October 03, 2017

CESC Limited

Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating action
Commercial Paper	Rs. 1300.00 crore (enhanced from Rs 160.00 crore)	[ICRA]A1+; assigned/outstanding

*Instrument details are provided in Annexure-1

Rating action

ICRA has assigned the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) to the Rs. 1300.00-crore[1] (enhanced from Rs 160.00 crore) Commercial Paper-programme of CESC Limited (CESC)[2].

Rationale

The rating action reflects CESC's low business risk profile in its core licensee operations, the cost-plus nature of the tariff-setting process, and the company's ability to outperform regulatory targets set by the West Bengal Electricity Regulatory Commission (WBERC), leading to healthy returns and stable cash flows. The rating also takes into account CESC's integrated nature of operations, with its presence across the generation and distribution verticals, and the regulatory clarity, as reflected by periodic tariff revisions, in turn leading to prompt pass-on of higher fuel costs. Moreover, the rating derives comfort from the company's ability to recover fuel and power-purchase cost escalations on a monthly basis through an operational monthly variable cost adjustment (MVCA) mechanism, which has benefited the company in terms of cash flows.

The rating also factors in the company's high level of billing/collection efficiency, and its favourable consumer mix, as indicated by a relatively lower level of cross-subsidisation, thereby implying lower vulnerability to migration of HT[3] consumers. The rating continues to derive strength from CESC's favourable operational indicators, with actual performance variables (such as station heat rate, plant availability, oil consumption norms, auxiliary energy, transmission and distribution loss levels etc.) remaining superior than regulatory targets. ICRA observes that CESC has continued to invest heavily in strengthening its power-distribution infrastructure, resulting in significant reduction in transmission and distribution (T&D) losses from 22.8% in FY2001 to 11.1% in FY2017, which is considerably lower than the normative benchmark of 14.3% set by the WBERC. Moreover, CESC's generation stations have consistently outperformed normative targets associated with station heat rates, auxiliary energy and fuel oil consumption, which has aided the company in earning superior returns. The rating also incorporates the company's limited fuel availability risks, with ~40% of its coal requirements met from captive coal mine at Sarisatolli, and the rest from the fuel-supply agreements (FSA) with Coal India Limited, thereby leading to a competitive cost of generation. However, the rating continues to factor in the negative bidding made by CESC to win back the Sarisatolli coal block, which is adversely impacting the company's profitability. Moreover, ICRA notes that CESC had paid Rs 1,044.87 crore towards additional levy for the Sarisatolli coal block, out of which the company expects to recover Rs 997.76 from consumers, which is pending approval from the WBERC, thereby exposing the company to regulatory risks in the interim period. However, ICRA continues to derive comfort from CESC's favorable financial

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[1] *100 lakh = 1 crore = 10 million*

[2] For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

[3] High Tension

risk profile, as indicated by its healthy profitability, comfortable interest coverage, and a moderate capital structure. Moreover, the liquidity position of CESC continues to remain comfortable, characterised by stable cash flows, and a large cash and liquid investment balance of around Rs. 1,430 crore as on March 31, 2017. Going forward, given CESC's large liquid investments and stable cash flows from the power-distribution business, its liquidity position is likely to remain comfortable, which would support its debt-servicing ability.

Key rating drivers

Credit strengths

- **Expected synergies as a result of restructuring of RP-SG Group entities into concentrated separate business verticals –** With an objective to simplify the corporate structure and bring in greater focus, the RP-SG Group announced plans to demerge multiple businesses, at present operating under CESC Limited (the flagship company) and its various step-down subsidiaries into four separate listed entities specialising in: a) power distribution (through CESC Limited), b) power generation (through Haldia Energy Limited), c) organised retail (through RP-SG Retail Limited), and d) business-process management, real estate, and FMCG (through RP-SG Business Process Services Limited). Post the unbundling, CESC Limited (CESC), along with the three resultant entities, will be listed on the stock exchanges, with a shareholding pattern which would mirror the present shareholding of CESC. The restructuring scheme has been proposed to be made effective from October 1, 2017, subject to receipt of requisite statutory approvals.
- **Regulated nature of business, including cost-plus based tariff principles for the power-distribution licensee operations –** The cost-plus nature of the tariff-setting process and periodic tariff revisions have led to stable cash flows generated from the power business. Additionally, the existence of monthly variable cost adjustment (MVCA)/monthly fuel cost adjustment (MFCA) mechanism allows the company to pass on the increase in fuel and power-purchase costs to the consumer on a monthly basis.
- **Favourable operational indicators with actual performance variables superior to regulatory targets; significant reduction in T&D losses achieved over the past periods -** Apart from outperforming normative operational benchmarks associated with plant availability and auxiliary energy consumption, CESC's generation stations also outperform the normative targets associated with station heat rates and fuel oil consumption, thus aiding in earning significant incentive income. Additionally, on account of CESC's initiatives towards loss-reduction measures, the company's current T&D levels (~11.1% in FY2017) are much lower than the normative levels (14.3%) as determined by the WBERC, which also helps in earning incentive income.
- **Limited fuel-availability risks, with a major portion of coal requirement met from captive coal mines and the fuel linkages with Coal India Limited (CIL) -** With over 95% of CESC's coal requirements met collectively from captive mines and long-term fuel supply linkages with CIL at notified prices, CESC remains almost insulated from fuel availability risks. Moreover, low dependence on coal imports leads to the competitive cost of generation.
- **Commissioning of the 600-MW thermal power plant at Haldia in February, 2015 led to a significant growth in consolidated profits -** The rating derives strength from the stabilisation of operations of the group's newly-commissioned 600-MW coal-based thermal power plant at Haldia [under a wholly-owned step-down subsidiary called Haldia Energy Limited (HEL)], which is supplying its entire power generation to CESC through long-term power-purchase agreement (PPA), and has FSA with Mahanadi Coalfield Limited, thereby almost mitigating off-take and fuel-availability risks. ICRA notes that HEL has been generating healthy cash accruals from operations, and is materially contributing to the group's profitability at the consolidated level.
- **Financial risk profile remained favourable, as indicated by healthy profitability, comfortable interest coverage, and a moderate capital structure -** The company's capital structure has

continued to remain conservative in the past couple of years, as indicated by a gearing of ~0.45 times as on March 31, 2017. Moreover, healthy operating profits result in comfortable interest coverage ratio of 4.14 times in FY2017.

- **Comfortable liquidity position, backed by high collection efficiency, as indicated by a large cash and liquid investment balance of ~Rs. 1,430 crore as on March 31, 2017 –** The company's liquidity position continues to remain healthy on the back of timely collection of bills and large security deposit from consumers. Moreover, CESC had a large portfolio of cash and liquid investments of around Rs. 1,430 crore as on March 31, 2017, which provides additional liquidity support to the company.

Credit weaknesses

- **Negative bidding to win back the Sarisatolli captive coal block is affecting the company's profitability –** Given the criticality of the captive coal block for the operational set-up of CESC's stations, the company participated and won back the Sarisatolli coal block in the auction held in February 2015 at a negative bid, which is affecting the company's profitability. Moreover, CESC remains exposed to regulatory uncertainties associated with the recovery of additional levy, which awaits approval from the West Bengal Electricity Regulatory Commission (WBERC) for pass-on in the tariff. ICRA, however, notes that such fuel cost under-recoveries are being partially mitigated by increased power purchase from HEL.
- **Funding support extended to the 600-MW new thermal power generation unit at Chandrapur exerted pressure on CESC's consolidated cash flows –** The company made significant debt-funded capital expenditure towards setting up another 600-MW coal-based thermal power plant at Chandrapur [under a wholly-owned step-down subsidiary, named Dhariwal Infrastructure Limited (DIL)]. The said plant is yet to operate at adequate plant load factor (PLF) levels, resulting in significant losses in DIL. However, ICRA notes that DIL has been securing fuel supply from South Eastern Coalfields Limited (SECL), and has also firmed up long-term PPAs, accumulating to 270 MW, which would allow it to run one unit at full load from FY2018, subject to adequate transmission corridor availability. This is expected to strengthen its operating profile and reduce its group dependence for bridging cash-flow mismatches.
- **Continuing losses in the group's retail business, though reduced in the last few quarters, is likely to entail incremental support from CESC in the near term -** The RP-SG Group's organised retail venture through Spencer's Retail Limited (SRL) has been able to steadily reduce its losses in the last few years, supported by store rationalisation and cost-optimisation initiatives. The company has been undertaking several measures towards turning around the retail business, which resulted in net losses reducing from ~Rs. 255 crore in FY2012 to ~Rs. 130 crore in FY2017. ICRA believes that with the gradual improvement in SRL's performance, incremental funding support from CESC is likely to reduce in the near to medium term.

Analytical approach: While assigning the rating, ICRA has considered the consolidated financial profile of Haldia Energy Limited, CESC Limited and Dhariwal Infrastructure Limited.

Links to applicable criteria

Corporate Credit Rating Methodology
Rating Methodology for Power Distribution Utilities
Rating Methodology for Thermal Power Producers

About the company
CESC, a part of the RP-SG Group, was incorporated in 1978 and is involved in the generation and distribution of electricity. It has the licence to supply electricity in Kolkata and Howrah. The licensee area covers 567 sq. km and it caters to over 3.0 million consumers at present with a generation capacity of 1,125 MW (coal based).

In FY2017, the company reported a profit after tax (PAT) of Rs. 862.86 crore on an operating income (OI) of Rs. 7,410.30 crore against a PAT of Rs. 845.13 crore on an OI of Rs. 6,607.98 crore during FY2016.

Key financial indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	6607.98	7410.30
PAT (Rs. crore)	845.13	862.86
OPBDIT/ OI (%)	27.70%	25.01%
RoCE (%)	7.04%	7.01%
Total Debt/TNW (times)	0.41	0.45
Total Debt/OPBDIT (times)	2.91	3.23
Interest Coverage (times)	4.01	4.14
NWC/ OI (%)	2%	0%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years
Table

S.No	**Name of Instrument**	**Current Rating (FY2018)**			**Chronology of Rating History for the past 3 years**		
		Type	**Rated amount (Rs. Crores)**	**Date & Rating**	**Date & Rating in FY2017**	**Date & Rating in FY2016**	**Date & Rating in FY2015**
				October 2017	**December 2016**	**October 2015**	**September 2014**
1	Commercial Paper	Short Term	1300.00	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+	[ICRA] A1+

Complexity level of the rated instrument
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Instrument Details

Instrument	Date of Issuance/Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
Commercial Paper *	-	-	-	1300.00	[ICRA]A1+

Source: CESC Limited; *ICRA rated Commercial Paper is yet to be placed

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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.
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