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December 19, 2011

Industry View
Cautious

India Utilities

Key Highlights from the Shunglu Committee Report on SEBs

Effectiveness lies in implementation: Most of the committee's recommendations to improve the future performance of distribution companies are intuitive – but their effectiveness would lie in their implementation. In 2001-03 the discoms were similarly bailed out with the proviso that they would improve their performance, which has clearly not happened. In our view, the committee has proposed another bailout through the SPV, but it remains to be seen whether RBI would be willing to be a party to this.

The Committee submitted its report on December 15… In July 2010, the Planning Commission set up a High Level Panel (Shunglu Committee) to look into the financial problems of the SEBs and identify corrective steps. The committee has found the accounts of many of the discoms to be in a less than desirable state. It estimates that the losses of discoms (post subsidy) of Rs270 bn in F2010 could come down to Rs221 bn by F2017 provided the discoms actively correct course.

…making certain key recommendations for discoms to correct their course:

- Creation of a SPV, with a line of credit from RBI, to buy distressed loans of discoms
- Improving the quality of accounts via computerization and rationalization of outstanding receivables
- Use of pre-paid meters for defaulting consumers
- Introduction of a zone-based loss surcharge, linked to the zone's loss levels, in bills
- Improving independence of the SERCs by changing the method of appointing members
- Monitoring of SERCs' performance in terms of regular and if required suo-moto tariff hike implementation by the SERCs

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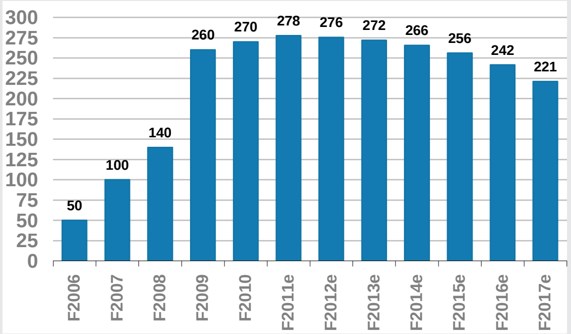
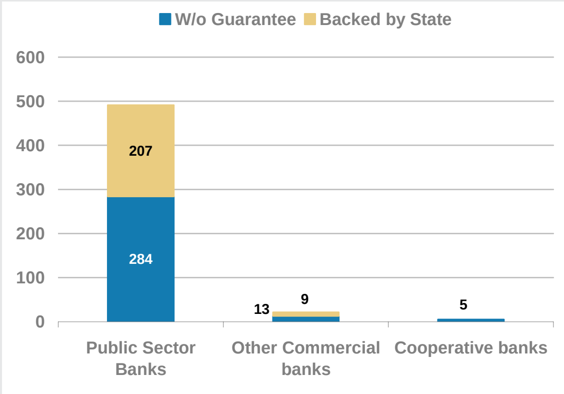
Dicoms' Net Loss (post subsidy) (Rs bn)



E=Shunglu Committee estimate
Source: Shunglu Committee Report, Morgan Stanley Research

Banks' Lending to Discoms in Last Fibe years (Rs bn)



Source: Shunglu Committee Report, Morgan Stanley Research

State of the Accounts

Despite repeated efforts by the committee, the F2010 accounts of Bihar, Jharkhand and UP could not be audited – hence, the unaudited versions have been used by the committee. The committee's analysis excludes West Bengal and Chhattisgarh because of issues with the data. It also does not include Goa and the northeastern states because these states have not corporatized the power distribution function. Hence, the finances of power distribution in these states are still a part of the state budget.

Sharp increase in current assets: The committee has noticed the significant increase in the current assets of the discoms between F2005 and F2010. The committee has not been able to establish what constitutes these current assets in the case of many states, especially UP, Rajasthan, AP and to some extent Maharashtra and MP. That's because those states have not maintained proper current assets records and registers. The committee believes the current assets could be including subsidy which remains to be paid by the state governments in some cases (AP and Rajasthan) and losses not shown as such in others.

Exhibit 1

Current Assets of Discoms

Curerent Assets (Rs bn)	F2010	F2005	Change
Cash and bank balances	100	50	50
Stocks	70	30	40
Sundry Debtors	560	310	250
Loans and Advances	50	10	40
Other Current Assets	770	210	560
Total	1,550	610	940

Source: Shunglu Committee Report, Morgan Stanley Research

Poor quality of receivables: The committee has found that while days receivable as a range have come down in F2010 from F2005, they remain extremely high. In fact, they have increased in many cases, for example UP and MP. In some cases like Bihar, the days receivable are so high that the committee doubts these can be classified as good debt at all.

The committee cites the case of Bhiwandi to illustrate the poor quality of the receivables. After the distribution area of Bhiwandi was handed over as a franchise five years back, all parameters in the area have improved. Technical losses have decreased to 15% and there are practically no commercial losses. But, the receivables outstanding at the time of the handling over of the franchise could not be collected. This goes to illustrate the doubtful quality of receivables in the case of many discoms.

Exhibit 2

Receivables Quality

Rs bn	F2010	F2005
Receivables	560	310
Revenue	1,500	900
Collection Period (Range)	36 to 645 days	54 to 933 days
MP	241 days	198 days
UP	317 days	199 days
Bihar	606 days	1006 days

Source: Shunglu Committee Report, Morgan Stanley Research

Recommendations by the committee:

- Physical verification and preparation of fixed asset register
- A program of stock reconciliation and physical verification
- Inter-unit reconciliation of accounts
- Review of the receivables outstanding with a view to enumerating what is recoverable and what is not
- Systematic and comprehensive computerization

Discoms' Losses

The committee has found the losses (post subsidy) of the discoms to have increased from Rs50 bn in F2006 to Rs270 bn in F2010. In the same period the loss (before subsidy) has increased from Rs170 bn to Rs570 bn. The reliance on subsidies has been found to have increased with the share of subsidies in the revenue having increased from 14% in F2006 to 20% in F2010.

Exhibit 3
Discoms' Losses F2006-F2010

Rs bn	F2010	F2009	F2008	F2007	F2006	Total
Revenue	1,500	1,340	1,190	1,070	900	6,000
Subsidies	300	250	170	130	120	970
Other Income	70	60	60	50	50	290
Total	1,870	1,650	1,420	1,250	1,070	7,260
% subsidy/revenue	20%	19%	14%	12%	14%	16%
Total expenditure	2,140	1,910	1,560	1,350	1,120	8,080
Net profit before subsidy	-570	-510	-310	-230	-170	-1,790
Net profit after subsidy	-270	-260	-140	-100	-50	-820

Source: Shunglu Committee Report, Morgan Stanley Research

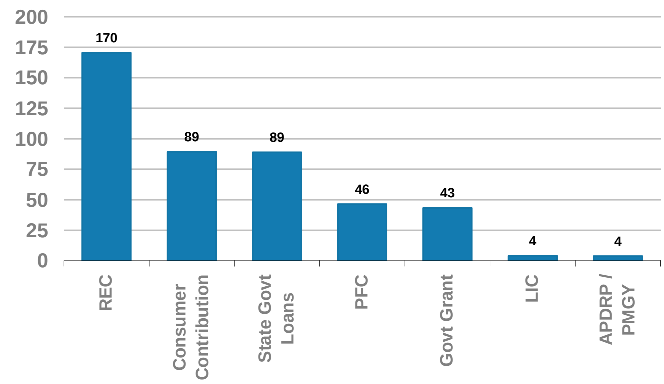
The cumulative losses in the last five years stand at Rs820 bn. This has been financed mainly through loans, which stand at Rs585 bn. Over 70% of the loss is financed by loans from public sector banks and only 42% of all bank loans are backed by state government guarantee.

Exhibit 4
Financing of Losses in the Last Five Years

Financing of Loss	Rs bn
Total Loss	820
Curr Assets - Curr Liabilities	70
Long term loans + own funds - creation of fixed assets	165
Bank Loans	585
Total	820

Source: Shunglu Committee Report, Morgan Stanley Research

Exhibit 5
Long Term Loans of discoms (Rs bn)



Source: Shunglu Committee Report, Morgan Stanley Research

The committee has also endeavored to forecast the losses till F2017 to provide a flavor of what would unfold in the 12th Plan Period. The basis of the committee's forecast is the power demand projection done by CEA as a part of the Eighteenth Power Survey. It has also incorporated CEA's estimate of the rate of power loss reduction for each state based on the current loss level in the states. Based on the above, the committee forecasts that the aggregate loss of the discoms (post subsidy) in F2017 could come down to Rs221 bn from Rs270 bn in F2010. The estimate assumes that the aggregate losses decline from 24% in F2010 to 19% in F2017.

Exhibit 6
Discoms' Losses (F2011e-F2017e)

Rs bn	F2010	F2011e	F2012e	F2013e	F2014e	F2015e	F2016e	F2017e
Revenue from sale of power	1,575	1,893	2,087	2,293	2,517	2,763	3,031	3,341
Subsidies and grants	297	327	361	395	430	469	511	558
Total Revenue	1,872	2,220	2,448	2,688	2,947	3,233	3,543	3,899
Total Expenditure	2,141	2,498	2,724	2,960	3,213	3,489	3,784	4,120
Profit (post subsidy)	-270	-278	-276	-272	-266	-256	-242	-221
Power Consumed (bn units)	445	526	580	637	698	765	839	923
Power Available (bn units)	586	689	751	816	885	961	1,042	1,134
Power Lost (bn units)	141	163	171	179	187	195	203	211
% units lost (T&D)	24%	24%	23%	22%	21%	20%	19%	19%
Avg Cost per unit sold	4.81	4.75	4.70	4.65	4.60	4.56	4.51	4.46
ARR per unit	4.21	4.22	4.22	4.22	4.22	4.22	4.22	4.22
Subsidy per unit	0.51	0.47	0.48	0.48	0.49	0.49	0.49	0.49

E= Shunglu Committee estimate
Source: Shunglu Committee Report, Morgan Stanley Research

Recommendations

Guarantee Redemption Funds: Ten states have set up guarantee redemption funds, which currently have Rs40 bn. The committee recommends that RBI should allow states to draw down from these funds in order to meet liabilities incurred by these states to banks.

Future bank lending: Discoms should receive loans only against verifiable assets and with the concurrence of the SPV. Cash credit and hypothecation facilities should not be available as these are not possible to monitor.

RBI backed SPV: The committee recommends setting up a Special Purpose Vehicle (SPV) entitled to purchase loans of banks where the public sector bank believes that it needs to redefine its portfolio. The Reserve Bank of India would extend a line of credit to the SPV to make the purchases. 76% of the share capital of the SPV would be held by RBI, while PFC and REC would hold the balance. The committee envisages such purchase of loans happening under certain conditions, some of which are:

- Bank should have negotiated with the state and come to an agreement on a revised payment schedule.
- The state government should have agreed to regular tariff increases to meet all current expenditure of discoms including interest payments
- The state government should have prepared an operational plan in consultation with the SPV to improve on the discom's technical and operational parameters and to franchise the distribution in the state.
- The state government should have taken all steps required to maintain independence of the regulator.
- The distribution utility would be required to undertake capital expenditure for technical and operational up gradation as a first priority.
- Any avoidable defaults by a state would be reported by the SPV to the RBI and RBI would be entitled to debit the defaulted amount from the account of the state government with the RBI.

Other Issues

Functioning of Regulators

Impartiality of regulators: The committee has recommended barring people who have worked with the state government in the last five years from taking positions on the SERC to maintain the impartiality of the regulators.

Tariff hikes without audited accounts: The committee has found that the SERCs' insistence on audited accounts for truing up and tariff determination exercise is often the reason for the delay in the tariff determination. It has recommended that the SERC should discharge their statutory duty of tariff determination with the best available data.

Suo-moto tariff hikes: The committee cites the Appellate Tribunal of Electricity (ATE) judgment of November 11 to re-iterate that the SERCs need to carry out suo-moto tariff hikes if the discoms don't file tariff hike petition in time.

Tariff dhock: The committee has recommended that the regulator should not implement partial tariff hikes to avoid tariff shock for consumers.

State Governments' Role

Uniform retail tariffs: The committee has found that some states have directed the regulators to maintain uniform retail tariff in the state for all discoms. This forces inefficient discoms to suffer losses. The committee has recommended removing this practice.

Overstating agricultural consumption: The committee found that agricultural consumption of power is always an estimate and is often overstated to hide the losses.

T&D Losses

The aggregate T&D losses in F2010 were 30.59%.

Tariff based on actual T&D loss: The committee has found that setting tariff on the normative T&D loss levels is another contributor to discoms' losses. Reducing T&D losses is often not in the discoms' control due to political intervention.

Loss surcharge: The committee has recommended introducing the concept of loss surcharge in the bill. This will ensure areas with higher commercial losses are billed higher.

RAPDRP Scheme Review

12th Plan: The committee has recommended extending the scheme to the 12th Plan period.

Expanding coverage: The scheme should be extended to all peripheral areas of existing cities covered under the scheme as that can be done with very little extra effort.

RGGVY Scheme Review

Metering: The committee has recommended that all consumers, including BPL consumers, should be metered and a suitable tariff collected from them.

The planning for domestic supply in rural areas should be done on the basis of 1 KW per house.

Franchise Model

The committee has found that the franchise model of power distribution has been running successfully in many areas and recommends adoption of the same. In this model the franchisee gets very less incremental income from tariff hikes and has to depend on reduction of T&D losses and addition of customers to increase its revenue. Hence, the efficiency of the system has been found to increase in towns with the franchise model.

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Industry Coverage:India Utilities

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NTPC (NTPC.BO)	O (06/13/2011)	Rs161.05
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