

November 09, 2021

Gulbarga Electricity Supply Company Limited: Rating assigned for enhanced limits and reaffirmed for existing limits

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Term Loan	487.28	1000.00	[ICRA]BBB-(Stable); Reaffirmed / Assigned
Fund-based Overdraft	100.00	100.00	[ICRA]BBB-(Stable); Reaffirmed
Non-fund-based Letter of Credit	300.00	300.00	[ICRA]A3; Reaffirmed
Unallocated	-	0.28	[ICRA]BBB- (Stable) / [ICRA]A3; Assigned
Total	887.28	1400.28	

*Instrument details are provided in Annexure-1

Rationale

ICRA's rating action continues to favourably factor in the 100% ownership of Gulbarga Electricity Supply Company Limited (GESCOM/company) 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 the established regulatory process in the state, evident from the presence of the 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 FY2022 was released in June 2021 with a tariff hike of 4.0% for GESCOM.

Further, the ratings derive comfort from the considerable cash inflows of GESCOM from consumer contribution and 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 the distribution loss level has reduced over the years to 11.7% in FY2021 from 16.5% in FY2018 as the utility took various projects to strengthen the system.

Additionally, the company's overall debtor level has come down over the last two years to Rs. 3,070.82 crore as on March 31, 2021 from Rs. 3,543.89 crore as on March 31, 2019, aided by healthy subsidy collections, albeit a marginal decline in FY2021, and recovery of the regulatory asset of the previous years. However, the sustainability of subsidy collections remains key from the credit perspective.

The ratings, however, 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 thus increased to Rs. 5.15 per unit in FY2021 from Rs. 4.94 per unit in FY2020 and was 1.6% higher than the approved cost for FY2021. This increase in PPC is accentuated by the company's inability to pass it on to consumers under the fuel cost adjustment (FCA) framework. The FCA framework approved by the Karnataka Electricity Regulatory Commission (KERC) does not allow the pass-through of any variation in the PPC from sources other than long-term thermal stations and is limited to variation in energy charges for these plants. The variation in PPC is approved during the annual true-up process, which happens with a lag, leading to a cash flow mismatch.

The ratings further remain tempered by the relatively high dependence (39% of revenues in FY2021) on the state government's subsidy due to the large share (45% in FY2021) of agriculture consumers in the overall energy sales mix. The subsidy collections declined marginally in FY2021 after improving in FY2020 and, hence, the cost coverage ratio¹ of the utility remains relatively modest at 82% in FY2021 exacerbated by low collections from government institutions, particularly from rural local bodies.

In addition, the ratings factor in the company's modest financial risk profile characterised by low operating profitability, high interest costs, including interest on dues from past years payable to power generators, large receivable position and its increasing dependence on debt. GESCOM had availed interest-free loan of Rs. 1,000 crore from the GoK in March 2020, besides GoK-guaranteed loans of Rs. 1,700 crore at competitive interest rates to pay the dues to central generators and independent power producers.

Further, ICRA takes note of GESCOM's high cross-subsidisation requirement, with higher tariffs charged from commercial and industrial consumers to compensate for the lower rates for domestic and agriculture users. This has resulted in a loss of industrial consumers for GESCOM in the recent past. The ratings also factor in the sizeable 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. Further, the improved operational efficiency in the form of satisfactory distribution losses is also expected to sustain going forward. However, GESCOM's ability to improve its profitability metrics through growth in volume sales, especially from non-agriculture segments, and tariff revisions in tandem with its cost structure will remain crucial from the 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 six 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 the cost structure to 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-ups in the past years. The tariff order for FY2022 was issued in June 2021 with an average tariff hike of 4.0%

Presence of government guarantee and demonstrated support from GoK - The utility has received continued support from the GoK in the form of equity infusion to meet capex 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 guarantee in FY2021 to clear the dues to power generating companies.

Satisfactory operating efficiency - GESCOM has been able to lower its distribution loss level to 11.2% in FY2020 from 16.5% in FY2018, aided by various projects to strengthen the system. However, in FY2021, the distribution loss level was 11.7%, marginally higher than the revised approved target of 11.0% for FY2021 by the KERC because of a decline in HT sales due to the Covid-19 pandemic.

¹ Ratio of the actual cash collections from customers including subsidy realised and the costs incurred by the company towards electricity distribution (including power purchase cost, other operating costs, interest, depreciation and taxes)

Financial profile supported by cash inflows in form of grants, equity and consumer contribution - The financial profile of GESCO 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. The aggregate cash inflow from grants, consumer contribution and equity were Rs. 304.5 crore in FY2020 and Rs. 139.96 crore in FY2021.

Credit challenges

Financial risk profile constrained by inadequate tariffs in relation to cost of supply and high receivable position – Inadequate tariffs in relation to the cost of supply and high receivable position constrain the financial profile of GESCO, resulting in accumulated losses and a high payable position. Further, the cost coverage ratio declined due to reduced subsidy realisation in FY2021. While the payable position remained high as on March 31, 2021, the utility availed GoK-guaranteed loans of Rs. 1,700 crore under the liquidity package scheme and the same were used to pay central generators and independent power producers.

High subsidy dependence - The subsidy dependence as a proportion of the operating income for GESCO remains high at about 39% of the revenues in FY2021. This is owing to the large share of agriculture consumers in the energy sales mix and a decline in the share of industrial and commercial consumers over the years. While the subsidy collections had improved in FY2020, it witnessed a marginal decline in FY2021. The sustainability of subsidy collections remains important from the credit perspective.

PPC for GESCO exposed to availability of supply from KPCL hydel stations and procurement mix - The PPC for GESCO is susceptible to the availability of power supply from KPCL hydel stations. Any shortfall in availability 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 lead to an increase in 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 the pass-through of any variation in PPC from sources other than long-term thermal stations and is limited to variation in energy charges for these plants. The variation in PPC is approved during the annual true-up process, which happens with a lag.

Tariff cross-subsidisation high 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 has resulted in a loss of industrial consumers for GESCO over the past few years, given the availability of cheaper power in the open-access market.

Large capital expenditure plans for GESCO - 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. While the cost associated with the capital investment is considered for recovery under the cost-plus tariff principles, any delays in the implementation would increase the project cost, which is exposed to the risk of disallowance by the KERC. Also, the largely debt-funded capex puts pressure on the leverage level.

Liquidity position: Adequate

The liquidity profile of GESCO is adequate, given the demonstrated support from the GoK in terms of subsidy payments, as well as the additional support through interest-free loans and GoK-guaranteed loans, which have helped the utility to pay the dues to its generators. In addition, the company has access to working capital lines from banks. The capex funding is met through fresh equity, capital grants, consumer contributions and long-term debt.

Rating sensitivities

Positive factors - The ratings can be upgraded if the utility sustains its operating efficiency improvement, reduces its receivable position and improves its profitability metrics led by growth in volume sales and tariff revisions commensurate with the cost structure. Further, the ratings remain sensitive to any movement in the credit profile of GoK.

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

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities
Parent/Group Support	The assigned rating factors in the systemic importance that GESCOM holds to the state power sector, which we expect should induce the GoK to extend timely financial support to the rated entity, should there be a need.
Consolidation/Standalone	For arriving at the rating, 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 in six districts of Karnataka namely, Gulbarga, Bidar, Yadgir, Raichur, Koppal and Bellary, covering an area of 43861 sq. km, with total consumers of 3.30 million as of September 2020. 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 (CESC). 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	FY2019 (Audited)	FY2020 (Audited)	FY2021 (Provisional)
Operating Income (Rs. crore)	5,817.1	5,250.2	5,430.6
PAT (Rs. crore)	701.8	-535.9	-495.6
OPBDIT/OI (%)	19.0%	3.5%	1.9%
PAT/OI (%)	12.1%	-10.2%	-9.1%
Total Outside Liabilities/Tangible Net Worth (times)	5.6	13.2	-94.2
Total Debt/OPBDIT (times)	1.0	12.1	34.1
Interest Coverage (times)	3.9	0.4	0.2

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 Mar 31, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019		
				Nov 09, 2021	May 07, 2021	Apr 17, 2020	-	Mar 11, 2019	Aug 23, 2018	
1	Term loans	Long Term	1000.00	1000.00	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	-	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)
2	Fund-based	Long Term	100.00	-	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)	-	[ICRA]BBB-(Stable)	[ICRA]BBB-(Negative)
3	Non-fund based	Short Term	300.00	-	[ICRA]A3	[ICRA]A3	[ICRA]A3	-	[ICRA]A3	[ICRA]A3
4	Unallocated	Long / Short Term	0.28	-	[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
Unallocated	NA

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 analyzing 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 / Bank Name	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
Bank of India	Term Loan	Oct 2020	-	Dec 2030	1000.00	[ICRA]BBB- (Stable)
State Bank of India	Fund-based Limit	-	-	-	100.00	[ICRA]BBB- (Stable)
State Bank of India	Non-fund-based Limit	-	-	-	300.00	[ICRA]A3
NA	Unallocated	-	-	-	0.28	[ICRA]BBB- (Stable) / [ICRA]A3

Source: Company

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Vikram V
+91 40 4067 6518
vikram.v@icraindia.com

Vinayak Ramesh
+91 98402 74435
r.vinayak@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



© Copyright, 2021 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.