

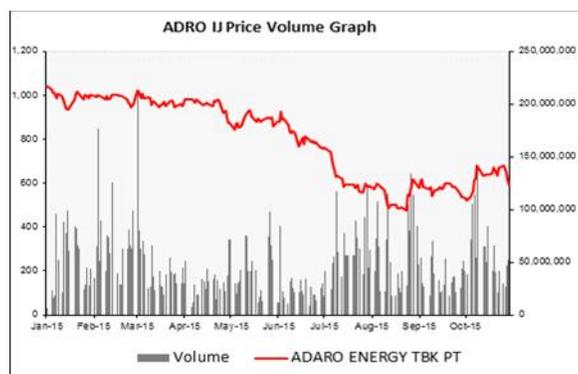
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**PT Adaro Energy Tbk is a coal mining company. The company and its subsidiaries currently deal in coal mining and trade, coal infrastructure and logistics, and mining contractor services.**

**Current Price: IDR 605**

**52-Week Target Price: IDR 750**



#### Share Price Performance

|                         |                  |
|-------------------------|------------------|
| Price (IDR)             | 605              |
| 52-Week High (11/03/14) | 1,150            |
| 52-Week Low (08/24/15)  | 467              |
| YTD Change/%            | (435) / (41.83%) |

#### Stock Information

|                      |                   |
|----------------------|-------------------|
| Market Cap (IDR)     | 19,351.5B         |
| Shares Out/Float (M) | 31,986.0/13,743.6 |

#### Initiating Coverage

### PT Adaro Energy Tbk (ADRO)

#### Weathering the Downturn

**BUY**

**BUY Rating with TP IDR 750**

We re-initiate ADRO with BUY recommendation and 52-week TP of IDR 750. The target price reflects 24% upside potential and 6.8x PER FY16F.

#### Inline 9M15 Results

The company booked 9M15 revenue decreased by 15.8% YoY to USD 2.11bn (75.9% of our FY15E) as sales volume declined by 3% YoY to 41.2 MT and ASP lowered by 14% YoY. Although the company booked a decrease in cost of revenue by 12.8% YoY to USD 1.68bn due to cost efficiency implementation, gross profit decreased by 25.4% YoY to USD 436.75mn and net profit also decreased by 19.5% YoY to USD 180.67mn (75.7% of our FY15E, 104.8% of FY15E consensus estimate).

#### Benefited from Reducing Finance Costs

The company has made full drawdowns of the US\$ 1bn facility in September 2014. This loan facility was used to refinance the Facility Agreement in 2011 of US\$ 750mn and the Senior Notes in 2009 of US\$ 800mn. As we noted, the interest cost expenses has significantly lowered by 62% YoY from USD 113.54mn in 9M14 to USD 43.18mn in 9M15 which saved the bottom line to 'only' decreased by 19.5% YoY.

#### 2015 Production Target Further Revised to 52-54 MT

The company has further revised downward its production target from the previous target of 54-56 Mt to 52-54 Mt due to anticipation of market conditions to be difficult for the rest of the year.

#### The Waiting of Batang's Financial Closure

The company is still waiting the financial closure to be done. It was extended for a 6-month period and it will due on April 6<sup>th</sup>, 2016. However, the management optimists the financial closure could be done before end of this year.

| Financial Highlights  | 2013  | 2014  | 2015E | 2016F | 2017F |
|-----------------------|-------|-------|-------|-------|-------|
| Revenue (USD mn)      | 3,285 | 3,325 | 2,782 | 3,061 | 3,378 |
| % growth              | -12%  | 1%    | -16%  | 10%   | 10%   |
| Gross Profit (USD mn) | 744   | 720   | 648   | 712   | 787   |
| Net Profit (USD mn)   | 231   | 183   | 238   | 267   | 295   |
| % growth              | -40%  | -21%  | 30%   | 12%   | 10%   |
| Gross Margin (%)      | 22.7% | 21.7% | 23.3% | 23.3% | 23.3% |
| Net Margin (%)        | 7.1%  | 5.5%  | 8.6%  | 8.7%  | 8.7%  |
| Return on Equity (%)  | 7.3%  | 5.6%  | 6.8%  | 7.2%  | 7.4%  |
| Return on Assets (%)  | 3.5%  | 2.9%  | 3.8%  | 4.1%  | 4.5%  |

Source: Bloomberg, Sinarmas Investment Research

Source: Company Data, Sinarmas Investment Research

### Inline 9M15 Results

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| Financial Statement (in USD mn) | 9M15    | 9M14    | % YoY |
|---------------------------------|---------|---------|-------|
| Revenue                         | 2,112   | 2,507   | -16%  |
| Cost of revenue                 | (1,675) | (1,922) | -13%  |
| Gross profit                    | 437     | 586     | -25%  |
| Operating income                | 320     | 469     | -32%  |
| Net income                      | 181     | 224     | -19%  |
| Operational EBITDA              | 568     | 700     | -19%  |
| Total assets                    | 6,215   | 7,496   | -17%  |
| Total liabilities               | 2,816   | 4,139   | -32%  |
| Net debt                        | 891     | 1,215   | -27%  |
| Gross profit margin             | 21%     | 23%     | -11%  |
| Operating margin                | 15%     | 19%     | -19%  |
| Net debt to equity (x)          | 0.26    | 0.36    |       |

### Benefited from Reducing Finance Costs

The company entered into an US\$ 1bn Facility Agreement with several banks on August 25<sup>th</sup>, 2014 and the company has made full drawdowns of the facility in September 2014. This loan facility was used to refinance the Facility Agreement in 2011 of US\$ 750mn and the Senior Notes in 2009 of US\$ 800mn. Thus, the interest cost expenses has significantly lowered by 62% YoY from USD 113.54mn in 9M14 to USD 43.18mn in 9M15 which saved the bottom line to 'only' decreased by 19.5% YoY.

### Cost Efficiency

On the back of lower than expected fuel price and lower freight and handling costs, the company can manage its cost more efficient during this challenging market condition. Cost of revenue was decreased by 13% YoY as result from strip ratio decreased from 5.77x in 9M14 to 5.35x in 9M15, and cash cost (excluding royalties) decreased by 13% YoY to USD 28.61 per tonne. Moreover, fuel costs as a significant component of cash cost, decreased by 39% YoY to USD 0.50s per liter.

#### **Minimal Benefit from IDR Depreciation**

As of October 28<sup>th</sup>, 2015, IDR has depreciated against USD by 9.4% YTD. Because the functional currency is already in USD, there is only minimal benefit from IDR depreciation.

#### **2015 Production Target Further Revised to 52-54 MT**

The company has further revised downward its production target from the previous target of 54-56 Mt to 52-54 Mt due to anticipation of market conditions to be difficult for the rest of the year especially sales in lower rank coal quality (4,000 kcal/kg). The company view that the lower quality of coal has been oversupplied in the market and has been affected to lower company's margin.

#### **The Waiting of Batang's Financial Closure**

After being postponed for 4 years due to land clearing issue, the kickoff ceremony of this project was done on August 28<sup>th</sup> at the site with approximately 11 ha of land area has not been acquired yet. That remaining land area is now under eminent domain law in the court system. The company is still waiting the financial closure to be done. It was extended for a 6-month period and it will due on April 6<sup>th</sup>, 2016. However, the management optimists the financial closure could be done before end of this year.

The Batang Power Plant, which is located on 200 ha of land area in Central Java, will have 2x1,000MW capacity. The investment cost is estimated approximately US\$ 4bn.

### **The Three Engines of Long-term Growth Strategy**

The company plans to shift its long-term growth strategy from current strategy which focus in coal mining business line to three pillars of growth engine. The three revenue engines are coming from mining production, logistics and mining services, and power business lines. Each of them are targeted to make contribution by approximately one third to company's total revenue in the future.

As in current position, mining business line made the biggest contribution by approximately 90%-95% to its top line. The company will maintain its future production growth as planned but with extra cautious as the coal market still in oversupply condition and the coal price remains weak. Thus, the company are taking control of their production and do not want to sell its coal at too much discount. On the top of that, the medium term coal production target remains 80 Mt.

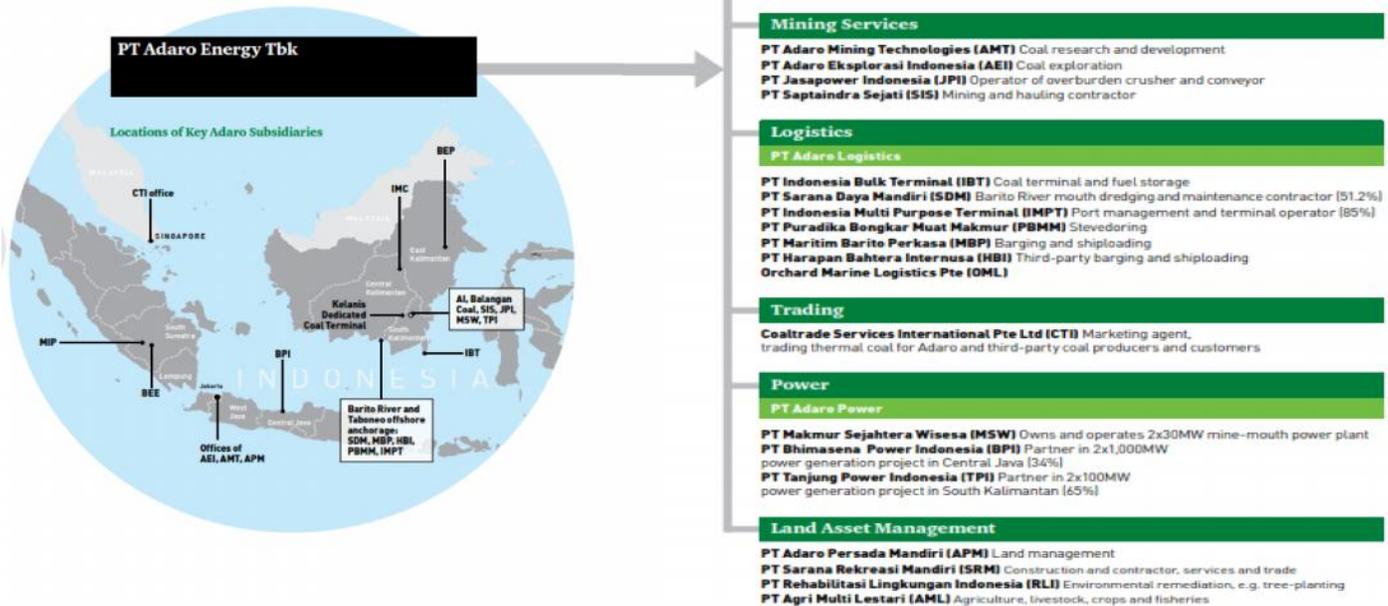
The company will gradually increase its two other pillars (logistics and services, and power) growth contribution to achieve its long term target. For logistics and services, the company will actively pursue third party revenue growth. They will ensure operational excellence, productivity improvement and timely reliable delivery to customers. Moreover, to grow its power business line, the company are looking to participate in power projects in Java, Sumatera and Kalimantan islands.

## Company Profile

Adaro Energy is a vertically integrated coal company from pit to power which including mining, barging, shiploading, dredging, port services, marketing and power generation with over 20 years experience of successful coal mining operations in Indonesia. It is the top five of thermal coal exporter globally.

The company's strategy is to focus on organic growth, enhance the contribution of the non-coal mining parts of their business, and further develop their power generation business.

The main site location is in South Kalimantan, where the company mines Envirocoal, a sub-bituminous, moderate heat-value, low pollutant coal. Adaro Energy becomes one of the world's lowest cost coal producers.



**Appendix I: Financial Statements**

| <b>Balance Sheet (in IDR Mn)</b>                           | <b>2013</b> | <b>2014</b> | <b>2015E</b> | <b>2016F</b> | <b>2017F</b> |
|--|-------------|-------------|--------------|--------------|--------------|
| <b>CURRENT ASSETS</b>                                      |             |             |              |              |              |
| Cash and cash equivalents                                  | 680,904     | 745,248     | 753,756      | 511,021      | 386,090      |
| Trade receivables - third parties                          | 309,565     | 285,560     | 250,542      | 269,263      | 300,695      |
| Inventories  | 102,747     | 96,743      | 83,978       | 90,726       | 101,050      |
| Total Current Assets                                       | 1,370,879   | 1,271,632   | 1,312,756    | 1,096,590    | 1,050,652    |
| <b>NON-CURRENT ASSETS</b>                                  |             |             |              |              |              |
| Investment in associates and joint ventures                | 402,021     | 395,626     | 335,735      | 366,790      | 406,235      |
| Mining properties  | 2,186,801   | 2,098,603   | 1,803,896    | 1,958,287    | 2,175,812    |
| Fixed assets   | 1,705,799   | 1,616,603   | 1,466,593    | 1,312,833    | 1,155,323    |
| Total Non-Current Assets                                   | 5,325,072   | 5,142,016   | 5,003,533    | 5,371,725    | 5,542,463    |
| <b>CURRENT LIABILITIES</b>                                 |             |             |              |              |              |
| Trade payables   | 326,987     | 351,145     | 281,043      | 312,908      | 343,296      |
| Bank loans   | 155,577     | 160,522     | 137,000      | 207,250      | 298,500      |
| Total Current Liabilities                                  | 773,679     | 774,595     | 662,507      | 789,929      | 896,899      |
| <b>NON-CURRENT LIABILITIES</b>                             |             |             |              |              |              |
| Bank loans   | 1,195,541   | 1,613,437   | 1,511,750    | 1,304,500    | 1,006,000    |
| Deferred tax liabilities                                   | 631,734     | 574,855     | 500,574      | 534,535      | 598,880      |
| Total Non-Current Liabilities                              | 2,748,079   | 2,380,905   | 2,137,851    | 1,938,270    | 1,710,306    |
| <b>EQUITY</b>  |             |             |              |              |              |
| Share capital  | 342,940     | 342,940     | 342,940      | 342,940      | 342,940      |
| Additional paid-in capital, net                            | 1,154,494   | 1,154,494   | 1,154,494    | 1,154,494    | 1,154,494    |
| Retained earnings  | 1,196,797   | 1,309,707   | 1,487,879    | 1,678,230    | 1,886,930    |
| Non-controlling interests                                  | 490,218     | 491,714     | 530,618      | 564,452      | 601,547      |
| Total Equity   | 3,174,193   | 3,258,148   | 3,515,931    | 3,740,116    | 3,985,910    |
| <b>Income Statement (in thousand of USD)</b>               |             |             |              |              |              |
| Revenue  | 3,285,142   | 3,325,444   | 2,782,204    | 3,061,153    | 3,378,350    |
| Cost of revenue  | 2,540,984   | 2,605,444   | 2,133,489    | 2,348,248    | 2,591,104    |
| Gross profit   | 744,158     | 720,000     | 648,716      | 712,905      | 787,246      |
| Operating expenses   | 173,089     | 159,734     | 140,115      | 150,601      | 168,172      |
| Other expenses, net  | 31,812      | 66,713      | 41,378       | 53,469       | 54,627       |
| Operating income   | 539,257     | 493,553     | 467,222      | 508,835      | 564,447      |
| Finance income   | 16,139      | 25,260      | 25,842       | 27,050       | 18,030       |
| Finance costs  | (116,582)   | (189,717)   | (63,499)     | (57,706)     | (52,911)     |
| Share in net loss of associates and joint ventures         | (14,558)    | (3,736)     | -            | -            | -            |
| Profit before income tax                                   | 424,256     | 325,360     | 429,566      | 478,178      | 529,566      |
| Income tax expense   | 192,259     | 141,820     | 190,954      | 210,497      | 234,262      |
| Profit for the year  | 231,997     | 183,540     | 238,612      | 267,681      | 295,303      |
| Other comprehensive income/(loss) for the year, net of tax | (3,852)     | (33,017)    | -            | -            | -            |
| Total comprehensive income for the year                    | 228,145     | 150,523     | 238,612      | 267,681      | 295,303      |

Source: Company data, Sinarmas Investment Research

**Appendix II: Financial Ratios**

| Ratios               | 2013   | 2014   | 2015E | 2016F | 2017F |
|----------------------|--------|--------|-------|-------|-------|
| <b>Profitability</b> |        |        |       |       |       |
| ROE                  | 7.3%   | 5.6%   | 6.8%  | 7.2%  | 7.4%  |
| ROA                  | 3.5%   | 2.9%   | 3.8%  | 4.1%  | 4.5%  |
| Gross margin         | 22.7%  | 21.7%  | 23.3% | 23.3% | 23.3% |
| Operating margin     | 16.4%  | 14.8%  | 16.8% | 16.6% | 16.7% |
| Net margin           | 7.1%   | 5.5%   | 8.6%  | 8.7%  | 8.7%  |
| Net income growth    | -39.5% | -20.9% | 30.0% | 12.2% | 10.3% |
| <b>Liquidity</b>     |        |        |       |       |       |
| Current Ratio (x)    | 1.77   | 1.64   | 1.98  | 1.39  | 1.17  |
| Quick Ratio (x)      | 1.64   | 1.52   | 1.85  | 1.27  | 1.06  |
| <b>Solvency</b>      |        |        |       |       |       |
| D/E (x)              | 0.39   | 0.52   | 0.44  | 0.35  | 0.25  |
| Debt/Assets (x)      | 0.19   | 0.26   | 0.25  | 0.20  | 0.15  |
| <b>Valuations</b>    |        |        |       |       |       |
| P/E (x)              | 7.52   | 9.87   | 7.59  | 6.77  | 6.14  |
| P/BV (x)             | 0.55   | 0.54   | 0.50  | 0.47  | 0.44  |

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