FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Pan Brothers at 'CCC-'/'CCC-(idn)'

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Fitch Ratings - Jakarta/Singapore - 31 Jul 2023: Fitch Ratings has affirmed Indonesia-based garment manufacturer PT Pan Brothers Tbk's Long-Term Issuer Default Rating (IDR) at 'CCC-'. Fitch has also affirmed the rating on Pan Brothers' USD171 million senior unsecured notes due December 2025, issued by PB International B.V., at 'CCC-' with a Recovery Rating of 'RR4'. At the same time, Fitch Ratings Indonesia has affirmed Pan Brothers' National Long-Term Rating at 'CCC-(idn)'.

The affirmation reflects the liquidity pressure from USD124 million syndication loan maturity in December 2023. Fitch expects Pan Brothers to refinance the loan as we do not expect the company will generate sufficient cash flow to repay the loan. Pan Brothers has started discussing refinancing with potential lenders and plans to conclude the process by the end of 3Q23.

'CCC' National Ratings denote a very high level of default risk relative to other issuers or obligations in the same country or monetary union.

KEY RATING DRIVERS

Imminent Debt Maturity: Pan Brothers faces a USD124 million maturity in December 2023 as part of its USD138 million syndicated loan. The company has started discussions with various banks to refinance the facility and plans to conclude the process by the end of 3Q23. Successful refinancing that extends the maturity would alleviate immediate liquidity constraints, as the next large debt repayment will only mature in 2025.

Negative Cash Flow from Operations: We expect cash flow from operations to remain negative in 2023 (1Q23: negative USD37 million), due to the company's large working-capital requirements. Liquidity pressure is exacerbated by maintenance and efficiency capex needs, which we estimate at around USD5 million in 2023, despite the absence of a capacity expansion plan.

Limited Financial Flexibility: We estimate that available cash and internal cash flow generation, excluding the December 2023 debt repayment, is sufficient to cover operational expenses, taxes, interest expense, working capital and capex until end-2023. This is supported by a USD48 million rights issues in 2023 and some repayments on existing loans in 4Q22 and 1Q23 following additional equity inflows. However, the company's ability to obtain additional bank facilities to sustain its operation is subject to execution risk following its debt-restructuring with bank lenders and bond holders.

Flat Revenue Growth: We expect revenue growth to stay flat in 2023, as the company's ability to invest in capacity expansion is limited. The steady revenue forecast is supported by our expectations of improved sales for the remainder of 2023, despite a weak 1Q23 amid low customer demand. We also expect the EBITDA margin to decline to below the 8% level in 2023 due to rising wage pressure.

ESG - Management Strategy: Improvement in its cash generation is dependent on Pan Brothers' strategy development and implementation in terms of working-capital and debt maturity management. Its debt repayment and refinancing capacity relies on its ability to attract new bank lenders beyond its previous and current lenders, or other alternative sources of funding.

DERIVATION SUMMARY

Pan Brothers' rating is driven by near-term liquidity pressure, with the maturity of a USD124 million syndication loan in 4Q23. Fitch believes the available cash balance and internal cash flow generation are insufficient to meet the repayment schedule.

KEY ASSUMPTIONS

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

- Flat revenue growth in 2023, followed by low single-digit growth in 2024

- EBITDA margin of below 8% in 2023, before recovering to around 8% in 2024

- Capex of around USD5 million in 2023, then doubling in 2024 as the company invests in capacity growth

- No dividend in 2023-2024

KEY RECOVERY RATING ASSUMPTIONS

The recovery analysis assumes that Pan Brothers would be reorganised as a going-concern in bankruptcy rather than liquidated. We assume a 10% administrative claim.

Going-Concern Approach

- The going-concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganisation EBITDA level upon which we base the enterprise valuation.

- We estimate EBITDA at USD62 million to reflect industry conditions and competitive dynamics.

- An enterprise value multiple of 5x EBITDA is applied to the going-concern EBITDA to calculate a post-reorganisation enterprise value. The multiple factors in Pan Brothers' customer quality and stable demand, despite Covid-19 pandemic-related disruption. The multiple also applies a discount from the median of around 8x of comparable Asian apparel peers, which are generally larger than Pan Brothers.

- The going-concern enterprise value corresponds to a 'RR3' Recovery Rating for the senior unsecured notes after adjusting for administrative claims. Nevertheless, Fitch has rated the senior unsecured bonds at 'CCC-' with a Recovery Rating of 'RR4' because, under our Country-Specific Treatment of Recovery Ratings Criteria, Indonesia is classified under the Group D of countries in terms of creditor friendliness, and instrument ratings of issuers with assets located in this group are subject to a soft cap at the issuer's IDR and a Recovery Ratings of 'RR4'.

RATING SENSITIVITIES

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

- Improved liquidity that includes continued access to bank funding

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

- Inability to refinance the upcoming syndicated loans by the end of 3Q23

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best-

and worst-case scenario credit ratings, visit
https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Insufficient Liquidity: Pan Brothers had USD36 million of available cash and no committed undrawn facilities at end-March 2023. This is insufficient to cover short-term debt maturities, which largely constitute a USD124 million syndicated loan that matures in December 2023. We also estimate that free cash flow will be negative in 2023, driven by a weaker working capital position, which will further drag on liquidity. The short time until the syndicated loan matures heightens the risk that Pan Brothers will be unable to find a solution to address the debt maturity.

ISSUER PROFILE

Pan Brothers is one of Indonesia's largest garment manufacturers, with Adidas and Uniqlo as its main customers. The company has a production capacity of up to 117 million pieces a year and exports represented around 95% of total sales in 2022.

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.

ESG CONSIDERATIONS

Pan Brothers has an ESG Relevance Score of '5' for Management Strategy, due to the impact of its strategy development and implementation in terms of working-capital management and funding, which has a negative impact on the credit profile, and is highly relevant to the rating, resulting in the weak liquidity position and high refinancing risk that underpins the rating.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			RECOVERY	PRIOR
PT Pan Brothers Tbk	LT IDR	CCC-	Affirmed		CCC-
	Natl LT	CCC-(idn)	Affirmed		CCC-(idn)
PB International B.V.					
senior unsecured	LT	CCC-	Affirmed	RR4	CCC-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 23 Dec 2020)

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

Corporate Rating Criteria (pub. 29 Oct 2022) (including rating assumption sensitivity)

Country-Specific Treatment of Recovery Ratings Criteria (pub. 04 Mar 2023)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 13 May 2023)

Climate Vulnerability in Corporate Ratings Criteria (pub. 22 Jul 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

PB International B.V.	EU Endorsed, UK Endorsed
PT Pan Brothers Tbk	EU Endorsed, UK Endorsed
PT Pan Brothers Tbk	EU Endorsed, UK Endorsed

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