No: 1:05:138:I:CS
Dated: 14.12.2018

National Stock Exchange of India Limited, Listing Department, Exchange Plaza, Bandra – Kurla Complex, Bandra (E) **MUMBAI – 400 051.** नेशनल स्टॉक एक्सचेंज ऑफ इंडिया लिमिटेड लिस्टिंग विभाग, एक्सचेंज प्लाजा, बांद्रा-कुर्ला कॉम्प्लेक्स, बांद्रा (पू), मुंबई-400 051	**Bombay Stock Exchange Limited,** Department of Corporate Services, Floor – 25, PJ Towers, Dalal Street, **MUMBAI – 400 001.** बंबई स्टॉक एक्सचेंज लिमिटेड, कॉर्पोरेट सेवाएं विभाग, मंजिल-25, पी .जे .टावर्स, दलाल स्ट्रीट, मुंबई-400 001

Sub: Intimation pursuant to Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015

Sir/Madam,

The Company had vide its letter dated 11th December, 2018 under Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, had announced the following:

> *"The Board of Directors of Power Finance Corporation Ltd. in its meeting held today i.e. 11th December, 2018 took note of Department of Investment and Public Asset Management, Ministry of Finance, Government of India O.M. dated 11th December, 2018 enclosing therewith a copy of PIB release dt. 6th December, 2018, regarding the Cabinet decision on the 'In-principle' approval for the strategic sale of the Government of India's existing 52.63% of total paid-up equity shareholding in Rural Electrification Corporation (REC Ltd.) to Power Finance Corporation Limited along with transfer of management control."*

After the said announcement, credit rating agencies have come out with some credit action. The action taken by the respective agencies is as under:-

1. CARE will closely monitor the development in this regard and continue to assess any impact on credit and financial profile of PFC and REC. (Copy of the press release is enclosed at Annexure I)
2. CRISIL will continue to closely monitor the developments and take appropriate need-based rating action thereafter. (Copy of the bulletin is enclosed at Annexure II)
3. ICRA has placed Ratings on watch with developing implications. (Copy of the rationale is enclosed at Annexure III)
4. S&P placed 'BBB-' Ratings on Credit Watch Negative on acquisition of REC Ltd. (Copy of the rationale is enclosed at Annexure IV)
5. Moody's reviews Power Finance Corporation for downgrade. (Copy of the press release is enclosed at Annexure V)

This is submitted for your information and record.

Thanking you,

Yours faithfully,
For Power Finance Corporation Ltd.

(Manohar Balwani)
Company Secretary
mb@pfcindia.com

Annexure - I

CARE Ratings
Professional Risk Opinion

Celebrating 25th Year

Power Finance Corporation Limited

December 13, 2018

Update on material event

On December 6, 2018, the Cabinet Committee on Economic Affairs gave its 'In Principle' approval for strategic sale of the Government of India's (GoI) existing 52.63% of total paid up equity shareholding in Rural Electrification Corporation (REC) to Power Finance Corporation (PFC) along with transfer of management control. As per release on PIB, the acquisition intends to achieve integration across the Power Chain, obtain better synergies, create economies of scale and have enhanced capability to support energy access and energy efficiency by improved capability to finance power sector. It may also allow for cheaper fund raising with increase in bargaining power for the combined entity. The transaction will impact capitalization profile of PFC with its CAR and Tier 1 capital expected to drop from current levels. PFC's CAR and Tier 1 capital were 17.91% and 14.91% respectively as on September 30, 2018 as against regulatory minimum requirement of 15% and 10% respectively. The modalities of the transaction along with the purchase consideration to be paid to GoI are yet to be finalized. Furthermore, the transaction will require various approvals including regulatory approvals. PFC management is also assessing the funding & transaction structure and consequent impact on PFC's capitalization ratios. Also, PFC is majority owned by GoI (65.64% as on September 30, 2018) and is expected to maintain comfortable capital structure and financial profile backed by expectation of continued strong support from GoI given PFC's majority sovereign ownership and its strategic importance in development and providing funding to the power sector. During H1 FY19, PFC reported profit after tax (PAT) of Rs.2,728 crore and its Gross and Net NPAs were 9.67% and 4.66% as on September 30, 2018.

Subsequent to the transaction, REC will become a subsidiary of PFC. While this transaction is not expected to impact financial profile of REC but given that majority ownership of REC will transfer from GoI to PFC, REC's credit profile will also have linkages with credit profile of PFC. During H1, FY19, REC reported PAT of Rs.3,233 crore and its Gross and Net NPAs were 7.92% and 4.28% as on September 30, 2018. REC's CAR and Tier 1 capital was 16.14% and 13.89% respectively as on September 30, 2018.

Ratings assigned to borrowing programmes of PFC and REC factor in majority sovereign ownership and expectation of continued strong support from GoI given their strategic importance for GoI. CARE will closely monitor the developments in this regard and continue to assess any impact on credit & financial profile of PFC & REC.

The previous press release is available on the following link: *Click here*

Analyst Contact:

Name: Puneet Maheshwari

Tel: 011-4533 3251

Mobile: 9871799127

Email: p.maheshwari@careratings.com

**For detailed Rationale Report and subscription information, please contact us at www.careratings.com

About CARE Ratings:

CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

Annexure – II

Credit Bulletin

December 11, 2018| Mumbai

Update on strategic sale of GoI's existing stake in REC to PFC

On December 06, 2018, the Cabinet Committee on Economic Affairs 'In Principle' approved the strategic sale of Government of India's existing stake in Rural Electrification Corporation Ltd (REC) to Power Finance Corporation Ltd (PFC), along with transfer of management control; government currently holds 52.63% stake in REC. The transaction is at a nascent stage and the contours of the deal are yet to be finalised. Furthermore, it will be subject to various approvals including the boards of the respective companies as well as the required regulatory approvals.

The acquisition intends to create a larger group catering to the financing needs of the power sector. In terms of size, PFC and REC together had total assets of around Rs 5.6 lakh crore as on September 30, 2018.

CRISIL's outstanding ratings on the debt instruments of these companies continue to reflect their strategic importance to, and majority ownership by, the Government of India; given their key role in financing the Indian power sector.

CRISIL will continue to closely monitor the developments and take appropriate need-based rating action thereafter.

For accessing the previous rating rationale, please use the following link:

Company name	Link to rating rationale
Power Finance Corporation Ltd	Click here
Rural Electrification Corporation Ltd	Click here

Power Finance Corporation Limited

December 11, 2018

Power Finance Corporation Limited- Ratings placed on watch with developing implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term borrowing programme FY2019	62,000	62,000^	[ICRA]AAA &; put on watch with developing implications
Short-term borrowing programme FY2019	20,000	20,000^	[ICRA]A1+; reaffirmed
Overall borrowing programme FY2019	82,000	82,000^	
Rated long-term/short-term borrowings of previous FYs	3,34,505	3,34,505	[ICRA]AAA & put on watch with developing implications/[ICRA] A1+ reaffirmed
Fixed deposit programme	-	-	MAAA &; put on watch with developing implications
Total	**4,16,505**	**4,16,505**	

^ Short-term borrowings are interchangeable with long-term borrowings, subject to the total borrowings in FY2019 not exceeding Rs. 82,000 crore
&Under Rating Watch with Developing Implications
** Instrument details are provided in Annexure-1*

Material Event

The Cabinet Committee on Economic Affairs has given its 'In Principle' approval for strategic sale of the Government of India's existing 52.63% of total paid up equity shareholding in Rural Electrification Corporation (REC) to Power Finance Corporation (PFC) along with transfer of management control.

Impact of the Material Event

Following this announcement, ICRA has placed the long-term rating of [ICRA]AAA (pronounced ICRA triple A) for the various debt programmes of PFC on watch with developing implications. ICRA also has an outstanding rating of [ICRA] A1+ (pronounced ICRA A one plus) on the short-term borrowing programme of the company. In ICRA's opinion, the proposed acquisition by PFC is likely to impact its capitalisation profile adversely as PFC would have to knock off its proposed investments in REC from its net owned funds, for capital adequacy calculations. ICRA has taken note the capitalisation profile PFC was adequate as on September 30, 2018 with Tier I% of 14.9% and CRAR of 17.91%, however depending upon the amount of investment and portfolio growth in H2FY2019, the Tier I % for PFC could come under pressure; however as per ICRA's estimates, it is likely to remain above the regulatory threshold of 10%. Additionally, if the acquisition is entirely debt funded, the gearing levels for PFC would also increase from current levels of 6.4 times as on September 30, 2018 to around 8 times in the near term. Thus, the need for external capital could go up for PFC, despite the good internal capital generation to prudent capitalisation in relation to the rating level. ICRA believes that prudent capitalisation is a key mitigant against the risks in PFCs portfolio arising out of the sectoral and credit concentration. The modalities for the proposed acquisition are yet to be finalised, ICRA would be monitoring the events closely and would take suitable rating action once more clarity emerges.

The ratings continue to factor in PFC's sovereign ownership (65.64% held by the Government of India (GoI) as on September 30, 2018) and its important role as a nodal agency for various GoI power sector schemes under Ultra Mega Power Projects (UMPPs) and the Integrated Power Development Scheme (IPDS). PFC, being the largest power sector financier in India, remains strategically important to the GoI, for augmenting power capacity across the country. Any significant dilution in the GoI's stake or change in ownership, or a change in PFC's strategic role could warrant a rating change for PFC.

Key rating drivers

Credit strengths

Strong parentage and strategic importance to GoI - The company is a nodal agency for various GoI schemes, such as UMPPs and IPDS, for the development of the country's power sector. Further, as one of the major power sector financiers, PFC remains strategically important for achieving the Government's objective of augmenting power capacity across the country. The GoI remains the majority shareholder in the company, with a stake of 65.64% as on September 30, 2018. PFC gained approval from the GoI to raise 54EC capital gain bonds in June 2017 and was also given permission to raise tax-free bonds in the past.

Experienced management and operational team - The company has an experienced management team with the senior team having an experience of more than 30 years in power financing. The company's well laid-out credit appraisal and monitoring systems have enabled it to establish itself as a preferred lender in the power sector.

Good financial flexibility and sovereign ownership support liquidity profile - Owing to its sovereign ownership, PFC has been able to raise funds at competitive rates. Around 76% of its outstanding borrowings, as on September 30, 2018, were in the form of long-term bonds, which augur well for the maturity profile of its assets. The company received approval from the GoI in June 2017 to raise 54EC low-cost capital gain bonds, which could further reduce its cost of funds.

Adequate profitability profile – PFC's yield moderated to 9.91% in FY2018 from 10.91% in FY2017 on account of a decline in systemic interest rates. The cost of funds also moderated to 7.66% in FY2018 from 7.82% in FY2017, albeit by a lower extent, leading to a decline in spreads and, hence, net interest margins (NIMs), which stood at 3.22% in FY2018 compared with 3.94% in FY2017. Nevertheless, the company's profitability remained comfortable with return on assets of 2.19% and return on equity of 15.34% during FY2018. Moreover, PFC is expected to maintain a spread of 2.5-3%. However, its credit costs could increase, going forward, if it is unable to recover effectively from stressed assets, thus adversely impacting its profitability. ICRA, nevertheless, derives comfort from PFC's strong capitalisation profile and likely support from the Government, in case of need.

Credit challenges

Capitalisation likely to be impacted post acquisition – ICRA has taken note the capitalisation profile PFC was adequate as on September 30, 2018 with Tier I% of 14.9% and CRAR of 17.91%, however depending upon the amount of investment and portfolio growth in H2FY2019, the Tier I % for PFC could come under pressure; however as per ICRA's estimates, it is likely to remain above the regulatory threshold of 10%. Additionally, if the acquisition is entirely debt funded, the gearing levels for PFC would also increase from current levels of 6.4 times as on September 30, 2018 to around 8 times in the near term. Thus, the need for external capital could go up for PFC, despite the good internal capital generation to prudent capitalisation in relation to the rating level.

High portfolio vulnerability likely to keep asset quality volatile - The company's asset quality deteriorated in FY2017 following a change in NPA recognition norms. However, since a large proportion of the projects that were classified as NPA, as on March 31, 2017, had already achieved the date of commencement of commercial operations (DCCO), some of those were upgraded in FY2018. Consequently, the gross NPA improved to 5.71% as on December 31, 2017 (12.50% as on March 31, 2017).

However, the company's asset quality deteriorated in Q4 FY2018 after the Reserve Bank of India (RBI) made changes in the framework for the resolution of stressed assets in February 2018, whereby all the earlier schemes for stressed assets were discontinued. Though the new guidelines were not applicable to PFC, the company decided to follow them, and loans under various RBI resolution schemes were classified as NPA. Consequently, the gross NPA increased to 9.57% as on March 31, 2018 (5.71% as on December 31, 2017) and the net NPA to 7.39% as on March 31, 2018 (4.23% as on December 31, 2017). Gross Stage 3 assets stood at 9.67% though net Stage 3 assets were lower at 4.66% as on September 30, 2018 on account of increased provisioning following the transition to IND-AS. Around 54% of the private sector book was recognised as a part of Stage 3 assets on which the company made provisions of 54%. PFC might have to create additional provisions if it is unable to effectively resolve the stressed assets. ICRA believes any stress in the loan book is likely to be restricted to PFC's private sector book (22% of the total portfolio as on September 30, 2018). Overall, the company's ability to grow its loan book, while maintaining adequate profitability and controlling credit costs, would be critical.

High concentration risk - The company's exposure to a single sector (i.e. power), large ticket size of loans, high concentration of exposure towards financially weak state power utilities and the vulnerability of its exposure to private sector borrowers (22% of the book as on September 30, 2018) increases its portfolio vulnerability. The risk is further heightened as PFC is exempt from the concentration norms applicable to non-banking finance companies, and thus has significantly concentrated exposures. PFC's independent power producer (IPP) portfolio remains impacted by concerns regarding fuel availability, disputed and competitive power sale tariffs, absence of power purchase agreements (PPAs), environmental clearance and land acquisition issues. However, with PFC not sanctioning new private sector thermal projects in the last four-five years and focussing on solar and wind projects, the vulnerability of the IPP book is expected to improve from the current levels in the medium term.

Liquidity position

PFC's ALM profile, as on September 30, 2018, indicates a cumulative negative mismatch of 2% of the total assets in the less than 1-year bucket. As per the ALM profile on September 30, 2018, the company has debt repayments of Rs. 24,748 crore in the next six months (including Rs. 6,400 crore of CP borrowings) against which it has maturities of Rs. 29,796 crore. Further, considering its good financial flexibility, supported by the sovereign ownership and availability of sufficient unutilised bank lines (Rs. 9,750 crore as on November 20, 2018), the company should be able to refinance the gaps in the ALM profile. Also, PFC would need to raise fresh funds for incremental disbursements and to the proposed acquisition of REC Ltd.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	ICRA's Credit Rating Methodology for Non-Banking Finance Companies
Parent/Group Support	The ratings derive significant strength from PFC's sovereign ownership (65.64% held by the GoI as on September 30, 2018) and its important role as a nodal agency for various GoI power sector schemes under UMPPs and IPDS. The sovereign ownership supports PFC's financial flexibility and liquidity profile
Consolidation / Standalone	Standalone

About the company

PFC was set up in 1986 by the GoI as a specialised development financial institution to fund projects in the domestic power sector. The GoI held a 65.64% stake in the company as on September 30, 2018. PFC provides loans for a range of power-sector activities including generation, distribution, transmission, and plant renovation and maintenance. It finances state sector entities including generating and distribution companies as well as IPPs. PFC is also the nodal agency for the development of 15 UMPPs in the country.

In FY2018, PFC reported a profit after tax (PAT) of Rs. 5,855 crore against PAT of Rs. 2,126 crore in FY2017. It reported PAT of Rs. 2,728 crore in H1 FY2019. As on September 30, 2018, PFC's reported capital adequacy was 17.91%. As on September 30, 2018, PFC had a total loan book of Rs. 2,92,648 crore (Rs. 2,58,050 crore as on September 30, 2017). Its exposure to state power utilities and Central and joint sector entities accounted for 78% of its total advances, and its exposure to IPPs was 22% as on September 30, 2018.

Key financial indicators (audited)

	FY2017	FY2018
Total income	27,019	26,738
Profit after tax	2,126	5,855
Net worth	36,470	39,861
Loan book	2,45,525	2,78,915
Total assets	2,53,305	2,81,427*
CRAR	19.28%	19.99%
Tier I	16.20%	16.98%
Gearing (times)	5.55	5.76
Return on net worth (%)	5.89%	15.34%
Gross NPAs (%)	12.50%	9.57%
Net NPAs (%)	10.55%	7.39%
Net NPA/Net worth	69%	52%

** GoI fully-serviced bonds not taken as part of total assets*

Source: PFC; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2019)							Chronology of Rating History for the Past Years		
		Type	Amount Rated	Amount Outstanding (Rs. crore)	Date & Rating				Date & Rating in FY2018	Date & Rating in FY2017	Date & Rating in FY2016
			(Rs. crore)		Dec-18	Dec-18	Nov-18	Apr-18	Apr-17	Apr-16	Apr-15
1	Long-term/Short-term borrowing programme for FY2018-FY2019	Long Term/ Short Term	82,000	82,000	[ICRA]AAA/A1+ &	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	-	-	-
2	Long-term/Short-term borrowing programme for FY2017-FY2018	Long Term/ Short Term	84,000	84,000	[ICRA]AAA/A1+ &	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	-	-
3	Long-term/Short-term borrowing programme for FY2016-FY2017	Short Term/ Short Term	92,000	92,000	[ICRA]AAA/A1+ &	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	-
4	Long-term/Short-term borrowing programme prior FY2016-FY2017	Long Term/ Short Term	1,58,505	1,58,505	[ICRA]AAA/A1+ &	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+	[ICRA]AAA(Stable)/A1+
5	Fixed deposit programme	Medium Term	-	-	MAAA &	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)	MAAA (Stable)

*** Long-term/short-term borrowing programmes include bonds, commercial papers, bank lines and other instruments*
&Under Rating Watch with Developing Implications
Source: ICRA research

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in.

S&P Global
Ratings

RatingsDirect®

Research Update:

Power Finance Corp. 'BBB-' Ratings Placed On CreditWatch Negative On Acquisition Of REC Ltd.

Primary Credit Analyst:
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Table Of Contents

Research Update:

Power Finance Corp. 'BBB-' Ratings Placed On CreditWatch Negative On Acquisition Of REC Ltd.

Overview

- The government of India has approved Power Finance Corp.'s (PFC) acquisition of REC Ltd. The deal will likely strengthen PFC's market share and business franchise, although a debt-funded acquisition could undermine PFC's capitalization.
- We are placing our 'BBB-' long-term issuer credit rating on PFC on CreditWatch with negative implications.
- We aim to resolve the CreditWatch placement within the next three to six months, once we have clarity on PFC's plan and timeline for acquiring REC.

Rating Action

On Dec. 12, 2018, S&P Global Ratings placed its 'BBB-' long-term issuer credit rating on India-based Power Finance Corp. on CreditWatch with negative implications. We also placed our 'BBB-' issue rating on the bank's senior unsecured debt on CreditWatch with negative implications.

Rationale

We placed the ratings on CreditWatch due to uncertainty around PFC's funding of its proposed acquisition of REC Ltd. We understand this deal is part of the government's divestment target. A debt-funded acquisition could undermine PFC's capitalization, but the total impact will depend upon the actual outlay and funding plans, which are currently unknown. In our view, somewhat lower capitalization could be offset by an improvement to the finance company's business franchise. However, a risk-adjusted capital (RAC) ratio below 7% will almost certainly result in a downgrade.

On Nov. 30, 2018, we revised our outlook on PFC to negative from stable. This reflected a one-in-three chance that the company will not sustain a RAC ratio above our threshold of 9.5% over the next 12-18 months. This outlook did not incorporate a potential acquisition of REC.

Now that a proposed acquisition has been approved by the government, we are assessing the potential impact on PFC ratings. Substantial uncertainty remains around the timing of the acquisition, although we believe the government is keen to have it completed before the current financial year ends in March 31, 2019. Furthermore, we understand that the government is working out how the deal will progress and will communicate this strategy to PFC.

We aim to resolve the CreditWatch status over the next three to six months. We will look for additional information on:

- purchase price;
- funding mix;
- time frame for completion;
- expected regulatory capital ratios; and
- PFC's strategy to support its business franchise and internal capital generation.

CreditWatch

We aim to resolve the CreditWatch placement within the next three to six months once we have clarity on the transaction's timing, cost, organizational structure and synergies, funding mix, impact on capitalization, and when the finance company receives relevant regulatory approvals.

We may lower our rating on PFC if a moderate weakness in capitalization is not offset by an improvement in business franchise. In a scenario that PFC's capitalization drops so sharply that RAC declines below 7%, we will very likely lower the rating.

We may affirm our rating if we believe the post-consolidated business franchise has sufficiently improved to offset a decline in capitalization.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

CreditWatch

	To	From
Power Finance Corp. Ltd.		
Issuer Credit Rating	BBB-/Watch Neg/--	BBB-/Negative/--
Power Finance Corp. Ltd.		
Senior Unsecured	BBB-/Watch Neg	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Annexure V

MOODY'S
INVESTORS SERVICE

Rating Action: Moody's reviews Power Finance Corporation and REC Limited for downgrade

13 Dec 2018

Singapore, December 13, 2018 – Moody's Investors Service has today placed on review for downgrade the Baa3 issuer ratings of Power Finance Corporation Limited (PFC) and REC Limited (REC)

At the same time, Moody's has placed on review for downgrade the (P)Baa3 foreign currency senior unsecured MTN program ratings and Baa3 foreign currency senior unsecured ratings of PFC and REC.

Moody's has also placed on review for downgrade PFC and REC's standalone credit profiles of ba3.

RATINGS RATIONALE

The review for downgrade is driven by the decision by the government of India (Baa2 stable) on 6 December 2018 to grant an 'in principle' approval for PFC acquisition of the government's entire 52.6% stake in REC. Upon completion of the transaction REC will become a subsidiary of PFC.

The acquisition by PFC of the government's stake in REC is credit negative for PFC, because it will materially weaken its consolidated capital ratios .

While the transaction could also create some operational synergies, as both PFC and REC operate in the same business segment, Moody's believes that the negative impact from lower capital levels will outweigh any potential synergies.

The review for downgrade of PFC's standalone credit profile will focus on the extent of decline in the post-transaction consolidated capital ratios of PFC. Specifically, Moody's review will assess (1) whether PFC will be required to make an open offer to minority investors in REC, and thus acquire a stake greater than just the 52.6% government stake; (2) the price that PFC will have to pay to acquire this stake, including any premium that it would have to pay over and above REC's prevailing market valuations; (3) any actions by PFC to mitigate the negative impact on its capital ratios, for example by raising new equity, although Moody's deems such measures as unlikely; and (4) the impact of the transaction on the company's liquidity profile, particularly its ability to raise sufficient funding to finance the transaction.

The review for downgrade of REC's standalone credit profile will focus on the impact of the transaction on the company's liquidity profile, particularly its ability to manage its liquidity profile in the event that change of control clauses in some of its outstanding bonds trigger accelerated repayments.

A downgrade of the companies' standalone credit profiles will lead to downward pressure on their issuer ratings.

Further, with PFC replacing the government as the main controlling shareholder in REC, affiliate support from PFC, rather than government support, would be the main way in which REC's ratings would receive an uplift from its standalone credit profile. Accordingly, negative pressure on PFC's ratings would translate into negative pressures on REC's ratings.

At the same time, the support anchor for REC will be PFC's final ratings rather than its standalone credit profile. As PFC's final ratings will continue to benefit from government support, REC's will ratings benefit from implicit government support in this rating architecture.

The review for both entities will also focus on any material and tangible evidence of operational synergies created by the transaction.

WHAT COULD MOVE THE RATING UP

An upgrade of PFC's and REC's standalone credit profile is unlikely, given the review for downgrade.

Nevertheless, PFC's standalone credit profile could be upgraded if there is a substantial improvement in its asset quality and capitalization.

PFC's issuer ratings could be upgraded if its standalone credit profile is upgraded by more than one notch.

REC's standalone credit profile could be upgraded if there is a substantial improvement in its asset quality and capital. Following the transaction, REC's issuer rating though will remain at the same level as that of PFC, unless its standalone credit profile is higher than PFC's issuer rating, a scenario that is unlikely based on its current financial metrics.

WHAT COULD MOVE THE RATING DOWN

PFC's standalone credit profile, and hence the issuer rating, could be downgraded if there is a material reduction in its consolidated capital ratios because of its acquisition of a majority stake in REC. Further, the rating could face negative pressure if (1) the financial strength of state-run power utilities deteriorates significantly; (2) the company's asset-liability mismatch deteriorates; (3) there is any indication of change in its exclusive focus on financing the power sector, which could imply a reduced policy role; and (4) the asset quality problems in the company's loans to the private sector exacerbate.

REC's standalone credit profile rating could face negative pressure if (1) the financial strength of the state-run power utilities deteriorates significantly; (2) the proportion of secured versus unsecured borrowings increase (while this metric has been declining, it is still high on an absolute basis); (3) its asset-liability mismatch deteriorates; (4) there is any indication of change in the company's exclusive focus on financing the power sector, which could imply a reduced policy role; or (5) the asset quality problems in the company's loans to the private sector exacerbate.

REC's issuer rating could be downgraded if PFC acquires a majority stake in the company and PFC's issuer rating is downgraded

The methodologies used in these ratings were Finance Companies published in December 2018, and Government-Related Issuers published in June 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

Power Finance Corporation Limited is headquartered in New Delhi, and reported total assets of INR2.86 trillion ($43 billion) at the end of March 2018.

REC Limited is headquartered in New Delhi, and reported total assets of INR2.46 trillion ($37 billion) at the end of March 2018.

REGULATORY DISCLOSURES

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