

## Power Finance Corporation Limited

Instrument	Amount rated	Rating	Rating Action
Short-term borrowing programme FY2017	Rs. 25,000 crore *	[ICRA]A1+	Rating Outstanding
Long-term borrowing programme FY2017	Rs. 45,000 crore *	[ICRA]AAA	Rating Outstanding
Overall borrowing programme FY2017	Rs. 70,000 crore *		

\*Short-term borrowings are interchangeable with long-term borrowings, subject to the total borrowings in FY2017 not exceeding Rs. 70,000 crore

ICRA has a rating outstanding of [ICRA]AAA (pronounced ICRA triple A) for the Rs. 45,000 crore long-term borrowing programme and a rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs. 25,000 crore short-term borrowing programme of Power Finance Corporation Limited (PFC)<sup>†</sup>. The overall rated borrowings for the year FY2017 stand at Rs. 70,000 crore. ICRA also has outstanding ratings of [ICRA]AAA/[ICRA]A1+ on the various long-term and short-term borrowing programmes aggregating to Rs. 313839.19 crore and an outstanding rating of MAAA (pronounced M triple A) to the fixed deposit programme of the entity.<sup>†</sup>

As a part of its rated long-term borrowing programme of Rs 45,000 crore for FY2017, PFC may raise extra-budgetary resources of Rs. 5,000 crore on behalf of the Ministry of Power (MoP), Government of India. As per an office memorandum/notification issued by Budget Division, Department of Economic Affairs, Ministry of Finance, Gol dated October 20, 2016, these bonds will be used to augment infrastructure funding and will be fully serviced (principal and interest) by the Gol through its general budget. For the purpose of this rating, ICRA has considered that PFC will ensure timely servicing of principal and interest on these bonds.

The ratings continue to reflect PFC's majority sovereign ownership (67.8% equity held by the Gol) as on September 30, 2016) and its strategically important role in the implementation of various Gol 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 achieving the government's objective of augmenting power capacities across the country. The ratings continue to draw comfort from PFC's adequate earning profile (net profit/ average total assets of ~2.6% for FY2016) supported by its strong financial flexibility, ability to raise 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 its exposure towards financially weak state power utilities and the vulnerability of its exposure to private sector borrowers.

While PFC's exposure to state sector utilities (66% of portfolio in September 2016) is primarily to generation companies, ICRA notes that the cash flows of these borrowers remain vulnerable to the performance of distribution entities in those states. However on account of prepayments under UDAY scheme, PFC's direct exposure to distribution entities stood at 10% of portfolio in September 2016 as compared to 22% as on September 2015, which eventually could reduce vulnerability. ICRA believes that the timely implementation of the UDAY scheme (financial and operational parameters) 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 upon adequate and timely tariff revision by SERCs including periodic pass-through of fuel cost fluctuations and timely & adequate subsidy releases by State Governments.

Following the approval of the Ujwal Discom Assurance Yojana (UDAY) in November 2015, till September 2016, discoms of thirteen states<sup>1</sup> (including Andhra Pradesh, Uttar Pradesh, Rajasthan, Haryana, Maharashtra and Punjab) have signed the memorandum of understanding for restructuring debt. Till September 30, 2016, PFC received ~Rs. 21,315 crore under the UDAY scheme.

<sup>†</sup> For complete rating scale and definitions, please refer to ICRA's website ([www.icra.in](http://www.icra.in)) or other ICRA rating publications.

<sup>1</sup> Out of outstanding exposure to sixteen states as on September 30, 2015

While the scheme could adversely impact PFCs profitability and credit growth in the short-term, ICRA expects PFC to maintain adequate profitability and growth supported by its increased focus on renewable sector projects and state generation utilities. PFC reported a return on average assets of 2.6% in FY2016 (2.8% in FY2015) and return on average networth of 18% in FY2016 (20% in FY2015). Going forward, the entity's ability to grow its loan book while maintaining adequate profitability and controlling credit costs would be critical.

As on September 30, 2016, PFC's exposure to the private sector (i.e. independent power producers, IPPs) stood at 17% of its total advances. Several of the IPP exposures have high vulnerability, being impacted by the sectoral concerns of fuel availability, disputed/competitive power sale tariffs, lack of PPAs leading to high offtake risk and environmental and land acquisition issues. ICRA notes that around 90% of PFC's reported gross NPAs of 3.21% as on September 30, 2016 were from the IPP segment. Around 54% of PFC's IPP exposures as on September 30, 2016 were classified as restructured, mainly on account of a shift in project commercial date of operations. ICRA favourably notes the sustained growth in coal output by Coal India Ltd and also the possible reduction counter party risks for IPPs with the implementation of the Uday scheme. Going forward, it would be important for the entity to maintain a strict control over collections from the IPP segment.

As on September 30, 2016, PFC's gearing was moderate at 5.0 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 has a comfortable asset-liability matching profile with low cumulative mismatches. PFCs strong financial flexibility, availability of unutilised bank lines and the expected inflows through the redemption of discom exposures under the Uday Scheme are expected to keep its short term liquidity comfortable.

Foreign currency borrowings of PFC without any hedging cover, stood at ~25% of its shareholder funds as on March 31, 2016, leaving it exposed to foreign currency variations. PFC amortises the exchange differences on its long-term foreign currency items over their tenure; the total un-amortised foreign currency translation losses as on March 31, 2016 stood at Rs. 740 crore or 2.1% of shareholder funds. If these losses were charged to the profit and loss account, PFC's net interest margins would reduce by around 30 bps (reported NIMs in FY2016 of 4.6%<sup>2</sup>). Repayments of a majority of the un-hedged foreign currency borrowings are staggered between FY 2017-22. Going forward, PFC's ability to manage its foreign currency risks would have a bearing on the stability of its earnings profile.

### **Company Profile**

PFC was set up in 1986 by the GoI, as a specialised development financial institution to fund projects in the domestic power sector. GoI held a 67.8% stake in the corporation as on September 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 including generating and distribution companies, as well as IPPs. The corporation is also the nodal agency to develop 16 UMPPs in the country.

In FY2016, PFC reported a profit after tax (PAT) of Rs. 6,113 crore on an asset base of Rs. 2,28,664 crore as against a PAT of Rs. 5,959 crore on an asset base of Rs. 1,94,164 crore in FY2015. In H1FY2017, the entity reported a PAT of Rs. 3,586 crore against a PAT of Rs. 3272 crore in H1FY2016. As on September 30, 2016, PFC's gross NPAs stood at 3.21%, net NPAs at 2.44% and its capital adequacy at 21.77% (Tier I – 18.59%).

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*For further details please contact:*

Analyst Contacts:

**Mr. Rohit Inamdar** (Tel. No. +91-124-4545847)  
rohit.inamdar@icraindia.com

**Manushree Saggur** (+91-124-4545316)  
manushrees@icraindia.com

**Gaurav Khandelwal** (+91-124-4545309)  
gaurav.khandelwal@icraindia.com

Relationship Contacts:

**Mr. L. Shivakumar**, (Tel. No. +91 22 6114 3406)  
shivakumar@icraindia.com

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<sup>2</sup> As per ICRA's computation



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**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](mailto: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](mailto: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](mailto: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](mailto: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](mailto: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](mailto: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](mailto: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](mailto:jayantac@icraindia.com)

4th Floor, Shobhan, 6-3-927/A&B. Somajiguda, Raj  
Bhavan Road, Hyderabad—500083  
Tel:- +91-40-40676500