July 29, 2021

CESC Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper (CP) Programme	1600.0	1600.0	[ICRA]A1+ reaffirmed
Total	**1600.0**	**1600.0**	

**Instrument details are provided in Annexure-1*

*CP facilities are availed for funding working capital requirements; **Rs. 1300-crore commercial paper facility is carved out of fund-based working capital lines from banks, and the rating of the aforementioned instrument is based on the condition that total short-term borrowings (including commercial paper raised against the Rs. 1300-crore line, short-term debt, and short-term bank borrowings) of the company at any given point of time should not exceed the company's drawing power or the bank sanctioned fund-based limits (whichever is lower). The balance Rs. 300 crore commercial paper facility is over and above the assessed fund-based working capital limits from banks.*

Rationale

The rating reaffirmation takes into account CESC Limited's (CESC) regulated electricity distribution operations in Kolkata area based on cost-plus based tariff principles, which leads to stable earnings and cash accruals. ICRA also takes a note of its efficient liquidity management despite the reduction in electricity demand by 10.6% in FY2021 and increase in receivable position for the distribution licensee operations, on account of delayed billing and deferment of collections in the wake of Covid-19 pandemic. While the receivable position increased to Rs. 1,394.4 crore as of March 2021 from Rs. 991.2 crore as of March 2020, the same is expected to reduce to the regular level by September 2021. The rating reaffirmation also considers CESC's diversified consumer base, favourable income levels in a metro city, and increased adoption of digital payments, which supports a healthy collection efficiency, and the high reliability of power supply in CESC's command area. CESC meets close to 90% of the electricity demand for the Kolkata region from its own generation stations, wherein the actual PLF has remained healthy. ICRA notes that CESC's coal-based generation capacities are primarily by long-term fuel supply agreements (FSA) with the subsidiaries of Coal India Limited (CIL), which mitigates the fuel availability risks, and supports in attaining competitive power generation cost. Further, ICRA takes note of the improvement in profitability metrics for a key subsidiary – Dhariwal Infrastructure Limited (DIL) with tie-up of short-term power purchase agreements (PPAs), thereby reducing support requirement from CESC.

The rating, however, is constrained by the deterioration in the regulatory environment, given the significant slippages in the release of tariff orders by the West Bengal Electricity Regulatory Commission (WBERC). However, an operational monthly variable cost adjustment (MVCA) mechanism provides an automatic avenue for a prompt pass-on of fuel and power purchase costs and helps provide some stability to the company's earnings. Moreover, CESC's operational indicators in the Kolkata licensee business remain superior than the normative targets, leading to sizeable efficiency gains and incentive income. This has helped the regulated power distribution business in Kolkata[1] generate consistent positive free cash flows despite its high operation and maintenance expenses, and stagnant tariff levels since January 2017.

The rating also takes into account the moderate leverage and debt protection metrics for CESC, given the debt-funded nature of capex and support extended to weaker Group entities in the past. The rating also incorporates CESC's lumpy scheduled repayments and low current ratio, which tempers its credit profile. However, the company's liquidity profile is supported by its sizeable cash and liquid investment balance of Rs. 2,026.9 crore at a consolidated level as on March 31, 2021. Going forward, given its large liquid investments, stable cash flows from the power distribution business, and high financial flexibility, its liquidity position is expected to remain comfortable, which would support its debt servicing ability.

[1] CESC (Standalone) + Haldia Energy Limited

Key rating drivers and their description

Credit strengths

Regulated operations based on cost-plus based tariff principles leading to stable earnings and cash accruals – The cost-plus nature of the tariff setting process leads to stable cash flows being generated from CESC's power distribution business in Kolkata. As per the regulatory norms, CESC is eligible to get a return of 15.5% on the regulated equity deployed in the generation business, and a return of 16.5% on the regulated equity deployed in the distribution business. CESC's power distribution license in Kolkata is valid till September 2, 2038. The rating derives comfort from the long residual validity of the power distribution license, which gives earnings visibility over the long term.

Diversified consumer base, favourable income levels and increased adoption of digital payments support healthy collection efficiency – CESC's consumer base of 3.4 million are almost entirely concentrated within Kolkata, which is one of the leading metro cities in India. Almost two third of CESC's sales are in the LT segment, with the balance one third in the high tension (HT) segment. Consequently, it has a diversified customer pool, which partly mitigates the counterparty credit risks. ICRA notes that almost 64% of consumers were making online payments accounting to 72% of the revenue in FY2021 compared to 51% and 66%, respectively, during the previous financial year. This results in a faster cash conversion cycle for the company.

The collection efficiency of the company averaged ~100% during FY2016 to FY2020 but dropped to ~94% in FY2021 primarily on account of delayed billing and deferment of collections to provide some relief to the general public in the wake of adverse impact of Covid-19 on earnings in general. The collection efficiency has been improving on a monthly basis and ICRA expects the same to normalise by September 2021.

Improved profitability of DIL and cost-plus nature of distribution operations supporting profitability despite decline in demand in FY2021 in Kolkata license area – The overall power demand in the Kolkata region declined by 10.6% in FY2021 primarily on account of lower industrial demand in the first half amid the Covid-19 pandemic. Despite a lower demand, the company was able to sustain profitability, at the consolidated level, on account of improved profitability from DIL and cost-plus nature of distribution licensee operations. DIL was able to improve its PLF's with tie-up of short-term PPA with Maharashtra Generation Company Limited (Mahagenco) for the 300-MW unit without long-term PPA. Along with this, at a consolidated level, the company was able to control its operating and administrative costs. Moreover, despite the overall debt levels remaining largely similar, the interest cost moderated by ~Rs. 150 crore due to declining yields.

High reliability of power supply; limited fuel availability risks for generation stations – The peak demand in CESC's command area stood at 1,865-MW in FY2021, against which it had an operational installed capacity of 1,725-MW (including the 600-MW capacity of Haldia Energy Limited (HEL)). Between FY2016 and FY2021, 80-90% of the power demand in CESC's licensee area has been met through generation from own stations, leading to a high reliability of power supply. The annual coal requirement for CESC's thermal generation capacity of 2,325 MW (including 600 MW of DIL) is between 8.5 and 9.0 million tonne per annum (MTPA). The company procures coal from a) captive coal mine, b) long-term FSA with CIL's subsidiaries, and c) through e-auction. CESC primarily remains insulated from fuel availability risks, as over 90% of its coal requirement for these stations are met collectively from the captive mine and long-term fuel supply linkages procured at notified prices.

Operational MVCA mechanism provides an automatic avenue for prompt pass-on of fuel and power purchase costs – Fuel and power purchase cost remain the highest contributor to CESC's operating costs, accounting for around 55% of CESC's turnover between FY2016 and FY2021. In this context, the operationalisation of an MVCA mechanism allows CESC to promptly pass-on increases in fuel and power purchase cost to the consumers, which in turn provides stability to its earnings and supports its liquidity profile. The company's average cost of supply (ACS) stood higher compared to its average realised tariff (including the levy of an MVCA of Rs. 0.29/unit), leading to a cost coverage ratio of around 94% in FY2021. Without the levy of MVCA, CESC's cost coverage would have been lower. However, such differential cost is recoverable by way of true-up orders as per necessary scrutiny by WBERC.

Operational indicators remain superior than normative targets leading to sizeable efficiency gains and incentive income – CESC's business risk profile derives strength from its efficient operational indicators, with actual performance variables (such as station heat rate, distribution loss levels, plant availability, oil consumption norms, and auxiliary energy consumption) remaining superior than the regulatory targets. ICRA notes that the station heat rates at the Budge Budge and Haldia power stations are superior than their normative levels. The utility's distribution loss level of 8.4% in FY2021 was also significantly lower than the normative allowed loss. This helps CESC derive sizeable efficiency gains and incentive income, which support its overall profits and accruals. In this regard, ICRA notes that WBERC has proposed a change in the basis of fuel cost determination for generation stations to new GCV[2]-based benchmarks from April 1, 2020. In the absence of tariff orders for the current fiscal, the new normative station heat rates for CESC and Haldia Energy are yet to be known. Moreover, given the absence of CESC's tariff orders, the normative distribution losses are also not known from FY2019. Consequently, any significant tightening in normative parameters remain a key rating sensitivity.

Credit challenges

Deterioration in regulatory environment due to significant slippages in release of tariff orders by the State Electricity Regulator – CESC is yet to receive tariff orders from FY2018, and true-up orders are pending from FY2015 onwards, thereby resulting in an unpredictable regulatory environment. Moreover, this has resulted in stagnation of CESC's tariff at Rs. 7.31 per unit (base tariff of Rs. 7.02/unit and MVCA of Rs. 0.29/unit) since January 2017. Consequently, given the increase in input costs during this period, CESC's operating profits from the regulated power business in Kolkata have witnessed moderation. As on March 31, 2021, CESC's regulated business in Kolkata had a cumulative regulatory asset base of Rs. 5,492 crore[3], of which ~75% was accounted by non-cash items such as deferred tax (with equivalent deferred tax liability) and exchange fluctuations. The remaining 25% of the outstanding balance was attributable to actual cost under-recoveries emanating from fuel and power purchase cost, and other adjustments having a bearing on the revenue account. However, a closer study of the annual movement in CESC's regulatory assets reveal that there has been an acceleration in the pace of fresh build-up of regulatory assets from FY2018, primarily due to stagnant tariff levels.

Negative bid in Sarisatolli captive coal block leading to fuel cost under-recoveries – Given the criticality of the captive coal block for the operational set up of CESC's 750-MW Budge Budge station, the company participated and won back the Sarisatolli coal block in the auction held in February 2015 at a negative bid of Rs. 470/MT (including the reserve price of Rs. 100/MT, which is a pass-on in the tariff). With around 45% of the coal requirement of the Budge Budge station met from the captive coal block, the negative bid has led to fuel-cost under-recoveries.

Operation and maintenance expense remain higher than regulatory approved limits in Kolkata licensee business – Operation and maintenance expense is a controllable cost as per the regulatory norms. ICRA notes that CESC's operation and maintenance expense remains considerably higher than the amount allowed by WBERC in the FY2018 tariff order, which tempers its profits and accruals to an extent.

Moderate leverage and debt protection metrics – The company's consolidated debt stood at Rs. 14,041 crore as on FY2021 end against Rs. 13,991 crore as on FY2020 end. DIL, HEL and CESC, on a standalone basis, accounted for 95% of the outstanding debt as on FY2021 end. Its capital structure remained moderately leveraged as reflected by a gearing of 1.4 times as on FY2021 end and debt/OPBITDA of 4.3 times in FY2021. The coverage indictors remained moderate with interest coverage of 2.7 times for FY2021. Its DSCR remained low primarily on account of bunching up of payments and the company generally reverts to refinancing the same.

Funding support extended to Group entities – In the past, CESC extended financial support to weaker entities of the Group, notably to DIL as well as distribution franchise SPVs in Kota, Bharatpur, and Bikaner. Moreover, CESC has taken over the Malegaon distribution franchise in Maharashtra from March 1, 2020, which is expected to entail capital support from the

[2] *GCV – Gross calorific value*

[3] *CESC (Standalone) – Rs. 4,240.80 crore and Haldia Energy Limited – Rs. 483.79 crore*

company during the initial years. While the profitability of DIL has improved in FY2021 led by tie-up of short-term PPA, thereby reducing funding support from CESC, its inability to renew such PPAs could lead to support requirement from the latter.

Irregular scheduled repayments and low current ratio constraining credit profile despite sizeable cash and liquid investment balance and high financial flexibility – CESC's standalone long-term debt outstanding as on March 31, 2021 stood at Rs. 6,365 crore against which the current maturity stood at Rs. 954 crore. This leads to an average debt tenure of only 6.7 years, whereas the benefit of such assets would be realised over a longer timeframe. ICRA believes that though this strategy of availing medium and short-term loans to fund long-term assets/investments can lead to savings in interest costs, but the same leads to refinancing risks due to the irregular nature of repayments. Reflecting the company's high dependence on short-term financing, CESC's current ratio has been less than 1 times in the past several years. ICRA, however, believes that with the company carrying a sizeable balance sheet liquidity, which is adequate to cover of ~15-month scheduled debt repayment, and a healthy financial flexibility, such refinancing risks are mitigated to an extent.

Liquidity position: Adequate

The company's liquidity position is **adequate** supported by its sizeable consolidated on-balance sheet liquidity. Despite stagnant tariffs levels for three and a half years, CESC's regulated power business in Kolkata (CESC – Standalone + HEL) has consistently generated free cash flows, supported by its efficient operations. It is expected to realise its stuck receivables in the current fiscal, which will boost up liquidity further. The company has repayment obligations of Rs. 1,576 crore for FY2022, which will increase to ~Rs. 2,000 to Rs. 2,200 crore over the next two years. The Group had cash balances of Rs. 2,027 crore (consolidated level), along with ~Rs. 800 cushion in working capital borrowings at a standalone level, which will aid in meeting cashflow mismatch if any. The company is also expected to roll over a portion of its borrowings. ICRA also notes that CESC has already prepaid debt amounting to ~Rs. 720 crore in the current fiscal.

Rating sensitivities

Positive factors – Not applicable

Negative factors – Negative pressure on CESC's rating could arise if, for reasons including inordinate delays in tariff revision and/or tightening of operating norms in future by WBERC leads to significantly lower-than-expected profits, as well as a marked deterioration in the consolidated liquidity profile. Moreover, net debt/OPBITDA crossing 5.0 times on a sustained basis may trigger a rating revision.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities Rating Methodology for Thermal Power Producers Rating Methodology for Solar Power Producers Rating Methodology for Wind Power Producers
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the company's consolidated financial profile

About the company

Incorporated in 1978, CESC is the flagship company of the RP-Sanjiv Goenka Group and is involved in the generation and distribution of electricity. CESC has the licence to supply electricity in Kolkata and Howrah till September 2, 2038. The licensee area is of 567 sq. km and it caters to over 3.4 million consumers with an own generation capacity of 1,125 MW (coal based). CESC has two wholly-owned subsidiaries, Haldia Energy Limited and Dhariwal Infrastructure Limited, each operating 2x300-MW coal-based thermal power plants. The entire generation capacity of Haldia Energy Limited is tied-up under long-term cost-plus based power purchase agreement (PPA) with CESC. For Dhariwal Infrastructure Limited's generation capacity, 50% has been tied-up under long-term PPA, and the balance caters to the short-term demand. the company has 174-MW renewable energy generation assets (wind: 156-MW and solar: 18-MW) and a 40-MW coal washery rejects-based thermal power plant under its two subsidiaries, Surya Vidyut Limited and Crescent Power Limited. In the power distribution segment, apart from Kolkata, CESC's through its subsidiary, i.e., Noida Power Company Limited (NPCL), has licence to supply electricity in the Greater Noida area in Uttar Pradesh. Besides the licensee power distribution business, CESC is gradually increasing its footprint in the power distribution franchise businesses. In FY2017, it took over the distribution franchise operations at Kota, Bharatpur and Bikaner in Rajasthan. In March 2020, CESC took over the power distribution franchise operations in Malegaon, Maharashtra.

Key financial indicators (Standalone)

CESC Standalone	FY2019	FY2020	FY2021
Operating Income (Rs. crore)	7,754	7,836	6,921
PAT (Rs. crore)	937	918	814
OPBDIT/OI (%)	18.8%	19.6%	18.6%
PAT/OI (%)	12.1%	11.7%	11.8%
Total Outside Liabilities/Tangible Net Worth (times)	1.7	1.7	1.8
Total Debt/OPBDIT (times)	4.1	4.2	5.6
Interest Coverage (times)	3.1	2.8	2.6

**PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation*

Key financial indicators (Consolidated)

CESC Consolidated	FY2019	FY2020	FY2021
Operating Income (Rs. crore)	10,664	12,159	11,639
PAT (Rs. crore)	1,129	1,309	1,363
OPBDIT/OI (%)	27.4%	26.6%	28.2%
PAT/OI (%)	10.6%	10.8%	11.7%
Total Outside Liabilities/Tangible Net Worth (times)	2.7	2.6	2.5
Total Debt/OPBDIT (times)	5.0	4.3	4.3
Interest Coverage (times)	2.2	2.3	2.7

**PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of May 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					July 29, 2021	July 30, 2020	-	January 31, 2019 March 29, 2019
1	Commercial Paper	Short term	1600.0	150.0	[ICRA]A1+	[ICRA]A1+	-	[ICRA]A1+

Complexity level of the rated instrument

Instrument	Complexity Indicator
Commercial Paper	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
INE486A14EK7	Commercial Paper	June 17, 2021	3.85%-5.45%	September 15, 2021	100.0	[ICRA]A1+
NA	Commercial Paper – Unplaced	-	-	-	1500.0	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Haldia Energy Limited	100.00%	Full Consolidation
Dhariwal Infrastructure Limited	100.00%	Full Consolidation
Surya Vidyut Limited	100.00%	Full Consolidation
Crescent Power Limited	67.83%	Full Consolidation
Noida Power Company Limited	72.73%	Equity Method
Kota Electricity Distribution Limited	100.00%	Full Consolidation
Bikaner Electricity Supply Limited	100.00%	Full Consolidation
Bharatpur Electricity Services Limited	100.00%	Full Consolidation
Mahuagarhi Coal Company Private Limited	50.00%	Joint Venture (Equity Method)
CESC Green Power Limited	100.00%	Full Consolidation
Malegoan Power Supply Limited	100.00%	Full Consolidation
CESC Projects Limited	100.00%	Full Consolidation
Bantal Singapore Pte Limited	100.00%	Full Consolidation
Pachi Hydropower Projects Limited	100.00%	Full Consolidation
Papu Hydropower Projects Limited	100.00%	Full Consolidation
Ranchi Power Distribution Company Limited	100.00%	Full Consolidation
Au Bon Pain Café India Limited	93.10%	Full Consolidation
Jarong Hydro-Electric Power Company Limited	100.00%	Full Consolidation
Jharkhand Electric Company Limited	100.00%	Full Consolidation
Eminent Electricity Distribution Limited	100.00%	Full Consolidation

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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