

Stable Outlook for Consumer Goods, Property, and Plantation Sectors in 2014, but Mining Remains Challenging

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After experiencing less than favorable economic conditions in the second half of 2013, with higher inflation and interest rates plus a depreciation of the Indonesian rupiah (IDR), Indonesia was still able to record a 5.7% year-on-year (YoY) economic growth in 2013. Although the economic growth in the first three months of 2014 slowed to 5.2% YoY, PEFINDO expects economic conditions to be fairly stable, despite some domestic and overseas challenges. This year, Indonesia will continue to face external challenges, such as the progress of the global economic recovery, volatile commodity prices, and the impact of the US tapering its monetary stimulus program. Domestically, the government needs to reduce the current account deficit, and maintain economic growth of at least 5.5% YoY and an inflation rate of 5%. Economic growth will still be driven by household consumption and investment, both in the real sector and in infrastructure. The upcoming general elections will also be crucial in determining political stability, national security, and economic policy.

In the first four months of 2014, PEFINDO lowered its published ratings for six companies and affirmed its ratings for 28 companies in the corporate sector excluding financial institutions. We also placed two out of the downgraded ratings in a negative outlook. The lowered ratings were mostly due to a combination of underperforming businesses and higher financial leverage as a result of greater additional debt than projected. By sector, adverse ratings and outlook revisions occurred in the plantation, mineral mining, and pharmaceutical sectors. Below is our view of the consumer goods, property, palm oil plantations, and mineral mining sectors for the next 12 months.

Consumer Goods

PEFINDO is of the view that the consumer goods industry in Indonesia will have a stable outlook for the next 12 months. This is supported by the stable demand of consumer goods consisting of the food and beverage and pharmaceutical sectors in our portfolio, which are considered as basic necessities. The sectors also have potential demand from a growing population and middle-class income as well as good demographics, with higher youth and productive ages and better purchasing power.

Nevertheless, the players in these sectors will face some challenges in 2014, including higher raw material costs, with the IDR depreciation against the USD for imported raw materials particularly for the pharmaceutical sector, and the volatility of raw material prices. Although the rupiah appreciated against the US dollar in the first quarter of 2014, the exchange rate is still higher than the same period in 2013. The sectors will also face increasing logistic costs as a result of poor infrastructure and higher energy costs, with a potential electricity rate hike for industry this year. These challenges could squeeze profitability margins if the increasing costs are not directly passed on to customers. Despite these unfavorable conditions, we expect the credit quality of the seven out of eight rated companies in our portfolio to remain stable this year unless accompanied by higher than expected debt funded expansion. We gave a negative outlook for PT Indofarma (Persero) Tbk, and we lowered its rating to “*id*BBB+” from “*id*A-” in February 2014, in anticipation of a further deterioration of its financial performance.

Table 1. Companies rated by PEFINDO in the consumer goods sector

No.	Company Name	Sector	Rating/Outlook
1.	PT Indofood Sukses Makmur Tbk (INDF)	Food and Beverage	idAA+/Stable
2.	PT Fastfood Indonesia Tbk (FAST)	Food and Beverage	idAA/Stable
3.	PT Kimia Farma (Persero) Tbk (KAEF)	Pharmaceutical	idAA-/Stable (rating expired)
4.	PT Mayora Indah Tbk (MYOR)	Food and Beverage	idAA-/Stable
5.	PT Nippon Indosari Tbk (ROTI)	Food and Beverage	idAA-/Stable
6.	PT Siantar Top Tbk (STTP)	Food and Beverage	idA/Stable
7.	PT Tiga Pilar Sejahtera Tbk (AISA)	Food and Beverage	idA-/Stable
8.	PT Indofarma Tbk (INAF)	Pharmaceutical	idBBB+/Negative

Source: PEFINDO's database

Property

PEFINDO views the outlook of the Indonesian property sector as stable for the next 12 months, supported by strong demand, particularly for the residential segment, with a sizeable housing backlog. Nevertheless, we expect that the currently high interest rates could reduce demand, particularly residential, as the middle-to-low-income sector still depends on mortgage loans for housing purchases. This could slow developers' sales growth, particularly those with a high contribution from housing loans.

In addition, the high inflation rate and the depreciation of the rupiah against the US dollar could increase construction costs, which will in turn squeeze profitability margins. The players also face challenges from the regulations on loan to value and indent restrictions for housing loans (*Kredit Kepemilikan Rumah/KPR*) published by Bank Indonesia to minimize speculative property transactions and the rise in housing prices, which could decrease the cash flow of developers, particularly the smaller players. The general elections in 2014 could also create an uncertain business environment and a wait-and-see attitude by investors, developers, and customers. This will adversely affect demand for new office space and/or industrial estates this year as some investors may delay expansion plans to next year and beyond.

We believe that the impact of slower economic growth on the rated companies in our portfolio will not be significant enough for any rating revisions in the near term, and most of our rated companies have a stable outlook as they have strong financial profiles. Nevertheless, we will continue to monitor their financial profiles, particularly for any possibility of weakening cash flow and more aggressive financial leverage levels after the implementation of the KPR indent restriction.

Table 2. Companies rated by PEFINDO in the property sector

No.	Company Name	Property Sector	Rating/Outlook
1.	PT Bumi Serpong Damai Tbk (BSDE)	Residential, Retail, Hotels	idAA-/Stable
2.	PT Summarecon Agung Tbk (SMRA)	Residential, Retail, Hotels	idA+/Stable
3.	PT Agung Podomoro Land Tbk (APLN)	Residential, Offices, Retail, Hotels	idA/Stable
4.	PT Surya Semesta Internusa Tbk (SSIA)	Industrial Estates, Hotels, Offices	idA/Stable
5.	PT Intiland Development Tbk (DILD)	Residential, Offices, Hotels	idA/Stable
6.	PT Modernland Realty Tbk (MDLN)	Residential, Industrial Estates, Hotels	idA-/Positive
7.	PT Wika Realty (WKTY)	Residential	idA-/Stable
8.	PT Duta Anggada Realty Tbk (DART)	Offices, Retail	idA-/Stable
9.	PT Perdana Gapuraprima Tbk (GPRA)	Residential, Offices, Hotels	idBBB+/Stable

Source: PEFINDO's database

Palm Oil Plantations

PEFINDO views the outlook of the Indonesian plantation sector, particularly for crude palm oil (CPO), as stable in 2014. Although CPO price has been relatively bullish in the first quarter of 2014, the price increase could be moderated by potential lower demand from China and India. China's economic growth is expected to slow to 7.5% in 2014 from 7.7% in 2013, while India has increased import duties on refined edible oil products including palm oil to 10% from 7.5%. Nevertheless, the CPO price could further improve with potential lower supply as a result of unfavorable weather conditions, such as a prolonged dry season or rainfall, which could adversely affect production. The global CPO supply will also potentially decline with the increasing domestic consumption of producing countries that have increased their mandatory use of biodiesel.

In Indonesia, we expect an increase in domestic consumption in line with the development of the CPO downstream sector. The government has raised the mandatory use of biodiesel to 10%, which could increase domestic CPO consumption by around three million tons. In addition, domestic consumption could increase through using processed palm oil (PPO) to feed diesel-fired power plants owned by PT Perusahaan Listrik Negara (PLN) to reduce its dependence on fossil fuels.

Nevertheless, plantation sector players may also face some challenges, which could apply pressure to profitability margins, including increasing labor and logistic costs as a result of poor infrastructure, a higher export tax on CPO, and negative environmental campaigns. The extension of the peat land moratorium, and limitations placed on plantation areas owned by groups could also hamper long term CPO plantation growth in Indonesia.

In the first four months of 2014, we lowered our published ratings for two companies in the sector and placed one rating at a negative outlook, as a result of higher than expected debt funded expansion, which has weakened capital structure and cash flow protection. We will continue to monitor the financial profiles of our rated companies, particularly for any possibility of weakening cash flows and more aggressive financial leverage levels.

Table 3. Companies rated by PEFINDO in the plantation sector

No.	Company Name	Plantation Sector	Rating/Outlook
1.	PT Salim Ivomas Pratama Tbk (SIMP)	CPO, Rubber	^{id} AA/Negative
2.	PT Sinar Mas Agro Resources and Technology Tbk (SMAR)	CPO	^{id} AA-/Stable
3.	PT Perkebunan Nusantara III (Persero) (PTPN)	CPO, Rubber	^{id} A+/Stable
4.	PT Perkebunan Nusantara X (Persero) (PTPX)	Sugarcane, Tobacco	^{id} A+/Stable
5.	PT Tunas Baru Lampung Tbk (TBLA)	CPO, Sugarcane	^{id} A/Negative
6.	PT Perkebunan Nusantara IX (Persero) (PTP9)	Sugarcane, Rubber, Tea, Coffee	^{id} A-/Stable (rating expired)
7.	PT BW Plantation Tbk (BWPT)	CPO	^{id} BBB+/Stable
8.	PT Perkebunan Nusantara II (Persero) (PTP2)	CPO, Rubber, Sugarcane, Tobacco	^{id} BBB/Negative (rating expired)

Source: PEFINDO's database

Mineral Mining

Contrary to the above sectors, PEFINDO is of the view that the outlook of the Indonesian mineral mining industry is negative for the next 12 months. This is triggered by the export ban of unprocessed mineral ores such as nickel, bauxite, tin, gold, and silver, which began on January 12, 2014. At some point, the regulation will have a positive impact on the development of the downstream sector to produce more value added mineral mining products in Indonesia for the medium to long term. However, we also believe that the regulation will adversely affect the financial performance of some players in the sector, at least in the near to medium term, as some are building new smelters to increase their capacity which will be completed in the medium term, assuming the availability of electricity in the smelter areas. We expect their credit quality will decline with lower profitability and cash flow as a result of revenue loss from the export of mineral ores, while their debt will significantly increase to finance the new smelters.

In addition, sector players are still exposed to low commodity prices. As China's economic growth slows, we expect the demand for mineral mining products will decline, which could potentially reduce prices. However, we expect any such price decline could be moderated by the limited supply of mineral ores from Indonesia particularly for nickel. In addition, the government has implemented a higher tax duty of 20% for exported mining products, which will gradually increase every year to 60% in 2017.

We will closely monitor the impact of the export ban on our rated companies. We have lowered the rating for PT Aneka Tambang (Persero) Tbk and its bonds to "^{id}A" from "^{id}AA-" and placed the negative outlook, reflecting our concern on potential weakening credit quality as a result of the export ban.

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