gradually increasing, perhaps because of higher exposures in renewables and infrastructure



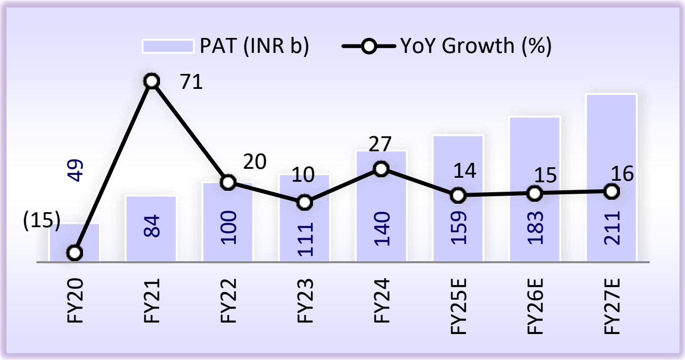
Negligible credit costs over FY25-FY27E



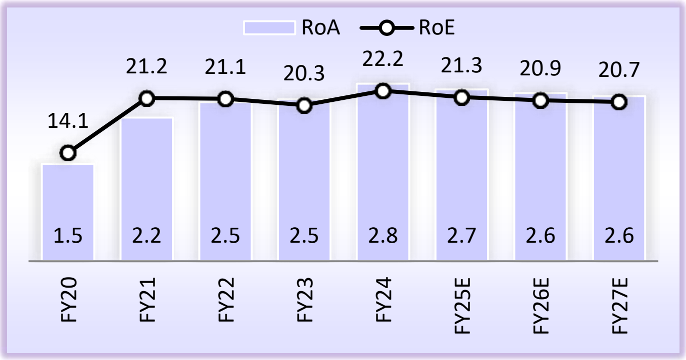
Stressed asset resolutions have led to an improvement in asset quality



PAT CAGR of ~15% over FY24-27



Healthy RoA/RoE of ~2.6%/21.0% in FY27



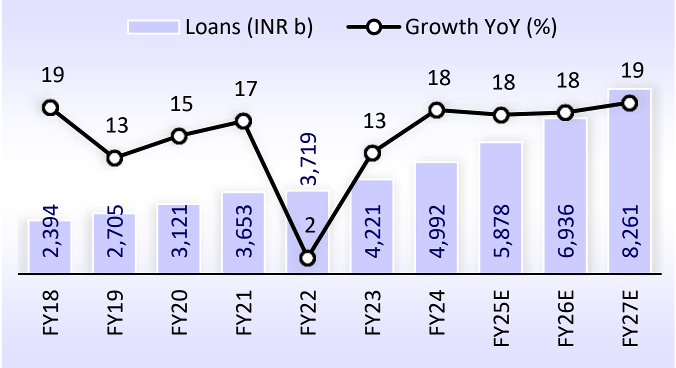
Investment proposition in REC

1. Disbursement and loan CAGR of 23% and 18%, respectively, over FY24-FY27E
2. NIM compression can be mitigated by leveraging credit costs
3. Diversified liabilities; borrower preference for rupee term loans over USD bonds
4. Stressed asset resolutions to continue; credit cost outlook remains benign
5. Healthy earnings growth trajectory; RoE of ~21% over FY25-27E

1. Disbursement/loan CAGR of 23%/18% during FY24-27E

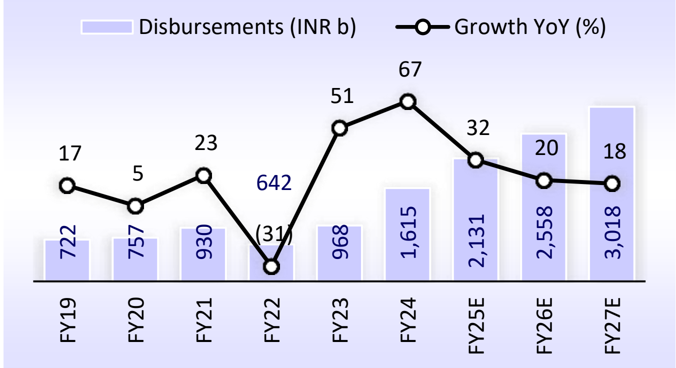
Given the increasing emphasis on financing renewable energy and infrastructure projects, REC has begun actively exploring new business avenues. It has started financing electric vehicles (EV)/EV charging infrastructure, smart metering projects, FGD installations, bio-refinery projects, and ethanol blending initiatives.

Exhibit 59: Loan book CAGR of 18% over FY24-27E…



Source: MOFSL, Company

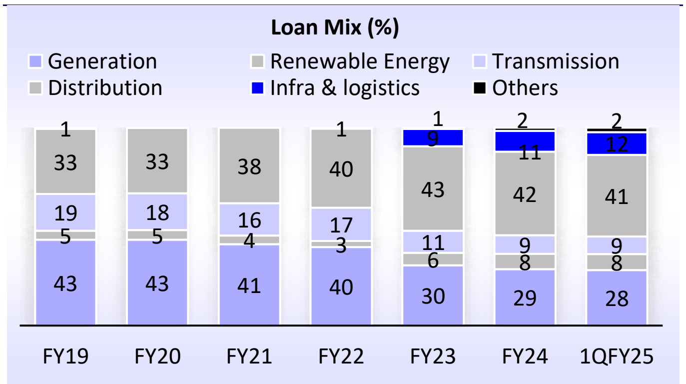
Exhibit 60: …supported by 23% disbursement CAGR



Source: MOFSL, Company

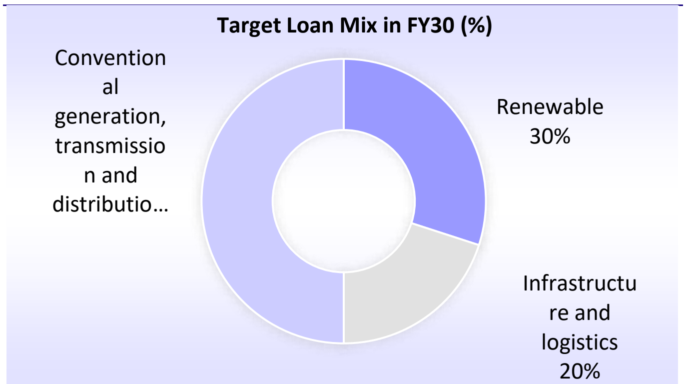
Renewables and infrastructure/logistics formed 8% and 12% of the loan mix for REC as of Jun'24, respectively. Management has indicated that by FY30, it aims to achieve a loan mix of 30% from renewable energy, ~20% from infrastructure/ logistics, and ~50% from conventional generation and T&D.

Exhibit 61: Share of renewable at ~8% as of Jun'24…



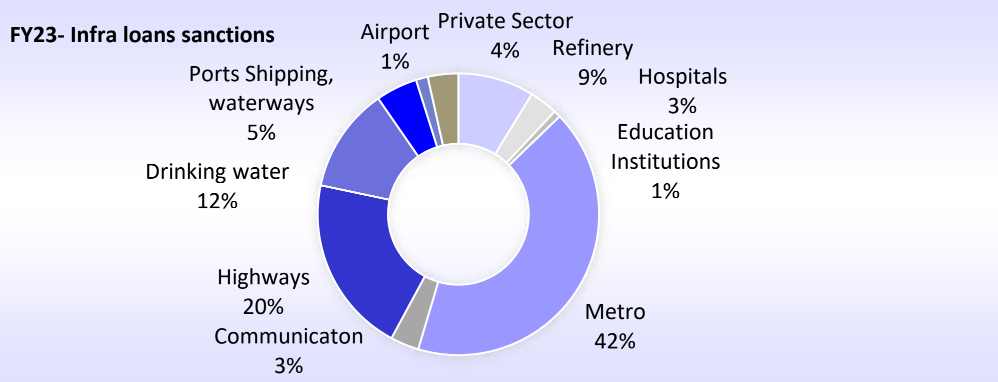
Source: MOFSL, Company

Exhibit 62: …which is expected to jump to ~30% by FY30



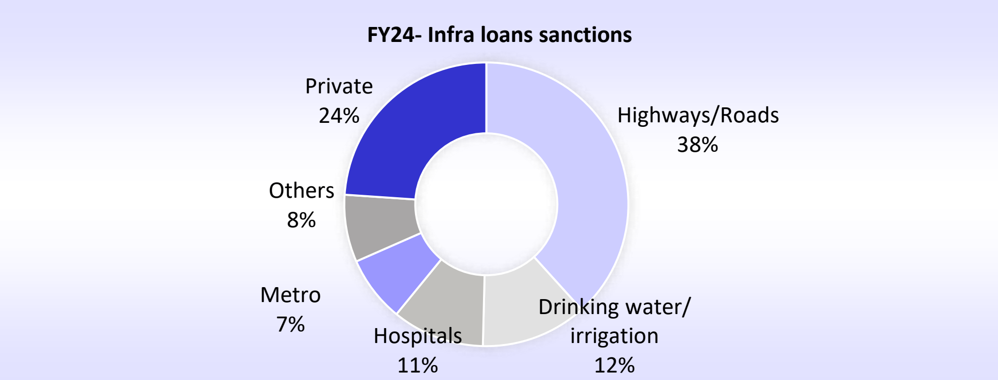
Source: MOFSL, Company

Exhibit 63: REC's infrastructure loan sanctions for FY23



Source: MOFSL, Company

Exhibit 64: REC's infrastructure loan sanctions for FY24

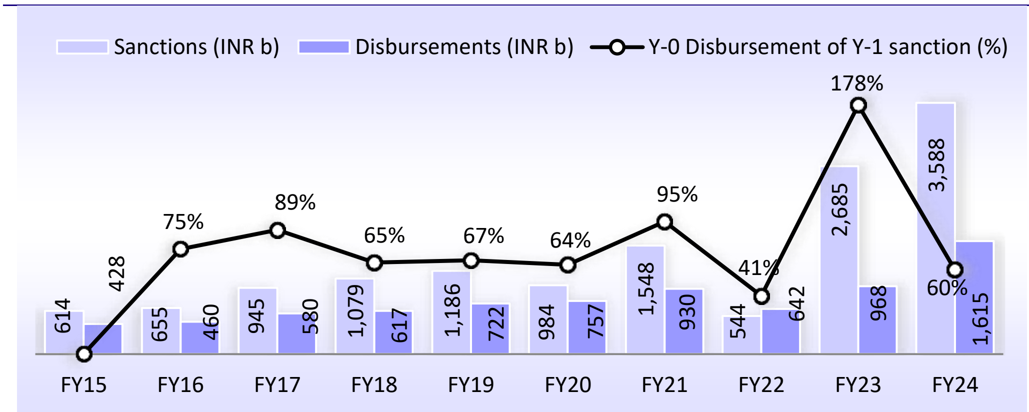


Source: MOFSL, Company

Infrastructure loans

The majority of the infra loans sanctioned by REC are directed towards government and state projects, which account for over 75% of the total infra loans. However, it is important to note that infrastructure loans to the private sector, which constituted <4% of the sanction mix in FY23, increased to ~25% in FY25. The growing share of infrastructure loans to the private sector may expose REC's loan portfolio to higher risks and might lead to elevated credit costs in the future.

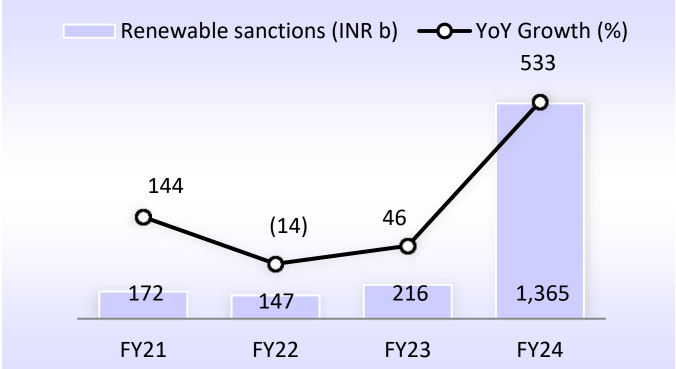
Exhibit 65: REC's annual disbursements to sanctions



Source: MOFSL, Company; Data is as of Mar'24

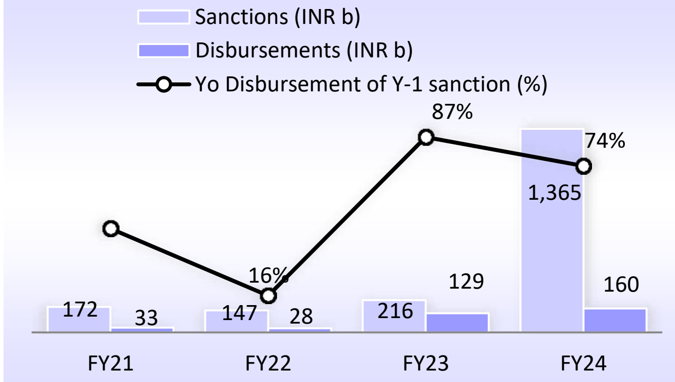
Disbursements for renewable generation project loans are typically back-ended, implying that the majority of disbursements in such projects occur in the second or third year following the initial loan sanction. REC reported robust growth in renewable sanctions in FY23 and FY24. Considering the healthy growth in renewable sanctions over the last two years, we anticipate strong growth in renewable disbursements over FY25-26.

Exhibit 66: Renewable sanctions surged ~533% in FY24



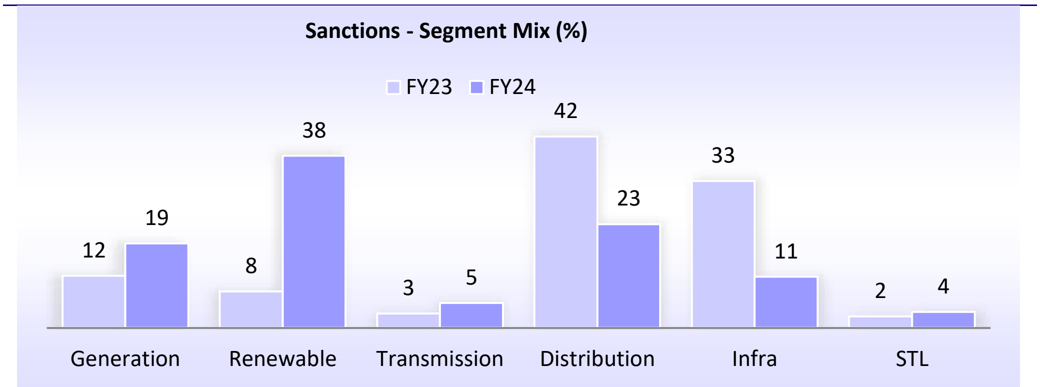
Source: MOFSL, Company

Exhibit 67: Renewable sanctions to disbursements



Source: MOFSL, Company

Exhibit 68: Share of renewable in the sanction mix improved in FY24



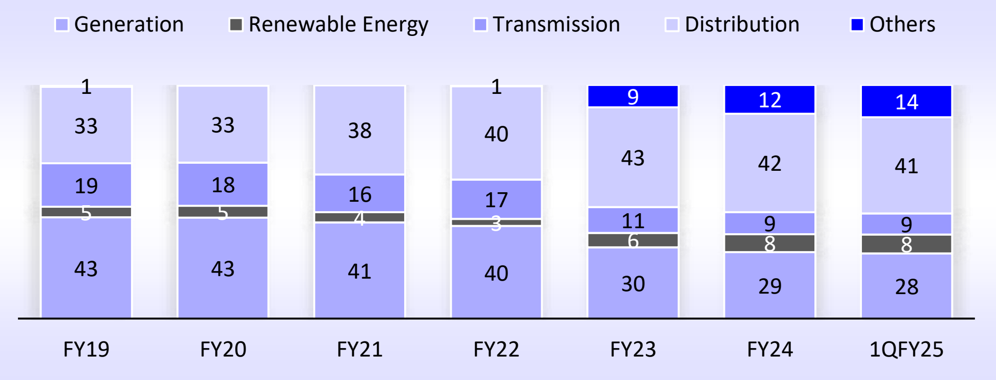
Source: MOFSL, Company; Data is as of Mar'24

The primary mandate of REC has been to finance rural electrification projects across India. This includes providing funding to state electricity boards, lending to state and central power utilities, and supporting rural electricity cooperatives. As a result, REC's loan book was relatively more skewed towards T&D vs. its parent (PFC).

Given that, REC traditionally had a higher exposure to T&D, we believe that the reform-based, result-linked power distribution sector scheme (covered extensively earlier in this report) launched by the GoI has improved (albeit marginally) the health of the distribution utilities and will benefit REC. This can potentially also lead to demand in the generation and transmission segments.

Modernization of traditional thermal power plants and installation of FGD systems in the existing and upcoming thermal power plants will also create lending opportunities for REC. The company is also working closely with different state governments for various lift irrigation projects.

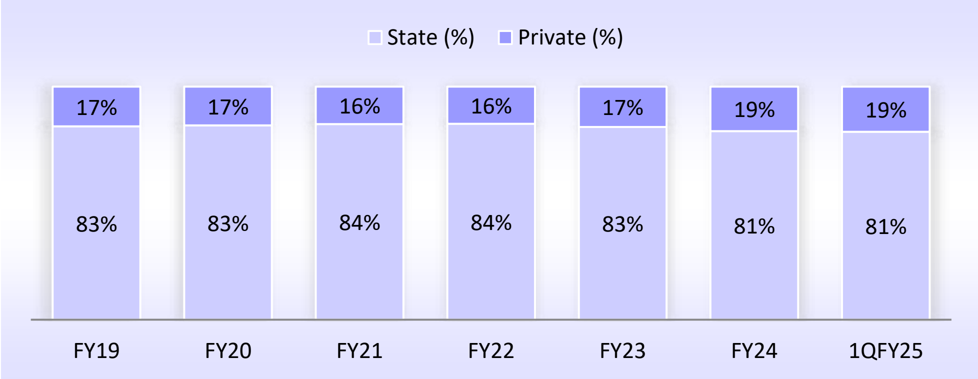
Exhibit 69: In its loan mix, REC has historically had a higher exposure to distribution (%)



Source: MOFSL, Company

India had committed under the 2015 Paris agreement to reduce the greenhouse gas emissions intensity by 33-35% below 2005 levels and to achieve 40% of installed electric power capacity from non-fossil sources by 2030. In 2015, India embarked on an ambitious plan of installing 500GW of renewable energy capacity by 2030. Against this target, total renewable capacity at the end of Jun'24 was ~200GW. **Renewable energy now contributes only 8% to REC's loan mix; however, we expect this share to grow to ~25% over the next five years.**

Exhibit 70: Exposure to private entities gradually increasing, perhaps because of higher exposures in renewables and infrastructure

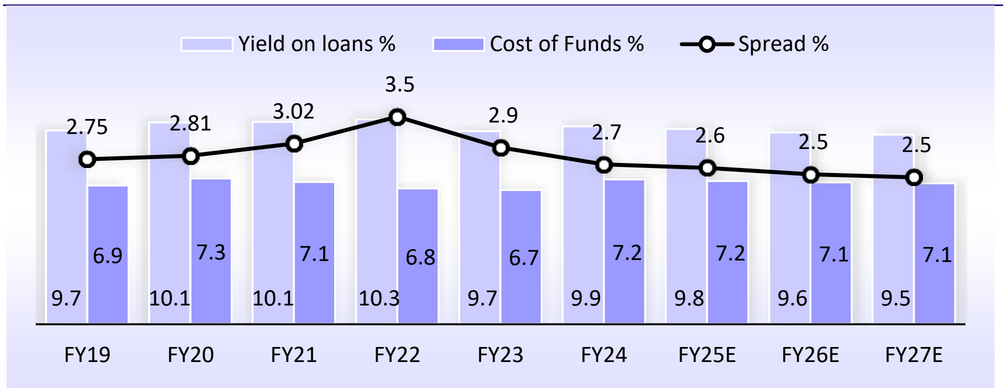


Source: MOFSL, Company

2. NIM compression can be mitigated with benign credit costs

With a shift in segment mix in favor of renewables and infrastructure, we expect the yield compression to continue. REC reported spreads of ~2.7% in FY24 and spreads of 2.6% in FY25E are likely to be at a decadal low. We expect further moderation in spreads for REC to ~2.5% by FY27, due to compression in yields led by a change in segment mix and high competitive intensity from banks and other NBFC peers in this segment.

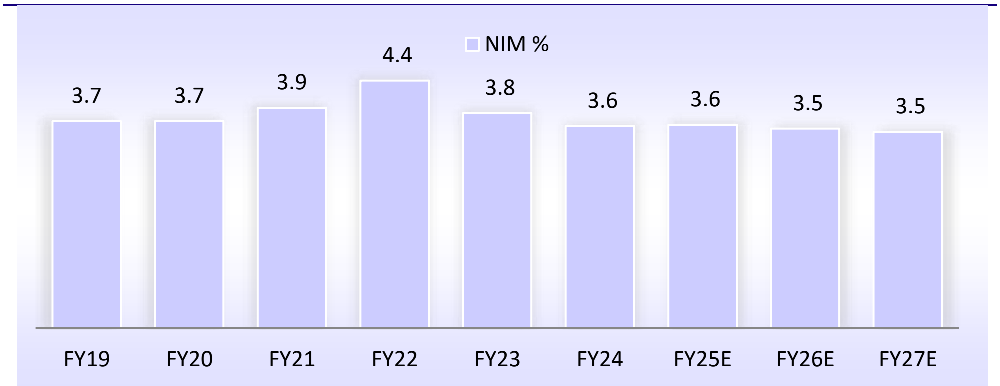
Exhibit 71: Intense competition and increase in renewables in the mix will lead to compression in spreads



Source: MOFSL, Company

Spreads may experience further compression due to the following factors: 1) banks continuing to be aggressive and willing to finance high-quality operational power projects; 2) lower spreads in renewable financing, which is characterized by intense competition; and 3) a decline in repo (interest) rates, as a significant portion of the asset side is linked to floating rates, while a large share of the liabilities, particularly in the domestic debt market and foreign borrowings, are fixed rate in nature.

Exhibit 72: NIM likely to compress due to a moderation in the yields



Source: MOFSL, Company

Our scenario analysis suggests that even if spreads were to moderate to ~2.2% over the next two years, REC will still be able to deliver NIM of ~3.2% and RoA/RoE of 2.4%/19.3%. This combination of return profile complemented with dividend yields of ~3.3% is by far better than many other PSU banks (which trade at marginally lower valuations compared to REC).

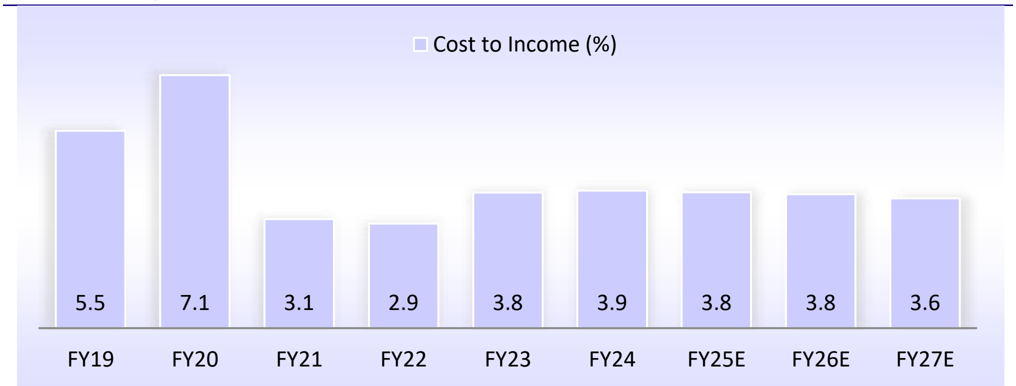
Exhibit 73: Scenario analysis on spreads/margin assuming other things remain unchanged (%)

REC - Scenario Analysis	Scenario 1	Scenario 2	Base Case
Yields	9.30	9.40	9.60
CoF	7.10	7.10	7.10
Spreads	2.20	2.30	2.50
Margin	3.20	3.30	3.50
RoA	2.4	2.5	2.6
RoE	19.3	19.9	20.9

Source: MOFSL, Company

Under our base case, we estimate a yield of 9.6%, spreads of 2.5%, and a margin of 3.5% in FY26 for REC.

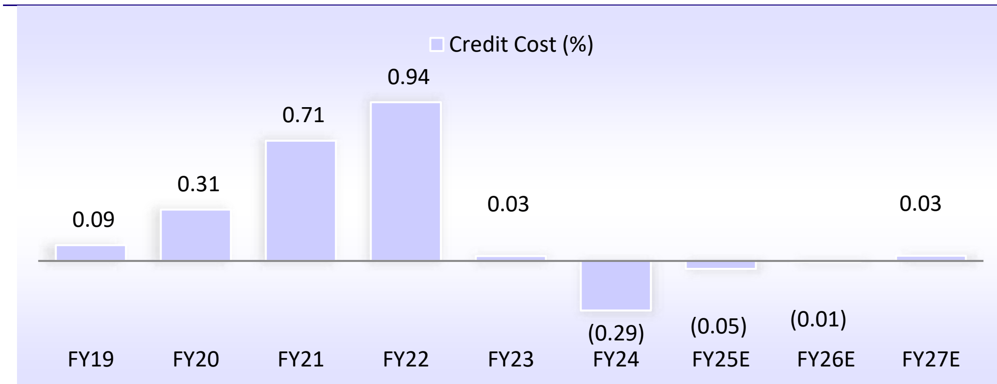
Exhibit 74: Expect cost ratios to remain stable at current levels



Source: MOFSL, Company

REC can mitigate some of this spread/margin compression due to the levers it has on credit costs, as we estimate credit costs to remain <5bp over FY25-27.

Exhibit 75: Negligible credit costs over FY25-FY27E

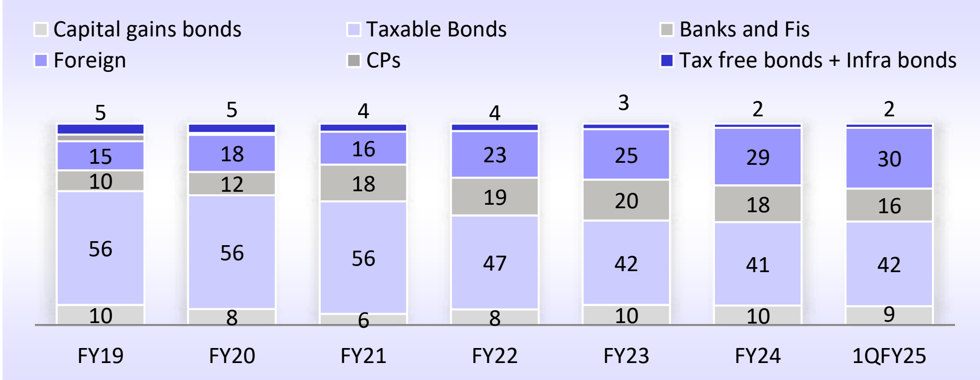


Source: MOFSL, Company

3. Diversified liabilities; borrower preference for rupee term loans over USD bonds

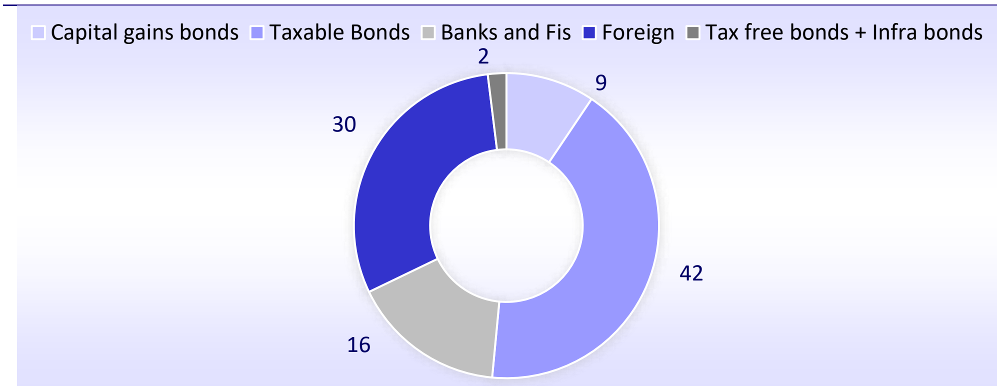
Similar to its parent PFC, REC is also rated AAA by various credit rating agencies. It also extensively leverages foreign currency borrowings that are 99% hedged for all such borrowings, which have a residual maturity of less than five years.

Exhibit 76: REC also has a fairly diversified borrowing mix (%)



Source: MOFSL, Company

Exhibit 77: Liability mix dominated by domestic NCDs (%)



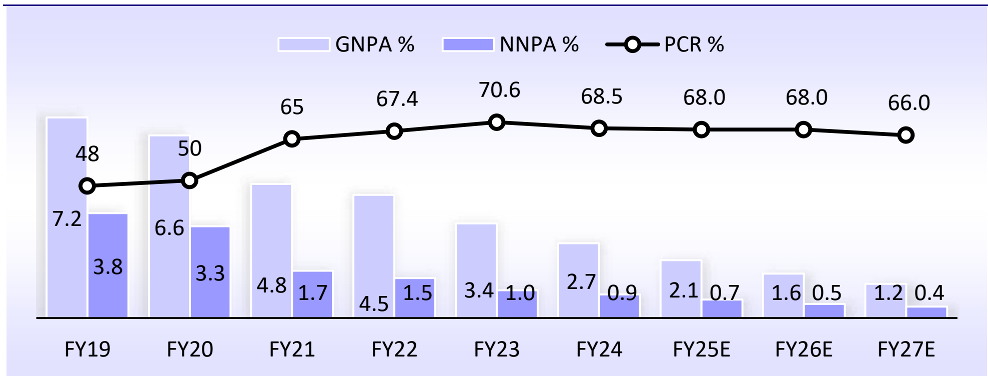
Source: MOFSL, Company; Note: Data as of Jun’24

PFC and REC, which possess a quasi-sovereign status, have demonstrated a strong correlation between their cost of borrowings (CoB) and government securities (G-Sec) yields. Quite a few power generators issued USD bonds when borrowing in USD was more cost-effective than borrowing in INR. As these maturing USD bonds are refinanced with INR term loans, it will present an additional opportunity for loan growth for REC.

4. Stressed asset resolutions to continue; credit cost outlook remains benign

Even though there is always an overarching risk associated with exposures to state government entities, they have managed to maintain stability due to guarantees from the state government and timely repayments just before they turn into NPAs. Many of the erstwhile stressed exposures are now in advanced stages of resolution. In our opinion, fresh slippages over the next two years would be far and few, as this current power upcycle (driven by power shortages) will continue to foster investments aimed at increasing both thermal and renewable generation capacities. This should translate into an improvement in the headline asset quality and in the provision coverage ratio.

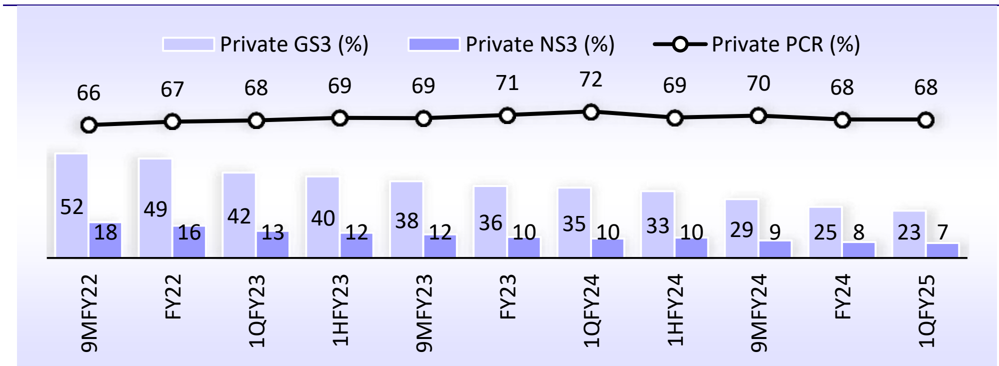
Exhibit 78: Stressed asset resolutions have led to an improvement in asset quality



Source: MOFSL, Company

REC does not have any exposure to state-sector projects that have been classified as NPAs. All the 16 projects that are classified as NPAs are from the private sector. Resolutions in 12 NPA projects are being pursued under NCLT, and REC is trying to achieve a resolution in the remaining four NPA projects outside the NCLT.

Exhibit 79: Resolutions of stressed exposures in the private sector to continue



Source: MOFSL, Company

As the stressed exposures continue to get resolved, REC has gradually been reducing the provision coverage on its Stage 3 loan assets, particularly on the 12 NPA projects that are being resolved in NCLT.

Exhibit 80: Healthy provision coverage on both NCLT and non-NCLT stressed exposures

Resolution Status	INR b
Under NCLT	123
Outside NCLT	15
Total Stage III	**138**
Resolution Status	**No. of projects**
Under NCLT	12
Outside NCLT	4
Total Stage III	**16**
PCR on Stage 3	**%**
Under NCLT	71
Outside NCLT	49
PCR on total Stage III	**69**

Source: MOFSL, Company

Exhibit 81: REC – A snapshot of NPA exposure along with expected recovery and current status of resolutions

Sr No.	Projects	State	Fuel	Outstanding (INR b)	NCLT	Stage of Resolution	Expected Recovery	Comments
1	Rattan India Nasik (Sinnar Thermal)	Maharashtra	Coal (domestic)	23.30	NCLT	Admitted in NCLT		❖ EOI Last date was 20th July 24
2	KSK Mahanadi	Chhattisgarh	Coal (domestic)	26.00	NCLT	Bids have come	115%	❖ Made provision of 50%. The project is expected to get resolved before year end.
3	Lanco Amarkantak	Chhattisgarh	Coal (domestic)	22.14	NCLT	Resolved in 2QFY25	37-38%	❖ No substantial write back expected as company has made provision of around ~60%.
4	IPCL Haldia	West Bengal	Imported coal	13.47	NCLT / IBC	Under IBC - Not in advanced Stage		❖ Prospective applicants list received. Stay order on the IBC process as of now.
5	Shri Maaheshwar Hydel	Madhya Pradesh	Hydel Power	2.50	NCLT	Advanced stages of resolution		❖ Last plan was submitted in August. Expected to be completed by year end
6	TRN Energy	Chhattisgarh	Coal (domestic)	15.00	Outside NCLT	Under Restructuring- Advanced Stage of Resolution		❖ Restructuring Proposal - Rating Process is ongoing.
7	Bhadreshwar	Gujarat	Coal (domestic)	10.00	NCLT	Advanced Stage of Resolution		❖ Resolution plan from Jindal Power received. Reverse bidding process is going on.
8	Nagai Power	Tamil Nadu	Coal (domestic)	5.61	NCLT	Resolved		❖ Resolved in 2QFY25
9	Konaseema	Andhra Pradesh	Coal (domestic)	2.22	NCLT	Under liquidation		
10	Jas Infra (coal)	Bihar	Coal (domestic)	0.33	NCLT	Under liquidation		
11	Ind Barath Madras	Tamil Nadu	Thermal Power	4.16	NCLT	Under liquidation		
12	Corporate Power	Jharkhand	Coal (domestic)	7.97	NCLT	Under liquidation		
13	Lanco Vidharba	Maharashtra	Coal (domestic)	5.00	NCLT	Under liquidation		

Source: MOFSL, Company

Exhibit 82: REC – Stressed loan projects that are in liquidation

Corporate	Outstanding amount (INR b)	Details
Konaseema	2.22	The project is under liquidation
Jas Infra (coal)	0.33	The project is under liquidation
Ind Barath Madras	4.16	The project is under liquidation
Corporate Power	7.97	The project is under liquidation
Lanco Vidharba	5.00	The project is under liquidation

Source: MOFSL, Company

Exhibit 83: REC – Stressed loan projects that are resolved.

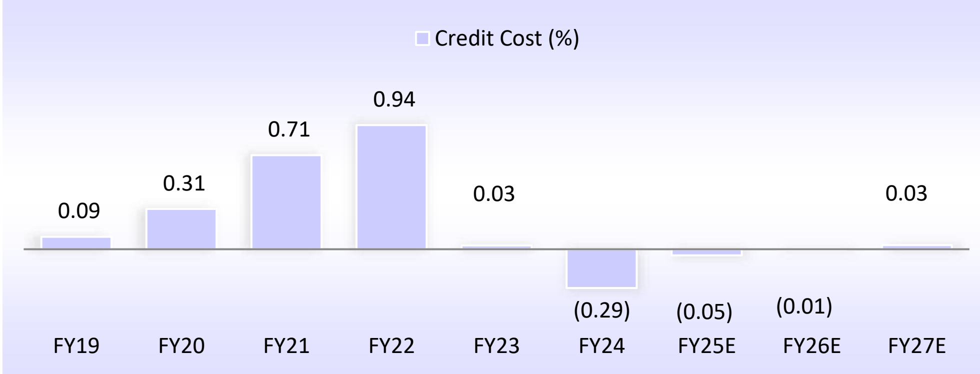
Name of the borrower	REC's exposure (INR b)	Remarks	Year of Resolution
Meenakshi Energy Private Limited	7	Resolved under IBC	FY24
Dans Energy Private Limited	4	Resolved through Restructuring	FY24
Classic Global Securities Limited	0	Resolved through OTS outside IBC	FY24
Meenakshi Energy Private Limited	7	Resolved under IBC	FY24
South-East UP Transmission Company Limited	9	Resolved under IBC	FY23
Jhabua Power Limited	3	Resolved under IBC	FY23
Ind Barath Energy (Utkal) Limited	8	Resolved under IBC	FY23
Gati Infrastructure Private Limited	2	Overdue has been fully paid by the company	FY23
ATN International Limited	0	Resolved through OTS outside IBC	FY23
Silicon Valley Infotech Limited	0	Resolved through OTS outside IBC	FY23
Essar Power (MP) Limited	13	Resolved under IBC	FY22
Amrit Jal Ventures Private Limited	0	Resolved under IBC	FY22
VS Lignite Power Private Limited	1	Resolved under IBC	FY22
Essar Power Transmission Company Limited	11	Resolved outside IBC by implementation of Restructuring Plan	FY21
Facor Power Limited	5	Resolved under IBC	FY21
RKM Powergen Private Limited	23	Resolved outside IBC by implementation of Restructuring Plan	FY21

Source: MOFSL, Company

Stressed project resolutions are driven by the power shortages and the consequent power upcycle. As of Jun'24, REC's Gross Stage 3 stood at 2.6%, down from its peak of 7.2% in Mar'19. We believe that the provision coverage on the stage 3 loans is adequate. Moreover, on the 12 projects that are being resolved under NCLT, REC carries a PCR of 71%, while on the four projects that are being resolved outside NCLT, it carries a PCR of 49%. With total PCR on its Stage 3 loans at ~69%, its Net Stage 3 has declined to ~0.8% as of Jun'24.

With multiple such large stressed exposures in advanced stages of resolution and high provision coverage on these loans, we anticipate a reversal of provisions, resulting in provision write-backs. This trend is expected to keep credit costs at a benign level of less than 5bp over FY25-27E.

Exhibit 84: Expect credit costs to remain benign over FY25-FY27



Source: MOFSL, Company

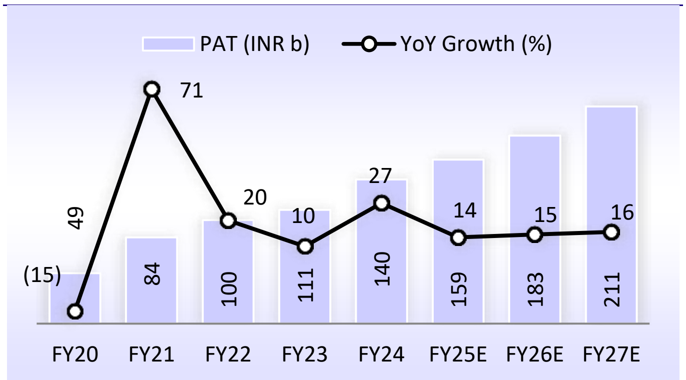
5. Healthy earnings growth trajectory; RoE of ~21% over FY25-27E

With high confidence in the sustainability of this power upcycle (because of reasons elaborated in detail earlier in this report), we attach a very low probability to new NPA formation and ascribe a high probability to continued resolutions in the stressed private sector assets. In the absence of any new NPA formation, the credit costs will remain benign in the foreseeable future.

Given the aspirations of India to achieve the energy transition and the investments in power generation (both conventional and renewable) to support the power demand, we believe that the strong loan growth for REC will sustain. Despite marginal NIM compression, we estimate REC will deliver a PAT CAGR of ~15% over FY24-FY27.

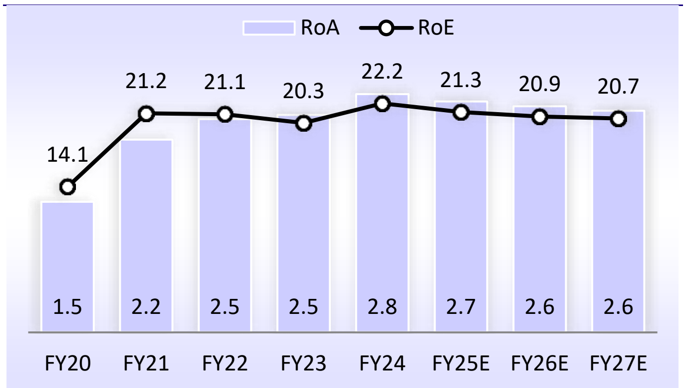
REC delivered an RoA/RoE of ~2.8%/22.0% in FY24, which was its best performance in the last six years. We expect REC to clock a RoE of ~21% over each of FY25-27E.

Exhibit 85: PAT CAGR of ~15% over FY24-27



Source: MOFSL, Company

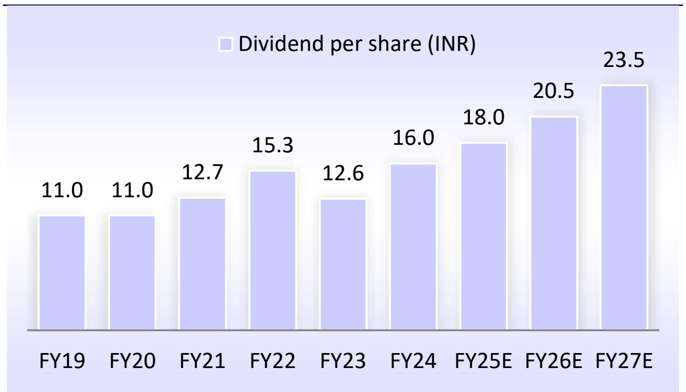
Exhibit 86: Healthy RoA/RoE of ~2.6%/21.0% in FY27



Source: MOFSL, Company

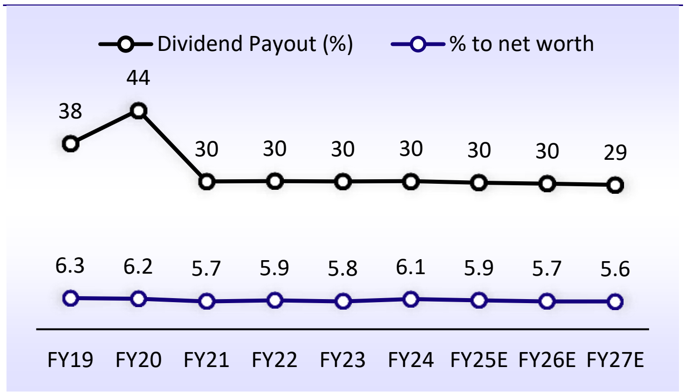
Back in May'16, the GoI mandated every CPSE to pay a minimum annual dividend that was higher of either 30% of PAT or 5% of the net worth. This was subject to the maximum dividend allowed to be paid out under the extant legal provisions. **We estimate a DPS of INR23.5/share and a dividend yield of ~4.5% in FY27E for REC.**

Exhibit 87: Healthy dividend payout…



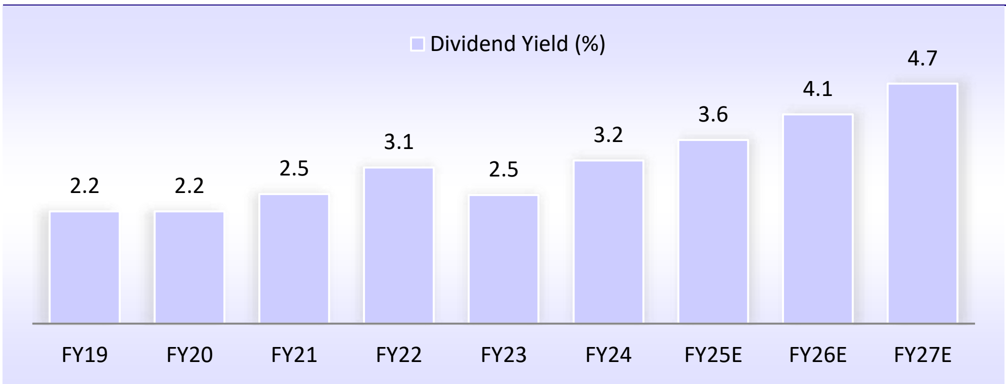
Source: MOFSL, Company

Exhibit 88: …driven by a dividend policy that is higher of either 30% of PAT or 5% of the net worth



Source: MOFSL, Company

Exhibit 89: Dividend yields of ~3-5% over the next three years are attractive



Source: MOFSL, Company

REC: Valuation and View

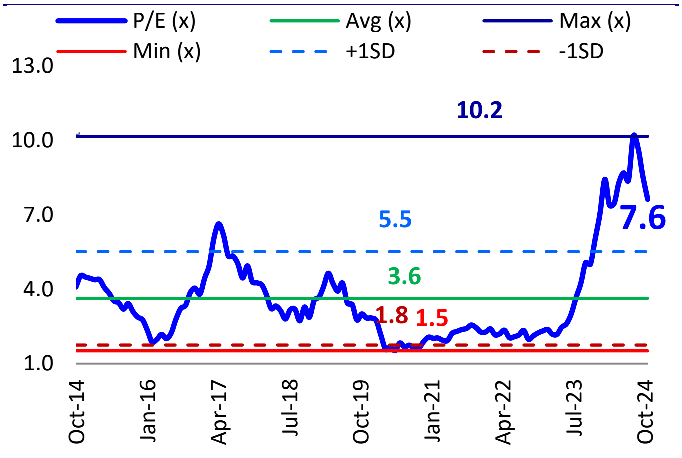
We believe that given the niche nature of power financing and the fact that REC and PFC are the nodal implementation agencies for the power reforms initiated by the government, REC will continue to maintain its relevance. Moreover, with emerging opportunities in renewable energy, electric vehicles, charging infrastructure, modernization of the existing thermal power plants, FGD installations, and smart metering, we believe that REC will be able to demonstrate steady loan growth while mitigating risks associated with asset quality.

REC is projected to deliver an earnings CAGR of ~15% over FY24-FY27, with an RoA/ RoE of 2.6%/21.0% and a dividend yield of ~4.1% in FY26. The stock trades at 1.4x FY26E P/ABV and we believe that the risk-rewards are attractive given the strong visibility on its earnings trajectory. Moreover, REC's stock price has corrected by ~25% from its recent highs, and now even provides a margin of safety in valuations. **We initiate coverage on REC with a BUY rating and a TP of INR630** (premised on a target multiple of 1.6x Sep'26E P/ABV).

Power financiers, namely REC and PFC, are both favored options to capitalize on the current power upcycle. Both of these lenders are poised to capture a significant share of the power financing opportunities in India over the next five years. However, they must remain cautious and avoid becoming overly ambitious regarding their target opportunities. We would appreciate if PFC and REC exercise prudence and refrain from investing in merchant plants (without Power Purchase Agreements), limit their exposure to private sector projects, and expand in a measured manner within infrastructure and logistics, areas that are not their core expertise.

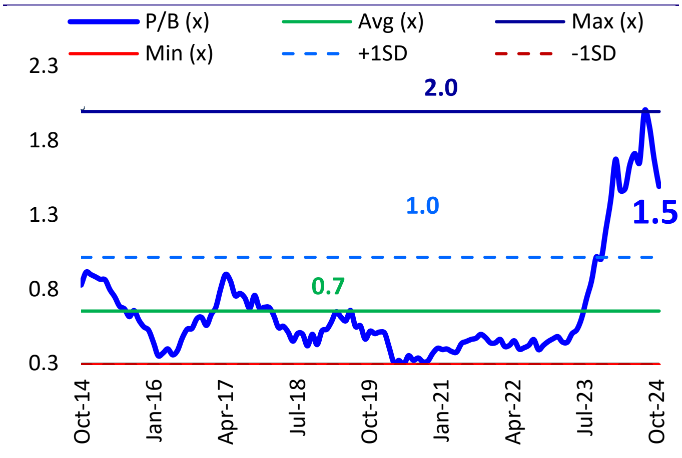
While we have a BUY rating on both PFC and REC, we prefer REC over PFC because of its better execution and stronger RoE profile.

Exhibit 90: REC - One-year forward P/E



Source: MOFSL, Company

Exhibit 91: REC - One-year forward P/B



Source: MOFSL, Company

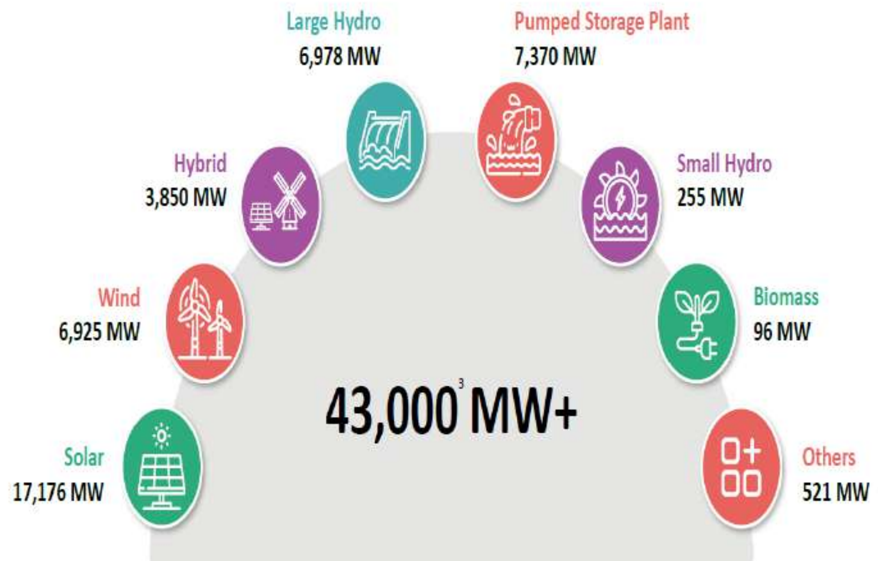
REC: Key risks

- **Increase in exposure to projects without PPA:** Lending to power projects without PPAs was a significant reason for financial strain in the past. While power sector lenders have since made PPAs a prerequisite for loan disbursal, there are still concerns about renewed exposure to projects lacking these PPAs. High-risk areas include: merchant renewable plants, where NBFCs have started partial lending without PPAs; pumped storage plants (PSPs), which require significant capital before securing PPAs; and green hydrogen projects, which lack a defined PPA structure and have high capex requirements.
- **Expanding exposure to private infrastructure loans:** Until recently, REC primarily extended loans to government entities in the infrastructure sector, with minimal exposure to private firms. However, any future increase in lending to private infrastructure or industrial projects could pose significant risks. Private loans (particularly those towards promoters) fall outside the core expertise of REC.
- **The RBI's draft stricter provisioning norms on project financing:** The RBI has proposed stricter lending norms for project financing, increasing provisioning requirements from 0.4% to 5%, with gradual reductions to 2.5% and 1% as projects become operational, subject to conditions. These changes apply across infrastructure, non-infrastructure, and commercial real estate projects for regulated financial entities. Additional guidelines, such as a minimum 10% exposure for consortium lending, are also included. While we attach a low probability to these draft guidelines on project financing being implemented in its current form, it still remains a risk to the overall sector.
- **Compression in spreads and margins:** We have previously emphasized that current yields are clearly unsustainable, based on the following factors: 1) as the financial health of the state DISCOMs improves, they will expect REC to extend loans to them at interest rates that are comparable to the state government bond yields; 2) with low systemic credit growth, banks will seek to selectively refinance operational and high-quality power projects of REC; and 3) the increasing proportion of renewables, which is a highly competitive segment with relatively lower spreads.
- **Asset quality stress due to any further deterioration in the health of private power projects or DISCOMS:** Although the government has implemented numerous reforms in the power sector that could potentially enhance its overall health, we cannot entirely dismiss the possibility of adverse effects on provisioning and credit costs. This could arise from slippages in some large private sector accounts and the adverse effect on interest income resulting from any government bailouts provided to DISCOMs.

REC: ESG initiatives

- In FY24, REC has sanctioned 82 renewable energy projects with installed generation capacity aggregating to 17,465MW, with total loan assistance of INR1.4t.
- As of Mar'24, the company had 78 permanent women employees, which represented 15% of the total work force. A women's cell has been in operation to look after the welfare and all-round development of the women employees.
- The company spent a total amount of ~INR2.5b during the year towards various CSR projects.
- REC's Board comprises eight directors, including four independent directors and one woman director.
- REC has set up a Risk Management Committee (RMC) of its directors in place for monitoring the integrated risks of the company. Further, as required under the RBI norms, the Board has appointed a Chief Risk Officer (CRO).

REC's contribution for Clean Energy Projects



Note: 43GW is based on sanctions. Source: Company, MOFSL

REC's Environmental Stewardship: Areas of Focus

Source: Company, MOFSL

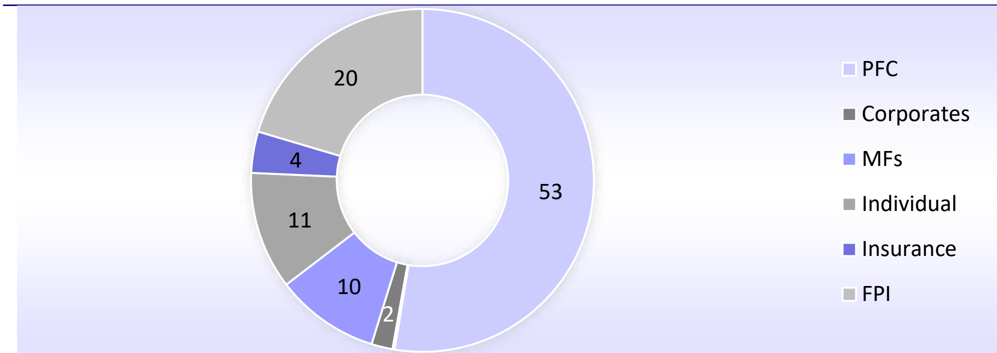
About REC

- REC is a leading NBFC categorized as an infrastructure finance company by the RBI, servicing the financing needs of the entire power sector value chain. REC advances financial assistance to the power sector in all segments, viz., generation (both conventional and renewable energy), and T&D.
- REC's principal products are interest-bearing loans to state utilities and private-sector borrowers. REC has contributed successfully to the development of power infrastructure in the country, right from its inception in 1969.
- REC has been appointed as a nodal agency for GoI's flagship schemes, viz., Pradhan Mantri Sahaj Bijli Har Ghar Yojana (SAUBHAGAYA), Deen Dayal Upadhaya Gram Jyoti Yojana (DDUGJY), and National Electricity Fund (NEF). Further, along with PFC, REC has also been designated as the Nodal Agency for Revamped Distribution Sector Scheme (RDSS).
- In addition, REC assists the Ministry of Power in monitoring the Ujjwal Discom Assurance Yojana (UDAY), which seeks to operationally reform and financially turnaround the power distribution companies of the country.
- **REC is currently led by Mr. Vivek Kumar Devangan, IAS, Chairman and Managing Director. REC is usually led by Secretary-level IAS officers.**

Markets served

REC operates in the Indian market and has a presence across the entire country. To mobilize resources, the company also taps international capital markets in addition to domestic markets.

Exhibit 92: Shareholding pattern (%)



Source: MOFSL, Company; Note: Data as of Jun'24

Exhibit 93: Top 10 shareholders

Sr. No.	Particulars	Shareholding %
1	Power Finance Corporation	52.63
2	Blackrock	2.04
3	Vanguard Group	1.96
4	HDFC Asset Management	1.44
5	Nippon Life India Asset Management	1.15
6	Dimensional Fund Advisors LP	1.10
7	Life Insurance Corporation of India	1.07
8	Republic of Singapore	1.02
9	Axis Asset Management	0.70
10	SBI Funds Management	0.59

Source: MOFSL, Bloomberg; Data as of 07th Oct'24

REC: Bull and Bear cases

Bull case

- ☑ In our bull case, we assume ~21% AUM CAGR, driven by a ~27% disbursement CAGR over FY24-FY27E.
- ☑ We expect spreads and margins to remain largely stable at ~2.6% and 3.5%, respectively, by FY27.
- ☑ We estimate NII and PPOP CAGR of ~20% each, over FY24-27 on account of strong loan growth and the company's ability to deliver operating efficiencies.
- ☑ We estimate cost ratios to improve over the next three years. We expect negligible credit cost, leading to a PAT CAGR of ~18% over FY24-FY27.

Bear case

- ☑ In our bear case, we assume ~13% AUM CAGR over FY24-FY27.
- ☑ We expect spreads to decline ~25bp and NIM to contract ~15bp by FY27.
- ☑ We estimate NII and PPOP CAGR of ~12% and 13%, respectively, over FY24-27.
- ☑ We project average credit costs of ~2-5bp to drive PAT CAGR of ~5% over FY24-FY27.

Exhibit 1: REC: Bull case scenario

INR m	FY25E	FY26E	FY27E
AUM	60,99,409	73,59,794	89,35,727
YoY Growth (%)	20	21	21
NIM (%)	3.6	3.6	3.5
NII	1,96,761	2,36,568	2,84,652
PPoP	1,97,678	2,38,410	2,87,163
Credit Costs	(7,526)	(2,764)	2,362
PBT	2,05,204	2,41,174	2,84,801
PAT	1,64,163	1,92,939	2,27,841
Growth (%)	17	18	18
RoA (%)	2.7	2.7	2.6
RoE (%)	21.9	21.9	21.9
BV (INR)	308	363	429
REC Target Multiple (Sep'26E)			**1.8**
REC Target Price (INR)			**725**
Upside (%)			**45%**

Source: MOFSL, Company

Exhibit 2: REC: Bear case scenario

INR m	FY25E	FY26E	FY27E
AUM	58,38,570	66,01,207	73,91,216
YoY Growth (%)	15	13	12
NIM (%)	3.5	3.4	3.4
NII	1,86,756	2,09,487	2,33,772
PPoP	1,87,674	2,11,329	2,36,283
Credit Costs	(1,633)	23,742	33,026
PBT	1,89,307	1,87,587	2,03,257
PAT	1,51,446	1,50,069	1,62,605
Growth (%)	8	-1	8
RoA (%)	2.6	2.3	2.2
RoE (%)	20.4	17.7	17.0
BV (INR)	303	342	386
REC Target Multiple (Sep'26E)			**1.1**
REC Target Price (INR)			**400**
Downside (%)			**-20%**

Source: MOFSL, Company

REC: SWOT analysis

- ☑ Improving asset quality with GS3 of <2.7% and NS3 of <1%.
- ☑ Healthy sanction pipeline will help the company achieve strong loan growth.

- ☑ Expanding exposure to private infrastructure projects raises risks as these loans fall outside REC's core business of lending to power projects.
- ☑ Increasing exposure to high risk power projects without PPAs such as merchant RE plants, pumped storage, and green hydrogen projects.

- ☑ Significant acceleration in Investments in renewable energy will help the company increase disbursements.
- ☑ The National Infrastructure Pipeline presents opportunity of ~INR35t across electricity generation and T&D, which will lead to strong loan growth of ~18% over FY24-27.

- ☑ Increasing competitiveness through active participation by banks in renewable financing might lead to margin compression.
- ☑ The RBI's draft circular on increasing provisioning requirement from ~0.4% to ~5.0%, which would be gradually brought down subject to conditions.

REC: Board of Directors

Shri Vivek Kumar Dewangan
Chairman and MD

Shri Vivek Kumar Dewangan is the Chairman & Managing Director of REC Limited since 17th May'22. He is an IAS officer (Manipur: 1993) and holds a degree in B.E. (Electronics) from NIT, Bhopal, and P.G. in Optoelectronics & Optical Communication from IIT, Delhi. Prior to joining REC, he was Additional Secretary in the Ministry of Power, Government of India.

Shri Vijay Kumar Singh
Director (Projects)

Shri Vijay Kumar Singh is the Director (Projects) of REC Limited since 15th Jul'22. Prior to his elevation, he was serving as an Executive Director in the company. He holds a Bachelor's Degree in Electrical Engineering from IIT, Roorkee, and has over 35 years of experience in the Indian power sector.

Shri Harsh Baweja
Director (Finance)

Shri Harsh Baweja is Director (Finance) of REC Limited since 14th May'24. With a wealth of experience spanning over three decades, his previous role as Executive Director (Finance) at REC showcased his adeptness in leading both state and private sector financing, showcasing exceptional acumen in managing diverse business verticals and financial

Shri Manoj Sharma
Nominee Director of PFC

Shri Manoj Sharma is a Chartered Accountant with a degree in law (LLB). He joined PFC in 1990 and was working as Executive Director (In charge) of Commercial Division before assuming charge as Director (Commercial), PFC. He has more than 30 years of experience

Shri Shashank Misra
Director (Govt. Nominee)

Shri Shashank Misra is an IAS officer and holds a B. Tech degree in Electrical Engineering from IIT Delhi. Presently, he is posted as Joint Secretory in the Ministry of Power, Government of India. Prior to joining in the Ministry of Power, he served in the Dept. of Revenue, Ministry of Finance.

Dr. Gambheer Singh
Part Time Non-official Independent Director

Professor Dr. Gambheer Singh has been appointed as a Part-time Non-official Independent Director on the Board of REC Limited w.e.f. 15th Nov'21. He is an MBBS from Gandhi Medical College, Bhopal and Master of Surgery from G.R. Medical College, Gwalior.

Dr. Manoj Manohar Pande
Part Time Non-official Independent Director

Dr. Manoj Manohar Pande has been appointed as Part-time non-official Independent Director on the Board of REC Limited with effect from November 15, 2021. He is currently working as a family physician and social worker in Yavatmal, Maharashtra. He is also at the helm of two NGOs, dedicated for the betterment of society since past 16 years.

Dr. Durgesh Nandini
Part time Non-official Independent Director

Dr. Durgesh Nandini has been appointed as Part-time Non-official Independent Director on the Board of REC Limited with effect from Dec'30, 2021. She holds a Master Degree in Arts from Gorakhpur University, Masters in Education from Maharshi Dayanand University, Rohtak and a doctorate degree in

Shri Narayanan Thirupathy
Part time Non official Independent Director

Shri Narayanan Thirupathy has been appointed as a Part-time non-official Independent Director on the Board of REC Limited w.e.f. 6th Mar'23. He holds a Bachelor's degree in Economics from the University of Madras. He is a popular television debater and social worker from Tamil Nadu.

REC: Financials and valuations

REC: Income Statement									(INR b)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**	**FY27E**
Interest on Loans	250	297	347	382	388	464	542	629	738
Interest Exp and Other Charges	156	190	215	221	237	299	347	403	474
Net Interest Income	**93**	**107**	**132**	**161**	**151**	**165**	**196**	**226**	**264**
Change (%)	6.6	14.3	23.7	22.3	-6.4	9.0	18.8	15.6	16.7
Forex Gains/(Losses)	-5	-24	-3	-8	-11	-2	-2	-2	-2
Net Interest Income (including forex gains/losses)	**88**	**83**	**129**	**153**	**140**	**163**	**194**	**225**	**262**
Other Operating Income	0	1	7	9	4	7	9	11	13
Other Income	0	1	0	1	0	1	1	1	1
Net Total Income	**88**	**85**	**136**	**164**	**144**	**171**	**204**	**237**	**276**
Change (%)	3.4	-4.0	60.4	20.5	-12.1	18.6	19.5	15.9	16.7
Employee Cost	2	2	1	2	2	2	2	3	3
Administrative Exp	3	4	3	3	3	4	5	6	7
Depreciation	0	0	0	0	0	0	0	0	0
Total Operating Expenses	**5**	**6**	**4**	**5**	**5**	**7**	**8**	**9**	**10**
PPoP	**83**	**79**	**132**	**159**	**139**	**164**	**196**	**228**	**266**
Change (%)	2.0	-5.6	67.4	20.7	-12.9	18.5	19.6	16.0	16.8
Total Provisions	**2**	**9**	**24**	**35**	**1**	**-14**	**-3**	**0**	**2**
% to Operating Income	2.9	11.3	18.4	21.8	0.8	-8.3	-1.3	-0.1	0.9
PBT	**81**	**70**	**108**	**124**	**137**	**178**	**199**	**228**	**264**
Tax (Incl Deferred tax)	23	21	24	24	27	38	40	46	53
Tax Rate (%)	28.8	30.0	22.3	19.1	19.5	21.2	20.0	20.0	20.0
PAT	**58**	**49**	**84**	**100**	**111**	**140**	**159**	**183**	**211**
Change (%)	30.4	-15.2	71.1	20.1	10.0	26.8	13.6	14.7	15.6

REC: Balance Sheet									(INR b)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**	**FY27E**
Capital	20	20	20	20	26	26	26	26	26
Reserves & Surplus	323	331	418	493	550	661	779	914	1,071
Net Worth	**343**	**351**	**438**	**513**	**577**	**688**	**805**	**940**	**1,097**
Borrowings	**2,395**	**2,815**	**3,228**	**3,263**	**3,808**	**4,456**	**5,210**	**6,135**	**7,310**
Change (%)	13.5	17.5	14.7	1.1	16.7	17.0	16.9	17.7	19.2
Total Liabilities	**2,738**	**3,166**	**3,666**	**3,776**	**4,385**	**5,144**	**6,015**	**7,075**	**8,407**
Investments	24	23	19	22	31	53	72	86	99
Change (%)	-6.9	-3.5	-17.4	13.0	45.4	69.5	35.0	20.0	15.0
Loans	**2,705**	**3,121**	**3,653**	**3,719**	**4,221**	**4,992**	**5,878**	**6,936**	**8,261**
Change (%)	12.9	15.4	17.0	1.8	13.5	18.3	17.7	18.0	19.1
Net Fixed Assets	4	5	6	6	6	7	7	7	7
Net current assets	0	0	0	0	0	0	0	0	0
Total Assets	**2,732**	**3,148**	**3,678**	**3,747**	**4,259**	**5,052**	**5,956**	**7,029**	**8,367**

E: MOFSL Estimates

REC: Financials and valuations

REC: Loans and Disbursements	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Gross Loans (INR b)	2,812	3,224	3,774	3,854	4,350	5,094	6,003	7,059	8,383
YoY Growth (%)	17	15	17	2	13	17	18	18	19
Disbursements (INR b)	722	757	930	642	968	1,615	2,131	2,558	3,018
YoY Growth (%)	17	5	23	-31	51	67	32	20	18

REC: Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Spreads Analysis (%)									
Avg. Yield - on Financing Portfolio	9.7	10.1	10.1	10.3	9.7	9.9	9.8	9.6	9.5
Avg Cost of Funds	6.9	7.3	7.1	6.8	6.7	7.2	7.2	7.1	7.1
Interest Spread	2.8	2.8	3.0	3.5	2.9	2.7	2.6	2.5	2.5
Net Interest Margin	3.7	3.7	3.9	4.4	3.8	3.6	3.6	3.5	3.5
Profitability Ratios (%)									
RoE	17.0	14.1	21.2	21.1	20.3	22.2	21.3	20.9	20.7
RoA	2.1	1.5	2.2	2.5	2.5	2.8	2.7	2.6	2.6
Efficiency Ratios (%)									
Int. Expended/Int. Earned	62.6	64.0	62.0	57.8	61.1	64.5	63.9	64.1	64.3
Other operating Inc./Net Income	-0.1	1.2	5.2	5.8	2.6	4.2	4.6	4.7	4.7
Other Income/Net Income	0.4	0.8	0.2	0.6	0.3	0.4	0.4	0.4	0.4
Op. Exps./Net Income	5.5	7.1	3.1	2.9	3.8	3.9	3.8	3.8	3.6
Empl. Cost/Op. Exps.	32.2	29.2	34.9	33.1	33.2	32.4	31.8	31.8	32.0
Asset-Liability Profile (%)									
Loans/Borrowings Ratio	112.9	110.9	113.1	114.0	110.8	112.0	112.8	113.1	113.0
Assets/Networth	8.0	9.0	8.4	7.3	7.4	7.3	7.4	7.5	7.6
Debt/Equity Ratio	7.0	8.0	7.4	6.4	6.6	6.5	6.5	6.5	6.7
Asset Quality (%)									
Gross Stage 3	7.2	6.6	4.8	4.5	3.4	2.7	2.1	1.6	1.2
Net Stage 3	3.8	3.3	1.7	1.5	1.0	0.9	0.7	0.5	0.4
PCR	47.7	49.6	64.6	67.4	70.6	68.5	68.0	68.0	66.0
Credit costs	0.1	0.3	0.7	0.9	0.0	-0.3	0.0	0.0	0.0

Valuations	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Book Value (INR)	174	178	222	260	219	261	306	357	417
BV Growth (%)	2.8	2.3	24.8	17.3	-15.7	19.3	17.0	16.8	16.7
Price-BV (x)	**2.9**	**2.8**	**2.3**	**1.9**	**2.3**	**1.9**	**1.6**	**1.4**	**1.2**
Adjusted Book Value (INR)	160	164	213	253	215	257	302	354	413
ABV Growth (%)	1.4	2.4	30.1	18.4	-15.0	19.6	17.4	17.1	16.9
Price-ABV (x)	**3.1**	**3.0**	**2.3**	**2.0**	**2.3**	**1.9**	**1.7**	**1.4**	**1.2**
EPS (INR)	29.2	24.7	42.3	50.9	42.0	53.2	60.5	69.3	80.1
EPS Growth (%)	30.4	-15.2	71.1	20.1	-17.5	26.8	13.6	14.7	15.6
Price-Earnings (x)	**17.1**	**20.2**	**11.8**	**9.8**	**11.9**	**9.4**	**8.3**	**7.2**	**6.2**
Dividend	11.0	11.0	12.7	15.3	12.6	16.0	18.0	20.5	23.5
Dividend Yield (%)	**2.2**	**2.2**	**2.5**	**3.1**	**2.5**	**3.2**	**3.6**	**4.1**	**4.7**

E: MOFSL Estimates

REC: Du Pont Analysis %	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Interest income	9.2	9.2	9.3	9.4	8.9	9.2	9.1	9.0	9.0
Interest expenses	5.8	5.9	5.8	5.4	5.4	5.9	5.8	5.8	5.8
Net Interest Income	**3.4**	**3.3**	**3.5**	**4.0**	**3.4**	**3.3**	**3.3**	**3.3**	**3.2**
Other Operating Income	-0.2	-0.7	0.1	0.0	-0.2	0.1	0.1	0.1	0.1
Other Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Income	**3.3**	**2.6**	**3.6**	**4.0**	**3.3**	**3.4**	**3.4**	**3.4**	**3.4**
Operating expenses	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Operating profits	**3.1**	**2.4**	**3.5**	**3.9**	**3.2**	**3.2**	**3.3**	**3.3**	**3.3**
Provisions	0.1	0.3	0.6	0.9	0.0	-0.3	0.0	0.0	0.0
PBT	**3.0**	**2.2**	**2.9**	**3.1**	**3.1**	**3.5**	**3.4**	**3.3**	**3.2**
Taxation	0.9	0.7	0.6	0.6	0.6	0.7	0.7	0.7	0.6
RoA	**2.1**	**1.5**	**2.2**	**2.5**	**2.5**	**2.8**	**2.7**	**2.6**	**2.6**
Leverage (x)	8.0	9.3	9.5	8.5	8.0	8.0	8.0	8.0	8.0
RoE	**17.0**	**14.1**	**21.2**	**21.1**	**20.3**	**22.2**	**21.3**	**20.9**	**20.7**

NOTES

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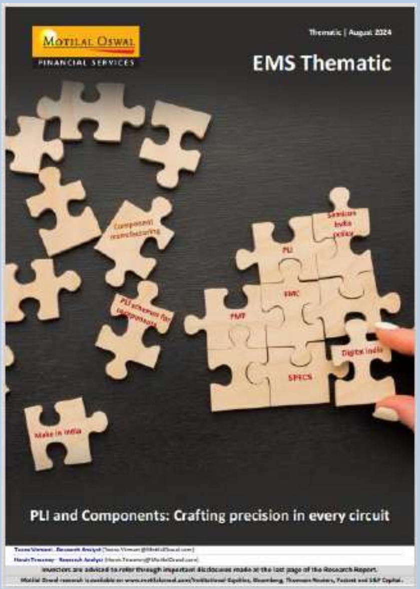

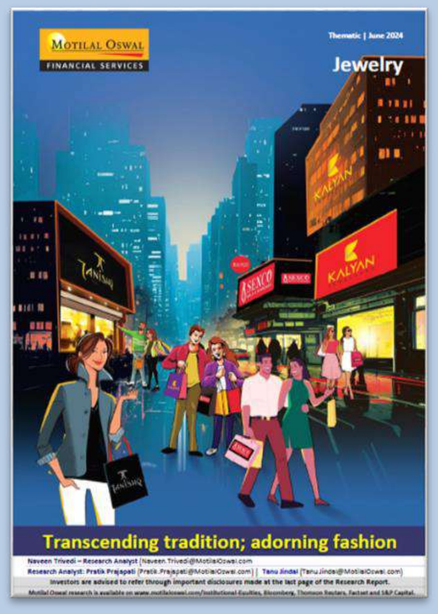

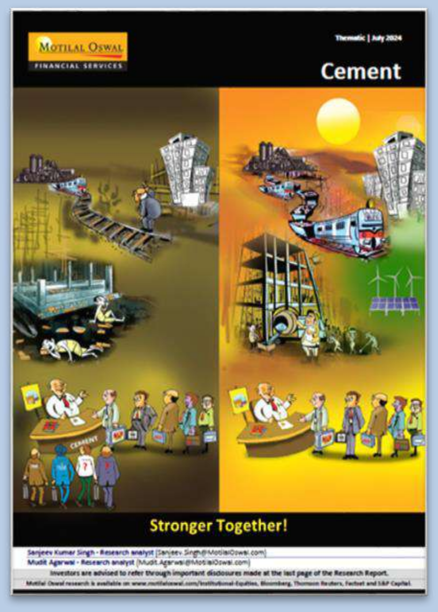

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