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Adani Carmichael Contractor Risks

Buyer Beware: Contracting with Adani Australia Entails Counterparty Risks

Executive Summary

- Adani Mining Pty Ltd has negative tangible assets, zero income, and two billion in existing liabilities.
- As of 31 March 2019, Adani Mining has negative shareholder funds of A$507m and appears to be insolvent were it not sustained by a 12-month parent entity guarantee from the ultimate parent entity, Adani Enterprises Ltd in India, but IEEFA notes even this is via tax-haven controlled entities based in Singapore and Mauritius.

- Adani Mining already has $1.8 billion dollars in debt in Australia, which means Australian contractors will need to ascertain carefully where their subordination sits should any future default occur.
- Engineering firm AECOM had to have a legal fight to get millions of dollars owed to it from Adani for works completed.
- In IEEFA's view the ultimate parent company Adani Enterprises Ltd (AEL), as the financial backer, does *not* currently have the financial capacity to deliver on the Carmichael mine and rail infrastructure project absent a multi-billion-dollar equity and/or debt raising, particularly in light of a large number of competing major Indian project proposals being pursued by Adani Enterprises Ltd.
- In IEEFA's view, Adani's Carmichael thermal coal proposal is unviable and unbankable on any normal commercial evaluation, absent massive government subsidy support in both India and Australia. Adani's suggestion it will self-fund this proposal is a clear acknowledgement of this.
- Adani Abbot Point Terminal (AAPT) has a gross liabilities of A$1.8bn, six times that of the book value of equity. Yet again in 2018/19, despite gross

income of $326m, huge financial leverage meant that AAPT reported a pre-tax loss and booked a tax credit.

Adani's Australian Entities Payment Risk

Already Steeped in Debt Prior to Construction Starting

Adani Mining Pty Ltd and Carmichael Rail Network Pty Ltd are the Australian entities listed as jointly responsible for the A$16.5 billion Carmichael thermal coal mine and rail proposal, according to the Queensland Government.[1]

- **Adani Mining** is an entity with negative A$507m shareholders' funds and total liabilities of A$1,979m - a serious financial challenge to say the least for an entity without any revenues (See Figure 1). Current liabilities of $1.8bn are many times the $30m of current assets, a position of 'technical' rather than actual insolvency.

- **Carmichael Rail Network Pty Ltd** had shareholders' equity of $1,000 as of March 2016. Its parent company Carmichael Rail Network Holdings Pty Ltd likewise had shareholders' equity of $1,000 as of March 2019 - three years later, suggesting no change to this almost zero equity capitalisation structure.

With negative tangible assets and zero income, Adani Australia does not have an ability to fund even the heavily downsized stage I mine and 200km rail proposal absent a significant equity injection from one of the parent entities.

Figure 1: Adani Mining Australia Looks Insolvent but for a Tax-haven Entity Guarantee

Adani Mining Pty Ltd		
A$m	31-Mar-19	31-Mar-18
Tangible Assets	97	98.8
Total Liabilities	1,979	1,768
Incl. Net Debt	1,806	1,606
Total Equity	(507)	(234)

Source: Australian Securities & Investment Commission.

Adani's Carmichael Proposal Looks Unbankable

When mines are proposed, the proponents generally rely on financial backers providing equity and financial support to a project.

[1] Queensland Government Dept. of State Development, Carmichael Coal Mine and Rail Project.

In November 2018 Adani Mining announced they had been singularly unsuccessful in securing the backing of any financial institutions willing to support its Carmichael thermal coal mine and rail project, to IEEFA a clear acknowledgement of the climate and stranded asset risks involved. Instead, Adani stated the Indian parent entity would self-finance the first stage of the mine, involving an additional US$2bn investment.

IEEFA has again reviewed the financial statements of the Indian listed parent entity, Adani Enterprises Ltd, noting that by normal bank lending standards, there is little if any spare borrowing capacity, particularly in light of the multitude of other business expansions already well underway e.g. the development of six new airport franchises.

Adani Enterprises Ltd has not informed investors of the decision to finance the Carmichael mine.

Further, as a National Stock Exchange (NSE) listed entity, normal continuous disclosure requirements would see Adani Enterprises Ltd inform investors if a project as financially significant as the Carmichael mine were to be financed. No such announcement has been made, somewhat in contradiction to the statements by the Australian subsidiary.

IEEFA notes the very unusual situation that Adani Enterprises Ltd has also rarely mentioned the Carmichael project in its quarterly results statements nor in discussions with the financial markets in their result presentations (transcripts of which are available online from Adani Enterprises Ltd).

As recently as 29 May 2019, Adani Enterprises Ltd management confirmed that despite a series of major Indian project expansions, no equity raise was required.[2] This was made in direct reference to the proposed debt funding of the acquisition cost of US$500m for six new Indian airport concessions and the capital cost of a sixfold expansion of domestic Indian coal mining capacity to 75 million tonnes per annum (Mtpa) that is currently underway. Additionally, in 2018/19, Adani Enterprises Ltd committed to building out a major new business segment in data centres, involving a multi-year capital investment of over US$500m. And a new greenfield expansion into Indian iron ore mining has also been commenced in the last year.

Over the years, Adani Australia has regularly announced plans to start the Carmichael project, hitting the green button prematurely several times. In recent years, substantive investment remains absent (not a dollar has been invested in property, plant and equipment in the 12 months to 31 March 2019 by Adani Mining Pty Ltd).

[2] Adani Enterprises, Adani Enterprises Limited Q4 FY-19 Earnings Conference Call, 29 May 2019.

In the last reporting period, any compulsory land purchases look to have been funded by an undisclosed third party like the Queensland Government Coordinator General's Office on behalf of Adani Australia (albeit good governance disclosures on this also appear to be entirely absent, given they do not appear on the Adani Mining balance sheet nor in the Directors' notes on material developments).

Adani Group Saddled With Debt

IEEFA fully recognises the significant and expanding financial strength of the Adani Group of companies in India.

Adani Group has had significant success in profitably expanding its Indian ports, transmission, gas and renewable energy businesses in particular. The combined market capitalisation of the now six NSE-listed Adani entities has more than trebled over the last five years.

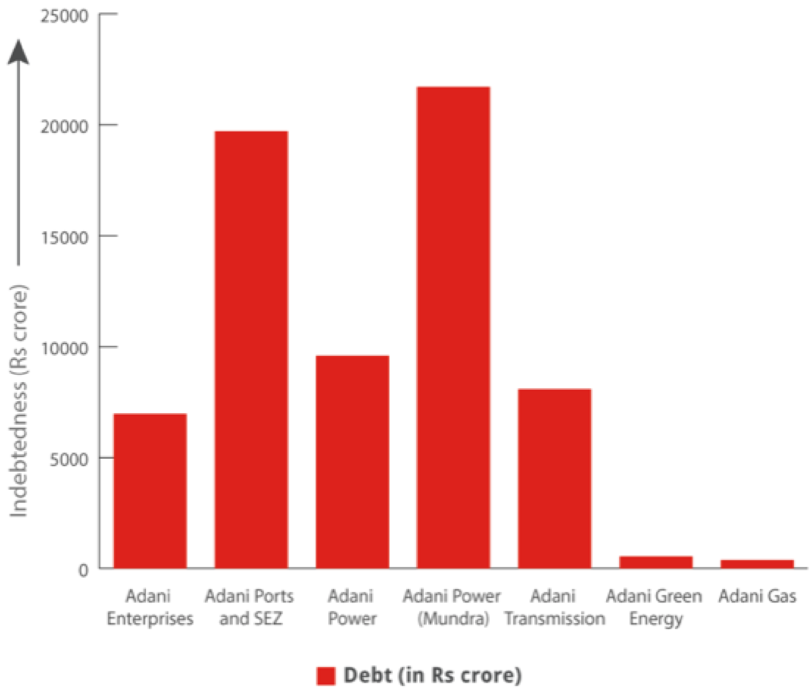
IEEFA notes that Adani Group's ongoing strategy of aggressive concurrent expansion on all fronts is enabled by massive financial leverage.

Net debts for the whole Adani group were recently estimated by Bloomberg at Rs100,000 crore (US$14.5 billion).

Additionally, Adani Power has consistently reported net financial losses over the last decade, drowning in massive, growing interest costs approaching US$1bn annually. Adani Power reported a total loss of US$145m for the fiscal year to 31 March 2019, the last available financial results.[3]

[3] Adani Power, Full year results to 31 March 2019.

Figure 2: Adani Group Debt Burden Across the Listed Entities (Rs Crores)



Source: M Rajshekhar Scroll.in, "From 2014 to 2019: How the Adani Group's footprint expanded across India".

Net debts for the whole Adani group cannot be fully ascertained but were recently estimated by Bloomberg at Rs100,000 crore (US$14.5 billion).

Another aspect of the Adani Group financing strategy is intercompany transfers, loans, investments and asset sales. As a private group, this would be entirely understandable. However, with six separately listed entities, material cross-dealings have been raised by investors and financial commentators as contrary to the interests of minority shareholders.

For example, Adani Ports' shares fell 8% in one day in February 2019 over a related party asset transfer (Adani Agro Logistics). Adani Ports management had committed to curbing excessive inter-company loans back in 2016 after sustained minority shareholder pressure.

Adani Australia Supported by Adani Enterprises for At Least 12 months

Adani Australia is a brand the group uses to encompass the combined operations of the Adani Family Group of entities that operate in Australia. Adani Australia Pty Ltd is a legal entity, but one that has no legal ownership in any of the other 25+ entities in Australia registered with the Australian Securities & Investments Commission (ASIC) (refer Appendix). Adani Australia includes:

- **The Adani Abbot Point Terminal** (AAPT) - Operating a 50Mtpa coal export facility under a lease from the Queensland Government since 2011 (91 years remaining), the port operated at an annual capacity utilisation of just 55-57% over the four years to 2018/19. Given the physical port asset is used as collateral for a significant amount of Australian debt, this subset of Adani entities is quarantined from other Australian entities of Adani Australia, and is owned by a series of trusts and companies in Australia including Atulya Resources Ltd (a Cayman Islands entity), which in turn is owned by ARFT Holding Ltd (incorporated in British Virgin Islands), an entity associated with the Adani family.[4]

- **Adani Renewables Australia** – Although this entity has built a 65 megawatt solar project at Rugby Run near Moranbah in Queensland, this asset is not owned by the NSE-listed Adani Green Energy.

- **Carmichael Mine and Rail** - The Carmichael thermal coal mine and rail proposal, where the joint proponents are listed as Adani Mining Pty Ltd and Carmichael Rail Network Pty Ltd, are ultimately owned by Adani Enterprises Ltd via a couple of tax-haven based intermediaries in Singapore, and then in Mauritius, the latter being Adani Global Ltd.

Contractors, Employees and Debtors Beware

While the Adani Group currently supports the cashflow needs of Adani's Australian subsidies, the Adani group is not a charity. With such a convoluted corporate structure and with financial leverage already extreme even before starting construction of the coal proposal, new debtors would do well to understand their likely place in the queue in the event of any bankruptcy down the track.

IEEFA cautions that while the current endorsement by the Adani Group of its Australian entities gives the expectation of continuing funding support, it does not directly evidence any legally binding commitment to support these businesses indefinitely into the future (we assume this is likely to be explicitly dealt with in major contracts on a case by case basis). The corporate / directors' guarantee stands for just 12 months from the time of the accounts being signed, and even this is complicated by the interspersing of tax-haven entities across several jurisdictions.

In the event of any future financial distress, the Adani Group's convoluted legal structure may affect contractors, employees and debtors to Adani Mining Pty Ltd and Carmichael Rail Network Pty Ltd. For instance, should Adani Mining Pty Ltd be liquidated, creditors will need to evaluate where they sit in a creditor ranking, given the entity already has A$2bn of existing liabilities to other Adani entities and massively negative net tangible assets.[5]

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[4] ABC, Adani: Investigation uncovers tax haven ties to British Virgin Islands, 3 October 2017.
[5] IEEFA does not provide or intend to provide legal nor personal financial advice. Figure 1 presents a balance sheet profile unlike almost any other we have encountered in our 30 years of

Although Adani has referenced self-financing the Carmichael thermal coal mine and rail infrastructure, the form this will take has not been disclosed.

IEEFA would also note that Adani Australia has been unable to reach agreement on an estimated $900m royalty holiday agreement with the Queensland Government. The company has required repeated deadline extensions, suggesting this relates to Adani's inability to-date to secure financial assurance.[6]

In IEEFA's view, the ultimate parent entity Adani Enterprises does not currently have the financial capacity to deliver on these projects absent a multi-billion dollar equity or debt raising, or through another strategy incorporating intercompany loans from separately listed entities with a common shareholder, thereby raising issues of minority interest rights (e.g. for almost six years Adani Ports provided security for a US$800m loan to the private family group on AAPT).

Contractors' Risks

Issues over contracting terms and payment disputes have been raised several times since Adani first entered Australia in 2010. Contractors have historically also had financial and legal issues with the Carmichael Rail Network.[7] Most suppliers have cited issues with speaking out given the likely resource sector customer backlash.

A press report in 2013 cited some 12 local companies in Mackay Queensland had 'fallen into trouble' after failing to fully grasp the way Adani operated around the globe, referencing onerous contracting terms.

Another press report[8] cited unbalanced terms such as the Adani requirement that suppliers lodge a deposit for 5-10% of the contract value upfront, but with vague contract terms including delays, meaning supplier capital could be tied up for years with no ability for contractors to recover their own capital, often equivalent to the entire profit margin on the contract awarded.

Issues of contractor deposits follow the announcement and cancellation of numerous letters of intent, memorandums of understanding and/or contracts of award. These have been announced by various firms including Downer EDI, RCR Tomlinson, Parsons Brinckerhoff, AECOM, POSCO of Korea, Aurecon and SMC.

In addition to questions regarding the ability of Adani Mining's to fund creditors, the Carmichael Rail Network Pty Ltd has been involved in a long legal battle with one key supplier, AECOM. The engineering firm struggled to get money owed for works completed.[9]

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financial analysis, particularly for an Australian entity looking to fund a high risk $2bn greenfield stage I of a $16bn project that will not generate any free cashflow for at least 3-4 years.

[6] The Guardian, Adani yet to sign royalties deal despite claiming to be close to financing mine, 3 November 2018.

[7] Australian Financial Review, Adani refuses to pay for work on Carmichael mine, 14 May 2019.

[8] The Daily Mercury, "Claims against Adani" by Kieran Moran, 10 February 2017.

[9] Australian Financial Review, Adani refuses to pay for work on Carmichael mine, 14 May 2019.

It was reported in September 2018 that AECOM had taken Adani to the Queensland Building and Construction Commission (QBCC) for arbitration as it sought to recover $16.9m from Adani for work completed on the now abandoned 392km rail project. With Carmichael Rail Network having no tangible assets, AECOM had relied on a letter of financial support from one of Adani's Singapore-based group shell companies, Abbot Point Port Holdings, the owner of the equity in AAPT (although ASIC still accountably records Adani Ports & SEZ Ltd as the owner six years post sale). By May 2019 Adani had taken AECOM to the Supreme Court in Brisbane claiming the QBCC did not have the jurisdiction to determine the money owed. The matter finally completed on 2 August 2019.[10]

At the same time it was reported that Jangga Operations, a cultural heritage body that specialises in surveying Native Title areas, was also understood to be owed money by Adani.

Carmichael Mine a Stranded Asset Risk

Even if the Carmichael thermal coal mine and rail proposal is self-funded and operationalised, IEEFA is of the view that the global seaborne thermal coal sector peaked back in 2014/15, and given permanent technology-driven relative cost changes, thermal coal has entered a terminal decline over the longer term.

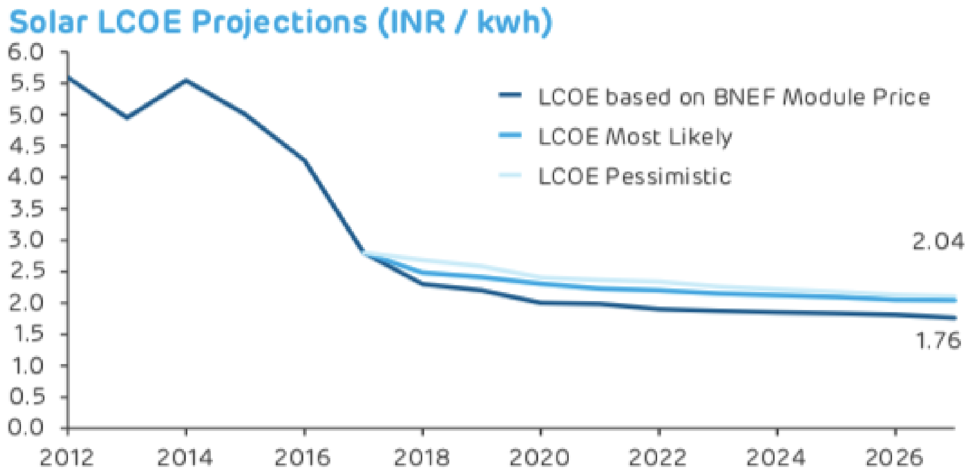
The International Energy Agency Sustainable Development Scenario models the near elimination of coal use globally by 2050.

Entirely consistent with this, Adani Green Energy's June 2019 Investor Presentation highlights that wind and solar energy generation is now consistently available at Rs2.40-3.00/kWh (with zero indexation), 20% below the wholesale price of electricity in India at Rs3.60/kWh, and that Adani expects solar power in particular to see further deflation of 25-35% in the coming decade before any material shipments of Carmichael thermal coal could be delivered to India. (Figure 3)

Renewable energy is now priced consistently some 50% below the cost of new imported coal-fired power generation.

[10] Queensland Courts, File Summary: 14035/18 CARMICHAEL RAIL NETWORK PTY LTD -V- AECOM AUSTRALIA PTY LTD & others, accessed 15 August 2019.

Figure 3: Cost of Electricity for Indian Solar (Rs/kWh, 2012-2026)



Source: Adani Green Energy Investor Presentation, May 2019.

Renewable energy is now priced consistently at some 50% below the cost of new imported coal-fired power generation. Further, renewable energy remains in a long-term deflationary trend. IEEFA concludes that any suggestion of new imported coal-fired power generation at a cost of Rs5-6/kWh is entirely unviable.

Ultimately, the Carmichael thermal coal proposal is in IEEFA's view unviable and unbankable on any normal commercial evaluation, absent massive ongoing government subsidy support in both India and Australia, particularly if carbon emissions pricing continues to be progressively ramped up globally.

Adani Abbot Point Terminal Pty Ltd (AAPT)

The AAPT results for the twelve months to 31 March 2019 have also been lodged with ASIC. These accounts illustrate two key aspects of the Adani Group business operations (as per Figure 4):

1. **Huge financial leverage**: AAPT has net liabilities of A$1.8bn secured against just A$207m book value of equity (a ratio of 8.6 times). IEEFA notes the Directors revalued the port assets by A$113m during 2018/19, more than doubling the reported book value of equity.

2. **Pre-tax losses**: Not withstanding revenues of over $300m annually and a 74.5% gross profit margin, the huge financial leverage and intercompany payments for related party "leases" means that yet again AAPT reported a pre-tax loss of A$25m for the 2018/19 year, generating a net tax benefit of A$7m.

Having invested well over A$2 billion in 2010 in AAPT, and A$3.3bn in the whole of Adani Australia, the Adani Group is yet to pay any material net corporate tax to the Australian government this past decade. IEEFA views this structure as designed to legally minimise tax, and notes a similar approach is evident in Adani Mining Pty Ltd. The precedent of the track record over the last decade suggests it fair to assume absent a major change in corporate intent, the Australian government is unlikely to see any material corporate tax payments in the coming decade from Adani Australia.

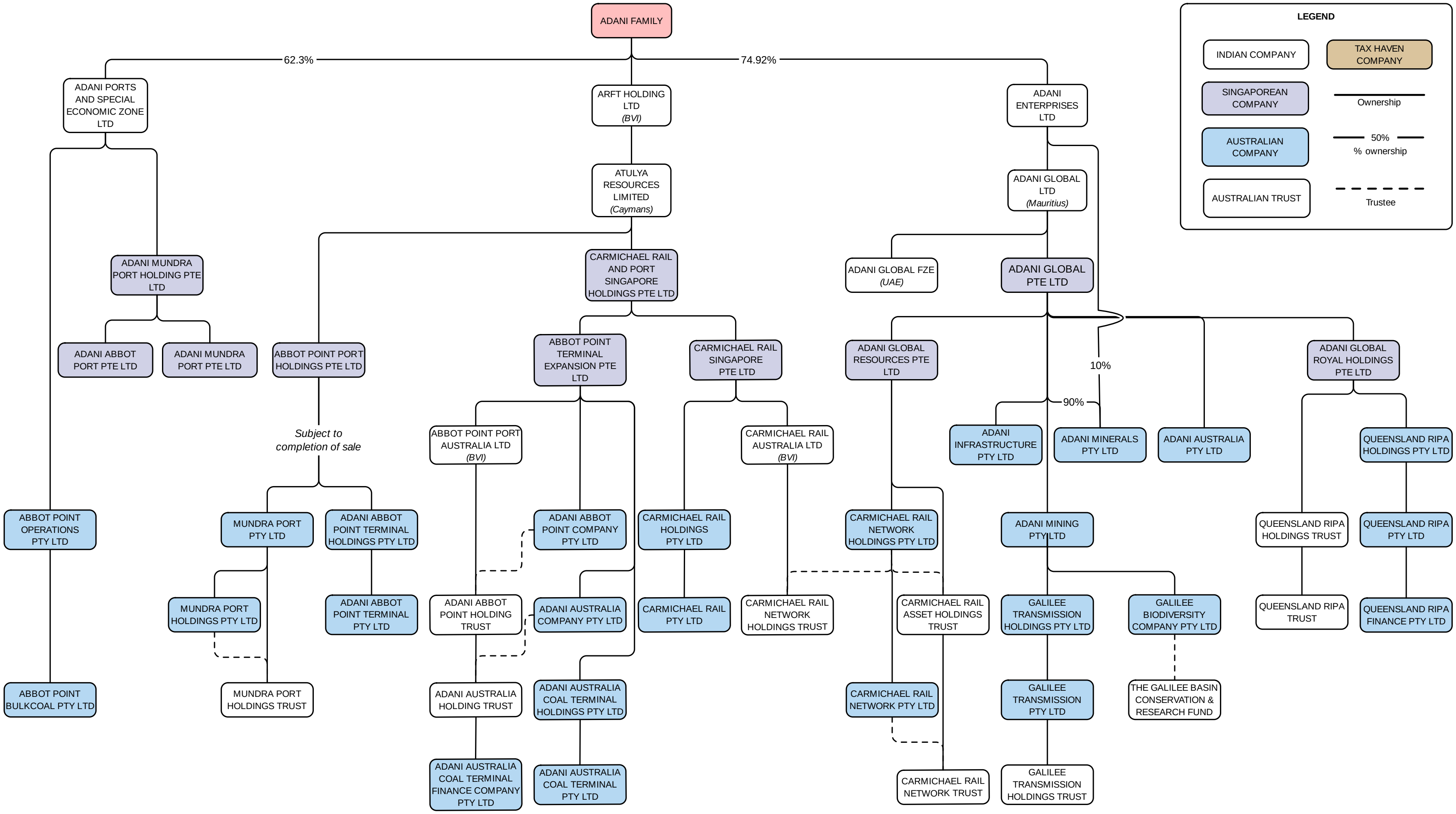
Figure 4: AAPT Balance Sheet and Income Statement (2018/19, A$m)

Balance Sheet A$m	**31-Mar-19**	
Total Assets	1,995	
Total Liabilities	1,788	
Shareholders Equity	207	
Liabilities to Equity (times)	8.6	
Income Statement (A$m)	**Year to 31-Mar-19**	**Year to 31-Mar-18**
Gross income	326	332
Operating expenses	-83	-70
Depreciation	-16	-16
Financing & leasing costs	-251	-241
Pretax profit	-25	6
Income tax benefit	7	-3
Net profit	-17	2
Gross cash profit margin	74.5%	78.9%

Source: AAPT Accounts, Australian Securities & Investment Commission.

IEEFA has reviewed the accounts of the main Australian subsidiary of the Adani Abbot Point Coal Terminal (AAPCT), where the majority of assets appear to be held, and the port revenues are understood to be booked. However, Adani operates several trusts within Australia relating to the AAPCT, and the accounts for these entities are not required to be lodged with ASIC, precluding an external evaluation of the exact full picture. Inter-company transfers within the multitude of Adani Australia group entities are extensive. We have traced this historically as best we can. To the extent of public available information, IEEFA considers our analysis illustrative of the total. Should additional information be made available by the Adani Group, we will update or correct this report accordingly.

Appendix: Adani Australia Corporate Structure (Excluding Renewables Companies)



Information sourced from ASIC and ACRA registers and company documents.
All ownership relationships 100% unless described. Note that voting rights do not necessarily r eflect equity interest.
Transparency related to trusts is limited ther efore we we recognise that some trust r elated relationships displayed may be incorr ect and/or out of date.

Source: Energy Resource Insights, 12 July 2019.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Author

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Tim Buckley, IEEFA's director of energy finance research, Australasia, has over 30 years of financial market experience covering the Australian, Asian and global equity markets from both a buy and sell side perspective. Tim was a top-rated Equity Research Analyst and has covered most sectors of the Australian economy. Tim was a Managing Director, Head of Equity Research at Citigroup for many years, as well as co-Managing Director of Arkx Investment Management P/L, a global listed clean energy investment company that was jointly owned by management and Westpac Group.