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India Ratings Upgrades JSW Energy and its NCDs to ‘IND AA’; Outlook Stable

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India Ratings and Research (Ind-Ra) has upgraded JSW Energy Limited’s (JSWEL) Long-Term Issuer Rating to ‘IND AA’ from ‘IND AA-’. The Outlook is Stable. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate	Maturity Date	Size of Issue (billion)	Rating/Outlook	Rating Action
Non-convertible debentures (NCDs)*	-	-	-	INR3.75 (reduced from INR7)	IND AA/Stable	Upgraded
Term loans	-	-	December 2023	INR5.43 (reduced from INR 6.82)	IND AA/Stable	Upgraded
Proposed NCDs#	-	-	-	INR5 (reduced from INR10)	IND AA/Stable	Upgraded
Fund-based limits	-	-	-	INR7.8 (increased from INR4.8)	IND AA/Stable/IND A1+	Long-term rating upgraded, short-term rating affirmed
Non-fund-based limits	-	-	-	INR28.48 (reduced from INR29.52)	IND A1+	Affirmed
Commercial paper (CP)**	-	-	7- 365 days	INR4.5	IND A1+	Affirmed
CP**	-	-	7- 365 days	INR2.5	IND A1+	Assigned

Proposed bank facilities	-	-	-	INR6.29	IND AA/Stable/IND A1+	Assigned

*Details in Annexure
Yet to be issued
** Carved out of the fund-based limits

ANALYTICAL APPROACH: Ind-Ra has continued to take a consolidated view of JSWEL and its subsidiaries, for arriving at the ratings, because of the strong operational and strategic linkages among them.

The upgrade reflects JSWEL's incremental tie-ups of long-term power purchase agreements (PPAs) during FY22, and Ind-Ra's expectation of future capital deployment towards non-conventional businesses including renewable energy value chain through long-term PPAs with debt sizing commensurate to the project cash flows. This would also de-risk the business away from thermal assets. The incremental capital allocation is likely to have a minimal offtake risk (covered through PPAs and better competitive cost of generation), lower execution risks as construction timelines are shorter than thermal projects, and healthy equity availability not leading to pressure on the holding company to borrow to support equity needs for growth. Ind-Ra expects the free cash flow of the thermal business to be either deployed or levered up to generate the desired equity for investments in the renewable energy chain. Although the net leverage (net debt/EBITDA) improved during FY21-9MFY22, Ind-Ra believes it will increase, given the annual capex outlay of INR80 billion-INR100 billion; however, the net leverage will be well supported by committed cash flows.

KEY RATING DRIVERS

Increase in Long-Term PPAs Tie-ups: JSWEL's overall long-term PPAs for the operational capacity increased to 86% of the overall capacity at 1HFYE22, post the tie-up of an open capacity at JSWEL's Ratnagiri plant with JSW Steel Limited (JSL; 'IND AA/Stable') as the latter's Dolvi expansion comes onstream. Furthermore, almost the entire under construction capacity has already been tied up under a long-term PPA excluding Kutehr hydro project, where the PPA is likely to be finalised in February 2022. Including Kutehr, the overall capacity tie up will increase to 91% of the overall portfolio of 7GW. The increase in the long-term tie-ups provide additional cash flows resulting in an improvement in committed cash flows. The untied capacity of 648MW at the standalone level is mainly left in the Vijaynagar plant, which is sold under the merchant/short-term contract route, based on the price attractiveness. JSWEL's low capital cost of INR42 million/MW along with efficient operations as reflected in its low operations and maintenance (O&M) expenses (FY21: INR1.61 million/MW) allows the company to benefit in the merchant markets, even in case of benign exchange prices, however, it is subject to the recovery of variable cost. The Vijaynagar plant has made substantial increase in profits during 3QFY22, given the higher demand and price realisation at exchanges. Although, JSWEL is exploring avenues to tie-up open capacity over the next two-to-three years from the upcoming renewable round-the-clock hybrid bids or from any increase in JSL's demand at its Vijayanagar plant. JSL's hydro plant has also been allowed to uprate the capacity by 91MW to 1,391MW, which remains open given the price attractiveness in exchanges at the peak time than its existing tariff. Given the management focus remains on the renewable projects for future growth, Ind-Ra expects a further improvement in the overall tie-ups in the future.

Healthy Operating Performance of Plants: JSWEL continued to report a plant availability factor above normative levels for its Barmer, hydro, Ratnagiri and Vijaynagar plants for the tied-up capacity for 1HFY22 and FY21, ensuring the entire fixed-cost recovery to the extent of the PPAs. The operating parameters for all of its thermal plants, including station heat rate and auxiliary consumption, remain in line with the normative, leading to no under recovery on fuel cost. The plant load factor (PLF) for plants improved in 9MFY22 with an improvement in power demand in 9MFY22, barring Ratnagiri plant on account of maintenance activities. JSWEL's O&M expenses also averaged INR1.61 million/MW in FY21 (FY20: INR1.8 million/MW). During FY21, the company derived 95% of its EBITDA from regulated operations/long-term PPAs. Furthermore, JSWEL's expanded renewable and hydro power capacities would be tied-up on a long-term basis under competitive bids, ensuring an improvement in the proportion of the tied-up capacity.

Liquidity Indicator - Adequate: JSWEL's liquidity remains comfortable with around INR21.9 billion of cash and cash equivalents at 9MFYE22 (FYE21: INR21.6 billion, FYE20: INR9 billion). The liquidity position is supported by its standalone fund-based limits of INR7.8 billion, whose average utilisation was below 10% for the 12 months ended December 2021. Since JSWEL avails acceptances facility for its creditors, the drawing power of its fund-based limits generally remains nil . Hence, JSWEL has also availed an INR4.5 billion of short-term loan facility, which can be availed without drawing power restrictions and is a backup for the rated CP.

JSWEL's consolidated EBITDA of INR29.1 billion in FY21 (FY20: INR29.6 billion) provides debt servicing visibility, along with the planned equity requirement for the under construction projects. JSWEL has repayments of INR9.3 billon and INR8.6 billion in FY22 and FY23, respectively. Of the total planned capex of INR168 billion, JSWEL's equity infusion requirement is around INR47 billion for the expansion over FY22-FY25. JSWEL has infused equity of around INR17 billion till 9MFY22. The consolidated debt at 9MFYE22 was INR87.4 billion (FYE21: INR86.8 billion, FYE20: INR107 billion), of which INR78 billion (INR80.5 billion, INR97.6 billion) was long term and INR9.4 billion (INR6.3 billion, INR9.9 billion) was short-term debt. Although the subsidiarised nature of the assets lends itself to lower cash flow fungibility, but JSWEL has up-streamed cash by way of share buybacks from JSW Energy (Barmer) Limited ('IND AA-'/Stable). Furthermore, the ongoing capex in Kutehr project can be funded by JSW Hydro Energy Limited ('IND AA-'/Stable), given hydro entity is its subsidiary.

Ind-Ra expects the debt service coverage ratio to remain comfortable above 1.5x for FY22 and FY23, respectively. JSWEL also holds shares of JSL valued at around INR42 billion as of December 2021 which could be utilised, if needed. The pledge on promoter shareholding has reduced to 13.9% as of 9MFY22 (FY21: 25.4%).

Low Offtake Risks: Offtake risks for JSWEL are limited on account of i) 1,300MW hydro projects with a must-run status and ii) a competitive tariff with variable cost of generation for Barmer thermal asset at about INR2.5/unit, thus positioning JSWEL better in the merit order dispatch. The under construction renewable projects are also at a blended tariff of INR3.08/unit, along with the estimated tariff of INR4.5/unit for hydro project keeping the offtake risk low. The company remains exposed to open capacity as the same is run on imported coal and the prevailing high prices make it less competitive. However, the overall contribution to EBITDA from the untied capacity remains low and any favourable opportunity provides an upside to the overall EBITDA as during 9MFY22. However, Ind-Ra, in its analysis, does not assume significant EBITDA generation from the sales from united capacity.

Progress in Under Construction Projects: JSWEL has 2.5GW of renewable projects in under construction stage with around 2.2GW in the wind and solar segment. Of the total under construction projects, JSW has tied up 810MW of renewable projects with Solar Energy Corporation of India (SECI) at a tariff of INR3.00/unit, 450MW of renewable capacity with SECI at INR2.78/unit, and 958MW capacity with JSL. JSL plans to commission the entire under construction renewable capacity in phases over 4QFY22-2QFY24 with around 225MW to be commissioned in 4QFY22. Furthermore, the Kutehr hydro project is progressing on track with around 60% of the tunnelling completed and is likely to be commissioned during FY25. The under construction capacity stands at 35% of the total capacity at 9MFY22, thus entailing significant construction risks. However, Ind-Ra draws comfort from JSWEL's track record of completing its existing thermal projects at healthy capital costs. The Vijayanagar plant has the lowest capital cost of INR36 million/MW. With the planned under construction capacity, the overall capacity would be fairly diversified with thermal power contributing around 45% to the total capacity by FY25(FYE21: 69%), hydro 23% (31%) and renewable 32% (nil).

Net leverage to Increase: Ind-Ra expects the net leverage to increase to 4.0x-4.5x by FY24, as the company draws debt to fund its announced capex of INR167 billion. Furthermore, the company intends to increase its capacity to around 10GW by FY25, which is likely to keep the capex elevated in the near-to-medium term. Hence, the leverage will be a function of the renewable portfolio and growth ambitions; however, the group has stated that the leverage will not increase beyond 4.5x on a sustained basis. The increase in leverage may not result in weakening of the financial metrics, as the increase would be on account of the nature of the projects, and the committed long tenured cash flows. The leverage could also be higher or lower-than-expected by Ind-Ra, depending on the capex finally incurred and commissioning schedules. Ind-Ra draws comfort from the management's stance taken historically with respect to staying away from ultra-mega power projects, no thermal expansion post FY13, delayed entry in renewables post adequate clarity and shelving of electric vehicles plans. The management's internal rate of return expectation is high, despite the low return environment, leading to limited bid activity.

Moreover, given the large capex intensity of the projects, JSWEL has focused on lowering capex cost per MW to remain competitive, resulting in low debt servicing requirements. JSWEL's net interest coverage (EBITDA/gross interest expense) improved to 4.3x in FY21 (FY20: 3.5x) and net leverage (net debt including acceptances/EBITDA) to 2.2x (3.3x). Ind-Ra expects the net leverage to increase to 2.5x-2.7x in FY22, given the strong free cash flow due to a strong operational performance and limited capex undertaken during 9MFY22. Ind-Ra would continue to evaluate the equity commitment in under construction projects with respect to equity generation. Any mismatch, leading to borrowings for equity and stretching the net leverage above Ind-Ra estimates on a sustained basis, could result in a negative rating action.

Debtors Under Control, Although Risk Remains: JSWEL's debtors remained at INR13.6 billion in 9MFY22 (FY21: INR13.1 billion, 9MFY21: INR16.9 billion). The debtors increased intermittently to INR19 billion in June 2021; although, the company managed to improve its collections over the last six months and keep debtors under control. Ind-Ra expects the company's counterparty risk to be fairly manged through i) the diversified nature of the off-takers across nine discoms, ii) sale of power on the cost-plus basis to JSW group to lower payments risk and 10% in merchant sales, iii) payment security mechanism in the form of letters of credit, iv) favourable positioning in the merit order despatch schedule, and iv) presence of state government guarantees in the Baspa and Barmer projects. The company also receives late payment surcharge against delayed payments. However, the debtor risk remains on account of the weak financial position of the discoms. As the share of renewable energy portfolio increases with strong counterparties, the receivable days are likely to remain comfortable.

Standalone Performance: At the standalone level, JSWEL reported revenue of INR25.6 billion in 9MFY22 (FY21: INR29 billion), EBITDA of INR7.8 billion (INR8.1 billion), interest coverage of 7.7x (3.9x) and net leverage of 0.32x (1.6x).

RATING SENSITIVITIES

Positive: A significant increase in the proportion of cash flows from non-conventional businesses, diversification in the value chain, continued healthy returns on incremental capex while ensuring significant cash flows from long-term PPA-backed projects with strong counterparties, leading to a continued improvement in the business and financial profile, would be positive for the ratings.

Negative: An increase in the debtors and/or significant outflows towards projects with non-committed cash flows and/or higher outflows towards loans and advances, and/or equity commitment being higher than that being internally generated and/or a lower-than-expected operational performance, leading to deterioration in the overall liquidity and a decline in the financial profile, will be negative for the ratings.

ESG ISSUES

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on JSWEL, either due to their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

COMPANY PROFILE

JSWEL is in the business of power generation and transmission primarily in the states of Karnataka, Maharashtra, Rajasthan, and Himachal Pradesh. The company has its presence across power sectors including generation, power transmission, mining, power plant equipment manufacturing and power trading.

JSWEL has a 4,559MW generation capacity, of which 3,158MW is thermal power including Vijayanagar, Karnataka (860MW); Ratnagiri, Maharashtra (1,200MW); lignite-based power plant in Barmer, Rajasthan (1,080MW), Nandyal, Andhra Pradesh (18MW), 1,391MW hydropower Karcham Wangtoo, Himachal Pradesh (1,091MW) and Baspa, Himachal Pradesh (300MW) and solar power across four states (10MW). JSWEL also has a transmission line through a 74:26 joint venture with Maharashtra State Electricity Transmission Company Limited. The project consists of a 400kV double circuit Jaigad – New Koyna (55km) and Jaigad – Karad (110km) lines for transmission of the power generated at the Ratnagiri plant (Maharashtra).

CONSOLIDATED FINANCIAL SUMMARY

Particulars	9MFY22	FY21	FY20
Revenue (INR billion)	57.1	69.2	82.7
EBITDA (INR billion)	24.2	29.1	29.6
EBITDA margin (%)	42.4	42.0	35.7
Gross interest coverage (x)	3.6	3.3	2.8
Net leverage (x)	2.15	2.24	3.3
Source: Ind-Ra, JSWEL			

RATING HISTORY

Instrument Type	ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (billion)	Rating/Outlook
NCDs	INE121E07320	30 December 2016	8.65	30 December 2022	INR2	IND AA/Stable
NCDs	INE121E07353	9 March 2021	*	16 February 2024	INR1.75	IND AA/Stable
NCDs	INE121E07346	29 January 2020	*	28 January 2022	INR3	WD (paid in full)

*(Benchmark 12-month treasury-bill rate) + 3.25 % p.a.

BANK WISE FACILITIES DETAILS

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COMPLEXITY LEVEL OF INSTRUMENTS

Instrument Type	Complexity Indicator
Term loans	Low
Fund-based limits	Low
Non-fund-based limits	Low
Proposed NCDs	Low
NCDs	Low
CP	Low
Proposed bank facilities	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

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Applicable Criteria

Evaluating Corporate Governance
Corporate Rating Methodology

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