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High debt puts gencos in a fix over cost clause

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POWER companies that have got captive coal mines in the recent auction are in a bind as they need to get into power purchase agreements (PPAs) that allow a fixed cost of ₹3.50 per unit and above to run the capacities linked to these mines, a near-impossible task in the current scenario.

Given the skewed debt-Ebitda ratio of most power companies, they can't operate the capacities which are to be fed from the newly won mines unless the revenues are enough to service the debt in relation to them and pay the annual premiums to the government (see chart).

A failure in paying the premiums to state governments could lead to hefty penalties on the firms, apart from the possibility of being blacklisted and barred from participating in future auctions.

Intense competition to get committed consumers via PPAs, analysts say, is bound to keep fixed cost below ₹2.50 per unit in any new agreement. Companies that have bound themselves to forego pass-through on fuel costs have little option but to expect the Centre to relent on its directive capping the fixed cost for any future procurement of power from a developer under the so-called Case-1 bidding.

The Centre's directive, which Union power minister Piyush Goyal justified even last week, is meant to ensure that "no undue and ineligible cost is loaded on the fixed charge", thus negating expected gains in tariff reduction from the reverse bidding methodology adopted for auction of coal blocks. The government's contention is that the companies were supposed to bid with their eyes open and if they hadn't, they can't expect the government to bail them out.

"The private sector may have bid in an irresponsibly aggressive manner. There is credence to this if one looks at a clear mismatch between the annual earnings for some companies over the last few years and the amounts they have to pay to the state governments (as premium)," Rajiv Mishra, MD, CLP India, the Indian arm of Hong Kong-based power company CLP, told *FE*.

Power companies are looking for PPA-bound consumers for nearly 22-25 GW of power by 2017.

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In a precarious state

Company	Coal block won	Untied capacity	Minimum tariff required for debt servicing (₹/unit)	Annual premiums to be paid to states (₹ cr)	Firm's debt/ Ebitda ratio* (FY14)
GMR Infra	Talabira-I & Ganeshpur	1,370	3.5	223	17.8
Adani Power	Jitpur	900	2.9	65	12.1
Jaiprakash Power	Amelia North	825	3.2	207	13.8
Essar Power	Tokisud	1,200	3.1	215	13.2 (FY 13)
CESC	Sarisatolli	None	2.7	81	3.45

*A ratio above 5 means debt servicing is constrained

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Given the tepid demand, this means that the fixed cost will be around Rs 2.50 per unit in new PPAs (under agreements signed in the last three years, fixed costs stood between Rs 2.75 and Rs 3 a unit. "State discoms have signed just about 8.5 GW of long-term PPAs in the last three years because of stretched financials, large capacity of existing PPAs and sluggish power demand. This will restrict any sharp increase in fixed tariffs (due to competition)," Crisil Research said in a report.

Among the firms that bagged coal blocks in the auction, only CESC has got PPA consumers for its entire capacity and has a healthy debt-Ebitda ratio.

"A very generous formula will only yield a fixed cost above Rs 2.50 per unit even if SERCs (state electricity regulatory commissions) take Rs 7 crore per megawatt for calculation. At this rate it would be extremely difficult for companies to offset the under-recovery in fuel cost to result from the aggressive bidding for coal mines," an industry analyst told FE on condition of anonymity. "These companies could fail to pay the premiums to state government."

Two companies, Monnet Ispat and Jindal India Thermal, have already moved court against the government's directive on capping the fixed cost. These companies have alleged that the directive was not a part of bidding norms and should be struck down. They have also pleaded that they be allowed to relinquish the blocks if the government stays on course to cap the fixed cost. The companies together won the Mandakini coal block as a joint venture while Monnet Ispat won Utkal-C.