

## Alternative Financing through Capital Markets: A Solution to Fund Infrastructure

*Analyst: Yogie Surya Perdana*

President Joko Widodo has said that infrastructure will continue to be the area of focus in his second-term administration. This will support the country's economic development towards Golden Indonesia 2045, and connectivity is still a crucial theme for infrastructure development according to the 2020-2024 National Medium-Term Development Plan (RPJMN).

The infrastructure construction program will focus on connecting existing infrastructure with economic centers. Hence, infrastructure can optimally create new economic centers to boost economic growth and enhance the country's competitiveness. According to the World Bank's Logistics Performance Index (LPI), which measures a country's logistic supply chain, Indonesia rose 17 spots to 46<sup>th</sup> out of 160 countries in 2018 from 63<sup>rd</sup> in 2016. However, it still lags behind fellow Southeast Asian countries: Singapore (7<sup>th</sup>), Thailand (32<sup>nd</sup>), Vietnam (39<sup>th</sup>), and Malaysia (41<sup>st</sup>). According to the 2019 Global Competitiveness Index by the World Economic Forum, Indonesia was ranked 50<sup>th</sup> out of 141 countries, and, again, below Singapore (1<sup>st</sup>), Malaysia (27<sup>th</sup>), and Thailand (40<sup>th</sup>).

The National Development Planning Agency (Bappenas) projects infrastructure financing needs for 2020-2024 at IDR6,445 trillion, about 37% of which will be borne by the government and 21% by state-owned enterprises (SOEs). The private sector is also expected to take a greater role by providing 42% of the total financing needs, though their participation remains dependent on a good contractual framework, regulatory transparency, and reasonable returns.

However, financing to carry out infrastructure development remains the most significant challenge. Bank funding has limitations as banks face legal lending limits and liquidity maturity mismatches due to the long return on investment periods of infrastructure projects. Banks are also required to hold higher levels of capital against long-term loans, making long-term project finance more expensive and less attractive. A number of SOEs, which over the past five years were involved heavily in infrastructure development given their status as agents of development, have been highly leveraged. This to some degree will limit their ability to finance further infrastructure projects, as they are bound to comply with existing loan covenants.

For years, SOEs have focused on increasing their financing capacity through creative financing schemes, including innovation through capital market instruments, to find alternative funding other than bond issuance and bank loans. Instruments that are quite popular in the capital markets include securitization of future cash flow through collective investment contracts (KIK), perpetual bonds, and project bonds. Each of these instruments has its own characteristics, including how it will be presented on the balance sheet. Asset monetization, either through divestment or new investor participation through a limited participation mutual funds (RDPT) or infrastructure investment funds (DINFRA), can also provide infrastructure financing solutions while allowing fundraisers to strengthen their capital structure.

Since 2017, state-owned toll road operator PT Jasa Marga (Persero) Tbk (JSMR, *idAA/stable*) has issued a number of alternative financing instruments to help fund its toll road projects, such as the Jakarta-Bogor-Ciawi (Jagorawi) toll road securitization (EBA Mandiri JSMR01, *idAAA/Stable*), project bonds, equity-based RDPT, and DINFRA. JSMR's project bond, rated *idAAA/Stable*, was issued by PT Marga Lingkar Jakarta, the operator of the W2 North (Ulujami-Kebon Jeruk) section of the Jakarta Outer Ring Road (JORR), with the bond proceeds used to refinance syndicated bank loans that were utilized for project construction. We are of the view that this type of bond offers a greater degree of financial flexibility for JSMR, as a project bond's principal repayment and tenor can be tailored to align with the project's cash flow. Both securitization on

mature toll road sections and project bonds can help reduce the average cost of debt due to the instruments' higher ratings, translating to lower costs of funds and reducing exposure to interest rate volatility as the coupon rate is fixed.

The national flag carrier, PT Garuda Indonesia (Persero) Tbk, and the state-owned electricity company, PT Perusahaan Listrik Negara (Persero) (PLN, *idAAA/Stable*), through its wholly-owned subsidiary, PT Indonesia Power (*idAAA/Stable*), also issued asset-backed securities under KIK to fund business expansions, with the former securitizing future revenue from ticket sales for flights from Middle Eastern routes connecting several cities in Indonesia to Jeddah and Medina totaling IDR2 trillion (EBA Mandiri GIAA01, *idAA+/stable*), and the latter securitizing future cash flow from component-A receivables from PLN to Indonesia Power of nearly IDR5 trillion (EBA Danareksa Indonesia Power PLN1, *idAAA/Stable*). The Jeddah and Medina routes are one of Garuda's most formidable routes thanks to the high demand from *umrah* pilgrimages while Indonesia Power's component-A is the cost of capital recovery calculated based on a net capability capacity at the level of a particular unit or power plant readiness. It consists of depreciation cost of productive assets, corporate tax, and cost of funds to invest the asset.

These securitization instruments are classified as other liabilities on the balance sheet (deferred revenue for JSMR and Garuda), which do not increase the issuer's gearing, thus providing some financial headroom. However, in assessing a company's financial risk profile, particularly capital structure, PEFINDO categorizes these liabilities as debt. PEFINDO made this adjustment because we believe that the nature of such transaction is similar to that of a collateralized borrowing. Many of the assets securitized represent some of the best assets and are regenerated in the ordinary course of business, therefore, needed to be financed on an ongoing basis.

### **Hybrid capital instruments**

Two state-owned contractors, PT Pembangunan Perumahan (Persero) Tbk (PTPP, *idA+/stable*) and PT Wijaya Karya (Persero) Tbk, successfully issued perpetual bonds, the former rated *idA-*, two notches below PTPP's corporate rating due to the bond's structurally subordinated characteristic with full discretion in coupon deferral. Perpetual bonds have no maturity date, which makes them similar in nature to equity instruments that pay dividends, rather than fixed-coupon or debt instruments. Thus, perpetual bonds are often termed hybrid instruments as they have the features of both debt and equity. Perpetual bonds address the problem of having cost-efficient funding in the form of liability, without having to add any financial pressure or reduce the financial flexibility of the issuer. The issuer may also expect to enhance its capital structure profile by substituting its debt with perpetual bonds.

In PEFINDO's analysis, we will make adjustment on the hybrid instruments based on our determination of their equity content. Where a hybrid instrument exhibits major characteristics of common equity, this will enhance the issuer's capital structure as it will be excluded from the adjusted debt and the interests or dividends are treated as dividends. For hybrid instruments with intermediate equity content, 50% of the principal will be treated as debt and the remaining half will be treated as equity, this is despite the fact that accounting standards may classify the instrument as 100% equity. This also applies in the calculation of interest expense. While hybrid instruments with no equity content are treated as debt and all interest or dividends are treated as interest.

#### DISCLAIMER

Peringkat yang dimuat dalam laporan atau publikasi ini adalah pendapat PT Pemeringkat Efek Indonesia (PEFINDO) yang diberikan berdasarkan hasil pemeringkatan pada saat tanggal dibuatnya peringkat. Peringkat merupakan opini ke depan mengenai kemampuan pihak yang diperingkat dalam memenuhi kewajiban finansialnya secara penuh dan tepat waktu, berdasarkan asumsi yang dibuat saat pemberian peringkat. Peringkat bukan merupakan rekomendasi bagi pemodal untuk mengambil keputusan investasi (baik keputusan untuk membeli, menjual, atau menahan efek utang apapun yang diterbitkan berdasarkan atau berhubungan dengan peringkat atau keputusan investasi lainnya) dan/atau opini atas nilai kewajaran efek utang dan/atau nilai entitas yang diberikan peringkat oleh PEFINDO. Semua data dan informasi yang diperlukan dalam proses pemeringkatan diperoleh dari pihak yang meminta pemeringkatan yang dianggap dapat dipercaya keakuratan dan kebenarannya dan dari sumber lain yang dianggap dapat diandalkan. PEFINDO tidak melakukan audit, uji tuntas, atau verifikasi secara independen dari setiap informasi dan data yang diterima dan digunakan sebagai dasar dalam proses pemeringkatan. PEFINDO tidak bertanggung jawab atas kebenaran, kelengkapan, ketepatan waktu, dan keakuratan informasi dan data yang dimaksud. Keakuratan dan kebenaran informasi dan data menjadi tanggung jawab sepenuhnya dari pihak yang memberikan informasi dan data yang dimaksud. PEFINDO dan setiap anggota Direksi, Komisaris, Pemegang Saham, serta Karyawannya tidak bertanggung jawab kepada pihak manapun atas segala kerugian, biaya-biaya dan pengeluaran yang diderita atau timbul sebagai akibat penggunaan isi dan/atau informasi dalam laporan atau publikasi ini, baik secara langsung maupun tidak langsung. PEFINDO menerima imbalan untuk jasa pemeringkatan umumnya dari pihak yang meminta dilakukannya jasa pemeringkatan, dan PEFINDO sudah menginformasikan biaya pemeringkatan sebelum penetapan peringkat. PEFINDO memiliki komitmen dalam bentuk kebijakan dan prosedur untuk menjaga obyektivitas, integritas, dan independensi dalam proses pemeringkatan. PEFINDO juga memiliki code of conduct untuk menghindari benturan kepentingan dalam proses pemeringkatan. Peringkat bisa berubah di masa depan karena peristiwa yang belum diantisipasi sebelumnya pada saat peringkat diberikan pertama kali. PEFINDO berhak menarik peringkat jika data dan informasi yang diterima tidak memadai dan/atau perusahaan yang diperingkat tidak memenuhi kewajibannya kepada PEFINDO. Atas peringkat yang sudah mendapat persetujuan publikasi dari pihak yang diperingkat, PEFINDO berhak untuk mempublikasikan peringkat dan analisisnya dalam laporan atau publikasi ini serta mempublikasikan hasil kaji ulang terhadap peringkat yang telah dipublikasikan, baik secara berkala maupun secara khusus dalam hal terdapat fakta material atau kejadian penting yang dapat mempengaruhi hasil pemeringkatan sebelumnya. Reproduksi isi publikasi ini, secara penuh atau sebagian, harus mendapat persetujuan tertulis dari PEFINDO. PEFINDO tidak bertanggung jawab atas publikasi yang dilakukan oleh pihak lain terkait peringkat yang diberikan oleh PEFINDO.