Credit Research Initiative
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Weekly Credit Brief
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High leverage and underlying governance issues plague the credit health of the Adani group

by [Amrita Parab](#)

- **NUS-CRI PD indicates a deterioration in credit health as the market rout in the Adani group of companies pressures the conglomerate's high leverage, largely acquired via debt-funded business expansions**
- **NUS-CRI Forward PD shows that credit risk in the group companies may stay elevated owing to higher refinancing risk and lingering governance concerns**

The Adani group of companies[1] is currently engulfed in a crisis precipitated by a short seller report accusing the group of stock manipulation and fraud while at the same time highlighting the highly-leveraged nature of the Adani group's companies. The NUS-CRI 1-year Aggregate (median) Probability of Default (Agg PD) of publicly-listed Adani group companies has been between the BB- upper bound and the B+ upper bound for the past two years due to an increase in the group's leverage to fund its rapid expansion (See Figure 1a). In Jan-2023, investor sentiment soured drastically as the report findings indicated lapses in corporate governance, stock and earnings manipulation via a network of offshore entities, and liquidity pressures faced by the conglomerate. The resultant stock rout saw the cumulative market capitalization of Adani group companies decrease by approximately USD 114bn or 50% within a week of the report being published. Resultantly, Adani Enterprises Ltd, the group's flagship company, which was set to raise USD 2.5bn, was forced to cancel the planned Follow-on public offer (FPO). As the crisis continues to unravel, the Adani group has scrambled into action to prevent further erosion of investor confidence.

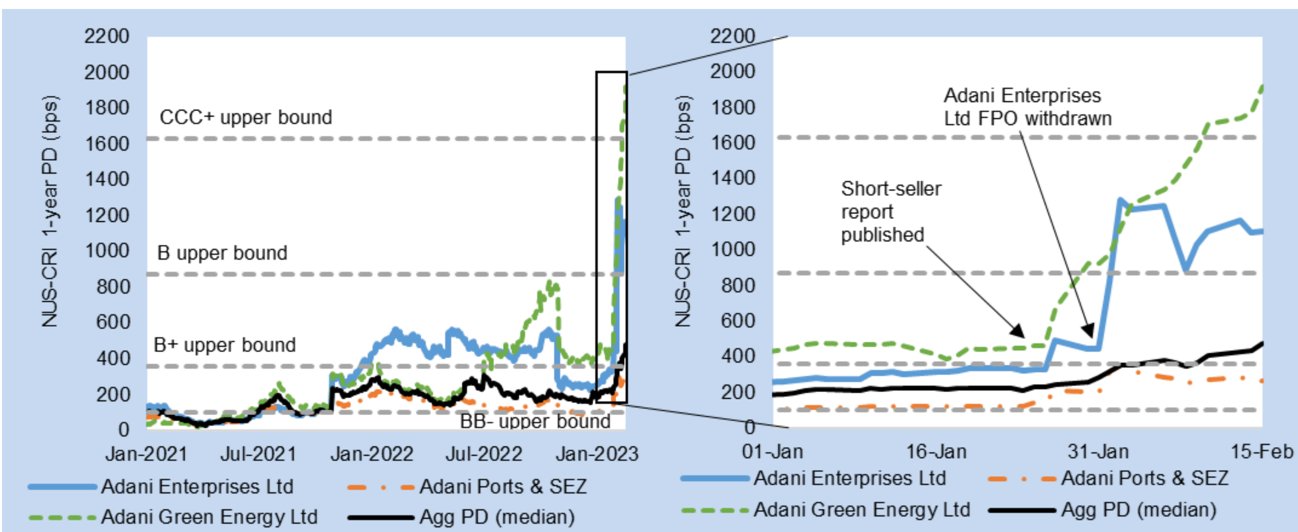

Figure 1a (LHS): NUS-CRI Agg (median) 1-year PD for key publicly-listed companies in the Adani group, Adani Ports & SEZ Ltd, Adani Enterprises Ltd., and Adani Green Energy Ltd with reference to PDiR2.0[2] bounds. Figure 1b (RHS): NUS-CRI Agg (median) 1-year PD for key publicly-listed companies in the Adani group, Adani Ports & SEZ Ltd, Adani Enterprises Ltd., and Adani Green Energy Ltd with reference to PDiR2.0 bounds. *Source: NUS-CRI*

The Adani group has rapidly expanded to become one of the largest conglomerates in India with a market cap of over USD 217bn as of Jan 24, 2023, with investments across many diverse sectors such as ports, airports, power, etc. The conglomerate's expansion has been largely fuelled by debt which has doubled over the past 4 years and now stands at USD 30bn. Amidst the market scrutiny triggered by the short-seller report, the group's

[1] The Adani group of 7 publicly-listed companies in our sample consist of Adani Ports & Special Economic Zone Ltd, Adani Total Gas Ltd, Adani Transmission Ltd, Adani Enterprises Ltd, Adani Wilmar Ltd, Adani Green Energy Ltd and Adani Power Ltd.

[2] The Probability of Default implied Rating version 2.0 (PDiR2.0) provides a more familiar interpretation through mapping the NUS-CRI 1-year PDs to the S&P letter grades. The method targets S&P's historical credit rating migration experience exhibited by its global corporate rating pool instead of relying solely on the reported default rates.

practice of pledging its stocks as collateral to raise debt has raised concerns. Due to the recent stock rout that caused a depreciation in collateral value, the group faced a USD 500mn margin call, adding to its liquidity pressures. Higher dependence on share-backed loans places the group in a vulnerable position as any further stock rout may force it to pledge additional shares or assets to service margin calls.[3] To add to its woes, the group has raised approximately USD 8bn from bond issuances in overseas markets in addition to securing loans from international banks, taking advantage of lower interest rates since 2020, and consequently, the group's debt mix is now skewed towards overseas financing.[4] Thus, increasing the group's exposure to foreign exchange risk, especially as the dollar becomes stronger following Fed's rate hikes.

The weak liquidity metrics across the majority of the group raise further questions about their ability to top up margin calls or meet debt obligations, especially for highly-indebted group companies such as Adani Green and Adani Transmission (See table 1). With USD 2.95bn[5] (34%) of its outstanding debt maturing over the next 3 years, the group may face substantial refinancing pain in wake of the current crisis and the higher interest rate environment. A significant portion of this debt is concentrated with Adani Green and Adani Ports & SEZ. Adani Ports & SEZ with comparatively lower leverage and better liquidity should be able to better manage the upcoming maturities as compared to Adani Green, as indicated by the significantly lower PD of Adani Ports & SEZ. (See Figure 1b)

	Adani Ports & SEZ	Adani Total Gas	Adani Transmission	Adani Enterprises	Adani Wilmar	Adani Green Energy	Adani Power
Current ratio	1.58x	0.47x	0.92x	0.89x	1.22x	0.71x	1.04x
Total debt to total capital	50.77%	30.93%	74.27%	53.24%	28.45%	88.51%	65.15%
Total debt to EBITDA	4.0x	1.5x	9.1x	6.4x	1.52x	12.8x	3.3x

Table 1: Key Financial ratios of companies within the Adani group as of Sep-2022. *Source: Bloomberg*

Adani Green Energy Ltd.(AGEL), which was established in 2015 to be a global renewable energy leader, is the most leveraged among all publicly listed Adani group companies. Funded by high levels of debt, the company has consistently seen double-digit revenue growth over the past 5 years. Although the company's revenue stream may be protected by long-term contracts, AGEL is free cash flow negative because of heavy capital expenditure. Its credit metrics suggest that it may struggle to refinance its upcoming USD 1.5bn worth of debt maturities in 2024. In the current scenario when its financing channels are severely constricted and refinancing costs soar, the group may even be forced to resort to asset sales to meet debt obligations.

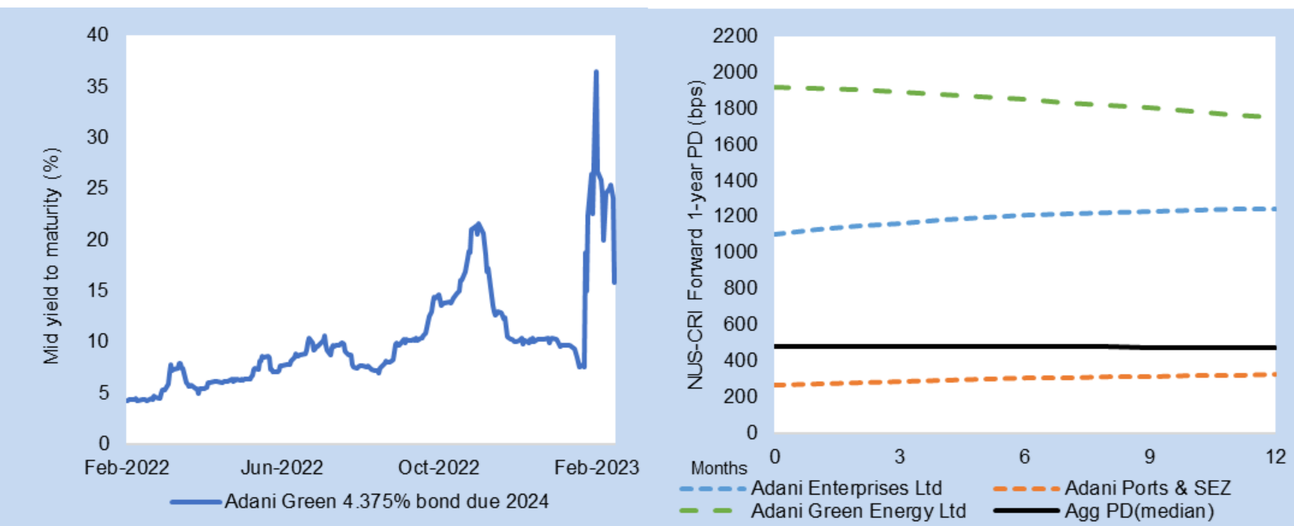

Figure 2a (LHS): Mid yield to maturity(%) of Adani Green Energy Ltd's bond due 2024; Figure 2b (RHS): NUS-CRI Agg (median) Forward 1-year PD for key publicly-listed companies in the Adani group, Adani Ports & SEZ Ltd, Adani Enterprises Ltd., and Adani Green Energy Ltd. *Source: Bloomberg, NUS-CRI*

In addition to weak credit metrics, serious lapses in corporate governance on behalf of the group pose a major hurdle to their access to additional financing in international markets. For instance, AGEL attracted a lot of global

[3] Due to the increased volatility of Adani stocks, prominent global banks such as Citigroup have already stopped accepting shares of some Adani Group companies as collateral on margin loans, thus further curtailing the group's ability to manage liquidity pressures.
[4] In Mar-2016, around 86% of the group's debt was financed by domestic banks whereas as of Mar-2022, that number shrank to 33%. The rest was financed mainly via dollar-denominated bonds (37%) and loans from foreign banks (18%).
[5] Data from Bloomberg

investors and raised funds via both equity and debt financing with a promise to deploy said funds to further its expansion into the renewables space. However, a recent filing indicates that AGEL was indirectly helping finance a coal mine. ESG investors who offer cheaper financing for capital marked for ESG-compliant uses may view this as a serious breach of trust. AGEL is already witnessing a withdrawal from investors, notably KLP, a Norwegian pension fund that recently dissolved its stake in the company. AGEL's green bonds maturing in 2024 have already surged to double-digit yields. The issue also highlights the lack of clarity in the ultimate use of funds as the group is engaged in multiple inter-corporate debt transactions.[6]

Going forward, the NUS-CRI Aggregate (median) Forward 1-year Probability of Default (Forward PD[7]) suggests that although stable, the credit risk of the Adani group of companies will remain high for the next 12 months. The infrastructure assets housed under the Adani group are geographically diversified and are currently under long-term annuity contracts which should ensure stable cash flows. This arrangement may provide support to the group's credit profile keeping it stable and preventing further deterioration in credit health. However, in the near term, the group will have to make significant efforts to deleverage and raise funds through possible asset sales to ensure its companies are able to withstand upcoming servicing obligations. Additionally, to facilitate improved access to financing at cheaper borrowing rates, the group will have to make significant structural and operational changes to regain investor confidence and rebuild its lost reputation. The Group has already announced that by Jun-2023 it will have a refinancing plan in place for AGEL's upcoming maturities, addressing a major point of concern for investors, and thus, leading to an improvement in AGEL bond yields (See Figure 2a). Similarly, it intends to undertake additional debt repayments which in turn will also result in the freeing of pledged shares. Likewise, the group may be required to revisit its debt-funded expansion strategy and reduce its discretionary capital expenditures to bring its leverage down to sustainable levels. That said, considering the capital-intensive nature of the group's businesses, its access to financing remains essential. As the current situation restricts its financing options and raises the cost of funding, the credit risk of Adani group's companies may stay elevated in the near term as suggested by the Forward PD in Fig 2b.

[6] Governance concerns could potentially stem from the fact that a significant portion of decision making for the group lies with members linked with the Adani family, thus, raising risk of neglect of shareholder value.

[7] The Forward PD estimates the credit risk of a company in a future period, which can be interpreted similarly to a forward interest rate. For example, the 6-month Forward 1-year PD is the probability that the firm defaults during the period from 6 months onwards to 18 months – this is conditional on the firm's survival in the next 6 months.

Credit News

China's state-owned property developers shun private-sector deals

Feb 20. Despite the Chinese government's encouragement for state-owned property companies to rescue distressed projects and assets of private real-estate developers over a year ago, few have taken action. The SOEs have declined to acquire several such projects altogether, with some only utilizing the M&A bond program to settle their debts. The SOEs would rather purchase land directly from local governments where prices are lower due to the absence of private competition than absorb defective projects. Besides, they have also experienced difficulties because of the property-market deceleration, albeit to a lesser extent than their private-sector counterparts. (WSJ)

Rising interest rates pose unaccustomed risk to Japanese earnings

Feb 17. The global rise in interest rates is affecting Japanese corporate earnings. The Fed, ECB, and other central banks have hiked rates to fight inflation, putting the BOJ under pressure to reconsider its ultra-loose policy. Interest rates impact how companies value assets on their books, with higher rates reducing the present value of future cash flows, forcing firms to write down the value of goodwill - the premium paid for the purchase. An increase in interest rates also results in larger debt payments, increasing the financial cost of Japanese companies. (Nikkei)

Investors pour record sums into high-grade corporate bonds

Feb 19. Investors are demonstrating their excitement for a typically low-risk asset class with a record-breaking investment of USD 19bn in high-quality corporate bonds this year, which now boasts the best returns in years. Average US investment grade yields have risen sharply over the past year due to fixed-income sell-offs following rapid interest rate hikes by the Fed to combat inflation, leading fund managers to favor corporate bonds issued by companies more capable of withstanding an economic downturn amid the rising yields. In Europe, high-grade issuance reached USD 246bn in the first few weeks of 2023, the strongest start to a year since 2012. (FT)

Sustainability bond market stumbles as investors get picky

Feb 14. The market for sustainability-linked bonds (SLBs), which aims to tie companies to their climate promises by punishing them with higher interest rates if they miss environmental targets, is struggling due to investor concerns that the penalties are not stringent enough. Last year, global SLB issuance fell 37% to USD 60bn, not in line with the analysts' expectation of rapid growth. Although some investors see SLB as a better option than green bonds, the increase in interest payments included in the bonds' terms, known as the 'step-up', has been deemed too insignificant to encourage issuers to decrease their environmentally unfriendly acts. It's not so much that investors are getting picky, but SLB issuers may need genuinely assume responsibility for going green. (FT)

Thai banks' bad loans decrease as debt restructuring picks up pace

Feb 20. Nonperforming loans held by Thai banks decreased for the third consecutive quarter due to ongoing debt restructuring measures amidst a fragile economic recovery. At the end of December, nonperforming loans amounted to THB 499.2bn, down from THB 502.7bn in September. The ratio of nonperforming loans to total loans also fell to 2.73%. However, annual loan growth decelerated to 2.1% from 6.5% in 2021. Meanwhile, household debt in Thailand, equivalent to 87% of GDP, remains the highest among Southeast Asian nations. It reached an all-time high of 91.7% in 2021 but fell to 86.8% in Q3 2022 before rising again. (Nikkei)

Debt-laden African countries charged 'extortionate' rates, U.N. chief says (Reuters)

U.S. bond funds see first weekly outflow in six weeks on rate hike concerns (Reuters)

Adani pledge to tackle debt deadlines triggers record bond jump (Bloomberg)

Regulatory Updates

Fed faces new inflection point amid troubling inflation data

Feb 17. New data released this week shows that the US economy is not slowing down as quickly as expected, complicating the Federal Reserve's task of cooling off inflation. While Fed officials are still optimistic about avoiding a recession in the short term, they may need to tighten policy even more than anticipated to combat inflation. Despite already raising interest rates from near zero to between 4.5% and 4.75% over the past year, the Fed's battle against high inflation seems to be far from over, posing a potential new inflection point in the economic outlook. (FT)

China refines capital and risk management of commercial banks

Feb 19. China's banking regulator and central bank have proposed revised draft rules that aim to improve the precision of risk measurement and guide banks toward better serving the real economy. The new rules will separate banks into three groups based on business scales and risk levels, with stricter capital requirements and more disclosure requirements for banks with larger scale assets or cross-border business. In addition, the rules will include more specific factors to measure banks' risk exposure to mortgage lending. The regulators are seeking public feedback before implementing the changes on Jan 1, 2024, and hope to bring China's banking sector closer to global standards while preventing risks in the financial system. (Reuters)

India setting up USD 4bn fund to backstop corporate debt market (Reuters)

Bank of Canada reasserts dovish tone in divergence from the Fed (FT)

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Contributing Editors: Raghav Mathur, Yao Xuan, Wang Anyi