EthiFinance Ratings

CANADIAN SOLAR INC

6578063 CORPORATE

BBB ISSUER RATING
Long term

OUTLOOK
Stable

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Rating Action and Rationale

- EthiFinance Ratings affirms Canadian Solar Inc´s rating at "BBB", maintaining its Stable outlook.
- This rating is underpinned by i) a sector with solid fundamentals (medium levels of profitability, controlled volatility, high barriers to entry and favourable growth prospects) which is further supported by the positive impact of ESG on its assessment; and ii) the strong competitive positioning based on its vertical integration, its appropriate size and an outstanding diversification. On the financial side, we highlight the controlled indebtedness (NFD/EBITDA ratio<4x) and an interest coverage ratio that, although expected to deteriorate in 2023 and 2024 due to the increase in interest costs, will remain at a reasonable (EBITDA/Interest ratio of ~7x on average).
- On the other hand, the rating is constrained by the medium capitalization, reflected in an Equity/TFD ratio below 80%. The NFD/EBITDA and EBITDA/Interest ratios are commensurate with the company´s rating.
- According to our methodology, the renewable energy sector (capital goods) is well aligned with ESG factors (heatmap score of between 1 and 1.9). This consideration results in a one-category upgrade (three notches) on the industry risk assessment. The group's ESG policies are considered neutral (ESG score between 2 and 2.5), resulting in a rating that is not affected by these factors.

Issuer Description

Canadian Solar is a multinational company involved in the manufacturing of photovoltaic panels and the development and operations of solar power plants. Founded in 2001 in Canada, Canadian Solar now employs 18,500 people and sells products and services in more than 160 countries. Headquartered in Canada, Canadian Solar has been listed on the Nasdaq since 2006. Its main subsidiary, CSI Solar, which manufactures products primarily in China, has been listed on the Shanghai Stock Exchange since 2023. For 2022, the sales of Canadian Solar were $7,469m with an EBITDA of $660m (EBITDA margin of 8.8%). The NFD/EBITDA ratio stood at 3.1x at the end of 2022. Canadian Solar's market capitalization reached $1.41bn (06/12/2023).

Fundamentals

Business Risk Profile

Industry Risk Assessment

- **The renewable energy sector offers high growth prospects. The manufacturing of PV panels is subject to medium volatility, offers medium margins and fairly high barriers to entry.**

As Canadian Solar's main activity is manufacturing, we use the sector "capital goods" sector for our industry risk assessment. The capital goods sector is characterised by medium volatility, fairly high barriers to entry (significant capex required to build up a plant) and a reasonable level of profitability (EBIT margin ~10%). In particular, the photovoltaic sector has increasingly strong growth prospects with a CAGR of 6.9% and 15% over the next 4 to 7 years. This growth will be underpinned by rising electricity demand and the increasing penetration of solar generation in the energy mix, driven by favourable policy and financial returns. The global PV sector is dominated by Chinese companies, which could be affected by geopolitical turmoil between China and the US. The market is therefore global.

- **An industry that benefits from positive ESG impact.**

In line with our methodology, the renewable energy sector is well aligned with ESG factors (heatmap score of between 1 and 1.9). The industry in which the company operates is considered a sector that is already benefiting from -or structurally positioned to benefit from - ESG trends. These trends are providing significant business opportunities and long-term visibility for the whole sector. This consideration results in a one-category upgrade (three notches) on the industry risk assessment.

Company's Competitive Positioning

- **Canadian Solar has a strong competitive positioning among PV manufacturing companies.**

Canadian Solar operates in a global industry. It is one of the top 5 manufacturers with an estimated market share of 9% at the end of 2022. It plans to increase its market share to 15% between 2026 and 2028 by adding manufacturing capacity.

Its strong market position is based on its vertical integration: Canadian Solar's CSI Solar division manufactures ingots, wafers, cells, modules and, from 2022, battery energy storage systems (BESS). The Recurrent Energy division is responsible for i) the EPC and financing of a project; and ii) the O&M of the solar power plants that sell electricity. The use of CSI Solar panels in the construction of its projects is an example of synergy.

In terms of diversification, the mix of sales by region has been balanced since 2008, with a similar weighting between the Americas, Asia and Europe & others. No single customer accounts for more than 4% of sales. Limitations include the dependence on polysilicon (the main raw material) and the concentration of suppliers in the market.

Governance

- **A listed company whose new access to the equity capital market may be subject to the Chinese government's approval.**

The majority shareholder is Shawn (Xiaohua) Qu, the founder of Canadian Solar, with a 21.3% stake.

Canadian Solar Inc. is publicly traded in the United States. CSI Solar is publicly traded in China. Canadian Solar Inc. owns 64% of CSI Solar and is consolidating its operations. The group has a proven track record of raising equity. Recent legislation by the Chinese authorities, which came into effect in March 2023, will regulate the disclosure of information and the issuance of securities when a domestic company is listed overseas, making the issuance of shares in the US subject to Chinese administrative approval and could potentially be more difficult. However, the Company confirmed it should not apply to Canadian Solar Inc.

The financial policy is adequate. Canadian Solar is expanding its manufacturing capacity with important capex, that is financed by both equity and debt, allowing the company to maintain a net leverage ratio between 2x and 4x EBITDA.

- **A neutral ESG policy.**

Based on the ESG data provided and according to our methodology, Canadian Solar's ESG policy is rated neutral (score between 1.5 and 2.0). This score does not affect the financial profile score for the rating.

Financial Risk Profile

Cash Flow and Leverage

- **An important expansion plan financed by a mix of debt and capital.**

Canadian Solar has a track record of positive FFO generation. However, due to a significant expansion of its manufacturing capacity in the past and expected until 2024, the group has been generating negative free cash flow since 2020. This cash consumption is being financed by both additional debt and equity (i.e. the partial IPO of CSI Solar in 2Q2023, which raised $928m). Investments are discretionary, so Canadian Solar may delay or cancel some of them to maintain financial flexibility.

- **A controlled indebtedness.**

Canadian Solar's track record has shown that financing through a mix of debt and equity has allowed the company to maintain an NFD/EBITDA below 4x, which stood at 3.1x at the end of 2022. This ratio is expected to decrease by the end of 2023 as a result of the capital raise but to return to a level of ~3x EBITDA in 2024.

The EBITDA/interest coverage ratio is reasonable. This ratio, which has been around [7-9]x for the past 3 years, is expected to decline slightly in 2023 and 2024 given the macroeconomic context of rising interest rates, which will increase the cost of debt. However, we note that Canadian Solar has a hedging policy in place, which makes it less sensitive to this fluctuation.

Capitalization

- **A correct capitalization.**

The Equity/TFD ratio has historically been around 60%, based on an accumulation of positive net income, no dividend payout and recurring capital injection (issuance of shares or sale of shares to minorities). We expect this ratio to increase to 79% in 2023 as a result of the capital increase carried out in 2Q23, and then to decrease to 70% in 2024 as a result of additional debt.

Liquidity

- **A good access to liquidity with internal cash restriction.**

Canadian Solar has diversified sources of funding (equity, bank debt and bonds), giving it good access to cash.

The CSI Solar division generates more than 80% of the group's EBITDA. This division is headquartered in China and appears to be a ring-fenced structure. Restrictions include cash collateral from Chinese banks, a ban on intercompany loans between the two divisions, withholding taxes on dividends paid by CSI Solar and potential Chinese regulatory oversight on issuing securities in foreign markets. We consider that management is aware of these restrictions and has put in place mitigating measures. Therefore, we do not expect liquidity issues in the Recurrent Energy division or the group in the short term.

Modifiers

Controversies

- We have not found any material negative news. There are no rating impacts.

Country Risk

- Despite a challenging geopolitical context between China and the United States, the first country is where Canadian Solar has most of its manufacturing capacity and the second is where it generates 17.5% of its sales, Canadian Solar has managed its operations to mitigate this risk. In the absence of an unexpected material event, we do not consider this to be a material factor that would penalise the rating for country risk issues.

Main Financial Figures

Main financial figures. Millions of USD.	2020	2021	2022	2023E[1]	2024E[1]	22vs21
Turnover	3,476	5,277	7,469	7,700	8,700	41.5%
EBITDA	508	510	660	797	901	29.4%
EBITDA Margin	14.6%	9.7%	8.8%	10.4%	10.4%	-0.8pp
EBIT	220	190	356	448	507	87.4%
EBIT Margin	6.3%	3.6%	4.8%	5.8%	5.8%	1.2pp
EBT	145	145	372	379	413	156.6%
Total Assets	6,537	7,388	9,038	11,109	12,717	22.3%
Equity	1,892	2,127	2,307	3,548	3,858	8.5%
Total Financial Debt	2,891	3,311	4,012	4,512	5,512	21.2%
Net Financial Debt	1,251	1,876	2,043	1,784	2,763	8.9%
Equity/TFD	65.4%	64.2%	57.5%	78.6%	70.0%	-6.7pp
NFD/EBITDA	2.5x	3.7x	3.1x	2.2x	3.1x	-0.6x
Funds From Operations	226	273	680	633	704	149.1%
FFO/NFD	18.1%	14.6%	33.3%	35.5%	25.5%	18.7pp
EBITDA/Interest	7.1x	8.8x	8.9x	6.9x	6.4x	0.1x

[1] Forecasts prepared by EthiFinance Ratings.

Credit Rating

Credit Rating	
Business Risk Profile	**BBB+**
Industry Risk Assessment	*A-*
Sector ESG Adjustment	*Positive*
Competitive Positioning	*A-*
Governance	*BBB*
Financial Risk Profile	**BBB-**
Cash flow and leverage	*BBB-*
Solvency	*BB*
Company's ESG Adjustment	*Neutral*
Anchor Rating	**BBB**
Modifiers	*No*
Rating	**BBB**

Rating Sensitivity

Factors that may (individually or collectively) impact the rating:

- **Long-term rating positive factors (↑)**

Increase in turnover; NFD/EBITDA ratio <2x; FFO/NFD>40%; EBITDA/Interest>10x; Equity/TFD>80%.

- **Long-term rating negative factors (↓)**

Turnover below $5.5bn; negative impact from extra-territoriality regulation from China or the United States; NFD/EBITDA ratio above 4x; FFO/NFD<20%; EBITDA/Interest<5x; Equity/TFD<50%.

Sources of information

The credit rating assigned in this report has been requested by the rated entity, which has also taken part in the process. It is based on private information as well as public information. The main sources of information are:

1. Annual Audit Reports.
2. Corporate Website.
3. Information published in the Official Bulletins.
4. Rating book provided by the Company.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, EthiFinance Ratings assumes no responsibility for the accuracy of the information and the conclusions drawn from it.

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies. Principal methodology used in this research are :
    - Corporate Rating Methodology - Long Term : https://files.qivalio.net/documents/methodologies/CRA 190 V3 Corporate%20Methodology 2023-10-06.pdf
- The rating scale used in this report is available at https://www.ethifinance.com/en/ratings/ratingScale.
- EthiFinance Ratings publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months EthiFinance Ratings has not provided ancillary services to the rated entity or its related third parties.
- The issued credit rating has been notified to the rated entity, and has not been modified since.