PTC India Financial Services Ltd

CRISIL IPO Grade 3/5 (Average)

March 01, 2011

Grading summary

CRISIL has assigned a CRISIL IPO grade of '**3/5**' (pronounced "three on five") to the proposed IPO of PTC India Financial Services Ltd (PFS). This grade indicates that the fundamentals of the IPO are **average** relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

The assigned grade showcases the high tide of financing opportunities arising for players like PFS thanks to large-scale investments required in the power sector following an increase in power demand. CRISIL Research expects more than Rs 9.3 tn will be invested in the power sector during FY10-15. The grade takes into account the rich vintage of the company's parent, PTC India, which has been a leader in power trading. The parent support will also help PFS in sourcing clients and synergise monitoring of common projects. The grade further draws support from the company's well-laid out systems and processes for project appraisal and collateral requirement.

However, the grade is moderated by the relatively small balance sheet of PFS given its short track record. PFS is likely to face intense competition from large banks and non-banking finance companies (NBFCs) who have strong balance sheets and long-existing clients. The company's high cost of funds also impacts its competitive position. The grade factors in the single sector risk (only power) as well as execution risk of the projects funded.

PFS reported PAT of Rs 255 mn on a total income of Rs 536 mn in H1FY11. The average yield and cost of funds during the same period were 16.9% and 10.7%, respectively. In H1FY11, the book value was Rs 15.21 per share.

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About the company

Incorporated as a wholly-owned subsidiary of PTC India in 2006, PFS commenced business in 2007. PFS is a 'systematically important' non-deposit taking non-banking finance company (NBFC) engaged in the business of making equity investments, providing debt financing, carbon credit financing, fee-based syndication and advisory services exclusively to the power sector. As on September 30, 2010, it carried out equity investments and debt financing (including long- and short-term) worth Rs 4,186 mn and Rs 6,048 mn, respectively.

In 2008, the company received Rs 1.55 bn in funds from private equity players Macquarie and Goldman Sachs for a 22% stake in the company.

Its promoter, PTC India, is the market leader in power trading solutions in India. Set up in 1999, PTC India is a Government of India initiated public-private partnership between National Thermal Power Corporation (NTPC), Power Grid Corporation of India Ltd (Power Grid), Power Finance Corporation Ltd (PFC) and NHPC Ltd (NHPC). As on September 30, 2010, PTC India had a portfolio of power purchase agreements aggregating to ~14,185 MW and memoranda of understandings for an additional ~11,781 MW. PFS has a group company, PTC Energy, which acts as a co-developer of energy projects with private project developers.

Issue details

Shares offered to public	156,700,000*
As per cent of post issue equity	27.88
Object of the issue	• To augment the company's capital base to meet future capital requirements for business growth • Issue-related expenses
Amount proposed to be raised	Not available at the time of grading
Price band	Not available at the time of grading
Lead managers	SBI Capital, JM Financial, ICICI Securities, Almondz, Avendus

*Includes offer for sale of 29.2 mn shares by Macquarie India Holdings Ltd

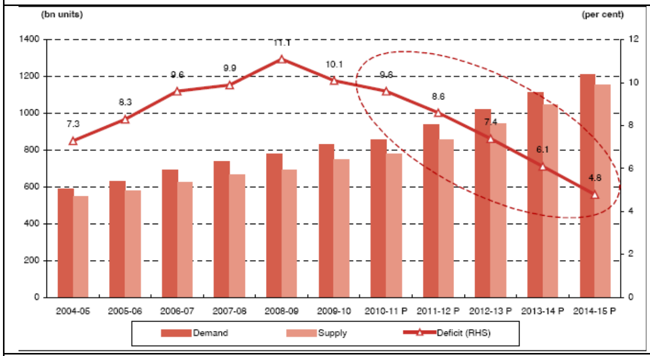
Detailed Grading Rationale

A. Business Prospects

- ***Investments worth Rs 9.3 tn expected in the power sector offer lending opportunities***

We expect PFS to ride the giant wave of lending opportunities thrown up by the power sector following an increase in demand for power. CRISIL Research expects power demand to grow at 7.8% CAGR over FY10-15 with the industrial sector leading the growth. India is estimated to add around 82 GW of power capacity over FY10-15 with power supply growing at 9.1% CAGR. The capacity additions are expected to be spearheaded by the private sector, with a share of 46 GW. With this, the power deficit in India will come down to 4.8% by FY15, but will continue.

Figure 1: Power deficit to continue



Source: CRISIL Research

Figure 2: Investments in the power sector

Rs billion	Total (2010-11 to 2014-15)
Generation-Utilities	5,067
Generation-Captives	749
Total T&D	3,442
Total Investments	**9,259**

Source: CRISIL Research

The sizeable capacity addition in the power sector is expected to translate to Rs 9.3 tn in investment over the next five years, with generation (both utilities and captives) comprising Rs 5.8 tn (63% of the total investment).

CRISIL Research estimates a CAGR of 23% for private sector investments compared to the overall 15% CAGR over the next five years. Consequently, the share of private sector investments is expected to increase to 60% in 2014-15 from 42% in 2009-10. During the same period, CRISIL Research expects total investments in the generation segment (utilities) to be ~Rs 5.1 tn, with the private sector accounting for about 57% of the investments.

- ***Leverages on expertise and relationships of its promoter PTC India***

PFS extensively benefits from the power sector expertise, network and relationships of PTC and its affiliates, which helps PFS to assess the financing needs of power projects. Synergies with PTC India help PFS in sourcing deals as well as to understand and efficiently cater to the developers' needs in a comprehensive manner. Also, financing the projects where PTC is a power trader helps continuous monitoring of the project. Further, it benefits from brand association – PTC India is an established brand name in the Indian power sector. Additionally, key management personnel inducted in PFS have been associated with the power sector and have the ability to identify specific requirements of power project developers.

- ***Well-established internal systems and processes***

PFS has laid down various systems and processes for project appraisal and monitoring. For instance, it has implemented the Advanced Internal Risk Scoring Model developed by ICRA Management Consulting Services Ltd for the assessment and mitigation of credit risk. These processes and systems include a detailed appraisal methodology, identification of risks and suitable structuring of credit risk mitigation measures. Further, it takes additional collaterals especially for weaker projects to protect itself from any deterioration in the asset quality.

- ***Relatively small balance sheet compared to peers, but enjoys cross-selling benefit***

PFS is relatively small with a net worth of just Rs 6,600 mn as on September 30, 2010 compared to other NBFCs in the power sector, namely PFC and REC, who have a stronger balance sheet with a net worth of Rs 126 bn and Rs 110 bn, respectively as of FY10, considering decades of existence in the lending business. Also, banks and NBFCs have an existing relationship with clients. A small balance sheet restricts the company's ability to fund large-scale projects. However, it enjoys benefits of cross-selling a basket of products like equity investments, structured products in debt financing and carbon credit financing unlike its competitors who only provide long- term financing.

- ***Short history of operations and high concentration risk***

With a short history of two to three years, PFS is still a relatively new player in equity and debt financing. Though the company enjoys support from parent PTC India, which helps it identify key project risks, its financing ability is yet to be proven. Most of its debt-financing (long-term) projects are still in the implementation/ moratorium stage. On the equity side it has, till date, monetised only one equity investment – IEX - for Rs 135 mn (partial exit) in September 2010. Only three of its eight equity investment projects - with an aggregate power generation capacity of 176 MW - have commenced commercial operations. However, some of the top management at PFS have expertise in the banking and NBFC sector which helps in structuring products while effectively minimising associated risks.

PFS funds projects only in the power sector, which exposes it to the single-sector concentration risk. Additionally, within the power sector, it has financed largely generation sector power projects. Further, all the power projects funded by PFS are usually small or medium projects. Considering that large power companies face several execution constraints leading to project delays, we believe small/ medium power projects could face larger execution risks. However, the projects funded by PFS till date have been able to largely meet their respective execution timelines. In terms of borrower concentration, its top five borrowers comprise 81% of the total loans outstanding as of FY10.

Concentration of outstanding loans as on September 30, 2010

Borrowers	Percentage of total outstanding loans
MB Power (Madhya Pradesh) Ltd	19.84%
Konaseema Gas Power Ltd	16.53%
Thermal Powertech Corp. India Ltd	16.53%
Athena Chhattisgarh Power Pvt. Ltd	14.88%
Surana Power Ltd	13.23%
Jhajjar Power Ltd	5.27%
OCL India Ltd	4.96%
A.A. Energy Ltd	2.69%
Amreli Power Projects (P) Ltd	2.51%
RKM Powergen P Ltd.-Phase-II	1.69%
Total	**98%**

Source: DRHP

- *Relatively high cost of funds*

PFS's cost of funds is higher compared to other financers. However, going forward, with its balance sheet size increasing, its cost of funds is expected to fall and the gap with peers would narrow. Further, IFC status to PFS offers it the benefit to issue infrastructure bonds as well as external commercial borrowings (ECB), which will help to reduce the cost of funds. Additionally, PFS does high-yielding short-term financing, which has helped it garner better interest margin. However, in order to mitigate the risks associated with short-term lending, it has systems and processes to take sufficient collateral.

Key ratio comparison amongst power-focused NBFCs

	PFS		PFC		REC	
	FY09	FY10	FY09	FY10	FY09	FY10
Yield on loan (%)	17.71	19.02	10.92	10.75	10.45	11.03
Cost of borrowings (%)	11.86	10.6	8.70	8.14	7.32	7.76
Spread (%)	5.85	8.42	2.22	2.61	3.13	3.27
NIM (%)	17.2	11.94	3.84	4.00	3.96	4.32

Source: Companies

B. Financial Performance

As on September 30, 2010, PFS has approved equity investments worth Rs 4,838 mn for 10 projects and disbursed equity investments worth Rs 4,186 mn for eight projects. It has approved debt financing worth Rs 18,815 mn for 27 projects of and disbursed debt financing of Rs 6,048 mn to 12 projects.

Given the recent commencement of business operations, it has till date only partially monetised one of its investments in Indian Energy Exchange for Rs 135 mn.

However, going forward, with increase in net worth post IPO, financials are expected to improve.

Financial performance snapshot

		FY09	FY10	H1FY11
Total income	Rs mn	116.0	534.9	536.1
Net profit	Rs mn	85.3	254.5	255.1
Adjusted EPS	Rs	0.35	0.59	0.59
Adjusted equity shares	Mn	434.6	434.6	434.6
Net worth	Rs mn	6,093	6,359	6,608
Book value	Rs	14.02	14.63	15.21
RoE	%	2.4	4.1	3.9
RoA	%	2.3	3.2	2.4
CRAR	%	275.4	88.3	60.9
Yield	%	17.7	19.0	16.9
Cost of funds	%	11.9	10.6	10.7
Spread	%	5.8	8.4	6.2
Net interest margin	%	17.2	11.9	8.4

Note: PFS has NIL NPAs as of date

Source: DRHP

C. Management Capabilities and Corporate Governance

- *Top management well experienced in the power sector*

  Most of PFS' top management personnel have several decades of experience in the power sector. Their experience will help PFS identify investment opportunities in the power sector. Also, PTC will support PFS in getting leads for investment opportunities as well in monitoring the progress of the projects (in case PTC is involved in the PPA arrangement).

- *A novice in financing business although a few key management personnel have banking/ lending background*

  Although PFS benefits from PTC India's industry experience, it is relatively new in the lending business. However, some of its key management personnel have banking/ lending background. For instance, PFS has hired people who have earlier served Power Finance Corporation. The CMD of PFS, who is also CMD of PTC India, has three decades of experience as a member of the Indian Audit and Accounts Service and previously was Director- Finance with PFC. However, none of them have equity investment experience.

- *Experienced and reputed independent directors*

  Independent directors are professionals with good experience and knowledge. Out of the six independent directors, two are also on the board of PTC India. One independent director, Mr Uddesh Kohli, was earlier the CMD of PFC and brings to the table his long years of experience as well as board practices of PFC. Mrs Rama Murali, retired Indian Audit and Accounts Service officer, inducted on the board in 2010 is the chairman of the Audit Committee. The company has 10 committees in place, of which four committees are chaired by the independent directors and the rest - IPO, Compensation, Nomination, Asset Liability Management, Issuance of Bonds and Directors committee - by the CMD.

- *Similar business interests: Both PFS and PTC India want to launch a PE fund*

  PFS and PTC India both have plans to launch a private equity fund. PTC India has already entered into an agreement with the Ashmore group to establish an energy fund and an asset management company. PFS too is keen on launching an energy fund. Although the terms of a definitive cooperation agreement between PFS and PTC India for PE fund are under discussion, no such definitive agreement has been entered into as of date. The Principles of Co-operation state that PFS shall refer all energy sector equity financing opportunities in India in excess of Rs 1,000 mn to PTC Ashmore Fund, while PTC Ashmore Fund shall refer to PFS all energy sector equity financing opportunities of less than or equal to Rs 1,000 mn.

Annexure I

Business Profile

Business overview

PFS provides equity financing, debt financing (long- and short-term), carbon credit financing as well as fee-based syndication and advisory services such as techno-economic feasibility studies for power projects in India. It is focused primarily on funding power generation projects.

- ***Equity financing***

PFS makes strategic equity investments in power sector companies, mostly greenfield projects. The nature and extent of equity participation in such companies vary in accordance with requirements, opportunities and risks associated with the relevant project. The first equity investment of Rs 65 mn was made in Indian Energy Exchange (IEX) in December 2007 for a 26% stake. In September 2010, it liquidated investments in IEX for Rs 135 mn, post which PFS' shareholding in IEX reduced to 21.12%. As of September 30, 2010, the company has approved and disbursed equity investments worth Rs 4,838 mn and Rs 4,186 mn, respectively.

- ***Debt financing***

PFS commenced the debt financing business including short-term, long-term as well as structured financing in FY09. Long-term loans act as a part of consortium financing, typically with a 10-15 years maturity period, bear floating interest rates and are usually backed by various securities and collaterals including, mortgage of immovable properties, hypothecation of movable assets, corporate guarantee, personal guarantee, pledge of shares of promoters, bank guarantee, etc. Short-term loans typically have a maturity period of up to five years. Short-term loans permit the borrower to provide one or more of the following types of any of the securities: a pledge of shares, hypothecation of assets, bank guarantee, corporate and personal guarantees. Additionally, it offers short-term loans which can get converted to long-term loans after the achievement of financial closure. Bridge loans are offered prior to financial closure of a project to expedite its implementation. The average yield on all loans was 19.02% for FY10 and 16.86% for H1FY11. As of September 30, 2010, the company has approved and disbursed debt financing worth Rs 18,815 mn and Rs 6,048 mn, respectively.

- ***Carbon credit financing against CER***

PFS commenced carbon credit financing against Certified Emission Reductions (CER) in March 2010. It finances companies by acquiring their CER rights, which have already accrued or will accrue to the companies in the future. It purchases future CERs from power project developers for sale to third parties. It enters into strategic partnerships with Macquarie Bank Ltd and Vitol SA for back to back sale of these CERs.

Sources of funding

PFS' primary fund sources include equity, term loans and non-convertible debentures (NCDs) issued. It issued NCDs of Rs 2 bn in October 2009 and Rs 3 bn February 2010. In October 2010, it also entered into agreement with Germany's Deutsche Investitions-UND Entwicklungsgesellschaft MBH (DEG) for US$26 mn ECB loan for on-lending to renewable energy projects. As of September 30, 2010, NCD and long-term loans formed 38.3% and 19.0%, respectively, of the total funding. The average funding cost was 10.60% in FY10 and 10.70% in H1FY11.

Infrastructure status given to PFS

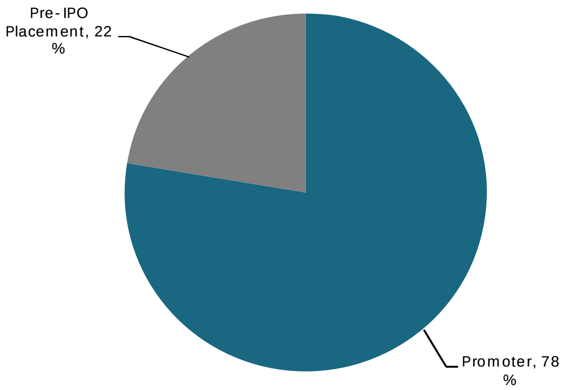
The Reserve Bank of India (RBI) classified PFS as an Infrastructure Finance Company (IFC) in August 2010. This will enable PFS to raise funds on cost-competitive basis and get higher debt exposures in infrastructure projects. It is entitled to lend up to 25% of its owned funds to a single borrower in the infrastructure sector, compared to 20% of owned funds by other NBFCs that have not been granted IFC status. It is also eligible to raise ECBs up to 50% of owned funds without prior RBI approval. Further, it can raise capital through issuance of infrastructure bonds at comparatively lower yields, as holders of such bonds are entitled to tax benefits under Section 80CCF of the Income Tax Act 1961 against cost of borrowing of 10.7-11%.

Key operational data

Parameters	
Average yields	19.02% in FY10 and 16.86% in H1 FY11
Average cost of funds	10.60% in FY10 and 10.70% in H1 FY11
NPAs	Nil

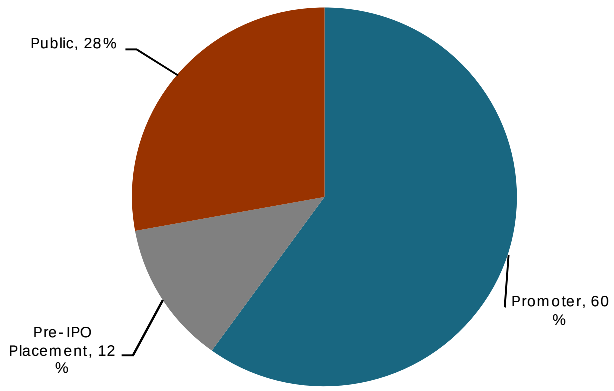
Source: DRHP

Pre-issue shareholding pattern



Source: DRHP

Post-issue shareholding pattern



Source: DRHP

Annexure II: Profile of the Directors

Name	Designation	Age	Date of joining	Qualification	Previous experience	Directorships / partnership in other entities
Tantra Narayan Thakur	Chairman and Managing Director	61	Since inception	Bachelor's degree in Engineering.	More than 30 years of experience as a member of the Indian Audit and Accounts Service. Also served as a Director (Finance and Financial Operations) in PFC. Currently, CMD of PTC India too	PTC India, PTC Energy, Athena Energy Ventures, RS India Wind Energy, etc.
Dr. Ashok Haldia	Whole Time Director and Chief Financial Officer	54	13-Aug-08	Chartered Accountant, PhD (on 'Privatisation of Public Enterprises in India')	Served as secretary in ICAI, Delhi for a decade. Earlier associated with PFC, State Enterprises Dept, etc.	PTC Energy, Meenakshi Energy Pvt., PTC Bermaco Green Energy, etc.
Shashi Shekhar	Non Executive Director	53	6-Aug-07	B.Sc (Hons) in Geology	Served as MD in Tamil Nadu Minerals Ltd, Tamil Nadu Transport Development Finance Corporation and Tamil Nadu Urban Infrastructure Financial Services Ltd. At present, also on board of PTC India	PTC Energy, Meenakshi Energy Pvt., PTC Bermaco Green Energy
Sudhir Kumar	Independent Director	54	22-Mar-10	M. Com (Delhi School of Economics, University of Delhi)	IAS; presently serving as Joint Secretary in Ministry of Power and on PTC India board	PTC India, NHPC, THDC, etc.
Prathipati Abraham	Independent Director	71	4-Jun-07	M.A. (Andhra University)	Presently serving as the chairman of Maharashtra State Electricity Board and is also on PTC India board	PTC India, JSW Energy, Visaka Industries, Lanco Infratech, etc.
Rama Murali	Independent Director	62	21-Apr-09	B.A. (Hons) (Maharani College, Jaipur)	Retired Indian Audit and Accounts Service officer	None
Dr. Uddesh Kohli	Independent Director	69	25-Sep-09	Bachelors degree (Hons) in Engineering, Ph.D. in Economics (Delhi School of Economics)	Former CMD of PFC; currently, chairman of Engineering Council of India and Construction Industry Arbitration Association	ICRA, Lanco Infratech, Henkel India, etc.
Surinder Singh Kohli	Independent Director	65	13-Dec-10	Bachelors degree in Mechanical Engineering (Benaras Hindu University), diploma in Industrial Finance from Indian Institute of Bankers	Former CMD of India Infrastructure Finance Company, PNB and SIDBI	IDFC, SME Rating Agency of India, Ahluwalia Contracts, etc.
Ramarao Muralidharan Coimbatore	Independent Director	63	11-Jan-10	B.Sc., certified associate of Indian Institute of Bankers	Earlier served in RBI, IRDA, etc.	City Union Bank, ICICI Prudential AMC
M K Goel	Non Executive Director	53	12-Jan-10	B. Tech (Electrical engineering)	Currently, director (commercial) of PFC, also on of PTC India board	PFC, PTC India, etc.
Neil Kant Arora	Non Executive Director	41	31-Jan-08	Degree in Actuarial Science (First class honours) (London School of Economics)	At present, ED with Macquarie Capital	Macquarie Capital Advisors, Dalian Holding Co, etc.

Source: Company, DRHP

Disclaimer

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