SOE Infrastructure Ratings in Focus: Two Years into the Pandemic

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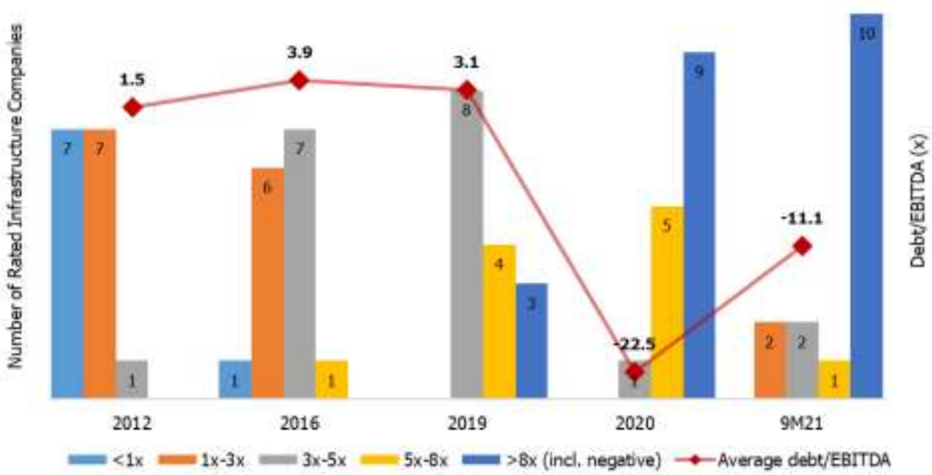
State-owned Enterprises (SOEs), particularly those providing public services, such as transportation and infrastructure, as well as state contractors, have been playing a pivotal role under President Joko Widodo's administration, since it places infrastructure as the government's top priority of the development program. To realize the government's plans, these SOEs rely heavily on external financing, resulting in weakening their balance sheets markedly. The debt of SOEs Infrastructure (including state-owned contractors) skyrocketed by nearly 1,500% between 2012 and September 30, 2021 (9M2021). However, since our rating reflects a forward-looking opinion, we have anticipated the weakening balance sheet of these SOEs into our ratings. We have only downgraded three SOEs: PT Pelabuhan Indonesia I (Persero) (Pelindo I), PT Waskita Karya (Persero) Tbk (Waskita), and PT Adhi Karya (Persero) Tbk (Adhi) during the 2013-2019 period, despite a hike in their leverage, as measured by debt-to-EBITDA, to around an average of 3.1x in 2019 from 1.5x in 2012. However, the Covid-19 pandemic hit the economy on multiple fronts, resulting in a global economic contraction of 3.1% in 2020 (IMF, October 2021 WEO). The government's focus to contain the pandemic through the adoption of mobility restriction measures has significantly aggravated the financial profile of SOE infrastructures, particularly those providing transportation services, such as toll roads, airports, and railway, during the peak of expanding their capacity, mainly through debt financing. The economic downturn impacted by the Covid-19 has also affected demand for products and services provided by SOEs. The profitability of SOE infrastructures dropped to unprecedented levels as revenues plummeted amid the rising debt for capacity and/or business expansion, weakening the leverage significantly to around an average of -22.5x in 2020 and -12.2x in 9M2021.

Figure 1. Leverage of SOE Infrastructure



Source: PEFINDO. The debt-to-EBITDA ratio was computed on 15 rated and non-rated SOE infrastructures engaged in the provision of airport, seaport, railway, toll road, housing, and construction services

The Covid-19 pandemic has posed significant challenges to the operating environment of nearly all SOE infrastructures stemming from the sluggish demand, due to health concerns related, mobility restrictions imposed by the government, and weaker purchasing power following the economic downturn, causing earnings to plunge significantly and quickly eroding their cash flows. Prior to the pandemic, we have not witnessed a prominent SOE failed to repay its debt instruments obligations promptly. State developer Perum Perumahan Nasional (Perumnas) was the first to miss its MTN's principal worth IDR200 billion due on April

28, 2020 (it was repaid later on May 8, 2020), followed by a state printing company, Perum Percetakan Negara Republik Indonesia, on its MTN's interest payment due on May 11, 2020. The liquidity of the state manufacturing company, PT Barata Indonesia (Persero) or Barata, has also come under severe pressure following delayed receivable collections from its customers and past track record of aggressive bidding; thereby, weakening its capacity to timely service its financial obligations and was only recently able to come out from Postponement of Debt Payment Obligations (PKPU) status after resolving a settlement agreement with its creditors.

The Covid-19 pandemic has also adversely impacted the construction sector. Contractors' capacity to generate sustained cash flows was prevented by the extended working capital cycle, as construction progress was delayed, and collection of receivables were lengthened. The cut in government budget allocation for infrastructure has also impacted the new contracts gained by state-contractors, diluting their revenue visibility over the near to medium term. Before the pandemic, state-contractors' new contracts growth already decelerated due to the weaker balance sheet capacity, resulting from the over aggressive new contracts' growth in 2015-2018. The budget for infrastructure spending for 2022 virtually unchanged at IDR384.8 trillion as against the revised IDR385 trillion in 2021 and well below initially anticipated at IDR450 trillion based on the 2022 macroeconomic and fiscal policy framework by the Ministry of Finance. In 2021, the government revised downward its infrastructure budget by 8% to IDR385 trillion from IDR417.4 trillion, prioritizing spending on healthcare, given the longer-than-expected impact of the Covid-19 pandemic, particularly after the resurgence of new cases, stemming from the Delta variant. In 2020, the infrastructure budget was cut by 33% to IDR281.1 trillion from IDR419.2 trillion, resulting in delays in the tender process for new infrastructure project contracts, leading to fewer contracts gained. In the first nine months of 2021 (9M2021), state contractors secured an aggregate of IDR58 trillion of new contracts, accounting for just 41% of the 2021 target. The pandemic and infrastructure budget cuts resulted in significantly lower revenue in 2020-2021. We are of the view that state contractors' ability to grow and recover post-Covid-19 will mainly depend on their leverage headroom, resting, to large extent, on their ability to recycle assets to free up capital. The total debt of state contractors amounted to IDR180 trillion as of September 30, 2021, with Waskita and PT Hutama Karya (Persero) contributing around 66% of the total state contractors' debt due to their substantial exposure to government priority projects (PSN).

Figure 2. Government Infrastructure Budget

Source: Ministry of Finance

Figure 3. SOE Contractors' New Contracts Achievement

Source: PEFINDO

Given SOE's role as an agent of development, the government's policy to support it during the pandemic has contributed to offsetting credit risks for some SOE issuers. We witnessed the government's direct support in the forms of equity injections and liquidity support, among others, through the National Economic Recovery (PEN) program. Other supports take the forms of government guarantee on bond issuance and/or loan syndication, and fiscal incentives. The parliament has approved the government's 2022 state injection budget of IDR73 trillion to SOEs, such as PT Kereta Api Indonesia (Persero) or KAI, Hutama Karya, Waskita, Adhi, and Perumnas. Though government support may vary in form and timeliness from one SOE to another, depending on their importance, we view that the support to SOE infrastructures will remain in place despite the fiscal pressure faced by the government, given the SOEs' role in keeping the pace for economic recovery post the pandemic. Most of the rated infrastructure SOEs receive multiple-notch uplift from the stand-alone credit profile based on our expectations of support from the government at a time of distress. These are SOEs that are wholly government-owned or those with government-guaranteed debt. However, during the pandemic we have also reduced the notch-uplift incorporated in the ratings of few companies to reflect our expectation of a lower likelihood of support than we previously anticipated.

In addition, the government may indirectly extend financial support through the credit market. Most of the SOEs that we rated have robust funding access, especially those with strong and credible management. We expect financial support for SOEs to come primarily from state-owned banks through debt restructuring and/or refinancing. As of September 30, 2021, the loans extended by the top three state-owned banks (PT Bank Mandiri (Persero) Tbk, PT Bank Rakyat Indonesia (Persero) Tbk, and PT Bank Negara Indonesia (Persero) Tbk accounted for around 25% of SOEs' debt. Over the near to medium term, we expect that state-owned banks will continue to support SOEs' infrastructure debt restructuring and refinancing given their relatively strong capital and liquidity.

From March 2020 to December 2021, we have lowered the rating of seven SOEs infrastructure, namely: KAI, PT Angkasa Pura I (Persero) or AP I, PT Angkasa Pura II (Persero) or AP II, PT Jasa Marga (Persero) Tbk or Jasa Marga, Perumnas, Waskita, and Barata, due to the weaker operating environment, notably the changing consumer behavior impacted by the pandemic and the deteriorating financial profile amid high debt burden. The outlook for KAI, AP I, AP II, and Perumnas are currently at negative to anticipate a weaker-than-expected financial profile, given their high sensitivity to the ongoing impact of the pandemic as well as high leverage level.

Figure 4. Profitability Profile of Rated SOE Infrastructure That Were Downgraded in 2020-2021

Source: PEFINDO

The year 2022 may augur well with positive credit momentum, signs of economic recovery gathering momentum, and more conducive financing conditions. Nevertheless, we view most of the SOEs we rated as operating at weaker credit metrics than the pre-Covid-19 due to the substantial earnings loss, which we believe will take some time and even years to recover, besides the additional financing to meet the working capital need. However, the potential resurgence of the Covid-19 variants, such as the omicron, will heighten uncertainties in containing the pandemic; thereby, dragging the positive momentum of the economic recovery, in our view.