FitchRatings

Fitch Assigns Adani Ports' Proposed USD Notes 'BBB-(EXP)'; Outlook Stable

Fitch Ratings - Hong Kong/Sydney - 21 June 2019: Fitch Ratings has assigned India-based port operator Adani Ports and Special Economic Zone Limited's (APSEZ, BBB-/Stable) proposed senior unsecured US dollar notes an expected rating of 'BBB-(EXP)' with a Stable Outlook. The proceeds will be primarily used for capex.

The final rating is contingent upon the receipt of final documents conforming to information already received.

RATING RATIONALE

APSEZ is India's largest commercial port operator, with best-in-class operational efficiency. Historically, the issuer has experienced throughput resilience in economic cycles. APSEZ has some flexibility in modifying tariffs and around 14% of its revenue in the financial year ended March 2019 (FY19) was associated with long-term revenue-guaranteed contracts. APSEZ has spare capacity and can fund its large capex plan from operational cash flow. Its debt structure is corporate like, with spread out bullet maturities.

Fitch's rating case projects adjusted net debt/EBITDAR to fall to an average of 2.7x in FY20-FY24, from 3.1x in FY19. APSEZ's standalone credit profile of 'bbb' is capped by India's Country Ceiling of 'BBB-'.

KEY RATING DRIVERS

Best-in-Class Port Operator - Revenue Risk (Volume): Stronger
APSEZ is the largest commercial port operator in India. It accounted for 21% of the country's seaborne cargo in FY19 through the 10 ports it operates along India's coastline. 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 state-of-the-art infrastructure, operational efficiency and integrated logistics solutions have resulted in market share gains and organic throughput growth above that of peers and India's economic growth. Its diversified cargo mix helped its throughput to continue expanding despite the global financial crisis and the government's attempt to reduce India's coal imports.

Long-term cargo, such as cargo from take-or-pay contracts and joint venture (JV) partners, contributes about 60% of 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. Mundra Port has a deep draft to handle container ships of up to 18,000 TEU (twenty-foot equivalent unit). APSEZ seeks to expand its container terminal network in south-east Asia. The company signed a 50-year contract in May 2019 to develop and operate an international container terminal at Yangon Port, Myanmar.

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 20% of total throughput, or 14% of consolidated revenue, in FY19, with a revenue-weighted remaining contract term of 12 years. Take-or-pay contracts should insulate revenue from throughput volatility.

Internally Funded Capex - Infrastructure Development and Renewal: Stronger
APSEZ's capacity is sufficient to support medium-term throughput growth. However, the company plans to expand capacity and diversify its cargo mix, including the construction of the Vizhinjam transhipment port, the upgrade of Dhamra and Kattupalli into multipurpose ports and the expansion of the logistics business. The company will also invest up to USD290 million to develop a container terminal in Yangon Port over next three years. APSEZ seeks to issue up to USD750 million 10-year senior unsecured notes to fund near-term capex. We believe the company has sufficient experience in executing its development plans based on its past success in turning around the Dhamra and Kattupalli ports. APSEZ's improving asset utilisation and profitability means we forecast a total of INR292 billion cash flow from operations in FY20-FY24 under Fitch's rating case, sufficient to fund its capex plan and dividend distribution in the long run.

Predominant Use of Fixed-Rate Bullet Bond - Debt Structure: Midrange
Fitch forecasts APSEZ will deleverage with improving cash flow over FY20-FY24. APSEZ's consolidated debt comprises mainly US dollar and Indian rupee bullet bonds and commercial paper. We expect its established access to capital markets and relationships with banks to mitigate refinancing risk. APSEZ has limited exposure to floating interest rates given its use of fixed-rate bonds and bank loans. The bonds do not benefit from restrictive financial covenants or reserve accounts. The company relies on natural hedging to manage foreign-exchange risk. A quarter 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; standalone credit profile: bbb) is the largest container port operator in Indonesia. APSEZ benefits from cargo under long-term contracts, which accounts for about 60% of total traffic. Pelindo II has an increasing leverage due to its intensive capex plan, but we expect APSEZ to deleverage following a peak in FY20 on improving free cash flow. We forecast an average leverage of 2.7x during the forecast period for APSEZ under our rating case, compared with 3.1x for Pelindo I. However, Pelindo II benefits from stable rental income from JVs, which accounts for about 60% of its EBITDA.

ABP Finance Plc (A-/Stable) is the financing vehicle of Associated British Ports (ABP), which operates 21 ports in the UK. ABP benefits from its perpetual ownership of port assets and its landlord-tenant business model, with long-term take-or-pay contracts representing around 45% of revenue in 2017. APSEZ benefits from long-term cargo but does not own on freehold its ports like ABP. ABP's leverage is higher than APSEZ, although ABP's debt includes extensive financial covenants, securities and other creditor-protective features.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:
- Prolonged deterioration of Fitch's rating case adjusted net debt/EBITDAR above 5.0x due to underperformance or a material reduction of average concession life
- A downgrade of India's Country Ceiling from 'BBB-'

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:
- An upgrade of India's Country Ceiling above 'BBB-'

TRANSACTION SUMMARY

APSEZ accounted for 21% of India's seaborne cargo in FY19. It operates a string of 10 ports across India. Its most important port, Mundra Port, contributed 66% of the group's throughput and serves as the gateway to landlocked north-western India.

CREDIT UPDATE

APSEZ's revenue dropped by 4% yoy in FY19 as strong cargo throughput growth of 15% was offset by a decline in logistics revenue due to unavailability of leased rakes, and lower special economic zone (SEZ) revenue due to one-off port development revenue of INR24 billion booked in FY18. Excluding revenue from SEZ, revenue would have increased by 15%. Management has ordered new rakes, which will be delivered by end-2019, and this will improve the rake availability for the APSEZ's logistics business.

Likewise, EBITDA was flat yoy as a result of lower logistics and SEZ revenue contribution. Excluding EBITDA contribution from SEZ, EBITDA increased by 17%. However, the EBITDA margin climbed higher to 65% due mainly to lower contribution from the logistics segment, which has a lower margin than the port business.

APSEZ has acquired Adani Agri Logistics Limited. APSEZ has also signed a definitive agreement to acquire Innovative B2B Logistics Solutions Private Limited. The transaction is expected to complete by first half of FY20. These acquisitions will complement APSEZ's existing logistics operations, and upon completion APSEZ will be India's largest private rail and logistics park operator. The two acquisitions would have added about INR4 billion revenue to APSEZ in FY19.

APSEZ through its subsidiary, Adani Yangon International Terminal Co. Ltd, signed a 50-year build, operate and transfer agreement with the Myanmar government to develop an 800,000-TEU international container terminal at Yangon Port. The agreement is extendable twice for 10 years each. The project will be conducted in two phases and has a total construction cost of USD275 million-290 million (INR19 billion-20 billion). Phase I development of 500,000 TEU capacity will commence in June 2019 and is expected to be completed in two years, with an estimated cost of USD220 million-230 million (INR15 billion-16 billion).

FINANCIAL ANALYSIS

Fitch's base case forecasts a 9% CAGR for APSEZ's throughput and 1.5% tariff increase every year in FY20-FY24. We forecast EBITDA margin to trend lower and average 62% in FY20-FY24 due mainly to increasing low-margin revenue. Our base-case assumptions also include capex of INR182 billion over the five-year forecast and a higher dividend payout ratio of 25% of net income (up from 15%) to reflect management's revised dividend policy. We also include management's plan for a share buyback with an aggregate amount of INR19.6 billion in FY20. This results in adjusted net debt/EBITDAR averaging 2.1x in FY20-FY24, with a maximum of 2.9x in FY20.

Fitch's rating case applies a 10% hair cut to base-case throughput and tariff growth assumptions. We forecast an average EBITDA margin of 60% in FY20-FY24 and apply 10% stress to our base-case capex assumption. We also assume a higher dividend payout ratio of 25% of net income (up from 15%). Our rating case's assumption also reflects management's plan for a share buyback with an aggregate amount of INR19.6 billion in FY20. Fitch's rating case also applies 2% interest rate stress to reflect APSEZ's refinancing risk. APSEZ's adjusted net debt/EBITDAR averages 2.7x in FY20-FY24 under Fitch's rating case, with a peak of 3.1x in FY20.

The Fitch base case forecasts adjusted net debt/operating EBITDAR to average 2.1x over the five-year forecast period, with a maximum of 2.9x in FY20. Under Fitch's rating case leverage will average 2.7x in FY20-FY24, with a maximum of 3.1x in FY20.

Date of Relevant Committee

17-Jun-2019

Public Ratings with Credit Linkage to Other Ratings

APSEZ's standalone credit profile of 'bbb' is capped by India's Country Ceiling of 'BBB-'.

RATING ACTIONS

ENTITY/DEBT	RATING		
Adani Ports and Special Economic Zone Limited			
Adani Ports and Special Economic Zone Limited/Debt/1	LT BBB-(EXP) Expected Rating		

Additional information is available on www.fitchratings.com

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Applicable Criteria

Ports Rating Criteria (pub. 23 Feb 2018)
Rating Criteria for Infrastructure and Project Finance (pub. 27 Jul 2018)

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