Ratings

CRISIL
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Press Release

May 06, 2019 | Mumbai

Square one: Discom debt to reach pre-UDAY levels this fiscal

Cost-reflective tariffs and a material reduction in AT&C losses critical for turnaround

Aggregate external debt of state-owned electricity distribution companies (discoms) is set to increase to pre-Ujwal Discom Assurance Yojana (UDAY) levels of Rs 2.6 lakh crore by the end of this fiscal.

With most states having limited fiscal headroom, continuous financial support to their discoms may be difficult. So discoms have to become commercially viable through prudent tariff hikes and a material reduction in aggregate technical and commercial (AT&C) losses, CRISIL's analysis of discoms in 15 states[1], which account for 85% of the aggregate losses, shows.

As per the memoranda of understanding that states had signed under UDAY in fiscal 2016, their discoms were to initiate structural reforms by reducing AT&C losses by 900 basis points (bps) to ~15% in fiscal 2019, and also implement regular tariff hikes of 5-6% per annum. In lieu, state governments took over three-fourths of discom debt, thus reducing the interest cost burden.

While discoms enjoyed the benefit of debt reduction, structural reforms have been slow to come by. For instance, AT&C losses reduced by only 400 bps by December 2018 from pre-UDAY levels and average tariff increase were a paltry 3% per annum.

"**Further improvement in operations may face challenges because the focus on new rural connections without adequate tariff hikes can increase losses," said Subodh Rai, Senior Director, CRISIL Ratings. "Add to that the funding needs for budgeted capital expenditure, and the external debt of discoms would balloon to ~Rs 2.6 lakh crore[1] by the end of fiscal 2020."**

That arithmetic is based on the assumption of average tariff increase of 2%, and partial funding of losses through state government grants, in line with the commitments made under UDAY.

As in the past, that leaves the states with two options: take hard decisions to get their discoms back into shape, or prepare for another bail-out. In 2016, most states had the fiscal headroom to assume three-fourths of the debt of their discoms, but now, because of deterioration in state finances over the past few years, the latitude is limited.

"Nine of the 15 states under CRISIL's study, accounting for more than two-thirds of the total external debt of discoms, are already in breach of the Fiscal Responsibility and Budget Management Act bound of 25% debt to gross state domestic product ratio," said Naveen Vaidyanathan, Associate Director, CRISIL Ratings.

That makes structural reforms of discoms, especially ensuring cost-reflective tariffs and a material reduction in AT&C losses using measures such as smart metering, a critical need. Any delay would increase the pain for the power sector, especially for the generating companies, investors and lenders.

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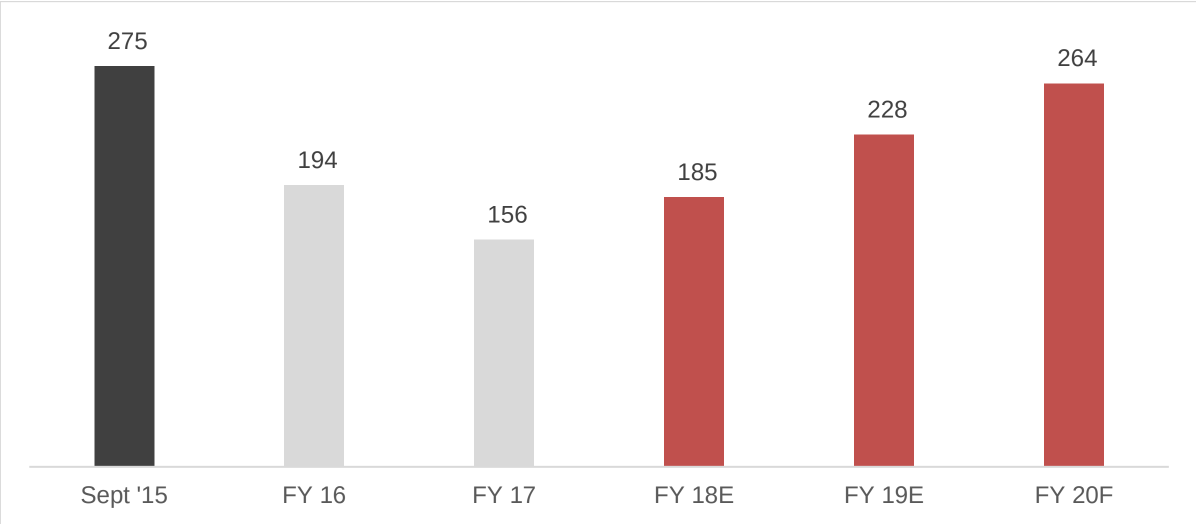
[1] Analysis based on discoms of 15 states – Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Haryana, Jammu & Kashmir, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Telangana, Uttar Pradesh and Uttarakhand

Annexure

Red streak

After declining in fiscals 2016 and 2017, discom debt is set to rebound to pre-UDAY levels

Rs '000 crore



Source: CRISIL Ratings, UDAY website and annual reports. E is estimates and F is forecasts

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