Sime Darby Plantation Sdn Bhd (/gws/en/esp/issr/96180520)

FitchRatings

Fitch Expects to Rate Sime Darby Plantation 'BBB+(EXP)'

Fitch Ratings-Singapore/Jakarta-18 April 2017: Fitch Ratings expects to assign Malaysia-based palm oil producer Sime Darby Plantation Sdn Bhd (SDP) a Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'BBB+(EXP)' with Stable Outlook, and an expected senior unsecured rating of 'BBB+(EXP)'.

SDP is undergoing a debt restructuring as part of a plan by parent Sime Darby Berhad (Sime Darby, BBB+/Rating Watch Negative) to split into three listed pure-play entities. We have assumed that SDP, which had about MYR8.3 billion of intercompany loans from Sime Darby and other group companies as at June 2016, will receive USD600 million of debt (including outstanding issuance under a USD1.5 billion sukuk programme) and MYR2.2 billion of perpetual subordinated sukuk (issued under a MYR3 billion programme) from Sime Darby. Fitch estimates the total debt to be transferred to SDP will be MYR4.9 billion by June 2017, when we expect the transfer to be completed. The remainder of SDP's intercompany loans will be capitalised or offset through asset transfers.

Fitch also expects to assign the USD1.5 billion sukuk programme and the outstanding issuance under the programme, which will be transferred to SDP, a rating of 'BBB+(EXP)'. The perpetual subordinated sukuk is eligible for 50% equity credit under Fitch's "Treatment of Hybrids in Nonfinancial Corporate and REIT Credit Analysis" criteria.

Final ratings are contingent upon the execution of Sime Darby's plan to restructure SDP's borrowings and list it as a separate entity; transfer of certain assets; and capitalisation of intercompany loans consistent with information already received.

KEY RATING DRIVERS

Large Scale, Well Diversified: SDP is the world's largest palm oil company by planted area and production of fresh fruit bunches (FFB), with planted area of over 600,000 hectares in Malaysia, Indonesia, Papua New Guinea (PNG), Liberia and Solomon Islands. Over 50% of its revenue is derived from downstream palm products, such as cooking oil and other food products and biodiesel, which are produced from refineries and other downstream units in eight countries. Through its acquisition of New Britain Palm Oil Limited (NBPOL) in March 2015, SDP gained better yielding palm acreage in PNG and Solomon Islands and refinery assets in the UK, which helped strengthen its focus on delivering certified sustainable food ingredients in the EU.

SDP's scale and diversification reduces risks from weather-related events in specific regions and changes in regulatory regimes, and gives the company better funding access. Its downstream manufacturing footprint also gives the company easier access to key palm product markets in Asia and Europe.

Upstream Metrics to Improve: SDP's upstream operating metrics of FFB yield and oil extraction rate are in line with the industry average. However, old trees form around 30% of SDP's planted acreage. SDP's yield and age profile is weighed down by its Indonesian operations, where 41% of the total planted area at end-June 2016 comprised old trees aged over 19 years.

SDP is focusing on improving its operating metrics and age profile through accelerated replanting at a rate of 5%-7% in Indonesia and 5% in Malaysia in the next few years, compared with an average replanting rate of around 4% over the financial year to June 2014 (FY14) to FY16. SDP aims to reduce the average tree age to 10 years from 13.2 years within the next 5-10 years. The company plans to supplement the replanting with the use of its own high-yielding seed varieties and more mechanisation. Several estates in South Sumatra and Kalimantan in Indonesia have already shown an improvement in yield of around 20% since FY08. Fitch expects SDP's replanting strategy to dominate its future capex and result in a gradual improvement in yield.

Sustainability Drives Long-Term Benefits: SDP is the world's largest producer of palm oil that has been certified by the Roundtable on Sustainable Palm Oil. SDP makes up around 20% of the global certified sustainable palm oil (CSPO) production. The company has been focusing on deriving more value from its CSPO output through higher sales of physical oil, which could garner price premiums of up to USD15 a tonne on average over uncertified oil.

We estimate that higher price realisations for certified sustainable products more than offset certification and implementation costs currently. The net benefit to SDP should improve with better access and more volumes to higher-margin markets in Europe and the US. Global consumer goods companies are increasingly committing to the use of CSPO products with many in Europe targeting 100% CSPO usage by 2020.

Healthy CPO Price Outlook: Malaysian free-on-board (FOB) spot prices for crude palm oil (CPO) have improved over the last year to an average of USD700 a tonne so far in 2017 from around USD500 at end-2015. The increase was due to severely reduced output due to El-Nino related dry weather conditions and robust demand. As a result, palm oil inventories contracted, with Malaysian inventories in February 2017 at their lowest in 10 years. Fitch expects CPO prices to be sustained at around USD675 a tonne over the longer term despite a rebound in output due to more favourable weather conditions.

Moderate Leverage Expected: We expect SDP's FFO-adjusted net leverage to reduce to 2.5x by FY18, from 3.5x in FY17. In addition to the proposed debt restructuring, SDP should benefit from better CPO prices from FY17. We have also assumed cash proceeds from land sales in Malaysia for our forecasts.

DERIVATION SUMMARY

SDP's rating is at the same level as Sime Darby's. The plantation business, mainly oil palm cultivation and processing, was a key driver of Sime Darby's cash flows and earnings, and accounted for 27% and 44% of Sime Darby's consolidated FY16 revenue and EBITDA, respectively. The plantation business was considered Sime Darby's strongest division. As a standalone entity SDP will have lower leverage than Sime Darby.

SDP's rating can be compared with that of Bunge Limited (BBB/Stable), which is a leading oilseed processing and logistics company with considerable geographical diversification that covers all major export and import markets. Like Bunge, SDP benefits from a large scale and geographical diversification. However, SDP has better profitability and lower leverage, which justifies a higher rating.

KEY ASSUMPTIONS

Fitch's key assumptions within the rating case include
- Average benchmark CPO price at USD665 a tonne in FY17, USD670 in FY18 and USD675 thereafter.
- Average US dollar-Malaysian ringgit exchange rate at 4.30 in FY17, weakening to 4.45 in FY18 and 4.75 in FY19.
- FFB yield of 20 tonnes per hectare in FY17, improving to 23 by FY20.
- Oil extraction rate of 21.5% in FY17, improving to 22.2% by FY20.
- Capex at MYR1.7 billion in FY17 and around MYR2.0 billion annually thereafter.
- SDP has MYR4.4 billion worth of land that can be disposed of in the period through to FY20 if required. We have assumed cash proceeds from land sales of MYR1.1 billion in FY18 and MYR1.2 billion in FY19.
- Dividend payout at 55% of net income. We have assumed a lower dividend payout compared with historical payout ratio of 75% based on expectation of dividend reinvestment.

RATING SENSITIVITIES

We do not expect a positive rating action in the over the next 24 months, based on our forecast that the company's leverage profile will remain consistent with its rating until FY19-FY20

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action
- Inability to improve FFO-adjusted net leverage to below 2.5x by FY20
- Negative FCF generation on a sustained basis

LIQUIDITY

Adequate Liquidity: We estimate SDP to have around MYR500 million of unrestricted cash and MYR1.7 billion of undrawn banking facilities at end-FY17. By comparison, debt due in FY18 is estimated at MYR2.7 billion, assuming USD400 million of novated sukuk under the USD1.5 billion sukuk programme becoming due in January 2018. Despite our forecast of free cash flow being inadequate to address debt maturities in FY18, we believe that SDP will be able to address its debt maturities through refinancing, given its good funding access.

Contact:

Primary Analyst
Akash Gupta
Associate Director
+65 6796 7242
Fitch Ratings Singapore Pte Ltd
One Raffles Quay
South Tower #22-11
Singapore 048583

Secondary Analyst
Rufina Tam
Associate Director
+62 21 2988 6813

Committee Chairperson
Vicky Melbourne
Senior Director
+61 2 8256 0325

Media Relations: Leslie Tan, Singapore, Tel: +65 67 96 7234, Email: leslie.tan@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895493)
Criteria for Rating Sukuk (pub. 16 Aug 2016) (https://www.fitchratings.com/site/re/885806)
Treatment and Notching of Hybrids in Non-Financial Corporate and REIT Credit Analysis (pub. 29 Feb 2016) (https://www.fitchratings.com/site/re/878264)

Additional Disclosures

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