December 24, 2021

Swelect Energy Systems Limited: Ratings downgraded with change in outlook

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund-based / Cash Credit	90.00	78.00	[ICRA]BBB+ (Stable); downgraded from [ICRA]A- (Negative)
Long Term – Fund-based Term Loan	75.40	64.39	[ICRA]BBB+ (Stable); downgraded from [ICRA]A- (Negative)
Short Term – Non-fund Based	35.00	35.00	[ICRA]A2; downgraded from [ICRA]A2+
Short Term – Sub Limit Facilities**	(85.00)	(68.00)	[ICRA]A2; downgraded from [ICRA]A2+
Long Term / Short Term – Sub Limit Facilities***	(35.00)	(35.00)	[ICRA]BBB+ (Stable) / [ICRA]A2; downgraded from [ICRA]A- (Negative) / [ICRA]A2+
Long Term / Short Term – Unallocated	1.00	24.01	[ICRA]BBB+ (Stable) / [ICRA]A2; downgraded from [ICRA]A- (Negative) / [ICRA]A2+
Total	**201.40**	**201.40**	

**Instrument details are provided in Annexure-1*

**Sublimit of Rs. 68 crore long-term fund-based facilities; ***Sublimit of Rs. 35 crore non-fund-based facilities

Rationale

ICRA's rating action factors in the deterioration in the debt coverage metrics of Swelect Energy Systems Limited (SESL) because of the increase in its leverage level and subdued profitability from two divisions –solar panel manufacturing/engineering, procurement & construction (EPC) and alloys casting. Further, the high reliance on short-term debt in the company's funding mix exposes it to refinancing risk. While the company continues to hold large liquid investments and fixed deposits, most of these investments are encumbered for the short-term borrowings. The net liquidity position[1] of the company declined to Rs. 77.5 crore as on September 30, 2021 from Rs. 204.0 crore as on March 2019 with the additional loans availed backed by these investments during this period.

The ratings remain constrained by the modest operating profitability of the solar panel manufacturing, EPC and alloys casting divisions due to the moderate scale of operations and stiff competition, impacting the return and debt coverage metrics of the company at the consolidated level. Further, the volatility in solar PV cell prices, higher commodity prices and the rise in freight charges owing to the global supply chain challenges have adversely impacted the profitability of the company in H1 FY2022. While the profitability is likely to recover to a certain extent in H2 FY2022, the debt coverage metrics of the company are expected to remain moderate owing to the increase in the leverage level. The total debt/OPBDITA increased to 6.8x in FY2021 from 5.2x in FY2020 and is likely to remain elevated in FY2022 and FY2023. Further, the ratio of profits before depreciation, interest and taxes (PBDITA) to the interest cost of SESL declined to 2.3x in H1 FY2022 from 4.1x in FY2021 and is likely to remain below 3.0x in FY2022.

The company has sizeable debt-funded capex plans over the next two to three years as it is setting up a 500-MW manufacturing unit for solar PV modules and ramping up the capacity of the independent power production (IPP) segment, which is likely to

[1] Total liquid investments & cash balances – total debt

keep the leverage levels elevated. The ability of the company to scale up its operations along with a commensurate order book and improved profitability across divisions remains a key monitorable.

The rating also considers the exposure of the cash flows of the IPP segment to external factors such as irradiation level, equipment quality and weather conditions at the project locations. These factors would impact the generation and in turn the cash flows of the company given the single-part tariff under the PPAs. Further, the solar power capacity is exposed to regulatory risks related to open access charges and renewable energy certificates (RECs) and the counterparty credit risks associated with various customers. Nonetheless, the payments have been largely timely from the customers, barring Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO), that covers for 14 MW of the portfolio, wherein significant delays have been observed. This apart, solar power capacity of 22 MW has power purchase agreements (PPA) of less than 5 years, exposing such capacity to demand and pricing risks. However, the tariffs offered by these projects are competitive in relation to the grid tariff, which is expected to support the renewal of these PPAs.

The ratings continue to positively factor in the diversification in revenues because of SESL's presence across three business segments - solar panel manufacturing/EPC for solar power projects, alloys & casting manufacturing and solar power generation. The company has recently commissioned a 16-MW solar power plant under the IPP segment, taking the total portfolio of solar power assets to ~89 MW (excluding the capacity of 5.5 MW used for internal consumption). The availability of medium to long-term PPAs at competitive tariffs for majority of this capacity limits the demand and pricing risks, thereby providing visibility on revenues.

ICRA also takes note of a favourable demand outlook for the solar PV module manufacturing segment given the strong demand prospects amid the large capacity addition targets set by the Government of India. Favourable policy developments to promote domestic module manufacturing like the imposition of basic customs duty (BCD) on imported solar PV cells & modules and promulgation of the Approved List of Module Manufacturers (ALMM) comprising only domestic solar original equipment manufacturers (OEMs) also work in favour of the company.

ICRA also takes comfort from the financial flexibility driven by the large liquid investments (~Rs. 435.4 crore at a consolidated level as on September 30, 2021) held by the company, allowing SESL to borrow funds against these instruments at competitive interest rates. Further, the recent development on the resumption of trading of renewable energy certificates (RECs) augurs well for SESL as 35 MW of its solar portfolio comes under the REC mechanism and would strengthen the cash flows from the IPP segment.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that the IPP segment would continue to demonstrate satisfactory generation levels leading to stable cash inflows that would support the company's profitability and debt servicing at a consolidated level.

Key rating drivers and their description

Credit strengths

Diversified business segments – SESL has presence across three segments - solar panel manufacturing/EPC for solar power projects, alloys & casting manufacturing and solar power generation (IPP), providing diversification to the revenues of the Group.

Favourable policy developments for domestic module manufacturers – The demand outlook remains positive for domestic module manufacturers, supported by favourable policy developments such as the imposition of BCD on imported solar PV cells & modules, promulgation of ALMM comprising only domestic solar OEMs and the large capacity addition expected in the solar power sector.

Limited demand risks for majority of the portfolio due to the availability of medium to long-term PPAs – The availability of medium to long-term PPAs with a tenure ranging from 10 years to 25 years at competitive tariffs for majority of the solar power capacity of the Group limits the demand and pricing risks and provides revenue visibility for the company.

Financial flexibility garnered through large liquid investments – The availability of large liquid investments in the form of mutual funds (MFs) and fixed deposits (FDs) amounting to ~Rs. 435.4 crore at a consolidated level as of September 2021 provides financial flexibility to the company, allowing them to raise debt at competitive rates.

Resumption of trading of RECs – The resumption in the trading of RECs following a favourable order from the Appellate Tribunal for Electricity (APTEL) in November 2021 is positive for the company and would allow it to monetise the REC inventory, supporting the revenue and profitability from the IPP segment.

Credit challenges

Subdued profitability from solar panel manufacturing/EPC and alloys casting divisions along with rising leverage level leading to subdued debt coverage metrics – The modest operating profitability of the solar panel manufacturing/EPC and alloys casting divisions due to the moderate scale of operations and stiff competition, along with the rising debt level, has adversely impacted the company's return and debt coverage metrics at the consolidated level. The volatility in solar PV cell prices, higher commodity prices and increased freight charges led to a further drop in the profitability margins in H1 FY2022. The debt-funded capex over the past years along with the increased dependence on short-term borrowings has led to higher leverage level for the company. The leverage level is likely to remain elevated and the coverage metrics moderate given the sizeable capex plans in the near term to expand the module manufacturing capacity and adding new solar power generation capacity.

Net liquidity position witnessed a decline over the past two and half years – SESL's net liquid investments (total liquid investments adjusted for total debt) have reduced steeply to Rs. 77.5 crore in as on September 30, 2021 from Rs. 204.0 crore as of March 2019 due to the short-term debt funding availed backed by these liquid investments. Further, the high reliance on the short-term debt in the company's funding mix exposes it to refinancing risk.

Cash flows for solar power projects sensitive to PLF levels – The cash flows in the IPP segment are vulnerable to the risk of variation in generation, given the single-part tariff under the PPAs. The generation remains linked to the irradiation levels, equipment quality and weather conditions at the project locations. Nonetheless, the track record of generation remains satisfactory so far.

Exposure to regulatory and counterparty credit risks – The sale of solar power through the third-party route and the REC-based capacity (35 MW out of 90 MW) remain exposed to the regulatory risks of open access charges and the adverse changes in REC regulations. Further, the solar projects are exposed to the counterparty credit risk of the respective off-takers. Nonetheless, the payments have been largely timely, except from TANGEDCO (14 MW), where there were significant delays.

Exposure to demand risks for capacities having short-tenure PPAs – Solar power capacity of 22 MW out of the total 90 MW has a PPA tenure of less than five years, exposing such capacity to demand and pricing risks. Nonetheless, the tariffs offered by these projects are competitive at a discount to the grid tariffs, which is expected to support the renewal of such PPAs.

Liquidity position: Adequate

SESL's liquidity position is adequate supported by stable cash flows from the IPP segment, returns on the large liquid investments, available cash balances of Rs. 22.89 crore and undrawn working capital lines of Rs. 22.38 crore as on September

30, 2021. While the quantum of liquid investments and fixed deposits available with the company is large, most of these instruments are lien-marked or collateralised to the working capital facilities availed.

Rating sensitivities

Positive factors - The ratings can be upgraded if the company is able to scale up its operations and profitability from the solar panel manufacturing and EPC segment, along with sustaining the healthy generation performance of the solar power plants, thereby leading to an improvement in its credit metrics and liquidity.

Negative factors - The ratings can be downgraded in case of sustained pressure on company's profitability owing to under performance of the solar power plants or inability to improve its profitability from the manufacturing and EPC divisions, leading to adverse impact on debt coverage metrics. Also, any significant capex that affects the company's capital structure or liquidity can also lead to a rating downgrade. Specific credit metrics that could lead to a downgrade is DSCR falling below 1.20 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Solar Power Producers Consolidation and Rating Approach
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the consolidated financial statements of Swelect Energy Systems Limited and its subsidiaries as mentioned in Annexure-II.

About the company

Swelect Energy Systems Limited is a solar power systems company with presence in solar PV module manufacturing, EPC services for solar power plants and solar power generation. The subsidiaries of SESL have been incorporated to develop and operate certain solar power plants of the Group. The other subsidiaries are involved in the manufacturing and trading of iron, steel and investment casting products that cater to both export and domestic customers.

In the module manufacturing segment, SESL is a mid-sized solar panel manufacturer with a current capacity of 110 MW per annum. The Group has an installed capacity of ~89 MW of solar power assets that supply power to various counterparties such as Solar Energy Corporation of India (SECI), TANGEDCO, Chamundeshwari Electricity Supply Corporation (CESC), Airports Authority of India (AAI), Hatsun Agro among others. The company's managing director Mr. R. Chellappan has more than 35 years of experience in the electrical/electronics industry.

Key financial indicators (Audited)

SESL Consolidated	FY2020	FY2021	H1FY2022
Operating Income (Rs. crore)	252.22	252.54	118.94
PAT (Rs. crore)	-10.17	26.04	1.45
OPBDIT/OI (%)	17.13%	20.60%	14.29%
PAT/OI (%)	-4.03%	10.31%	1.22%
Total Outside Liabilities/Tangible Net Worth (times)	0.45	0.59	0.65
Total Debt/OPBDIT (times)	5.17	6.80	11.20
Interest Coverage (times)	2.50	2.93	1.35
PBDITA/Interest & Finance Charges (times)	2.32	4.13	2.31

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Sep 30, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Dec 24, 2021	Apr 19, 2021	Apr 30, 2020	-	Oct 10, 2018
1	Fund Based/CC	Long Term	78.00	-	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	-	[ICRA]A- (Stable)
2	Fund Based TL	Long Term	64.39	64.39	[ICRA]BBB+ (Stable)	[ICRA]A- (Negative)	[ICRA]A- (Negative)	-	[ICRA]A- (Stable)
3	Non-Fund Based	Short Term	35.00	-	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2+
4	Sub Limit Facilities*	Short Term	(68.00)	-	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2+
5	Sub Limit Facilities**	Long/ Short Term	(35.00)	-	[ICRA]BBB+ (Stable) / [ICRA]A2	[ICRA]A- (Negative) / [ICRA]A2+	[ICRA]A- (Negative) / [ICRA]A2+	-	[ICRA]A- (Stable) / [ICRA]A2+
6	Unallocated	Long/ Short Term	24.01	-	[ICRA]BBB+ (Stable) / [ICRA]A2	[ICRA]A- (Negative) / [ICRA]A2+	[ICRA]A- (Negative) / [ICRA]A2+	-	[ICRA]A- (Stable) / [ICRA]A2+

*Sublimit of Rs. 68 crore long-term fund-based facilities

**Sublimit of Rs. 35 crore non-fund-based facilities

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based / Cash Credit	Simple
Term Loan	Simple
Non-fund based	Very Simple

Sub Limit Facilities	Very Simple
Unallocated	NA

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Long Term Fund Based / CC	-	-	-	78.00	[ICRA]BBB+ (Stable)
NA	Long Term Fund Based TL	Sep 2019	-	Sep 2029	64.39	[ICRA]BBB+ (Stable)
NA	Short Term – Non-Fund Based	-	-	-	35.00	[ICRA]A2
NA	Short Term – Sub Limit Facilities*	-	-	-	(68.00)	[ICRA]A2
NA	Long Term / Short Term – Sub Limit Facilities**	-	-	-	(35.00)	[ICRA]BBB+ (Stable) / [ICRA]A2
NA	Unallocated	-	-	-	24.01	[ICRA]BBB+ (Stable) / [ICRA]A2

Source: *Company*

*Sublimit of Rs. 68 crore long-term fund-based facilities

**Sublimit of Rs. 35 crore non-fund-based facilities

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
SWELECT Energy Systems Pte. Limited, Singapore	100.00%	Full Consolidation
SWELECT Inc., USA	100.00%	Full Consolidation
Amex Alloys Private Limited	100.00%	Full Consolidation
SWELECT Solar Energy Private Limited	100.00%	Full Consolidation
SWELECT Green Energy Solutions Private Limited	100.00%	Full Consolidation
SWELECT Power Systems Private Limited	100.00%	Full Consolidation
Noel Media & Advertising Private Limited*	100.00%	Full Consolidation
K J Solar Systems Private Limited*	100.00%	Full Consolidation
SWELECT Sun Energy Private Limited	73.99%	Full Consolidation
SWEES Employees' Welfare Trust	**	Full Consolidation
SWELECT Renewable Energy Private Limited	100.00%	Full Consolidation
SWELECT HHV Solar Photovoltaics Private Limited	100.00%	Full Consolidation

Source: FY2021 Annual report

**100% subsidiary of SWELECT Solar Energy Private Limited*

***No shareholding; the entity is a trust in which the company has control*

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ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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