

Mangalore Electricity Supply Company Limited

March 30, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based - Term loan	673.80	585.51	[ICRA]BBB+ (Stable); reaffirmed
Fund based – Overdraft	265.00	315.00	[ICRA]BBB+ (Stable); reaffirmed
Fund based - Short term loan	127.78	72.22	[ICRA]A2; reaffirmed
Non-Fund based limit	100.00	175.00	[ICRA]A2; reaffirmed
Unallocated	33.42	52.27	[ICRA]BBB+ (Stable) / [ICRA]A2; reaffirmed
Total	1200.00	1200.00	

Rating action

ICRA has reaffirmed the ratings assigned to the Rs. 1200.00 crore bank loan limits of Mangalore Electricity Supply Company Limited (MESCOM) at [ICRA]BBB+ (pronounced ICRA triple B plus) and [ICRA]A2 (pronounced ICRA A two). The outlook on the long-term rating is Stable.

Rationale

ICRA's rating reaffirmation factors in the 100% ownership of MESCOM by the Government of Karnataka (GoK), strategic importance of the company to the state power sector and the regulated nature of the business supported by cost-plus tariff-based principles. The rating continues to draw strength from the healthy operating efficiency of MESCOM as reflected by the relatively low distribution loss level of 11.4% in FY2017. The rating is also supported by the established regulatory process in the state, which is reflected by the presence of the multi-year tariff (MYT) regime, regular issuance of tariff orders with upward tariff revisions and annual true-up of the actual performance of the distribution companies (discoms). Further, the rating draws comfort from the considerable cash inflows for MESCOM from consumer contribution and grants towards capital assets, equity infusion from the GoK and security deposits from consumers. Also, ICRA takes 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 MESCOM to lower its receivable and payable position by about Rs. 219.59 crore.

The rating, however, is constrained by the high receivable position of MESCOM which, along with the support extended to weaker discoms in the state through inter-discom energy balancing dues, has made the company dependent on short-term borrowings. This, coupled with the debt-funded capex has increased the overall debt of the company to Rs. 922.81 crore as on March 31, 2017 from Rs. 772.47 crore as on March 31, 2016. Nonetheless, the capital structure of the company remains comfortable with gearing at 0.83 times as on March 31, 2017. The rating is also constrained by the vulnerability of power purchase costs (PPC) of MESCOM to availability of power supply from long-term sources, mainly from Karnataka Power Corporation Limited (KPCL), with any shortfall in availability leading to dependence on high cost power as seen in the past. The actual per unit PPC for MESCOM was higher by 11% against the cost approved by the Karnataka Electricity Regulatory Commission (KERC) for FY2017. This is further accentuated by the inability of the company to pass on the increase in PPCs to consumers under the fuel cost adjustment (FCA) framework. The FCA

framework approved by KERC does not allow the 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. ICRA also takes note of the MESCOM's increased dependence on subsidy in FY2017 with subsidy as a proportion of operating income increasing to 23.4% from 18.5% in FY2016 owing to a significant increase in sales to agriculture consumers. The higher than approved PPC coupled with non-receipt of a sizeable portion of the subsidy booked for FY2017 has led to decline in the cost coverage ratio¹ for the company to 0.85 times in FY2017 from 0.89 times in FY2016. ICRA further takes note of the high level of cross-subsidisation with higher tariffs charged to commercial and industrial consumers, compensating for the lower rates for domestic and agricultural users. This, however, resulted in the loss of industrial consumers for MESCOM in FY2016. The rating also factors in the sizeable capital expenditure plans by MESCOM related to system improvements that are to be funded through a mix of long-term debt, capital receipts such as consumer contribution and Government grants and equity from the GoK.

Going forward, MESCOM's ability to recover the outstanding receivables, including subsidy and inter-discom dues, remains crucial for the improvement of its financial profile. Further, the adequacy of the tariff revision by KERC in relation to the cost of supply for MESCOM and timeliness in receipt of subsidy from the GoK remain the key rating sensitivities.

Outlook: Stable

ICRA believes that MESCOM will continue to benefit from the cost-plus tariff-based operations in its distribution licensee area along with the support received from GoK in the form of equity and grants. The outlook may be revised to Positive in case of a significant improvement in cost-coverage ratio, strengthening the financial risk profile and reducing dependence on short-term borrowings. The outlook may be revised to Negative in case of significant increase in dependence on short-term borrowings or in case of considerable deterioration in cost coverage ratio due to inadequate tariffs in relation to cost of supply or loss of high-paying consumers.

Key rating drivers

Credit strengths

State-owned power distribution company with regulated nature of business – MESCOM is a GoK-owned power distribution utility that supplies electricity to consumers in four districts of Karnataka. The utility receives regular support from the 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 MESCOM 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 in the past years. The tariff order for FY2018 was issued on April 11, 2017 with an average tariff hike of 8.1%.

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

Healthy operating efficiency reflected from the lowest distribution loss among all discoms in Karnataka – MESCOM's distribution loss level of 11.4% is lowest among all the discoms in Karnataka. This is supported by moderately favourable customer profile, with industrial and commercial consumers accounting for 31% of the volume sales in FY2017, which is higher than for three of the other four discoms in Karnataka.

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 MESCOM is supported by considerable cash inflows from consumer contribution and subsidy grants towards capital assets (Rs. 59.64 crore in FY2017), security deposits from consumers (Rs. 41.65 crore in FY2017) and equity infusion from GoK (Rs. 91.71 crore in FY2017). Its capital structure is comfortable with gearing at 0.83 times as on March 31, 2017.

Liquidation of past electricity dues from village panchayats to improve 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 MESCOM by Rs. 219.59 crore by the end of FY2018.

Credit challenges

Financial profile of MESCOM is constrained by high receivable position – The financial profile of MESCOM is constrained by its high receivable position, mainly from the Government departments subsidy receipts from the GoK and energy balancing dues from other discoms. This results in dependence on short-term borrowings. The receivables along with regulatory asset position stood at Rs. 1885.96 crore as on March 31, 2017.

PPC for MESCOM remains dependent on availability of supply from KPCL – The PPC for MESCOM is dependent on availability of power supply from long-term sources, mainly KPCL. Any shortfall in availability may lead to a dependence on high cost power, as seen in the past. This is further accentuated by the inability of the company to pass on the increase in PPCs to the consumers under the existing quarterly FCA framework. The FCA framework approved by KERC does not allow the pass-through of variation in PPCs from sources other than KPCL. The variation in PPCs is approved during the annual true-up process, which happens with a lag.

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 in Karnataka. However, the track record of inadequate subsidy payments from the GoK resulted in subsidy build-up of Rs. 442.61 crore as on March 2017 for MESCOM.

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

Large capital expenditure plans for MESCOM – The company has significant capital expenditure plans 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

MESCOM 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. MESCOM is licensed to distribute electricity in four districts of Karnataka namely, Dakshina Kannada, Udipi, Shimoga and Chickmagalur covering an area of 26,222 sq kms with total consumers of 2.2 million. The other distribution utilities in Karnataka are Bangalore Electricity Supply Company Limited (BESCOM), Gulbarga Electricity Supply Company Limited (GESCOM), Hubli Electricity Supply Company Limited (HESCOM) and Chamundeshwari Electricity Supply Corporation Limited (CESCOM). 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 profit (including prior period changes) of Rs. 12.94 crore on an operating income of Rs. 3338.17 crore, compared with a net profit of Rs. 11.11 crore on an operating income of Rs. 2755.57 crore in the previous year.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	2755.57	3338.17
PAT (Rs. crore)*	11.11	12.94
OPBDIT/ OI (%)	6.19%	12.13%
RoCE (%)	7.32%	19.23%
Total Debt/ TNW (times)	0.81	0.83
Total Debt/ OPBDIT (times)	4.53	2.28
Interest Coverage (times)	1.54	3.19
NWC/ OI (%)	8%	31%

*Including prior period changes

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument	Type	Current Rating (FY2018)		Chronology of Rating History for the past 3 years					
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating March 2018	Date & Rating in FY2017 February 2017	Date & Rating in FY2016			Date & Rating in FY2015 February 2015
						March 2016	February 2016	December 2015	
1	Term loans	673.80	585.51	[ICRA]BB B+ (Stable)	[ICRA]BBB + (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BB B+ (Stable)	-	[ICRA]BB B+ (Stable)
2	Fund-based	265.00	315.00	[ICRA]BB B+ (Stable)	[ICRA]BBB + (Stable)	[ICRA]BB B+ (Stable)	[ICRA]BB B+ (Stable)	-	[ICRA]BB B+ (Stable)
3	Term loans	127.78	72.22	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	-	[ICRA]A2
4	Non-Fund based limit	100.00	175.00	[ICRA]A2	[ICRA]A2	-	-	-	-
5	Unallocated	33.42	52.27	[ICRA]BB B+ (Stable) / [ICRA]A2	[ICRA]BBB + (Stable) / [ICRA]A2	[ICRA]BB B+ (Stable) / [ICRA]A2	-	-	[ICRA]BB B+ (Stable) / [ICRA]A2
6	Issuer Rating	-	-		IrBBB+ (withdrawn)				IrBBB+ (notice of withdrawal of one year)

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

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	February-2009	NA	November 2024	585.51	[ICRA]BBB+ (Stable)
NA	Fund-based limit	-	-	-	315.00	[ICRA]BBB+ (Stable)
NA	Short-term loan	-	-	November-2018	72.22	[ICRA]A2
NA	Non-fund based limit	-	-	-	175.00	[ICRA]A2
NA	Unallocated	-	-	-	52.27	[ICRA]BBB+ (Stable) / [ICRA]A2

Source: MESCOM

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About ICRA Limited:

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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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