CMBI Credit Commentary

INDYIJ – Indika Energy Initiation

Polly Ng 吴宝玲
(852) 3657 6234
pollyng@cmbi.com.hk

Glenn Ko, CFA 高志和
(852) 3657 6235
glennko@cmbi.com.hk

Wilson Lu 路伟同
(852) 3761 8918
wilsonlu@cmbi.com.hk

James Wen 温展俊
(852) 3757 6291
jameswen@cmbi.com.hk

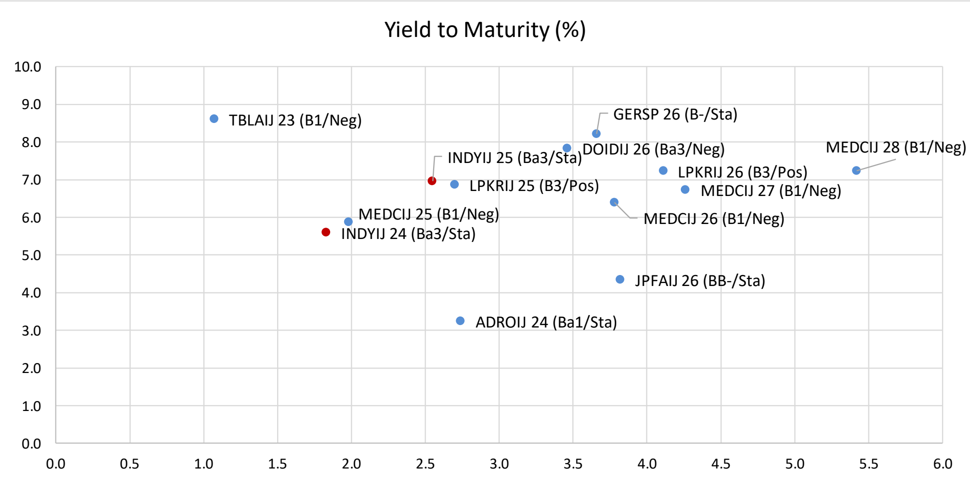
CMBI Fixed Income
fis@cmbi.com.hk

Initiate Buy on INDYIJs '24 and '25

We initiate an OW on Indika (Ba3/Stable) - INDYIJs '24 and '25 on the back of favorable coal price trend, its stable leverage and a prudent diversification strategy. We expect Indika's bond price to remain well-supported among Indonesian BB cohorts. We are OW on INDYIJ 5.875% '24 at 100.7 (YTM~5.6%) and INDYIJ 8.25% '25 at 104.3 (YTM~7.0%), as both provide >200bp pick up over BB Indonesia peers, i.e. ADROIJ '24 at YTM~3.3% (Ba1/Stable) and JPFAIJ '26 at YTM~4.3% (BB-/Stable).

Compared with lowly-rated coal peers, i.e GERSP '26 (B-/Stable) at YTM~8.2%, and DOIDIJ '26 (Ba3/Neg) at YTM~7.8%, INDYIJ also provides better risk reward, thanks to its longer coal reserve life.

We view Indika as a quality credit among Indonesian HY, its YTD bond price performance underperformed ADROIJ '24 and BSDEIJ '25, when INDYIJ '25 fell from 108.6 (YTM~5.8%) at the beginning of this year.

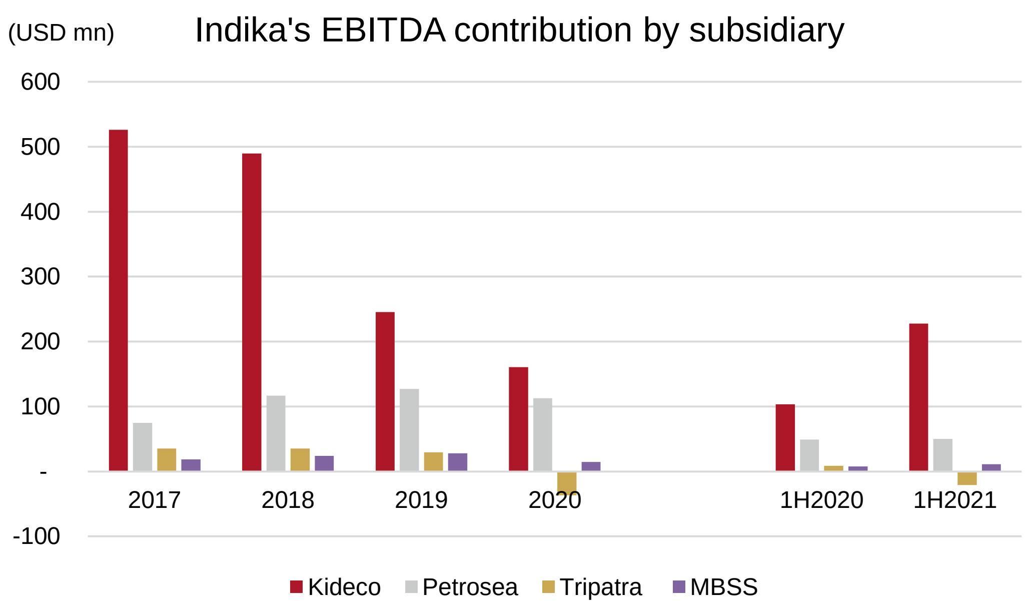


Kideco will remain to be a key contributor

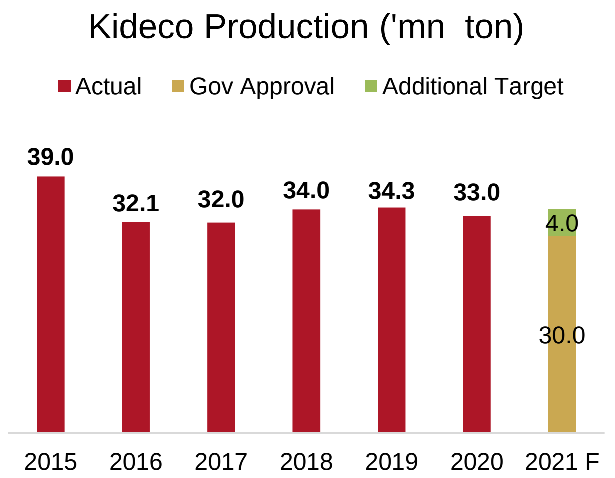
Founded in 2000 and listed on Indonesia Stock Exchange in 2008, PT. Indika Energy (Indika) is the 3rd largest coal miner by sale volume through the ownership of Kideco. Indika also operates energy services a) via its 69.8% stake in Petrosea, in contract mining, engineering and construction;

and b) conducts EPC, operations and maintenance (O&M) in oil & gas and power generation via its wholly-owned subsidiary – Tripatra. As of 2020, Indika derives 24% of revenue from non-coal related business.

Indika raised its stake in Kideco to 91% from 46% in Dec'17. Since then, Kideco contributed to 60%-85% of Indika's consolidated EBITDA, followed by its contract mining subsidiary Petrosea. CMBI expects contribution from Kideco, which in turn, driven by coal price, to continue to be the key driver of Indika's earnings trajectory and credit profile.



Long reserve life….



Kideco conducts open pit coal mining in East Kalimantan which has an estimated proved and probable coal reserves of 531mn tons as at end-2019. This represents 15 years of reserve life, based on Kideco's annual production volume of 35mn tons. In 2021, Kideco received government approval of production volume of 35.7mn ton, the company expects to produce 34-35mn tons of coal in 2022. Its mine is mature and requires low maintenance capex. This will help generate decent organic operating cash flow for its strategic diversification initiative over next 3 years.

…. more clarity on licensing after Bumi's Arutmin renewal

On 10 Jun 2020, Indonesian parliament issued Mining Law No.3 of 2020, which technically guarantees holders of CCoW (Kideco's mining license) extensions for 20 years effectively.

Kideco's existing CCoW will expire on March 2023, it will be extended by conversion to an IUPK Continuation. The company is confident of its license renewal. Kideco will need to submit an extension plan for approval to the Ministry of Energy and Mineral Resources (MEMR) at least one year before license expiry, subject to meeting several statutory requirements on administrative, technical, environmental and financial matters.

Arutmin, under Bumi Resources Tbk, has already extended its CCoW via a conversion to IUPK license in Nov'20. This will likely serve as a precedent for license extension for Kideco, under largely similar terms that Arutmin received for its extension.

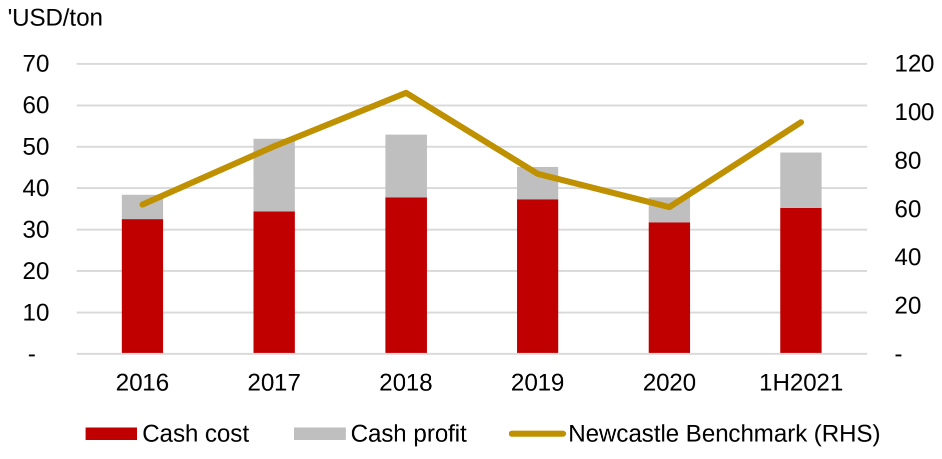
The new IUPK license granted Arutmin a mining concession area of 34,207 hectares, reducing from 57,107 hectares indicated in Arutmin's expired Coal Contract of Work (CCOW) mining license. The lower concession area is due to Arutmin returned post-mining land to the government. In addition, Arutmin's 20-year production plan remains intact.

So far in 2021, Arutmin's royalty rates on coal sales and corporate tax rate under IUPK remain the same at CCoW at 13.5% and 45%, respectively. The only difference is an additional 10% net profit sharing tax charged by the government.

Managed to stay profitable through cycles….

Kideco managed to stay profitable in times of depressed coal price in both 2016 and 2020, thanks to its relatively low cash cost of USD31.8/ton (incl. royalty). Based on our sensitivity analysis, an increase of USD10/ton in ASP above USD35 per ton will raise Kideco's annual EBITDA by USD 250mn.

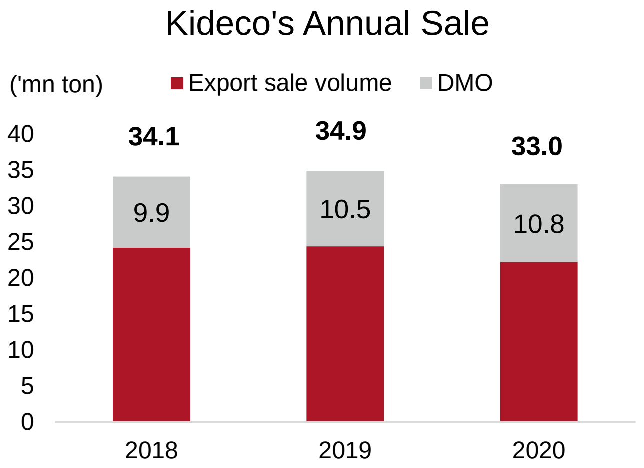
During 1H2021, Newcastle Benchmark recovered to USD 96/ton, from USD 61/ton in 1H2020, and Kideco's ASP rose to USD 49, from USD 40 correspondingly. Kideco's cash EBITDA per ton recovered to USD 13.3, from USD 7.2 in 1H2020. Its reported EBITDA rose to USD 228mn, from USD103mn in 1H2020. Looking into 2022, Kideco's cash profit will expand in current coal price upcycle.

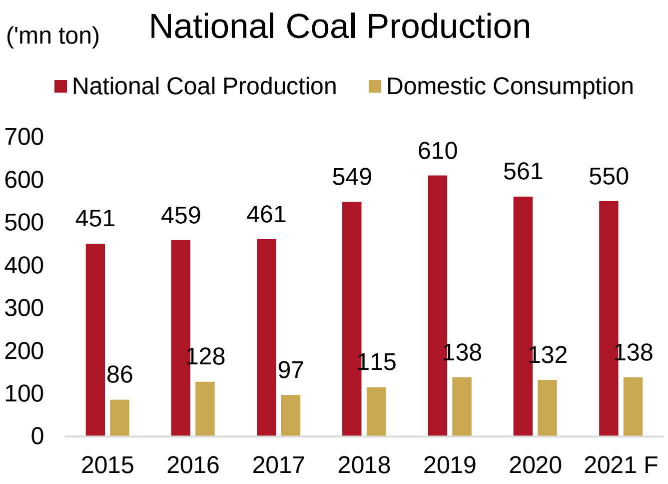


*Cash profit (USD per ton) derives from ASP minus cash cost per ton, including royalties.

Source: Indika, CMBI

…. as well as fulfilling DMO





Source: Indika

Since 2018 Indonesian government implemented Domestic Market Obligation (DMO), Indonesian coal miners must supply at least 25% of their output to the domestic market. Kideco has been supplying around 33% of its coal domestically.

The DMO is in place to ensure domestic power stability because majority of domestic coal sale (>80%) is used for electricity generation. The government also implemented a price cap for coal sold to power plants domestically. (Price cap of USD 70 per ton for coal with a calorific value of >6,000 kcal/kg, and price cap of USD 43 per ton of coal with calorific value between 4,500 – 6000 kcal/kg.)

The DMO could somewhat limit the upside on Indika's profitability in upcycles of coal price. That said, Indika is allowed to boost their coal output (based on government approved production quota) by 10% for that year if it fulfils DMO.

Financial profile to improve from current level

For 2022, we forecast that Indika's revenue will remain at high level of USD2.7bn, vs our estimate of 2021's revenue of USD2.9bn (2020: USD 2.1bn). This is based on our assumption of Kideco's coal price ASP of USD 56/ton and USD50/ton in 2021 and 2022, at 50% discount to Newcastle coal benchmark (adjusting for its calorific value and 1/3 domestic sales). Annual sales volume will remain at 34mn - 35mn tons, similar to 2020.

Indika's EBITDA will increase to USD 700mn – USD 800mn in 2021, and taper somewhat to USD 500mn - USD 600mn in 2022, vs 2020's low of USD220mn. Annual operating cash flow will be lower than its EBITDA at USD 400mn – USD 500mn in next 2 years, sufficient to fund its gross capex of USD 150mn, interest payment of USD 100mn and tax of USD 150mn.

Indika's gross debt will remain stable next two years, Debt/EBITDA will trend down lower to 2.5x in 2021, and around 3.5x in 2022. This will be significantly lower than its 8x Debt/EBITDA in 2020. EBIT/Interest coverage ratio will also improve to 4x and 3x in 2021 and 2022, respectively, up from -0.2x in 2020. These credit metric can retain Indika in current Ba3 rating, against its Moody's downgrade trigger of above 4.0x Debt/EBITDA and below 2.0x EBIT/Interest ratio for an extended period.

ESG not an immediate concern

Foreign financial institutions are increasingly reducing their exposure to coal miners on ESG concern. This may give rise to technical weakness of Indika's USD bond price, when more international asset managers employ ESG mandate. Nonetheless, according to Indika's management, the company is able to roll over existing bank loans with foreign banks, and we expect its next refinancing need will only come in Nov 2024 when its USD bond comes due.

Indika complies with all Indonesian environmental laws, regulations and standards. Kideco also won a Gold Proper National Award from Ministry of Environment and Forestry in 2020, putting it among top 32 companies in incorporating environmental excellence in operation, out of 2,038 Indonesian companies.

Execution risk from diversification contained.

Indika targets to diversify its business with a 5-year plan to generate 50% of revenue and 25% of its core profit from non-coal business, compared to currently 24% revenue and less than 10% core profit from non-coal businesses. We expect bulk of its non-coal earnings will come from its fully acquired of Nusantara Resources – Awak Mas Gold project which targets to be commence production by end-2024.

Indika has completed definitive feasibility study on Awak Mas Gold project which has probable reserves of 1.46mn onz of gold, with a mine life of 16 years' production. The project is an open-pit with an all-in production cost of USD875/oz, below global average cost of USD998/oz as of end-2020. The estimated NPV of the project is USD500mn based on a gold price assumption of USD 1,700/ton. The project shall contribute to low-teens% of Indika's gross profit in 2025 at its first full year of operation.

Indika has a track record of prudent financial policy, it made historical acquisitions when its operating cash flow was strong at times of relatively high coal price. Indika's financial risk should be contained thanks to its good organic cash flow and low maintenance capex of USD 15mn. Indika budgets to spend USD233mn in capex for Awak Mas Gold project over next 3 years, 70% of which to be financed by bank loans. Indika also plans to carry out half of this mining work by its subsidiary Petrosea, this should help lower its execution risk to some extent.

PT INDIKA ENERGY TBK						
Consolidated, Figures in USDmn						
FY ended 31 December	**2017**	**2018**	**2019**	**2020**	**1H20**	**1H21**
INCOME STATEMENT						
Revenue	1,099	2,963	2,783	2,077	1,129	1,288
Revenue from contracts with customers	666	714	822	549	323	235
Sale of Coal	432	2,230	1,900	1,451	796	1,033
- Foreign customers	393	1,717	1,386	992	558	740
- Domestic customers	40	513	514	459	238	293
Other trading	-	19	61	78	10	20
- Foreign customers			-	35		
- Domestic customers		19	61	42	10	20
Cost of sales	(976)	(2,322)	(2,356)	(1,823)	(955)	(994)
Gross profit	123	641	427	254	174	294
Equity in net profit of associates	136	21	30	33	13	17
Selling, general and administrative expenses	(89)	(133)	(137)	(138)	(77)	(75)
Impairment losses of financial assets, net	(170)	(8)	(3)	(6)		
Investment income	9	14	16	11	5	3
Gain from a bargain purchase			-	16	11	
Final tax	(16)	(13)	(20)	(9)	(5)	(4)
Fair value changes on contingent consideration obligation		(15)	(19)	(3)	(5)	(10)
Gain on revaluation	384					
Amortization of intangible assets	(18)	(136)	(136)	(136)	(68)	(68)
Other Expense	18	(6)	5	(2)	(13)	(0)
Finance costs	(77)	(100)	(109)	(120)	(48)	(55)
- Interest on bank and other borrowings	*(3)*	*(6)*	*(11)*	*(11)*	(6)	*(6)*
- Interest on corporate bond	*(54)*	*(84)*	*(79)*	*(76)*	(35)	*(45)*
- Premium on early redemption of Senior Notes	-		*(5)*	*(12)*	-	-
- Interest on lease liabilities	*(1)*		*(1)*	*(3)*	(2)	*(1)*
- Acceleration of amortization on bond issuance Cost Seni	*(5)*		*(4)*	*(7)*	-	-
- Amortization of bonds issuance and discount	*(4)*	*(7)*	*(7)*	*(7)*	(3)	*(3)*
- Others	*(10)*	*(3)*	*(2)*	*(3)*	(1)	*(1)*
Profit before tax	300	265	54	(99)	(11)	102
Income tax expense (Benefit)	22	(167)	(49)	(4)	(5)	(73)
Profit for the year	322	98	5	(103)	(16)	29
Attributable to:						
Owners of the Company	335	80	(18)	(118)	(22)	12
Non-controlling interests	(14)	18	23	14	6	17

BALANCE SHEET	2017	2018	2019	2020	1H20	1H21
Non-current Assets:						
Property, plant and equipment	611	627	683	614	627	604
Mining properties	9	11	12	9	10	10
Other righ-of-use assets			-	63	78	47
Intangible assets	756	622	501	376	436	312
Investments in asociates	110	119	118	159	128	162
Investment in a joint venture	10					
Goodwill	699	699	702	702	702	703
Other financial assets	29	69	78	84	84	68
Other accounts receivables	25	18	12	10	10	10
Deferred tax assets	0	2	1	5	1	23
Derivative assets			1	-		
Refundable deposits	3	4	4	4	4	3
Exploration and evaluation of assets	7	8	9	12	10	13
Stripping activity assets	1	0	2	4	2	3
Third parties	2	2	0	10	2	9
Claims for tax refund	8	22	22	10	21	43
Advances and noncurrent assets	12	9	41	38	56	46
Total non-current assets	2,282	2,210	2,185	2,100	2,173	2,057
Current Assets:						
Accounts receivables (other)	49	22	34	44	21	76
Inventory	76	73	48	42	50	48
Trade receivables	339	429	513	462	375	576
Contract asset			-	2	47	0
Other financial assets	78	81	57	57	49	74
Estimated earnings in excess of billings on contracts and w	1	22	6	-		
Prepaid taxes	48	50	63	60	71	47
Derivative assets		1	1	0	1	1
Restricted cash	31	42	50	63	58	78
Cash and cash equivalents	591	571	519	588	431	537
Other current assets	141	170	142	75	94	101
Total current assets	1,354	1,460	1,431	1,394	1,196	1,539
Total assets	3,636	3,670	3,616	3,494	3,369	3,596

Current Liabilities:						
Trade and bills payables	235	274	337	335	293	401
Other payables, deposits received and accruals	17	21	19	16	14	18
Contract liabilities			-	17	3	19
Amounts due to related parties						
Loans from related parties						
Interest-bearing bank and other borrowings	81	32	10	66	18	53
Current portion of long term loans	1	22	84	89	84	98
Current portion of long term bonds payable	23	23	16	15	17	16
Current portion of long term lease liabilities	7	7	11	21	22	14
Billings in excess of estimated earnings recognized	33	56	89	-		
Advances from third party customers	18	9	11	7	8	9
Dividends payable	0	0	0	0	6	0
Taxes payable	181	169	80	63	44	119
Accrued expenses	63	57	54	78	56	99
Total current liabilities	659	670	711	708	565	845
Non-current Liabilities:						
Interest-bearing bank and other borrowings		67	268	251	252	214
Senior notes	1,294	1,301	1,098	1,225	1,101	1,227
Lease liabilities	11	8	26	30	43	29
Other long-term liability - third party	1	1	-	-		
Advances from third party customers	2					
Deferred tax liabilities	354	285	228	156	188	126
Provision for mine rehabilitation, mine closure and decomm	30	29	30	33	32	34
Contingent consideration obligation	127	143	162	164	167	174
Derivative liabilities		-	0	6	8	4
Employment benefits	42	38	48	52	49	54
Total non-current liabilities	1,861	1,872	1,859	1,919	1,839	1,863
Total liabilities	2,521	2,543	2,570	2,626	2,404	2,708
Equity:						
Issued capital	311	311	311	311	311	311
Others	64	68	28	14	14	16
Retained earnings	550	570	512	361	456	373
Non-controlling interests	190	179	195	182	184	189
Total equity	1,115	1,127	1,046	867	965	888
Total liabilites and equity	3,636	3,670	3,616	3,494	3,369	3,596

CASH FLOW - RE-ARRANGED	2017	2018	2019	2020	1H20	1H21
Profit before tax	300	265	54	(99)	(11)	102
Depreciation and amortisation	99	251	250	228	114	116
Others	(41)	(202)	(136)	(72)	26	(40)
Funds from operations (FFO)	**358**	**314**	**168**	**56**	**129**	**178**
Net changes in working capital	(172)	(24)	(12)	66	(83)	(100)
Cash flow from operations (CFFO)	**186**	**290**	**156**	**123**	**46**	**77**
Gross capex	(66)	(150)	(157)	(84)	(51)	(37)
Disposals	165	42	101	40	31	70
Investments	(397)	6	(37)	(42)	(3)	(5)
Others	(35)	(70)	(77)	(26)	(52)	(67)
Free operating cash flow (FOCF)	**(147)**	**117**	**(13)**	**11**	**(30)**	**39**
Dividends paid to the equity holders of the company	-	(59)	(39)	(32)	(32)	-
Dividends paid to a non-controlling shareholder of a subsid	-	(22)	(16)	(12)	(5)	(6)
Free cash flow (FCF)	**(147)**	**36**	**(68)**	**(33)**	**(66)**	**33**
Debt Raised	961	172	335	891	54	12
Repayments	(414)	(210)	(343)	(775)	(79)	(78)
Equity	-	-	-	-	-	-
Others	(23)	(4)	31	0	13	(1)
Change in cash	**377**	**(6)**	**(46)**	**83**	**(78)**	**(34)**

CREDIT STATISTICS	2017	2018	2019	2020	1H20	1H21
Gross margin (%)	11%	22%	15%	12%	15%	23%
Operating margin (%)	1%	13%	6%	-1%	3%	12%
EBITDA margin (%)	10%	21%	15%	10%	13%	21%
EBIT/total gross interest (x)	0.3	4.1	1.7	(0.2)	0.7	3.0
Net profit margin (%)	29%	3%	0%	-5%	-1%	2%
Debt/EBITDA (x)	12.2	2.3	3.7	8.0	5.2	3.0
Net debt/EBITDA (x)	6.8	1.3	2.3	4.9	3.5	1.9
Net debt/EBITDA (x) - incl share of profit of associates and JV and attributable debts						
FFO/debt (%)	25%	22%	11%	3%	17%	22%
FFO/net debt (%)	46%	37%	18%	6%	26%	35%
Debt/CFFO (x)	7.6	5.0	9.5	13.6	16.3	10.5
Net debt/CFFO (x)	4.2	2.9	5.9	8.3	11.0	6.5
CFFO/ Gross Interest (x)	3.3	3.2	1.7	1.4	1.1	1.5
Debt/equity (%)	126.1%	128.8%	142.1%	192.2%	154.8%	182.5%
Net debt /equity (%)	70.3%	74.4%	87.7%	117.1%	104.2%	113.4%
Debt/total capitalisation (%)	55.8%	56.3%	58.7%	65.8%	60.8%	64.6%
Net debt (debt - unrestricted cash)/net total capitalisation (%	41.3%	42.7%	46.7%	53.9%	51.0%	53.1%
Cash excl restricted cash /total assets (%)	16.3%	15.6%	14.4%	16.8%	12.8%	14.9%
Cash excl restricted cash / Total debt (%)	42.1%	39.3%	34.9%	35.3%	28.8%	33.1%
Working capital cycles:						
AR days	112.5	52.9	67.3	81.2	60.6	81.7
AP days	87.8	43.1	52.2	67.1	56.0	73.7
Inventory days	28.6	11.5	7.5	8.4	9.5	8.8
Cash conversion cycle	53.3	21.3	22.5	22.5	14.1	16.8

Source: Indika and CMBI

CMB International Securities Limited
Fixed Income Department
Tel: 852 3761 8867/ 852 3657 6291
fis@cmbi.com.hk

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