Financial flexibility key in easing liquidity pressure amid COVID-19 pandemic

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The pressure on corporates' liquidity is at an all-time high, due to severe earnings losses and delayed receivables collection caused by the COVID-19 pandemic. Given the high uncertainty over the magnitude, duration, and overall impact of the pandemic, a company's ability to conserve cash will be key to surviving the crisis. Corporate cash flow and operating management will be tested. Hence, PEFINDO is of the view that a company's ability to manage operating costs, flexibility to reschedule capital spending, and financial flexibility to access various liquidity sources, including the ability to timely refinance maturing debts, are critical success factors in responding to the pandemic, the latter of which we view to be increasingly important in determining a company's credit profile.

The loan and debt capital markets, now more than ever, are key sources of liquidity for corporates. However, access to these markets has become increasingly challenging amid the pandemic, due to the following factors:

- The banking sector is more selective amid deteriorating asset quality, so credit approval may be too slow to deliver the necessary funding in time
- Banks' risk tolerance has increasingly become more stringent, so they reluctant to risk more exposure
- Liquidity in the debt capital market has been impaired as investors become more risk averse

PEFINDO's approach in assessing a company's financial flexibility is very qualitative. We generally begin by looking at the strength and stability of the company's relationships with its core bankers, by examining the availability of unused credit facilities and ability in the past to drawdown these facilities. The ability to amend credit agreements, be it to provide covenant relief, payment deferrals, or consent to incur additional debt, should also aid a company's financial flexibility during the pandemic. The Financial Services Authority (OJK) regulation related to special debt restructuring, and its policy in providing an economic stimulus for banks to maintain asset quality and non-performing loans (POJK 11/2020), are viewed as credit positive, as this, to a large extent, should help corporates come to terms with their bankers and increase their chance to conserve cash amid a weaker operating environment. OJK's policy to lower the minimum liquidity coverage ratio to 85% from 100% and temporarily remove the obligation to fulfill the 2.5% capital conservation buffer until March 31, 2021, should further strengthen banks' capital and provide ample liquidity to support the economy during the crisis, and facilitate a rapid and sustained recovery afterward. An understanding of the company's business and the industry in which it operates is also an important part of our assessment, as we understand some banks or investors may reduce their exposure to certain industries. In the past, we have witnessed that a loss of bank and/or market confidence, be it industry- or company-specific, can translate quickly into a liquidity crisis.

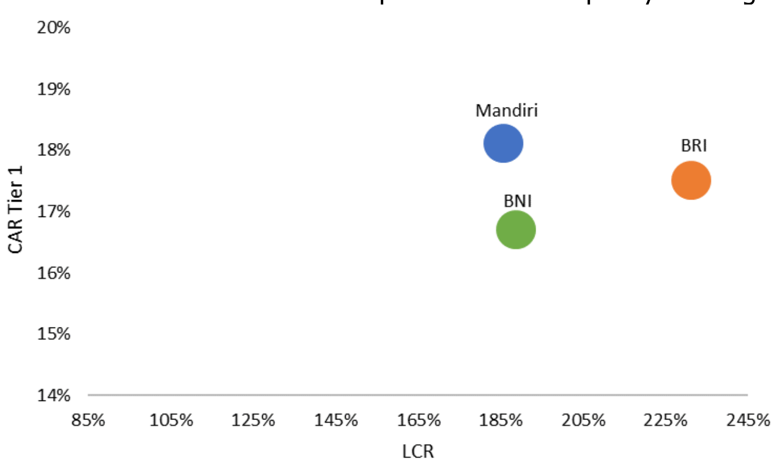
PEFINDO also looks to address how much of unencumbered assets may be used to secure new external funding, as we are of the view that having fewer encumbered assets aids financial flexibility. Corporates are able to use unencumbered assets as collateral for secured borrowing if access to unsecured borrowing becomes unavailable, particularly during a tight liquidity market, for which the request for collateral tends to increase. Due to COVID-19, we have witnessed certain corporates that might have been able to issue unsecured bonds in the past may now need to factor in collateral, and, for some, credit enhancement features, to meet investor expectations.

We also look at the impact of the company's distress on the financial system. Corporates with adverse systemic implications to the financial system should have stronger financial flexibility compared to corporates whose defaults are relatively tolerable.

Financial flexibility of state-owned enterprises (SOEs)

In addition to healthcare support, the government's measures in handling the COVID-19 impact are aimed at economic recovery, with household, industrial, and business support, including support to SOEs. In the past five years, SOEs have participated heavily in the government's infrastructure program. Therefore, PEFINDO is of the view that an SOE with a major public service obligation (PSO) role, as well as a significant role in infrastructure projects, will have a strong likelihood of government support, be it direct or indirect - the latter of which we believe will be through funding access with state-owned banks and/or other government-owned institutions. Given their strong capitalization and liquidity, PEFINDO is of the view that the major state-owned banks: Bank Mandiri ($_{id}$AAA/stable), Bank Rakyat Indonesia ($_{id}$AAA/stable), and Bank Negara Indonesia ($_{id}$AAA/stable), have the capacity to support SOE debt through restructuring and refinancing, including the roll-over of short-term working capital loans, as well as to provide bridging loans to address upcoming bond maturities. As part of the economic recovery, the government has appointed PT Sarana Multi Infrastruktur (Persero) ($_{id}$AAA/stable) and PT Sarana Multigriya Finansial (Persero), both of which are special mission vehicles under the Ministry of Finance, to channel soft loans to SOEs heavily affected by COVID-19, such as Kereta Api Indonesia ($_{id}$AA+/negative), Krakatau Steel, Garuda Indonesia, and Perumnas ($_{id}$BBB-/negative).

Exhibit 1. State-owned banks' capitalization and liquidity coverage ratios as of June 30, 2020



Source: PEFINDO
CAR Tier 1: Capital Tier 1/risk weighted assets
Liquidity coverage ratios (LCR): High quality liquid assets/net cash flow

For private corporates, particularly those heavily affected by COVID-19 with weak operations and operating management, the outlook for access to sources of liquidity from banks and debt capital markets is increasingly limited. Therefore, they are more vulnerable to defaults. There have been nine cases of corporate defaults in 2020, six of which were privates.

Despite a company's ability to obtain additional financial flexibility, PEFINDO notes that credit conditions for corporates will remain under pressure over the near to medium term, given weaker operating performances and recovery prospects. Those able to stay afloat during the severe downturn will probably do so with higher debt levels and weaker profits, and thus, weaker credit profiles. The number of rating downgrades year-to-date 2020 has already surpassed those in 2019, while the revision of rating outlooks has exceeded by nearly 5x the number in 2019. Due to the high degree of uncertainty around the extent and duration of the pandemic, we will continue to monitor the operating and financial performances of rated corporates to measure performance expectations and impact on corporate credit risk.

Exhibit 2. PEFINDO's published rated SOEs

Company	**Industry**	**Government ownership**	**Benefits from government notching**	**Rating/outlook**	
				Current	**Pre-COVID-19**
Perusahaan Listrik Negara	Electricity	100%	Yes	$_{id}$AAA/stable	$_{id}$AAA/stable
Bio Farma	Pharmacy	100%	Yes	$_{id}$AAA/stable	$_{id}$AAA/stable
Angkasa Pura I	Airport	100%	Yes	$_{id}$AAA/negative	$_{id}$AAA/stable
Angkasa Pura II	Airport	100%	Yes	$_{id}$AAA/negative	$_{id}$AAA/stable
Kereta Api Indonesia	Transportation	100%	Yes	$_{id}$AA+/negative	$_{id}$AAA/stable
ASDP Indonesia Ferry	Transportation	100%	Yes	$_{id}$AA/stable	$_{id}$AA/stable
Semen Indonesia	Cement	51%	Yes	$_{id}$AA/stable	$_{id}$AA/stable
Pelindo IV	Seaport	100%	Yes	$_{id}$AA/stable	$_{id}$AA/stable
Pelindo I	Seaport	100%	Yes	$_{id}$AA-/stable	$_{id}$AA/negative
Jasa Marga	Toll Road	70%	Yes	$_{id}$AA-/stable	$_{id}$AA/stable
Pembangunan Perumahan	Construction	51%	Yes	$_{id}$A+/negative	$_{id}$A+/stable
Hutama Karya	Construction	100%	Yes	$_{id}$A/negative	$_{id}$A/stable
Semen Baturaja	Cement	75%	No	$_{id}$A/stable	$_{id}$A/stable
Adhi Karya	Construction	51%	Yes	$_{id}$A-/negative	$_{id}$A-/stable
Pindad	Manufacturing	100%	Yes	$_{id}$A-/negative	$_{id}$A-/stable
Waskita Karya	Construction	66%	Yes	$_{id}$BBB+/negative	$_{id}$A-/negative
Industri Kereta Api	Manufacturing	100%	Yes	$_{id}$BBB+/negative	$_{id}$A-/stable
Pos Indonesia	Post and logistics	100%	Yes	$_{id}$BBB+/negative	$_{id}$A-/stable
Perkebunan Nusantara III	Plantation	100%	Yes	$_{id}$BBB/CW negative	$_{id}$A/stable
Perumnas	Property	100%	Yes	$_{id}$BBB-/negative	$_{id}$BBB+/stable
Perikanan Indonesia	Fishery	100%	No	$_{id}$BB+/stable	$_{id}$BB+/stable
Perikanan Nusantara	Fishery	100%	No	$_{id}$BB-/CW negative	$_{id}$BB/negative
Barata Indonesia	Manufacturing	100%	No	$_{id}$SD	$_{id}$BBB/stable

Source: PEFINDO, as of Sept. 22, 2020