April 19, 2021

Swelect Energy Systems Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based/ CC	50.00	90.00	[ICRA]A-(Negative); Reaffirmed
Long- term Fund-based TL	33.00	75.40	[ICRA]A-(Negative); Reaffirmed
Short-term Non-Fund based	35.00	35.00	[ICRA]A2+; Reaffirmed
Short-term Sub Limit Facilities **	(50.00)	(85.00)	[ICRA]A2+; Reaffirmed
Long-term/ Short-term Sub Limit Facilities ***	(35.00)	(35.00)	[ICRA]A-(Negative)/[ICRA]A2+; Reaffirmed
Long-term/ Short-term Unallocated	17.00	1.00	[ICRA]A-(Negative)/[ICRA]A2+; Reaffirmed
Total	**135.00**	**201.40**	

**Instrument details are provided in Annexure-1*

** Sublimit of Rs. 90 crore long-term fund-based facilities

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

Rationale

The reaffirmation in ratings factors in ICRA's expectation of improved cash flows from Swelect Energy Systems Limited's (SESL/ the company) solar power production segment, which has an aggregate capacity of ~77 MW and long-term power purchase agreements (PPA) with various PSU entities such as Tamil Nadu Generation and Distribution Corporation Limited (TANGEDCO), Solar Energy Corporation of India (SECI), Airport Authority of India (AAI) and Chamundeshwari Electricity Supply Corporation (CESC Mysore). The company has been making continuous investments in solar power projects, which have supported and improved its overall profitability (OPM increased to 22.2% in 9MFY2021 from 17.1% in FY2020) and fund flow from operations. The ratings also reflect the company's borrowing profile, primarily secured by collaterals in the form of fixed deposit and mutual funds, which lends healthy financial flexibility. Moreover, its healthy capital structure, as illustrated by a gearing of 0.3 times as on December 2020, provides comfort.

The ratings also consider SESL's diversified business segments, comprising three primary segments—the solar panel/EPC segment, the alloys and casting segment that cater to the oil and gas and the engineering industries, and the solar power/independent power producer (IPP) segment that supplies power to PSU entities and private players. The ratings continue to favourably factor in SESL's established brand position, through HHV Solar Technologies, in the solar module manufacturing segment, with presence across the value chain. The solar panel/EPC segment manufactures solar photo voltaic (PV) modules, 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, however, remain constrained the company's subdued profitability, reflected in its modest RoCE (6.3% in 9M FY2021 as against 1.1% in FY2020), primarily due to weak profitability from the solar panel/EPC segment (due to low capacity utilisation, moderate-scale of operation and stiff competition) and moderate returns from the IPP segment. The ratings factor in the operating risks faced by the solar IPP segment because of dependence on solar irradiance and the risk of devolvement of warranties inherent in the solar panel industry (however, there are no major instance of any warranty invocation in past). Nonetheless, an experienced managerial team and strict quality assurance mitigate this risk to some extent. Further, ICRA notes that the company's large investments in mutual funds (held as collateral) are inherently susceptible to market and credit risks. ICRA also takes into account the vulnerability of cash flows to regulatory risks (primarily IPP and solar panel manufacturing segments).

The outlook on the long-term rating continues to be negative because of the uncertainty in cash flows from the IPP segment, following the pause on trading of Renewable Energy Certificate (REC). Approximately 30% of the company's installed solar power projects are REC backed and hence any adverse regulation pertaining to it could exert pressure on the ratings. ICRA also notes that the continued pressure on profitability because of subdued order inflow in solar panels manufacturing/installation segment; Improved order inflows and profitability from the solar panels manufacturing/installation segment will be a key rating monitorable.

Key rating drivers and their description

Credit strengths

Strong free cash flows from solar power/IPP segment – The company has long-term power PPAs for its solar power plants, totalling to ~77-MW capacity across Tamil Nadu, Karnataka and Andhra Pradesh. It plans to invest in solar power projects under the third-party sale model. Moreover, its PPA contracts with major counterparties are likely to support and improve its profitability as well as free cash flows from the high-margin solar power/IPP segment. Some of its major counterparties under long-term PPAs include TANGEDCO (14MW), SECI (10MW), CESC Mysore (10 MW), AAI (23MW), Integral Coach Factory (ICF), Chennai Metro Rail Limited (CMRL) and Hindustan Petroleum Corporation (HPCL). These apart, the company has supply agreements with private entities such as Schaeffler India Limited (5MW), V-Guard Industries (2MW), and Brookefields Estates Private Limited (3MW).

Diversified business segment– The company has a diversified business segment comprising three primary segments—the solar panel/EPC segment, the alloys and casting segment that cater to the oil and gas and the engineering industries, and the solar power/independent power producer (IPP) segment that supplies power to PSU entities and private players. The diversification in its business portfolio is expected to ensure revenue stability by mitigating dependency on a specific sector to an extent.

Strong capital structure – The company's capital structure remains strong, as illustrated by a gearing of 0.3 times and TNW of Rs. 749.1 crore as of December 2020 against a gearing of 0.3 times and TNW of Rs. 719.5 crore as of March 2020. It remains net debt negative, with a total debt of ~Rs. 223.4 crore as against total cash and liquid investments (including encumbered portion) of Rs. 404.2 crore as on March 2020. 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.

Established brand image of HHV Solar Technologies in solar panel segment – SESL's has an established brand position through HHV-Solar Technologies, which 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 its relationship with a diverse clientele have resulted in stable revenues from the solar panel and EPC/installation segments to some extent.

Credit challenges

Subdued profitability and moderate debt protection metrics – The company's RoCE remained low at 2.9% in FY2019, 1.1% in FY2020 and 6.3% in 9M FY2021. Its moderate scale of operations, exposure to intense competition and low capacity utilisation in the solar panel manufacturing/installation segment have resulted in low profitability due to subdued economies of scale. 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 returns from its older projects. ICRA notes that profitability from the IPP segment is susceptible to performance risk because of any volatility/deterioration in the solar plant's CUF levels with its dependence on solar irradiance. The operating margin in its alloy and casting segment has improved in recent quarters (OPM improved to 13.6% in 9M FY2021 from 7.3% in FY2020) due to improvement in sales realisation; nonetheless, the sustainability of the same is yet to be witnessed. ICRA also notes that the income from mutual funds remains vulnerable to associated market/credit /liquidity risk. Nonetheless, ICRA notes that the company has been earning returns at ~7% from these funds and has investments in funds with a healthier liquidity profile. The returns from the same will also remain a key rating monitorable.

Average profitability coupled with increase in debt levels (Rs. 223.4 crore in FY20 from Rs. 197.5 crore in FY19) had resulted in moderate debt protection metrics, with the company's interest coverage ratio at 2.5 times and 2.9 times in FY2020 and 9M FYFY2021, respectively. Further, its PBDITA/Interest and finance cost remained moderate at 2.32 times in FY2020 and 4.93 times in 9MFY2021.

Vulnerability of cash flows to regulatory risks and counterparty credit profile – At present, there is an uncertainty in cash flows from the IPP segments following the pause on trading of Renewable Energy Certificate (REC). Approximately 30% of the company's installed solar power projects are REC backed and hence any adverse regulation pertaining to it could exert pressure on the ratings. Further, the company's operations in panel/EPC segment remain highly vulnerable to regulatory interventions and the impact of anti-dumping duty and other Government policy on profitability and scale, both of which will continue to be key rating monitorable. The outlook for solar panel manufacturing/installation remains subdued, with low order inflows in FY2021, because of likely postponement of capex plans by private entities. ICRA also notes that the continued pressure on profitability because of subdued order inflow in solar panels manufacturing/installation segment; Improved order inflows and profitability from the solar panels manufacturing/installation segment will be a key rating monitorable.

Liquidity position: Adequate

SESL's liquidity position is **adequate** with availability of undrawn limits (an average utilisation of 80% in its overdraft facility in last nine-month period ended December 2020) and cash and bank balances to support its working capital requirements. ICRA notes that the company remains net cash positive, considering that a major portion of its borrowings are backed by 100% margin on FDs/Mutual funds. Nonetheless, ICRA notes that though over the years, the company's liquidity position has moderated as it undertook significant capex, nonetheless, its cash flow from IPP segment has remained robust. ICRA also notes the large contingent liability of Rs. 36.9 crore as on March 2020, associated with tax-related issues.

Rating sensitivities

Positive factors – Given the negative outlook, an upgrade in SESL's ratings in the near term is unlikely. However, ICRA may revise the outlook to 'stable' if the company shows sustained improvement in cash flows and operating margin, backed by favourable improvement in demand scenario and regulatory environment in the solar panel/IPP segment.

Negative factors – The ratings will be downgraded if the company's profitability and debt protection metrics weaken on a sustained basis. Specific credit metrics that could lead to a downgrade is PBDITA/Interest & finance charges falling below 4.0 times on a sustained basis. Further, prolonged regulatory uncertainties in REC trading will also be a key negative trigger. These apart any significant capex that affects the company's capital structure or liquidity can also lead to a rating downgrade.

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 2.

About the company

Swelect Energy Systems Limited is a solar power systems company with strong presence in solar PV module manufacturing, solar power generating systems, solar IPP and solar power EPC segment. The company has subsidiaries, which have long-term

PPAs for selling solar power to Government utilities and a subsidiary. The subsidiary is involved in manufacturing and trading of iron, steel and investment castings products that cater 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 ~77 MW of solar power assets that supply power to various counterparties such as SECI, TANGEDCO, CESC, AAI. 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)

SESL	FY2019	FY2020	9M FY21 (prov.)
Operating Income (Rs. crore)	227.67	252.22	173.98
PAT (Rs. crore)	6.8	-10.2	30.5
OPBDIT/OI (%)	13.7%	17.1%	22.2%
PAT/OI (%)	3.0%	-4.0%	17.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.5	0.4
Total Debt/OPBDIT (times)	6.3	5.2	4.5
Interest Coverage (times)	2.0	2.5	2.9
PBDITA/ Int. & Finance Charges	3.4	2.3	4.9

Source: Company; All ratios as per ICRA's calculations;

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 of Mar 31, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Apr 19, 2021	Apr 30,2020	-	Oct 10,2018
1	Long-Term Fund Based/ CC	Long term	90.00	*	[ICRA]A-(Negative)	[ICRA]A-(Negative)	-	[ICRA]A-(Stable)
2	Long- Term Fund based TL	Long term	75.40	*	[ICRA]A-(Negative)	[ICRA]A-(Negative)	-	[ICRA]A-(Stable)
3	Short Term – Non-Fund based	Short term	35.00	*	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2+
4	Short Term – Sub Limit Facilities **	Short term	(85.00)	*	[ICRA]A2+	[ICRA]A2+	-	[ICRA]A2+
5	Long Term/ Short Term – Sub Limit Facilities ***	Long term/Short term	(35.00)	*	[ICRA]A-(Negative)/ [ICRA]A2+	[ICRA]A-(Negative)/ [ICRA]A2+	-	[ICRA]A-(Stable)/ [ICRA]A2+
6	Long Term/ Short Term Unallocated	Long term/Short term	1.00	*	[ICRA]A-(Negative)/ [ICRA]A2+	[ICRA]A-(Negative)/ [ICRA]A2+	-	[ICRA]A-(Stable)/ [ICRA]A2+

** Sublimit of Rs. 90 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 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	NA	NA	NA	90.00	[ICRA]A- (Negative)
NA	Long- Term Fund based TL	Sep -2019	NA	Sep -2029	75.40	[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	(85.00)	[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	1.00	[ICRA]A- (Negative)/[ICRA]A2+

Source: *Company*

** Sublimit of Rs. 90 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 Energy Systems LLC, USA**	100.00%	Full Consolidation

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

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

Source: FY2020 Annual report

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About ICRA Limited:

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.

For more information, visit www.icra.in

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