

June 20, 2017

## Karnataka Power Corporation Limited

### Summary of rated instruments

Instrument*	Rated Amount (in Rs. crore)	Rating Action
Long-term loans	5400.00	[ICRA]BBB- Reaffirmed; outlook revised to Negative
Fund-based limit	150.00	[ICRA]BBB- Reaffirmed; outlook revised to Negative
Non-fund based limit	100.00	[ICRA]BBB- Reaffirmed; outlook revised to Negative
Short-term loans	11000.00 (enhanced from 10000)	[ICRA]A3 Reaffirmed

\*Instrument details are provided in Annexure-1

### Rating action

ICRA has reaffirmed the long-term rating at [ICRA]BBB- (pronounced ICRA triple B minus)<sup>1</sup> for the long-term loan limits of Rs. 5400.00 crore, fund-based limit of Rs. 150.00 crore and non-fund based limit of Rs. 100.00 crore of Karnataka Power Corporation Limited (KPCL). ICRA also reaffirmed the short-term rating at [ICRA]A3 (pronounced ICRA A three) for the Rs. 11000 crore (enhanced from Rs. 10000 crore) short-term loan limits of KPCL. The outlook on the long-term rating has been revised to Negative from Stable.

### Rationale

ICRA's revision of KPCL's rating outlook factors in the continued rise in receivables from the state electricity distribution companies (discoms) in Karnataka, which increased to Rs. 15630.85 crore as on December 31, 2016 from Rs. 13619.89 crore as on March 31, 2016. This has further increased the company's dependence on short-term borrowings, adversely affecting its capital structure, profitability and debt coverage metrics. ICRA notes that the high receivable position for KPCL is owing to the weak liquidity profile of most discoms in Karnataka, which is due to delay in the realisation of electricity bill payments from Government entities and also a delay in the receipt of subsidy from the Government of Karnataka (GoK), primarily related to free power supply to agriculture consumers. ICRA has taken note that the GoK in the state budget for FY2018, approved the clearing of electricity bill arrears of gram panchayats up to March 31, 2015 amounting to Rs. 3766.81 crore to the state discoms. This in turn, will be used to clear the power purchase cost arrears from discoms to KPCL. However, the timely completion of this process remains crucial for the credit quality of KPCL.

The rating also factors in the hydrology risks associated with KPCL's hydro power projects, wherein adverse variations in water availability would result in lower generation from these projects as seen in FY2016 and FY2017. While revenue contribution from hydel assets remains relatively low (~10-11% of overall revenues in FY2016 and FY2017) due to depreciated asset base, lower generation from hydro power projects in the state necessitates procurement from high cost short-term sources for the discoms, which in turn has led to an increase in the receivable position, given the delays in payments from discoms. Further, ICRA takes a note of the fuel supply risk for the recently commissioned capacity of 2300 MW,

<sup>1</sup> For complete rating scale and definitions, please refer to ICRA's website [www.icra.in](http://www.icra.in) or other ICRA Rating Publications

(comprising 700 MW unit-3 of Bellary Thermal Power Station (BTPS) and 1600 MW Yeramarus Thermal Power Station (YTPS) under a joint venture with Bharat Heavy Electricals Limited (BHEL)), given that the coal production from the captive mine allocated by Government of India is yet to commence. While the cost competitiveness of the recently commissioned capacity of 2300 MW is adversely affected by the high capital cost, primarily due to delays in the execution of these projects, the cost-plus tariff structure for power sale to the discoms with availability linked payment of capacity charges and the company's plan to procure coal under bridge linkage from domestic sources for these projects, till the development of the captive mine mitigates the risks to some extent. ICRA also takes note of the sizeable capital expansion plans of the company with under-implementation gas-based capacity of 370 MW and planned coal-based capacity of 2400 MW, which will entail large equity and debt funding.

The ratings however positively factor in the 100% ownership of KPCL by GoK and strategic importance of the company to the state power sector as it accounts for 41% of the installed power generation capacity in the state as of April 2017. The rating draws strength from the limited demand risks for the power generation business of KPCL with presence of long-term power purchase agreements (PPAs) with the discoms of Karnataka. Also, the tariff risks remain limited given the presence of two-part cost-plus tariff structure with availability linked payment of capacity charges and pass-through of fuel cost variations, subject to adhering to normative operating parameters approved by the Karnataka Electricity Regulatory Commission (KERC). Further, the rating draws comfort from the well established regulatory processes in Karnataka with tariff norms approved for KPCL as well as regular and timely issuance of tariff orders for discoms by KERC.

Going forward, a sustainable improvement in collection efficiency for payments from discoms and a suitable mechanism for recovery of outstanding receivables will be the key rating sensitivities for KPCL.

### **Key rating drivers**

#### **Credit strengths**

- 100% ownership by GoK and the strategically important role of KPCL in the state power sector by virtue of accounting for 41% of installed power generation capacity in the state as of April 2017
- Limited demands risk for KPCL with the presence of long-term PPAs with the Karnataka discoms; limited tariff risks given the presence of two-part cost-plus tariff structure approved by KERC allowing KPCL to pass on variations in cost to the discoms, subject to adherence to approved operational norms
- Fuel supply agreements in place with Coal India Limited (CIL) and Singareni Collieries Company Limited (SCCL) for Raichur Thermal Power station (RTPS), while fuel for BTPS is currently sourced from SCCL and Mahanadi Coalfields Limited (MCL) under the MoU route
- Established regulatory processes in Karnataka with approved norms for generation utilities as well as regular and timely issuance of retail tariff orders for discoms

**Credit weaknesses**

- Significant counter-party credit risks due to large build up of receivables from discoms with outstanding dues of Rs. 15630.85 crore as on December 31, 2016 (including interest claimed on delayed payments) leading to high dependence on short-term borrowings
- Capital structure and debt coverage indicators constrained by high dependence on short-term borrowings towards funding the receivables from discoms; debt-funded capital investment also affect the coverage metrics
- KPCL's hydro power projects remain exposed to hydrology risks as issues with water availability would result in lower generation from these projects as seen in FY2016 and FY2017
- Coal production from the reallocated coal mines for BTPS is yet to commence owing to pending issues related to the selection of mine operator; also coal supply for the new units of BTPS and YTPS are proposed to be met from captive mine, wherein development of these mines could take three-five years; fuel supply in the interim is proposed to be met through bridge linkage from CIL/SCCL
- Capital expansion plan remain significant with under-implementation capacity of 370 MW and planned coal-based capacity of 2400 MW, which will entail large equity and debt funding

**Description of key rating drivers:**

KPCL's power generation capacity increased to 7116 MW as of April 2017 from 6524 MW as of March 2016 with the commissioning of the 700 MW unit-3 of BTPS. In addition, the company commissioned a 1600 MW thermal power project in April 2017, which has been set up under a special purpose vehicle namely, Raichur Power Corporation Limited, a joint venture between KPCL and BHEL. The overall energy sales by KPCL declined by 2.0% to 23024 MUs in FY2017 from 23466 MUs in FY2016, which declined by 16.8% as compared to the energy sales of 28214 MUs in FY2015. This is owing to the continued decline in generation from the company's hydel power projects, owing to inadequate water availability for power generation. This was partially offset by higher generation from the thermal power stations. The mix of thermal and hydro generation in overall energy sales mix stood at 71:29 in FY2017 as against 69:31 in FY2016 and 55:45 in FY2015.

The operating performance of the thermal power units (RTPS and BTPS) remained satisfactory with plant availability and auxiliary consumption remaining largely in line with the normative parameters approved by KERC. However, the station heat rate remained slightly higher than the normative value, partly due to the low quality coal supplied by CIL and SCCL. In terms of fuel mix, KPCL's dependence on imported coal has decreased with improved supplies from domestic sources. In case of BTPS, the company is yet to commence production from the captive coal mines reallocated by Government of India (which were earlier de-allocated as per the Supreme Court's order in September 2014), due to issues over selection of the mine operator. The previous mining contractor claimed the right of first refusal in the selection of the mine operator, which has been contested by KPCL. The matter is pending before the Supreme Court.

The demand risks for the power generating business of KPCL remains limited given that the presence of long-term PPAs with state discoms and as the company's supplies about 35% of Karnataka's energy requirement. The tariff risk is mitigated to a large extent given the presence of two-part cost-plus tariff structure, allowing KPCL to pass on variations in cost to discoms, subject to adherence to approved operational norms. However, the counter-party credit risks are high for KPCL given the weak liquidity profile of most of the state discoms, leading to high pending receivables. The outstanding receivables including interest on belated payments, stood at Rs. 15630.85 crore as on December 31, 2016. This increased company's dependence on short-term borrowings, constraining profitability, capital structure and debt coverage metrics.



In the budget for FY2018, the GoK approved the clearing of electricity bill arrears of gram panchayats up to March 31, 2015 amounting to Rs. 3766.81 crore to the state discoms. This in turn will be used to clear the power purchase cost arrears from discoms to KPCL. These dues shall be cleared by raising a loan of equivalent amount by Power Corporation of Karnataka Limited (PCKL) from banks and financial institutions backed by the state government. The company's ability to realise the pending receivables in a timely manner, will have a crucial bearing on its credit rating, going forward.

### **Analytical approach**

For arriving at the rating, ICRA has applied its rating methodology as indicated below.

### **Links to applicable criteria**

[Corporate Credit Rating – A Note on Methodology](#)

[Rating Methodology for Thermal Power Producers](#)

### **About the company**

KPCL is the state owned power generation company of Karnataka. It is responsible for developing and operating power generation stations including thermal, hydro, and renewable. As of April 2017, the installed power generation capacity of KPCL stood at 7116 MW comprising hydel power generation capacity of 3667 MW, thermal capacity of 3420 MW and renewable energy capacity of 29 MW. In addition, the company owns a 1600 MW thermal power project under a JV with BHEL. The five state-owned distribution companies of Karnataka namely Bangalore Electricity Supply Company Limited (BESCOM), Mangalore Electricity Company Limited (MESCOM), Hubli Electricity Supply Company Limited (HESCOM), Gulbarga Electric Supply Company Limited (GESCOM) and Chamundeshwari Electricity Supply Corporation Limited (CESC) source power from KPCL under the allocated power purchase agreements and as per the tariff regulations approved by KERC.

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

**Any other information:** Not applicable

**Rating history for the last three years:**
**Table: Rating history**

S.No	Instrument	Current Rating		Chronology of Rating History for the past 3 years			
		Type	Rated amount (Rs. Crores)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2016	Date & Rating in FY2015
				<b>June 2017</b>	<b>May 2016</b>	<b>June 2015</b>	<b>April 2014</b>
1	Long-term Loans	Long Term	5400.00	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based Limit	Long Term	150.00	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Non-fund Based Limit	Long Term	100.00	[ICRA]BBB- (Negative)	[ICRA]BBB- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
4	Short-term Loans	Short Term	11000.00	[ICRA]A3	[ICRA]A3	[ICRA]A2+	[ICRA]A2+

**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**

<b>Instrument</b>	<b>Date of Issuance / Sanction</b>	<b>Coupon Rate</b>	<b>Maturity Date</b>	<b>Amount Rated (Rs. crore)</b>	<b>Current Rating and Outlook</b>
Long-term Loans	-	-	March-2029	5400.00	[ICRA]BBB- (Negative)
Fund-based Limit	-	-	-	150.00	[ICRA]BBB- (Negative)
Non-fund Based Limit	-	-	-	100.00	[ICRA]BBB- (Negative)
Short-term Loans	-	-	-	11000.00	[ICRA]A3

Source: KPCL

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