30 APR 2021

# Fitch Affirms HMC Polymers at 'A-(tha)'; Outlook Remains Negative

Fitch Ratings - Bangkok - 30 Apr 2021: Fitch Ratings (Thailand) has affirmed HMC Polymers Company Limited's National Long-Term Rating and senior unsecured rating at 'A-(tha)'. The Outlook remains Negative.

The Negative Outlook reflects risks to HMC's deleveraging after a large investment in 2020-2021 from weaker operating cash flow than Fitch's expectation due to the impact of the coronavirus pandemic, in addition to any significant delays in the start-up of its new polypropylene (PP) plant, PP Line 4, in 2Q22.

HMC's financial leverage - measured by funds from operations (FFO) net leverage - is likely to increase to 3.5x-4.0x in 2021, above a negative threshold for the current rating. Fitch expects leverage to fall below 3.5x by 2022 when the PP line 4 is fully operational. HMC's financial leverage could be sustained above 3.5x if demand recovery is materially weaker than Fitch expects beyond 2021 or the PP line 4 start-up is delayed significantly.

HMC's rating incorporates a one-notch uplift from the '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)). PTTGC is HMC's largest shareholder with a 41% stake.

HMC's SCP reflects its position as the largest PP producer in Thailand, and its leading technology and product innovation, which enables it to focus on high-value-added products. However, HMC's limited product diversification, the cyclical petrochemical industry and our expectations of a moderate financial profile weigh on the rating.

## Key Rating Drivers

High Capex: HMC's capex will remain high in 2021-2022 due to the large committed investment in the PP line 4 with production capacity of 250,000 tonnes per annum. Pandemic-related disruptions caused some project spending in 2020 to be delayed until 2021-2022. However, PP line 4 remains on target to start in 2Q22, as HMC expects to speed up construction in 2021. The rest of PP line 4's THB5.9 billion capex is likely to be spent in 2021-2022. HMC has secured THB10 billion in bank loans to fund the investment.

Some Production Constraint in 2021: Fitch expects HMC's sales volume to decrease by about 7% in 2021 (2020: 744 kilotonnes), although we expect demand for PP to improve. This is due to a planned major turnaround in 2021 and partial impact from a fire at one of its blending silos in November 2020, which will restrain the company's production until the completion of repairs in August 2021.

However, EBITDA is likely to improve slightly, supported by our expectation of better product spreads. Fitch sees the strong rebound in the petrochemical business in 2H20 continuing in 2021 as vaccinations are rolled out and industrial and business activities recover, although new capacity may soften margins from 2H21. The start-up of PP line 4 will support EBITDA growth in 2022-2023.

Leverage to Rise: Fitch expects HMC's FFO net leverage to increase to 3.5x-4.0x in 2021, from 2.6x in 2020, due to the construction of the PP line 4. The leverage is projected to decrease to about 3.0x in 2022 and 2.3x in 2023, when the PP line 4 is fully operational.

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 50% in 2020, from about 35% in 2015. The company aims to raise the contribution to about 70% of sales by 2030. These products, according to the company, provide a premium of about 5% over its commodity PP product price, which supports HMC's higher profitability than competitors.

Leading South-East Asian PP Producer: HMC is the largest PP producer in Thailand, with a market share of about 33% in 2020. It 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 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).

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 world's first producer of PP for dielectric film using modern technology. All of HMC's products use LyondellBasell's global brand names.

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 also produces only PP products, making it less diversified than domestic chemical peers.

Linkage with PTTGC: We assess linkages between HMC and PTTGC as moderate, under our Parent and Subsidiary Linkage Rating Criteria. HMC is a propylene off-taker of PTTGC, and 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. Fitch believes PTTGC is likely to provide extraordinary support to HMC, if needed, without any constraints in providing the support.

## Derivation Summary

HMC's business profile is moderate relative to Thai downstream oil and gas, and chemicals 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(tha)). 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 that of PTL, and its lower end-user segments compared with that of EPG. Even so, HMC's financial leverage leads to a lower SCP than PTL and EPG.

## Key Assumptions

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

- Demand and PP prices to improve from 2021 onwards, supporting revenue and earnings growth;

- Sale volume to decrease by about 7% in 2021 due to production constraint until August 2021 and a planned major turnaround;

- Product-to-feed margin to improve gradually from 2021 onwards, increasing the EBITDA margin to around 11%-12% in 2021 and 2022 (2020: 11%);

- EBITDA margin to improve to around 12%-13% from 2023 onwards following the commercial operation of PP line 4;

- PP line 4 to start operating in 2Q22, adding capacity of 250,000 tonnes per annum;

- Capex of THB 5.9 billion during 2021-2022 for PP line 4 plus other capex of THB1.0 billion-1.6 billion a year during 2021-2023 for maintenance and efficiency improvement;

- Dividend payout ratio at 90% for 2021-2023.

## 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 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 PP line 4 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

Satisfactory Liquidity: HMC had outstanding debt of THB9.0 billion at end-December 2020. Debt consisted of THB5.0 billion in debentures and THB4.0 billion in long-term bank loans with no principal repayment in 2021. HMC issued THB5.0 billion of debentures to refinance bank loans in 2020. The outstanding THB4.0 billion in bank loans at end-2020 were a drawdown of the THB10 billion in bank loans to fund the investment. Liquidity is adequate, supported by cash on hand of THB1.8 billion and a committed, available revolving credit facility of THB4.0 billion.

## 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.

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## Rating Actions

| ENTITY/DEBT | RATING | | | RECOVERY | PRIOR |
|---|---|---|---|---|---|
| HMC Polymers Company Limited | Natl LT | A-(tha) | Affirmed | | A-(tha) |
| • senior unsecured | Natl LT | A-(tha) | Affirmed | | A-(tha) |

| RATINGS KEY | OUTLOOK | WATCH |
|---|---|---|
| **POSITIVE** | | |
| **NEGATIVE** | | |
| **EVOLVING** | | |
| **STABLE** | | |

## Applicable Criteria

Corporate Rating Criteria (pub.21 Dec 2020) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.09 Apr 2021) (including rating assumption sensitivity)

National Scale Rating Criteria (pub.22 Dec 2020)

Parent and Subsidiary Linkage Rating Criteria (pub.26 Aug 2020)

Sector Navigators - Addendum to the Corporate Rating Criteria (pub.21 Dec 2020)

## Applicable Models

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)

## Additional Disclosures

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Endorsement Status

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