April 30, 2020

Swelect Energy Systems Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-Term Fund Based/ CC	50.0	50.00	[ICRA]A- reaffirmed; Outlook revised to Negative from Stable
Long- Term Fund based TL	23.35	33.00	[ICRA]A- reaffirmed; Outlook revised to Negative from Stable
Short Term – Non-Fund based	25.00	35.00	[ICRA]A2+; reaffirmed
Short Term – Sub Limit Facilities **	(50.00)	(50.00)	[ICRA]A2+; reaffirmed
Long Term/ Short Term – Sub Limit Facilities ***	(10.00)	(35.00)	[ICRA]A-/[ICRA]A2+ reaffirmed; Outlook revised to Negative from Stable
Long Term/ Short Term Unallocated	36.65	17.00	[ICRA]A-/[ICRA]A2+ reaffirmed; Outlook revised to Negative from Stable
Total	**135.00**	**135.00**	

**Instrument details are provided in Annexure-1*
*** Sublimit of Rs. 50-crore long-term fund-based facilities*
**** Sublimit of Rs. 35-crore non-fund-based facilities*

Rationale

The ratings reaffirmation factors in ICRA's expectation of healthy cash accruals from Swelect Energy Systems Limited's (SESL) solar power projects, which at present aggregate to 66.2 MW. The ratings note its long-term power purchase agreements (PPA) with various entities such as Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO), Solar Energy Corporation of India (SECI), Airport Authority of India (AAI) and Chamundeswari Electricity Supply Company (CESC Mysore). The company has been making continued investments in solar power projects and the same has been supporting its profitability and fund flow from operations. The ratings consider the company's borrowing profile, primarily secured by collaterals in the form of fixed deposit and mutual funds, thereby lending healthy financial flexibility. Moreover, its strong capital structure as illustrated by a gearing of 0.3 times as of December 2019 provides comfort.

The ratings continue to favourably factor in SESL's established brand position of HHV Solar in the solar module manufacturing segment. In addition, the company has also presence in the solar power generating systems (SPGS), module mounting structures (MMS) and is involved in the implementation of turnkey solar EPC (together referred as solar panels/EPC segment). The ratings also consider SESL's diversified business segments comprising solar panels/EPC segment, castings segment that caters to the oil and gas as well as engineering industry, and solar power/independent power producer (IPP) segment.

The ratings, however, remain constrained the company's subdued profitability as reflected by its low RoCE (3.0% in 9M FY2020 as against 2.9% in FY2019), primarily due to weak profitability from the solar module manufacturing/EPC segment (due to low capacity utilisation and stiff competition in these segments) and moderate IRR from IPP segment. The ratings factor in the operating risks faced by the solar IPP segment associated with dependence on solar irradiance and risk of devolvement of warranties inherent to the solar panel industry (however, there are no major instances of any warranty invocation in the past). Nonetheless, an experienced managerial team and strict quality assurance mitigate this risk to an extent. Further, ICRA notes that the company's large investments in mutual funds (held as collateral) are inherently susceptible to market and credit risks.

The revision in outlook to Negative for SESL follows the weak business outlook in solar panels and castings segment and possible disruptions in revenue from the IPP segment because of demand slowdown amid the lockdown situation due to the Covid-19 pandemic. The company's cash flow from operations is likely to remain under pressure owing to subdued order inflows in both solar panels – manufacturing/EPC segment and casting segment, and high likelihood of invocation of force majeure clauses in solar IPP segment from key customers, especially from the private sector (accounting to ~15% of total supply capacity). The strength of the recovery will be contingent on the duration and extent of the Covid-19 pandemic, stability of cash flows from IPP segment and revival in demand scenario in the domestic solar segment (for solar panel manufacturing and EPC) and end-user industries (for casting).

Key rating drivers and their description

Credit strengths

Strong free cash flows from solar power/IPP segment – The group has aggregate 66.2 MW capacity solar power plants commissioned across Tamil Nadu, Karnataka and Andhra Pradesh. It has executed long-term PPAs for major portion of the solar power assets under IPP/RESCO models with reputed counterparties which is expected to support its free cash flows, going forward. Some of its major counterparties under long-term PPA's include TANGEDCO (14 MW), SECI (10 MW), CESC Mysore (10 MW), AAI (12 MW), Integral Coach Factory (ICF), Chennai Metro Rail Limited (CMRL) and Hindustan Petroleum Corporation (HPCL), among others. These apart, the company has PPAs with private entities such as Schaeffler India Limited (5 MW), V-Guard Industries (2 MW), Brookefields Estates Private Limited (3MW), amongst others.

Established brand of HHV Solar in solar panel segment – SESL's has an established brand - HHV – Solar and has vast experience spanning over a decade in the solar panel manufacturing segment. The company has an installed capacity of 110 MW in solar module manufacturing unit as on date. Its established position in the solar power industry and relationship with a diverse clientele has resulted in stable revenues from the solar panel manufacturing and EPC segments.

Diversified business segment – The company has a diversified business segment comprising solar panels/EPC segment and castings segment catering to the oil and gas as well as engineering industries, and sale of solar power (under IPP/RESCO model) that supplies power to private sector entities and Government utilities/institutions. The diversification in its business portfolio is expected to support stability in its revenues by mitigating dependency on a specific sector to an extent.

Strong capital structure – The company's capital structure remains strong as illustrated by gearing of 0.3 times and TNW of Rs. 732 crore as of December 2019 against a gearing of 0.3 times and TNW of Rs. 726 crore as of March 2019. It remains net cash positive (after adjusting fund-based borrowings against fixed deposits/mutual funds). SESL's borrowings are mainly backed by investments in Mutual Funds (MF) and Fixed Deposits (FD) enabling it to have competitive interest cost. However, its investments in mutual funds (held as collateral) remain inherently susceptible to market and credit risk.

Credit challenges

Subdued profitability and moderate debt protection metrics – The company's RoCE remained low at 4.3% in FY2018, 2.9% in FY2019 and 3.0% in 9M FY2020. It has a moderate scale of operations and low capacity utilisation in the solar panel manufacturing segment, resulting in low profitability due to subdued economies of scale (Nonetheless, ICRA notes that the company has been leveraging its panel manufacturing capacity for its investment in solar IPP segment). Further, SESL faces intense competition in the domestic solar PV industry (from both domestic players and imports) and its profitability indicators remain exposed to volatility and linkage between price movement of solar cells and modules. Further, the company's operations are exposed to risks pertaining to any devolvement of warranties given on the supply of solar modules (nonetheless, there are no major instances of any warranty invocation in the past as stated by the management).

SESL's profitability (at RoCE levels) from the IPP segment remained subdued due to modest IRR from its older projects. ICRA notes that profitability from the IPP segment is susceptible to performance risk because of volatility/deterioration in the solar plant's CUF levels with its dependence on solar irradiance. Similarly, the operating margin in its casting segment remained subdued (OPM at 3% in FY2019 and 6% in 9M FY2020) due to moderate capacity utilisation (especially in investing casting division) and stiff competition. ICRA also notes that income from mutual funds remain vulnerable to market/credit risk/liquidity associated. Nonetheless, ICRA factors in that the company has been earning returns at ~7% from these funds and has investments in funds with a relatively healthier liquidity profile.

Moderate profitability had resulted in moderate debt protection metrics, with the company's interest coverage ratio at 3.43 times and 2.04 times in FY2018 and FY2019, respectively. Further, its PBDITA/Interest and finance cost remained moderate at 3.38 times in FY2019 and 3.35 times in 9M FY2020.

Weak business outlook due to economic slowdown/lockdown-related issues – ICRA expects the company's performance to remain subdued. Its cash flow from operations is expected to be under pressure in the near-term on account of weak business outlook in solar panels and castings segment, and possible disruptions in revenue from the IPP segment because of demand slowdown and lockdown situation due to the Covid-19 pandemic. The outlook for solar panel manufacturing/EPC is expected to be weak on account of likely postponement of capex plans by private entities. The demand in casting segment is also likely to remain subdued owing to weak industry outlook of the end-user industries – oil and auto.

The pressure on cash flows from the IPP segment is on account of likely subdued power offtake by private sector counterparties in Q1 FY2021 and high likelihood invocation of force majeure clauses in the IPP/solar power segment by key customers, especially from the private sectors (accounting to ~15% of total supply capacity). ICRA notes that the company is actively seeking alternate arrangements for sale of power (for undelivered portion). The strength of the recovery will be contingent on the duration and extent of the Covid-19 pandemic, stability of cash flows from the IPP segment and revival in demand scenario in the domestic solar segment (for solar panel manufacturing and EPC) and end-user industries (for casting).

Liquidity position: Adequate

SESL's liquidity position is **adequate** with availability of undrawn limits and cash and bank balances to support its working capital requirements. ICRA notes that the company's mutual funds balances outstanding remain significantly higher than the amount required to be earmarked for its borrowing requirements. ICRA takes comfort from the company's proposed reimbursement loans, which is expected to support its liquidity further. ICRA also expects the healthy fund flow from operations in the IPP segment to support its liquidity position.

Rating sensitivities

Positive triggers – Given the Negative outlook, a rating upgrade in the near-term is unlikely. However, ICRA may revise the outlook to Stable, if the company is able to avoid any sustained deterioration in its profitability and debt protection metrics. Revival in demand scenario in the solar panel manufacturing/EPC business and casting segment and improvement in cash flows from the IPP segment will be the key to sustain its profitability and debt protection metrics.

Negative triggers – Negative pressure on the SESL's rating could arise if its profitability and debt protection metrics weaken on a sustained basis on account of weak demand scenario in the solar panel manufacturing/EPC business and any significant disruption in revenue/cash flows from IPP segment. Specific credit metrics that may lead to a downgrade is PBDITA/Interest and finance charges falling below 3.0 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 (referred together as the group) as mentioned in Annexure 2.

About the company

Swelect Energy Systems Limited is a solar power systems company with a strong presence in solar PV module manufacturing, solar power generating systems, solar IPP and solar power EPC segment. The company has subsidiaries, which has long-term PPAs for selling solar power to Government utilities and a subsidiary, which is involved in the manufacturing and trading of iron, steel and investment castings catering to both export and domestic customers. In the module manufacturing segment, it is a mid-sized solar panel manufacturer with a current capacity of 110 MW/p.a. The Group has an installed capacity of 66.2 MW representing solar assets exporting power to various counterparties such as SECI, TANGEDCO, CESC, AAI, etc. The company's Managing Director Mr. R. Chellappan has more than 35 years of experience in the electrical/electronics industry.

Key financial indicators (Consolidated*) - Audited

	FY2018	FY2019	9M FY2020 (Prov.)
Operating Income (Rs. crore)	294.50	227.67	189.16
PAT (Rs. crore)	15.9	6.8	4.7
OPBDITA/OI (%)	11.2%	13.7%	15.3%
RoCE (%)	4.3%	2.9%	3.0%
Total Outside Liabilities/Tangible Net Worth (times)	0.39	0.37	0.42
Total Debt/OPBDITA (times)	6.3	6.3	5.64
Interest Coverage (times)	3.43	2.04	2.28
PBDITA/ Int. & Finance Charges	6.28	3.38	3.35
DSCR	1.04	1.57	*

Source: The Company
**Consolidated financials of Swelect Energy Systems Limited; * denotes unknown*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2020)				Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding (as on 10th April 2020)	Current Rating	FY2019	FY2018	FY2017
					30-Apr-2020	10-Oct - 2018	-	-
1	Long-Term Fund Based/ CC	Long Term	50.00	46.35	[ICRA]A- (Negative)	[ICRA]A- (Stable)	-	-
2	Long- Term Fund based TL	Long Term	33.00	33.00	[ICRA]A- (Negative)	[ICRA]A- (Stable)	-	-
3	Short Term – Non-Fund based	Short Term	35.00	17.58	[ICRA]A2+	[ICRA]A2+	-	-
4	Short Term – Sub Limit Facilities **	Short Term	(50.00)	0.23	[ICRA]A2+	[ICRA]A2+	-	-
5	Long Term/ Short Term – Sub Limit Facilities ***	Long term/Short term	(35.00)	13.5	[ICRA]A-(Negative) /[ICRA]A2+	[ICRA]A-(Stable) /[ICRA]A2+	-	-
6	Long Term/ Short Term Unallocated	Long term/Short term	17.00	-	[ICRA]A-(Negative) /[ICRA]A2+	[ICRA]A-(Stable) /[ICRA]A2+	-	-

Amount in Rs. Crore;

** Sublimit of Rs. 50 crore long-term fund-based facilities

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

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-Term Fund Based/ CC	NA	NA	NA	50.00	[ICRA]A- (Negative)
NA	Long- Term Fund based TL	Sep – 2019	NA	Sep – 2029	33.00	[ICRA]A- (Negative)
NA	Short Term – Non-Fund based	NA	NA	NA	35.00	[ICRA]A2+
NA	Short Term – Sub Limit Facilities	NA	NA	NA	(50.00)	[ICRA]A2+
NA	Long Term/ Short Term – Sub Limit Facilities	NA	NA	NA	(35.00)	[ICRA]A- (Negative) /[ICRA]A2+
NA	Long Term/ Short Term Unallocated	NA	NA	NA	17.00	[ICRA]A- (Negative) /[ICRA]A2+

Source: The company

Annexure-2: List of entities considered for consolidated analysis:

Company Name	Ownership	Consolidation Approach
SWELECT Energy Systems Pte. Limited, Singapore	100%	Full Consolidation
SWELECT Inc, USA	100%	Full Consolidation
SWELECT Energy systems LLC, USA**	100%	Full Consolidation
Amex Alloys Private Limited	100%	Full Consolidation
SWELECT Solar Energy Private Limited	100%	Full Consolidation
SWELECT Green Energy Solutions Private Limited	100%	Full Consolidation
SWELECT Power Systems Private Limited	100%	Full Consolidation
Noel Media & Advertising Private Limited*	100%	Full Consolidation
K J Solar Systems Private Limited*	100%	Full Consolidation
SWELECT Energy Systems (Asia Pacific) Pte. Limited, Singapore***	51%	Full Consolidation

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

*** 100% subsidiary of SWELECT Inc, USA*

**** 100% subsidiary of SWELECT Energy Systems Pte. Ltd, Singapore; the name has been struck of in government records in February 2019*

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