

July 11, 2023

TP Western Odisha Distribution Limited: Ratings reaffirmed and outlook on long-term rating revised to Positive

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- (Positive); reaffirmed with revision in outlook to Positive from Stable
Non-fund based - Letter of credit	275.00	275.00	[ICRA]A1+; reaffirmed
Total	475.00	475.00	

*Instrument details are provided in Annexure-I

Rationale

The revision in the outlook to Positive on the long-term rating assigned to TP Western Odisha Distribution Limited (TPWODL) factors in the improvement in the credit profile of its parent, The Tata Power Company Limited (TPCL; rated [ICRA]AA (Positive)) led by the improvement in its operating and financial performance across the generation and distribution businesses. This was supported by recovery in electricity demand growth, improved operating efficiencies in the distribution business, scale up in renewable capacity, operating 4150-MW Mundra UMPP under Section 11 of the Electricity Act and improved collections from the state distribution utilities following implementation of the Electricity (Late Payment Surcharge and Related Matters) Rules, 2022 (LPS). Overall, the improved performance has allowed TPCL to improve its financial leverage and debt coverage metrics.

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 2.28 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 continue to 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 FY2024 was issued by Odisha Electricity Regulatory Commission (OERC) in March 2023 with an annual revenue requirement (ARR) of Rs. 6192.72 crore and average cost of supply of Rs. 5.69 per unit. The average tariff approved for FY2024 is Rs. 5.74 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 ratio 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 65% of the volume sales in its licence area in FY2023, which is an enabling factor to improve billing and collection efficiencies.

ICRA noted that the aggregate technical & commercial (AT&C) losses for TPWODL have reduced significantly to 18.3% in FY2023 from 26.8% in FY2022 and lower than the OERC approved level of 20.4%. Further, the AT&C losses remain lower than the trajectory committed by TPCL for FY2023 under the bid. This is supported by the various steps and investments taken by the

company to improve the billing and collection efficiency. However, it must be noted that the actual AT&C loss level remains relatively high and a sustained improvement in line with the committed trajectory under the bid remains important. This would remain as the key monitorable for the ratings assigned to TPWODL. Herein, 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 of Rs. 320-330 crore per annum over the next two years, 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 such capital investment 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.

Key rating drivers and their description

Credit strengths

Strong parentage and track record of the Group in distribution business – TPWODL is a 51% owned subsidiary of TPCL, which is a leading company in the power sector with presence across generation, transmission and distribution. The credit profile of TPCL is supported by the large scale of operations with presence across the power sector value chain, reduction in leverage level and an improved performance across the generation and distribution businesses. While the Mundra UMPP remains a drag on TPCL's profitability, the availability of profits from the coal companies in Indonesia in a tax-efficient manner post the merger of the Mundra UMPP with TPCL mitigate this risk to a large extent. Further, the strong financial flexibility from being a part of the Tata Group is a comforting factor. 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 for TPWODL.

Comfortable capital structure – As per the terms of the acquisition, the balance sheet transferred to TPWODL at the time of takeover of WESCO's¹ 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 65% of the volume sales in FY2023 and limited exposure to agriculture consumers. This is an enabling factor for TPWODL to improve the billing and collection efficiencies.

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

Credit challenges

Significant improvement achieved in reducing AT&C losses in FY2023; sustainability remains to be seen – 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, TPWODL has been able to achieve a significant improvement by reducing the AT&C loss to 18.3% in FY2023 from 26.8% in FY2022 and lower than the OERC approved level of 20.4%. This is driven by the steps taken by the company to improve the billing and collection efficiency. However, the actual AT&C loss level remains relatively high and a sustained improvement in line with the committed trajectory under the bid remains important. The bid trajectory committed by TPCL requires the AT&C losses to be lowered to less than 16% by FY2026 and 10% by FY2030.

Large capital expenditure plans – The capital expenditure plans remain significant for TPWODL at Rs. 320-330 crore per annum for the next two years 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. 939 crore in FY2023 and Rs. 258 crore in FY2022, which was funded by a mix of equity, debt and customer deposits. While the debt funded capex would increase the debt level for the company, the capital structure and debt coverage metrics are expected to remain comfortable.

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 company's liquidity is expected to remain adequate, supported by healthy cash flows from operations and availability of large cash and liquid investments of Rs. 1538.12 crore as on March 31, 2023. The company has capex requirement of around Rs 320-330 crore per annum for next two years which is expected to be funded by equity infusion from promoters, debt, customers deposits and internal accruals. Also, there is a build-up of regulatory liability on the books of TPWODL, as the revenues achieved by the company for FY2022 and FY2023 were significantly higher than the same approved in the tariff order owing to a sharp increase in electricity demand in its license area. This liability is expected to be liquidated over FY2024 and FY2025 based on the true-up orders from OERC and using the surplus cash generated by the company over the past two years.

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 sustained 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. Also, under-performance against the committed AT&C loss or lack of adequate tariff revisions to pass on the cost variations, thereby adversely impacting the company's profitability on a sustained basis could be the other triggers for a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities
Parent/Group support	Parent Company: Tata Power Company Limited; ICRA expects TPCL (rated [ICRA]AA (Positive)) 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 2.28 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	FY2022	FY2023
Operating Income (Rs. crore)	4257.36	6258.57
PAT (Rs. crore)	63.74	91.08
OPBDITA/OI (%)	3.29%	3.05%
PAT/OI (%)	1.50%	1.46%
Total Outside Liabilities/Tangible Net Worth (times)	1.98	2.41
Total Debt/OPBDITA (times)	1.29	1.17
Interest Coverage (times)	3.26	2.35

PAT: Profit after tax; OPBDITA: Operating profit before depreciation, interest, taxes and amortisation

Source: Company data, ICRA Research; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2023 (Rs. crore)	Date & Rating	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
					Jul 11, 2023	Dec 30, 2022	Oct 07, 2021	-
1	Fund based limits	Long Term	200.00	-	[ICRA]AA-(Positive)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	-
3	Non-fund based limits	Short term	275.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

Complexity level of the rated instruments

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- (Positive)
-	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

ANALYST CONTACTS

Sabyasachi Majumdar

+91 124 4545304
sabyasachi@icraindia.com

Vikram V

+91 40 4547 4829
vikram.v@icraindia.com

Pooja Goyal

+91 22 6169 3349
pooja.goyal@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar

+912261143406
shivakumar@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, 2023 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.