

Rating Methodology for Port Projects

Background

India has 7,517-km long coastline with 13 major ports and 187 minor/intermediate ports, which handle bulk of India's international trade. The primary responsibility of development and management of major ports is with Central Government. These ports are governed by the Major Port Trusts Act, 1963. The non major ports are administratively under the state government and are governed by the Indian Ports Act, 1908. Operations of the Indian ports are characterised by full utilization of capacities at the major ports, inefficient handling, poor maintenance, labour issues and draft constraints. On the other hand, development of new minor ports have been affected by inadequate connectivity with the hinterland, absence of multi-modal connectivity to and from ports and the differential royalties and revenue-sharing models of ports. Permission for 100% FDI in port sector and encouragement for PPP in non major ports has helped in growing private participation in the sector. Besides, Government of India is working towards corporatization of a few ports.

With a view to streamline the operations of the ports and to enable India increase its share in global trade, the port sector requires huge investments over the next few years. Most of this investment is envisaged from the private sector depending upon the commercial viability of the project.

CARE has developed a rating methodology for port projects keeping in view the operating environment for Indian ports.

Rating Methodology:

Project overview

CARE examines the broad parameters of the project based on the detailed project report submitted by the client. The major areas covered are:

- Location: The location of a port is key to its operations being commercially viable. Location has a bearing on the project cost and other key operating characteristics like draft, siltation, storage and evacuation facilities etc.
- Accessibility to the port
- Technical arrangements and collaborations
- Implementation schedule
- Any firm contracts for loading / unloading of cargo
- Economic development of the hinterland

Project Implementation Risk

The risk associated with the completion of a greenfield project on time is generally high due to long set-up time and large financial outlays. In this regard, the following issues are examined.

- Capabilities of the contractor and other parties involved in implementing the project.
- Financial tie-up.
- Cushion provided in the financing plan and construction schedule for possible delays.
- Legal and environmental clearances required for the execution of the project.

During project implementation, CARE would monitor the progress vis-a-vis the initial cost and time estimates to determine the effect of variations from schedule on the ability to meet debt servicing obligations.

Demand Analysis

Focus on demand and potential variation of demand due to economic changes, is the most essential ingredient for commercially viable operations. The aspects examined are:

- Demand sensitivity to tariff
- Location of the port and its connectivity

- Cargo and revenue mix
- Development of new alternative ports
- Government policies on international trade

Evaluation of cargo-mix

CARE evaluates the cargo-mix closely to assess the port's vulnerability to competition and the stability of revenue streams.

- Trends in international and national cargo movements
- Demand for specific cargo types
- Cyclical nature of the cargo and cargo movement
- Revenue stream from different types of cargo
- Flexibility of the port to shift from one cargo type to another
- Trends of imports and exports to/from the region

Regulatory Framework

- Government policies and procedures
- Identification of the obligations and rights of the project sponsor
- Terms and conditions of the contract
- Environmental regulations
- Political risks

Financial Structure

- Study of the capital structure of the project to determine the optimal leverage
- Exposure to currency risk
- Maturity profile
- Payback period and sensitivity to financing costs
- Any covenants in the debt documents or the agreement, which may impair debt servicing capability, are also evaluated critically

Management Evaluation

CARE evaluates the management from different perspectives like

- Organisation structure and degree of autonomy
- Financial capabilities
- Experience in the sector

- Ability to maintain harmonious labour relations
- Track record in implementing and operating large projects

Operating risks

Port operations carry the following unique operating risks which CARE analyses in detail:

- Susceptibility to the vagaries of weather and other natural hazards
- Proportion of firm commitments for cargo movement
- Ability of the operator to maintain optimum operating conditions
- Changes in global shipping practices
- Contract terms with the shipping lines
- Customer profile and degree of diversification
- Competition from any other alternative mode
- Technology

Financial Analysis

An in-depth analysis of the projected operations is undertaken to assess the ability of the port operations to service its debt obligations. This would also entail a critical examination of the underlying assumptions in context of the above factors. CARE would also examine the following as part of its financial evaluation:

- adequacy and stability of cash flow
- coverage available for debt servicing
- financial flexibility
- comparison with other similar ports
- factors which could have a critical impact on the servicing ability

Conclusion

CARE analyses each of the above factors and their linkages to arrive at the overall assessment of credit quality. The reduction in credit risk due to any credit enhancement provided is carefully evaluated before assigning the final rating.

While the methodology encompasses comprehensive analysis of the project implementation risks, demand analysis, regulatory framework, management evaluation and financial analysis, the credit rating is awarded on the basis of an overall assessment of all aspects.

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