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Coal picking up steam in Indonesia

by Crystopaz ANGGA

With coal losing more than 50% of its value since its peak in 2011, coal miners are struggling to stay afloat in the bearish market and many have been hit by a wave of defaults and bankruptcies. Although the recent price rally seems to have abated the suffering, the outlook on coal mining remains bleak. Increase in Chinese coal imports, due to supply tightening at home, has been largely cancelled by India's waning import demand. As India aims to be sell-sufficient in energy, the second largest coal importer has been aggressive in reducing imports.

In the face of slowing export demand, coal supply in Indonesia is likely to decrease. Indonesia's coal production fell by 16.3% YoY in January-June period to 101mn tons, far below the production target of 419mn tons for 2016, as small miners chose to cease production amid a low price. The situation is likely to worsen as India, a major coal importer, considers to export coal after a surge in production. According to a spokesman from the Energy and Mineral Resources Ministry, coal exports in January-June period dropped by 37.7 tons or 32% YoY due to weak demand from China and India (see left panel of Figure 1).

Figure 1: YoY growth of Indonesian coal export by destination (left panel) and market cap of three Indonesian coal miners (right panel). Information of Indonesia's coal's export to India after December 2015 is not available. S*ource: Bloomberg*

Despite the market gloom, large coal miners in Indonesia remain resilient in weathering the market downturn. The market cap of the two leading coal miners, Adaro Energy and Tambang Batubara Bukit Asam, has more than doubled since mining stocks plummeted to a nine-year low in December last year (see right panel of Figure 1). The aggregate RMI-CRI 1-year Probability of Default (PD) for Indonesian coal companies, which is a simple median of fifteen coal companies, has also fallen from 34.5bps in March to 11.0 bps in July (see Figure 2).

While the surge in stock prices might be temporarily fueled by the recent coal price rally, the recovery in the Indonesian coal mining is likely to be sustained by the rise in domestic demand. In April 2015, the Indonesian government launched a 35,000 MW power expansion project in 2015, which would add 35,000 MW of power by 2019. With 55% of the additional power to be generated from coal, the Indonesia Coal Association predicted that coal demand will rise by 74 million tons in 2019 or 19% annually from 2015 to 2019. Domestic consumption in the first half of the year increased by 1.94 tons (8% YoY), boosted by the expansion in the power generation sector and a pick-up in infrastructure projects.

Adaro Energy and Bukit Asam have been quick to reduce their reliance to exports as they diversify towards the coal-fired power segment. In line with the government's ambitious project, Adaro Energy plans to expand its coal-fired power capacity by 20 gigawatts by 2032 while Bukit Asam plans to add 5 gigawatts by 2020. In April, Adaro successfully acquired land for its controversial 2,000 MW coal-fired plant in Batang, Central Java while also securing a USD 3.4bn loan from a Japanese consortium in June. With an additional 3,000 MW projects in the pipeline, Adaro expects the power generation sector to make up 30% of its revenue in five to ten years' time, up from 5 to 10% currently. Similarly, Bukit Asam also expects to earn 40% of its revenue from power by 2019 as it expands its power plant projects to Riau, South Sumatera and Moluccas. In light of its large coal reserve and power expansion projects in the pipeline, the company remains optimistic on its 5,000 MW target.

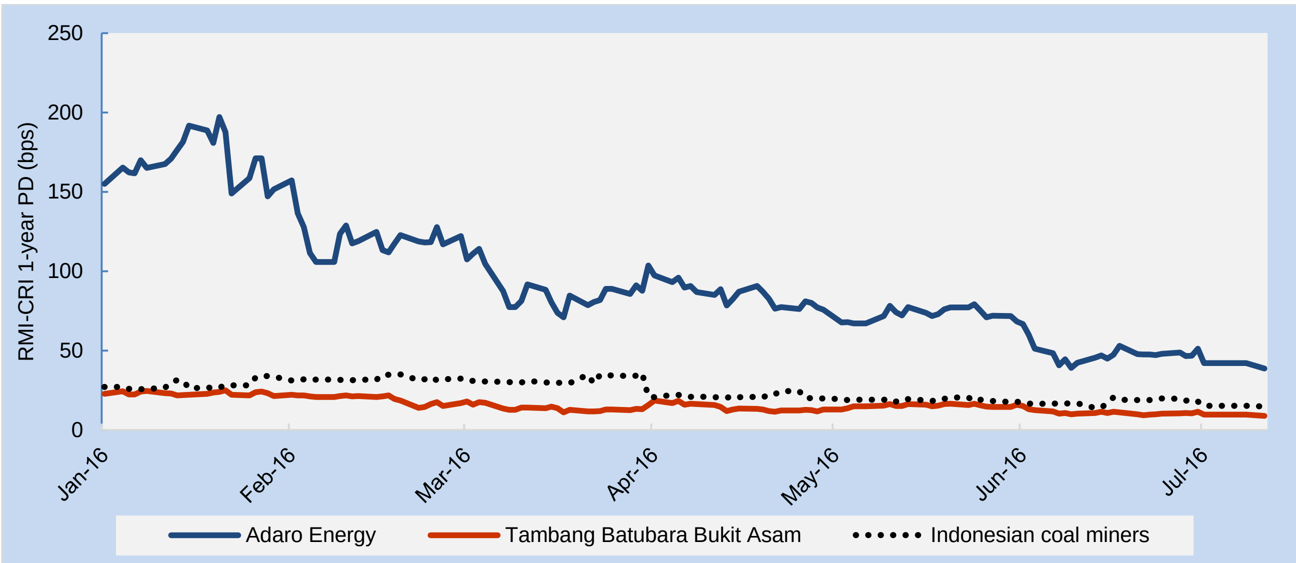

Figure 2: RMI-CRI 1-year PDs for Indonesian coal miners. *Source: RMI-CRI*

Adaro Energy's credit worthiness has significantly improved in light of its stronger fundamentals. The RMI-CRI 1-year Probability of default (PD) for Adaro has fallen from 197bps in January to 35bps on July 29 (see Figure 2). In Q1, Adaro, the second largest coal miner in Indonesia, reported a higher operating margin of 21% (see Figure 1) on the backbone of strong cost cutting. Adaro's coal cash cost excluding royalty fell by 16% YoY to USD 28 in 2015, driven by lower diesel cost, lower handling costs, and lower strip ratio (ratio of the volume of waste material that must be handled to the volume of metal ore extracted). According to its 2015 annual report, Adaro successfully refinanced a USD 400mn facility agreement with a more competitive rate and longer maturity whereas its net debt declined by 25% YoY in 2015 after repaying USD 625mn in bank loans. With USD 762mn of liquidity, Adaro maintains that its debt repayment remains manageable. Adaro's total debt-to-equity ratio has steadily declined (see Table 1).

Compared with Adaro, Bukit Asam has a significantly lower debt-to-equity ratio (see Table 1). The RMI-CRI 1-year Probability of default (PD) for Bukit Asam has remained low for the past one year, hovering below 30bps. Unlike Adaro, Bukit Asam has low exposure to China and India as its exports are mainly driven by demand from Taiwan and Japan, which make up 24% and 12.3% of the company's revenue in 2015. Bukit Asam's operating income also increased by 28% in Q1, driven by 14% YoY increase in its coal sales volume. While other miners, such as Adaro, have been reducing production amid a low price, Bukit Asam aims to increase production and sales by 34% and 52% respectively in 2016, citing increasing domestic demand and the recently expanded railway capacity as its main reasons. In line with the company's ambitious target, Bukit Asam's coal sales volume rose 11% YoY in the January-June period.

	Adaro Energy				Tambang Batubara Bukit Asam			
Quarter	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2015	Q3 2015	Q4 2015	Q1 2016
Operating income (USD mn)	109.7	88.3	27.6	123.8	40.7	65.3	44.8	34.2
Operating margin (%)	15.9	12.4	4.8	21.1	16.5	22.7	19.1	13.0
Coal cash cost (USD/ mt)	---	---	28.0	20.9	47.0	46.3	42.3	46.3
Total debt to equity (x)	51.2	49.3	46.7	44.4	26.1	23.4	21.8	22.0

Table 1: Financial data for Adaro Energy and Tambang Batubara Bukit Asam. *Source: Bloomberg*

Globally, the prospect of coal mining remains challenging. With shale gas hitting a 17-year low, European countries have turned away from coal in favor of cheaper and cleaner natural gas. Consequently, Colombian and South African miners are diverting coal sales from Europe to Japan, Korea, and India, which is made possible by cheaper freight cost and increased cost efficiency at home. While demand from Bangladesh, Philippines, and Korea is projected to rise, it is uncertain that the rally in coal price can be sustained, considering India's fast increase in coal production.

Despite the global uncertainty, the government-led power expansion project has helped to provide some stability in the Indonesian coal market. In light of the pervasive power outage in Indonesia, domestic consumption, driven by the power generation sector, is likely to be the future lifeblood of Indonesian coal miners. Although coal has been shunned everywhere, it could still burn hot in Indonesia.

Credit News

Swiber drops liquidation plans following talks with creditor

Jul 30. Swiber Holdings, the Singapore offshore oil and gas services group, said it is dropping liquidation plans and intends to restructure its business after talking with its major financial creditor. Swiber filed a petition to wind up and undergo liquidation after facing SGD 25.9mn claims from creditors, dragging the SGX Oil & Gas Index to a new low. As operating under judicial management would allow the company to continue operating in an attempt to turn around the business under court supervision, it was said that some of its lenders could recover more of their loans under this arrangement. DBS Group Holdings, Southeast Asia's biggest lender, said Thursday it has about SGD 700mn in total exposure to Swiber and expects to recover half of the amount. (Bloomberg)

Shell's debt nears edge of comfort zone as rout boosts borrowing

Jul 28. Low crude oil prices forced Royal Dutch Shell Plc to increase borrowing. With net debt standing at USD 75bn and a gearing ratio of 28.1% in June 2016, the company said it is on the verge of breaching its self-assigned 30% comfort level. The borrowing was meant to fund dividends and investments as the company pledged to maintain shareholder payouts. To keep the company's finance in check, the company plans to reduce capital expenditure and operating costs as well as divest 17 assets. Volatile oil prices have made financial planning difficult. If the oil prices stay below USD 50 a barrel, Shell will cut spending further and defer more projects. (Bloomberg)

Telefónica shares dip as investors seek greater progress on debt reduction

Jul 28. Spanish telecommunications giant Telefónica SA's shares led losses on Spain's benchmark index following the release of its 2nd quarter earnings. During its presentation, Telefónica executives assured analysts that strong free cash flow would help the company stay ahead of its mounting debts. Further, executives mentioned that issuance of a type of bond that does not directly fall under debt is under consideration. The company reported weaker YoY quarterly earnings, attributing it to weaker Brazilian, Argentine and UK currencies relative to the euro while revenue and operating income excluding depreciation and amortization had declined from a year earlier. With Telefonica's deal of selling its British mobile operator O2 blocked by the European commission, investors had sought for concrete plans by Telefónica to pare back on debt. Analysts at credit-rating firms cautioned that the company needs to cut back on debt or risk a potential downgrade in its investment-grade credit rating. (WSJ)

Bondholders suffer from Singapore-listed China Fishery's bankruptcy bid

Jul 27. China Fishery Group's filing for Chapter 11 bankruptcy protection has increased doubts on whether it can extract enough value from the sale of the company's assets in Peru to repay bondholders. With the firm's Chapter 11 filing, its 2015 notes have seen a 10.5 cent drop. An analyst at Fitch Ratings mentioned that the sale of the Peruvian assets is pivotal to the prospects of recovery for China Fishery, and with the company entering bankruptcy protection with a lack of updates on the sale of the assets, doubts are rising whether the sale will take place. (Straits Times)

Chinese default exposes creditor anger at political interference

Jul 27. The lack of a transparent process for resolving bad debt in China is frustrating creditors. Many Chinese firms had not paid interest on their loans and there were inadequate channels for bondholders to seek redress. Some of these bad loans involve state owned enterprises (SOEs). Previously, debt issued by SOEs were thought to carry an implicit guarantee. However, with the rising numbers of SOE defaults, bondholders had become more vocal in chasing the local governments for outstanding debt. In many of these instances, the courts were influenced by the government in rejecting bankruptcy petitions. (FT)

Coal miner Alpha emerges from bankruptcy amid doubts on outlook (Reuters)

Creditors demand more cash from Hanjin Shipping (Korea Herald)

Cheap oil squeezes South Asia's cash lifeline (WSJ)

Regulatory Updates

Reforms to Singapore bankruptcy framework take effect

Jul 27. The new bankruptcy framework, which aims to encourage creditors to exercise prudence when extending credit, will come into force on Aug 1. One key change lies in the bankruptcy debt threshold, which would be increased from SGD 10,000 to SGD 15,000. This change sought to encourage both debtors and creditors to resolve small debts without resorting to the formal bankruptcy process. Another big change was the expedited bankruptcy application process. The creditors will no longer have to wait for a 21-day period before filing a bankruptcy application. It also introduced a differentiated discharge regime to create a more rehabilitative regime that set out fixed exit points for bankrupts to be discharged. (Channel NewsAsia)

Bank CoCo Coupon payments made safer under ECB capital rules

Jul 27. The ECB is changing capital requirements for banks, making it easier for them to pay dividends, bonuses and additional Tier 1 coupons. Previously, once a bank's loss breached a certain capital level, the bank would not be allowed to distribute capital to stakeholders. The new rule relaxes capital rules by splitting capital demands into requirements and guidance. The latter, was introduced by Daniele Nouy, the head of the ECB's supervisory arm last month, although the portion of capital guidance was not made explicit. (Bloomberg)

Zimbabwe securities regulator approves debt listing requirements (Bloomberg)

Deutsche Bank fares better in EBA stress test than in 2014 (Bloomberg)

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