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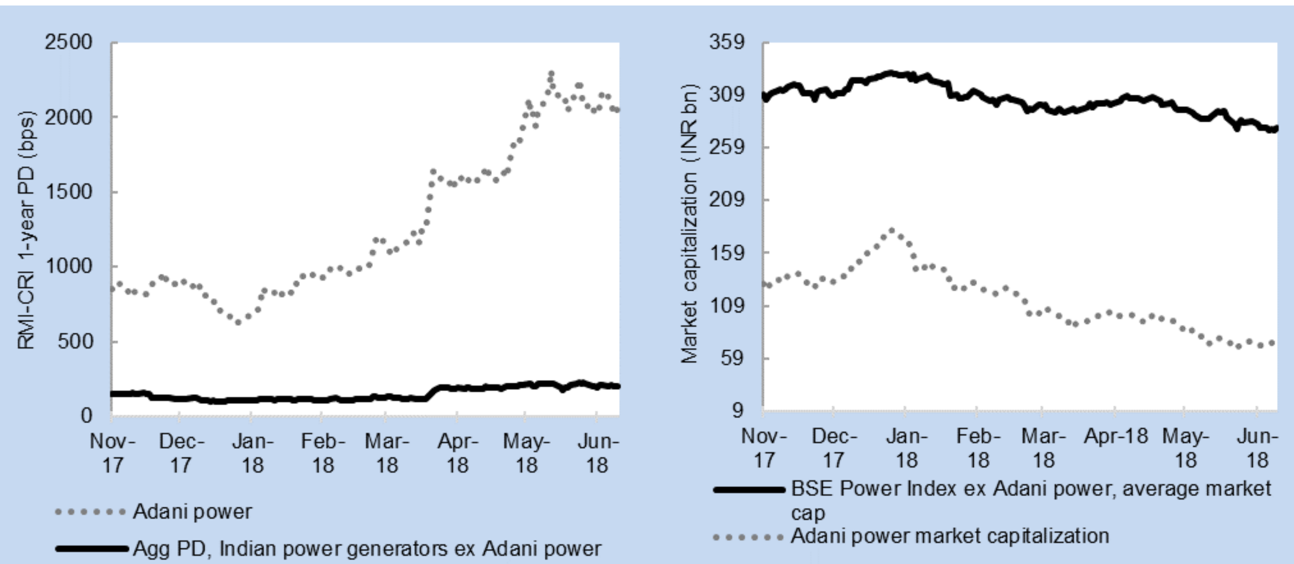
India's largest thermal power producer faces dire straits as losses widen

By Shubham Maheshwari

Major power sector players in India have been under some stress for the past one year owing to rising coal prices and subdued power demand. Of the major companies in the sector, Adani Power has been affected the most. For Adani Power, it is not only the external factors that are impacting the company, its weak balance sheet has also been adding to its misery. Adani Power lost INR 61bn in FY17 and INR 21bn in FY18. Even though power companies have started the gradual shift to utilize renewable sources of energy, close to 66% of India's power is still produced using conventional non-renewable sources of energy.

Adani Power Limited is the power business subsidiary of Indian Conglomerate Adani Group. With a power producing capacity close to 11,000 MW, it is one of India's largest power producers. The company is also the leading solar power producer in India with a capacity close to 700 MW. The parent company, Adani Group has businesses in energy, resources, logistics, agriculture, real estate, financial services, defence and aerospace.

RMI-CRI's data reflects a deterioration in the credit outlook for Adani Power, since January 2018. The RMI-CRI 1-year Probability of Default (PD) for Adani Power soared to 2317bps on May 24, 2018, and has been above the 2000 mark till date.



Figures 1a & 1b: Comparison of RMI-CRI 1-year PD for Adani Power and Aggregate (or median) 1-year PD of 17 companies involved in the S&P BSE Power Index; Market capitalization of Adani Power vs peers in the BSE Power Index. *Source: RMI-CRI, Bloomberg*

The S&P BSE Power index is an index comprising of the leading power sector companies based in India. For the last one year, the Power Index has been relatively stable with steady decline lately in the first quarter of FY 2018-19 i.e. for April 2018 to June 2018 whereas the market cap of Adani Power Ltd has been much more volatile and has decreased enormously in the past few months.

The whole power sector has been hit by the growing coal prices, due to its increasing scarcity and government regulations in favor of renewable sources. With the coal prices ever rising, it is gradually becoming too difficult for the companies to operate with coal as the main input as increasing coal prices increases the cost of production and in turn decreases the plant's efficiency. Also, the BSE power index companies have been in red, i.e. in losses for the past one year. Due to high barriers to entry, the competition is majorly between the existing players and with the sluggish demand for power consumption for the last 1 year, the competition for the shrinking market has been stiff.

Adani Power has been facing huge losses for the previous quarters, mainly due to bad acquisitions, high fuels and interest costs. In the Q3 2017-18 report, the company stated that it has been using imported coal from Carmichael mega-mine in Queensland as the main raw material. Owing to the weak Indian currency, high importing and transportation costs, this is no longer a viable proposition. The company expects to receive domestic coals to reduce fuels costs and improve plant efficiency. One of the company's main plant, Mundra power plant has been performing poorly due to inflated imported coal prices. Average Plant Load Factor (PLF) achieved during Q3 FY2017-18 was 58 per cent, as compared to 69 per cent achieved in the corresponding quarter of FY2016-17. Plant load factor is a measure of the efficiency of the machinery setup.

According to the company's annual report, the lower PLF has been attributed to lower coal availability (primary source of electricity generation) at numerous plants and scheduled maintenance. After Q4 2017-18 results, the company's net equity i.e. total assets minus debt stood at INR 9bn. Adani Power has debts of about INR 500bn and its high interest costs, as the Interest Coverage Ratio suggests, has raised questions on its ability to repay its obligations. The total debt on the company is huge and any further big losses in the upcoming quarters might lead to insolvency.

As of	Mar 2017	Sep 2017	Mar 2018
Revenue YoY Growth (%)	-5.76	-4.88	-8.97
Interest Coverage Ratio	0.43	1.02	0.46
Net Income Margin (%)	-14.6	-12.5	-10.2
Quick Ratio (%)	42	33	25
Total debt / total capital (%)	94.26	94.38	98.23

Table 1: Key Financial metrics of Adani Power on a trailing twelve month basis. *Source: Bloomberg*

The company's financial position is in a bad shape for the past year especially with the falling revenue and incurring losses due to unavailability of cheap coal and low PLF. The quick ratio, which is considered a very important credit metric has also been poor for the past few financial periods.

The debt ridden Adani's Mundra plant has been avowed to approach the National Company Law Tribunal (NCLT) for bankruptcy protection. This move is believed to be a response to Reserve Bank of India's (RBI) revised guidelines on stressed assets, which brought the Mundra Plant under the ambit. Mundra reportedly faces loans more than INR 200bn.

The financial outlook of Adani Power Limited looks grim as the company has incurred huge losses in the past quarters. Government regulations and rising coal prices have worsened the situation. With such high debts and underperforming plants, it remains to be seen how the company rescues itself from this credit debacle.

Credit News

Australian banks face rural lending reckoning

Jun 25. A wave of M&A deals has left Australia's biggest banks with risky loan amidst continuous drought and volatile commodity prices. This condition led to a heightened curb on lending for the agriculture sector, which is deemed as a minor but risky component of Australian banks' loan books. Funding for farming has been difficult as banks do not break out profits from farm lending and lenders are looking for risk reduction during the current economic downturn. Despite regulations on farmers debt mediation scheme have been implemented, a consultant to farmers involved in bank disputes claimed that more agribusiness lending regulations are needed due to the knock-on effect in rural centers when lenders stop their funding and call in debts. The debt problem goes beyond the banks and causes a big structural problem as debt has been accumulated to lenders, who are mostly from suppliers and businesses in the areas. (Business Times)

Banks may be using Lehman-style trick to disguise debt

Jun 24. Banks might be disguising their liabilities with falling leverage ratios by using repurchase agreements. Data from US money market mutual funds show cyclical patterns in USD repo borrowings, indicating a potential of window-dressing practice in repo markets among banks. This method is similar to Lehman Brother's method of massaging down their assets as reporting dates approach. The practice boosts leverage ratios and allows banks to report them as being in line with regulatory requirements. Aside from generating negative effects on financial stability, using repos to fulfill the limits imposed by regulators hinders access to the market and obstructs monetary policy implementation. (FT)

Walmart defies investor push to rewrite bond rules

Jun 22. On June 20, Walmart sold USD 8.5bn bonds as part of its USD 16bn debt fundraising to fund its acquisition of Indian e-commerce company Flipkart. Critics against the bonds issuance said that the prospectus contained legal language that could be used to withhold compensation to investors if the acquisition deal is delayed. In response to the issue, Walmart agreed to buy back five tranches of debt, worth USD 9.5bn, at 101% of face value if it does not acquire a majority stake in Flipkart by June 7, 2019. Nevertheless, USD 8.5bn of the bonds allows Walmart to buy them back at a lower face value. As the number of bond issuance increases, the Credit Roundtable has called for better protections for bondholders in contracts. (FT)

Largest banks clear US Fed's toughest annual stress tests

Jun 22. 35 of the largest US banks cleared the first stage of the Fed's toughest annual stress tests. This year test features a severe global recession with a steepening Treasury yield curve and rocketing US unemployment rate reaching 10%. Despite the banks losing USD 578mn under the Fed's most severe scenario, the lenders' high-quality capital outweigh the required threshold. Tougher tests will be conducted which include operational factors such as risk management. Market observers expect banks to put more money towards dividends, share buybacks, and business investments after the stress test results. (Reuters)

Euro zone agrees on debt relief package for Greece

Jun 21. On June 22, euro zone finance ministers agreed to a debt relief package for Greece which includes a disbursement of EUR 15bn as part of its current EUR 86mn bailout program. The package constitutes of a 10-year deferral on interest payments and a 10-year maturity extension on loans from the European Financial Stability Facility. This package will provide a cash buffer of EUR 21bn to Greece, which would be sufficient to cover its financing needs for 21 months. Hence, Greece will be able to issue bonds across the yield curve and pay lower borrowing costs. This debt relief package signals Greece's comeback from the crisis with a EUR 15bn credit line to ensure Athens to stand on its own feet after it exits its bailout in August. (CNBC)

Noble Group secures USD 100mn in financing from investors in restructuring boost debt (Reuters)

House of Fraser CVA approval puts 6000 jobs at risk (FT)

Fitch downgrades Deutsche Bank outlook amid strategy concerns (Nasdaq)

Regulatory Updates

China moves to quell systemic bond risks after default wave

Jun 22. After a wave of defaults and drop in bond financings last month, China's policy makers and local authorities are preventing tightening strains in the USD 11bn bond market from spiraling into a collapse. The moves have significantly promoted financial deleveraging which aimed at encouraging more productive allocation of capital and reducing dependency on government support. The challenge remains in the process of encouraging the market-oriented efforts to resolve corporate debt issues without reinforcing the old image of a state-dominated financial system. Despite increasing demands from the private sector for government support, the government still promotes market-oriented resolutions. In the recent interventions, authorities have mostly stopped paying off corporate debt, yet served as coordinators to establish repayment plans. (Bloomberg)

Germany, France push for easier debt restructuring in euro zone

Jun 20. Germany and France are introducing a legal clause in newly issued bonds to ease the sovereign debt's restructuring process in the euro zone. The clause, which is called roadmap by the EU improves the existing framework in promoting debt sustainability by strengthening collective action clauses (CACs) in bonds. Euro zone bonds have included CACs since 2013 and the roadmap strengthens them with single-limb aggregation, which allow a single restructuring decision to encompass all bonds. Eurozone officials say laying out the rules for such operations would make them “less ad hoc” and would also discipline profligate euro zone governments because markets would pay closer attention to their fiscal policies. (Reuters)

Fed Chair Powell calls case 'strong' for more interest rate hikes (CNBC)

China to unleash USD 108bn in reserve cut for some banks (Bloomberg)

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