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Research Update:

PT Fajar Surya Wisesa Tbk. Rating Raised To 'B+' On Strong Operating Performance, Capacity Expansion; Outlook Stable

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Overview

- Fajar's operating performance remained strong over the past year and its capacity expansion is nearing completion.
- We raised the long-term corporate credit rating on Fajar and the issue rating on its notes to 'B+' from 'B'.
- The stable outlook reflects our expectation that Fajar can maintain its improved operating performance.

Rating Action

On Dec. 16, 2010, Standard & Poor's Ratings Services raised its long-term corporate credit rating on Indonesia-based pulp and paper company PT Fajar Surya Wisesa Tbk. (Fajar) to 'B+' from 'B'. The outlook is stable. At the same time, we raised the rating on the senior secured notes issued by Fajar Paper Finance B.V. and guaranteed by Fajar to 'B+' from 'B'.

Rationale

We raised the rating on Fajar to reflect our expectation that the company can continue its strong operating performance over the past year. In addition, Fajar's existing capacity will significantly increase after a new paper machine is operational. Fajar has also secured bank facilities in order to refinance its existing senior secured notes due October 2011.

Fajar's operating performance started to improve in the second half of fiscal ended December 2009, helped by a recovery in the demand and price of paper products, which has strengthened the company's cash flows. We expect price and demand for packing paper to remain robust, reflecting healthy growth prospects for Indonesia (Foreign currency BB/Positive/B; local currency BB+/Positive/B; ASEAN scale axBBB+/axA-2). We also anticipate that Fajar's proportion of domestic sales, which have higher margins than exports, will remain at more than 95% of total sales.

Fajar's fifth paper machine will come on stream in the first quarter of fiscal 2011. This will increase its capacity by about 50%. The company also plans to modify two of its existing machines at a moderate capital expenditure, further adding to capacity. In line with continued improvement in demand, we expect the company's capacity utilization to be close to 100% in the next few quarters.

We believe Fajar has demonstrated prudence by securing US$120 million in a syndicated credit facility to refinance its existing senior secured notes due October 2011. This substantially mitigates refinancing risk. The credit facility has lower interest rates than existing notes and it amortizes over five years. Fajar should also be able to secure sufficient funds for the modification and debottlenecking of two paper machines (PM2 and PM7) over the next two years. We expect Fajar to service its debt-service obligations without difficulty.

Fajar's financial risk profile has improved over past year. While we expect the proposed capital expenditure for the PM2 and PM7 modifications to increase Fajar's debt, we don't believe this will significantly weaken the company's debt-to-EBITDA ratio, which should benefit from an improving operating environment and better margins. In our opinion, Fajar's debt-to-EBITDA ratio, which was 2.7x at September 2010, will weaken only moderately to about 3.0x in fiscal 2011 and reduce thereafter as its bank loan amortizes.

Liquidity

We believe Fajar's liquidity is adequate. It can use US$100 million of its US$120 million syndicated credit facility to refinance its senior secured notes maturing in October 2011 and the remainder for general corporate purposes. The company also has a credit facility of about US$40 million for general corporate purposes.

In our view, Fajar's debt maturity profile will be manageable following the refinancing of the notes. We expect the company to generate funds from operations of more than US$40 million and that it will comply with the covenants without difficulty.

Outlook

The stable outlook reflects our expectation that Fajar's operating performance over the next few quarters is likely to be stable, in line with robust demand for paper products and prices. The stable outlook also assumes smooth refinancing of the existing notes due October 2011, using the already tied-up bank loans.

We may lower the rating if Fajar's consolidated credit measures deteriorate, such that its ratio of debt to EBITDA is more than 4.0x on a sustained basis. Credit measures could weaken due to higher-than-expected debt (to fund capital expenditure or acquisitions), weaker paper demand and prices, or higher input costs.

We may raise the rating if: (1) Fajar improves its market position, resulting in stronger cash flows; or (2) the company maintains its financial metrics after taking into consideration capital expenditure, supported by a continued improvement in the operating environment, stable margins, and adequate liquidity.

Related Criteria And Research

- Corporate Ratings Criteria 2008, published April 15, 2008

Ratings List

Upgraded

	To	From
PT Fajar Surya Wisesa Tbk.		
Corporate Credit Rating	B+/Stable/--	B/Stable/--
Fajar Paper Finance B.V.		
Senior Secured	B+	B

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