Rating Rationale for DPSC Ltd's proposed Secured Non-Convertible Debentures Issue of ₹ 100 Crore with Greenshoe option of ₹ 200 crore

NCD Issue Rating: BWR A+ (SO)	Outlook : Stable

Brickwork Ratings (BWR) has assigned **BWR A+ [Pronounced BWR A Plus]** for DPSC Ltd's proposed Secured Bond Issue of ₹ 300 crore, having a tenor of 10 years. **'BWR A+'** stands for an instrument that is considered to offer **Adequate** credit quality in terms of timely servicing of principal and interest obligations.

The rating has factored, inter alia, the assured revenue model from the regulated nature of Power business, the satisfactory technical parameters of the power plants and the strong credentials of the Promoters. The rating is however constrained by Large Project implementation risk, long gestation period for the new projects, raw materials risk, balance sheet risk arising from an impending sudden growth of assets and customer concentration risk. DPSC's ability to efficiently implement and commission its large generation projects and effectively manage its capital structure coupled with expanding its revenues profile will remain important rating sensitivities.

Background

DPSC Ltd was incorporated in 1919 as Dishergarh Power Supply Company Limited as a captive unit to Bengal Coal Company Ltd. & also to cater to the power requirements of the Railways, industries and townships in Asansol – Ranigunj- Barakar coal belt. With the formation of Damodar Valley Corporation (DVC) in 1948, responsibility for power generation went to DVC and DPSC's focus shifted more to power distribution. In 1991, DPSC took over the Chinakuri Power Station of Eastern Coalfields Ltd. (ECL) on a lease for 20 years for operation and maintenance. The lease is due for renewal in April 2011. DPSC has licenses for power generation, transmission and distribution. Power supply license of DPSC, initially issued in 1932, is valid up to December 2012. The company is confident on the renewal of license.

DPSC is currently engaged in the business of generation, transmission and distribution of electricity. It has two power generating plants, with a total generating capacity of 42.2 Mega Watts (MW) both of which are located in Burdwan, West Bengal. DPSC Ltd was acquired by SREI Infrastructure Finance Pvt. Ltd. through its SPV, Orbis Power Venture Pvt. Ltd., and a group company, India Power Corporation Ltd. (IPCL). SREI holds 93% in DPSC Ltd. through Orbis and IPCL. SREI is one of the leading Infrastructure finance players in India with presence in Equipment Leasing, Project Finance etc.

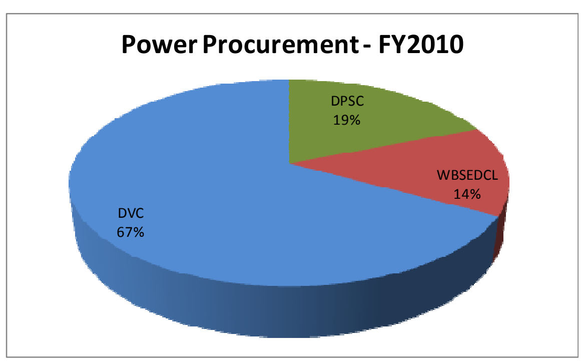
Security for the NCD Issue and use of funds

The company plans to raise Rs 300 Cr by way of secured NCD with tenor of 10 years. The NCD's will be redeemed from the 6th year onwards and carry an annual coupon of 10.75%. The proceeds will be used for setting up of new generation and augmentation/upgradation of distribution facilities, Refinancing of existing debt, and for Working Capital and general corporate purposes. DPSC is setting up 500MW thermal plant at Dishergarh and 170MW thermal plant at Chinakuri. The company plans to engage reputed EPC vendors for commissioning the power plants.

The NCD is secured through a first pari-passu charge on the immovable properties of the issuer located at various places in the state of West Bengal and/or; first pari-passu charge on assets of the issuer present and/or future; and/or first pari-passu charge over the land and building of the registered office of the company located at plot no. X-1, 2 & 3 Block EP, Sector V, Salt Lake, City Kolkata with the existing/future secured lenders such as to provide an asset cover ratio of 1.25 times of the total outstanding at all times.

Operations

DPSC is currently engaged in the businesses of generation, transmission & distribution of electricity for public and private purposes within West Bengal. It has a small generation capacity from its two power plants, at Dishergarh (12.2 MW) and Chinakuri (30 MW) in West Bengal. The Company's generation meets about 19-20% of power demand in the allocated license area, while the balance is sourced from DVC and West Bengal State Electricity Distribution Company Ltd. (WBSEDCL). Presently power purchase costs account for around 72% of DPSC's total expenses. The ageing plants (particularly Dishergrh which is over 45 years old) have resulted in very low PLF of about 25%. The company's Dishergarh plant will be decommissioned and closure is expected by September 2011. DPSC proposes to set up its new generation capacity at the location.



The company procures most of its coal requirements from ECL. Fuel costs about 13% of the company's expenses. Shortage of fuel (coal), due to coal supply linked to a lower normative (SHR) Station Heat Rate than the actual SHR achieved, have resulted in loss of generation. For its new projects, the company expects to get appropriate coal availability as the SHR performance is likely to be within the normative range.

On the distribution front, DPSC has a license area of 618 sq km with a capacity of ~190 MVA (11Kv - 30 Switching Stations and 33 Kv - 11 Switching Stations). The company also has 8 sub stations through which it distributes power. Transmission and distribution losses of the company are within the prescribed regulatory limits at about 4-4.5%. DPSC's customers primarily comprise of high and extra high voltage category from the industrial belt with over 50% of its revenues coming from ECL. DPSC has a fully metered network with a strong collection efficiency of almost 99%. The company operates on a cost plus profit percentage tariffs model fixed by West Bengal Electricity Regulatory Commission (WBERC). The tariff order for 2010 – 2011 was passed in July 2010.

The Company also has a solar plant at Shibpur with a total generating capacity of 2 MW of which 1.2 MW is operational. The plant is in collaboration with West Bengal Green Energy Corporation Ltd

Project Implementation

DPSC is primarily a power distribution company with very low existing generation capacity of 42.2 MW with aged plants. In order to augment its generation capacity, DPSC's proposes to set up plants at Chinakuri (160MW) and at Dishergarh (2*250MW) with aggregate project costs of about ₹ 3,700 crore. The projects are expected to be commissioned in FY13 and FY14 respectively. With these new capacities coming on stream, DPSC will benefit from availability of low cost power from efficient plants. (PLF of ~80% vis a vis current PLF of ~25% at Dishergarh). Further, it will also enable the company to tap open access sales. However, the large size and scale of these projects spread over 2- 3 years gives rise to risks related to timely execution and implementation of the capex programme. DPSC looks to address these through appropriate EPC contracts with reputed vendors such as BHEL, Thermax etc.

Financial Performance

Moderate revenue growth: DPSC's revenues increased to ₹ 410 crore in FY10 from ₹ 379 Crore in FY09, registering a moderate growth of 8.3%. However, EBITDA decreased marginally to ₹ 15 crore in FY10 from ₹ 16 crore in FY09 due to rising fuel and employee costs among others. The company registered a PAT of ₹ 14.2 Crore in FY10, an increase from ₹ 7.6 crore in FY 09 primarily on account of lower interest expense and extraordinary income of Rs. 5 crore on sale of long term investments.

Healthy capital structure in the past: Networth of the company stood at ₹ 103.86 Crore in FY10 while total borrowings were at ₹ 15.42 crore. DPSC's proposed upgrade of its existing generation and T&D capacities as well as its power generation units at Chinakuri and at Dishergarh with aggregate project costs of about ₹ 3,700 crore will involve significant debt coming on books. The projects will be funded through a debt-equity mix of 70:30. DPSC has already raised ₹ 100 crore through NCD issue in November 2010 and another ₹ 200 crore is expected to be raised by end of FY11. Consequently leverage is expected to increase to 2.71x in FY11 from 0.16x in FY10.

Although, the company's proposed capacity expansion in power generation projects (500MW & 160 MW) is expected to lower its reliance on power purchased from WBSEDCL and improve operational efficiency, the large capex is likely to put pressure on the company's cashflows during the project implementation stage. Project debt which will be raised over the next 2 years is expected to further strain the DPSC's capital structure in the near term. The company anticipates that favorable tariff revisions will help in improving revenues for the company. Further, DPSC plans to finance the projects (debt and equity) in a phased manner to ensure timely completion of the projects as well as effectively manage any financial strain on the company.

For the half year ended September 30, 2010, the company registered net sales of ₹ 208.04 crs, an increase of 2% from net sales of ₹ 203.73 crs for half year ended September 2009. Net profit in H2FY11 stood at ₹ 6.64 crs as compared to ₹ 4.82 crore in the corresponding previous half year.

Abridged Balance Sheet, P&L, Key financial ratios for the period FY08 – FY10 and the performance for half year ended September 30, 2010 have been given in Annexure I, II, III and IV respectively.

Rating Outlook

The power sector in West Bengal looks buoyant with necessary expansion required in generation, transmission and distribution networks to meet the continuing demand supply gap in the state. Going forward, DPSC intends to expand its customer base as well as gather more revenue from power generation. The Company is also likely to benefit from the strength of SREI group in the infrastructure business. The timely completion of these projects remains one of the risk factors for this NCD. Additionally, DPSC will be exposed to balance sheet risk because of large levels of debt it plans to take for implementation of these projects.

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Key Financials for DPSC

Annexure I: Balance Sheet

₹ Crore

	2010	2009	2008
Liabilities			
Equity Share Capital	4	4	4
Reserves	101	87	80
Tangible Networth	**104**	**91**	**84**
Secured Loans	15	26	50
Total Debt	**15**	**26**	**50**
Other Funds	6	11	25
Deferred Tax Liability	14	15	14
Total Liabilities	**144**	**143**	**157**
Assets	**2010**	**2009**	**2008**
Gross Fixed Assets	146	143	125
Accumulated Depreciation	36	32	27
Net Fixed Assets	**110**	**111**	**98**
CWIP	6	5	11
Investments	4	5	5
Current Assets	**143**	**127**	**114**
Receivables	118	107	85
Inventories	9	9	8
Cash & Bank	7	4	12
Loans & Advances	7	6	7
Current Liabilities	119	105	70
Net Current Assets	**24**	**22**	**43**
Total Assets	**144**	**143**	**157**

Annexure II: Abridged Profit and Loss

₹ Crore

Particulars	2010	2009	2008
Net Operating Income	**410**	**379**	**320**
EBIDTA	**15**	**16**	**8**
Depreciation & Amortization	5	5	4
Interest	3	5	5
Other Income	3	4	3
Exceptional Items	5	-	-
PBT	**16**	**10**	**3**
Tax	1	3	2
PAT	**14**	**8**	**1**

Annexure III: Ratio Analysis

	2010	2009	2008
Debt Equity Ratio (x)	0.16	0.31	0.61
Interest Coverage (x)	5.01	3.02	1.69
Debt-Service coverage ratio (x)	3.21	1.99	1.13
Operating Margins (%)	3.66	4.32	2.54
Profitability margins (%)	3.46	2.00	0.33
Return on capital employed (%)	13.83	11.78	5.06
Net cash accruals to total debt (x)	1.13	0.42	0.08
Current ratio (x)	1.11	1.09	1.39

Annexure IV: Performance for Half Year ended 30th September 2010

₹ Crore

Particulars	Half Year Ended	
	30-09-2010	30-09-2009
Net Sales	208.0	203.7
Operating Income	0.65	0.04
Total Operating Income	**208.7**	**204.1**
Raw Material consumption	15.7	27.3
Energy Purchased	158.5	143.1
Staff Costs	15.5	14.3
Other Expenses	8.0	9.6
Cost of Sales	197.7	194.2
EBITDA	**10.4**	**9.5**
Interest	0.8	1.5
Depreciation	2.7	2.7
OPBT	**6.9**	**5.3**
Other Income	1.5	1.5
Exceptional Item	1.5	
PBT	**9.9**	**6.7**
Tax	3.3	1.9
PAT	**6.6**	**4.8**