# Rating Methodology - Port Projects

[In supersession of "Rating Methodology - Port Projects" issued in September 2018]

## Industry Overview

India has 7,517-km long coastline with 12 major ports and 205 notified minor and intermediate ports, which handle bulk of India's international trade. Further, under National Perspective Plan for Sagarmala, 6 new mega ports will be developed in the country. 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 has 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 under the automatic route for port and harbour construction and maintenance projects 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.

## Prospects of Port Industry

Currently India has 12 major ports and under Sagarmala projects, Indian government plans to develop 6 new mega ports ( Vadhavan -Maharashtra, Tajpur -West Bengal, Paradip Outer Harbour -Odhisha, Cuddalore/Sirkazhi-Tamil Nadu, Belikeri –Karnataka and Enayam-Tamil Nadu). More than 610 projects have been identified for implementation, during 2015-2035, across the areas of port modernization & new port development, port connectivity enhancement, port-linked industrialization and coastal community development with estimated cost of Rs.7.78 lakh crore and as on July 31, 2019, 542 projects (costing around Rs. 4.75 lakh crore) were under various stages of implementation, development and completion.

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

## Rating Methodology

### For Greenfield port projects

CARE's approach towards analyzing port projects is developed keeping in view the operating environment for Indian ports. CARE examines the broad parameters of the project based on the detailed project report submitted by the client. The following are key factors, CARE analyses while arriving at the rating of greenfield port companies.

- ***Location of proposed port:*** Site selection is one of the most critical factors for the success and attractiveness of any port project. The ideal port should have adequate depth, shelter from waves and sea currents, good logistic access and proximity to areas with export and import demands. The project viability is heavily dependent on a suitable location.
- **Project Implementation Risk:** The risk associated with the completion of a greenfield port project on time is generally high due to long set-up time and large financial outlays. In this regard, CARE examines the following issues:
  - **Capabilities of the contractor:** Capabilities of EPC contractor is crucial to the successful implementation of the port project in a timely manner. A reputed and experienced contractor having experience in similar projects is a positive factor. Also fixed-price and time contracts help to mitigate the price escalation to an extent and are viewed positively. CARE critically analyses the terms of the EPC contract to understand the obligations of the EPC contractor for timely completion of the project and Liquidated Damage clauses for any delay in completion of the project.
  - **Financial closure:** CARE critically evaluates the status of infusion of promoter funds, status of debt tie-up, pre-disbursement conditions and critical covenants of tied-up debt (viz. interest rate, moratorium period, repayment period, structuring of repayments, cash flow waterfall mechanism, TRA, subordination of promoter's contribution infused in other than equity form etc.). Financial closure at the initial stages of the project is viewed positively by CARE.
  - **Status of statutory clearances:** Port project is subject to various type of clearances and approval like land clearance, fire clearance, environmental clearances, coastal regulation zone clearance, DGTD/CCI&E confirmation related to automatic clearance for the import of capital goods and Raw materials, labour license, etc. Presence of adequate clearances is viewed positively.

**For operational port projects:**

CARE analyses the following risks for operating port companies**:**

1. Operating & Business Risk.
2. Regulatory Framework & Force-Majeure Risk.
3. Financial Risk.
4. Management Evaluation.

**<u>Operating & business risks:</u>** Given the cyclical nature of the industry, high degree of operating efficiency would lessen the impact of volatility in revenues. Operating risks primarily includes factors such as location of the port and its connectivity, cargo and revenue mix, proportion of firm commitments for cargo movement, customer profile and degree of diversification, contract terms with the shipping lines, any changes in global shipping practices, labour relationship, flexibility of pricing, competition from any other alternative mode and the technology adapted by the operating port to enhance its operating efficiency and susceptibility to the vagaries of weather and other natural hazards. CARE evaluates the demand and its sensitivity to tariff arising out of changing economic condition as the same is one of the vital ingredient for commercially viable operations. Accordingly, CARE analyses the impact of development of new alternative ports closer to it, government policies on international trade, demand for specific cargo types, cyclical nature of the cargo and cargo movement and flexibility of port to shift from one cargo type to another, estimated/expected revenue stream from different types of cargo and trends of imports and exports to/from the region etc. to evaluate the demand prospects of the ports. Some of the key factors are elaborated below.

- **Location *of the port and its connectivity:*** Location of the port and its connectivity is one of critical enablers for ports and the end-to-end effectiveness of the logistics system drives competitiveness for the maritime industry as well. A better connectivity of major ports with the hinterland endorses smooth flow of traffic. Further, deep seawater harbor leads to lower dredging cost and port maintenance. However, on the other side, ports close to the estuaries will have higher silting issues which will lead to high operating cost. Ports with better connectivity, good weather conditions throughout the year and low dredging & port maintenance cost are viewed positively.
- ***Cargo and* revenue *mix***: Vessels are classified on the basis of the type of cargo carried by them viz., Bulk carriers, Tankers, Container shipping and Specialized Vessels. Top commodities handled at Indian ports are petroleum products, coal, iron ore, engineering goods, chemicals and electronics.

The flexibility and ability of handling different kinds of cargo are one of key operating risk sensitivity to counter change in products portfolio of port. Further, an established mechanized cargo handling system with capability to handle different type of cargo helps in quicker turnaround time and ensures faster delivery of services.

- ***Customer* profile *and degree of diversification***: Customers profile and its degree of diversification is also one of key indication of effectiveness of port operation. Reputed and diversified customers help the ports to generate its regular cash flow. CARE Ratings believes that the long -term contracts and stable relationship with large client base can provide better financial flexibility to the company.
- ***Labour relationship***: The productivity of labour is one of the key operating factors to derive effective turnaround time, pre-berthing time and output per ship berth. A cordial labour relationship and effective productivity helps to achieve smooth operation. Besides, ports having high level of mechanization for material handling further enhances the productivity as a whole.

2. **Regulatory Framework:** The operations of the ports are subject to various regulatory risks. CARE evaluates the various regulatory risks like government policies and procedures, environmental regulations, terms & conditions of agreement, political risk etc.

Port is a highly regulated industry and tariff rates of major ports are still driven by Tariff Authority for Major Ports (TAMP). However, the non-major ports have better flexibility in term of fixation of tariff structures.

- **Force-*Majeure* risk:** Further, ports projects are also exposed to forced majeure risks which are partially mitigated through insurance cover. CARE critically evaluates the concession agreement, insurance contracts to ascertain the degree of risk cover in case of occurrence of force majeure events. CARE also examines termination clauses, mechanism for settlements compensation at the time of termination of agreement and possible impacts on its debt protection metrics.

3. **Financial Risk:** An in-depth analysis of the past financial performance, future projection including underlying assumptions & future capital expenditures are undertaken to assess the ability of the port to timely service its debt obligations. In this context, CARE examines the following:

- Adequacy and stability of cash flow
- Capital structure & coverage available for debt servicing
- Financial flexibility & liquidity

- Foreign currency fluctuation risks
- Exposure to group companies
- Off balance sheet exposures
- Factors which could have a critical impact on the servicing ability

For more details on Financial ratios, please refer to CARE's methodology on '***Financial Ratios-Non financial sector entities***'.

**4. Management Evaluation: Refer to 'CARE's Rating Methodology - Manufacturing companies'**

## 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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