Power Finance Corporation Limited

Instrument	Amount rated	Rating	Rating Action
Short term borrowing programme 2016-17	Rs. 25,000 crore * (enhanced from Rs. 23,000 crore)	[ICRA]A1+	Assigned
Long term borrowing programme 2016-17	Rs. 45,000 crore * (enhanced from Rs. 19,000 crore)	[ICRA]AAA	Assigned
Overall borrowing programme 2016-17	Rs. 70,000 crore *		

**Short term borrowing programme is interchangeable with long term borrowing programme, subject to total short term and long term borrowings in FY17 not exceeding Rs. 70,000 crore*

ICRA has assigned the rating of [ICRA]AAA (pronounced ICRA triple A) to the Rs. 45,000 crore[1] (enhanced from Rs. 19,000 crore) long term borrowing programme and rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 25,000 crore (enhanced from Rs. 23,000 crore) short term borrowing programme of Power Finance Corporation Limited (PFC)[2†]. The overall rated borrowing programme for the year 2016-17 stands at Rs. 70,000 crore. ICRA has outstanding rating of [ICRA]AAA on the various long-term bond and bank borrowing programmes, an outstanding rating of MAAA (pronounced M triple A) to the fixed deposit programme and a rating of [ICRA]A1+ (pronounced ICRA A one plus) for commercial paper/short-term debt programme of the corporation.[3†]

The highest-credit-quality ratings continue to reflect PFC's majority sovereign ownership (67.8% equity shared are held by Government of India or GoI as on June 30, 2016 and its strategically important role in the implementation of various GoI schemes—such as Ultra Mega Power Projects (UMPPs) and Integrated Power Development Scheme (IPDs)—for the development of the country's power sector. Further, PFC, as one of the major power sector financiers, remains strategically important for the Government of India (GoI), given the latter's objective of augmenting power capacities across the country. The ratings continue to draw comfort from PFC's adequate earning profile (net profit in relation to average total assets of ~2.6% for FY2016) supported by its strong financial flexibility and ability to borrow funds at competitive rates and low operating costs (0.12% for FY2016).

These strengths are partly offset by the corporation's exposure to a single sector (i.e. power sector), high concentration of exposure towards weaker-credit-quality state power utilities and the vulnerability of its exposure to private sector borrowers.

PFC's exposure to state sector utilities (67% of portfolio in June-16) is primarily to generation companies, while its exposure to the more vulnerable distribution entities of states with weaker credit profiles is limited[4]. Counter party risks of PFC's state power generating borrowers remains a credit concern given that such state generating entities could find their cash flows impacted by the weak fiscal health of the distribution entities (11% of portfolio in June-16). ICRA however notes the approval of UDAY (Ujwal DISCOM Assurance Yojana) on November 5, 2015 by GoI, a scheme with an objective to turnaround the financial health of state owned distribution companies. The scheme proposes a phased takeover of discom debt by state governments and steps to improve operational efficiencies reduce cost of power purchase and enforce financial discipline of DISCOMs through an alignment with state finances. The scheme also envisages the states taking over the future losses of discoms from FY 2016-17 onwards in a graded manner. ICRA believes that the timely implementation of the scheme (financial and operational parameters), which is optional, by State Governments remains critical for ensuring the credit quality of not only the distribution companies, but also for the generation industry by enabling the discoms to offtake power as well as make timely payments. However apart from expected improvement from implementation of UDAY scheme, health of the discoms would also be dependent

[1] Rs. 25,000 crore short term borrowing programme is interchangeable with long term borrowings, subject to total long term borrowings not exceeding Rs.70,000 crore

[2†] For complete rating scale and definitions, please refer ICRA's website www.icra.in or other ICRA Rating Publications.

[3]

[4] PFCs exposure to the states of Tamilnadu, Rajasthan, Uttar Pradesh, Madhya Pradesh, Punjab, Haryana and Bihar accounted for ~7% of its total portfolio in June-16, while the exposure was ~17% as on Sep-2015. Reduction mainly on account of repayments under UDAY scheme

upon adequate and timely tariff revision by SERCs including periodic pass-through of fuel cost fluctuations and timely & adequate subsidy releases by State Governments.

As on June 2016, discoms of ten States (including Uttar Pradesh, Rajasthan, Haryana, Bihar and Punjab) have signed the memorandum of understanding for restructuring of discom debt under UDAY. Till June 30, 2016, PFC has received ~Rs. 21,060 crore under UDAY scheme.

The scheme however could result in a weakening in the profitability and impact the credit growth for PFC over short term. However PFC is expected to continue to maintain reasonable profitability and growth on the back of increased focus on renewable sector projects and state power utilities. PFC reported return on average assets of ~2.6% and return on average networth of ~18% during FY2016. Going forward, ability of corporation to grow its loan book while maintaining adequate profitability and controlling rising credit cost would also have critical bearing on its profitability profile.

As on June-16 PFCs exposure to the private sector i.e. Independent Power Producers (IPP) stood at 17% of its total advances. Several of PFCs IPP exposures have high vulnerability, being impacted by the sectoral concerns with respect to fuel availability, disputed/competitive power sale tariffs, lack of PPAs leading to high offtake risk and environmental & land acquisition issues. PFC reported Gross NPA[5] of 3.34% & Net NPA of 2.66% as on June 30, 2016. Out of reported Gross NPAs, ~90% are in IPP segment. Close to 57% of PFC's IPP exposures as on June 30, 2016 are classified as re-structured. A large share of the re-structuring however is on account of a shift in project commercial date of operations, and excluding these PFC's share of re-structured assets would be lower. ICRA favorably notes the sustained coal output growth by Coal India Ltd and also the possible easing of counter party risks for IPPs incase of successful implementation of the Uday scheme. Going forward, it would be important for the corporation to maintain a strict control over collections from the IPP segment.

As on June 30, 2016, PFC's debt as percentage of shareholder funds was at a moderate 5.2 times, and going forward, its ability to maintain this ratio at a prudent level given the concentrated nature of its exposures would be an important rating consideration.

PFC enjoys a comfortable asset-liability matching profile with low cumulative mismatches. PFCs strong financial flexibility, availability of un-utilized bank lines and the expected inflows through the redemption of discom exposures under the Uday Scheme are expected to keep short term liquidity comfortable.

Un-hedged foreign currency borrowings of PFC stood at ~25% of its shareholder funds as on March 31, 2016, which exposes it to foreign currency variations. PFC adopts an accounting policy of amortizing exchange differences on long term foreign currency items over their tenure. Total un-amortized foreign currency item translation losses of PFC as on March 31, 2016 stood at Rs. 740 crore or 2.1% of shareholder funds. If these were to be charged entirely in the P&L the NIMs of the corporation could come down by around 30 bps (NIMs as on March 31, 2016 were 4.6%[6]). Repayments on a majority of PFCs un-hedged foreign currency borrowings are largely staggered between FY 17-FY22 and such losses could crystallize unless there is a reversal in foreign currency rates by then. Going forward ability of the corporation to manage its foreign currency risks would have an important bearing over the stability of its earnings profile.

About the Corporation

PFC was set up in 1986 as specialised development financial institution to fund projects in the domestic power sector. GoI hold a 67.8% stake in the corporation as on June 30, 2016. PFC provides loans for a range of power-sector activities, including generation, distribution, transmission, and plant renovation and maintenance. PFC finances State sector entities such as State Electricity Boards and State Generating Companies, as well as IPPs. In addition, the corporation has been appointed the nodal agency to develop 16 UMPPs in the country.

As per audited results for the financial year ended March 31, 2016, PFC reported a profit after tax (PAT) of Rs. 6113 crore on an asset base of Rs. 2,28,664 crore, as against a PAT of Rs. 5959 crore on an asset base of Rs. 1,94,164 crore in the previous financial year. During the three month period ended June 30, 2016 the corporation reported a profit after tax of Rs. 1713 crore against Rs. 1576 crore during the corresponding period

[5] Non Performing Assets
[6] As per ICRA's computation

in the previous financial year. As on June 30, 2016, PFC had a gross NPA% of 3.34% and a net NPA% of 2.66% (Company follows 150+ days past due for recognising NPA).

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For further details please contact:
Analyst Contacts:
Rohit Inamdar (Tel. No. +91-124-4545847)
rohit.inamdar@icraindia.com

Manushree Saggar (Tel. No. +91-124-4545316)
manushrees@icraindia.com

Gaurav Khandelwal (Tel. No.+91-124-4545309)
gaurav.khandelwal@icraindia.com

Relationship Contacts:
L. Shivakumar, (Tel No.: 91-22-30470005)
shivakumar@icraindia.com

Registered Office
ICRA Limited
1105, Kailash Building, 11th Floor, 26, Kasturba Gandhi Marg, New Delhi 110001
Tel: +91-11-23357940-50, Fax: +91-11-23357014

Corporate Office
Mr. Vivek Mathur
Mobile: +**91 9871221122**
Email: vivek@icraindia.com

Building No. 8, 2nd Floor, Tower A, DLF Cyber City, Phase II, Gurgaon 122002
Ph: +91-124-4545310 (D), 4545300 / 4545800 (B) Fax; +91- 124-4050424

Mumbai **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 3rd Floor, Electric Mansion Appasaheb Marathe Marg, Prabhadevi Mumbai—400025, Board : +91-22-61796300; Fax: +91-22-24331390	**Kolkata** **Mr. Jayanta Roy** Mobile: **+91 9903394664** Email: jayanta@icraindia.com A-10 & 11, 3rd Floor, FMC Fortuna 234/3A, A.J.C. Bose Road Kolkata—700020 Tel +91-33-22876617/8839 22800008/22831411, Fax +91-33-22870728
Chennai **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 5th Floor, Karumuttu Centre 634 Anna Salai, Nandanam Chennai—600035 Tel: +91-44-45964300; Fax: +91-44 24343663	**Bangalore** **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 'The Millenia' Tower B, Unit No. 1004,10th Floor, Level 2 12-14, 1 & 2, Murphy Road, Bangalore 560 008 Tel: +91-80-43326400; Fax: +91-80-43326409
Ahmedabad **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 907 & 908 Sakar -II, Ellisbridge, Ahmedabad- 380006 Tel: +91-79-26585049, 26585494, 26584924; Fax: +91-79-25569231	**Pune** **Mr. L. Shivakumar** Mobile: +**91 9821086490** Email: shivakumar@icraindia.com 5A, 5th Floor, Symphony, S.No. 210, CTS 3202, Range Hills Road, Shivajinagar,Pune-411 020 Tel: + 91-20-25561194-25560196; Fax: +91-20- 25561231
Hyderabad **Mr. Jayanta Chatterjee** Mobile: +**91 9845022459** Email: jayantac@icraindia.com 4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj Bhavan Road, Hyderabad—500083 Tel:- +91-40-40676500	