January 19, 2023

Gulbarga Electricity Supply Company Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based term loans	1,000.00	1,000.00	[ICRA]BBB- (Stable); reaffirmed
Fund-based overdraft	100.00	100.00	[ICRA]BBB- (Stable); reaffirmed
Non-fund-based letter of credit	300.00	300.00	[ICRA]A3; reaffirmed
Unallocated	0.28	0.28	[ICRA]BBB- (Stable)/[ICRA]A3; reaffirmed
Total	**1,400.28**	**1,400.28**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA's reaffirmation of ratings for Gulbarga Electricity Supply Company Limited (GESCOM/company) continues to favourably factor in its 100% ownership by the Government of Karnataka (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. The ratings are also supported by the established regulatory process in the state, evident from the presence of a multi-year tariff (MYT) regime, the 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 a tariff hike of 4.5% for GESCOM.

Further, the ratings derive comfort from the cash inflows of GESCOM from consumer contribution and capital grants towards capital assets, equity infusion from the GoK and security deposits from consumers. ICRA also considers the company's satisfactory operational efficiency as the distribution loss level has reduced over the years to 10.5% in FY2022 from 16.5% in FY2018 as the utility took various projects to strengthen the system.

Additionally, the company's overall debtor level has come down to Rs. 2,490.75 crore as on September 30, 2022 from Rs. 3,070.82 crore as on March 31, 2021, aided by the recovery of subsidy arrears in FY2022 and reduction in the regulatory asset position. However, the receivables from government bodies (rural and urban local bodies) have increased, keeping the overall receivable position elevated.

The ratings remain constrained by the vulnerability of GESCOM's power purchase cost (PPC) to its power procurement mix, particularly the availability of power from the hydel stations of Karnataka Power Corporation Limited (KPCL), as any shortfall would lead to dependence on high-cost power as seen in the past. Also, the increasing share of renewables in the power purchase mix of GESCOM in recent years has led to the backing down of long-term thermal stations, wherein the discoms would continue to pay fixed charges. Nonetheless, the PPC of GESCOM has decreased to Rs. 4.93 per unit in FY2022 from Rs. 5.04 per unit in FY2021 and was within the approved cost for FY2022. The sustainability of the same remains to be seen, as a higher-than-approved PPC is accentuated by the company's inability to pass it on to consumers under the fuel cost adjustment (FCA) framework approved by the Karnataka Electricity Regulatory Commission (KERC).

The ratings further remain tempered by the relatively high dependence (40% of revenues in FY2021) on the state government's subsidy due to the large share (46% in FY2022) of agriculture consumers in the overall energy sales mix. In addition, the ratings factor in the company's modest financial risk profile, characterised by a weak capital structure, modest debt coverage metrics and its increasing dependence on debt to clear the outstanding dues to power generators. While the cost coverage ratio improved in FY2022 to over 1.0x supported by the recovery of subsidy arrears, the sustainability of this improvement remains linked to the timely collections from various government departments and the PPC remaining within the approved level.

Further, ICRA takes note of GESCOM's high cross-subsidisation requirement, with higher tariffs charged from commercial and industrial (C&I) consumers to compensate for the lower rates for domestic and agriculture users. This could result in a loss of industrial consumers for GESCOM, as seen in the past. However, the company has been able to achieve a growth in sales contribution from the C&I segment in FY2022 and H1 FY2023. The ratings also factor in the sizeable capital expenditure plans by GESCOM for system improvements that are to be funded through a mix of long-term debt, capital receipts and equity from the GoK.

The Stable outlook on the rating for the bank facilities of GESCOM reflects ICRA's opinion that the entity will continue to be supported by the GoK, given its strategic importance as one of the state power distribution utilities. GESCOM's ability to improve its profitability metrics through growth in volume sales and tariff revisions in tandem with its cost structure and achieve timely collections will remain crucial from a credit perspective.

Key rating drivers and their description

Credit strengths

State-owned power distribution company with cost-plus tariff - GESCOM is a GoK-owned power distribution utility that supplies electricity to consumers in seven 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 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 the 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 4.5%.

Demonstrated support from GoK - The utility has received continued support from the GoK in the form of equity infusion to meet capex and through an interest-free loan of Rs. 1,000 crore in March 2020 to meet its cash flow gap. In addition, GESCOM had raised loans backed by state government guarantees in FY2021 and FY2022 to clear the dues to power generating companies.

Satisfactory operating efficiency - GESCOM has been able to lower its distribution loss level to 10.5% in FY2022 from 16.5% in FY2018, aided by various projects, to strengthen the system. However, the distribution loss level increased to 11.7% in H1 FY2023, higher than the approved target of 10.5% for FY2023 by the KERC.

Financial profile supported by cash inflows in the form of grants, equity and consumer contribution - The financial profile of GESCOM 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.

Credit challenges

Financial risk profile constrained by inadequate tariffs in relation to cost of supply and moderately high receivable position - Inadequate tariffs in relation to the cost of supply and a moderately high receivable position constrain the financial profile of GESCOM, resulting in accumulated losses and a high payable position. In FY2022, the company booked a marginal profit and the cost coverage ratio improved to over 1.0x due to subsidy arrears realisation and PPC remaining within the approved level. However, the receivable from the sale of power continues to accumulate due to delayed receipts from government departments. The payable position remained high as on March 31, 2022, with the utility proposing to avail debt of ~Rs. 2,000 crore under the late payment surcharge (LPS) scheme to clear the dues of central generators and independent power producers. This would in turn put pressure on the debt coverage metrics.

High subsidy dependence - The subsidy dependence as a proportion of the operating income for GESCOM remains high at about 40% of the revenues in FY2022. This is owing to the large share of agriculture consumers in the energy sales mix and a decline in the share of industrial and commercial consumers over the years. While the subsidy collections had improved substantially in FY2022 with the recovery of earlier subsidy dues, the collection efficiency witnessed a marginal decline in H1 FY2023. The sustainability of timely and adequate subsidy collections remains important from a credit perspective.

Sensitivity of power purchase cost to GoK's power allocation policy - The PPC for GESCOM is susceptible to the power allocation policy of the GoK and the availability of power supply from KPCL hydel stations. Any shortfall in the availability of cheap hydel power leads to dependence on high-cost power, as seen in the past. Also, the growing sharing of renewables in the power purchase mix in recent years has led to a backing down of the thermal stations (wherein discoms would continue to pay the fixed charges). This could increase the PPC for the company. This is 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 the KERC does not allow pass-through of any 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.

High tariff cross-subsidisation with subsidised supply to agriculture and domestic consumers - The cross-subsidisation requirement persists with higher tariffs charged from commercial and industrial consumers to compensate for the lower rates for domestic and agriculture consumers. This could result in a loss of industrial consumers for GESCOM, given the availability of cheaper power in the open-access market.

Large capital expenditure plans - 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 investment 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 puts pressure on the leverage level.

Liquidity position: Adequate

The liquidity profile of GESCOM is adequate, supported by undrawn working capital lines and cash balances. Moreover, the demonstrated support from the GoK through interest-free and GoK-guaranteed loans has helped the utility to pay the dues to its generators. The capex funding is met through fresh equity, capital grants, consumer contributions and long-term debt.

Rating sensitivities

Positive factors – The ratings can be upgraded if the utility reduces its receivable position, improves its profitability metrics led by growth in volume sales and tariff revisions commensurate with the cost structure, while sustaining the improvement in its operating efficiency. Further, the ratings remain sensitive to the credit profile of the GoK.

Negative factors – The ratings could face pressure in case of significant delays in the issuance of tariff order and/or inadequacy of the tariff approved, adversely impacting the profitability and cash flows. Also, an increase in the receivable position or higher-than-approved distribution loss levels would exert pressure on the ratings. Further, the ratings remain sensitive to the credit profile of GoK.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities Rating Approach - Implicit parent or group support
Parent/Group support	The assigned rating factors in the systemic importance that GESCOM holds for the state power sector, which we expect 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 GESCOM.

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 to seven districts of Karnataka, namely Bellary, Bidar, Kalaburagi, Koppala, Raichur, Yadgiri and Vijayanagar, covering an area of 43,861 sq. km with total consumers of 3.42 million as on January 31, 2022. 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 (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.

Key financial indicators

GESCOM Standalone (audited)	FY2020	FY2021	FY2022
Operating income (Rs. crore)	5250.1	5387.9	5946.6
PAT (Rs. crore)*	-987.6	-1065.8	10.5
OPBDIT/OI (%)	3.5%	3.1%	11.1%
PAT/OI (%)*	-18.8%	-19.8%	0.2%
Total outside liabilities/Tangible net worth (times)	13.17	-101.90	-66.15
Total debt/OPBDIT (times)	12.10	20.42	4.93
Interest coverage (times)	0.38	0.38	1.58

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; *PAT has been adjusted for prior period regulatory changes*

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 Oct 31, 2022 (Rs. crore)	Date & rating	Date & rating in FY2022		Date & rating in FY2021	Date & rating in FY2020
					Jan 19, 2023	Nov 09, 2021	May 07, 2021	Apr 17, 2020	-
1	**Term loans**	Long-Term	1000.00	1000.00	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Negative)**	-
2	**Fund-based overdraft**	Long-Term	100.00	-	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Stable)**	**[ICRA]BBB- (Negative)**	-
3	**Non-fund based letter of credit**	Short-Term	300.00	-	**[ICRA]A3**	**[ICRA]A3**	**[ICRA]A3**	**[ICRA]A3**	-
4	**Unallocated**	Long-Term / Short-Term	0.28	-	**[ICRA]BBB- (Stable) / [ICRA]A3**	**[ICRA]BBB- (Stable) / [ICRA]A3**	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based – Term loan	Simple
Fund-based – Overdraft	Simple
Non-fund based – Letter of credit	Very Simple
Unallocated	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 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 / Sanction	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Term loan**	Oct 2020	-	Dec 2030	1000.00	[ICRA]BBB- (Stable)
NA	**Fund-based overdraft**	-	-	-	100.00	[ICRA]BBB- (Stable)
NA	**Non-fund-based letter of credit**	-	-	-	300.00	[ICRA]A3
NA	**Unallocated**	-	-	-	0.28	[ICRA]BBB- (Stable) / [ICRA]A3

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Not Applicable

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Vikram V
+91 40 4067 6518
vikram.v@icraindia.com

Vinayak Ramesh
+91 40 4067 6535
r.vinayak@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches