

June 03, 2022

Bangalore Electricity Supply Company Limited: Rating downgraded to [ICRA]BBB+; outlook revised to Stable from Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	NA*	NA*	[ICRA]BBB+; downgraded from [ICRA]A-; outlook revised to Stable from Negative

*Not applicable as this is an issuer rating

Rationale

ICRA's rating action on the issuer rating for Bangalore Electricity Supply Company Limited (BESCOM/the company) factors in the company's continued high receivable position (including regulatory asset), which increased to Rs. 13,439.1 crore as on March 31, 2021 from Rs. 11,111.7 crore as on March 31, 2020 because of the increase in the regulatory asset¹ position, subsidy arrears from the Government of Karnataka (GoK) and huge electricity dues from Government bodies. The high receivable position has impacted the entity's cash flows and its cost coverage ratio² and has increased its dependence on short-term borrowings and the payables to power generating companies. The GoK had extended a cash support of Rs. 1,000 crore to BESCOM in FY2022 to clear the dues to the state-owned power generator, Karnataka Power Corporation Limited (KPCL). This cash support along with an interest-free loan of Rs. 500 crore extended in FY2020 is being adjusted against the subsidy dues from the GoK. However, the financial support from the GoK is subject to BESCOM writing off the subsidy arrears for the period prior to FY2017 amounting to Rs. 1,938.04 crore, which will adversely impact the company's profitability and net worth. Moreover, the receivable position for BESCOM is expected to remain high as of March 2022 owing to the large regulatory asset and electricity dues from Government bodies, thereby keeping the reliance on short-term borrowings high.

Further, after the decline in the power purchase cost (PPC) in FY2021 and FY2022 with the higher allocation of hydel power, there might be an upward pressure on PPC in FY2023 with the increased allocation of high-cost thermal power stations as per the tariff order issued for the said period. Thus, the elevated receivable position along with an increase in PPC without a commensurate increase in tariffs is likely to adversely impact the company's financial profile. In addition, ICRA takes note of the additional prudential norms prescribed by the Ministry of Power (MoP) to extend working capital loans to state distribution utilities (discoms), with conditions such as timely filing of tariff petitions and issuance of tariff orders. Other key conditions include timely availability of audited accounts, timely payment of subsidy dues, no outstanding dues from state government departments and restriction of working capital debt to 25% of revenues. These conditions could adversely impact the company's financial flexibility and its ability to secure additional working capital facilities.

Further, the rating remains constrained by the vulnerability of BESCOM's PPC to the power-procurement mix, particularly to the availability of power supply from the hydel stations of KPCL; any shortfall in these stations could lead to dependence on high-cost power, as seen in the past. Also, increased procurement of renewable power in the power purchase mix of BESCOM in recent years has led to the backing down of long-term thermal stations, wherein the discom would continue to pay the fixed charges, which in turn could increase the PPC per unit. This is accentuated by the company's inability to pass on the increase

¹ The regulatory asset arises from the gap between actual power purchase cost (PPC) and approved PPC by the state electricity regulatory commission

² Ratio of the actual cash collections from customers including subsidy realised and the costs incurred by the company towards electricity distribution (including power purchase cost, other operating costs, interest, depreciation and taxes)

in PPC to consumers under the fuel cost adjustment (FCA) framework. The FCA framework, approved by the KERC, does not allow the pass-through of variation in PPCs from sources other than long-term thermal stations and is limited to the variation in energy charges for these plants. The variation in PPC is approved during the annual true-up process, which happens with a lag, thus leading to a cash-flow mismatch.

ICRA further takes note of the high level of cross-subsidisation with higher tariffs charged to commercial and industrial consumers, which compensates for the lower rates for domestic and agriculture users. This has resulted in the loss of high-paying industrial consumers for BESCOM in the last few years, given the cheaper alternatives in the open-access market. The rating also factors in the sizeable capital expenditure plans by BESCOM for system improvements, to be funded through a mix of long-term debt, capital receipts and equity from the GoK.

The rating, however, continues to positively factor in the 100% ownership of BESCOM by the GoK, the strategic importance of the company to the state power sector, and the monopolistic nature of the business supported by cost-plus tariff-based principles. Also, the rating derives strength from the favourable customer profile in BESCOM's licence area for electricity distribution, which has enabled it to achieve healthy operating efficiencies, as reflected in the relatively low distribution loss level of 11.2% in FY2022. Moreover, this has led to much lower dependence on subsidy as a proportion of total revenue for BESCOM, compared to the other discoms in the state.

The rating is also supported by the established regulatory process in the state, which is reflected in the presence of the multi-year tariff (MYT) regime, timely issuance of tariff orders with upward tariff revisions and the annual true-up of the actual performance of the distribution companies (discoms). ICRA notes that the tariff order for FY2023 was released in April 2022 with an average tariff hike of 4.2%. Further, the rating draws comfort from the considerable cash inflows for BESCOM from consumer contribution and capital grants towards capital assets, equity infusion from the GoK and security deposits from consumers. BESCOM's potential to increase revenue upon completion of a major ongoing project of converting the overhead lines to underground cables (UGC) in Bengaluru, which would help in reducing disruptions in power supply, is also viewed positively. The UGC project is augmented with a provision for optical fibre cabling and offers BESCOM additional revenue potential through a lease model. Additionally, BESCOM has accumulated Renewable Energy Certificates (RECs) owing to higher procurement from renewable energy sources against the Renewable Purchase Obligation (RPO) targets set by KERC. The income from sale of such RECs would supplement the profitability and cashflows of the company.

The Stable outlook on the issuer rating of BESCOM reflects ICRA's opinion that the entity will maintain its strong operational efficiency and continue to be supported by the GOK, given its strategic importance as one of the state power distribution utilities. Nonetheless, the movement in the receivable position and the consequent leverage levels remain key monitorables from a credit perspective.

Key rating drivers and their description

Credit strengths

State-owned power distribution utility with cost-plus tariff - BESCOM is a GoK-owned power distribution utility that supplies electricity to consumers in eight districts of Karnataka. The utility receives regular support from the GoK in the form of equity and capital grants. The monopolistic nature of the business with cost-plus tariff principles having a regulated return on equity is a credit positive.

Established regulatory processes in Karnataka - The operations of BESCOM are supported by well-established regulatory processes in Karnataka, with presence of MYT regulations along with regular and timely issuance of tariff orders by the KERC, including annual true-up in the past years. The tariff order for FY2023 was issued in April 2022, with an average tariff hike of 4.2%.

Favourable customer profile in licence area allows BESCOM to achieve healthy operating efficiency - BESCOM's customer profile comprises a high proportion of industrial and commercial consumers, which allows it to achieve healthy operating efficiencies, as reflected in the relatively low distribution loss level of 11.2% in FY2022. This has also led to lower subsidy dependence as a proportion of revenues for BESCOM compared to the other discoms in the state.

Financial profile supported by cash inflows in the form of grants, equity, interest free loan and consumer contribution - The financial profile of BESCOM is supported by considerable cash inflows from consumer contribution and subsidy grants towards capital assets, security deposits from consumers and equity infusion from the GoK. The aggregate cash inflow from grants, consumer contribution and equity stood at Rs. 437.3 crore in FY2021. Also, the GoK extended Rs. 500-crore interest-free loan in FY2020 and a cash support of Rs. 1,000 crore in March 2022, which are being adjusted against the pending subsidy arrears from the GoK.

Potential for increasing revenue in the near term - The company is undertaking a capital expenditure of ~Rs. 5,000 crore to convert the overhead lines to underground cables (UGC) in Bengaluru. The project is in the last leg of execution and upon completion is expected to improve the quality of power supply to customers by reducing disruptions. This would increase the energy sales to the high tariff paying commercial & industrial (C&I) segment and reduce the distribution losses, leading to cost savings. The UGC project is augmented with a provision for optical fibre cabling and offers BESCOM an additional revenue potential through a lease model. Further, BESCOM has accumulated RECs to the extent of 6560 MUs arising from exceeding the RPO targets set by KERC, which would aid the profitability and cash flows of the company.

Credit challenges

Financial risk profile constrained by high receivable position and consequent dependence on debt - BESCOM's financial profile remains constrained by the build-up in the receivable position, mainly from Government bodies and subsidy receipts from the GoK in lieu of the free power supply policy for agriculture consumers. This, along with the large regulatory assets booked in the last three years due to the gap between the actual and the approved PPC, has increased the overall receivable position, adversely impacting the cash flows thereby leading to high reliance on short-term & medium-term debt and payables to power generating companies. The overall receivable position, including regulatory asset (excluding unbilled revenue), increased to Rs. 13,439 crore as of March 2021 from Rs. 11,111.7 crore as of March 2020.

Power purchase cost remains exposed to availability of hydel power - The PPC for BESCOM is exposed to the energy procurement mix between thermal, hydel and renewable energy sources. Any shortfall in availability/reduction in allocation from the hydel power plants leads to dependence on high-cost power, as seen in the past. Also, the increasing share of renewables in the power purchase mix in recent years, has led to backing down of thermal stations (wherein discom would continue to pay the fixed charges) and in turn increased the overall PPC per unit. 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 long-term thermal stations and is limited to variation in energy charges for these plants. The variation in PPC is approved during the annual true-up process, which happens with a lag. The PPC for BESCOM remained high at Rs. 5.70 per unit and Rs. 5.52 per unit in FY2021 and FY2022 respectively, against the KERC approved cost of Rs. 5.30 per unit and Rs. 5.44 per unit for FY2021 and FY2022 respectively.

Subdued cost coverage ratio - The higher-than-approved PPC and the increase in subsidy dues from the GoK and electricity dues from Government institutions have led to a modest cost coverage ratio of 0.87-0.91 during FY2019-FY2021. While the cost coverage ratio has improved in FY2022 on the back of cash support from the GoK adjusted for subsidy arrears, the same is expected to remain modest in FY2023 owing to the increase in PPC.

Tariff cross-subsidisation remains high in view of rising PPC and subsidised supply to agriculture and domestic consumers - Given the rising PPC, the requirement for cross-subsidisation with higher tariff rates for commercial and industrial consumers to compensate for the lower rates charged for domestic and agriculture users continues. This has resulted in a loss of industrial consumers for BESCOM over the past few years, given the availability of cheaper power in the open-access market.

Large capital expenditure plans for BESCOM - The company has sizeable capital expenditure plans related to investments in infrastructure improvement, feeder separation programme, consumer and feeder metering etc., which will be funded through a mix of debt, equity, consumer contribution and capital grants. While the cost associated with the capital investments is considered for recovery under the cost-plus tariff principles, any delays in the implementation would increase the project cost, which is exposed to the risk of disallowance by the KERC. Also, the largely debt-funded capex keeps the leverage level relatively high.

Liquidity position: Stretched

The liquidity of the utility is stretched due to the high receivable position, driven by the accumulation of regulatory assets, delays in the receipt of subsidy support from the GoK and delays in payments by Government institutions. While the presence of working capital facilities from multiple banks and the ability to raise short-term debt from banks and financial institutions is a mitigant, ICRA takes note of the guidelines issued by the Ministry of Power (MoP) that require discoms to be compliant with certain conditions to avail working capital funding. This could constrain the financial flexibility of the company and its ability to secure additional working capital facilities. The capex funding is met through fresh equity, capital grants, consumer contributions and long-term debt.

Rating sensitivities

Positive factors - The rating can be upgraded if BESCOM's receivable position decreases, improving the cost coverage ratio and reducing the dependence on short-term borrowings on a sustained basis.

Negative factors - The rating could face negative pressure if there are significant delays in issuing the tariff order and/or if the approved tariff is inadequate, adversely impacting the profitability and cash flows. Also, an increase in the receivable position or higher-than-approved distribution loss levels would exert negative pressure on the rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities
Parent/Group Support	The assigned rating factors in the systemic importance that BESCOM holds for the state power sector, which ICRA expects should induce the GoK to extend timely financial support to the rated entity, should there be a need.
Consolidation/Standalone	For arriving at the rating, ICRA has considered the standalone financials of BESCOM

About the company

BESCOM, incorporated in 2002, is one of the five state-owned distribution utilities in Karnataka that are licensed to supply electricity in the five designated areas of the state. It is licensed to distribute electricity in eight districts of Karnataka, namely Bengaluru Urban and Bengaluru Rural, Ramanagara, Kolar, Chikkaballapura, Tumkur, Chitradurga, and Davanagere, covering an area of 41,092 sq. km with total consumers of 13.3 million as of March 2022. The other distribution utilities in Karnataka are Gulbarga Electricity Supply Company Limited (GESCOM), 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.

Key financial indicators (audited)

BESCOM Standalone	FY2020	FY2021
Operating Income (Rs. crore)	23,239.1	22,056.7
PAT (Rs. crore)	146.5	208.2
OPBDIT/OI (%)	7.8%	10.2%
PAT/OI (%)	0.6%	0.9%
Total Outside Liabilities/Tangible Net Worth (times)	4.38	4.60
Total Debt/OPBDIT (times)	6.07	5.88
Interest Coverage (times)	2.00	2.02

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2022 (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Jun 03, 2022	Apr 23, 2021	Feb 18, 2021 & Apr 20, 2020	-
1	Issuer Rating	Long Term	-	-	[ICRA]BBB+ (Stable)	[ICRA]A-(Negative)	[ICRA]A- (Negative)	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Rating	NA

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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer Rating	-	-	-	NA*	[ICRA]BBB+ (Stable)

Source: Company; *Not applicable as this is an issuer rating

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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