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IPO note: Indian Railway Finance Corporation Limited (IRFC) - "SUBSCRIBE" **January 17, 2021**

IRFC is registered with RBI as a systemically important NBFC-ND-IFC, wholly-owned by the GOI acting through Ministry of Railways ("MoR"). It is the dedicated market borrowing arm for the Indian Railways (IR) and has played a significant role in supporting the capacity enhancement of the Indian Railways by financing a proportion of their annual plan outlay. It's primary business is: a) financing the acquisition of rolling stock assets (wagons, trucks, electric multiple units, locomotives, coaches), b) leasing of railway infrastructure assets and national projects of the Government of India and c) lending to other entities under the MoR.

Strategic role in financing growth of Indian Railways

a) Dedicated market borrowing arm for the Indian Railways; played a strategic role in financing the operations of IR; financed 48.22% of the actual capital expenditure of the IR in FY20
b) The Union Budget proposed a capital expenditure of Rs. 1,610 billion for the Railways Ministry for Fiscal 2021. For Fiscal 2021, the MoR, through its letter dated April 10, 2020, indicated its intention to borrow Rs. 580.00 billion from IRFC, however, subsequently, the MoR, through its letter dated January 7, 2021, has revised the said target to be borrowed from IRFC to Rs. 625.67 billion for fiscal2021

Competitive cost of borrowing

a) Highest credit rating for an Indian issuer from ICRA CRISIL & CARE
b) Diversified funding sources including taxable and tax-free bonds issuances, term loans from banks/financial institutions, ECB's,internal accruals, asset securitization and lease financing in addition to equity infusion from time-to-time

Low risk, cost –plus business model

c) The relationship with the MoR enables them to maintain a low risk profile (NIL GNPA). IRFC acquires leasehold interest in the project assets under a lease agreement and MoR is required to pay lease rentals.
d) However, IRFC is yet to execute the lease, license and development agency agreements with the MoR (in respect of the projects funding provided by them from FY16 to FY20) as the projects are still being developed and the costs to the MoR have not been completely determined by the MoR.
e) Expenses incurred w.r.t 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 on which IRFC earns a margin as determined by the MoR.

Strong asset-liability management

a) IRFC borrows on a long-term basis to align with the long-term tenure of the assets funded by them.
b) MoR is required to provide for any shortfall in funding under the Standard Lease Agreement.
c) In order to manage the liquidity risk and interest rate risk, IRFC undertakes periodic analysis of profiles of its assets, liabilities, receipts and debt service obligations, to ensure that it has minimum asset-liability mismatches.
d) Under the terms of the Standard Lease Agreement, the MoR covenants that in the event of IRFC being unable to redeem its bonds on maturity and/ or repay loans resulting from inadequate cash flows, the MoR is required to make good such shortfall through bullet payments in advance before the maturity dates of such bonds/ term loans.

Consistent financial performance

e) Net Profit witnessed a CAGR of 34% from FY18 to FY20
f) Low overheads, administrative costs and high operational efficiency has resulted in increased profitability for the Company.

Issue date	**Jan. 18 – Jan. 20, 2021**
Listing date	Jan. 29, 2021
Price Band	Rs. 25 - Rs. 26 (Face value: Rs. 10)
Bid lot	575 equity shares and in multiples thereof 575 shares thereafter
Issue type	Fresh Issue up to 1,188,046,000 Equity Shares, Offer for sale up to 594,023,000 Equity Shares
Issue size	Rs. 4,633 crores
Issue structure	QIB – 50 %, NIB – 15%, Retail – 35%
Post issue shares	1306.85 crore equity shares
Post issue market cap	Rs. 33,978 crores
BRLM	DAM Capital, HSBC, ICICI Securities, SBI Capital Markets
Registrar to the issue	KFin Technologies Pvt. Ltd.

Particulars (Rs. crores)	**H1FY21**	**FY20**	**FY19**	**FY18**
Revenue from operations	7,383	13,421	10,987	9,207
Interest income	1,717	2,748	1,723	989
Lease income	5,666	10,672	9,264	8,218
NIM (%)	0.71	1.38	1.57	1.83
Cost of Borrowing (%)	3.55	7.27	7.09	6.82
Profit before tax	1,887	3,192	2,755	2,532
PAT	1,887	3,192	2,140	2,001
Equity share cap.	11,880.46	11,880.46	9,380.46	6,526.46
Networth	31,687	30,300	24,866	20,324
AUM	278,007	266,137	200,937	154,535
Disbursements	19,016	71,392	52,535	36,722
Cost/Income (%)	2.94	1.97	0.76	1.49
GNPA/NNPA	-	-	-	-
Post IPO EPS (Rs.)	1.44	2.44	1.64	1.53
P/E (x)	-	11	16	17
Book value (Rs.)	26.67	25.50	26.51	31.14
RoE (%)	-	10.5	8.6	9.8

Source: RHP, # denotes P/E and ROE on annualised H1FY21 numbers

Investment recommendation and rationale

At the upper end of the price band of Rs. 26, the Company's IPO is valued at P/BV of 0.97x which is cheap considering secondary market conditions. The Company is expected to enjoy premium post listing owing to its strategic role in financing growth of Indian Railways. We recommend "SUBSCRIBE" to the issue due to the following factors: a) played a significant role in supporting the capacity enhancement of the Indian Railways, b) with the expansion of the freight network and passengers demand, the requirement of rolling stock will increase substantially which will drive business growth, c) low risk, cost – plus business model, d) strong asset-liability management, e) zero NPAs which is a rare sight, f) consistent financial performance with PAT CAGR of 20 percent over FY18-20, g) good credit rating - CRISIL AAA/A1+ and ICRA AAA/A1+, h) the Company raised Rs. Rs 1,398.63 crore from 31 anchor investors which instills confidence in the issue.

Research report written by - Akash Jain, MBA (Financial Markets), Vice – President Research

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Background

The Company follows a financial leasing model for financing the Rolling Stock Assets. The period of lease with respect to Rolling Stock Assets typically 30 years, comprises a primary period of 15 years followed by a secondary period of 15 years, unless otherwise revised by mutual consent. They also follow a leasing model for Project Assets, which typically provide for lease periods of 30 years.

As of September 30, 2020, their 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.

IRFC is a Systemically Important NBFC-ND-IFC and enjoys certain regulatory exemptions

Asset classification norms: IRFC is exempted from the RBI's asset classification norms to the extent of its direct exposure on the sovereign -MoR. However, company follows the asset classification norms as provided by the RBI for loans/ leases/ advances to entities other than MoR.

Provisioning norms: IRFC is exempted from the RBI's provisioning norms to the extent of its direct exposure on the sovereign - MoR. However, company follows provisioning norms as provided by the RBI for loans/ leases/ advances to entities other than MoR

Exposure norms: IRFC is exempted from the RBI's exposure norms to the extent of its direct exposure on the sovereign - MoR

Credit concentration norms: IRFC was granted exemption by the RBI from credit concentration norms to the extent of 100% of their owned funds for their exposure to Railway entities in which the ownership of the State/Central Government is minimum 51%

Minimum Alternate Tax: IRFC is outside the scope of section 115JB of the Income Tax Act, 1961 and accordingly, is not required to pay 'minimum alternate tax' with effect from Fiscal 2020. After adoption of Section 115BAA, the taxable income under the normal provision income tax may become NIL and IRFC will be outside the scope and applicability of MAT Provision under section 115JB of Income Tax Act, 1961. Hence, no tax liability may be there w.e.f F.Y 2019-20 on the Company.

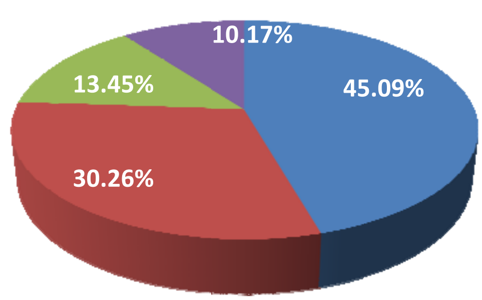
Goods and service tax: The GST Council has exempted the services of leasing of assets (rolling stock assets including wagons, coaches, locos) by IRFC to MoR from the levy of Goods & Service Tax (GST) with effect from 1st July 2017.

As the Company is registered as an NBFC and classified under the category of an "Infrastructure Finance Company", as per RBI guidelines, it is 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 RBI

IRFC is exempted from the RBI's provisioning norms to the extent of its direct exposure on the sovereign -MoR

However, company follows provisioning norms as provided by the RBI for loans/ leases/ advances to entities other than MoR

Diversified sources of funding, credit ratings and strategic relationship with the MoR, have enabled IRFC to keep costs of borrowing competitive



Objects of the issue

The Issue comprises a Fresh Issue by the Company and an Offer for Sale by the Selling Shareholder.

The Offer for Sale
Offer for sale of up to 594,023,000 Equity Shares by The President of India, acting through MoR - Rs. 1,544.46 at upper end of the price band - Rs. 26
The proceeds of the Offer for Sale shall be received by the Selling Shareholder only and the Company will not receive any proceeds from the Offer for Sale.

Objects of the Fresh Issue
Fresh Issue –up to 1,188,046,000 Equity Shares - Rs. 3088.91 at upper end of the price band - Rs. 26
The Net Proceeds are proposed to be utilised towards funding of the following objects:
(1) Augmenting the Company's equity capital base to meet its future capital requirements arising out of growth in its business; and
(2) General corporate purposes.

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For research related queries contact:

Mr. Akash Jain – Vice President (Research) at research@ajcon.net, 022-67160431 (D)

CIN: L74140MH1986PLC041941

SEBI registration Number: INH000001170 as per SEBI (Research Analysts) Regulations, 2014.

Website: www.ajcononline.com

Registered and Corporate office

408 - (4th Floor), Express Zone, “A” Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel’s, Western Express Highway, Goregaon (East), Mumbai – 400063. Tel: 91-22-67160400, Fax: 022-28722062