

9 September 2024

Basic Materials | Mining

Adaro Energy (ADRO IJ)

Buy (from Trading Buy)

Catching The Wave; U/G To BUY

Target Price (Return): IDR3,900 (12.4%)
Price (Market Cap): IDR3,470 (USD6,941m)
ESG score: 2.8 (out of 4)
Avg Daily Turnover (IDR/USD) 94,113m/5.93m

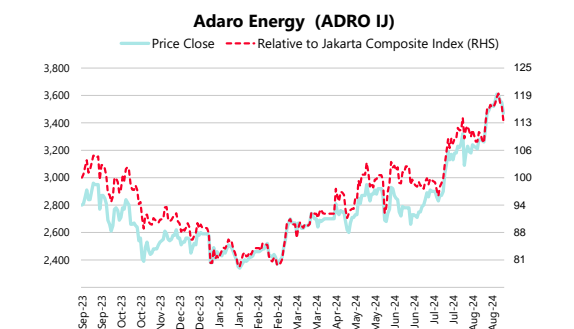
- **Upgrade to BUY from Trading Buy, with new IDR3,900 DCF TP from IDR3,200, 12% upside and c.8% yield.** Following a better-than-estimated 1H24 performance, we upgrade our FY24-25F earnings estimates for Adaro Energy by 17% and 21%. The adjustment reflects a more favourable outlook for thermal coal demand ahead of peak season at end-3Q. This is aided by its operational efficiencies while maintaining stable production. Our DCF-based TP includes a c.7x P/E target, in line with the 5-year mean and a 4% ESG discount. We input a medium-term DCF scenario (WACC 12%, TG 3%)
- **Stable volume supported by fair efficiency.** ADRO's production has remained relatively stable throughout the year (1H24: c.36m tonnes; +7% YoY vs industry's 3% YoY). Efficiency has been displayed through manageable stripping ratio (fairly similar to 5-year 1H average at 4x). The favourable shipping conditions, due to improved weather in early 1H24, have driven higher coal sales as well. We view ADRO's topline performance as well-supported for the rest of the year, considering coal price expectations are relatively more defensive than market forecasts. Historical margins for ADRO have also been well-preserved (Figure 4), with its 5-year average cash margin from coal sales at c.USD50/tonne – one of the highest vs peers.
- **Stock appreciation and upcoming policy implications.** Apart from the fluctuating sentiment on thermal coal outlook (due to higher demand from utilities in stabilising energy stock from weather extremities), ADRO's stock appreciation was relatively influenced by the buyback programme initiated in mid-May. A topic in the market is the government's plan to revise coal royalty regulations, particularly IUPK concessions (rates linked to coal price movements that may touch 19-27% at benchmark price at above USD100/tonne, with 14% rate remaining for domestic market obligation destination). While details of these changes are still pending, any adjustment in royalty rates could impact the profitability (*ceteris paribus*, 1% rate change could affect 2-3% of the company's bottomline). However, due to the current domestic political and economic challenges, the Government may continue to focus on optimising non-tax revenues from the still-lucrative coal industry.
- **Limited downside on pricing risk.** We believe the price pressure risk is relatively limited, and the market seems to have priced in concerns about lower net profit due to normalised coal prices. However, the new-normal for coal price levels stays higher than past peaks (topped at USD100-120/tonne level). Furthermore, clearer upside may be seen for thermal coal, while coking coal demand remains constrained by limited activity on steel manufacturing.
- **Fair choice for trading opportunity.** The stock is trading at 6.4x (rolling-forward), close to its 5-year P/E average of c.7x, and has risen 48% YTD (21% since our last call in May). ADRO is favoured by investors seeking to capitalise on its significant liquidity competitive margins compared to peers.

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	45.8	9.1	21.8	30.0	20.9
Relative	39.6	0.8	11.1	24.7	10.5
52-wk Price low/high (IDR)				2,340	3,610



Source: Bloomberg

Overall ESG Score: 2.8 (out of 4)

E: GOOD

Among ADRO's efforts to minimise the impact of mining activities to the environment is its preservation initiatives at the Bakut Island conservation area (15.58ha), in collaboration with South Kalimantan Agency for Conservation of Natural Resources or BKSDA. It received a Gold Proper Award from the Ministry of Environment & Forestry in 2020 – an award it has consecutively won since 2018.

S: GOOD

ADRO realised a social development investment of USD7.3m to carry out its CSR programme – this was an increase from USD4.1m in 2019. It also received the 2020 Charity & Community Impact Award from Coaltrans Asia

G: GOOD

Its MSCI rating has been upgraded to BB from B, due to significant improvements in its corporate governance practices – notably with an increase in board size with the appointment of another independent commissioner. In addition, ADRO's good corporate governance implementation is also based on ASEAN Corporate Governance Scorecard parameters.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (USDm)	7,991	6,305	6,059	5,359	5,216
Recurring net profit (USDm)	2,493	1,606	1,378	1,125	930
Recurring net profit growth (%)	167.1	(35.6)	(14.2)	(18.3)	(17.4)
Recurring P/E (x)	2.90	4.49	5.24	6.41	7.76
P/B (x)	1.2	1.1	0.9	0.9	0.8
P/CF (x)	1.91	4.59	3.78	4.40	4.86
Dividend Yield (%)	5.3	15.4	11.3	8.0	6.6
EV/EBITDA (x)	0.82	1.74	1.64	1.70	1.56
Return on average equity (%)	49.1	25.1	19.1	14.2	11.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (USD)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Indonesia	Recurring EPS	0.08	0.05	0.04	0.04	0.03
Basic Materials	DPS	0.01	0.03	0.03	0.02	0.01
Adaro Energy	BVPS	0.19	0.21	0.24	0.26	0.27
ADRO IJ	Return on average equity (%)	49.1	25.1	19.1	14.2	11.1
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	2.90	4.49	5.24	6.41	7.76
5-years DCF, and P/E valuation	P/B (x)	1.2	1.1	0.9	0.9	0.8
	FCF Yield (%)	50.6	12.6	11.2	17.4	16.1
	Dividend Yield (%)	5.3	15.4	11.3	8.0	6.6
Key drivers	EV/EBITDA (x)	0.82	1.74	1.64	1.70	1.56
i. Increase in coal sales volumes;	EV/EBIT (x)	0.92	1.90	1.98	2.12	2.03
ii. Increase in coal prices;						
iii. A drop in oil prices.						
Key risks	Income statement (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
i. Weaker ASPs due to slower GDP growth if the economic recovery takes longer than expected;	Total turnover	7,991	6,305	6,059	5,359	5,216
ii. Slower demand growth leading to a further glut in global supply;	Gross profit	4,542	2,325	2,254	1,834	1,614
iii. Unexpected bad weather halting production.	EBITDA	4,655	2,172	2,367	1,924	1,718
	Depreciation and amortisation	(489)	(191)	(406)	(384)	(400)
	Operating profit	4,166	1,981	1,960	1,540	1,318
	Net interest	(42)	31	(10)	55	55
	Pre-tax profit	4,476	2,259	2,035	1,680	1,423
	Taxation	(1,645)	(439)	(448)	(370)	(313)
	Reported net profit	2,493	1,606	1,378	1,125	930
	Recurring net profit	2,493	1,606	1,378	1,125	930
Company Profile	Cash flow (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Adaro Energy is a coal mining company. The company and its subsidiaries currently deal in coal mining & trade, coal infrastructure & logistics, and mining contractor services.	Change in working capital	11	878	(2)	50	38
	Cash flow from operations	3,786	1,572	1,908	1,639	1,484
	Capex	(133)	(665)	(1,101)	(386)	(322)
	Cash flow from investing activities	(1,203)	(899)	(1,103)	(371)	(311)
	Dividends paid	(381)	(1,112)	(819)	(574)	(474)
	Cash flow from financing activities	(479)	(1,527)	(1,000)	(735)	(625)
	Cash at beginning of period	1,814	4,071	3,315	3,537	3,729
	Net change in cash	2,104	(854)	(194)	533	548
	Ending balance cash	4,071	3,315	3,537	3,729	3,837
	Balance sheet (USDm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	4,071	3,315	3,537	3,729	3,837
	Tangible fixed assets	1,373	1,642	2,211	2,201	2,111
	Total investments	1,418	1,507	1,507	1,507	1,507
	Total assets	10,677	10,424	11,317	11,402	11,394
	Short-term debt	176	252	809	579	279
	Total long-term debt	1,407	490	480	471	461
	Total liabilities	4,255	3,064	3,614	3,333	3,049
	Total equity	6,422	7,360	7,703	8,069	8,345
	Total liabilities & equity	10,677	10,424	11,317	11,402	11,394
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	100.1	(21.1)	(3.9)	(11.6)	(2.7)
	Recurrent EPS growth (%)	167.1	(35.6)	(14.2)	(18.3)	(17.4)
	Gross margin (%)	56.8	36.9	37.2	34.2	30.9
	Operating EBITDA margin (%)	58.3	34.4	39.1	35.9	32.9
	Net profit margin (%)	31.2	25.5	22.7	21.0	17.8
	Dividend payout ratio (%)	15.3	69.2	59.4	51.0	51.0
	Capex/sales (%)	1.7	10.5	18.2	7.2	6.2
	Interest cover (x)	46.6	18.1	13.1	18.1	15.5

Source: Company data, RHB

Figure 1: RHB vs Street's estimates

(USDm)	RHB (new)			RHB (old)			Change			Street			RHB vs Street		
	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F	2024F	2025F	2026F
Revenue	6,059	5,359	5,216	5,725	4,650	4,606	5.8%	15.3%	13.3%	5,506	5,286	5,140	10.0%	1.4%	1.5%
Gross profit	2,254	1,834	1,614	2,033	1,555	1,412	10.8%	17.9%	14.3%	2,029	1,826	1,798	11.1%	0.5%	-10.2%
Operating profit	1,960	1,540	1,318	1,761	1,286	1,137	11.3%	19.7%	15.9%	1,663	1,507	1,478	17.9%	2.2%	-10.8%
Pre-tax profit	2,035	1,680	1,423	1,836	1,426	1,242	10.9%	17.8%	14.6%	1,715	1,527	1,537	18.7%	10.0%	-7.4%
Net profit	1,378	1,125	930	1,178	932	794	17.0%	20.8%	17.1%	1,286	1,134	1,049	7.1%	-0.8%	-11.4%
Margin															
Gross	37.2%	34.2%	30.9%	35.5%	33.5%	30.7%				36.9%	34.5%	35.0%			
EBIT	32.4%	28.7%	25.3%	30.8%	27.7%	24.7%				30.2%	28.5%	28.8%			
Pre-tax	33.6%	31.4%	27.3%	32.1%	30.7%	27.0%				31.1%	28.9%	29.9%			
NPM	22.7%	21.0%	17.8%	20.6%	20.0%	17.2%				23.4%	21.5%	20.4%			
Key assumptions															
Vol. production (m tonnes)	70.5	70.9	71.4	66.1	67.7	69.3	6.6%	4.8%	2.9%						
ASP (USD/tonne)	84.6	74.4	71.9	81.6	63.8	61.3	3.7%	16.7%	17.3%						
Cash cost (USD/tonne)*	34.2	34.1	35.1	34.7	29.0	29.4	-1.3%	17.7%	19.2%						

Note: *Ex-royalty costs

Source: Company data, RHB

Figure 2: Valuation

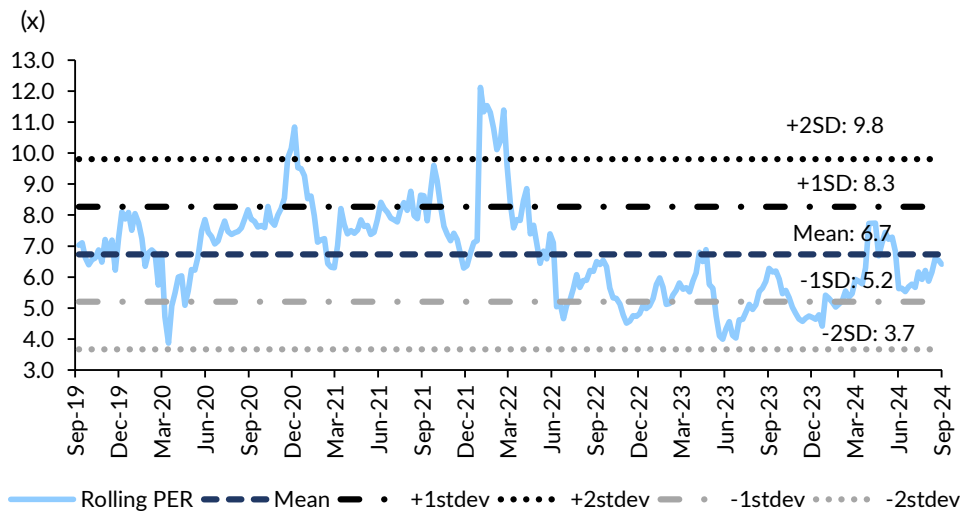
DCF		2024F	2025F	2026F	2027F	2028F	2029F
EBITDA	USDm	2,367	1,924	1,718	980	894	901
Δ WC	USDm	48	29	23	69	7	2
Capex	USDm	(950)	(550)	(500)	(500)	(500)	(500)
Tax	USDm	(448)	(370)	(313)	(128)	(106)	(104)
FCF	USDm	1,017	1,034	929	422	295	298
Period	#	0	1	2	3	4	5
PV FCF	USDm	1,017	925	743	302	189	171
WACC	%	11.8%					
Terminal growth	%	3%					
Sum of PV FCF	USDm	3,345					
PV of terminal value	USDm	2,098					
Equity value	USDm	5,443					
Net debt (cash)	USDm	(2,248)					
NCI	USDm	665					
Equity	USDm	7,691					
# shares	m	31,986					
EV/share	IDR	3,700					
P/E							
EPS 2024F	IDR/share	655					
EPS 2025F	IDR/share	535					
24/25F RHB EPS rolling-forward	IDR/share	595					
Target multiple	x	7					
24/25F Cons EPS	IDR/share	570					
Cons 12-M TP	IDR	3,800					
Rounded TP	IDR	4,100					
Combined							
Average TP (4% discount applied)		3,900					

Note: *Ex-royalty costs

Source: Company data, RHB

◆ As our base scenario is a short-term DCF of five years (reflecting the fluctuating nature of commodities), we input the USD100-85/tonne coal benchmark price that is beyond its terminal period.

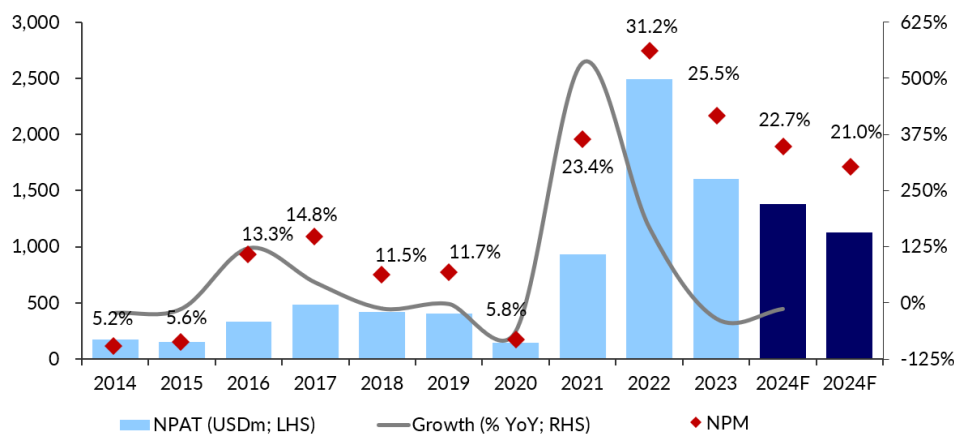
Figure 3: ADRO's 5-year average P/E band



Source: Bloomberg, RHB

◆ Despite the limited premium from coal price corrections (resulting in an expected drop in our earnings projection), our DCF valuation suggests a fundamental opportunity (fair operational margin and healthy cash flow) that is parallel with the upcoming traction in coal prices.

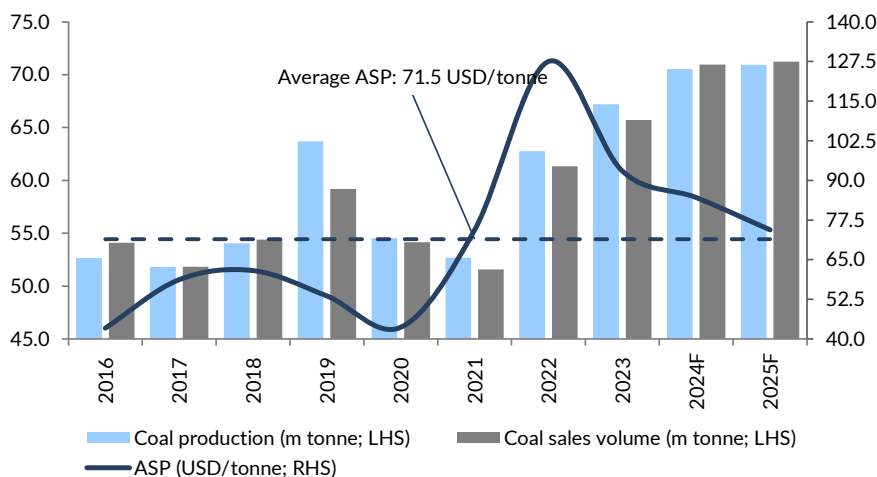
Figure 4: ADRO's earnings trend vs net margin



Source: Bloomberg, RHB

◆ In spite of the imminent correction in net earnings, the figures are virtually better compared to the pre-pandemic years, on top of fair margin

Figure 5: ADRO's production trend



Source: Bloomberg, RHB

◆ Despite output increasing over the last few years, mine life is still within the fair-investment period (c.15-20 years remaining) before the company embarks on other prominent businesses (eg aluminum and renewable energy)

◆ Domestic sales accounted for c.27% of ADRO's output, followed by sales to China (15%), India (12%) and other regions: North-East Asia (27%), South-East Asia (ex-Indonesia) (18%), and minor destinations (1%)

Emissions And ESG

Trend analysis

The company started its GHG emissions reduction programme by developing a Carbon Abatement Roadmap for all of its subsidiaries. GHG emission intensity has improved to 3.67 (in 2022) from 4.31 (in 2020) tonnes of CO₂eq/GWh.

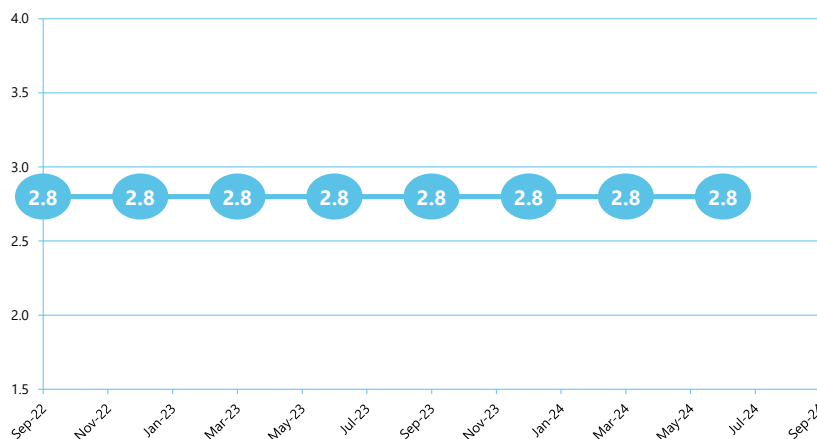
Emissions (tCO ₂ e)	Dec-21	Dec-22	Dec-23
Scope 1	1,155,768	1,280,242	na
Scope 2	266	264	na
Scope 3	na	na	na
Total emissions	1,156,033	1,280,506	na

Source: Company data, RHB

Latest ESG-Related Developments

- ADRO has installed emission control equipment – electrostatic precipitators and baghouse dust collectors at its coal power plant businesses (under Makmur Sejahtera Wisesa and Tanjung Power Indonesia).
- The company uses B30 biodiesel fuel that could reduce GHG emissions by 28%. In 2023, the company plans to utilise more biodiesel (B35). ADRO is currently exploring opportunities to increase the use of RE sources – solar PVs with potential annual energy capacity of up to 749,294kWh.
- The project could replace up to 200,000 litres of biodiesel per year, and avoid emissions of up to 400t CO₂e per year. Management aims to develop solar pv utilisation to the 8MW peak per year.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-05-22	Trading Buy	3,200	2,920
2024-03-04	Neutral	2,500	2,540
2023-11-22	Neutral	2,740	2,590
2023-02-10	Neutral	3,050	2,740
2022-08-31	Trading Buy	4,800	3,540
2022-06-03	Trading Buy	4,400	3,520
2022-04-07	Trading Buy	3,600	3,050
2022-03-04	Trading Buy	3,400	3,040
2021-12-02	Neutral	1,900	1,810
2021-10-11	Neutral	1,900	1,915
2021-09-07	Buy	1,750	1,345
2021-07-07	Buy	1,675	1,250
2021-04-27	Buy	1,500	1,210
2021-03-05	Buy	1,500	1,180
2021-02-22	Buy	1,500	1,210

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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