

## RATING ACTION COMMENTARY

### Fitch Affirms Sime Darby Plantation at 'BBB'; Outlook Stable

Mon 25 Mar, 2024 - 1:35 AM ET

Fitch Ratings - Singapore - 25 Mar 2024: Fitch Ratings has affirmed Sime Darby Plantation Berhad's (SDP) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook. Fitch also affirmed SDP's senior unsecured rating and the rating on subsidiary Sime Darby Plantation Global Berhad's sukuk programme at 'BBB'.

SDP's position as the world's largest oil palm plantation group by planted area and its large refining operations, robust sustainability credentials and healthy financial access underpin the group's credit profile. However, high production costs weigh on its business profile.

We estimate SDP's EBITDA leverage (total debt/EBITDA), including 50% equity credit to its perpetual sukuk, will increase to close to 3.0x by 2025, from 2.2x in 2023. Our forecast is driven by our expectation of a decline in crude palm oil (CPO) prices, which is likely to overshadow the benefit from higher output and lower production costs, and result in lower EBITDA.

SDP's rating headroom is low, based on our leverage forecast. However, we expect the group to manage its operating costs, capex and dividends, such that its leverage remains consistent with the rating through the CPO price cycle.

## KEY RATING DRIVERS

**Large Scale, Vertical Integration:** SDP has oil palm planted acreage of close to 570,000 hectares, with about 50% in Malaysia, 33% in Indonesia and the rest in Papua New Guinea and the Solomon Islands (PNG/SI). SDP also has around 4.0 million tonnes (t) of annual CPO refining capacity in several countries. The large scale and geographical spread give SDP robust customer access, and mitigate regulatory and weather-related risks. Significant refining and other downstream operations also reduce the impact of volatile CPO prices on margins, while allowing SDP to earn profits across the value chain.

**Yields to Improve:** We expect overall fresh fruit bunch (FFB) yield to jump by 12% in 2024, driven by sustained recovery in Malaysia. Yield rose by 8% in 2023 on ebbing labour shortages in Malaysia. However, the increase was weaker than we expected, with yields in Indonesia and PNG/SI declining marginally. Extreme weather, with flooding in early 2023 and dry weather in the latter half, affected yields. We forecast yield to improve by 1%-2% in 2025-26, supported by the maturing of SDP's immature and young acreage, which comprises 42% of the total planted area.

**Costs Likely to Moderate:** SDP's consolidated FFB production unit cash cost rose to over USD90/t in 2022, and remained at that level in 2023. Production cost was above our expectation in 2023 due to rehabilitation costs in Malaysia and flooding and weaker yields in Indonesia and PNG/SI. However, we expect the cash cost to fall significantly in 2024, on the completion of rehabilitation in Malaysia by 1H24, lower fertiliser costs and higher yield. Nonetheless, SDP's costs will remain high and weigh on its business profile. We also see the risk of cost improvement being weaker than we expect.

**Lower Prices to Impact Leverage:** We expect CPO prices to weaken from 2Q24, supported by latest forecasts of a dissipation of the dry-weather-inducing El Nino pattern by 1H24 and lower fertiliser costs. Weaker CPO prices, along with higher dividends and capex in 2024, should result in higher EBITDA leverage. The impact on SDP's financial metrics is likely to be mitigated by higher yields, lower unit production costs, net working-capital reduction and inflows from further asset sales. We estimate leverage to increase to 2.5x by 2024 and 2.9x by 2025, from 2.2x as of 2023.

**Divestments to Offset Negative FCF:** We estimate SDP's free cash flow (FCF), based on deduction of capex and dividends from cash flow from operations, to remain negative in 2024-2025. SDP's dividend outflow in 2024 will jump due to a special dividend declared out of divestment gains in 2023. SDP's 2024 capex will also increase due to spending on a new refinery in Indonesia. We expect SDP to reduce dividends and capex in 2025 if CPO prices weaken as we expect, but lower EBITDA is likely to pressure its FCF profile.

Despite negative FCF, we do not expect debt to increase over 2024-2025. SDP's cash flow should benefit from sustained divestment proceeds, driven by the sale of land in Malaysia. Given the recurring nature of inflows from asset sales, which SDP uses to manage its capex, dividends, debt and leverage profile, we no longer consider sustained negative FCF as a driver for negative rating action.

**Robust Sustainability Credentials:** SDP is the world's largest producer of Roundtable on Sustainable Palm Oil (RSPO) certified sustainable palm oil (CSPO), contributing around 15%

of the global supply. SDP's adherence to global sustainability standards, such as those by RSPO, gives it better access to developed markets, where customers are willing to pay a premium for such credentials. It also reduces long-term risk to operations from regulatory changes and conflicts with labour and local communities.

**Solid Financial Access:** Permodalan Nasional Berhad (PNB), which is a Malaysian government-controlled fund management company, and its various funds together own more than 55% of SDP. We think SDP's ownership and its robust business profile grant it very strong access to domestic banks and investors. This mitigates risks related to liquidity and refinancing, even during industry downturns. SDP refinanced around MYR2.6 billion of debt in late 2023 with the help of several Malaysian banks.

## **DERIVATION SUMMARY**

SDP is rated close to the upper end of the sector risk profile band in Fitch's navigator for palm oil companies, reflecting operating strengths in terms of a very large and diversified plantation acreage, healthy vertical integration due to significant refining capacity, robust sustainability credentials and a relatively young tree age profile. SDP's rating also incorporates a modest leverage, which we forecast will rise in the next two years, robust coverage and access to diverse funding sources. These are balanced against its high FFB production costs.

Beyond palm oil, SDP's rating can also be compared with those of agricultural commodity processing and trading companies such as Bunge Global SA (BBB/Rating Watch Positive) and Cargill Incorporated (A/Stable). Bunge's and SDP's ratings benefit from their large scale of operations and geographical diversification. SDP is significantly smaller than Bunge in terms of EBITDA size, although its margins are considerably higher due to vertically integrated operations. Cargill's higher rating reflects a substantially larger EBITDA scale and greater product diversification, in addition to its lower adjusted leverage of less than 2.0x.

## **KEY ASSUMPTIONS**

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Average Malaysian benchmark spot CPO price of USD700/tonne (t) in 2024 and 2025, and USD650/t in 2026;
- CPO production to jump by 10% in 2024 and stay broadly flat until 2026;

- Annual capex of MYR2.4 billion in 2024, MYR2.0 billion in 2025 and MYR1.6 billion in 2026;
- Total proceeds from divestments of MYR1.9 billion over 2024-2026;
- Dividend payments of MYR1.1 billion in 2024, and totalling MYR650 million over 2025-2026.

## **RATING SENSITIVITIES**

### **Factors that could, individually or collectively, lead to positive rating action/upgrade:**

- We do not anticipate positive rating action over the medium term on account of SDP's high production costs and FCF profile. However, Fitch may consider positive action if SDP maintains EBITDA leverage (total debt with equity credit/EBITDA) below 1.5x on a sustained basis.

### **Factors that could, individually or collectively, lead to negative rating action/downgrade:**

- EBITDA leverage above 3.0x on a sustained basis.

## **LIQUIDITY AND DEBT STRUCTURE**

**Healthy Liquidity:** SDP reported MYR5.3 billion of total borrowings and MYR830 million of cash as of end-2023. Of the total debt, MYR1.7 billion is due in 2023, which comprises almost entirely of revolving credit facilities. Thereafter, we estimate SDP has term loan maturities of around MYR300 million in 2025 and around MYR450 million in 2026.

We expect roll-over or refinancing of revolving credit facilities, as is usually the case. We estimate that SDP's cash balance and divestment proceeds should enable it to repay the term loans due in 2025 and 2026. However, the group's robust financial access makes refinancing of a significant portion of maturing debt more likely.

## **ISSUER PROFILE**

SDP is the world's largest oil palm plantation group in terms of planted acreage, with an output of 2.2 million tonnes of CPO in 2023. It has a large refining capacity for processing CPO into products such as cooking oil, margarine, biodiesel and oleochemicals. SDP generated an EBITDA of over USD650 million in 2023.

## **SUMMARY OF FINANCIAL ADJUSTMENTS**

Material financial adjustments include:

- SDP's perpetual sukuk has been treated as debt (MYR2.2 billion) and 50% equity credit has been assigned to it. Fitch has assumed permanence of these subordinated securities, given the company's intention stated in the offering circular to maintain the instrument at least until 2046, their relatively low cost and the flexibility it provides SDP of coupon deferral on a cumulative basis. Distributions on perpetual sukuk have been treated as interest expense.

- Items such as impairment losses, write-offs, fair value changes, foreign exchange and hedging gains and losses, and dividends received have been excluded from EBITDA.

- Outstanding off-balance sheet amount for receivables factored has been added to reported debt, and financial guarantees have been treated as off-balance sheet debt.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

<https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

## RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡	PRIOR ⚡
Sime Darby Plantation Berhad	LT IDR    BBB Rating Outlook Stable Affirmed	BBB Rating Outlook Stable

senior unsecured

LT

BBB

Affirmed

BBB

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Sime Darby Plantation  
Global Berhad

senior unsecured

LT

BBB

Affirmed

BBB

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[VIEW ADDITIONAL RATING DETAILS](#)

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## **APPLICABLE CRITERIA**

[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)

[Sukuk Rating Criteria \(pub. 13 Jun 2022\)](#)

[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 14 Oct 2023\) \(including rating assumption sensitivity\)](#)

[Corporate Rating Criteria \(pub. 04 Nov 2023\) \(including rating assumption sensitivity\)](#)

[Sector Navigators – Addendum to the Corporate Rating Criteria \(pub. 04 Nov 2023\)](#)

## **APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

[Corporate Monitoring & Forecasting Model \(COMFORT Model\), v8.1.0 \(1\)](#)

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Sime Darby Plantation Berhad

EU Endorsed, UK Endorsed

Sime Darby Plantation Global Berhad

EU Endorsed, UK Endorsed

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