



## Fitch Affirms Ceylon Electricity Board at 'AA-(lka)'; Outlook Stable

Fitch Ratings - Colombo - 11 Nov 2022: Fitch Ratings has affirmed Sri Lanka-based Ceylon Electricity Board's (CEB) National Long-Term Rating at 'AA-(lka)' with a Stable Outlook. We have also affirmed the National Long-Term Rating on CEB's senior unsecured debentures at 'AA-(lka)'.

CEB's ratings are equalised with that of its parent, the Sri Lankan sovereign (Long-Term Local-Currency Issuer Default Rating: CCC/Under Criteria Observation), in line with Fitch's Government-Related Entities (GRE) Rating Criteria. This is based on our assessment of a very strong likelihood of support from the state. CEB is the country's monopoly electricity transmitter and distributor and accounts for around 75% of power generation.

### KEY RATING DRIVERS

**'Very Strong' State Linkages:** Fitch believes CEB's status, ownership and control by the Sri Lankan sovereign is 'Very Strong'. The government fully owns CEB, appoints its board and senior management, sets tariffs, and decides on its investment strategy. CEB fulfils an essential service for the state by providing electricity at subsidised rates for a large portion of the population.

**'Very Strong' Support Record:** Government support to CEB has included direct grants, two-step loans from international donor agencies - which account for around 65% of its outstanding debt - equity injections, and guarantees on bank loans for some of its investment projects and working-capital funding. We expect the support to continue, as the government would want to ensure that the country's power supply is uninterrupted.

**'Very Strong' Support Incentive:** We see the socio-political implications of a CEB default as 'Very Strong'. Such a default would lead to service disruption, because CEB accounts for most of the country's power-generation capacity. A default would also make it difficult for CEB to source imported feedstock for power generation, such as heavy oil and coal. CEB's independent power producer (IPP) agreements, which account for around 20% of the power generated, would be affected, as they are external arrangements with no clear alternatives, and most of these IPPs use imported oil in their operations.

A default would have a 'Very Strong' financial effect on the state, as CEB's project loans are also the state's obligations. These loans are extended by bilateral and multilateral agencies and routed through the government for development of the country's power infrastructure. A default of CEB's outstanding debentures would also limit other state entities' ability to tap capital markets for funding in future. Despite CEB's weak financial profile, support has been forthcoming, and this is reflected in its continuing ability to service its debt obligations and manage liquidity requirements.

**Higher Tariffs to Reduce Losses:** The government increased the average electricity tariff by 75% in August 2022 amid higher feedstock costs, resulting in large losses for

CEB. We do not believe the new tariff will be sufficient to cover CEB's operating costs at current feedstock prices, but it should help to reduce losses. However, if feedstock costs fall from the current highs and CEB is able to shift its generation mix towards renewable energy, which is less costly than thermal power, it could help CEB to break even and improve its financial flexibility.

**Challenges in Feedstock Imports:** CEB generates almost 50% of its electricity from thermal sources and imports all its feedstock requirements. It has had increasing difficulty paying for feedstock in the past 12 months amid the country's severe foreign-currency shortage. Suppliers have refused to sell feedstock on credit terms in light of Sri Lanka's poor financial profile. The government has helped CEB by prioritising fuel imports and providing foreign currency to pay for purchases, but procuring feedstock will continue to remain challenging with the country's weak external finances.

**Large Dues to Power Generators:** CEB owed LKR105 billion to IPPs and renewable energy generators as of end-August 2022, a 120% increase since end-2021. Due to non-payment, some IPPs have stopped supplying to the grid, while the smaller players are facing significant liquidity issues. CEB plans to settle the dues in the next 12 months, with the support of the tariff hike and by negotiating new funding lines. Fitch estimates around LKR175 billion of additional cash receipts annually from the tariff hike, but timely collection could be challenging in the weak economic environment.

**Weak Standalone Profile:** Fitch assesses CEB's standalone credit profile (SCP) to be much weaker than its support-driven rating. We believe providing a standalone credit view of CEB is not meaningful, as its ability to operate depends on continuing state support and it cannot be meaningfully delinked from the government. CEB's free cash flow remains negative due to the absence of a robust tariff structure, high debt-servicing obligations and large capital outlays.

## DERIVATION SUMMARY

CEB, which has 'Very Strong' assessments in each sub-factor score under the GRE criteria, can be compared with Sri Lanka Telecom PLC (SLT, AA-(lka)/Stable), another state-owned company. SLT has a stronger credit profile than the sovereign and its rating is constrained by strong linkages with the state under the GRE criteria.

We assess SLT as 'Strong' for status, ownership and control because the state holds a majority stake directly and indirectly, and exercises significant influence over its operating and financial profile. We consider the support record for SLT to be 'Strong' in light of its strategic importance in expanding the country's fibre infrastructure. SLT has not required tangible financial support in the past due to its healthy financial profile.

Fitch sees the socio-political implications of a default by SLT as 'Moderate' due to the presence of three other privately owned telcos. However, such a default could affect the fixed-line market, because SLT acts as a policy company investing in fibre networks across the island to support the government's vision of having fibre-based internet for all households. We see the financial implications of a default as 'Strong', as it may have an impact on the availability and cost of financing options for other Sri Lankan GREs.

## KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Sri Lanka's annual electricity demand growth to average around 6% over 2022-2026;
- No material increases in electricity tariffs in the next 12-18 months;
- Generation mix to broadly remain at 50% thermal, 30% hydro and 20% others over 2022-2025;
- Capex of LKR80 billion per annum over the next two years, spent on maintenance and new generation capacity.

## RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- An upgrade of the Sri Lankan sovereign's Long-Term IDR could result in corresponding action on CEB's National Long-Term Rating.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- A significant weakening in the likelihood of support from the sovereign;
- A downgrade of the Sri Lankan sovereign's Long-Term IDR could result in corresponding action on CEB's National Long-Term Rating.

## LIQUIDITY AND DEBT STRUCTURE

**Liquidity Support from Government:** CEB had LKR7 billion in unrestricted cash at end-June 2022 to meet LKR73 billion in debt due in the next 12 months. Around LKR40 billion of the debt consisted of working-capital lines, which we believe will be rolled over in the normal course of business. We believe the government will continue to provide funding support to meet the contractual maturities of CEB amid the latter's weak liquidity.

In addition to contractual obligations, CEB has significant payments due to feedstock suppliers such as Ceylon Petroleum Corporation and other private power generators. CEB plans to settle these debts by using additional cash flow from the increased electricity tariff and by securing new funding facilities from state banks. CEB received LKR80 billion in funding in 2022 from the Ministry of Finance to settle its dues to CPC, and we believe similar liquidity support from the government would be forthcoming, given the essential service CEB provides.

## ISSUER PROFILE

CEB is the sole electricity transmitter and distributor in Sri Lanka and is a fully owned state entity. It accounts for 75% of domestic electricity generation through its network of hydro and thermal power plants.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

CEB's ratings are equalised with that of its parent, the Sri Lankan sovereign, in line with Fitch's Government-Related Entities Rating Criteria.

### RATING ACTIONS

ENTITY / DEBT ⇅	RATING ⇅	PRIOR ⇅
<input type="text"/>	<input type="text"/>	<input type="text"/>
Ceylon Electricity Board	Natl LT AA-(lka) ● Affirmed	AA-(lka) ●
senior unsecured	Natl LT AA-(lka) Affirmed	AA-(lka)

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[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

## APPLICABLE CRITERIA

- [Government-Related Entities Rating Criteria \(pub. 30 Sep 2020\)](#)
- [National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)
- [Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\) \(including rating assumption sensitivity\)](#)
- [Corporate Rating Criteria \(pub. 29 Oct 2022\) \(including rating assumption sensitivity\)](#)

## APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 ([1](#))

## ADDITIONAL DISCLOSURES

- [Solicitation Status](#)
- [Endorsement Policy](#)
- [Potential Conflicts Resulting from Revenue Concentrations](#)

## ENDORSEMENT STATUS

Ceylon Electricity Board -

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