

We had visited one of ADRO's coal site in South Kalimantan. Here are some key takeaways from our visit:

Adaro Indonesia (AI) is currently ADRO's largest coal mining concession with an output capacity of more than 50 Mt per annum. Within its concession, AI owns 3 main pits which are Tutupan; Paringin; and Wara, producing thermal coal with caloric value ranging from 4,000 Kcal/Kg to 5,000 Kcal/Kg. Their operations emphasize on supply chain efficiency by integrating all operation processes as well as focusing on internal process improvement.

Operation process.

- Mining

Adaro Indonesia has one of the biggest coal concession in Indonesia with an area of more than 30,000 hectares and total reserve of around 980 Mt. Within its concession, AI has 3 main pits which are Tutupan, Paringin and Wara. In total, they have a production capacity above 50 Mt per year. Currently, they have 3 main coal contractors on the ground; PAMA, BUMA and SIS which are responsible for each pit. PAMA is responsible for Tutupan area while BUMA handles Paringin. Meanwhile, Wara will be operated by SIS, a subsidiary's of ADRO.

Tutupan mine pit



Source: Sinarmas Investment Research

- Hauling

Once coal has been extracted from ground, it will be directly transported from mine pit to Kelanis port using a hauling truck with average coal capacity of 130 tonnes per truck. Note that ADRO has built and operated their own hauling road with a total length of 80 Km from their mine pit all the way to their port. These roads enable smooth transportation, ensure on-time delivery and reduce logistic costs; though repair and maintenance needs to be done frequently. Nevertheless, we see that ADRO has one of the most efficient transportation logistic in South Kalimantan.

Adaro hauling roads



Source: Sinarmas Investment Research

**Richard Suherman**

Equity Analyst

+62 21 392 5550 ext. 610

[Richard.suherman@sinarmassekuritas.co.id](mailto:Richard.suherman@sinarmassekuritas.co.id)

- **Barging**

In Kelanis port, coal will be stored and processed before being transported to a barge ship. Once coal has arrived in Kelanis port, it will be transferred to the conveyor belt equipped with metal detector and separator. This is to ensure that there will be no other metal attached to the coal. Next, it will go through the crushing machine to cut its size according to the demands. Currently, ADRO owns several crushing machines with total capacity above 67 Mt per year. After that, some processed coal will be directly transported to a barge ship while the rest will be stored in their stockpiles. Kelanis stockpile has a total capacity of 350,000 tonnes with an average level maintained at around 50%. Finally, the barge ship will be transported to Taborneo, transferring the coal to a mother vessel. Each barge ship has a capacity ranging from 8,000 – 18,000 tonnes depending on its size. Note that all operations in Kelanis port are fully automated, hence leading to a better cost efficiency.

Coal processing and barging at Kelanis port

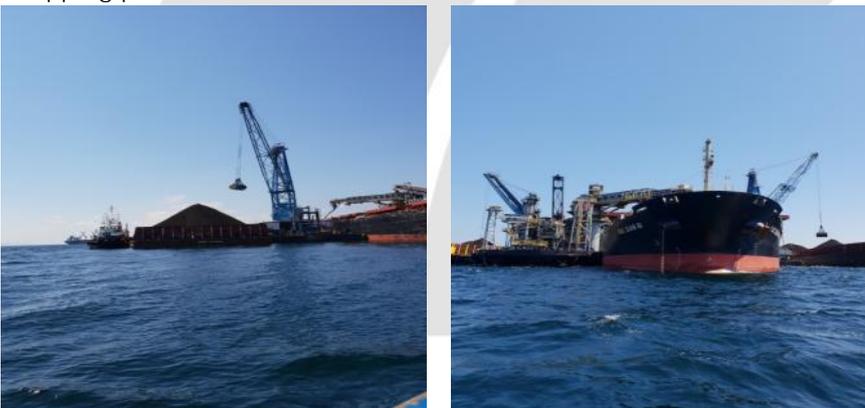


Source: Sinarmas Investment Research

- **Shipping**

The last operation process will be transferring coal from the barge ship to the mother vessel. The barge ship will sail through Barito river to reach the mother vessel awaiting at Taborneo sea. In those area, ADRO built a station where they could monitor all of the coal transfer process. The process, which usually takes around half day for one barge ship, is supported by 5 floating cranes to transfer the coal from the barge ship to mother vessels. Note that all operations from barging to shipping are done by MBP, one of ADRO's subsidiary.

Shipping process to mother vessel



Source: Sinarmas Investment Research

## Key Takeaways

- High operation efficiency. ADRO's operation process emphasizes on supply chain efficiency by integrating all of their supply chain processes. Moreover, ADRO always ensure each of the process are being handled in the most efficient ways. Some of the initiatives include developing better infrastructure, building automation process and implementing advanced technology to reduce logistic and operation costs.
- Vertical integration. ADRO's business model focuses on vertical integration supply chain "from pit to port to power" with subsidiaries involved in almost all of the operations. They have SIS to operate coal mining operation, MBP to operate barging process and Adaro Power to handle power plant project. This business model enhances cost efficiency and maximize returns.

## Operation and Financial Highlights

1Q18 production result was recorded at 10.95 Mt, below management target (20.3% of FY18 target) due to continuous heavy rainfall in 1Q18. The operation mine team in site mentioned that this year's rainfall have shorter duration with a higher intensity and frequency, hence disrupting coal production process. The stockpile that usually maintained at 50% capacity level had gone down to around 30% in the first quarter. However, slight recovery was seen in April production numbers. Currently, to catch up with its production target, ADRO has started to ramp up its production since May. Moreover, during our visit, we had witnessed the arrival of the heavy equipment ordered by the company, which should boost production in upcoming quarters. As a result, we think the company will achieve its FY18 production target at 54-56 Mt.

ADRO's net margin in 1Q18 went down to 9.7% (vs 13.4% in 1Q17) due to higher cost of production and operational expenses. Cash cost went up due to higher stripping ratio to maximize coal reserve as well as higher fuel cost. Meanwhile on operational side, ADRO current new recruitment for SIS which is intended to ramp up production, has led to higher operating expenses. Nevertheless, with current coal price at above USD 100 per ton coupled with better production output, we think margins will improve significantly in the upcoming quarters. We maintain our OVERWEIGHT view on ADRO with FY18 target price at IDR 2,480

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