



Fitch Upgrades Indika Energy to 'B-/Stable'; Rates USD Notes Final 'B-'

Fitch Ratings-Singapore-06 April 2017: Fitch Ratings has upgraded Indonesia-based PT Indika Energy Tbk's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'B-' from 'CCC'. The agency has also upgraded Indika's outstanding senior notes due 2018 and 2023 to 'B-' from 'CCC' with a Recovery Rating of 'RR4'. Simultaneously, all ratings have been removed from Rating Watch Positive and a Stable Outlook has been assigned to the Long-Term IDRs. The agency has assigned a final rating of 'B-/RR4' to Indika Energy Capital II Pte Ltd's USD265 million senior notes, which are guaranteed by Indika.

The upgrade follows the successful issue of the USD265 million senior notes to refinance Indika's 2018 USD note maturities. We believe the note issue has improved Indika's liquidity, which is in addition to our expected cash flow improvement due to higher thermal coal prices. We expect Indika to manage its debt repayments over the medium term comfortably within forecast cash generation at the Indika level (holding company on a standalone basis) and maintain a sufficiently large cash balance at the Indika-level to support overall liquidity. However, the company now faces a lumpy refinancing in 2022-2023, which is factored in our 'B-' rating. Indika has time to address this risk and its long-term capital structure, given these maturities are five years away.

The assignment of the final rating to the USD265 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 26 March 2017.

KEY RATING DRIVERS

Successful Refinancing Improves Liquidity: We believe Indika's liquidity has improved substantially with the issuance of the new US dollar notes to refinance its 2018 notes, which have USD171 million remaining. We expect the cost and extended debt maturity profile to be accommodated within the company's forecast cash generation and provide the company with adequate time to address its capital structure. Indika's cash flow generation should improve along with higher coal prices.

Revised Coal Price Assumptions: We increased our prices assumptions for 2017 thermal coal - Newcastle 6,000 kcal - to USD70 per metric tonne (mt), from USD57/mt in March 2017, and assume the price to be USD65/mt thereafter, compared with USD60 previously. Prices have come off the peak reached in late 2016, but our increased mid-cycle assumptions reflect China's policies, which aim to manage coal production and prices. We expect some production uptick in Australia, China and Indonesia in response to higher prices, which should lead to some price moderation as reflected in the updated price assumptions.

Higher Kideco Dividends: The improvement in coal prices will drive higher cash generation at PT Kideco Jaya Agung, Indika's key coal mining asset, and consequently lead to higher dividend flows to Indika, which owns 46% of Kideco and heavily relies on Kideco's dividends. We now assume dividend receipts from Kideco to be around USD40 million in 2017 (including dividend of USD16 million received during 4Q16), and to rise in 2018 to around USD70 million based on our coal-price assumptions.

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

Cash Flow Recovery: Fitch expects higher dividends from Kideco to support recovery in Indika's cash flow. We estimate Indika's (entity level) cash flow to be neutral in 2017 and to cover its operating expenses and interest costs without the need to dip into its cash reserves of USD146 million at end-2016. We further expect cash flow to turn positive from 2018 and remain so over the medium-term based on our revised coal assumptions and in the absence of any significant debt maturities over this period post refinancing. This should eliminate any reliance on short-term debt over the medium term.

Subsidiaries' Cash Generation Muted: We do not expect dividends in 2017 from Indika's key subsidiaries - 70%-owned PT Petrosea Tbk (a mining contractor) and 51%-owned PT Mitrabahtera Segara Sejati Tbk (MBSS, coal barging and handling) - given their losses during 2016. We anticipate the higher commodity prices to result in modest improvement in the subsidiaries' trading performance and cash generation in 2017, with a more sustained recovery from 2018. We believe these subsidiaries will be able to fund their own investment needs and will not require financial support from Indika.

Revenue of fully owned Tripatra, an engineering, procurement and construction company, declined during 2016, but we expect its order book to benefit from an increase in infrastructure investments in Indonesia, including in the oil and gas sector.

Lumpy Debt Maturities: The new bond has significantly improved near- to medium-term liquidity for Indika, but has also resulted in

lumpy debt maturities, with its new USD265 million notes maturing in 2022 and its USD500 million notes due in 2023.

DERIVATION SUMMARY

Indika's rating reflects its improved liquidity, which is supported by the successful refinancing of its 2018 debt maturities and improved cash flow from higher coal prices. We expect Indika's (entity level) FCF to turn positive from 2018. Indika has better liquidity compared with MIE Holdings Corporation (CCC), which faces a significant challenge in refinancing its outstanding notes due February 2018 and April 2019, made more difficult by the company's depleted asset base relative to its high indebtedness. Yanzhou Coal Mining Company Limited's 'B/Negative' rating reflects its high financial leverage and weak liquidity. The rating however also incorporates ongoing adequate access to banking and domestic capital markets as a provincial state-owned enterprise. This explains the one notch difference to Indika.

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). See Updating Fitch's Mid-Cycle Commodity Price Assumptions (<https://www.fitchratings.com/site/re/895103>), dated 2 March 2017.
- Kideco coal volumes of around 32mt in 2017 and increasing to around 36mt by 2019. Capex remaining low at around USD3 million in 2017 and USD5 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 USD5 million from Petrosea in 2018. Dividends from associate PT Cirebon Electric Power of about USD7 million per year through to 2019.
- Low capex at Tripatra and MBSS, and marginally higher capex at Petrosea, to support new mining contracts, resulting in capex of around USD80 million in 2017, declining to around USD50 million a year thereafter.

RATING SENSITIVITIES

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

- Meaningful improvement in Indika's medium- to long-term financial flexibility, such that Indika can comfortably address large and lumpy debt maturities in 2022-2023.

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

- Weakening of liquidity, which may arise from weaker-than-expected coal prices and dividend, and lower access to credit facilities.

LIQUIDITY

Indika's near- to medium-term liquidity has improved with the issuance of the new US dollar notes to refinance its existing 2018 debt maturities.

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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. 10 Mar 2017) (<https://www.fitchratings.com/site/re/895493>)

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

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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