



## RATING ACTION COMMENTARY

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

Tue 29 Mar, 2022 - 4:57 AM ET

Fitch Ratings - Singapore - 29 Mar 2022: 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 ratings on subsidiary Sime Darby Plantation Global Berhad's sukuk programme. A full list of rating actions is below.

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 it has an average plantation yield profile and high production costs weigh on its business profile.

SDP's net debt to EBITDA leverage, including 50% equity credit to its perpetual sukuk, almost halved to around 1.5x in 2021, as high CPO prices led to a jump in EBITDA. We expect CPO prices to decline on higher industry supply, increasing SDP's leverage in the next 2-3 years. SDP's capex is also likely to increase during this period due to spending on projects. Nonetheless, we expect SDP's leverage profile will remain consistent with its rating.

## KEY RATING DRIVERS

Large Scale, Vertical Integration: SDP has planted acreage of around 580k hectares, of which roughly 50% is in Malaysia, 33% in Indonesia and the rest in Papua New Guinea

and the Solomon Islands. SDP also operates 11 refineries across several countries, and its total refining capacity is more than sufficient to process its CPO output.

The company's large scale and geographical spread of operations not only allows it better access to customers globally, but also mitigates risks from changes in regulations and weather-related events. Significant refining and other downstream operations also reduce the impact of volatile CPO prices on margins while allowing SDP to earn profits across the palm oil value chain.

**Flat Yields, Higher Costs in 2022:** SDP's yield of fresh fruit bunches (FFB) fell by 8% in Malaysia in 2021, which negated growth in other regions. Productivity in Malaysia may weaken further in 2022 on an acute shortage of foreign labour, which is unlikely to improve before 2H22. However, we expect sustained yield improvement elsewhere to largely offset weakness in Malaysia. SDP's FFB production cash cost - relatively high at over USD60/tonne - should increase further in 2022 on higher fertiliser and labour costs.

**Better Yields, Lower Unit Cost in 2023:** We expect yields to improve significantly in 2023, driven by a return of foreign workers to Malaysia and favourable weather, leading to lower unit production cost.

**Increased Capex Likely:** We expect SDP's capex to pick-up from 2022, as the group expands downstream capacity and continues spending on replanting. Indonesia has taken steps to encourage downstream processing of palm oil through a differential levy structure, and additional refining capacity in the country should allow SDP to benefit from lower feedstock costs. Accelerated replanting of acreage with higher-yielding seeds has helped the group reduce the average tree age to around 12 years, from 13 years in 2016, and such efforts are likely to continue.

**Asset Disposals to Support Debt Reduction:** We estimate SDP's debt will continue to decline over the next 2-3 years, helped by cash inflows from sale of land in Malaysia and weak-performing or non-core assets elsewhere. However, we forecast net debt/EBITDA leverage to increase to 2.5x by 2024, on lower EBITDA, based on our assumption of substantially lower CPO prices in 2023-2024.

An increase in capex for expansion projects could result in SDP's free cash flow (FCF) turning neutral to negative over the next three years, based on our estimate of lower EBITDA. Even so, we expect SDP to manage its capex prudently over the longer term such that it maintains a neutral or positive FCF profile.

**Event Risk from Litigation:** SDP is also facing a lawsuit in Indonesia for MYR1.7 billion from a company interested in buying certain assets in the country, for not selling those to them. The penalty sought could cause SDP's leverage to increase by more than 0.5x over the longer term, delay asset sales and weaken its credit profile. However, we treat this as an event risk given significant uncertainties regarding the outcome of the case. SDP is of the view that it has sufficient legal basis to defend itself.

**ESG - Labour Relations & Practices:** SDP has an ESG Relevance Score of '4' for Labour Relations & Practices. The United States Customs and Border Protection (USCBP) issued a Notice of Finding against SDP for use of forced labour in January 2022, following its earlier Withhold Release Order in December 2020, authorising seizure of its products in the US. SDP's exports to the US formed less than 1% of total revenue before the USCBP action, and dealings with other customers and financial institutions have been largely unaffected so far. However, a lengthy delay in resolution could affect SDP's reputation, exports and financial access.

SDP has taken several steps to address any shortcomings in its labour practises and we expect the issue to be resolved within the next 12-15 months, which would also lead to a lower ESG Relevance Score. We assess the risk of the issue prolonging or worsening to be low, given SDP's longstanding commitment to sustainability and 100% certification of its operations by the Roundtable on Sustainable Palm Oil (RSPO).

## **DERIVATION SUMMARY**

SDP is rated at the same level as global commodity trading and processing company Bunge Limited (BBB/Stable), and significantly higher than palm-oil producer PT Tunas Baru Lampung Tbk (TBLA, B/Stable).

Bunge's and SDP's ratings benefit from their large-scale and geographical diversification. Fitch expects both companies to maintain a modest leverage profile. SDP is significantly smaller than Bunge in terms of EBITDA size, although its margins are considerably higher due to vertically integrated operations.

SDP's higher rating compared with TBLA's reflects its significantly stronger operating and financial profile. SDP's planted acreage is more than 10x that of TBLA's and is spread across multiple countries. This lowers weather and regulatory risks relative to TBLA's operations, which are entirely in Indonesia. SDP has better access to product and financial markets, as TBLA is hampered by the lack of RSPO certification. SDP's credit profile also benefits from lower leverage and considerably higher coverage.

## **KEY ASSUMPTIONS**

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

- Average Malaysian benchmark spot CPO price of USD1,000/tonne (t) in 2022, USD700/t in 2023 and USD600/t in 2024;
- CPO production CAGR of 3% over 2022-2024;
- Average annual capex of MYR2.1 billion for 2022-2024;
- Total proceeds from divestments of MYR1.8 billion over 2022-2024;
- Average annual cash dividends of around MYR900 million for 2022-24.

## **RATING SENSITIVITIES**

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

- We do not anticipate positive 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 net debt (with equity credit)/EBITDA leverage below 1.0x and funds flow from operations (FFO) net leverage below 1.5x on a sustained basis.

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

- Net debt (with equity credit)/EBITDA leverage above 2.5x on a sustained basis;
- FFO net leverage above 3.0x on a sustained basis;
- Prolonged negative FCF.

## **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**

**Adequate Liquidity:** SDP reported MYR6.3 billion of total debt and around MYR590 million of cash as of end-2021. Of the total debt, MYR2.2 billion is due in 2022 and we estimate it includes maturities of long-term debt of around MYR650 million, apart from short-term debt facilities related to working capital. Beyond 2022, we estimate SDP has long-term debt maturities of around MYR800 million in 2023 and MYR2.3 billion in 2024, including about MYR500 million of multi-currency sukuk notes due in January 2023.

We expect roll-over or refinancing of short-term facilities, as is usually the case. We estimate that SDP's cash balance, FCF and divestment proceeds will be sufficient to repay the long-term debt due in 2022-2023. 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 2.4 million tonnes in 2021. Refining capacity of 3.7 million tonnes is spread across multiple countries, processing products such as cooking oil, margarine, biodiesel and oleochemicals. SDP is also the world's largest producer of certified sustainable palm oil, supplying about 20% of the global output.

## **SUMMARY OF FINANCIAL ADJUSTMENTS**

Material financial adjustments include the treatment of SDP's perpetual sukuk as debt (MYR2.2 billion) and assignment of 50% equity credit to it. Fitch has assumed permanence of these subordinated securities, given a 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.

## **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**

SDP has an ESG Relevance Score of '4' for Labour Relations & Practices due to an unresolved notice against it by the US customs for use of forced labour, which could affect its dealings with customers and financial institutions. This has a negative impact on the credit profile and is relevant to the ratings in conjunction with other factors.

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](http://www.fitchratings.com/esg)

## RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕	PRIOR ↕
Sime Darby Plantation Global Berhad		
senior unsecured	LT BBB Affirmed	BBB
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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**APPLICABLE CRITERIA**[Corporate Hybrids Treatment and Notching Criteria \(pub. 12 Nov 2020\)](#)[Sukuk Rating Criteria - Effective from 15 February 2021 to 13 June 2022 \(pub. 16 Feb 2021\)](#)[Corporates Recovery Ratings and Instrument Ratings Criteria \(pub. 09 Apr 2021\)  
\(including rating assumption sensitivity\)](#)[Corporate Rating Criteria - Effective from 15 October 2021 to 28 October 2022 \(pub. 16 Oct 2021\) \(including rating assumption sensitivity\)](#)[Sector Navigators - Addendum to the Corporate Rating Criteria - Effective from 15 October 2021 to 15 July 2022 \(pub. 16 Oct 2021\)](#)**APPLICABLE MODELS**

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

Corporate Monitoring &amp; Forecasting Model (COMFORT Model), v7.9.0 (1)

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EU Endorsed, UK Endorsed

Sime Darby Plantation Global Berhad

EU Endorsed, UK Endorsed

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