CESC Limited Revised

January 31, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper	1,300.00	1,300.00	[ICRA]A1+ reaffirmed
Total	**1,300.00**	**1,300.00**	

*Instrument details are provided in Annexure-1

Rationale

The rating reflects CESC Limited's (CESC) high financial flexibility and comfortable liquidity position, supported by a sizeable cash and liquid investment balance of Rs. 1470.83 crore as on March 31, 2018. The rating also 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) pertaining to distribution loss levels and operational efficiency parameters pertaining to generation stations, leading to healthy returns and stable cash flows. ICRA observes that CESC has continued to invest in strengthening its power distribution infrastructure, resulting in significant reduction in distribution losses from 22.8% in FY2001 to 9.8% in FY2018, which is considerably lower than the normative benchmark of 14.3% set by WBERC. The rating further takes into account CESC's integrated nature of operations, with its presence across the generation and distribution verticals, and the company's high reliability of power supply, with 85-90% of the demand being met from generation from its own stations. 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 it in terms of cash flows.

The rating also incorporates CESC's limited fuel availability risks, with bulk of the coal sourced from the captive coal mine at Sarisatolli and long-term fuel supply agreements (FSA) with Coal India Limited (CIL), leading to a competitive cost of generation. The rating also derives strength from the healthy financial performance of Haldia Energy Limited (HEL), which has meaningfully supported the consolidated profits and accruals, the improvement in the financial performance of Dhariwal Infrastructure Limited (DIL) in the current fiscal, and the significant increase in CESC's profits from traded sales in the current year. However, the rating continues to factor in the company's moderate capital structure and debt protection metrics at a consolidated level, and 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 has lumpy scheduled repayments in the near term, exposing the company to refinancing risks. However, the company's healthy financial flexibility and demonstrated track record of refinancing mitigates refinancing risks to a large extent. The rating also considers CESC's higher operation and maintenance expense than allowed by WBERC, which tempers its business returns, and the financial support extended to weaker entities of the Group, which exerts pressure on the consolidated cash accruals. However, ICRA notes that in the current fiscal, CESC has demerged the non-power businesses into two separately listed entities, and therefore, going forward, CESC would no longer be required to provide funding support for the growth plans of Spencers Retail Limited, which remains a positive from the credit perspective. Going forward, given CESC's 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.

Key rating drivers

Credit strengths

High financial flexibility and comfortable liquidity position – CESC had a consolidated cash and liquid investment balance of Rs. 1470.83 crore as on March 31, 2018, which supports its liquidity profile. In addition, the company derives a high degree of financial flexibility, given its status as the flagship company of the RP-SG Group.

Regulated nature of business based on cost-plus based tariff principles - The cost-plus nature of the tariff setting process and periodic tariff revisions have led to stable cash flows from the power business. As per regulatory norms, CESC is eligible to get a return of 15.5% on regulated equity deployed in the generation business, and a return of 16.5% on regulated equity deployed in the distribution business. ICRA estimates CESC's regulated return on equity to be around Rs. 640 crore in FY2019.

Operational MVCA mechanism leads to prompt pass-on of fuel and power purchase cost - Fuel and power purchase cost remain the highest contributor to CESC's operating costs, accounting for around 52% of CESC's turnover between FY2014 and FY2018. 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 CESC's earnings and supports its liquidity profile. CESC's tariff order for FY2019 is yet to be released by WBERC. However, supported by the levy of an MVCA of Rs. 0.29/unit, the gap between CESC's estimated annual revenue requirement for FY2019 and the revenue generated from the sale of power at the prevailing tariff for FY2018 has been bridged to a large extent through the MVCA top-up.

Operational indicators remain superior than normative targets leading to sizeable efficiency gains and incentive income - CESC's business risk profile derives strength from its favourable 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 regulatory targets. ICRA notes that the station heat rate at Budge Budge is better than the normative level of 2,470 kcal/kwh, and the distribution loss level stands at 9.8% against the normative allowed loss of 14.3%. This helps CESC derive sizeable efficiency gains and incentive income, and consequently, any significant tightening in normative parameters remain a rating sensitivity.

Limited fuel availability risks - Coal for CESC's generation stations is procured from three sources – a) captive coal mine (meeting ~40-45% of the total requirement for the Budge Budge plant), b) long-term fuel supply agreement with subsidiaries of Coal India Ltd, and c) through e-auction/imports. With over 90% of CESC's coal requirement being met collectively from the captive mine and long-term fuel supply linkages procured at notified prices, CESC largely remains insulated from fuel availability risks. Moreover, proximity of CESC's generation stations to the coal belt (resulting in low freight costs) lead to a competitive cost of generation.

High reliability of power supply, with 85-90% of the demand being met from own generation stations – The peak demand in CESC's licensee area stood at 2,159-MW against which it had an operational installed capacity of 1,725-MW (including the capacity of HEL). Between FY2016 and FY2018, 85-90% of the power demand in CESC's licensee area was met through generation from own stations, leading to a high reliability of power supply.

Healthy financial performance of HEL has meaningfully supported the consolidated profits and accruals - The rating derives strength from the stabilisation of operations of the Group's 600-MW coal-based thermal power plant at Haldia, which is supplying its entire power generation to CESC through long-term power purchase agreement (PPA), and has fuel supply agreement (FSA) with Mahanadi Coalfields Limited (MCL), largely mitigating off-take and fuel availability risks. ICRA notes that HEL's plant load factor (PLF) has steadily increased from 70% in FY2016 to 93% in 9M FY2019, resulting in healthy cash accruals from operations.

Improvement in the financial performance of DIL in FY2019 – Following the commencement of 185-MW power supply by DIL to Maharashtra State Power Generation Co. Limited (Mahagenco) on a short-term basis from April 2018, the plant's PLF has seen an improvement from 42% in 9M FY2018 to 68% in 9M FY2019. ICRA, therefore, expects DIL's financial performance to register an uptrend in the current fiscal, which in turn would lower its funding dependence from CESC and/or HEL.

Significant increase in profits from traded sales in the current year – In the current fiscal, CESC's profits from traded sales are expected to register a substantial jump, supported by a rise in average realised tariff to Rs. 5.94/unit during April – November 2018 against Rs. 2.15/unit realised in FY2018 full year. With CESC's energy cost per unit of traded sale estimated at around Rs. 2.78/unit in the current year (which includes additional reserve price payable on captive coal consumed for merchant sale), contribution per unit of traded sale stands at around Rs. 3.16/unit, of which 40% of the normative profits would be retained by CESC.

Credit challenges

Moderate capital structure and debt protection metrics at a consolidated level - Given the large debt-funded capex for setting up the 600-MW power generation assets by HEL and DIL, along with the sizeable distribution system improvement capex at CESC averaging between Rs. 700-1,000 crore annually, the consolidated debt protection metrics remain at moderate levels. In FY2018, CESC's consolidated interest coverage stood at 2.40 times, and the consolidated total debt/OPBITDA stood at 4.67 times. However, CESC's credit profile derives comfort from the high degree of stability in earnings and predictability of its cash flows, which, despite its leveraged capital structure and moderate debt protection metrics, support its financial risk profile.

Lumpy scheduled debt repayments in the near term exposes the company to refinancing risks – CESC has consolidated scheduled debt repayments of around Rs. 1,330 crore in FY2019 and around Rs. 1,740 crore in FY2020. Given the lumpiness in repayments, CESC is expected to have a refinancing requirement over the near term to tide over the temporary cash flow timing mismatch. However, the company's healthy financial flexibility and demonstrated track record of refinancing mitigate refinancing risks to a large extent. Apart from operating cash flows, CESC has a consolidated cash and liquid investment balance of around Rs. 1470.83 crore as on March 31, 2018, which supports its debt servicing ability.

Negative bid in the Sarisatolli captive coal block has led to fuel cost under-recoveries – Given the criticality of the captive coal block for the operational setup of CESC's 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 40-45% of the coal requirement at Budge Budge being met from the captive coal block, the negative bid would lead to fuel-cost under-recoveries. However, winning back the captive coal block has ensured uninterrupted coal supply for the company. ICRA notes that the recovery of additional levy of Rs 997.76 crore (paid for the Sarisatolli coal block as per the judgment of the Hon'ble Supreme Court) awaits approval from WBERC for pass-on in the tariff.

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

Funding support extended to Group entities – In the past, CESC has 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 emerged as the winning bidder in the Malegaon distribution franchise in Maharashtra, which is expected to entail capital support from CESC during the initial years. Till the time DIL and the distribution franchise businesses start generating positive stable net earnings, their dependence on CESC and/or HEL would exert pressure on the consolidated cash accruals. However, in the current fiscal, CESC has demerged the non-power businesses into two separately listed entities, and therefore, going forward, CESC would no longer be required to provide funding support for the growth plans of Spencers Retail Limited, which remains a positive from the credit perspective.

Liquidity Position:

CESC has consolidated scheduled debt repayments of around Rs. 1,330 crore in FY2019 and around Rs. 1,740 crore in FY2020. With annual retained cash flows estimated between Rs. 1,600-1,500 crore in FY2019 and FY2020, and the consolidated budgeted capex ranging between Rs. 760-770 crore, CESC would have refinancing requirements in the near term to tide over the cash flow timing mismatch. However, the company's healthy financial flexibility and demonstrated track record of refinancing mitigate such risk to a large extent. Apart from operating cash flows, CESC has a consolidated cash and liquid investment balance of around Rs. 1,470.83 crore as on March 31, 2018, which also supports its debt servicing ability.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology] [Rating Methodology for Power Distribution Utilities]
Group Support	Group: RP-SG Group CESC is the flagship company of the RP-SG Group, which lends it a high degree of financial flexibility
Consolidation / Standalone	For arriving at the rating, ICRA has considered the consolidated financials of CESC Limited. As on March 31, 2018, the Company had 14 subsidiaries, 2 associates, and 1 JV, that are enlisted in Annexure-2.

About the company:

Incorporated in 1978, CESC is the flagship company of the RP-SG 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 3.0 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% is tied-up under long-term PPA, and the balance is catering to short-term demand. CESC also 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 two subsidiaries, Surya Vidyut Limited and Crescent Power Limited. In the power distribution segment, apart from Kolkata, CESC's 49.55% associate, Noida Power Company Limited (NPCL)[1], has licence to supply electricity in Greater Noida area in Uttar Pradesh. Apart from the licensee power distribution business, CESC is gradually increasing its footprint in the power distribution franchise businesses. In FY2017, CESC has taken over the distribution franchise operations at Kota, Bharatpur and Bikaner in Rajasthan. In the current year, CESC has emerged as the winning bidder for the power distribution franchise operations in Malegaon, Maharashtra.

[1] RP-SG Group has 73% shareholding and Greater Noida Industrial Development Authority has 27% shareholding in Noida Power Company Limited

In the current fiscal, with retrospective effect from October 1, 2017, the non-power businesses of CESC has been demerged into two separately listed entities: a) CESC Ventures Limited (the holding company of the business process management, snacking, and retail property businesses), and b) Spencer's Retail Limited (the holding company of the organised retail business).

In FY2018, the company reported a consolidated net profit of Rs. 975.25 crore on an operating income of Rs. 10,274.86 crore, compared to a net profit of Rs. 810.19 crore on an operating income of Rs. 8,363.36 crore in the previous year.

Key consolidated financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	8,363.36	10,274.86
PAT (Rs. crore)*	810.19	975.25
OPBDIT/OI (%)	34.43%	30.41%
RoCE (%)	8.53%	8.85%
Total Debt/TNW (times)	1.32	1.72
Total Debt/OPBDIT (times)	5.43	4.67
Interest coverage (times)	2.10	2.40

**including profit from discontinued operations and share of profit from JVs*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating Jan 2019	Date & Rating in FY2018 Oct 2017	Date & Rating in FY2017 Dec 2016	Date & Rating in FY2016 Nov 2015
1	Commercial Paper	Short Term	1300.00	1100.00	[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

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Commercial Paper	NA	NA	7-365 days	1300.00	[ICRA]A1+

Source: CESC Limited

Annexure-2: List of key 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	49.55%	Equity Method
Noida Solar Energy Private Limited	49.55%	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
Nalanda Power Company 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

**Subsidiary companies are yet to commence their commercial operations*

Corrigendum

Document dated January 31, 2019 has been corrected with revisions as detailed below:

- The below change has been made in page number 2, under Credit Strengths:
  "ICRA notes that the station heat rate at Budge Budge is better than the normative level of 2,470 kcal/kwh, and the distribution loss level stands at 9.8% against the normative allowed loss of 14.3%."

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