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Research Update:

PT Chandra Asri Outlook Revised To Stable On Parent's Stabilizing Credit Profile; 'B+' Rating Affirmed

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Table Of Contents

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Overview

- We consider Barito Pacific's 'b+' group credit profile to have stabilized following the completion of its corporate reorganization and based on the release of its first pro forma consolidated financial statements since the acquisition of power producer Star Energy.
- The prospect of a rating upside or rating downside for Chandra Asri, a core subsidiary of Barito Pacific, has reduced as a result of the stabilized credit profile of the group.
- We are revising our outlook on Chandra Asri to stable from developing. We are also affirming our 'B+' ratings on Chandra Asri and on its US$300 million senior unsecured notes.
- The stable outlook on Chandra Asri reflects our expectation that the credit profile of parent Barito Pacific will remain stable over the next 12 months, with a consolidated debt-to-EBITDA ratio of close to 3.5x, and that Chandra Asri will remain a core subsidiary within the group.

Rating Action

On Sept. 14, 2018, S&P Global Ratings revised its outlook on PT Chandra Asri Petrochemical Tbk. to stable from developing. At the same time, we also affirmed our 'B+' long-term issuer credit rating on the company and the 'B+' issue rating on its senior unsecured notes. Chandra Asri is an Indonesia-based producer of petrochemical products.

Rationale

We revised the outlook to stable to reflect our view that the credit profile of Chandra Asri's parent, PT Barito Pacific Tbk., has stabilized following its recently completed reorganization and is unlikely to change over the next 12-18 months. We assess Barito Pacific's credit profile at 'b+' and the stand-alone credit profile of Chandra Asri as 'bb-'; we cap the rating on Chandra Asri to the level of the group credit profile.

We now have better visibility over the steady-state financial profile of Barito Pacific. This follows the release of its first pro forma consolidated financial statements since the company acquired a 66.67% stake in Star Energy

Group Holdings Pte. Ltd., an Indonesian geothermal power producer, and the completion of a rights issue in late June 2018. Consolidated debt increased to about US$2.52 billion as of June 30, 2018, compared with about US$540 million in 2016 before the acquisition. Most of the additional debt (about US$1.7 billion) comes from the full consolidation of operating debt for Star Energy's power generation assets. Debt at the chemical operations (through Chandra Asri) is about US$600 million and debt at Barito Pacific parent level is about US$250 million as of June 30, 2018.

We forecast Barito Pacific's consolidated pro forma debt-to-EBITDA ratio at 3.5x-3.7x over the next 24 months. We consider that level commensurate with a 'b+' credit profile given the quality and predictability of the group's earnings. We base that projection on the following assumptions:

- Consolidated EBITDA for the group (on a full-year basis) at US$700 milllion-US$750 million over the next two years.
- Consolidated debt at Barito Pacific at US$2.4 billion-US$2.7 billion over the next two years.

Our estimate for consolidated EBITDA assumes EBITDA of about US$350 million at Star Energy, EBITDA of at least US$350 million from Chandra Asri, and immaterial losses at the parent company's own operations.

In our view, Chandra Asri can self-fund a sizable investment program with operating cash flows and a sizable cash balance of about US$715 million as of June 30, 2018. The company has limited need for additional debt in our base case. Debt at Star Energy is likely to stay broadly stable, given only about US$200 million of debt matures within the next two years. Finally, and unlike what it had earlier announced, Barito Pacific will use about US$111 million in additional proceeds from its rights issue for working capital purposes at subsidiaries rather than to partially repay the US$250 million bank loan. Our debt projections exclude further debt-funded investment at Barito Pacific, especially in other power projects.

Barito Pacific owns about 46% of Chandra Asri (and about 61%, including related party holdings) and its economic interest in Star Energy power generation assets varies from 35% for the Salak and Darajat plants to 40% for the Wayang Windu plant. Those minorities create leakage of dividends. Still, the group's cash flow adequacy and leverage ratios do not significantly change, assuming a proportionate consolidation of debt and EBITDA at its operating subsidiaries. We estimate the debt-to-EBITDA ratio, on a proportionate consolidation basis, at 3.7x-3.8x. Nearly 90% of the consolidated debt is at the operating company level and well-matched with respective subsidiaries operating cash flows. Assuming debt at the parent-level remains US$250 million or below, structural subordination risk remains manageable, in our view.

The acquisition of Star Energy reduces the volatility of Barito Pacific's earnings, which have historically been driven by volatile profits from the chemical operations. Earnings and cash flows from Star Energy benefit from predictable power offtake agreements for both volumes and tariffs with state-owned electricity distributor PT Perusahaan Listrik Negara for the next 20 years. The capacity factor at all three power plants have been in excess of 85% since 2016, noting a one-time interruption of production at the Wayang Windu plant in 2015.

We equalize the rating on Chandra Asri to the level of the group credit profile because we still view the company as an integral part of the group's strategy, given it still contributes nearly 50% of the group's consolidated EBITDA. We expect Barito Pacific and related parties to maintain a majority shareholding in Chandra Asri over the next few years and exert management and financial control, especially regarding financial policies.

We also cap the rating on Chandra Asri to the credit profile of its group because we believe that Barito Pacific could rely on Chandra Asri's resources, through cash calls, higher dividends, asset swaps or other means, if itself or other group subsidiaries face tighter financial conditions or require liquidity. Barito Pacific has relied in the past on Chandra Asri to raise funding, most notably the US$250 million bank loan, which is collateralized with Chandra Asri shares. Barito Pacific will also rely on dividends from Chandra Asri to service its own debt. Proceeds from Chandra Asri's US$377 million rights issue in September 2017 could also technically be sent upstream to its main shareholders if needed without breaching covenants on Chandra Asri's US$300 million bond. Finally, future expansion at Chandra Asri, especially for its second naphtha cracker, may also require buying land from Barito Pacific's sponsor.

Chandra Asri's 'bb-' stand-alone credit profile reflects the company's still-modest scale compared with regional peers, high single-site concentration, and its exposure to volatile product spreads in the petrochemical sector. Chandra Asri's integrated operations, larger operating scale following its cracker expansion, and improved balance sheet mitigate these weaknesses.

We project the ratio of debt-to-EBITDA below 2.0x through 2019. That level is solid for the 'bb-' SACP, but captures the inherent volatility in product spreads and sharp changes in EBITDA and operating cash flows at weaker points in the cycle. Under a mid-cycle spread environment, the company could generate at least US$175 million in EBITDA (translating into a debt-to-EBITDA ratio of 2.5x-3.0x), with the ratio not exceeding 4.0x under more stressed market conditions.

Our base case assumes the following for Chandra Asri:
- GDP growth in Indonesia, Chandra Asri's main market, at 5%-6% annually through 2020, with sustained demand for petrochemical products domestically.
- Brent crude oil price at US$65 per barrel for the rest of 2018, US$60 for 2019, and US$55 in 2020 as per our current price deck.

- Broadly stable sales volume of 1.9 million tons-2.1 million tons through 2018. Sales volumes in 2019 and 2020 could increase as new debottlenecking projects and polyethylene expansion are completed.
- Spreads for ethylene and polyethylene over naphtha to remain solid for the rest of 2018 (based on realized spreads for the first six months), with a modest decline in 2019.
- Utilization rates staying above 90%, in line with historical levels.
- Gross profit per ton of product sold, excluding depreciation, between US$200 and US$250 in 2018 and 2019.
- Annual capital spending of a maximum of US$550 million in 2018 and 2019.
- A dividend payout of about 40% over the next three years.
- Reported gross debt not exceeding US$800 million through 2020.

The assumptions lead to the following credit ratios:

- Debt-to-EBITDA ratio below 2.0x over the next two years.
- Ratio of funds from operations (FFO) to debt averaging about 40% over the next two years.
- Negative discretionary cash flows of about US$550 million over the next 18 months, funded with cash balance.

Chandra Asri's results for the half year ended June 30, 2018, remained solid despite rising feedstock prices. EBITDA was about US$233 million, representing nearly 65% of our full-year EBITDA expectation. The company's second quarter EBITDA reduced to about US$100 million from nearly US$135 million in the first quarter of the year following rising naphtha prices. We still project EBITDA of at least US$350 million in 2018 and 2019 even if oil prices stay around the current levels of US$75-US$80 per barrel. The company remained in net cash position as of June 30, 2018, though that's mostly because of most of the capital spending for the year will take place in the second half of 2018.

We are not including sizable spending associated with a second naphtha cracker project, given the investment decision is likely to be taken only in 2020. However, we could reassess the likelihood of the project taking place if the company materially steps up preparatory spending on the cracker over the next 12 months.

Liquidity

Chandra Asri's liquidity is adequate. Given the cyclical nature of the company's business, its cash flows are volatile. Nevertheless, we expect Chandra Asri's sources of liquidity to exceed its uses by about 1.3x in the next 12 months. The company's sizable cash balance and our projection of a sound earnings profile for the next 12 months translates in sufficient headroom under its bank loan covenants, even if forecasted EBITDA were to decline by 20%. Chandra Asri also has well-diversified and supportive pool of banking relationships.

Liquidity sources:

- About US$715 million in cash and cash equivalents as of June 30, 2018.
- Cash FFO that we forecast at about US$250 million-US$300 million over the 12 months to June 2019.

Liquidity uses

- Short-term debt maturities of about US$68 million as of June 30, 2018.
- Capital spending of no more than US$550 million over the 12 months ending June 2019, to be funded through operating cash flows and cash on hand.
- No more than US$150 million in dividends.

Barito Pacific can amply cover interest servicing on its US$250 million bank loan with dividends from operating subsidiaries, especially Chandra Asri. We also expect Barito Pacific to prudently manage its cash balance and liquidity in light of the relatively short maturity of the US$250 million bank loan, which matures in September 2019. Barito Pacific may seek to refinance the bank loan over the next few months, though we would expect the company to use its cash balance, which we estimate at about US$125 million as of June 30, 2018, to repay the loan partly if refinancing initiatives are delayed.

Outlook

The stable outlook on Chandra Asri reflects our expectation that the credit profile of parent Barito Pacific will remain stable over the next 12 months, with a consolidated debt-to-EBITDA ratio of close to 3.5x, and that Chandra Asri will remain a core subsidiary within the group.

Downside scenario

We may lower the rating on Chandra Asri if we assess the consolidated credit profile of Barito Pacific as having substantially weakened. This could materialize if one or more of the following occurs:

- We assess Barito Pacific's cash flow adequacy and leverage ratios as having substantially weakened because of more aggressive spending. A consolidated ratio of debt to EBITDA exceeding 4.0x without any prospect of near-term improvement would be indicative of a weaker group credit profile.
- Barito Pacific fails to maintain ample liquidity at the parent company level or its debt maturity profile stays concentrated, leading to persistent refinancing risks.
- Chandra Asri's own operations deteriorate materially from current levels because of a sharp and sudden decline in product spreads or much higher spending than we anticipate, diminishing the profit-generation capacity

of the group as a whole.

We may assess Chandra Asri's SACP lower at 'b+' if the company embarks in near-term and large-scale greenfield projects or its product spreads decline sharply such that its debt-to-EBITDA ratio exceeds 3.5x with no prospect of recovery. We view this situation as unlikely over the next 12 months, given our forecasts of subdued oil and naphtha prices, steady product spreads and EBITDA.

Upside scenario

We may raise the rating on Chandra Asri if we assess the consolidated credit profile and balance sheet of Barito Pacific to be commensurate with at least a 'bb-' level, with a consolidated debt-to-EBITDA ratio sustainably below 3.0x after the company reorganization. A higher credit profile at Barito Pacific would also be contingent upon the group demonstrating and maintaining ample liquidity at the parent company level and proactively lengthening its debt maturity profile within the group.

A higher SACP at Chandra Asri is unlikely over the next 12-24 months, given the company's structural exposure to industry risks in the petrochemical sector, volatile product spreads, high operating advantage, and moderate scale compared with higher-rated peers regionally and globally. A 'bb' SACP would require the company to achieve a larger scale, broader product diversity, a permanently reduced sensitivity to fluctuations in product spreads through enhanced integration and greater economies of scale, while maintaining a debt-to-EBITDA ratio below 2.0x through a product spread cycle.

Ratings Score Snapshot

Issuer Credit Rating: B+/Stable/--

- Business risk: Weak
- Country risk: High
- Industry risk: Moderately high
- Competitive position: Weak
- Financial risk: Significant
- Cash flow/Leverage: Modest

Anchor: bb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)

- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bb-

- Group credit profile: b+
- Group status: Core (-1 notch)

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria - Corporates - Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
PT Chandra Asri Petrochemical Tbk.		
Issuer Credit Rating	B+/Stable/--	B+/Developing/--

Ratings Affirmed

PT Chandra Asri Petrochemical Tbk.

Senior Unsecured	B+