Rating Criteria – Rating of Port projects

EXECUTIVE SUMMARY

The port sector contributes 95% to India's international trade in volume and around 70% in terms of value. India has 12 major ports (regulated by the Central Government) and 212 non-major ports (regulated by the State Government's marine boards (GMB)) spread across nine coastal states, of which 44 are functional. Jawaharlal Nehru Port Trust (JNPT) is the largest major port in India whereas Mundra is the largest private port. All major ports are under the jurisdiction of the Government of India and are governed by Major Port Trusts Act 1963, except Kamarajar Port ((erstwhile Ennore Port), which was administered under the companies Act 1965. But now Kamarajar Port's shareholding is also taken over by Chennai Port Trust).

India is strategically located on the world's shipping routes with a total coastline length of 7,517 kms, consisting of mainland coastline length of 5423 kms and island territories coastline length of 2094 kms. India's major port capacity in FY19 was 1,514 mn tonnes per annum (MTPA) as against the Maritime agenda 2010-20 target of 3,130 MT. During FY20, major ports handled 704.82 mn tonnes (MT) of cargo traffic, with CAGR growth of 2.74% (FY16-FY20), container traffic of 9.98 TEU, a growth of 1.12% (y-o-y) and iron ore traffic of 54.99 MT. The market share of major ports as of FY20 was ~55% of total cargo, whereas the remaining 45% was with non-major ports. Cargo traffic at non-major ports reached 447.21 million tonnes as of FY20. Solid cargo still constitutes a major chunk of the major port operations at 42%, followed by liquid (petroleum, oil and lubricants) 37% and container share of 21%.

The importance of ports in increasing international trade cannot be undermined, as it provides linkages between domestic and international manufacturing and distribution centres due to which there has been a huge participation from the private sector (mostly in non-major ports) and adoption of new and improved technology to improve port infrastructure. The Ministry of Shipping has plans to increase the overall port capacity to 3300+ million tonnes per annum to cater to projected traffic of 2500 million tonnes per annum by 2025. Total investment in the port sector is expected to reach US$43.03 billion by 2020. Going forward, the sector is expected to receive very high investments over the coming five years. Most of this investment is envisaged from the private sector and is based on the commercial viability of the upcoming projects. The Sagarmala Programme, which aims at port modernization, port connectivity enhancement, port linked industrialization and coastal community development, is another initiative undertaken to improve infrastructure facilities at ports. Under the programme, 143 projects were completed, while 190 projects worth INR 2.1 lakh crore have been awarded and are under implementation.

SCOPE

The document provides a brief analysis of the attributes considered by Brickwork Ratings (BWR) in rating port projects. The scope of this document is to capture important aspects of various risks associated while arriving at the rating of a port. A brief summary of the effect of these attributes on the overall credit rating of Port Trusts/SPVs is highlighted which helps ascertain the debt servicing capability as against generation of cash flow and the ability of these port operators to undertake large scale infrastructure projects.

RISK ASSESSMENT AND RATING CRITERIA AT BRICKWORK RATINGS

Brickwork ratings factors in the various quantitative and qualitative risks that the SPVs/ companies are exposed to, while assessing the risks in these projects. As highlighted above, the key risks that port trusts may face in a port project are the funding risk, underlying financing risks, legal risk, counterparty risk, risks related to lease agreements or landlord port model etc. These risks are considered to arrive at the rating of a port project. The risks and how they are incorporated in the rating framework are discussed in detail below.

Project risk:

The risks that a project is exposed to at the initial stages of construction have a huge role to play in its successful completion and operation. Port projects being highly capital intensive, require expensive infrastructure to be able to complete successfully. Delays in obtaining various statutory/legal/environmental clearances at the beginning of the project can hinder the cash flows and impact the profitability negatively. These risks mainly include:

- Project Planning & completion risk: This includes the evaluation of the risks associated with the financial closure of the project, any associated technology risks or the track record of the sponsor in completing similar projects in the past and current status of the project.
    - Funding risk: Equity is arranged by sponsors privately whereas for their debt requirements, SPVs have to depend on banks, financial institutions and capital markets. The ability of an SPV to tie up the required funding for timely closure of the project is a critical factor.
    - Contractual structure and lease agreements: Tenant lease agreement is an important aspect as port operators play an important role in port operations irrespective of being a landlord port or an operator port. A port service agreement includes clauses related to development of port/terminals/berths, performance standards, project completion schedule, tenor of project and lock in period for the equity holders etc.
    - Track record of EPC contractor: The construction risk is usually borne by an EPC contractor so it is important to have a contractor with an extensive knowledge about various costs and experience of implementing similar projects.
    - Stage of project completion: The stage of project completion at the time of evaluation is assessed. The greater the level of completion, lesser are the chances of non-completion and delays, leading to time and cost overruns.

- Project Implementation risk: Brickwork assesses risks of unfavourable government policies, delays in obtaining clearances for timely completion, which are likely to affect the cost structure and credit profile of the project.
    - Government Policy: Favourable government intervention which leads to development of port infrastructure through budgetary allocations is likely to help in smooth operations of the project.
    - Environmental/statutory/legal clearances: Risks related to changes in legislation, delays in obtaining clearances (land clearance, coastal regulation zone clearance, fire clearance etc.) can hamper the implementation of projects as scheduled and should be analyzed carefully.
    - Complexity of the Project/ Terrain: If the port project is exposed to strong tidal waves or winds, heavy rainfall and adverse climatic conditions, huge costs will have to be incurred for maintenance. The terrain where the project is going to be located and the ability of the port to withstand erratic weather conditions is critically assessed.
    - Adoption of technology: Adoption of high complexity and superior technology not only leads to timely project completion but also helps in reducing maintenance costs.

Operational risk:
It includes all factors responsible for the operational efficiency, financial closure and successful and timely completion of the project.

- Financial risk: Port projects being highly capital intensive, require a significant proportion of debt and equity to fund their capital expenditure program. Brickwork assesses the leverage and coverage ratio of promoters, liquidity, financial flexibility and currency and interest rate fluctuations risks. Profitability of a port depends on the operational efficiency parameters such as high berth utilization, low turnaround time, high cargo and vessels handling capacity and in-house marine services offered by the port.
    - Adequacy and stability of cash flow
    - Leverage indicators (DE, Debt to EBITDA)
    - Coverage indicators (DSCR, ISCR)
    - Profitability and Returns.
    - Liquidity and financial flexibility
    - Interest rate and foreign exchange risks
    - Off balance sheet exposures

- Criticality risk: Macroeconomic risks which affect the timely completion and profitability of port projects form part of criticality risks. These mainly include risks arising out of changes in regulatory process, environment and statutory clearances required, terms and conditions of port service agreement etc. The ability of an SPV to provide for these additional costs due to changes in laws or government regulations is assessed by Brickwork extensively. Also, the geographical risks relating to location of the project and terrain complexity, force majeure (act of god) risks such as war or armed conflict, inter socio political risks need to be assessed.

- Counterparty credit risk: Counterparties in ports include shippers, shipping companies, terminal/berth operators, rail companies and other logistics companies. The extent of counterparty risk depends on the market position and on how essential the port is. In case a port is a primary port and has a strong market position, it will not be affected by the bankruptcy of a single shipper whereas a counterparty risk could be more pronounced for a port following a landlord model, where revenues are more dependent on user/operator creditworthiness.

- Business risk: Brickwork assesses the ability of a port to handle different types of cargoes and larger vessels, which determine the operational efficiency of the project.
    - Location and last mile connectivity/Multi modal connectivity: Connectivity to a rail and road network, along with Inland Container Depots (ICDs), are essential for smooth operations of ports. Proximity to exporting centres and markets ensures healthy demand which ensures stability of cash flows.
    - Ability to handle larger vessels and cargoes: Generally, a function of onshore facilities and dredging facilities available for cargo handling, a port with an ability to withstand larger and different types of cargoes has better operational efficiency. The lesser the voyage time, more will be the number of cargoes (container, break bulk, liquid bulk, bulk and passenger) a port can carry.
    - Cost competitiveness and revenue mix: It is important for a port operator to have a diversified traffic for cargoes. There are three types of port business mainly dry bulk and liquid, crude oil and container business. Ability to handle such traffic provides higher revenues visibility.
    - Availability of productive labour and relationships: The availability of a productive labour force at the port enhances output per berth, average pre-berthing time (in hrs) and Average turnaround time (ATT) of vessels on port (in days). Ports with single window clearance systems services and mechanised loading and unloading facilities will have high productivity and operating efficiency and ability to handle more cargo.
    - Management and corporate governance: A highly motivated, competent management with an efficient risk management team adds to the strength and viability of the project company.

CONCLUSION

BWR analyses each of the above parameters after measuring the impact of each of the above-mentioned risks and attributes, along with financial projections over the life of the facility to arrive at the overall assessment of the credit quality of the issuer. The sensitivity analysis of the financial projections provides understanding of cash flows as against the debt servicing obligations. While the methodology comprises comprehensive analysis of various risks associated with the project implementation, regulatory aspects, financial risk, Industry, operational and business risk, the competitive profile, the final rating is assigned based on the overall credit assessment of Issuer. Due to the long gestation period of port projects, the financial profile of counterparties and sponsors associated with the project is critically assessed to service debt obligations.

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