

July 29, 2024

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 the Kolkata area based on cost-plus 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 ~14 more years. The rating reaffirmation also considers CESC's favourable consumer base, the growing demand for electricity and the high reliability of power supply in CESC's command area, with around 80% of the electricity demand met from its own generation stations. The company sources its energy requirement for the Kolkata distribution business from the 885-MW¹ 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. This, along with the superior operating efficiency of the own generation plants, helps in attaining a competitive power generation cost. Further, the financial performance of its key subsidiary - Dhariwal Infrastructure Limited (DIL) - operating a 600-MW coal-based power generation plant in Maharashtra, has improved over the past three years, which has reduced the requirement of incremental funding support from CESC/other Group companies. There is also a significant reduction in the offtake risk for DIL as it has tied up a three-year medium-term power purchase agreement (PPA) for 210 MW 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, cost-reflective tariffs, and any large cost disallowances in the APR² orders. 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. The stagnant tariffs over the past several years have resulted in a significant build-up of regulatory assets, which increased to around Rs. 3,299 crore as of March 31, 2024 (net of advance against depreciation and deferred taxes) from around Rs. 1,407 crore as of March 31, 2023 (net of advance against depreciation and deferred taxes), owing to the increase in the fuel and power purchase costs. There is limited visibility on the timing of recovery of the cost-under-recoveries as the APR orders are pending since FY2020. CESC's operational indicators in the Kolkata licensee business remain superior to the normative targets, leading to sizeable efficiency gains and incentive income. 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 loss has been reduced to 8.5% for FY2025 and 8.0% for FY2026 compared to 14.3% prevailing till FY2023.

ICRA also notes that the operational monthly variable cost adjustment (MVCA) mechanism, which provided an automatic avenue for pass-through of fuel and power purchase costs, was not implemented since February 2022. Moreover, the WBERC had last approved the tariff order till FY2023 and the tariff orders from FY2024 onwards remain pending. However, ICRA takes

¹Excluding the 250 MW Titagarh plant which has been retired

² Annual performance review

note of the recent development, wherein the company has started levying FPPAS³ amounting to 5.7% of the existing tariff from June 2024, pursuant to the amendments to the Electricity Rules notified by the Government of India, which allow discoms to pass on the variation in fuel and power purchase costs. In the absence of tariff hikes, which has led to a sizeable build-up of regulatory assets, the FPPAS mechanism, if implemented on a sustained basis, can prevent fresh build-up of regulatory assets and improve the cash flow generation.

The rating also takes into account the moderate leverage and debt protection metrics for CESC, given the debt-funded nature of the 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. 2,716 crore at a consolidated level as on March 31, 2024. 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 the 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 3.6 million is almost entirely concentrated within Kolkata. Almost two-thirds of CESC's sales are in the low-tension (LT) segment, with the balance one-third is 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 98-99%.

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 6.89% in FY2024 was also significantly lower than the normative allowed loss of 9.0%. This helps CESC derive sizeable efficiency gains and incentive income, which support its overall profits and accruals. The tightening of the regulatory norms, including the revision in the normative distribution loss, 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 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 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 has commenced from April 1, 2022. This has significantly reduced DIL's

³ Fuel and Power Purchase Adjustment Surcharge

offtake risk. DIL did not require any funding support from CESC/Group companies FY2022 onwards on the back of adequate internal accruals and no incremental support is expected in the near to medium term as well.

High reliability of power supply; limited fuel availability risks for generation stations – The peak demand in CESC’s command area stood at more than 2600 MW in FY2024, against which it had an operational installed capacity of 1,485 MW (including the 600-MW capacity of HEL). Between FY2016 and FY2024, 80-90% of the power demand in CESC’s licensee area has been met through generation from 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 are met collectively from the captive mine and the long-term fuel supply linkages procured at notified prices.

Credit challenges

Regulatory risk related to timely issuance of tariff order, disallowances in cost items in the APR order and stagnant tariffs 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 order and any large cost disallowances in the APR orders. Any major disallowances in 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. The stagnant tariffs over the past several years have resulted in a significant build-up of regulatory assets, which increased to around Rs. 3,299 crore as of March 31, 2024 (net of advance against depreciation and deferred taxes) from around Rs. 1,407 crore as of March 31, 2023 (net of advance against depreciation and deferred taxes), owing to the increase in the fuel and power purchase costs. There is limited visibility on the timing of recovery of the cost-under-recoveries as the APR orders are pending since FY2020. ICRA also notes that the WBERC had last approved the tariff order till FY2023 and the tariff orders from FY2024 onwards are still pending with the regulatory commission.

Negative bid in 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 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 operation 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.

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 1.2 times and total debt/OPBDITA of 3.6 times as of FY2024-end. The coverage indicators remained moderate with interest coverage of 2.9 times for FY2024. The DSCR remained low primarily on account of bunching up of payments and the company generally reverts to refinancing the same. CESC has significant repayments of more than Rs. 6,000 crore over the next three years on a consolidated basis. ICRA believes that though the strategy of availing medium-term loans to fund the 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.

Liquidity position- Adequate

The company's liquidity position is adequate, supported by its sizeable on-balance sheet liquidity on a consolidated basis. At a consolidated level, the company has repayment obligations of more than Rs. 2000 crore annually in FY2025 and FY2026. As on March 31, 2024, the consolidated cash balances and liquid investments stood at Rs. 2,716 crore which will aid in meeting cashflow 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 the future by the WBERC leads to a 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 with coal-based power plants being 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 that 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 company's profitability and cash flows.

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, further supported by experienced board members in the areas of corporate governance, business strategy and operational and financial capabilities, among others.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Power – Solar Power - Thermal Power - Distribution
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 3.6 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	FY2023 (Audited)	FY2024 (Audited)
Operating income* (Rs. crore)	14,246.4	15,293.2
PAT (Rs. crore)	1,397.3	1,447.3
OPBDITA/OI (%)	22.9%	23.7%
PAT/OI (%)	9.0%	8.5%
Total outside liabilities/Tangible net worth (times)	2.3	2.1
Total debt/OPBDITA (times)	4.0	3.6
Interest coverage (times)	2.9	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 (FY2025)			Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022
				Jul 29, 2024	Jul 31, 2023	Jul 22, 2022	Jul 29, 2021
1	CP	Short-term	1600	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
CP	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
INE486A14FA5	CP	May 14, 2024	-	Aug 13, 2024	150.00	[ICRA]A1+
INE486A14FB3	CP	July 5, 2024	-	Sep 20, 2024	200.00	[ICRA]A1+
INE486A14FC1	CP	July 23, 2024	-	Oct 21, 2024	150.00	[ICRA]A1+
Not placed	CP	-	-	-	1100.00	[ICRA]A1+

Source: Company

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%	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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