PT Chandra Asri Petrochemical Tbk (/gws/en/esp/issr/96560991)

FitchRatings

Fitch Assigns Chandra Asri First-Time IDR of 'BB-'; Rates Proposed USD Notes 'BB-(EXP)'

Fitch Ratings-Singapore/Jakarta-23 October 2017: Fitch Ratings has assigned Indonesia-based PT Chandra Asri Petrochemical Tbk (CAP) a Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'BB-'. The Outlook is Stable. The agency has also assigned CAP's proposed senior unsecured US dollar notes an expected rating of 'BB-(EXP)'. At the same time, Fitch Ratings Indonesia has also assigned a National Long-Term Rating of 'AA-(idn)' with a Stable Outlook.

CAP's rating reflects its leading market position as the largest petrochemical producer in Indonesia, supported by its integrated operations and more diverse product offerings compared with its domestic peers, favourable long-term industry prospects in Indonesia, the cyclical nature of the petrochemical industry and its strong financial profile.

The proposed notes will rank pari passu with other senior unsecured borrowings of CAP and its subsidiaries. The final rating on the proposed notes is contingent upon the receipt of documents conforming to information already received.

'AA' National Ratings denote expectations of very low default risk relative to other issuers or obligations in the same country. The default risk inherently differs only slightly from that of the country's highest rated issuers or obligations.

KEY RATING DRIVERS

Leading Market Position: CAP's credit profile benefits from its leading market position as the largest petrochemical producer in Indonesia, accounting for about 35% of the country's olefin and polymer production capacity. CAP is also the only producer of butadiene and styrene monomer and one of the top two producers of propylene and polyethylene in Indonesia. CAP's market position is also aided by operations that are relatively better integrated than its domestic peers, a diversified customer base, proximity to some of its key customers and good infrastructure including customer pipeline connectivity.

Integrated Operations, Improved Profitability: We believe CAP's integrated operations enable it to diversify its product offerings and improve operational efficiencies - delivering higher profitability - relative to its peers. In our view, the expansion of CAP's naphtha cracker unit in late-2015 has improved its integration and has enabled it to capture value chain benefits while meeting the majority of its input requirements, along with its captive power plants. The plant's location, close to many of its key customers with pipeline connectivity, also supports its higher realisations and profitability. CAP is also setting up a synthetic rubber plant jointly with Compagnie Financiere Du Groupe Michelin, which is expected to start operations in 1Q18, enabling the company to further improve downstream integration.

Strong Financial Profile: We expect CAP's financial profile to remain strong over the medium term despite its large capex plans. CAP benefits from the strong operating cash flows from its expanded naphtha cracker and improving downstream integration. We expect CAP's financial profile to improve further in 2017, with a turnaround to a net cash position, supported by strong operating cash generation and USD378 million raised from its recently completed rights issue.

However, we expect CAP's net cash position to reverse over the medium term due to its large investment plans, although its key credit metrics will remain strong over the medium term. We expect FFO adjusted net leverage to remain below 1x (2016: 0.2x) and FFO fixed charge cover to stay above 9x (2016:14.2x) through 2020.

Large Investments to Continue: CAP plans to invest about USD1 billion till 2019 to increase the capacity of its downstream products. This includes its plans to add a new polyethylene plant while also increasing the capacity of its existing polypropylene and butadiene plants. We believe these investments will continue to support CAP's growth over the medium term and its leading market position. The company may also consider a second petrochemical complex; however, in the absence of a firm plan, we have factored in only a minimal investment in our analysis.

Favourable, Albeit Cyclical, Growth: We expect CAP to benefit from stable demand growth for petrochemical products in Indonesia over the medium-to-long term and the country's position as a net importer of key petrochemical products. We believe Indonesia's strong GDP growth coupled with relatively lower per capita consumption will drive growth for key polyolefins over the medium-to-long term. Indonesia produces only about half of its polypropylene and polyethylene demand; we believe CAP's proposed expansion will benefit from its access to the domestic market. However, we expect the capacity expansion plans of other Indonesian petrochemical players to result in more intense competition over the medium to long-term.

However, CAP's credit profile remains vulnerable to the commodity cycle, as its earnings and cash flow are linked to the petrochemical industry. Petrochemical prices and product spreads are impacted by movements in crude oil prices and global demand-supply dynamics. We expect some moderation in the product spreads over the medium term with new capacity additions globally

Standalone Profile: We assess CAP's credit profile on a standalone basis without considering the credit profile of its largest shareholder, the Barito group. In our view, the Barito group's consolidated credit profile is likely to be similar to CAP's over the medium term, after the completion of its acquisition of a 67% stake in Star Energy Holdings Pte Ltd (Star), a company with geothermal operations in Indonesia. We expect the Star acquisition to help diversify the Barito group's business risk profile. We also believe Star's revenue generating assets are likely to be aid the Barito group's moderate financial profile. However, any weakening in the Barito group's credit profile may impact CAP's rating.

In our view, CAP's second-largest shareholder, SCG Chemicals Company Limited (SCG), provides benefits such as technical expertise and synergies from access to some feedstock supplies.

DERIVATION SUMMARY

CAP's ratings reflect its leading market position as the largest petrochemical producer in Indonesia, its integrated operations, more diverse product offerings compared with other domestic peers, favourable long-term industry prospects in Indonesia, the cyclical nature of the petrochemical industry and its strong financial profile. China XD Plastics Co Ltd (XD Plastics, B+/Stable) has a weaker market position due to stiffer competition from foreign chemical companies, resulting in pricing pressure. CAP's rating is one notch higher than XD Plastics' due to its leading market position and stronger financial profile.

Shandong Yuhuang Chemical Co., Ltd. (B/Positive) has a larger operational scale compared with CAP. However, it faces significant execution and financing risks in its US project. CAP has considerably higher margins, a larger share in its home market, and a significantly better financial profile, resulting in the two-notch difference. Magnesita Refratarios S.A. (BB/Stable) benefits from its position as the world's third-largest refractory manufacturer in a highly fragmented market, its 80% vertical integration, geographical diversification and its long-life mine reserves. These factors allow the Brazil-based company to operate with a good level of profitability that combined with its geographic diversification provide some business resilience, resulting in a rating that is a notch higher than CAP's, despite CAP's better financial profile.

CAP's national rating of 'AA-(idn)' is well-positioned compared to PT Sumber Alfaria Trijaya Tbk (Alfamart; 'AA-(idn)/Stable) and PT Mayora Indah Tbk (Mayora; 'AA(idn)/Stable'). Comparing with Alfamart, both companies have significance presence in their respective industries. We view that Alfamart has larger operational scale with more stable and defensive business profile, as most of their revenue generated from food-related products, compared to CAP which is exposed to the cyclicality of commodities. However, this is offset by CAP's better margins and lower expected leverage profile in the medum term. As a result, we view that CAP and Alfamart is warranted to be rated on the same level.

In comparison with Mayora, we see that both companies benefits from being a significant player in their industries. However, we see that CAP's larger revenue scale is balanced by Mayora's more proven stable margins, suggesting the ability to pass through costs. We also expect Mayora to generate neutral to positive FCF in the medium term compared to CAP's expectation to experience negative FCF due to its planned expansions. Hence, we view that CAP's rating of one notch below Mayora is justified.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Moderation in product margins (spreads) of key polyolefins over the medium term
- Naphtha cracker's operating rate remaining high at around 98%-99%
- Operations at the expanded facilities for polypropylene and butadiene units to start in 2019 and polyethylene in 2020.
- Capex of around USD1 billion till 2019.
- Dividend payout ratio of 30% over the medium term.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action
- We do not expect any upgrade in CAP's standalone credit profile in the near to medium term, given its limited scale and diversification and high uncommitted capex. It standalone credit profile may be upgraded if there is a significant improvement in its business profile, driven by an improvement in scale and vertical linkages that will support further diversification, while maintaining a strong financial profile such that its FFO net leverage does not exceed 1.5x on a sustained basis. However, an upgrade in CAP's Foreign-Currency IDR will only result from an improvement in CAP's standalone credit profile and a similar improvement in the Barito group's credit profile.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Any deterioration of CAP's financial profile resulting in its FFO net leverage exceeding 3x on a sustained basis, provided Barito group's credit profile also weakens.
- Any deterioration in Barito group's credit profile with its FFO net leverage exceeding 4x on a sustained basis.

LIQUIDITY

Comfortable Liquidity: In our view, CAP's liquidity position is comfortable with a cash balance of around USD248 million as of end-June 2017. CAP's liquidity is expected to improve after the completion of its USD378 million rights issuance in September 2017. The company's debt maturities are staggered over the medium term with debt maturities of USD87 million in 2017. We expect CAP's liquidity to remain comfortable in the near to medium term, given our expectations of strong operating cash flows and the company's debt-raising plans in 2017 for funding its capex over the next two to three years. We believe CAP also enjoys strong relationships with domestic banks, including access to some Thai banks, due to its linkages with SCG, which is part of the Siam Cement group.

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Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(idn)' for National ratings in Indonesia. Specific letter grades are not therefore internationally comparable

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Additional information is available on www.fitchratings.com

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017) (https://www.fitchratings.com/site/re/901296)
Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016) (https://www.fitchratings.com/site/re/887669)
National Scale Ratings Criteria (pub. 07 Mar 2017) (https://www.fitchratings.com/site/re/895106)
Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017) (https://www.fitchratings.com/site/re/899659)
Parent and Subsidiary Rating Linkage (pub. 31 Aug 2016) (https://www.fitchratings.com/site/re/886557)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/1031152)
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