FITCH DOWNGRADES INDIKA TO 'B'; OUTLOOK NEGATIVE

Fitch Ratings-Singapore/Jakarta-22 July 2015: Fitch Ratings has downgraded the Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) of Indonesia-based Indika Energy Tbk (Indika) to 'B' from 'B+'. The Outlook on the ratings remains Negative. Indika's senior unsecured notes have also been downgraded to 'B' from 'B+', with a Recovery Rating of 'RR4'.

The downgrade of Indika's rating and maintenance of the Negative Outlook reflects Fitch's expectation of sustained weak credit metrics, largely as a result of lower dividend inflows from its coal mining company, PT Kideco Jaya Angung (Kideco), as coal prices are likely to remain weak.

The company has made some progress with trimming costs and capex that drain its cash flows. While Indika maintains adequate liquidity with over USD230m cash and equivalents at the company level, the Negative Outlook reflects challenges the company may face in refinancing the bonds due in 2018 and 2023 if coal prices remain subdued for an extended period. Such an environment also raises the possibility that the company's interest burden would increase substantially when it refinances its long-term debt. The coupon on Indika's existing USD300m notes due in 2018 is 7% per annum and that on its USD500m notes due in 2023 is 6.375%; its cost of debt on refinancing is likely to be higher given the weakened credit profile, which may further weigh on its cash flows.

KEY RATING DRIVERS

Weakened Credit Profile: Fitch expects Indika's interest coverage to fall below 1x in 2016 and 2017 (1.7x in 2014); where interest coverage is the ratio of EBITDA minus taxes, of the company at a standalone-level and its fully owned subsidiaries plus dividend inflows from all its non-fully owned subsidiaries and associate companies to the interest expense of the holding company and fully owned subsidiaries. The ratio's decline is primarily due to lower dividends from 46%-owned Kideco. Fitch, however, expects the ratio to gradually improve to over 1x by 2018 with our assumption of moderate increases in coal prices; however, an increase in Indika's cost of debt could mute the extent of the improvement.

Lower Dividends from Kideco: Fitch expects dividends from Kideco to remain weak due to our expectation of low coal prices. The majority of Indika's cash inflow is from the Kideco dividends, which amounted to over USD200m in 2012. This fell to USD88m in 2014 and we expect it to be around USD65m in 2015 and less than USD50m in 2016. The dividends can likely recover gradually, in line with our forecast moderate improvements in coal prices. Fitch expects the Newcastle coal price benchmark to gradually rise from current levels, due to global production rationalisation and rising demand from India and Indonesia, but remain below USD70 a tonne until 2018.

Indika expects Kideco to continue paying out about 90% of its net profit as dividends. Kideco carries no debt, and has minimal capex requirements because it has capacity of about 50mtpa compared with production of 40mtpa in 2014. Kideco also is one of the lowest cost producers supplying to the seaborne thermal coal market, and is placed among the lowest quartile of the cost curve for seaborne supply. The weak global coal prices have put pressure on its earnings, with EBITDA falling to USD318m in 2014 from USD850m in 2011.

Holding Company Cost Cuts: Indika continues to trim costs at the holding company level, with operating costs falling by about USD20m to about USD55m in 2014. Cost cutting measures mostly related to halting spending on new greenfield coal assets. While Fitch expects further cost cuts at the holding company level, we do not think this will be adequate to fully offset the reduction in dividends from Kideco.

Adequate Liquidity: On a standalone basis Indika had about USD180m in cash and equivalents, and USD55m in liquid funds. Its fully owned subsidiary Tripatra had USD58m of cash balances and debt of USD25m. On a standalone basis Indika does not have any major debt maturities until its USD300m of senior unsecured bonds come due in 2018. Fitch expects Indika's standalone net cash generation to be marginally negative to neutral over the coming few years, and that its cash balances would be able to comfortably cover any negative cash flows during this period.

Refinancing Risk: Indika would require refinancing when its USD300m of bonds mature in 2018. Indika has another USD500m of senior unsecured notes due in 2023, and USD80m of working capital facilities taken on for its coal trading operations. Of the USD500m of notes, USD115m has been extended to its 70%-owned subsidiary Petrosea, a mining contractor, whose operating and financial performance too has weakened with the challenges facing the Indonesian coal mining industry.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Newcastle prices of USD62, USD66, USD67, USD71 and USD72 from 2015 to 2019.
- Kideco continues to maintain a dividend payout ratio of 90%. Dividends from Kideco remain below USD50m until 2019.
- EBITDA losses on a standalone basis fall to USD29m from USD47m in 2014, owing to cost cuts, stopping exploration spending at its new assets and other measures.
- Dividends from Petrosea immaterial throughout the forecast due to weak profits. Dividends from PT Mitrabahtera Segara Sejati Tbk and PT Cirebon Electric Power (its associate power company) amount to about USD13m per annum throughout the forecast.

RATING SENSITIVITIES

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

- A material weakening of liquidity at the holding company level due to a deterioration of its cash balances and access to external funding
- A failure to improve the holding company interest coverage to above 1.0x on a forecast basis

Positive: Future developments that may, individually or collectively, lead to positive rating action include:
Fitch may revise Indika's rating Outlook to Stable, while affirming its IDR at 'B' if the company can improve its holding company interest coverage comfortably above 1.0x while satisfactorily addressing its refinancing risks and maintaining adequate liquidity.

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Applicable Criteria
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 28 May 2014)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393