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NOMURA INTERNATIONAL (HK) LIMITED

Asia Credit Trade Idea

Buy Chandra Asri (B2/B+) 2015

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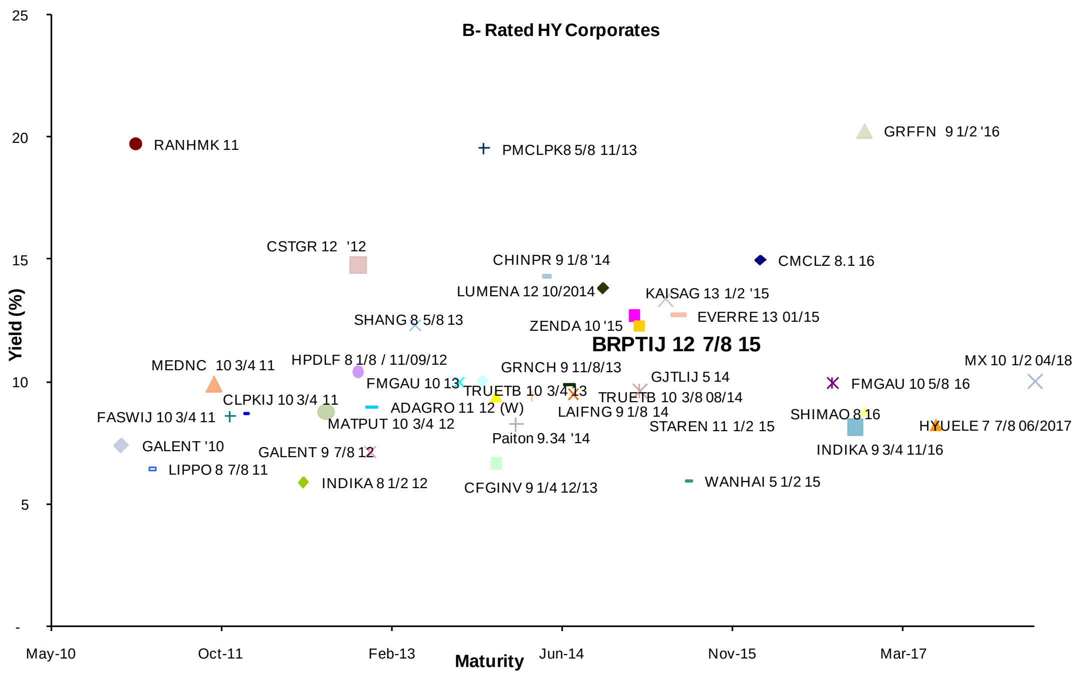
We recommend buying the Chandra Asri (B2/B+) 2015 at a yield of 11.9%. We believe the upside on the bond is another 100bp (equivalent to 3 bond points). This is in comparison to its peers such as Evergrande (B1/BB-) 2015 at 12.8%, Star Energy(B2/B+) at 9.5%, Gajah Tunggal (B3) 2014 at 10.1%. As compared to its Chinese peers, Chandra Asri is not facing a similar level of macro policy headwinds while relative to its Indonesian industrial peers, Chandra Asri has a lower leverage. We believe the key drivers to the spread tightening are our expectation of a strong set of operating results for 1Q, which should be out in a few weeks' time, and further strengthening in balance sheet benefiting from a one-off US$35mm tax rebate that was received in 1Q10.

Company background: Chandra Asri (CA) is the largest petrochemical operator in Indonesia with the only naphtha cracker. The company's range of petrochemical products include ethylene (capacity: 600ktpa), propylene (320ktpa), polyethylene (320ktpa) and styrene monomer (340ktpa). CA is 70% owned by PT Barito Pacific and 30% by Temasek. The company's near-term plans are to expand the polyethylene capacity by 30ktpa in 2011 for US$13mm and potentially consider investing in a butadiene facility on a JV basis. CA is still evaluating the butadiene facility with a decision to be finalized later this year. The capex for a butadiene facility is US$100mm, though should the company invest in the facility on a JV basis and with a 60-70% borrowing, the actual cash outflow from CA is likely to be in the range of US$15-20mm over a 2 year period.

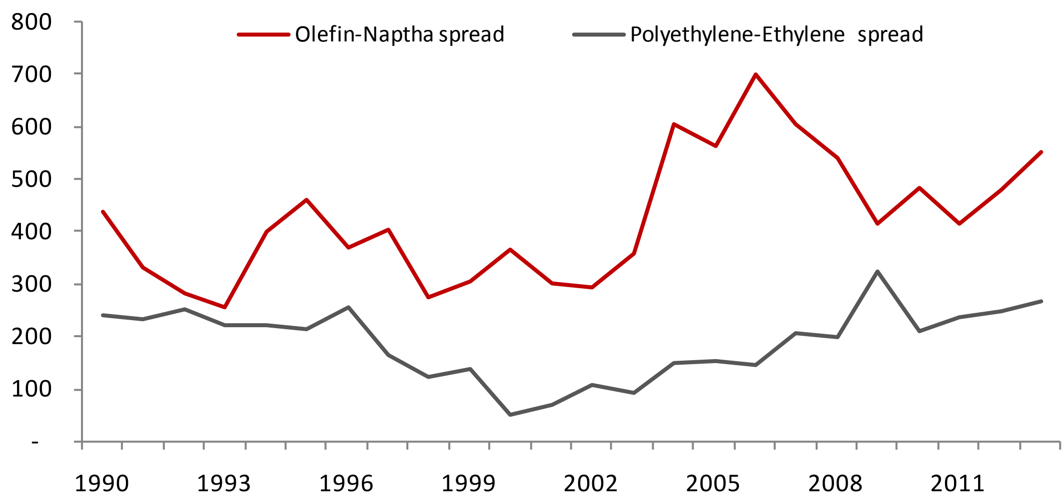
Exhibit 1. Asia HY RV



Source: Nomura

Industry outlook: While the regional economy is on a recovery trajectory following the global financial crisis, the petrochemical industry and in specific, the ethylene chain is facing a meaningful increase in capacity in 2010. Global capacity for ethylene is expected to increase by 8% this year or by about 10mmtpa to 143mmtpa. As compared to the increase in capacity, demand growth of 4% to 115mmt in 2010 is equivalent to 80% of the total capacity. This is the lowest take-up rate as compared to the 90-94% from 2004 to 2008 though the take-up rate should improve to 88% by 2012. Despite the increase in capacity, the current ongoing build up in inventory is, in fact, helping support margins as projected by CMAI. Nonetheless, for our projection purposes we have assumed a slight decrease in margins in 2010 as compared to 2009.

Exhibit 2. Asia HY RV



Source: Nomura

Financials: We currently project CA to generate revenues and EBITDA of US$1.5bn and US$100mm in 2010 as compared to respective figures of US$1.1bn and US$117mm in 2009. The company's credit profile should continue to remain robust with gross debt to EBITDA holding steady at 2.3x and net debt to EBITDA at 1.3x. From a cash flow perspective, our estimates show that the company is in a very comfortable position. Against the US$100mm in EBITDA and net tax benefit of US$10mm, the outflows include US$37mm in interest expense, US$18mm of working capital, US$14mm of capex, US$23mm reduction in debt and US$13mm in dividends paid out. The result is a net decline in cash position of US$10mm to US$100mm.

Risks: We believe the two biggest risks to owning the CA's bonds are a change in ownership and earnings volatility in light of the increase in capacity. While CA's bonds carry a change in control (CoC) clause of both shareholders holding at least 51%, that does not prevent Temasek selling its 30% interest without breaching the CoC clause. A sale by Temasek would bring corporate governance risk into the spotlight particularly as a result of the inter-company related transactions with its sister company, Tripolyta. On the earnings front, a double-dip recession would certainly put pressure on margins and pricing which was reflected in the company's 2008 EBITDA loss of US$90mm (which included a US$40mm inventory writedown).

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