Funding for Carmichael coal and rail plus Abbot Point T0

Adani Enterprises needs to complete all environmental approvals and then raise A$8bn of additional debt and equity financing to achieve financial close and hence allow construction to commence on the Carmichael coal, rail and port proposal. Raising US$2-3bn of new equity from external shareholders seems a minimum requirement. First coal is increasingly unlikely prior to 2018 at the earliest. Lessons from the WICET greenfield coal port expansion need to be heeded. This Research Brief examines various factors affecting financial close for Adani Mining's Carmichael project in the Galilee Basin, Queensland.

The funding size: Adani has announced a A$10-11bn investment in its Australian coal, rail and port expansion. Of this, some A$2.8bn has been funded to-date. This leaves A$8bn still to be funded, a serious challenge for a group with external debts exceeding US$12bn.[i]

Existing asset base in Australia: The Adani family acquired the Adani Abbot Point Coal Terminal T1 (AAPCT) in Mar'2013 for A$2bn. In addition, Adani Enterprises has spent upwards of A$300m on staffing, drilling, EIS reports and options to acquire land holdings for the mine and rail. This follows the acquisition of the coal deposit mining rights from Linc Energy and Mineralogy P/L for a collective A$525m in 2011 (refer pg 15 of *Remote Prospects*).

Scope to borrow against existing Australian assets

T1: The AAPCT already had a A$1.1bn Australian bank debt syndicate (lead by NAB, CBA and Westpac, with 4 international banks), plus a US$800m facility from State Bank of India (refer pg 59 of *Remote Prospects*). In Oct'2013 CBA, Deutsche Bank and Westpac were appointed as joint lead managers for $1.25 billion of debt refinancing on AAPCT (T1).[ii] The press speculated NAB has lost its lead banker role and reduced its exposure to AAPCT or withdrew entirely from the syndicate. Credit Agricole also confirmed to BankTrack they had withdrawn from the facility on the refinancing as well. With a total of A$2.1bn of loans already against AAPCT T1, there is no scope for the Adani group to borrow any more against this loss-making port.

T0: While commodity prices are depressed, there is little scope to put in non-recourse project financing for a greenfield coal terminal at T0 that will take 3-4 years to start generating any cashflow to service the loan. While project financing does get done in Australia, normally the banks would require significant security in the form of supporting equity (i.e. cash injection from the parent) plus secure long term off-take contracts against >80% of the capacity of the port. Adani Power is the key likely customer of T0, and in its current state does not represent a bankable counterparty.

Carmichael coal deposit: Despite having invested some A$800m buying the right to develop this coal deposit and an option over the Moray Cattle farm it sits under, there are few tangible bankable assets in Adani Mining P/L. Without a sizable equity injection, the banks would not be likely to provide multi-billions of dollars of project loan finance against a greenfield project which will not have any supporting cashflows for 3+ years.

Rail Infrastructure: Without any supporting cashflow prospects for 3+ years, banks again will not provide multi-billion dollar project loan finance against a A$1.0-2.2bn greenfield railway prospect. A secure, long term take-or-pay covering most of the base railway capacity would also be required. A suitably well capitalized counter-party would be needed. A well capitalized infrastructure joint venture partner would significantly assist in the financing of a greenfield railway. However, most infrastructure funds do not like taking on project development risk, nor has there been any speculation that Adani has lined up any possible partner. Adani Mining's EIS talks about the suboptimal nature of partnering with either Aurizon, China First or GVK.[iii]

The scope for Adani Enterprises to raise A$8bn

The Adani Group indebtedness: The listed Adani group has US$10bn of net debts across its three listed entities and their subsidiaries. The private Adani Family has US$2bn of debt against AAPCT T1. Adani Enterprises has an equity market capitalisation of US$3.8bn[iv] and a free float of only 25%. With net debt more than twice the equity cap of Adani Enterprises, this leaves little scope for AEL to further increase its group indebtedness.

Adani Enterprises – net profit profile: For the December 2013 quarter, Adani Enterprise's net profit of US$11m or Rs682m was down 84% yoy, but at least it was a profit, given the September 2013 quarter was a net loss of US$67m due to foreign exchange losses as the Rupee collapsed. Earnings before interest and tax (EBIT) was US$204m for the quarter, this was only marginally ahead of Adani Enterprises' net interest bill of US$172m – giving a skinny net interest cover of 1.2x.[v]

Indian Banks: The role of the leading global banks in project finance is critical. China has 4 of the top 10 banks by equity capitalisation at the end of 2013. Australia has 4 of the top 20 banks. India has no banks in the top 50 banks globally. This makes the balance sheet risk of funding a US$10bn project very pronounced for even a large group of Indian banks without the support of the Australian and global bank majors.

Further, Indian Power sector loans outstanding rose to Rs4,038bn (US$65bn) as of March 2013. Gross bad debts from this sector rose from Rs8.0bn in March 2009 to Rs23.06bn in March 2013 (US$370m).[vi] The extent of the Indian banking systems loan portfolio concentration to the power sector is a cause of increasing concern to the Reserve Bank of India, particularly with the associated loss making nature of the leading generators (Adani Power, Tata Power, GVK, Lanco Infratech).

Would the US Ex-Im bank provide trade finance?: It is possible that the US Export-Import Bank (a US State owned enterprise) might be willing to provide say US$1bn of vendor equipment finance via GE or Caterpillar locomotives, rail wagons and earth moving equipment. In addition to promoting US exports, the Ex-Im bank might argue this is providing capital to facilitate an integrated Indian owned coal-to-power project for a developing country that has no viable alternatives. Post President Obama's State of the Union address and Climate Change Pledges,[vii] this looks an increasingly remote prospect.

A US$2-3bn Equity Raising?: For Adani Enterprises to secure bank project financing for its US$10bn Australian development, at the least Adani will need to raise US$2-3bn of new equity capital from external shareholders.

Selling down Adani Ports: One avenue to raise new equity capital would be for Adani Enterprises to reduce its controlling stake in Adani Ports from 75% currently to say 50%. Selling 25% of existing shares to external shareholders at say a 5-6% discount to the current price of Rs147 would raise US$1.16bn. Given the robust capitalisation and track record of growth in Adani Ports, this is very doable. However, it would require Adani Enterprises to be willing to divest a significant stake in its successful, core business in order to fund a very risky, marginal at best integrated coal operation in an unfamiliar market.

Selling down Adani Enterprises: Another source of new equity capital would be for Adani Enterprises to issue say 366m new Adani Enterprises shares to external shareholders. Assuming the promoters don't have surplus capital to support such an issue, this could see the Adani Family dilute its controlling stake in Adani Enterprises from 75% currently to a still majority holding of say 50%. Assuming a 10% new issue discount, this could raise Rs70bn or US$1.1bn.

US$8bn of funding: Coupled with the sell-down of 25% of Adani Ports, a sale of 25% of Adani Enterprises could raise a combined US$2.2bn of new equity in cash – possibly sufficient to fund the equity portion of the Carmichael project if the Indian, Australian and global banks were willing to provide say US$5bn of project finance and if the US Ex-Im Bank (a SOE) was willing to provide say US$1bn of vendor equipment finance. In the absence of the US Ex-Im bank, an equally creative funding source would need to be found from infrastructure funds or elsewhere, or via a sustained, significant lift in profitability from Adani Enterprises.

What if Adani can't raise US$8bn of new equity and debt funding?

When Adani Group first acquired the Carmichael Project in 2011, the stated expectation was first coal production by 2014. With financial close looking unlikely for many months yet, and allowing for a 3 year construction period post financial close, material coal sales are now unlikely until at least 2018.

Financial close requires lining up A$8bn of financing plus the associated rail and port ToP and customer off-take agreements, all of which needs to be done concurrently. Achieving this at the peak in the thermal coal market in 2011 seemed feasible. But with the thermal coal price in the doldrums and expected to remain there,[viii] financial close today becomes exponentially harder.

The answer to this riddle is possibly contained in a broker report released by Adani Enterprise's house broker, Morgan Stanley in Nov'2013 and available from Adani's website.[ix] Morgan Stanley in this report downgraded their valuation of Carmichael project proposal to zero, and stated:

> "*While the company expects the environmental clearance to come through in F2H14, it does not plan to spend money on developing the mine until coal prices rise from current levels.*"

In the absence of massive external funding, Adani Enterprises might well put the Carmichael proposal on care-and-maintenance and hope for a cyclical bounce in thermal coal prices and a sustained fall in the A$/US$ (to lower the projects US$ cash breakeven).

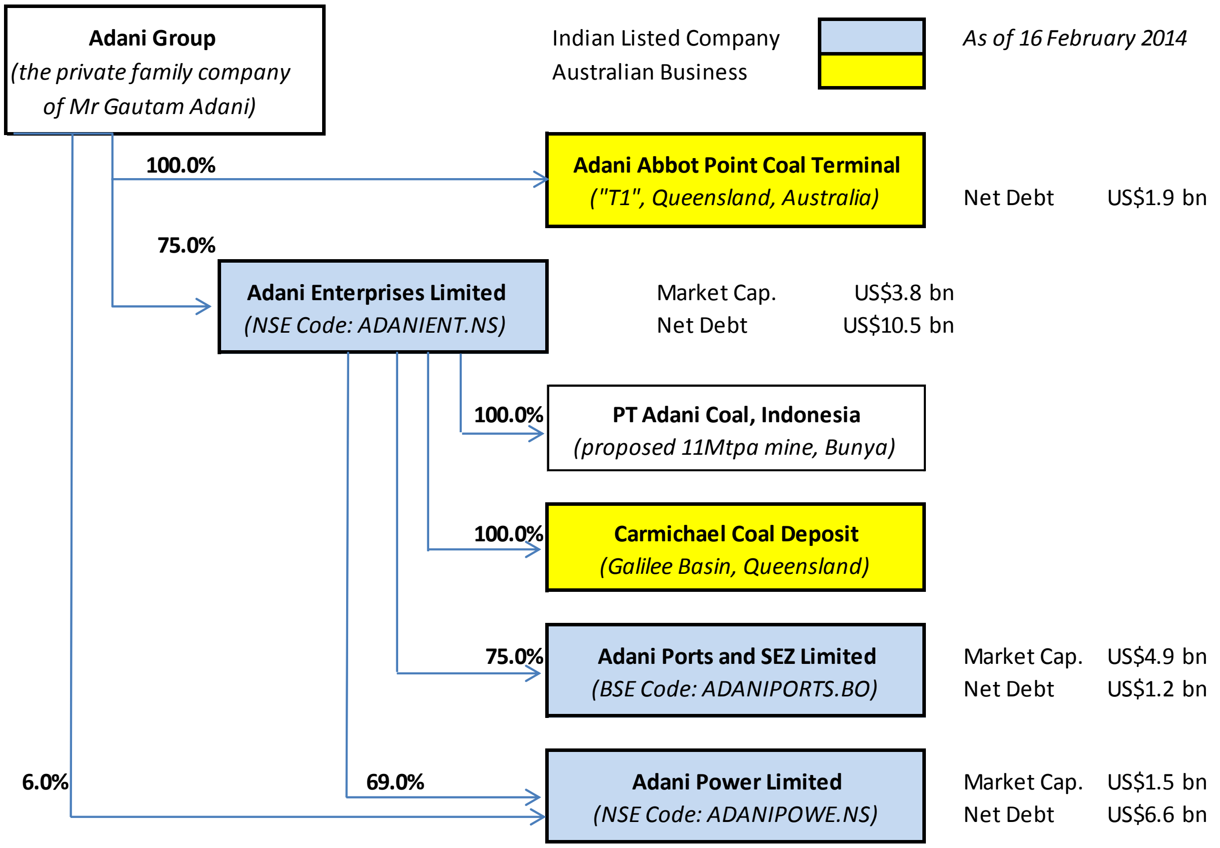
Wild cards for funding

The Modi-Adani Nexus: With Modi looking increasingly likely to be the next Prime Minister of India post May 2014, the connections between The Gujarat-based Adani Family and the Gujarat Chief Minister Narendra Modi have long worked together for a mutually beneficial relationship. Several articles detail the exceptional land deals Adani received with respect to Mundra port,[x] and at the time very generous terms for Adani Power's 2006 power purchase agreements (PPAs) relative to Tata Power.[xi]

Morgan Stanley stated that they see Adani as the best leveraged Indian firm to regulatory reform should Modi win. How this would work is unclear, but with Adani very leveraged to majority government owned banks, and reliant on a number of long term PPAs from Government agencies, endorsement could emerge via a number of channels.

India Coal Ltd (CIL): One potential area of financial support rests with the exceptionally well capitalized CIL. As at Mar'2013 CIL had Net Cash holdings of Rs782 billion (US$12.5bn). Not withstanding the Jan'2014 announcement to return a Rs183bn (US$3bn) special interim dividend[xii] , there remains upwards of US$10bn to fund acquisitions and / or additional capital returns. CIL has long pursued a to-date very unsuccessful international thermal coal asset acquisition strategy. Adani would receive a huge boost if it were able to bring in CIL as an equity partner via say a US$1bn equity investment in the coal and / or rail prospects. Why CIL would want to be a minority investor in a very marginal, potentially stranded project remains a challenge.

ADANI ENTERPRISES LIMITED
Corporate Structure



Equity and Net Debt Capitalisation of the Adani Group (US$bn)

US$bn	Rs	Market Cap.	Cross-holding	External Market Cap.	Net Debt (1) & (2)
Adani Enterprises	Rs215.00	US$3.81		US$3.81	US$10.54
Adani Ports	Rs147.00	US$4.91	75.0%	US$1.23	US$1.24
Adani Power	Rs33.00	US$1.53	69.0%	US$0.47	US$6.62
Total		US$10.25		US$5.51	US$18.40

(1) Excludes the debt of ~US$1.95bn attached to AAPCT and any other debt in the Adani family group of companies.

(2) Net debt is calculated using consensus forecast for 31 March 2014 so as to reflect the Adani Ports equity raising of Rs10bn (US$180m) in June 2013 and Adani Power raising in May 2013 of Rs25bn (US$456m).

Consensus forecasts accessed from Thomson Reuters Analytics. 27-Jan-14

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Lessons from WICET

The Wiggins Island Coal Export Terminal (WICET) is a A$2.5bn greenfield 27Mtpa project at Gladstone that has rapidly come unstuck, even before the planned commissioning of the port. Owned by a consortium of coal mining firms lead by Glencore, this consortium includes a number of coal mining juniors who are unlikely to be able to honour their take-or-pay port commitments. The collapse in the coal price over 2012-13 has meant an inability to finance their greenfield coal projects. Aurizon in Feb'2014 announced commissioning of the port and associated A$867m rail development had been delayed, with first coal shipments not due till the Jun'2015 quarter, with full commissioning by Dec'2015 and a gradual ramp-up to full capacity over several years.[xiii]

Wood Mackenzie expects the port will only operate at 40-60% of capacity[xiv] and that both the equity and debt providers are facing writedowns on this investment even before commissioning. Given this, it does beg the question of the sense of pursuing yet another greenfield coal export terminal at Abbot Point, and whether the banks will continue to provide funding for potentially stranded fossil fuel assets.

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[i] http://www.ieefa.org/adani_coal_report/

[ii] http://www.theaustralian.com.au/business/mining-energy/banks-appointed-on-adani-abbott-point-debt-issue/story-e6frg9df-1226740165990

[iii] http://www.dsdip.qld.gov.au/resources/project/north-galilee-basin-rail/ngbr-eis.pdf

[iv] AEL share price Rs215 and Rupee to USD62 as of 16 February 2014

[v] http://www.adani.com/Common/Uploads/FinanceTemplate/2_FFReport_AEL%20Results%20-%20Q3%20FY13-14.pdf

[vi] Utpal Bhaskar 16 Sept 2013 "Bhel sends legal notices to recover Rs17,000 crore in dues"

[vii] http://www.washingtonpost.com/blogs/plum-line/wp/2014/01/28/in-the-state-of-the-union-obama-pledges-strong-action-on-climate/

[viii] http://www.ieefa.org/wp-content/uploads/2014/02/Thermal-Coal-Outlook-February-2014-Observations-IEEFA.pdf

[ix] http://www.adani.com/Common/Uploads/FinanceTemplate/3_FFReport_AEL_Morgan_Nov_13_293_update.pdf

[x] http://www.ummid.com/news/2013/November/23.11.2013/land-to-adani.html#sthash.peZtff4b.dpuf

[xi] http://gulail.com/adani-modi-nexus-to-result-in-loss-of-rs-23625-crore-to-gujarat-in-one-deal-alone/

[xii] https://www.coalindia.in/Manage/ViewNews.aspx

[xiii] http://www.aurizon.com.au/Downloads/Aurizon%20Half%20Year%20Report%20Presentation%202014.pdf

[xiv] http://www.businessweek.com/news/2013-10-14/coal-slump-leaves-aussie-port-half-used-and-bank-lenders-at-risk#p1