



RATING ACTION COMMENTARY

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

Mon 27 Mar, 2023 - 6:17 AM ET

Fitch Ratings - Singapore - 27 Mar 2023: 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, with large refining operations and robust sustainability credentials, underpins its credit profile. However, we think its 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 around 3.0x by 2024, from 1.7x in 2022, substantially reducing the rating headroom. Our forecast is driven by our expectation of a decline in prices of crude palm oil (CPO), which is likely to overshadow the benefit from higher output. SDP's capex is also likely to jump in 2023, but we expect the company to reduce it thereafter to mitigate the impact of a weaker EBITDA on its free cash flow (FCF) profile.

SDP has achieved its 2023 leverage target of net debt/equity of 30% in 2022. However, we expect the company to focus on further deleveraging by managing its operating costs, capex and dividends, which should help it to maintain credit metrics consistent with the rating through the CPO price cycle.

KEY RATING DRIVERS

Large Scale, Vertical Integration: SDP has oil palm planted acreage of about 580,000 hectares, with 51% in Malaysia, 33% in Indonesia and the rest in Papua New Guinea and the Solomon Islands (PNG/SI). SDP also has around 3.7 million tonnes (t) of annual refining capacity in several countries to process CPO. The large scale and geographical spread give SDP robust customer access, and mitigates 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 Poised to Jump: Fitch estimates SDP's total fresh fruit bunch (FFB) output will rise by 15% in 2023, driven by adequate labour availability in Malaysia, favourable weather conditions and a maturing acreage. We expect yields to rise further in 2024. SDP's average FFB yield fell by 10% in 2022 to 16.6t per hectare of mature acreage. SDP's yields in Malaysia fell by 24%, which offset gains in Indonesia and PNG/SI. Output in Malaysia was hit by a shortage of foreign workers since 2020, but the situation has been improving since 4Q22, and SDP expects it to be resolved by 1H23.

Costs Likely to Moderate: SDP's consolidated FFB production unit cash cost jumped to over USD90/t in 2022, due to higher fertiliser and labour costs, amid lower yields in Malaysia. We expect the cost to drop in 2023 on higher yields and lower fertiliser and logistics costs. SDP is seeking to increase mechanisation at its Malaysian estates to reduce its workforce by 55%, mostly in non-harvesting activities, by end-2023. This should help SDP cut costs further, and we assume unit cash cost will fall to about USD75/t in 2024. However, we think SDP's costs will remain high, weakening its business profile.

Robust Sustainability Credentials: SDP is the world's largest producer of Roundtable on Sustainable Palm Oil (RSPO) certified sustainable palm oil (CSPO), contributing 15% of the global supply in 2021. All of SDP's mills are RSPO certified, and it aims for 100% estate certification by 2023. 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.

An overhang on SDP's reputation was removed when the US Customs and Border Protection modified its earlier finding of forced labour against the company in February 2023, allowing it to resume exports to the US. This followed efforts by SDP to improve its labour sourcing and management practises.

Healthy Industry Fundamentals: Oil palm has the highest productivity among oilseed crops, based on tonnage of oil produced per hectare. This underpins the palm oil industry's competitive advantage relative to substitute vegetable oils, and allows producers to generate healthy CFO even when CPO prices are weak. We expect CPO demand to be buoyant in the next decade due to increasing edible oil consumption in various emerging markets and higher biodiesel use in Indonesia and Malaysia.

Capex Likely to Increase: We expect SDP's capex to increase from 2023 due to projects, such as its new refinery in Indonesia and those related to worker welfare and carbon footprint reduction, apart from regular planting and maintenance. However, we think SDP can delay the projects if CPO prices fall sharply, lowering its capex to around MYR1.5 billion (2023E: MYR3 billion). This, in addition to lower dividends based on a pay-out ratio of at least 50% of recurring net profit, should reduce the impact of low CPO prices and allow it to maintain neutral or positive FCF over a five- to six-year price cycle.

Higher Leverage, Negative FCF Forecast: We think CPO prices will weaken significantly from 2H23, due to higher supply of CPO and other competing vegetable oils, which will raise SDP's leverage and turn its FCF negative over 2023-2024. The price impact should be mitigated by higher yields, lower unit production costs, net working-capital reduction and substantial inflows from further asset sales. We see higher-than-expected costs and dividends, and delays in asset divestments, as key risks to our forecast and SDP's rating.

SDP's EBITDA and leverage in 2022, based on unaudited full-year results, were in line with Fitch's expectations. SDP benefitted from higher-than-expected CPO prices and lower-than-estimated capex, but these factors were offset by a jump in production costs, weaker yields and higher dividends.

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 benefits from a modest leverage, high coverage and access to diverse funding sources. These strengths are offset to some extent by its high FFB production costs and a weak FCF profile.

Beyond palm oil, SDP's rating can also be compared with those of agricultural commodity processing and trading companies such as Bunge Limited (BBB/Positive) and Cargill Incorporated (A/Stable). Bunge's and SDP's ratings benefit from their large-scale and geographical diversification. Fitch expects both companies to maintain modest

leverage profiles. 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 larger operational scale and greater product diversification, in addition to its lower leverage of around 1x.

KEY ASSUMPTIONS

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

- Average Malaysian benchmark spot CPO price of USD850/tonne (t) in 2023, USD600/t in 2024 and USD650/t in 2025;
- CPO production to jump by 14% in 2023 and 10% in 2024, stay flat in 2025;
- Average annual capex of MYR2.2 billion for 2023-2025;
- Total proceeds from divestments of MYR2.5 billion over 2023-2025;
- Average annual cash dividends of around MYR600 million for 2023-2025.

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;
- Prolonged negative FCF.

We have switched to using total debt/EBITDA based leverage sensitivities, from those based on net debt, to better account for SDP's group structure. Significant cash is generated by operating subsidiaries outside Malaysia, which is subject to taxation upon upstreaming as dividends. Therefore, a small portion of its consolidated cash may not be available for debt servicing within the group.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

LIQUIDITY AND DEBT STRUCTURE

Financial Access Supports Liquidity: SDP reported MYR6.1 billion of total debt and MYR635 million of cash as of end-2022. Of the total debt, MYR2.5 billion is due in 2023 and we estimate it includes maturities of long-term debt of around MYR800 million, apart from short-term debt facilities related to working capital. We also estimate SDP has long-term debt maturities of around MYR2.5 billion in 2024, mainly towards the end of the year.

We expect roll-over or refinancing of short-term facilities, as is usually the case. We think that SDP's cash balance, FCF and divestment proceeds will be sufficient to repay the long-term debt due in 2023. We also expect SDP to refinance a significant portion of the debt due in 2024 well in advance, helped by its robust financial access.

ISSUER PROFILE

SDP is the world's largest oil palm plantation group in terms of planted acreage, with an output of 2.1 million tonnes of CPO in 2022 and a large refining capacity for processing CPO into products such as cooking oil, margarine, biodiesel and oleochemicals. SDP generated an EBITDA of USD1 billion in 2022.

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 stated intention 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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Sime Darby Plantation Berhad	LT IDR	BBB Rating Outlook Stable		BBB Rating Outlook Stable
	Affirmed			
senior unsecured	LT	BBB	Affirmed	BBB
Sime Darby Plantation Global Berhad				
senior unsecured	LT	BBB	Affirmed	BBB

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)
\(including rating assumption sensitivity\)](#)[Sukuk Rating Criteria \(pub. 13 Jun 2022\)](#)

[Sector Navigators: Addendum to the Corporate Rating Criteria \(pub. 29 Oct 2022\)](#)

[Corporate Rating Criteria \(pub. 29 Oct 2022\) \(including rating assumption sensitivity\)](#)

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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EU Endorsed, UK Endorsed

Sime Darby Plantation Global Berhad

EU Endorsed, UK Endorsed

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