FitchRatings

Fitch Rates Bayan Resources' Proposed USD Notes 'BB-'

Fitch Ratings - Singapore - 08 January 2020:

Fitch Ratings has assigned PT Bayan Resources Tbk's (BB-/Stable) proposed US dollar-denominated notes a rating of 'BB-'.

The notes will constitute Bayan's direct, unconditional and unsecured obligations. Bayan's rating reflects the low-cost position of its key coal mine, adequate reserves, diversified customer base and a strong financial profile. This is partially offset by mine concentration, regulatory risk and the cyclical nature of the coal industry.

Key Rating Drivers

Low Cost Position: Bayan benefits from the low-cost structure at its key mine, Bara Tabang, which contributes from the company's Tabang concessions. Their average life-of-mine strip ratio of around 3.6x (2018: 2.60x) along with the well-connected infrastructure and logistics of Bayan's mines contribute to its low-cost structure. Bayan owns and operates the Balikpapan coal terminal, one of Indonesia's largest, along with floating transfer stations. Bayan's other mines, which have stable production levels, have higher cost structures and are more vulnerable to lower coal prices.

Robust Cash Flow: Our expectation of higher sales volume of about 37 million tonnes (mt) in 2020 (9M19: 23.6mt), driven mainly by the Tabang concessions should further support Bayan's robust operating cash flow in the medium term, despite Fitch's lower coal price assumptions compared with 2019. The rising volumes, together with strong coal prices, supported improvement in Bayan's average EDITDA/tonne to USD25 in 2018, from around USD13 in 2016. We estimate that the EBITDA/tonne was around USD14 in 2019, which was still higher than most of its peers in Indonesia, in spite of volatile prices in the year.

Operational Issues at Tabang: Bayan has intermittently faced operational challenges in shipping coal from Bara Tabang due to low river levels; it implemented a month-long force majeure in March 2019 and faced similar issues in October-November 2019, August 2019 and in 2018, although for shorter duration. However, in all these instances, Bayan was able to ship the stockpiled coal in the following months, limiting the effect on overall sales volume. We believe frequent or prolonged recurrence of such events could hurt Bayan's reputation as a reliable supplier and its ability to renew or sign new contracts in the long term. This could affect the company's plan to increase sales volume to over 40mt by 2023.

Bayan has started construction of a 100 kilometre direct coal-haul road from its Tabang mine to the Mahakam River to provide an alternative route to ship its coal. The company started building the road in non-forested areas in December 2019 and expects to complete the project by end-2022, subject to timely receipts of permits. The road will help Bayan reduce operational risk related to low water levels at the tributaries used for barging coal to the Mahakam River.

Customer Diversification: We expect Bayan's diversified customer base to support stable demand

for its coal over the medium term. Bayan's customer base is geographically more diversified than those of most peers. Bayan's exports were mainly to India (26%), Philippines (20%), Malaysia (13%) and China (12%) in 9M19. It also has a diverse product offering, as its coal ranges from Tabang's 4000-4300kcal low-sulphur and ash content coal to high calorific value (over 6000kcal) coal from its other mines.

Increasing Production Scale: We expect production to increase to 32.5mt in 2020 (9M19: 26mt), driven primarily by production from Tabang. The company targets 40mt of annual production over the medium term, supported by further ramp up at Tabang and contribution from North Pakar (scheduled to start production in 2022-2023), which is an extension of the Tabang concession and is currently under exploration and development. Bayan's infrastructure can support sales of about 45mt; capacity will expand to 50mt by the end of the year when capacity at Balikpapan will increase to 25mt, from 20mt.

Adequate Reserves: Bayan's proved (1P) reserves are 612mt, which results in reserve life of around 15 years based on the planned increase in production to around 40mt over the medium term and the 1P reserves. Bayan's 2P reserves rose to about 964mt (excluding South Pakar), from 764mt at end-2018, after the company completed a feasibility study in the North Pakar region. Bayan's acquisition of the remaining stake in Kangaroo Resources Limited in 2018 also increased its reserve life. We estimate Bayan's reserve life based on the 2P reserves to be at around 25 years, up from our previous estimate of 15 years based on its medium-term production scale of 40mt.

Limited Mine Diversity: Tabang (including North Pakar) accounts for more than three quarters of Bayan's 2P reserves and total production. We expect Tabang's contribution to remain high, as most of the ramp up in production is likely to come from existing operational mines at Tabang and the North Pakar concession. That said, we believe risks related to Bayan's coal mining operations itself 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.

Strong Financial Profile: We expect Bayan's financial profile to continue to remain strong, based on our coal price assumptions supported by its rising production volume and low-cost position. Bayan's financial profile improved substantially after it prepaid all its restructured debt in 2017 and improved its profitability post commencement of its Tabang operation and from higher coal prices. Bayan paid a dividend of USD300 million in 2H19 which, in our view, would change its net cash position to net debt in 2019. We expect Bayan to maintain a strong financial profile over the medium term, in light of our dividend assumptions and limited capex.

Cyclicality of 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 (BB-/Stable). The two companies have comparable business profiles; Indika's larger production scale, longer operating record of its key coal asset - Kideco Jaya Agung - and integrated operation are offset by Bayan's better cost position and stronger financial profile. We expect both companies to maintain a healthy cash balance over the medium term, with adequate cash flow. This would also give Indika the flexibility to address its lumpy debt maturities.

PT Golden Energy Mines Tbk (B+/Stable) has higher reserves and reserve life than Bayan, but this is balanced by Bayan's larger and increasing production scale and better cost structure. Both companies have strong financial profiles.

Key Assumptions

- Coal price assumptions in line with Fitch's mid-cycle at Newcastle 6000kcal price assumptions, adjusted for the difference in calorific value; coal price for 2020 at USD73/mt, 2021 at USD72/mt and 2022 at USD70/mt

- Coal sales to increase to 37mt in 2020 and 40mt thereafter. We expect the Tabang concession to be the key driver of production growth.

- Dividend payout to remain at 50%.

- Total capex of around USD328 million until 2023, of which USD238 million is estimated for infrastructure expansion

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

- Increase in scale to about 40mt a year, with an average remaining reserve life of around 15-20 years, while maintaining a low-cost position and stable financial profile, with funds from operations (FFO) adjusted net leverage below 1.5x (2018: -0.2x)

- Material progress towards infrastructure enhancement to ensure continuity of operations, limiting the company's exposure to weather-related issues.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

- Weaker cash-flow generation than Fitch expects 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 (2018: -0.2x)

- FFO fixed-charge coverage falling below 4.0x (2018: 111x)

Liquidity and Debt Structure

Adequate Liquidity: Bayan's proposed bonds would be the company's only debt, as it would be used to repay all its outstanding short-term loans used for working-capital purposes. Bayan paid a dividend of USD300 million in July 2019 (payout of 52% based on 2018 net income), which led to a net debt position for 2019. However, Fitch assumes that Bayan will be able to return to a net cash position over the next two years with modest capex and positive free cash-flow generation, and

maintain high liquidity over the next two to three years.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on Bayan, either due to their nature or the way in which they are being managed by the company.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING		
PT Bayan Resources Tbk			
senior unsecured	LT BB- New Rating		

Additional information is available on www.fitchratings.com

Applicable Criteria

Country-Specific Treatment of Recovery Ratings Criteria (pub. 18 Jan 2019)
Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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