

March 12, 2024

Mangalore 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	1,595.43	1,232.19	[ICRA]A- (Stable); reaffirmed
Fund-based - Overdraft	500.00	500.00	[ICRA]A- (Stable); reaffirmed
Non-fund-based - Letter of credit	200.00	200.00	[ICRA]A2+; reaffirmed
Unallocated	54.57	417.81	[ICRA]A- (Stable)/[ICRA]A2+; reaffirmed
Total	2,350.00	2,350.00	

*Instrument details are provided in Annexure-1

Rationale

ICRA's ratings for Mangalore Electricity Supply Company Limited (MESCOM)/the company) factor in the 100% ownership of MESCOM by the Government of Karnataka (GoK), its strategic importance to the state power sector and the monopolistic nature of the business, supported by cost-plus tariff-based principles. The ratings continue to derive support from the healthy operating efficiency of MESCOM, reflected in the relatively low distribution loss levels of 8.42% in FY2023, which is the lowest among the five distribution utilities (discoms) in Karnataka.

The ratings also factor in the established regulatory process in the state, evident from the presence of a multi-year tariff (MYT) regime, the regular issuance of tariff orders with upward tariff revision and the annual true-up of the actual performance of the distribution companies (discoms). Further, the ratings draw comfort from the considerable cash inflows of MESCOM from government grants and consumer contribution towards capital assets, equity infusion from the GoK and security deposits from consumers. Furthermore, MESCOM's financial profile is supported by the low leverage, comfortable debt coverage metrics, decline in receivables and adequate liquidity position. All these factors have led to a comfortable cost coverage ratio¹ of over 1.0x for the company over the past two years.

The ratings, however, remain constrained by the dependence of MESCOM's power purchase cost (PPC) on the power allocation policy of the GoK and its vulnerability to the overall power procurement mix and in particular, to the proportion of power sourced from the hydel stations of Karnataka Power Corporation Limited (KPCL); any shortfall in supply from these stations could lead to dependence on high-cost power, as seen in the past. This is further accentuated by the company's inability to pass on the increase in PPC to consumers under the fuel cost adjustment (FCA) framework, approved by the Karnataka Electricity Regulatory Commission (KERC).

The ratings are further constrained by the risk of delays in receiving subsidy from the GoK, given the free power policy for agriculture and domestic consumers, and electricity dues from state government bodies. The subsidy dependence for MESCOM is expected to increase from ~23% of the operating income in FY2023 to 33% in FY2024 and thereafter owing to the implementation of the Gruha Jyoti scheme by the Karnataka government, effective from August 01, 2023, wherein electricity consumption up to 200 units is being provided free to the residential customers. While the subsidy collections remained healthy over FY2022-FY2023, the sustainability of the same remains to be seen amid the increased subsidy dependence.

¹ 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)

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 led to subdued growth of industrial and commercial customers in the overall sales mix. The ratings also factor in MESCOM's sizeable capital expenditure plans for system improvements, that are funded through a mix of long-term debt, internal accruals, capital receipts and equity from the GoK.

The Stable outlook on the rating of MESCOM's bank facilities 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. However, MESCOM's ability to maintain its profitability metrics through growth in volume sales and tariff revisions in tandem with its cost structure will remain crucial from a credit perspective.

Key rating drivers and their description

Credit strengths

State-owned power distribution company with cost-plus tariff - 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 capital grants. The monopolistic nature of the business with cost-plus tariff principles allows the utility to pass on the variation in cost structure to the consumers.

Established regulatory processes in Karnataka - The operations of MESCOM 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 FY2024 was issued in May 2023, with an average tariff hike of 8.8%.

Healthy operating efficiency with lowest distribution loss among all Karnataka discoms - MESCOM's distribution loss level of 8.42% in FY2023, that came down from 9.02% in FY2022, is the lowest among all the discoms in Karnataka. This is supported by the moderately favourable customer profile, with industrial and commercial consumers accounting for 31% of the volume sales in FY2023 against 29% in FY2022 which is higher than three of the other four discoms in Karnataka.

Comfortable financial profile - The financial profile of MESCOM is comfortable, reflected in the low leverage level with a gearing of 0.7x as on March 31, 2023 (1.0x as on March 31, 2022), and healthy debt coverage metrics with DSCR of over 2.0x during FY2022-FY2023. Further, the financial profile is supported by cash inflows from consumer contributions and government 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 around Rs. 156.2 crore in FY2023.

Credit challenges

Sensitivity of power purchase cost to GOK's power allocation policy - The PPC for MESCOM depends on the allotment of power sources by the GoK each year, rendering it susceptible to the availability of power supply from KPCL hydel stations. Any shortfall in availability here leads to 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 PPC to the consumers under the existing quarterly FCA framework.

The FCA framework approved by the KERC does not allow pass-through of PPC variation from sources other than long-term thermal stations and is limited to variation in energy charges at these plants. Further, the approval of this variation in the PPC during the annual true-up process happens with a lag. While MESCOM benefitted from a favourable allocation of power sources with higher procurement from the hydel power sources over FY2022-FY2023, the decline in hydel generation in the state has sharply increased the PPC in FY2024. Nonetheless, the company is expected to maintain its profitability supported by the tariff hike approved by the regulator for FY2024.

Large subsidy dependence exposes company to timely subsidy release by GoK; also, delays in payments from government bodies a concern - The financial profile of MESCOM is constrained by the risk of delays in receiving subsidy from GoK, in lieu of the free power supply policy for agriculture and domestic consumers, and electricity dues from government bodies. This results in dependence on short-term borrowings and payables to the state-owned power generation company, KPCL. Further, the dependence on the state government subsidy has increased from this fiscal onwards owing to the implementation of the Gruha Jyoti scheme by the Karnataka government, effective from August 01, 2023. The subsidy dependence as a percentage of the operating income is expected to increase to ~33% in FY2024 compared to ~23% in FY2023.

High tariff cross-subsidisation – There is a high level of cross-subsidisation as MESCOM charges higher tariff rates from commercial and industrial consumers to compensate for the lower rates offered to domestic and agriculture consumers. This has led to subdued growth of industrial and commercial customers in the overall sales mix.

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

Liquidity position: Adequate

The liquidity profile of MESCOM remains adequate and is supported by the presence of a moderately favourable consumer profile that ensures healthy collections from consumers, monthly subsidy payments by the GoK and availability of working capital funding limits. Also, the company has historically demonstrated the ability to raise short-term debt from banks and financial institutions, whenever necessary. The company is expected to generate cash flows from operations of ~Rs. 500-550.0 crore over FY2024-FY2025 against expected annual debt repayments of Rs. 220-240.0 crore over the same period. Further, the company is expected to incur capex of ~Rs. 400-450.0 crore over FY2024-FY2025, which is expected to be funded through internal accruals, fresh equity, capital grants, consumer contributions and long-term debt.

Rating sensitivities

Positive factors – Timely issuance of the tariff orders allowing pass-through of cost variation to customers, sustenance of a healthy operating efficiency and reduction in the receivable position, leading to an improvement in the cost coverage ratio to 1.00 times or higher on a sustained basis, would be the positive triggers for an upgrade. Further, the ratings also remain sensitive to the credit profile of the GoK.

Negative factors – The ratings could face pressure in case of significant delays in issuing tariff orders or inadequacy of the approved tariff, which will adversely impact 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 the GoK.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Distribution Utilities
Parent/Group support	The assigned ratings factor in the systemic importance that MESCOM holds for the state power sector, owing to which GoK is expected to extend timely financial support to the entity, if needed
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of MESCOM

About the company

Mangalore Electricity Supply Company Limited (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, Udupi, Shivamogga and Chikkamagaluru with total consumers of 2.56 million as on March 31, 2022. 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 (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 Karnataka Power Corporation Limited (KPCL). The Government of Karnataka (GoK) initiated the reforms process in the state power sector in 1999-2000 with the setting up of the Karnataka Electricity Regulatory Commission (KERC) and corporatisation of the electricity board.

Key financial indicators

MESCOM Standalone (audited)	FY2022	FY2023
Operating income (Rs. crore)	4,050.0	4,698.9
PAT (Rs. crore)*	32.7	51.9
OPBDIT/OI (%)	19.0%	16.0%
PAT/OI (%)*	0.8%	1.1%
Total outside liabilities/Tangible net worth (times)	2.8	2.3
Total debt/OPBDIT (times)	2.3	1.9
Interest coverage (times)	4.8	4.7

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	Type	Current rating (FY2024)			Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as on Oct 31, 2023 (Rs. crore)	Date & rating	Date & rating in FY2023		Date & rating in FY2022		Date & rating in FY2021
					Mar 12, 2024	Dec 29, 2022	Sep 28, 2021	Jun 29, 2021	
1 Term loans	Long-term	1,232.19	1,170.20	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	
2 Fund-based	Long-term	500.00	-	[ICRA]A-(Stable)	[ICRA]A-(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	[ICRA]BBB+(Stable)	
3 Non-fund based	Short-term	200.00	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	
4 Unallocated	Long-term/ Short-term	417.81	-	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]BBB+(Stable)/ [ICRA]A2	-	-	

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	Jun 2016	-	May 2024	8.33	[ICRA]A- (Stable)
NA	Term loan	Aug 2015	-	Jul 2024	4.68	[ICRA]A- (Stable)
NA	Term loan	Dec 2018	-	Oct 2028	84.72	[ICRA]A- (Stable)
NA	Term loan	Sep 2016	-	Aug 2024	11.90	[ICRA]A- (Stable)
NA	Term loan	Sep 2016	-	Aug 2024	6.20	[ICRA]A- (Stable)
NA	Term loan	Nov 2017	-	Oct 2027	111.13	[ICRA]A- (Stable)
NA	Term loan	Mar 2020	-	Feb 2030	105.56	[ICRA]A- (Stable)
NA	Term loan	Jun 2018	-	May 2028	77.78	[ICRA]A- (Stable)
NA	Term loan	Mar 2020	-	Feb 2030	182.98	[ICRA]A- (Stable)
NA	Term loan	Jun 2021	-	May 2031	238.47	[ICRA]A- (Stable)
NA	Term loan	Mar 2022	-	Mar 2032	203.70	[ICRA]A- (Stable)
NA	Term loan	FY2021	-	FY2034	196.74	[ICRA]A- (Stable)
NA	Fund-based limit	-	-	-	500.00	[ICRA]A- (Stable)
NA	Non-fund-based limit	-	-	-	200.00	[ICRA]A2+
NA	Unallocated	-	-	-	417.81	[ICRA]A- (Stable)/[ICRA]A2+

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

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