July 22, 2022

CESC Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper (CP)	1,600	1,600	[ICRA]A1+ reaffirmed
Total	**1,600**	**1,600**	

**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 lead to stable earnings and cash accruals. The long-term revenue visibility for the company remains high as the distribution licence in Kolkata is valid for ~16 more years. The rating reaffirmation also considers CESC's favourable consumer base, growing demand for electricity and the high reliability of power supply in CESC's command area, with close to 90% of the electricity demand met from its own generation stations.

ICRA notes that CESC's coal-based generation capacities are primarily backed by long-term fuel supply agreements (FSA) with the subsidiaries of Coal India Limited (CIL), which mitigate the fuel availability risks. This, along with the superior operating efficiency of the own generation plants, supports in attaining a competitive power generation cost. Further, the financial performance of its key subsidiary - Dhariwal Infrastructure Limited (DIL) - has improved over the past couple of years, which has reduced the requirement of incremental funding support from CESC/other Group companies. Additionally, there is a significant reduction in offtake risk for DIL, as it has recently tied up a three-year medium-term power purchase agreement (PPA) for 210-MW (gross capacity: 230 MW) out of the 300-MW capacity under Unit II, which was previously operating entirely based on a short-term arrangement.

The rating, however, remains constrained by the company's exposure to the regulatory risk associated with the delay in issuing tariff orders and the inadequacy of the tariffs approved by the state regulatory commission in relation to the cost structure. ICRA notes that the West Bengal Electricity Regulatory Commission (WBERC) had earlier delayed in issuing tariff orders and orders related to the annual performance review (APR). The WBERC had approved the tariff order for FY2019 and FY2020 in February 2022, wherein there were disallowances in fuel and fixed charges against the claims made by the company. Nonetheless, the fuel costs approved remain higher than the actual fuel costs incurred by the company in these years. Also, the WBERC has stated in the tariff order that some of the cost items could be considered at the time of true-up/APR process. Any major disallowances in the expenses and/or capital costs could impact the company's profitability and return indicators and remain a key rating monitorable.

The stagnant tariffs over the past 4-5 years have resulted in a significant build-up of regulatory assets. ICRA notes that there is an operational monthly variable cost adjustment (MVCA) mechanism which provides an automatic avenue for a prompt pass-through 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 delays in issuance of tariff orders. ICRA also takes note of the increase in the base-tariff for CESC as per the recent tariff order for FY2019 and FY2020, to Rs 7.31/unit from the earlier approved Rs 7.02/unit, which would help curtail the cost under-recoveries to some extent.

The rating also takes into account the moderate leverage and debt protection metrics for CESC, given the debt-funded nature of capex and the 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. 3,594 crore at a consolidated level as on March 31, 2022. Going forward, given its large liquid investments, stable cash flows from the power distribution business, and high financial flexibility, CESC's liquidity position is expected to remain comfortable, which would support its debt servicing ability.

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 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 licence in Kolkata is valid till September 2, 2038. The rating derives comfort from the long residual validity of the power distribution licence, which gives earnings visibility over the long term.

Diversified consumer base and healthy collection efficiency for Kolkata distribution business – CESC's consumer base of 3.5 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 low tension (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. The collection efficiency of the distribution business has historically remained strong at around ~99.5%.

Reduction in offtake risk for DIL; lower dependence on CESC/Group companies for funding requirement – DIL faced significant offtake risk for 300-MW capacity under its Unit 2 which did not have a long-term PPA and was relying on short-term arrangements for sale of power, which supported its revenues in the last two fiscals. The capacity under Unit 2 is already tied-up under a long-term PPA arrangement and does not face any offtake risk. Recently, DIL has tied up a three-year PPA for 210 MW (gross capacity of 230 MW) out of the 300 MW of its Unit 1 capacity with the Indian Railways at a base tariff of Rs. 4.10/unit (fixed and variable charge of Rs 2.05/unit each), with annual escalation available in both the fixed and variable components. The supply under this PPA has commenced from April 01, 2022. With this, only 70 MW capacity under DIL remains untied, against 300 MW earlier. There was no funding support required from CESC/Group companies in FY2022 on the back of adequate internal accruals and no incremental support is expected in the near to medium term to DIL.

High reliability of power supply; limited fuel availability risks for generation stations – The peak demand in CESC's command area stood at 2012 MW in FY2022, 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 FY2022, 80-90% of the power demand in CESC's licensee area has been met through generation from own stations, leading to 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 8.5-9.0 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.

[1] CESC (Standalone) + Haldia Energy Limited

Operational MVCA mechanism provides an automatic avenue for prompt pass-on of fuel and power purchase costs – Fuel and power purchase costs remain the highest contributor to CESC's operating costs, accounting for around 50-55% of CESC's turnover between FY2016 and FY2022. In this context, the operationalisation of an MVCA mechanism allows CESC to promptly pass-on the increases in fuel and power purchase costs to the consumers, which in turn provides stability to its earnings and supports its liquidity profile. The company's average realised tariff (including the levy of an MVCA of Rs. 0.29/unit) was around Rs. 7.31/unit for the last 3.5-4 years. In the recent tariff order issued by the WBERC for FY2019 and FY2020 in February 2022, the MCVA of Rs. 0.29/unit has been subsumed in the base tariff. Thus, the base tariff has increased to Rs. 7.31/unit compared to Rs. 7.02/unit earlier. While the company has not levied MVCA from February 2022, it may charge it in future to cover the increase in fuel costs.

Operational indicators 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 the 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 the normative levels. The utility's distribution loss level of 7.98% in FY2022 was also significantly lower than the normative allowed loss of 14.3%. This helps CESC derive sizeable efficiency gains and incentive income, which support its overall profits and accruals. As per the recent tariff order issued for FY2019 & FY2020, the normative distribution loss and efficiency parameters for CESC's generation stations have remained unchanged. Nonetheless, any significant tightening in normative efficiency parameters would remain a key rating sensitivity.

Credit challenges

Regulatory risk related to timely issuance of tariff order and disallowances in cost items impacting full cost recovery – As CESC's tariff is on a cost-plus basis as determined by the WBERC, the company remains exposed to regulatory risks associated with the delay in receiving tariff order and disallowance of costs by the state regulatory commission. The company faces risk of lower returns in case of disallowance in any of the major cost items. The WBERC has recently approved the tariff order for FY2019 and FY2020 in which the fuel cost has been largely allowed in line with the actual fuel costs. However, there were disallowances in certain fixed charges. While the WBERC in its tariff order has stated that some of the cost items could be considered at the time of true-up/APR process, any major disallowances in the expenses and/or capital costs could impact the company's profitability and return indicators.

Significant build-up of regulatory assets – There has been significant delays by the WBERC in releasing the tariff orders and completing the true up process for the previous years. While the company has received the tariff orders till FY2020, the true-up orders are pending from FY2015 onwards, thereby resulting in an unpredictable regulatory environment. The company's tariff remained stagnant 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, 2022, CESC's regulated business in Kolkata had a cumulative regulatory asset (RA) base of Rs 2147[2] crore due to actual cost under-recoveries emanating from fuel, power purchase cost, and other adjustments having a bearing on the revenue account.

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 inadequate fuel-cost absorption.

[2] 34% of the total cumulative regulatory assets, rest 66% being non-cash items arising because of accounting treatment requirements

Operation and maintenance expense higher than regulatory approved limits in Kolkata licensee business – The operation and maintenance expense is a controllable cost, as per the regulatory norms. ICRA notes that CESC's operation and maintenance expense remains higher than the amount allowed by the WBERC in the tariff orders for FY2018 to FY2020, which tempers its profits and accruals to an extent. However, WBERC has stated to consider the same at the time of the annual performance review (APR) petition in respect of these years.

Moderate leverage and debt protection metrics; refinancing risks due to lumpy repayments – CESC's capital structure, on a consolidated basis, remained moderately leveraged as reflected in a gearing of 1.38 times and debt/OPBITDA of 4.93 times as of FY2022-end. The coverage indictors remained moderate with interest coverage of 2.43 times for FY2022. The DSCR remained low primarily on account of bunching up of payments and the company generally reverts to refinancing the same. CESC has signficant repayments of ~Rs. 4,600 crore over the next three years on a standalone basis. ICRA believes that though the strategy of availing medium and short-term loans to fund long-term assets/investments can lead to savings in interest costs, the same leads to refinancing risks due to the bunching up of repayments. Nonetheless, the company is carrying a sizeable balance sheet liquidity, which is adequate to cover at least 12 months' scheduled debt repayments. Also, the healthy financial flexibility of the Group is expected to mitigate the refinancing risks to a large extent.

Funding support extended to Group entities – In the past, CESC extended financial support to the weaker entities of the Group, notably to DIL as well as the 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 company during the initial years. Nonetheless, the profitability of DIL has improved in the last two fiscals, led by a tie up of short-term PPA, thereby reducing the funding support from CESC. Moreover, DIL has signed a medium term PPA with Indian Railways for three years, with supply commencing from April 01, 2022. This has significantly reduced DIL's offtake risk, as now only 90 MW capacity remains untied. Given this, the funding support requirement for DIL is expected to be minimal.

Liquidity position: Adequate

The company's liquidity position is **adequate,** supported by its sizeable on-balance sheet liquidity on a consolidated basis. Despite stagnant tariffs levels for over four years, CESC's regulated power business in Kolkata (CESC – Standalone + HEL) has consistently generated free cash flows, supported by its efficient operations. At a consolidated level, the company has repayment obligations of Rs. 1,918 crore for FY2023, Rs 2,312 crore for FY2024 and Rs 1,996 crore for FY2025. As on March 31, 2022, the consolidated cash balances and liquid investments stood at Rs. 3,594 crore, along with ~Rs. 425-crore cushion in working capital borrowings at a standalone level, which will aid in meeting cashflow mismatch, if any. The company is also expected to refinance a portion of its borrowings.

Rating Sensitivities

Positive factors – Not applicable

Negative factors – The rating could be downgraded if inordinate delays in tariff revision and/or tightening of operating norms in future by the WBERC leads to significant decline in profits and marked deterioration in the consolidated liquidity profile. Moreover, the 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
Parent/Group support	Not applicable

Consolidation/Standalone	The rating is based on the company's consolidated financial profile

About the Company

CESC, incorporated in 1978, 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 3.5 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 a long-term cost-plus based power purchase agreement (PPA) with CESC. For Dhariwal Infrastructure Limited's generation capacity, 50% has been tied-up under a long-term PPA, and the balance caters to the short-term & medium-term demand.

The company has 18-MW solar power assets and a 40-MW coal washery rejects-based thermal power plant under its subsidiary, Crescent Power Limited. In the power distribution segment, apart from Kolkata, CESC through its subsidiary, i.e., Noida Power Company Limited (NPCL), has the 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 - Consolidated

	FY2021 (Audited)	FY2022 (Audited)
Operating income (Rs. crore)	11,631.51	12,543.88
PAT (Rs. crore)	1,362.81	1,404.08
OPBDIT/OI	28.18%	24.19%
PAT/OI	11.72%	11.19%
Total outside liabilities/Tangible net worth (times)	2.49	2.46
Total debt/OPBDIT (times)	4.36	4.93
Interest coverage (times)	2.45	2.43

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; all ratios as per ICRA's calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on June 30, 2022 (Rs. crore)	Date & rating in	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					July 22, 2022	July 29, 2021	July 30, 2020	-
1	Commercial Paper	Short Term	1600	400	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

Complexity level of the rated instruments

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 are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE486A14EV4	Commercial Paper	June 13,2022	5.28%	September 06,2022	100	[ICRA]A1+
INE486A14EU6	Commercial Paper	May 10,2022	4.24%	August 08,2022	300	[ICRA]A1+
-	Commercial Paper - Unplaced	NA	-	-	1200	[ICRA]A1+

Source: *Company*

Annexure II: 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
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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