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PT Pelabuhan Indonesia II (Persero)

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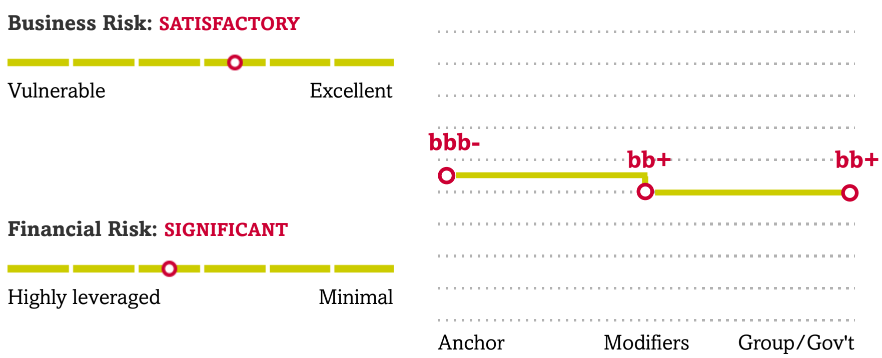
PT Pelabuhan Indonesia II (Persero)



CORPORATE CREDIT RATING

BB+/Positive/--

ASEAN Regional Scale

axBBB+/--/--

Rationale

Business Risk: Satisfactory	Financial Risk: Significant
• Solid and sustainable competitive advantage in a large and growing port concession area in Indonesia • Stable profitability thanks to a mixed port operator/ infrastructure lessor business model. • Exposure to Indonesia's high country risk. • Execution risks associated with large investments.	• High negative free operating cash flows because of high capital spending over the next three years. • Comfortable interest coverage ratios, given access to low-cost funding. • Recurring income that adds stability to projected cash flow adequacy ratios.

Outlook: Stable

The positive outlook on PT Pelabuhan Indonesia II (Persero) (Pelindo II) reflects the outlook on the sovereign credit rating on Indonesia (BB+/Positive/B; axBBB+/axA-2) and our expectation of continued government support to the company, given Pelindo II's significant role.

Downside scenario

At the current sovereign rating level, a downgrade of Pelindo II's SACP would lead to a lower corporate credit rating. We could lower the SACP if the company's FFO-to-debt ratio falls below 20%, with no prospect for improvement. This could happen if: (1) annual revenue declines by a mid- to high-single-digit level over the next two years while gross margins weaken below 50% with no prospect of recovery; (2) the company undertakes debt-funded expansion program well above our base-case forecasts; or (3) the company faces significant cost overruns and delays in its port expansion.

Upside scenario

We will raise the rating on Pelindo II following a similar action on Indonesia, provided the company's stand-alone credit profile (SACP) remains unchanged at 'bb+'. We see limited negative pressure on the SACP, reflecting our view that Pelindo II will maintain its sound competitive position in Indonesia over the next 24 months and a stable operating profile, thanks to a high share of predictable income from its joint ventures (JVs). We expect Pelindo II to maintain a ratio of funds from operations (FFO) to debt of about 25% through 2017. This is despite execution risks and additional debt related to the company's large expansion and modernization program.

Standard & Poor's Base-Case Scenario

Assumptions

- Indonesia's real GDP will grow 4.9% in 2015, increasing to 5.3% in 2016.
- Pelindo II's annual adjusted EBITDA, including royalty, lease income, and dividends from JVs, will exceed Indonesian rupiah (IDR) 3.5 trillion in 2015 and 2016.
- Annual capital expenditure will be no more than IDR7.0 trillion in 2015 and 2016.
- Capital spending will be fully funded following the issuance of US$1.6 billion in bonds in the first half of the year and no more debt raising until the second half of 2017 or early 2018.

Key Metrics

	2014A	2015E	2016E
EBITDA margin (%)	27	24-25	24-25
FFO-to-debt ratio	30.7	23-25	27-29
Debt/EBITDA	2.3	2.2-2.5	2.2-2.5
FOCF/Debt	(38.3)	Negative 2-10	Negative 30-35

EBITDA margin is reported. All other ratios are adjusted. E--Estimate. FFO--Funds from operations. FOCF--Free operating cash flows.

Company Description

Pelindo II is a port operator that the government of Indonesia fully owns. Pelindo II operates multi-ports domestically, including Indonesia's largest port Tanjung Priok.

Business Risk: Satisfactory

Pelindo II's sustainable market position and the competitive advantage of the company's major ports underpin the company's business risk profile. Pelindo II controls the Tanjung Priok port complex, a major gateway to West Java, the most heavily populated area in Indonesia and a large and diversified economic center. The port complex alone is responsible for almost half of Indonesia's yearly domestic container traffic by throughput capacity. The bulk of Pelindo II's revenues also comes from origin and destination shipments. We view this segment to be less competitive, and less prone to volume risks, than the transshipment business.

Pelindo II's growing share of income from royalties, lease payments, and dividends from JVs adds predictability to the company's EBITDA, margins, and cash flows. We anticipate that royalty, lease income, and dividends from the company's JVs at Tanjung Priok and New Priok will account for more than 60% of our adjusted EBITDA forecasts through 2016. Part of the royalty and lease income is fixed, reducing exposure to volume conditions. Counterparties include Hutchison Port Holdings and Mitsui & Co. Ltd., both of which are experienced operators. We therefore view counterparty risk associated with these lease payments as limited.

Pelindo II's performance for the half year ended June 30, 2015, was mostly in line with our expectations. Despite a near 3% decline in revenue, reported EBITDA, excluding royalty, lease payments, and dividends from JVs, was about IDR863 billion, representing close to 52% of our full-year expectations. We anticipate that an upward revision in royalty and lease payments at the company's JVs (effective July 1, 2015) will materially increase the company's profit for the second half of 2015 and in 2016. The delay in handing over the first phase of the New Priok port expansion, CT-1, to the consortium with Mistui will not have a major impact on Pelindo II's 2015 EBITDA, in our view. We had built in some delays in the handover in our base case, and the shortfall from a likely handover in early 2016 will only be about US$15 million in our base case, or less than 5% of our full-year adjusted EBITDA forecast.

S&P Base-Case Operating Scenario

- Growth in container volumes at Pelindo II's Tanjung Priok port operations will be about 0.6x our GDP forecast for Indonesia in 2015, rising to about 0.8x in 2016.
- The growth in container and cargo tariffs will follow our forecast for consumer price inflation over the next two years.
- Pelindo II's revenue growth will be in mid-single digits in 2016 and 2017.
- Cost inflation will persist and reported EBITDA margins will be 24%-25%.
- The revised joint-venture agreements and the CT-1 terminal will make full-year contributions from 2016 onwards.

Peer comparison

We consider PT Pelabuhan Indonesia III (Persero) (Pelindo III: BB+/Positive/--; axBBB+/--) to be the closest peer for Pelindo II. Both companies have a sustainable market position as natural monopolies in different parts of Indonesia and have a similar scale. Both ports also have similar single-port concentration and face execution risks on large expansion plans. Pelindo II's business model is more tilted towards infrastructure lessor than Pelindo III and that provides it with additional cash flow stability. Hutchison Port Holdings Trust (BBB+/Stable/--; cnA+/--) is larger in scale than both Pelindo II and Pelindo III and also has marginally higher port diversity. OJSC Novorossiysk Commercial Sea Port (BB-/Stable/--; ruAA-/--) also has a larger scale than Pelindo II and Pelindo III but faces similarly high country risks from its operations in Russia.

Table 1

PT Pelabuhan II (Persero) -- Peer Comparison

Industry Sector: Misc. Transportation

	PT Pelabuhan II (Persero)	PT Pelabuhan Indonesia III (Persero)	Adani Ports and Special Economic Zone Ltd.	Hutchison Port Holdings Trust	OJSC Novorossiysk Commercial Sea Port
Rating as of Sep. 9, 2015	BB+/Positive/--	BB+/Positive/--	BBB-/Stable/--	BBB+/Stable/--	BB-/Stable/--
	--Average of past three fiscal years--				
(Mil. mix currency)	IDR	IDR	INR	HK$	$
Revenues	6,290,282.6	5,125,894.7	47,842.0	12,477.9	972.5
EBITDA	2,346,977.8	2,318,440.8	30,249.1	7,137.6	629.0
Funds from operations (FFO)	1,794,171.4	1,627,932.6	22,951.1	5,876.0	404.8
Capital expenditures	2,706,711.0	1,624,587.9	22,945.7	854.1	82.2
Free operating cash flow	(818,876.1)	108,725.4	(8,954.0)	4,433.7	339.4
Discretionary cash flow	(1,441,951.4)	(522,654.3)	(11,111.9)	(1,016.3)	323.9
Adjusted ratios					
EBITDA margin (%)	37.3	45.2	63.2	57.2	64.7
EBITDA interest coverage (x)	14.9	11.3	3.5	14.3	3.6
FFO cash interest coverage (x)	16.1	10.4	3.7	13.1	4.6
Debt/EBITDA (x)	1.0	0.7	6.0	3.9	3.9
FFO/debt (%)	78.3	94.5	12.6	21.3	16.6
Free operating cash flow/debt (%)	(35.7)	6.3	(4.9)	16.1	13.9
Discretionary cash flow/debt (%)	(62.9)	(30.3)	(6.1)	(3.7)	13.3

IDR--Indonesian rupiah. INR--Indian rupee. HK$--Hong Kong dollar.

Financial Risk: Significant

Pelindo II's leverage will increase in 2015 following the issuance of US$1.6 billion in bonds in the first half of the year. The issuance is larger than the US$1 billion we had anticipated. But the repayment of about IDR6.7 trillion in amortizing syndicated loans limited the increase in net debt to about IDR4.1 trillion as of June 30, 2015, compared with about IDR3.6 trillion as of Dec. 31, 2014.

Notwithstanding higher debt levels, we still forecast Pelindo II's ratio of FFO to debt to average about 25% over the next three years. This level is comfortably within our "significant" financial risk profile category. We also still project a gradual increase in the company's adjusted EBITDA to about IDR4.5 trillion in 2016, from about IDR2.2 trillion in 2014. The higher EBITDA reflects the full-year effect of increased royalties and lease income fees at its joint ventures PT Jakarta International Container Terminal (JICT) and KOJA, as well as lease payments on CT-1 to an international consortium. We also expect the company's FFO interest coverage to remain above 5.0x through 2017 given the low cost of its U.S. dollar bonds--less than 5% on average.

We forecast Pelindo II's annual free operating cash flows, excluding upfront payment fees from the New Priok terminals, to be negative IDR3 trillion- negative IDR4 trillion for the next three years. That's because of the company's aggressive investment plan. While those levels are a step change compared with historical levels, the company's capital spending plan is fully funded under our base-case projections with no need for further debt until the second half of 2017 or early 2018. Pelindo II has a cash balance and short-term investments of about IDR17.3 trillion as of June 30, 2015. The company also received an additional US$255 million in upfront payment fees in July 2015. This followed the renegotiation of terms of a joint venture.

Pelindo II's exposure to the recent depreciation in the Indonesian rupiah is limited, in our view. More than 70% of the company's EBITDA is in U.S. dollars or linked to U.S. dollars, including the royalties, lease payments, and dividends from joint ventures. We estimate that EBITDA in U.S. dollars will cover the company's interest expense in U.S. dollars by more than 2.5x from 2016 onwards. We also estimate that Pelindo II also holds cash balance and short-term investments of about IDR12.8 trillion in U.S. dollars, excluding the upfront fee received in July 2015.

S&P Base-Case Cash Flow And Capital Structure Scenario

- Capital spending of IDR6 trillion-IDR7 trillion in 2016 and 2017. Capital spending could be slightly below that range in 2015, based on actual spending in the first half of 2015.
- No new debt until the second half of 2017 or early 2018.
- Dividend payout limited to about 10% of net income annually.

Financial summary

Table 2

PT Pelabuhan II (Persero) -- Financial Summary

Industry Sector: Misc. Transportation

	--Fiscal year ended Dec. 31--		
(Mil. IDR)	**2014**	**2013**	**2012**
Revenues	6,768,602.1	6,400,766.6	5,701,478.9
EBITDA	2,155,448.4	2,447,155.4	2,438,329.6
Funds from operations (FFO)	1,535,338.7	1,913,287.1	1,933,888.3
Cash flow from operations	1,988,652.9	2,111,750.1	1,563,101.5
Free operating cash flow	(1,916,495.7)	(590,223.7)	50,091.0
Discretionary cash flow	(2,733,860.0)	(1,193,430.0)	(398,564.0)
Adjusted ratios			
EBITDA margin (%)	31.8	38.2	42.8
EBITDA interest coverage (x)	7.8	25.7	23.8
FFO cash interest coverage (x)	6.6	27.7	134.1
Debt/EBITDA (x)	2.3	0.5	0.2
FFO/debt (%)	30.7	142.7	365.1
Free operating cash flow/debt (%)	(38.3)	(44.0)	9.5

IDR--Indonesian rupiah.

Liquidity: Adequate

We assess Pelindo II's liquidity as "adequate." We project the company's liquidity sources to cover liquidity uses by at least 1.2x in the 12 months. We forecast liquidity sources will exceed uses even if EBITDA declines 15%.

Principal Liquidity Sources	Principal Liquidity Uses
• Cash and equivalents of about IDR17.3 trillion as of June 30, 2015. • FFO, including upfront fee payments for CT-1 received in July 2015, of about IDR6.0 trillion over the next 12 months.	• Capital spending of IDR6 trillion-IDR7 trillion, although we acknowledge that the minimum capital spending is closer to IDR5 trillion annually. • Dividend payments of about IDR500 billion. Our assessment includes our understanding that the government would be willing to reduce dividends if needed.

Debt maturities

Table 3

PT Pelabuhan Indonesia II (Persero) -- Debt Maturities As Of June 30, 2015

	Amount (bil. IDR)
2015	--
2016	--
2017	--
2018	--

Table 3

PT Pelabuhan Indonesia II (Persero) -- Debt Maturities As Of June 30, 2015 (cont.)	
2019	
Thereafter	21,119.2

IDR--Indonesian rupiah.

Covenant Analysis

Following the repayment of its amortizing loans, Pelindo II no longer has to abide by minimum maintenance financial covenants.

Other Credit Considerations

The step-change in Pelindo II's capital spending strategy over the next decade weighs on the company's risk profile because we believe it entails substantial execution risks. Capital spending on port expansion over the next three years, in particular capacity addition at Tanjung Priok, will likely be almost double that in 2014. In our view, Pelindo II is yet to demonstrate its ability to execute the large-scale reclamation project for the subsequent phases at New Priok over the next two to three years.

Moreover, the additional capacity being built at New Priok is yet to be sub-leased. Although we understand the tendering process of some of this capacity with international operators may happen in 2015, we still believe this "build-and-they-will-come" expansion strategy comes with risks. As a result of both factors, we make a negative comparable ratings adjustment, which translates into a stand-alone credit profile of 'bb+'.

Government Influence

We view Pelindo II as a government-related entity (GRE) and the rating factors in our view of a "very high" likelihood of extraordinary support from the government of Indonesia, based on the following company characteristics:

- A "very important" role for the Indonesia government because the company manages ports that we view as strategic for the economy, given about 95% of Indonesia's goods are transported by sea. We also consider the company's operations to be well-aligned with the government's major economic policy of infrastructure improvement.
- A "very strong" link with its sole owner, the Indonesian government, which exerts substantial control on the company's strategy. We believe the government is committed to retaining a controlling stake over the next three years at least.

As per our criteria, the stand-alone credit profile does not benefit from any notch uplift from our view of a "very high" likelihood of extraordinary support from the government of Indonesia because the sovereign rating is 'BB+' currently.

Ratings Score Snapshot

Corporate Credit Rating

BB+/Positive/--

Business risk: Satisfactory

- **Country risk:** High
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/Leverage:** Significant

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Fair (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Stand-alone credit profile : bb+

- **Related government rating:** BB+
- **Likelihood of government support:** Very high (no impact)

Reconciliation

Table 4

Reconciliation Of PT Pelabuhan II (Persero) Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. IDR)

	--Fiscal year ended Dec. 31, 2014--							
PT Pelabuhan II (Persero) reported amounts								
	Debt	**Shareholders' equity**	**Revenues**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	6,889,455.9	9,591,638.0	6,406,942.1	1,730,801.3	1,266,572.7	101,815.5	1,730,801.3	1,456,278.5
Standard & Poor's adjustments								
Interest expense (reported)	--	--	--	--	--	--	(101,815.5)	--
Interest income (reported)	--	--	--	--	--	--	56,448.1	--

Table 4

Reconciliation Of PT Pelabuhan II (Persero) Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. IDR) (cont.)

Current tax expense (reported)	--	--	--	--	--	--	(379,611.9)	--
Postretirement benefit obligations/deferred compensation	591,340.4	135,276.0	--	95,105.5	95,105.5	66,673.5	7,539.4	71,090.0
Surplus cash	(2,656,825.1)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	139,682.7	(139,682.7)	--
Non-operating income (expense)	--	--	--	--	822,821.2	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	--	461,284.4
Non-controlling Interest/Minority interest	--	116,824.4	--	--	--	--	--	--
Debt - Amortized cost	182,045.6	--	--	--	--	--	--	--
Revenues - Other	--	--	361,660.0	361,660.0	361,660.0	--	361,660.0	--
EBITDA - Other	--	--	--	(32,118.4)	(32,118.4)	--	(32,118.4)	--
Interest expense - Other	--	--	--	--	--	(32,118.4)	32,118.4	--
Total adjustments	(1,883,439.1)	252,100.4	361,660.0	424,647.1	1,247,468.4	174,237.8	(195,462.6)	532,374.4
Standard & Poor's adjusted amounts								
	Debt	**Equity**	**Revenues**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	5,006,016.7	9,843,738.4	6,768,602.1	2,155,448.4	2,514,041.1	276,053.3	1,535,338.7	1,988,652.9

IDR--Indonesian rupiah.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- National And Regional Scale Credit Ratings, Sept. 22, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	**bbb-/bb+**	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of September 18, 2015)

PT Pelabuhan Indonesia II (Persero)	
Corporate Credit Rating	BB+/Positive/--
ASEAN Regional Scale	axBBB+/--/--
Senior Unsecured	BB+
Corporate Credit Ratings History	
21-May-2015	BB+/Positive/--
14-Apr-2015	BB+/Stable/--
14-Apr-2015 *ASEAN Regional Scale*	axBBB+/--/--
Related Entities	
Indonesia (Republic of)	
Issuer Credit Rating	BB+/Positive/B
ASEAN Regional Scale	axBBB+/--/axA-2
Transfer & Convertibility Assessment	BBB-
Senior Unsecured	BB+
Lembaga Pembiayaan Ekspor Indonesia (Indonesia Eximbank)	
Issuer Credit Rating	BB+/Positive/B
ASEAN Regional Scale	axBBB+/--/axA-2
Senior Unsecured *ASEAN Regional Scale*	axBBB+
Senior Unsecured	BB+
PT ANTAM (Persero) Tbk.	
Issuer Credit Rating	B-/Stable/--
ASEAN Regional Scale	axB/--/--
PT Bank Mandiri (Persero)	
Issuer Credit Rating	BB+/Stable/B
ASEAN Regional Scale	axBBB+/--/axA-2
PT Pelabuhan Indonesia III (Persero)	
Issuer Credit Rating	BB+/Positive/--
ASEAN Regional Scale	axBBB+/--/--
Senior Unsecured	BB+
PT Pertamina (Persero)	
Issuer Credit Rating	BB+/Positive/--

Ratings Detail (As Of September 18, 2015) (cont.)	
ASEAN Regional Scale	axBBB+/--/--
Senior Unsecured *ASEAN Regional Scale*	 axBBB+
Senior Unsecured	BB+
PT Perusahaan Gas Negara (Persero) Tbk.	
Issuer Credit Rating	BB+/Positive/--
ASEAN Regional Scale	axBBB+/--/--
Senior Unsecured	BB+
PT Perusahaan Listrik Negara (Persero)	
Issuer Credit Rating	BB/Positive/--
ASEAN Regional Scale	axBBB/--/--
Senior Unsecured	BB

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.