Indian Railway Finance Corporation Ltd

ICICI direct Research

Price Band ₹ 25-26

UNRATED

January 15, 2021

Indian Railway Finance Corporation (IRFC) is the dedicated market borrowing arm of the Indian Railways. The company registered with the RBI as a NBFC and is classified under the category of an "Infrastructure Finance Company". The primary business is financing the acquisition of rolling stock assets, which includes both powered and unpowered vehicles, as enumerated in the Standard Lease Agreement, leasing of railway infrastructure assets and national projects of the Government of India, and lending to other entities under the Ministry of Railways, Government of India.

In FY20, IRFC had financed 76% of the rolling stock purchased and leased to the MoR (Ministry of Railways). IRFC's total revenue from operations increased by 19.3% from ₹9207.9 crore in FY18 to ₹10987.4 crore in FY19 and by 22.2% to ₹13421.9 crore in FY20, and was ₹7384.8 crore in 1HFY21. In FY18, FY19, FY20, and 1HFY21, net profit stood at ₹2001.46 crore, ₹2139.93 crore, ₹3192.09 crore and ₹1886.84 crore, respectively.

Strategic role in financing growth of Indian Railways

As a dedicated market borrowing arm, IRFC has played a strategic role in financing the operations of the Indian Railways. The extensive expansion plans of the Indian Railways in the future will involve significant financing, and as a primary financing source for the Indian Railways, the company's operations will increase significantly. In FY20, IRFC financed ₹71,392 crore accounting for 48.22% of actual capital expenditure of Indian Railways.

Low risk business model & RoE at ~11-12%

IRFC's relationship with the MoR enables it to maintain a low risk profile. As of September 30, 2020, IRFC did not have any non-performing assets. Further, expenses incurred with respect to any foreign currency hedging costs and/ or losses (and gains, if any) and hedging costs for interest rate fluctuations are built into the weighted average cost of incremental borrowing. Risks relating to damage to Rolling Stock assets as a result of natural calamities and accidents are also passed on to the MoR. Accordingly, IRFC return ratio (RoE) is at ~11-12%.

Key risks and concerns

- Substantial dependence on Indian Railways for revenue
- Government control makes company susceptible to policy changes

Priced at P/BV of 1x H1FY21 (post issue) on upper band

As a dedicated finance arm of Indian Railways, IRFC remains a low risk model with no non-performing asset and RoE at 11-12%. At the higher end of the price band of ₹ 26 per share, the stock is available at a P/B of ~1x on H1FY21 BV.

Particulars	
Issue Details	
Issue Opens	18th January 2020
Issue Closes	20th January 2020
Issue Size (₹ crore)	4455 - 4633
Fresh Issue (₹crore)	3089
Offer for Sale (₹crore)	1544
Price Band (₹)	25-26
No. of shares on offer (in crore)	178.2
QIB (%)	50
Retail (%)	35
Min Lot size (No. of shares)	575

Shareholding Pattern (%)

	Pre-Issue	Post-Issue
Promoter Group	100.0	86.3
Public	0.0	13.7

Objects of issue

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Augmenting equity capital base to meet future capital requirements arising out of growth in busines

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Key Financial Summary

	FY18	FY19	FY20	H1FY21	CAGR (FY18-20)
Total Revenue	9207.0	10987.4	13421.0	7383.1	20.7
PAT	2001.5	2139.9	3192.1	1886.8	26.3
EPS	3.1	3.3	3.4	1.6	5.2
BVPS	31.4	26.5	25.5	26.7	
RoA%	1.4	1.2	1.3	0.66*	
RoNW%	12.3	9.5	11.6	6.09*	

** Not annualised*
Source: ICICI Direct Research, RHP

Company background

IRFC is the dedicated market borrowing arm of the Indian Railways. The 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, leasing of railway infrastructure assets, national projects of the Government of India, and lending to other entities under the Ministry of Railways, Government of India.

IRFC is wholly-owned by the Government of India acting through the MoR and is registered with the RBI as a NBFC (Systematically Important) classified under the category of an "Infrastructure Finance Company". Over the last three decades, IRFC has played a significant role in supporting the capacity enhancement of the Indian Railways by financing a proportion of its annual plan outlay.

The company follows a financial leasing model for financing the Rolling Stock Assets. The period of lease with respect to Rolling Stock Assets is typically 30 years comprising a primary period of 15 years followed by a secondary period of 15 years, unless otherwise revised by mutual consent. 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 the company at the end of each fiscal.

Exhibit 1: AUM Break-up (₹ crore)

	FY18	FY19	FY20	H1FY21
Lease receivables	109471.7	125026.5	148579.8	153846.8
Loan assets	5238.0	5919.2	6449.2	6268.1
Advances against Railway infra assets	39825.1	69991.7	111108.0	117892.7
Total	154534.7	200937.3	266137.0	278007.6

Source: RHP, ICICI Direct Research

Exhibit 2: Borrowing Break-up (₹ crore)

	FY18	FY19	FY20	H1FY21
ECB	12070.8	9959.9	25401.1	25007.0
Taxable Bonds	69707.5	79760.1	103282.8	110890.2
Rupee Term Loan	18169.2	47710.4	69386.9	74421.0
Tax Free Bonds	34007.5	34007.5	33080.3	33080.3
Commercial Papers	1000.0	3000.0	3875.0	2550.0
Total	134955.0	174437.9	235026.1	245948.4

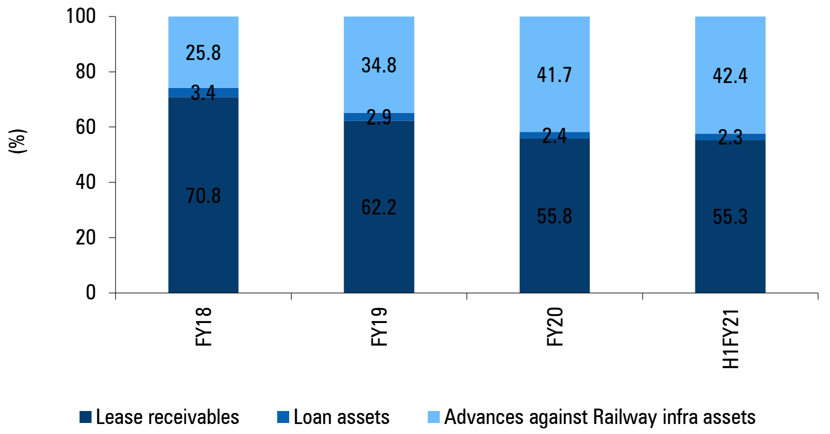
Source: RHP, ICICI Direct Research

Investment Rationale

Strategic role in financing growth of Indian Railways

IRFC is dedicated market borrowing arm for the Indian Railways and has played a strategic role in financing the operations of the Indian Railways. In FY20, IRFC financed ₹71,392 crore, accounting for 48.2% of the actual capital expenditure of the Indian Railways. In FY18, FY19, FY20, and 1HFY21, it financed Rolling Stock Assets worth ₹18,669.86 crore, ₹24,055.08 crore, ₹33,544.10 crore and ₹10,816.4 crore, respectively. The extensive expansion plans of the Indian Railways in the future will involve significant financing, and as a primary financing source for the Indian Railways, the company's operations will increase significantly. The financing targets are determined annually by the MoR (Ministry of Railways) based on the annual planned capital outlay contained in the Union Budget of India for Indian Railways.

Exhibit 3: AUM break-up (%)

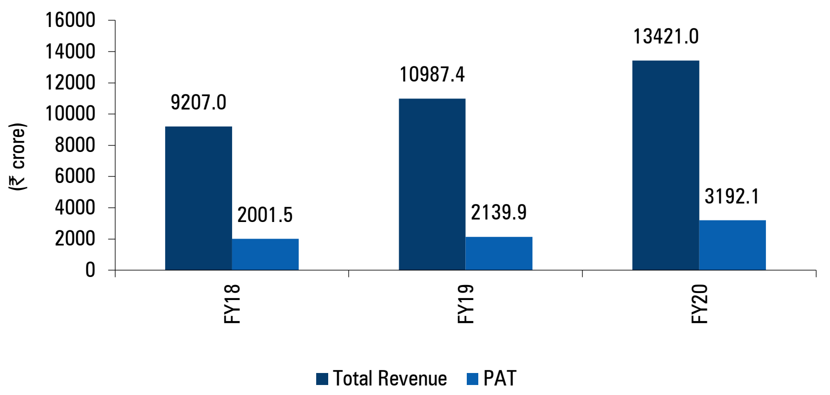


Source: RHP, ICICI Direct Research

Consistent financial performance and cost plus model

IRFC's total revenue from operations increased by 19.33% from ₹9,207.9 crore in FY18 to ₹10,987.4 crore in FY19 and by 22.15% to ₹13,421.9 crore in FY20, and was ₹7,384.8 crore in 1HFY21. In FY18, FY19, FY20, and 1HFY21, net profit was ₹2,001.46 crore, ₹2,139.9 crore, ₹3,192.1 crore and ₹1,886.84 crore, respectively. Net worth increased from ₹20,324.28 crore as of FY18 to ₹31,686.96 crore as of September 30, 2020. IRFC's cost-plus based Standard Lease Agreement with the MoR has historically provided a margin over the weighted average cost of incremental borrowing determined by the MoR in consultation with the company at the end of each fiscal. In FY20, the company was entitled to a margin of 40 bps over the weighted average cost of incremental borrowing for financing Rolling Stock Assets and a margin of 35 bps over the weighted average cost of incremental borrowing for financing Project Assets. Similarly, the company follows the cost-plus pricing model for financing to other PSU entities, which typically provide for a relatively higher margin. In addition, low overhead and administrative costs and high operational efficiency has resulted in increased profitability. In FY18, FY19, FY20, and 1HFY21, IRFC's employee benefit expenses accounted for 0.06%, 0.06%, 0.05% and 0.04% of total income, respectively.

Exhibit 4: Increasing trend in Revenue and PAT

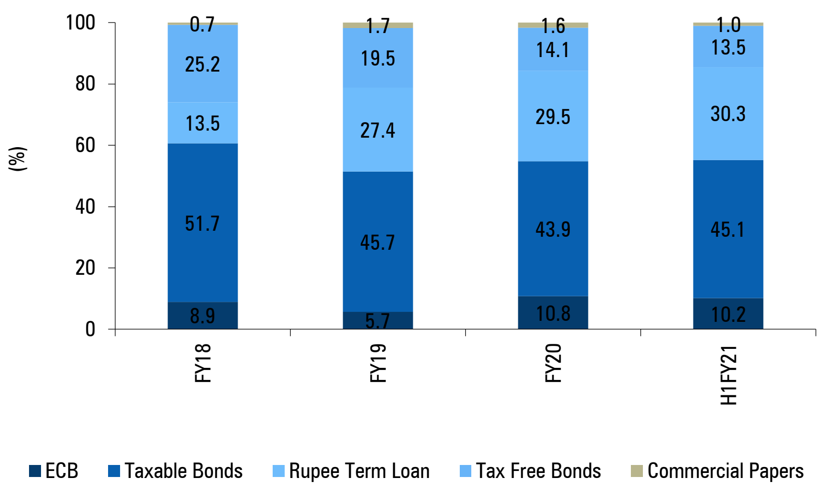


Source: RHP, ICICI Direct Research

Competitive cost of borrowings based on strong credit rating

Diversified sources of funding, highest credit ratings and strategic relationship with the MoR, have enabled the company to keep cost of borrowing competitive. In addition to equity infusion from time-to-time by the Government of India, 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. The company has a diverse base of investors from whom it raises funds through issuance of bonds in the domestic and international bonds. Cost of borrowings was 6.82%, 7.09% and 7.27% in FY18, FY19, and FY20, respectively, and 3.91% and 3.55% (non-annualized) in 1HFY20 and 1HFY21, respectively. The company 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+.

Exhibit 5: Borrowing break-up (%)



Source: RHP, ICICI Direct Research

Low risk business model

IRFC's relationship with the MoR enables it to maintain a low risk profile. Typically, the expenses incurred 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 are built into the weighted average cost of incremental borrowing. Risks relating to damage to Rolling Stock Assets as a result of natural calamities and accidents are also passed on to the MoR. Further, the MoR is required to indemnify the company at all times from and against any loss or seizure of the Rolling Stock assets under distress, execution or other legal process.

As of September 30, 2020, the company did not have any non-performing assets. Liquidity risk is also minimized as the MoR is required to cover any funding shortfall required for the redemption of bonds issued by IRFC on maturity or repay term loan facilities availed. In order to minimize interest rate and foreign currency exchange risks, IRFC enters into hedging arrangements with respect to a portion of interest rate risk and foreign currency exposure, particularly arising from external commercial borrowings. The costs of such hedging are typically included in the weighted average cost of incremental borrowing which are included in the lease rentals payable by the MoR.

Strong asset-liability management

IRFC manages its cash flows through an active asset and liability management strategy and it's ALM model is structured in a manner which ensures minimum asset-liability mismatches. IRFC borrows on a long-term basis to align with the long-term tenure of the assets funded. The approach of matching the tenure of advances with borrowings allows to manage liquidity better and meet the growing demands of the Indian Railways. To ensure having sufficient funds to meet commitments, IRFC maintains satisfactory levels of liquidity to ensure availability of funds at any time to meet operational and statutory requirements. Further, in the event if the company does not have sufficient funds to redeem bonds or repay term loans owing to inadequate cash flows, 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.

Key risks and concerns

Dependence on single single source for substantial business

The vast majority of IRFC's revenue is generated from leasing Rolling Stock Assets to the Indian Railways. Lease income, interest on loans and pre commencement lease interest income together represented 99.75% and 99.87% of total revenue from operations in FY20 and 1HFY21, respectively. Any shift in the funding pattern of the Indian Railways, such as, reduced demand for Rolling Stock Assets or reliance on internal accruals or preference to other funding arrangements etc. will have an adverse impact on results of operations. Any corporatization or privatization of the Indian Railways allowing the MoR to raise funds directly from banks, NBFCs and other financial institutions will also have an adverse impact on the business.

The Indian Railways' has got competition from other means of transportation that could increase if cross-subsidies between freight and passenger fares remain at the current high levels, particularly when the road network is improving, and oil pipelines are being built. Therefore, any slowdown in the growth of the Indian railways sector and changes in the policies could have a material adverse effect on IRFC's business.

Mismatch in the tenor of leases and borrowings may lead to reinvestment and liquidity risk

A majority of the company's revenues is derived from the Standard Lease Agreements. IRFC receives lease rentals, which include the value of the Rolling Stock Assets leased to the MoR in the relevant fiscal year, the weighted average cost of incremental borrowing as well as a certain margin, within the primary lease period. Repayments occur half yearly by instalments during the primary lease period. While a majority of borrowings requires IRFC to make bullet repayments, the company also has certain borrowings where it is required to make one-time repayments. Such repayment of such borrowings in certain years may give rise to a temporary mismatch. This may potentially lead to a liquidity risk and interest rate risk.

GoI control makes company susceptible to policy changes

IRFC is wholly-owned and controlled by GoI acting through the MoR. Accordingly, GoI will continue to exercise significant influence over company's business policies and affairs. IRFC is required to adhere to certain restrictions and may not be able to diversify borrowing portfolio by issuing different instruments without prior approval of the GoI. The GoI may, from time to time, issue directives or instructions as may be considered necessary in regard to the conduct of business and affairs and may vary and annul any such directive or instruction. The GoI will have the power to elect and remove the Directors and therefore determine the outcome of most proposals for corporate action requiring approval of the Board or shareholders, including with respect to the payment of dividends. Given the importance of the Indian Railways to Indian economy, the GoI could require the company to take actions aimed at serving the public interest, which may not necessarily be profitable or financially feasible.

Changes in value of currency could have adverse impact

A significant portion of the company's borrowings are denominated in currencies other than Indian rupees, most significantly the U.S. dollar and Japanese yen. Significant fluctuations in currency exchange rates between the Indian rupee and these currencies and inter-se such currencies may increase the cost of borrowings. Although IRFC enters into hedging transactions to minimize currency exchange risks and build in such costs in the weighted average cost of incremental borrowing which are included in the lease rentals payable by the MoR, there can be no assurance that such measures will enable to avoid the effect of any adverse fluctuations in the value of the Indian rupee against the U.S. dollar, Japanese yen or other relevant foreign currencies.

Withdrawal of exemption from provisioning requirements in respect to DTA & DTL can impact profitability

Pursuant to circular S.O. 529 (E) dated February 5, 2018 and subsequent amendment through circular dated April 2, 2018 (collectively, the “DTL Circulars”) issued by the MCA, a government company which is engaged in the business of infrastructure finance leasing with not less than 75% of its total revenue being generated from business with government companies or other entities owned or controlled by the GoI are exempt from the requirements of provisioning in respect of Ind AS 22 or Ind AS 12 relating to deferred tax asset or deferred tax liability. IRFC’s profitability may be adversely affected if any of these DTL Circulars are withdrawn. Further, there can be no assurance that the MCA will not withdraw the existing exemptions, which may adversely affect the company’s business, net worth, financial condition and results of operations

Financial Summary

Exhibit 6: Profit & loss statement (₹ crore)

	FY18	FY19	FY20	H1FY21
Interest income	988.6	1723.1	2748.0	1716.8
Dividend income	0.5	0.5	0.6	0.2
Lease income	8217.9	9263.8	10672.4	5666.1
Total revenue from operations	9207.0	10987.4	13421.0	7383.1
Other income	0.9	0.0	0.1	1.7
Total income	**9207.8**	**10987.4**	**13421.1**	**7384.8**
Finance costs	6637.6	8183.1	10162.7	5441.0
Impairment on financial instruments	-	27.5	2.1	-
Employee benefit expense	5.5	6.3	6.3	2.7
Depreciation, amortization and Impariement	0.4	0.4	0.5	0.2
Other expenses	32.4	14.7	57.5	54.1
Total expenses	**6675.9**	**8232.0**	**10229.0**	**5498.0**
PBT	2531.9	2755.3	3192.1	1886.8
Tax expense	530.5	615.4	-	-
Profit for the period	**2001.5**	**2139.9**	**3192.1**	**1886.8**

Source: RHP, ICICI Direct Research

Exhibit 7: Balance Sheet (₹ crore)

ASSETS	FY18	FY19	FY20	H1FY21
Cash, cash equivalents and Bank	99.8	81.1	100.8	95.9
Lease receivables	109471.7	125026.5	148579.8	153846.8
Loans	5238.0	5895.5	6423.4	6243.0
Investments	14.0	13.1	11.5	11.4
Current tax assets (net)	38.8	41.5	630.8	863.1
Property, plant and equipment & Intangibles	11.3	11.3	11.0	11.0
Other assets	46577.5	75369.3	119746.8	130915.4
Total Assets	**161451.0**	**206438.3**	**275504.1**	**291986.6**
Equity and Liabilities				
Debt securities	110844.2	123597.9	155290.5	161258.7
Borrowings (other than debt)	23161.3	50334.8	79086.3	84090.7
Other Liabilities & Provisions	7121.2	7639.3	10827.7	14950.3
EQUITY				
Equity share capital	6526.5	9380.5	11880.5	11880.5
Other equity	13797.8	15485.8	18419.3	19806.5
Total Liabilities and Equity	**161451.0**	**206438.3**	**275504.1**	**291986.6**

Source: RHP, ICICI Direct Research

Exhibit 8: Key ratios (%)

	FY18	FY19	FY20	H1FY21
NIM %	1.8	1.6	1.4	0.71*
Cost to Income %	1.5	0.8	2.0	2.9
GNPA	0.0	0.0	0.0	0.0
NNPA	0.0	0.0	0.0	0.0
ROA%	1.4	1.2	1.3	0.66*
ROE%	12.3	9.5	11.6	6.09*

**not annualised*
Source: RHP, ICICI Direct Research,

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