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CMBI Credit Commentary

INDYIJs: still offers decent risk-return profile

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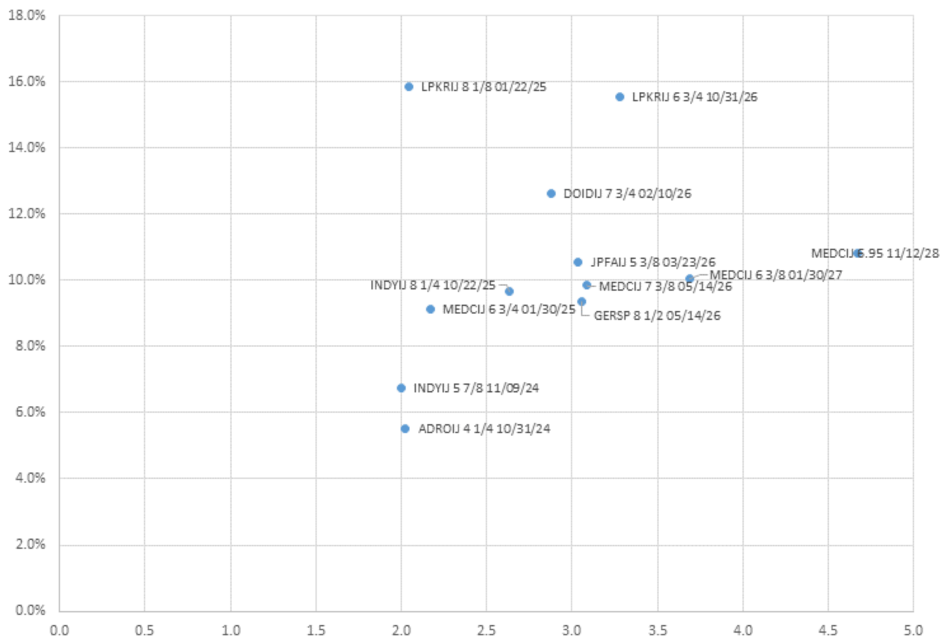
Buy INDYIJs, prefer INDYIJ'25

Offered at 98.7 and 96.7, INDYIJ 5.875% '24 and INDYIJ 8.25% are trading at YTW of 6.7% and 9.7%, respectively. INDYIJs continues to offer decent superior risk-return profile amongst Indonesia non-distressed HYs. Indika's credit profile has improved considerably over the past 18 months on the back of substantial increase in ASP of thermal coal and disposals of MBSS and Petrosea. Its disciplined diversification strategies and financial policy should help protect its credit profile against coal price volatility. We maintain buy on INDYIJs. Between '24 and '25, we prefer '25 for 270bps yield pick-up for c1-year maturity extension.



Strong 1H22 results……

In 1H22, Indika's revenue and EBITDA increased 66.5% and 149.6% to USD1.9bn and 624.2mn, respectively. EBITDA margin, as a result, widened to 32% in 1H22 from 28% in FY21. The strong results were mainly driven by the significant increase in Kideco's ASP to USD81.5/ton in 1H22 from USD48.6/ton in 1H21. This more than offset the 5.9% yoy decline in sales volume to 17mn tons. We estimate its FY22 EBITDA to be cUSD1bn assuming Kideco's ASP to be USD65/ton (vs. Indika's budgeted ASP of USD52.5/ton and ASP of USD81.5/ton in 1H22). To illustrate, ASP of USD65/ton in FY22 implies that the ASP in 2H22 would decline 40% HOH to USD48.5/ton and sales volume in 2H22 would be

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flat compared with that in 1H21. We consider the ASP assumption conservative taking cues from the current thermal coal price (XW1) of USD425/ton, compared with USD386/ton in 2Q22 and USD151.75/ton in FY21.

…… impact of conversion into IUPK contained

We expect the coal concession of Kideco to be converted into IUPK from CCOW by Mar'23 given its track record of timely fulfilment of tax obligations and DMO. The impact of higher royalty rate (increase from 14% to 14%-28% depending on coal price) will be offset by lower profit tax rate (to be lowered from 45% to 22%). As per Indika, the new tax and regulatory regime will lower its operating cash flow by 10% based on the pro-forma figures of FY21.

Gradual diversification from coal operations and stepping-up ESG initiatives

Indika has been gradually diversifying its businesses. It completed the divestments of its 2 coal services subsidiaries: 51% stakes in MBSS for USD 41mn in Oct'21 and 69.8% stakes in Petrosea for USD 147mn in Jul'22. The divestments has reduced Indika's reliance on the cyclical coal operations and allowed it to reallocate resources to fund its solar, plantation (biomass co-firing and carbon credit potential) and gold mine operations. Indika targets to install 500MW solar panel over the next 5 years, through its 51% owned EMITS JV with an Indian solar developer – Fourth Partner Energy. It also targets to achieve annual output of biomass/wood pellets 650-700k ton and carbon offset of 550-600k ton. Its Awak Mas gold mine will commence production in 2025. Indika targets to generate 50% of its revenue from non-coal businesses and to achieve net-zero emission by 2025. Nonetheless, we believe that these non-coal operations will take time to ramp up the scale and profitability. Over the coming 2-3 years, coal operations (Kideco and MUTU) will continue to be the key cash flow contributors for Indika. In 1H22, coal operations contributed 90% and 98% of its continued operations' revenue and gross profit, respectively.

Credit profile to remain solid over the coming 2-3 years

While Indika's total debts and net debts in Jun'22 were largely stable compared with those in Dec'21, its key coverage ratios such as debt/EBITDA, net debt/EBITDA and EBITDA/int strengthened notably to 1.2x, 0.4x and 12.6x in 1H22 from 1.7x, 0.7x and 8.5x in FY21, respectively, thanks to the significant increase in EBITDA. We expect the strong free cash generation driven mainly by substantially higher thermal coal price and asset disposal (Petrosea) to lead to debt reduction in the coming 1-2 years. Over the coming 3-4 years, we expect Indika's debt/EBITDA, net debt/EBITDA and EBITDA/int to maintain at 1.2-2.2x, 0.4-0.8x and 6.6-10.8x, assuming ASP of thermal coal to moderate notably from USD81.5/ton in 1H22 to USD50-60/ton. We understand that Indika's financial policy is to maintain debt/EBITDA not exceeding 2.75x throughout cycles.

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