June 11, 2019

Hero Solar Energy Pvt Ltd: Rating reaffirmed; Outlook revised to Negative from Stable; rated amount enhanced

Summary of rating action

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Programme (NCD)	175.0	175.0	[ICRA]A+ (Negative); *reaffirmed* *Outlook revised to Negative from Stable*
Proposed NCD	-	300.0	[ICRA]A+ (Negative); *assigned*
Medium Term loan	-	200.0	[ICRA]A+ (Negative); *assigned*
Total	**175.0**	**675.0**	

*Instrument details are provided in Annexure-1

Rationale

In order to arrive at the rating, ICRA has relied on its *Rating Methodology for Holding Companies* (link shared below). Within this framework, ICRA has combined the business and financial risk profiles of the ultimate renewable energy holding company of the Hero Group in India – Hero Future Energies Pvt Ltd (HFEPL) – and Hero Wind Energy Pvt Ltd (HWEPL) and Hero Solar Energy Pvt Ltd (HSEPL), along with their Special Purpose Vehicles (SPVs), which are respectively the wind and solar holding companies of the Group's Indian renewable energy operations. The rating also factors support from a strong parent – Bahadur Chand Investments Private Limited (BCIPL) – which is rated [ICRA]AA(Stable)/[ICRA]A1+.

While revising the outlook, ICRA has taken a note of the higher than expected debt at the Group level, especially at the three holding companies i.e. HFEPL, HWEPL and HSEPL. Higher than anticipated debt has been used to part fund the equity and debt requirement of the various growth endeavours of the Group. The rating action also factors a delay in equity infusion by an external investor though the same is still expected in the H1FY2020, as per the management.

Despite the rating action, ICRA has taken into consideration the size and scale of operations of the Hero Group. The Group entities have commissioned and are operating more than 1,200 MW of wind and solar assets in India (built largely through organic route). This apart, the Group has an under-construction pipeline of more than 925 MW which is expected to take the overall Group capacity to more than 2,000 MW over the next few quarters. The rating continues to factor in assurance provided by the management that an equity infusion by an external investor is expected in H1FY2020, although the same is delayed. Given the more than 925 MW of under-construction capacity which is in different stages of development, the said equity infusion will alleviate the equity funding risk to a certain extent.

Apart from this, the rating action takes into account the strong sponsor strength given HWEPL and HSEPL are a part of HFEPL, which in turn is promoted by BCIPL and Brijmohan Lal Om Prakash (BMOP), a partnership firm and ultimate holding company of the Hero Group. Operations of the Group have been supported by consistent fund infusion from the parent in the past as well as a $125mn equity infusion by the International Finance Corporation (IFC) and IFC GIF, members of the World Bank Group in FY2018 and FY2019. The management team comprises experienced technocrats and investment/finance professionals. The rating also draws comfort from satisfactory track record of commissioning and managing operations of more than 1,200 MW wind and solar power projects under various subsidiaries. The portfolio of assets is spread over multiple geographies, exposed to a number of counterparties (including discoms, group captives, open access customers and central offtakers) and developed by varied EPC/O&M contractors thus offering the benefits of diversification. ICRA takes comfort from the satisfactory generation performance of many of the individual projects and takes note that for the remaining ones the underperformance is attributable to stabilisation issues, low resource availability or one-time factors which are likely to be overcome shortly, as disclosed by the management. The payment cycle from counterparties remains typical of what has been observed across the renewable energy industry. While in the case of certain offtakers such as group captives, open access customers, Rajasthan discoms, central offtakers etc the payments remain regular, others such as discoms of Maharashtra, Andhra Pradesh, Hubli Electricity Supply Company Limited (HESCOM) etc. doesn't have consistent payment cycle. This has led to promoters resorting to working capital (WC) funding in some of these SPVs or SPVs drawing their own WC facilities or even infusing temporary liquidity in order to meet debt obligations. Finally, ICRA also takes comfort that most of the operational projects have entered into long term power purchase agreements (PPAs) with different counterparties which mitigates demand risk to a large extent.

Despite these strengths, ICRA takes cognizance of the expansion plans of the Group with more than 925 MW under construction and in different stages of development. This exposes the company to execution related risks such as time and cost overrun which are generally associated with greenfield projects. It also creates large funding requirements given the pipeline of under construction projects as well as any requirements in case additional capacity is won through auctions or in case of acquisitions. Therefore, equity infusion by an external investor which is expected in H1FY2020, as disclosed by the management, will remain a key development for the timely completion of the under-construction capacity especially since most of the capacity under-construction has been won through competitive bidding and has to be completed in a time bound manner. ICRA takes note that though 1,200 MW capacity has been commissioned by the Group, only about 37% of the operational capacity has more than 3 years track record indicating that the asset fleet is relatively young. The rating factors in the exposure of some of the assets to state discoms many of which are not in good financial health. ICRA also acknowledges that the renewable energy sector in India is going through a number of industry/regulatory challenges such as safeguard duty, GST compensation, lack of availability of ISTS transmission infrastructure etc. which may create execution related hurdles. Further, projects in the renewable energy space in India are now being awarded through competitive bidding which has led to a drastic fall in tariffs. While lower tariffs increase the attractiveness of renewable power and mitigates offtake risk for developers, the same also leads to viability related challenges. In this scenario, the ability of the Group to keep actual costs within budgeted levels and achieve operational parameters in line with estimates drawn at the time of bidding would be very critical. Finally, ICRA takes note of the operating risks associated with renewable power projects due to uncertainty in resource availability. This has an impact on cash flows as the tariffs are single part in nature and revenue is linked to actual generation only.

The reduction in gearing at the Group level, on-time commissioning of projects which are in various stages of development, the timeliness and adequacy of support from external investor, future project pipeline as well as the funding pattern of the same would be the key sensitivities going forward.

Outlook: Negative

Delay in equity infusion and higher than anticipated debt levels to fund the growth endeavours of the Group have hampered the gearing and other capitalization ratios of the Group. The outlook may be revised if funding and execution risks are mitigated and if assets continue to ramp up successfully.

Key rating drivers

Credit strengths

Strong sponsor strength along with experienced management lends comfort – Strong sponsor strength since the company is ultimately promoted by BCIPL (rated [ICRA]AA(Stable)/A1+); BCIPL is also the holding company for Hero Motocorp (rated [ICRA]AAA/A1+). Further, there has been an equity infusion of USD125mn by IFC and IFC GIF which are arms of the World Bank and rated AAA by Moody's. Based on discussion with the management, another round of external equity funding is expected in H1FY2020.

Well diversified asset base – The Group has a commissioned renewable energy capacity of over 1,200 MW. The Group's assets are spread across high renewable energy potential states and prominent among those are Rajasthan, Karnataka, Andhra Pradesh, Madhya Pradesh, Tamil Nadu, Maharashtra etc resulting in geographic diversification of the asset base. Projects are also well diversified across a number of offtakers such as group captive, open access users, central offtakers and a number of discoms. In terms of technology mix, about half of the commissioned capacity is based on solar with wind making up the other half. Similarly the portfolio is also well diversified across various EPC/O&M players such as Gamesa, Inox, Regen and Suzlon.

Minimum demand risk for operational assets as they have long-term PPAs in place – The power purchase agreements for operational projects have been signed with state distribution utilities on long-term basis for two-thirds of operational capacity, with Central agencies comprising about one-fifth of operational capacity and group captive customers and open access customers at negotiated tariffs for ~12% operational capacity, thereby mitigating offtake risk to a large extent. Among state distribution utilities, the operational portfolio is well diversified with no state distribution utility accounting for more 13% of the total capacity. This too mitigates counterparty risk to a certain extent.

Satisfactory performance of operational projects – About 37% of the operational capacity has more than three years of satisfactory operational track record, while another 27% of operational capacity has track record of one to three years of operations remaining less than one year. ICRA takes comfort from the satisfactory generation performance of many of the individual projects and takes note that for the remaining ones the underperformance is attributable to stabilisation issues, low resource availability or one-time factors which are likely to be overcome shortly, as disclosed by the management.

Credit challenges

Risks associated with developing greenfield projects - The Group has won four projects aggregating 925.6 MW under auctions conducted by Central and state agencies. The ability of the group to execute these projects without time and cost overrun, mitigate funding, regulatory, industry risks etc. and achieve satisfactory operational performance post commissioning shall be critical.

Credit risks arising out of exposure to state utilities – The counterparty profile of the Group's projects includes exposure to group captive and open access customers, state distribution utilities including those of Karnataka, Madhya Pradesh, Rajasthan, Maharashtra, Andhra Pradesh etc and central offtakers. While in the case of certain offtakers such as group captives, open access customers, Rajasthan discoms, central offtakers etc the payments remain regular, others such as discoms of Maharashtra, Andhra Pradesh, HESCOM etc. have an irregular payment cycle. Receivable pattern from distribution utilities will thus remain a key rating sensitivity. However, post the commissioning of the under-construction projects, the counterparty risk profile is expected to improve as majority the new projects would be selling power to Central offtakers.

Vulnerability to weather conditions - As is a feature with wind and solar power plants, cash flows are directly linked to prevalent wind conditions and insolation levels at site. Further, tariff is single part in nature which accentuates the resource availability risk.

Liquidity Position:

Despite the erratic payment schedule by some discoms and weaker than expected generation in certain projects due to one-off or other reasons, the liquidity at the portfolio level remains comfortable as shortfall in one project is compensated for by better generation and/or collections in others. The SPVs have created 1 – 2 quarter Debt Service

Reserve Account (DSRA) in many cases and have not dipped into it for any of the projects. Further, many of these projects have sanctioned working capital facilities which provides liquidity support with management in the process of setting up such facilities across other projects as well. Finally, the Group has demonstrated the ability to raise short term / medium term bridge funding in the past to meet varied funding requirements across the Group in case of any cash flow mismatches.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Holding Companies Rating Methodology for Wind Power Producers Rating Methodology for Solar Power Producers
Parent/Group Support	Group: Hero Group The support from the parent group is explicit and is in the form of periodic equity infusions and other means of promoter funding
Consolidation / Standalone	The rating is based on consolidated financials of the following - Hero Future Energies Pvt Ltd - Hero Wind Energy Pvt Ltd - Hero Solar Energy Pvt Ltd - Clean Wind Power (Devgarh) Pvt Ltd - Clean Wind Power (Satara) Pvt Ltd - Clean Wind Power (Manvi) Pvt Ltd - Clean Wind Power (Pratapgarh) Pvt Ltd - Clean Wind Power (Ratlam) Pvt Ltd - Vayu Urja Pvt Ltd - Clean Wind Power (Piploda) Pvt Ltd - Clean Wind Power (Bableshwar) Pvt Ltd - LNJ Power Ventures Ltd. - Bhilwara Green Energy Ltd - Clean Wind Power (Bhavnagar) Pvt Ltd - Clean Wind Power (Jaisalmer) Pvt Ltd - Clean Wind Power (Anantpur) Pvt Ltd - Clean Solar Power (Dhar) Pvt Ltd - Clean Solar Power (Bellary) Pvt Ltd - Rajkot (Gujarat) Solar Energy Pvt Ltd - Clean Solar Power (Chitradurga) Pvt Ltd - Clean Solar Power (Tumkur) Pvt Ltd - Clean Solar Power (Gulbarga) Pvt Ltd - Clean Solar Power (Jaipur) Pvt Ltd - Clean Solar Power (Bhadla) Pvt Ltd - Clean Solar Power (Jodhpur) Pvt Ltd

About the company

HSEPL is the solar holding company of the Hero Group and is 100% owned by HFEPL, which also owns a 100% stake in the wind holding company of the Hero Group – HWEPL – and is the holding company of the Hero Group for renewable energy. HSEPL, through its 100% subsidiaries, has nine commissioned projects with an aggregate capacity of over 625 MW and has two under construction projects with an aggregate capacity of 550.0 MW. In total, the operational and under-construction/implementation capacity of HSEPL is ~1,175 MW.

HSEPL, on standalone basis, reported a profit after tax (PAT) of Rs. 34.6 crore on an operating income (OI) of Rs. 119.5 crore in FY2018 and PAT of Rs. 6.1 crore on an OI of Rs. 170.6 crore in FY2017.

Key financial indicators (Standalone)

	FY2017	FY2018
Operating Income (Rs. crore)	170.6	119.5
PAT (Rs. crore)	6.1	34.6
OPBDIT/OI (%)	7.3%	39.0%
RoCE (%)	N/A	N/A
Total Debt/TNW (times) (adjusted for promoter debt)	0.54	0.26
Total Debt/OPBDIT (times)	N/A	N/A
Interest coverage (times)	N/A	N/A

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2020)					Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating Jun 2019	Apr 2019	Date & Rating in FY2019	Date & Rating in FY2018 Mar 2018	Date & Rating in FY2017 Dec 2016
1	NCD	Long Term	175.00	175.00	[ICRA]A+ (negative)	[ICRA]A+ (stable)	-	[ICRA]A (stable)	[ICRA]A (stable)
2	Proposed NCD	Long Term	300.0	Nil	[ICRA]A+ (negative)	-	-	-	-
3	Medium term loan	Long term	200.0	200.0	[ICRA]A+ (negative)	-	-	-	-

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
INE316W07013	NCD 1 Tranche 1	Dec-21-2016	9.995%	Jun-21-2021	87.50	**[ICRA]A+ (negative)**
INE316W07013	NCD 1 Tranche 2	Dec-21-2016	9.995%	Jun-21-2022	87.50	**[ICRA]A+ (negative)**
Proposed NCD	NCD	N/A	N/A	N/A	300.0	**[ICRA]A+ (negative)**
N/A	Medium Term loan	March 2019	-	FY2021	200.0	**[ICRA]A+ (negative)**

Source: HSEPL

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545304
sabyasachi@icraindia.com

Shaurya Maini
+91 124 4545388
shaurya.maini@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91-022-61693300
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

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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

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
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Hyderabad	+ (91 40) 2373 5061/7251
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