Sime Darby Plantation Berhad (/gws/en/esp/issr/96180520)

FitchRatings

Fitch Assigns Sime Darby Plantation 'BBB+' Rating; Outlook Stable

Fitch Ratings-Singapore/Jakarta-22 November 2017: Fitch Ratings has assigned Malaysia-based palm oil producer Sime Darby Plantation Berhad (SDP) a Long-Term Foreign-Currency Issuer Default Rating (IDR) of 'BBB+' with Stable Outlook and a senior unsecured rating of 'BBB+'. Fitch has also removed the Rating Watch Negative on the USD1.5 billion sukuk programme and the outstanding issuance under the programme, which were transferred to SDP from Sime Darby Berhad (Sime Darby) in May 2017, and affirmed them at 'BBB+'.

SDP is targeting to be listed as a standalone entity on 30 November 2017, following its demerger with Sime Darby after securing the necessary shareholder and regulatory approvals. SDP's debt restructuring, a component of the demerger process, has been in line with Fitch's expectations.

SDP had debt of MYR13.9 billion at the end of the financial year to June 2016 (FY16), including inter-company debt and capital leases. We had expected post-restructuring debt of MYR10.3 billion at SDP as of FYE17, including MYR2.2 billion of subordinated perpetual sukuk and outstanding amounts under its USD1.5 billion multi-currency sukuk programme. While SDP's debt was higher than expected at MYR11.6 billion at FYE17, around MYR1.5 billion of inter-company loans owed by SDP have since been settled.

KEY RATING DRIVERS

Large Scale, Well-Diversified Operations: SDP is the world's largest palm oil company by planted area and production of fresh fruit bunches (FFB), with planted area of around 600,000 hectares in Malaysia, Indonesia, Papua New Guinea (PNG), Liberia and Solomon Islands at FYE17. Around 75% of revenue is derived from downstream products, such as refined edible oils, fats and biodiesel, from refineries and other downstream units in eight countries. SDP's scale and diversification reduces risks from weather-related events and regulatory changes in specific regions, and gives it better funding access. SDP also has easier access to key markets in Asia and Europe via its downstream business.

Upstream Metrics to Improve: SDP's FFB yield of 19.4 tonnes per hectare of mature acreage in FY17 and oil extraction rate of 21.3% are broadly in line with the industry average. However, old trees form around 30% of SDP's total planted acreage. SDP's yield and age profile is weighed down by its Indonesian operations, where 46% of the total planted area at end-June 2017 comprised old trees aged over 19 years.

SDP is focusing on improving its operating metrics and age profile by speeding up 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% since FY14. SDP aims to reduce the average tree age to 10 years from 13 years by 2025. The company plans to supplement the replanting with the use of its own high-yielding seed varieties. 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. While 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 sales to higher-margin markets in Europe and the US.

The crude palm oil (CPO) industry is facing increasing pressure to use sustainable production practices, especially in the EU, which accounts for around 15% of global palm oil imports. The EU Parliament passed a resolution in April 2017 that recommended the phasing-out of the use of palm oil in biodiesel production and introduction of a single-certification scheme for oil entering the EU by 2020. 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 FOB spot prices for CPO averaged around USD655/tonne in 2017, even as output and inventories have recovered with improved weather conditions. Malaysia's palm oil inventories in September 2017 were up 31% yoy and also 4% higher than the average level over 2007-16. However, we expect CPO prices to remain steady, with sustained demand growth constraining a further rise in inventory levels.

Moderate Leverage, Positive FCF: We expect SDP's FFO-adjusted net leverage to reduce to below 2.5x by FY20, from 3.5x in

FY18. SDP should benefit from improving yields and healthy CPO prices, resulting in positive FCFs. 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, before the demerger of its plantation and property businesses. 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's projected leverage profile is also better than Fitch's forecast for Sime Darby before the demerger.

SDP's rating can be compared with that of Bunge Limited (BBB/Negative), 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 higher profitability and faces lower risks related to the industry and leverage outlook than Bunge. These factors support a higher rating for SDP.

KEY ASSUMPTIONS
Fitch's key assumptions within the rating case include
- Average benchmark CPO price of USD660 a tonne in FY18, USD670 in FY19 and USD675 thereafter.
- Average US dollar-Malaysian ringgit exchange rate at 4.3 in FY18 and at 4.2 from FY19.
- FFB yield of 20.4 tonnes per hectare in FY18, improving to 21.5 in FY19 and 22.5 in FY20.
- Oil extraction rate of 21.5% in FY18, improving to 21.8% by FY20.
- Capex at MYR1.7 billion in FY18 and FY19, and MYR1.8 billion annually thereafter.
- SDP has around MYR4 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 each in FY19 and FY20.
- Cash dividend outflow of around 50% of net income from FY19. For SDP, a dividend reinvestment plan will be effective from FY19.

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

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
Comfortable Liquidity: SDP had external debt, including perpetual sukuk, of MYR10.1 billion as of FYE17, almost all of which was unsecured or subordinated. Of the total, around MYR1.3 billion was working-capital-related debt and the current portion of long-term loans. By comparison, SDP had cash and cash equivalents of MYR713 million and committed but undrawn facilities of MYR5.0 billion. In addition, SDP has robust banking relationships and the ability to access diverse sources of funding.

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Summary of Financial Statement Adjustments:
- Use of a 5x multiple to capitalise SDP's operating lease expenses, which are dominated by estate land leases in Papua New Guinea and the Solomon Islands.
- EUR40 million of off-balance sheet amount as of FYE17 related to debt factoring has been added to secured debt.
- Reported operating income and expenses, which include FX, derivatives, fair value and asset disposal gains/losses, have been excluded from EBITDA computation.
- Unamortised deferred financing expenses of MYR30 million as of FYE17 have been added back to debt.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Corporate Rating Criteria (pub. 07 Aug 2017) (https://www.fitchratings.com/site/re/901296)
Non-Financial Corporates Hybrids Treatment and Notching Criteria (pub. 27 Apr 2017) (https://www.fitchratings.com/site/re/896881)
Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017) (https://www.fitchratings.com/site/re/899659)
Sukuk Rating Criteria (pub. 14 Aug 2017) (https://www.fitchratings.com/site/re/902221)

Additional Disclosures
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