FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Adani Ports at 'BBB-'; Outlook Negative

Tue 15 Jun, 2021 - 6:59 AM ET

Fitch Ratings - Singapore - 15 Jun 2021: Fitch Ratings has affirmed India-based port operator Adani Ports and Special Economic Zone Limited's (APSEZ) Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB-'. The Outlook is Negative. A full list of rating actions is at the end of this commentary.

RATING RATIONALE

APSEZ's underlying credit profile is assessed at 'bbb' while its rating is capped by India's Country Ceiling of 'BBB-'.

APSEZ's underlying credit profile reflects its status as the largest commercial port operator in India, with best-in-class operational efficiency. Historically, the issuer has experienced throughput resilience in economic cycles, including the current Covid-19-related downturn. Cargo throughput for APSEZ rose by nearly 2% (11% if including its Krishnapatnam Port Company Limited (KPCL) acquisition) in the financial year ended March 2021 (FY21), compared with the nearly 5% decrease for cargo throughput at all Indian ports.

About 56% of APSEZ's cargo is sticky, which includes contractual take-or-pay cargo, cargo that is unlikely to be diverted to other ports due to infrastructure restrictions, such as the lack of facilities to handle crude oil, and cargo from joint-venture (JV) partners. APSEZ has timing flexibility in its expansion projects. Management has budgeted about INR30 billion-40 billion for capex in FY22, but this could be cut down to INR8 billion for maintenance only.

We believe APSEZ has adequate liquidity to weather near-term challenges. The company had a readily available cash balance of about INR53 billion at FYE21, against operating expenses of INR33 billion and interest cost of about INR21 billion. APSEZ has INR14 billion due in FY22 to be repaid or refinanced. The company, as a member of one the largest conglomerates in India spanning different sectors, has strong banking relationships and established access to the capital markets.

Fitch's rating case projects adjusted net debt/EBITDAR will average 3.6x in FY22-FY26. The ratio can also drop below 3.0x if management is able to maintain consolidated EBITDA margins of 65%.

KEY RATING DRIVERS

Best-in-Class Port Operator - Revenue Risk (Volume): Stronger

APSEZ is the largest commercial port operator in India. It handled about 25% of the country's seaborne cargo in FY21 through the 12 ports it operates. Most of them are primary ports of call in their regions. Its flagship Mundra Port is the gateway to north-western India. APSEZ's traffic is mainly origin and destination, with limited transhipment cargo. Its advanced infrastructure, operational efficiency and integrated logistics solutions have resulted in market share gains and faster organic growth in throughput than its peers and India's economic growth.

Cargo that is difficult to switch to other ports made up 56% of APSEZ's total throughput. Its well-developed transport infrastructure ensures smooth cargo evacuation and enables end-to-end logistic services by transporting cargo from the ports to its inland depots via railways. APSEZ acquired KPCL in FY21 and continued to diversify its throughput from the west coast, with the east coast terminals accounted for 26% of the total, up from 20% a year earlier.

The company has been expanding its logistics business to cover all of India and has built multimodal logistics for warehousing, rail transportation, and distribution. Its logistics business currently operates 61 railways on the Indian Railway network and includes container, auto, grain, and bulk rakes under the general-purpose wagon investment scheme.

Flexibility in Modifying Tariffs - Revenue Risk (Price): Midrange

APSEZ's portfolio is mainly private ports, which have the freedom to fix their own tariffs. The company has entered into take-or-pay contracts, which accounted for about 10% of its port revenue in FY21 with a revenue-weighted remaining contract term of 10 years. Take-or-pay contracts insulate revenue from throughput volatility.

APSEZ's tariffs are generally higher than other Indian ports, but this is justified by its better operational efficiency and connection with the hinterland. This results in lower overall logistics cost for shippers, according to management.

Internally Funded Capex - Infrastructure Development and Renewal: Stronger

APSEZ's capacity is sufficient to support medium-term throughput growth. However, APSEZ plans to further upgrade its infrastructure, diversify its cargo mix and expand its logistics business. The plan includes the upgrade of Dhamra Port's railway connectivity and upgrades at the Hazira, Katupali and Mundra projects. However, most of this is discretionary capex, which the company can postpone without having a major impact on its operations.

Fixed-Rate Bullet Bonds Dominate - Debt Structure: Midrange

APSEZ's consolidated debt comprises mainly US dollar and Indian rupee bullet bonds. We expect its business strengths, established access to capital markets and relationships with banks to mitigate refinancing risk. Aside from refinancing risk, APSEZ has limited exposure to floating interest rates due to its use of fixed-rate bonds and bank loans. The bonds do not benefit from restrictive financial covenants and reserve accounts. The company relies on natural hedging to manage its foreign-exchange risk. A third of its revenue is in US dollars, which should be sufficient to cover its US dollar debt servicing.

PEER GROUP

PT Pelabuhan Indonesia II (Persero) (Pelindo II, BBB/Stable; underlying credit rating: bbb) is the largest container port operator in Indonesia. APSEZ benefits from cargo under long-term contracts, which accounts for about 56% of total traffic. In comparison, Pelindo II benefits from stable rental income from JVs, which accounts for about 60% of its EBITDA. We forecast average leverage of 3.6x during the forecast period for APSEZ under our rating case, a level similar to that of Pelindo II.

Port of Melbourne (issuing entity, Lonsdale Finance Pty Ltd: BBB/Stable) is the primary port of call serving the Victorian and broader Australian market, with limited competition. Its rating benefits from a diversified landlord port business model, long concession life and low infrastructure development and renewal risk. However, it is much smaller in operational scale than APSEZ. Its overall stronger qualitative attributes support higher leverage; it had average net debt/EBITDA of 8.5x under the Fitch rating case, compared with APSEZ's 3.6x for the same underlying credit profile.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- We do not expect positive rating action in the near term

- A revision in Outlook on the Indian sovereign to Stable would indicate that the Country Ceiling is likely to remain at 'BBB-' and therefore our Outlook on APSEZ would also be revised to Stable

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Prolonged deterioration of Fitch's rating case adjusted net debt/EBITDAR to above 5.0x due to underperformance or a material reduction of average concession life

- Lowering of India's Country Ceiling to 'BB+'

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sectorspecific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

APSEZ accounted for around 25% of India's seaborne cargo in FY21. It operates 12 ports across India. Its most important port, Mundra Port, contributed 58% of the group's throughput and serves as the gateway to landlocked north-western India.

CREDIT UPDATE

APSEZ throughput growth has consistently outperformed the wider industry's in India. Cargo throughput for APSEZ rose by nearly 2%, or 11% if including the KPCL acquisition, in FY21, versus the 5% decline for all ports in India. The above-industry average growth reflects APSEZ's expertise in turning around troubled assets and its operational efficiency. Throughput growth was mainly driven by the Mundra and Dhamra ports, where throughput increase by 4% and 9%, respectively, as container volume at Mundra climbed by 18% and dry bulk at Dhamra rose by 7%. Newly acquired KPCL also contributed to about an 8% increase in cargo throughput. APSEZ also continued to diversify its throughput from the west coast, with the east coast terminals of KPCL, Dhamra, Kattupali and Ennore now accounting for 26% of total throughput, up from 20% a year earlier.

Total EBITDA increased by 7% in FY21 while the EBITDA margin widened due to rising revenue contribution from the ports segment, which has a higher EBITDA margin.

Outstanding debt increased as the company issued two US dollar bonds in FY21 with total proceeds of USD1.25 billion, part of which was used to repay a USD500 million bond due 2022.

Management intends to distribute 20% of profit after tax (PAT) in FY21, similar to FY20. Depending on the financial performance in the medium term, management intends to stick with policy of distributing 20%-25% of PAT.

FINANCIAL ANALYSIS

The Fitch base case assumes a 22.5% increase in throughput in FY22, which is 2.5 percentage points lower than management's projection of a 25% increase in throughput in FY22. The increase in throughput in FY22 is primarily due to the addition of newly acquired KPCL and Gangavaram Port Ltd. (GPL). We assume throughput will rise by 6.7% per annum thereafter, in line with the CAGR of Indian GDP in the past five years. It implies a throughput CAGR of about 7% between FY21 and FY26. For tariffs, we assumed 2.5% growth rate, the lower end of management guidance of 2.5% to 3% realisation growth. We assume constant capex of INR40 billion per year in FY22 to FY26. We also assume dividend payouts will be 25% of PAT in FY22 and beyond. Our base case generates an average adjusted net debt/EBITDAR of 3.2x with a maximum of 3.5x.

Fitch's rating case assumes a 10% haircut on the base case throughput for FY22-FY26. It implies a throughput CAGR of about 5% between FY22 and FY26. We also applied a 10% haircut to Fitch base-case tariff growth and applied 10% stress to our base-case capex assumption. We assume dividend payouts are the same as in the base case, in line with management's guidance. Our rating case generates an average adjusted net debt/EBITDAR of 3.6x with a maximum of 3.7x.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

APSEZ's rating is capped by India's Country Ceiling of 'BBB-'.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Adani Ports and Special Economic Zone Limited	LT IDR	BBB- Rating Outlook Negative	Affirmed	BBB- Rating Outlook Negative
• Adani Ports and Special Economic Zone Limited/Debt/1 LT	LT	BBB- Rating Outlook Negative	Affirmed	BBB- Rating Outlook Negative

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Infrastructure and Project Finance Rating Criteria (pub. 24 Mar 2020) (including rating assumption sensitivity)

Ports Rating Criteria (pub. 15 Oct 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Adani Ports and Special Economic Zone Limited	EU Endorsed, UK Endorsed

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Infrastructure and Project Finance Asia-Pacific India

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