

RETAIL EQUITY RESEARCH

Indian Railways Finance corporation Ltd.

NBFC (Infrastructure Finance Company)

Sensex: 49,035

Nifty: 14,434

SUBSCRIBE

Price Range Rs. 25 - Rs. 26

Low risk business model with Strong asset-liability management ...

Indian Railway Finance Corporation Limited (IRFC), wholly-owned by the Government of India, is the dedicated market borrowing arm of the Indian Railways. Incorporated in 1986, it follows a financial leasing model to finance the acquisition of rolling stock assets, which includes locomotives, coaches, wagons, trucks, flats, electric multiple units, containers, cranes, trollies etc. IRFC is also into 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 ("MoR").

- IRFC follows a low risk business model with a margin determined by the MoR at the end of each Fiscal year.
- In FY20, IRFC was entitled a margin of 40 bps over the weighted average cost of incremental borrowing for financing Rolling Stock Assets.
- In FY20, IRFC financed Rs713.92 billion accounting for 48.22% of the actual capital expenditure of the Indian Railways. For FY21, MoR is expected to borrow Rs.1155.67 billion.
- IRFC's AUM represents sum of total lease receivables (55.34%), loans to Other PSU Entities (2.25%), and advances against leasing of Project Assets (42.41%), and has grown by 80% to Rs.278007.6cr from March 31, 2018 to September 30, 2020.
- It enjoys the benefit of competitive cost of borrowings based on strong credit ratings and diversified sources of earning.
- For FY18-20, revenue grew at a CAGR of 21% while PAT grew by 26% CAGR. In FY20, IRFC reported PAT of Rs.3,192cr on revenue of Rs.13,421cr.
- In FY17, 18, 19 and 20, IRFC financed 72%, 93%, 84% and 76%, respectively, of the rolling stock purchased by it and leased to the MoR.
- From April 1, 2017 to September 30, 2020, IRFC financed Rs. 1.79 trillion to the Indian Railways.
- At the upper price band of Rs.26, IRFC is available at a P/E of 9x and P/B of 1.1x on an annualized basis, which appears attractive. Considering the extensive expansion plans of the Indian Railways, monopoly in the business, a low risk business model and stable RoE, we assign a Subscribe rating for the issue.

Purpose of IPO

The offer comprises of fresh issue and offer for sale. The proceeds of the offer for sale shall be received by the selling shareholders. The net proceeds of the fresh issue will be utilized for augmenting the equity capital base to meet the future capital requirements in the business and general corporate purposes.

Key Risks

- Any downgrade in its credit ratings or India's debt rating could increase finance costs.
- Changes in government policies.

Issue Details			
Date of Opening	18 th January, 2021		
Date of Closing	20 th January, 2021		
Total no. of Shares offered(cr)	178.2		
Post Issue No. of shares (cr)	1306.85		
Price Band	Rs. 25- 26		
Face Value	Rs. 10		
Bid Lot	250 shares		
Minimum application for retail (upper price band for 1 lot)	Rs. 14,950		
Maximum application for retail (upper price band for 13 lot)	Rs. 1,94,350		
Listing	BSE & NSE		
Lead Manager	DAM Capital Advisors Ltd, HSBC Securities and Capital Markets (India) Pvt. Ltd. ICICI Securities Ltd. SBI Capital Markets Ltd.		
Registrars	KFin Technologies Pvt Ltd.		
Issue size (upper price)			
Fresh Issue	3,088.9		
OFS	1,544.5		
Total Issue	4,633.4		
Shareholding (%)			
	Pre Issue	Post Issue	
Promoters	100	86	
Others	0	14	
Total	100	100	
Issue structure			
	Allocation %	Size	Rs.cr
Retail	35	1,621	
Non -Institutional	15	695	
QIB	50	2,317	
Employee Reservation	-	0.5	
Total	100	4,633.4	
Y.E March (Rs cr)			
	FY19	FY20	H1FY21
Sales	10,987	13,421	7,383
Growth (%)	19.3	22.1	-
EBITDA	10,939	13,355	7,326
Margin%	99.6	99.5	99.2
PAT Adj	2,140	3,192	1,887
Growth (%)	6.9	49.2	-
EPS	2.4	1.2	2.9*
P/E (x)	15.9	10.6	9*
EV/EBITDA	7.7	8.5	16.2*
RoE (%)	9.5	11.6	6.5

*Annualised

Company Description

Indian Railway Finance Corporation Limited (IRFC), wholly-owned by the Government of India, is the dedicated market borrowing arm of the Indian Railways. Incorporated in 1986, it follows a financial leasing model to finance the acquisition of rolling stock assets, which includes locomotives, coaches, wagons, trucks, flats, electric multiple units, containers, cranes, trollies etc. IRFC is also into 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 ("MoR"). IRFC is the first government-owned NBFC to go public. It is registered with the Reserve Bank of India and is classified under the category of an "Infrastructure Finance Company". Primary objective of IRFC is to meet 'Extra Budgetary Resources' (EBR) requirement of the Indian Railways through market borrowings. IRFC's financing targets are determined annually by the MoR based on the annual planned capital outlay contained in the Union Budget. The company borrows through issue of both taxable and tax-free bonds, term loan from banks/financial institutions besides off-shore borrowings, at competitive market rates. IRFC has also been lending to various entities in Railway sector like Rail Vikas Nigam Limited (RVNL), Raitel, Konkan Railway Corporation Limited (KRCL), Pipavav Railway Corporation Limited (PRCL) etc. IRFC has received the highest credit ratings from CRISIL – CRISIL AAA and CRISIL A1+, ICRA – ICRA AAA and ICRA A1+, and CARE – CARE AAA and CARE A1+. They are accorded with Baa3 (Negative) rating by Moody's, BBB- (Stable) rating by Standard and Poor's and BBB- (Negative) rating by Fitch.

Business overview

The primary business of IRFC is financing the acquisition of **Rolling Stock Assets** and **Project Assets** of the Indian Railways and **lending** to other entities under the MoR. In FY20, IRFC financed Rs.713.92 billion accounting for 48.22% of the actual capital expenditure of the Indian Railways. In FY18, 19, 20, and in the six months ended September 30, 2020, IRFC financed Rolling Stock Assets worth Rs.186.7billion, Rs.240.6billion, Rs.335.4billion and Rs. 108.2billion, respectively. They have also financed Project Assets aggregating to Rs. 339.4billion and Rs.75billion in FY20 and the six months ended September 30, 2020, respectively.

As of September 30, 2020, the total AUM, consisted of 55.34% of lease receivables primarily in relation to Rolling Stock Assets, 2.25% of loans to central public sector enterprises entities under the administrative control of MoR ("Other PSU Entities"), and 42.41% of advances against leasing of Project Assets.

Mode of operation

IRFC's financing targets are determined annually by the MoR based on the annual planned capital outlay contained in the Union Budget. At the beginning of each Fiscal, the MoR provides IRFC with its target fund requirement based on its planned capital expenditure, which IRFC meets by raising funds through various sources including the issue of taxable and tax-free bonds in India, term loans from banks/ financial institutions, external commercial borrowings including bonds and syndicated loans, internal accruals, asset securitization and lease financing. For all the Rolling Stock Assets acquired during a financial year by Indian Railways, IRFC enters into cost-plus based Standard Lease Agreement with the MoR following the close of each respective Fiscal.

The period of lease with respect to Rolling Stock Assets typically is 30 years. Under the terms of the Standard Lease Agreement between the Indian Railways/ MoR and IRFC, with, IRFC as a lessor of the Rolling Stock Assets, retain legal title to such leased assets. At the end of 30 years, the assets are to be transferred to the MoR for a nominal price of Rs.1 plus applicable taxes, if any. In Fiscal 2020, IRFC was entitled to a margin of 40 bps over the weighted average cost of incremental borrowing for financing Rolling Stock Assets and a spread of 35 bps over the weighted average cost of incremental borrowing for financing Project Assets.

IRFC follows the cost-plus pricing model for the financing to Other PSU Entities, which typically provides a relatively higher margin. Such financing activity along with the deployment of net owned funds has allowed IRFC to maintain a net interest margin of 1.83%, 1.57%, 1.38% and 0.71% in Fiscals 2018, 2019 and 2020, and the six months ended September 30, 2020, respectively.

Margin Rate over and above weighted average cost of incremental borrowings

Particulars	As at September 30,2020	As at September 30,2019	As at March 30,2020	As at March 30,2019	As at March 30,2018
Project assets	35bps	35bps	35bps	35bps	25bps
Rolling stocks	40bps	40bps	40bps	40bps	30bps

Source: RHP

The MoR has provided targets for market borrowings from IRFC for funding of Rolling Stock Assets and Project Assets with Rs.625.67 billion for Fiscal 2021, which includes financing of Rs.331.37 billion for Rolling Stock Assets, Rs.14.30 billion for projects being executed by RVNL and Rs.280 billion for projects under EBR-IF. In addition, the MoR has further indicated its intention to additionally borrow Rs.530.00 in Fiscal 2021 and the Company will be informed after the necessary approvals (to operationalize the proposed borrowings) are obtained.

Margin on Incremental Rolling Stock Assets leased to MoR

Period	Cost to MoR	Weighted Average Cost of Borrowing to the company for financing Rolling Stock Assets	Margin on Incremental Rolling Stock Assets leased	
FY20		7.77%	7.37%	0.40%
FY19		8.49%	8.09%	0.40%
FY18		8.05%	7.75%	0.30%

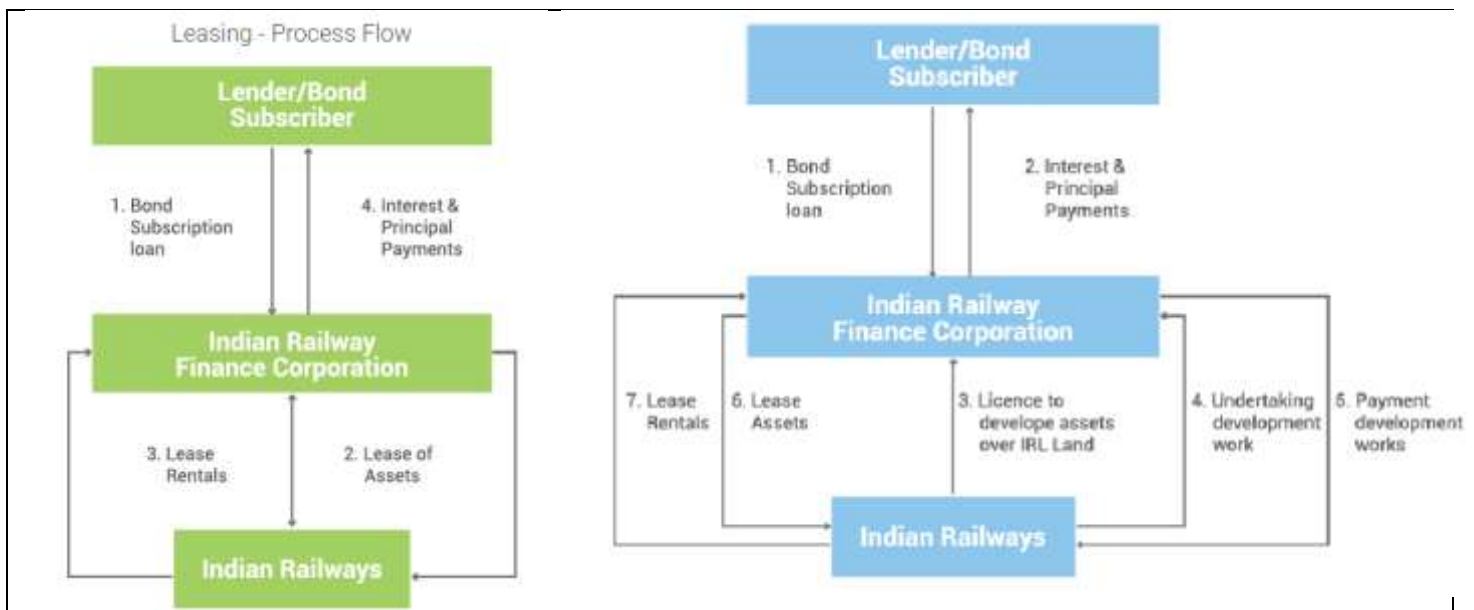
Source: RHP

Business operations

1. Leasing

IRFC follows a leasing model to finance the rolling stock assets and project assets of Indian Railways. The lease period is typically for 30 years, comprising a primary component of 15 years followed by a secondary period of 15 years. As part of the lease, recovery of the principal component and interest is affected during the primary lease period and at the end of the lease, assets are typically sold to the MoR for a nominal price. The Company has adopted a cost plus lease arrangement with the Ministry of Railways which ensures a net interest margin for IRFC. The MoR pays lease rentals to the Company on half yearly basis and the lease pricing comprises both principal repayment and interest payment.

In terms of the leasing arrangements, the principal amount pertaining to the leased assets is effectively payable during the primary 15 years lease period, along with the weighted average cost of incremental borrowing and a margin determined by the MOR in consultation with IRFC at the end of each Fiscal. Typically, the weighted average cost of incremental borrowing factors in any expenses incurred by IRFC with respect to any foreign currency hedging costs and/ or losses (and gains, if any) as well as any hedging costs for interest rate fluctuations. A nominal amount of Rs.100,000 per annum shall be payable for the second 15 year period or until the Rolling Stock Assets are sold out to the MoR or any other buyer before the completion of the lease period. The lease rentals during the second 15 year period are subject to revision with mutual consent. IRFC also follows a leasing model for Project Assets with lease periods of 15 to 30 years depending on the mode of raising funds for such leasing.



Source: RHP, company website

2. Lending

IRFC also has presence in lending activities and has provided funds to various companies in Railway sector like Rail Vikas Nigam Limited (RVNL), Konkan Railway Corporation Limited, Rail Land Development Authority, Railtel Corporation of India and Pipavav Railway Corporation Limited. IRFC's foray into funding of railway projects began in 2011-12 which has accelerated the project execution on many fronts like capacity enhancement etc. Besides, the Company has been assigned the additional task of funding Railway Projects through Institutional Finance to the extent of Rs.1.50 Lakh Crore by 2019-20.

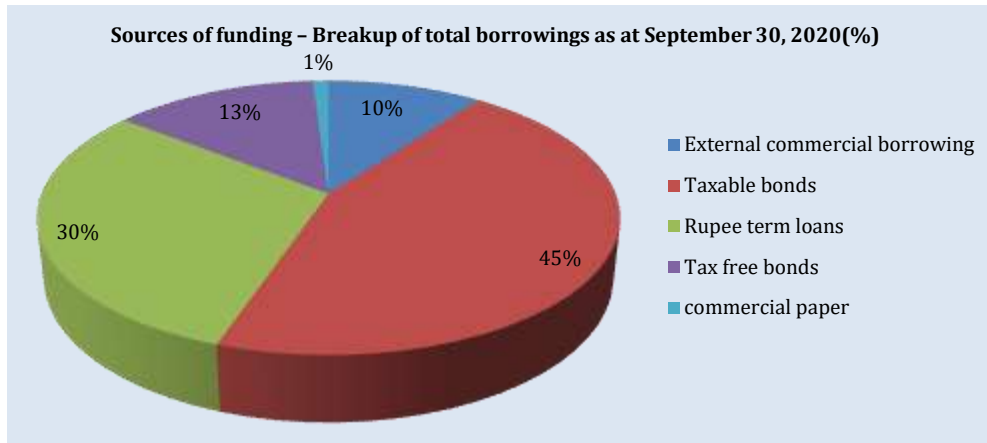
3. Borrowing

IRFC has been meeting its funding requirements from various sources to extract the lowest possible pricing from the markets. In addition to the equity infusion from time-to-time by the Government of India, IRFC has been mobilizing funds through both taxable and tax-free bond issuances, term loans from banks and FIs and ECBs. The funding plan of IRFC is carried out with the prime objective to minimize its price of borrowings which in turn will benefit the Indian Railways as it works on a cost plus margin basis.

Competitive cost of borrowings

IRFC meets funding requirements through various sources. They fund acquisitions of Rolling Stock Assets and Project Assets through market borrowings of various maturities and currencies. The ability to source external commercial borrowings in the form of syndicated foreign currency term loans, issuance of bonds/ notes in offshore markets at competitive rates supplement the funds available from domestic sources. Since IRFC is registered as an NBFC and classified under the category of an "Infrastructure Finance Company", they are allowed to raise external commercial borrowings of up to USD 750 million or equivalent per financial year under the automatic route without the prior approval of the Reserve Bank of India.

In addition to equity infusion from time-to-time by the Government of India, the long/ medium term sources of funding include taxable and tax-free bond issuances, term loans from banks/financial institutions, external commercial borrowings, internal accruals, asset securitization and lease financing.



Source: RHP, company website

They also have a diverse base of investors from whom they raise funds through the issuance of bonds in the domestic and international bonds. These include banks and financial institutions, pension funds, provident fund trusts, insurance companies, sovereign funds, corporates, public (including high net worth individuals, retail investors and non-resident investors), trusts and mutual funds.

Low risk business model

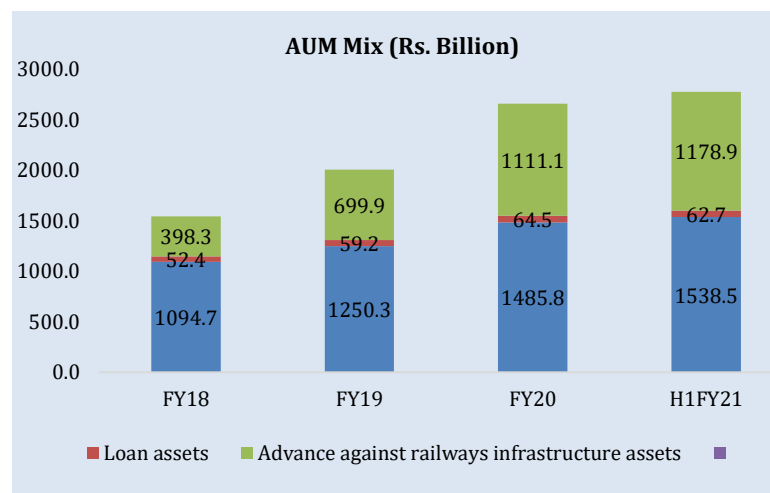
The expenses incurred by IRFC with respect to any foreign currency hedging costs and/ or losses as well as any hedging costs for interest rate fluctuations are built into the weighted average cost of incremental borrowing. This enables IRFC to earn a margin, as determined by the MoR in consultation with them at the end of each Fiscal, over the life of the lease. Risks relating to damage to Rolling Stock Assets as a result of natural calamities and accidents are also passed on to the MoR. IRFC's liquidity risk is also minimized as the MoR is required to cover any funding shortfall required by them for the redemption of bonds issued by IRFC on maturity or repay term loan facilities availed by them. The MoR has historically never defaulted in its payment obligations under the Standard Lease Agreement. In addition, lease payments by the MoR form part of the annual railway budget in the Union Budget of India.

Strong asset-liability management

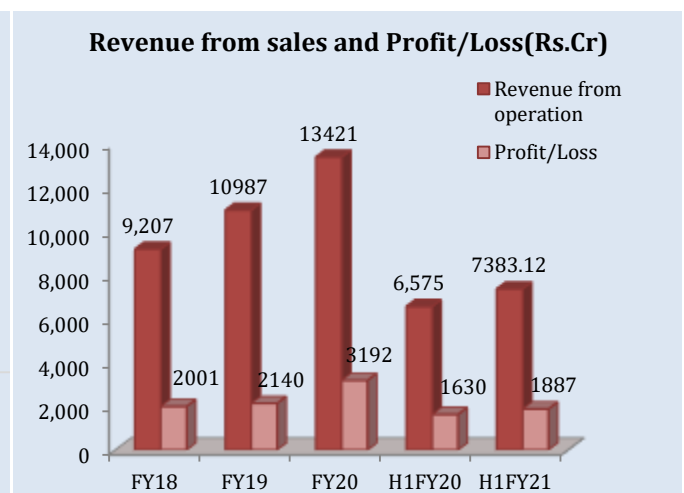
IRFC's asset-liability management model is structured in a manner which ensures that they have minimum asset-liability mismatches. They borrow on a long-term basis to align with the long-term tenure of the assets funded by them. Such an approach of matching the tenure of the advances with borrowings allows them to manage the liquidity better and meet the growing demands of the Indian Railways. Further, in the event IRFC does not have sufficient funds to redeem bonds or repay term loans owing to inadequate cash flows during the fiscal year, the MoR is required under the Standard Lease Agreement to provide for such shortfall, through bullet payments in advance prior to maturity of the relevant bonds or term loans. Such payments are required to be adjusted in the subsequent lease rentals payable under the respective Standard Lease Agreement.

Financial track record...

The total revenue from operations increased by 19.33% from Rs.9207.84cr in FY18 to Rs.10,987.4cr in FY19 and by 22.15% to Rs.13,421.1cr in FY20, and was Rs.7,384.83cr in the six months ended September 30, 2020. In Fiscals 2018, 2019 and 2020, and the six months ended September 30, 2020, the profit for the period was Rs.2001.5cr, Rs.2139.93cr, Rs.3192.1cr and Rs.1886.8cr, respectively. The AUM, which represents sum of total lease receivables, loans to Other PSU Entities, and advances against leasing of Project Assets, have grown by 30.03% from Rs.154534.7cr as of March 31, 2018 to Rs.200937.3cr as of March 31, 2019 and by 32.45% to Rs.266136.99cr as of March 31, 2020, and was Rs.278007.59cr in the six months ended September 30, 2020. Disbursements to the MoR increased by 43.06% from Rs.36722.25cr in FY18 to Rs.52535.18cr in FY19 and by 35.89% to Rs.71,392.07cr in FY20, and was Rs.19,016.38cr in the six months ended September 30, 2020. IRFC's capital adequacy ratio as of March 31, 2020 and September 30, 2020 was 395.39% and 433.92%, respectively. As of September 30, 2020, the company did not have any non-performing assets.



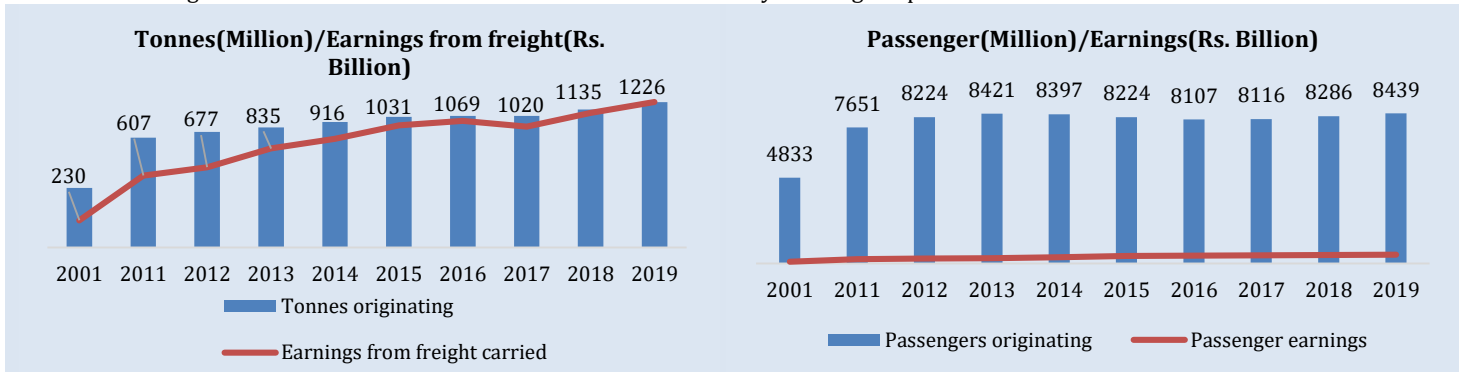
Source: RHP



Industry Outlook

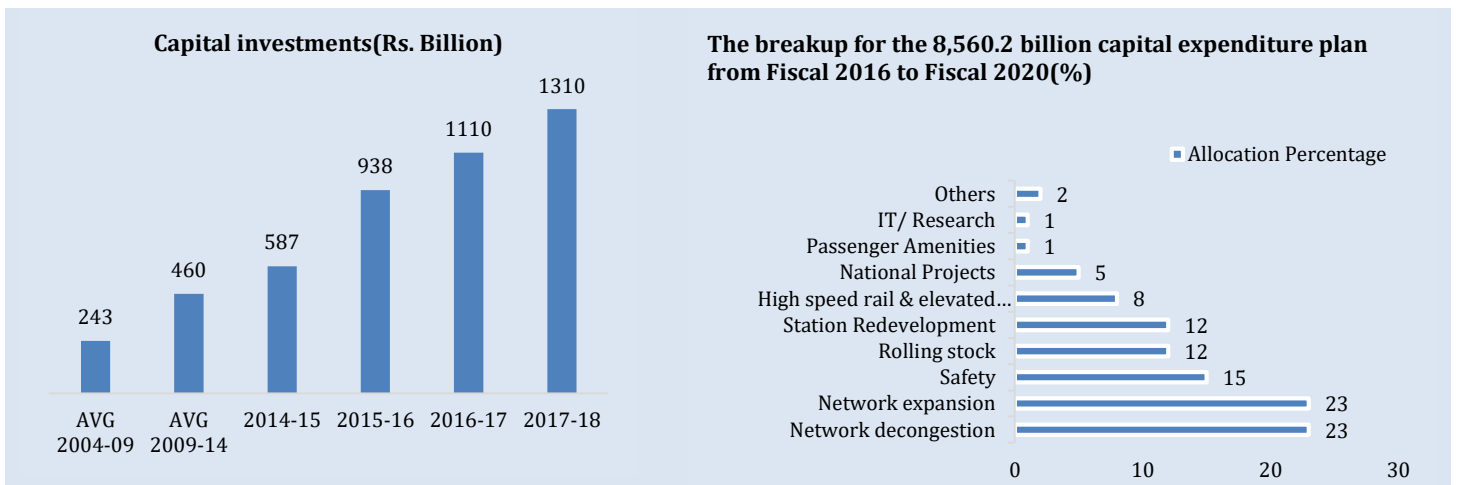
The Indian Railways is a departmental undertaking of the GoI, which owns and operates India's rail transport, through the Ministry of Railways. Being the largest rail network in India, the Indian railways deploy approximately 13,452 trains every day transporting 22.70 million passengers per day in Fiscal 2018. The Indian railways earn its internal revenue primarily from passenger and freight traffic where it reported an increase in revenues from approx. Rs.1653 billion in Fiscal 2017 to Rs.1787 billion in Fiscal 2018. Freight remains the major revenue earning segment of the Indian railways. Freight utilizes one-third of the capacity and generates two-thirds of Indian Railway's revenues whereas passenger trains utilize two-third of the capacity but generates only one-third of total revenues.

There has been substantial investment in railway infrastructure in recent times with amount of investment made during Fiscal 2015 and Fiscal 2017 being 75% of the total investment made in the Indian Railways during the prior 10 Fiscals.



Source: RHP

The primary sources of funds for the Indian railway are GBS, internally generated funds, public private partnerships and market borrowings leasing through IRFC and other sources (EBR-IF), railway safety fund and RRSK. The Indian Railway has planned to borrow 2.50 trillion from IRFC, including 1 trillion for Rolling Stock Assets to fund its proposed capital expenditure from Fiscal 2016 to Fiscal 2020. As of March 31, 2019, the cumulative funding by IRFC to the MoR amounted to 2,688.67 billion including 162 billion from LIC.



Source: RHP

Promoter and promoter group

The Promoter is the President of India, acting through the MoR. The Promoter, along with its nominees, currently holds 100% of the pre-Issue paid-up Equity Share capital of the Company. After this Issue, the Promoter shall hold 86.36% of the post Issue paid-up Equity Share capital of the Company.

Brief profiles of Directors

- **Amitabh Banerjee** is the Chairman and Managing Director of the Company. Prior to his current position, he was associated with Konkan Railway Corporation Limited as well as the Hindustan Paper Corporation Limited in the capacity of director (finance).
- **Shelly Verma** is the Director (Finance) and Chief Financial Officer of the Company. Prior to her appointment to the Board, she has served in various capacities, including, most recently, as an executive director with Power Finance Corporation Limited.
- **Baldeo Purushartha** is a Part-time Government Director of the Company. He is on the board of several institutions, including the India Infrastructure Finance Company Limited, ONGC Videsh Limited, Indian Railway Stations Development Corporation Limited and Asian Infrastructure Investment Bank
- **Chetan Venugopal** is a Part-time Non-official Director (Independent Director) of the Company.
- **Ashok Kumar Singhal** is a Non-official Director (Independent Director) of the Company. He is a former head of the Indian Cost Accounts Service.
- **Bhaskar Choradia** is a Part-time Government Director of the Company. He is an officer of the Indian Railway Accounts Service.

Financials

Profit & Loss Account

Y.E March (Rscr)	FY19	FY20	H1FY21
Sales	10,987	13,421	7,383
% change	19.3	22.1	-
EBITDA	10,939	13,355	7,326
% change	19.3	22.1	-
Depreciation	0.4	0.5	0.2
EBIT	10,938	13,355	7,326
Interest	8,183	10,163	5,441
Other Income	0.0	0.1	1.7
Exceptional Items	0	0	0
PBT	2,755	3,192	1,887
% change	9	15.9	-
Tax	615	-	-
Tax Rate (%)	22.3	-	-
Reported PAT	2,140	3,192	1,887
Adj	-	-	-
Adj PAT	2,140	3,192	1,887
% change	6.9	49.2	-
No. of shares (cr)	1306.85	1306.85	1306.85
Adj EPS (Rs)	1.6	2.4	2.9*

Cash Flow

Y.E March (Rscr)	FY19	FY20	H1FY21
PBT	2,755	3,192	1,887
Non-cash adj.	142	-27	48
Changes in W.C	(44,646)	(65,882)	(12,839)
C.F.O	(41,748)	(62,718)	(10,904)
Capital exp.	(0.4)	-	-
Change in inv.	-	-	-
Sale of investment	1.2	1.1	0.5
Other invest.CF	0.5	0.6	-
C.F - investing	1.3	1.5	0.7
Issue of equity	2,854	2,500	-
Issue/repay debt	39,347	60,455	10,904
Dividends paid	(375)	(200)	-
Other finance.CF	(77.1)	(41)	-
C.F - Financing	41,749	62,714	10,904
Chg. in cash	2.6	(2.3)	0.5
Closing cash	1.1	3.7	1.4

*Annualized

Balance Sheet

Y.E March (Rscr)	FY19	FY20	H1FY21
Cash	81	100.8	95.9
Accounts Receivable	1,25,027	1,48,580	1,53,847
Inventories	-	-	-
Other Cur. Assets	47	-	-
Investments	13	11.5	11.4
Net Fixed Assets	11.2	11.0	10.9
CWIP	-	-	-
Intangible Assets	0.1	0.0	0.0
Other Assets	81,218	1,26,170	1,37,158
Total Assets	2,06,438	2,75,504	2,91,987
Current Liabilities	17	70	50
Provisions	1,30,910	1,65,642	1,75,771
Debt Funds	50,645	79,493	84,479
Minority Interests	0	0	0
Def. Tax	0	0	0
Equity Capital	9,380	11,880	11,880
Reserves & Surplus	15,486	18,419	19,807
Shareholder's Fund	24,866	30,340	31,687
Total Liabilities	2,06,438	2,75,504	2,91,987
BVPS (Rs)	19	23	24

Ratios

Y.E March	FY19	FY20	H1FY21
Profitab. & Return			
EBITDA margin (%)	99.6	99.5	99.2
EBIT margin (%)	99.6	99.5	99.2
Net profit mgn.(%)	19.5	23.8	25.6
ROE (%)	9.5	11.6	6.5
ROCE (%)	14.2	14.4	7.6
AUM	2,00,937	2,66,137	2,78,007
Growth(%)	30	32	-
NIM(%)	1.5	1.3	0.7
Cost of Borrowing %	7.0	7.3	7.1*
	-	-	-
Turnover & Levq.			
	-	-	-
Total asset T.O (x)	0.1	0.1	0.0
Int. covge. ratio (x)	1.3	1.3	1.3
Adj. debt/equity (x)	2.0	2.6	2.7
Valuation ratios			
EV/Sales (x)	7.7	8.5	16
EV/EBITDA (x)	7.7	8.5	16
P/E (x)	15.9	10.6	9
P/BV (x)	1.4	1.1	1.1

General Disclosures and Disclaimers

CERTIFICATION

We, Mithun T Joseph and Rajeev.T author(s) of this Report, hereby certify that all the views expressed in this research report reflect my personal views about any or all of the subject issuer or securities. This report has been prepared by the Research Team of Geojit Financial Services Limited, hereinafter referred to as Geojit.

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