



## Fitch Upgrades Indika Energy to 'B+'; Outlook Positive

Fitch Ratings-Singapore-12 December 2017: Fitch Ratings has upgraded Indonesia-based PT Indika Energy Tbk's (Indika) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'B+' from 'B-' and removed the ratings from Rating Watch Positive. The Outlook is Positive. The agency has also upgraded Indika's outstanding senior notes due 2023 and Indika Energy Capital II Pte Ltd's USD265 million senior notes due 2022 (guaranteed by Indika) to 'B+' from 'B-' with a Recovery Rating of 'RR4'. Fitch has also assigned Indika Energy Capital III Pte. Ltd.'s USD575 million senior notes (guaranteed by Indika) a final rating of 'B+' with a Recovery Rating of RR4'.

The upgrade reflects Fitch's expectations of improvement in Indika's credit profile following the acquisition of an additional stake in PT Kideco Jaya Agung (Kideco), Indika's key coal mining asset. The additional stake in Kideco, in our view, will increase cash flows available to Indika, based on Fitch's updated coal price assumptions relative to the additional debt required for financing the transaction. We believe Indika's consolidated business profile and credit metrics, given its enhanced operating and financial control of Kideco, will be comparable with other low 'BB' rated coal peers. However, the company's lumpy debt maturities constrain the ratings.

The Positive Outlook reflects Fitch's expectations of the flexibility available to Indika to address its lumpy debt maturities. We believe Indika has the flexibility to improve its capital structure by reducing its debt through the use of its cash flow or refinancing part of its existing debt in the near to medium term well before the debt maturities.

The assignment of the final rating to the USD575 million notes follows a review of the final documentation, which conforms to the draft documentation previously received. The final rating is the same as the expected rating assigned on 27 September 2017.

### KEY RATING DRIVERS

**Additional Stake Adds Value:** We expect Indika's acquisition of the additional 45% stake in Kideco to be value accretive, after weighing the purchase consideration against the benefits of additional cash access and greater operational and financial control. The transaction has an initial payout of around USD517.5 million and a deferred consideration of around USD160 million, on a present-value basis. The deferred consideration will be paid upon fulfilment of certain terms and conditions.

We expect Indika's incremental dividends from the additional stake in Kideco to be sufficient to repay more than half of additional debt after meeting funding costs on the additional debt over the next five years. We also believe that Indika will have greater control to influence the production plans and timing of dividends.

**Credit Metrics to Improve:** We expect Indika's credit metrics to improve in FY18 following the completion of the share purchase and the revision in our coal price assumptions. Consolidated EBITDAR fixed-charge cover should be over 4.5x from FY18, while consolidated net leverage (net adjusted debt/ EBITDAR) is likely to decline to around 1.6x in FY18 and remain around 1.2x-1.7x over the medium term. We also expect Indika's standalone (holding company on a standalone basis) EBITDA interest cover to improve and range between 2x-4x over the next five years, with average interest cover of over 2.5x versus our previous expectations of around 1.3x.

**Lumpy Debt Maturities Constrain Ratings:** Indika has USD265 million in notes maturing in 2022, USD500 million in notes due 2023 and USD575 million in notes due 2024. Most coal-mining and coal-related peers have more staggered debt maturities. Fitch believes Indika has some flexibility in managing its debt maturity profile from its ability to reduce debt using cash flows or undertake pro-active liability management to address its capital structure in the near to medium term well before the debt matures, although risks remain against a backdrop of rising global interest rates and coal-price volatility.

**Consolidated Approach:** Fitch expects to take a consolidated view of Indika that includes Kideco, with Kideco becoming a majority-owned subsidiary of Indika, in addition to analysing Indika's holding company cash flows on a standalone basis. The consolidated view reflects Indika's greater control over Kideco's operations and financial strategy. We believe Indika's cash flows and credit metrics will benefit from the favourable incremental dividends relative to the additional debt.

**Cyclical Coal-Industry Exposure:** Indika is vulnerable to the commodity cycle as its earnings and cash flow are linked to the thermal coal industry. Fitch has increased the 2018 price for thermal coal - Newcastle 6,000 kcal - to USD72/metric ton (mt) (from USD65/mt), and assumed a price of USD67/mt thereafter (from USD65/mt). Thermal coal prices have come off their late-2016 peak, reflecting China's coal-price management policies.

Fitch expects some production uptick in response to higher prices, which should lead to further price moderation over the medium term and is reflected in our price assumptions. Furthermore, we expect Asian thermal coal prices to be highly susceptible to import demand in the region, particularly Chinese demand and policies relating to the coal sector.

**Kideco's Low-Cost Operations:** Kideco benefits from the low-cost structure of its key mines (first and second quartile) and high production flexibility and capacity, which require little capex. It also benefits from the large reserves (proven reserves of around 422 million tonnes) and relatively favourable reserve life of its mines. The absence of any debt also supports its profitability and pre-dividend free cash generation. Kideco trimmed costs during 2016, but we expect rising oil prices to drive up costs marginally over the medium term. Notwithstanding this, Kideco retains its ability to generate stronger cash flow based on our coal-price assumptions.

**Subsidiaries' Operations to Improve Gradually:** We expect operations of 70%-owned PT Petrosea Tbk (a mining contractor) and 51%-owned PT Mitrabahera Segara Sejati Tbk (MBSS, coal barging and handling) to improve gradually in 2017 and 2018, supported by higher commodity prices. We expect Petrosea and MBSS to turn around and generate net profit from 2017 and 2018, respectively, compared with their net losses in 2015 and 2016.

We believe these subsidiaries will be able to fund their own investment needs and will not require financial support from Indika. We expect the order-book and revenue of fully owned Tripatra (an engineering, procurement and construction company) to benefit from a boost to infrastructure investments in Indonesia - including the oil and gas sector - over the medium term. Tripatra's revenue increased by 25% yoy during 1H17 to USD149 million.

## DERIVATION SUMMARY

Indika's ratings reflect Fitch's expectation of improvement in Indika's profile following the completion of the agreement to purchase additional shares in Kideco, its key coal mining asset. We expect Indika to benefit from incremental cash flows and greater operational control of Kideco when weighed against the purchase consideration. We expect Indika's business profile to be comparable with PT Bukit Makmur Mandiri Utama (BUMA, BB-/Stable) and PT ABM Investama Tbk (BB-/ Stable) given the low-cost position of Kideco, one of the top three coal producers in Indonesia, and the partially integrated operations of coal mine contracting and transportation through its other subsidiaries. However, we assess Indika's financial profile to be weaker due to its large lumpy debt maturities, which can expose the company to refinancing risks over the medium term, resulting in its rating being one notch lower.

Geo Energy Resources Limited's (B+/Stable) business profile is weaker given its small scale of operations and the limited reserves of its mines compared with Indika. However, Geo Energy has a stronger financial profile compared with Indika after the latter's share purchase transaction, resulting in their similar ratings.

## KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:

- Coal prices in line with Fitch's mid-cycle commodity price assumptions, adjusted for difference in calorific value (average Newcastle 6,000 kcal free-on-board: USD72/mt in 2018 and USD67/mt thereafter). For more details, see Updating Fitch's Mid-Cycle Commodity Price Assumptions (<https://www.fitchratings.com/site/re/10006725>), dated 9 October 2017.
- Acquisition of 45% additional equity stake in Kideco for around USD677.5 million in 2017, with USD517.5 million payable in 2017.
- Kideco coal volumes of around 32 mt in 2017, 34 mt in 2018 and around 36 mt by 2019. Capex of around USD3 million in 2017 and around USD10 million in 2018 and 2019.
- Dividend payout ratio for Kideco remaining high at around 95%-98%.
- No dividend from MBSS or Petrosea in 2017, with dividends of around USD1 million from Petrosea in 2018. Dividends from associate PT Cirebon Electric Power of about USD6 million per year over the medium term.
- Low capex at Tripatra and MBSS, and higher capex at Petrosea, to support new mining contracts, resulting in capex of around USD115 million in 2017 and in the range of USD75 million-100 million a year thereafter.

Fitch's key assumptions for bespoke recovery analysis include:

- The recovery analysis assumes that Indika and its subsidiaries would be considered a 'going concern' in bankruptcy, and that the company would be reorganised rather than liquidated. We have assumed a 10% administrative claim.
- Kideco's going-concern EBITDA is based on last six months June 2017 EBITDA, and includes pro-forma adjustments for the EBITDA contributions from increasing coal volumes and Fitch's coal price assumptions over the next three years.
- The going-concern EBITDA estimate reflects Fitch's view of a sustainable, post-reorganisation EBITDA level upon which we base the valuation of the company. The going-concern EBITDA is 30% below the mid-cycle EBITDA based on the long-term average thermal coal price assumptions used by Fitch. The post-reorganisation EBITDA assumes some post-default operating improvement, and is at a level that may violate the intended covenants for its US dollar notes.

- The going-concern EBITDA for Indika's subsidiaries, Petrosea and MBSS, is based on last six months June 2017 EBITDA, adjusted for our expectations of an increase in revenue, if any, over the next three years given new contracts or orders.
- Fitch generally assumes fully drawn working capital of about USD50 million in its recovery analysis, since working-capital debt is tapped as companies are under distress.
- An enterprise value (EV) multiple of 3.5x is used to calculate a post-reorganisation valuation for Kideco based on the share-purchase agreement. The historical EV multiple for companies in the natural resources sector ranged from 5.8x-11x, with a median of 8.7x. However, we have used a conservative multiple, given the transaction. An EV multiple of 5x is used to calculate a post-reorganisation valuation for Indika's other investments.
- The property owned by Indika is assumed to be sold at a 50% discount to the market value of around USD100 million, which is based on the company's estimate.
- The waterfall results in a recovery of around 70% for the note holders of the USD575 million issuance. However, Fitch applies a soft cap of 'RR4' for the Recovery Ratings of Indika, given that most of its businesses are located in Indonesia, a Group D country. Fitch consequently rates the senior unsecured US dollar notes at 'B+'.

## RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

- Fitch will upgrade Indika's rating if it successfully addresses its lumpy debt maturities while maintaining net leverage (net adjusted debt/ EBITDAR) below 2.5x and EBITDA fixed charge cover above 3.5x.

Developments that May, Individually or Collectively, Lead to Negative Rating Action

- Failure to meet the above positive rating guideline could lead to the revision of its Outlook back to Stable.

## LIQUIDITY

Comfortable Near-Term Liquidity: Indika's near- to medium-term liquidity is comfortable in the absence of any significant debt maturities. Indika has a minimal debt amortisation schedule until 2021. Significant liquidity needs for debt repayment will only happen from 2022. We expect Indika's cash balances to be sufficient to repay its 2022 debt maturities based on our current coal price assumptions.

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## Applicable Criteria

Corporate Rating Criteria (pub. 07 Aug 2017) (<https://www.fitchratings.com/site/re/901296>)

Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016) (<https://www.fitchratings.com/site/re/887669>)

National Scale Ratings Criteria (pub. 07 Mar 2017) (<https://www.fitchratings.com/site/re/895106>)

Non-Financial Corporates Notching and Recovery Ratings Criteria (pub. 16 Jun 2017) (<https://www.fitchratings.com/site/re/899659>)

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