FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Hong Kong - 16 Jun 2020: 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 Stable.

RATING RATIONALE

The coronavirus pandemic and government containment measures worldwide have created an uncertain global environment for the seaport sector. APSEZ's most recently available issuer data may not have indicated an impairment in performance, but material changes in revenue and cost profile are occurring across the seaport sector and will continue to evolve as economic activity and government restrictions respond to the ongoing situation. Fitch's ratings are forward-looking in nature, and we will monitor developments in the sector as a result of the pandemic's severity and duration, and incorporate revised base- and rating-case qualitative and quantitative inputs based on our expectations for future performance and assessment of key risks.

The Indian government imposed a nationwide lockdown on 25 March 2020 and is now opening up different states in phases. A prolonged pandemic and further deterioration in the economy will hurt domestic consumption and disrupt the supply chain. However, while the lockdown restricts people's mobility, it does not apply to cargo to ensure a steady supply of food and medical supplies.

APSEZ confirms that its seaside port operation has been largely uninterrupted; dock workers reside at and continue to work at the ports as they are declared essential services by the government. However, a lack of truck drivers has disrupted cargo transportation by road. This has resulted in the increasing use of railways to move cargo, which is more efficient as passenger rail service has stopped.

APSEZ's throughput dropped about 30% yoy in April 2020 mainly due to disrupted cargo movement and lower export and import throughput due to factory shutdowns. Management expects throughput in the financial year ending March 2021 (FY21) to be flat or marginally lower yoy although the full impact of the coronavirus remains to be seen. Cargo and geographical diversification would help limit the throughput decline. Management expects all types of cargo to rebound once economic activity restarts in India. About 60% 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 crude oil and cargo from joint-venture (JV) partners.

APSEZ has timing flexibility in its expansion projects. Management had previously budgeted about INR40 billion for capex in FY21 and has reduced it to INR23 billion. In the worst-case scenario, management could cut capex to only maintenance, which is about INR8 billion.

APSEZ announced its acquisition of a 75% stake in Krishnapatnam Port Company Limited (KPCL) in January 2020, which will be fully funded through internal accruals and existing cash balances. APSEZ will consolidate KPCL's debt of INR62 billion into its balance sheet and incur INR55 billion in cash outflow to fund the acquisition, which will not affect APSEZ's rating, in our view. However, the acquisition is still pending regulatory approvals. Management expects the acquisition to be completed only in 3QFY21. We have not included the acquisition or EBITDA contribution from KPCL in our forecast due to the pending regulatory approvals.

We believe APSEZ has adequate liquidity to weather the near-term challenges. The company had a cash and bank balance of about INR73 billion as of March 2020 and committed undrawn banking facilities of INR16 billion. This compares with its operating expense (excluding depreciation and amortisation) of INR43 billion and interest cost of about INR20 billion in FY20. APSEZ has INR33 billion due in FY21 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 market.

Feedback

Fitch's rating case projects adjusted net debt/EBITDAR will average 3.1x in FY21-FY25. APSEZ's underlying rating of 'bbb' is capped by India's Country Ceiling of 'BBB-'.

KEY RATING DRIVERS

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

APSEZ, as the largest commercial port operator in India, accounted for approximately 17% of the country's seaborne cargo in FY20 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 faster organic throughput growth than its 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 or JV partners, contributed about 60% of its 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 10% of its port revenue in FY20 with a revenue-weighted remaining contract term of 10 years. Take-or-pay contracts could insulate its revenue from throughput volatility.

Internally Funded Capex - Infrastructure Development and Renewal: Stronger

APSEZ's current capacity is sufficient to support medium-term throughput growth. However, APSEZ has a capex plan to further expand its capacity and diversify its cargo mix. The plan includes the construction of the Vizhinjam transhipment port, development of a container terminal in Yangon Port, and the expansion of the logistics business. The company is also in the process of acquiring KPCL in Andhra Pradesh and Dighi Port in Maharashtra. 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.

Predominant Use of Fixed-Rate Bullet Bond - Debt Structure: Midrange

APSEZ's consolidated debt comprises mainly US dollar and Indian rupee bullet bonds. We expect its established access to capital markets and relationships with banks to mitigate refinancing risk. Its average debt maturity has been extended from four years to more than five years after the issuance of two US dollar bonds in 2019. 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 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; underlying credit rating: 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. On the other hand, Pelindo II benefits from stable rental income from JVs, which accounts for about 60% of its EBITDA. We forecast average leverage of 3.1x during the forecast period for APSEZ under our rating case, a level similar to that of Pelindo II.

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 2018. APSEZ benefits from long-term cargo but does not own on freehold its ports like ABP. ABP's leverage is higher than that of APSEZ, although ABP's debt includes extensive financial covenants, securities and other creditor-protective features.

RATING SENSITIVITIES

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

- A downgrade of India's Country Ceiling from 'BBB-'

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

- An upgrade of India's Country Ceiling above 'BBB-'

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance 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 sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

TRANSACTION SUMMARY

APSEZ accounted for approximately 17% of India's seaborne cargo in FY20. It operates a string of 10 ports across India. Its most important port, Mundra Port, contributed 62% of the group's throughput and serves as the gateway to landlocked north-western India.

CREDIT UPDATE

APSEZ's throughput growth normalised in FY20 after a sharp rebound of 15% in FY19. Throughput rose by 7% yoy in FY20, faster than the 4% for all Indian ports. The above-industry average growth reflects APSEZ's expertise in turning around troubled assets and its operational efficiency. Throughput growth was mainly driven by Kattupali and new liquefied natural gas and liquefied petroleum gas terminals at Dhamra and Mundra. The company also continued to diversify its throughput from the west coast, with the east coast terminals of Dhamra, Kattupali and Ennore now accounting for 20% of total throughput, up from 15% a year earlier.

APSEZ's revenue rebounded 9% yoy in FY20, driven by higher port revenue and a recovery in logistics revenue, partially offset by lower special economic zone revenue, which was due to timing differences in executing contracts.

Its logistics business revenue rebounded by 65% yoy in FY20 after a 30% decline in FY19 due to unavailability of rakes. APSEZ has purchased additional container rakes and acquired Innovative B2B Logistics (B2B). This increased its total number of rakes from 20 to 60 currently. The acquisition of Adani Agri Logistics Limited also increased the logistics business revenue. APSEZ will continue to increase the geographical coverage of its warehouses and construct grain silos, which will provide an end-to-end solution to its cargo customers.

Total EBITDA increased by 7% in FY20 while the EBITDA margin continued to narrow due to increasing revenue contribution from the logistics segment, which has a lower EBITDA margin.

Outstanding debt increased as the company issued two US dollar bonds in FY20 with total proceeds of USD1.4 billion, part of which was used to repay a USD650 million bond due 2020.

APSEZ declared and paid an interim dividend of INR3.2/share in FY20, representing around 20% of the full-year profit after tax (PAT). The company does not expect any final dividend for FY20. Management intends to stick with its policy of distributing 20%-25% of PAT in FY21, depending on its financial performance.

FINANCIAL ANALYSIS

The Fitch base case assumes a 6% throughput decline in FY21 and an 11% rebound in FY22, in line with management's forecast. 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 5% between FY20 and FY25. We have incorporated management's expectation of a delay in some capex in FY21. Our base case assumes INR123 billion in capex in FY21-FY25, of which INR23 billion will be spent in FY21. We also assume dividend payouts will be 20% of PAT in FY21 and 25% thereafter. Our base case generates an average adjusted net debt/EBITDAR of 2.4x with a maximum of 3.2x.

Fitch's rating case assumes a 10% throughput decline in FY21, followed by a 10% recovery in FY22. We have applied a 10% haircut to the base case's throughput growth assumption thereafter. It implies a throughput CAGR of about 3% between FY20 and FY25. We also applied 10% stress to our base-case capex assumption. We assume dividend payouts will be 20% of PAT in FY21 and 25% afterwards. Our rating case generates an average adjusted net debt/EBITDAR of 3.1x with a maximum of 3.6x.

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

RATING ACTIONS

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

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 — Effective 3/24/20—10/15/20 (pub. 24 Mar 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

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