

Indian Railways Finance Corp. Ltd.

SSIS IPO GRADE 4.5/5 (Great Fundamentals)

16th January, 2021

Rating Overview

Indian Railway Finance Corp (IRFC), acting through the Ministry of Railways (MOR), Government of India is a dedicated borrowing arm of the Indian Railways. Healthy asset growth, diversified borrowing mix, regulated lending margins, and lean cost structure are characteristics unique to IRFC, a PSU NBFC.

IRFC is a dedicated borrowing arm of Indian Railways with 100% ownership with GoI. It leases rolling stock to IRs and collects lease rental proceeds. It has a cost plus mark-up structure and earns spread of 30-50bps over its all inclusive cost of borrowing. Its PAT CAGR was ~50% over FY17-1HFY21 with RoAE of 10-11% during the period; lower than PFC/REC. On an average it finances close to one-third of the actual capital expenditure of Indian Railways and hence is strategically important to and gets support from GoI.

Common sovereign ownership with its counterparty makes IRFC unique. It poses a lower risk compared to other PSUs and this is also reflected in NIL NPA status and 20-80bps lower bond spreads. Strategic importance to Indian Railways and the Ministry of Railways' expansion plans imply AUM growth of >25% over next 5 years and margin continuity (though capped) in the longer run. Nevertheless, RoE expansion beyond 10-11% depends on increase in margins. Given profitability not being primary objective of both IR and IRFC, sustained margin improvement looks unlikely. Government intent to privatize IR could expose IRFC to higher risk assets.

Expected valuation of ~1x P/B is at 30-40% premium to PFC/REC. But at this point IRFC enjoys higher earnings visibility backed by very low credit risk and almost assured business flow; expansion into private sector cannot be ruled out. Effectively, IRFC's equity is a quasi-sovereign bond earning marginally higher than g-sec. With no benefit of an operating leverage play and capped margins, expected RoE of 10-12% leaves no meaningful fundamental-based upside on table. With fate of IRFC being largely tied to IR with possibility of private sector risk build-up investing in bond instrument of IRFC could be a better alternative.

Our overall rating of IRFC is fundamentally strong and it holds a fair valuation post issue. Investors who wish a quasi-bond investment (stable return and dividend) can subscribe to this issue and others can avoid.

Note: The analyst has no plans of subscribing to the offer and does not hold any shares in the company prior to, or at the time of writing this review.

Business Overview

Indian Railway Finance Corporation Ltd. (popularly known as IRFC) is the dedicated market borrowing arm of the Indian Railways. Its primary business is financing the acquisition of rolling stock assets, which includes both powered and unpowered vehicles, for example, locomotives, coaches, wagons, trucks, flats, electric multiple units, containers, cranes, trollies of all kinds and other items of rolling stock components as enumerated in the Standard Lease Agreement (collectively, 'Rolling Stock Assets'), leasing of railway infrastructure assets and national projects of the Government of India (collectively, 'Project Assets') and lending to other entities under the Ministry of Railways, Government of India ('MoR'). The MoR is responsible for the procurement of Rolling Stock Assets and for the improvement, expansion and maintenance of Project Assets.

IRFC is responsible for raising the finance necessary for such activities. Over the last three decades, it has played a significant role in supporting the capacity enhancement of the Indian Railways by financing a proportion of its annual plan outlay. The Union Budget proposed a capital expenditure of Rs. 1,610 billion for the Indian Railways for Fiscal 2021, which was higher than the capital expenditure of Rs. 1,480.64 billion in Fiscal 2020 (Source: Ministry of Railways).

The outlay for Fiscal 2021 comprises Rs. 702.50 billion from gross budgetary support, Rs. 75 billion from internal resources and Rs. 832.92 billion from extra-budgetary resources ('EBR'). (Source: Ministry of Railways) In Fiscal 2020, IRFC financed Rs. 713.92 billion accounting for 48.22% of the actual capital expenditure of the Indian Railways. It is wholly-owned by the Government of India acting through the MoR.

In Fiscals 2017, 2018, 2019 and 2020 (revised estimate), IRFC is responsible for financing 72%, 93%, 84% and 76%, respectively, of the rolling stock purchased by it and leased to the MoR (Source: Ministry of Railways). As on September 30, 2020, the total value of Rolling Stock Assets financed by IRFC stands at Rs. 234627.17 cr. Since FY18, its AuM has posted growth of 27% CAGR.

IRFC is confident for its 'Future on Track' as it is providing financial assistance to the largest rail network in Asia. Considering the highest ever allocation of budgetary funding for railways in the last budget, IRFC is providing an opportunity to invest in its journey to progress.

Financial Performance

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On the financial performance front, for the last three fiscals, IRFC has posted total income/net profits of Rs. 9207.84 cr. / Rs. 2001.46 cr. (FY18), Rs. 10987.36 cr. / Rs. 2139.93 cr. (FY19), Rs. 13421.09 cr. / Rs. 3192.10 cr. (FY20). For the first six months ended on September 30, 2020, it has earned a net profit of Rs. 1886.84 cr. on total income of Rs. 7384.83 cr. Being a special purpose vehicle (SPV) of Railway Ministry in association with the

Ministry of Finance, as this company get advance funding from Railways for its infra development, IRFC enjoys a sub-zero status in taxation.

For the last three fiscals, IRFC has reported an average EPS of Rs. 3.30 and an average RoNW of 11%. The issue is priced at a P/BV of 0.97 based on its NAV of Rs. 26.67 and at a P/BV of 0.98 based on post issue NAV of Rs. 26.61 (at the upper cap).

If we annualize FY21 first-half earnings and attribute it on fully diluted equity post IPO, then asking price is at a P/E of around 9, Thus the issue is priced attractively. As on September 30, 2021, it's paid-up equity capital of Rs. 11880.46 cr. is supported by free reserves of Rs. 19806.65 cr.

Post issue, its current paid-up equity capital of Rs. 11880.46 cr. will stand enhanced to Rs.13068.51. With the issue price at the upper cap, the company is looking for a market cap of Rs. 33978.12 cr.

IRFC has paid a dividend of Rs. 0.36, Rs. 0.48 and Rs. 0.21 per share for the last three fiscals respectively. For the first half of the current fiscal, it has already paid an interim dividend of 0.53 per share. Thus it is a dividend-paying company. It has been maintaining the margins with the growing business.

Summary of financial Information (Restated Consolidated)				
Particulars	For the year/period ended (₹ in millions)			
	30-Sep-20	31-Mar-20	31-Mar-19	31-Mar-18
Total Assets	29,19,865.81	27,55,041.29	20,64,382.95	16,14,510.41
Total Revenue	73,848.29	1,34,210.90	1,09,873.55	92,078.39
Profit After Tax	18,868.41	31,920.96	21,399.33	20,014.60

Issue Details

To part finance its plans for augmenting equity capital base to meet future capital requirements out of planned growth, general corpus purpose, IRFC is coming out with its maiden IPO of Rs. 4455.17 cr. to Rs. 4633.38 cr. (based on lower and upper price band). The issues consist of 1188046000 fresh equity shares of Rs. 10 each and offer for sale of 594023000 equity shares. Thus the overall size of the issue is 1782069000 equity shares, that constitutes 15% of the post issue paid-up capital of the company. The company has fixed the price band of Rs. 25 - Rs.26 per share and minimum application are to be made for 575 shares and in multiples thereon, thereafter. The issue opens for subscription on January 18, 2021, and will close on January 20, 2021. Post allotment, shares will be listed on BSE and NSE.

The company has reserved equity shares worth Rs. 0.5 cr. for its eligible employees and from the residual portion; it has kept 50% for QIBs, 15% for HNIs and 35% for retail investors. For the first time, Anchor allocation is done by any PSU for its IPO, thus on this front IRFC is breaking the ice. IRFC has raised entire equity at par value so far and thus the average cost of acquisition by selling stakeholders as well as other holders is Rs. 10

per share.

This issue is jointly lead managed by DAM Capital Advisors Ltd. (erstwhile known as IDFC Securities Ltd.), HSBC Securities and Capital Markets (India) Pvt. Ltd., ICICI Securities Ltd. and SBI Capital Markets Ltd. KFin Technologies Pvt. Ltd. is the registrar to the issue.

Application Dates	Jan 18, 2021 – Jan 20, 2021
Issue Type	Book Built Issue IPO
Face Value	₹10 per equity share
IPO Price	₹25 to ₹26 per equity share
Market Lot	575 Shares
Listing At	BSE, NSE
Issue Size	[.] Eq Shares of ₹10 (Up to ₹4,633.38Cr)

Issue Timeline

Basis of Allotment Date	Jan 25, 2021
Initiation of Refunds	Jan 27, 2021
Credit of Shares to Demat Account	Jan 28, 2021
IPO Listing Date	Jan 29, 2021

Investment Strategy

The issue is priced attractively by a dividend-paying PSU. It is likely to get fancy post listing being the first mover in the segment. Investors may consider investment for long term rewards as this company is laying its future on track and poised for better growth going forward.