Rating Rationale for Tamil Nadu Electricity Board's proposed Bond Issue of ₹ 1500 crore

Bond Issue Rating: BWR A(SO)	Outlook : Stable

Brickwork Ratings (BWR) has assigned **BWR A (SO)** [Pronounced BWR A (Structured obligation)] Rating for **Tamil Nadu Electricity Board's (TNEB)** proposed ₹ 1500 crore Bond issue with a tenor of 10 years. '**BWR A (SO)**' stands for an instrument that is considered to offer **Adequate** credit quality / safety in terms of timely servicing of principal and interest obligations.

The Rating factors, inter alia, TNEB's performance and its track record of debt servicing, unconditional and irrevocable guarantee from the Govt. of Tamil Nadu (GoTN) and escrow mechanism for servicing proposed issue of the bond. However the Rating is subject to creating the escrow mechanism by TNEB.

Issue Details

Instruments	Amount	Rating	Assigned/ Reaffirmed	Issue Date	Maturity Date	Rating As on
Bond Issue	₹ 1500 Crore	BWR A (SO) (Stable Outlook)	Assigned	NA	NA	BWR A (SO) (Stable) September 2010

Background

TNEB, a wholly owned statutory body of GoTN, was constituted under the Electricity (Supply) Act, 1948 (Central Act 54 of 1948) and authorised to function as 'the State Transmission Utility and a Licensee' under the Notification issued by the Government of Tamil Nadu (GoTN) under clause (a) of Section 172 of the Electricity Act, 2003. TNEB is responsible for the generation, transmission and distribution of electricity in Tamil Nadu. TNEB has one of the largest consumer bases (of about 212 lakh) with 1.92 lakh distribution transformers, including 1345 substations, 1.69 lakh Kms of EHT lines/ HT lines and 5.38 lakh Kms of LT lines. As on March 2010, the total capacity in the state including the share of central sector and private sector power plants aggregates to 15800 MW, of which TNEB's installed capacity is 5690 MW.

Conventional sources (Hydel, oil and Coal based) and Renewable or Non Conventional (wind mills, Co-generation and Biomass) sources generation capacity constituted 64% and 36% respectively.

Being a Government of Tamil Nadu undertaking, TNEB's Board of Directors is appointed by the GoTN and its management has a rich industry experience.

Restructuring/Unbundling of TNEB

In October 2008, GoTN accorded in principle approval for the re-organisation of TNEB by the establishment of a holding company, by the name TNEB Ltd and two subsidiary companies, namely Tamil Nadu Transmission Corporation Ltd (TANTRANSCO) and Tamil Nadu Generation and Distribution Corporation Ltd (TANGEDCO) with the stipulation that the aforementioned companies shall be fully owned by Government. The Govt. also constituted a Steering Committee to finalise the transfer scheme for the re-organisation of Board under section 131 of the Electricity Act, 2003. The draft transfer scheme has been prepared and submitted to Government of Tamil Nadu for approval. The assets will be divided among the two companies based on the actual use of the asset. The restructuring process is expected to be completed in another 2 months as of date (around December 2010).

Structured Payment Mechanism

The proposed ₹ 1500 crore bond issue of TNEB has a tenor of 10 years with repayment a 5 equal installments from 6th year onwards. GoTN has issued unconditional & irrevocable guarantee for the repayment of principle and interest of the proposed bond issue. TNEB will put in place an escrow mechanism to ensure timely repayment of principle and interest on due dates. The escrow account will be linked to TNEB's collections account. The escrow mechanism will be finalized at the time of placing the issue and this rating is subject to the creation of the structured payment mechanism as discussed with TNEB

Business

TNEB is the State Electricity Board and is in the process of being restructured in line with the Electricity Act 2003. Tamil Nadu Electricity Board has a total installed capacity of 10,214 MW which includes State, Central share and Independent power producers (4524 MW). Other than this, the state has installations in renewable energy sources like windmill, Bio mass and Cogeneration up to 5586 MW. As of now, the installed capacity in Tamil Nadu is 15800 MW. Due to the astronomical increase in energy demand in the last few years, the state has a deficit of

power which was estimated to be around 11.9% as on Feb 2009 which was reduced to 7% in May 2010. To meet the ever-increasing energy demand in the coming years, TNEB has proposed new generation projects for the next 5 years. TNEB has fully exploited the hydroelectric potential available in the state. However, to tide over the peak hour shortage, 3 Pumped storage schemes totalling 1200 MW in Kundah (500 MW), Mettur (500 MW) and Vellimalai (200 MW) are available.

TNEB has a total of 1202 substations with HT and EHT lines to a length of 1,63,883 Kms. The voltage levels in use in TNEB are 400KV, 230 KV, 110 KV, 66 KV, 33 KV, 22 KV and 11 KV. In order to evacuate bulk power from one region to another region, there is a more scope for enhancing transmission capability to 765 KV level and setting up of 800 KV High Voltage DC system.

Financial Performance

TNEB's networth stood at ₹ -13145.23 Crore (negative networth) in FY10 (RE) down from ₹ -7524.50 Crore (negative networth) in FY09 mainly due to high accumulated cash losses of ₹ 16774.47 Crore in FY09. TNEB's net losses increased to ₹ 7880.80 Crore in FY10 (RE) from ₹ 7131.94 Crore in FY09 mainly due to the high cost of open market power purchasing to meet state's power deficit not accompanied by any revision in power tariff and significant increase in employee costs on implementation of the sixth pay commission recommendations. However, its revenue increased to ₹ 17441.85 Crore in FY10 (RE) from ₹ 15322.55 Crore in FY09.
The Company's borrowings increased substantially to ₹ 32488.80 Crore in FY10 (RE) from ₹ 20250.32 Crore in FY09. Gearing levels were high and negative in FY10 on account of negative

net-worth mainly eroded due to accumulated losses over the years. Currently, TNEB faces cash flow constraints due to the increase in power purchase costs and these constraints are met with borrowings.

Key Financials:

Table 1

₹ Crore	2007-08 (A)	2008-09 (A)	2009-10 (RE)	2010-11 (BE)
Revenue Receipts	**17508.43**	**17537.44**	**20149.09**	**21307.23**
Revenue from sale of Power	15672.85	15322.55	17441.85	18420.66
Tariff Subsidy from GoTN	1457.02	1581.61	1943.55	2157.15
Hydel swing support Scheme subsidy	-	250.00	250.00	125.00
Other Income	378.56	383.28	513.69	604.42
Revenue Expenses	**20669.87**	**24669.38**	**28029.89**	**30833.18**
Power Purchase	12195.09	14337.38	16810.90	17423.89
Fuel cost/ Generation of Power	3678.01	4693.19	4108.25	4739.04
Establishment charges/Employee cost	2370.17	2420.56	3085.18	3331.31
Interest and finance charges	1586.96	2006.97	2551.83	3629.78
Revenue Surplus/ Gap	**-3512.08**	**-7131.94**	**-7880.80**	**-9525.95**
Balance carried forward	**-9642.53**	**-16774.47**	**-23906.41**	**-31787.21**
Net-worth	**-2292.88**	**-7524.50**	**-13145.23**	**-19916.97**
Borrowings	**13754.21**	**20250.32**	**32488.80**	**47503.54**

Government of Tamil Nadu

As the rating of TNEB factors the unconditional and irrevocable guarantee from GoTN, the states' performance has been considered in our analysis.

Socio-Economic Background

Tamil Nadu State is located in the south eastern side of Indian peninsula with Kanyakumari as the southernmost tip of the land. Tamil Nadu has a long eastern coastline dotted with enchanting beaches with Bay of Bengal in the east. Marina in Chennai, is one of the longest beaches in the world.

Tamil Nadu is one of the most industrialised states in India with a high Human Development index. Chennai (formerly known as Madras), the capital city of Tamil Nadu, is the gateway of South India with an international airport, sea ports and good rail and road network connectivity. Coimbatore, Madurai and Tiruchirappalli, Salem and Tirunelveli are some of the other major towns in the state.

Tamil Nadu, rich in culture and heritage, is one of the largest states in India covering an area of 130058 sq. km. As per 2001 census, the state had a population of 6.24 Crore and a population density of 480 persons per sq. km. Per capita income (at current prices) has stood at ₹ 51097 in 2009.

GSDP (at current prices) increased from ₹ 223,528 Crore in 2005 to ₹ 33,921,164 in 2009. Sectoral contribution to GSDP (current prices) is as shown in Table 2. GoTN thrust towards industry is reflected in increasing share of secondary sector in GSDP.

Table 2

Sectoral Contribution to GSDP (%)	**2009**
Primary (Agriculture)	12
Secondary (Industry)	28
Tertiary (Services)	60

GoTN is focusing on the energy sector to meet its power deficit and also to tap its various green energy resources viz. wind, solar, biomass. The state govt. actively promotes green energy projects. Investments valued at ₹ 61,014 crore are scheduled to go on stream in the state, during July-March 2010-11. The electricity sector accounts for a significant 38.55 per cent of the total investments scheduled to be completed in the state, during FY11.

State Finances

GoTN revenues reflect a growth trend over the last few years, with total revenues registering a 18% CAGR (2005-2009) while state's own tax revenues have grown at a 15% CAGR during the same period. Total Revenue Receipts grew by about 16% in FY09 chiefly driven by increase in State's Own Tax Revenues (14%), States Non Tax Revenues (73%) and Grants-In-Aid (9%). The growth in Total Revenue Receipts during FY09 was however lower than growth rate in the previous years (18% CAGR 2006-08) due to slowdown in economic conditions which impacted SOTR and State's share in Union Taxes.

Though the State's Own Tax Revenues have shown growth over previous years, however the share in Total Revenue Receipts fell from 67.9% in FY05 to 65.7% in FY09 (see Table 3). Sales Tax accounted for major share of SOTR with 61% share in FY09, while stamp duties & registrations declined due to economic slowdown. There was also a decrease in taxes on goods & passengers during the year. The State's Own Non-Tax Revenue constituted 7% of Total Revenue Receipts (see Table 3).

Table 3

Composition of Revenue Receipts	2005	2006	2007	2008	2009	2010RE	2011BE
State's own tax revenue	67.9%	62.3%	61.2%	65.2%	65.7%	67.9%	62.3%
State's own non-tax revenue	8.4%	7.0%	10.4%	8.1%	6.5%	8.4%	7.0%
Share in Central taxes	15.6%	17.0%	15.5%	16.1%	16.5%	15.6%	17.0%
Grants from the Centre	8.1%	13.7%	13.0%	10.6%	11.3%	8.1%	13.7%

The Total Expenditure of the state increased 25% in FY09. During FY09, Revenue Expenditure had a predominant share in the Total Expenditure at about 85% and has increased 24.7% over the previous year. On the other hand, the share of Capital Expenditure in Total Expenditure stood about 15% and recorded a 22% increase over previous year. Revenue Expenditure increased primarily on account of increased spending on Social Services (36%) and Economic Services (24%). Committed expenditure (interest, salaries & wages, pension and subsidies) as a percentage of Revenue Receipts increased from 59.3% in 2008 to 65.5% in 2009, with salaries, wages and pension aggregating to 51% of total committed expenditure as a result of the implementation of the 6th pay commission recommendations.

GoTN has enacted the Tamil Nadu Fiscal Responsibility and Budget Management (FRBM) Act in 2003 to ensure prudence in fiscal management and to maintain fiscal stability in the State. The state had achieved revenue surplus of ₹1453 crore in FY09, however, implementation of the 6th pay commission recommendations and slowdown in economy coupled with increased spending on social and welfare services resulted in the state estimating a revenue deficit of ₹5020 crore in 2010 (R.E). GoTN's revenue deficit is estimated at ₹3396 crore 2011 (B.E.). The state has managed to maintain its GFD/GSDP as per FRBM requirement at ~3% until 2009 and below 4% as per the revised targets. Fiscal deficit is estimated to deteriorate to ₹12860 crore in 2010 (R.E.) and further increase in 2011 (B.E.) to ₹16222 crore. SOTR/RR marginally increased to 80% in 2009 from 79% in 2008. RD/GFD was -17% in FY2009. Interest to RR stands at 10.8% in 2009 improving from 12.8% in 2008. However it is expected to increase to 12% in FY2010 (R.E.).

Summary of Tamil Nadu's Key Fiscal Parameters is shown in Table 4

Table 4

₹ Crs	2007	2008	2009	2010RE	2011 BE
Revenue Receipts (RR)	40,913	47,521	55,042	54,290	63,092
Tax Revenue	34,165	37,684	42,195	44,154	51,840
State's Own Tax Revenue (SoTR)	27,771	29,619	33,684	35,396	41,438
State's Non - Tax Revenue	3,422	3,304	5,712	4,399	4,101
Grants from Centre	3,326	6,532	7,135	5,736	7,150
Total Revenue Expenditure	38,265	42,975	53,590	59,310	66,488
Revenue Deficit (-)/ Surplus (RD)	2,648	4,546	1,452	-5,020	-3,396
Capital Expenditure	5,952	7,462	9,104	8,609	12,285
Gross Fiscal Deficit (-) (GFD)	-3,956	-3,686	-8,548	-12,860	-16,222
Gross State Domestic product (GSDP)	2,46,266	2,79,287	3,39,212	3,97,964	4,36,646
Primary Deficit (-) /surplus (+)	1,550	-2,400	2,585	-6,134	-8,550
RD/GSFD	-67%	-123%	-17%	39%	21%
RD/GSDP	1.1%	1.60%	0.40%	-1.30%	-0.80%
GSFD/GSDP	-1.6%	-1.3%	-2.5%	-3.2%	-3.7%
SoTR/GSDP	11.3%	10.6%	9.9%	8.9%	9.5%
SoTR/RR	81.3%	78.6%	79.8%	80.2%	79.9%

Note: GSDP from CAG report 2009 & MTFP GoTN

Outlook

The power sector in Tamil Nadu is on the threshold of change with large state and private power generation projects in various stages of execution. T&D losses in the state at 18% is lower than all India average. TNEB has, however, huge accumulated losses and increased borrowing to meet its revenue gap is expected to further weaken its financial profile. Additional capacities which are expected to coming on stream in the next 2 years, will significantly reduce power purchase costs and enable it improve its profitability. The restructuring process of TNEB is presently underway and bifurcation of assets and liabilities is expected to be completed in 2 months. Continued Support of GoTN is very crucial for TNEB's performance.

GoTN's revenue deficit levels are expected to increase to meet higher expenditure on social & welfare schemes and subsidies. Support extended to TNEB is also likely to increase considering TNEB's weakening financial profile. Discretion in revenue expenditure and grant of subsidies coupled with steady growth in revenues will help GoTN to attain its FRBM objectives and sustain its stable fiscal position.

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