Moody's
INVESTORS SERVICE

Rating Action: Moody's downgrades Indika's CFR to B2 from B1; Outlook negative

Global Credit Research - 24 Aug 2015

Singapore, August 24, 2015 -- Moody's Investors Service has downgraded Indika Energy Tbk (P.T.)'s (Indika) corporate family rating to B2 from B1.

At the same time, Moody's also downgraded the ratings on the $300 million notes due 2018 and the $500 million notes due 2023, issued by Indo Energy Finance B.V. and Indo Energy Finance II B.V., respectively, to B2 from B1. The two issuers are wholly owned subsidiaries of Indika. The notes are unconditionally guaranteed by Indika.

The outlook on all ratings remains negative.

RATINGS RATIONALE

"The ratings downgrade to B2 reflects our view that Indika's operating performance will continue to deteriorate throughout 2015 and 2016 as weak coal prices weigh on the group's pricing power and operating margins" says Brian Grieser, a Moody's Vice President and Senior Analyst. "We expect lower earnings generation plus higher debt levels, largely attributable to growth in Indika's low margin coal trading business, will drive its adjusted debt-to-EBITDA above 6.0x for 2015 and 2016" adds Grieser.

"While leverage will remain high in this weak operating environment, Indika continues to maintain consolidated cash balances of over $400 million at 30 June and will receive around $60 million of dividends from its investments in the second half of 2015, which is well in excess of near term debt service requirements," adds Grieser, who is also Lead Analyst for Indika.

We project dividends from Indika's 46%-owned coal mining operations, Kideco (unrated), to fall to around $50 million in 2016 from $65 million in 2015. Given these cash flow expectations, we expect Indika to maintain high cash balances through 2016 at both the holding company and operating subsidiary levels. Further, we expect Kideco's profits to weaken further than initially anticipated with average selling prices likely to equal $43 per tonne relative to our original expectation of $45 in 2015 and coal volumes to remain around 40 million tonnes.

Indika has also seen significant deterioration in its Petrosea (unrated) and MBSS (unrated) operations. Petrosea's waste removal volumes have fallen 45% in H1 2015 while EBITDA has declined 38% in the same period. This was largely due to early termination of a major contract with ABN in May 2015 and lower volumes from Bayan's new mine which only partially offset lost contracted volumes at Bayan's old mine. MBSS, an integrated coal transport and logistics services company, has also been hit by the weak price environment and has seen its EBITDA fall almost 30%. We expect these trends to continue in the second half of 2015 and stabilize in 2016.

Engineering, procurement and construction (EPC) contractor and wholly-owned subsidiary, Tripatra (unrated) has also seen profitability decline despite higher revenue in 2015. More importantly, the company has been unable to sign new contracts in 2015 and thus seen its backlog fall. As such, we expect this business to provide reduced levels of cash flows in 2016.

Aside from short term loans totaling some $110 million (June 30) used to fund Indika's coal trading business, the next material maturity for Indika is its $300 million notes in May 2018. While still over two and a half years away, refinancing risk will elevate over time absent a material improvement in operating performance and cash flow generation or a preemptive refinancing.

The negative outlook reflects Moody's expectation that Indika's credit profile will likely deteriorate in 2015-16 as cash dividends from Kideco and earnings from its other coal-related businesses decline. Further, the negative outlook reflects the increasing refinancing risk.

A ratings downgrade could occur if 1) coal prices fail to stabilize and Kideco's average selling price falls short of our $43 per tonne target in the next twelve months ; 2) Tripatra, Petrosea, and MBSS fail to win contracts such that cash flow turn meaningfully negative; 3) the relationship between Samtan (the co-shareholder in Kideco) and Indika deteriorates; 4) Indika undertakes any large debt-funded acquisitions; or 5) its liquidity profile deteriorates such that cash balances at the the holding company level fall below $200 million ($250 million as at 30 June 2015).

Specific indicators Moody's would look for include total debt/EBITDA (including dividends from associates) exceeding 6.0x, net debt/EBITDA over 5.0x and EBIT/interest below 1.0x as its notes maturity approaches.

Upward ratings momentum is unlikely in the near-to medium-term given the negative outlook and our view that deleveraging will be challenging in the current environment for coal prices. However, the rating outlook could stabilize if Indika improves its financial leverage, such that its total debt/EBITDA (including dividends from associates) falls below 5.0x and EBIT/interest improves to over 2.0x. Any positive action would require Indika to maintain the current strength of its liquidity profile in concert with an improvement in realizable coal prices for Kideco.

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

Indika is an Indonesian integrated energy group listed on Indonesia's Stock Exchange. Through a number of acquisitions, Indika has positioned itself as an integrated energy group with a focus on energy resources (primarily through 46% interest in Kideco), energy services (primarily through wholly owned Tripatra and 69.8% stake in Petrosea) and energy infrastructure (primarily through its 51% stake in MBSS).

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