

April 30, 2024

Gulbarga Electricity Supply Company Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based term loans	1,000.00	940.00	[ICRA]BBB- (Stable); reaffirmed
Fund-based overdraft	100.00	100.00	[ICRA]BBB- (Stable); reaffirmed
Non-fund-based letter of credit	300.00	261.00	[ICRA]A3; reaffirmed
Unallocated	0.28	0.00	-
Total	1,400.28	1,301.00	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of the ratings for Gulbarga Electricity Supply Company Limited (GESCOM/company) continues to favourably factor in its 100% ownership by the Government of Karnataka (GoK), the strategic importance of the company to the state power sector and the monopolistic nature of the business supported by cost-plus tariff-based principles. The ratings are also supported by an established regulatory process in the state, evident from the presence of a multi-year tariff (MYT) regime, the timely issuance of tariff orders with upward tariff revisions and the annual true-up of the actual performance of the distribution companies (discoms). ICRA notes that the tariff order for FY2023 was released in April 2023 with a tariff hike of 8.7% for GESCOM.

Further, the ratings derive comfort from the cash inflows of GESCOM from consumer contribution and the capital grants towards capital assets, equity infusion from the GoK and security deposits from consumers. ICRA also considers the company's satisfactory operational efficiency as distribution loss level has reduced over the years to 10.5% in FY2023 from 16.5% in FY2018 as the utility took various projects to strengthen the system.

The ratings remain constrained by the vulnerability of GESCOM's power purchase cost (PPC) to its power procurement mix, particularly the availability of power from the hydel stations of Karnataka Power Corporation Limited (KPCL), as any shortfall would lead to dependence on high-cost power, as seen in the past. Also, the increasing share of renewables in the power purchase mix of GESCOM in recent years has led to the backing down of long-term thermal stations, wherein the discoms would continue to pay fixed charges. The PPC of GESCOM has increased to Rs. 5.85 per unit in FY2023 from Rs. 4.93 per unit in FY2022. The PPC was higher than the approved cost for FY2023. Higher-than-approved PPC is accentuated by the company's inability to pass it on to consumers under the fuel cost adjustment (FCA) framework approved by the Karnataka Electricity Regulatory Commission (KERC).

The ratings are further tempered by the relatively high dependence (36% of revenues in FY2023) on the state government's subsidy due to the large share (43% in FY2023) of agriculture consumers in the overall energy sales mix. In addition, the ratings factor in the company's modest financial risk profile, characterised by a weak capital structure, modest debt coverage metrics and its increasing dependence on debt to clear the outstanding dues to power generators. The cost coverage ratio for the company deteriorated in FY2023 to less than 1.0x due to the under-recovery of approved subsidy and collections from various government departments and the PPC being higher than the approved level. Nonetheless, the company is expected to receive Rs. ~1340 crore through a securitisation transaction wherein Power Company of Karnataka Limited (PCKL) will raise the fund for clearing the dues for FY2016-FY2023 period (only principal component) from Gram Panchayats to Karnataka ESCOMs. The receipt of the securitisation proceeds is expected to be utilised for reducing the outstanding payables and short-term debt by the company.

Further, ICRA takes note of GESCOM's high cross-subsidisation requirement, with higher tariffs charged from commercial and industrial (C&I) consumers to compensate for the lower rates for domestic and agriculture users. This could result in a loss of industrial consumers for GESCOM, as seen in the past. However, the company has been able to achieve a growth in sales contribution from the C&I segment in FY2023. The ratings also factor in the capital expenditure plans by GESCOM for system improvements that are to be funded through a mix of long-term debt, capital receipts and equity from the GoK.

The Stable outlook on the rating for the bank facilities of GESCOM reflects ICRA's opinion that the entity will continue to be supported by the GoK, given its strategic importance as one of the state power distribution utilities. GESCOM's ability to improve its profitability metrics through growth in volume sales and tariff revisions in tandem with its cost structure and achieve timely collections will remain crucial from a credit perspective.

Key rating drivers and their description

Credit strengths

State-owned power distribution company with cost-plus tariff - GESCOM is a GoK-owned power distribution utility that supplies electricity to consumers in seven districts of Karnataka. The utility receives regular support from the GoK in the form of equity and capital grants. The monopolistic nature of the business with cost-plus tariff principles allows the utility to pass on the variations in cost structure to the consumers.

Established regulatory processes in Karnataka - The operations of GESCOM are supported by well-established regulatory processes in Karnataka, with the presence of MYT regulations along with regular and timely issuance of tariff orders by the KERC, including annual true-up in the past years. The tariff order for FY2025 was issued in February 2024.

Demonstrated support from GoK - The utility has received continued support from the GoK in the form of equity infusion to meet its capex requirements and through an interest-free loan of Rs. 1,000 crore in March 2020 to meet its cash flow gap. In addition, GESCOM raised loans backed by state government guarantees in FY2021 and FY2022 to clear the dues to power generating companies.

Satisfactory operating efficiency - GESCOM has been able to lower its distribution loss level to 10.5% in FY2023 from 16.5% in FY2018, aided by various projects, to strengthen the system. The distribution loss level was within the KERC's approved target of 10.5% for FY2023.

Financial profile supported by cash inflows in the form of grants, equity and consumer contribution - The financial profile of GESCOM is supported by considerable cash inflows from consumer contribution and subsidy grants towards capital assets, security deposits from consumers and equity infusion from the GoK.

Credit challenges

Financial risk profile constrained by inadequate tariffs in relation to cost of supply and moderately high receivable position - Inadequate tariffs in relation to the cost of supply and a moderately high receivable position constrain the financial profile of GESCOM, resulting in accumulated losses and a high payable position. In FY2023, the company reported losses and the cost coverage ratio was below 1.0x due to lower subsidy realisation compared to the approved subsidy and the PPC being higher than the approved level. The receivable from the sale of power continues to accumulate due to delayed receipts from government departments. The payable position has improved with the ongoing clearance of past dues (till June 2022) of central generators and independent power producers through 48 monthly instalments under the late payment surcharge (LPS) scheme which in turn has put pressure on the debt coverage metrics. The company is expected to receive Rs. ~1,340 crore through the securitisation transaction which is expected to be utilised to reduce the company's outstanding payables and short-term debt.

High subsidy dependence - The subsidy dependence as a proportion of the operating income for GESCOM remains high at about 36% of the revenues in FY2023. This is owing to the large share of agriculture consumers in the energy sales mix which is expected to go up in FY2024. While the subsidy collections had improved substantially in FY2022 with the recovery of earlier subsidy dues, the collection efficiency declined in FY2023 and 9M FY2024. Timely and adequate subsidy collection remains important from a credit perspective.

Sensitivity of power purchase cost to GoK's power allocation policy - The PPC for GESCOM is susceptible to the power allocation policy of the GoK and the availability of power supply from KPCL's hydel stations. Any shortfall in the availability of cheap hydel power leads to dependence on high-cost power, as seen in the past. Also, the growing sharing of renewables in the power purchase mix in recent years has led to a backing down of the thermal stations (wherein discoms would continue to pay the fixed charges). This could increase the PPC for the company. This is accentuated by the inability of the company to pass on the increase in PPC to the consumers under the existing quarterly FCA framework. The FCA framework approved by the KERC does not allow pass-through of any variation in PPC from sources other than long-term thermal stations and is limited to the variation in energy charges for these plants. The variation in PPC is approved during the annual true-up process, which happens with a lag.

High tariff cross-subsidisation with subsidised supply to agriculture and domestic consumers - The cross-subsidisation requirement persists with higher tariffs charged from commercial and industrial consumers to compensate for the lower rates for domestic and agriculture consumers. This could result in a loss of industrial consumers for GESCOM, given the availability of cheaper power in the open-access market.

Sizeable capital expenditure plans - The company has sizeable capital expenditure plans related to investments in infrastructure improvement, feeder separation programme, consumer and feeder metering etc., which will be funded through a mix of debt, equity, consumer contribution and capital grants. The largely debt-funded capex puts pressure on the leverage level.

Liquidity position: Stretched

The liquidity profile of GESCOM is stretched, based on the limited available cash balances and high working capital utilisation as on December 31, 2023. Nonetheless, the demonstrated support from the GoK through interest-free and GoK-guaranteed loans is expected to help the utility pay the dues to its generators. The capex funding is met through fresh equity, capital grants, consumer contributions and long-term debt. Going forward, timely realisation of the receivables from consumers and timely receipt of the approved subsidy from the GoK will remain critical for the company.

Rating sensitivities

Positive factors – The ratings can be upgraded if the utility reduces its receivable position, improves its profitability metrics leading to improvement in its liquidity, along with improvement in its operating efficiency. Further, the ratings remain sensitive to the credit profile of the GoK.

Negative factors – The ratings could face pressure in case of significant delays in the issuance of tariff order and/or inadequacy of the tariff approved, adversely impacting the profitability and cash flows. Also, an increase in the receivable position or higher-than-approved distribution loss levels would exert pressure on the ratings. Further, the ratings remain sensitive to the credit profile of the GoK.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Power Distribution Utilities
Parent/Group support	The assigned ratings factor in the systemic importance that GESCOM holds for the state power sector, which ICRA expects should induce the GoK to extend timely financial support to the rated entity, should there be a need
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of GESCOM

About the company

GESCOM, incorporated in 2002, is one of the five state-owned distribution utilities in Karnataka, which are licensed to supply electricity in the five designated areas of the state. GESCOM is licensed to distribute electricity to seven districts of Karnataka - Bellary, Bidar, Kalaburagi, Koppala, Raichur, Yadgiri and Vijayanagar - covering an area of 43,861 sq. km with 3.59 million consumers as on March 31, 2023. The other distribution utilities in Karnataka are Bangalore Electricity Supply Company Limited (BESCOM), Mangalore Electricity Supply Company Limited (MESCOM), Hubli Electricity Supply Company Limited (HESCOM) and Chamundeshwari Electricity Supply Corporation Limited (CESCOM). The transmission function in Karnataka is under state-owned Karnataka Power Transmission Corporation Limited (KPTCL), while the state-owned power generation assets are under KPCL.

Key financial indicators

GESCOM Standalone (audited)	FY2022	FY2023
Operating income (Rs. crore)	5946.6	7465.8
PAT (Rs. crore)*	10.5	-296.0
OPBDIT/OI (%)	11.1%	6.8%
PAT/OI (%)*	0.2%	-2.8%
Total outside liabilities/Tangible net worth (times)	-66.15	-32.09
Total debt/OPBDIT (times)	4.93	7.32
Interest coverage (times)	1.58	0.91

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; *PAT has been adjusted for prior period regulatory changes

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

Instrument		Current rating (FY2025)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as on Dec 31, 2023 (Rs. crore)	Date & rating	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021
					Apr 30, 2024	Jan 19, 2023	Nov 09, 2021	May 07, 2021	Apr 17, 2020
1	Term loans	Long-Term	940.00	975.92	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)
2	Fund-based overdraft	Long-Term	100.00	-	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)
3	Non-fund based letter of credit	Short-Term	261.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3	[ICRA]A3
4	Unallocated	Long-Term / Short-Term	0.00	-	-	[ICRA]BBB-(Stable) / [ICRA]A3	[ICRA]BBB-(Stable) / [ICRA]A3	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based – Term loan	Simple
Fund-based – Overdraft	Simple
Non-fund based – Letter of credit	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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term loan	Oct 2020	-	Dec 2030	940.00	[ICRA]BBB- (Stable)
NA	Fund-based overdraft	-	-	-	100.00	[ICRA]BBB- (Stable)
NA	Non-fund-based letter of credit	-	-	-	261.00	[ICRA]A3

Source: Company

Annexure II: List of entities considered for consolidated analysis

Not Applicable

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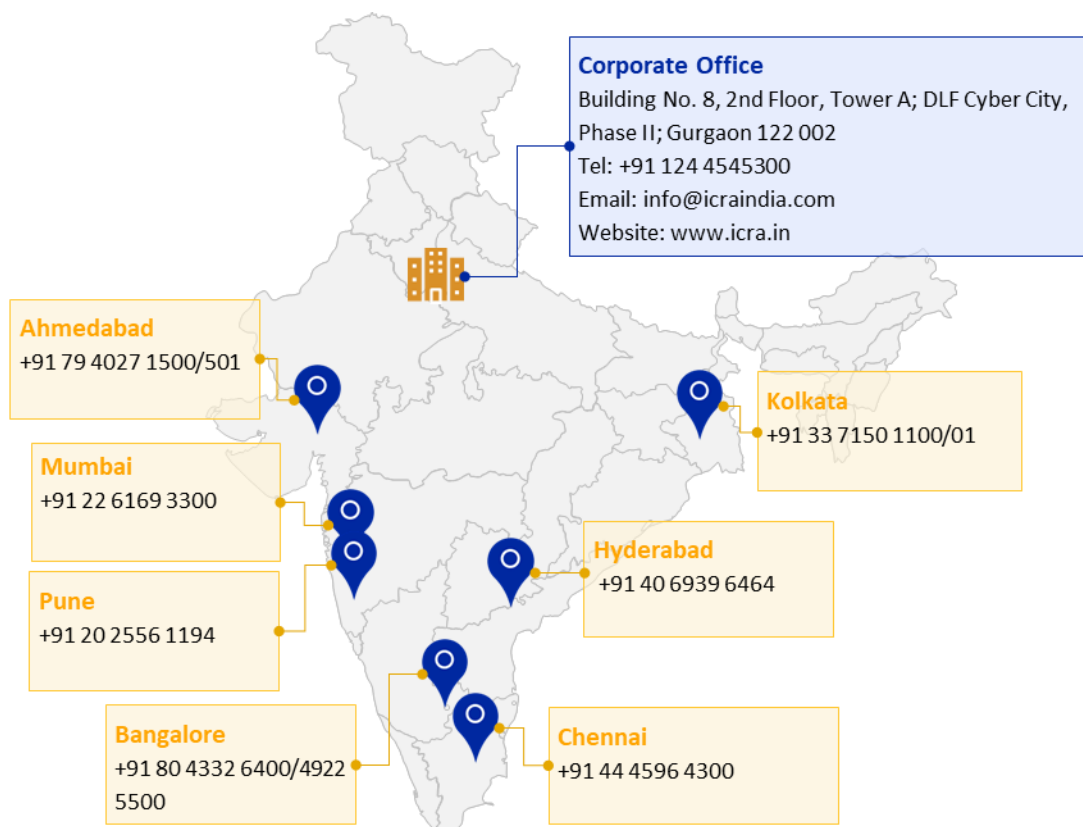


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