

## Gulbarga Electricity Supply Company Limited

March 08, 2018

### Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based -Term Loan	653.00	653.00	[ICRA]BBB- (Negative); reaffirmed
Fund based – Overdraft	100.00	100.00	[ICRA]BBB- (Negative); reaffirmed
<b>Total</b>	<b>753.00</b>	<b>753.00</b>	

### Rating action

ICRA has reaffirmed the long-term rating assigned to the Rs. 753.00-crore bank loan limits of Gulbarga Electricity Supply Company Limited (GESCOM) at [ICRA]BBB- (pronounced ICRA triple B minus). The outlook on the long-term rating remains Negative.

### Rationale

ICRA's reaffirmation of the rating outlook at Negative for GESCOM factors in the large gap between the average tariff and average cost of supply in FY2017 for its electricity distribution business owing to significant increase in power purchase cost (Rs. 4.30 per unit) against the cost approved by Karnataka Electricity Regulatory Commission (KERC) in the tariff order (Rs. 3.60 per unit). The increase in power purchase costs (PPC) is due to the shortfall in supply from the hydel-power projects of Karnataka Power Corporation Limited (KPCL), leading to dependence on high-cost power from other sources. Further, the fuel cost adjustment (FCA) framework approved by KERK does not allow pass-through of variation in PPCs from sources other than KPCL. The variation in PPC is approved during the annual true-up process, which happens with a lag. Nonetheless, the cost coverage ratio<sup>1</sup> for the company improved in FY2017 following the release of a portion of subsidy arrears by the Government of Karnataka (GoK). The rating continues to factor in the modest operational profile of GESCOM characterised by relatively high distribution losses and low metering level due to larger share of agriculture consumers in the overall consumer mix. Nonetheless, the distribution loss level declined from 18.0% in FY2016 to 17.3% in FY2017 and is within the range approved by KERK. Further, the rating is constrained by the weak financial profile of the company owing to inadequacy of the revenues in relation to cost of supply and large build-up of receivables (both subsidy from GoK and receivables from government departments). The receivables are being funded through debt and delayed payments to power-generating companies, primarily to KPCL, leading to interest charges on belated payments. ICRA notes that the overall debt position of the company has increased from Rs. 848.80 crore as on March 31, 2016 to Rs. 1,044.14 crore as on March 31, 2017 because of higher working-capital borrowings. ICRA further takes note of GESCOM's high cross-subsidisation requirement with higher tariffs charged to commercial and industrial consumers to compensate for the lower rates for domestic and agriculture users. This, however, has resulted in the loss of industrial consumers for GESCOM in FY2017.

<sup>1</sup> Ratio of revenue realised based on cash collections and the overall costs incurred by the company towards electricity distribution

The rating is however supported by 100% ownership of GESCOM by GoK, strategic importance of the company to the state power sector and regulated nature of the business supported by cost-plus tariff principles. The rating is also supported by the established regulatory process in the state, which is reflected from the presence of multi-year tariff (MYT) regime, regular issuance of tariff orders with upward tariff revisions and annual true-up of actual performance of the distribution companies (discoms). Further, the rating draws comfort from the considerable inflows for GESCOM from consumer contribution and grants towards capital assets, security deposits from consumers and equity infusion from GoK towards funding the capital investments. As a result, the capital structure of the company remains comfortable with gearing of 1.29 times as on March 31, 2017. Also, ICRA has taken note that the GoK, in the state budget for FY2018, has approved the clearing of electricity bill arrears of gram panchayats amounting to Rs. 3,766.81 crore up to March 31, 2015 to the state discoms. This in turn, will be used to clear the power purchase dues of the discoms. Once completed, this would allow GESCOM to lower its receivable and payable position by about Rs. 748 crore.

Going forward, the ability of GESCOM to keep the performance and cost parameters within KERC approved levels and timeliness in receipt of pending receivables including subsidy support from GoK remain the key rating sensitivities. Further, the adequacy of the tariff revision by KERC in relation to the cost of supply for GESCOM will be a key rating sensitivity.

### Outlook: Negative

The Negative outlook on the rating assigned to GESCOM reflects the continued rise in receivable position and persistent gap between average tariff and average cost of supply. The outlook may be revised to Stable in case of a significant reduction in the receivable position along with sustainable improvement in cost-coverage ratio. However, the rating could be downgraded in case of any significant increase in dependence on short-term borrowings or in case of deterioration in cost-coverage ratio due to inadequate tariffs in relation to cost of supply.

### Key rating drivers

#### Credit strengths

**State-owned power distribution company with regulated nature of business** – GESCOM is a GoK-owned power distribution utility that supplies electricity to consumers in six districts of Karnataka. The utility receives regular support from GoK in the form of equity and subsidy grants. The regulated nature of the business with cost-plus tariff principles allows the utility to pass on the variations in cost structure to consumers.

**Established regulatory processes in Karnataka** – The operations of GESCOM are supported by well-established regulatory processes in Karnataka with presence of MYT regulations along with regular and timely issuance of tariff orders by KERC including annual true-up of past years. The tariff order for FY2018 was issued on April 11, 2017 with an average tariff hike of 8.1%.

**Financial profile supported by cash inflows in the form of consumer contribution, subsidy grants, equity from GoK and security deposits from customers** – The financial profile of GESCOM is supported by considerable cash inflows from consumer contribution and subsidy grants towards capital assets (Rs. 134 crore in FY2017), equity infusion from GoK (Rs. 194 crore in FY2017) and security deposits. Further, the liquidity profile of GESCOM was supported by release of a portion of the subsidy arrears in FY2017.

**Liquidation of past electricity dues from village panchayats to improve the receivable position** - The GoK in the budget for FY2018 has announced liquidation of electricity dues of Rs. 3,766.81 crore, pending from village panchayats to the discoms of Karnataka. This is expected to reduce the receivable and payable position for GESCOM by Rs. 748 crore by the end of FY2018.

## Credit challenges

**Financial profile of GESCOM remains constrained by inadequacy of tariffs in relation to cost of supply and high receivable position** – The financial profile of GESCOM is constrained by inadequacy of tariff in relation to cost of supply, resulting in accumulated losses and weak debt-coverage indicators. This is accentuated by the significant increase in power purchase costs in FY2017 against the cost approved by the regulator. Also, the financial profile is affected by high receivable position, mainly from Government departments and subsidy receipts from GoK, resulting in delayed payments to power generators.

**Power purchase costs for GESCOM remains exposed to availability of supply from KPCL** – The PPC for GESCOM is exposed to availability of power supply from long-term sources, mainly from KPCL, with any shortfall in availability leading to a dependence on high cost power as seen in FY2017. This is further 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 KERC does not allow the pass-through of variation in PPC from sources other than KPCL. The variation in PPC is approved during the annual true-up process, which happens with a lag.

**High distribution losses because of unfavourable customer profile in its license area** – GESCOM's customer profile constitutes a large proportion of agriculture consumers (more than 50% by volume sales), leading to significant dependence on subsidy support and relatively high distribution loss level of 17.3% in FY2017.

**Build-up of subsidy dues because of inadequate subsidy payments from GoK in the past** – The free power supply policy for agriculture consumers in Karnataka has resulted in high subsidy dependence for the discoms. However, the track record of inadequate subsidy payments from the GoK has resulted in subsidy build-up of Rs. 803.71 crore as on March 2017 for GESCOM.

**Tariff cross-subsidization remains high in view of the rising PPCs and subsidized supply to agriculture and domestic consumers** – The cross-subsidization requirement with higher rates for commercial and industrial consumers to compensate for the lower rates charged for domestic and agriculture users persists, in view of the rising PPCs. This has resulted in loss of industrial consumers for GESCOM in FY2017, given the availability of cheaper power in the open access market.

**Large capital expenditure plans for GESCOM** – The capital expenditure plans remain significant for GESCOM with respect to investments for infrastructure improvement, feeder separation program, village and household electrification etc, which will be funded through a mix of debt, equity, consumer contribution and capital grants.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

### Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

[Rating Methodology for Power Distribution Utilities](#)

## 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. Kms with total consumers of 2.9 million as on September 2017. 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.

In FY2017, the company reported a net loss (including prior period changes) of Rs. 312.84 crore on an operating income of Rs. 4152.27 crore, as compared to a net loss of Rs. 131.25 crore on an operating income of Rs. 4078.16 crore in the previous year.

## Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	4078.16	4152.27
PAT (Rs. crore)*	-131.25	-312.84
OPBDIT/ OI (%)	7.87%	3.66%
RoCE (%)	22.12%	6.50%
Total Debt/ TNW (times)	1.07	1.29
Total Debt/ OPBDIT (times)	2.64	6.87
Interest coverage (times)	0.90	0.44
NWC/ OI (%)	-11%	-13%

\*Including prior period changes

**Status of non-cooperation with previous CRA: Not applicable**

**Any other information: None**

## Rating history for last three years

		Current Rating (FY2018)			Chronology of Rating History for the past 3 years				
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating March 2018	Date & Rating in	Date & Rating in	Date & Rating in FY2015		
					FY2017 February 2017	FY2016 October 2015	October 2014	July 2014	
1	Term loans	Long Term	653.00	653.00	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)
2	Fund-based	Long Term	100.00	100.00	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Negative)	[ICRA]BBB-(Stable)	[ICRA]BBB-(Stable)

## Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)

### Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loans	Oct-2016	-	Dec-2026	653.00	[ICRA]BBB-(Negative)
NA	Fund-based Limit	-	-	-	100.00	[ICRA]BBB-(Negative)

Source: GESCOM

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