Rating Approach for Debt Availed By Distribution Franchisee Players

Special Report

Scope

India Ratings and Research (Ind-Ra) shall apply the rating approach highlighted in this report towards the debt availed by a distribution franchisee (DF) for incurring capital expenditure in the franchise area of a distribution licensee/distribution company (discom) under a signed distribution franchise agreement for a fixed contract term. The rating methodology shall be appropriate to DFs operating under various business models, primarily including input-based DF and collection- or revenue-based DF.

This special report shall also be pertinent for rating the balance sheet debt of a company operating multiple distribution assets located in various franchise areas of a single/multiple discom(s) and held by individual special purpose vehicles (SPVs). However, the consolidation approach for rating such companies shall be governed by the 'Cash Flow Consolidation Method'.

This rating approach paper is guided by the Master Rating Criteria for Infrastructure and Project Finance (dated 17 May 2019) and is specifically applicable to power distribution-based infrastructure assets which are managed by DFs under a fixed-term contract signed between DF and discom for the 'Area of Supply' (AoS). The special report highlights the key credit risk parameters of a DF's contractual business operations and analyses the debt servicing ability based on the regulated and identifiable stream of cash flows generated by the company during the duration of the contract.

Key Rating Drivers

Revenue Risk Profile of DF

Input-Based DF Model: The revenue profile of a DF predominantly depends on collections from electricity consumers in a franchise area based on an input-based DF model. The business model has the following two distinct approaches:

(i) The consumers in AoS pay against the monthly electricity bill raised by the DF which is eventually deposited in the escrow account of DF. The DF makes monthly payments to the discom for power purchase costs along with electricity taxes (including duties, other surcharges) and other outstanding arrears of the discom.

The subsidy claims of relevant customers (typically agricultural consumers/ select industrial customers) are deducted from the monthly bills raised by the DF. The subsidy claims submitted by the DF for the current month's bill shall be audited by the discom and provisional credit shall be allowed in the subsequent month's bill. However, this mechanism of subsidy treatment is typically followed by a reconciliation of accounts and an audit by independent parties periodically.

The DF is also eligible to receive incentives through provisional credit available in the monthly bills raised by the discom (for input energy supplied). Such incentives, applicable during the initial few years of the contract, are towards collections by the DF related to the outstanding arrears of permanently disconnected customers as well as live customers, prior to the effective date of the contract.

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(ii) The consumers in AoS pay against the monthly electricity bill raised by the DF which is eventually deposited in a discom-controlled escrow account and after a certain time period, the discom releases the DF's portion of revenue as per the revenue share of the DF stipulated in the contract.

Counterparty risk is two-fold for DFs and stems from collection from consumers and on outstanding payments from or revenue share adjustments by discoms. Both the above arrangements indicate a moderate-to-strong linkage with the credit profile of discoms. The agency believes the dependence on discoms for payments to the DFs under the revenue sharing input-based model is fairly higher than in the first approach where the discoms provides a provisional credit, typically comprising a month, towards the subsidy claims submitted by the DF. Accordingly, the likelihood of high average receivable days for a DF is more in the second payment structure, assuming the presence discoms with a similar credit profile for both payment mechanisms. Ind-Ra shall independently assess the counterparty risk of the discom based on the underlying structure in the DF contract and its historical average receivable days for the payments made to the DF since project commissioning.

The counterparty risk arising from non-timeliness in bill payments by consumers can be established from the billing & payment history of the consumers for a reasonably long period (both under DF and discom's operations). Ind-Ra shall also assess the demand risk of a DF's revenue profile in the event there is a material transition in existing customers to a different distribution network or shifting of some consumers to cheaper sources of power available in the market including open-access. The agency shall exhaustively analyse the contract structure to evaluate any safeguarding mechanism available to the DF to mitigate possible revenue losses arising from such demand risk.

Collection-Based DF Model: As stated above, the revenue collection mechanism of this model is similar to the second payment mechanism for input-based DF model discussed above. The entire collections from consumers shall be deposited in the escrow account of the discom as per the contract terms and the discom shall pay commission and incentive-based income to DF based on achieving the target aggregate technical & commercial (AT&C) losses. Typically, the target AT&C loss limit is subject to review by the discom at least annually to maintain the expected operational performance.

Therefore, Ind-Ra shall monitor the average receivable days of the discom, as per the operational history to evaluate the timeliness of the stipulated revenue payments (commissions/incentives) to the collection-based DF for debt repayments.

Adequacy of AT&C Losses: For both the input-based and collection-based models, Ind-Ra will evaluate the accuracy and reliability of AT&C loss or any other parameter for base year on which the revenue or cost of DF depends on, using the disclosures from discoms, any techno economic viability report or other technical studies carried out by a DF, comparable AT&C loss and other technical parameters for other locations of the discoms, etc. A higher uncertainty may be attributed to revenue until a DF demonstrates AT&C loss closer to its initial expectations. The agency will also test the resilience of the debt service coverage ratios (DSCRs) of the DF due to any significant deterioration in the original AT&C loss assumptions.

Ind-Ra shall also assess the uncertainties in the profitability of DF based on the accuracy of baseline data on AT&C loss provided by the discom during bidding stage. Any clause in DF agreement which protects the DF from revenue losses in case of a material variation between the baseline numbers and the actual numbers for AT&C loss will provide comfort.

Historical Operational Track Record of DF

The agency's credit rating assessment factors in the operational track record of the DF company/sponsor of a single project SPV in similar sized projects including other performance obligations stipulated in the distribution franchise agreement (DFA) such as timely payments to discom for the purchased units of power, creation of a performance guarantee with the discom to take care of payment delays and strict adherence to the target infrastructure rollout plan for the additional capex incurred by the DF, to improve the quality of power supply.

Ind-Ra will rely on a technical study/techno economic viability report (if any), along with the DFA, to assess the size/appropriateness of the quoted capex by the DF during loan tenor. The agency shall also refer to the relevance of capex-related aspects from the bid document for the respective circle. The benchmarking of quoted capex shall also be done with similar rated projects in the agency's portfolio.

One of the key parameters to gauge the sustainability of business operations is the reduction in annual AT&C losses during the contract's duration and subsequent enhancement in the billing & collection efficiency. Typically, lower are the AT&C losses, higher is the billing & collection efficiency in an input-based DF model and lower is the gap between the units purchased from the discom and the units sold to consumers of a franchised AoS, thereby leading to improved revenues for debt servicing. Similarly, lower are the AT&C losses in a collection-based DF model, higher is the probability of the DF achieving its stipulated revenue target and therefore receiving its quoted commissions or being eligible for incentives on exceeding the baseline revenue collections.

Consumer Mix and Credit Profile of DISCOM

A discom's role is integral to the smooth functioning of the DF contract. The agency shall factor in its credit rating analysis, the counterparty's potential to efficiently perform its obligations under the DF contract. The sustainability of the revenue profile of the DF during the contract term also depends on the timeliness of tariff revisions (represented by average billing rate), timely & regular receipts of input energy, mix of consumer profile (residential/ industrial/ agricultural) in the AoS and timely receipt of shared revenues from the discom related to revenue sharing input-based model and collection-based model. The tariff collected by the DF from the customers residing in the franchise area is guided by the prevailing tariff order notified by State Electricity Regulatory Commission (SERC) for the respective discom. Clientele mix is a critical element and the average billing rate of the customers in an AoS, indicated by the SERC governed tariff, could be different for a varying mix of consumers, typically higher for a higher percentage of industrial consumers in the franchise area.

Ind-Ra shall assess the discom's ability to supply the stipulated minimum annual input energy to the DF during the contract term, which is corroborated by its financial strength and operational history in ensuring adequate power purchase continuously. The discom shall serve as the key facilitator between SERC and the DF, in the event there is any shortfall in the procurement of specified input energy and DF plans to procure the input energy shortfall from other sources, subject to the payment of additional wheeling charges to the discom for using its transmission network.

Moreover, the discom's capability to implement adequate tariff hikes by filing timely tariff petitions with SERC (true-up mechanism) along with the expeditious recovery of regulatory costs not only enhances its credit quality but also supports smooth operations of the DF's business. The discom's ability to perform its obligations under the DF contract including timely revenue sharing payments or commission payments to the DF, which are commonly a part of the monthly billed invoices, partly mitigates the revenue risk profile of the DF.

Additionally, the infrastructure quality of the distribution assets owned by the discom will reflect on the proposed capital expenditure to be funded by the DF for providing uninterrupted electricity in the franchisee area. A discom with superior quality infrastructure may reduce the need of a significant debt requirement by DF for funding incremental capex. Also, during a termination event, the discom's credit profile will estimate its capacity to make termination payments to the DF which is equivalent to the depreciable value of capital assets in compliance with SERC regulations. This shall ensure retirement of the outstanding debt of DF in a timely fashion.

Role of Sponsor Support in DF Operations

One of the key rating drivers is the DF's dependence on the sponsor and the latter's capacity to support the project in the implementation stage as well as operational stage. The sponsor's overall strength and its creditworthiness will determine whether the DF has the potential to timely complete its capital expenditure program which was originally envisaged, without any material time or cost overruns. The presence of a strong sponsor with sufficient experience in the development & operations of power distribution assets and timely equity infusions towards fulfilment of capex programs during contract term can reduce the likelihood of cost or time overrun. Significant delays in the completion of target capex by DF due to hindrance in the achievement of financial closure or absence of promoter funds towards equity injection in a timely manner may lead to penalties levied by the discom.

The project implementation period for additional capex incurred by the DF typically is three to five years on an average, wherein a significant portion of the capex program (more than 60% of total budgeted cost during DF contract tenor) is incurred. The balance capex is expended during the remaining tenor of a DF contract. Ind-Ra shall assess the creditworthiness of the sponsor to evaluate the ability of the sponsor to support the project, both during the implementation phase (higher dependence on sponsor) as well as during the balance tenor of contract after the completion of initial capex program envisaged in the original DF agreement.

Additionally, a moderately strong sponsor with adequate liquidity can support for a temporary shortfall in scheduled debt obligations of the DF during unprecedented stress situations such as significantly low collections during force majeure events (global/ national pandemic events viz. COVID-19; cyclone, earthquake and other natural catastrophes, etc) or other events of economic slowdown. Furthermore, the availability of a strong sponsor will enable availability of working capital requirements in a timely fashion during situations of a considerable mismatch between receivables from customers and payables to the discom for power purchase. Ind-Ra would evaluate the sponsor undertakings or committed contractual obligations of the sponsor for arriving at the ratings.

Debt Structural Features

The rating approach shall also be dependent on the overall debt structure prescribed in the financing documents including prevailing debt: equity ratio for the proposed capex program, availability of debt service reserve (DSR), financial covenant-based testing, restricted payment conditions, tail period (difference between DF contract term and the scheduled debt maturity) and cash sweep waterfall mechanism. The presence of additional working capital loan (funded within the stipulated maximum debt: equity ratio) and its cross default implications with the rated senior term loan may have rating implications depending on the adequacy of cash flow available for debt servicing. Also, the capability of the DF to reduce its loan interest rate post completing capex program and achieving reasonable stability in operations will be a critical factor in the rating analysis.

The adequacy of cash flows for meeting payments for power purchase costs in input-based model is a critical component. A payment security mechanism in the form of an unconditional and irrevocable letter of credit is generally established by a DF with respect to power purchase from its discom (commonly one to two months' power purchase costs). The likelihood of the invocation of letter of credit will be critical in Ind-Ra's assessment, as power purchase payments will have priority over debt servicing.

Ind-Ra will also assess the adequacy of the termination-related compensation payable to DF (due to an event of default of DF or discom) to cover the rated debt outstanding during a potential termination event.

Operative Structure of Existing DF Models

The debt requirement of a DF operating under the two primary business models prevalent in India, namely input-based model and collection-based model, may be significantly varying. Under the more popular input-based model, the DF undertakes capital expenditure with a scheduled implementation period, for purchasing distribution assets to reduce AT&C losses and expand operations in the franchise area including providing new connections during the contract term. These new distribution assets are owned by the DF (existing distribution network owned by discom) and the debt availed to fund the capex is physically secured by such distribution assets.

The primary source of cash flow generation for debt serviceability is the net revenue collections by the DF in the franchise area, adjusted for deductions such as electricity duty and tax on sale of electricity along with power purchase cost payable to discom for the input energy purchased under the DF contract & other miscellaneous costs (including employee expenses). The discussed rating methodology shall assess the standalone performance of a DF and its overall capacity for repaying debt obligations in a timely manner.

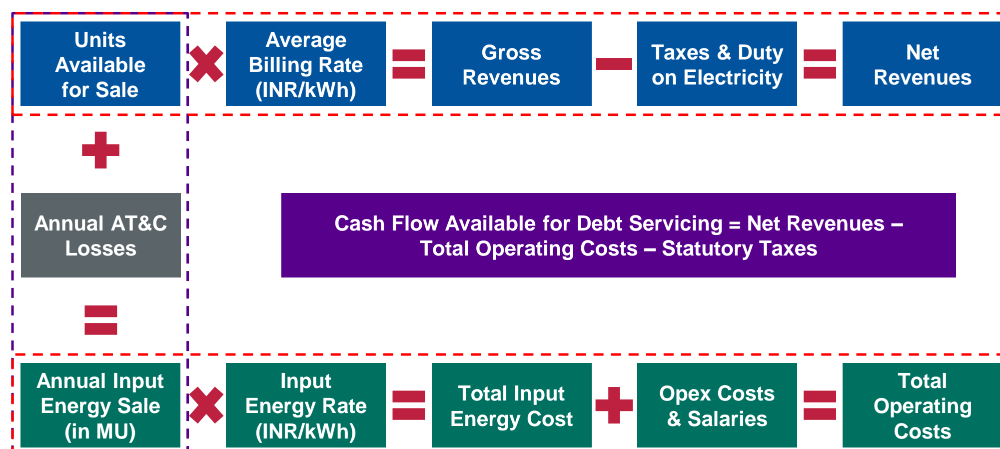
The collection-based DF model is less widespread and any capex undertaken in the franchise area is typically managed and funded by the discom. Therefore, a long-term loan may not be necessary for a collection-based DF; however, Ind-Ra does not rule out the requirement of short-term loans for the purpose of working capital.

The key elements of the operating revenue and operating costs of an input-based DF model and a collection-based DF model are provided below:

Figure 1

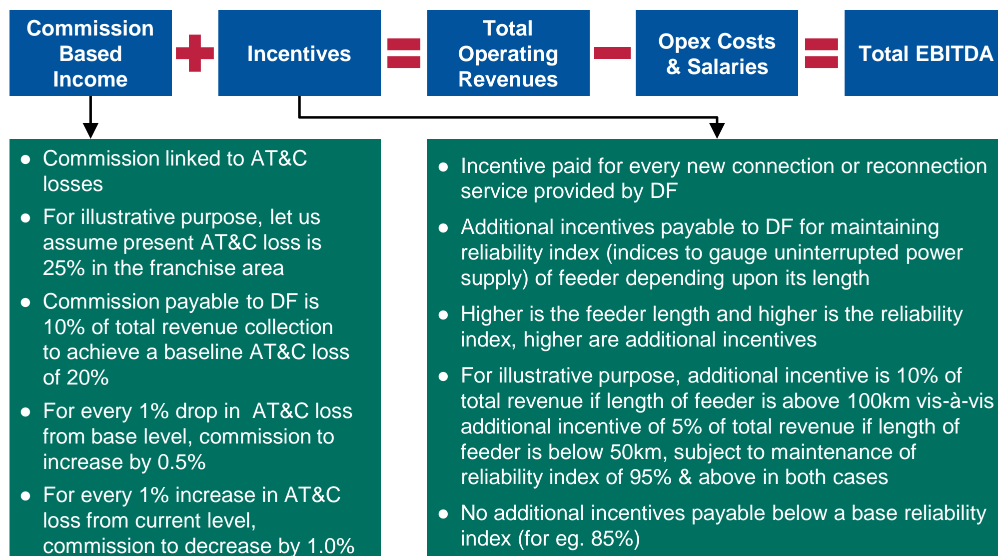
Key Components of Revenue & Cost in Input-Based DF Model

Input-Based DF Model



Source: Ind-Ra

Figure 2
Key Components of Revenue & Cost in Collection-Based DF Model



Source: Ind-Ra

Structural Features in DF Contract from a Rating Perspective

The robustness of the DF contract under both models is represented by the guidelines laying out the performance obligations of both parties viz. DF and discom in the DF contract.

Some of the key structural features in a collection-based DF contract which enhance the revenue profile of the DF include AT&C losses linked commission payable to the DF, additional incentives for DF for maintaining the reliability of its feeder network and ensuring negligible load shedding, termination clauses and related termination payments (if any). Ind-Ra shall evaluate the revenue risk, operating risk and counterparty risk of the DF from the structural features of the collection-based DF contract.

Figure 3
Rating Enablers in a Collection-Based DF Contract

Importance of Structural Features from Rating Perspective	Classification
Commission/incentives of DF linked to target AT&C losses	✔
Termination of contract by DF due to the non-compliance of discom's performance obligations (includes termination-related compensation payments, if any)	✔
Strong credit profile of discom	✔
Distribution assets are owned by discom (likelihood of negligible or nil capex by DF, leading to lower debt availment)	✔
Periodic review of AT&C loss limit (likelihood of higher commissions in case target AT&C losses are revised)	✔
Termination of contract by discom due to a high increase in AT&C losses from stipulated levels (includes termination-related compensation payments, if any)	✔
Provision to extend the contract on mutually agreed terms	!
Performance security deposit provided by DF to discom (to ensure strict adherence to performance obligations of DF)	!
Deposit of collections by DF in revenue account of discom (likelihood of high receivable days of discom on commission/ incentives payable to DF)	✘
Lock-in period lower than original contract term (typically allows termination provisions prior to contract expiry)	✘

Source: Collection-Based DF Scheme of APDCL; Ind-Ra
✔ = Enabler; ! = Neutral; ✘ = Disabler

Similarly, establishing a performance guarantee by DF for the benefit of discom, a clearly laid-out target infrastructure roll-out plan, a long contract term (higher than debt tenor), obligation of discom to supply minimum input energy, termination clauses & related event of default and consequences of event of default are some of the critical structural features in an input-based DF contract. Ind-Ra shall evaluate the revenue risk, operating risk and counterparty risk of the DF from the structural features of the input-based DF contract.

Figure 4
Rating Enablers in a Input-Based DF Contract

Importance of Structural Features from Rating Perspective	Classification
Clarity on revenue-sharing mechanism, treatment of subsidy, annual AT&C losses, input energy charge, etc	✔
Defined plan for target infrastructure development during implementation period	✔
Minimum supply of input energy by discom (shortfall in which leads to event of default of discom)	✔
Option for DF to procure power from alternative sources in the event of shortfall in supply from discom	✔
Termination payments payable to DF by discom during a termination event or on expiry of the DF contract	✔
Incentives payable to DF for recovery of arrears from permanently disconnected consumers (on effective date of DF contract) and active consumers	✔
Insurance of distribution assets purchased by DF as a part of capex program	✔
Total collections by DF is deposited in escrow account of DF	✔
Availability of cure period for critical and non-critical event of default of DF or discom	!
Provision to extend the contract on mutually agreed terms	!
Performance guarantee provided by DF to discom (to ensure strict adherence to performance obligations of DF)	!
Lock-in period in DF contract lower than scheduled debt tenor	✘
Total collections by DF are deposited in discom-controlled escrow account	✘

Source: Ind-Ra
✔ = Enabler; ! = Neutral; ✘ = Disabler

Rating Approach

Ind-Ra shall evaluate the following risks to rate any standalone project of a DF held by an SPV with ring-fenced project cash flows. However, as mentioned above, the agency shall adopt the rating methodology described in the 'Cash Flow Consolidation Criteria' to rate a sponsor owning multiple distribution assets in separate SPVs or a single company holding various distribution assets within the same company.

As a general principle and as more precisely explained in the master criteria for infrastructure and project finance, under implementation DF projects would be rated lower than DF projects in the operational phase post completion of planned capital expenditure program.

Figure 5
DF Project Characteristics – Risk Assessment Matrix

Risk/Attributes	Strong	Medium	Weak
Sponsor risk	• Sponsor has a strong credit profile • Has demonstrated timely equity infusion in completed projects • Has strong capacity to support project cost/time overruns	• Sponsor has a moderately strong credit profile • Limited history of completing similar DF projects; though no material delay observed in equity infusions	• Sponsor has a weak credit profile coupled by nil or limited operational history of timely project completion • Observance of delay in equity injection in past projects
Completion risk	• Timely financial closure • DF has completed projects on time in the past & no penalties paid to discom for laxity in performance obligations • Strong executional experience in distribution space and large order book outstanding of DF/ DF's sponsor	• Timely financial closure • Limited history of DF/ DF's sponsor on timely completion of projects • Moderate executional experience; however no penalties ever paid to discom for laxity in performance obligations	• Delay in financial closure (debt/ equity tie-up) • Nil or negligible history of DF/ DF's sponsor on execution of DF projects in a timely fashion • Penalties may have been charged on DF for extending scheduled capex program
Operations risk	• Fixed annualised input rate (AIR) over contract tenor, subject to tariff indexation • Timely increase in average billing rate (ABR) payable to DF in line with Central Electricity Regulatory Commission (CERC)/SERC regulations • Strong operational experience of DF in similar projects during past history	• Fixed AIR over contract tenor, subject to tariff indexation • Limited delays in applicability of tariff escalations for ABR payable to DF in line with CERC/SERC regulations • Moderate operational experience of DF in similar projects; however, no projects ever terminated due to negligence of DF	• Variable AIR or limited clarity in AIR and ABR i.e. billing and payment mechanism of DF in contract • Weak operational performance of DF in the past or poor history with penalties levied to DF for non-timely payment of bills or other reasons • Other similar projects terminated in the past
Revenue risk	• Fixed revenue profile/ defined revenue share and no demand risk (likelihood of existing customers shifting to other networks) • Minimum supply obligation of discom for input energy, breach of which is an event of default, unless cured • No payment delay by DF for input energy purchased • Timely payment of revenue share/ /commission/incentives by discom as per contract terms	• Adherence to fixed revenue profile albeit limited delay in tariff escalations • Low demand risk • Minimum supply obligation of discom for input energy, breach of which is an event of default, unless cured • Low payment delay by DF for input energy purchased • Limited delay in payment of revenue share/commission/incentives by discom as per contract terms	• Variable revenue or lack of clarity in revenue collection mechanism • High demand risk • No minimum supply obligation of discom for input energy • Material payment delay by DF for input energy purchased • Material delay in payment of revenue share/ commission/incentives by discom as per contract terms
Debt structure risk	• Average DSCR of 1.6x and above • DSR of six months and above • Strong financial covenants, restricted payment conditions, cash trap mechanism	• Average DSCR of 1.3x and above • DSR between three to six months • Reasonable financial covenants, restricted payment conditions, cash trap mechanism	• Average DSCR of 1.1x or below • DSR below three months or non-availability of DSR • Poor financial covenants, no cash trap mechanism
Counterparty risk	• Average receivable days of DF company from discom are low in a revenue-sharing DF contract (typically less than six months) • Payments made to DF within stipulated credit period are available to discom within due date • No delay from consumer payments in franchise area (total arrears as a % of revenues collected) is negligible	• Average receivable days of DF from discom are modest in a revenue sharing DF contract (typically between six to nine months) • Payments made to DF with occasional delays from credit period available to discom • Low-to-medium delay in payments from customers in franchise area (total arrears as a % of revenues collected) is low	• Average receivable days of DF from discom are high in a revenue-sharing DF contract (typically above nine months) • Payments made to DF with frequent delays from credit period available to discom • Significant delays in payments from customers in franchise area (total arrears as a % of revenues collected) is high
Termination risk	• Termination payment received from discom in case of an event of default of any party in similar projects • Amount (depreciable value of capital assets purchased by DF) is sufficient to repay outstanding debt • Strong ability of DF to manage AT&C losses as per stipulated limits	• Termination payment received from discom in case of an event of default of any party in similar projects • Termination amount is sufficient to repay a large portion of outstanding debt • Reasonable ability of DF to manage AT&C losses as per stipulated limits	• No or minimal termination payment received in case of an event of default of any party in similar projects • Termination amount is inadequate to repay outstanding debt • Inability of DF to manage AT&C losses as per stipulated limits
Technology risk	• DF uses industry proven technology for supplying power in franchise area • Distribution assets purchased by DF employ technology as per industry standards and in line with CERC/SERC regulations • Existing distribution-related infrastructure of discom employs standard technology	• Standard technology used • Distribution assets purchased by DF employ technology as per industry standards and are largely in line with CERC/SERC regulations • Existing distribution-related infrastructure of DISCOM employs largely standard technology	• Obsolete technology used in the distribution of power • Existing/new distribution-related infrastructure not in conformance with CERC/SERC regulations

Source: Ind-Ra

Political Risk

Ind-Ra shall also assess the political risk involved in distribution assets, considering that the power sector is regulated by state government/ central government entities and there is a likelihood of any change in regulation that affects the stability of the operations. Any tariff change not in line with the DF agreement would be treated as an event risk. The agency factors in the stability of policies and consistent application of the policies as an important consideration.

Financial Model Assumptions

The key technical and quantitative parameters (AT&C, AIR, ABR, computation of tariff indexation ratio, threshold input energy supplied by DISCOM, etc) are a part of the DF contract and the agency shall validate the financial model assumptions provided by an DF, in accordance with the behaviour of such parameters in the DF agreement. Ind-Ra shall derive its base case assumptions in line with the stipulated parameters of the contract, corroborated by the past performance of the DF and its sponsor in a similar line of business activities.

Figure 6 shows the DSCR computation for a DF profile which collects revenue and pays the monthly bill raised by its discom for the input energy purchased along with electricity taxes as per billing formula in an input-based DF contract.

Figure 6

DSCR Computation for an Input-Based DF Model (First Variant)

Particulars (INR million)	Value
Input energy units (million kWh) --> (A)	1,000
AT&C losses (%) --> (B)	20
Energy Units Available for Sale (Million kWh) --> (C) = A*(1 - B)	800
Annualized Input Rate (current year) --> (D) (in INR/ kWh)	2.5
Average Billing Rate (base year) --> (E) (in INR/ kWh)	4
Average Billing Rate (current year) --> (F) (in INR/ kWh)	5
Tariff Indexing Ratio --> (G) = F/ E	1.25
Total input energy cost --> (H) = A*D*G	**3,125**
Other opex costs (incl. employee expenses) --> (I)	150
Total operating expenses --> (J) = H+I	**3,275**
Total gross revenues --> (K)=C*F	**4,000**
Electricity duty and taxes on sale of electricity@8% of gross revenues --> (L)	320
Total net revenues --> (M)=K-L	**3,680**
EBITDA --> (N)= M -J	405
Tax --> (O)	40
CFADS --> (P) = N - O	365
Total debt servicing obligations --> (Q)	**320**
DSCR --> (R)= P/Q	**1.14**

Source: Ind-Ra

Figure 7 shows the DSCR computation for a DF profile which collects revenue and deposits in a discom-controlled escrow account and consequently after a time lag, it receives payments from the discom, adjusted for input energy cost, as per its revenue share stipulated in the revenue sharing-based DF contract.

Figure 7

DSCR Computation for an Input-Based DF Model (Second Variant)

Particulars (INR million)	Value
Base year assumptions	
Input energy units in base year (million kWh) --> (A1)	1,000
Billed energy units in base year (million kWh) --> (B)	800
Billing efficiency in base year --> (C%)=B/A	80
Average billing rate in base year (in INR/ kWh) --> (D)	4
Billed energy to consumers in base year-> (E)=B*D	3,200
Gross revenue collected from consumers in base year --> (F1)	2,750
Electricity duty and taxes on sale of electricity @8% of gross revenues --> (F2)	220
Net revenue collected from consumers in base year --> (F3)=F2 - F1	2,530
Collection efficiency in base year --> (G%)=F1/E	86
AT&C losses in base year --> (H%) = 1-(C*G)	31.25
Revenue per unit (RPU) in base year (in INR/ kWh) --> (I) = F1/A1	**2.53**
Current year assumptions	
Input energy units in base year (million kWh) --> (A2)	1,000
Average billing rate in current year (in INR/ kWh) --> (J)	5.00
Billing efficiency in current year --> (K%)	89
Collection efficiency in current year --> (L%)	90
AT&C losses in current year --> (M%) = 1-(K*L)	20
Billed energy units in current year (Million kWh) --> (N)=A*K	889
Billed energy to consumers in current year-> (O)=J*N	4,444
Gross revenue collected from consumers in current year --> (P1)=L*O	4,000
Electricity duty and taxes on sale of electricity @8% of gross revenues --> (P2)	320
Net revenue collected from consumers in base year --> (P3)=P2 - P1	3,680
RPU in current year (in INR/ kWh) --> (Q)=P3/A2	**3.68**
Revenue share payable to DF in current year --> (R%)	50
Total revenues of DF --> (S)= (Q - I)*A*R	**575**
Opex costs (incl. employee expenses) --> (T)	150
EBITDA --> (U)= S - T	425
Tax --> (V)	45
CFADS --> (W) = U - V	380
Total debt servicing obligations --> (X)	**320**
DSCR --> (Y)= W/X	**1.19**

Source: Ind-Ra

Figure 8 shows the DSCR computation of a collection-based DF profile where revenue is generated from commission and incentives from the discom based on its ability to reduce the AT&C losses below the levels existing at the time of entering into the DF contract. The agency believes that short-term loans would only be required for managing working capital related requirements, as capex is generally funded by the discom in a collection-based DF agreement.

Figure 8

DSCR Computation for a Collection-Based DF Model

Particulars (INR million)	Value (%)
AT&C losses during contract signing (%) --> (A)	30
Billing & collection efficiency during contract signing --> (B%)=1-A	70
AT&C losses in current year (%) --> (C)	20
Billing & collection efficiency in current year --> (D%)=1-C	80
Available energy for sale to consumers in current year-> (E%)	1,000
Revenue collected from consumers in current year --> (F)=D*E	800
Commission & incentives (as a % of total revenue collections)--> (G)	10
Total revenues of DF --> (H)= F*G	**80**
Operating costs (incl. employee expenses) --> (I)	20
EBITDA --> (J)= H - I	60
Tax --> (K)	12
CFADS --> (L) = J - K	48
Total debt servicing obligations --> (M)	**40**
DSCR --> (N)= L/M	**1.20**

Source: Ind-Ra

Common FAQs

Q1. Is it necessary for the discom (acting as the counterparty to DF) to be publicly rated by Ind-Ra or any other SEBI-accredited agency?

A. It may not be necessary for the associated discom/ franchisor to be publicly rated by Ind-Ra or other credit rating agency to conduct a rating exercise on its DF company. However, a highly-rated discom with a reasonably strong credit profile will typically have the potential to provide strong operational support to the DF and therefore, Ind-Ra will factor the same while arriving at the ratings of the DF company.

Nevertheless, the discom's public credit rating is not a mandatory requirement and Ind-Ra shall independently evaluate the operational & financial performance of the discom who is a party to the DF contract.

Q2. Is it necessary for the DF's sponsor/promoters to be publicly rated by Ind-Ra or any other SEBI-accredited agency?

A. While a highly-rated sponsor with strong executional & operational experience of DF projects in the past will be an enabler to the ratings of a DF company, Ind-Ra believes the non-availability of a sponsor rating may not prohibit the agency from rating a DF company.

Ind-Ra understands that the distribution franchisee sector is still evolving, with only 12 DFs operating in the country as of April 2020 while 14 DF contracts have been annulled in the past. Therefore, Ind-Ra shall continue to rate DF companies with or without a sponsor rating; however, the agency shall independently evaluate whether a sponsor has sufficient financial flexibility to support its DF during project implementation period as well as operations period during stress scenarios.

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