Rating Action: Moody's downgrades Indika to Caa1; outlook negative

Global Credit Research - 06 Apr 2016

Singapore, April 06, 2016 -- Moody's Investors Service has downgraded the corporate family rating (CFR) of Indika Energy Tbk (P.T.) to Caa1 from B3.

At the same time, Moody's has also downgraded the ratings on the $171 million notes due 2018 and issued by Indo Energy Finance B.V., as well as the ratings on the $500 million notes due 2023 and issued by Indo Energy Finance II B.V.. Both ratings have been downgraded to Caa1 from B3.

The two bond issuing entities are wholly-owned subsidiaries of Indika and both notes are unconditionally guaranteed by Indika.

The ratings outlook is negative.

Moody's rating actions conclude Moody's review of the ratings above, initiated on 22 January 2016 when Moody's placed the ratings on review for downgrade, reflecting Moody's effort to recalibrate ratings in the mining industry to align with the fundamental shift in the credit conditions faced by the global mining sector.

List of affected ratings:

Downgrades:

..Issuer: Indika Energy Tbk (P.T.)

.... Corporate Family Rating, Downgraded to Caa1 from B3

..Issuer: Indo Energy Finance B.V.

.... $171mm GTD SR SEC GLOBAL NOTES due 2018, Downgraded to Caa1 from B3

..Issuer: Indo Energy Finance II B.V.

.... $500mm GTD GLOBAL NOTES due 2023, Downgraded to Caa1 from B3

Outlook Actions:

..Issuer: Indika Energy Tbk (P.T.)

.... Outlook, Changed to Negative from Ratings on Review for Downgrade

..Issuer: Indo Energy Finance B.V.

.... Outlook, Changed to Negative from Ratings on Review for Downgrade

..Issuer: Indo Energy Finance II B.V.

.... Outlook, Changed to Negative from Ratings on Review for Downgrade

RATINGS RATIONALE

"The downgrade of Indika's CFR to Caa1 reflects the company's elevated leverage, driven largely by the impact of weak thermal coal prices across Indika's businesses", says Brian Grieser, a Moody's Vice President and Senior Analyst.

"The downgrade also incorporates our view that Indika's cash flows will diminish materially in 2017," adds Grieser.

Indika's primary source of cash flows comes from dividends paid by 46% owned PT Kideco Jaya Agung (Kideco, unrated), Indonesia's third-largest domestic coal producer by tons. Continued pressure on thermal coal prices over the past few years has led to a significant reduction in dividends from Kideco to an estimated $60 million in 2016 compared to $207 million in 2012.

Average selling prices (ASPs) for Kideco's thermal coal fell below $40 in the fourth quarter of 2015 compared to $49 in the fourth quarter of 2014. Moody's expects that ASPs will remain below $40 in 2016, which Moody's expects to result in a maeterial reduction in Kideco's earnings in 2016, leading to a significant decline in dividends available to Indika in 2017.

While Moody's does not expect that cash flows from Kideco and other Indika investments will cover Indika's debt service requirements in 2017, Moody's notes that Indika holds substantial cash balances that will allow the company to service its debt over the next two years (2016-2017). At 31 December 2015, consolidated cash balances were $339.4 million.

In December 2015, Indika engaged in a balance sheet management exercise which resulted in the retirement of $128.6 million of principal value for the 2018 notes for $77.1 million. Moody's would likely view any additional discounted note repurchases as a distressed exchange under Moody's definition of default, given Moody's expectation for a material reduction in Indika's cash flows and its highly leveraged capital structure.

Moody's expects adjusted debt-to-EBITDA to exceed 6.5x in both 2016-2017.

The negative outlook on the ratings reflects Indika's weak underlying pricing power across its businesses, against the backdrop of persistently weak thermal coal prices.

An upgrade of the ratings is unlikely over the next 12 months because of the weak outlook for thermal coal. Nonetheless, upward ratings pressure would emerge if Indika successfully refinances the balance of its 2018 notes, or if coal prices improve such that earnings—including dividends from its subsidiaries—result in leverage below 6.0x. A ratings upgrade would require Indika to maintain a solid liquidity profile, with in excess of $200 million in available cash at the holding company level.

A ratings downgrade could arise if Indika's liquidity levels deteriorate, or if coal prices continue to fall, such that leverage increases and registers in excess of 7.0x for an extended period. A deterioration in liquidity, such that the holding company's cash balance falls below $175 million, could also lead to a downgrade.

The principal methodology used in these ratings was Business and Consumer Service Industry published in December 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Indika Energy Tbk (P.T.) is an Indonesian integrated energy group listed on Indonesia's Stock Exchange. Its principal investment for its energy resources group is a 46% stake in Kideco Jaya Agung (P.T.), Indonesia's third-largest domestic coal producer and one of the world's lowest-cost producers and exporters of coal.

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