Infrastructure Financing Industry Outlook for 2022

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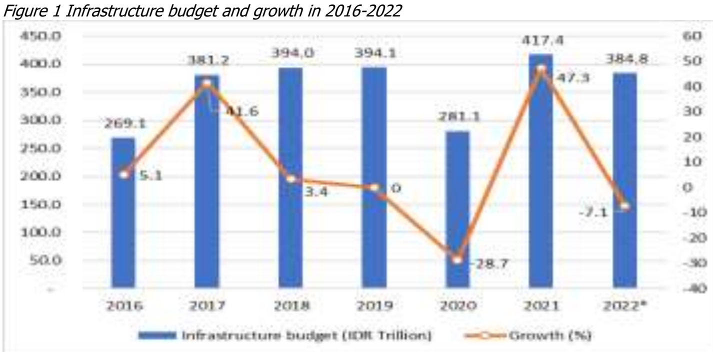
PEFINDO views Indonesia's infrastructure financing industry outlook as stable in the near to medium term, given the potentially high demand for financing for infrastructure projects. Despite the prolonged pandemic including the surging cases due to Delta variant in the third quarter of 2021, we are of the view that economic activities will gradually recover assuming the Government could maintain manageable rate of Covid-19 positive cases and continue rolling out its vaccination program. The industry's risk profile is considered low due to its pivotal role in the national economy, underpinned by a strong regulatory framework. In Indonesia, infrastructure development is critical to support industrial transformation in response to the fourth industrial revolution and to accelerate the distribution of goods and logistics, essential not only during the pandemic. Although the pandemic has altered the timeline of some infrastructure projects, we expect them to be completed eventually as the infrastructure remains one of the priorities of the Government. During the pandemic, the infrastructure financing industry remained resilience, reflected by its total financing grew by 16.3% YoY in 2020 and 11.7% YoY in 9M2021. However, we also do not dismiss the likelihood of the prolonged sluggish economic recovery to lower investors' appetite for the infrastructure sector, due to the heightening risk of project delays or budget refocusing by the Government, particularly to healthcare and economic relief programs if there are other spikes in Covid-19 positive cases due to Omicron or other variants.

Business growth potential to complement the state budget limitation

PEFINDO is of the view that infrastructure development will continue to be the government priority, with the national medium-term development plan of 2020-2024 stated the infrastructure budget of IDR6,445 trillion, whereas the Government allocated IDR2,385 trillion, accounting for only 37% of the total budget. In 2020-2024, infrastructure development focused on supporting basic services, economic development, and urban development. The sizeable financing gap between the total infrastructure budget and the Government capacity creates substantial opportunities for infrastructure financing companies to participate not only in financing state-owned enterprises' (SOEs) infrastructure projects but also for public-private partnership projects (PPP). Despite the Government's significant allocation of 10%-15% for infrastructure segment from its total state budget, the massive demand of infrastructure projects will need other sources of financing. PEFINDO has two infrastructure financing companies in its portfolio, which is PT Sarana Multi Infrastruktur (Persero) (SMI, rated "$_{id}$AAA/stable") and PT Indonesia Infrastructure Finance (IIF, rated "$_{id}$AAA/stable). During the pandemic, the Government is refocusing the budget and prioritizing the budget mainly for health sector to reduce the impact of the Covid-19 pandemic. However, this condition doesn't impact SMI and IIF as these two infrastructure financing companies continue to grow positively, although with different focuses. During the pandemic, SMI has put more focus on financing to municipals, particularly for the infrastructure development in the region to support the national economic recovery program, while IIF remains focused on business expansion, especially to push its debtors to withdraw financing facilities that had been provided before the Covid-19 era.

On the other hand, we view there are lingering challenge in finding commercially viable infrastructure projects, given the limited feasible projects. In addition, an essential assessment as a prerequisite in infrastructure projects is complying with the social and environmental (S&E) criteria, a rigorous process to minimize adverse impacts on society and the environment. The assessment includes, among others, an analysis of labor and working conditions, waste and pollution management, protection of the biological environment, the use of renewable energy, local community empowerment, and many more. We view that some of the project owners have not aware on this issue and it resulted in longer time than expected before it move to financing process. To raise the number of feasible projects, SMI and IIF have also provided project preparation and consultation services. Despite the progress made, the lengthy process to prepare the projects for commercialization has remained a challenge for potential investors and creditors. Another potentially arising issue is the settlement of administrative issues, such as permits or land acquisition, especially during the implementation of restriction of public activities, resulting in a longer time completion.

Figure 1 Infrastructure budget and growth in 2016-2022



Source: Ministry of Finance, processed by PEFINDO
**) State Budget Plan FY2022 (RAPBN 2022)*

Moderate competition with banks

The level of competition in the infrastructure financing industry is moderate with only big commercial banks and infrastructure financing companies will participate in infrastructure financing due to its sizeable funding needs and complex structure. Generally, SOE banks focus on financing SOE projects, while private banks and infrastructure financing companies focus on PPP projects. As the only financing companies focusing on infrastructure, SMI and IIF play different roles with SMI focuses on financing government or municipal projects, while IIF on private and commercial projects. In our opinion, infrastructure finance companies have a competitive advantage over commercial banks due to the more varied products offered, ranging from senior loans, junior loans, mezzanines, bond investment to equity participation. Banks, on the other side have the cost advantage given their direct access to third-party deposits, while infrastructure financing companies can only access public funds through debt issuances. Infrastructure financing companies' portfolio is expected to remain concentrated to some of infrastructure sub-sectors, particularly sub-sectors that related to basic infrastructure such as roads and electricity. In addition, the limited number of debtors with a high average financing amount is also exposed infrastructure financing companies to concentration risk. Furthermore, we view that the infrastructure project preparation process generally takes a long time before it can proceed to the next step, which is financing process.

Although we expect the demand for infrastructure financing to remain high in the near term, we view the growth as moderate, mainly due to the complexity of project requirements, undergoing many processes before being determined as feasible for financings, such as conducting a comprehensive feasibility study, preparing a complete infrastructure, including manpower and information technology, and completing all legal requirements and permits. In addition, many projects do not have a social and environmental impact assessment, a prerequisite before it is eligible for financing. Overall, we project infrastructure financing to grow moderately at 10% -15% for the next 12-24 months.

Figure 2 Infrastructure financing diversification

Source: OJK statistics, processed by PEFINDO

Strong financial profile but concentration risk remains

The financial profile of infrastructure financing companies is projected to remain robust in the near to medium term. Capitalization remains very strong, with substantial total equity of IDR40.5 trillion as of September 2021. The debt-to-equity ratio (DER) remained low at 2.2x in 9M2021 and 1.9x in FY2020, which we view as more than sufficient to support business expansion and absorb potential business risks.

Regarding the asset quality, we expect it to remain manageable given its prudent underwriting practices and high portion of creditworthy debtors such as large SOEs, private companies, and municipals which repayment sources are supported by fund transfer from central government. The profitability performance of the industry has remained robust, due to its efficient operation. We expect the operating expense to operating income ratio (BOPO) to be within the 63%-65% range in the near to medium term. Its ROAA decreased to 1.1% in 9M2021 from 1.7% in FY2020, mainly resulting from the lower interest-earning, while the interest paid increased. We expect it to recover in the near term in line with the economic recovery; thereby, boosting its new financing and raising revenue generation. Moreover, we project the asset-liability management and financial flexibility of infrastructure financing companies to remain very strong bolstered by its ample liquid assets and very strong support from the Government and shareholders. However, the industry is exposed to concentration risks, given the sizeable average financing amount. Delinquency by a few debtors may significantly aggravate the infrastructure financing companies' asset quality profile. In addition, the financing portfolio is also concentrated on few sectors, such as toll roads, electricity, telecommunication, and water.

Table 1 Infrastructure financing's financial profile

Financial profile	2016	2017	2018	2019	2020	9M2021
Total assets [IDR Trillion]	55.2	68.3	73.1	88.2	115.7	133.3
Total equity [IDR Trillion]	33.2	36.5	37.7	39.1	40.1	40.5
Debt received [IDR Trillion]	12.6	15.5	18.5	23.6	51.2	63.6
Bond issued [IDR Trillion]	8.8	15.7	15.9	24.3	23.2	27.4
Total debt [IDR Trillion]	21.5	31.2	34.4	47.9	74.4	91.0
Operating income [IDR trillion]	2.8	3.8	4.6	6.1	6.6	4.6
Operating expenses [IDR trillion]	1.2	2.3	2.9	3.9	4.1	2.9
Net income [IDR Trillion]	1.4	1.2	1.5	1.8	2.0	1.4
DER [x]	0.6	0.9	0.9	1.2	1.9	2.2
BOPO [%]	42.8	61.7	62.4	63.9	61.8	63.6
ROA [%]	2.5	1.7	2.0	2.0	1.7	1.1

Source: OJK Statistics, processed by PEFINDO