July 31, 2023

# CESC Limited: Rating reaffirmed

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Commercial paper (CP) | 1,600 | 1,600 | [ICRA]A1+ reaffirmed |
| **Total** | **1,600** | **1,600** | |

**Instrument details are provided in Annexure-I*

## Rationale

The rating reaffirmation takes into account CESC Limited's (CESC) regulated electricity distribution operations in Kolkata area based on cost-plus based tariff principles, which lead to stable earnings and cash accruals. The long-term revenue visibility for the company remains high as the distribution licence in Kolkata is valid for ~15 more years. The rating reaffirmation also considers CESC's favourable consumer base, growing demand for electricity and the high reliability of power supply in CESC's command area, with close to 85% of the electricity demand met from its own generation stations. The company sources its energy requirement for the Kolkata distribution business from the 885-MW[1] capacity on its books and the 600-MW capacity under its subsidiary, Haldia Energy Limited (HEL).

ICRA notes that CESC's coal-based generation capacities are primarily backed by long-term fuel supply agreements (FSA) with the subsidiaries of Coal India Limited (CIL), which mitigate the fuel availability risks. The assured fuel supply, along with the superior operating efficiency of the own-generation plants, supports a competitive power generation cost for CESC. Further, the financial performance of its key subsidiary - Dhariwal Infrastructure Limited (DIL) – that operates a 600-MW coal-based power generation plant in Maharashtra has improved over the past three years, lowering the requirement of incremental funding support from CESC/other Group companies. There is a significant reduction in DIL's offtake risk as it has tied up a three-year medium-term power purchase agreement (PPA) for 210 MW out of the 300-MW capacity under Unit I which commenced supply from April 1, 2022. This unit was previously operating entirely based on a short-term arrangement. Unit-II (300-MW) has already tied-up long-term PPAs.

The rating, however, remains constrained by the company's exposure to the regulatory risk associated with the delay in issuing tariff orders and the inadequacy of the tariffs approved by the state regulatory commission in relation to the cost structure. ICRA notes that the West Bengal Electricity Regulatory Commission (WBERC) had earlier delayed in issuing tariff orders and orders related to the annual performance review (APR). The WBERC had approved the tariff order for FY2021-FY2023 in August 2022, wherein there were disallowances in fuel and fixed charges against the claims made by the company. The WBERC has stated in the tariff order that some of the cost items could be considered at the time of true-up/APR process. Any major disallowances in the expenses and/or capital costs at the time of true-up could impact the company's profitability and return indicators and remain a key rating monitorable. However, the commission has kept the tariffs unchanged in this order.

The stagnant tariffs over the past 4-5 years have resulted in a significant build-up of regulatory assets, which increased to Rs. 3,381 crore as of March 2023 from Rs. 2,147 crore as of March 2022, owing to the increase in fuel and power purchase costs. While there is an operational monthly variable cost adjustment (MVCA) mechanism which provides an automatic avenue for a pass-through of fuel and power purchase costs, the mechanism has not been implemented since February 22. Nonetheless, CESC's operational indicators in the Kolkata licensee business remain superior to the normative targets, leading to sizeable efficiency gains and incentive income. This has helped the regulated power distribution business in Kolkata generate consistent

[1]Excluding the 250 MW Titagarh plant which has been retired

positive cash flows from operations, despite its high operation and maintenance expenses and lack of tariff revision. However, the extent of the gains is likely to moderate, going forward, considering the revised tariff norms notified by the WBERC, wherein the approved distribution losses have been reduced to 9.0% for FY2024 from 14.3%.

The rating also takes into account the moderate leverage and debt protection metrics for CESC, given the debt-funded nature of capex and the support extended to weaker Group entities in the past. The rating also incorporates CESC's lumpy scheduled repayments and low current ratio, which tempers its credit profile. However, the company's liquidity profile is supported by its sizeable cash and liquid investment balance of Rs. 2,913 crore at a consolidated level as on May 31, 2023. Going forward, the available cash balances, stable cash flows from the power distribution business, improved performance of DIL and high financial flexibility would support its debt servicing ability.

## Key rating drivers and their description

### Credit strengths

**Regulated operations based on cost-plus based tariff principles, leading to stable earnings and cash accruals –** The cost-plus nature of the tariff setting process leads to stable cash flows from CESC's power distribution business in Kolkata. As per the regulatory norms, CESC is eligible to get a return of 15.5% on the regulated equity deployed in the generation business, and a return of 16.5% on the regulated equity deployed in the distribution business. The allowed return on equity (RoE) has been reduced by 1% w.e.f April 1, 2023 for the assets added from this date, as per the revised norms notified by WBERC. CESC's power distribution licence in Kolkata is valid till September 2, 2038. The rating derives comfort from the long residual validity of the power distribution licence, which gives earnings visibility over the long term.

**Diversified consumer base and healthy collection efficiency for Kolkata distribution business –** CESC's consumer base of 3.5 million is almost entirely concentrated within Kolkata, which is one of the leading metro cities in India. Almost two-third of CESC's sales is in the low tension (LT) segment, with the balance one-third in the high tension (HT) segment. Consequently, it has a diversified customer pool, which partly mitigates the counterparty credit risks. The collection efficiency of the distribution business has historically remained strong at around ~99.3%.

**Operational indicators superior than normative targets, leading to sizeable efficiency gains and incentive income –** CESC's business risk profile derives strength from its efficient operational indicators, with the actual performance variables (such as station heat rate, distribution loss levels, plant availability, oil consumption norms and auxiliary energy consumption) remaining superior than the regulatory targets. ICRA notes that the station heat rates at the Budge Budge and Haldia power stations are superior than the normative levels. The utility's distribution loss level of 7.23% in FY2023 was also significantly lower than the normative allowed loss of 14.3%. This helps CESC derive sizeable efficiency gains and incentive income, which supports its overall profits and accruals. The tightening of the regulatory norms, including the revision in the normative distribution loss to 9% from 14.3% w.e.f April 1, 2023, is likely to moderate the gains, going forward.

**Reduction in offtake risk for DIL; lower dependence on CESC/Group companies for funding requirement –** DIL faced significant offtake risk for the 300-MW capacity under its Unit 1, which did not have a long-term PPA and was relying on short-term arrangements for the sale of power. The capacity under Unit 2 is already tied up under long-term PPAs and does not face offtake risk. DIL has tied up a three-year PPA for 210 MW out of the 300-MW of its Unit 1 capacity with the Indian Railways at a base tariff of Rs. 4.10/unit (fixed and variable charge of Rs 2.05/unit each), with annual escalation available in both the fixed and variable components. The supply under this PPA commenced from April 1, 2022. This has significantly reduced the offtake risk for DIL. It did not require any funding support from CESC/Group companies in FY2022 and FY2023 on the back of adequate internal accruals. CESC is not expected to extend any incremental support to DIL in the near to medium term.

**High reliability of power supply; limited fuel availability risks for generation stations –** The peak demand in CESC's command area stood at 2,339 MW in FY2022, against which it had an operational installed capacity of 1,485 MW (including the 600-MW capacity of HEL). Between FY2016 and FY2023, 80-90% of the power demand in CESC's licensee area has been met through generation from its own stations, leading to high reliability of power supply. The annual coal requirement for CESC's thermal generation capacity is met from a) captive coal mine b) long-term FSA with CIL's subsidiaries, and c) through e-auction. CESC primarily remains insulated from fuel availability risks as over 90% of its coal requirement for these stations is met collectively from the captive mine and long-term fuel supply linkages procured at notified prices.

## Credit challenges

**Regulatory risk related to timely issuance of tariff order and disallowances in cost items impacting full cost recovery, leading to significant build-up of regulatory assets –** As CESC's tariff is on a cost-plus basis as determined by the WBERC, the company remains exposed to regulatory risks associated with the delay in receiving tariff orders and disallowance of costs by the state regulatory commission. The company faces risk of lower returns in case of disallowance in any of the major cost items. The WBERC has recently approved the tariff order for FY2021-FY2023 and there has been some disallowance in both fixed charges and energy charges. While the WBERC in its tariff order has stated that some of the cost items could be considered at the time of true-up/APR process, any major disallowances in the expenses and/or capital costs could impact the company's profitability and return indicators. Further, the true-up orders are pending from FY2019 onwards, thereby resulting in an unpredictable regulatory environment. The company's tariff has remained stagnant at Rs. 7.31 per unit since January 2017. Consequently, there is a build-up in regulatory asset for the Kolkata distribution business, which increased to Rs. 3,381[2] crore as on March 31, 2023 from Rs. 2,147 crore as on March 31, 2022, with the rise in fuel, power purchase and other operating costs .

**Negative bid for Sarisatolli captive coal block, leading to fuel cost under-recoveries –** Given the criticality of the captive coal block for the operational set-up of CESC's 750-MW 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 45% of the coal requirement of the Budge Budge station being met from the captive coal block, the negative bid has led to inadequate fuel cost absorption.

**Operation and maintenance expense higher than regulatory approved limits in Kolkata licensee business –** The operation and maintenance expense is a controllable cost, as per the regulatory norms. ICRA notes that CESC's operations and maintenance expense remains higher than the amount allowed by the WBERC in the tariff orders for FY2018 to FY2023, which tempers its profits and accruals to an extent. However, the WBERC has stated to consider the same at the time of the annual performance review (APR) petition in respect of these years.

**Moderate leverage and debt protection metrics; refinancing risks due to lumpy repayments –** CESC's capital structure, on a consolidated basis, remained moderately leveraged, reflected in a gearing of 1.31 times and debt/OPBITDA of 4.02 times as of FY2023-end. The coverage indictors remained moderate with interest coverage of 2.9 times for FY2023. The DSCR remained low primarily on account of bunching up of payments and the company generally reverts to refinancing the same. CESC has signficant repayments of ~Rs. 6,600 crore over the next three years on a consolidated basis. ICRA believes that though the strategy of availing medium-term loans to fund long-term assets/investments can lead to savings in interest costs, it leads to refinancing risks due to the bunching up of repayments. Nonetheless, the company is carrying a sizeable balance sheet liquidity, which is adequate to cover at least 12 months' scheduled debt repayments. Also, the healthy financial flexibility of the Group is expected to mitigate the refinancing risks to a large extent. Further, CESC extended financial support to the weaker entities of the Group, notably to DIL as well as the distribution franchise SPVs in Kota, Bharatpur, Bikaner and Malegaon. Nonetheless, the extent of support is coming down with the improving performance of these SPVs, mainly DIL.

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[2] 44% of the total cumulative regulatory assets, rest 56% being non-cash items arising because of accounting treatment requirements

## Liquidity position- Adequate

The company's liquidity position is adequate, supported by its sizeable on-balance sheet liquidity on a consolidated basis. Despite the stagnant tariffs levels for over four years, CESC's regulated power business in Kolkata (CESC – Standalone + HEL) has consistently generated free cash flows, supported by its efficient operations. At a consolidated level, the company has repayment obligations of Rs. 2,461 crore and Rs. 2,262 crore over FY2024 and FY2025. As on May 31, 2023, the consolidated cash balances and liquid investments stood at Rs. 2,913 crore, along with ~Rs. 465-crore cushion in working capital borrowings at a consolidated level, which will aid in meeting the cash flow mismatch, if any. The company is also expected to refinance a portion of its borrowings.

## Rating sensitivities

**Positive factors –** Not applicable

**Negative factors –** The rating could be downgraded if inordinate delays in tariff revision and/or tightening of operating norms in future by the WBERC leads to significant decline in profits and a marked deterioration in the consolidated liquidity profile. Moreover, the net debt/OPBITDA crossing 5.0 times on a sustained basis may trigger a rating revision.

## Environmental and Social Risks

The environmental risks for coal-based power producers emanate from their exposure to fossil fuels as coal-based power plants are the leading emitters of pollutants and one of the largest industrial users of water. It is important for the power producers to comply with the emission and water consumption norms prescribed by the Government to avoid any disruption in operations or penalties for non-compliance. CESC is exposed to high carbon transition risk because its entire generation business, except for a small solar capacity, is reliant on coal-fired generation. However, the company is expected to make adequate investments to make all its thermal plants compliant with the emission norms, within the timeline provided by the Government.

CESC is exposed to the risk of natural disasters and extreme weather conditions, which could damage the power generation equipment or transmission lines. Nonetheless, the company avails insurance against such risks. CESC also remains exposed to social risks because of the adverse impact of air pollution by coal-based power plants in nearby localities and could trigger local criticism. This apart, the distribution business faces social risks in the form of resistance against tariff hikes from the political establishment and the public. This manifests as instances of deferment of the tariff hikes, thereby adversely impacting the profitability and cash flows of the company.

CESC is exposed to moderate governance risk given the concentrated shareholding of Rainbow Investments Limited, a company of the RPSG Group. However, this risk is mitigated by an experienced management team, which is further supported by experienced board members in the areas of corporate governance, business strategy and operational and financial capabilities.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for Solar Power Producers<br>Rating Methodology for Thermal Power Producers<br>Rating Methodology for Power Distribution Utilities |
| **Parent/Group support** | Not applicable |
| **Consolidation/Standalone** | The rating is based on the consolidated business and financial profile of the company. The entities considered for consolidation are enlisted in Annexure-II |

## About the company

CESC, incorporated in 1978, is the flagship company of the RP-Sanjiv Goenka 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 3.5 million consumers with an own-generation capacity of 885 MW (coal based). CESC has two wholly-owned subsidiaries, HEL and DIL , each operating 2x300-MW coal-based thermal power plants. The entire generation capacity of HEL is tied up under a long-term cost-plus based PPA with CESC. For DIL's generation capacity, 50% has been tied up under a long-term PPA, and the balance caters to the short-term & medium-term demand.

The company has 18-MW solar power assets and a 40-MW coal washery rejects-based thermal power plant under its subsidiary, Crescent Power Limited. In the power distribution segment, apart from Kolkata, CESC through its subsidiary, i.e., Noida Power Company Limited (NPCL), has the licence to supply electricity in the Greater Noida area in Uttar Pradesh. Besides the licensee power distribution business, CESC is gradually increasing its footprint in the power distribution franchise businesses. In FY2017, it took over the distribution franchise operations at Kota, Bharatpur and Bikaner in Rajasthan. In March 2020, CESC took over the power distribution franchise operations in Malegaon, Maharashtra.

### Key financial indicators

| Consolidated | FY2022 (Audited) | FY2023 (Audited) |
|---|---|---|
| **Operating Income* (Rs. crore)** | 12,544 | 14,246 |
| **PAT (Rs. crore)** | 1,404 | 1,397 |
| **OPBDITA/OI (%)** | 28.4% | 22.9% |
| **PAT/OI (%)** | 10.6% | 9.0% |
| **Total Outside Liabilities/Tangible Net Worth (times)** | 2.5 | 2.3 |
| **Total Debt/OPBDITA (times)** | 4.0 | 4.0 |
| **Interest Coverage (times)** | 3.0 | 2.9 |

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

**Without considering the regulatory income*

*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 in FY2024 | Date & rating in FY2023 | Date & rating in FY2022 | Date & rating in FY2021 |
| | | | | | Jul 31, 2023 | Jul 22, 2022 | Jul 29, 2021 | Jul 30, 2020 |
| 1 | **Commercial Paper** | Short-term | 1,600 | - | **[ICRA]A1+** | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| **Commercial Paper** | 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 | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| - | Commercial Paper* | - | - | - | 1600.00 | [ICRA]A1+ |

*Source: Company; *yet to be placed*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | Ownership (%) | Consolidation Approach |
|---|---|---|
| **Haldia Energy Limited** | 100.00% | Full Consolidation |
| **Dhariwal Infrastructure Limited** | 100.00% | Full Consolidation |
| **Crescent Power Limited** | 67.83% | Full Consolidation |
| **Noida Power Company Limited** | 72.73% | Full Consolidation |
| **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 |
| **Malegoan Power Supply 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 |
| **Au Bon Pain Café India Limited** | 93.10% | Full Consolidation |
| **Jarong Hydro-Electric Power Company Limited** | 100.00% | Full Consolidation |
| **Jharkhand Electric Company Limited** | 100.00% | Full Consolidation |
| **Eminent Electricity Distribution Limited** | 100.00% | Full Consolidation |

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## 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.

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