

Fitch Rates HMC Polymers' Proposed Debentures 'A-(tha)'

Fitch Ratings-Bangkok-17 September 2020:

Fitch Ratings (Thailand) has assigned HMC Polymers Company Limited's (HMC, A-(tha)/Negative) proposed senior unsecured debentures of up to THB5 billion a National Long-Term Rating of 'A-(tha)'. The proceeds of the debentures will be used to refinance its existing bank loans and for working capital. The proposed debentures constitute direct, unsecured, unconditional and unsubordinated obligations of the company and are rated at the same level as HMC's National Long-Term Rating.

HMC's 'A-(tha)' rating incorporates a one-notch uplift from its 'bbb+(tha)' Standalone Credit Profile (SCP), as Fitch has assessed that HMC has moderate linkages with PTT Global Chemical Public Company Limited (PTTGC; AA+(tha)/Negative, SCP: aa-(tha)), its largest shareholder with a 41% stake, in line with our Parent and Subsidiary Linkage Rating Criteria.

The Negative Outlook reflects potential risks to the polypropylene (PP) manufacturer's deleveraging after a large investment in 2020-2021 amid weak demand due to the disruptions caused by the coronavirus. Fitch expects HMC's financial leverage, measured by FFO net leverage, to increase to above 4.5x in 2020-2021 due to its large committed investment in its new PP production line 4 and weak operating cash flows.

We expect leverage to fall below 3.5x by 2022, supported by an improvement in cash flows due to earnings from new capacity in addition to a general improvement in demand, margins and product spreads after the pandemic. However, HMC's financial leverage could be sustained above 3.5x if demand or margins remain weak on account of a protracted deterioration in the economic environment beyond 2021. HMC's 1H20 performance has largely been in line with Fitch's expectations as the company's EBITDA fell to THB972 million from THB2.3 billion in 1H19 on account of the pandemic.

Key Rating Drivers

Leading South-East Asian PP Producer: HMC is the largest PP producer in Thailand, with a market share of about 33% in 2019. The company is also one of the leading PP manufacturers in south-east Asia. HMC's capacity will increase to about 1.1 million tonnes per annum by 2022, making it the largest PP producer in the region after the PP line 4 is completed. Its market position

is also enhanced by its focus on differentiated and specialty products, and partial upstream integration into a propane dehydrogenation plant (PDH).

Focus on High-Value-Added Products: HMC focuses on differentiated and specialty products, which have lower competition and higher margins. The proportion of sales of these products increased to around 46% in 2019, from about 35% in 2015. The company plans to raise the contribution to more than 60% of sales after its PP line 4 is fully operational. These products, according to the company, provide a premium of about 5% over its commodity PP product price, which supports its higher profitability than its competitors.

More than 75% of HMC's products are sold to packaging businesses - about 40% for flexible and 35% for rigid packaging - although the company targets more sophisticated packaging applications such as film functional layers or high-impact-resistant packaging. In addition, sales to the healthcare and hygiene, and industrial sectors have increased gradually in the past four years (2019: 15.1% of sales).

Leading Technology, Product Innovation: HMC uses leading PP technology from LyondellBasell, a key shareholder, in its production. It will use the latest PP technology for its PP line 4 - one of only two plants in the world that can use C6 monomer to enhance PP properties - and expand its product portfolio for new applications. HMC is the leader in pipe grade and medical grade PP in Thailand, and is the first PP producer in the LyondellBasell group to make dielectric film using modern technology. All of HMC's products use LyondellBasell's global brand names.

Partial Integration; Diversified Feedstock: HMC has partially moved towards upstream production via its PDH plant, supplying feedstock for about 40% of its PP production. The remaining propylene feedstock is secured under long-term contracts with PTTGC, Rayong Olefins Company Limited (in which HMC holds a 14.3% stake) and a local refinery. HMC has from time to time imported propylene to manage supply risk.

Imported propylene will increase to about 7% of its requirements once its PP line 4 is fully operational. About half of its propylene feedstock is gas-based, which has a cost advantage in a high oil-price environment, although this will drop to about 40% after PP line 4's completion. The remaining propylene feedstock is naphtha-based.

Feedstock Pricing Reduces Volatility: HMC procures propane, which is available domestically, from PTT Public Company Limited (BBB+/Stable), PTTGC's parent, under a gas-supply agreement based on a net-back pricing scheme linking gas feedstock prices with PP prices. This reduces margin volatility when market conditions fluctuate and provides a degree of production integration.

Leverage to Increase: Fitch expects HMC's FFO net leverage to increase substantially to about

4.5x-5.5x in 2020-2021, from 2.5x in 2019, due to the construction of the new PP line with production capacity of 250,000 tonnes per annum. The project will cost about USD300 million, or THB9.4 billion, which will be spent mostly in 2020-2021. Fitch expects HMC's financial leverage to decrease to about 3.2x in 2022 and 2.5x in 2023, when the PP line 4 is fully operational.

Cyclicality and Limited Diversification: HMC's credit profile is tempered by its limited product diversification and the inherent cyclicality of the industry. The company's earnings and cash flow are affected significantly by volatile petrochemical prices and margins, and demand-supply dynamics. HMC produces only PP products, making it less diversified than its domestic chemical peers. The company also has only one production site.

Linkage with PTTGC: We assess linkages between HMC and PTTGC to be moderate. HMC is a propylene off-taker of PTTGC, which considers HMC as its key vehicle in the PP business. HMC has a non-compete arrangement with PTTGC for petrochemical products, reflecting their strategic linkages. PTTGC and LyondellBasell appoint the majority of HMC's directors and some key management personnel. Fitch believes PTTGC is likely to provide extraordinary support to HMC, if needed, without any constraints.

Derivation Summary

HMC's business profile is moderate relative to that of Thai downstream oil and gas, and chemical peers, while its financial profile is also moderate during the normal run of business.

HMC has smaller operating scale as well as lower upstream integration and product diversification than IRPC Public Company Limited (A-(tha)/Stable, SCP: bbb(th)). However, HMC is more advanced in product and technology, and generates higher margins than IRPC, even excluding the refinery business, as HMC focuses on differentiated and specialty products. HMC has more diversified feedstock, which is based on gas and naphtha. We believe their business profiles are comparable but HMC has stronger credit metrics. Hence, HMC's SCP is one notch higher than that of IRPC.

HMC's business profile is slightly stronger than that of other companies in the polymer and plastic-product business including Polyplex (Thailand) Public Company Limited (PTL, A-(tha)/Stable) and Eastern Polymer Group Public Company Limited (EPG, A-(tha)/Stable). We believe HMC's leading market position in south-east Asia offsets its lower geographical diversification compared with PTL and its lower end-user segments compared with EPG. Nevertheless, HMC's financial leverage leads to a lower SCP than the ratings of PTL and EPG.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue to decline by around 24% in 2020 as a result of lower demand due to the coronavirus pandemic and weaker PP prices following a drop in crude prices. Demand and PP prices to improve gradually, starting 2021, supporting revenue growth.
- EBITDA margin to drop to around 10% in 2020 due to weak demand and low product-to-feed margin.
- Product-to-feed margin to improve gradually from 2021, helping the EBITDA margin to widen to around 12%-13% in 2021-2022.
- New PP plant to start operating in 2Q22, adding capacity of 250,000 tonnes per annum.
- Capex of THB8.1 billion in 2020-2022 for PP line 4 plus other capex of THB0.6 billion-1.4 billion a year in 2020-2022 for maintenance and efficiency improvements.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- The Outlook could be revised to Stable if FFO net leverage decreases to below 3.5x by 2022
- Evidence of stronger ties with PTTGC

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Deterioration in operating performance, delays in the start-up of the PP line 4 project or additional capex and high dividend payouts, which result in a failure to reduce FFO net leverage below 3.5x by end-2022
- Deterioration of EBITDA margin to below 10% on a sustained basis
- Weakened ties with PTTGC

Liquidity and Debt Structure

Manageable Liquidity: HMC had outstanding debt of THB6.9 billion at end-December 2019. Debt consisted of a short-term loan of THB1.5 billion and long-term bank loans with a current portion of THB1.3 billion due to mature within 12 months. Liquidity is manageable, supported by cash on hand of THB1.3 billion and a committed revolving credit facility of THB3.0 billion. HMC will

generate substantial negative free cash flow in 2020-2021 as a result of the large capex for its PP line 4. However, HMC has already secured THB10 billion in bank loans to fund the investment and started drawing these down in 1H20.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

HMC Polymers Company Limited

---senior unsecured; National Long Term Rating; New Rating; A-(tha)

Contacts:

Primary Rating Analyst

Lertchai Kochareonrattanakul,

Senior Director

+66 2 108 0158

Fitch Ratings (Thailand) Limited

Park Ventures, Level 17 57 Wireless Road, Lumpini

Bangkok 10330

Secondary Rating Analyst

Obboon Thirachit,

Director

+66 2 108 0159

Committee Chairperson

Muralidharan Ramakrishnan,

Senior Director

+65 6796 7236

Media Relations: Leslie Tan, Singapore, Tel: +65 6796 7234, Email: leslie.tan@thefitchgroup.com

Peter Hoflich, Singapore, Tel: +65 6796 7229, Email: peter.hoflich@thefitchgroup.com

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Applicable Criteria

[Corporate Rating Criteria \(pub. 01 May 2020\) \(including rating assumption sensitivity\)](#)

[Corporates Notching and Recovery Ratings Criteria \(pub. 14 Oct 2019\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub. 08 Jun 2020\)](#)

[Parent and Subsidiary Linkage Rating Criteria \(pub. 26 Aug 2020\)](#)

[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub. 26 Jun 2020\)](#)

Applicable Model

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 ([1](#))

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