2018-10-18 | Rating Action Commentary

Fitch Affirms Chandra Asri at 'BB-'/'AA-(idn)'; Outlook Stable

Fitch Ratings-Singapore/Mumbai-18 October 2018: Fitch Ratings has affirmed Indonesia-based PT Chandra Asri Petrochemical Tbk's (CAP) Long-Term Issuer Default Rating at 'BB-'. The Outlook is Stable. The agency has also affirmed the rating on the company's USD300 million senior unsecured notes at 'BB-'. At the same time, Fitch Ratings Indonesia has affirmed CAP's National Long-Term Rating at 'AA-(idn)' with a Stable Outlook.

We assess CAP's linkage with its dominant shareholder, PT Barito Pacific Tbk, as moderate and consequently rate CAP on the consolidated credit profile of the Barito group, which we consider to be 'BB-' post its acquisition of Star Energy Holdings Pte Ltd., Indonesia's largest geothermal energy producer. Any weakening of the Barito group's credit profile may affect CAP's rating.

We continue to assess CAP's standalone credit profile at 'BB-', reflecting its leading market position as the country's largest petrochemical producer, which is supported by its integrated operation, more diverse product offering compared with domestic peers, strong financial profile and favourable long-term industry prospects in Indonesia and is offset by the cyclical nature of the petrochemical industry.

'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

CAP's Leading Market Position; Integrated Operations: CAP's standalone credit profile benefits from its leading market position as Indonesia's largest petrochemical producer, accounting for about 35% of the country's olefin and polymer production capacity. Its market position is also aided by better-integrated operations than those of domestic peers as well as a diverse product offering and customer base. This, together with its plant being located close to many key customers with pipeline connectivity to some, will continue to support its higher realisation and profitability.

CAP's plans to add a new polyethylene plant and increase capacity at its existing polypropylene and butadiene plants to improve downstream integration and further capture value chain benefits. The company commissioned its synthetic rubber plant in a joint venture with Compagnie Financiere Du Groupe Michelin (55% shareholding; CAP: 45%) in 3Q18.

Product Spread to Moderate: Fitch expects the spread of key petrochemical products to moderate during the next two years due to global capacity additions. However, margin compression should be lower for CAP than for domestic peers due to its operational flexibility in varying its product slate, diversified supplier base and long-term key- customer relationships. CAP also benefits from its association with SCG Chemicals Company Limited, which owns 31% of CAP, for part of its feedstock procurement.

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. Indonesia's strong GDP growth, coupled with increasing urbanisation and consumption growth, is likely to drive demand for key polyolefins. However, CAP's credit profile remains vulnerable to the commodity cycle, as its earnings and cash flow are affected by crude oil price movements and global demand-supply dynamics.

Moderate Linkages with Shareholders: We assess the linkage between CAP and its largest shareholder, Barito Pacific, as moderate, based on our Parent and Subsidiary Rating Linkage criteria, and consequently rate CAP on the consolidated financial profile of the Barito group. The group benefits from a diversified presence across the petrochemical and energy businesses, a leading market position, integrated petrochemical operations and a strong record in geothermal operation with long-term contracts driving stable revenue. Barito also has a marginal presence in plantation, forestry and property businesses through its wholly owned subsidiaries.

Barito group's 2018 acquisition of Star Energy is positive for its rating. We expect Star Energy's diversified and established operation, together with its long-term contracts (residual term of 19 years or more) with PT Perusahaan Listrik Negara (Persero) (BBB/Stable), to result in stable revenue and cash flow. Star Energy's operation benefits from high availability, a favourable cost position and the long operating history of its assets, although it acquired its joint venture Salak and Darajat assets onlyin 1H17. Barito expects Star Energy's profitability to improve over the medium-term based on improved efficiencies from the acquisition.

Large Investments at CAP: CAP plans to invest about USD1.2 billion through to 2020 to increase its downstream operation capacity and to cover the initial spending for a second petrochemical complex, which should help it to maintain its leading market position over the medium term. The company indicates that its projects are progressing on schedule and that it started up its butadiene plant with expanded capacity of 137,000 metric tonnes per annum (+37%) in June 2018. Given the initial phase of CAP's second petrochemical complex, we have factored in only pre-final investment decision capex in our analysis of CAP and limited spending on the project thereafter.

Barito also has a modest investment plan for its power business via a medium- to long-term expansion of Star Energy's geothermal operations. In addition, Barito plans to invest in a 2GW green-field coal-fired power project called PT Indo Raya Tenega in Indonesia, in which Barito has a 49% stake. The estimated total project cost is around USD3.1 billion.

Moderate Consolidated Financial Profile: We expect Barito group's consolidated financial profile to weaken, although stay moderate, over the medium-term, with consolidated FFO net leverage rising to around 3.5x (2017: 0.1x) on its USD755 million Star Energy acquisition. Barito funded USD515 million of the acquisition cost for its 66.67% stake through equity, but the remaining large debt has weakened its consolidated credit metrics, which are unlikely to improve over the medium-term given its large investment plans. We expect CAP's financial profile to remain strong, despite its large capex plans, with FFO adjusted net leverage to remain below 2.0x (2017: -0.6x).

DERIVATION SUMMARY

CAP's ratings reflects Barito group's diversified business across the petrochemical and energy businesses, its leading market position as Indonesia's largest petrochemical producer, integrated operation and a strong record of geothermal operation with long-term contracts driving stable revenue. The ratings also reflect Barito group's moderate consolidated financial profile. CAP's stronger standalone financial profile counteracts the group weaker financial profile, resulting in a similar assessment of the two entities' credit profiles.

Ineos Group Holdings S.A. (BB+/Stable) is the world's largest commodity chemical producer, with diversified integrated production facilities, access to low-cost feedstock and feedstock flexibility. CAP's smaller scale and limited geographical diversification results in its rating being lower by two notches, despite a stronger financial profile.

PJSC Kazanorgsintez (B+/Stable) is one of Russia's largest chemical companies and the country's largest polyethylene producer. We believe CAP's more diversified product profile, slightly larger size and marginally better cost structure justifies the one-notch difference in the two entities' ratings, despite similar financial profiles.

Shandong Yuhuang Chemical Co., Ltd. (B/Negative) has a larger operational scale than CAP, but faces significant execution and financing risk in its US project. CAP has higher margins, a larger share in its home market and a significantly better financial profile, resulting in a two-notch rating difference.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Moderation in the product margins (spreads) of key polyolefins over the near to medium term
- Naphtha cracker's operating rate remaining above 90%, except for turnaround maintenance in 2020
- Operations at the expanded polypropylene and polyethylene units to start in 2020
- Capex of around USD1.2 billion till 2020
- Dividend payout ratio of 30% over the medium term

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
We do not expect an 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, as seen by larger scale and vertical linkages that support further diversification, while maintaining a strong financial profile such that FFO net leverage does not exceed 1.5x on a sustained basis. An upgrade in CAP's Foreign-Currency Issuer Default Rating will only result from an improvement in its standalone credit profile and a similar improvement in Barito group's credit profile.

Developments that May, Individually or Collectively, Lead to Negative Rating Action

- Any deterioration in Barito group's credit profile, with FFO net leverage exceeding 4.0x for a sustained period.
- For CAP's standalone credit profile, any deterioration of CAP's financial profile resulting in FFO net leverage exceeding 3.0x on a sustained period.

LIQUIDITY

Strong Liquidity: CAP has strong liquidity, with a cash balance of USD743 million and undrawn committed credit facilities of USD76 million as at end-June 2018, against scheduled debt maturities of USD89 million in 2018. CAP also enjoys strong relationships with domestic banks as well as access to some Thai banks due to its linkages with SCG Chemicals, which is part of the Siam Cement group, one of Thailand's largest conglomerates with leading market positions and diverse sources of revenue from its core businesses in cement and building materials, chemicals, and packaging. CAP successfully raised a USD300 million bond in October 2017 through the offshore bond market.

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Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018)
Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)
Country-Specific Treatment of Recovery Ratings Criteria (pub. 16 Apr 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)
Sector Navigators (pub. 23 Mar 2018)

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