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15 November 2017

Indonesia

Petro/Chems

Reuters BRPT.JK
Bloomberg BRPT IJ

Priced on 15 November 2017

Jakarta Comp @ 5,972.3

12M hi/lo Rp2,290/698

12M price target Rp2,500
±% potential +16%

Shares in issue 13,959.8m
Free float (est.) 29.0%

Market cap US\$2,215m

3M average daily volume
Rp72.4bn (US\$5.4m)

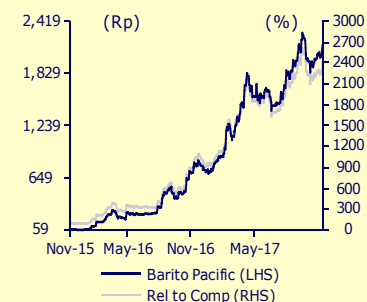
Foreign s'holding 2.2%

Major shareholders

Magna Resources 52.1%
DBS Bank Trust 7.9%

Stock performance (%)

	1M	3M	12M
Absolute	10.5	16.8	174.8
Relative	9.6	14.2	133.6
Abs (US\$)	10.1	15.1	170.8



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Beyond petrochemical

Diversifying into power through acquisition and JV

Barito Pacific plans to acquire a geothermal company, Star Energy, and enter into a JV with PLN, highlighting its goal to diversify its business from only petrochemical. Geothermal outlook is positive and barriers to entry are significant. This venture could be big in the medium term. Until then, petrochemical spread movement and volume growth are earnings drivers. We value BRPT using discounted multiple compared to its operating subsidiary TPIA. Initiate with Outperform and TP of Rp2,500.

Plans to acquire Star Energy and enter into JV with PLN

While petrochemical accounts for a significant portion of BRPT revenue, the holding company is looking to diversify into power. It is looking to acquire the largest geothermal company in the country, Star Energy. Indonesia is number 3 in the world in terms of geothermal capacity. Also, Barito is entering into a joint venture with PLN to develop a 2,000MW power plant that would power its subsidiary TPIA's second petrochemical complex, among others.

For geothermal, growth is significant and competition is limited

PLN forecasts electricity from geothermal to grow c.4x the level today in the next ten years. On the positive side, geothermal is not susceptible to fuel price volatility like coal, or rainfall like hydro. It also has high utilisation. But the challenge is in developing new fields. Given this challenge, expansion of existing field to increase capacity is more likely. This favours existing players, as competition is likely to remain limited.

Higher ASP is good, but spread matters more

Even though diversification could be big for BRPT in the medium term, petrochemical still dominates in the near term. Higher crude prices may lift ASP, but it could also increase cost. Given crude's rally since June, changes to spread have varied. Slower-moving gas prices meant decline in ethylene products spreads, while rally in rubber prices drove synthetic rubber products spreads higher.

Growth option from petrochemical and power; initiate with O-PF

We value BRPT using the average of EV/Ebitda (10x adjusted Ebitda) and PE (16x) of our forecasts for 19CL. The multiples we used are discounted compared to our valuation of TPIA. Diversification could provide a boost in the medium term. Initiate with a TP of Rp2,500 – Outperform.

Financials

Year to 31 December	15A	16A	17CL	18CL	19CL
Revenue (US\$m)	1,406	1,961	2,389	2,341	2,534
Net income (US\$m)	(5)	132	155	119	154
EPS (US¢)	(0.04)	0.94	1.11	0.85	1.10
CL/consensus (0) (EPS%)	-	-	-	-	-
EPS growth (% YoY)	nm	nm	17.7	(23.1)	28.9
PE (x)	nm	17.1	14.3	17.9	13.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	(6.2)	16.1	9.3	(0.1)	(2.4)
PB (x)	3.1	2.7	1.6	1.4	1.3
ROE (%)	(0.8)	16.9	14.0	8.3	9.8
Net debt/equity (%)	41.7	13.4	(16.5)	(12.7)	(7.6)

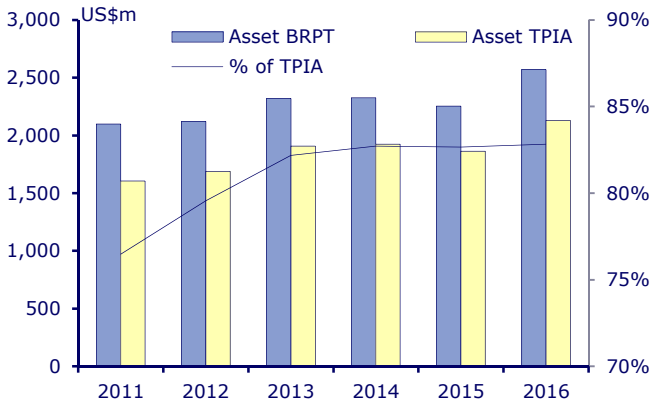
Source: CLSA

Expanding into power

To say that petrochemical plays a big part in Barito Pacific's business is an understatement. Through its subsidiary, Chandra Asri, 98% of Barito's revenue came from petrochemical.

Figure 1

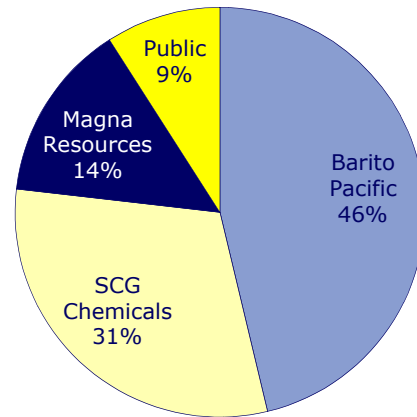
Asset – TPIA makes up the bulk of BRPT



Source: CLSA, BRPT

Figure 2

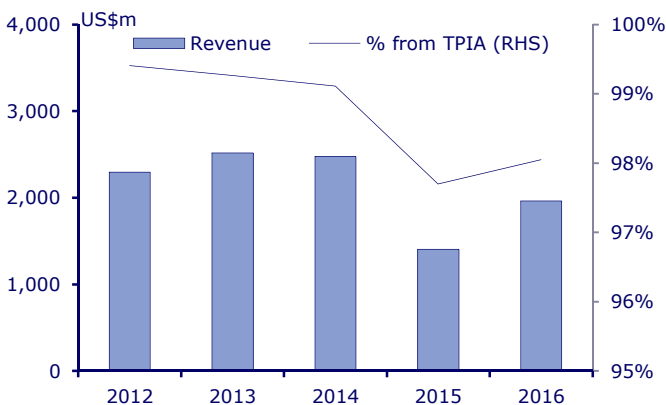
Ownership of TPIA



Source: CLSA, BRPT

Figure 3

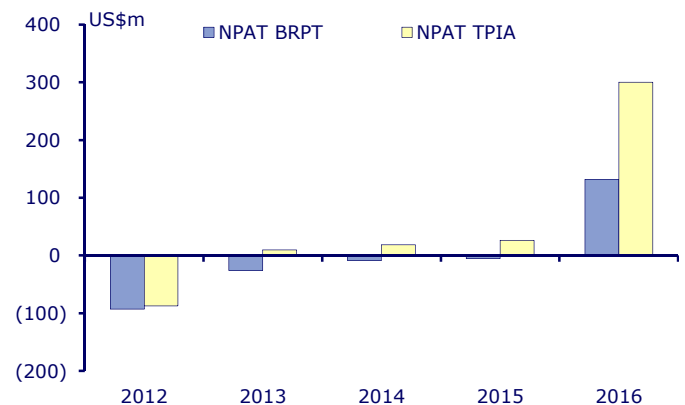
Revenue – Percentage of TPIA of total is significant



Source: CLSA, BRPT

Figure 4

NPAT – TPIA has higher NPAT due to minority portion



Source: CLSA, BRPT

But this may change as news resurfaced of Barito trying to acquire Star Energy. Star Energy is Indonesia's largest geothermal power plant operator with 875MW of total installed capacity. Indonesia has the three biggest geothermal generating capacities in the world after the United States and the Philippines. Star Energy shares the same shareholder with Barito.

This is not the first time that news of a possible Star acquisition has surfaced. But unlike 2009, this time it appears more likely given that a consortium led by Star acquired Chevron's geothermal assets in Indonesia for US\$2.3billion.

Additionally, in a sign that Star is trying to raise funds, it sold 33% of its share to Thailand's BCPG, a listed subsidiary of Bangchak Petroleum. News reports highlighted that the share purchased was done at a price not exceeding US\$357.5m.

Furthermore, Star Energy is planning to expand the capacity of its Wayang Windu plant from 227MW to 354MW. It is also developing its plant in Hamiding, Halmahera, and Suoh Sekincau, Lampung.

Figure 5

Star Energy’s geothermal capacity

	Location	Installed Cap.	Status
Wayang Windu	West Java	227	In Operation
Darajat	West Java	271	In Operation
Salak	West Java	377	In Operation
Hamiding	Halmahera	N/A	Development
Suoh Sekincau	Lampung	N/A	Development

Source: CLSA, Government of Indonesia

Separately, Barito also entered into a partnership with Indonesia Power, PLN’s power generation subsidiary to develop a 2 x 1,000MW coal-fired power plant in Banten. Barito owns 49% of the partnership through its subsidiary, while Indonesia Power owns 51%.

The power plants, known as Jawa 9 and 10, will be located in Suralaya, Cilegon. The project is an expansion of the existing Suralaya Power Plant complex with 4,000MW capacity.

The power supply from the new power plant is meant to support growth in industrial demand in the area including Chandra Asri’s second naphtha cracker and the additional downstream processing facilities.

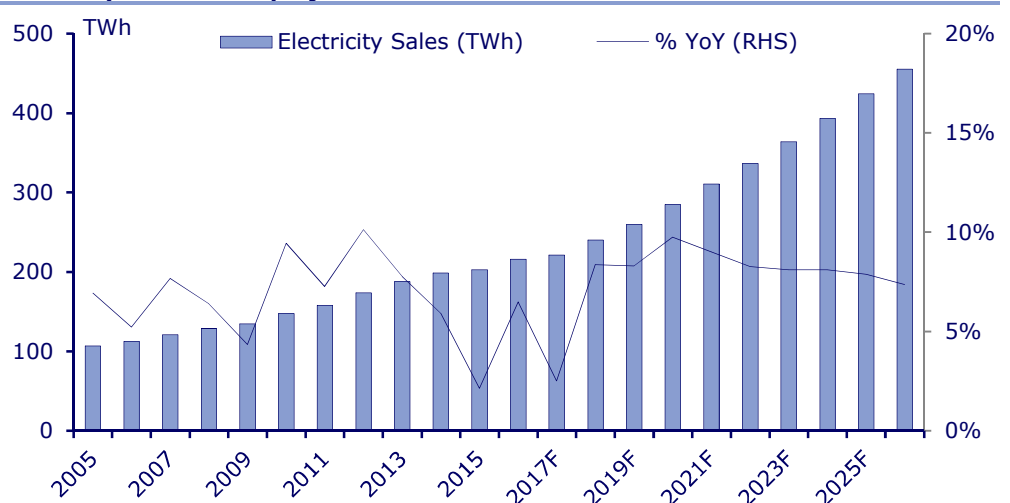
As Indonesia increases its power production capacity, Barito could be in a good position to capitalise and find a second growth engine.

Geothermal capacity growth plan is faster than coal

PLN expects electricity sales in Indonesia to slightly more than double the level in 2016 in the next ten years. This is approximately 7.7% Cagr.

Figure 6

Electricity sales – PLN projection



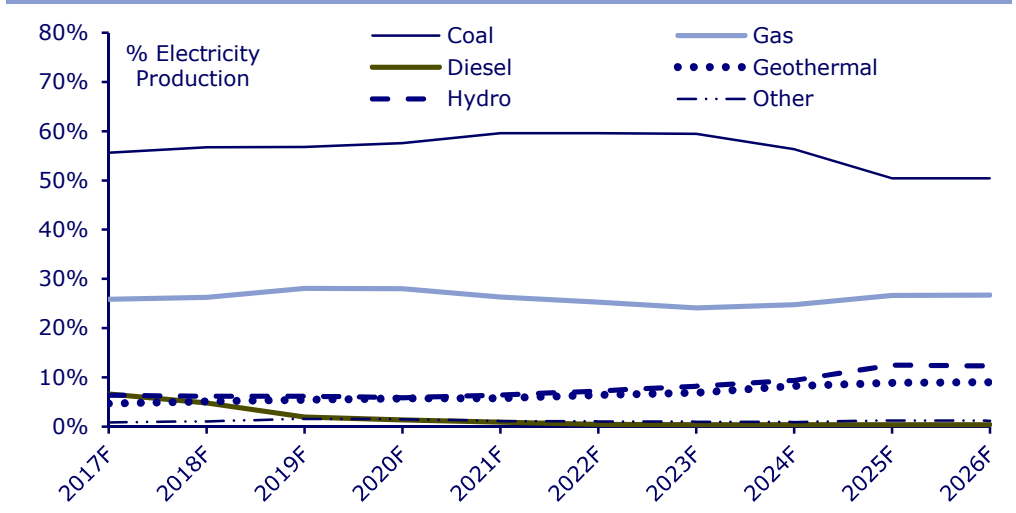
Source: CLSA, PLN

The bulk of this growth would be power using coal despite PLN expecting coal's percentage to decline from 56% to 50%. It still grows the largest in absolute terms followed by combined cycled gas.

The biggest improvement in allocation percentage however comes from the two renewable resources: geothermal and hydro. PLN forecasts the percentage of electricity from geothermal to grow from 5% to 9% of total production. Meanwhile, it also forecasted electricity from hydro to grow from 6% to 12%.

Figure 7

Electricity production mix – PLN's 10-year plan – Geothermal and Hydro to grow 4x in 10 years

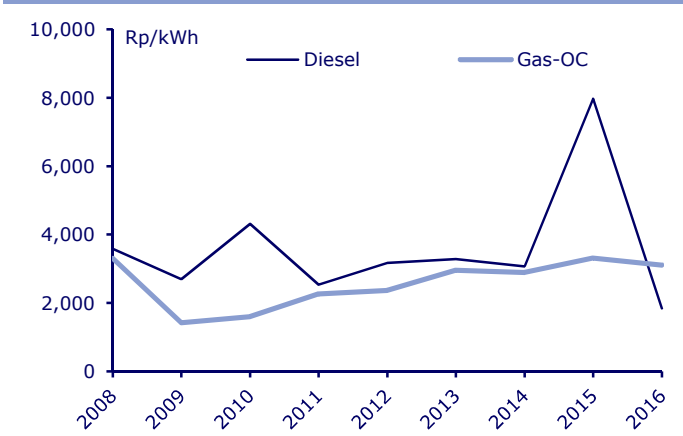


Source: CLSA, PLN

The focus on coal, gas, hydro and geothermal makes sense because they have the lowest production cost. Each carries a different risk. Both coal and gas are susceptible to price volatility and supply which is likely to decline. Hydro is susceptible to rain and geothermal is susceptible to geological uncertainty.

Figure 8

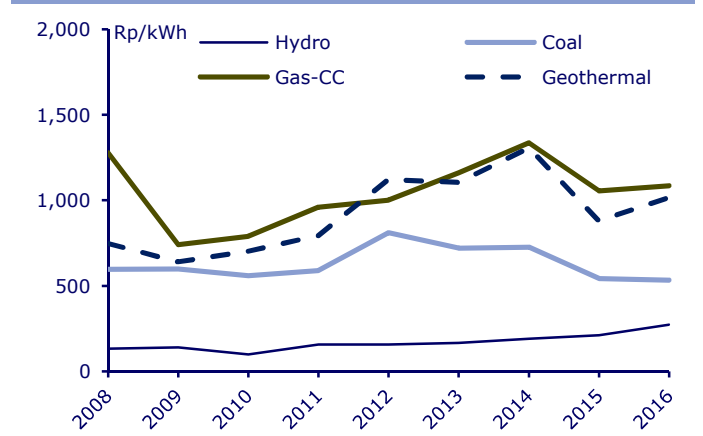
Electricity Prod Cost per kWh – Diesel powered becomes more expensive



Source: CLSA, PLN

Figure 9

Electricity Prod Cost per kWh – Possible increase in coal powered if higher crude lifts coal prices

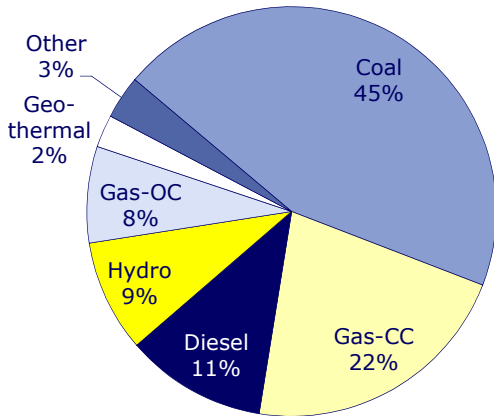


Source: CLSA, PLN

While hydro and coal have lower cost per kWh than geothermal, the latter has a significant advantage in terms of utilisation. As long as the operator can maintain a good supply of steam with minimal brine, the downtime is limited.

Figure 10

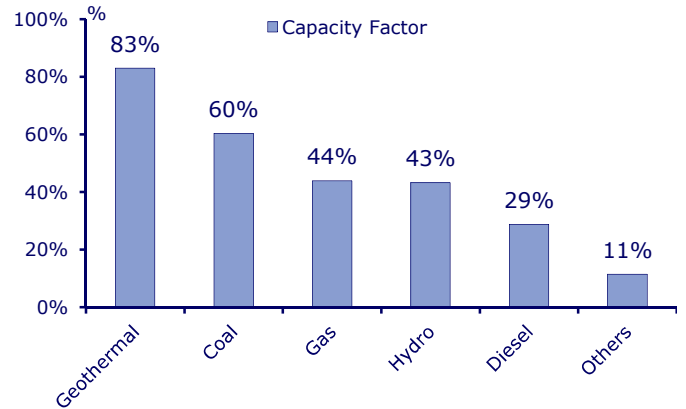
2016 Installed Power Plant Cap – Geothermal is small



Source: CLSA, PLN

Figure 11

2016 Capacity Factor - ... but utilisation is high

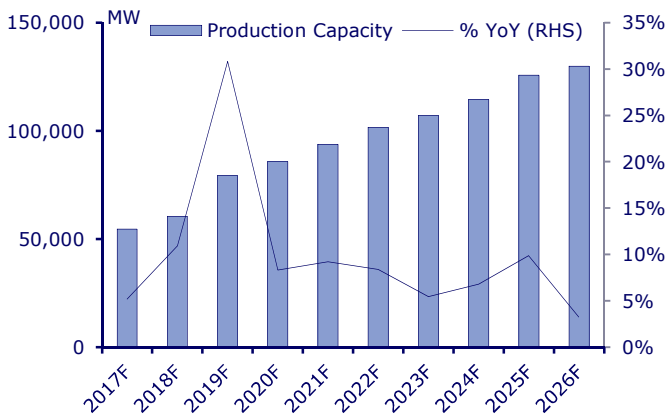


Source: CLSA, PLN

It is likely that due to the low cost and high utilisation, PLN targets geothermal capacity growth to be faster than overall. But note that the bulk of the addition comes much later, as developing geothermal field takes time.

Figure 12

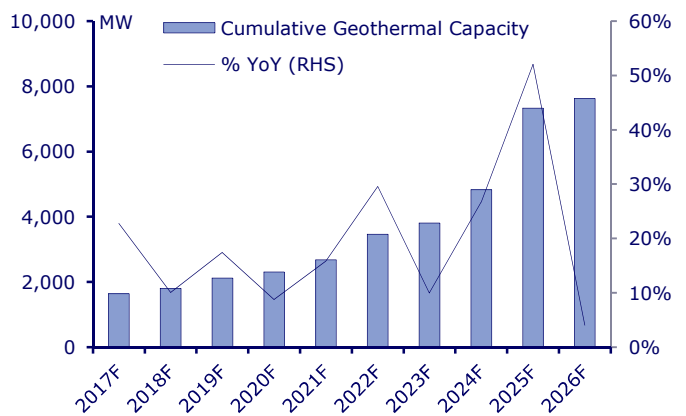
Total power production capacity addition – 10% Cagr, 2016–2026F



Source: CLSA, PLN

Figure 13

geothermal power plant capacity – 19% Cagr 2016-2026F



Source: CLSA, PLN

It takes significant resources to conduct a study of a geothermal field. Operators need to make sure that there is sufficient steam in the field, a way to replenish the supply of steam and the right technology to maintain the quality of the steam while still keeping the project feasible.

Figure 14

Indonesia's geothermal potential

Island	Location	Total potential (MW)	Proven Potential (MW)	Installed Capacity (MW)
Sumatera	97	12,912	380	287
Java	73	9,795	1,815	1,224
Bali	6	354	-	-
Nusa Tenggara	27	1,566	15	13
Kalimantan	14	183	-	-
Sulawesi	77	3,208	120	120
Maluku	33	1,451	-	-
Papua	3	75	-	-
Total	330	29,544	2,330	1,644

Source: CLSA, PLN

More positively, the complexity works as a sort of barrier to entry. Unlike a coal-fired power plant where there are numerous companies trying to enter, Indonesian geothermal only have four companies with operating plants; Star Energy, PLN – Geo Dipa, Pertamina Geothermal Energy – PGE, and Medco Power. Five if we include Supreme Energy which is building its facility in Sumatera.

Therefore, given the risk of developing greenfield, we think PLN is more likely to push for expansion of existing field. This gives existing players such as Star an advantage.

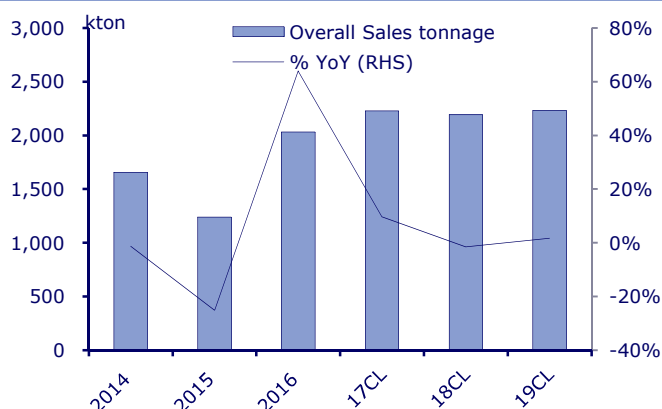
Higher ASP is good but it's the spread that matters

For now, the diversification into power plant is an option for shareholders. Until the acquisition is done, Barito's financials will be a function of the petrochemical business. More detail on Chandra's operation in our most recent report, [Capitalising on volume](#).

Despite the recent pullback in crude prices, the general trend since June 2017 was strong crude. This is partly positive because ASP is likely to be stronger. But so would its main raw material, naphtha. The spread is what matters.

Figure 15

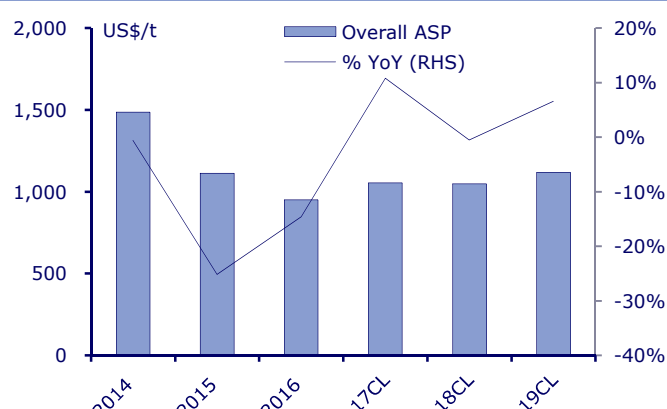
Petrochemical sales volume forecast



Source: CLSA, BRPT

Figure 16

Petrochemical ASP forecast



Source: CLSA, BRPT

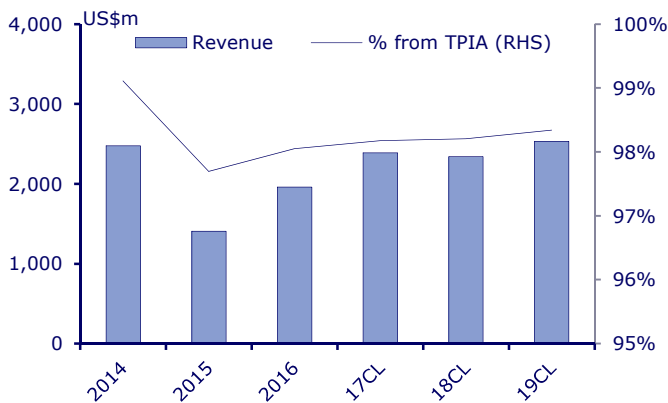
The issue here is some producers with raw-material supply advantage used ethane as a raw material. While Brent and WTI grew 29% and 23% over the

past six months, gas prices in Henry Hub only increased by 2% over the same period. Fortunately, product from gas crackers is limited to ethylene and its derivative.

Therefore, even spread for polyethylene narrowed; the spread for the rest of the products has been stable. In fact for rubber-related products, spread expanded due to shortage in rubber.

Figure 17

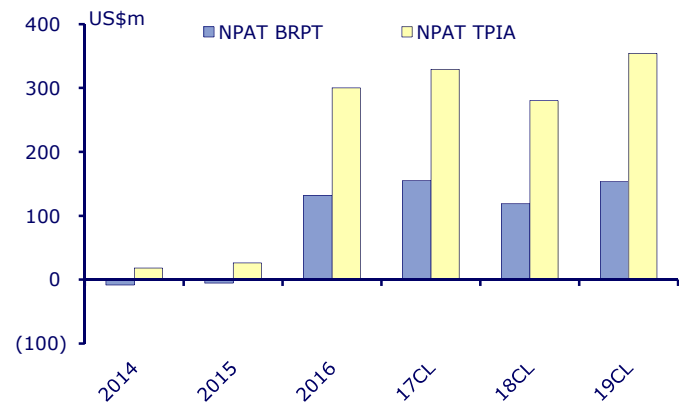
Revenue forecasts



Source: CLSA, BRPT

Figure 18

NPAT forecasts



Source: CLSA, BRPT

Option on power – Initiate with O-PF

Barito is planning to diversify into power, as it highlighted its interest to acquire Star Energy. Even though it is a related party, Star Energy is also Indonesia’s largest geothermal company. With the challenges in developing a new field, Star Energy stands to gain from Indonesia’s push for more geothermal.

Additionally, Barito is entering into a Joint Venture with Indonesia Power to build a 2 x 1,000 coal-fired power plant (Jawa 9 and 10) in Cilegon. This expansion of Suralaya will power among others the heavy industries in Cilegon including Chandra Asri’s second complex.

These projects could provide a potential growth option for Barito shareholders. For now, we focus our valuation on the existing business. With higher crude prices, there is a risk of spread compression as a result of higher naphtha prices. So far, the trend in spread is mixed, with ethylene and polyethylene declining, rubber-related products increasing and polypropylene essentially flat.

We value the stock using discounted multiple relative to our valuation for Chandra Asri given that this is a holding company. We initiate with O-PF and TP of Rp2,500.

Figure 19

Valuation calculation

Method	Multiple	Valuation
EV/Ebitda (adjusted Ebitda)	10	2,483
P/E	16	2,468
Target Valuation		2,500

Source: CLSA

Valuation details

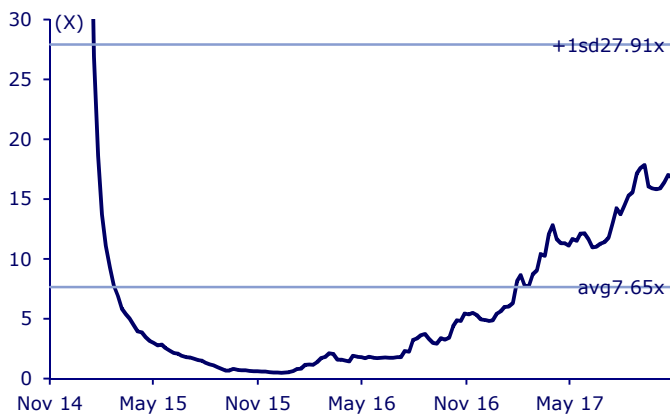
We value the stock using the average of 10x EV/Ebitda (adjusted Ebitda to exclude Chandra Asri's minority portion) and 16x P/E for our 19CL forecast. This is discount relative to the valuation we used to value Chandra Asri (11x EV/Ebitda, 20x P/E). The discount is warranted given that Barito is a holding company. Chandra Asri's trading multiple is in-line with other petrochemical companies in its sector.

Investment risks

Since majority of the earnings still come from Petrochemical industry, significant portion of its risk is related to its Petrochemical operation. Our petrochemical forecast is dependent on the company meeting its facility upgrade targets that it set for the next three years. Earnings are sensitive to spread of products against naphtha. Increase in naphtha without similar improvement in downstream product prices would result in smaller margin and lower valuation. With its expansion into power generating business, the company will be exposed to a monopoly counter party (PLN) that purchased all of the electricity produced.

Figure 20

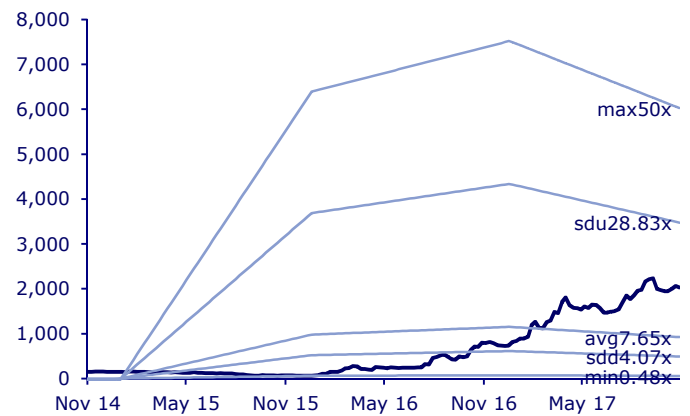
12-month forward PE range



Source: CLSA, Bloomberg

Figure 21

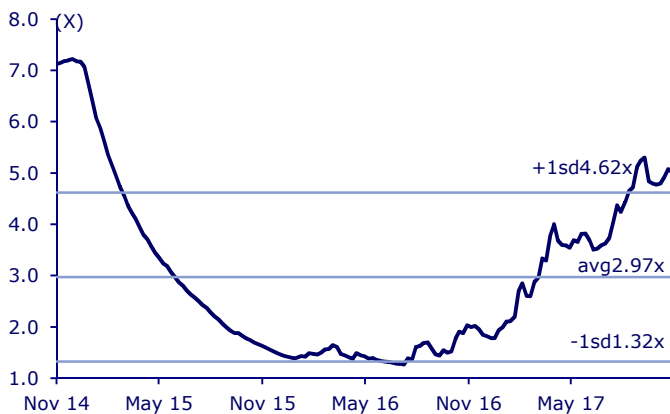
12-month forward PE trading band



Source: CLSA, Bloomberg

Figure 22

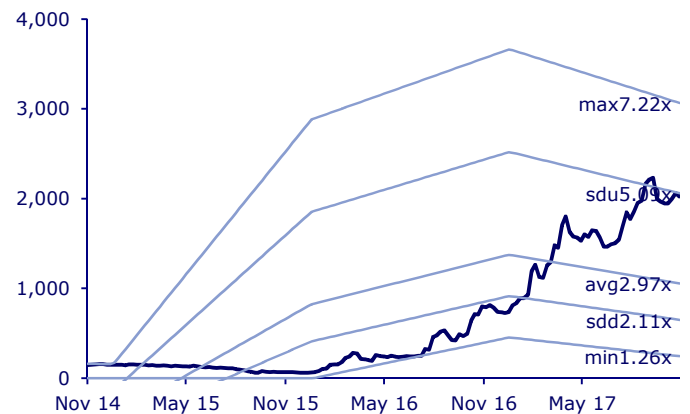
12-month forward EV/Ebitda range (unadjusted Ebitda)



Source: CLSA, Bloomberg

Figure 23

12m forward EV/Ebitda trad band (unadjusted Ebitda)



Source: CLSA, Bloomberg

Figure 24

Earnings and balance-sheet risk scores (lower the better)		
	Score	Comments
Earnings-quality flags		
Capex indiscipline	1	Recent capex was needed to immediately build scale, else it would remain subscale
Cash burn	0	
Rising non-core or intangibles	0	
Rising working capital	0	
Poor cash conversion	0	
Earnings-quality risk score (EQRS)	1/5	
Balance-sheet-quality flags		
Cash burn	0	
Excessive leverage	0	
Frequent fundraising	0	
Liquidity concerns	0	
Operational stress	0	
Balance-sheet-quality risk score (BQRS)	0/5	

Source: CLSA

Figure 25

Regional Petrochemical Comps

Ticker	Company	Share Price	Mcap (US\$m)	PE18	ROE18	EV/ Ebitda 2018
BRPT IJ	Barito Pacific	2,150	2,164	17.9	8.3	5.3
TPIA IJ	Chandra Asri	28,500	7,489	23.8	14.0	13.1
SCC TB	Siam Cement	472	17,153	10.9	18.1	8.0
PTTGC TB	PTTGC	79.25	10,784	10.5	12.3	5.7
PCHEM MK	Petronas Chemicals	7.25	14,120	13.7	14.1	7.2
DLG MK	Dialog	2.37	3,241	37.1	12.8	25.1
014680 KS	Hansol Chemical	73,800	749	11.3	20.3	7.9
011780 KS	Kumho Petrochem	70,700	2,004	9.7	13.4	7.2
051910 KS	LG Chem	397,000	24,861	14.0	13.4	6.4
011170 KS	Lotte Chemical	346,500	10,994	7.1	13.8	3.9
Average				15.6	14.1	9.0

Source: CLSA

Summary financials

Year to 31 December	2015A	2016A	2017CL	2018CL	2019CL
Summary P&L forecast (US\$m)					
Revenue	1,406	1,961	2,389	2,341	2,534
Op Ebitda	142	499	555	477	590
Op Ebit	65	408	464	381	479
Interest income	0	0	0	0	0
Interest expense	(29)	(38)	(35)	(35)	(35)
Other items	(1)	10	12	12	13
Profit before tax	35	380	442	359	458
Taxation	(30)	(100)	(110)	(90)	(114)
Minorities/pref divs/affils	(10)	(148)	(176)	(150)	(190)
Net income	(5)	132	155	119	154
Summary cashflow forecast (US\$m)					
Net income	(5)	132	155	119	154
Operating adjustments	-	-	-	-	-
Depreciation/amortisation	77	91	91	95	111
Working capital changes	(53)	(7)	(47)	7	(7)
Non-operating adjustments	62	221	178	150	190
Net operating cashflow	81	437	376	371	447
Capital expenditure	(221)	(74)	(171)	(374)	(499)
Free cashflow	(140)	363	205	(2)	(52)
Acq/inv/disposals	(24)	(61)	(1)	-	-
Net investing cashflow	(245)	(135)	(173)	(374)	(499)
Increase in loans	(74)	(67)	13	(25)	27
Dividends	(3)	(22)	(31)	(53)	(45)
Net equity raised/other	127	(11)	376	0	0
Net financing cashflow	51	(100)	359	(78)	(18)
Incr/(decr) in net cash	(114)	201	562	(80)	(70)
Exch rate movements	0	0	0	0	0
Opening cash	219	105	306	869	788
Closing cash	105	306	869	788	719
Summary balance sheet forecast (US\$m)					
Cash & equivalents	105	306	869	788	719
Debtors	60	148	181	177	192
Inventories	183	202	249	254	266
Other current assets	100	72	72	72	72
Fixed assets	1,587	1,585	1,665	1,944	2,331
Intangible assets	0	0	0	0	0
Other term assets	217	257	259	259	259
Total assets	2,253	2,571	3,294	3,493	3,838
Short-term debt	129	133	126	122	126
Creditors	264	367	398	407	426
Other current liabs	13	44	46	46	46
Long-term debt/CBs	475	367	391	369	393
Provisions/other LT liabs	176	211	207	208	207
Minorities/other equity	481	607	752	849	994
Shareholder funds	715	842	1,373	1,492	1,646
Total liabs & equity	2,253	2,571	3,294	3,493	3,838
Ratio analysis					
Revenue growth (% YoY)	(43.2)	39.5	21.8	(2.0)	8.3
Ebitda growth (% YoY)	28.9	251.9	11.2	(14.1)	23.9
Ebitda margin (%)	10.1	25.4	23.2	20.4	23.3
Net income margin (%)	(0.4)	6.7	6.5	5.1	6.1
Dividend payout (%)	-	0.0	0.0	0.0	0.0
Effective tax rate (%)	85.4	26.4	25.0	25.0	25.0
Ebitda/net int exp (x)	5.0	13.1	15.8	13.7	16.9
Net debt/equity (%)	41.7	13.4	(16.5)	(12.7)	(7.6)
ROE (%)	(0.8)	16.9	14.0	8.3	9.8
ROIC (%)	0.6	17.5	19.9	14.7	15.8
EVA®/IC (%)	(5.1)	10.0	12.4	7.2	8.3

Source: CLSA



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Companies mentioned

Barito Pacific (BRPT IJ - RP2,150 - OUTPERFORM)
 Bangchak Petroleum (N-R)
 Chandra Asri (TPIA IJ - RP28,500 - O-PF)
 Chevron (N-R)
 Dialog (DLG MK - RM2.37 - O-PF)
 Geo Dipa (N-R)
 Hansol Chemical (014680 KS - ₩73,800 - BUY)
 Indonesia Power (N-R)
 Kumho Petrochem (011780 KS - ₩70,700 - BUY)
 LG Chem (051910 KS - ₩397,000 - BUY)
 Lotte Chemical (011170 KS - ₩346,500 - O-PF)
 Magna Resources (N-R)
 Medco Energi (N-R)
 Pertamina Geothermal Energy (N-R)
 Petronas Chemicals (PCHEM MK - RM7.25 - BUY)
 PLN (N-R)
 PT Medco (N-R)
 PTTGC (PTTGC TB - BT79.2 - BUY)
 SCG Chemicals (N-R)
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