February 29, 2024

Adani Energy Solutions Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial paper (CP)	1,000.00	1,000.00	[ICRA]A1+; reaffirmed
Total	**1,000.00**	**1,000.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating reaffirmation for Adani Energy Solutions Limited (AESL) factors in the completion of most of the regulatory investigations into the Adani Group. The investigations pertaining to most of the issues have been completed with only two matters pending that are expected to be completed over the next three months. The outcome of the final investigations will remain a key monitorable, going forward, and any material adverse impact on the Group or its entities will be a key rating sensitivity. Additionally, the rating factors in the significant improvement in the financial flexibility of the Group, demonstrated in the improved secondary market bond yields and equity share prices of the Adani Group entities.

The rating takes into account the satisfactory operating track record of AESL's power transmission projects with the line availability remaining above the normative level and the associated low demand risks for these projects due to the long-term transmission service agreements (TSAs) with beneficiary customers with availability-linked tariff payments. Moreover, the cost-plus tariff for the four major transmission lines housed under the two wholly-owned subsidiaries of AESL - Adani Transmission India Ltd (ATIL) and Maharashtra Eastern Power Transmission Company Ltd (MEGPTCL) - as well as for the Mumbai licence area under Adani Mumbai Electricity Limited (AEML) provides regulated returns (15.5% post tax), subject to the cost and availability remaining within the normative parameters, as per the approved tariff orders.

Further, the counterparty credit risk for the company is mitigated by the significant diversification and the strong payment security mechanism for the underlying inter-state power transmission assets. The Central Transmission Utility (CTU) is responsible for collecting the transmission charges from the beneficiary users and disbursing the same to the inter-state transmission licensees. The CTU function is managed by the Central Transmission Utility of India Limited, a subsidiary of Power Grid Corporation of India Limited (PGCIL).

The rating also takes into consideration the company's favourable customer profile in the Mumbai licence area and the healthy operational profile with good collection efficiency, low distribution loss levels and high supply reliability. Also, the tariff order is in place for the distribution business in Mumbai under AEML for the control period from FY2021 to FY2025. The rating also considers the satisfactory execution track record of the company, with commissioning of 17 greenfield transmission assets over the past few years, and another project being energised recently.

While the company's leverage level remains high due to the largely debt-funded expansion, the coverage metrics are expected to be comfortable with the debt service coverage ratio (DSCR) likely to remain above 1.3x, supported by stable revenues from the transmission assets and the cost-plus operations for the distribution business.

AESL, however, is exposed to the execution risk associated with the sizeable under-construction portfolio of the transmission assets (through eight subsidiaries) with cumulative investment of ~Rs. 16,300 crore. The company has secured debt financing for four of the eight projects, while two of the projects are being funded through internal accruals. The financial closure is pending for the remaining two projects, accounting for 22% of the projects under construction by value. A timely tie-up of debt funding for these projects remains important. Moreover, for the bid-based under-construction projects, the company's ability to keep the cost (both capital and operating) within the tariff assumption post commissioning remains critical, given that the tariff is competitively bid and fixed in nature. Nonetheless, comfort is drawn from the execution track record of the company in the transmission segment. Further, the company has ventured into smart meter installation with income on an annuity basis. The company has won nine contracts for installing 21.1 million smart meters. The total capex for these projects is estimated at Rs. ~11,000-11,500 crore, which will be funded through debt, accruals from operationalised meters, equity and grant received on operational go-live.

The rating also factors in the refinancing risk associated with the debt having bullet repayments (first such debt of US$ 500 million bond maturing in FY2027) and the foreign exchange movement risk on the dollar debt, which constitutes over 70% of the consolidated debt as of September 2023. While the refinancing risk is partially mitigated by the long residual TSA tenure of the transmission assets, ICRA would continue to monitor the impact of the any further development on the financial flexibility of the Group and the cost of debt financing. Also, the forex risk is managed by the hedging strategy followed by the company for the coupon payments and principal exposure. While some of the exposure has been hedged for the entire tenure of the bonds through swaps, the remaining has been hedged through rolling one-year forward contracts.

The rating also takes into consideration the moderate counterparty credit risk pertaining to the exposure to the state-owned power utilities (STU) of Rajasthan, Maharashtra and Uttar Pradesh. However, the payments have remained largely timely so far from the utilities in these states. The counterparty risk is also offset to some extent by the stipulation of a payment security mechanism (one month of LC), the right of power regulation available with CTU/STU in case of any significant delays by the system users and the small share of transmission charges in the overall cost structure of the discoms.

Key rating drivers and their description

Credit strengths

Satisfactory operating track record of operational transmission lines and favourable demography in Mumbai licence area - The line availability for all the operational transmission lines of the company has been higher (>99%) than the normative levels (95-98%) since commissioning. This also allows the project subsidiaries of AESL to earn availability-linked incentives. For the Mumbai distribution licence area, the demographic profile is favourable and the distribution loss levels remained low at 5.35% in 9M FY2024 while also being well within the approved loss level of 6.80% for FY2024.

Tariff orders for cost-plus based transmission projects and distribution licensee business in Mumbai ensure regulatory clarity – The tariff mechanism for cost-plus based projects ensures recovery of all fixed costs and allows a 15.5% post-tax return on equity (RoE). For the competitive tariff-based projects, however, the tariff is fixed and as a result, the ability to ensure the costs within the tariff assumption remains critical. Going forward, with majority of the new projects commissioned being competitive tariff-based in nature, the overall ratio of the cost-plus based projects in the total AESL transmission revenue is estimated to decline from over 90% in FY2018 to about 40-50% over the next two fiscals. However, the cost-plus nature of the AEML business will ensure that a significant proportion of the total revenue of the consolidated entity will continue to be cost-plus based, assuring stable cash flows. While the increase in regulatory asset (RA) owing to the sharp rise in fuel costs and cost of power from the short-term market for AEML was a concern in FY2023, the company is recovering the RA in FY2024 and FY2025. Also, regular and timely issuance of the tariff orders with pass-through of cost variations for AEML in the past is a comforting factor.

Demand risks limited by long-term TSAs for transmission assets - The demand risk for the company is low as AESL's transmission lines are part of the inter-state and intra-state grid network, having long-term TSAs. Further, the payment of transmission tariff is based on meeting the normative line availability criteria of 95-98%, depending on the type of the transmission line (DC or AC).

Timely payment track record of counterparties - The counterparty risk is low for project subsidiaries, which are part of the inter-state transmission network, as they enjoy strong payment security with the CTU being responsible for raising the bills and collecting payments from the transmission system consumers. While the company's tariff revenues for the transmission business have significant exposure to the utilities in Rajasthan, Maharashtra and Uttar Pradesh, the payments have been largely on time over the past few years. Further, the counterparty credit risk for intra-state and inter-state transmission projects is offset to some extent due to the right of power regulation available with the CTU/STU in case of any huge delays by the system users and the small share of transmission charges in the overall cost structure of the discoms.

Demonstrated ability to raise equity and debt funding - The company has demonstrated its debt raising abilities through different debt instruments, such as rupee term loans, offshore dollar-denominated bonds and NCDs of varying maturities in the last three to four years. In FY2022, AEML tied up $2-billion global medium-term notes (GMTN) for the planned capex, of which $300 million was drawn in the first tranche in July 2021. The facility allows AEML to draw down debt in tranches, based on the yearly capex requirement with each tranche repayment after 10 years of drawdown. Additionally, in October 2021, AESL raised a $700-million revolving project finance facility, which will be used to finance its under-construction transmission projects. Also, the company raised $500-million equity from a strategic investor in FY2023, which was used to retire the perpetual equity instruments of the promoter group. Concerns over the Group's financial flexibility after the Hindenberg issue in FY2023 have subsided and most of the regulatory investigations into the Adani Group have been completed. There has been a significant improvement in the financial flexibility of the Group, demonstrated in the improved secondary market bond yields and equity share prices of the Adani Group entities.

Credit challenges

Large capital expansion plans to keep leverage level elevated; concerns over project execution and funding risks –AESL has eight under-construction greenfield projects with a project cost of about Rs. ~16,300 crore. Additionally, the company has won nine contracts in the smart meter segment to install and operate 21.1 million meters. The contract period for these projects is ~10 years, including ~2.5 years of installation period. The capex for smart meter projects is estimated at Rs. 11,000-11,500 crore, which will be incurred over the next two years. The overall capital expenditure by AESL is expected to be funded through debt, internal accruals, equity and Government grant available for smart meters. Hence, AESL's financial leverage will continue to be high (total debt/OPBDITA of 5.5-6.5x) as more projects get added due to the lag between debt incurrence and the start of revenue contribution after a project is commissioned.

Any further significant project commitments or acquisitions that can impact the funding requirements and cash flows substantially will be a rating sensitivity. All these projects remain exposed to execution risks arising from delays in getting the required statutory clearances/permits or right of way permissions. Further, the ability of the company to tie up debt funding in a timely manner remains important.

Refinancing and foreign exchange risks on dollar-bond issuance – At present, AESL's debt comprises a mix of NCDs, term loans and bonds with maturities varying from three to 30 years. A major refinancing requirement will arise in FY2027 when the bullet payment for its earlier bond issuance ($500 million issued in FY2017) will be due. Further, AESL is exposed to forex risk as a significant proportion of the company's total debt at a consolidated level is in the form of forex bonds. This risk is managed by the hedging strategy followed by the company for the coupon payments and principal exposure. While some of the exposure has been hedged for the entire tenure of the bonds through swaps, the remaining has been hedged through rolling one-year forward contracts.

Exposure to state distribution utilities for intra-state projects – The counterparty credit risks arise from the exposure to the state utilities of Maharashtra, Rajasthan, Uttar Pradesh and Madhya Pradesh for the transmission projects (including under-construction projects). The credit profile of these utilities remains moderate to weak owing to the delays in issuing tariff orders, weak operating efficiencies and inadequate tariffs in relation to the cost of supply. Nonetheless, the payments have been largely timely so far.

Environmental and Social Risks

AESL's subsidiary, AEML, owns and operates a 500-MW coal-fired power station for supply to the Mumbai licence area. The environmental risks for coal-based power producers emanate from their exposure to fossil fuels and as they are one of the leading emitters of pollutants and largest industrial users of water. However, this plant contributes to a small portion of the Group's earnings. AEML has committed to increasing the use of renewable power to meet its energy requirements. Some of AESL's transmission projects have been delayed because of the delays in securing the required forest approvals. Further, AESL is exposed to some degree of bushfire risk because its network spans forest areas. The company is also exposed to the risk of natural disasters and extreme weather conditions, which could damage the power transmission lines. If these risks materialise, AESL might be able to recover the cost of replacing the damaged equipment through insurance reserve and coverage, and loss of revenues through the force majeure clause under the TSAs for transmission assets.

AESL is exposed to social risks arising from the challenges related to land acquisition for the ongoing transmission projects. Also, projects passing through forests face delays in receiving statutory approvals owing to concerns over their impact on the flora and fauna. Further, the company's distribution business remains exposed to social risks in the form of resistance by consumers to tariff hikes and the consequent inability to recover the costs.

Liquidity position: Adequate

AESL's liquidity position remains adequate with the available cash balances (~Rs. 1,100-1,200 crore at a standalone level as on September 30, 2023), working capital lines and upstreaming of surplus cash flows sufficient to meet the debt obligation at the standalone level and equity funding for the ongoing projects. The debt at the standalone level constitutes a Rs. 100-crore NCD maturing in 2024. The funding for the ongoing projects in subsidiaries is being met through a mix of internal accruals and debt funding. At consolidated level, company had cash balances of over Rs. 4,000 crore as on December 31, 2023.

Rating sensitivities

Positive factors - Not applicable.

Negative factors - The rating could be revised downwards, if the company undertakes any large debt-funded capex and/or acquisition without a commensurate increase in revenues and profitability, adversely impacting its leverage and coverage metrics. Also, significant delays in getting payments from counterparties that will adversely impact the liquidity of the company could trigger a rating revision. Any material adverse regulatory action for the ongoing investigations may also result in a downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Power Transmission Companies
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of AESL. The entities considered for consolidation are enlisted in Annexure II

About the company

AESL is the holding company for the transmission & distribution business of the Adani Group and it owns a 100% stake in various operational companies, viz. ATIL, MEGPTCL, among others. As on December 31, 2023, AESL had a portfolio of 37 transmission projects (including eight lines under construction), Adani Electricity Mumbai Limited's (AEML) generation, transmission & distribution (GTD) business in Mumbai and the transmission & distribution (TD) business in Mundra SEZ with presence in 14 states. Its network includes transmission lines with a total length of 20,423 ckm, making it the largest privately operating transmission line company in India. AESL's transmission assets are spread across the western, northern and central parts of the country. AESL also has a power distribution licence for the Mumbai region with access to the integrated distribution network, catering to over 3 million households housed under AEML. The company has also forayed into smart meter projects with orders totalling 21.1 million smart meters as on December 31, 2023.

Key financial indicators - Consolidated

	FY2022 – Audited	FY2023 – Audited
Operating income (OI) (Rs. crore)	11,940	14,328
PAT (Rs. crore)	1,236	1,281
OPBDIT/OI (%)	40.9%	38.8%
PAT/OI (%)	10.4%	8.9%
Total outside liabilities/Tangible net worth (times)	3.3	3.2
Total debt/OPBDIT (times)	6.1	6.2
Interest coverage (times)	2.1	2.0

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Source: Company data, ICRA Research; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

SN	Instrument	Current rating (FY2024)				Chronology of rating history					
		Type	Amount rated (Rs. crore)	Amount outstanding as on Sep 30, 2023 (Rs. crore)	Date & rating on	Date & rating in FY2023				Date & rating in FY2022	Date & rating in FY2021
					Feb 29, 2024	Feb 24, 2023	Feb 01, 2023	Jan 19, 2023	Sep 21, 2022	Jan 31,2022	Jan 29,2021
1	**Commercial paper**	Short-term	1000	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Commercial paper	Very simple

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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	**Commercial paper***	-	-	7-365 days	1000.00	[ICRA]A1+

Source: *Company; *Unplaced CP*

Annexure II: List of entities considered for consolidated analysis

Company Name	AESL Ownership	Consolidation Approach
Adani Energy Solutions Limited	100.0% (rated entity)	Full Consolidation
Adani Transmission (India) Ltd	100.0%	Full Consolidation
Maharashtra Eastern Grid Power Transmission Company Ltd	100.0% (step-down subsidiary)	Full Consolidation
Sipat Transmission Ltd	100.0%	Full Consolidation
Raipur-Rajnandgaon-Warora Transmission Ltd	100.0%	Full Consolidation
Chhattisgarh-WR Transmission Ltd	100.0%	Full Consolidation
Adani Transmission (Rajasthan) Ltd	100.0%	Full Consolidation
North Karanpura Transco Ltd	100.0%	Full Consolidation
Maru Transmission Service Company Ltd	100.0%	Full Consolidation
Aravali Transmission Service Company Ltd	100.0%	Full Consolidation
Hadoti Power Transmission Service Ltd	100.0%	Full Consolidation
Barmer Power Transmission Service Ltd	100.0%	Full Consolidation
Thar Power Transmission Service Ltd	100.0%	Full Consolidation
Western Transco Power Ltd	100.0%	Full Consolidation
Western Transmission (Gujarat) Ltd	100.0%	Full Consolidation
Fatehgarh-Bhadla Transmission Ltd	100.0%	Full Consolidation
Ghatampur Transmission Limited	100.0%	Full Consolidation
Adani Electricity Mumbai Limited	74.9%	Full Consolidation
Adani Electricity Navi Mumbai Limited (formerly known as AEML Infrastructure Limited)	100.0%	Full Consolidation
OBRA-C Badaun Transmission Limited	100.0%	Full Consolidation
Adani Transmission Bikaner Sikar Private Limited	99.99%	Full Consolidation
Bikaner Khetri Transmission Limited	100.0%	Full Consolidation
WRSS XXI (A) Transco Limited	100.0%	Full Consolidation
Arasan Infra Limited	100.0%	Full Consolidation
Sunrays Infra Space Private Limited	100.0%	Full Consolidation
Lakadia Banaskantha Transco Limited	100.0%	Full Consolidation
Jamkhambaliya Transco Limited	100.0%	Full Consolidation
Power Distribution Services Limited	74.9%	Full Consolidation
Adani Electricity Mumbai Infra Limited	100.0%	Full Consolidation
Kharghar Vikhroli Transmission Private Limited	100.0%	Full Consolidation
Alipurdar Transmission Limited	100.0%	Full Consolidation
Warora Kurnool Transmission Limited	100.0%	Full Consolidation
ATL HVDC Limited	100.0%	Full Consolidation
AEML Seepz Limited	100.0%	Full Consolidation
Adani Transmission Step-One Limited	100.0%	Full Consolidation
MP Power Transmission Package II Limited	100.0%	Full Consolidation
MPSEZ Utilities Limited	100.0%	Full Consolidation

Company Name	AESL Ownership	Consolidation Approach
Karur Transmission Limited	100.0%	Full Consolidation
Khavda-Bhuj Transmission Limited	100.0%	Full Consolidation
Adani Transmission Mahan Limited	100.0% (step-down subsidiary)	Full Consolidation
Adani Electricity Jewar Limited	100.0%	Full Consolidation
Adani Transmission Step Two Limited	100.0%	Full Consolidation
Adani Cooling Solutions Limited	100.0%	Full Consolidation
WRSR Power Transmission Limited	100.0%	Full Consolidation
Khavda II-A Transmission Limited	100.0%	Full Consolidation
Adani-LCC JV	Adani Enterprises -60%, Adani Energy Solutions Limited-20%, LCC-20%	Full Consolidation
Adani Electricity Nashik Limited	100.0%	Full Consolidation
BEST Smart Metering Limited	100%	Full Consolidation
Adani Transmission Step-Three Limited	100%	Full Consolidation
Adani Transmission Step-Four Limited	100%	Full Consolidation
Adani Transmission Step-Five Limited	100%	Full Consolidation
Adani Transmission Step-Six Limited	100%	Full Consolidation
Adani Transmission Step-Seven Limited	100%	Full Consolidation
Adani Transmission Step-Eight Limited	100.0%	Full Consolidation
Adani Transmission Step-Nine Limited	100.0%	Full Consolidation
Adani Electricity Aurangabad Limited	100.0%	Full Conolidation
Adani Green Energy Thirty Limited	100% (step-down subsidiary)	Full Consolidation

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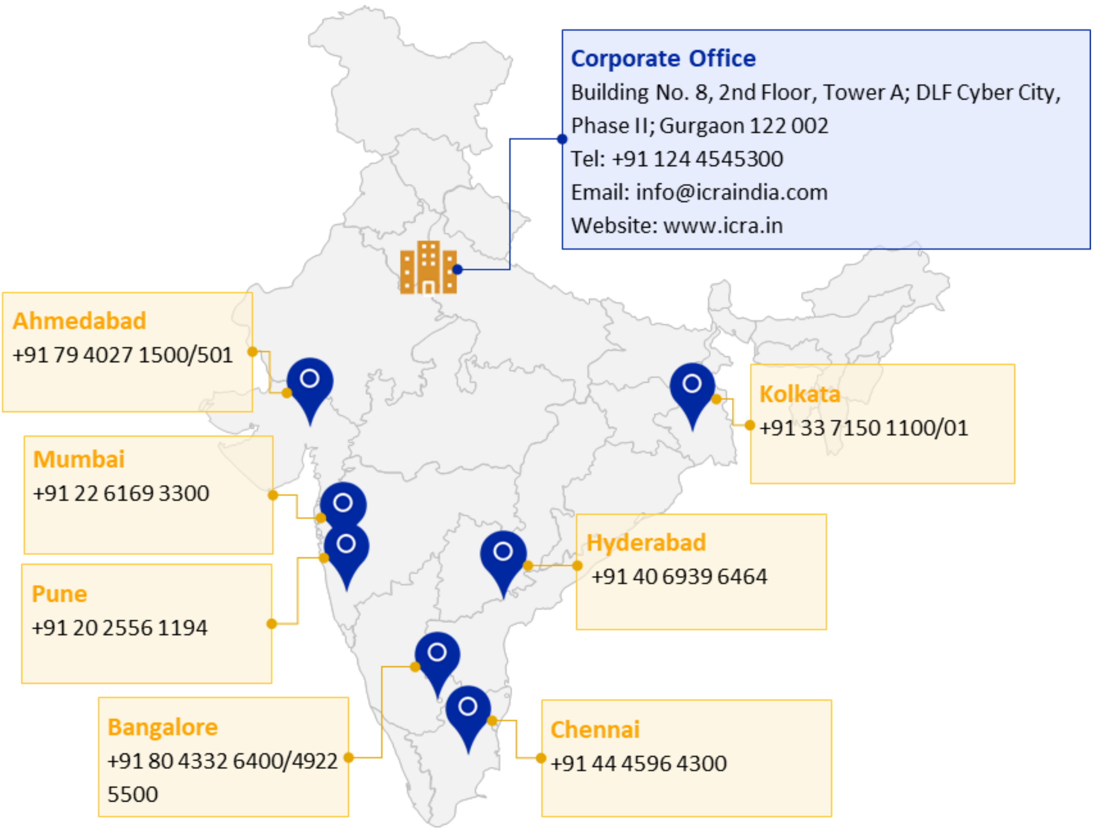

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