IPO ALERT: Indian Railway Finance Corporation

17th January, 2021

Government of India (Promoter)
Owns IRFC via Ministry of Railways (MoR). MoR is the only borrower (customer) of IRFC.

Indian Railway Finance Corporation
Supports expansion of Indian Railways by financing a significant proportion of its annual plan outlay.

Issue period	
Issue Opens on	18th Jan, 2021
Issue Closes on	20th Jan, 2021
Post-IPO market cap (Rs cr)	~ 33,969

Offer Details for Retail category	
Bid Lot *(Qty)*	575
Offer Price *[Rs 25 - Rs 26 per share]*	26
Bid Amount per Lot *(at Upper Band)*	14,950

Issue Details (Rs Cr)	
Shares sold (OFS) by Promoter	1,544
Fresh Issue of Shares *	3,089
IPO Size	4,633

Promoter Stake (%)	
Pre-IPO	100.0%
Post-IPO	86.4%

Financials	H1 FY21	H1 FY20	FY 19-20
Revenue *(Rs Cr)*	7,383	6,575	13,421
Profit from operations *(Rs Cr)*	1,887	1,630	3,192
Net Asset Value per share *(Rs,*	26.7	28.0	25.5

IRFC's revenues are dependent on how much the GoI wants to spend on Railway Infra. In last few years, GoI has been investing heavily in railway infra.

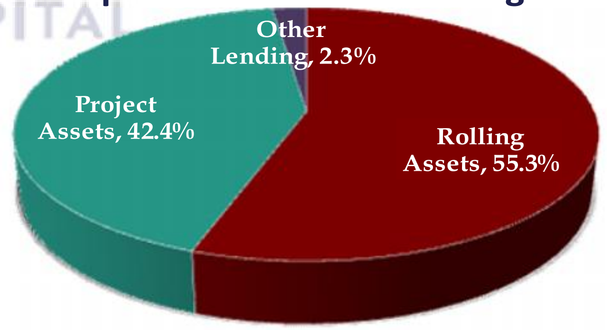
What is the business of IRFC?

IRFC is the dedicated market borrowing arm of Indian Railways. Its primary business is financing the acquisition of **Rolling Stock Assets and Project Assets** of Indian Railways and lending to other entities under MoR.

Rolling Assets *- Locomotives, coaches, wagons, trucks, cranes, etc.*

Project Assets *- Railway infra assets and national projects of GoI.*

Break-up of Assets Under Management



How does IRFC make money?

IRFC operates on a ***cost-plus*** based model.

Cost = weighted average cost of incremental borrowing incurred by IRFC.

Plus = A certain margin which is decided by MoR every year in consultation with IRFC.

Margin in FY20	%
Rolling Assets	0.40%
Project Assets	0.35%

If the incremental cost of borrowing is 7.00%, rolling asset lease will be designed to give a return of 7.4% to IRFC. Similarly, project asset lease will be designed to ensure an IRR of 7.35% for IRFC.

IRFC is like an *agent* for MoR. Borrow from market, add your margin and lend forward to railways.

NO DEFAULT RISK - IRFC lends only to Indian railways which is a GoI entity. Thus, it does not face the risk of NPAs. It has a pre-decided margin with MoR so its **revenues are predictable and consistent.** Margin is reviewed annually.

So, what are the risks to IRFC's business model?

Revenue is 100% dependent on Government Policy? What if the Government policy changes?

Let's say GoI decides to cut down on investment in railway infra, or

May be the GoI decides to explore other funding models like Public Private Partnerships.

There is another big risk - Dilution of Equity.

The Government will have to very smart with the amount of equity it raises. It can't be too little as it will slow down growth and it cannot be too much as it will lead to dilution of EPS and NAV per share.

Analyst - CA Saurabh Chhajed
saurabh@qratecapital.com

*** Most important of all, why is IRFC raising money?**

IRFC is an NBFC. Thus, its a "***leverage business***". For every Rs 100 of equity, it borrows roughly ~Rs 800 from the market. *[~8x leverage is the norm as per their historical balance sheets.]*

Out of this 900, it will lend Rs 890-895 to the Railways. [It keeps some buffer cash to have liquidity reserves].

This **3,089** cr of equity will allow it to borrow more. **More borrowing → More Lending → More Revenue** for IRFC.

This business model is such that IRFC continuously needs to raise equity. Let's understand why..

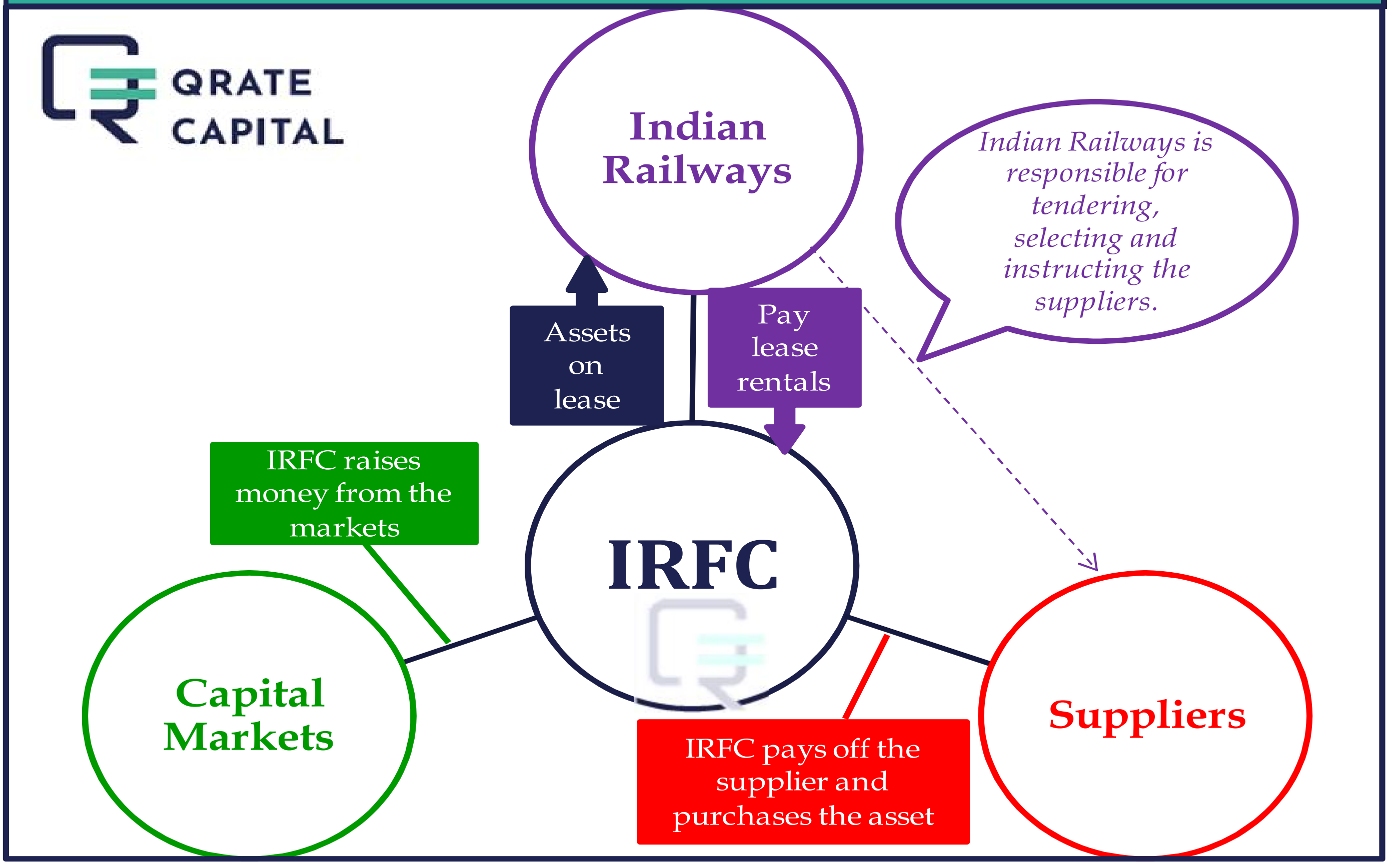
After infusion of Rs 3,089 crores, IRFC will be able to borrow Rs 24,000 cr [~8x leverage].
This allows IRFC to lend a total of Rs ~27,000 crores to Indian Railways.
IRFC's current AUM is approx Rs 3 lakhs cr. Even a 15% growth in AUM is Rs 45,000 cr.
Thus, a shortfall of Rs 18,000 cr [45,000 - 27,000].
In order, to make for this shortfall, IRFC cannot borrow the entire amount.
A part of it will be funded by the profits of the current year. Let's assume Rs 4000 cr.
To stop the leverage ratio from increasing, IRFC will issue new Equity and new debt in the ratio of 1:8 which will make up for the balance of the shortfall, i.e. Rs 14,000 cr.

Equity *raised in IPO*	3,000
Debt *[8x of equity]*	24,000
Total	27,000
Required next year	**45,000**
Shortfall	18,000
Profit in CY	4,000
New Equity issue	**1,556**
New Debt *[8x]*	12,444

Conclusion

IRFC has a unique business model. There is no listed company in India which has a similar business model.
It works in a low-risk environment. Default risk is negligible and revenues are predictable.
IPO price of Rs 26 per share is less than the book value per share of Rs 26.7. Valuations are reasonable.
Government is keen to develop railway infra and will need IRFC's help to raise necessary funds.
IRFC is a company that is well placed to deliver stable and consistent returns in a low-risk manner in the forseeable future.

IRFC's Business Model in a Nutshell



Source: ***Qrate Capital LLP***

Found this useful? Follow us on LinkedIn - https://www.linkedin.com/company/qrate-capital-llp

Disclaimer - This is not a stock tip/reco. Please consult your advisor before making any investment decisions.

 Analyst - CA Saurabh Chhajed saurabh@qratecapital.com