

# Adaro Energy (ADRO)

## Plotting paths to USD10bn valuation

### Gas crunch in Europe leads to surging coal demand globally

The unprecedented surge in natural gas over the past 12 months is exacerbated by uncertainties over oil and gas supplies Russia due to its aggression towards Ukraine in the past 2 weeks. **Europe relies heavily (30-40% of its imports) on Russian oil and gas supply.** To reduce future dependency on Russian energy imports, **several European governments consider several measures.** Extending coal power plants life could be the short-term fix as other options required at least several months to deploy. However, **Europe is also dependent on coal imports from Russia** with a lack of alternative sources of coal. **This should further add demand-supply imbalance in global trade.**

### Seaborne thermal coal price should remain high in mid-term

Meanwhile, **China's thermal coal imports should remain strong** hovering between 250-300mn tonnes annually, **as its coal stocks remain underwhelming** with just ~13 days avg. days of burn for its critical power plants. We expect Indonesia to continue to benefit by supplying ~60% of China's coal imports given no clear signal on the potential easing of its unofficial import ban on Australian coal. **We lifted our FY22/23F coal price assumptions to USD190/t and USD150/t, respectively (from USD150/t and USD100/t previously).**

### Strong earnings to continue in the next quarters

**ADRO managed to book a record quarterly high net profit at USD513mn in 4Q21**, to bring its FY21 earnings to USD933mn (~6.3x YoY) exceeding both our and consensus estimates by 16% and 45%, respectively. We expect ADRO to continue to enjoy high coal prices and have low cash costs to break USD1bn earnings in FY22.

### Massive earnings upgrade – reiterate BUY call with 48% upside

We revised up our ADRO's FY22/FY23F coal price assumptions to USD95.9/USD79.3 per tonne (from USD92.8/USD64.3 per tonne previously), resulting in a massive 43%/116% earnings upgrade for FY22/23F. We **value ADRO using SOTP** considering its diversified portfolio **consisting of its existing thermal coal business, ADMR (which value is unlocked recently), and power plants.** Our SOTP valuation of **USD10.1bn**, implies 6.7x FY22F PE (lower than its 5-year mean) and **translates to a street high TP of IDR4,500/sh.** Risk to our call includes changes in gov't regulation and potential oversupply of Russian coal in the aftermath of recent conflicts.

	2020A	2021A	2022F	2023F	2024F
Sales (USD mn)	2,535	3,993	5,757	5,024	4,238
GP (USD mn)	577	1,770	2,590	1,808	1,166
OP (USD mn)	411	1,585	2,383	1,590	942
NP (USD mn)	147	933	1,466	1,008	586
EBITDA (USD mn)	584	1,762	2,469	1,781	1,209
Net debt (USD mn)	248	(250)	(1,113)	(952)	(843)
OP margin (%)	16.2	39.7	41.4	31.7	22.2
ROE (%)	3.7	20.9	28.6	19.3	11.3
Dividend yield (%)	3.7	2.2	11.4	13.6	9.3
EPS (USD)	67	417	678	473	275
chg. (% YoY)	-63%	525%	63%	-30%	-42%
BPS (USD)	1,797	1,993	2,372	2,446	2,427
DPS (USD)	114	66	346	413	284
PE (x)	45.5	7.3	4.5	6.4	11.1
PB (x)	1.7	1.5	1.3	1.2	1.3
EV/EBITDA (x)	11.9	3.7	2.3	3.2	4.8

## Company Update

### Commodities

Mar 7, 2022

12M rating **BUY (Maintain)**  
12M TP **IDR 4,500** (Prev IDR 2,400)  
Upside **+48%**

#### Stock Data

JCI (Mar 4)	6,928
Stock price (Mar 4, IDR)	3,040
Market cap (IDR bn)	97,237
Shares outstanding (m)	31.986
52-week high/low (IDR)	3,050 / 1,160
6M avg. daily turnover (IDR bn)	312.1
Free float (%)	43.7

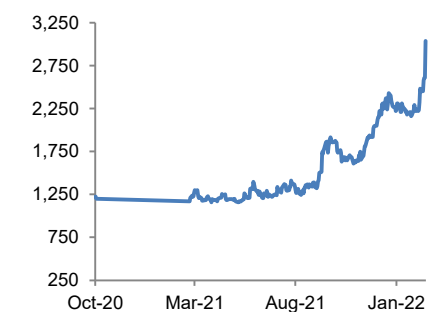
#### Major shareholders (%)

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

#### Performance

	1M	6M	12M
Absolute (%)	39.4	140.3	181.7
Relative to JCI (%p)	37.0	96.5	132.7

#### ADRO stock price



Source: Bloomberg

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## I. Natural gas crunch in Europe leads to surging demand for coal

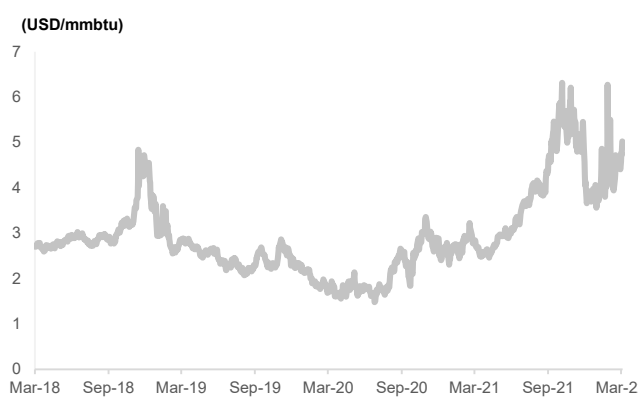
US, UK, EU, and their allies have imposed sanctions on Russia (e.g. freezing financial assets, banning Russian aircrafts, etc) for its aggression towards Ukraine in the past 2 weeks. However, ban on energy imports from Russia is still being debated over given its importance mostly for EU countries. The policymakers have been reluctant to hit Russian energy trade for a fear of a spike in energy prices would be detrimental to their economics. Europe relies on Russia for ~40% of its gas imports and ~30% of its oil imports. The uncertainties over oil and gas supplies on potential further sanctions on Moscow sent natural gas prices to an unprecedented level.

The unprecedented surge in natural gas over the past 12 months has prompted several European governments to consider several measures to reduce dependency on Russian energy imports in the future including the extension of coal and nuclear power plants life, more LNG facilities projects, and acceleration of renewables deployment. LNG facilities require at least 3 years to construct, while renewables (i.e. onshore wind, offshore wind, solar PV, etc) take at least 4 months to deploy. Thus, among those measures, extending the life of coal power plants could be the more short-term fix as an alternative to a shortage in natural gas.

Shifting to coal-generated power is more cost-effective (excl. the carbon tax) as compared to other alternative energy sources. As an example, Fig 3 shows that Germany's power generation by coal has rebounded by 33% YoY in 2021 (after a 25% YoY drop in 2020) and could remain above its 2019 level for the time being.

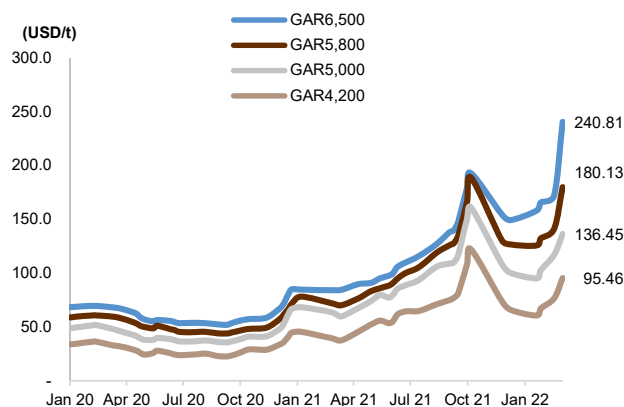
However, European countries are also very much dependent on Russian coal with ~70% of its imports. Therefore, potential further sanctions on coal imports from Russia should elevate coal prices further, particularly in Europe. US and Colombia are the alternative coal sources for Europe, but their supplies are not enough to replace Europe's imports from Russia.

Fig 1. Natural gas price trend



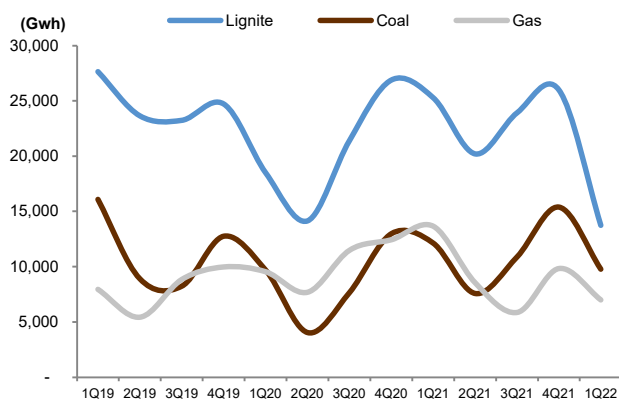
Source: Bloomberg, KISI

Fig 2. Coal price trend



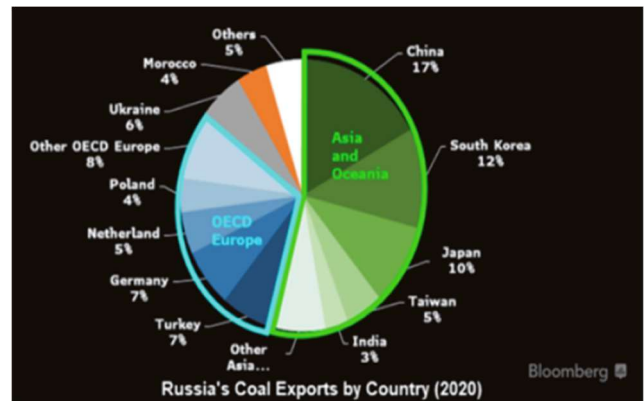
Source: Argus, KISI

Fig 3. Germany power generation (by gas, coal, lignite)



Source: Bloomberg Intelligence, KISI

Fig 4. Russia coal exports



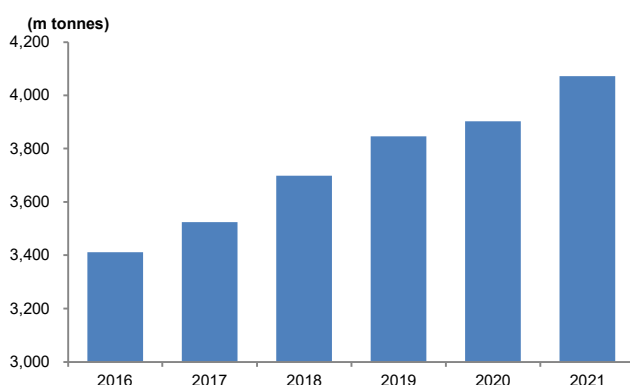
Source: Bloomberg Intelligence, KISI

Meanwhile, the largest coal producer China should continue to grow as China approved additional 300mn tonnes of capacity in 2021. As its domestic supply ramps up, China is unlikely to face a repeat of coal shortage like it did winter season of 2020 and 2021. Currently, its power plant inventory stood at 217k tonnes or only ~13 days of burn for its critical power plants (on the low side in the past two years).

Based on its demand and supply, China's thermal coal imports should remain strong hovering between 250-300mn tonnes annually. Indonesia and Russia are China's biggest seaborne thermal coal providers with 196mn tonnes and 57mn tonnes, respectively in 2021. We should expect this trend to continue with no clear signal whether China may ease its unofficial import ban on Australian coal.

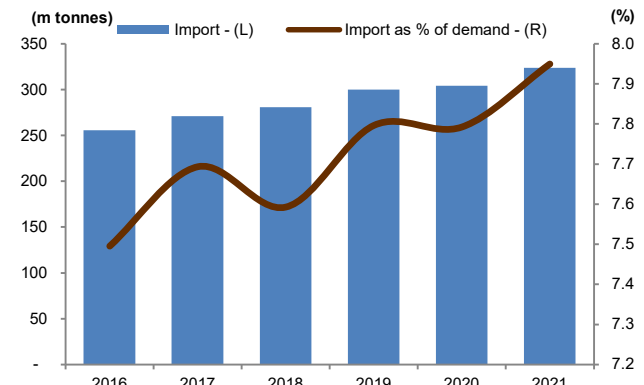
Considering all the factors, we believe that seaborne thermal coal price should remain high in the mid-term. Therefore, we lifted our FY22/23F coal price assumptions to USD190/t and USD150/t, respectively (from USD150/t and USD100/t previously).

Fig 5. China coal production



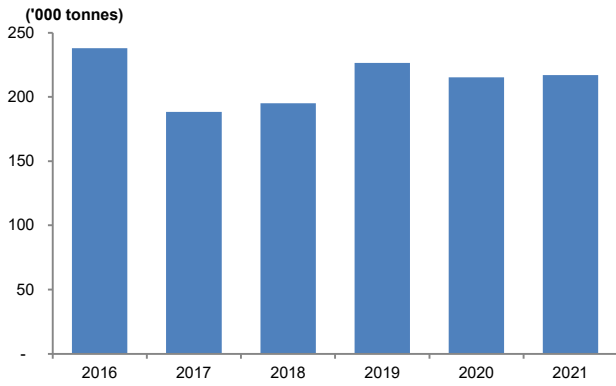
Source: Bloomberg Intelligence, KISI

Fig 6. China coal import & import as % of demand



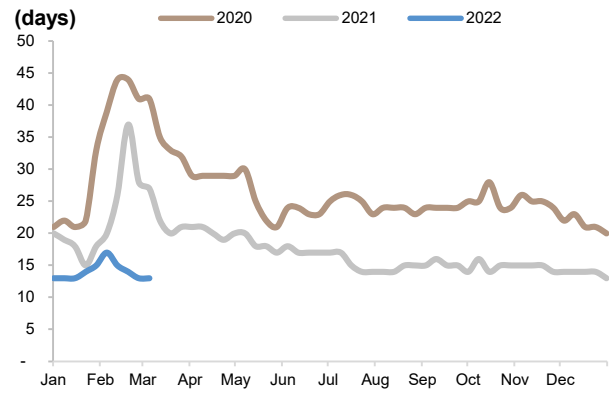
Source: Bloomberg Intelligence, KISI

**Fig 7. China coal inventory**



Source: Bloomberg Intelligence, KISI

**Fig 8. Avg. days of burn in China's key power plants remains low**



Source: Bloomberg Intelligence, KISI

## II. Strong 4Q21 results to continue

Table 1. ADRO's strong FY21 operational and financial results

ADRO 4Q21 results snapshot										
in USD mn	4Q20	3Q21	4Q21	QoQ	YoY	FY20	FY21	YoY	% of FY21F KISI	% to cons
Revenue	580	1,006	1,424	41.5%	145.4%	2,535	3,993	57.5%	94.3%	102.6%
Gross Profit	114	472	799	69.4%	599.4%	577	1,770	206.7%	108.8%	126.4%
Operating Profit	78	427	744	74.2%	852.8%	412	1,585	284.6%	112.8%	135.1%
Net Income	38	251	513	104.3%	1265.2%	147	933	535.3%	116.5%	144.7%
GPM	19.7%	46.9%	56.1%			22.8%	44.3%			
OPM	13.5%	42.5%	52.3%			16.3%	39.7%			
NPM	6.5%	24.9%	36.0%			5.8%	23.4%			

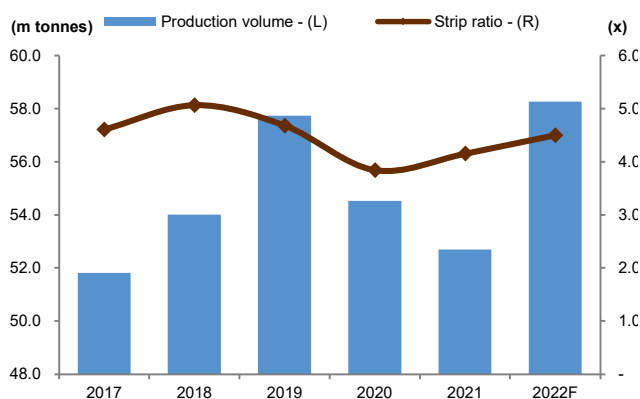
  

ADRO 4Q21 operational										
in USD mn	4Q20	3Q21	4Q21	QoQ	YoY	FY20	FY21	YoY	% of FY21F KISI	
Production vol (mn)	13.4	13.2	13.1	-0.7%	-2.5%	54.5	52.7	-3.3%	100.3%	
Sales vol (mt)	13.3	13.1	12.7	-2.8%	-4.6%	54.1	51.6	-4.7%	98.7%	
ASP	40.1	74.7	107.3	43.8%	168.0%	43.2	74.4	72.1%		
OB removal (m bcm)	49.1	58.1	45.9	-21.0%	-6.6%	209.5	218.9	4.5%	87.7%	
Stripping ratio	3.8	4.4	3.5	-20.5%	-8.6%	3.8	4.2	8.1%		

Source: Company, KISI

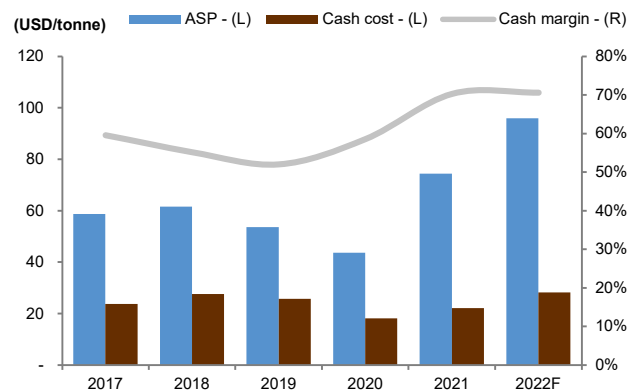
ADRO managed to book a record quarterly high net profit at USD513mn in 4Q21, to bring its FY21 earnings to USD933mn (~6.3x YoY) exceeding both our and consensus estimates by 16% and 45%, respectively. The outperformance in 4Q21 was primarily due to 1) a much lower COGS (from much lower OB removal due to wet weather) and 2) a spike in coal ASP (+43.8% QoQ) to an unprecedented level at USD107.3/t. This record high GP margin of 56% in 4Q21 pushed its FY21 GP margin to an uncharted level of 44.3%. No significant deviations to our estimates on its operational and financial costs as they are all quite stable on yearly basis.

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



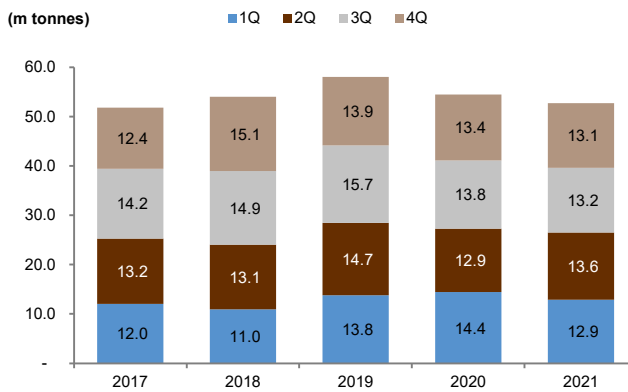
Source: Company, KISI

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



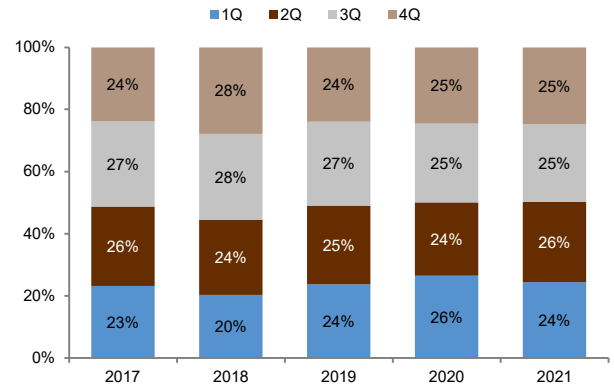
Source: Company, KISI

**Fig 11. ADRO production volume**



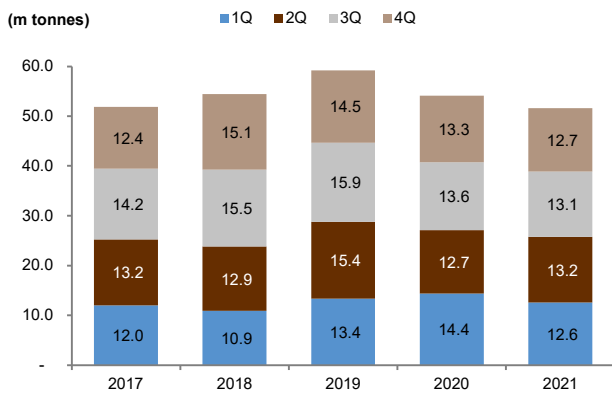
Source: Company, KISI

**Fig 12. ADRO production volume seasonality**



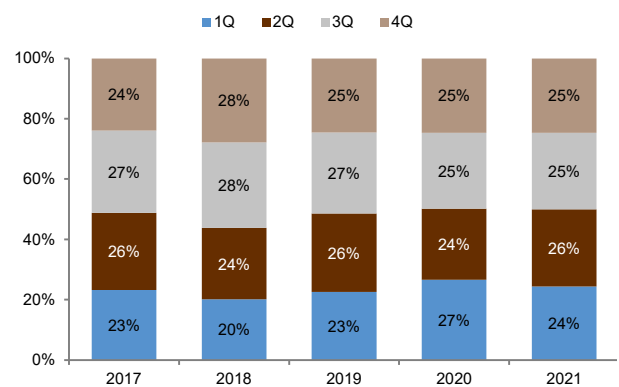
Source: Company, KISI

**Fig 13. ADRO sales volume**



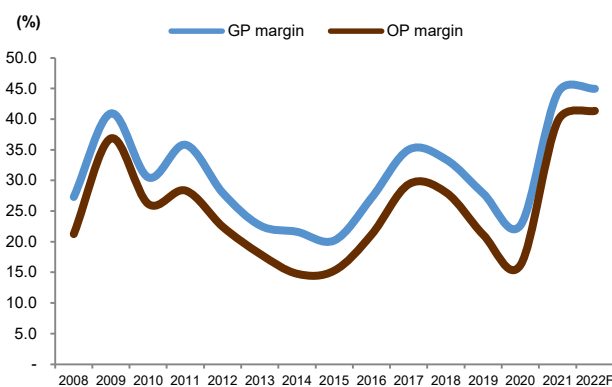
Source: Company, KISI

**Fig 14. ADRO sales volume seasonality**



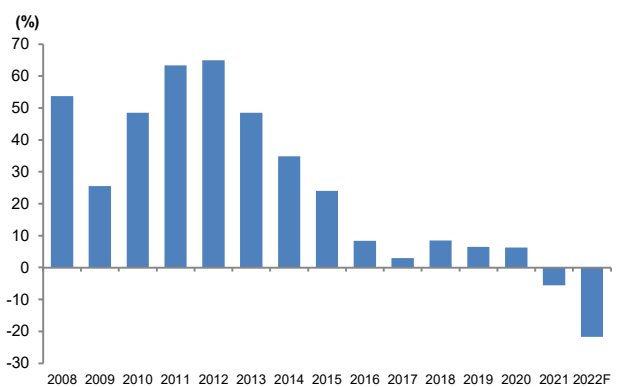
Source: Company, KISI

**Fig 15. ADRO's GP & OP margins trend**



Source: Company, KISI

**Fig 16. ADRO's net gearing – Net cash for the 1<sup>st</sup> time**



Source: Company, KISI

### III. Massive earnings upgrade – reiterate BUY

Considering the current high coal price environment, we revised up our ADRO's FY22/FY23F coal price assumptions to USD95.9/USD79.3 per tonne (from USD92.8/USD64.3 per tonne previously). Subsequently, we revised up our FY22/23F earnings assumptions by 43%/116% to USD1.46bn/1.0bn.

ADRO managed to unlock massive value on its subsidiary Adaro Mineral Indonesia (ADMR) through IPO on 3Jan2022 which has since skyrocketed to ~IDR72tn market value (from just IDR4.1tn).

We value ADRO using SOTP considering its diversified portfolio consisting of its existing thermal coal business, ADMR, and power plants. Our SOTP valuation of USD10.1bn, implies 6.7x FY22F PE (around its 5-year mean) and this translates to a street high TP of IDR4,500/sh, offering 48% upside from the last closing price.

Based on our sensitivity analysis, a 10% lower coal price would lead to 16% lower earnings and 14% lower fair value on ADRO and vice versa.

Risk on our call includes potential oversupply of Russian coal in the ex-Europe markets as a result of potential coal imports ban by European countries, which could put heavy downward pressure on coal price in the aftermath of current conflicts.

**Table 2. ADRO's SOTP valuation**

Assets	Stakes (%)	Full value (USDmn)	Adjusted value (USDmn)	Estimated FY22 NP (USDmn)	Method
<b>Thermal coal mining, mining services &amp; logistics</b>					
	100.0%	5,631	5,631	1,126	PE multiples (5x)
<b>Adaro Minerals Indonesia (ADMR)</b>					
	68.6%	4,392	3,011		Current mkt. value
<b>Equity investments</b>					
Kestrel	48.0%	518	249		Book value
Bhimasena Power Indonesia (BPI) 2x1,000MW	34.0%	274	93		Book value
Tanjung Power Indonesia (TPI) 2x100MW	65.0%	56	36		Book value
Net cash (debt)			1,113		
<b>Total Equity Value</b>			<b>10,132</b>		
No. of shares (bn)			31.99		
<b>Equity Value per share (IDR)</b>			<b>4,500</b>		

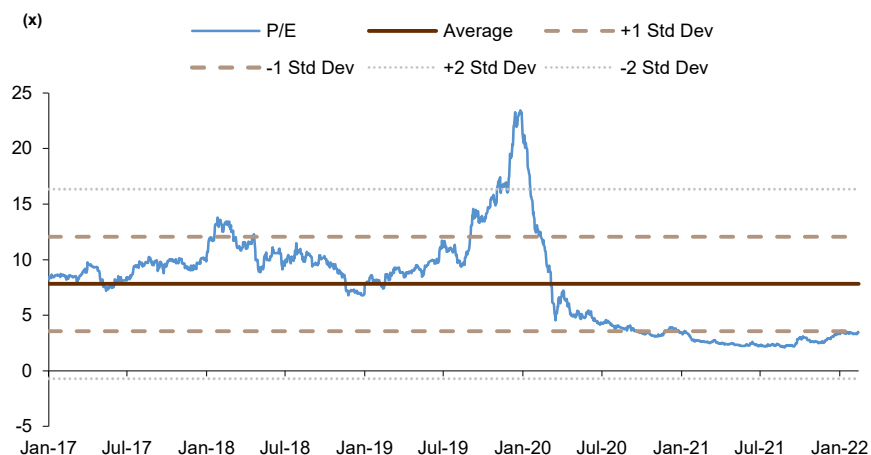
Source: KISI

**Table 3. ADRO's DCF valuation**

DCF Valuation Summary		Assumption	
<b>Enterprise value (USD mn)</b>	<b>8,851</b>	Risk-free rate	6.5%
Net cash (USD mn)	1,113	Market Premium	5.0%
<b>Equity Value (USD mn)</b>	<b>9,964</b>	Beta	1.4
Shares outstanding (mn)	31,986	After tax Cost of Debt	5.4%
Target Price (USD / share)	0.31	Debt Proportion	35.7%
		Equity Proportion	64.3%
		Cost of Equity	13.5%
<b>Target Price (IDR /share - rounded)</b>	<b>4,500</b>	Long-term growth	0.0%
Target P/E	6.7	<i>consider 5 year life-mine after 2025</i>	
Current P/E	4.5	WACC	10.6%

Source: KISI

Fig 17. ADRO's PE band



Source: Bloomberg, KISI

Table 4. Summary of assumptions changes

Assumptions	Unit	Current			Previous		
		FY21A	FY22F	FY23F	FY21F	FY22F	FY23F
Sales volume	m tonnes	51.6	58.3	61.2	52.3	56.1	58.3
Change (%)		-1%	4%	5%			
Global coal price	USD/tonne	136.5	190.0	150.0	135.0	150.0	100.0
Change (%)		1%	27%	50%			
ASP	USD/tonne	74.4	95.9	79.3	77.6	92.8	64.3
Change (%)		-4%	3%	23%			
Revenue	USD mn	3,993	5,757	5,024	4,232	5,393	3,940
Change (%)		-6%	7%	28%			
Cost of revenue	USD mn	2,223	3,167	3,217	2,605	3,560	2,941
Change (%)		-15%	-11%	9%			
EBITDA	USD mn	1,762	2,469	1,781	1,454	1,690	981
Change (%)		21%	46%	81%			
Net profit	USD mn	933	1,466	1,008	801	1,025	466
Change (%)		17%	43%	116%			
Target price	IDR		4,500			2,400	
Change (%)			88%				
<b>Recommendation</b>			<b>BUY</b>			<b>BUY</b>	

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 on-going IPP projects joint ventures, Bhimasena Power Indonesia (BPI) in Batang, Central Java and Tanjung Power Indonesia (TPI) in South Kalimantan.

Fig 18. ADRO corporate structure



Source: Company's annual report , KISI

**Balance sheet** (USDmn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
<b>Current assets</b>					
Cash & cash equivalent	1,174	1,811	2,504	2,216	1,229
Accounts & other receivables	224	452	631	551	464
Inventories	105	126	148	175	172
Others	229	449	288	251	212
<b>Non-current assets</b>					
Fixed assets	3,062	2,769	2,768	2,808	2,749
Mining properties	1,588	1,980	2,316	2,306	2,291
Other non-current assets	6,382	7,587	8,655	8,307	7,117
<b>Total assets</b>					
<b>Current liabilities</b>	214	272	416	423	404
Accounts & other payables	-	-	-	1	1
ST debt	643	271	(91)	659	(92)
Current portion of LT debt	288	818	1,113	845	646
Others					
<b>Non-current liabilities</b>	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	3,528	3,091	1,941
<b>Total liabilities</b>					
Controlling interest	1,497	1,497	1,497	1,497	1,497
Capital stock	-	-	-	-	-
Additional paid-in capital	-	-	-	-	-
Other Reserves	2,215	2,639	3,359	3,487	3,468
Retained earnings	240	322	271	231	211
Minority interest	3,952	4,458	5,127	5,216	5,176
<b>Shareholders' equity</b>	1,174	1,811	2,504	2,216	1,229

**Cash flow** (USDmn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
<b>C/F from operating</b>	151	1,290	2,122	1,302	934
Net profit	159	1,029	1,611	1,108	636
Depreciation	284	288	303	326	345
Net incr. in W/C	(262)	95	390	(190)	(110)
Others	(30)	(121)	(182)	59	63
<b>C/F from investing</b>	83	(236)	(319)	(444)	(365)
CAPEX	(11)	6	(302)	(366)	(286)
Others	95	(241)	(16)	(78)	(79)
<b>C/F from financing</b>	(637)	(417)	(1,110)	(1,147)	(1,556)
Incr. in equity	60	(375)	(196)	(140)	(71)
Incr. in debts	(447)	105	(167)	(128)	(880)
Dividends	(250)	(147)	(747)	(880)	(605)
Others	-	-	-	-	-
<b>C/F from others</b>	-	-	-	-	-
<b>Increase in cash</b>	(402)	637	693	(289)	(987)

**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)	(3,167)	(3,217)	(3,072)
<b>Gross profit</b>	577	1,770	2,590	1,808	1,166
SG&A expense	(165)	(185)	(207)	(217)	(224)
<b>Operating profit</b>	411	1,585	2,383	1,590	942
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	63	79	80
<b>Earnings before tax</b>	222	1,486	2,223	1,477	849
Income taxes	(64)	(458)	(611)	(369)	(212)
<b>Net profit</b>	147	933	1,466	1,008	586
Non-controlling interest	12	95	145	100	51
Other comprehensive profit	-	-	-	-	-
<b>Total comprehensive profit</b>	-	-	-	-	-
Total comprehensive profit of controlling interest	-	-	-	-	-
<b>EBITDA</b>	584	1,762	2,469	1,781	1,209

**Key financial data**

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
per share data (IDR)					
EPS	67	417	678	473	275
BPS	1,797	1,993	2,372	2,446	2,427
DPS	114	66	346	413	284
Growth (%)					
Sales growth	(27)	58	44	(13)	(16)
OP growth	(44)	285	50	(33)	(41)
NP growth	(64)	535	57	(31)	(42)
EBITDA growth	(37)	202	40	(28)	(32)
Profitability (%)					
OP margin	16.2	39.7	41.4	31.7	22.2
NP margin	5.8	23.4	25.5	20.1	13.8
EBITDA margin	23.0	44.1	42.9	35.4	28.5
ROA	2.3	12.3	16.9	12.1	8.2
ROE	3.7	20.9	28.6	19.3	11.3
Dividend yield	3.7	2.2	11.4	13.6	9.3
Dividend payout ratio	62	100	80	60	60
Stability					
Net debt (US\$ m)	248	(250)	(1,113)	(952)	(843)
Int.-bearing debt/equity (%)	36	35	27	24	7
Valuation (X)					
PE	45.5	7.3	4.5	6.4	11.1
PB	1.7	1.5	1.3	1.2	1.3
EV/EBITDA	11.9	3.7	2.3	3.2	4.8

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