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## Research Update:

# PT Chandra Asri Outlook Revised To Developing Pending Clarity On Group Credit Profile; 'B+' Rating Affirmed; SACP Raised

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## Research Update:

# PT Chandra Asri Outlook Revised To Developing Pending Clarity On Group Credit Profile; 'B+' Rating Affirmed; SACP Raised

## Overview

- Chandra Asri reduced its debt further, and its operating cash flows for the quarter ended March 31, 2017, remain sound amid supportive industry conditions, high utilization rates, and expanded production capacity.
- We are revising upward our stand-alone credit profile on the Indonesian petrochemical producer to 'bb-' from 'b+' as a result of its sustainably stronger balance sheet.
- Nevertheless, the direction of the credit profile and leverage at Chandra Asri's majority shareholder and parent Barito Pacific remain uncertain at this stage, pending the completion over the next few months of a wide-ranging corporate reorganization initiated at the end of 2016.
- We are revising our outlook on the long-term rating on Chandra Asri to developing from positive. We are also affirming our 'B+' corporate credit rating and 'axBB' ASEAN regional scale rating on Chandra Asri.
- The developing outlook on Chandra Asri reflects the uncertain direction of the credit profile and balance sheet strength of Barito Pacific upon completion of the group's corporate reorganization.

## Rating Action

On May 24, 2017, S&P Global Ratings revised its outlook on Indonesia-based petrochemical producer PT Chandra Asri Petrochemical Tbk. (Chandra Asri) to developing from positive. At the same time, we affirmed our 'B+' long-term corporate credit rating and our 'axBB' long-term ASEAN regional scale rating on the company. We also revised upward the stand-alone credit profile (SACP) on Chandra Asri to 'bb-' from 'b+'.

## Rationale

We revised the outlook on Chandra Asri to developing from positive to reflect the uncertain direction of the credit profile of and leverage at parent company PT Barito Pacific Tbk. following a major corporate reorganization at Barito Pacific started at the end of 2016; we expect it will be completed within the next few months. The higher SACP on Chandra Asri reflects, on the other hand, further debt reduction, sound operating cash flows, and a sustainably stronger balance sheet.

The 'bb-' SACP on Chandra Asri reflects the company's reduced debt following the expansion of its expanded cracker capacity and steady market conditions. Chandra Asri's reported debt declined to about US\$385 million as of March 31, 2017, from about US\$550 million in 2015, with cash on hand nearly tripling over the period to about US\$278 million. At the same time, reported EBITDA grew to about US\$500 million in 2016 (2015: about US\$145 million) and reached about US\$170 million in the quarter ended March 31, 2017, amid higher sales volumes and supportive conditions for naphtha-based petrochemical producers regionally. Chandra Asri's ratio of debt to EBITDA fell below 1x in 2016.

Product spreads in the chemical sector fluctuate rapidly and the sector has high operating leverage. Current spreads for ethylene--a major contributor to Chandra Asri's profits--are also near all-time highs, thanks to subdued oil and naphtha prices. While spreads may not be sustainable at this level for an extended period, we still project Chandra Asri's debt-to-EBITDA ratio to stay below 1.5x through 2018 even if product spreads weaken from current levels. We anticipate EBITDA of at least US\$400 million in 2017 and above US\$300 million in 2018. We also believe substantial debt repayment since 2015 has reduced somewhat the sensitivity of Chandra Asri's cash flow adequacy and leverage ratios to fluctuating product spreads. Under a mid-cycle spread environment, we believe the company could generate at least US\$175 million in EBITDA (translating into a debt-to-EBITDA ratio of about 2.5x), given its capacity is about 40% greater than during the last down cycle in 2012 and it has somewhat better product integration. We therefore revised upward our financial risk profile assessment on the company to significant from aggressive previously.

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 assumed at US\$50 per barrel for 2017, US\$50 for 2018, and US\$55 in 2019, with naphtha prices likely to remain subdued over the period.
- Spreads for ethylene and polyethylene over naphtha to remain fairly solid in 2017 (based on data for the first five months), with a gradual and slow decline through 2019.
- 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.
- Utilization rates staying above 90%, in line with historical levels.
- A gross profit per ton (before depreciation and amortization) of about US\$375 per ton in 2017, declining to about US\$300 in 2018-2019.
- Capital spending of about US\$150 million in 2017 and about US\$210 million in 2018, mostly on the polyethylene expansion and other smaller debottlenecking projects.
- A dividend payout of 30% in 2017 and 30%-50% in 2018.

We do not incorporate potential spending associated with a second naphtha cracker, a project that the company highlighted as a potential growth

opportunity. We understand that this project is under study, but the large size, potential complexities, and necessary approvals could lead to an investment decision in the second half of 2018 only. The precise involvement of Chandra Asri and its stake in such a project, as well as the funding structure, are also uncertain at this stage.

The assumptions lead to the following credit ratios:

- Debt-to-EBITDA ratio below 1.5x through 2018.
- Ratio of funds from operations (FFO) to debt exceeding 60% through 2018.
- Positive discretionary cash flows in 2017, turning negative in 2018.
- Reported debt levels below US\$375 million through 2018 while the company funds the cash deficit with cash on hand.

We have historically considered that Chandra Asri and Barito Pacific, its majority shareholder, have similar credit profiles. This is because Chandra Asri historically represented more than 90% of its parent's assets, debt, revenues, and EBITDA. With limited leverage and immaterial activities on its own, Barito Pacific's consolidated cash flow adequacy ratios were broadly consistent to those of Chandra Asri. We had assessed Barito Pacific's consolidated group credit profile as 'b+'.

At the end of 2016, Barito Pacific initiated a major reorganization of its operations. That reorganization entailed the purchase of Indonesia-based geothermal power and oil and gas producer Star Energy, a sister company to Chandra Asri owned by the ultimate shareholder of Barito Pacific. The purchase price that Barito Pacific paid was not disclosed. We understand that the transaction has not yet closed, with a number of considerations related to corporate structure and funding still pending and not publicly disclosed. Given Barito Pacific is listed on the Jakarta Stock Exchange, we believe the financial statements of Barito Pacific's corporate actions will reflect its recent corporate reorganization upon the transaction's closure. But this may take a few more months.

At this stage, we are uncertain about the implications of the Star Energy acquisition for Barito Pacific's asset base, debt, revenues, pro forma profits, and, ultimately, its leverage and cash flow adequacy ratios. We believe consolidated leverage is likely to increase as the group will now consolidate debt from Chandra Asri (about US\$385 million as of March 31, 2017), acquisition-related debt, and, depending on the structure, potentially the debt at Star Energy (which had, until recently, debt including a US\$350 million bond). We estimate that reported debt at Barito Pacific already increased to about US\$685 million for the quarter ended March 31, 2017, from about US\$537 million as of Dec. 31, 2017. We also note that a consortium led by Star Energy signed a sale and purchase agreement to buy certain assets of oil and gas major Chevron, with potential further implications for Star Energy's own balance sheet and that of Barito Pacific indirectly. However, the acquired assets are generally income producing and will add to Barito Pacific's consolidated EBITDA and cash flows.

We believe the pro forma group credit profile of Barito Pacific could therefore remain unchanged at 'b+', be stronger or weaker upon transaction completion, depending on the ultimate corporate structure and funding profile. A consolidated ratio of debt to EBITDA below 3.0x could be indicative of a 'bb-' group credit profile, pending further analysis of the stability of Star Energy's operations and the group's liquidity management. On the other hand, a consolidated ratio of debt to EBITDA above 3.5x, or an unfavorable debt maturity schedule post transaction closure could be indicative of a 'b+' group credit profile or lower, noting residual volatility in consolidated performance given sizable petrochemical operations.

We view Chandra Asri as a core and non-insulated member of Barito Pacific given its major, though somewhat diluted, contribution to group earnings post transaction, main strategic pillar for the group, record of support between Chandra Asri and Barito Pacific, and group control. As a result, the rating on Chandra Asri remains constrained by our current assessment of group credit profile at 'b+'.

## **Liquidity**

In our assessment, 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 more than 1.2x in the next 12 months.

The company's sizable cash balance and our projection of a sound earnings profile for 2017 provide sufficient headroom under its bank loan covenants, even if forecast EBITDA declines 20%.

Principal liquidity sources include:

- About US\$278 million in cash and cash equivalents as of March 31, 2017.
- Cash FFO that we forecast at about US\$300 million over the next 12 months.

Principal liquidity uses include:

- Current debt maturity of about US\$70 million.
- Capital spending of US\$160 million-US\$170 million over the next 12 months.
- Modest working capital outflows of no more than US\$30 million over the next 12 months.

## **Outlook**

The developing outlook on Chandra Asri reflects the uncertain direction of the credit profile and balance sheet strength of Barito Pacific when the group's corporate reorganization is completed.

## **Downside scenario**

We may revise the outlook to stable or 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 post completion of the group corporate reorganization, with a consolidated ratio of debt to EBITDA exceeding 3.5x with no prospect of near-term improvement;
- The group fails to maintain ample liquidity or its debt maturity profile is concentrated, leading to persistent refinancing risks; or
- 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 lower Chandra Asri's SACP to '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 near-term 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 ratings 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 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 leverage, and moderate scale compared with higher-rated peers regionally and globally. A 'bb' SACP would require 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**

Corporate Credit Rating: B+/Developing/--

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

Stand-alone credit profile: bb-

- Group Credit Profile: b+
- Group Status: Core (-1 notch)

## **Related Criteria**

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Commodity Chemicals Industry, Dec. 31, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, 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: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Related Research

- PT Chandra Asri Outlook Revised To Positive On Prospective Debt Reduction; 'B+' Rating Affirmed, April 22, 2016

## Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
PT Chandra Asri Petrochemical Tbk. Corporate Credit Rating	B+/Developing/--	B+/Positive/--

Ratings Affirmed

PT Chandra Asri Petrochemical Tbk. Corporate Credit Rating ASEAN Regional Scale	axBB/--/--
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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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.



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