

Agribusiness Industry - Key Success Factors

The key success factors apply to companies engaged in the production or manufacturing of agricultural products. The criteria exclude companies engaged in the production or manufacturing of non-agricultural products. The industry includes:

- Plantation
- Sugar refinery
- Animal feed and husbandry
- Aquaculture
- Fishery
- Etc, other related industries

BUSINESS RISK ASSESSMENT

Market Position

The assessment of market position is needed to understand the Company's ability to generate revenue and profit. The analysis includes an assessment of the following major factors:

- The company's presence and domination in the market, including its ability to maintain its presence going forward.
- The production and sales volume growths to see the sustainability of the business.
- The company's business size and economies of scale, including the scale of production as an important factor to increase competitiveness products.
- The target market, as affected by supply and demand, commodity prices, and economic conditions, will also be reviewed.

Vertical Integration

The analysis covers assessments of how well the company's businesses are vertically integrated in a bid for efficiency and optimization margin and profit. The assessment will include the following major indicators:

- The level of vertical integration from planting, cultivating, harvesting, and processing products and derivatives. Having facilities to produce a variety of derivative products could reduce exposures from commodity price fluctuation.
- The productivity of production facilities, such as the utilization rate, feed conversion ratio, survival or density rate for live stocks.
- The procurement or availability of raw materials, processing facilities and capacity, and power supply.
- The infrastructure and facilities of integrated operations, such as the availability of shipment infrastructure such as storage tanks or warehouses and proximity to shipping ports.
- The use of modern farming techniques and bio-security implementation for live stocks are also crucial to prevent and minimize potential outbreak of diseases.
- Ponds profile for the fishery and aquaculture industry.

Diversification

The analysis includes risk assessments of the company's ability to stabilize overall operating performance and cash flow through diversification of its revenue sources in terms of products offered, customer base, sales area, production facilities and geographical area, leading to improved credit protection measures. The company's creativity to diversify products and markets to stimulate consumers' buying interests in order to ensure revenue stability is also taken into rating consideration. In general, players with substantial diversification often exhibit more stable operating results.

Operating Management

The analysis covers the examinations of the company's operating efficiency and cost position advantages (fixed vs. variable costs) and its ability to control costs through efficient cost management (including its

ability to effectively utilize its installed capacity to reach economies of scale and how it manages its days receivables versus days payable). Therefore, lower cost producers would tend to have stronger resistance towards the unfavorable price swing. The analysis covers the assessment of the following major indicators:

- Cost structure and efficiency, including the production cost and cash cost per ton.
- The analysis of profit margins, particularly EBIT and EBITDA margins, including the comparison with other players in the same industry or other industry with similar characteristics.
- Working capital management and the comparison with other players in the same industry or other industry with similar characteristics.
- Capability, commitment, and experience of the company's management on achieving the target, compliance, environment and social issues.

FINANCIAL RISK ASSESSMENT

Financial Policy

It is important to understand the management's philosophy and strategy toward financing decisions (historical, current, and future). The aggressive financial policy will carry higher financial risk as opposed to conservative financial policy with lower financial risk. The analysis includes a review and examination of:

- Management's financial targets including growth, leverage, debt structure, hedging and dividend policy
- Debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate)
- Track record on fulfilling its previous financial obligations to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis
- Other policies to reduce the company's overall financial risk (historical vs. future)

Capital Structure

We are of the view that the debt obligation level in relation to earnings and capital condition is the fundamental part of a company's financial risk profile. The analysis covers careful examination of the company's historical, current and projected leverage, indicated mainly by total and net debt in relation to EBITDA (Debt-to-EBITDA) and equity (Debt-to-Equity).

Cash Flow Protection and Liquidity

The pattern of current and future cash flow generation is also one of the most vital indicators of a company's financial risk. The analysis covers reviews of the company's cash flow generation and capability to meet its short-term and long-term financial obligations, mainly measured by:

- Debt coverage ratio (Funds from Operation to Debt)
- Interest coverage ratio (EBITDA to Interest)

The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also assessed. The sources of cash include:

- Cash balance
- Estimated cash flow from operations
- Other sources of cash

Under some circumstances, liquidity attains such primacy that it alone constrains a company's credit rating, leaving other credit drivers as a secondary indicator even if supportive. This follows from our view that to succeed in the long term, a company first needs to survive in the short term.

Financial Flexibility

Financial flexibility is an essential factor for a company to carry out its operating activities and/or refinance existing borrowings regularly at short notice. We are of the view that strong financial flexibility will enhance a company's credit profile as it might partially mitigate liquidity risk, while weak financial flexibility could

underwhelm a company's credit profile despite having decent credit ratios. The analysis covers evaluation of the company's capability in raising funds, including options under distress, contingency plans, and flexibility to deal with various adverse scenarios. Analysis includes other related factors or figures that are not specifically examined above, such as:

- Banking relationship
- Experience and track record debt and capital markets
- Covenants' compliance in loan/bond agreements
- Parental/shareholders' commitment and support
- Unused credit facilities (committed and uncommitted)
- Unpledged assets

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