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India-ASEAN Infrastructure: Sovereign Strains Add To Lockdown Pain

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Key Takeaways

- One in four South and Southeast Asian infrastructure companies and utilities face downgrade pressure.
- Regulatory actions expose structural issues underlying infrastructure firms.
- The sharp fall in economic growth, ratings pressure on sovereigns, and a softening in state support for key counterparties pose further downside risks.

COVID-19 containment measures have been hard on South and Southeast Asian transport infrastructure and utilities. Many piled on leverage in expectation of strong secular growth. Now firms are grappling with the double hit of stringent government restrictions, and rising sovereign rating risk. S&P Global Ratings has already taken ratings action on several transport infrastructure and utilities in this region and strains may linger well into 2021.

Regulatory actions are creating fresh uncertainties. Many South and Southeast Asian countries were slow to impose measures to fight COVID-19, and then moved abruptly to full lockdown mode in March. The region's airports are taking the biggest hit with their operations disrupted and cash flows weakened for up to two years.

Toll roads face a sharp fall in cash collections, squeezing liquidity. The sector will likely recover quickly. Ports are stable but volumes will suffer as the second-order effects of a global slowdown kick in. Regulated utilities, while more resilient, are exposed to regulatory actions and weakening counterparty credit profiles.

A slower than expected economic recovery, funding and liquidity strains, and any weakness in the ability or willingness of governments to support state-owned entities also present risks to ratings (see table 1).

Table 1

COVID-19 Fallout Hits All Sectors With Indian Airports Most Exposed

Sector	COVID-19 effects	Expected recovery after restrictions are lifted	Key downside risks
Airports--India	Very high: closure of airports, domestic/global travel restrictions	Slow: 24 months to recover. Domestic traffic will gradually return but international traffic will likely stay sharply down	Extended restrictions; delayed or lowered regulatory tariffs
Toll roads--Indonesia	High: restriction on people movement, discontinuation of toll collection and lower economic activity	Fast: within 12 months. Passenger traffic will jump back but commercial traffic will be affected by the economic slowdown	Liquidity pressures; extension of toll-free/lower rate period; fall in commercial traffic tracking GDP decline
Independent power producers (IPPs)	Medium: fall in demand	Medium: industrial demand will partly recover on removal of lockdown. Hot summer months may support higher residential demand.	Merit order (cost of power); nature of contract (take or pay versus merchant)
Ports	Limited: essential cargo activities largely continue despite some interruptions and fall in volumes	Medium: slower economic growth will likely result in fall in volumes after stocking for medical, consumption items subsides	Cargo mix (container more exposed); origin and destination port versus transshipment (more exposed)
Renewables--India	Limited: generation and dispatch largely unaffected	Limited: expect "must dispatch status"* to be maintained but there will likely be working capital drag due to delays from payment relief for power distribution companies	Weaker counterparty credit profile can hurt ratings; deleveraging will be delayed due to working capital drag
Regulated utilities	Limited: regulated returns often without price and volume risk	Fast: regulated returns should protect cash flows	Uncompensated regulatory tariff/collection relief (capex flexibility may offset pressure)

*distributor must pay for the power regardless of demand. Source: S&P Global Ratings.

Demand Drop And Uneven Recovery Follow COVID-19 Measures

Restrictions on people movement have hurt demand for airports and toll roads. Initially selective restrictions had a moderate effect on ports and power. However, the implementation of stricter lockdowns in India, Indonesia, Singapore, Malaysia, and the Philippines has since ensnared even these more resilient sectors.

A complete lockdown of airports in India from the middle of March has left only a few cargo flights operational. Even on lifting of restrictions we expect traffic will likely rebound gradually, taking more than 24 months to revert to pre-COVID-19 levels.

Indonesian toll roads slumped after the government imposed a lockdown on people movement (except for essential services) in late March. Rated toll-road entities will likely recover lost volumes over the next 12 months lifted by increased passenger volumes, but the economic slowdown will dampen commercial vehicle traffic.

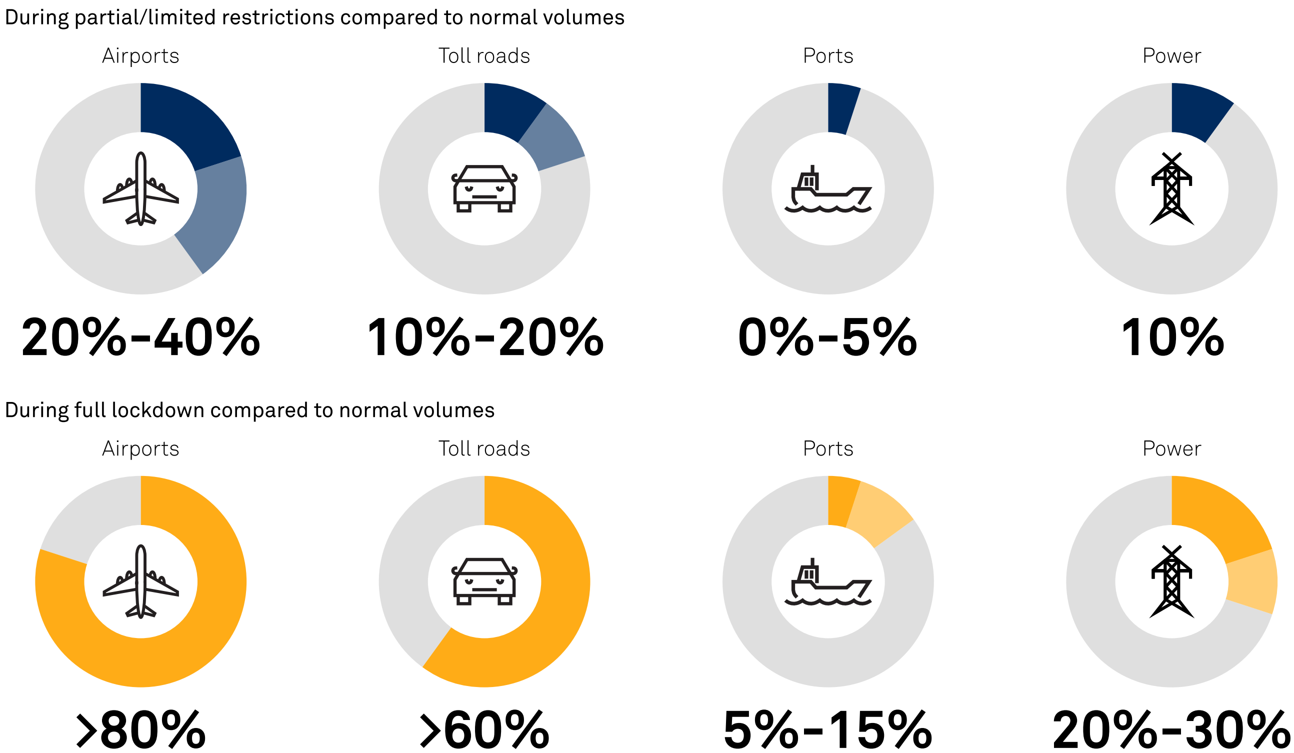
Singapore ports registered volume growth during the initial stages of the outbreak, as it took some traffic from disrupted Chinese ports. Origin-and-destination volumes for Indian and Indonesian ports were fairly resilient in the early stages of the pandemic. Ports will continue to demonstrate resilience but slowing economic and trade trends skew their risks to the downside.

Demand for Indian power fell by over 20% in March when the government limited activities to essential services. Increased power use at home failed to offset large drops in commercial and industrial use. Power demand should recover as the state lifts lockdown measures, and as consumption gets a seasonal bump over the summer. However, Indian power use will not likely go back to pre-COVID-19 levels again in 2020.

Chart 1

COVID-19-Related Lockdowns And Restrictions Hit Infrastructure Hard

Estimated drop in revenues for SSEA rated entities



Source: S&P Global Ratings.

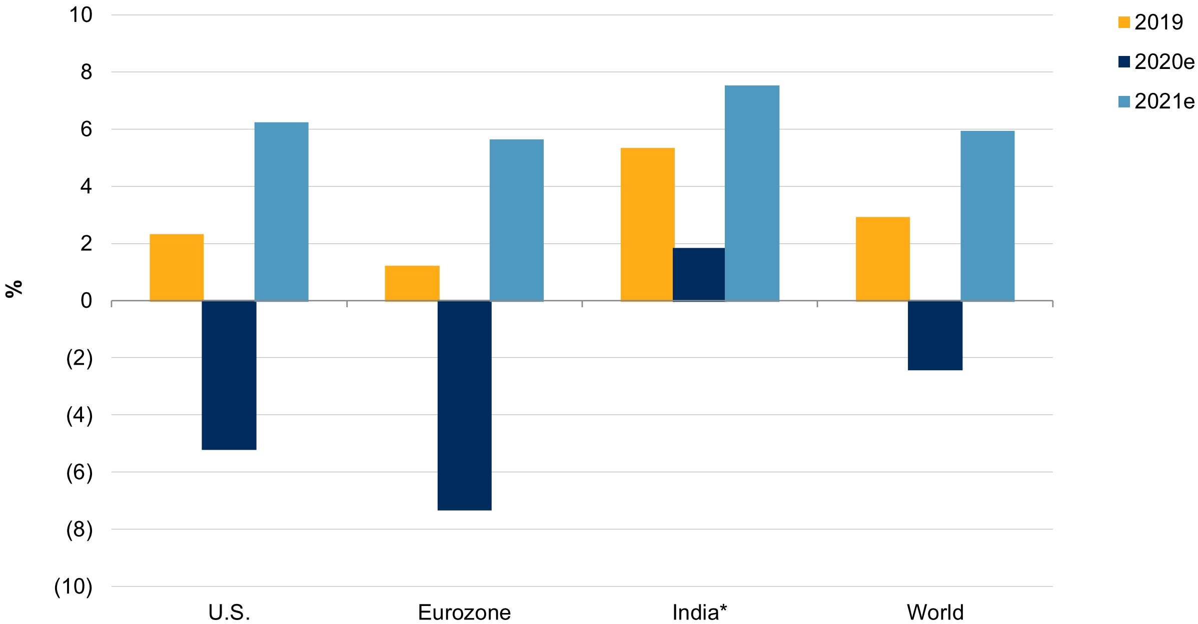
Slower Economic Growth Amplifies Downside Risk

Indian and Indonesian GDP will likely grow 1.8% this year, a previously unthinkably low level for two high-speed economies. The economic hit of COVID-19 is longer and more intense than we initially expected, and we have again lowered our macro forecasts. We now assume global GDP will drop 2.4% this year, with the U.S. economy contracting 5.2% and eurozone GDP shrinking a stunning 7.3%. We believe global GDP will rebound to 5.9% growth in 2021.

In Asia-Pacific, accounting for sharply weaker demand in the U.S., Europe, and China relative to our pre-COVID-19 forecast, we now expect 2020 growth will come 4-6 percentage points below previous growth estimates. The region will likely brush against recession in 2020, growing an anemic 0.3% (see "Up Next: The Complicated Transition From COVID-19 Lockdown," April 17, 2020).

Chart 2

COVID-19 Deals A Larger, Longer Hit To Global GDP
Year-on-year economic growth



*Fiscal year ending March. e--Estimate. Sources: S&P Global Economics and Oxford Economics.

We believe weaker economic growth presents downside risks to sectors such as power and ports. The International Air Transport Association (IATA) projects airlines' revenue per kilometer to drop 30%-50% in 2020, suggesting downside risk to our current estimates of a 25%-30% drop in Indian airport traffic.

European toll-road traffic volume dropped to 60%-80% of normal levels during lockdowns. This serves as a good reference point for estimating what to expect for Indonesian and Indian toll-road operators. Weaker economic growth may yet hit commercial vehicle traffic, which has been resilient during our current lockdown phase.

Container traffic has historically had a GDP multiplier of 1.5x-2x in India and Indonesia, and slowing growth will result in weaker volumes. The World Trade Organization has projected global trade volumes will slide 13%-32% in 2020, which is significantly higher than our estimates for a 5%-10% volume drop in India and Indonesia.

India will likely have power surplus in 2020 for the first time ever given the precipitous decline in consumption.

Sovereign Weakness And Counterparty Risks Suggest Strains

South and Southeast Asia's transport infrastructure and utilities are dealing with another source of stress: sovereign rating actions and weaker counterparty credit profiles. Many of these entities are linked to the government, and so are the ratings on the entities.

We have revised our outlook on the sovereign rating on Indonesia to negative from stable to reflect downside risk to the government's fiscal metrics, accounting for the effect of COVID-19.

On April 27, 2020, S&P Global Ratings revised the rating and outlook on three Indonesian government related entities (GREs) on the lower likelihood of timely extraordinary government support. This revision reflects high differentiation and selective willingness of the Indonesian government to support GREs amid high leverage and recent developments of debt restructuring involving some of the unrated GREs (see "Various Rating Actions Taken After Reassessment Of Support For Indonesian Government-Related Entities ," April 27, 2020).

We have also revised our outlook on the sovereign rating on Thailand to stable from positive. This reflects our view that COVID-19-induced economic uncertainty and the subsequent state of emergency declaration could delay political transitions expected under the civilian government over the next 12 months.

The outlook change for some of our rated infrastructure and utilities tracks the changes in outlooks for the sovereign ratings. Many government-owned distribution utilities or integrated players are key offtakers in the power sector.

The weaker credit profile for such offtakers may affect receivables collection and increase counterparty risk for rated utilities. Any weakening in the ability or willingness of the sovereign to support the government-related entities may result in downgrades.

Regulatory And Government Actions Expose Structural Issues

We believe the short-term cash flow hit from most regulatory and government COVID-19 measures will be manageable. However, conditions do expose long-standing structural issues chipping at the credit standing of some entities.

The effects may not be temporary. Liquidity strains due to working capital drag may be manageable for now, but additional debt will weigh on the balance sheets of the sectors' many highly leveraged entities. Rising counterparty risk, revisions to established formulas for calculating regulated pass-through costs, and a deterioration in payment discipline may all develop into bigger issues.

Table 2

Regulatory Actions Weigh On Utilities

Sector	Action	Effect	Structural issues
Power--India	Payment relief for power distribution companies (see box)	Higher working capital needs will delay ever-elusive deleveraging	Further weakening in credit quality can put credit pressure on rated utilities

Table 2

Regulatory Actions Weigh On Utilities (cont.)

Sector	Action	Effect	Structural issues
Power--Maharashtra state (India)	18% drop in notified tariff by Maharashtra Electricity Regulatory Commission	No material impact on companies such as Adani Electricity Mumbai Ltd. and Adani Transmission Ltd. Drop in tariff largely reflects lower pass-through power purchase costs, regulated returns and cost pass-through mechanism will still prevail, protecting cash flows	Risk of delays or denial in approval for capitalizing capex though record suggests such deviations are unlikely to be material
Power--Indonesia	Free electricity for three months (April-June 2020) for 24 million households and 50% cut to electricity rates for 7 million households	We don't expect credit impact as government subsidy to PT Perusahaan Perseroan (Persero) PT Perusahaan Listrik Negara (PLN) will increase by up to IDR4 trillion for the three-month period. PLN's cash flows will not be affected	Further increase in PLN's dependence on timely payment from government for subsidy
Power--Indonesia	Lower gas prices at US$6 per million British thermal units	We expect PT Perusahaan Gas Negara Tbk to maintain positive gas spreads and maintain its credit profile	Regulated nature of returns will be put to question if sourcing prices fail to adjust
Power--Thailand	3% electricity tariff drop	Limited impact on cash flows for Ratch Group Public Company Ltd., Global Power Synergy Public Co. Ltd. And EGAT International Co. Ltd.	We don't expect any structural issues to emerge out of this temporary tariff cut
Airports--India	Uncertainty on timing and notification of control period three	Delhi International Airport Ltd. and GMR Hyderabad Airport Pvt. Ltd. ratings factor in one-year of delay for regulatory tariff notification	Timeliness (or the lack of it) and tariff setting considerations will affect credit profile

IDR--Indonesian rupiah. Source: S&P Global Ratings.

India's Ministry of Power announced at end-March 2020 payment relief for power distribution companies, which are grappling with a drop in cash flow due to COVID-19 restrictions. Many investors asked us about this issue out of concern it would affect the credit standing of all power suppliers.

It is important to note this is a narrow measure. It was widely characterized in the Indian press as a payments "moratorium." However, the government has since clarified that the measure is chiefly about letting distributors pay a normal (not penal) rate on late payments till June 30, 2020. The government has also relaxed standards for offering letters of credit for scheduling power.

Power distribution firms will still need to make regular payments as per their power purchase agreements, and their obligation to pay for capacity charges and transmission charges will continue.

Renewables will continue to benefit from their "must-run" status and priority dispatch, and will not be subject to curtailment.

Higher working capital requirements for power companies will likely be manageable. We note the firms' modest debt, flexible capital expenditure (capex), good access to bank lines and strong sponsor support (as seen with Indian renewables).

There is one caveat, however. The weaker Indian power distribution companies may use the government measure as an additional excuse to delay their payments to producers. Now that the government has flagged that distribution firms are going through difficult times, some may see that as a green light to halt payments. This would raise liquidity and counterparty risks for the sector.

We believe this may strain some of India's rated power producers. Further weakness in distributors' credit quality compounded with payment delays may result in unpaid receivables, denting the counterparty profile of most rated Indian utilities.

Feel The Force Majeure--Will Firms Invoke 'Act Of God' Clause?

We don't expect companies to renege on contractual liabilities. That said, the force majeure clause is a typical feature of many contracts. Firms may plausibly view COVID-19 as an event beyond their control, and may invoke force majeure to get cover from the event.

In so doing, transport infrastructure and utilities may note widespread COVID-19-triggered disruptions that affect their ability to operate normally and maintain capex. Labor shortages, a need to maintain social distancing, and supply chain outages all disrupt these companies' normal services.

However, firms must clear a threshold of evidence to invoke force majeure. The act may also damage important long-standing relationships with suppliers and other parties. As such, we believe most will not use force majeure to exit contractual obligations. However, within the contractual framework there may be some instances where two parties agree on temporary relief during this disruption.

Adani Ports has already said it would invoke force majeure if it were unable to continue normal operations in the event of a protracted lockdown.

Perusahaan Perseroan (Persero) PT Perusahaan Listrik Negara (PLN) has had discussions with PT Perusahaan Gas Negara Tbk. (PGN) on scenarios for using force majeure. We expect the power purchase agreement will remain in effect. However, should both parties agree to end the contract under the cover of force majeure, this may hurt PGN's cash flows.

Elsewhere, Indian renewable companies have gladly accepted state dispensation allowing them to invoke force majeure to defer capex, likely past the monsoon season in August.

Domestic Markets Open For Some, Offshore Markets Closed for Most

We believe the liquidity positions of almost all our rated credits are manageable. However, rising nonperforming loans and a deteriorating global economy may prod banks to be more careful with their lending than the volume of committed facilities now suggests. Large infrastructure firms and utilities currently enjoy good access to domestic bank loans, aided by government and regulatory measures to shore up bank liquidity.

We will analyze any requests for debt moratorium on bank loans based on our criteria for such exchanges (see "General Criteria: Rating Implications Of Exchange Offers And Similar Restructurings, Update," May 12, 2009). We will determine whether such an offer is distressed or opportunistic. Exchange offers for which we believe the issuer does not face insolvency or bankruptcy in the near to medium term if the offer is not accepted are viewed as opportunistic exchanges, not distressed exchanges.

Government stakes in many utilities give banks confidence to lend to them. The firms' typically long-dated debt maturity profiles also help. We believe many firms' capex plans are flexible, allowing companies to cut such spending to protect liquidity.

Delays to the collection of receivables present liquidity risk. This might be due to delays in collection from end customers, state-directed tariff or payment relief, or a weakening in the credit profiles of key counterparties. This is most likely to affect Indian renewable players grappling with an increased risk of payment delays from the already weak state power distributors.

Nevertheless, strong sponsors at Greenko Energy Holdings and ReNew Power Ltd. Restricted Group, as well as structural mechanisms in the form of reserves and covenant lock-ups at Adani Green Energy Ltd. Restricted Group 2 and Parampujya Solar Energy Private Limited Restricted Group may provide some mitigation.

Environmental, social, and governance (ESG) risks are now enshrined in the portfolio mandates of many large investment firms. State-owned thermal power producers enjoy strong access to domestic and international capital markets as quasi-sovereign entities. However, higher exposure to environmental risks will limit the number of international funds with ESG mandates willing to invest in them, affecting cost of debt.

Capex Delays Likely And Outright Cancellation Remains A Real Option

Rated companies have one big tool to manage cash leverage and cash flow ratios: cutting capex. Disruption in construction activity, lockdown restrictions, social distancing and use of force majeure all show how capex may be delayed.

This is a key credit lever. It gives companies flexibility in funding and boosts their liquidity. For instance, we believe PLN may cancel or defer a significant part of its ambitious capex plans, which will conserve funds. Adani Ports and Special Economic Zone Ltd. will also likely reevaluate its capex and dividend plans.

Companies that stick to their capex plans may use surplus funds or limit shareholder distributions. Regulated utilities such as airports or regulated power companies in India will likely continue with their planned capex as their returns are assured--they are not contingent on end demand.

Companies that fail to exercise financial discipline and conserve liquidity would be highly exposed to rating pressures.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Infrastructure Outlook Uniformly Negative For First Time Since 2008

The global economic slowdown will directly hurt South and Southeast Asian infrastructure and utility credits. Operating cash flows will weaken for most companies, with cuts to capex and dividends the only controllable options to maintain their financial profile.

The key risks we are monitoring are weaker counterparty credit, and liquidity drag stemming from payment delays. Such factors may hit even the most resilient regulated utilities. In South and

Southeast Asia, given the varying stages of lockdown the region is under, the rate of recovery is highly uncertain. Downside risks abound.

Table 3

Rating Actions On SSEA Infrastructure And Utilities Suggest Vulnerabilities Ahead

Entities in gray have incurred rating action since the start of the year

	Current long-term foreign-currency rating*	CreditWatch/ Outlook*	Pre-outbreak long-term foreign-currency rating§	CreditWatch/ Outlook§
Delhi International Airport Ltd.	BB-	Watch Neg	BB	Stable
EGAT International Co Ltd.	BBB+	Stable	BBB+	Positive
GMR Hyderabad International Airport Ltd	BB	Negative	BB+	Stable
Perusahaan Perseroan (Persero) PT Perusahaan Listrik Negara	BBB	Negative	BBB	Stable
PT Jasa Marga (Persero) Tbk.	BB-	Negative	BB+	Stable
PT Pelabuhan Indonesia II (Persero)	BBB-	Stable	BBB	Stable
PT Pelabuhan Indonesia III (Persero)	BBB-	Negative	BBB-	Stable
PT Perusahaan Gas Negara Tbk.	BBB-	Negative	BBB-	Stable
Adani Electricity Mumbai Ltd.	BBB-	Stable	BBB-	Stable
Adani Green Energy Ltd. Restricted Group 2	BBB-	Stable	BBB-	Stable
Adani Ports and Special Economic Zone Ltd.	BBB-	Stable	BBB-	Stable
Adani Transmission Ltd.	BBB-	Stable	BBB-	Stable
Global Power Synergy Public Co. Ltd.	BBB-	Stable	BBB-	Stable
Greenko Energy Holdings	B+	Stable	B+	Stable
Manila Electric Co.	BBB-	Stable	BBB-	Stable
NHPC Ltd.	BBB-	Stable	BBB-	Stable
NTPC Ltd.	BBB-	Stable	BBB-	Stable
Parampujya Solar Energy Private Limited Restricted Group	BB+	Stable	BB+	Stable
Power Grid Corp. of India Ltd.	BBB-	Stable	BBB-	Stable
PSA Corp. Ltd.	AA	Stable	AA	Stable
PSA International Pte. Ltd.	AA	Stable	AA	Stable
PT Cikarang Listrindo Tbk.	BB+	Stable	BB+	Stable
Ratch Group Public Co. Ltd.	BBB+	Stable	BBB+	Stable
ReNew Power Ltd.	BB-	Stable	BB-	Stable
ReNew Power Ltd. Restricted Group	BB-	Stable	BB-	Stable
Singapore Power Ltd.	AA	Positive	AA	Positive
SMRT Corp. Ltd.	AA+	Stable	AA+	Stable
SP PowerAssets Ltd.	AA	Positive	AA	Positive
Tenaga Nasional Bhd.	BBB+	Stable	BBB+	Stable
Vena Energy Capital Pte Ltd	BBB-	Stable	BBB-	Stable

*As of April 27, 2020. §As of Jan. 1, 2020. Source: S&P Global Ratings.

This report does not constitute a rating action.