



## Fitch Downgrades Indika Energy to 'CCC'

Fitch Ratings-Singapore-02 June 2016: Fitch Ratings has downgraded the Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) of Indonesia-based PT Indika Energy Tbk (Indika) to 'CCC', from 'B' with Negative Outlook. Indika's senior notes due 2018 and 2023 have also been downgraded to 'CCC' with a Recovery Rating of 'RR4', from 'B'.

The downgrade reflects Indika's weakened cash generation from expected lower dividend receipts, higher reliance on short-term debt facilities, our expectation of negative cash flow generation at Indika (after debt servicing costs) beyond 2016 leading to lower cash reserves, and uncertainties relating to how the 2018 note will be redeemed.

### KEY RATING DRIVERS

**Sustained Weak Coal Market:** Weak demand from China and India continues to hobble the Asia-Pacific thermal coal market, with key benchmark prices across the region falling about 15% in the last year. Prices have started to stabilise in recent months, but we do not expect any meaningful recovery in coal prices in the medium term. Domestic demand for steam coal in Indonesia is rising as domestic production declines, but this is not sufficient to balance the seaborne coal market.

**Dividends from Kideco to Fall:** Indika continues to rely heavily on dividends from its 46%-held coal company PT Kideco Jaya Agung (Kideco) for cash generation. However, Kideco's net income is likely to fall substantially in 2016 and 2017 because of lower production (Fitch expects 33 million tonnes in 2016, down from 39 million tonnes in 2015) and a shift to production of coal with lower calorific value. As a result, Fitch expects Kideco's dividend payment to Indika to fall to less than USD40m a year, from USD60m in 2016 and USD65m in 2015.

Kideco, however, remains profitable, with relatively high production flexibility and capacity (requiring little capex), generally low cash operating costs and little debt. We expect Kideco to be able to maintain a low strip ratio and to be able to further trim costs in 2016, especially on contractor payments. However, rising oil prices amid flat coal prices could put pressure on its margins over time.

**Subsidiaries' Cash Generation to Worsen:** Indika's dependence on Kideco has increased because the weak coal market has impaired the trading performance and cash generation of its other subsidiaries, especially 70%-owned PT Petrosea Tbk (Petrosea, a mining contractor) and 51%-owned PT Mitrabahtera Segara Sejati Tbk (MBSS, coal barging and handling). We now expect no dividend contribution from MBSS and Petrosea in the next two to three years. Indika received about USD19m of dividends in 2015 from MBSS, Petrosea and PT Cirebon Electric Power (20% interest).

The order book and revenue of fully owned Tripatra, an engineering, procurement and construction company, have also declined. However, we expect Tripatra's order book to benefit from an increase in infrastructure investments, including in oil & gas, in Indonesia.

**Reliance on Short-Term Debt:** With lower dividends likely from its investments, Indika will have to depend more heavily on short-term debt facilities. The company's short-term debt increased after it used its cash to repurchase about USD129m of the 2018 notes, which have total principal value of USD300m, for USD77m in November 2015. The company still has substantial cash balances. At end-March 2016, it had about USD215m of cash after receiving USD32m of the USD60m dividends due from Kideco in

March, with total group consolidated cash balances at USD396m. This compared with about USD95m of short-term credit facilities (about USD93m of which has been drawn at end-March 2016), which require rolling over. The company is likely to repay some of these facilities and is in talks to or agreed to maintain the remaining. We believe the company will be able to roll over these facilities, although its interest charges on these facilities are likely to increase.

**Deterioration in Liquidity Profile:** Indika has taken further steps with the aim to reduce operating expenses at the company level by around USD10m a year, to around USD35m-40m a year. The company has several properties it can monetise. It recently sold a property in Singapore for around SGD30m (USD22m), but it is still not clear if the company will sell its properties in Jakarta. However, lower dividend receipts from 2017 and interest expenses at the Indika level of around USD45m a year would mean that the company will have to draw on its cash reserves, further reducing its financial flexibility and liquidity.

**Looming Debt Maturity:** Aside from its short-term debt facilities, the remaining USD171m of the 2018 notes fall due in May 2018. The next large debt maturity is for the USD500m notes due in Jan 2023. The company is weighing its options to address its debt structure, especially the repayment of the 2018 notes. Fitch is unlikely to treat another below-par debt repurchase or exchange as opportunistic given the weakened liquidity profile of the company.

## KEY ASSUMPTIONS

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

- Coal prices in line with Fitch's mid-cycle commodity price assumptions, adjusted for difference in calorific value (Newcastle 6,000 FOB: USD50/mt in 2016, USD52 in 2017 and 2018)
- Dividend payout ratio for Kideco of around 95%-98%. Indika's share of dividends to remain below USD40m till 2018
- No dividends from MBSS in 2016 and 2017 and around USD2m in dividends thereafter. No dividends from Petrosea till 2018. Dividends from associate PT Cirebon Electric Power of about USD7m a year through to 2018
- Low capex at Tripatra, Petrosea and MBSS resulting in lower capex of around USD40m in 2016 and around USD45m a year in 2017 and 2018
- Indika will be able to roll over its short-term debt facilities

## RATING SENSITIVITIES

**Positive:** Future developments that may, individually or collectively, lead to positive rating action include:

- An upgrade of Indika's ratings is unlikely until the company addresses its liquidity. 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. An upgrade will also depend on Indika being able to at least break even on a cash flow basis such that its cash balances do not continue to reduce.

**Negative:** Future developments that may, individually or collectively, lead to negative rating action include:

- A further weakening of liquidity, which may arise from weaker-than-expected coal prices and dividend receipts, and reduced access to credit facilities

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### **Applicable Criteria**

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 17 Aug 2015) ([https://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=869362&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiE0NjQ4OTM2NTgsInNlc3Npb25LZXkiOiJMRLg4N1Q1Uk4xQzhZM1pBR1BMSU1GTVMUZQSEZITURSVlpGUDREln0.0c-Ax46X\\_62l\\_3aIU1RG6OSVQkl\\_nPHxGOA1BAXfwHk](https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=869362&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiE0NjQ4OTM2NTgsInNlc3Npb25LZXkiOiJMRLg4N1Q1Uk4xQzhZM1pBR1BMSU1GTVMUZQSEZITURSVlpGUDREln0.0c-Ax46X_62l_3aIU1RG6OSVQkl_nPHxGOA1BAXfwHk))

### **Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form

([https://www.fitchratings.com/creditdesk/press\\_releases/content/ridf\\_frame.cfm?pr\\_id=1005466&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiE0NjQ4OTM2NTgsInNlc3Npb25LZXkiOiJMRLg4N1Q1Uk4xQzhZM1pBR1BMSU1GTVMUZQSEZITURSVlpGUDREln0.0c-Ax46X\\_62l\\_3aIU1RG6OSVQkl\\_nPHxGOA1BAXfwHk](https://www.fitchratings.com/creditdesk/press_releases/content/ridf_frame.cfm?pr_id=1005466&cft=eyJ0eXAiOiJKV1QiLCJhbGciOiJIUzI1NiJ9.eyJleHAiOiE0NjQ4OTM2NTgsInNlc3Npb25LZXkiOiJMRLg4N1Q1Uk4xQzhZM1pBR1BMSU1GTVMUZQSEZITURSVlpGUDREln0.0c-Ax46X_62l_3aIU1RG6OSVQkl_nPHxGOA1BAXfwHk))

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