

India Ratings Assigns Andhra Pradesh Power Finance Corporation Limited's Bank Facilities 'IND A(CE)'/Stable

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India Ratings and Research (Ind-Ra) has rated Andhra Pradesh Power Finance Corporation Limited's (APPFCL) bank loans as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Size of Issue (million)	Rating/ Outlook	Rating Action
Bank loans	-	-	INR90,165.95	IND A(CE)/Stable	Assigned
Proposed bank loans	-	-	INR69,834.05	Provisional IND A(CE)/Stable	Assigned
Unsupported rating\$	-	-	-	IND BB+/Stable	Assigned

#Ind-Ra has assigned provisional ratings to the proposed bank loans. The final rating, upon the receipt of sanction letter, the government order for the pre-default guarantee and documents confirming the additional debt service reserve account (DSRA) maintenance, shall be assigned within 90 days from the date of issuance of the instrument. The provisional rating may be extended by another 90 days, subject to Ind-Ra's policy, if the execution of the documents is pending. In the absence of the documentation considered while affirming the provisional rating, the agency would have rated the proposed bank loans at 'IND BB+'.

\$Ind-Ra has assigned an 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: Ind-Ra has factored in the strong legal and financial linkages between APPFCL and the government of Andhra Pradesh (GoAP). Ind-Ra takes comfort from the unconditional, irrevocable and continuing pre-default guarantee agreement executed between the GoAP, APPFCL and the banks, which will remain in force and effect until the loans are fully repaid. Basis the pre-default guarantee, a CE suffix is assigned to the rating of the proposed bank loans.

Key Rating Drivers

Pre-default Government Guarantee for Bank Loans: The GoAP has given an unconditional, irrevocable and continuing pre-default guarantee for the bank loans of APPFCL, which will remain in force and effect until the loans are fully repaid. A tripartite agreement has been executed between the guarantor, borrower and lender. The GoAP will act as the principal debtor and not merely as surety and would pay principal/interest and other charges in entirety to the bank. The deed of guarantee specifies an obligation on the part of the GoAP to fund the shortfall in

DSRA when called upon by the bank, as per the stipulated timeline in the guarantee deed.

Ind-Ra, in its analysis, has stressed the GoAP's credit profile by considering a sizeable portion of the guarantee to devolve. As per Ind-Ra's analysis, the guarantor, even in the stress scenario, is likely to meet all the guaranteed debt obligations.

Adequacy of Credit Enhancement-Structured Payment Mechanism with Adequate DSRA: The GoAP has maintained adequate DSRA for the bank loans of APPFCL. The guarantor shall ensure repayment of interest and principal or any other charges of the aforesaid credit facilities on or before the due dates and will ensure that the borrower deploys adequate funds with the lender bank in the form of liquid assets such as DSRA deposits equivalent to at least one installment of principal and interest prior to 15 days of the due date with a condition that the bank shall have full rights to block the funds from withdrawal within 15 days of the due date of payment and to use the funds for debt servicing on the due date without seeking any further permission from the borrower in case the repayment/interest payment amount is not made available by the borrower on the due date.

In the event of a shortfall in the DSRA deposits equivalent to the interest and principal prior to 15 days of the due date, the bank shall issue a notice of default to both borrower and guarantor immediately. The borrower within five days of receiving the notice of default (before 10th day from the due date) shall cure the shortfall in the DSRA deposits. In case of any default in curing the shortfall in the DSRA deposits before the 10th day from the due date by the borrower, the bank shall make a demand to guarantor to make good the shortfall in DSRA deposits within five days (at least five days from the due date).

If at any time, the shortfall in the DSRA deposits is not made good by the borrower at least prior to five days of the due date, with interest and principal, the bank shall invoke the guarantee on the third day before the due date. The guarantor shall forthwith, upon invocation, pay to the bank without any protest/demur/deduction, the outstanding amount as on date of default together with interest, costs, charges, expenses that may be due to the bank in respect of the credit facilities.

APPFCL had been servicing its bank loan's debt liability on a timely basis. However, in March 2023, there was a delay the repayment due to a technical glitch in the GoAP's comprehensive financial management system.

Recovery in State's Economic Performance: AP's economic structure is somewhat different from that of the national economy. The share of agricultural sector in the state economy is higher at 31.9% than the sector's share in the national economy (15.1%) in FY23. The share of industry in the state's economy reduced to 27.1% in FY23 from 32.2% in FY12. At 6.2%, the gross state value added (GSVA) growth of AP during FY12-FY23 was higher than the all-India growth. GSVA growth was driven by the services sector and agricultural sector, while average industry/manufacturing sector growth was lower than the national average during FY12-FY23. The GSDP growth of AP shrunk by 2.5% in FY21, much lower than the peer states and all-India level. The rebound was also stronger with a growth of 11.2% in FY22 (all-India: 9.1%). The GSDP growth in FY23 stood at 7.0%, lower than 7.2% at the all-India level.

State's Moderate Fiscal Performance: According to the revised estimate (RE) for FY23, the revenue balance clocked a deficit of 2.2% against the budgeted estimate (BE) of 1.3% of GSDP. The revenue deficit was higher than the budgeted levels due to a shortfall of INR147.77 billion in the revenue receipts of INR1,912.25 billion in FY23 (BE). The fiscal deficit/GSDP ratio was, however, the same as the budgeted estimate at 3.6% in FY23(RE), due to a lower-than-budgeted capex. For FY24, the state government expects revenue deficit of 1.5% and fiscal deficit of 3.8% of the GSDP.

Dependent Public sector entity: APPFCL is a 100% state-government owned company and has strong operational, managerial and financial linkages with the GoAP. The GoAP nominates members to APPFCL's board, thereby exercising strong hold over its policies and strategies. APPFCL is entrusted with the provisioning of funds to entities in the power sector at lower rates than existing public financial institutions to reduce the interest cost of these entities. The lower interest cost is likely to eventually help the final customer, thereby serving larger social benefit.

Strategically Important to GoAP: APPFC's primary objective is to provide funds to power sector entities, in order to bring down the funding cost of these entities, to ultimately benefit the public at large. APPFCL has maintained the rate of interest at the same levels for a long time. With many structural reforms being carried out in the power sector, APPFCL is likely to provide the much-needed debt capital at competitive rates, which will reduce the cost of debt. Ind-Ra considers the strategic importance of APPFCL as moderately supportive of its credit quality.

Liquidity Indicator - Adequate: As on 31 March 2023, APPFCL did not have any cumulative asset liability management mismatches for the next one year. Furthermore, Ind-Ra believes APPFCL has the financial flexibility to get bank limits sanctioned, for which it has a demonstrated track record. This provides comfort to the liquidity position.

Adequate Capitalisation and Nil Slippages: APPFCL's capital-to-risk weighted assets ratio (CRAR) stood at 27.22% (Tier – I: 24.74% and Tier – II: 2.48%) at FYE23, well above the regulatory threshold of 15%. The CRAR has been witnessing an improving trend. Ind-Ra believes the CRAR ratio will remain comfortably above the minimum threshold in the near-to-medium term.

Though the entity has overdue receivables, it did not have any NPA accounts during FY19-FY23. As the monies are lent to public sector undertakings and are guaranteed by the GoAP, there was no instance of an account turning NPA and the dues were met before the regulatory timelines. However, as per the Reserve Bank of India's (RBI) guideline, the entity has made a provision on standard assets at 0.40% on the loans advanced to the power companies within the state of Andhra Pradesh.

Concentration in Portfolio: APPFCL offers funding only to the power sector entities of Andhra Pradesh (AP). The aim of APPFCL is to become an alternative to other lenders for the GoAP's power sector entities. APPFCL has to offer lesser rate of interest to these entities, so that their financial health improves. The objective constrains APPFCL's ability to borrow as well as lend funds at a higher rate. This particular aspect reflects in the loan book, which does not show continuous growth. The assets under management fell to INR142,190 million in FY23 from INR185,392 million in FY22 on account of prepayments from the AP power distribution companies.

Continued Default on Bonds Issued Prior to State Bifurcation: The bonds issued by APPFCL before the state's bifurcation have been in default (Ind-Ra does not rate these bonds) since September 2015. APPFCL has been paying its share of dues, as per the state bifurcation plan, on time. However, there have been delays in payments to bond holders by Telangana State Power Finance Corporation (TSPFC). Telangana has contested the scheme of debt bifurcation between APPFCL and TSPFC. The bank loans for which Ind-Ra has assigned ratings have already been drawn by APPFCL. These have a guarantee from the GoAP, which shifts the credit risk to the GoAP from the balance sheet of APPFCL. For the unsupported rating, the bank loan facilities availed by APPFCL have been serviced in time and this is likely to continue, considering APPFCL's financial flexibility. However, it is constrained by any risks that might emanate from the continuing default on the bonds issued earlier by APPFCL.

Rating Sensitivities

For CE Rating

Positive: A positive rating action could result from an improvement in GoAP's credit profile.

Negative: The following developments, individually or collectively, could lead to a negative rating action:

- deterioration of the GoAP's credit profile
- any weakening of linkages with the GoAP, including liquidity support on a timely basis
- significant deviation from the structured payment mechanism.

For Unsupported Rating

Positive: An overall improvement in the financial health of APPFCL along with the curation of the default of the listed bonds will be positive for the ratings.

Negative: The following developments, individually or collectively, could lead to a negative rating action:

- receivable build-up, resulting in a deterioration of liquidity and/or large asset liability management mismatches
- the CRAR falling below 18%

Company Profile

APPFCL was incorporated as a government company under the Companies Act, 1956 on 12 July 2000, with 100% ownership by the government of Andhra Pradesh. APPFCL is also registered with the RBI as a non-banking finance company– non-deposit taking systematically important company with effect from 25 August 2000. The objective of the company is to support/augment the resources for financing the power sector reforms in the state of Andhra Pradesh.

FINANCIAL SUMMARY

APPFCL

Particulars (INR billion)	FY22	FY23
Total assets	185.39	142.84
Net interest income	2.01	2.46
Net income	1.49	1.92
Gross NPA (%)	-	-
CRAR (%)	15.00	27.22
Source: APPFCL; Ind-Ra		

GoAP

(As a % of GSDP)	FY23(RE)	FY24(BE)
Revenue balance	-2.2	-1.5
Fiscal balance	-3.6	-3.8
Total debt	32.5	33.5
Source: GoAP, Ind-Ra		

Non-Cooperation with previous rating agency

APPFCL has been placed in the non-cooperating category by Brickwork Ratings India Private Limited due to inadequate information provided by the company for the review.

Solicitation Disclosures

Additional information is available at www.indiaratings.co.in. The ratings above were solicited by, or on behalf of, the issuer, and therefore, India Ratings has been compensated for the provision of the ratings.

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APPLICABLE CRITERIA

Local and State Government Rating Criteria

Rating of Public Sector Entities

Evaluating Corporate Governance

Policy for Credit Enhanced (CE) Ratings

Policy on Provisional Ratings

The Rating Process

Annexure

Covenants

The guarantor shall ensure repayment of interest and principal or any other charges of the aforesaid credit facilities on or before the due dates and will ensure that the borrower deploys adequate funds with the lender bank in the form of liquid assets like DSRA deposits equivalent to at least one installment of principal and interest prior to 15 days of the due date with a condition that the bank shall have full rights to block the funds from withdrawal within 15 days of due date of payment and to use the funds for debt servicing on the due date without seeking any further permission from the borrower in case of default of repayment/interest payment by the borrower on the due date.

In the event of shortfall in DSRA deposits equivalent to the interest and principal prior to 15 days of the due date, the bank shall issue a notice of default to both borrower and guarantor immediately. The borrower within 5 days after notice of default (before 10th day from due date) shall cure the shortfall in DSRA deposits. In case of default of curing shortfall in DSRA deposits before 10th day from due date by borrower, the bank shall make a demand to guarantor to make good the shortfall in DSRA deposits within 5 days (at least 5 days from the due date). If any time, shortfall in the DSRA deposits is not made good by the borrower at least prior to 5 days of the due, with interest and principal, the bank shall invoke the guarantee on the 3rd day before the due date. The guarantor shall forthwith, upon invocation, pay to the bank without any protest/demur/deduction, the outstanding amount as on date of default together with interest, costs, charges, expenses that may be due to the bank in respect of the credit facilities.

The guarantee extended is unconditional, irrevocable and enforceable at all the time during the tenor of the loan, against the guarantors notwithstanding any dispute between the bank and the borrower.

The guarantor undertakes to comply with the guarantee deed and act as principal debtor, not merely as surety and pay principal/interest and other charges as per the guarantee deed in entirety to the bank.

The guarantor undertakes to make the payment under the guarantee forthwith upon receipt of first notice from the bank as per the terms of the deed.

The liability of the guarantor under the guarantee deed shall not be affected nor shall the guarantee deed be discharged or diminished by reason of any renewal, variation or modification of the terms of credit facilities between the bank and the borrower and agrees to waive the rights offered to it under the contract act or any other relevant laws.

The guarantee shall not be affected by an infirmity or irregularity on the part of the company to undertake all or any other obligations thereunder including any reference to the company under the insolvency and bankruptcy code, 2016 or under the

purview of any other authority with powers in respect of liquidation/winding up initiated by or against the company.

Annexure-II

Sl.no.	Pending Critical Documentation while Assigning Provisional Rating*	Risks Associated with Provisional Nature of Credit Rating in the Absence of Completed Documentation or Change in Documentation
1	Final sanction letter	In the absence of executed documents, the transaction structure would be weak.
2	GoAP guarantee order	
3	Tripartite pre-default guarantee deed signed between the bank, APPFCL and the GoAP	
6	Creation of minimum DSRA (as per the Sanction Letter)	Non-creation of minimum DSRA would increase the vulnerability to cashflow mismatches and the risk of timely debt servicing.
*Additionally, any other relevant documents executed for the transaction should be provided to the agency.		

Bank wise Facilities Details

Click here to see the details

Complexity Level of Instruments

Instrument Type	Complexity Indicator
Bank loans	Low

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

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Ind-Ra currently maintains coverage of corporate issuers, financial institutions (including banks and insurance companies), finance and leasing companies, managed funds, urban local bodies and project finance companies.

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