Corporate Announcement / Credit rating Action by the International Rating Agencies

1. Corporate Announcement

Board of Directors 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 dated 06th December, 2018, regarding cabinet decision on the 'In-principle' approval for the strategic sale of the GoI's existing 52.63% of total paid-up equity shareholding in REC Ltd. to PFC Ltd. along with transfer of the management control.

2. Credit rating Action by the International rating Agencies (copies as below)

a. Moody's reviews Power Finance Corporation for downgrade.
b. S&P revised the outlook of PFC from Stable to Negative
c. S&P placed 'BBB-' Ratings on Credit Watch Negative on acquisition of REC Ltd.

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

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

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Research Update:

Power Finance Corp. Ltd. Outlook Revised To Negative From Stable; 'BBB-' Rating Affirmed

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Research Update:

Power Finance Corp. Ltd. Outlook Revised To Negative From Stable; 'BBB-' Rating Affirmed

Overview

- PFC's capitalization is at the lower end of our threshold for a strong assessment, and we could revise our assessment down if the company grows loans faster and retains less capital than we expect.
- We do not factor in a potential merger of PFC with another Indian government-owned finance company, REC Ltd.
- We are revising our rating outlook on PFC to negative from stable. At the same time, we are affirming our 'BBB-' long-term issuer credit rating on PFC. We are also affirming the 'BBB-' long-term issue rating on PFC's outstanding debt.
- The negative outlook on PFC reflects 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.

Rating Action

On Nov. 30, 2018, S&P Global Ratings revised its outlook on Power Finance Corp. (PFC) to negative from stable. At the same time, we affirmed our 'BBB-' long-term issuer credit rating on the India-based power finance company. We also affirmed the 'BBB-' long-term issue rating on PFC's outstanding debt.

Rationale

We revised the outlook to negative to reflect our view that PFC's capitalization is at the lower end of our threshold for a strong assessment, and we could revise our assessment down if the company grows loans faster and retains less capital than we expect.

We expect PFC's risk-adjusted capital (RAC) ratio to be 9.5%-10.0% over the period next 12-18 months. Our lower RAC ratio limit for a bank's capital and earnings to be assessed as strong is 9.5%. PFC's RAC ratio was 10.1% as at March 31, 2018. A lower capital and earnings assessment would weaken our assessment of PFC's stand-alone credit profile (SACP) to 'bb' from 'bb+', which would lead to a downgrade to 'BB+', other factors remaining unchanged.

Substantial uncertainty remains around the timing of resolution of stressed assets, reversal of provisions for such assets, and the government's request for dividends. These could put downside pressure on the RAC ratio.

We affirmed the rating to reflect our assessment of PFC's SACP at 'bb+', and our view that the company has an extremely high likelihood of timely and sufficient extraordinary support in the event of financial distress. High business risks from PFC's concentration in the electricity sector and the weak credit quality of borrowers constrain its SACP. The company's regulatory Tier 1 ratio of 14.9% as of Sept. 30, 2018, is better than peers'.

Our outlook and ratings on PFC do not factor in a potential merger of the company with REC Ltd.

Outlook

The negative outlook on PFC reflects a one-in-three chance that the company will not sustain a RAC ratio above 9.5% over the next 12-18 months.

We expect no change in our assessment of PFC's business position, risk profile, and funding and liquidity. In our view, government support is also unlikely to change over the next 12-18 months.

Downside scenario

We would lower the rating if PFC's RAC ratio sustains below 9.5%. The RAC ratio could fall if the company has higher growth or lower capital retention than we forecast.

Although unlikely, we would also lower the rating on PFC if the company's link with the government weakens. A privatization of PFC would lead to our reassessment of this link.

Upside scenario

We would revise the outlook on PFC to stable if the company sustains a RAC ratio above 9.5% and downside risks associated with loan growth and capital retention abate.

An upgrade of PFC is unlikely over the next two years.

Ratings Score Snapshot

	To	From
Issuer Credit Rating:	BBB-/Negative/--	BBB-/Stable/--
Stand-Alone Credit Profile:	bb+	bb+
Anchor:	bb	bb
•Entity-Specific Anchor Adjustment:	(+1)	(+1)
•Business Position:	Adequate (0)	Adequate (0)

•Capital, Leverage, and Earnings:	Strong (+1)	Strong (+1)
•Risk Position:	Moderate (-1)	Moderate (-1)
•Funding and Liquidity:	Adequate and Adequate (0)	Adequate and Adequate (0
•Comparable Rating Analysis	(0)	(0)
External Influence:	+1	+1
•Government Influence:	+1	+1
•Group Influence:	0	0
•Guarantees or Other External Influences:	0	0
•Rating Above The Sovereign:	0	0

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

Related Research

- General: Assumptions For Liquidity Stress Test Analysis Under "Nonbank Financial Institutions Rating Methodology", March 22, 2018

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Power Finance Corp. Ltd.		
Issuer Credit Rating	BBB-/Negative/--	BBB-/Stable/--

Ratings Affirmed

Power Finance Corp. Ltd.	
Senior Unsecured	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.

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Research Update:

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

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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
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- 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.