Merged PFC-REC may face mounting borrowing costs

Anshika Kayastha &
Subhana Shaikh

MUMBAI

The long-awaited merger of REC Ltd with its parent, Power Finance Corp. (PFC), won board approval late Sunday, creating a stronger balance sheet and a larger lending institution. But the merged entity may face higher borrowing costs in the near term, as investor exposure limits would narrow its bond investor base, market experts said, calling for a diversified funding basket.

The merger combines two of India's top bond issuers. MINT

The merger combines two of India's top bond issuers, accounting for over half of India's corporate bond market in fiscal year 2026. Their merger will leave mutual funds, insurers and other domestic institutional investors with less room to buy fresh bonds under single-issuer exposure limits.

"Overall borrowing requirements are unlikely to change because the underlying funding needs remain intact. The merged entity will still have to raise money from the market," said Ajay Manglunia, executive director at Capri Global Capital.

"The main impact is on investor appetite. Earlier, investors could buy bonds issued by two separate entities. After the merger, exposure gets concentrated in a single issuer, so the appetite could reduce," he said, adding that the entity may need to diversify its funding mix and could see yields "harden slightly" until then.

As of 31 March, domestic bonds made up 56% of PFC's total outstanding borrowing of ₹4.9 trillion. Foreign currency debt comprised 20% of borrowings followed by real time liquidity (RTLs) from banks and financial institutions, as per data from PFC's investor presentation for FY26.

In FY26, PFC and REC had domestic bond borrowings of

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₹2.75 trillion and ₹2.77 trillion, respectively. PFC's borrowings were equivalent to 25.4% of India's corporate bond market in FY26, while REC's represented 25.6%, according to data from Primedatabase.

"There will be some impact on demand. Earlier, there were two issuers but now there will be one. That means exposure limits get exhausted faster, creating some pressure on demand," said Killol Pandya, head of fixed income at JM Financial Asset Management.

The Securities and Exchange Board of India has capped mutual funds' exposure to a single issuer at 10% of a scheme's net assets and the Insurance Regulatory and Development Authority of India has a single exposure cap of 15% on net controlled funds of an insurance scheme.

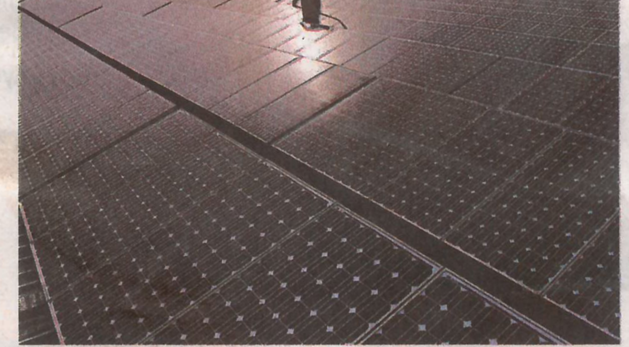
Some experts believe the government may allow some leeway to PFC and REC's existing debt, including exemption from exposure limits to allow them to consolidate balance sheets and borrowing profile without hurting capital access.

The companies are engaging with the government and regulators to smoothen out these things.

The regulators may allow some exemption to enable them to borrow from banks sufficiently to meet the business needs," a senior industry official told *Mint*. "In terms of pricing, I don't think the market is rewarding them as such for now. Going ahead, things (yields) could only become tighter for them," he added.

On the condition of anonymity, a senior fixed income expert said the merged entity will be forced to diversify its funding sources, including raising bank borrowings, instead of relying only on the bond market.

"Banks are not as tightly constrained by issuer-level norms, so the merged entity can continue issuing, and banks can absorb more of the supply. On the margin, yields may need to be slightly higher initially to attract demand," said JM Financial's Pandya.



PFC and REC together accounted for over half of India's corporate bond market in FY26.

BLOOMBERG

The Reserve Bank of India has capped banks and non-bank financial companies' (NBFCs) exposure to a single company at 25%.

Another source of funds could be higher overseas borrowing, according to some market participants. However, overseas issuances could be muted till there is more clarity over the treatment and classification of such bonds.

Both PFC and REC are 'Maharatna' central public sector enterprises under the power ministry. PFC had acquired government's 52.63% holding in REC for ₹14,500 crore in March 2019. Since then, REC has been operating as a subsidiary of PFC, making the latter the largest government-owned NBFC.

MEGA MERGER

IN FY26, domestic bond borrowings of PFC and REC stood at ₹2.75 trillion and ₹2.77 trillion

PFC's borrowings were equal to 25.4% of corporate bond market, while REC's represented 25.6%

Despite the possible short-term funding constraints, PFC's credit rating is seen unchanged, given its government-backing and key role in power finance, said Borhan Lin, director—International Public Finance at Fitch Ratings. "We view PFC as a reference issuer of the Government of India (GoI), as its access to funding is important for supporting policy lending to the power sector," Lin said, adding that this comfort supports the 'stable' outlook on the rating of the company. Fitch has a 'BBB-' rating on PFC's debt.

As per the merger papers, PFC will become government's apex institution for power reforms. The merged entity is seen benefiting from balance sheet strength, stronger capital base, and higher efficiencies, enabling large funding and better credit flow across the sector value chain, the document said.

The merger moots a share-swap ratio of 88 PFC equity shares per 100 REC shares. PFC stock ended down 1.7% at ₹425.50 on NSE Monday, while REC was up 0.1% at ₹365.

anshika.kayastha@livemint.com

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