

PT Indika Energy Tbk (/gws/en/esp/issr/85309273)



Fitch Assigns Indika Energy Positive Outlook on Higher Coal Prices

Fitch Ratings-Singapore-06 March 2017: Fitch Ratings has affirmed Indonesia-based PT Indika Energy Tbk's (Indika) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'CCC' and assigned a Positive Outlook. Indika's senior notes due 2018 and 2023 have also been affirmed at 'CCC' with a Recovery Rating of 'RR4'.

The Positive Outlook reflects Fitch's expectation of improvement in Indika's cash flows due to higher thermal coal prices. Fitch revised its mid-cycle price assumptions for thermal coal on 2 March 2017. We believe the higher cash generation has substantially improved the company's ability to refinance its 2018 notes, and the need for any debt restructuring has receded significantly. We are likely to upgrade Indika's ratings to 'B-' should the company successfully refinance its 2018 notes. This is provided such refinancing does not significantly raise its annual debt refinancing needs and can be managed comfortably within forecast cash generation at the Indika level (holding company on a standalone basis), and maintains a sufficiently large cash balance at Indika-level to support overall liquidity.

KEY RATING DRIVERS

Updated Coal Price Assumptions: Fitch has increased the 2017 price for thermal coal - Newcastle 6,000 kcal - to USD70/metric tonne (mt) (from USD57), and assume USD65/mt thereafter (from USD60) (see Updating Fitch's Commodity Price Assumptions published on 2 March 2017: <https://www.fitchratings.com/site/re/895103>). Prices have come off the peak reached in late 2016, but our increased mid-cycle price assumptions reflect China's policies aimed at managing coal production and prices. We expect some production uptick in Australia, China and Indonesia in response to higher prices, which should lead to some further moderation in prices as reflected in the updated price assumptions.

Higher Kideco Dividends: The improvement in coal prices will drive higher cash generation at PT Kideco Jaya Angung, Indika's key coal mining asset (Kideco - 46% held by Indika), and consequently lead to higher dividend flows to Indika. Indika relies heavily on dividends from Kideco. We now assume dividend receipts from Kideco to be around USD40m in 2017 (including a dividend of USD17m received during 4Q16), and to rise further in 2018 to over USD70m in the next year (against previous assumptions of below USD40m) based on our revised coal price assumptions.

Kideco's relatively high production flexibility and capacity (requiring little capex), generally low cash operating costs and absence of any debt support its profitability and pre-dividend free cash generation. Kideco trimmed costs and maintained a low strip ratio during 2016, while we expect the rising oil prices to drive up costs during 2017. Notwithstanding this, Kideco retains its ability to generate stronger cash flows under higher coal prices.

Weak, but Improving Liquidity: Fitch expects higher dividends from Kideco to arrest deterioration in Indika's liquidity profile. We estimate Indika's (entity level) cash flows to be neutral in 2017 and to cover its operating expenses and interest costs without the need to dip in to its cash reserves (estimated at around USD150m as of end-December 2016). This is also likely to reduce its reliance on short-term debt in the near term. We expect the situation to improve further in 2018, based on our revised coal assumptions for 2018-2019.

Better Refinancing Ability: We expect the sustained improvement in Indika's cash flows to enhance its refinancing ability, particularly the 2018 notes (USD171m remaining). We believe that a successful refinancing - at a cost not significantly higher than its existing notes and a manageable debt maturity profile which can be accommodated within its forecast cash generation - will provide the company adequate time to address its capital structure, with the next large debt maturity the USD500m notes due in January 2023.

Subsidiaries' Cash Generation to Remain Muted: We expect no dividends in 2017 from Indika's key subsidiaries - 70%-owned PT Petrosea Tbk (Petrosea, a mining contractor) and 51%-owned PT MitraBhatera Segara Sejati Tbk (MBSS, coal barging and handling) - given their losses during 2016. We anticipate the higher commodity prices to result in some (but only a modest) improvement in the trading performance and cash generation of these subsidiaries during 2017, with a more sustained recovery from 2018. We believe the investment needs of these subsidiaries can be self-funded, requiring no financial support from Indika.

The revenues of fully owned Tripatra - an engineering, procurement and construction company - declined during 2016, while we expect its order-book to benefit from an increase in infrastructure investments in Indonesia, including oil & gas.

DERIVATION SUMMARY

Indika's 'CCC' rating reflects its weak liquidity and high refinancing risk for its debt maturing in 2018. The Positive Outlook, however, reflects the likely improvement in Indika's cash flows supported by higher coal prices, which consequently enhances its ability to refinance the 2018 debt maturity. We now expect Indika's (entity level) FCF to be neutral in 2017. Indika's ratings are comparable with those of MIE Holdings Corporation (MIE, CCC), which also faces significant challenges in relation to refinancing its outstanding notes due in February 2018 and April 2019. MIE's challenges are more complicated than those of Indika, from its depleted asset base relative to indebtedness which is still high. Yanzhou Coal Mining Company Limited's (Yancoal, B/ Negative) reflects its high financial leverage and weak liquidity; the 'B' IDR, however, incorporates ongoing adequate access to banking and domestic capital markets as a provincial state-owned enterprise.

KEY ASSUMPTIONS

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

- Coal prices in line with Fitch's mid-cycle commodity price assumptions, adjusted for difference in calorific value (average Newcastle 6000 kcal free-on-board (FOB): USD70/mt in 2017 and USD65/mt thereafter)
- Kideco coal volumes of around 32 million tonnes in 2017 and around 36mt in 2018. Capex remaining low around USD3m in 2017 and around USD5m in 2018 and 2019
- Dividend payout ratio for Kideco remaining high around 95%-98%
- No dividend from MBSS and Petrosea in 2017, with dividends of around USD5m from Petrosea in 2018. Dividends from associate PT Cirebon Electric Power of about USD7m per year through to 2018
- Low capex at Tripatra and MBSS, and marginally higher capex at Petrosea to support new mining contracts resulting in capex of around USD70m in 2017 and declining to around USD50m a year thereafter.

RATING SENSITIVITIES

Future Developments That May, Individually or Collectively, Lead to Positive Rating Action

- A successful refinancing of its 2018 notes is important for any positive rating action, provided any new debt raised for refinancing does not significantly increase its annual total debt-servicing requirement, such that Indika can manage its liquidity needs within operating cash generation at the Indika level, and maintains a cash balance of at least USD100m at the Indika level.

Future Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Failure to refinance the 2018 notes; not meeting the above upgrade guidance
- Any further weakening of liquidity, which may arise from weaker-than-expected coal prices and dividend receipts, and reduced access to credit facilities.

LIQUIDITY

Indika's liquidity position is weak, but likely to improve with higher coal prices - as stated above.

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Applicable Criteria

Country-Specific Treatment of Recovery Ratings (pub. 18 Oct 2016) (<https://www.fitchratings.com/site/re/887669>)
 Criteria for Rating Non-Financial Corporates (pub. 27 Sep 2016) (<https://www.fitchratings.com/site/re/885629>)
 Recovery Ratings and Notching Criteria for Non-Financial Corporate Issuers (pub. 21 Nov 2016) (<https://www.fitchratings.com/site/re/890199>)

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