December 30, 2022

TP Western Odisha Distribution Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Cash credit	200.00	200.00	[ICRA]AA- (Stable); reaffirmed
Non-fund based - Letter of credit	275.00	275.00	[ICRA]A1+; reaffirmed
Total	**475.00**	**475.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the ratings for TP Western Odisha Distribution Limited (TPWODL) factor in its strong parentage and the established track record of Tata Power Company Limited (TPCL) in the electricity distribution business. TPCL has a rating of [ICRA]AA (Stable). TPWODL is a joint venture between TPCL (51%) and the Government of Odisha (49%), responsible for supplying electricity in the western region of Odisha. TPCL had won the distribution licence to supply electricity to 2.2 million consumers in this region through a competitive bidding process. Given the strategic importance of the distribution business for TPCL as a focus area for growth, it is expected to support TPWODL through equity for capex and in the case of any cash flow mismatch. Further, TPCL and its subsidiaries enjoy strong financial flexibility and access to debt funding at highly competitive rates for being a part of the Tata Group.

The ratings factor in the regulated nature of the business for TPWODL, supported by a cost-plus tariff regime with assured return on equity, subject to meeting the prescribed operating efficiency targets. The tariff order for FY2023 was issued by Odisha Electricity Regulatory Commission (OERC) in March 2022 with an annual revenue requirement (ARR) of Rs. 4,079.34 crore and average cost of supply of Rs. 5.46 per unit. The average tariff approved for FY2023 is Rs. 5.51 per unit. Any variation in the cost structure is reviewed by the regulator at the time of true-up and allowed in the ARR as per the tariff regulations. The ratings further take into consideration the comfortable capital structure of the company, with the balance sheet transferred to TPWODL having no legacy liabilities at the time of takeover. Moreover, the coverage metrics for the company are expected to remain adequate with interest coverage remaining above 3.0x and the debt service coverage ratio (DSCR) above 2.0x over the near to medium term. ICRA also takes note of the favourable consumer profile of TPWODL with sales to industrial and commercial consumers accounting for more than 50% of the volume sales in its licence area, which is an enabling factor to improve billing and collection efficiencies.

The ratings, however, are constrained by the weak operating efficiency of TPWODL's distribution operations, reflected from the aggregate technical & commercial (AT&C) loss level of 26.8% in FY2022 against 20.4% approved by OERC. This is owing to the inefficiencies in billing and collections. Nonetheless, the AT&C losses have reduced from 28.6% in FY2020 with the various efficiency improvement measures undertaken by the company post the takeover. Also, the AT&C loss for FY2022 is within the trajectory committed by TPCL under the bid. Further, the loss level has improved in H1 FY2023 over H1 FY2022. ICRA notes that the AT&C losses are likely to remain higher than the level approved by OERC during the initial years of operations, leading to under-recovery of power purchase cost and an adverse impact on the profitability of the company. The ability of the company to improve the AT&C losses in line with the approved trajectory remains the key monitorable for the ratings. ICRA draws comfort from the demonstrated track record of the Group in turning around the distribution business as seen in Delhi and Ajmer.

Further, the ratings factor in the significant capital expenditure plans of TPWODL with an aggregate capex of Rs. 1,663 crore over FY2022 to FY2026, as committed under the bid. This is towards upgrading the distribution, metering and IT infrastructure.

The capex will be funded through a debt and equity ratio of 70:30 as allowed under the tariff regulations. While this would increase the leverage level for the company, ICRA notes that the capital cost would be a pass-through under the tariff through interest, depreciation and return on equity, subject to review by the regulator. The rating also takes into consideration the risk of delays in approving the tariff orders, including true-up for previous years by the state regulator and inadequacy of the tariffs in relation to the cost structure. Nonetheless, comfort can be drawn from the timely issuance of tariff orders in the past.

The Stable outlook on the ratings consider the strong parentage, established track record of TPCL in the distribution business and the cost-plus tariff principles of the distribution business of TPWODL.

Key rating drivers and their description

Credit strengths

Strong parentage and track record of the Group in distribution business – TPWODL benefits from the operational and managerial support from its parent TPCL. The parent company has a strong credit profile with a healthy scale of operations and presence across the generation, distribution and transmission businesses. Being a part of the Tata Group, TPCL and its subsidiaries enjoy strong financial flexibility and access to funding from various institutions. Given the strategic importance of the distribution business to TPCL, it is expected to support TPWODL in the form of equity for capex and in case of any cash flow mismatch. Also, the Group has a demonstrated track record of turning around distribution businesses.

Cost-plus tariff regime with assured return on equity – OERC has approved the regulations for the determination of tariff for distribution utilities on normative cost-plus basis along with the provision for an annual true-up. The return on equity allowed by the regulator is 16% on the regulated equity. This ensures recovery of costs incurred as per the applicable operating efficiency target, return on equity and opportunity to generate additional income through incentives.

Comfortable capital structure – As per the terms of the acquisition, the balance sheet transferred to TPWODL at the time of takeover of WESCO's[1] operations was without any legacy liabilities. The licence was acquired with equity infused by the parent, as per the shareholding pattern (51% stake with TPCL and 49% stake with the state government of Odisha). As a result, the capital structure remains comfortable with gearing below 1.0x. Also, the debt coverage metrics for TPWODL are expected to remain adequate with interest coverage ratio above 3.0x and DSCR above 2.0x over the near to medium term.

Favourable customer profile – TPWODL's customer profile remains favourable with industrial and commercial customers accounting for more than 50% of the volume sales and limited exposure to agriculture consumers. This is an enabling factor for TPWODL to improve the billing and collection efficiencies.

Credit challenges

Operating efficiency constrained by higher than approved AT&C losses – Historically, the AT&C loss levels for WESCO have remained higher than the approved level due to weak billing and collection efficiency. The actual AT&C loss level in FY2020 was 28.6% against the approved level of 20.4%. Post the takeover, the AT&C loss for TPWODL reduced to 26.8% in FY2022, though remaining higher than the approved level of 20.4%. ICRA notes that the AT&C losses for TPWODL are likely to remain higher than the level approved by OERC during the initial years of operations, leading to under-recovery of power purchase cost and adversely impacting the company's profitability. The ability of the company to improve the AT&C losses in line with the approved trajectory remains the key monitorable for the ratings.

[1]Western Electricity Supply Company of Odisha (WESCO) - Erstwhile distribution utility in the western region of Odisha

Significant capital expenditure plans – The capital expenditure plans remain significant for TPWODL at Rs. 1,663 crore for the period FY2022 to FY2026 towards upgrading the distribution, metering and IT infrastructure. This will be largely funded through debt as allowed under the tariff regulations. Nonetheless, the capital cost is a pass-through under the tariff through interest, depreciation and return on equity, subject to review by the regulator. The company incurred a capex of over Rs. 250 crore in FY2022 and is expected to incur a capex of close to Rs. 500 crore in FY2023.

Risk of delays in approving tariff orders and inadequate tariff in relation to cost structure – Historically, tariff orders have been issued by OERC in a timely manner, providing stability to the regulatory regime. However, the risk of delays in the issuance of tariff orders or inadequacy of tariff revision cannot be ruled out. Moreover, the absence of a fuel & power purchase cost adjustment mechanism could result in a lag in recovery of the cost variations from the consumers. Also, any difference in the tariff approved by OERC and the cost structure may lead to under-recovery, impacting the company's financial risk profile.

Liquidity position: Adequate

The liquidity profile of the company is expected to be supported by regular cash flows from the sale of power under the cost-plus tariff principles, available cash balances and working capital lines. The capex funding is expected to be met through a mix of debt and equity from sponsors. Moreover, the promoter (TPCL) is expected to extend funding support, if required. As on September 30, 2022, the company has free cash balances and liquid investments of ~Rs. 1,074 crore.

Rating sensitivities

Positive factors – ICRA could upgrade TPWODL's rating if there is an improvement in the credit profile of its parent, TPCL. Further, a reduction in the AT&C loss level at a rate higher than the trajectory committed in the bid, leading to healthy profitability metrics on a sustained basis could lead to an upgrade.

Negative factors – The rating could face pressure in case of a deterioration in the credit profile of TPCL or weakening in linkages with TPCL or a change in the support philosophy of the parent towards TPWODL. Under-performance against the committed AT&C loss or lack of adequate tariff revisions on a sustained basis could be the other triggers for a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Impact of Parent or Group Support Rating Methodology for Power Distribution Utilities
Parent/Group Support	Parent Company: Tata Power Company Limited; ICRA expects TPCL (rated [ICRA]AA (Stable)) to be willing to extend financial support to TPWODL, should there be a need, as it is a subsidiary of TPCL and the distribution segment remains the focus area of growth for TPCL.
Consolidation/Standalone	The rating is based on the standalone financial profile of the company.

About the company

TPWODL, incorporated in December 2020, is a joint venture between TPCL and the Government of Odisha with majority stake being held by TPCL (51%). The distribution licence was awarded by the Government of Odisha and OERC through a competitive bidding process with equity value of the new licensee being the bid parameter. TPCL had emerged as the winning bidder for owning a 51% stake by quoting an equity value of Rs. 500 crore for a 100% stake in the company and based on the trajectory provided to reduce the AT&C losses. Thereafter, TPCL acquired a 51% stake in TPWODL from GRIDCO Limited (company owned by Government of Odisha) on January 1, 2021 at a consideration of Rs. 255 crore. The distribution licence is offered for a period of 25 years from the date of issue of the vesting order (December 28, 2020). The company took over the distribution operations from January 2021. TPWODL has a customer base of 2.2 million and a distribution area in the western part of Odisha covering 48,373 sq. km in Rourkela, Sambalpur, Bargarh, Bolangir and Bhawanipatna circles across nine districts of western Odisha.

Key financial indicators (audited)

	Q4 FY2021	FY2022
Operating income (Rs. crore)	839.45	4,257.35
PAT (Rs. crore)	-1.04	63.73
OPBDIT/OI (%)	-0.37%	3.29%
PAT/OI (%)	-0.12%	1.50%
Total outside liabilities/Tangible net worth (times)	1.32	1.98
Total debt/OPBDIT (times)	-45.72	1.29
Interest coverage (times)	-0.28	3.26

Source: Company data, ICRA Research 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 (FY2023)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as on Sep 30, 2022 (Rs. crore)	Date & rating	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
					Dec 30, 2022	Oct 07, 2021		
1	Fund based limits	Long Term	200.00	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	-	-
2	Non-fund based limits	Short term	275.00	-	[ICRA]A1+	[ICRA]A1+	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long Term Fund Based – CC	Simple
Short term – 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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Cash Credit	-	-	-	200.00	[ICRA]AA- (Stable)
-	Letter of Credit	-	-	-	275.00	[ICRA]A1+

Source: *Company data*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis: Not applicable

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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.

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