Limited growth for heavy equipment leasing

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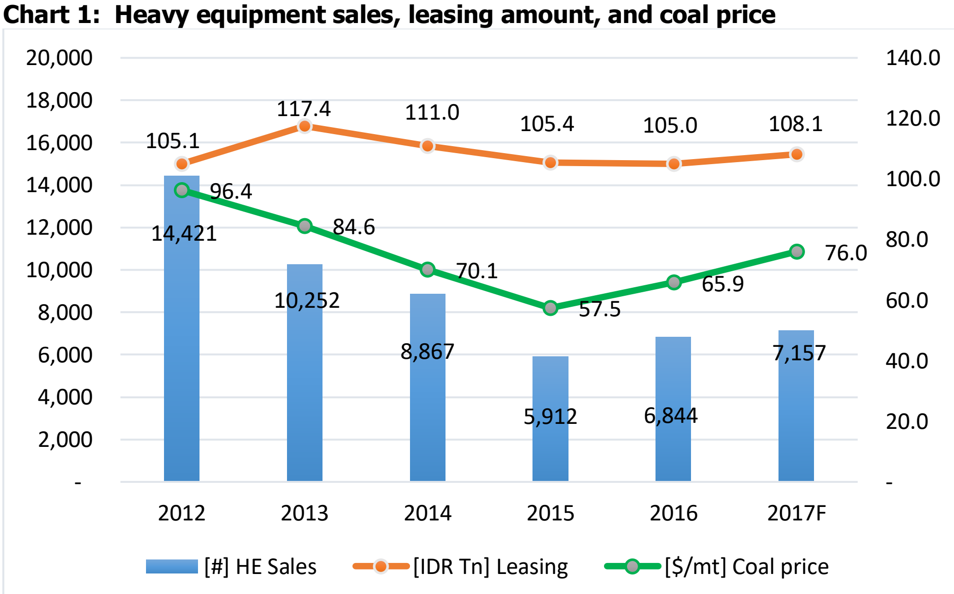
PEFINDO projects the business growth of heavy equipment (HE) leasing companies at a low or single digit level of 3%-5%. This is primarily due to our estimation that the mining sector – the highest source of growth for this business – is still showing an unstable trend, and its overall performance has not improved significantly. With the mining sector predicted to remain under pressure, its supporting industries, including HE leasing companies, will experience stagnant business growth in the near term. We are also of the view that the strategy to shift into other sectors, such as infrastructure and property, cannot compensate for the declining revenue from the mining sector, as the average financing in the mining sector is significantly higher compared to other sectors.

Leasing business and coal price correlation

Chart 1: Heavy equipment sales, leasing amount, and coal price



Source: PEFINDO

We can see from the above chart that the highest amount financed by HE occurred in 2013, when sales were still high and the coal price was at a safe level above USD80/metric ton. In 2014, with the issuance of Ministry of Energy and Mineral Resources Regulation No.7/2012, which prohibited the export of mineral ores from early January 2014, combined with lower coal prices globally, business activities in the mining sector were sluggish, directly resulting in lower sales. HE sales dropped by 13.5% in 2014 to 8,867 units from 10,252 units in 2013, and dropped again by 33.3% in 2015 at 5,912 units, aligning with the downward trend of coal prices to USD57.5/mt in 2015, from USD70.1/mt in 2014. This affected the leasing industry as its financing amount continued to fall from IDR117.4 trillion in 2013 to IDR111.0 trillion in 2014, IDR105.4 trillion in 2015, and IDR105.0 trillion in 2016.

In the near term, we expect the source of growth of leasing companies to change and not depend heavily on the commodity sector. Outside the mining sector, we project that the infrastructure sector has the potential to become source of growth for HE leasing companies. Given the current rapid expansion of infrastructure projects in the nation that need huge financing, we are of the view that this will bring decent opportunities for HE leasing companies to boost its financing growth during weak demand in the mining sector. The positive growth of the infrastructure sector can be seen in the financial services regulator's (OJK) banking statistics on loans per sector, where construction loans; electricity, gas and water loans; and transportation, warehouse and communication loans have showed positive growth in recent years, while mining loans continue to decline in the years under review.

Table 1: Banking infrastructure loans [IDR billion]

	2014	2015	2016	1H2017
Mining	141,823.5	135,273.3	126,335.5	122,472.1
Construction	147,266.2	172,934.2	214,756.5	234,149.2
Electricity, gas and water	81,130.1	99,447.3	135,461.1	127,073.8
Transportation, warehouse and communication	171,805.1	177,545.9	171,795.4	173,979.2

Source: OJK banking statistics, June 2017

Product diversification

In terms of product type, we are of the view that there will be a change in terms of HE types financed by leasing companies, from the previously big-sized HE to small and mid-sized HE. Those used in the mining sector are usually categorized as big HE and have specific features. These include dump trucks, excavators, wheel loaders, and bulldozers. In the infrastructure sector, there is less variety compared to the mining sector, and examples of HE used include excavators, stone crushers, and trucks, which are far smaller in size. We project the shift in HE types will impact the amount of finance realization from HE leasing companies as the price per unit for HE in the mining sector is higher compared to other sectors such as infrastructure. With the lower price per unit in other sectors, the quantity of HE being leased need to achieve at least two times in order to have the same financing amount if it give financing to the mining sector. The importance of the mining sector can be seen in the table below of Komatsu's sales diversification per economic sector.

Table 2: Komatsu HE sales per economic sector 2012-2016 (units)

Sector	2012	2013	2014	2015	2016
Agro	1,552	1,093	808	297	218
Construction	993	967	984	765	1,003
Forestry	310	336	492	446	305
Mining	3,351	1,807	1,230	616	654
Total	6,206	4,203	3,513	2,124	2,181

Source: United Tractor's annual report 2012-2016, processed by PEFINDO

In accordance with POJK Number 29/POJK.05/2014 regarding the expansion of the multifinance industry, including leasing companies, leasing companies now can distribute their financing to investment, working capital, and multi-purpose use. Multi-purpose use can expand to various forms including for maintenance, refinancing, spare part financing, and used equipment financing. During soft economic conditions, the demand for new HE units is expected to remain low, and we are of the view that the strategy of the leasing industry to enlarge its business in other segments, such as used HE, spare parts, and maintenance, is more reasonable to patch up the demand from its core segment – new HE.

Growth affected by asset quality

PEFINDO projects that the growth of HE leasing will be 3%-5%. Minimum growth cannot be separated from our assumption that the mining sector will not recover significantly in the next one to two years. Unstable activities in the mining sector are also related to prolonged low commodity prices, including coal. We are of the view that the slower growth of HE leasing in the next few years is due to the focus of HE leasing companies on improving their asset quality, as this currently shows a deteriorating trend. The leasing companies that have strong parents, such as banks or authorized dealers, should have an advantage compared to other companies. Companies that have banks as their parent will benefit in terms of liquidity facilities that can be used for business expansion or in times of financial distress. Companies affiliated with

HE distributors will benefit in terms of business sustainability, as they will receive a percentage of credit sales from their parent.

According to OJK statistics on finance companies as of June 2017, the non-performing financing ratio (NPR) for multifinance companies was 3.47%, from 3.26% in December 2016. The focus to improve asset quality performance is important as indirectly it will also affect profitability figures. Analyzing further, PEFINDO's rated HE leasing companies has also showed an increasing trend of its NPR averaging above 5% in 2016 compared to previous years at below 5%. With the deterioration in asset quality, we are of the view that many leasing companies will halt business expansion and add a significant amount of provisions to cover bad receivables. This combination will result in a downward trend of profitability indicators. The expansion of HE leasing companies to the consumer segment, such as car and motorcycle financing, needs time before producing significant results. HE leasing companies need to increase their networks significantly, including the number of branches and employees, to run this new business. Unsuccessful execution of expansion in this new segment could further worsen the condition of HE leasing companies' asset quality and profitability performance.

Stable outlook for PEFINDO's rated portfolio

PEFINDO has published the ratings of four HE leasing companies, and they span from $_{id}$BBB+ to $_{id}$AA+ in the rating scale. The outlook for all rated HE leasing companies is stable. We expect HE leasing will have minimum growth in 2017 due to the low demand in the mining sector. The four rated companies have shown stagnant growth during the past two years due to weaker demand in the mining sector. We are of the view that the improving and sustainable commodity prices particularly coal price will be the key factor that will drive industry's growth in the near to medium term. We are also of the view that growth improvement will be directly connected with improving asset quality indicators.

Table 3: Rated HE leasing companies

Company	Rating / Outlook	NSA	Equity	DER	NPR	ROAA
PT Surya Artha Nusantara Finance	$_{id}$AA-/Stable	5,604.13*	1,444.11*	3.51x	6.79%	1.19%
PT Komatsu Astra Finance	$_{id}$AA+/Stable	232.59**	96.02**	1.67x	4.98%	2.57%
PT Chandra Sakti Utama Leasing	$_{id}$A/Stable	2,729.97*	967.32*	2.25x	9.17%	1.86%
PT Buana Finance Tbk	$_{id}$BBB+/Stable	3,485.02*	1,099.9*	2.24x	7.67%	1.54%

Source: PEFINDO's database and published financial statements (as of December 31, 2016).
NSA (net service assets);
DER (debt to equity);
NPR (non-performing receivables – delinquent receivables overdue more than 30 days); ROAA (return on average assets).
** In IDR billion.   ** In USD million.*