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Research Update:

Chandra Asri Petrochemical Upgraded To 'BB-' On Stronger Credit Quality Of The Parent; Outlook Stable

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PRIMARY CREDIT ANALYST

Vishal Kulkarni, CFA
Singapore
(65) 6216-1047
vishal.kulkarni
@spglobal.com

SECONDARY CONTACT

Bertrand P Jabouley, CFA
Singapore
(65) 6239-6303
bertrand.jabouley
@spglobal.com

Rating Action Overview

- Star Energy's stable and highly profitable operations will contribute meaningfully to Barito's earnings, improving their resilience.
- Accordingly, we expect Barito's leverage will remain below 4.0x, despite volatile cash flows at its key subsidiary Chandra Asri and a potential rise in investments over the next three to five years.
- On June 26, 2019, S&P Global Ratings raised its long-term issuer credit rating on Chandra Asri and the long-term issue ratings on the company's US$300 million senior unsecured notes to 'BB-' from 'B+'.
- The stable outlook on Chandra Asri reflects our view that both the parent and the subsidiary will maintain their credit quality over the next two years, with the consolidated debt-to-EBITDA ratio remaining below 3.5x.

Rating Action Rationale

We raised the ratings on PT Chandra Asri Petrochemical Tbk. to reflect the stronger operating performance of parent PT Barito Pacific Tbk. We now view the credit quality of Barito to be similar to that of Chandra Asri, which we expect will remain a core, uninsulated subsidiary. Barito's other subsidiary Star Energy Ltd., has become a meaningful contributor, improving the parent's earnings stability and diversity.

The addition of Star Energy's stable cash flows has lowered Barito's reliance on Chandra Asri's performance. Barito acquired a 66.67% stake in Star Energy, an Indonesian geothermal power producer in June 2018 in a non-cash transaction. Star Energy has installed capacity of 875 megawatts (MW) across three power generating assets, Wayang Windu, Salak, and Darjat. Its take-or-pay power purchase contracts benefit from creditworthy counterparties, i.e., PT Perusahaan Listrik Negara (PLN; BBB/Stable/--) and PT Pertamina (Persero) (BBB/Stable/--). The tariffs under the off take contracts cover foreign exchange, operations, and maintenance cost inflation risks. Star Energy's geological reserves indicate sufficiency for the power plant to operate at the current capacity for more than 20 years. Both provide substantial visibility to the company's operating performance.

Star Energy's stable operating cash flows also temper the volatile and cyclical cash flows from Chandra Asri's petrochemical operations. Over the past two years, Star Energy has benefited from high utilization levels of more than of 90%. However, the company faces a few risks, such as geothermal operational stability. Recently, geological disturbances caused unplanned shut downs of three to five days at a couple of units.

We forecast Star Energy will account for 50% or more of Barito's EBITDA over the next two years. We estimate that Star Energy's EBITDA will be US$350 million-US$400 million during this time and its debt will amortize down from the current level of about US$1.5 billion. The company should have adequate buffer after servicing its debt, including annual interest expenses of US$130 million-US$140 million, and principal amortization of about US$40 million. Capital spending will be about US$50 million a year. Star Energy's individual assets have meaningful minority stakes owned by partners. Therefore dividends available to Barito from Star Energy will remain minimal.

We anticipate that Chandra Asri will generate EBITDA of US$275 million-US$325 million over 2019-2020, commensurate with our expectations of mid-cycle spreads for the petrochemical products for the industry overall. The company maintains a strong cash balance of more US$500 million compared to debt of around US$650 million. We expect Chandra Asri to maintain its ratio of gross debt to EBITDA at less than 2.5x through the cycle, at least until it progresses on its cracker expansion.

We expect Barito to maintain EBITDA of more than US$700 million over the next two years, compared with gross debt of US$2.3 billion. This translates to the ratio of gross debt to EBITDA averaging less than 3.5x through the cycle. The company's debt will remain stable or perhaps even decline during this time, until capex at Chandra Asri begins to increase. At the holding company—Barito—level, the main source of cash flows will be dividends from Chandra Asri. We expect Chandra Asri to pay about US$80 million a year in dividends, with US$40 million of that going to Barito. This amount is sufficient to cover Barito's interest payment of about US$20 million on its US$200 million debt.

Chandra Asri and Barito's new capital expenditure planned over the next four to five years could increase their individual leverage. Chandra Asri is finalizing its plan to build a second cracker plant with capacity similar to its existing one at a total investment of about US$4 billion. The investment will happen over 2021-2024, once the final investment decision is made potentially by end-2020. We believe the company will secure a partner to shoulder a significant share of this project's expenses. Although Chandra Asri will fund a large portion of its share of the investment in the cracker with internal cash flows, it will still need to take on some debt. At the peak of this investment cycle, the company's cash flow leverage could increase beyond our expectation, but will come down to levels commensurate with a 'bb-' stand-alone credit profile (SACP) once the project is operational.

In our view, Barito's credit profile can accommodate additional borrowings of US$100 million-US$150 million. In partnership with PLN, Barito is progressing on a new thermal power plant project, which will have a total investment of US$3.1 billion. Barito will not consolidate this project in its financials given its 49% ownership, and will fund it by project debt of 70% or more. The company will partly fund its equity contribution of US$150 million by exercising the warrants it issued in 2018. Barito will pay the rest of the equity contribution in kind by providing land of about 40 hectares for the project. The company has the flexibility and willingness to bring in partners to share the ownership and investment obligations for its share of the project. The financial closure and final investment decision for this project is pending.

We equalize the rating on Chandra Asri to Barito's group credit profile of 'bb-'. That's because we view Chandra Asri as an integral part of the group's strategy, the company contributes 40%-50% of the group's consolidated EBITDA, and it will remain majority-owned and controlled by the group. Barito will continue to rely on Chandra Asri for its liquidity and debt servicing needs. Also, we expect the business and financial relations between the two to stay strong, such that their credit quality is unlikely to be different.

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

Outlook

The stable outlook on Chandra Asri reflects our expectation that Barito's credit profile will remain stable over the next 12 months, with a consolidated debt-to-EBITDA ratio of close to 3.5x. We also expect Chandra Asri to remain a core subsidiary within the group. During the period, we expect the company to maintain steady production, sales, and mid-cycle profitability such that its debt-to-EBITDA ratio stays below 2.5x.

Downside scenario

We may lower the rating on Chandra Asri if the consolidated credit profile of Barito weakens substantially. Barito's consolidated ratio of debt to EBITDA exceeding 4.0x without any prospect of near-term improvement could indicate such weakness. The ratio could deteriorate if:

- Chandra Asri's operations deteriorate materially because of a pronounced and lasting decline in product spreads;
- Star Energy faces geological or operational issues undermining power generation; or
- New investments through the group increase Barito's gross debt beyond US$3.5 billion, without commensurate cash flow additions.

The rating could also come under pressure if Barito's liquidity deteriorates due to a depleting cash pile, material fall in dividend income, or absence of timely refinancing.

We may revise our assessment of Chandra Asri's SACP down to 'b+' if the company's debt-to-EBITDA ratio approaches 3.5x with no prospect of recovery. Such a scenario could most likely arise if the company's investments increase its debt toward US$1.5 billion while EBITDA fails to stay above US$300 million due to prolonged weakness in petrochemical product spreads.

Upside scenario

We may raise the rating on Chandra Asri if we expect Barito's credit quality to improve, a scenario we believe is unlikely over the next two to three years. Such an improvement at Barito hinges on: (1) the company's consolidated debt-to-EBITDA ratio reaching 3.0x, especially after the peak of the group's investment cycle; (2) Barito and Chandra Asri maintaining sufficient liquidity and raising the necessary funding for investment well in advance; (3) Barito's operating profile remaining steady through the investment phase and amid volatile margins through the cycle; and

(4) new projects being completed on time and within budget to improve Barito's operating scale.

A higher SACP for Chandra Asri is unlikely until at least its new cracker expansion is complete and increases production. 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 or greater economies of scale. For an upward revision to the SACP, Chandra Asri's debt-to-EBITDA ratio has to stay less than 2.0x through a product spread cycle.

Company Description

Chandra Asri is the largest listed petrochemical company in Indonesia and operates a sizeable (capacity of 2 million tons per annum) naphtha cracker. Barito owns 46% of Chandra Asri and with the Pangestu family, which directly owns 15%, has effective control over the company. Siam Cement Group has a strategic ownership of 31% in Chandra Asri since 2012. Chandra Asri's product suite primarily consists of olefins, polyolefins, styrene monomer, and butadiene.

Our Base-Case Scenario

- GDP growth in Indonesia, Chandra Asri's main market, at 5%-6% annually through 2020, with sustained demand for petrochemical products.
- Brent crude oil price at US$60 per barrel for the rest of 2019 through 2020 dipping to US$55 a barrel in 2021 and after.
- Chandra Asri's sales volume of about 2.0 million tons through 2019, possibly increasing in 2020 and 2021 as new debottlenecking projects and polyethylene expansion are completed and production ramps up.
- The company's products spread will fall in 2019 and then stabilize in 2020 and after.
- Utilization rates staying above 90%, in line with historical levels.
- Gross profit per ton of product sold, excluding depreciation, of US$175-US$225 over 2019-2021.
- Average annual capital spending of near US$350 million in the period.
- Dividend payout of 30%-40% over the next three years.
- Reported gross debt to stay below US$700 million through 2021.

The assumptions lead to the following credit ratios:

- Debt-to-EBITDA ratio of less than 2.5x over the next two years.
- Negative discretionary cash flows over the period.

Liquidity

Chandra Asri's liquidity is adequate. Given the cyclical nature of the company's business, its cash flows are volatile. Nevertheless, we expect its sources of liquidity to exceed uses by more than 1.2x in the 12 months ending March 31, 2020. Chandra Asri's sizable cash balance and likely sound earnings during this time should provide sufficient headroom under its bank loan covenants, even if forecast EBITDA declines by 20%. The company also has well-diversified and supportive banking relationships.

Liquidity sources include:

- US$548 million in cash and cash equivalents as of March 31, 2019.
- Cash flow from operations of US$125 million-US$150 million over the 12 months ending March 31, 2020.

Liquidity uses include:

- Short-term debt maturities of US$53 million as of March 31, 2019.
- Capital spending of about US$400 million, to be funded through operating cash flows and cash on hand.
- Dividends of about US$80 million annually.

Barito can sufficiently cover interest servicing on its US$200 million bank loan with dividends from Chandra Asri. We also expect Barito to prudently manage its cash balance and liquidity.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of March 31, 2019, Chandra Asri's capital structure consists of US$300 million in unsecured notes due November 2024, another US$140 million in unsecured Indonesian rupiah bonds, and US$254 million in secured bank loans outstanding.

Analytical conclusions

All of Chandra Asri's assets are located in Indonesia, a jurisdiction that we consider to have a weak rule of law, a lack of creditor-friendly features, and a lack of consistency in the conformity of the distribution of proceeds to legal rankings of claims. Recovery prospects in the event of bankruptcy are uncertain in the country a result of the weak jurisdictional context. Therefore, we equalize the rating on the proposed notes to the issuer credit rating on the company.

Ratings Score Snapshot

Issuer Credit Rating: BB-/Stable/--

Business risk: Weak

- Country risk: Moderately High
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Significant

- Cash flow/Leverage: Significant

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: bb-
- Group status: Core (no impact)

Related Criteria

- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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 Unregulated Power And Gas Industry, March 28, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018

Ratings List

Upgraded

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

Upgraded

	To	From
Senior Unsecured	BB-	B+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.