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India Ratings Affirms U.P. Power Corporation's NCD Ratings

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By Kunal Garg

India Ratings and Research (Ind-Ra) has taken the following rating actions on U.P. Power Corporation Limited's (UPPCL) debt instruments:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
NCDs (Series 1)*	-	-	-	INR99,995	IND AA(CE)/Stable	Affirmed
NCDs (Series 2 Tranche 1)*	-	-	-	INR42,336 (reduced from INR44,982)	IND A+(CE)/Stable	Affirmed
NCDs (Series 2 Tranche 2)*	-	-	-	INR51,680 (reduced from INR54,910)	IND A+(CE)/Stable	Affirmed
Unsupported ratings\$	-	-	-	-	IND BBB+ /Stable	Assigned

* Details in annexure

\$ Ind-Ra has assigned the unsupported rating in compliance with the Securities Exchange Board of India's circular dated 13 June 2019, which requires credit rating agencies to disclose unsupported ratings without factoring in the explicit credit enhancement (CE) and supported rating after factoring in the explicit CE.

Analytical Approach:

For Series-1 bonds: Ind-Ra has factored in the state's consolidated fund backing for the timely payment of debt servicing and the replenishment of the debt service reserve account (DSRA); this is similar to the comfort available to state development loan investors and ensures timeliness. Although there has been no delay/default in state development loan payments, there have been some defaults in government guaranteed bonds of various states. This extraordinary cushion available to investors of Series-I is reflected in the two-notch rating differential from Series-2 bonds.

For Series-2 bonds: Ind-Ra has factored in the structured payment mechanism, adequate liquidity buffer and escrow mechanism to trap the subsidy receipts of the government of Uttar Pradesh (GoUP) to replenish the DSRA in case it falls below the requirement.

Apart from these, Ind-Ra factors in (for both the Series) the unconditional and irrevocable guarantee given by the GoUP for the timely payment of both principal and interest until the debt instruments are fully paid.

Therefore, UPPCL's unsupported rating is based on the credit profile of the GoUP and the strength of linkage between UPPCL and the state government.

KEY RATING DRIVERS

Unconditional, Irrevocable Guarantee: The GoUP has extended an unconditional and irrevocable guarantee for the rated bonds. The respective structures define the event for invocation of the guarantee by the trustee.

Adherence of Servicing Mechanism: The ratings are supported by the presence of a well-orchestrated debt servicing mechanism to ensure the timely servicing of the bonds. The mechanism, which is ensuring a daily pro-rated transfer of appropriate funds from UPPCL's daily collections to the respective receipt accounts of different bonds, is being duly adhered to.

Rolling DSRA Coverage: The affirmation is further supported by the adequate liquidity buffer available for bond servicing in the form of a rolling DSRA. The account, at all times, should be maintained at an amount equivalent to the total debt servicing obligation (principal and interest) for the next one quarter for Series 1 (INR99.995 billion) and two quarters for Series 2 (INR99.892 billion).

UPPCL is maintaining comfortable coverages both in terms of DSRA and bond servicing accounts. For the Series 1 bonds, the average quarterly DSRA coverage had been maintained at 1.02x till end-February 2020, while the bond servicing cover was 1.01x. For Series 2 bonds, the average quarterly DSRA coverage was maintained at around 2.39x, while the bond servicing cover was 1.04x.

Reducing Power Losses, however at Slower Pace than UDAY Memorandum of Understanding: UPPCL's aggregate technical and commercial (AT&C) losses declined over FY17-9MFY20 to 30.09% (FY19: 33.40%; FY18: 37.78%). However, the achievement is slower than the committed progress under Ujjwal DISCOM Assurance Yojana's (UDAY) target of 15.0%. Its collection efficiency improved to 86.52% in 9MFY20 from 75.3% in FY17 (FY19: 81.90%; FY18: 79.06%).

The reduced losses were a result of the company stepping up its investments in the distribution infrastructure. It has implemented various programmes such as Deen Dayal Upadhyay Yojna and the Saubhagya Scheme for expanding its distribution network and feeder segregation. It has also used aerial bundled cables and added sub-station and capacity enhancement lines for the reduction of distribution losses. To increase its collection efficiency further, UPPCL is shifting its billing agencies, working on payment gateways and enabling more mobile billing options for consumers.

Sustained Revenue Surplus Position: The GoUP's revenue account remained in surplus over FY15-FY19. The state government has projected revenue receipts growth of 12.21% yoy in FY20 (revised estimate: RE), lower than the CAGR of 14.29% witnessed over FY15-FY19. On an average, the devolution and grants from the central government accounted for 54.22% of the GoUP's revenue receipts over FY15-FY20 (RE). The revenue receipts were 5.5% yoy lower at INR3,702.65 billion (RE) in FY20 against the budget estimate for FY20 mainly due to a sharp decline in devolution from the central government against the budgeted amount. The share in central taxes were 9.06% yoy lower at INR1,353.12 billion in FY20 (RE) against the budgeted amount. The revenue balance remained in surplus in FY20 (RE) despite lower-than-budgeted growth in revenue receipts as expenditure on the revenue account was also 5.5% lower than that budgeted. The state government has projected a revenue surplus of 1.53% of gross state domestic product (GSDP) for FY21 (FY20 (RE): 1.56%).

State's High Debt Burden: Uttar Pradesh's fiscal deficit/GSDP peaked in FY04 at 7.0% of GSDP. Thereafter, the state's finances have improved. Over FY16-FY17, the GoUP's finances came under pressure owing to the adjustment related to UDAY. Fiscal deficit ratios worsened to 4.54% and 5.22%, respectively, in FY17 and FY16 from 3.21% in FY15. Although the fiscal deficit ratio moderated to well within the prudential level of 3% of GSDP over FY18-FY20 (RE), the state's debt to GSDP ratio remained above 25% during the same period (RE). Debt to GSDP ratio is budgeted at 28.82% for FY21. Since the revenue account remained in surplus, higher borrowings were channelised towards funding capex that is positive for the long-term growth prospects of the state's economy.

Liquidity Indicator - Stretched at Entity Level, Adequate for Bonds: UPPCL's available funds, comprising cash and unrestricted investments, grew to INR20.48 billion at FYE19 (FYE18: INR20.21 billion). However, its liquidity profile remained stretched due to its high debt burden and mounting expenditure. There were limited funds available to cover its operating expenditure (FY19: 3.7%) and long-term debt (4.0%). UPPCL had working capital limits of INR17.6 billion over April 2019-February 2020. The average utilisation of the working capital limits was 42.03%. However, due to various credit enhancements in the form of DSRA and the escrow of revenue for debt servicing, the liquidity for bond servicing is adequate.

Unsupported Rating Based on Linkages with GoUP: UPPCL is 100% owned by the GoUP. It has a monopoly over power distribution in Uttar Pradesh. The tariffs are fixed by the state regulator, thus mitigating large fluctuations in its financial performance. However, insufficient and infrequent tariff revisions have an impact on UPPCL's financial performance. The GoUP provides revenue subsidy to UPPCL for supplying power to the below-poverty-line families and agriculture consumers. The projects implemented by UPPCL are supported by capital grants under various state and center sponsored schemes. UPPCL has been regularly receiving grants from the GoUP which helped it manage its repayment obligations on time. The total subsidy to be received from GoUP in FY20 was INR101.20 billion, of which only INR3.5 billion was due as on 3 February 2020, UPPCL expects to receive it before FYE20. The subsidy for FY21 has been budgeted at INR102.50 billion.

RATING SENSITIVITIES

For Bonds

Positive: An improvement in the credit profile of Uttar Pradesh would lead to a positive rating action.

Negative: Any one or all of the following would result in a negative rating action:

- any deviation from the terms of the bonds or the structured payment mechanism
- a weakening of the credit profile of the state

For Unsupported Ratings

Positive: The following triggers can lead to a positive rating action:

- an improvement in GoUP's credit profile
- sustaining positive EBIDTA (consolidated) for at least two consecutive years.
- debt/EBIDTA (consolidated) falling below 8.0x for two consecutive years

Negative: Events that could, individually or collectively, lead to a negative rating action include:

- significant deterioration in the GoUP's credit profile
- any weakening of UPPCL's linkages with the GoUP
- deterioration in debt/EBITDA to negative 10.0x for two consecutive years
- delay in the receipt of subsidy from GoUP (subsidy receivables increasing to over 90 days for two consecutive years)

COMPANY PROFILE

UPPCL is the power distribution arm of the state electricity board. UPPCL was incorporated on 30 November 1999 after the unbundling of UP State Electricity Board and came online on 15 January 2000. It undertakes business through five subsidiaries.

FINANCIAL SUMMARY

GoUP

Parameters	FY20 (RE)	FY21 (BE)
Revenue receipts (INR billion)	3,702.65	4,225.68
Revenue expenditure (INR billion)	3,439.83	3,951.17

Revenue balance (INR billion)	262.82	274.51
Fiscal balance/GSDP (%)	-2.98	-2.97
Debt/GSDP (%)	28.18	28.82
Source: Reserve Bank of India, Ind-Ra		

UPPCL (standalone)

Parameters	FY18	FY19
Net profit (INR billion)	-84.16	-76.76
Total revenues (INR billion)	465.21	554.34
Operating margin (%)	-0.92	0.12
Total debt (INR billion)	527.60	517.44
Source: UPPCL		

UPPCL (consolidated)

Parameters	FY17	FY18
Net profit (INR billion)	-118.93	-132.08
Total revenues (INR billion)	487.56	535.55
Operating margin (%)	0.44	-0.39
Total debt (INR billion)	515.55	573.32
Deb/EBITDA (x)	-4.68	-6.63
Source: UPPCL		

RATING HISTORY

Instrument Type	Current Rating/Outlook	Historical Rating/Outlook	
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	Rating Type	Rated Limits (million)	Rating	16 September 2019	22 March 2019	9 March 2018	02 March 2017
NCDs (Series 1)	Long-term	INR99,995	IND AA(CE)/Stable	IND AA(CE)/Stable	IND AA(SO)/Stable	IND AA(SO)/Stable	IND AA(SO)/Stable
NCDs (Series 2 Tranche1)	Long-term	INR42,336	IND A+(CE)/Stable	IND A+ (CE)/Stable	IND A+ (SO)/Stable	IND A+ (SO)/Stable	-
NCDs (Series 2 Tranche2)	Long-term	INR51,680	IND A+(CE)/Stable	IND A+ (CE)/Stable	IND A+ (SO)/Stable	Provisional IND A+ (SO)/Stable	-
Unsupported Rating	Long Term	-	IND BBB+ /Stable	-	-	-	-

ANNEXURE

Instrument	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook
NCDs (Series 1)	INE540P07046	17 February 2017	8.97	15 February 2021	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07053	17 February 2017	8.97	15 February 2022	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07061	17 February 2017	8.97	15 February 2023	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07079	17 February 2017	8.97	15 February 2024	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07087	17 February 2017	8.97	14 February 2025	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07095	17 February 2017	8.97	13 February 2026	INR9,300	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07103	17 February 2017	8.97	15 February 2027	INR9,300	IND AA(CE)/Stable

NCDs (Series 1)	INE540P07111	27 March 2017	8.48	15 March 2021	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07129	27 March 2017	8.48	15 March 2022	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07137	27 March 2017	8.48	15 March 2023	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07145	27 March 2017	8.48	15 March 2024	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07152	27 March 2017	8.48	14 March 2025	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07160	27 March 2017	8.48	13 March 2026	INR4,985	IND AA(CE)/Stable
NCDs (Series 1)	INE540P07178	27 March 2017	8.48	15 March 2027	INR4,985	IND AA(CE)/Stable
Total (Series 1)					INR99,995	
NCDs (Series 2 Tranche 1)	INE540P07194	5 December 2017	9.75	20 October 2020	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07202	5 December 2017	9.75	20 October 2021	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07210	5 December 2017	9.75	20 October 2022	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07228	5 December 2017	9.75	20 October 2023	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07236	5 December 2017	9.75	20 October 2024	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07244	5 December 2017	9.75	20 October 2025	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07251	5 December 2017	9.75	20 October 2026	INR5,292	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 1)	INE540P07269	5 December 2017	9.75	20 October 2027	INR5,292	IND A+ (CE)/Stable
Total (Series 2 Tranche 1)					INR42,336	

NCDs (Series 2 Tranche 2)	INE540P07285	27 March 2018	10.15	20 January 2021	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07293	27 March 2018	10.15	20 January 2022	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07301	27 March 2018	10.15	20 January 2023	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07319	27 March 2018	10.15	19 January 2024	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07327	27 March 2018	10.15	20 January 2025	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07335	27 March 2018	10.15	20 January 2026	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07343	27 March 2018	10.15	20 January 2027	INR6,460	IND A+ (CE)/Stable
NCDs (Series 2 Tranche 2)	INE540P07350	27 March 2018	10.15	20 January 2028	INR6,460	IND A+ (CE)/Stable
Total (Series 2 Tranche 2)					INR51,680	
Total (Series 1 and Series 2)					INR194,011	
NCDs (Series 2 Tranche 1)	INE540P07186	5 December 2017	9.75	18 October 2019	INR2,646	WD (Paid in full)
NCDs (Series 2 Tranche 2)	INE540P07277	27 March 2018	10.15	20 January 2020	INR3,230	WD (Paid in full)

Covenants (series 1):

- 1) Default in payment: In case of any event of default in the payment of interest and/or principal redemption on the due dates, additional interest of at least 2% p.a.* over the coupon rate will be payable by the company for the defaulting period.

- 2) Delay in listing: In case of any delay in the listing of the debt securities beyond 30 days from the deemed date of allotment, the company will pay penal interest of at least 1% p.a.* over the coupon rate from the expiry of 20 days from the deemed date of allotment till the listing of such debt securities to the investor.
 - 3) Security creation (where applicable): In case of delay in the execution of trust deed and change documents, the company will refund the subscription with agreed rate of interest or will pay penal interest of at least 2% p.a.* over the coupon rate till these conditions are complied with at the option of the investor.
- * the interest rates mentioned in above cases are the minimum interest rates payable by the company and are independent of each other.

Covenants (series 2)

- 1) The non-payment of any bond servicing obligation on due date.
- 2) Any failure on behalf of issuer to perform or comply with one or more of its material obligations in relation to the bonds issued in pursuance of terms and conditions stated in the disclosure document and debenture trustee agreement which, in opinion of the trustee, is incapable of remedy.

COMPLEXITY LEVEL OF INSTRUMENTS

For details on the complexity level of the instruments, please visit <https://www.indiaratings.co.in/complexity-indicators>.

SOLICITATION DISCLOSURES

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Applicable Criteria

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