FitchRatings

Fitch Publishes Bayan Resources' First-Time 'BB-' Rating; Outlook Stable

Fitch Ratings-Singapore-15 October 2018: Fitch Ratings has published Indonesia-based PT Bayan Resources Tbk's Long-Term Issuer Default Rating of 'BB-'. The Outlook is Stable.

The rating reflects the low-cost position of Bayan's key coal mine, adequate reserves, diversified customer base and strong financial profile. This is partially counteracted by its limited mine diversity and the cyclical nature of the coal industry.

KEY RATING DRIVERS

Low-Cost Key Mine Structure: Bayan benefits from the low-cost structure of its key coal mine, Bara Tabang, which is part of its Tabang concession. Tabang's cash costs are in the first quartile of the global seaborne coal supply curve on energy adjusted basis with quite low average life-of-mine strip ratios of around 2.75x-3.0x at its operating mines (2017: 1.5x). This, together with the company's plan to increase its production volumes, should support Bayan's strong profitability and operating cash flows over the medium term. Bayan's other mines have higher cost structures and are more vulnerable to lower coal prices.

Bayan's low-cost structure also reflects its mines' well-connected infrastructure and logistics. The company owns and operates the Balikpapan coal terminal, one of Indonesia's largest, and floating transfer stations. Bayan's EBITDA margin improved to 45% in 2017, from around 30% in 2016, supported by higher production in Tabang and stronger global thermal-coal prices.

Rising Production: We expect Bayan's production volumes to rise to 27.3 million tonnes (mt) in 2018 (2017: 20.7 mt) primarily driven by higher production from Tabang. The company targets 46 mt of annual production over the medium term, supported by further ramp-up at Tabang and contribution from the North Pakar area, which is currently under exploration/ development.

Adequate Reserves: Bayan has proved reserves (1P) of about 333 mt (proved and probable reserves (2P) of about 600 mt) as of end-2017 with Tabang accounting for almost 262 mt of Bayan's 1P reserves. We expect Bayan's 1P reserves to increase to 388 mt and 2P reserves to 792 mt after Bayan completes its Kangaroo Resources Limited (KRL) acquisition. Bayan's reserve life is estimated at around 15 years (based on the 2P reserves) with a planned increase in production to about 40 mt over the medium term.

The company expects the reserves and the reserve life to improve after it completes exploration in the North Pakar area, which is an extension of the Tabang concession. Mining licences for the two operational mines at Tabang, which management expects to renew, are valid till 2025 and 2028.

Concentration Risk: Tabang accounts for about more than half of Bayan's 2P reserves and 75% of its total production. We estimate Tabang's contribution will decrease, but remain high, accounting for around two-thirds of Bayan's production by 2021. In addition, we believe risks related to Bayan's coal mining operations are minimised by its contracts with PT Petrosea Tbk and PT Bukit Makmur Mandiri Utama (BB-/Stable), two of Indonesia's largest coal mining contractors, which cover about 90% of Tabang's planned production.

Bayan has also taken initiatives to limit risks related to coal transportation and has planned infrastructure investments to ensure continuity of operations even during extreme weather events. Low river-water levels affected Tabang's barging operations during 2016, reducing sales volumes.

Strong Financial Profile: We expect Bayan's financial profile to remain strong, supported by rising production volumes, the low cost position of the Tabang operations and Fitch's coal price expectations. We expect Bayan's free cash flow to remain positive amid a modest capex of around USD300 million over the next four years. We do not expect Bayan to need any long-term debt to fund the planned purchase of the 44% stake in KRL. We expect Bayan to be able to maintain FFO adjusted net leverage below 1.0x, even if it makes an acquisition of USD300 million in 2019. We believe that if an opportunity arises, management may make another investment to support future growth.

Bayan's financial profile improved significantly over the last two years, supported by better profitability after Tabang started operations and higher coal prices during 2016. The company was able to repay all its long-term restructured debt and reduce its gross debt by more than USD350 million in 2017.

Diversified Customer Base: Bayan benefits from a diversified customer base in terms of geography, end-users and trading companies. Its coal ranges from Tabang's 4000-4300 kcal low-sulphur and ash content coal to high calorific value (over 6000kcal) coal from its other mines, enabling it to diversify its customer base. We expect Bayan's diversified customer base to support stable demand for its coal the medium term.

Exposure to Cyclical Coal Industry: Bayan remains vulnerable to the commodity cycle as its earnings and cash flow are linked to the thermal coal industry. However, these risks are mitigated by the low-cost position of its key mine.

DERIVATION SUMMARY

Bayan's closest peer is PT Indika Energy Tbk (B+/Positive). The two companies have similar business profiles - Indika's larger production scale, longer operating track record of its key coal asset, Kideco Jaya Agung, and integrated operations are offset by Bayan's better cost position. Bayan's stronger financial profile results in its rating being one notch higher than Indika's. The Positive Outlook on Indika's reflects the expectations of improvement in its financial profile mainly through addressing lumpy debt maturities.

While PT Golden Energy Mines Tbk (GEMS; B+/Positive) has higher reserves and reserve life than Bayan, these are balanced by the latter's larger production scale and better cost structure. Bayan and GEMS have strong financial profiles. The Positive Outlook on GEMS reflects Fitch's expectation that the company will be able to continue its production ramp-up to a level commensurate with the profile of a 'BB-' rated entity over the next 12-18 months. Geo Energy Resources Limited's (B/ Stable) weaker business profile given its small scale of production, lower reserves and reserve life and higher cost structure compared to Bayan explains it lower rating, though both companies have strong financial profiles.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer
- Coal prices in line with Fitch's mid-cycle Newcastle 6,000 kcal price assumptions, adjusted for the difference in calorific values. Coal price for 2018 at USD88/mt, 2019 at -USD79/mt, 2020 at USD77/me and USD75/mt thereafter

- Coal production at the Tabang concession to increase to about 28 mt per annum by 2021, with total production increasing to about 42.5mt per annum
- Dividend pay-out of around 45%
- Capex of around USD300 million over the next four years.
- Acquisition of a 44% stake in KRL for about USD180 million. We have also assumed a greenfield acquisition of about USD300 million in 2019.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
- Increase in scale to about 40mt per annum with an average remaining reserve life at around 15-20 years, while maintaining its low-cost position and stable financial profile, with FFO adjusted net leverage below 1.5x (2017: 0.1x)

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- Weaker-than-Fitch-expected cash flow generation due to adverse industry conditions, higher capex or larger-than-expected cash outflow leading to a deterioration of credit metrics for a sustained period
- FFO adjusted net leverage above 3.0x
- FFO fixed-charge coverage falling below 4.0x (2017: 13.7x)
- Failure to renew its expiring mining licences

LIQUIDITY

High Liquidity: Bayan does not have any outstanding long-term debt and only has a short-term working-capital debt of about USD100 million outstanding as of end-2018. We expect Bayan to fund its KRL acquisition via internal cash given its modest capex plans and positive free cash flows. Bayan has a total of USD175 million of working capital facilities available, which might be tapped if need arises.

Contact:

Primary Analyst
Shubha Sethi
Associate Director
+65 6796 7245
Fitch Ratings Singapore Pte Ltd.
One Raffles Quay
South Tower #22-11
Singapore 048583

Secondary Analyst
Shahim Zubair
Director
+65 6796 7243

Committee Chairperson
Jeong Min Pak
Senior Director
+822 3278 8360

Media Relations: Peter Hoflich, Singapore, Tel: +65 6796 7229, Email: peter.hoflich@thefitchgroup.com
Leslie Tan, Singapore, Tel: +65 6796 7234, Email: leslie.tan@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Corporate Rating Criteria (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023785)
Sector Navigators (pub. 23 Mar 2018) (https://www.fitchratings.com/site/re/10023790)

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