

Adaro Energy (ADRO)

Massive cashflow for future diversification

Pockets of opportunity for Indonesia coal miners

Japan and EU countries are Russia's key coal export destinations, representing ~49% of Russia's total coal export value. *Fig 2 shows the major coal importers from Russia.* The 5th of EU sanctions adopted in Apr2022 in response to Russia's invasion of Ukraine would result in EU completely abandoning Russian coal by mid-Aug2022. Meanwhile, Japan has joined western nations to gradually phase out its coal import from Russia. Some indications from major European ports showed that Russia's coal exports to EU have declined 28% MoM. **The inevitable gap in coal supply for those countries provides pockets of opportunity for Indonesian coal miners.**

Robust demand to support seaborne thermal coal prices

Meanwhile, we see robust coal demand to continue as 1) gradual easing of **covid lockdowns in China** (Monday 20Jun2022 marked the 1st day of zero new cases reported in either Beijing or Shanghai) should revive industrial activities **in addition to the expected high electricity consumption during** more than a month-long **peak summer temperature starting mid Jul2022**; and 2) **India's struggle to resolve its power crunch** should provide another ground to **accelerate its coal imports** from either **Indonesia** or **Australia**. *Fig 4 & 6 show the underwhelming coal stocks for critical power plants in China and India.*

2Q22 results preview: strong earnings to continue

Considering 2Q22 ASP of ~USD101/t (+4% QoQ) and sales of 14mn tonnes (+15% QoQ), we estimate ADRO to generate ~USD465mn earnings (+16% QoQ), to bring its 1H22 earnings to USD865mn earnings (5x YoY, 55% of our FY22F est.). *Refer to more details in Table 4.*

Reiterate BUY call on ADRO as heavyweight in coal sector

We adjusted our ADRO's FY22/23F earnings assumptions by +6%/(-)21% to reflect better subsidiaries & JV earnings in FY22, while applying new royalty taxes in accordance with latest regulations from FY23 onwards. This resulted in a 6% lower valuation at USD9.2bn (implying 5.9x FY22F PE) but still offers a substantial 56% upside from current level. We have not included potential additional value from ADRO's venture into smelter aluminum project in addition to its minor 3.7% stakes in PT. Cita Mineral Investindo (CITA). Risk on our call includes further regulation changes imposed by Indonesia's government amid surging commodities prices.

	2020A	2021A	2022F	2023F	2024F
Sales (USD mn)	2,535	3,993	5,757	5,024	4,238
GP (USD mn)	577	1,770	2,562	1,465	887
OP (USD mn)	411	1,585	2,320	1,211	626
NP (USD mn)	147	933	1,554	794	380
EBITDA (USD mn)	584	1,762	2,593	1,488	929
Net debt (USD mn)	248	(250)	(1,032)	(500)	(288)
OP margin (%)	16.2	39.7	40.3	24.1	14.8
ROE (%)	3.7	20.9	29.8	15.7	7.7
Dividend yield (%)	4.0	2.3	12.1	15.3	7.8
EPS (USD)	67	417	719	372	178
chg. (% YoY)	-63%	525%	72%	-48%	-52%
BPS (USD)	1,797	1,993	2,411	2,364	2,313
DPS (USD)	114	66	346	437	223
PE (x)	40.7	6.5	3.8	7.3	15.3
PB (x)	1.7	1.5	1.3	1.3	1.3
EV/EBITDA (x)	10.7	3.3	1.9	3.7	6.1

Company Update

Commodities

Jul 4, 2022

12M rating **BUY (Maintain)**
12M TP **IDR 4,250** (Prev IDR 4,500)
Upside **+56%**

Stock Data

JCI (Jul 1)	6,794
Stock price (Jul 1, IDR)	2,720
Market cap (IDR bn)	87,002
Shares outstanding (m)	31.986
52-week high/low (IDR)	3,710 / 1,195
6M avg. daily turnover (IDR bn)	442.6
Free float (%)	43.7

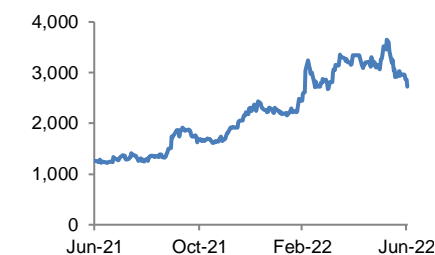
Major shareholders (%)

PT Adaro Strategic	43.9
Garibaldi Thohir	6.2
Edwin Soeryadaya	3.3
Theodore Permadi Rachmat	2.6

Performance

	1M	6M	12M
Absolute (%)	(9.2)	38.9	164.1
Relative to JCI (%p)	(9.5)	21.0	105.5

ADRO stock price



Source: Bloomberg

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I. Remains bullish despite new royalty taxes

ADRO will be subjected to new royalty taxes for coal export as the Coal Contract Agreement (CCA) with Indonesia gov't for its subsidiary PT Adaro Indonesia (the group's largest coal mining operation in Kalimantan) has to be converted to IUPK for an extension by Oct2022. As **stipulated in gov't regulation no. 15/2022 issued on 11Apr2022**, the revised royalty taxes for coal export now range from 14% to 28% depending on Indonesia Coal Price Reference (HBA) and CCoW generation. *Refer to Table 1 below for more details.* Applying these new royalty taxes **resulted in 21% lower FY23F earnings estimates.**

Table 1. Royalty tax changes for coal export & domestic sales

Coal sold for	Reference Price (HBA)	PP no. 81/2019	PP no. 15/2022	
			CCoW Gen 1	CCoW Gen 1+
Export	≤ USD70/t	13.5% of selling price	14% of selling price	20% of selling price
	USD70/t < HBA ≤ USD80/t		17% of selling price	21% of selling price
	USD80/t < HBA ≤ USD90/t		23% of selling price	22% of selling price
	USD90/t < HBA ≤ USD100/t		25% of selling price	24% of selling price
	> USD100/t		28% of selling price	27% of selling price
Domestic		13.5% of selling price	Flat 14% of selling price	Flat 14% of selling price

Source: Gov't regulation no. 15/2022, KISI

Table 2. Summary of assumptions changes

Assumptions	Unit	Current			Previous	
		FY22F	FY23F	FY24F	FY22F	FY23F
Sales volume	m tonnes	58.3	61.2	63.1	58.3	61.2
Change (%)		0%	0%	new		
Global coal price	USD/tonne	190.0	150.0	100.0	190.0	150.0
Change (%)		0%	0%	new		
ASP	USD/tonne	95.9	79.3	64.3	95.9	79.3
Change (%)		0%	0%	new		
Revenue	USD mn	5,757	5,024	4,238	5,757	5,024
Change (%)		0%	0%	new		
Cost of revenue	USD mn	3,195	3,560	3,351	3,167	3,217
Change (%)		1%	11%	new		
EBITDA	USD mn	2,593	1,488	929	2,469	1,781
Change (%)		5%	-16%	new		
Net profit	USD mn	1,554	794	380	1,466	1,008
Change (%)		6%	-21%	new		
Target price	IDR		4,250			4,500
Change (%)			-6%			
Recommendation			BUY			BUY

Source: KISI

We value ADRO using SOTP method considering its diversified portfolio consisting of its existing thermal coal business, ADMR, and power plants. Our SOTP valuation **of USD9.2bn implies 5.9x FY22F PE (at +0.5 std dev of its 5-year mean)** and this **translates to TP of IDR4,250/sh**, offering 56% upside from the last closing price. Based on our sensitivity analysis, a 10% movement in coal price would lead to 16% and 14% movements in ADRO's earnings and fair value.

We have not included the potential additional value from ADRO's latest venture into aluminum smelter project in North Kalimantan which will be developed at Green Industrial Park Indonesia (developed by PT Kalimantan Industrial Park Indonesia). This estimated USD728mn project is currently under feasibility study and should potentially help to further diversify ADRO's portfolio away from its core coal-related business. **The minor 3.7% stake investment in CITA can be viewed as part of ADRO's strategy to have access to one of the largest bauxite reserves in Indonesia with alumina refining & processing operations to produce Smelter Grade Alumina (SGA).**

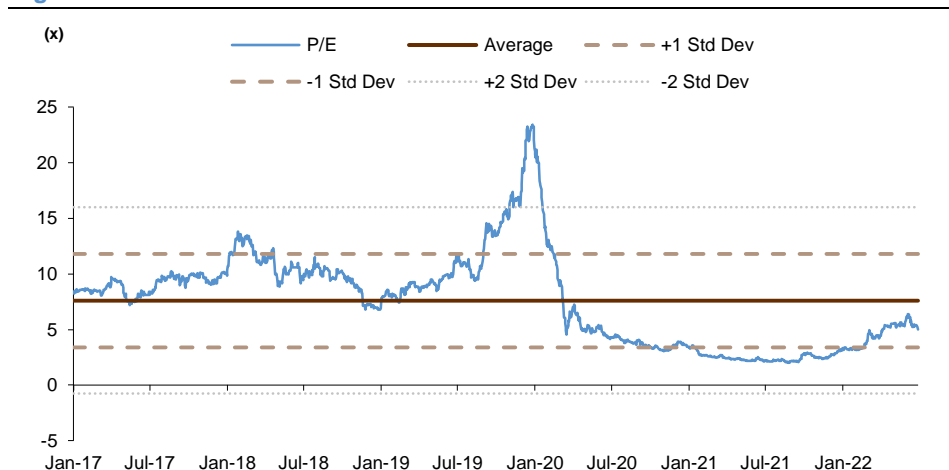
Risk on our call includes further regulation changes imposed by Indonesia's government amid surging commodities prices.

Table 3. ADRO's SOTP valuation

Assets	Stakes (%)	Full value (USDmn)	Adjusted value (USDmn)	Estimated FY22 NP (USDmn)	Method
Thermal coal mining, mining services & logistics					
	100.0%	5,345	5,345	1,069	PE multiples (5x)
Adaro Minerals Indonesia (ADMR)					
	83.8%	2,837	2,377	269	PE multiples (10x)
Equity investments					
Kestrel	48.0%	715	343		
Bhimasena Power Indonesia (BPI) 2x1,000MW	34.0%	274	93		BV multiples (1.2x)
Tanjung Power Indonesia (TPI) 2x100MW	65.0%	56	36		
Net cash (debt)			1,032		
Total Equity Value			9,227		
No. of shares (bn)			31.99		
Equity Value per share (IDR)			4,250		
USD/IDR assumed			14,800		

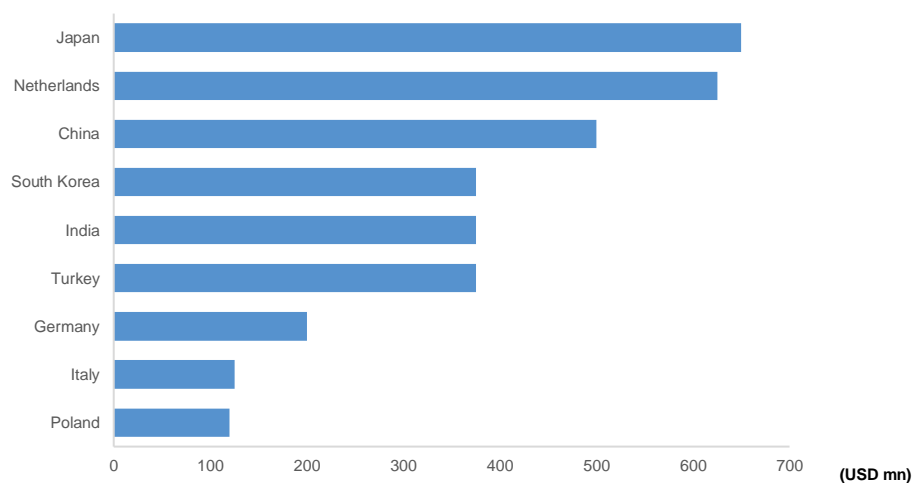
Source: KISI

Fig 1. ADRO's PE band



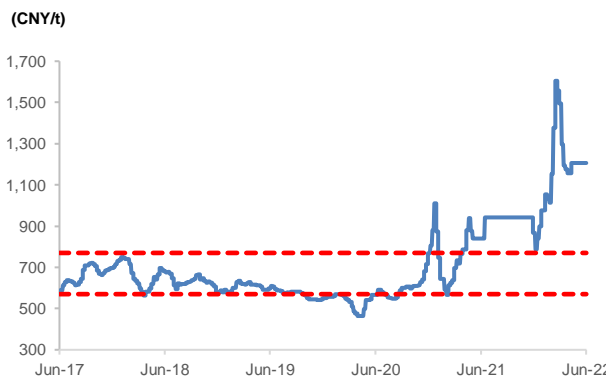
Source: Bloomberg, KISI

Fig 2. Largest coal importers from Russia in first 100 days of invasion



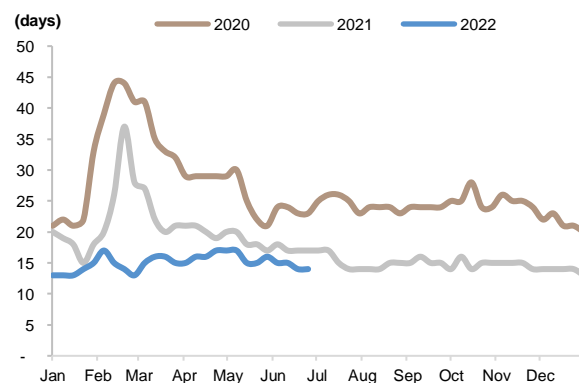
Source: Centre for Research on Energy and Clean Air, Visual Capitalist, KISI

Fig 3. China domestic spot coal prices



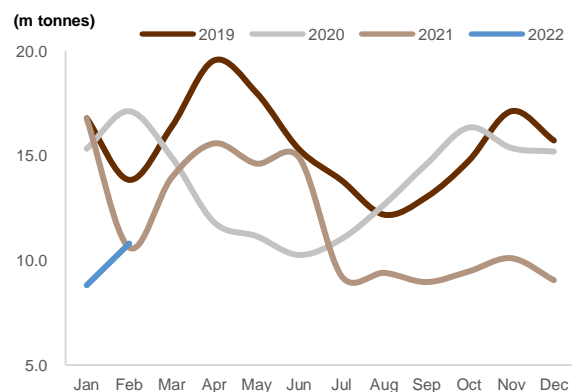
Source: Bloomberg, KISI. Note: Price range guidance for 5,500 kcal /kg coal at Qinhuangdao port is CNY 570-770 / tonne

Fig 4. Low avg. days of burn in China's key power plants



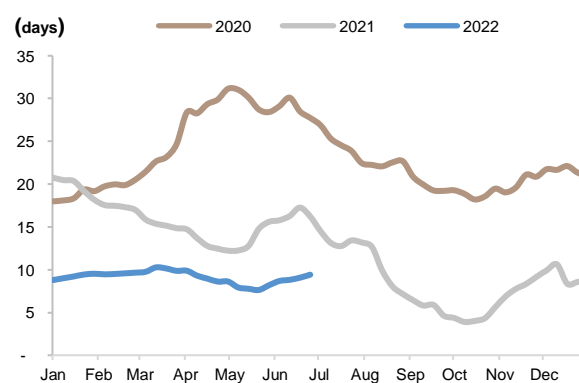
Source: Bloomberg, KISI

Fig 5. India monthly coal imports



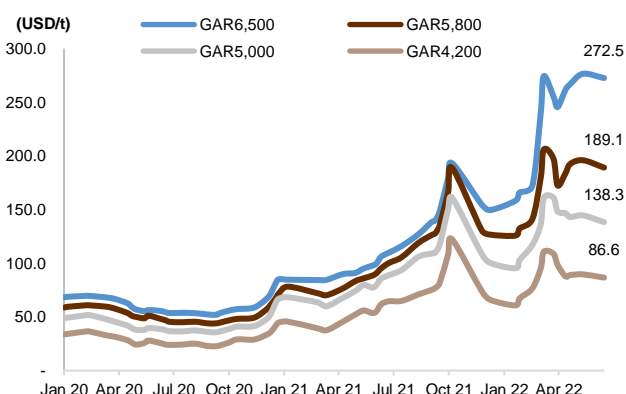
Source: Bloomberg, KISI

Fig 6. India's coal inventory days – remains low



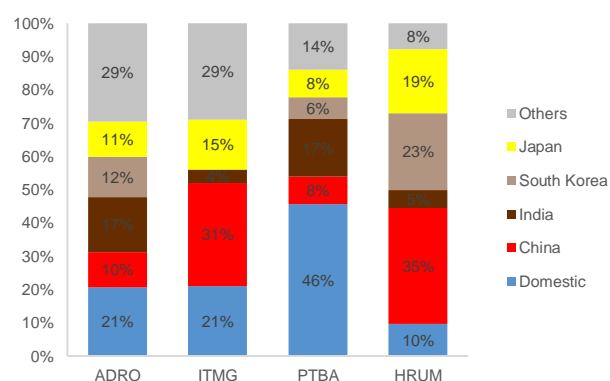
Source: Bloomberg, KISI

Fig 7. Coal prices trend



Source: Argus, KISI

Fig 8. Coal producers – 1Q22 sales by destinations



Source: Companies, KISI

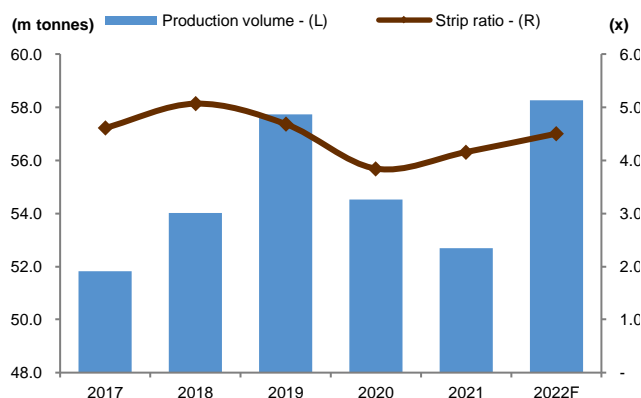
Table 4. 2Q22 results preview

ADRO 2Q22 financial results preview									
in USD mn	2Q21	1Q22	2Q22F	QoQ	YoY	6M21	6M22F	YoY	% of FY22F KISI
Revenue	871	1,225	1,410	15.1%	61.9%	1,563	2,634	68.6%	45.8%
Gross Profit	309	602	705	17.1%	127.8%	499	1,307	161.8%	51.0%
Operating Profit	269	535	634	18.5%	135.8%	413	1,170	183.3%	50.4%
Net Income	98	400	465	16.3%	373.7%	170	865	409.1%	55.7%
GPM	35.5%	49.1%	50.0%			31.9%	49.6%		
OPM	30.9%	43.7%	45.0%			26.4%	44.4%		
NPM	11.3%	32.7%	33.0%			10.9%	32.8%		

ADRO 2Q22 operational results preview									
	2Q21	1Q22	2Q22F	QoQ	YoY	6M21	6M22F	YoY	% of FY22F KISI
Production vol (mn)	13.6	12.2	14.0	15.0%	2.6%	26.5	26.1	-1.4%	44.8%
Sales vol (mt)	13.2	12.2	14.0	14.5%	5.9%	25.8	26.2	1.5%	44.9%
ASP	63.3	97.4	100.9	3.6%	59.5%	58.0	99.2	71.3%	
OB removal (m bcm)	62.4	48.2	62.9	30.4%	0.7%	115.0	111.1	-3.4%	42.4%
Stripping ratio	4.6	4.0	4.5			4.3	4.3	-2.0%	

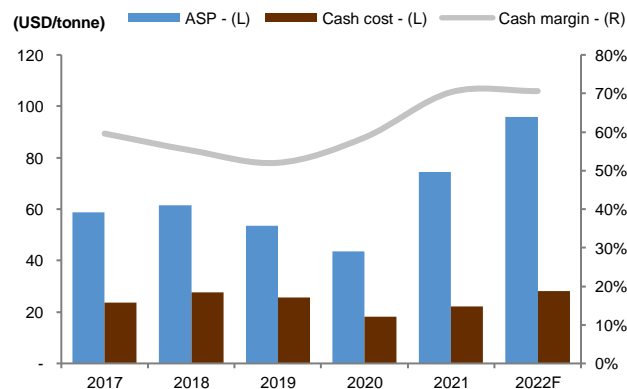
Source: Company, KISI

Fig 9. ADRO's production vol. & strip ratio trend



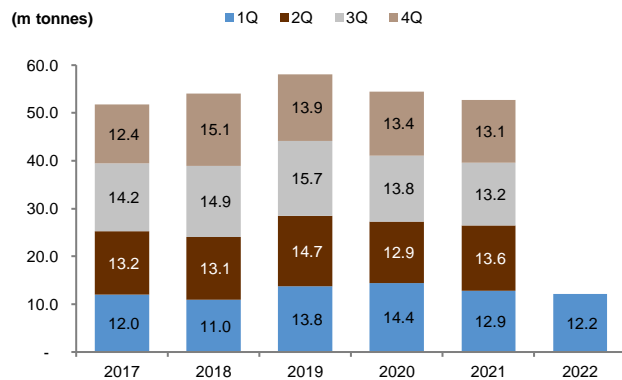
Source: Company, KISI

Fig 10. ADRO's ASP, cash cost & cash margin trend



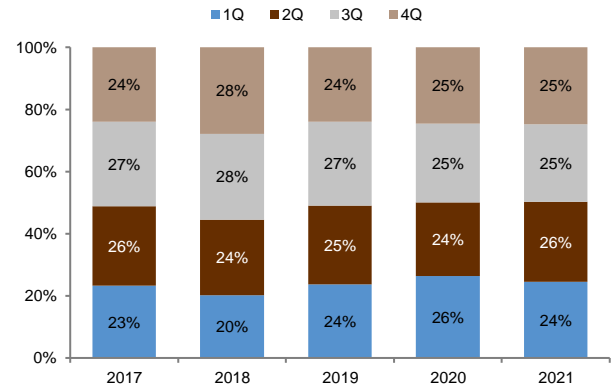
Source: Company, KISI

Fig 11. ADRO production volume



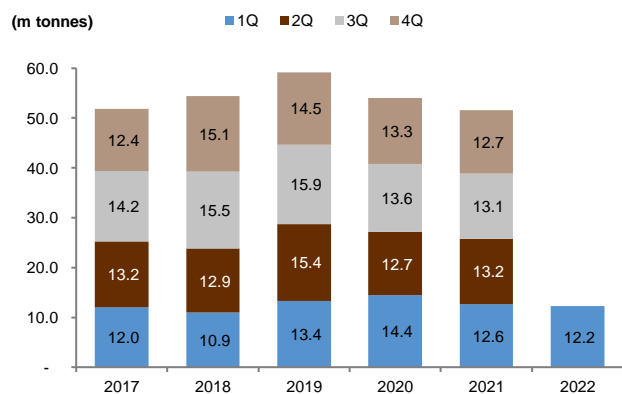
Source: Company, KISI

Fig 12. ADRO production volume seasonality



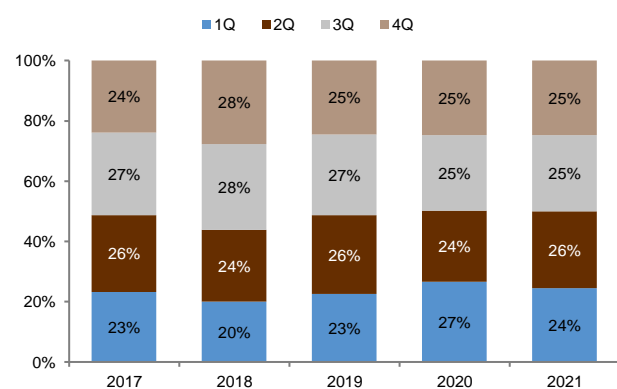
Source: Company, KISI

Fig 13. ADRO sales volume



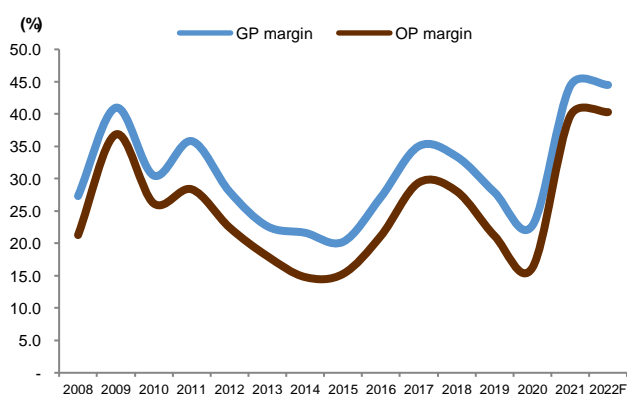
Source: Company, KISI

Fig 14. ADRO sales volume seasonality



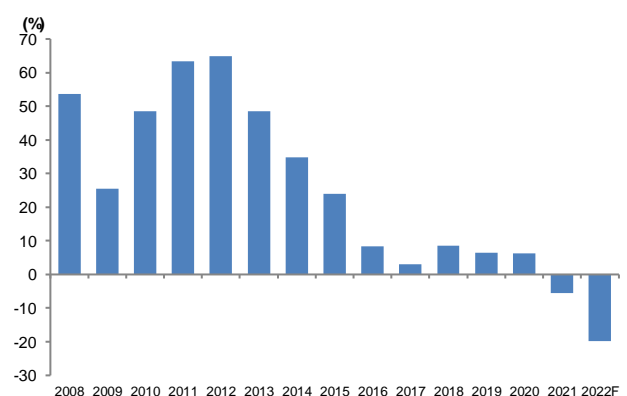
Source: Company, KISI

Fig 15. ADRO's GP & OP margins trend



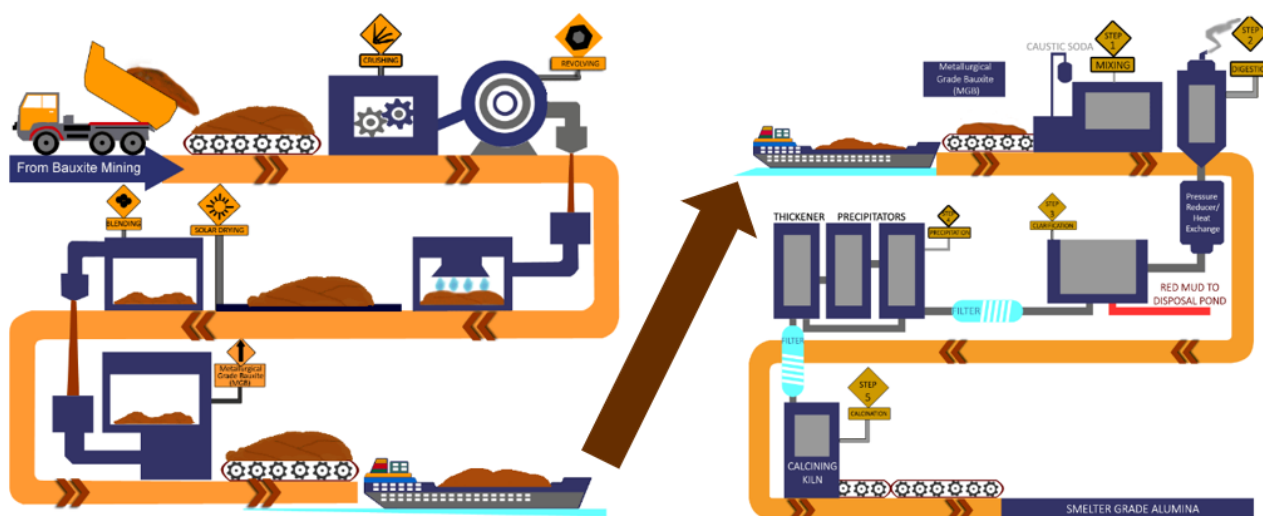
Source: Company, KISI

Fig 16. ADRO's net gearing – Net cash for the 1st time



Source: Company, KISI

Fig 17. Raw bauxite to Smelter Grade Alumina (SGA) process



Source: Cita Mineral website, KISI

Note: At the initial stage, the raw bauxite is processed to undergo the beneficiation process to become a Metallurgical Grade Bauxite (MGB). At this stage, MGB usually has around 45%-48% of aluminum content. Furthermore, MGB is processed with Bayer process which produces SGA (with around 98.5% of Al_2O_3 content), the main raw material for aluminum production.

We estimate ADRO's USD728mn aluminum smelter project announced in Dec2021 to have a potential long-term additional value of USD2.5bn, considering the 500k tonnes p.a sales (for 20 years – feed from Well Harvest Winning Alumina Refinery), USD2,000/t long-term aluminum price and 40% EBITDA margin.

Table 5. Potential value from aluminum smelter project

Aluminum smelter project	Units	Remarks
Potential value	US\$m	2,503.8
Assumed capacity	mn tonnes p.a	0.5
Assumed SGA feed	mn tonnes p.a	1.0 US\$400 per tonne
Assumed LT aluminum price	USD / t	2,000
Assumed EBITDA margin	%	40%
Assumed capex	US\$m	728 70% funded by debt
WACC	%	9.6%

Source: KISI

Company Overview

Adaro Energy (ADRO) is a vertically integrated energy producer in Indonesia. The company has an integrated business model with eight pillars; including Adaro Mining, Adaro Services, Adaro Logistics, and Adaro Power.

Adaro Mining has seven mines, including Adaro Indonesia (South Kalimantan), Balangan Coal (South Kalimantan), Mustika Indah Permai (South Sumatra), Bukit Enim Energi (South Sumatra), Adaro Metcoal (Central & East Kalimantan), Bhakti Energi Persada (BEP), and Kestrel Coal Resources (Queensland, Australia). The company produces low CV thermal coal, semi-soft coking coal, and hard premium coking coal.

Besides coal mining, the company is also expanding to Independent Power Plant (IPP) project under Adaro Power. At the moment the company has two ongoing IPP projects joint ventures, Bhimasena Power Indonesia (BPI) in Batang, Central Java, and Tanjung Power Indonesia (TPI) in South Kalimantan.

Fig 18. ADRO simplified corporate structure

ADAROMINING	ADAROSERVICES	ADAROLOGISTICS	ADAROPOWER
THERMAL COAL Adaro Indonesia (AI) 88.5% Coal mining, S. Kalimantan Balangan Coal 75% Coal Mining, S. Kalimantan Mustika Indah Permai (MIP) 75% Coal Mining, S. Sumatra Bukit Enim Energi (BEE) 61% Coal Mining, S. Sumatra Bhakti Energi Persada (BEP) 10.2% Coal mining, E. Kalimantan METALLURGICAL COAL PT Adaro Minerals Indonesia Tbk (AMI) 83.8% Coal mining, C. Kalimantan, E. Kalimantan Kestrel Coal Resources¹ 48% Queensland, Australia	MINING SERVICES Saptaindra Sejati (SIS) 100% Coal mining and hauling contractor Jasapower Indonesia (JPI) 100% Operator of overburden crusher and conveyor Adaro Jasabara Indonesia (AJI) 100% Mining services Adaro Mining Technologies (AMT) 100% Coal research & development COAL TRADING Coaltrade Services International Pte. Ltd (CTI) 90% Coal Trader	Maritim Barito Perkasa (MBP) 100% Barging & Shipping Sarana Daya Mandiri (SDM) 51.2% Dredging & maintenance in Barito River mouth Indonesia Multi Purpose Terminal (IMPT) 100% Port management & terminal operator Indonesia Bulk Terminal (IBT) 100% Coal terminal & fuel storage Puradika Bongkar Muat Makmur (PBMM) 100% Cargo loading & unloading Harapan Bahtera Internusa (HBI) 100% Shipping administration Barito Galangan Nusantara (BGN) 100% Maintenance services	Makmur Sejahtera Wisesa (MSW) 100% Operator of 2x30MW mine-mouth power plant in S. Kalimantan Tanjung Power Indonesia (TPI) 65% Partner in 2x100MW power plant project in S. Kalimantan Bhimasena Power Indonesia (BPI) 34% Partner in 2x1000MW power generation project in Central Java

¹) Kestrel Coal Resources has 80% ownership on Kestrel Coal Mine

Note : Simplified Corporate Structure

Source: Company's presentation, KISI

Balance sheet (USDmn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
Current assets					
Cash & cash equivalent	1,174	1,811	2,424	1,763	674
Accounts & other receivables	224	452	631	551	464
Inventories	105	126	148	185	189
Others	229	449	288	251	212
Non-current assets					
Fixed assets	3,062	2,769	2,768	2,808	2,749
Mining properties	1,588	1,980	2,512	2,568	2,571
Other non-current assets	6,382	7,587	8,772	8,126	6,859
Total assets					
Current liabilities	214	272	420	468	441
Accounts & other payables	-	-	-	1	1
ST debt	643	271	(91)	659	(92)
Current portion of LT debt	288	818	1,141	794	595
Others					
Non-current liabilities	780	1,291	1,482	604	478
LT debt & financial liabilities	225	187	187	187	187
Employee benefits liability	280	289	419	372	318
Other non-current liabilities	2,430	3,129	3,560	3,084	1,928
Total liabilities					
Controlling interest	1,497	1,497	1,497	1,497	1,497
Capital stock	-	-	-	-	-
Additional paid-in capital	-	-	-	-	-
Other Reserves	2,215	2,639	3,447	3,308	3,211
Retained earnings	240	322	268	236	223
Minority interest	3,952	4,458	5,212	5,042	4,932
Shareholders' equity	1,174	1,811	2,424	1,763	674

Cash flow (USDmn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
C/F from operating	151	1,290	2,249	1,019	696
Net profit	159	1,029	1,708	873	413
Depreciation	284	288	303	326	345
Net incr. in W/C	(262)	95	421	(238)	(124)
Others	(30)	(121)	(182)	59	63
C/F from investing	83	(236)	(515)	(509)	(383)
CAPEX	(11)	6	(302)	(366)	(286)
Others	95	(241)	(213)	(144)	(98)
C/F from financing	(637)	(417)	(1,121)	(1,170)	(1,403)
Incr. in equity	60	(375)	(207)	(110)	(46)
Incr. in debts	(447)	105	(167)	(128)	(880)
Dividends	(250)	(147)	(747)	(932)	(476)
Others	-	-	-	-	-
C/F from others	-	-	-	-	-
Increase in cash	(402)	637	613	(661)	(1,089)

Income statement (USDmn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
Sales	2,535	3,993	5,757	5,024	4,238
COGS	(1,958)	(2,223)	(3,195)	(3,560)	(3,351)
Gross profit	577	1,770	2,562	1,465	887
SG&A expense	(165)	(185)	(242)	(254)	(261)
Operating profit	411	1,585	2,320	1,211	626
Financial income	36	34	37	36	20
Financial expense	(89)	(83)	(88)	(78)	(67)
Other expense	(126)	(57)	(173)	(151)	(127)
Other non-operating profit	-	-	-	1	1
Income (loss) from JV	(9)	7	260	145	99
Earnings before tax	222	1,486	2,355	1,163	550
Income taxes	(64)	(458)	(648)	(291)	(138)
Net profit	147	933	1,554	794	380
Non-controlling interest	12	95	154	79	33
Other comprehensive profit	-	-	-	-	-
Total comprehensive profit	-	-	-	-	-
Total comprehensive profit of controlling interest	-	-	-	-	-
EBITDA	584	1,762	2,593	1,488	929

Key financial data

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
per share data (IDR)					
EPS	67	417	719	372	178
BPS	1,797	1,993	2,411	2,364	2,313
DPS	114	66	346	437	223
Growth (%)					
Sales growth	(27)	58	44	(13)	(16)
OP growth	(44)	285	46	(48)	(48)
NP growth	(64)	535	66	(49)	(52)
EBITDA growth	(37)	202	47	(43)	(38)
Profitability (%)					
OP margin	16.2	39.7	40.3	24.1	14.8
NP margin	5.8	23.4	27.0	15.8	9.0
EBITDA margin	23.0	44.1	45.0	29.6	21.9
ROA	2.3	12.3	17.7	9.8	5.5
ROE	3.7	20.9	29.8	15.7	7.7
Dividend yield	4.0	2.3	12.1	15.3	7.8
Dividend payout ratio	62	100	80	60	60
Stability					
Net debt (US\$ m)	248	(250)	(1,032)	(500)	(288)
Int.-bearing debt/equity (%)	36	35	27	25	8
Valuation (X)					
PE	40.7	6.5	3.8	7.3	15.3
PB	1.7	1.5	1.3	1.3	1.3
EV/EBITDA	10.7	3.3	1.9	3.7	6.1

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