Maharashtra State Electricity Distribution Company Limited

Ratings

Facilities	Amount (Rs. crore)	Ratings[1]	Remarks
Proposed Term loans/NCDs	500.00	Provisional 'CARE A+ (SO)' @[Provisional Single A Plus (Structured Obligation)]	Assigned
Total	**500.00**		

@The assigned rating is provisional and based on structured payment mechanism. The final rating would be assigned on fulfillment of various terms mentioned in the term sheet

Rating Rationale

The assigned rating to the proposed long term borrowing of MSEDCL factors in trustee monitored structured payment mechanism where in cash collections from certain identified circles would be separated in an escrow account such that the monthly cash collection in the escrow account is at least 3.5 times the monthly debt servicing of the proposed borrowings. Further, there would be liquidity back up in the form of Debt Service Reserve Account (DSRA) which would be maintained at 2.0 times of monthly debt servicing for proposed borrowing. The identified circles for escrow arrangement have demonstrated steady growth, strong cash collections and high collection efficiency (>99%) on account of favourable consumer mix for a long period of time. This coupled with utility nature of cash flows would result in long term visibility and steady debt protection indicators for the structure.

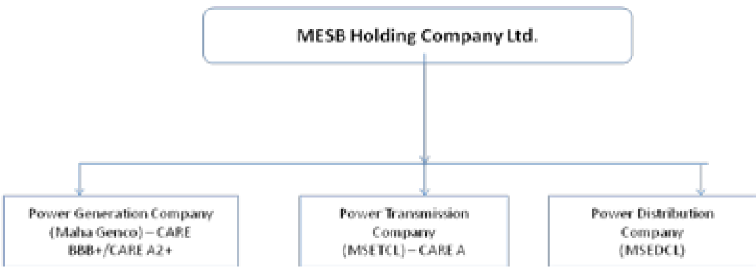
The rating also builds in strategic importance of MSEDCL for the state due to its role in providing essential services, regulated operations based on 'cost-plus' tariff scheme and Multi Year Tariff (MYT) regulations providing revenue visibility.

The above rating strengths are tempered by deterioration in overall collection efficiency due to weak collections especially in agricultural dominated circles and losses in past few years due to under recovery of cost along with exposure to regulatory risk. The rating also factors in high level of ongoing capital expenditure to augment the network which exposes the company to project implementation and funding related risks and weakening in financial risk profile due to reduction in networth due to losses in past few years and elevated debt levels.

Adherence to the normative operating parameters, resolution of receivable recovery related issues, timely and favourable adherence of regulatory regime, implementation of on-going projects as envisaged and timely disbursement of government grants & subsidy are the key rating sensitivities.

Background

Maharashtra State Electricity Distribution Company Limited (MSEDCL) was incorporated on June 6, 2005 as a wholly owned entity of Government of Maharashtra (GoM, entities guaranteed by GoM are rated CARE A-) with the objective of carrying out power distribution activity of erstwhile Maharashtra State Electricity Board (MSEB) through a separate dedicated company as a part of domestic power sector reform & unbundling exercise in compliance with Electricity Act 2003, which also led to creation of Maharashtra State Electricity Holding Co Ltd, a holding company and three separate companies with distinct functions as shown in table below:



MSEDCL is the power distribution licensee for the entire state of Maharashtra (with consumer base of 2.30 crore) excluding the island city of Mumbai.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and other CARE publications*

Credit Risk Assessment

Wholly owned undertaking of GoM

MSEDCL continues to receive funding support from the State Government for its ongoing capital expenditure programme program (in terms of grants, equity infusion as well as extension of corporate guarantee for capex term loans) as well as for supporting subsidized nature of tariff for certain sections of society (like agriculture). Although there is generally a lag of one quarter in receipt of the same, the overall realization of subsidy remains at almost 100% levels (subsidy of Rs.5,783 crore booked during FY14 and Rs.5,368 crore is received during the year).

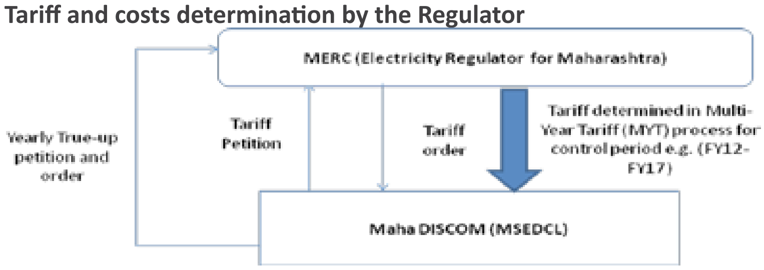
Largest power distribution entity in India and major distributor in Maharashtra

MSEDCL is the largest power distribution entity in India with consumer base of over 2.30 crore spanning over 3.08 lakh sq.km geographical area of Maharashtra. MSEDCL supplies electricity to the entire state of Maharashtra excluding the island city of Mumbai. The distribution network is divided into 14 zones, 48 circles, 156 divisions and 715 sub divisions. The company has 39,788 substations (33 KV) with 73,527 MVA (Megavolt Ampere) of transformation capacity, 10334 HV (High Voltage) feeders, and several thousand circuit km of HT (High Tension) and LT (Low Tension) lines covering 41,095 villages and 457 towns. Though MSEDCL enjoys almost a monopoly in the state, the possibility of consumers opting for open access (direct power purchase from exchanges) or parallel licensing could disrupt the tariff structure which banks on subsidizing consumers to pay for the subsidized ones, unless the company is able to provide quality service at competitive rates.

Regulatory framework –"Cost Plus' structure for MSEDCL

Maharashtra Electricity Regulatory Commission (MERC), the state regulator fixes tariff over the control period (MYT period) and allows uncontrollable costs (power purchase costs, operating costs) to be passed on to consumers, subject to adherence of Merit order Dispatch (MoD) for purchase of power. Thus 'Cost Plus' model helps MSEDCL recovery all the charges, albeit with a lag. Following table elaborates the regulatory framework:

Tariff and costs determination by the Regulator



Source: CARE Ratings

The regulator approves the tariff and expenditure through MYT regime and any increase/ decrease in tariff due uncontrollable factors is approved through True-up order on a yearly basis.

Moderate consumption mix

MSEDCL has a moderate consumption mix with high tariff segments (such as commercial & industrial) accounting for almost 50% of the consumption and contributing about 65% of the revenue while agriculture, the subsidized segment, consuming around 25% of the electricity and contributing about 5% to the revenue. However, collection efficiency in the subsidized segment (primarily agriculture) is not favourable with outstanding dues from this segment exceeding Rs.11,601 crore as on FY14-end, thereby stretching the working capital cycle of the company.

Consumers	Consumption (MUs)			Consumption (%)		
	FY12	FY13	FY14	FY12	FY13	FY14
Commercial	5,067	6,035	5,440	6.2	7.1	6.4
Industrial	30,031	30,255	27,827	36.8	35.5	32.5
Railways	1,325	1,477	1,435	1.6	1.7	1.7
Domestic	13,099	14,439	15,152	16.1	16.9	17.7
Agriculture	21643	20,891	21,610	26.5	24.5	25.2
Public works/Municipal	2640	2,980	3,003	3.2	3.5	3.5

Others	7,763	9,141	11,164	9.5	10.7	13.0
Total	**81,568**	**85,218**	**85,631**	**100**	**100**	**100**

Consumers	**Revenue Break-up (Rs. Cr)**			**Revenue Contribution (%)**		
	FY12	**FY13**	**FY14**	**FY12**	**FY13**	**FY14**
Commercial	5,379	6,966	6,935	14.8	15.6	15.5
Industrial	19,396	21,915	20,450	53.4	49.1	45.7
Railways	943	1,224	1,247	2.6	2.7	2.8
Domestic	7,217	9,264	10,152	19.9	20.8	22.7
Agriculture	1,303	2,154	2,406	3.6	4.8	5.4
Public works/Municipal	871	1,059	1,019	2.4	2.4	2.3
Others	1,226	2,014	2,529	3.4	4.5	5.7
Total	**36,335**	**44,596**	**44,738**	**100.0**	**100.0**	**100.0**

Reduction in Distribution and Aggregate Technical and Commercial (AT&C) losses over the review period

MSEDCL, on an overall basis, has 93% metered supply and has collection efficiency of over 95%. However, proportion of metered supply remains quite low, at about 50%, for the agricultural segment. MSEDCL reported steady reduction in distribution losses as well as AT&C losses over the period as shown below and has been able to report distribution loss well within the normative levels during FY14.

Particulars (%)	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**
Actual Distribution Loss	20.60	17.28	16.03	14.67	14.00
Admitted Distribution Loss	18.20	17.20	16.27	15.77	14.00
Actual Transmission Loss	5.79	4.62	3.27	1.23	4.08
Collection Efficiency	98.97	98.52	97.57	95.28	95.63
Actual AT&C Loss	21.41	18.45	18.32	18.08	17.76

The company implemented measures to reduce technical loss by strengthening network, augmenting existing substation capacity and reducing LT/HT ratio. To reduce commercial losses, the company has stepped up its efforts to curb theft, replace old electromechanical meters with static meters and implement distribution franchise scheme in areas with high distribution losses and low collection efficiencies.

MSEDCL's AT&C losses and collection efficiency stood at 18.08% and 95.28% compared to All India average of 25.38% and 90.78% in FY13.

Weakening in financial risk profile though the same is likely improve with favourable MERC order

MSEDCL reported CAGR of 13% in revenue from FY12-FY14 on the back of increase in volume of power sold as well as tariff, but continued to report losses as the stipulated tariff (though revised in the interim period) could not cover the rising power purchase cost due to 10% ceiling on Fuel Adjustment Costs (FAC) leading to accumulation of unrecovered FAC. In wake of higher power purchase cost along with higher transmission charges, MSEDCL was also bearing a brunt of higher costs, which it was unable to pass-on to consumers. This resulted in gap in revenue and cos as depicted below.

Particulars (Rs/unit)	**FY12**	**FY13**	**FY14**
Average Revenue Realized (ARR)	4.27	4.75	5.18
Average Cost of Sales (ACS)	4.40	4.86	5.37
Gap	(0.13)	(0.12)	(0.18)

However, the regulator, MERC in its order dated June 26, 2015 has harmonized the various major cost components, which is likely to result in steady power procurement cost and reduction in transmission cost from June 1, 2015 onwards. Thus, going forward, CARE expects MSEDCL to reduce power purchase costs and improve cash flow position.

Impact on liquidity profile due to under-recovery of receivables

MSEDCL had total outstanding receivables to the tune of Rs.15,432 crore primarily contributed by the Agriculture segment i.e.~Rs.11,000 crore, Public Water Works department and permanently disconnected consumers as on March 31, 2014. The above receivables include over Rs.2,500 crore to be recovered from Mula Pravara Electric Cooperative Society Limited which have been outstanding for some years. Further, trade receivables outstanding over three years amount to Rs.3,830 crore and receivables outstanding for less than three years but more than six months amount to Rs.7,193 crore. Under-recovery of receivables has impacted the liquidity profile of the company and resulted in pile up of creditors (primarily creditors for power purchase and creditors for O&M expenses due to major renovation and modernization carried out).

STRUCTURAL FEATURES ENHANCES THE CREDIT METRICS FOR PROPOSED BORROWING

- MSEDCL is planning to mobilize funds of about Rs.5,000 crore through long term loans/NCDs with tenure of 10 years. These funds would be utilized to primarily pay out existing high cost debt. MSEDCL presently operates in 44 circles (excluding franchisees) in the state of Maharashtra. Few of these circles have demonstrated steady and strong cash collection due to favourable consumer mix and utility nature of cash flows. The company would escrow cash flows from these identified two circles (HT collections) to cover the interest and principal repayments of proposed Term Loans/NCDs. The aggregate cash collection of these two circles (HT users) for FY14 and FY15 was Rs.3,584 crore and Rs.4,111 crore respectively.

The two identified circles consist of Washi (in Bhandup Zone) and Ganeshkhind (in Pune Zone). These are few of the largest and consistently profitable circles for MSEDCL with high collection efficiency. While, Washi collects 58.44% of the sales (MUs) from HT customers, Ganeshkhind has 50.80% from the HT customers.

Sr. No.	Name of Circle	Input FY14	Demand	Cash collections	FY14		FY15	
		(MUs)	Rs. crore	Rs crore	HT (MUs)	LT (MUs)	HT (MUs)	LT (MUs)
1	Washi	4,609	3,300	3335	2,368	1,684	2,461	1,827
2	Ganeshkhind	4,270	3,040	3023	1,936	1,875	2,082	2,017
		8,879	6,340	6358	4,304	3,559	4,543	3,844

ZONE	CIRCLE	AREA - SUB-DIVISIONS COVERED	HT/LT Mix (%)	HT COLLECTIONS (Rs. Crs.)					CAGR (%)
Years				FY11	FY12	FY13	FY14	FY15	
BHANDUP(U)	WASHI	Nerul, CBD Belapur, Kalamboli, Kaporkahirane, Palm Beach Road, Uran	58.44	1,435	1,716	1,992	2,003	2,308	12.6
PUNE	GANESHKHIND	Bhosari, Akurdi, Alandi, Kothrud, Pimpri, Shivaji nagar	50.80	1,169	1,414	1,629	1,581	1,803	11.5
Total				**2,603**	**3,130**	**3,622**	**3,584**	**4,111**	**12.1**

- The ratio of escrowed collections to repayment for any particular period would always be maintained at 3.5 times or more. During the tenure of the Term loan/NCDs at any point of time, if ratio falls below 3.5 times then lenders/trustees would have right to ask for additional circles as a part of escrow arrangement so the ratio is restored back to 3.5 times.

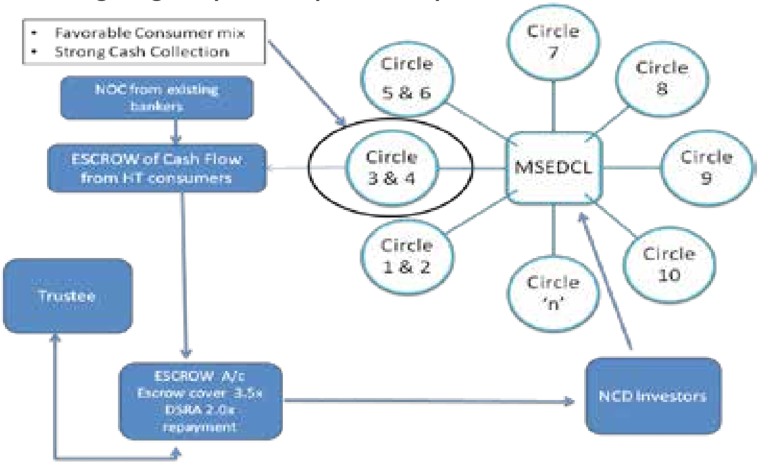
- There would be a clear prioritization of escrowed cash flows available for servicing of NCD obligations. The company would obtain No Objection Certificate (NOC) from existing lenders and other escrow holders giving their consent for escrowing of specific cash flows in favour of term lenders/NCD holders, if required.

- The total debt borrowing is based on above structure would be restricted to 5 times of "Pro-forma EBITDA" of designated circles. It would be calculated as Pro-forma EBITDA= (cash collections of escrowed circles)-[Input units for escrowed circles x (Average power purchase cost per unit + Average employee cost per unit + other overhead expenses per unit)]

- The escrow account would be a separate account and HT cash collections from the identified circles would be deposited directly into this account to meet the debt servicing obligations. There would be a tripartite agreement among borrower (MSEDCL), lenders/trustee and escrow account operating bank (agent) to assign necessary rights so the above structure is operationalised and maintained during the tenure of NCDs.

- There would be liquidity back up in form of Debt Service Reserve Account (DSRA) of 2.0 times of monthly repayment amount.
- If at T-2 (two working days prior to designated debt servicing on due date) Trustee finds that amount available in escrow account is not sufficient they will use the funds from DSRA. Further, DSRA would be replenished from subsequent periods cash collection deposited in the escrow account. Until the DSRA amount is replenished entirely no transfer of funds would be allowed from the escrow account.

Following Diagram provides pictorial representation of above structure.



Proposed structure supported by Escrow arrangement of cash collections of circles with favourable consumer mix (Industrial and commercial users) translating into high cash collection efficiency (>99%) and strong and steady cash collections results into improved debt protection metrics for proposed NCD/term loan lenders.

Financial Performance

(Rs. Cr)

For the period ended / as at March 31,	2012 (12m, A)	2013 (12m, A)	2014 (12m, A)
Working Results			
Net Sales	39,555	45,575	50,622
Total Operating income	40,806	46,437	51,630
PBILDT	1,276	2,090	2,778*
Interest	2,004	2,397	3,042
Depreciation	(500)	1,027	1,676
PBT	(2)	(576)	(1,167)
PAT (after deferred tax)	(808)	(871)	(280)
Gross Cash Accruals	(1,308)	156	1,397
Financial Position			
Equity Capital	3,000	5,317	5,317
Networth	6,727	5,966	6,800
Total capital employed	20,359	26,159	30,010
Key Ratios			
Growth			
Growth in Total income (%)	18.99	13.80	11.18
Growth in PAT (after D.Tax) (%)	N.M.	7.83	N.M.

Profitability			
PBILDT/Total Op. income (%)	3.13	4.50	5.38
PAT (after deferred tax)/ Total income (%)	(1.98)	(1.88)	(0.54)
ROCE (%)	1.79	4.57	3.92
Solvency			
Long Term Debt Equity ratio (times)	1.70	3.18	2.96
Overall gearing ratio(times)	2.16	3.58	3.43
Interest coverage(times)	0.72	0.94	0.96
Total debt/Gross cash accruals(years)	(11.12)	136.64	16.72
Liquidity			
Current ratio (times)	0.48	0.80	0.73
Quick ratio (times)	0.73	0.75	0.70
Turnover			
Average collection period (days)	107	130	141
Average creditors (days)	66	84	100
Operating cycle (days)	50	55	48
Average Creditors Period (days)	55	70	91
Operating cycle (days)	64	33	54
Average Creditors Period(days)	17	15	30
Operating cycle (days)	98	94	131

**PBILDT is lower due to one-time expense pertaining to historical debtors write-off of Rs.2,254 crore*

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(This follows our brief rational for entity published on 14 September, 2015)

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